Integrative Case 4

Exchange Rate Arrangements and Foreign Exchange Broking

You have just been hired as a consultant by a currency trading firm to analyze trends in exchange rate arrangements and their implications for international financial markets. It is early 2003, and the world economy is slowly recovering from the global slowdown following the September 11, 2001 terrorist attacks in New York. Yet foreign exchange broking is an industry under pressure and the outlook is not rosy. You are asked to prepare a presentation addressing the challenges that the industry is facing.

You notice the recent creation of a single European currency, the euro, which has replaced the national currencies of twelve member countries of the European monetary union. You see the trend towards currency unions and dollarization in Latin America and Eastern Europe. Japan has recently expressed interest in exploring alternative monetary arrangements. Even Canadians are debating whether they should continue floating their currency or consider alternative monetary arrangements such as membership in a currency union with the United States and Mexico.

To prepare your presentation, you have decided to identify a number of questions that you think they will ask. You begin by visiting the web site of the International Monetary Fund (IMF) at www.imf.org, with the hope that you will find some relevant (and non-technical) articles to read and prepare for these questions. Click on *Publications*, then on *Periodicals*, and then on *Finance & Development* (luckily, you don't even have to pay for subscription). After you review the contents of *Finance & Development*, you find an interesting article in the June 2001 Volume with the title "Exchange Rate Regimes: Is the Bipolar View Correct?" written by Stanley Fischer, the First Deputy Managing Director of the IMF. You prepare the following questions, addressing the big picture and long-term trends.

1. What is a hard peg? What is a soft peg?
2. What is the difference between pegs and a fixed exchange rate regime?
3. What is dollarization? What is the difference between dollarization, a currency board, and a fixed exchange rate regime? Do you know of any countries that have recently adopted dollarization?
4. What happened to the proportion of IMF members with hard pegs in the 1990s? To the proportion with soft pegs? To the proportion with flexible exchange rate arrangements?
5. What happened to the proportion of developed and emerging market countries with hard pegs in the 1990s? To the proportion with soft pegs? To the proportion with flexible exchange rate arrangements?
6. In the 1990s, a number of countries experienced major international capital market-related crises. At the same time, other countries managed to avoid similar crises. What are the lessons to be drawn from the different experiences of these countries?
7. What does the future hold for foreign exchange brokers?