

Reserve moves with New Currency while the dollar shrinks in Bangladesh

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Abstract

The factors that affect the choice of the currency combination for official foreign exchange reserves are examined in this paper. On the major currencies in the world economy's foreign exchange reserves is the key criterion that has been debated with current issues. The demand for dollars is extremely great, which is the key factor driving the dollar upward. Economic forecasts for the bulk of economies point to a sharp drop. Meanwhile, market volatility and geopolitical risk have significantly grown as a result of the Ukraine conflict. In addition, historically rising inflation has caused the US Federal Reserve to quickly boost rates. Investors are dumping their holdings in the YUAN, emerging markets, and other places as a result of these and other considerations, fleeing for safety in US-denominated assets, which must obviously be bought with dollars.

The co-movement of the domestic currency with major currencies and the currency invoicing of commerce are closely correlated with the currency composition of reserves. Instead of being characteristics of the US or the Eurozone, these aspects are characteristics of the dollar or the YUAN. Being the second-largest economy after the United States, China has emerged as a significant economic force and has gained significant sway over the world economy and financial markets. It has increased the world economy by more than 30% during the past ten years. They have about similar effects on the foreign exchange reserves' currency composition. It needs to be shown that these results hold up across a wide range of other potential influences. In Bangladesh, the reserve moves with New Currency, while the dollar shrinks steadily.

Keywords: Reserve, Currency, USD Dollar, Yuan, Inflation, Economy

Date of Submission: 01-09-2022

Date of Acceptance: 13-09-2022

I. Introduction

In an effort to aid foreign investors amid growing commercial engagement with China, the Bangladesh Bank later proclaimed the yuan to be an acceptable currency for reserve holding and began to increase the share of Chinese currency in the reserve.

According to Bangladesh Bank data, the proportion of yuan in the country's foreign exchange reserves climbed to 1.32% in August of this year from 1% in 2017, a time when the reserve's predominate US dollar declined dramatically to 75% from 81%. There has also been a rise in other reserve currencies. For instance, according to central bank data, the pound's share grew to 4.4% from 3.43%, and the euro, which is the second-highest reserve currency, had its stake rise to 5% in August 2018 from 3.84% in 2017.

Since the yuan was added to the International Monetary Fund's (IMF's) Special Drawing Rights (SDR) currency basket in 2016, its percentage in the nation's foreign exchange reserve has been continuously increasing. \$528 million was still held as yuan was still invested in the Chinese financial sector as of August 2022. The Bangladesh Bank reports that in January 2017, the amount was \$323 million.

The People's Bank of China, the central Bank of China, has offered to enter into a currency swap arrangement with the Bangladesh Bank so that both the RENMINBI and the taka can be used for pricing and settlement in bilateral trade. The Chinese Embassy in Dhaka stated in a letter dated August 19 that a currency swap agreement will help to minimize the cost of foreign exchange transactions and help to manage the risk of fluctuating exchange rates. In FY21, China's total imports were Tk 1 lakh crore, whereas Bangladesh's exports to China were Tk 4,804 crore.

The American dollar, on the other hand, has recently regained most of its strength from the 1970s. There is no cause for alarm about this. The currency is not a "problem" that needs the government to provide a

"solution." Both economic and noneconomic factors can be seen in the dollar's health. Instead of being cause for concern, a strong dollar is something to be proud of and to be happy about. Every area of the international economy is impacted by the U.S. dollar, which is a universally recognized unit of account, a major reserve currency, and used to acquire and sell basic raw materials. Since it is the currency used to buy and sell necessary raw materials, investors choose it as a haven when times are rough. The value of the dollar against other major foreign currencies has risen to a 20-year high, among other reasons being the expectation that the Federal Reserve will raise interest rates more swiftly than other central banks.

The demand for dollars is extremely great, which is the key factor driving the dollar upward. Economic forecasts for the bulk of economies point to a sharp drop. As an illustration, 75% of Bangladesh's stated reserves are in US dollars, yet they are depleting much too quickly.

1.1 Milieu, Objective, Methodology, and Limitation of the Study

The purpose of this study is to provide information, including a theoretical overview of how a sustained appreciation of the reserve currency might lead to a lingering problem with global competitiveness as well as some quantitative studies and supporting data. In order to show that continuous misalignment can have long-term repercussions, the paper begins by offering a simple evaluation of the degree of prolonged overvaluation. Under the cited explanations, the shifting of the reserve with the new currency yuan, while the Bangladeshi dollar declines are taken into consideration:

The **First** is how the reserve affects the USD's position as a foreign investment vehicle, which has drastically altered from being the largest creditor in the world to a debtor.

The **second** is how the overvalued dollar affects how capital is allocated between domestic and international competitive industries.

Third, it's likely that foreign businesses have invested in intangible assets like distribution networks and reputation, which has led to a loss of market share for the dollar that cannot be made up for by merely bringing the currency back to its previous levels. The data are brought together in the paper's conclusion.

2. Why reserve moves to yuan while the dollar shrinks in Bangladesh

2.1 China is the second-largest economy in the world

Being the second-largest economy after the United States, China is quickly gaining economic clout and is now a prominent player in the world economy and financial markets. More than 30% of the expansion in the world economy over the past ten years has come from it.

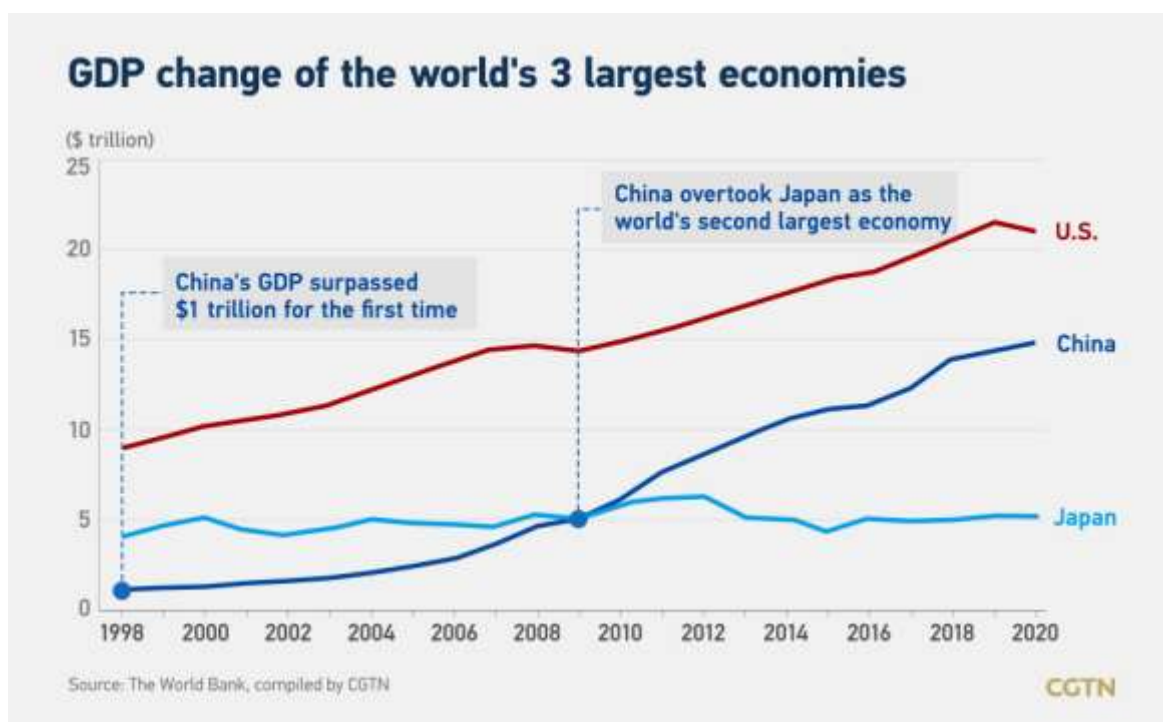
According to the most recent official data from Tokyo, Japan's gross domestic product grew by just under 4% in 2010, which is much less than China's pace of development and insufficient to maintain Japan's economy ahead. For Japan, which has been the second-largest economy in the world for more than 40 years, this signifies the end of an era.

In terms of PPP, China has the largest nominal GDP and the second-largest nominal GDP in the world. China may be on course to overtake the United States as the world's largest economy by nominal GDP in the years to come with annual growth that routinely exceeds that of the US.

2.2 China's economy upturn economic growth and living standards

Over the past four decades, China's economy has gradually opened up, leading to significant advancements in both economic growth and living standards. Foreign and domestic commerce and investment have exploded as a result of the government's progressive phase-out of collectivized agriculture and industry, increased latitude for market prices, and enhanced company autonomy. This, along with an industrial policy that supports domestic production, has elevated China to the top exporter in the world. Despite these benefits, China still has some major obstacles to overcome, including a fast aging population and serious environmental damage. China's GDP growth has averaged about 10% per year since it started to open up and reform its economy in 1978, and more than 800 million people have been pulled out of poverty. Over the same time span, access to health, education, and other services has also significantly improved. Growth is anticipated to decline to 5.0 percent in 2022 from real GDP growth of 8.1 percent in 2021.

The outlook indicates rising headwinds: With the war in Ukraine, domestic demand has decreased and the state of the world economy has drastically deteriorated. Additionally, COVID intrusions have increased in frequency and scope. Since the end of the nationwide lockdown in March 2020, China is currently experiencing the greatest COVID wave. The authorities have announced a considerable easing of policy in response to these shocks. There is room in the 2022 budget for a fiscal increase of up to 2.7 percent of GDP. A larger-than-anticipated global downturn, a shock to commodities prices that last longer, and more severe financial stress among real estate developers are all risks that are firmly on the downside. China still faces the threat of COVID outbreaks escalating again, which could cause serious economic damage. In a worst-case scenario, economic growth in 2022 might slacken to 4.0 percent.



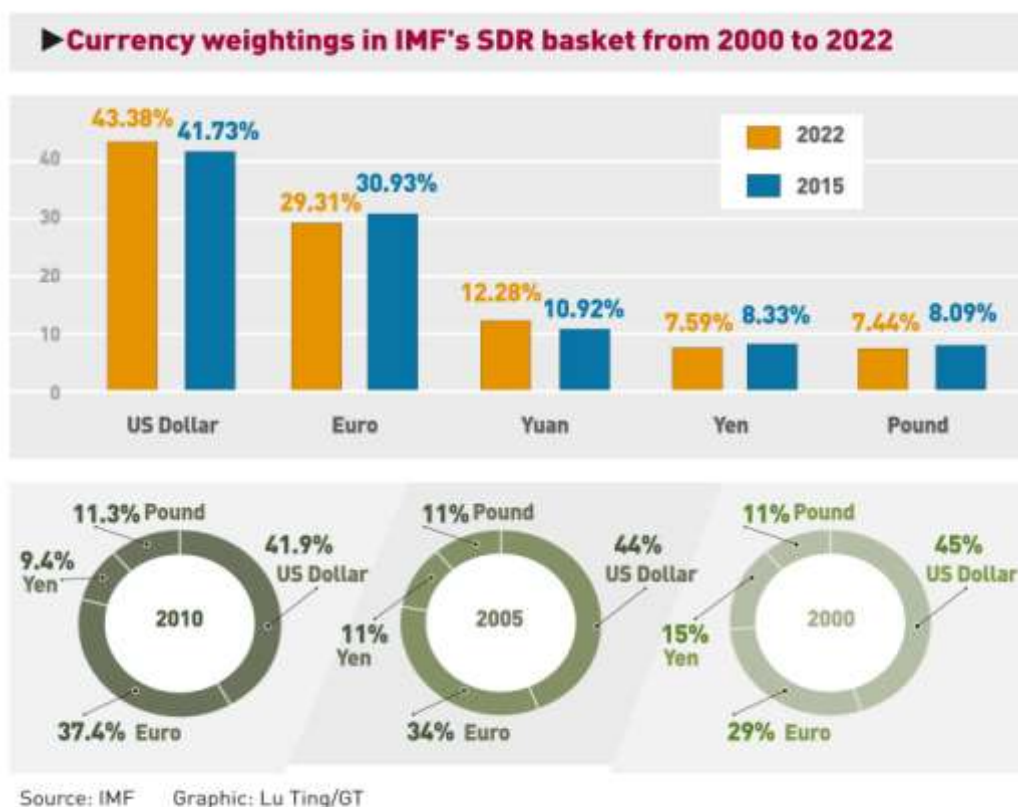
2.3 IMF included the yuan as a fifth currency to its SDR basket:

Along with the US dollar, the euro, the Japanese yen, and the British pound, the yuan was added by the IMF as the fifth currency in its SDR basket. The yuan is now an internationally convertible currency as a result of its inclusion in the SDR basket.



2.4 Currency weightings in IMF's SDR basket

The US dollar and the euro are now the two currencies with the most weight in the SDR basket, with the Chinese yuan coming in third. The SDR, or Special Drawing Rights, is a global reserve asset that supports members' official reserves and can be converted into freely useable currencies by governments in times of need. Following the yuan's inclusion in the SDR, China intensified its efforts to encourage the yuan's internationalization and the opening of its financial system in order to entice foreign investors to make investments in the Chinese market.



2.5 China moved away from giving loans in dollars to the yuan

As part of promoting its currency, China has largely moved away from giving loans in dollars to the yuan when it comes to financial assistance to Bangladesh. Its loan commitment in yuan has more than doubled in four years from FY17 to FY20 while disbursement in yuan has increased by more than seven times. China emerged as one of the biggest sources of funds entering into the top development partner list of Bangladesh at the time. The share of China in total foreign aid increased to 11.2% in FY21, securing the sixth highest level of development partner position of Bangladesh, a tremendous growth considering that funding from China was zero after independence.

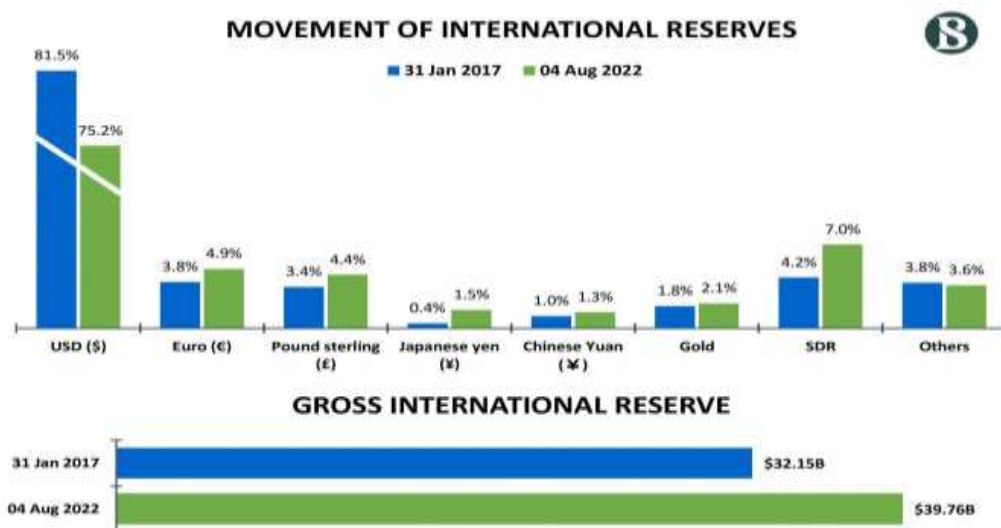
2.6 Yuan to BDT in Bangladeshi Project!

China's commitment in yuan more than quadrupled in 2016-17 from the previous year, mainly riding on three projects – the construction of the tunnel under the River Karnaphuli, Dasherbandi sewage treatment plan, and the procurement of six vessels. In 2018-19, China disbursed all of its assistance in yuan, completely bypassing the dollar. Direct investment by Chinese firms in related projects was worth \$15 billion last year, a quarter of which was in yuan. China now settles 15% of its foreign trade in the currency, up from 11% in 2015.

3. Movement of international reserve in Yuan

Yuan use in foreign exchange reserves reaches a five-year high and could go further due to Western sanctions against Russia. According to the most recent IMF data, the percentage of claims in Chinese yuan increased to a new high in total foreign exchange reserves in the fourth quarter of 2021. The yuan's internationalization has been relentlessly pushed for by China's growing economic power. This year, the yuan's size or share in global foreign exchange reserves will increase as sanctions between the West and Russia and the resulting financial upheaval increasingly highlight the risks of continuing to use the US dollar or the euro as reserve currencies. According to data from the IMF's Currency Composition of Official Foreign Currency Reserves (COFER), claims in yuan reached \$336.1 billion in the fourth quarter of 2021, or 2.79 percent of the total allocated foreign exchange reserves in the same period the previous year. According to IMF data, the ratio has marginally increased from 2.66 percent in the third quarter of last year, which was also the highest level since the third quarter of 2016. The yuan ranked fifth in the COFER by the end of 2021, behind the US dollar, the euro, the Japanese yen, and the pound sterling. IMF data revealed that the majority, or 58.8% of all central bank currency reserves, are still held in US dollars. But interest in the US currency is ebbing over time. About

70% of global central bank reserves were held in US dollars in 2007, but by the third quarter of last year, that percentage had fallen to 59.2%. In addition to proportion, the size of the yuan foreign exchange reserves is also steadily growing. Claims in RENMINBI for foreign exchange reserves were over \$336 billion in the last three months of 2021, up from \$320.1 billion in the third quarter of last year. Given that the yuan's influence grows along with China's economic might, this expansion in the yuan's share and scale is an unstoppable trend.



3.1 Foreign Currency Transaction:

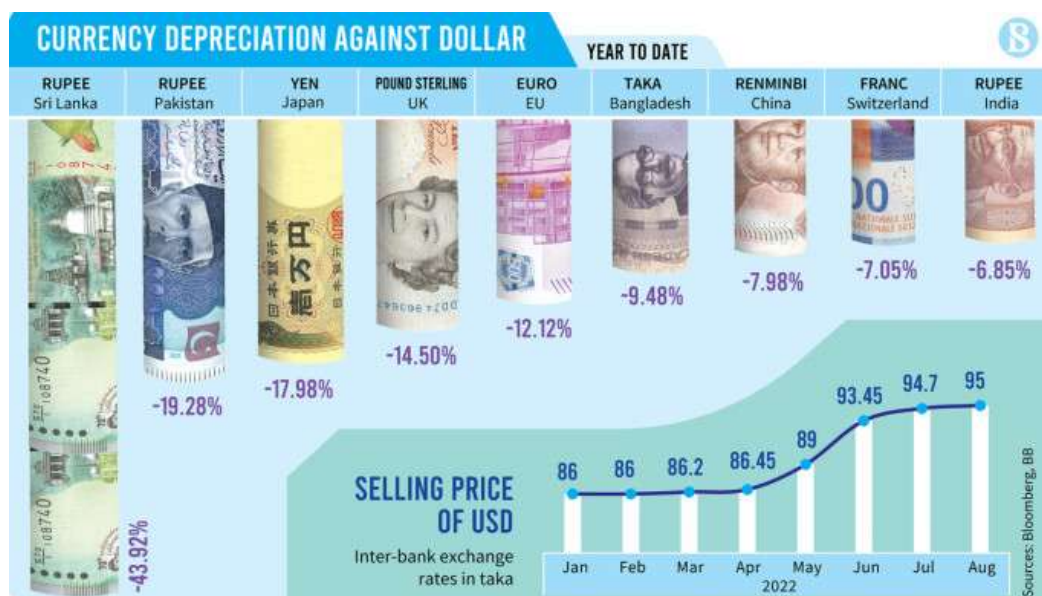
In fact, everyone is affected by the USD's value. 90% of the \$6.6 trillion daily transactions in foreign exchange, 50% of all international debt, and 59% of all publicly stated foreign exchange reserve holdings include the US dollar (IMF data).



A "strong dollar policy" is not essential to the USD's function. By utilizing domestic measures that do not target exchange rates, the Fed aims to reduce domestic inflation. The US dollar is allowed to float freely, and the Fed does not actively intervene in currency markets.

The Dollar Index (DI) compares the value of the dollar to a basket of other currencies. The index's rise is the sum of US dollar gains against the euro, yen, pound sterling, Canadian dollar, Swedish krona, and Swiss franc. The USD has only been stronger three times since the 1960s, in 1969, 1985, and 2002, when it will be over 109 on August 31, 2022.

With the exception of 2022, the majority of other currencies have decreased in value. A 24-year low was reached by the yen, the euro went to parity with the dollar for the first time since 2002, and the British pound declined by around 12%. Over 80% of the DI basket is comprised of these three.



3.2 Currency depreciation against the dollar

High commodity prices, a gradual but vigorous tightening of US monetary policy, and continuous geopolitical tensions all worked together to support the dollar's rise. Investors commonly use investments having a dollar value to hedge their risks during periods of inflation and recession.

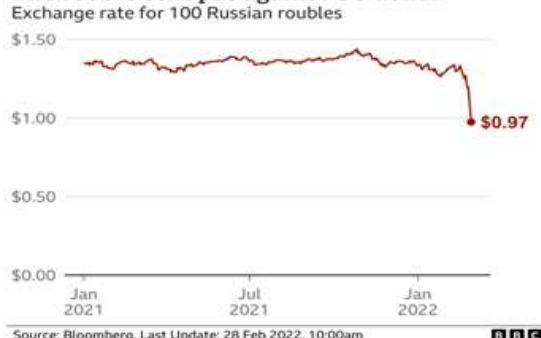
3.3 Dollar flight questionable

The dollar might depreciate if the situation in Ukraine is resolved, the US has a recession, the Fed reduces interest rates, and the US government implements fiscal consolidation—all largely improbable scenarios. Global reserve managers have recently diversified their holdings in favor of non-traditional reserve currencies, such as the Chinese yuan, due to concerns of one-sided sanctions. Currently, the currency in which some countries are paid for trade is being renegotiated. Such initiatives, however, have a small probability of succeeding. The dollar is the only currency that may be used now. Never before has the dollar enjoyed greater stability. China continues to enact capital controls, while Europe lacks an equivalent secure asset.

Russian Ruble Selloff Intensifies



The rouble collapse against US dollar



3.4 The FED will announce a strict monetary policy

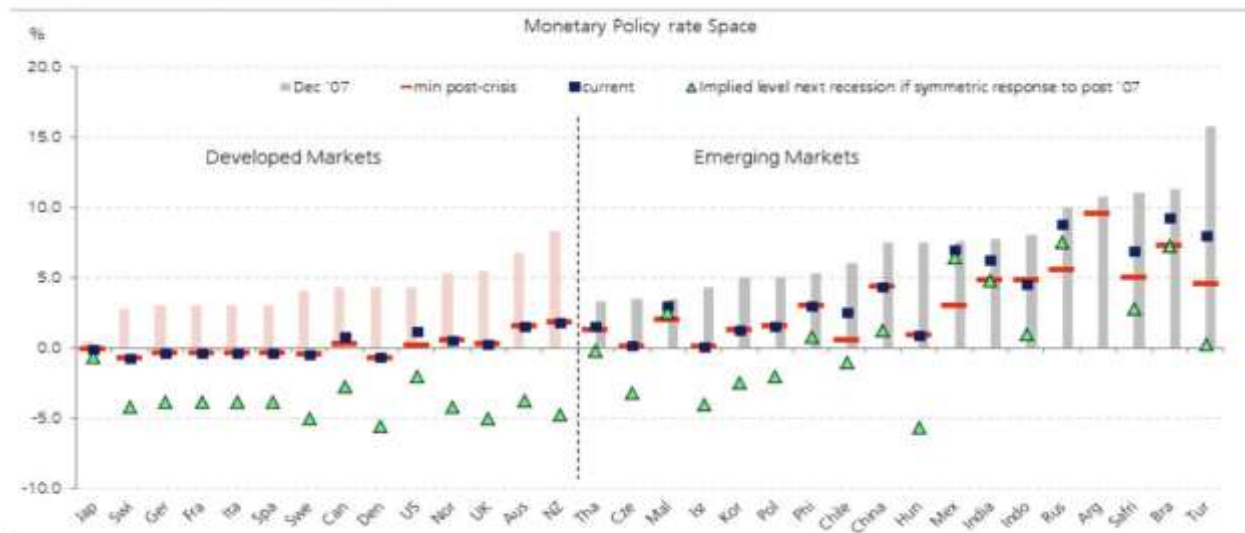
The USD might advance a little farther. In his statement on August 26, 2022, the Fed Chair suggested a more stringent monetary policy would be in place "for some time." The Fed has also begun quantitative tightening in an effort to further combat the possibility of inflation. Despite this, it's possible that the majority of the dollar's gain has already happened. The European Central Bank is now expected to raise interest rates

significantly in September. The profits are likely to persist until the uncertainties disappear and interest rates settle. The risks related to energy are generally avoided by the US. The US dollar appears to be in high demand as Europe braces for an energy crisis, US interest rates continue to rise due to chronic inflation, Japan fights rate increases, China locks down its supply chains, and other nations experience inflation and sovereign debt defaults. These will surely maintain high USD prices and world tensions.

4. How yuan is emerging as global reserve currency

According to the UBS Asset Management annual reserve manager survey, which was published in July of this year, almost 85% of central banks claim they have invested in yuan or are considering doing so. This is an increase from 81% a year ago.

Figure 49: Monetary Policy Space



Source: Haver, UBS

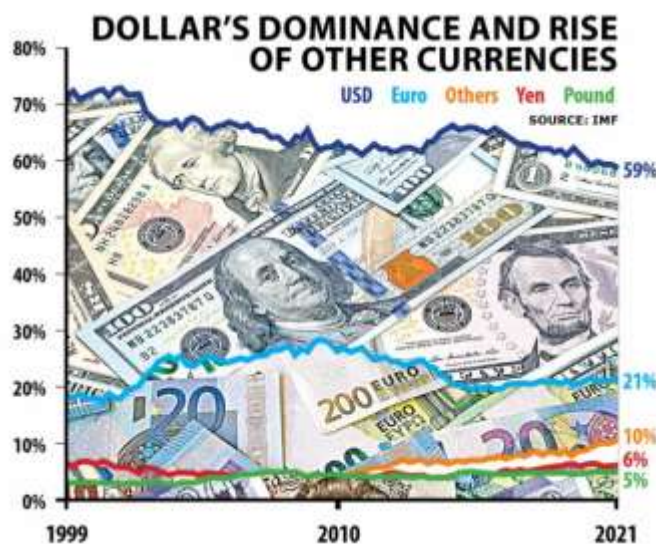
A full-service asset manager, UBS Asset Management (Americas), Inc. offers investment and sub-advisory services to US institutions, financial advisers, and individual investors. In the next ten years, central bank foreign exchange managers anticipate holding 5.8% of their reserves in yuan, up from 5.7% in the previous year. That would represent a significant increase over the 2.9% level the IMF reported. The poll found that, as of June 2022, central banks held, on average, 63% of US dollars, down from 69% the year before.



4.1 No more Dollar to be Retain in Reserve Currency!

According to media reports, the UBS claimed that less Latin American banks—which generally retain more dollars—were questioned this year. According to more than 81% of survey participants from UBS, the transition to a "multipolar" world will be advantageous for the yuan. In a reflection of the asset's appeal during periods of economic or geopolitical crisis, 46% of respondents believed the dollar will benefit.

5. How Dollar become Global Reserve Currency



5.1 WWII Imposed an Impact on The World's Financial System

Nearly everything in the globe was altered by the Second World War. Or, to put it succinctly, we can say that after World War II, the world altered in a way that it had not changed in a long time. Thus, WWII also had an impact on the world's financial system. World leaders began debating the creation of a reliable financial system for conducting an international business as World War II was coming to a conclusion. Because the 1930 Great Depression had a profound impact on the then-dominant worldwide gold standard of trade. The world's leaders struggled to come up with a workable solution to the erratic international trade.

In 1944, more than 700 representatives from 44 nations met in Bretton Woods, New Hampshire, to decide to fix the US dollar as the world's reserve currency since at the time, America had the largest gold reserve. This decision came after more than ten years of the Great Depression.

5.2 Gold vs Dollar!

At the Bretton Woods conference, government officials made a vow to exchange their national currencies for their gold equivalent upon demand. This deal made it possible for other nations to use dollars rather than gold to support their currencies. The US dollar's road toward becoming the primary convertible currency in the world and the global reserve currency has just begun. The dollar's value in relation to gold was set by the US at \$35 per ounce.

5.3 Exchange Rates in The Medium of Exchange

According to NPR, an independent, nonprofit media organization, other nations fixed their exchange rates in line with the dollar, making it the system's primary medium of exchange.

However, the government found it too expensive to uphold the pledge as the US began running up massive deficits and exhausting its gold reserves in the 1960s. So, in 1971, President Nixon orchestrated the separation of currency from gold.

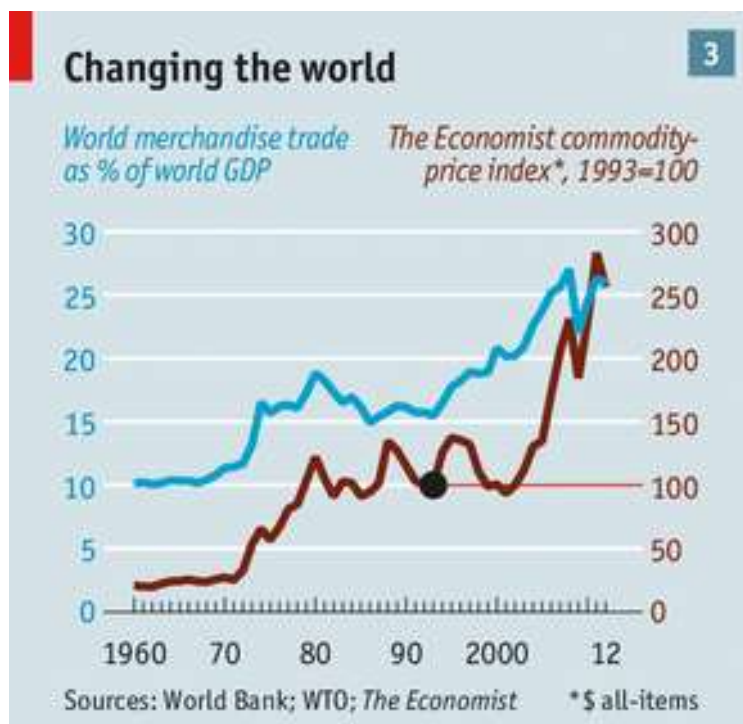
5.4 Dollar Determines Every Decision on the Value of the Dollar

Today, a jumble of political and economic factors, including central bank decisions and the frantic buying and selling of traders throughout the world, determine the value of the dollar.

The original Bretton Woods agreement is now gone, but the dollar is still the world's reserve currency. If some data on global finance are analyzed, it is possible to see the US dollar's supremacy.

5.5 United States is Responsible for Global Merchandise Trade

In 2015, the financial magazine The Economist reported that the United States is responsible for 12% of global merchandise trade and 23% of the world's GDP.



However, a de facto dollar zone exists where currencies are linked to the dollar or move somewhat in sympathy with it, accounting for around 60% of global output and a corresponding portion of the global population. The US had \$2.04 trillion in currency in circulation as of 2020.

5.6 The Dollar is King on the Foreign Currency Market

The Balance, an online journal, estimates that up to half of that worth is in circulation elsewhere. The dollar is king on the foreign currency market. The US dollar is a common currency in forex trading (around 90%). The dollar's value is supported by the relative strength of the American economy. The dollar is the most potent currency because of this. By the end of 2020, there was \$2.04 trillion in circulation in the United States. It is believed that up to half of that value is in foreign circulation.

What To Know About the US Dollar as the Global Currency

- Panel 1:** The 1944 Bretton Woods agreement allowed other countries to back their currencies with dollars rather than gold.
- Panel 2:** In the early 1970s, former President Nixon separated the dollar from gold.
- Panel 3:** The relative strength of the U.S. economy supports the value of the dollar.
- Panel 4:** The dollar rules the foreign exchange market.

\$	USD	+2.74	▲
€	EUR	+2.31	▲
£	GBP	-0.41	▼
¥	JPY	+3.16	▲
A\$	AUD	+2.71	▲
- Panel 5:** Nearly 40% of the world's debt is issued in dollars.
- Panel 6:** Countries like China and Russia are currently calling for a one-world currency.

the balance

According to the International Standards Organization List, there are 185 different currencies in circulation worldwide, although most of them are only used within the borders of their respective nations.

5.7 The currency of about 40% of global debt is the dollar

Dollars make up nearly 40% of the world's debt. As a result, operating foreign banks is very expensive. According to *The Economist*, one quirk of globalization is that while America's financial footprint has shrunk, its trading footprint has not. When the Fed shifts its policy, trillions of dollars do too, all over the world.

6. Findings & Recommendation

- While China's economy may be expanding, it wants the yuan to replace the US dollar as the world's reserve currency. The Bangladesh Bank is following suit, and central banks all over the world are increasing their yuan holdings in their reserves.
- As the Chinese currency becomes more widely accepted on international markets as an alternative to the dollar, the Bangladesh Bank has been increasing the share of yuan in its foreign exchange reserve while decreasing the share of dollars.
- Going for a currency swap will be simpler now that Chinese money is freely convertible internationally and Bangladesh is holding yuan in reserve. In terms of imports, China is Bangladesh's main commercial partner.
- What can we therefore expect? The majority of forecasting indicators indicate to a definite decline in the world economy this year and the year after. Diversified export-driven countries will continue to outperform those with problematic investments, trade, and debt. These nations also have a sizable amount of dollar reserves and little debt in dollar terms. The maintenance of their manufacturing systems will require developing nations like Bangladesh to deal with tighter financial conditions, challenging macroeconomic management, and the acquisition of foreign currency.
- In order for the RENMINBI and the taka to be used for pricing and settlement in bilateral trade, the People's Bank of China, the central Bank of China, has offered to enter into a currency swap agreement with the Bangladesh Bank. • A currency swap agreement will help to reduce the cost of foreign exchange transactions and help to manage the risk of fluctuating exchange rates.
- In contrast, the dollar has just regained the majority of its 1970s strength. There is no reason to be concerned about this. The currency is not a "problem" that calls for a "solution" from the government. The condition of the dollar can be detected in both economic and noneconomic elements. A strong reserve currency is something to be proud of and glad about, not something to be concerned about.
- The U.S. dollar, which is a widely accepted unit of account, a significant reserve currency, and used to buy and sell fundamental raw resources, has an impact on every aspect of the global economy. Investors look to this currency as a safe haven during difficult times because it is the one utilized to acquire and sell essential raw goods. The anticipation that the Federal Reserve will raise interest rates more quickly than other central banks is one of the factors driving the dollar's value against other major foreign currencies to a 20-year high.
- The main element pushing the dollar higher is the exceptionally high demand for dollars. The majority of economies' economic predictions indicate a significant decline. For instance, 75% of Bangladesh's declared reserves are in US dollars, yet they are being used up far too quickly.

7. Conclusions

The recent strength of the yuan and its transition to the status of a reserve currency, while the dollar's decline in Bangladesh, were some of the probable effects explored in this study. Although it is easy to conceive scenarios in which repeated departures of a reserve currency from its long-run sustainable level do have long-term impacts, the evidence for such consequences in the case of the dollar is surprisingly scant. The burden of stabilizing the debt-to-GDP ratio will not be materially exacerbated by the ratio's increase because the real interest rate does not materially exceed the growth rate.

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Mst. Afroja Aktar. "Reserve moves with New Currency while the dollar shrinks in Bangladesh." *IOSR Journal of Economics and Finance (IOSR-JEF)*, 13(5), 2022, pp. 33-43.