International Money and Monetary System

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Evolution of the International Monetary System

- Before 1875: Bimetallism
- 1875 – 1914: Classical Gold Standard
- 1915 – 1944: Interwar Period
- 1945 – 1972: Bretton Woods System
- 1973 – Present: The Flexible Exchange Rate Regime
# Evolution of the International Monetary System

## Bimetallism
- Some countries were on the gold standard, some on the silver standard, some on both
- Payment and the exchange rates among currencies were determined by either their gold or silver contents

## Classical Gold Standard
- Exchange rate determined by their relative gold contents
- Gold could be freely exported or imported
- Conducive to international trade and investment
- Supported by the *price-specie-flow mechanism*

## Interwar Period
- Exchange rates fluctuated as countries widely used “predatory” depreciations
- Participants lacked the political will to “follow the rules of the game”
- International trade and investment was profoundly detrimental

## Bretton Woods System
- Postwar international monetary system
- Creation of the IMF and World Bank
- Exchange rate stability achieved without the gold standard
- US dollar was pegged to gold at $35 per ounce and other currencies were pegged to US Dollar
- Dollar-based gold exchange standard
- Collapse due to increased in money supply, significant inflation and speculation on the devaluation of Dollar

## The Flexible Exchange Rate Regime
- Central banks were allowed to intervene in the exchange rate markets to prevent unwarranted volatilities
- Gold was abandoned as an international reserve asset
- Non-oil-exporting and less-developed countries given greater access to IMF funds
Which is Better – Fixed Rates or Floating Rates?

**Floating exchange rates system**
- Monetary policy autonomy
- Automatic trade balance adjustments

**Fixed exchange rates system**
- Provides monetary discipline
- Minimizes speculation
- Reduces uncertainty

Type of Exchange Rate System is in Practice Today?

- Fixed Peg: 28%
- Managed float: 26%
- No Separate Tender: 22%
- Free Float: 14%
- Adjustable Peg: 6%
- Currency Board: 4%
Special Drawing Rights (SDR)

- On 30 Nov 2015, IMF decided to include the Chinese renminbi as a fifth currency to the basket of Special Drawing Rights (SDR)

- Effective 1 Oct 2016, the SDR basket consists of the US dollar, euro, the Chinese renminbi, Japanese yen, and pound sterling
Policy for a new Global Monetary System

- The **US Dollar** is going to the primus inter pares in the medium term
- The **Euro** holds the potential to become more attractive once the Euro Zone has solved its debt crisis convincingly
- **China** begun to encourage foreigners to use the Renminbi (RMB), promoting the currency to international investors and central banks

- **Further international coordination of monetary and currency policies is a necessity**
  - Reduced the central banks’ influence on the domestic money supply

- **Correlation between capital mobility and crisis probability**
  - Set of rules is required to regulate handling and form of capital movement controls (establishment of big currency reserves, introduction of capital movement controls, currency market interventions)

- **Develop globally valid rules for financial stability and facilitate national reforms**
  - Not only monitor national economies, but also check the implications of contagion, synergy and feedback effects and be able to intervene when the need arises

- **More details and timely publication of important financial indicator is essential for an early warning system**
  - Reform may require better intervention possibility by the IMF
What’s Important

Managing volatility
- Availability of ample reserves
- Maintain strong economic fundamentals
- Manage exposure to external debt

IMF’s role
- IMF could enhance effectiveness of the current monetary system
- Shared responsibility – strong, sustainable & balanced growth
Thank you