

Preface

Determining the levels of (and changes in) exchange rates, as well as assessing the impact of these changes are topics that have been receiving increasing attention since 1973. This interest came as a result of the global shift to flexible exchange rates following the collapse of the Bretton Woods system of fixed exchange rates in 1971 when the United States suspended the convertibility of the dollar into gold. Academic and professional economists are interested in these topics because they constitute a challenging area of inquiry and because variations in exchange rates affect the risk and return on investment, as well as market shares, whenever a foreign exchange factor is involved, which is inevitable in this era of globalization. Indicative of the importance of the exchange rate factor is that foreign exchange risk management has become a thriving field since the regime shift in the 1970s, and as a result instruments and techniques have been developed to deal with this risk. Policymakers are also interested in the determination of, and changes in, exchange rates because these changes have significant macroeconomic ramifications, affecting almost every macroeconomic variable, including the major four (growth, inflation, unemployment, and the balance of payments). It is for all of these reasons that research on exchange rates has been mushrooming.

Given the importance of the topic and because it is constantly evolving with momentum, we decided to write this book as a comprehensive reference for those interested in the field. The book provides detailed exposition (using both diagrammatic and mathematical representation) of the models of exchange rates and the balance of payments. Moreover, we highlight the observed failure of the macroeconomic approach to exchange rates, providing explanations for this failure and discussing alternative approaches such as the microstructure approach and behavioral finance. It is hoped that this book will be a helpful reference for economists and policymakers who are interested in exchange rates.

Writing this book was a rather hectic job that would not have been possible without the help and support we received from several individuals. First and foremost, we must thank our families who had to bear the opportunity cost of writing this book. The list of individuals whom we would like to thank is rather long, but there are people who were specifically helpful. We utilized the computer skills and data retrieving ability of John Vaz who was (and is) always ready to give a hand. Liam Lenten was just as helpful in providing data and other information. Lee Smith and Hassan Shahzad read previous tedious versions of the manuscript and came up with sets of constructive suggestions that have helped improve the presentation. Shobita Koohli, the librarian at GUST, was helpful in obtaining many of the references cited in this book, which she did rather efficiently. Sulaiman Al-Jassar provided much-needed help, technical and otherwise, for the first author when he first arrived at Kuwait University in October 2008, when this book was finalized. Informal discussions with Weshah Razzak on exchange rate economics proved to be useful for refining some of the ideas presented in this book.

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Needless to say, we are responsible entirely for any errors and omissions in this book. It is dedicated to our beloved children who are concerned about changes in exchange rates as they experience the rise and fall of the value of domestic currencies in foreign currency terms when they travel abroad.

Imad Moosa
Razzaque Bhatti
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