Forum: The Group of Twenty (G20)

Issue: Discussing and Regulating Currency Manipulation on a Global Level

Student Officer: Vasilis Bogdanis

Position: President

PERSONAL INTRODUCTION

Dear Delegates of The Group of Twenty,

My name is Vasilis Bogdanis, and I am currently a freshman at The American College of Greece. For the duration of the 11th Platon School Model United Nations, I will be serving as the President of The Group of Twenty while also serving as the expert chair on the issue of "Discussing and Regulating Currency Manipulation on a Global Level".

This study guide is created only as a measure to introduce you to the topic, while I strongly urge you to also do your own research outside of the framework of this guide.

If you have any further questions regarding the topic, please don't hesitate to reach me at:
billbogdanis@gmail.com

Kind Regards,
Vasilis Bogdanis

TOPIC INTRODUCTION

Currency manipulation is a topic that is hotly debated in the economic sector and throughout the world today. Currency manipulation, also known as currency intervention, occurs when a central bank or government buys or sells its own currency in exchange for another currency to influence trade and exchange rates; Countries participate in currency manipulation in order to weaken their currency's purchasing power. That enables them to keep the prices of the products that they are exporting low in order to keep the interest in the high.

The value of a currency today is determined by the Law of Supply and Demand. This theory does not only apply to different goods, but to currencies as well. Thus, if the demand for the US Dollar starts rising, while demand for the Euro starts failing, with the supply of both currencies staying at the same levels, the US Dollar will see a rise in its price while the Euro will be depreciating in value. To add to that, by artificially keeping the price of your own currency low, a nation is able to import goods at lower prices. Following the Law of Supply and Demand, said product will then see a rise in demand, because it is cheap, and the nation will be able to profit from the sale of it.

It's worth mentioning that strategic currency depreciation doesn't always succeed, and it can even lead to a huge 'currency war' between nations. Competitive devaluation is an instance in which one country responds to the sudden devaluation of another nations' national currency depreciation by devaluing its own currency. In other words, currency depreciation in one country is mirrored by a currency devaluation from another country. If both currencies have fixed-exchange-rate regimes instead of market-determined floating exchange rates, this happens more frequently [1].

Our goal as a committee is to be able to propose different solutions in order to regulate the issue of currency manipulation.

DEFINITION OF KEY TERMS

Inflation

Inflation is the gradual loss of a currency's buying value over time. The increase in the average price level of a basket of selected goods and services in an economy over time may be used to calculate a quantitative estimate of the pace at which buying power

[1] Hayes, Adam. "3 Reasons Why Countries Devalue Their Currency." *Investopedia*, Investopedia, 28 Aug. 2020, https://www.investopedia.com/articles/investing/090215/3-reasons-why-countries-devalue-their-currency.asp#:~:text=It%20is%20worth,floating%20exchange%20rates.

declines. A rise in the overall level of prices, which is frequently stated as a percentage, signifies that a unit of money now buys less than it did previously.[2]

Hyperinflation

Hyperinflation is a phrase used to characterize an economy's fast, excessive, and out-of-control price increases.[3]

Currency Manipulation

A monetary policy operation in which a government or central bank buys or sells foreign currency in exchange for its own domestic currency, usually to influence the exchange rate and trade policy.

Floating exchange rates

A floating exchange rate, also known as a fluctuating exchange rate, is one in which the value of a currency is permitted to vary in accordance with the foreign exchange market. Floating currency is a currency that utilizes a floating exchange rate. A floating currency, such as the dollar, is an example.[4]

Fixed exchange-rate regimes

A fixed exchange rate system, also known as a pegged exchange rate system, is a currency system in which governments attempt to keep the value of their currency constant in relation to a certain currency or item. A country's government determines the value of its currency in terms of a predetermined weight of an asset, another currency, or a basket of other currencies under a fixed-exchange-rate system. A country's central bank is always committed to buying and selling its currency at a predetermined price.[5]

Trade deficit

The amount by which the goods imported by a country exceeds the value of its exports[6]

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2 Fernando, Jason. “What Is Inflation?” Investopedia, Investopedia, 18 Dec. 2021, https://www.investopedia.com/terms/i/inflation.asp.

3 Kenton, Will. “What Causes Hyperinflation.” Investopedia, Investopedia, 30 Dec. 2021, https://www.investopedia.com/terms/h/hyperinflation.asp

4 Boundless. “Boundless Economics.” Lumen, https://courses.lumenlearning.com/boundless-economics/chapter/exchangerates/#:~:text=A%20floating%20exchange%20rate%2C%20or,example%20of%20a%20floating%20currency.

5 Boundless. “Boundless Economics.” Lumen, https://courses.lumenlearning.com/boundless-economics/chapter/exchangerates/#:~:text=A%20floating%20exchange%20rate%2C%20or,example%20of%20a%20floating%20currency.

6 Oxford Languages

Stagflation
An economic situation that is the result of slow economic growth, high unemployment rates, and rising prices.

The Law of Supply and Demand
The law of supply and demand is a theory that explains the interaction between the sellers of a resource and the buyers for that resource. The theory defines the relationship between the price of a given good or product and the willingness of people to either buy or sell it. Generally, as price increases, people are willing to supply more and demand less and vice versa when the price falls.

BACKGROUND INFORMATION

How does currency manipulation work on a global scale?
The most important thing in regulating currency manipulation, is understanding why it happens. To begin with, currency manipulation is an action taken by foreign governments to artificially control the price of different currencies. For example, country A would like to raise the price of the national currency of Country B so that people would choose to import the products of country A. In order to achieve that country A would invest in the economy of Country B so they can artificially strengthen it and drive the price of the national currency of Country B up. This would result in the same product costing more to import from Country B than Country A. This is the simplified way in which countries manipulate each other's currencies.

The importance of regulating currency manipulation
Obviously having this constant "war" between nations would result in the destruction of the global economy. When manipulating a currency, the results of it do not only affect the currency's price, things are much more complicated. Firstly, when such an instance occurs, it leads to lower economic growth for the country being manipulated. That happens because exports for said country are now becoming gradually more expensive. Following that a country's imports start to overtake the exports, and creating a trade deficit. If the trade deficit is sustained for a long period of time, a nation could start going into debt. After some time has passed this debt accompanied by the trade deficit faced by the nation, will drive domestic investors to foreign markets for more favorable opportunities. And as people turn to foreign markets, jobs will start being cut and the domino effect continues. As one can see currency manipulation is not a simple matter and affects a nation at a plethora of different levels. Thus, the importance of regulating it.

Causes of currency manipulation
Currency manipulation usually occurs due to a plethora of reasons that can be brought down to 3 main ones.

Controlling inflation

When devaluating a currency, which is a type of currency manipulation, a significant issue is caused. The prices of imported goods start to climb, thus the demand for domestic products also rises. The issue here is the fact that, when this happens inflation, on domestic products, skyrockets. If this occurs, the government may be forced to boost interest rates in order to keep inflation under control, but at the expense of slower economic development.[7]

Currency manipulation is thought to be a good solution for nation struggling with inflation. To put that into perspective, we can use the example of the Swiss Franc in 2008. During 2008 the Franc saw an appreciation in its value causing stagflation, as Switzerland was still recovering from the effects of the US economic crisis. To prevent the further appreciation of the Franc, the Swiss National Bank (SNB), decided to exchange its currency for Euros and US Dollars, and it worked temporarily as history repeated itself in 2009. In 2009 the SNB decided to exchange Francs for Euros and Dollars, and has since stabilized the inflation rates.

International competitiveness

In order for nations to be able to maintain their competitive status in the global markets, they have to keep the cost of goods and services coming from their nations low. Furthermore, in order to determine the competitiveness of a nation, one should also take into account other factors such as labor productivity. Labor productivity is the reason behind, goods created in certain nations are cheaper than the same or similar ones from other nations.

Moreover, if a nation is able to retain a lower inflation rate than its competitors, it is able to grow a lot faster and create more lucrative deals for investors looking to expand in that nation.

Financial stability

Lastly a nation may manipulate its own currency in order to achieve and sustain financial stability. Financial stability, according to the majority of definitions, is defined as the absence of system-wide instances in which the financial system fails to operate (crises). It's also about the financial systems' ability to withstand stress. A stable financial system is able to efficiently allocate resources, assessing and managing financial risks, maintain employment levels close to the natural rate of the economy, and preventing relative price movements of real or financial assets from affecting monetary stability or employment levels. In times of financial instability, the genuine importance of financial stability is best demonstrated. Banks are hesitant to finance profitable ventures during these times, asset prices diverge

7 "Currency Devaluation and Revaluation." Currency Devaluation and Revaluation - FEDERAL RESERVE BANK of NEW YORK, https://www.newyorkfed.org/aboutthefed/fedpoint/fed38.html.

significantly from their actual values, and payments may be late. Bank runs, hyperinflation, and stock market crashes may all result from major upheaval. It has the potential to seriously undermine public trust in the financial and economic systems. [8]

Identifying currency manipulation

As there is no set legal framework on how countries trade their own currencies, spotting currency manipulation, can at times prove a really hard task. To add to that, there is no set way for spotting currency manipulation. One of the methods used today is to look at the imports and the exports of a nation over a large amount of time (i.e. 6 months or 1 year), and see if the exports outweigh the imports and by how much. The issue here is that this by itself is not a very accurate measure, usually takes up a lot of time, and might not prove anything by the end of the investigation. Furthermore, there is also the issue of quantitative easing. Quantitative easing is a measure taken by central banks, in order to lower the interest rates at a national level. Moreover, its' goals are to increase the borrowing levels and to encourage its' people to spend more. But the end result of this is also the depreciation of the national currency and many consider this measure to be falling under the category of currency manipulation as well.

The case of El Salvador

El Salvador is the first jurisdiction to adopt the decentralized digital asset in addition to the US dollar as legal tender. After several years of high inflation, which peaked at over 32% in 1986, the Salvadoran colón was replaced by the US Dollar in 2001. Bitcoin, on the other hand, has experienced the opposite issue. Its value has risen in its brief life and remains highly volatile, rather than losing purchasing power due to inflation.

South America has a history of hyperinflation, as evidenced by the fact that banknotes in Venezuela are currently more valuable as novelty objects than as currency. The benefits of a bigger money supply are not available to inhabitants of developing countries. Their spare cash is far too tiny to be invested effectively, and the bulk of them lack the potential to generate interest on their savings. Bitcoin is unique in that it has a limited quantity. Only 21 million bitcoins will ever exist. Bitcoin's value rises in tandem with its demand. Because the money is limited, it helps to reduce global poverty by preventing inflation.[9]

The relationship between exchange rates and trade

Because there is a perpetual feedback loop between international commerce and the way a country's currency is valued, the link between a country's imports and exports and its exchange rate is intricate. The exchange rate influences the trade surplus or

8 World Bank Group. "Financial Stability." World Bank, World Bank Group, 7 Nov. 2017, https://www.worldbank.org/en/publication/gfdr/gfdr-2016/background/financial-stability.

9 "How Bitcoin in El Salvador Could Help End Poverty." BORGEN, 10 Dec. 2021, https://www.borgenmagazine.com/bitcoin-in-el-salvador/.

deficit, which influences the exchange rate again, and so on. A weaker native currency boosts exports while increasing import costs. A strong native currency, on the other hand, stifles exports while lowering the cost of imports.

Let's look at the example, of a car part in the United States that is priced at 10$ and will be exported to India. Let's also assume that the exchange rate is 50 rupees for 1 USD. Putting duties and shipping aside, this car part should cost the Indian importer 500 rupees.

In case that the U.S. Dollar strengthens against the Indian Rupee, let's say that the new exchange rate is now 55 rupees for 1 U.S.D. The new price for the car part is 550 rupees, again disregarding the duties and the shipping rates. This may drive the Indian importer to hunt for components from other countries that are less expensive. The US exporter's competitiveness in the Indian market has consequently been harmed by the dollar's 10% increase against the rupee.[10]

Floating exchange rates

Long-term currency price variations in floating exchange rate regimes reflect relative economic strength and interest rate differentials across countries. Short-term movements in a floating exchange rate currency reflect speculation, rumors, natural calamities, and the currency's daily supply and demand. When supply exceeds demand, the currency falls, and when demand exceeds supply, the currency rises. Even in a floating rate regime, extreme short-term movements can lead to central bank intervention. As a result, while the majority of major global currencies are considered floating, central banks and governments may intervene if the value of a country's currency gets too high or low. A currency that is either too high or too low in value can have a detrimental impact on the economy, impacting commerce and the capacity to pay obligations. The government or central bank will try to put in place policies that will allow its currency to trade at a more advantageous rate.

Currency appreciation

In a floating rate exchange system, the value of a currency changes often based on supply and demand in the forex market. By increasing or decreasing their holdings, traders and corporations can profit from price changes. Currency appreciation, on the other hand, is not the same as a gain in the value of securities. Currency trading takes place in pairs. As a result, when one currency's value rises in reference to another, the other currency's value rises as well. This is in contrast to a stock whose price increases due to the market's judgment of its inherent worth. Demand and appreciation are

10 Kramer, Leslie. "How Importing and Exporting Impacts the Economy." Investopedia, Investopedia, 7 Dec. 2021, https://www.investopedia.com/articles/investing/100813/interesting-facts-about-imports-and-exports.asp.

inextricably related. When a currency's value grows (or appreciates), so does the demand for it. When a currency depreciates, on the other hand, it loses value in relation to the currency against which it is exchanged.[11]

Effects of Currency Appreciation

Rising export cost

Foreign nations will find American goods more costly if the US currency advances because they will have to pay more in USD in order to import goods. As a result of the increased price, the number of US goods exported is anticipated to decrease. This eventually results in a decrease in gross domestic product (GDP), which is not beneficial for the nation.

Cheaper import cost

Foreign products, or imports, will become cheaper in the United States if the US Dollar becomes more expensive on the international market. This is because the length to which the US Dollar will stretch will increase, allowing you to purchase more imported products. As a result, decreased prices benefit consumers, resulting in lower total inflation.

Currency depreciation

Depreciating currencies are common in countries with weak economic fundamentals, such as persistent current account deficits and high inflation rates. If done correctly and gradually, currency depreciation enhances a country's export competitiveness and, over time, may reduce its trade imbalance. An abrupt and significant currency devaluation, on the other hand, may frighten foreign investors who worry the currency may fall further, prompting them to withdraw their portfolio assets from the nation. The currency will be further weakened as a result of these activities. One of the most common reasons of currency depreciation is rising inflation. Hundreds of billions of dollars (or any other currency) pursue the most significant yield when interest rates are low. Expected interest rate differentials can trigger currency depreciation. To counteract inflation, central banks will raise interest rates, as too much inflation might lead to currency devaluation.

11 Chen, James. "Currency Appreciation Definition." Investopedia, Investopedia, 8 Feb. 2022, https://www.investopedia.com/terms/c/currency-appreciation.asp.

Please keep in mind that when talking about floating exchange rates the term used is depreciation of a currency. While on the other hand, in case we are talking about fixed exchange rates, the correct term is devaluation of a currency.[12]

Effects of currency depreciation

Lower export cost

In the case of currency depreciation, foreign nations will find American goods cheaper if the US currency falls because they will have to pay less in USD in order to import goods. As a result of the decreased price, the number of US goods exported is anticipated to increase. This eventually results in an increase in gross domestic product (GDP), which is beneficial for the nation.

Higher import cost

Foreign products, or imports, will become more expensive in the United States if the US Dollar becomes less expensive on the international market. This is because the length to which the US Dollar will stretch will decrease, allowing you to purchase less imported products. As a result, increased prices benefit consumers, resulting in higher total inflation.

MAJOR COUNTRIES AND ORGANIZATIONS INVOLVED

China

China, being the world's largest exporter, is heavily involved in this issue. China is the country most frequently accused of manipulating currency to entice countries to buy its commodities over the ones produced by other nations. Currency manipulation is said to be the reason China is the world's largest exporter, because importing products from China is so affordable. However, the International Monetary Fund (IMF)[13] added the Chinese Yuan to its Special Drawing Right (SDR), which serves as the IMF's international currency reserve, in 2015. The IMF's decision to include the Yuan indicates that it believes this currency is stable and dependable. Because it has a direct influence on international reserves, it will be examined more closely, and

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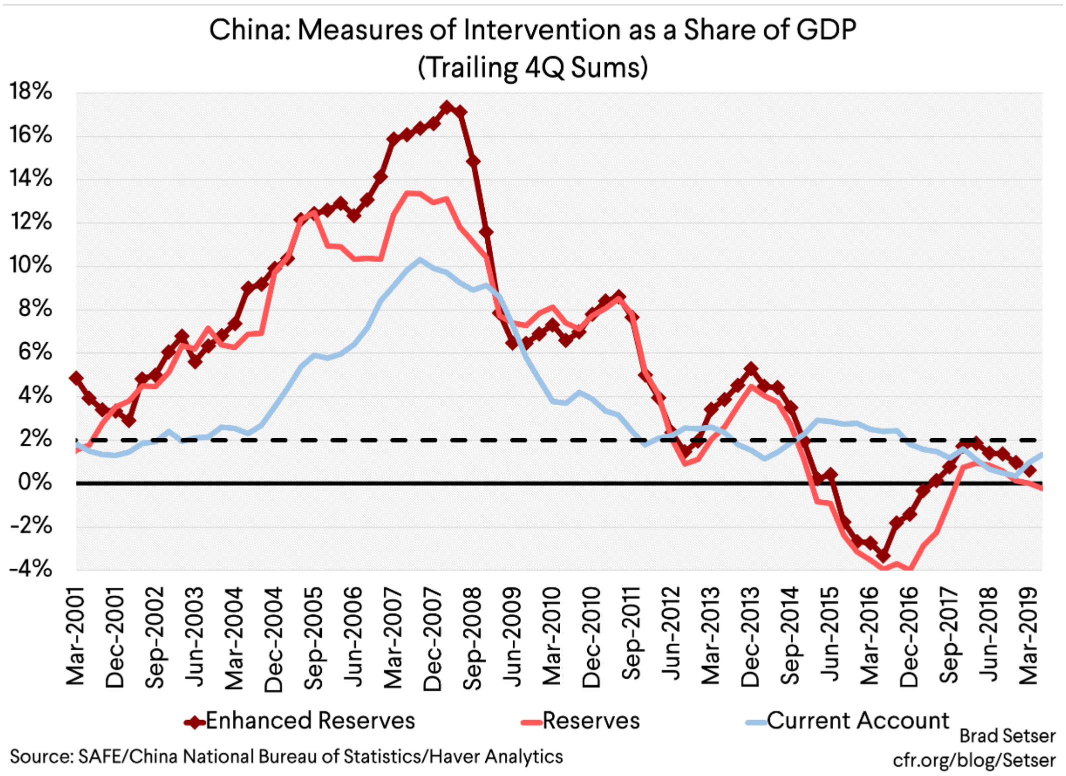
12 Smith, Tim. "What Is Currency Depreciation?" Investopedia, Investopedia, 8 Feb. 2022, https://www.investopedia.com/terms/c/currency-depreciation.asp.

13 News, IMF. "IMF Adds Chinese Renminbi to Special Drawing Rights Basket." IMF, 30 Sept. 2016, https://www.imf.org/en/News/Articles/2016/09/29/AM16-NA093016IMF-Adds-Chinese-Renminbi-to-Special-Drawing-Rights-Basket#:~:text=Effective%20October%201%2C%20the%20IMF,Special%20Drawing%20Right%2C%20or%20SDR.

governments will not be as tolerant with any type of currency manipulation as they have been with China.



United States of America

The United States are interested in this issue since it is the country that has accused others of currency manipulation the most, more particularly China. The topic of currency manipulation has been a lengthy source of contention between the two nations, with the United States claiming that the Chinese currency manipulation has a direct impact on its economy. Following recent changes in their foreign policy, the United States have adopted a more conservative economic strategy, imposing taxes on imported commodities from China[14]. The US administration believes that by placing tariffs on foreign goods, that will bring jobs back to the United States; this may or may not be true; nevertheless, it is certain that it will encourage China to, allegedly, continue manipulating its currency to maintain its value low in order to entice other countries to buy its goods.

World Trade Organization (WTO)

The World Trade Organization was established in 1995 with the goal of regulating and establishing standards for international trade. The WTO is based in Geneva,

14 Pramuk, Jacob. "Treasury Secretary Steven Mnuchin Says Steel and Aluminum Tariffs on China Will Stay in Place." CNBC, CNBC, 22 May 2018, https://www.cnbc.com/2018/05/22/steven-mnuchin-says-china-steel-and-aluminum-tariffs-will-remain.html.

Switzerland, and has 164 members. The World Trade Organization has been chastised for not having a clear policy against currency manipulation. The group has rigorous anti-subsidies policies that imply resistance to currency manipulation. Because the WTO's regulations on currency manipulation are imprecise, it's unclear where the organization stands on the matter or whether it will take a position.

International Monetary Fund (IMF)

The International Monetary Fund, based in Washington, D.C., was founded in 1945. The IMF is a component of the United Nations with 189 member countries. "The International Monetary Fund is the world's main monetary policy body.[15]" The IMF, in contrast to the WTO, maintains severe restrictions against currency manipulation because it considers that currency manipulation offers countries an unfair trade advantage. Despite popular opinion, the IMF lacks the authority to modify a country's exchange rate policies and hence cannot take direct action on this problem; but it may indirectly influence a country to persuade it to stop manipulating its currency rates.

TIMELINE OF EVENTS

Date of Event	Description of event
1978-1979	The United States makes the first known currency intervention, significantly intervening in order to boost the dollar during a period of high prices.
September 1985	G5 nations convene in Plaza Accord to debate ways to contain the surging US currency. The countries agree to intervene with dollar sales to weaken the currency and restore international competitiveness to normal levels.
February 1987	The United States dollar has depreciated dramatically as a result of the Plaza Accords, and the United States has been buying dollars in large quantities in try to boost its value.
January 1st 1999	Launch of the Euro
September 22nd 2000	Central banks in Europe, Japan, and the United States join forces to raise the value of the Euro after it fell to an all-time low, marking the Euro's first intervention since its launch.
January 30th 2004	Japan sells a record 7.1545 trillion yen, causing the dollar to fall dramatically.
2008	Switzerland decides to exchange its domestic currency for foreign ones, in order to stop it from appreciating more.
February 4th 2016	The Trans-Pacific Partnership was signed by 11 states

15 Unit, UNT Libraries' Digital Projects. UNT Digital Library, https://digital.library.unt.edu/.

PREVIOUS ATTEMPTS TO SOLVE THE ISSUE

All attempts at currency manipulation solutions have been diplomatic, with the majority of them coming from the United States. There are no accords or treaties focusing on currency manipulation that have been created by the United Nations. The present international trade law system is not designed to directly address currency manipulation. This might have been done on purpose, as currency manipulation can sometimes save countries from a socio-economic catastrophe. Below one can find some attempts that have taken place on an international level.

The Plaza Accord

The Plaza Accord was signed on September 22, 1985. The Plaza Accord was designed to depreciate the US currency, with the US, Japan, and Germany committing to execute specific policy steps to accomplish this goal. The United States has committed to reducing its fiscal deficit. Japan and Germany were supposed to promote domestic demand by pursuing measures like tax cuts. To fix current account imbalances, all parties committed to intervene directly in currency markets as needed. The US dollar increased by about 47.9% from the beginning of 1980 to its high in March 1985, leading up to the Plaza Accord.

The Trans-Pacific Partnership

On February 4, 2016, Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam, and the United States signed the Trans-Pacific Partnership (TPP), or Trans-Pacific Partnership Agreement. TPP could not be approved and did not enter into force when newly elected US President Donald Trump withdrew his signature from the pact in January 2017. The remaining nations negotiated the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, which contains the majority of the TPP's provisions and went into effect on December 30, 2018. [16] The Partnership aimed to facilitate the export and import of goods for companies in the partner states by lowering taxes, establishing a fair legal regime, and removing other trade restrictions.

The Eurozone

All European Union Member States are part of the Economic and Monetary Union (EMU) and coordinate their economic policy-making to support the economic aims of the EU. However, a few of Member States have gone one step further and replaced their native currencies with the euro. The Eurozone is made up of these members. The eurozone was made up of 11 of the then-15 EU Member States when it was originally launched in 1999. Slovenia, Cyprus, and Malta joined in 2007, Slovakia in 2009, Estonia

16 Monday, On. "TPP: Trump's Decision to Kill Trade Deal Leaves Door Open for China." CNNMoney, Cable News Network, https://money.cnn.com/2017/01/23/news/economy/tpp-trump-china/.

in 2011, Latvia in 2014, and Lithuania in 2015. There are 19 EU member states in the eurozone today.

Denmark has a 'opt-out' from entering the euro area, as stipulated in a Protocol appended to the Treaty, however it can join in the future if it so desires. Sweden has not yet met the criteria to join the eurozone.[17]

POSSIBLE SOLUTIONS

Countervailing currency intervention

Counter Currency Intervention (CCI) is a solution that can be adopted by a nation to counter the effects of currency manipulation. In this instance when a nation wants to buy U.S. Dollars in order to keep the value of its own currency weak, the United States can simply buy the same amount of that country's currency in order to neutralize the effects. This solution could be put into effect with the creation of a global tracking software, used to surveillance unusual exchange of foreign currencies.

Third-party intervention

This issue does not see any immediate solutions without the intervention of a third party. But, the intervention of any third party raises many challenges. There are two possible scenarios to approaching this issue. One of the third parties that could intervene is the International Monetary Fund (IMF), which has more authority when it comes to making policies, but it lacks the means to enforce those policies. On the other hand, the World Trade Organization (WTO) could also be used to intervene, but although it is capable of enforcing policies, it lacks the authority to create new policies regarding monetary affairs. That is why a solution to this problem would be for the IMF and the WTO to work together to produce a convention or accord that would open the way for currency manipulation to be controlled.

Creation of an exchange-rate union (monetary integration)

European monetary integration is a type of monetary partnership aimed at reducing the US dollar's overwhelming impact on domestic exchange rates, which has led to the development of a Monetary Union as well as a shared currency via numerous initiatives. Therefore the creation of further monetary unions will help minimize transaction costs in an increasingly integrated regional economy from an economic standpoint. It also contributes to greater price transparency, which boosts intra-regional competition and market efficiency. As a result, monetary integration provides

17 "What Is the Euro Area?" European Commission - European Commission, 30 Apr. 2021, https://ec.europa.eu/info/business-economy-euro/euro-area/what-euro-area_en.

chances for economic stability, increased growth, and increased employment, all of which benefit the union's citizens directly.

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