

## **An Empirical Investigation to Exchange Rate Overshooting: Insights from Bangladesh**

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*Following the abandonment of the Bretons Woods Agreement in 1973, exchange rate has become an important macroeconomic variable that can be linked to multidimensional sectors within an economy. It has been empirically acknowledged that countries participating in rigorous bilateral and multilateral trade activities are often vulnerable to unanticipated exchange rate movements following which the economy as a whole could be adversely affected. It is believed that exchange rate appreciation in developing countries in particular can lead to a sharp decline in export competitiveness marginalizing their export-led growth strategies to a huge extent. Conversely, rapid depreciation in the nominal exchange rate of a country has also empirically been found to generate negative externalities on the economy as a whole. The focal point of this paper is to identify the causal associations between Nominal Exchange Rate (NER) of Bangladesh and its macro fundamentals using relevant annual time series data from 1980 to 2015. A multivariate linear log-log model was used in which NER was expressed as a function of Money supply (M2), GDP, Domestic Interest Rate (INT) and Local Rate of Inflation (INF). As part of the methodology, Johansen Cointegration test was employed to identify the long run association between the variables considered in the model. In addition, the results from the Vector Error-Correction Model (VECM) approach and Granger Causality test provided the directions of causalities between NER and its determinants. Our results reveal that GDP and INT are effective in influencing NER in the long run while M2 and INF are found to be ineffective. Thus, macroeconomic variables are partially effective in stimulating exchange rate movements in Bangladesh.*

**Field of Research:** Economics

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