Exchange rate regimes

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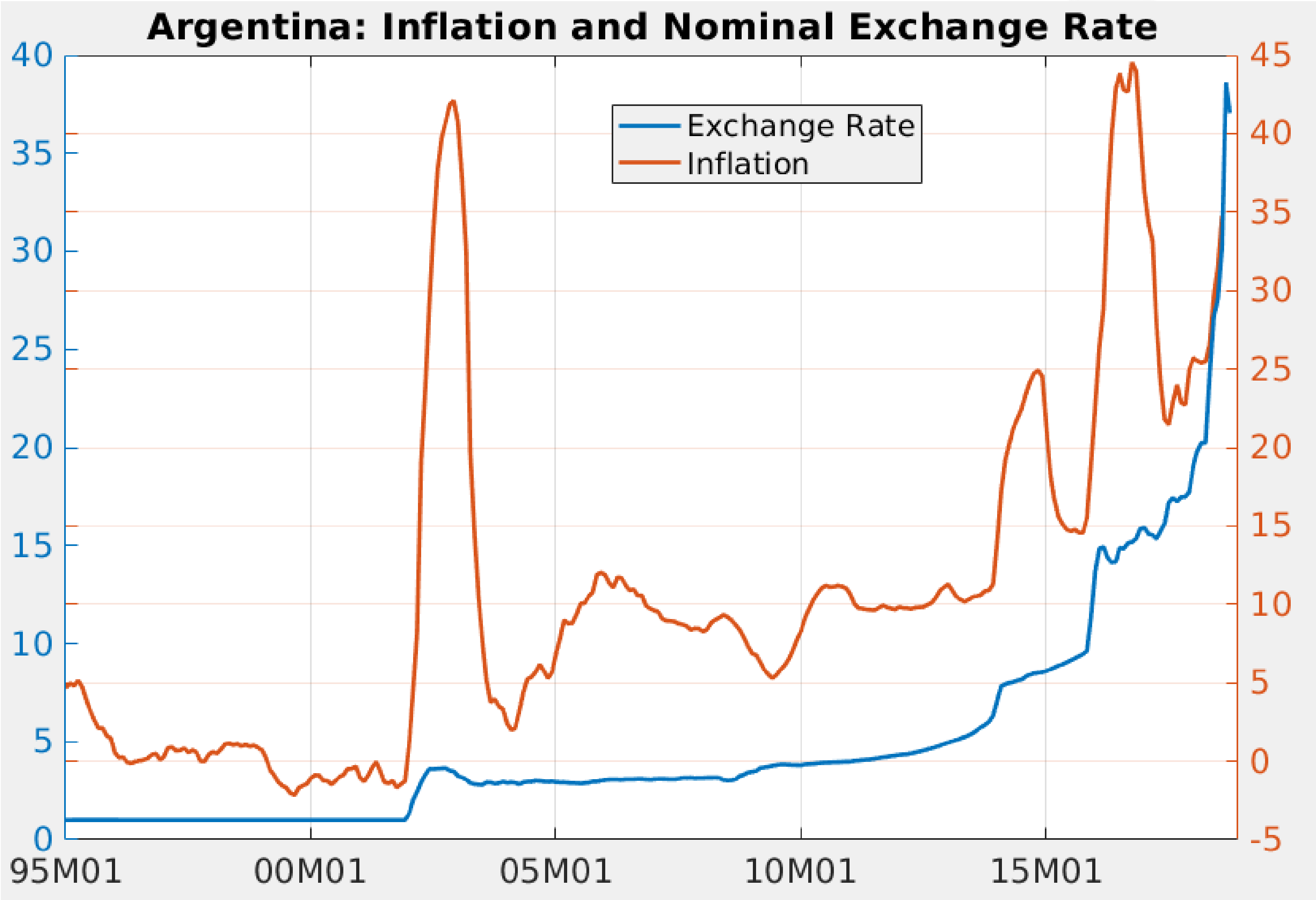
A bit of theory...

- Role of MP: provide a “nominal anchor”:
  - Some sort of price level / growth targeting:
    - Inflation targeting
    - Monetary aggregates targeting (P*T = M*V)
    - Different tools: exchange rate, reserve requirements, …
  - Nominal exchange rate targeting:
    - Fixed exchange rate
    - Crawling peg
    - Weird rules (Laos, Angola, …)
  - Commodity (gold) standard

Monetary policy can only influence nominal variables in the long run

- $Z_t = S_t + P^*_t - P_t$
- Central bank cannot influence P*
- Central bank cannot influence Z in the long run
- Therefore, central bank only chooses a trade-off between S and P

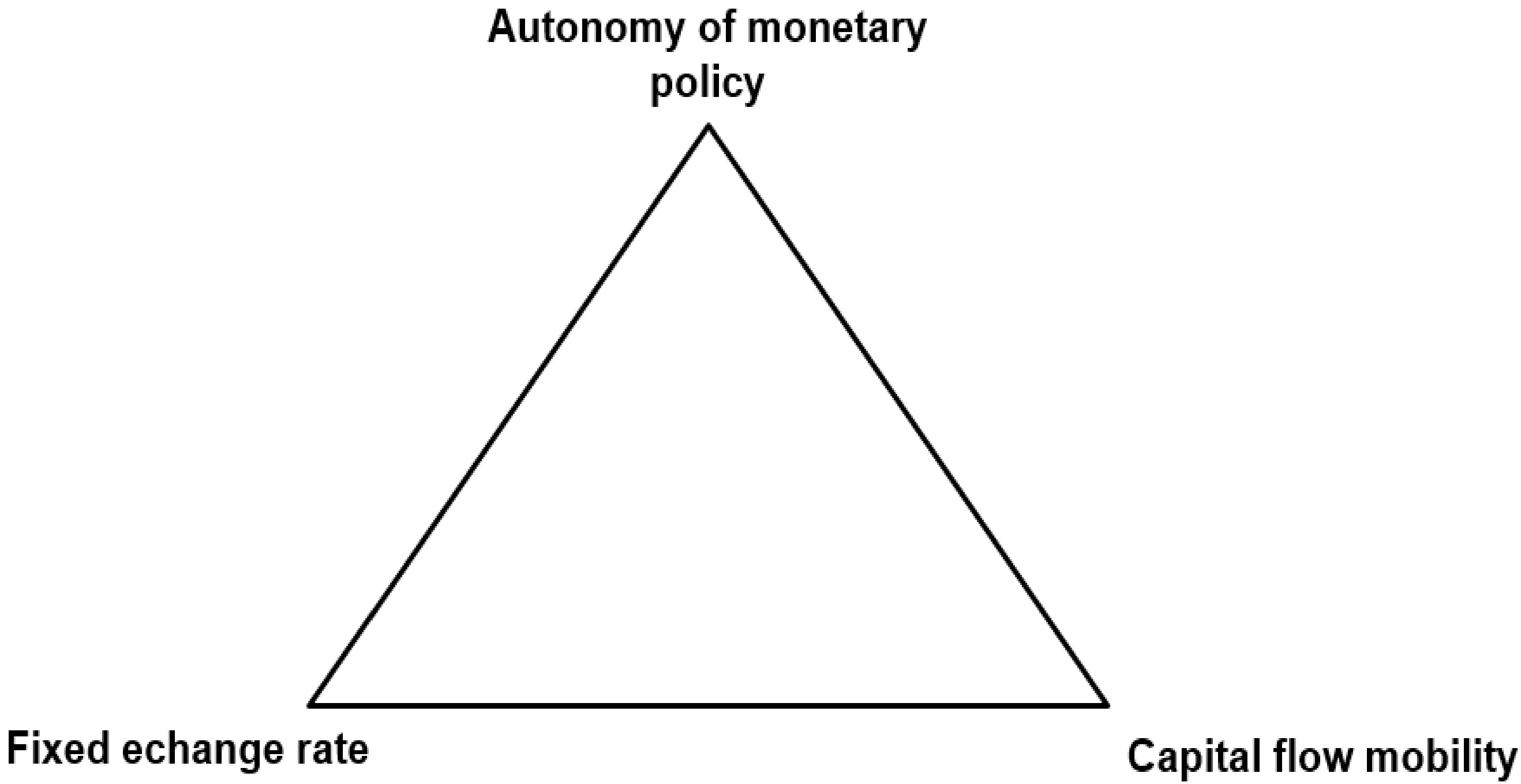
Floating exchange rate comes with great responsibility



What do you need for successful fixed exchange rate regime?

- Fixed exchange rate requires:
  - Money (foreign reserves)
  - Will to tighten macroeconomic policies if needed
- What it doesn't require:
  - Capable central bank and policymakers
- That's why resource-rich countries like fixed exchange rate
- Where is the problem?

Fixed exchange rate often comes with restrictions



Why doesn’t everyone float?

- Many countries have lately moved to floating
- New responsibilities:
  - How do you set interest rates?
  - How do you set money growth targets?
  - How do you communicate your decisions?

- The transition is not easy nor fast process, there are many risks