

Exchange rate policy: Choices, challenges, constraints

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The most important price

- Links domestic and foreign prices
- Regulates domestic relative prices (T/NT)
- Influences domestic monetary conditions
- Multitude of choices

Exchange rate arrangements in CESEE countries (1996-2009)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009				
Bulgaria	Floating		Currency board, DM	Currency board, EUR														
Czech Rep.	Band 65% DM, 35% USD ±7.5%		Floating															
Estonia	Currency board to DM						Currency board to EUR			ERM-II, Currency board								
Hungary	Crawling band, ±2.25%, 30% USD & 70% ECU 70% DM			Crawling band, EUR ±2.25%		EUR band ±15%					Floating							
Latvia	Peg to SDR, ±1%									Peg	ERM-II ±1%							
Lithuania	Currency board to USD						Currency board to EUR			ERM-II, Currency board								
Poland	Crawling band 45% USD, 35% DM, 10% GBP, 5% FRF, 5% CHF ±7%				±10%		±12.5%		55% EUR, 45% USD ±15%						Floating			
Romania	Floating																	
Slovakia	60% DM, 40% USD band ±3% ±5% ±7%			Floating							ERM-II ±1.5%, de facto float with revaluations			Euro				
Slovenia	Managed floating, de facto peg or crawling peg to DM/Euro								ERM-II narrow band			Euro						
Albania	Floating (1992.07.-)																	
Bosnia & H.	Currency board to DM			Currency board to Euro														
Croatia	Managed floating			Managed floating, de facto peg to EUR														
Macedonia FYR	de facto peg to the DM/EUR																	
Montenegro	Peg DM					Euroization												
Serbia	Peg DM					Managed floating												
Ukraine	Peg or de facto peg to USD													Floating				

	Peg/band to USD		Peg/band to a basket		Peg/band to DM/Euro		ERM-II		Euro		Float
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The most important price

- Links domestic and foreign prices
- Regulates domestic relative prices (T/NT)
- Influences domestic monetary conditions
- Multitude of choices
- Made by government
- Choices not simply technical/economic, but *political* → *political economy*

Choices and tradeoffs

- Regime: fixed to floating
Stability and credibility
vs. policy flexibility
- Level: low/weak to high/strong
“Competitiveness” (substitution)
vs. purchasing power
(income)

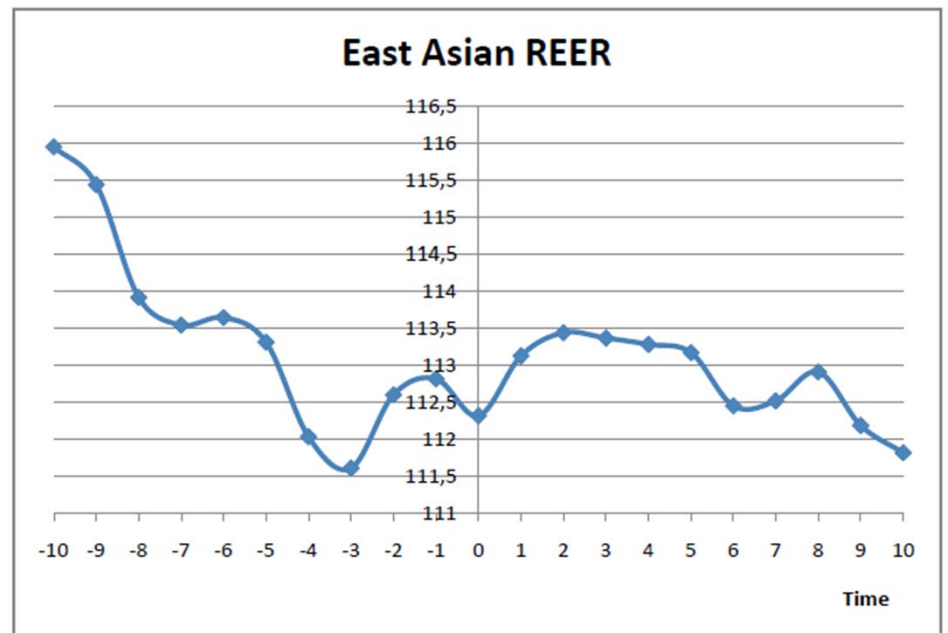
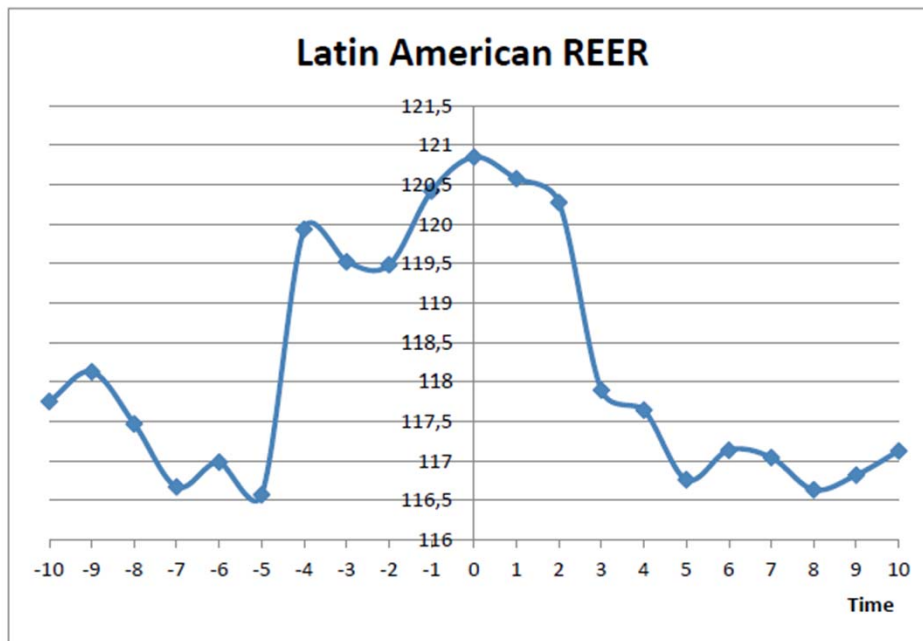
Winners and losers

- Cross-border economic interests – investment, finance, trade; forex debt: fix
- Tradable producers, concern about competitiveness: depreciate/float
- Consumers: income effect of strong currency
- Broader: encourage economic integration
- Many nuances, complexities (cf. exporters)

Interests in conflict

- Internationally exposed sectors for stable currency
- Tradables producers for depreciated currency
- Consumer/electoral desire for strong currency, for greater integration
- Cross-cutting pressures: ECE *de jure/de facto* experience

Real exchange rates around elections: Latin America and East Asia



Source: Huang and Terra (2014)

Inflation targeting

- Still choices, constraints
- Tradeoffs
 - IT vs. external balance, currency stability
 - Intervention
 - Capital controls
 - IT vs. financial stability
 - Liquidity management
 - Manipulation of reserve requirements
 - Macroprudential regulation

Conclusions

- Exchange rate policy requires making choices, with tradeoffs
- Tradeoffs implicate contending interests
- Interests in conflict create cross-cutting political pressures
- ER policy – like all econ policy – is *political*
- Recognize political pressures on policy