Session 7: Exchange rate regimes and currency crises

1. Describe very briefly the main categories of exchange rate regimes (ERR), in order of diminishing flexibility of the exchange rate.

Exchange rate regimes: Credible fixed ERR vs. flexible ERR

2. Describe very briefly what the main motives for adopting a fixed ERR are. What are the key implications of a fixed ERR for the conduct of monetary policy?
3. What is the Poole theorem and what is its relevance in the ERR framework?
4. In the European Monetary System (EMS) a participating country was forced to adopt the inflation rate of its partners. Why wasn't Germany then concerned about importing Italy's high rate of inflation?
5. Consider two countries, *H* and *F*, with *H* pegging unilaterally its currency to the currency of *F*. Assume perfect capital mobility and price stickiness in both countries. A monetary expansion in *F* will lead to (assume nominal wage rigidity and perfect capital mobility)
   - ❑ Unchanged interest rates in *F* and *H*.
   - ❑ Lower interest rates in *F* and higher interest rates in *H*
   - ❑ Lower interest rates in *H* and *F*.
   - ❑ Lower interest rates in *H* and higher interest rates in *F*
6. Assume the same situation as in the question before (monetary expansion in *F*) but, this time, evaluate the effects if *H* is willing to abandon the peg.
7. The empirical evidence concerning flexible exchange rate systems suggests that they are associated (compared to fixed regimes) with
   - ❑ Higher inflation
   - ❑ Lower inflation
   - ❑ Larger trade imbalances
   - ❑ Smaller trade imbalances

Currency and financial crises

8. Give a brief definition of a currency crisis. How is a currency crisis linked with a financial crisis?
9. Characterise models of currency crises of the first and second generation.
10. Speculative attacks are more likely to take place during a recession because
    - ❑ Inflation is lower
    - ❑ Interest rates are lower
    - ❑ Productivity is lower
    - ❑ None of the above
11. Why does moral hazard play an important role in the context of international investment?
12. A troubled banking sector makes it harder to defend a fixed exchange rate regime. Evaluate.
13. Can currency crises be prevented?
14. Can you think of arguments in favour and against IMF involvement in the case of regional financial crises?
15. Compare and contrast the currency crisis in Asia in 1997 and that in the EWS in 1992. In particular, make a list of key features they had in common, and another list of the key ways in which they were different.