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Comments of "Exchange Rate Management and Crisis Susceptibility: A Reassessment"

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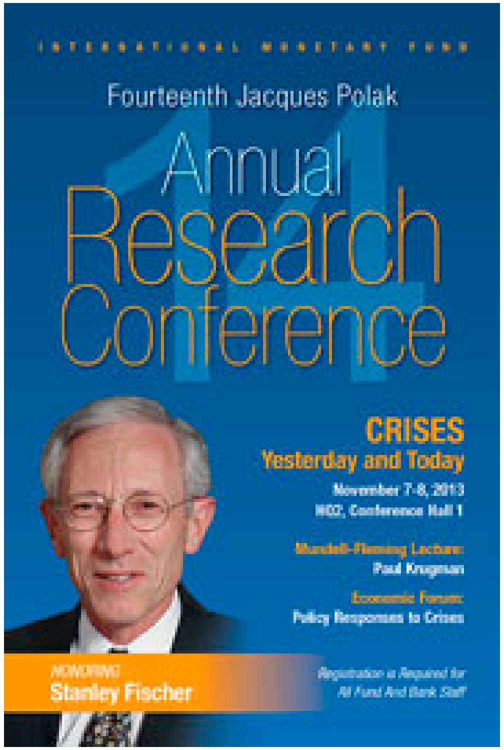
Comments on

"Exchange Rate Management & Crisis Susceptibility: A Reassessment,"

by Atish Ghosh, Jonathan Ostry & Mahvash Qureshi



Jeffrey Frankel,
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IMF ARC, Nov. 7, 2013

Reassessment of what?

- Reassessment of what Stan Fischer in his famous 2001 paper called the "Bipolar View,"
  - but which is also known by other names,
  - especially the Corners Hypothesis.
- "Intermediate exchange rate regimes are no longer viable; to avoid crises, countries should move either to the hard peg corner or the floating corner."
- It was the conventional wisdom in 2001,
  - not just among Fischer, Summers & other leaders of the multilateral response to the currency crashes of the 1990s,
  - but also their critics, like Allan Meltzer. Just about everyone.

The hypothesis is indeed worth reassessing

- 2001 was the high-water mark
  for the corners hypothesis.

- Evidence?
  Each year I give a lecture at the IMF Institute.
  - I poll the staff on how many perceive the corners hypothesis to be IMF "conventional wisdom":
    - "Yes" = 61% in 2002;
    - declined to 0% by 2010.

- Many EMs still follow intermediate regimes.
  - Ghosh, Ostry & Qureshi find that countries
    have not been switching to the corners, on net.

Three hard pegs

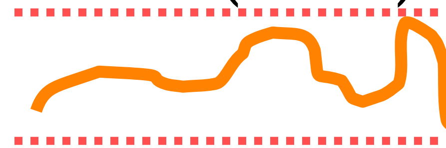
- currency board

- dollarization

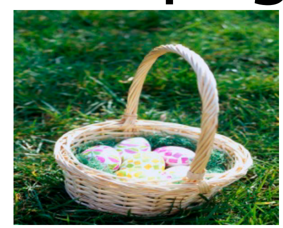
- monetary union

Four intermediate regimes

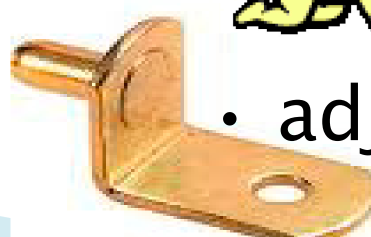
- target zone (band)



- basket peg



- crawling peg



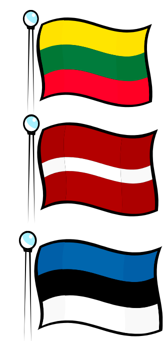
- adjustable peg

Why did the pendulum swung back?

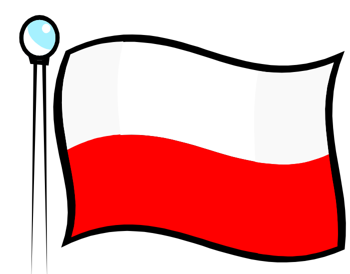
Some salient cases:

- In 2001, the Argentine crisis revealed hard pegs to be more vulnerable than had been thought.

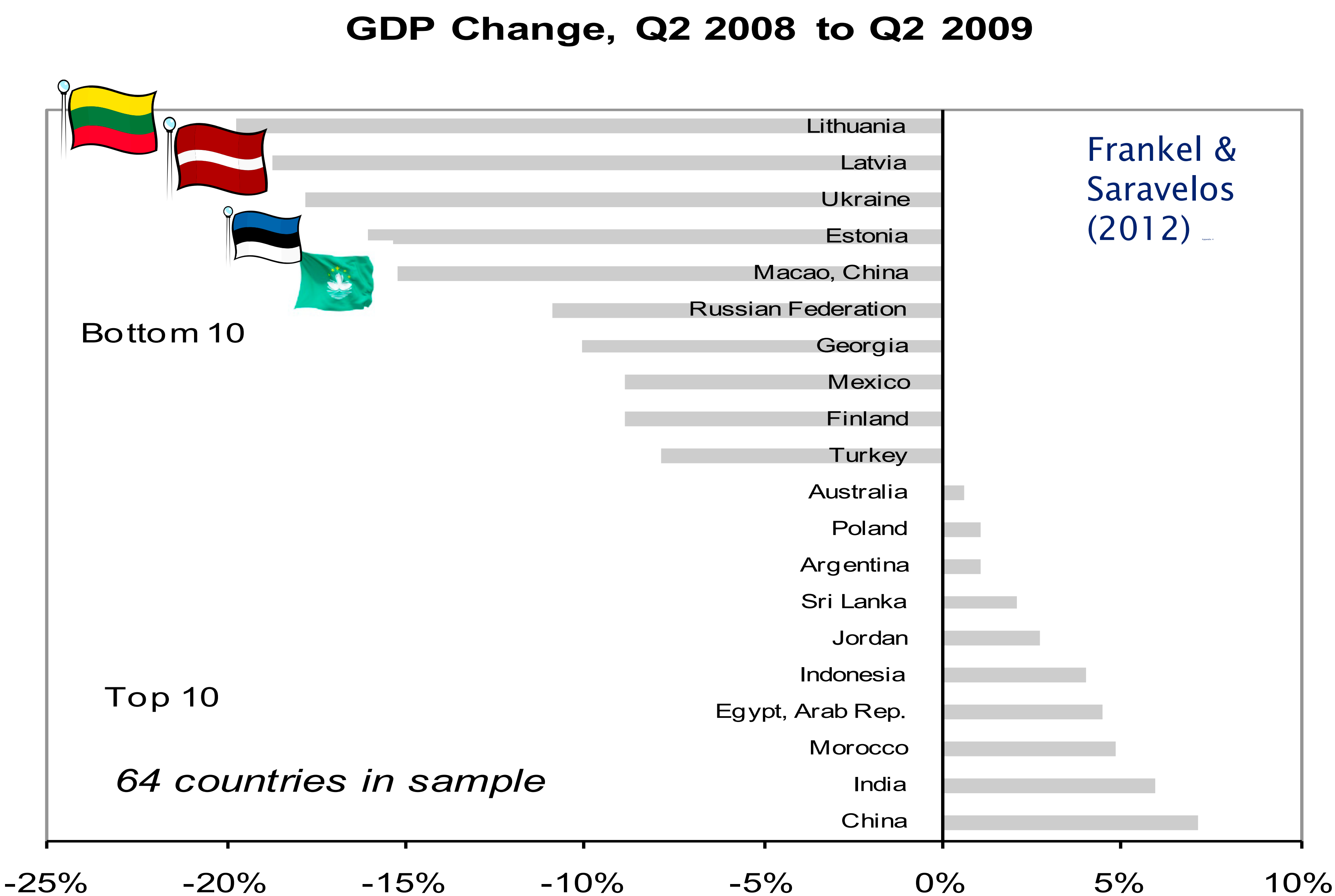
- In the 2008-09 Global Financial Crisis,
  - hard-pegging EU countries like the Baltics suffered the most severe recessions,



  - while the floater Poland, alone in the EU, suffered no recession,
    - as a depreciated zloty boosted exports.

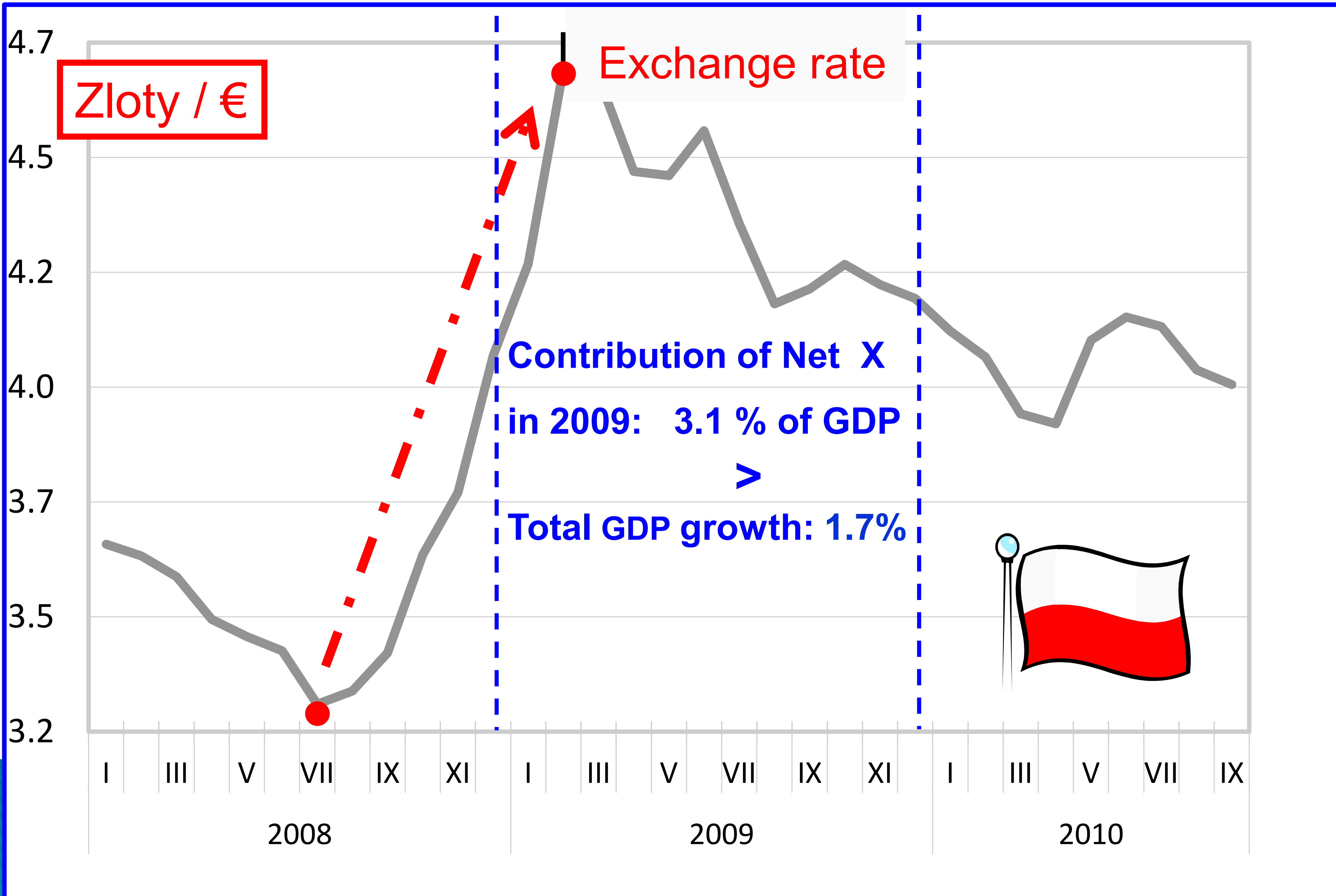


In the Global Financial Crisis, hard-pegging Baltics suffered the worst recessions



But when the GFC hit, Poland's exchange rate rose 35%.

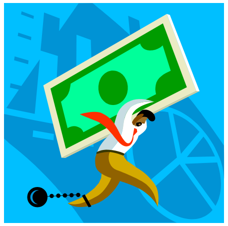
Depreciation boosted net exports; contribution to GDP growth > 100%.



It is difficult to classify countries by exchange rate regime

- De jure ≠ de facto
  - The authors say the bias is to false claims of flexibility
    - "Fear of Floating"
    - Calvo & Reinhart (2001, 2002); Reinhart (2000).

  - But equally important are false claims of fixing
    - "The Mirage of Fixed Exchange Rates"
    - Obstfeld & Rogoff (1995).



  - and false claims of Band-Basket-Crawl
    - with basket weights kept secret to hide the truth
    - Frankel, Schmukler & Servén (2000).

Ghosh, Ostry & Qureshi's methodology is careful and convincing.

- 50 EMs, 1980-2011
- Exchange rate regimes taken from IMF's de facto classification scheme (& Reinhart-Rogoff, 2004).
- The question -- Which regimes are prone to:
- crises ? (using a probit model)
  - Banking crises
  - Currency crises
  - Sovereign debt crises
  - Growth collapses
- vulnerabilities ? (using binary recursive tree analysis)
  - Financial: credit expansion, foreign debt, domestic fx liabilities…
  - Macroeconomic: real overvaluation, CA deficits, low reserves…

Ghosh, Ostry & Qureshi findings: more pro-float than anti-intermediate

Very briefly:

- Hard pegs prone to growth collapses,
  - via vulnerabilities such as domestic fx liabilities.
- Intermediate regimes susceptible to crises too:
  - Banking & currency crises,
  - via vulnerabilities such as fx liabilities, overvaluation CADs, low Reserves
- Floats *less* prone to risks.
- The open question:
  - Are managed floats to be classified as floats?
    - or as intermediate regimes?
    - How should the line be drawn?

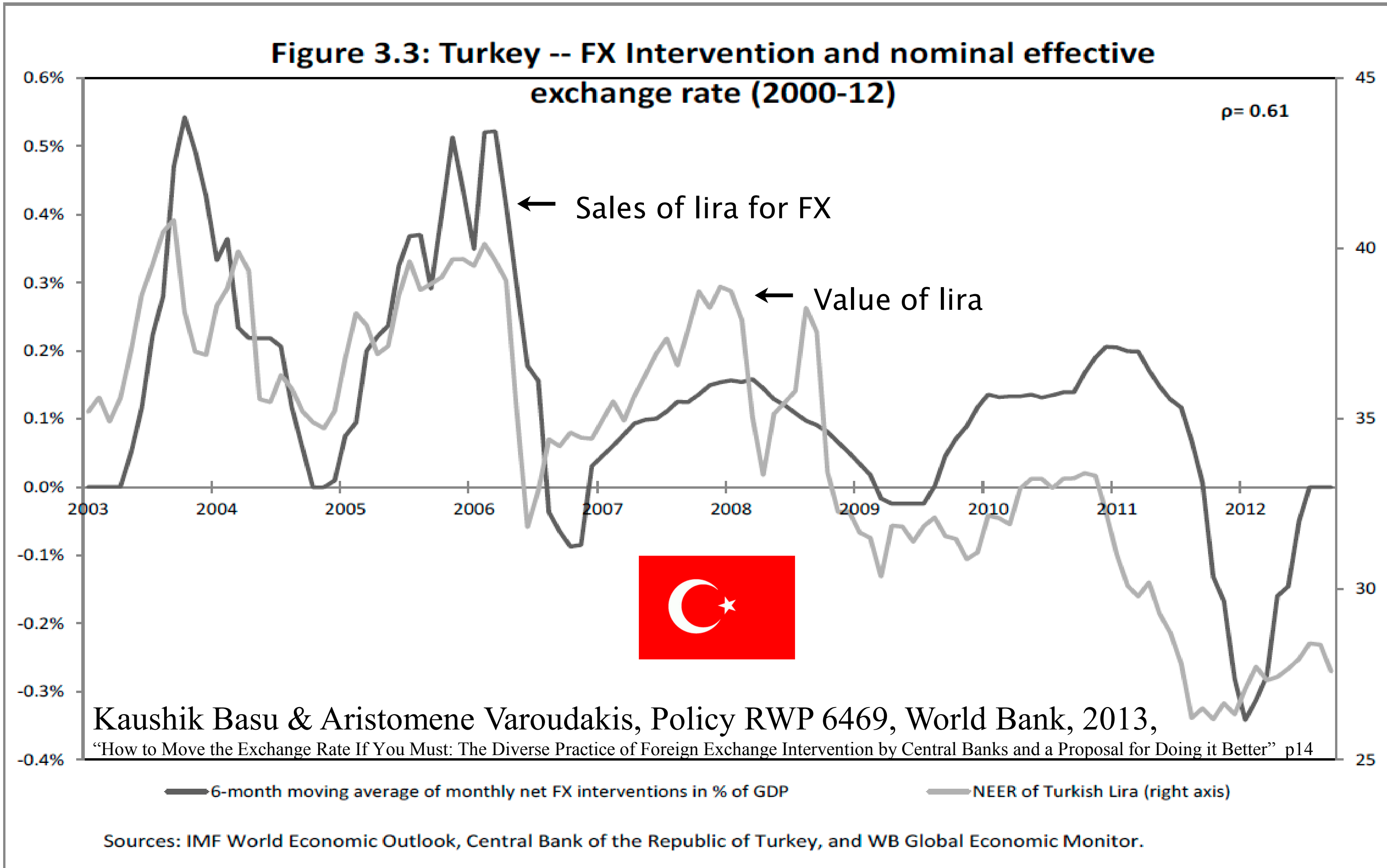
Perhaps we should distinguish a particular kind of managed float

Systematic leaning against the wind:

- For every 1% of Exchange Market Pressure,
- the authorities take ϕ % as Δ exchange rate
  - and $1-\phi$ % as a change in FX reserves
  - where ϕ is the degree of flexibility.
- This is another intermediate regime,
  - if $0 >> \phi >> 1$.

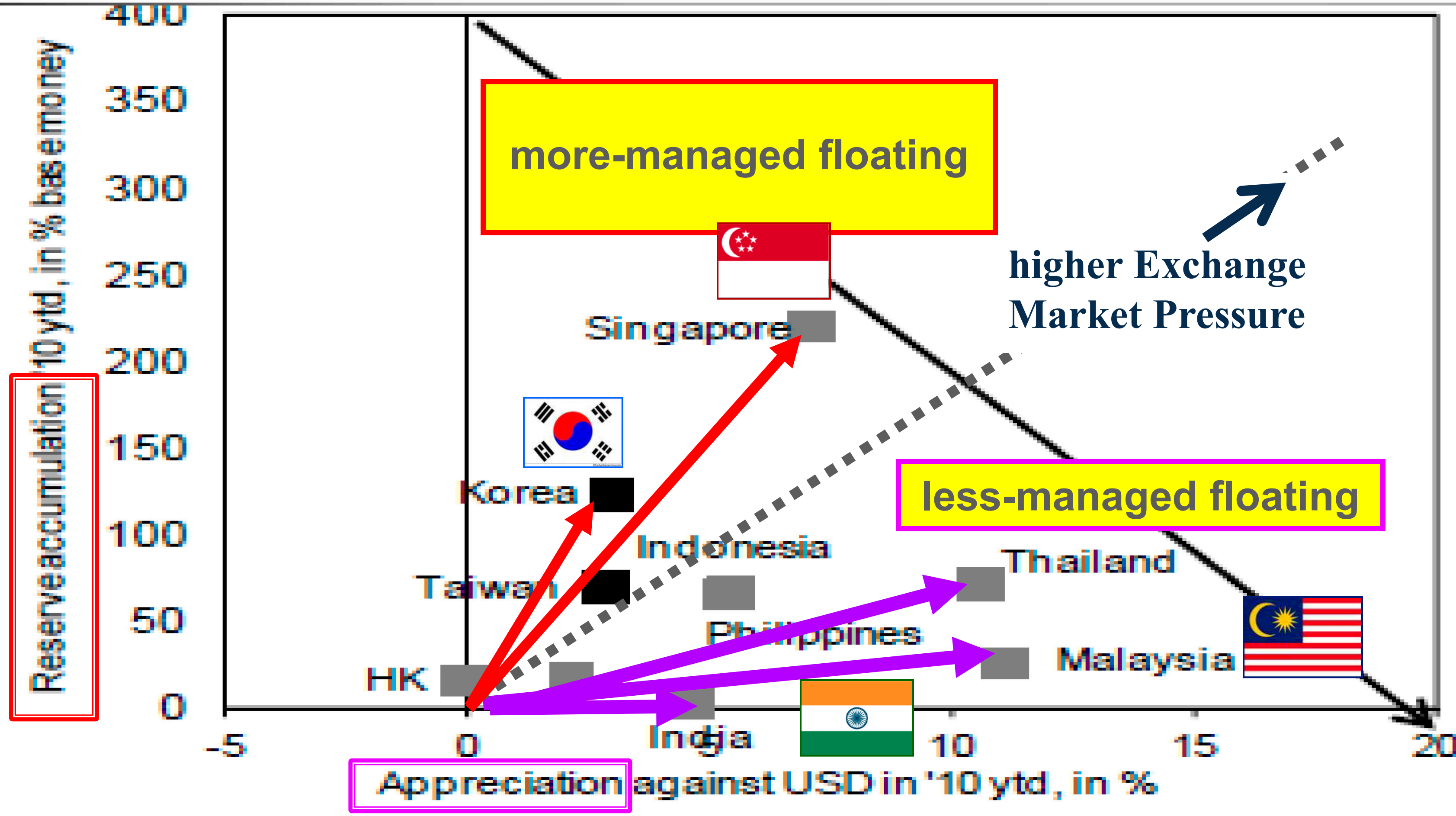
An example of systematic leaning against the wind

Turkey's central bank buys lira when it depreciates, and sells when it is appreciates.



In Asia, Korea & Singapore took 2010 inflows mostly in the form of reserves,

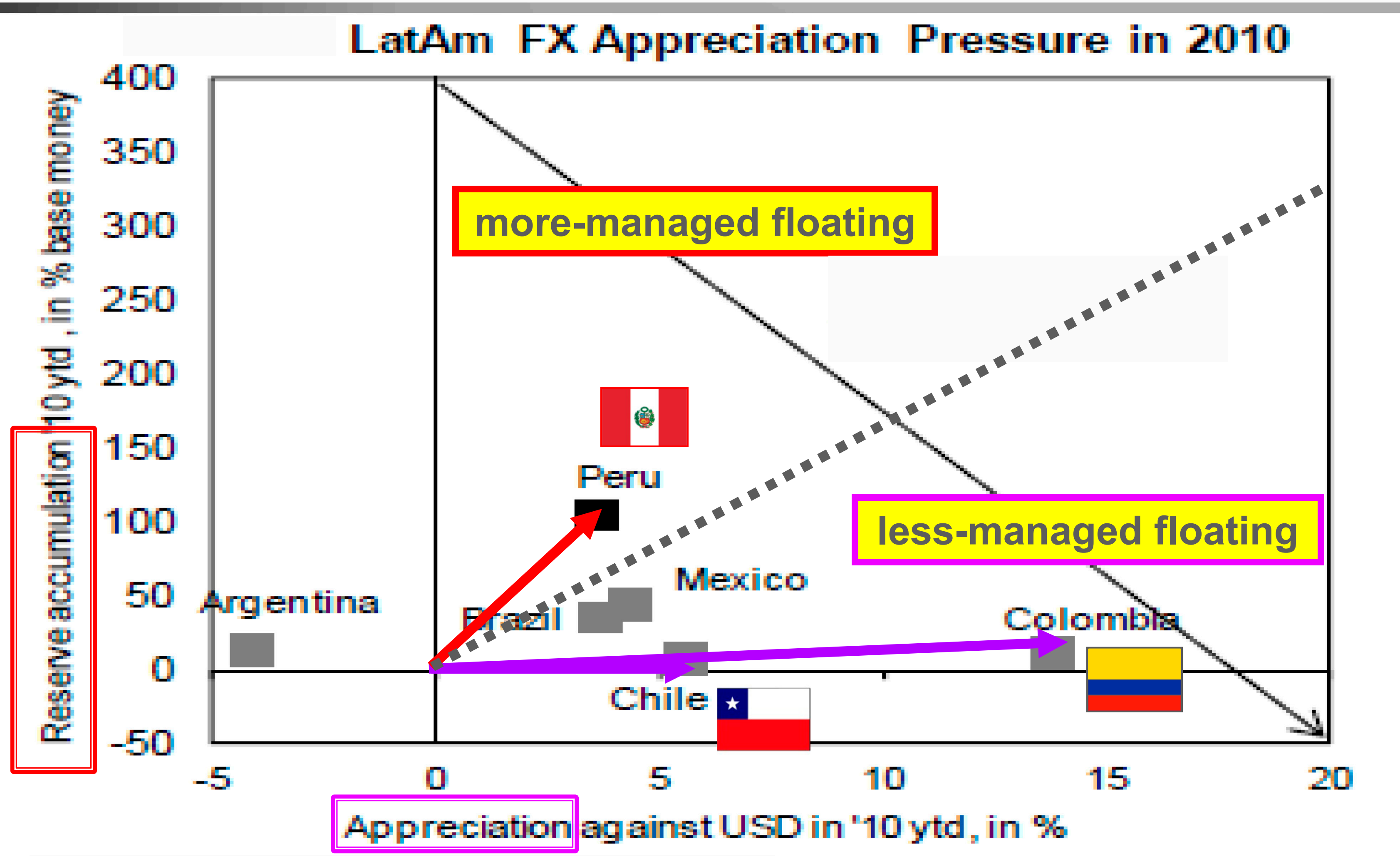
while India, Malaysia & Thailand took them mostly in the form of currency appreciation.



Source: GS Global ECS Research

In Latin America, 2010 inflows

were reflected mostly as reserve accumulation in Peru, but as appreciation in Chile & Colombia.

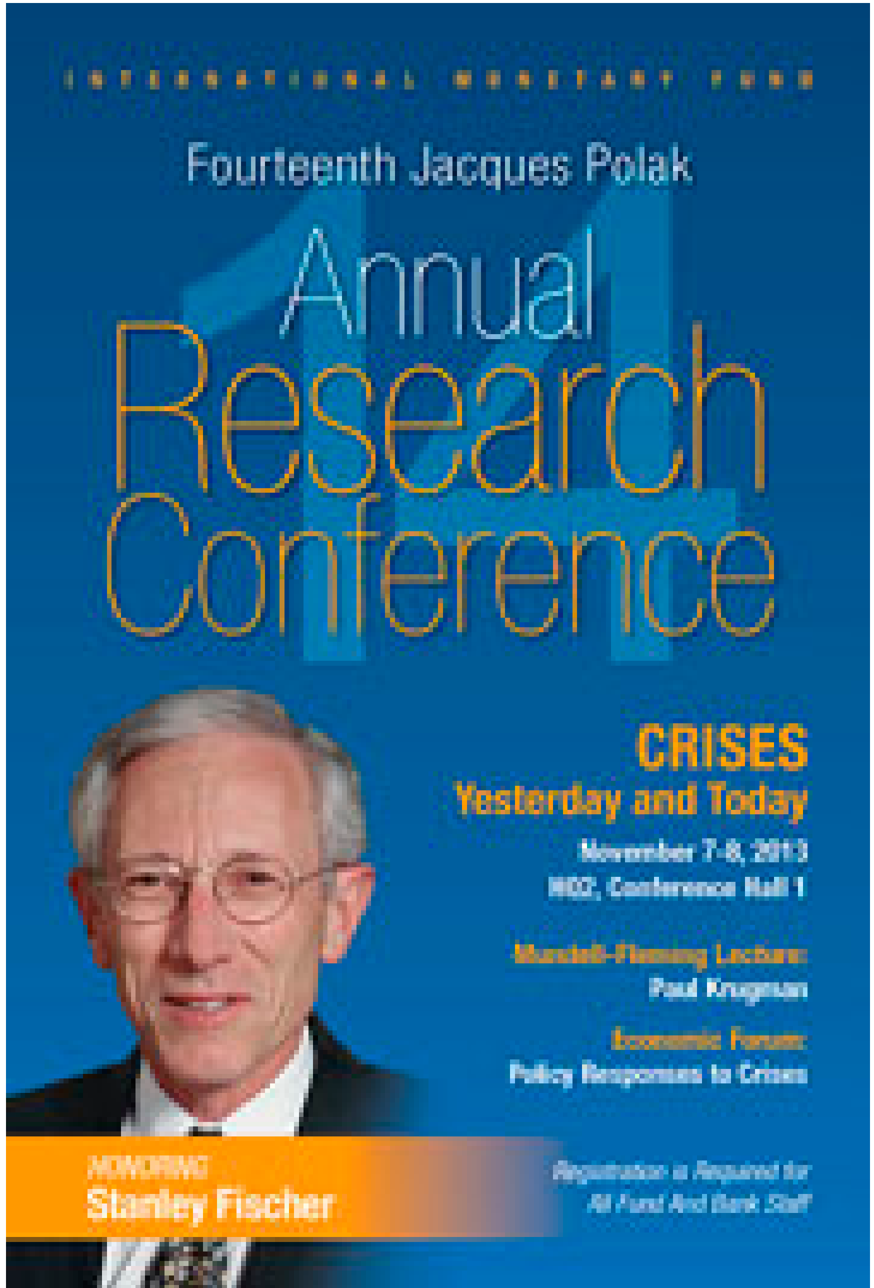


Source: GS Global ECS Research

Why do different de facto classification schemes give very different answers?

- Many schemes still use primitive methodologies,
  - e.g., failing to distinguish whether an exchange rate has a higher variance due to a more flexible regime or because the country was hit by bigger shocks;
  - Or failing to estimate the anchor ($ vs. € vs. basket).
    - Frankel & Xie (*AER*, 2010).

- Many countries change "regimes" more frequently than the interval of estimation,
  - particularly those with intermediate regimes,
  - despite the authors' "regimes are slow-moving variables."
  - Some might best be described as having no regime.
    - Rose (*JEL,* 2011) "Fixed, Floating & Flaky."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