Discussion of Currency Manipulation

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Gains from Exchange Rate Stabilization

• Trade (Bacchetta, Van Wincoop)

• Nominal Anchor and Credibility
  – The mirage of Fixed Exchange Rate (Obstfeld)

• Financial Market Development
  – Nominal Stability and Endogenous Asset Supply (Gaytan, 2004)

• Growth
  – Long run growth effects of exchange rare regimes (Aghion, Bacchetta, Ranciere, Rogoff, JME, 2009)
Some Frictions Involved

• Deviation from PPP (trade)
• Commitment/Credibility Issue (Nominal Anchor)
• Limited Participation and Non Convexity (Acemoglu-Zilibotti)
• Borrowing Constraints (ABRR)
ABRR

• Current Profits affect future investment and growth

• Stabilizing Profits
  – Real Shocks: Floating Regime
  – Financial Shocks: Fixed Regime
  – Optimal Exchange Policy
Risk-Channel of ER Stabilization

: This paper

• Large country currencies tend to
• Pay little interest rate in good times
• Appreciate in bad times where trade goods are expensive
• Hedge against consumption risk
• Favor capital accumulation (low interest rate)
• Can we « import » this property by pegging.
• What are the effect of the targeted countries
Among Different cases

• **Best Case:** Small country pegging to a large country. Negative cost of stabilization. Reserves accumulation.
  – Small emerging economies pegging

• **Damaging Case:** Country target of stabilization by a large country can lose.
  – Transfer its advantage to the other
Issues for Discussion (1)

• Evidence:
  – Most evidence comes from the dollar which displays other features (exhorbitant privilege)
  – Similar evidence for other relatively large country currency: Euro, South African Rand

• Multi-Lateral issues
  – Two countries pegging to a third one also peg between themselves.
  – Is it optimal? Can it overturn the result.
  – East Asian Countries
Issues for Discussion (2)

• Types of Shocks involved
  – Small shocks (Business Cycles)
  – Large shocks (Financial Crises)

• Ability to peg
  – Cost of Reserves
  – Credibility of Exchange Rate
  – The Case of Dollarization
Issues for Discussion (3)

• Stage of Economic Development and Optimal Exchange Rate Policy
  – When to switch?

• Maximizing World Welfare
  – What should the IMF do in that context