

NINETY-THIRD INTERNATIONAL ATLANTIC ECONOMIC EUROPEAN CONFERENCE

THE CASE FOR FLEXIBLE EXCHANGE RATES IS
INTELLECTUALLY BANKRUPT

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OVERVIEW

p2

- FOUR STYLIZED FACTS ABOUT OVERSHOOTING
- GOODS MARKET SHOCKS VS MONEY MARKET SHOCKS
- THREE COUNTRY EXPERIENCES
- CONCLUSION

OVERSHOOTING FOUR STYLIZED FACTS

p3

- OVERSHOOTING AND THE MARKET IN CURRENCIES
- OVERSHOOTING AND THE MARKET IN SECURITIES
- OVERSHOOTING AND BANKING CRISES
- WHY THE UNITED STATES MORPHED FROM THE LARGEST CREDITOR TO THE LARGEST DEBTOR

GOODS MARKET SHOCKS VS MONEY MARKET SHOCKS

p4

- DID THE CHANGES IN THE U.S. INTERNATIONAL INVESTMENT POSITION FOLLOW FROM CHANGES IN U.S. TRADE BALANCE ?
- OR
- DID THE CHANGES IN THE U.S. TRADE BALANCE FOLLOW FROM CHANGES IN THE U.S. INTERNATIONAL INVESTMENT POSITION?

THE ICELANDIC EXPERIENCE

p5

- ICELAND EXPERIENCED AN AUTONOMOUS INCREASE IN ITS CAPITAL ACCOUNT SURPLUS
- ICELAND REQUIRED A CORRESPONDING INCREASE IN ITS CURRENT ACCOUNT DEFICIT
- TWO CONTRIBUTING FACTORS
 - INCREASE IN THE PRICE OF KRONA
 - INCREASE IN PRICE OF ICELANDIC STOCKS
- INCREASE IN EXTERNAL INDEBTEDNESS IS TOO RAPID TO BE SUSTAINED
- AS INVESTMENT INFLOWS SLOWED, PRICE OF KRONA AND KRONA SECURITIES FELL THESE PRICES HAD BEEN INVOLVED IN OVERSHOOTING

THE JAPANESE EXPERIENCE 1980-1989

p6

- 1985 CAPITAL ACCOUNT DEFICIT 5 PERCENT OF GDP
- 1985-89 DECLINE IN CAPITAL ACCOUNT DEFICIT TO TWO PERCENT
- A COMPARABLE DECLINE IN CURRENT ACCOUNT SURPLUS
- INCREASE IN PRICE FOR JAPANESE YEN
- INCREASE IN PRICE OF JAPANESE STOCKS
- DECEMBER 1989 CAPITAL ACCOUNT DEFICIT TWO PERCENT OF GDP
- NO NEED FOR FURTHER REDUCTION IN CAPITAL ACCOUNT DEFICIT AND HENCE NO NEED FOR FURTHER INCREASE IN ASSET PRICES

THE U.S. EXPERIENCE 1980-2020

p7

- FOUR SPIKES IN PRICES OF ASSETS
- THREE SPIKES IN PRICE OF THE U.S. DOLLAR
- ONE MASSIVE BANKING PRICE
- THE UNITED STATES EVOLVES FROM WORLD'S LARGEST CREDITOR TO THE WORLD'S LARGEST DEBTOR

CONCLUSION –WHY THE CASE FOR FLEXIBLE EXCHANGE RATES IS INTELLECTUALLY BANKRUPT

p8

- CENTRAL BANK MONETARY INDEPENDENCE IS PRIMARY MOTIVE
- INVESTORS HAVE MUCH GREATER INCENTIVES TO BUY FOREIGN SECURITIES
- PURCHASES OF FOREIGN SECURITIES LEADS TO OVERSHOOTING
- IMPLOSION OF ASSET PRICE SPIKES LEADS TO BANKING CRISES

