

Predetermined Exchange Rate, Flexible Exchange Rate and Inflation Targeting Regimes

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Abstract

There is a large literature on optimal exchange rate regimes. The advantages and disadvantages of predetermined exchange rate and flexible exchange rate regimes have long been debated. Reflecting the fact that many emerging market countries have shifted to the regime of inflation targeting, this paper aims to extend the literature to include the inflation targeting regime. The results of our analysis show that the interest rule with an inflation target is superior (or at least equal) to the two above mentioned regimes in absorbing either real or monetary shocks.

Keywords: optimal exchange rate regimes, predetermined exchange rate, flexible exchange rate, inflation targeting, monetary shock, real shock, small open economy

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