

Financial Stability, Impossible Trinity, and Macroprudential Policy

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Abstract

According to monetary policy trilemma, a country cannot simultaneously accomplish three goals: exchange rate stability, monetary independence, and capital openness. In this paper, we suggest a quadrilemma: financial stability has a trade-off relationship with traditional trilemma variables. Further, we investigate whether macroprudential policy can mitigate this trade-off between four objective variables. Using 116 country data set over the period 2000–2013, we find that macroprudential policy is a promising tool to relax the traditional trilemma and the quadrilemma constraints.

Keywords: Impossible trinity; macroprudential policy; financial stability; capital flow

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