The Impacts of Crises on the Trilemma Configurations

Author:Joshua Aizenman, Menzie D. Chinn, Hiro Ito

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The “monetary trilemma” – the hypothesis that full monetary policy autonomy, exchange rate stability, and financial openness cannot simultaneously be achieved – has long been studied. Recently, holding international reserves (IR) has become an important policy instrument, insuring against liquidity shortages. We find that countries’ policy mixes are diverse, and have varied over time, sometimes in response to crises. We illustrate how the policy combinations changed drastically after the Asian Financial Crisis (AFC). In contrast, the Global Financial Crisis did not lead to a drastic change in the policy arrangements. We find that countries that faced large terms of trade shocks or negative economic growth during the crisis increased IR holding, post-AFC. Countries that had negative growth during the crisis also tended to pursue greater exchange rate flexibility and financial openness. This finding is true for commodity, but not manufactured goods, exporters. Countries with large current account deficits tend to be more sensitive to economic growth at the time of the AFC. Countries that are under IMF stabilization programs or those with sovereign wealth funds tended to hold more IR. In general, countries increased their IR holdings after the GFC, but did not otherwise respond concurrently to crisis conditions.