|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Exchange rate arrangement** |  | **Monetary Policy Framework** |  |  |
|  | **Exchange Rate Anchor** | *Monetary Aggregate Target* | *Inflation Targeting Framework* | *Other* |
|  | *US Dollar* |  |  |  |
| *No Separate Legal Tender (Hard Peg)* **[3]** | Ecuador, El Salvador, Panama |  |  |  |
| *Currency Board (Hard Peg)* **[6]** | Antigua y Barbuda – *East Caribbean Dollar* (XCD), Dominica – *East Caribbean Dollar* (XCD), Granada - *East Caribbean Dollar* (XCD), Saint Kitts y Nevis - *East Caribbean Dollar (XCD)*, Saint Lucia - *East Caribbean Dollar (XCD)*, Saint Vincent and the Grenadines - *East Caribbean Dollar (XCD)* |  |  |  |
| *Conventional Peg (Soft Peg*) **[7]** | Aruba– *Arubian Florin (AWG)*, The Bahamas – *Bahamian Dollar (BSD)*, Barbados – *Barbadian Dollar (BBD)*, Belize – *Belize Dollar (BZD)*, Curacao – *Netherlads Antillean Guilder (ANG)*, Sin Maarten - *Netherlads Antillean Guilder (ANG)*, Venezuela – *Bolivar Fuerte (VEF)* |  |  |  |
| *Stabilized Arrangement (Soft Peg)* **[3]** | Guyana **–** *Guyanese Dollar (GYD)*, Surinam – *Surinamese Dollar (SRD)*, Trinidad y Tobago – *Trinidad and Tobago Dollar (TTD)* |  |  |  |
| *Crawling Peg (Soft Peg)* **[1]** | Nicaragua – *Córdoba (NIO)* |  |  |  |
| *Crawl-Like Arrangement (Soft Peg)* **[6]** | Honduras – *Lempira (HNL),* Jamaica *– Jamaican Dollar (JMD)* |  | Guatemala – Quetzal (GTQ), Dominican Republic – Peso (DOP) | Argentina– *Peso (ARS),*Haiti – *Haitian Gourde (HTG)* |
| *Floating (Floating Regimes)* **[5]** |  | Uruguay– *Uruguayan Peso (UYU)* | Brazil– *Real (BRL)*, Colombia – *Peso (COP),* Paraguay *– Guarani (PYG),* Peru *– Nuevo Sol (PEN)* |  |
| *Free-Floating (Floating Regimes)* **[2]** |  |  | Chile – *Chilean Peso (CLP)*, Mexico – *Peso (MXN)* |  |
| *Other Managed Arrangements (Residual)* **[1]** |  |  |  | Costa Rica - *Costa Rican Colon (CRC)* |

**Exchange Rate Regimes of the Region and Monetary Policy Framework**

**Explanation**

According to the IMF exchange rate regimes can be divided into four broad categories: (1) Hard pegs, (2) Soft Pegs, (3) Floating Arrangements and (4) Residual. On their turn hard pegs can be divided into: *no separate legal tender* and *currency board*, soft pegs can divided into: *conventional peg, Stabilized Arrangement, Crawling Peg and Crawl-Like Arrangements,* floating regimes can be split up into: *floating* and *free-floating,* and residual is marked as Other Managed Arrangements.

Since it might be relevant for our cluster analysis I have used these definitions of the IMF and created a table with the exchange rate regimes of the countries of the region and their adopted monetary policy framework.

Based on this information we might be able to create a variable that can be useful in our cluster analysis.

*Note:* *i)T*he numbers between [] signify the number of countries in the region with this regime, *ii)* As an exchange rate anchor I have only included the US Dollar because it is the only foreign currency used as an anchor by the countries of the region.

**Definitions**

**A) Exchange Rate Arrangements**

*No Separate Legal Tender -* Classification as an exchange rate arrangement with no separate legal tender involves confirmation of the country authorities’ de jure exchange rate arrangement. The currency of another country circulates as the sole legal tender (formal dollarization). Adopting such an arrangement implies complete surrender of the monetary authorities’ control over domestic monetary policy. Note: effective January 1, 2007, exchange arrangements of countries that belong to a monetary or currency union in which the same legal tender is shared by the members of the union are classified under the arrangement governing the joint currency. This classification is based on the behavior of the common currency, whereas the previous classification was based on the lack of a separate legal tender. The classification thus reflects only a definitional change and is not based on a judgment that there has been a substantive change in the exchange arrangement or other policies of the currency union or its members.

*Currency Board* - Classification as a currency board involves confirmation of the country authorities’ de jure exchange rate arrangement. A currency board arrangement is a monetary arrangement based on an explicit legislative commitment to exchange domestic currency for a specified foreign currency at a fixed exchange rate, combined with restrictions on the issuance authority to ensure the fulfillment of its legal obligation. This implies that domestic currency is usually fully backed by foreign assets, eliminating traditional central bank functions such as monetary control and lender of last resort, and leaving little room for discretionary monetary policy. Some flexibility may still be afforded, depending on the strictness of the banking rules of the currency board arrangement.

*Conventional Peg* - Classification as a conventional peg involves confirmation of the country authorities’ de jure exchange rate arrangement. For this category the country formally (de jure) pegs its currency at a fixed rate to another currency or a basket of currencies, where the basket is formed, for example, from the currencies of major trading or financial partners and weights reflect the geographic distribution of trade, services, or capital flows. The anchor currency or basket weights are public or notified to the IMF. The country authorities stand ready to maintain the fixed parity through direct intervention (i.e., via sale or purchase of foreign exchange in the market) or indirect intervention (e.g., via exchange-rate-related use of interest rate policy, imposition of foreign exchange regulations, exercise of moral suasion that constrains foreign exchange activity, or intervention by other public institutions). There is no commitment to irrevocably keep the parity, but the formal arrangement must be confirmed empirically: the exchange rate may fluctuate within narrow margins of less than ±1% around a central rate—or the maximum and minimum values of the spot market exchange rate must remain within a narrow margin of 2% for at least six months.

*Stabilized Arrangement -* Classification as a stabilized arrangement entails a spot market exchange rate that remains within a margin of 2% for six months or more (with the exception of a specified number of outliers or step adjustments) and is not floating. The required margin of stability can be met either with respect to a single currency or a basket of currencies, where the anchor currency or the basket is ascertained or confirmed using statistical techniques. Classification as a stabilized arrangement requires that the statistical criteria are met and that the exchange rate remains stable as a result of official action (including structural market rigidities). The classification does not imply a policy commitment on the part of the country authorities.

*Crawling Peg* - Classification as a crawling peg involves confirmation of the country authorities’ de jure exchange rate arrangement. The currency is adjusted in small amounts at a fixed rate or in response to changes in selected quantitative indicators, such as past inflation differentials vis-à-vis major trading partners or differentials between the inflation target and expected inflation in major trading partners. The rate of crawl can be set to generate inflation-adjusted changes in the exchange rate (backward looking) or set at a predetermined fixed rate and/or below the projected inflation differentials (forward looking). The rules and parameters of the arrangement are public or notified to the IMF.

*Crawl-like arrangement* - For classification as a crawl-like arrangement, the exchange rate must remain within a narrow margin of 2% relative to a statistically identified trend for six months or more (with the exception of a specified number of outliers), and the exchange rate arrangement cannot be considered as floating. Usually, a minimum rate of change greater than allowed under a stabilized (peg-like) arrangement is required; however, an arrangement is considered crawl-like with an annualized rate of change of at least 1%, provided the exchange rate appreciates or depreciates in a sufficiently monotonic and continuous manner.

*Floating* - A floating exchange rate is largely market determined, without an ascertainable or predictable path for the rate. In particular, an exchange rate that satisfies the statistical criteria for a stabilized or a crawl-like arrangement is classified as such unless it is clear that the stability of the exchange rate is not the result of official actions. Foreign exchange market intervention may be either direct or indirect and serves to moderate the rate of change and prevent undue fluctuations in the exchange rate, but policies targeting a specific level of the exchange rate are incompatible with floating. Indicators for managing the rate are broadly judgmental (e.g., balance of payments position, international reserves, parallel market developments). Floating arrangements may exhibit more or less exchange rate volatility, depending on the size of the shocks affecting the economy.

*Free Floating* - A floating exchange rate can be classified as free floating if intervention occurs only exceptionally and aims to address disorderly market conditions and if the authorities have provided information or data confirming that intervention has been limited to at most three instances in the previous six months, each lasting no more than three business days. If the information or data required are not available to the IMF staff, the arrangement is classified as floating. Detailed data on intervention or official foreign exchange transactions will not be requested routinely of member countries—only when other information available to the staff is not sufficient to resolve uncertainties about the appropriate classification.

*Other Managed Arrangements*- This category is a residual and is used when the exchange rate arrangement does not meet the criteria for any of the other categories. Arrangements characterized by frequent shifts in policies may fall into this category.

**Monetary Policy Framework**

*Exchange rate anchor* - The monetary authority buys or sells foreign exchange to maintain the exchange rate at its predetermined level or within a range. The exchange rate thus serves as the nominal anchor or intermediate target of monetary policy. These frameworks are associated with exchange rate arrangements with no separate legal tender, currency board arrangements, pegs (or stabilized arrangements) with or without bands, crawling pegs (or crawl-like arrangements), and other managed arrangements.

*Monetary aggregate target -* The monetary authority uses its instruments to achieve a target growth rate for a monetary aggregate, such as reserve money, M1, or M2, and the targeted aggregate becomes the nominal anchor or intermediate target of monetary policy.

*Inflation-targeting framework* - This involves the public announcement of numerical targets for inflation, with an institutional commitment by the monetary authority to achieve these targets, typically over a medium-term horizon. Additional key features normally include increased communication with the public and the markets about the plans and objectives of monetary policymakers and increased accountability of the central bank for achieving its inflation objectives. Monetary policy decisions are often guided by the deviation of forecasts of future inflation from the announced inflation target, with the inflation forecast acting (implicitly or explicitly) as the intermediate target of monetary policy.

*Other Monetary Framework* - The country has no explicitly stated nominal anchor, but rather monitors various indicators in conducting monetary policy. This category is also used when no relevant information on the country is available.