

## **EXCHANGE RATE REGIMES, CURRENCY CRISES AND RECESSIONS\***

The choice of exchange rate regime is a key decision for policy makers in modern economies, since the right choice may be an important ingredient for successful economic development. A poor option, on the other hand, may be the recipe for disaster. The four papers in this section are related to the choice of exchange rate regime, its impact on economic performance, and the occurrence of currency crises. They represent an attempt to move forward in our quest for answers regarding the optimal policies in modern open economies.

The first paper, by Felipe Larraín and Francisco Parro, investigates the relationship between output growth and volatility and the choice of exchange rate regime, for a panel of 147 countries over the period 1975-2000. Their results show that the linkage between both economic growth and growth fluctuations, and the choice of the exchange rate regime is statistically significant and robust. The results of the paper tend to support the bipolar view, i.e., that there are good reasons why intermediate exchange regimes are becoming increasingly unpopular, in favour of hard pegs or floats. Moreover, the evidence indicates that floating rates are superior to hard pegs in terms of growth and volatility.

In the second paper of the section, Federico Sturzenegger goes further and tries to explain why developing countries with fixed exchange rate regimes tend to grow less. Thus, he analyzes the transmission channels between fixation and economic growth. One hypothesis explores the endogeneity of the decision of fixing the exchange rate, given the characteristics of capital inflows to developing countries. Sturzenegger also argues that the probability of a sudden stop of capital inflows is higher under a fixed regime, according to the international evidence.

Gerardo Esquivel and Felipe Larraín study several aspects of currency crises in the third paper. Through their analysis, they conclude three main points. First, based on an international comparison of countries between 1970 and 2002, the number of currency crises around the world is clearly diminishing. This fact suggests that economies are better prepared today to smooth out negative shocks than they were in the 70s or 80s. Second, currency crises can be adequately modelled based on a few variables, such as seigniorage, real exchange rate misalignment, current account balance, an indicator of money to international reserves, terms of trade shocks and contagion effects. Third, currency crises are not completely unpredictable: the authors use a simple model to perform out-of-

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sample predictions of currency crises for the period 1996-2000, obtaining fairly good results in terms of crises correctly predicted versus false alarms.

In the last paper of the section, Felipe Larraín and Se Kyu Choi try to answer a question which is partially raised by the previous article on crises: what determines the difference in the expected length of an economic contraction across countries? Using the standard definition of a recession and estimating count-data models, the authors find that more open and diversified countries tend to spend less time in recession. Furthermore, there is evidence supporting the bipolar view of exchange rate regimes: countries using an intermediate exchange rate regime tend to spend more time in recession than those under hard pegs or floats.