

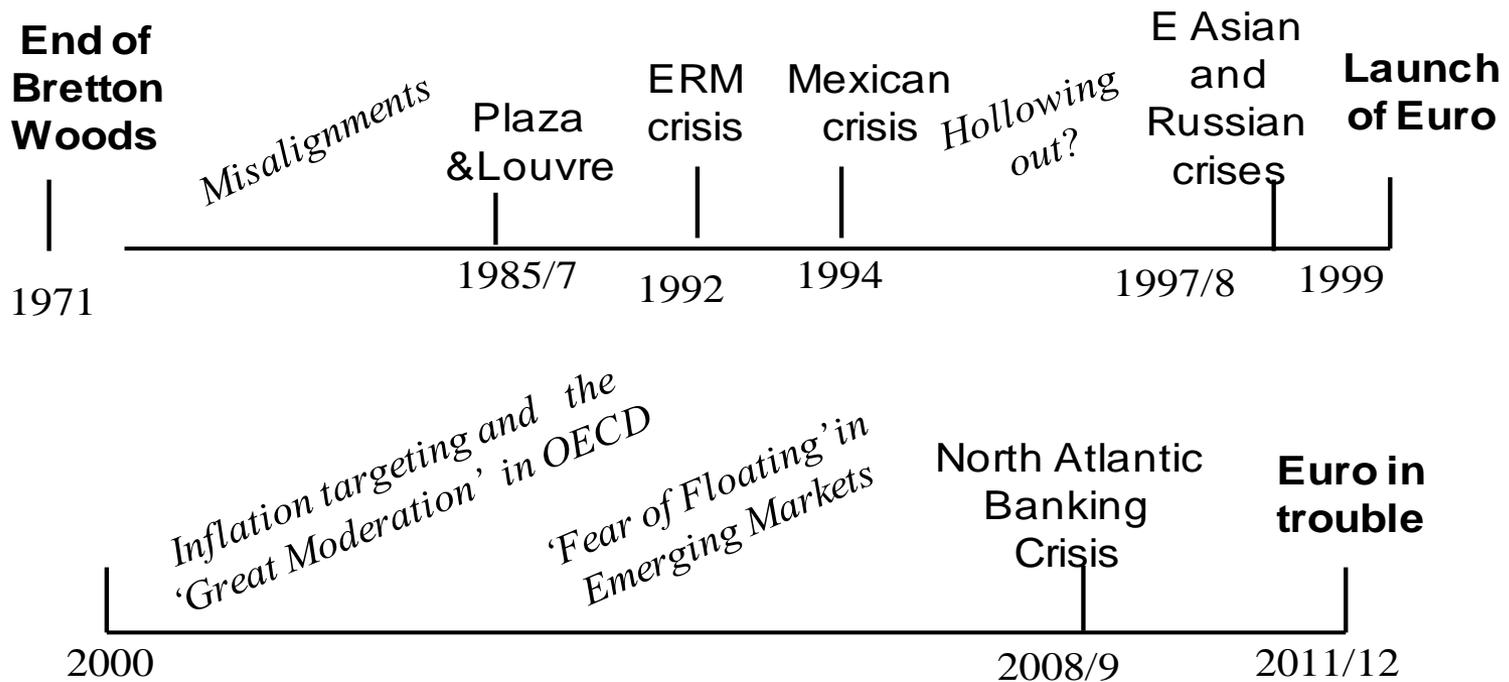


Target zones and monitoring bands : a bird's eye view

Marcus Miller
University of Warwick

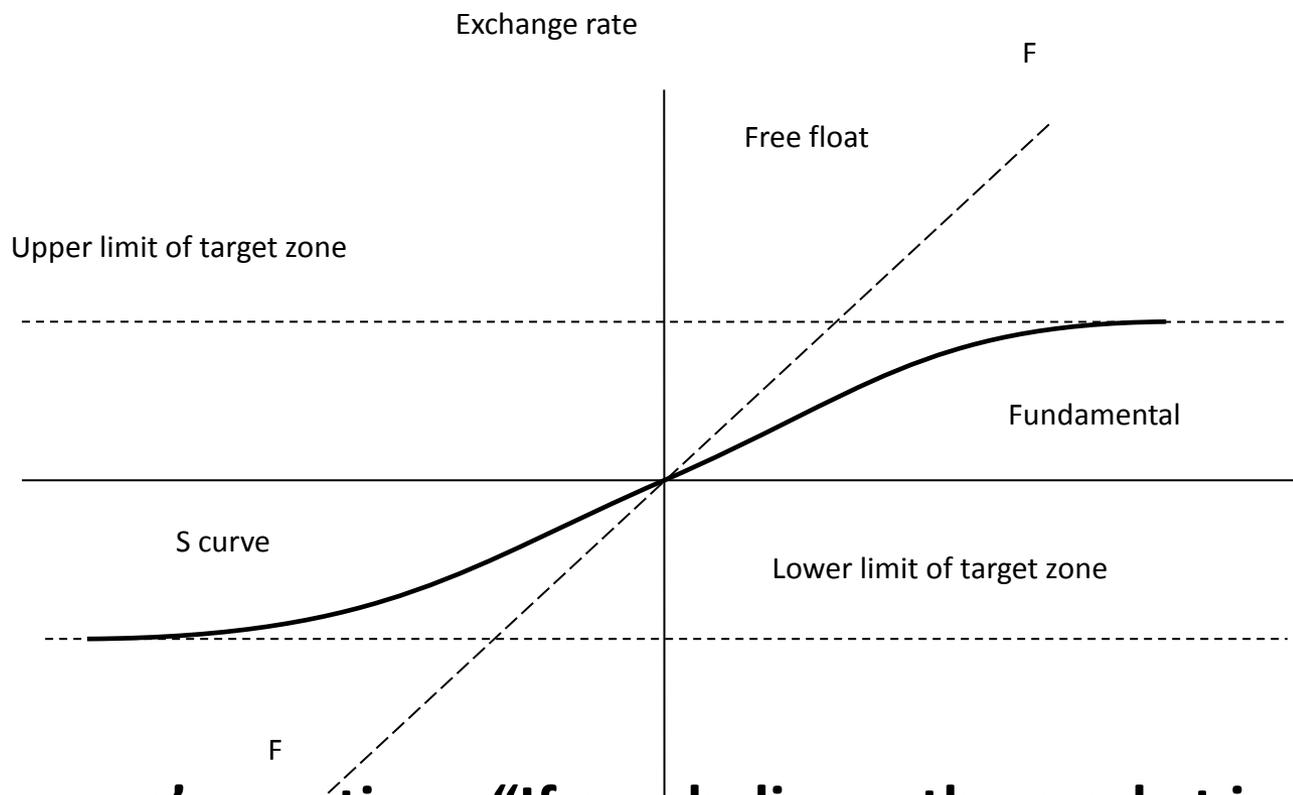
A short history of time ...

Chart 1 Timeline : late 20th Century ...



...and the brave new world of 21st century

Exchange Rates in a Target Zone: Paul Krugman's opening Shot



John Williamson's reaction: "If one believes the market is forward-looking and rational, then one would not want to intervene at all: free floating is the preferred policy"

George Akerlof's culinary warning: economists like French chefs!

- 'Economic theorists, like French chefs in regard to food, have developed stylized models whose ingredients are limited by some unwritten rules...
- I disagree with any rules that limit the ingredients in economic models'.

Akerlof's hints for new ingredients?

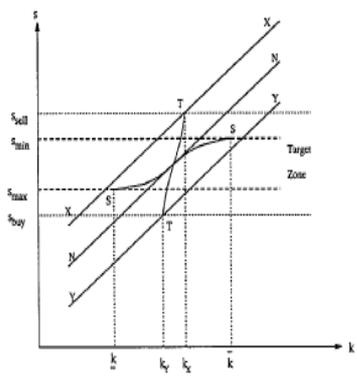
- “The absence of **psychological–anthropological-sociological behaviors** in economic theory allows a whole new field of potential interest .. [where] the economic theorist [can] ask what the consequences of these behaviours will be for the usual economic results.”

How traders in FX markets behave: four parables in the literature

- **Stop-loss traders** (Krugman and Miller)
- **Noise Traders** (Jeanne and Rose)
- **Chartists and Fundamentalists** (Kubelec and De Grauwe and Grimaldi)
- **Bulls and Bears**(Corrado et al.)

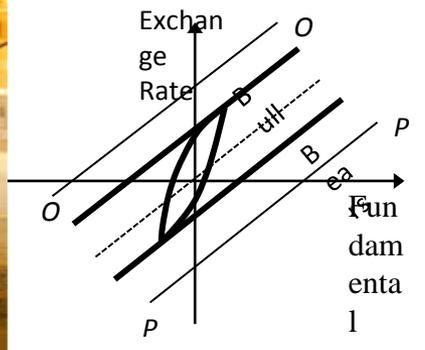
FX Markets: take a closer look!

Stop Loss traders

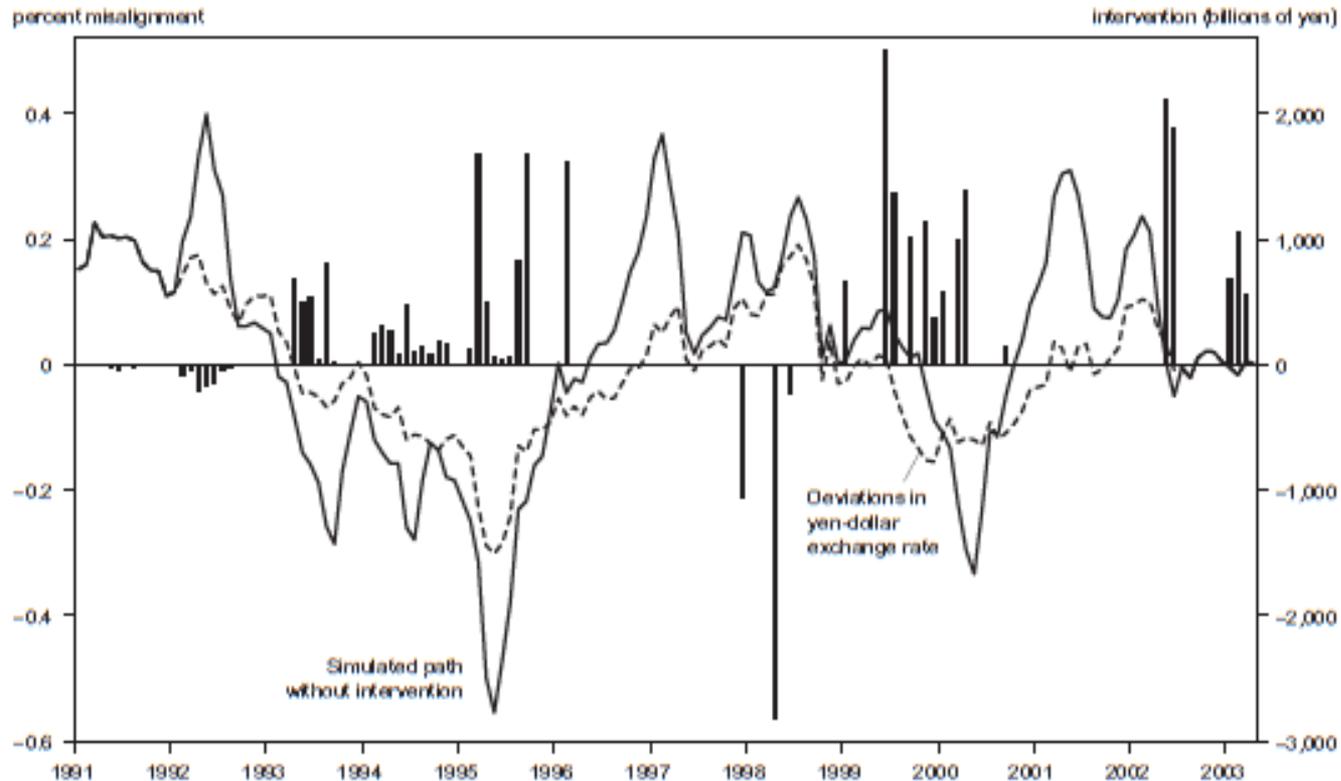


Noise traders

Bulls and Bears



Chris Kubelec calibrates success of Mr Yen



Note: Bars represent interventions.
Source: Kubelec (2004).

'We have the biggest stash of cash in Asia'
claims Mr Sakakibara.

Breaking news: Joe Gagnon of PIIIE denies doctrine of 'Impossible Trinity'.

- Doctrine of the 'impossible trinity' claims that with perfect capital mobility, one has to choose between an independent monetary policy and exchange rate management.
- But, given failure of Efficient Market Theory , Gagnon argues, you can have both!

Joe Gagnon rejects false dilemma: endorses Monitoring Bands

- Sterilized exchange rate intervention is seen as a separate policy tool.
- “As long as monetary policy is free to pursue the stabilisation of output and inflation”, the logic goes, “there is no reason not to use this policy lever to do some good.”
- Monitoring zone proposal ‘helpful in reducing and stabilizing volatile risk premiums’

Finally: the future of macroeconomics?

	Possible developments	John's score?	Why
1	More eclectic theory, not just DSGE*	****	Rejection of Efficient Markets
2	Attention to facts rather than prior assumptions	****	Focus on markets and institutions
3	Use of other disciplines	*****	Study of actual behaviour

* DSGE = Rational Expectations + Representative Agent + Efficient Markets

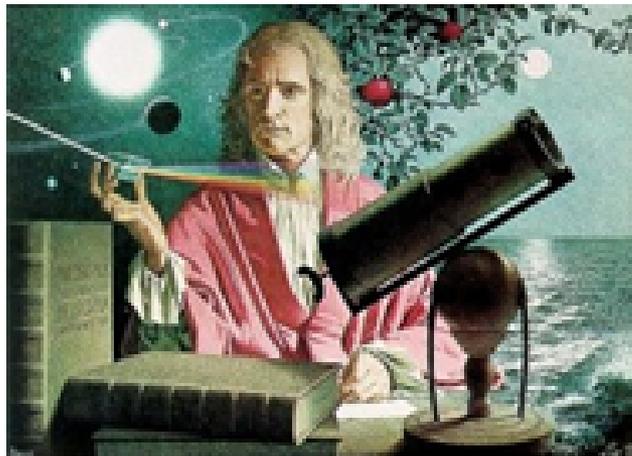
New role models for economics?

Hard Sciences:

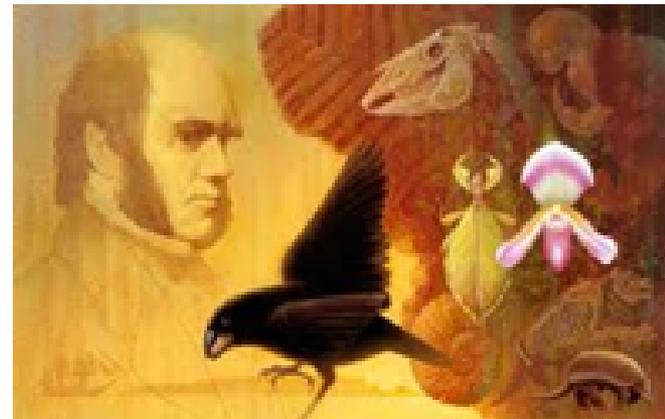
Mathematics

Physics

Statistics



Isaac Newton



Charles Darwin

Life Sciences:

Ecosystems (May and Haldane)

Natural selection (Haldane)

Mimicking (Foster and Young)

A target zone to 'stop loss stoppers'

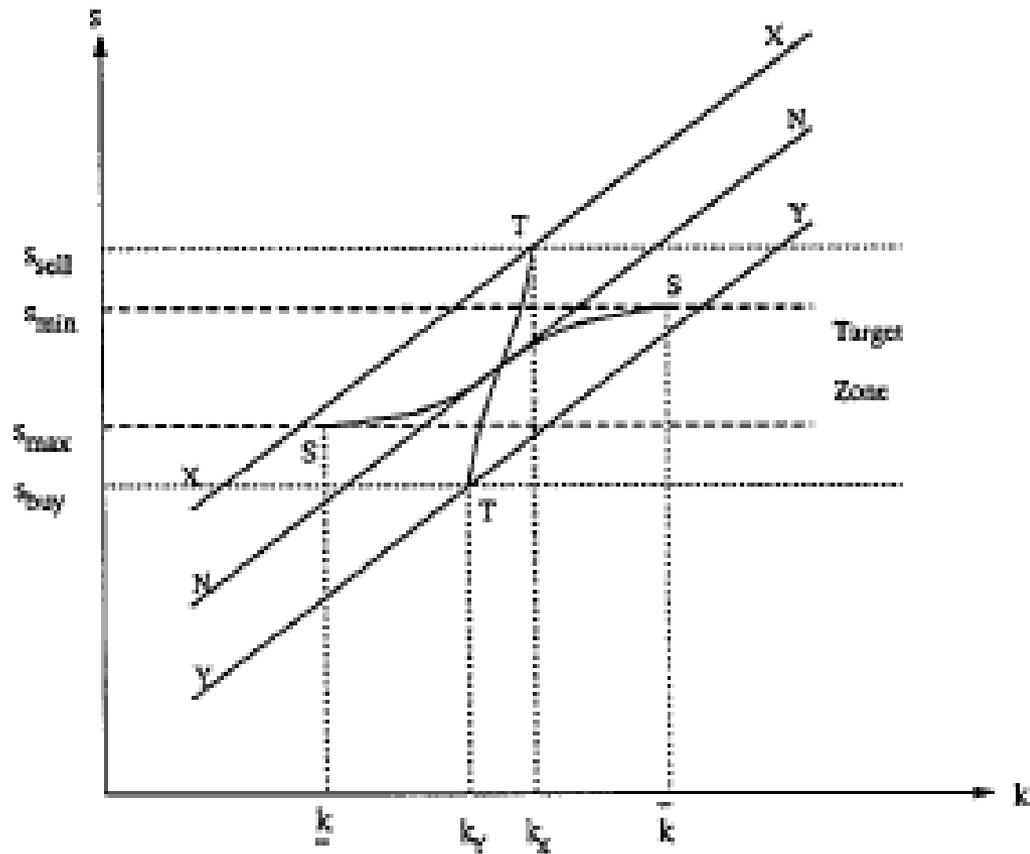


Figure 2. Target Zone with Informed Investors.

Bulls, Bears and excess volatility

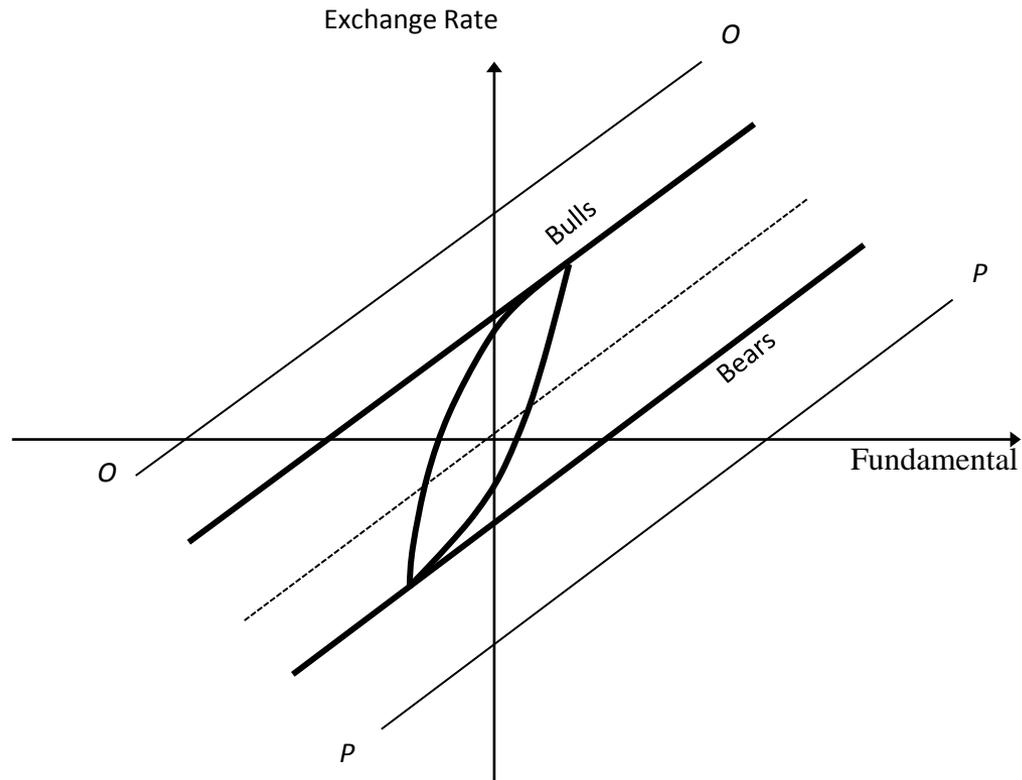


Figure 4. Excess volatility with repeated switching.

Bulls and bears in a monitoring band

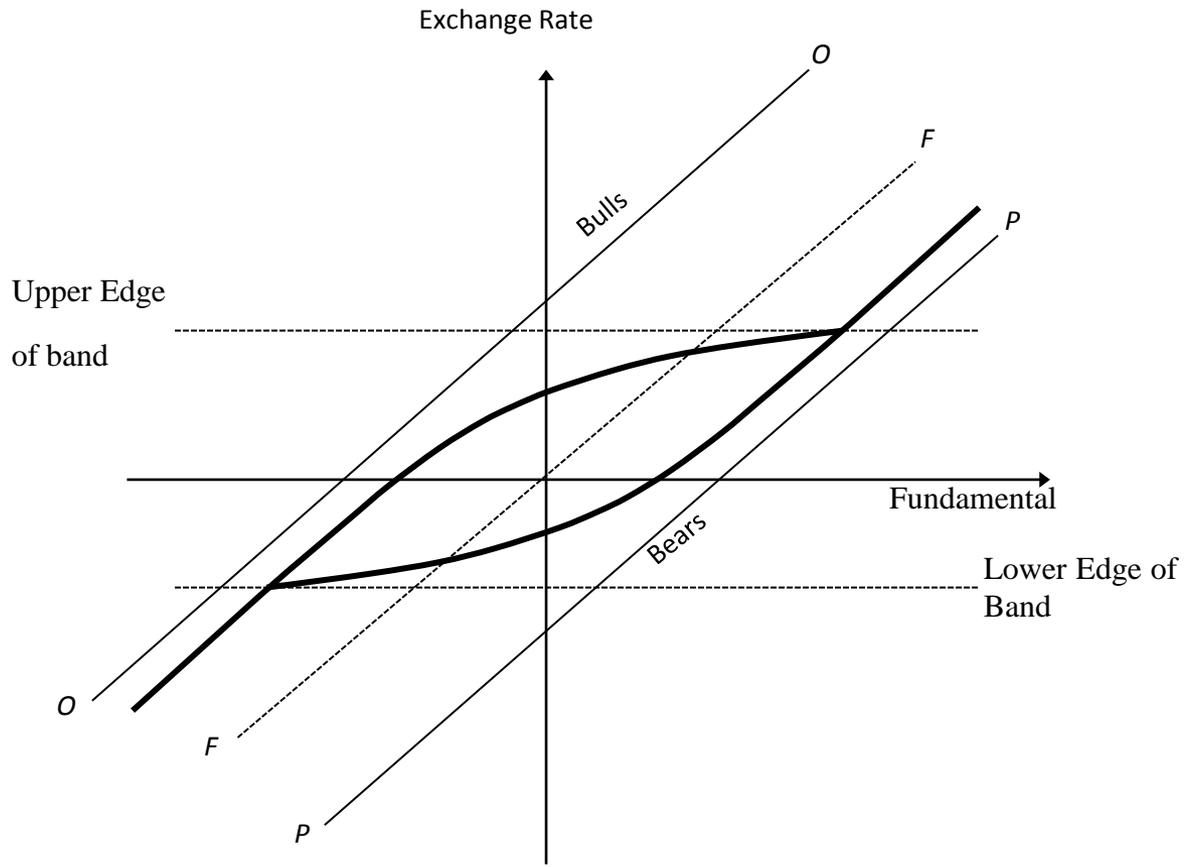


Figure 5. Bulls and bears in a monitoring band.

