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Fixed on Flexible Rethinking Exchange Rate Regimes after the Great Recession

CFM-DP2017-21

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The zero lower bound problem during the Great Recession has exposed the limits of monetary autonomy, prompting a re-evaluation of the relative benefits of currency pegs and monetary unions (see e.g. Cook and Devereux, 2016). We revisit this issue from the perspective of a small open economy. While a peg can be beneficial when the recession originates domestically, we show that a oat dominates in the face of deflationary demand shocks abroad. When the rest of the world is in a liquidity trap, the domestic currency depreciates in nominal and real terms even in the absence of domestic monetary stimulus (if domestic rates are also at the zero lower bound)|enhancing the country's competitiveness and insulating to some extent the domestic economy from foreign deflationary pressure.