

The advantages of introducing an exchange rate target within the statutes of the European Central Bank

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Abstract

With the help of a Keynesian dynamic macro-economic model in an open economy, this paper aims at studying the possible consequences of introducing an exchange rate target within the statutes of the European Central Bank. Even if we assume zero cooperation between the ECB and the various budgetary authorities, it appears that such a target would have only slight implications for the stabilization of demand or for the mitigation of external supply shocks. But in case of internal negative supply shocks, this scheme could limit the conflict of goals between the monetary and budgetary authorities, a conflict that could lead to excessive economic policies, while it would at the same time reduce the slowdown in economic activity. Finally, in the case of positive shocks on interest rates in the rest of the world, an exchange rate target could have advantages which are different from those implied by a goal of limiting the variation in interest rates. Such a scheme could increase the role of the central bank in the control of restrictive policies designed to stabilize these shocks. The paper then concludes that such an exchange rate target could limit variations in economic activity triggered in the monetary union by foreign shocks.

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