Branko Urošević
(Faculty of Economics, University of Belgrade, Serbia)

Title:

Globalization, Exchange Rate Regimes and Financial Contagion

Abstract:

The crisis of the Euro zone brought to the fore important questions including: what is the proper level of financial integration and what are the optimal exchange rate arrangements between countries that are part of tightly knit financial networks. Using a simple Diamond-Dybvig-style theoretical model we show that the effects of increased financial interconnectedness and different exchange rate regimes on financial stability should not be studied in isolation from one another. We demonstrate that a switch from fixed to flexible exchange rate regime in one country increases financial fragility of multi-currency networks under a complete system of financial links and decreases fragility if the set of links is incomplete. On the other hand, an increase in financial interconnectedness reduces fragility under fixed regime, but not necessarily does so under the flexible exchange rate regime.