

# Exchange rate risks in a small open economy

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## Abstract

This paper analyzes the choice of an effective exchange rate policy for a small open economy indebted in foreign currency, incorporating the open economy financial accelerator. We show that a trade-weighted currency basket adopted in many previous studies is not sufficient to stabilize the economy, because currency mismatches between assets and liabilities cause balance-sheet effects and the effects have a serious impact on the economic stability. This result implies that the currency composition of liabilities has an influence on a choice of exchange rate policies and that we need decide it based on those influences.

*keywords* : Currency mismatch, Balance-sheet effect, DSGE, Exchange rate regime

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