

# **How tight should central bank's hand be tied? Credibility, volatility and the band width of a target zone**

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This paper analyzes the relation between the credibility of target zones and the band width. Time consistency considerations require a trade-off between discipline and credibility. Some empirical works have pointed out that credibility increased after the widening of ERM bands in August 1993. We first construct a model of exchange rate determination in a target zone and, second, we show the circumstances under which the probability of defending a currency increases with a wider band.

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