IMPOSSIBLE TRINITY

Group 11

- **Akhil**
- **Amanpreet Singh**
- **Ankur**
- **Imnalensa**
- **Khyati Garg**
- **Neha Chauhan**
- **Supriya**
- **Yiramayi**

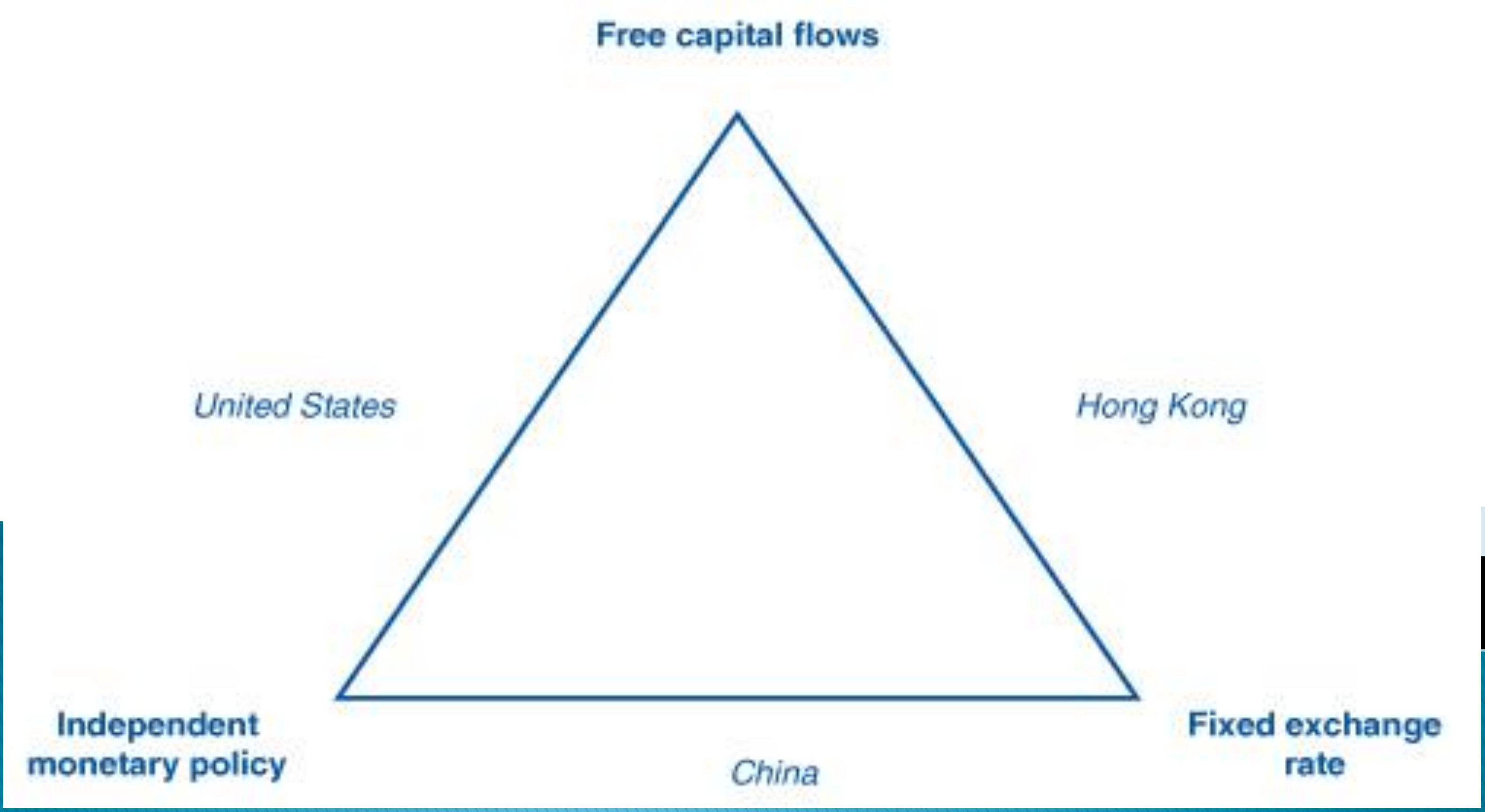
Impossible Trinity

It is not possible for a country to maintain all three of the following:

1) free capital flows
2) a fixed exchange rate
3) independent monetary policy

Impossible Trinity (continued)

A country can choose any two of the three:



Impossible Trinity (contd.)

- A central bank can only pursue two of the three policies simultaneously
- Setting lower interest rates: depreciation pressure on home currency
- Investors would invest more in dollars
- For free capital flows: central banks ‘facilitate’ dollar purchase

Impossible Trinity (examples)

1) U.S. allows free flow of capital & maintains monetary authority but does not have a fixed exchange rate

2) Eurozone has a fixed exchange rate & allows free flow of capital but does not have independent monetary authority

3) In the past, China had a fixed interest rates and monetary policy but did not allow the free flow of capital

Asian Financial Crisis 1997-98

- Originated in Thailand and spread to neighboring countries like South Korea and Indonesia
- World Bank and International Monetary Fund encouraged Asian economies to open up their capital account
- Inflow of short-term capital (hot money) into Thailand economy and its neighbors.

IMF Intervention

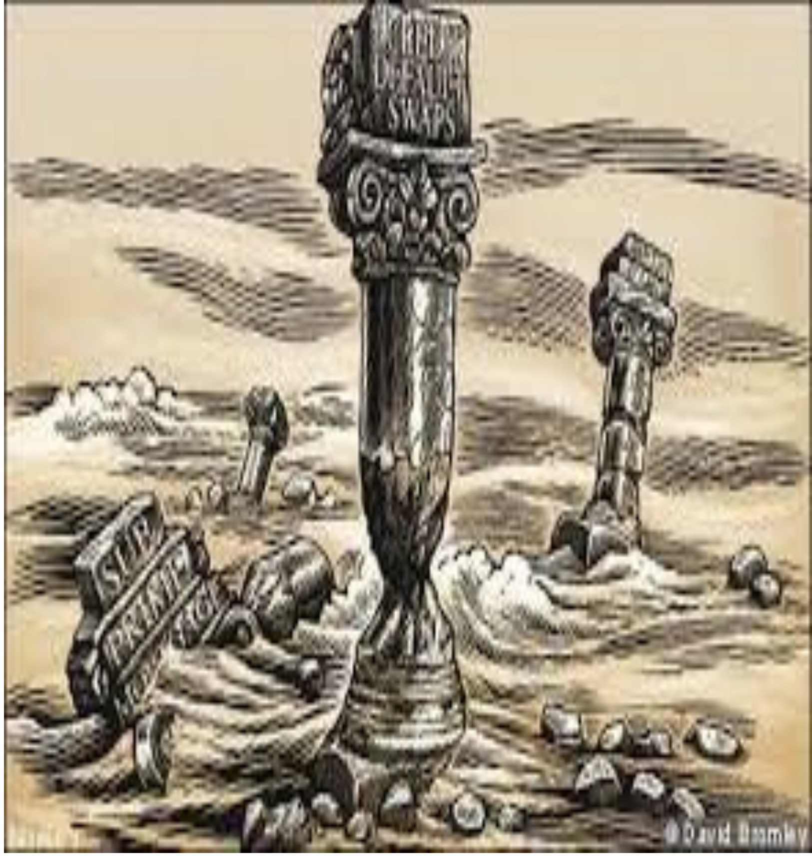
- 40 billion dollar bail-out package by IMF. IMF support was conditional on a series of economic reforms- Reduction in government spending and deficits, allowing insolvent banks and financial institutions to fail etc.
- Economies started recovering and back to normal condition by 1999.

SUB PRIME CRISIS 2008

Content

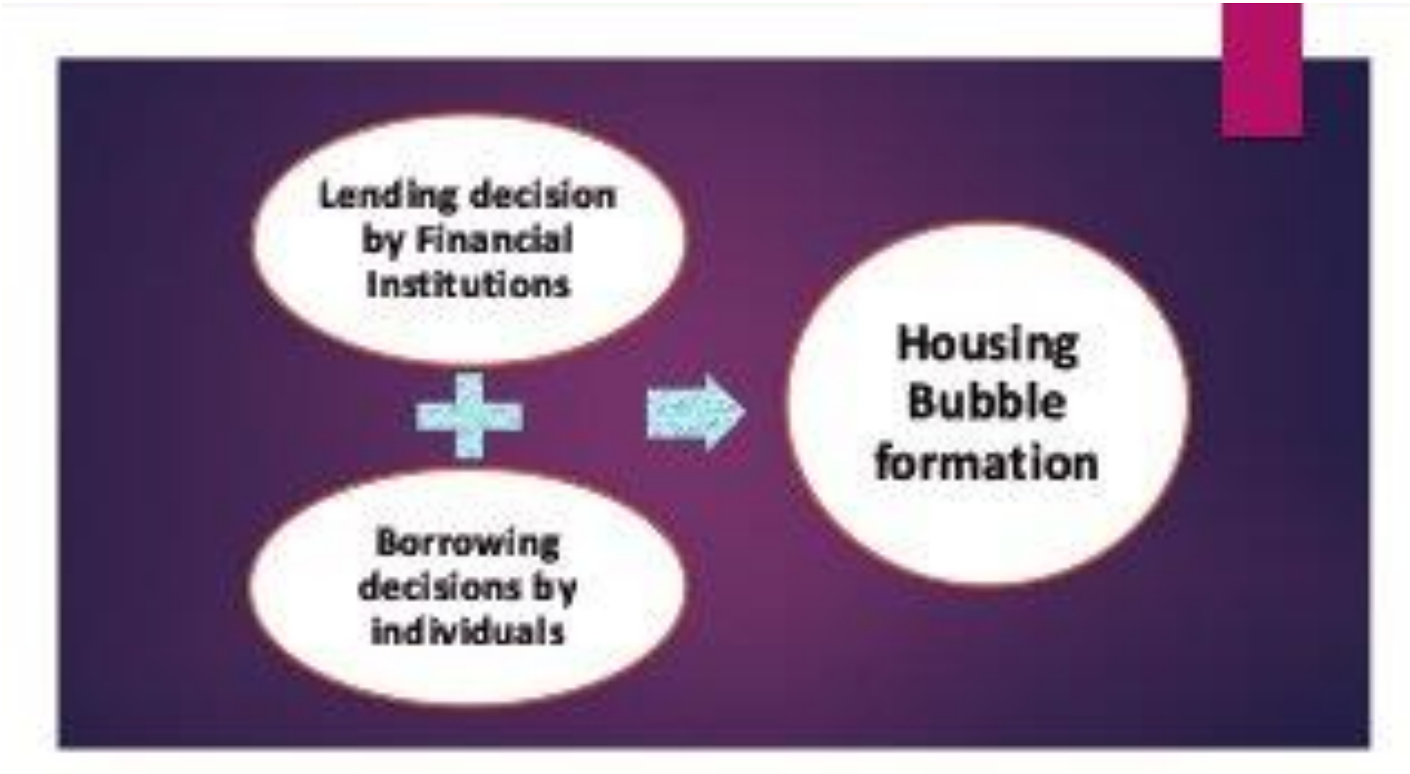
- Cause of the crisis
- Impact of financial crisis
- Global crisis and impossible trinity

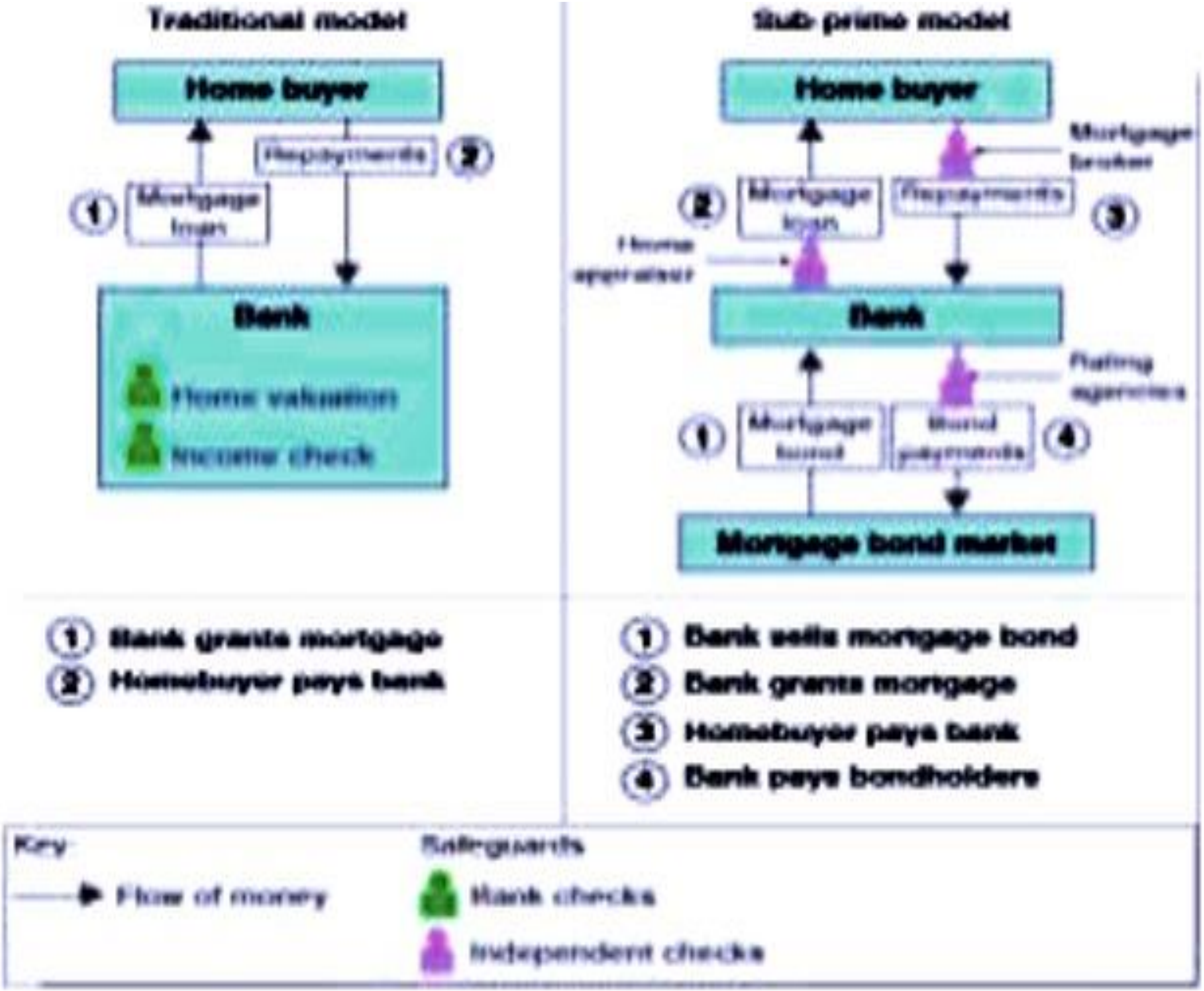
.Launched the start of the new crisis with the announcement of a giant financial institution, is the Lehman Brothers' bankruptcy for a symbolic beginning of the dangerous, because of this great institution was one of the few companies that survived the massacre of the Great Depression in1929.



♦On February 7, 2007 one of the world's largest banks, HSBC, announced losses related to U.S. sub prime mortgage loans. A couple of months later, on April 3, New Century Financial, a sub prime specialist,, Bear Stearns told an incredulous financial community that two of its hedge funds suffered large losses related to sub prime mortgages .

Cause Of The Crisis


Lending decision by Financial Institutions
Borrowing decisions by individuals
Housing Bubble formation



Traditional model
Home buyer
Repayments
Mortgage loan
Bank
Home valuation
Income check
Sub-prime model
Home buyer
Mortgage broker
Mortgage loan
Repayments
Home appraiser
Bank
Rating agencies
Mortgage bond
Bond payments
Mortgage bond market
1 Bank grants mortgage
2 Homebuyer pays bank
1 Bank sells mortgage bond
2 Bank grants mortgage
3 Homebuyer pays bank
4 Bank pays bondholders
Key:
Flow of money
Safeguards
Bank checks
Independent checks

Cause of the crisis

. Expanded U.S. financial institutions to grant housing loans largely on the one hand, and increased the percentage of loans to the value of the property (housing) on the other. Has provided financial institutions such loans to a large number of consumers

Cause of the crisis

Cause of the crisis

. owners credit were bad in the sense that their willingness and ability to repay loans is low and thus stumble upon solutions dates of repayment of loans, which affects the development of financial institutions that granted loans, and then not being able to fulfill their obligations and collapse.

Cause of the crisis

Cause of the crisis

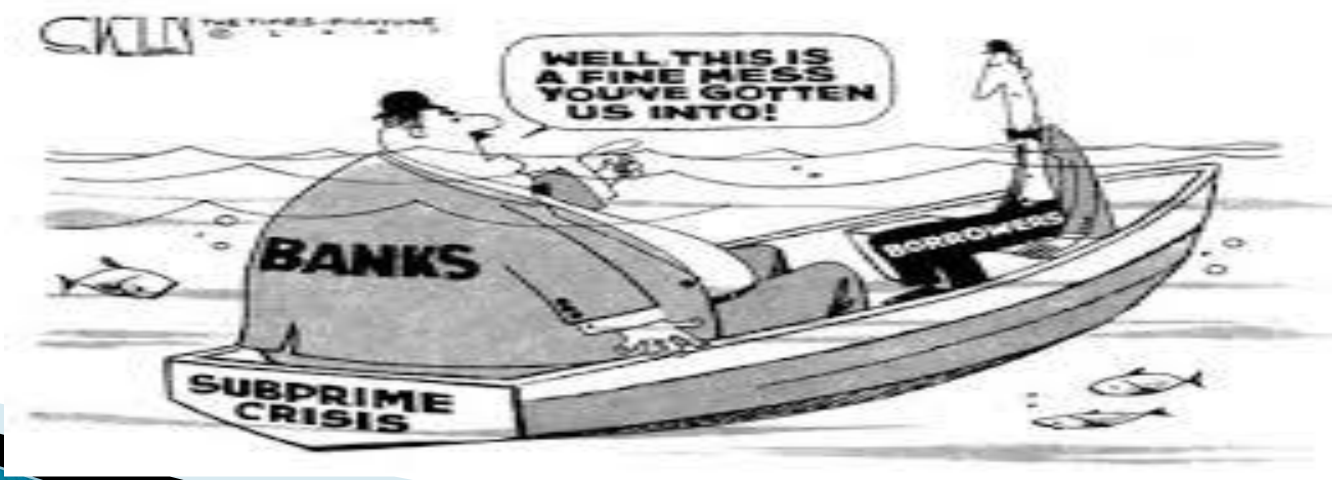
. the sudden withdrawal of deposits leads to the collapse of the financial institutions even if it is placed well and healthy. This is called the domino effect, so that if she broke down and one sheet of paper to the rest of the dominoes game cards collapsed, so we find that the intervention of central banks in these cases is essential .

Impact of Crisis

- A crisis of liquidity in global financial markets.

- Reduced demand for raw materials and especially the oil resulting in a lower price.

- Bankruptcy a large number of major international companies in several areas linked.



Impossible trinity and Crisis

The freedom of the market and lack of government control meant there was no one to prevent a major crisis and worldwide recession. Capital mobility meant investment could pour into countries and overheat their boom (Ireland, Greece, Spain etc) leading to inflation and unsustainable growth. It also meant that when the bubble burst, capital was free to leave the country, destabilising the economy and leading to severe recessions..

So to conclude, no country can have all three parts of the Impossible Trinity. Which two they chose has an important effect on the economy. A major explanation for the Financial Crisis and why it effected economy so badly was because these nations had free capital mobility and no control over interest rates. This meant we were unable to dampen the boom .

solution in such crises lies in stable exchange rates and independent monetary policy backed by capital controls in order to restore balance and prevent the wild swings from re-occurring.

The economy has shown that left to roam wild, it does not lead to prosperity, but rather chaos. Wild markets are hotbeds of speculation, bubbles and uncontrollable swings. We have all seen the damage down when people's lives are left at the mercy of speculators. A stable economy makes business decisions easier and allows the economy to run smoothly without the wild swings from boom to bust and flood to drought. We may not like capital controls, but we need them.

Thank you