High variability of nominal exchange rates also tends to be accompanied by high variability of real exchange rates.[8] Real exchange rate variability is a major policy concern for flexible exchange rate regimes since movements in the real exchange rate exert important effects on economic activity, especially in the traded-goods sector.

Fixed exchange rate regimes reduce exchange rate variability provided that the fixed parity can be maintained. However, such regimes are often forced to make large changes in the parity or abandon the fixed exchange rate system as a result of speculative attacks. Some interesting evidence on speculative attacks is provide by recent currency crises in the EMS and the dramatic collapse of the Mexican peso.[9] The evidence shows that although attacks against a currency tend to occur suddenly,

- a widespread perception generally exists for some period prior to the attack that the fixed price of the currency is not sustainable.

One typical reason for such a perception is that the price level of the country is rising relative to the foreign level and is causing a real appreciation of the currency under the fixed exchange rate. This situation raises serious doubts about the credibility of the domestic monetary authorities to maintain a fixed parity regime.

Another interesting finding is that wide bands around the fixed parity do not appear to help much in the event of an attack. For example, during the 1992 EMS crises the 12% wide bands did not prevent successful speculative attacks against Britain, Spain and Portugal. Subsequently, Spain and Portugal adopted a 30% wide target zone. Nonetheless, they both were still forced to devalue in 1995.

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[8] For example, see Michael Mussa, "Nominal Exchange Rate Regimes and the Behavior of the Real Exchange Rate", in K. Brunner and A. H. Meltzer (eds.), **Real Business Cycles, Real Exchange Rates and Actual Policies**, New York: North-Holland, 1986, 117-213.

[9] For a discussion of these episodes, see Maurice Obstfeld and Kenneth Rogoff, "The Mirage of Fixed Exchange Rates", **Journal of Economic Perspectives** 9, Fall 1995, 73-96.