committing to use foreign exchange market intervention or capital controls as the primary instrument to maintain external competitiveness. This will allow them to take actions to prevent exchange rate overshooting in exceptional circumstances without departing from the inflation targeting framework.

Central banks should also make clear, however, that monetary policy is only one part of the policy response. Bond purchases without fiscal and structural adjustment achieve nothing. Maintaining a stable and fairly valued real exchange rate is not exclusively the responsibility of the central bank; achieving this goal and deriving benefits from it also require prudent fiscal policies, sound macroprudential supervision, and, where necessary, regulation of the capital account. The message from central banks has to be: we are willing to keep an eye on the currency with the goal of preventing overvaluation as long as the fiscal and regulatory authorities are fulfilling their part of the bargain as well. Making the quid pro quo with the government explicit not only educates the public, it helps deflect pressure from the central bank.

Similarly, with regard to the challenges posed by debt overhangs, particularly those of the public sector, a communication strategy that addresses recurring concerns about the central bank's independence from the fiscal authorities will be crucial in maintaining credibility. More transparency on the policy objectives and strategy are especially valuable in periods (such as that now being experienced by the Federal Reserve) when a very expansive policy stance is observationally equivalent to monetization of the debt.