60 Second Adventures in Economics

5. The Impossible Trinity

60 Second Adventures in Economics – Number five: The Impossible Trinity.

Most countries trade with one another – which is usually pretty good for all involved – but it does mean it's a bit harder for each to keep control of its own finances.

There are three things that governments are particularly keen on.

They like to keep the exchange rate stable so that import and export prices don't suddenly jump around

They also like to control interest rates so they can keep borrowers happy without upsetting savers.

And they like to let money flow in and out of their country without causing too much disruption.

But there's a problem when you try to do all of these at once. Say for example, the Eurozone tries to lower its interest rate to boost investment and reduce unemployment.

Money flows out to earn higher interest rates elsewhere. Exchange rates drop, which causes inflation, so the Euro interest rate is forced back up again.

You can either fix your exchange rate and let money flow freely across national borders – but have no control over your interest rates

Or control your interest and exchange rates – but then you can't stop the capital flowing in and out.

But, like an overzealous triathlete – you can’t do all three at once.