BANK FOR INTERNATIONAL SETTLEMENTS

Toward a joined-up research agenda for central banks

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*Views expressed here are mine, not necessarily those of the BIS

Metropolitana Cathedral, Mexico City

The “punished one”

- In 1947, a novice bell ringer died in an accident when he tried to move one of the bells while standing under it
- The offending bell was “punished” by having its clapper removed and then tied down, sentenced to remain so for 50 years. It was renamed *La Castigada* (the “punished one”)
- Sentence was commuted in the Jubilee of 2000. The bell is now allowed to ring again, though it is still known as *La Castigada*

https://www.youtube.com/watch?v=0A32Yt4vFOA

Anthropomorphising the "market"

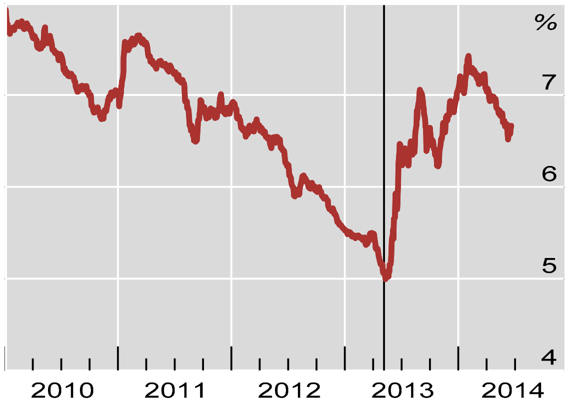
- Temptation to treat the "market" as a person capable of coherent beliefs
  - Central bank communication takes centre stage
  - Underpinned by the expectations theory of the yield curve

- But the "market" is not a person; market prices are *outcomes*, not *beliefs*

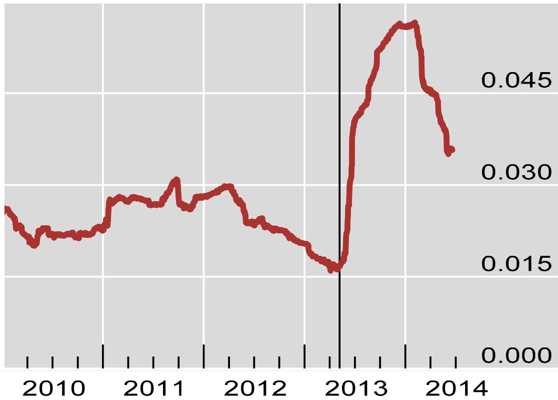
- Key to monetary policy transmission are shifts in *risk premium* - the unexplained residual
  - Hanson and Stein (2012), Gertler and Karadi (2013)

Yields of local EM government bonds and exchange rates

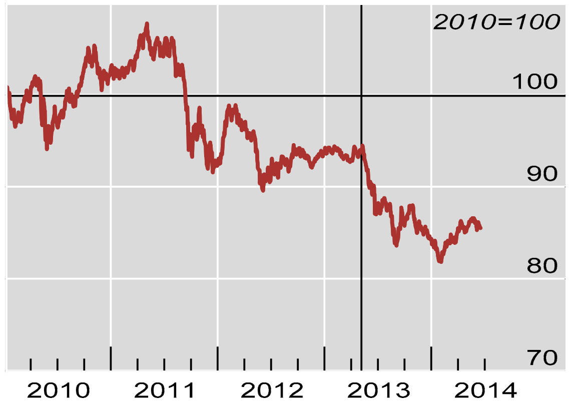
Five-year govt bond yields



Volatility of yields



The exchange rate



The black vertical line corresponds to 1 May 2013 (FOMC statement changing the wording on asset purchases).

Countries included: Brazil, India, Indonesia, Malaysia, Mexico, the Philippines, Poland, South Africa and Turkey.

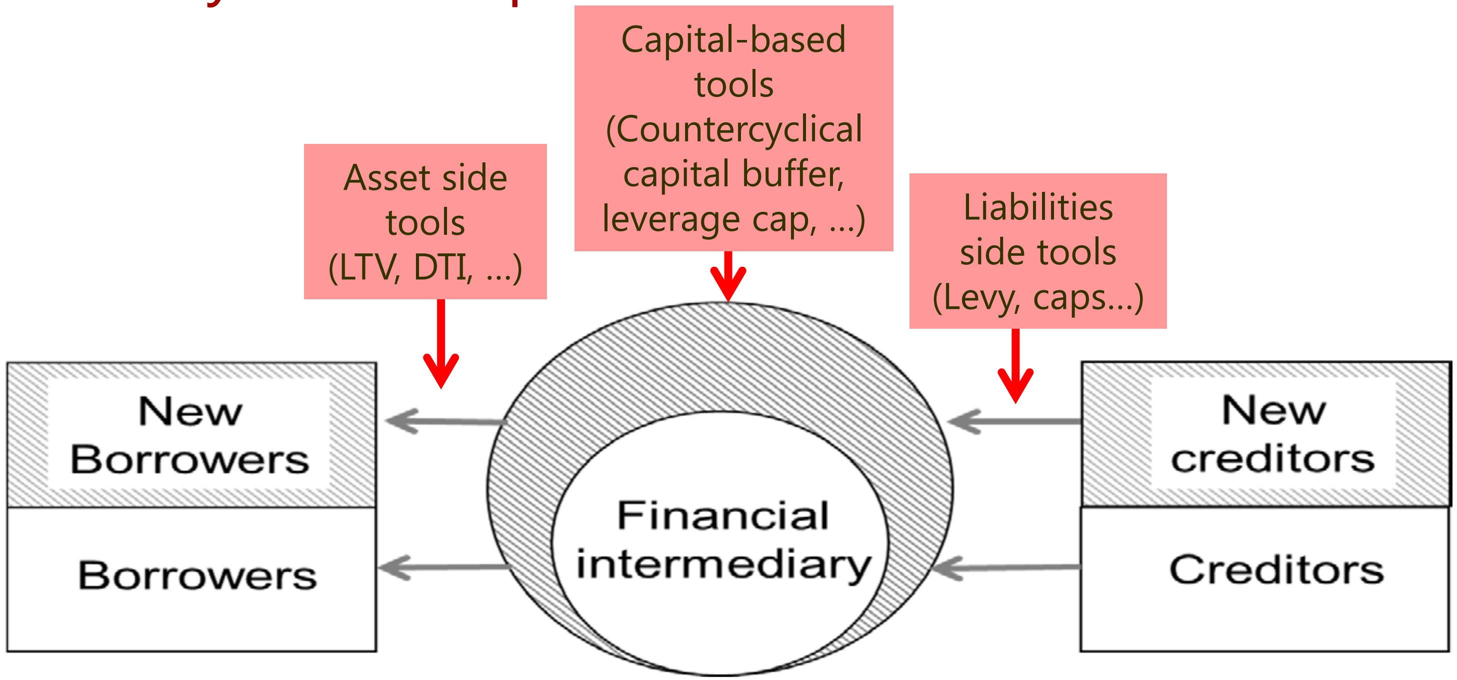
Source: Turner (2014) http://www.bis.org/publ/work441.pdf

Risk-taking channel of monetary policy

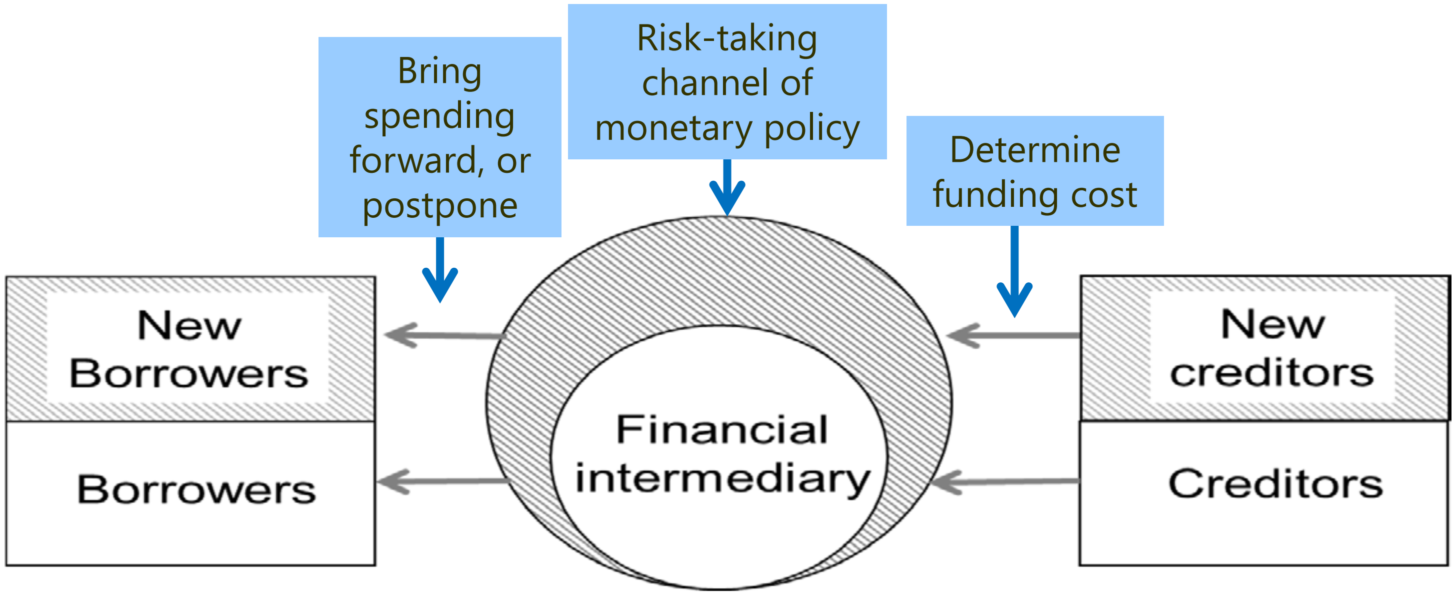
- "Risk-taking channel" of monetary policy (Borio and Zhu (2008))
- Not one channel but several; through a variety of financial intermediaries
  - Leverage cycle (banks, broker-dealers)
  - Reaching for yield (long-term investors)
  - Chasing disappearing (or negative) yields (life insurers)
- To do list item 1: get to know your players
  - Become familiar with modes of financial intermediation
  - Learn how they react to market prices and to each other
  - Be on the lookout for amplification channels

Macroprudential policy

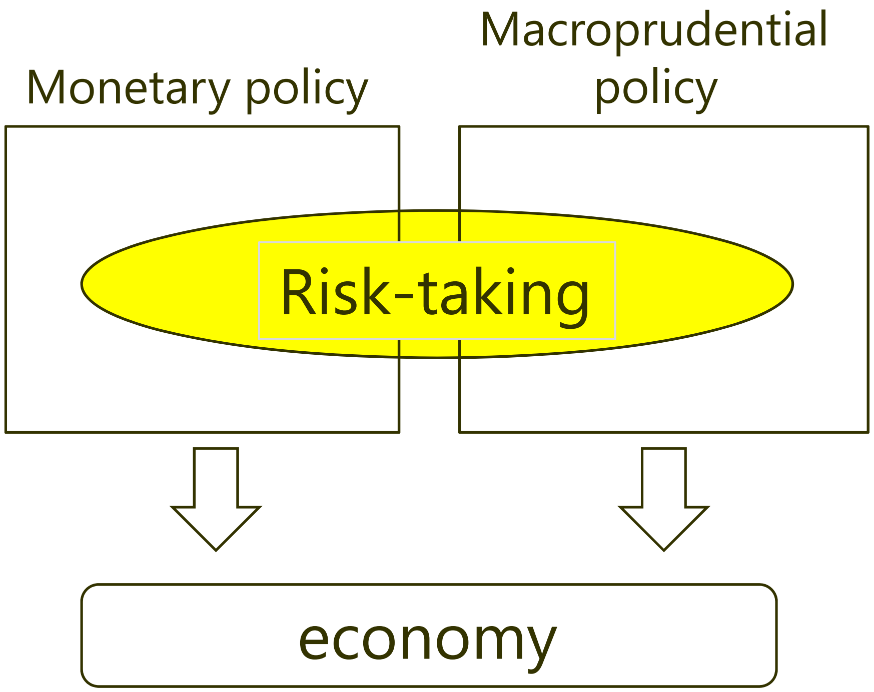
A taxonomy of macroprudential tools



Monetary policy has similar impact to macroprudential policy



Risk-taking channel as the linchpin

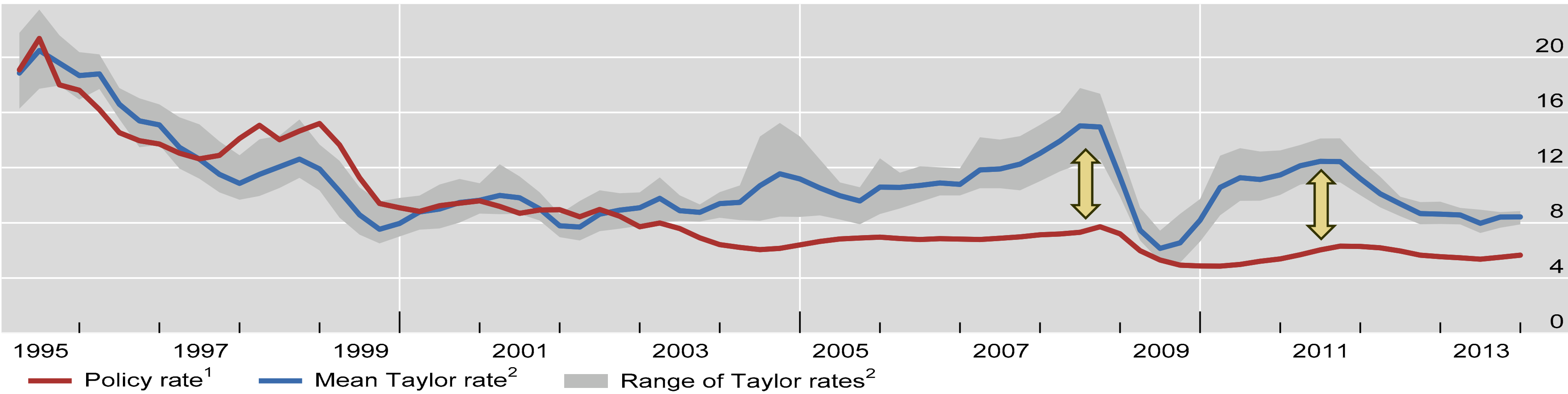


Monetary policy and macroprudential policy

- Both *mopo* and *macropru* have impact on
  - Demand for credit, bank risk-taking and funding costs
- Are *mopo* and *macropru* complements or substitutes?
  - Should they pull in same direction or in opposite directions?
- Is the objective to lean against booms or to build resilience?
  - Sorting out stocks and flows (Drehmann and Juselius (2014))
- To do list item 2: find out more on how financial stability considerations should enter in the conduct of monetary policy
  - How can *mopo* and *macropru* be used in concert?
  - How effective is *mopo* in the face of global liquidity?

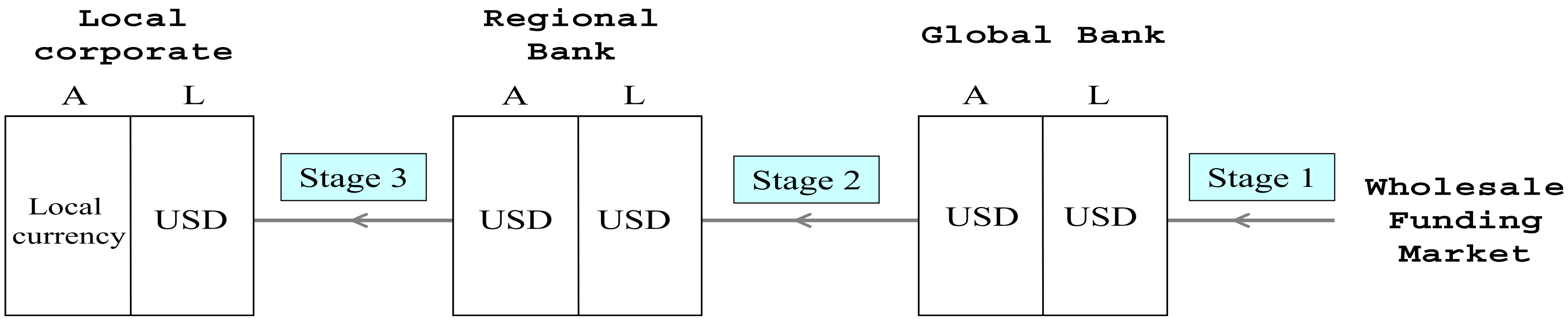
Global liquidity

Policy interest rates and Taylor rule rates in EMEs



[1] Weighted average based on 2005 GDP and PPP exchange rates for Argentina, Brazil, China, Chinese Taipei, the Czech Republic, Hong Kong SAR, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Poland, Singapore, South Africa and Thailand. [2] The range and the mean of the Taylor rates for all inflation-output gap combinations. See B Hofmann and B Bogdanova, "Taylor rules and monetary policy: a global 'Great Deviation'?", *BIS Quarterly Review*, September 2012, pp 37–49.

Currency appreciation and lending boom



- Local currency appreciation strengthens borrower balance sheet
- Creates slack in lending capacity of local banks; creates slack in global bank lending capacity; local and global banks drive credit boom
- Higher interest rate differential vis-à-vis the dollar amplifies boom

Source: Bruno and Shin (2014) http://www.bis.org/publ/work458.pdf

How do monetary policy and macroprudential policy fare in the face of global liquidity?

- Trilemma or dilemma?
  - Floating exchange rate does not always insulate an economy to pursue autonomous monetary policy (Helene Rey)

- To do list item 3: learn more about channels of spillovers
  - How does the interaction of *mopo* and *macropru* depend on the phase of global liquidity?

To do list

1. Get to know your players
   - Become familiar with modes of financial intermediation
   - Learn how they react to market prices and to each other
   - Be on the lookout for amplification channels
2. Find out more on how financial stability considerations should enter in the conduct of monetary policy
   - How can *mopo* and *macropru* be used in concert?
3. Learn more about channels of spillovers
   - How effective is *mopo* in the face of global liquidity?
   - How does the interaction of *mopo* and *macropru* depend on the phase of global liquidity?