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# Discussant comments on

# Monetary Policy in Emerging Market Economies: What Lessons from the Global Financial Crisis?

Brahima Coulibaly

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"Monetary policy, financial stability and the business cycle"

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Discussant*: Roberto Chang
Affiliation: Rutgers University
Email: chang@econ.rutgers.edu,

* These comments reflect the views of the author and not necessarily those of the BIS or of central banks participating in the meeting.

# Discussion on Coulibaly’s “Monetary Policy in Emerging Market Economies”

Roberto Chang
Rutgers University and NBER
May 2011

# Summary of Paper

- The paper estimates what factors can explain whether monetary policy loosened after crises.
- Panel of 188 countries, 1970-2009, 1462 crises.
- Up to recently, central banks in emerging countries tightened after crises.
- But they loosened policy in response to 2008-9 global crisis.

# Methodology

- Crisis observations: either steep depreciation (Frenkel-Rose) or nonpositive GDP growth.
- Dependent Variable: binary equal to one if short term interest rates declined or central bank’s domestic credit growth exceeded previous norm.
- Logit specification, look at panel and recent crisis episode (cross section)

# Main claims

- Stronger fundamentals (low inflation), openness, and financial development are significant factors.
- But the paper argues that “the most important determinants” have been financial reforms and the adoption of inflation targeting.

# Motivation

- Worth thinking about what we hope to learn (exactly which lessons from the financial crisis?)
- The exercise does help isolating which factors differentiated countries that *did* loosen policy from those that did not.
- But it is more questionable to suggest that emerging countries *could not* loosen policy in previous crises, and to claim to identify reforms and institutions that would *enable the shift in monetary policy.*

# Ability or willingness?

- The paper suggests that it is obvious that looser policy in the wake of crises is desirable.
- While many (including myself) have argued in that direction, and policymakers seem to have adopted it recently too (Obstfeld, Shambaugh, and Taylor), I would be reluctant to say that there is a consensus.

# Previous: Fix or Float Debate

- To illustrate, not too long ago (1997-9) there was a lively debate on whether monetary policy should be loose (Stiglitz, World Bank) or tight (Fischer, IMF) in a crisis.
- Arguments for tighter policy: currency mismatches and balance sheet effects.
- Other: credibility and commitment

# Some Consequences

- Arguably, in past crises some central banks did not loosen policy because they did not believe that was the correct response.
- One could argue that central banks have changed their views (OST).
- Maybe the panel nature of the data can be exploited to test this (e.g. if the short term-reserves ratio is now significant but was not before).

# More Thoughts on Identification

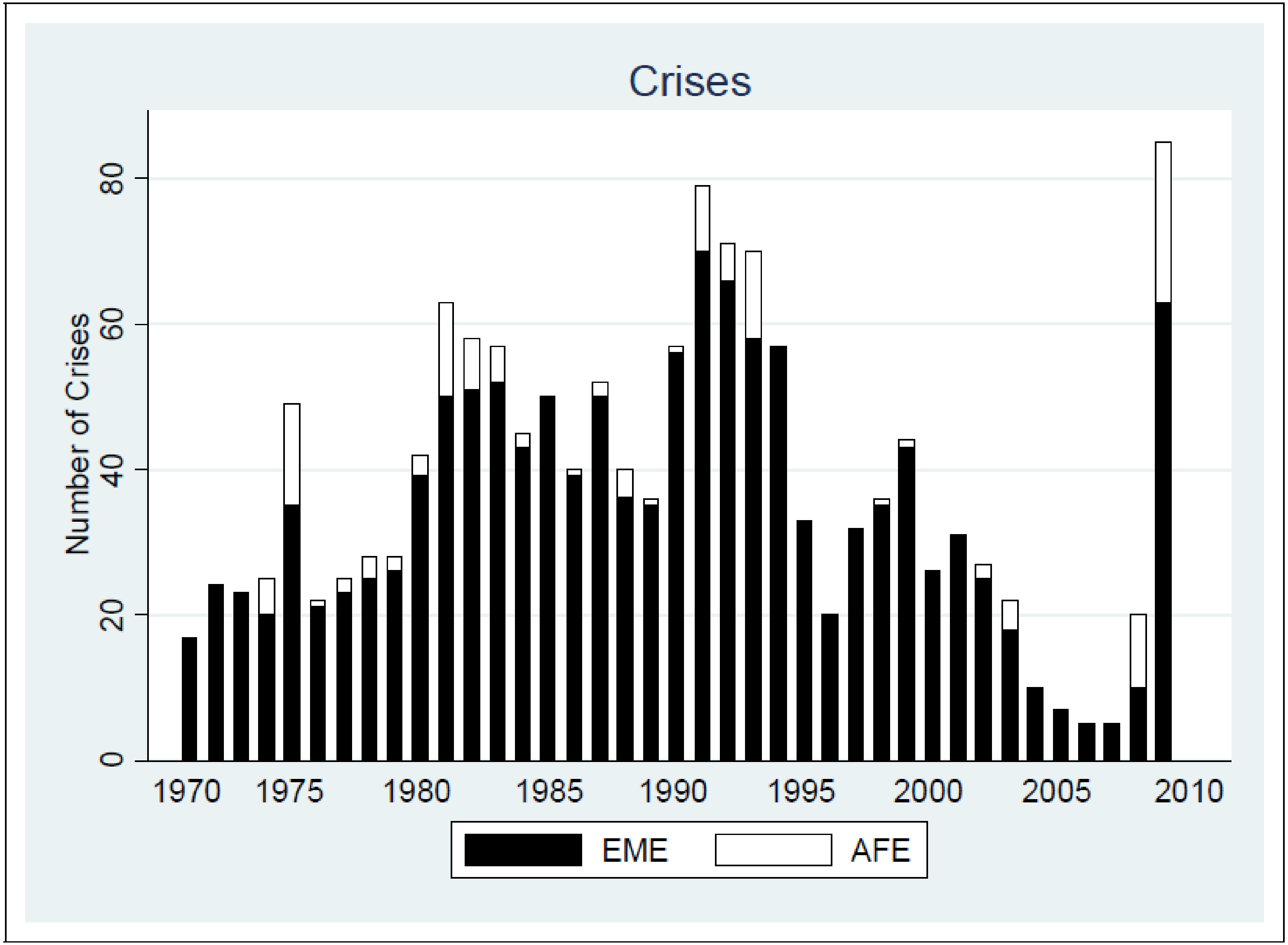
- Expanding the discussion of mechanisms through which the different variables might have helped is warranted, especially with reference to identification
- Consider the role of inflation targeting (IT): has IT relaxed other constraints that prevented countercyclical policy? Or, instead, are the adoption of IT and countercyclical policy both expressions of an increased consensus on best monetary practice?

# The Recent Crisis vs the Others

- The paper emphasizes that policy responses were quite different this time around.
- But (again) it may be the case that the recent crisis was different from previous ones and, therefore, warranted a different response.
- For example, this crisis originated in the center, not the periphery.
- Can one control for the differences?

# Defining Crisis Periods

- Definition of crisis period: either exchange rate depreciation or negative or zero GDP growth.
- Too many “crises”?
- Looking at Figure 1, more “crises” in emerging markets in early 1990s relative to before and after. (Uh?)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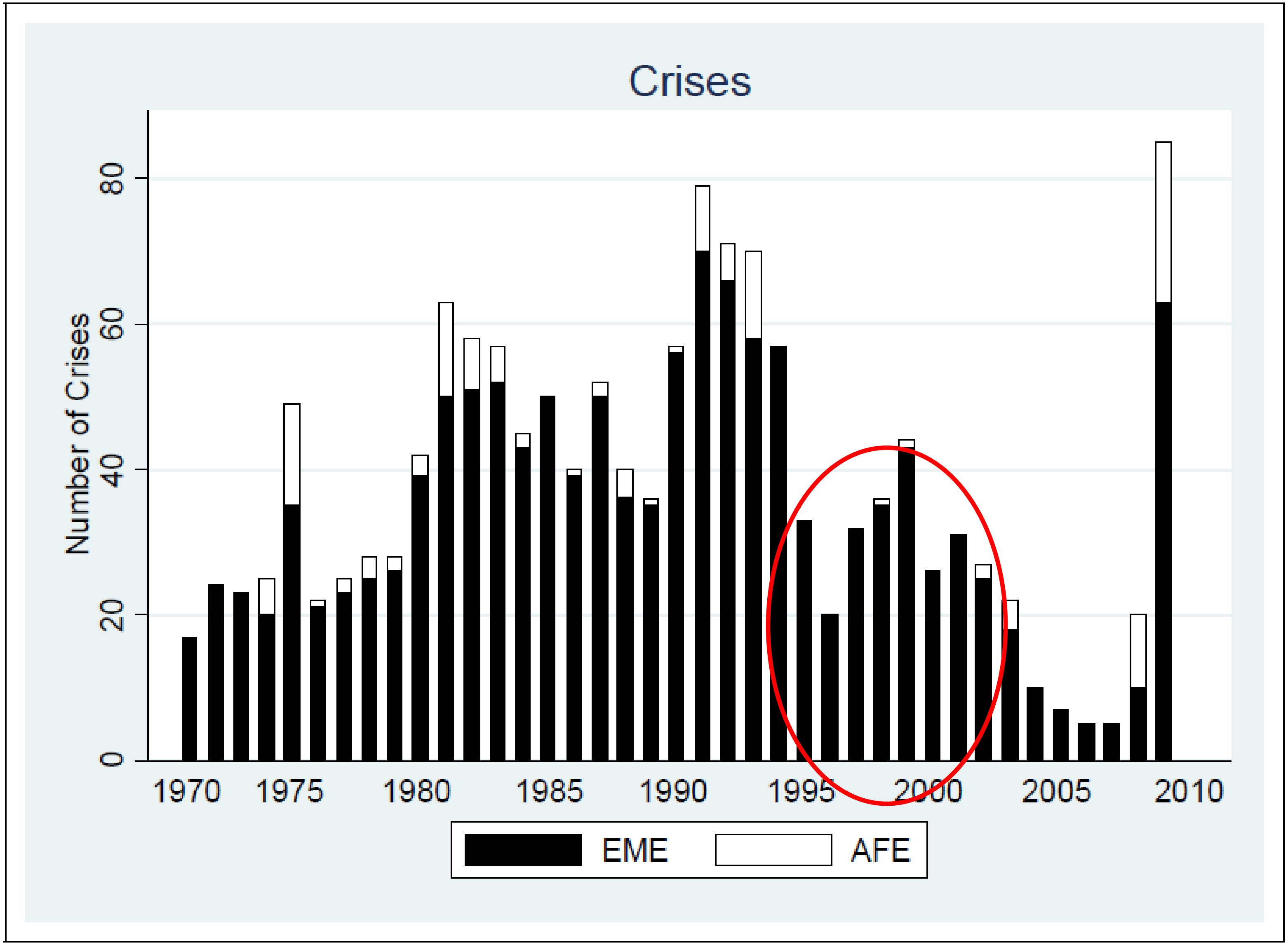
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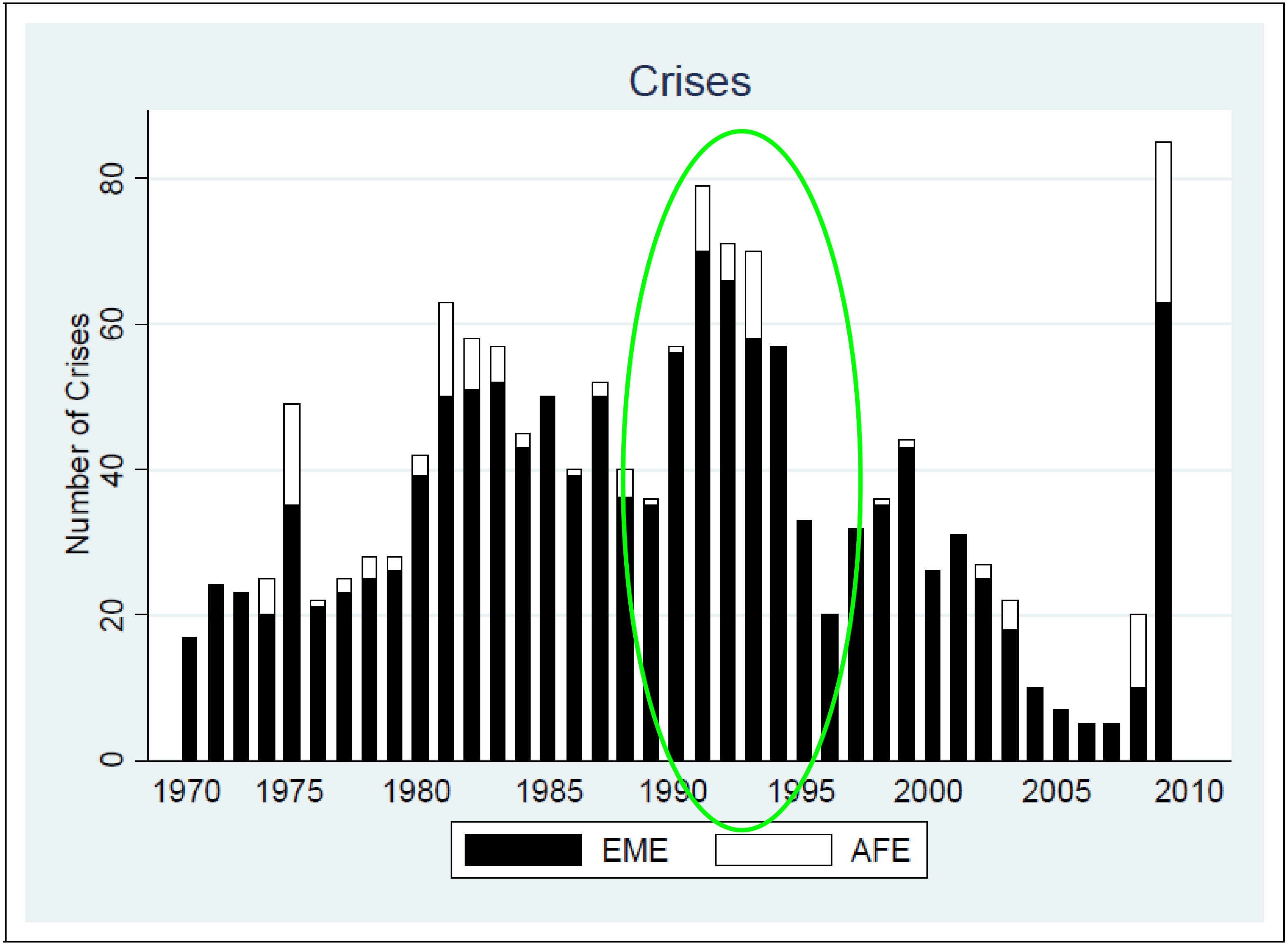

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- Too many “crises”?
- Looking at Figure 1, more “crises” in emerging markets in early 1990s relative to before and after. (Uh?)
- Careful not to count the same (long) crisis as several ones.
- Should look at time series for different countries.

# Countercyclical Policies

- In Figure 2, what is remarkable is the 1980s for AFEs. Otherwise, there would be a trend in AFEs too.

- Thatcherism and Volcker deflation (again, it is willingness, not ability, which may be driving policy).

# On Expected Signs

- More discussion of the expected signs of coefficients is warranted.
- For instance, it is not obvious (to me, at least) that financial development “increases the incentives to conduct countercyclical monetary policy”.
- It would be useful to refer to particular models of these links.

# The Role of Openness

- Paper assumes that more openness should be associated with more countercyclical policy.
- But this is not obvious at all!
- Presumably, more open economies can be “punished” more severely by the international market for unexpected policy moves.

# On the Explanatory Variables

- Several of the measures have been subject to considerable debate
- Consider the exchange rate regime, for instance. The paper uses AREAER data. Why not alternatives (e.g. de facto measures such as Levi Yeyati-Sturzenegger)
- Also debatable: IT index (not described in the paper)

# Questions About the Econometrics

1. Continuous variables are grouped into high, middle, low ranges “for ease of interpretation”. Is this necessary? Does it throw away information?

# Questions About the Econometrics

2. Multivariate analysis: used OxMetrics which “explores various combinations of regressors to maximize the fit of the model”. What does this specifically mean?

# Questions About the Econometrics

3. “Due to [not discussed!] data limitations” the analysis is redone substituting the financial reforms variable by a linear combination of IT, OPENTRADE, and OPENFIN. But the same three variables remain in the specification. Is this harmless?

Table 3: ODDS RATIOS FROM LOGIT ESTIMATES OF COUNTERCYCLICAL MONETARY POLICY FUNCTION

| Variable | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) | (11) | (12) | (13) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *INF - LOW* | 1.89** | | 1.92** | 1.78** | 1.85** | 1.81** | 1.87** | 1.91** | | 1.89** | | 1.88** | |
| *INF - MID* | | 0.54** | | | | | | | 0.54** | | 0.54** | | 0.55** |
| *INF - HIGH* | | 0.42** | | | | | | | 0.40** | | 0.40** | | 0.40** |
| *CAB2GDP - HIGH* | 1.57 | | 1.56 | 1.49 | 1.52 | | 1.55 | 1.54 | 1.51 | | | 1.58 | 1.54 |
| *CGD2GDP - HIGH* | 0.63 | 0.69 | 0.59* | 0.66 | 0.64 | 0.59* | 0.62 | 0.62 | 0.66 | 0.66 | 0.58* | 0.63 | 0.67 |
| *FXR2GDP - HIGH* | | 1.73* | 1.68* | | | | | | | | 1.65* | | |
| *STDT2EXTDT - LOW* | | | 1.39 | | | | | | | | 1.43 | | |
| *STDT2FXR - LOW* | 2.06** | 1.76* | | | 1.92** | 2.15** | | 2.07** | 1.83** | | | 2.06** | 1.82** |
| *STDT2FXR - MID* | | | | 0.55** | | | | | | 0.54** | | | |
| *STDT2FXR - HIGH* | | | | 0.36*** | | | 0.57* | | | 0.36*** | | | |
| | | | | | | | | | | | | | |
| *OPENFIN - LOW* | | 0.76 | | | | | | 0.75 | 0.77 | 0.78 | 0.77 | | |
| *OPENFIN - MID* | | | 0.86 | 0.79 | 0.83 | 0.91 | 0.79 | | | | | | |
| *OPENFIN - HIGH* | 1.43 | | | | | | | | | | | 1.43 | 1.40 |
| *OPENTRADE - HIGH* | 2.03** | | 1.74** | 1.51 | 1.83** | 1.94** | 2.04** | 1.53 | 1.32 | 1.54 | 1.21 | 1.48 | 1.27 |
| | | | | | | | | | | | | | |
| *IT* | 17.35*** | 11.71** | 13.31** | 10.81** | 14.68** | 15.97** | 13.22** | 17.66*** | 14.71** | 13.75** | 12.78** | 17.12** | 14.11** |
| *EXCHREG* - HIGH | 1.48 | 1.28 | 1.35 | 1.39 | 1.52 | 1.6 | 1.53 | 2.05** | 1.82** | 1.67* | 1.66* | 2.01** | 1.77* |
| | | | | | | | | | | | | | |
| *FINDEV - LOW* | 2.04*** | 1.93** | 1.99** | | | 1.99** | 1.91** | 2.05*** | 2.11*** | 1.90** | 2.15*** | | |
| *FINDEV - MID* | | | | 0.72 | 0.50** | | | | | | | 0.49** | 0.47*** |
| *FINDEV - HIGH* | | | | | 0.53* | | | | | | | 0.50* | 0.49* |
| | | | | | | | | | | | | | |
| *N* | 372 | 374 | 372 | 372 | 372 | 373 | 372 | 372 | 372 | 373 | 373 | 372 | 372 |

Table 7: ODDS RATIOS FROM LOGIT ESTIMATES OF COUNTERCYCLICAL MONETARY POLICY FUNCTION

| Variable | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) | (11) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| $INF$ - LOW | 1.83** | 1.79** | 1.88** | | | | 1.82** | 1.89** | 1.81** | | 1.92** |
| $INF$ - MID | | | | 0.62* | 0.64* | 0.59** | | | | 0.65* | |
| $FXR2GDP$ - HIGH | 1.72** | 1.85** | 1.75** | 1.96** | 1.94** | 1.77** | 1.82** | 1.81** | 1.89** | 2.05** | 1.82** |
| $CGD2GDP$ - LOW | | 0.83 | | | 0.74 | | 0.77 | | 0.79 | 0.75 | |
| $CGD2GDP$ - MID | | | | | | 1.15 | | | | | 1.11 |
| $CGD2GDP$ - HIGH | 1.02 | | 1.03 | 1.12 | | | | 1.07 | | | |
| $STDT2FXR$ - LOW | 1.13 | | 1.14 | | 1.26 | 1.26 | 1.16 | | | | 1.12 |
| $STDT2FXR$ - MID | | 0.92 | | 0.86 | | | | 0.90 | 0.90 | 0.86 | |
| | | | | | | | | | | | |
| $OPENTRADE$ - LOW | | | | | | 0.66* | | | | | |
| $OPENFIN$ - MID | | 0.90 | 0.86 | | 0.86 | 0.87 | | 0.87 | | | |
| $OPENFIN$- HIGH | | 1.02 | | 1.10 | | | 1.04 | | 1.04 | 1.10 | 1.00 |
| | | | | | | | | | | | |
| $IT$ | 7.70* | 8.08* | 7.76* | 12.49** | 12.26** | 11.72** | 10.00** | 9.53** | 10.24* | 12.92** | 8.90* |
| $FINREF$ - MID | | | | | | | 0.98 | | 0.98 | | |
| $FINREF$ - HIGH | 2.70*** | 2.72*** | 2.71*** | 2.56*** | 2.59*** | 2.54*** | 2.64** | 2.71*** | 2.67** | 2.58*** | 2.66*** |
| $FINDEV$- LOW | 1.73 | 1.75 | 1.73** | 1.77** | 1.77** | 1.85** | 1.83** | 1.81** | 1.87** | 1.86** | 1.82** |
| $FINDEV$ - MID | 0.94 | 0.97 | | | | | | | | | |
| $PEG$ | 1.33 | 1.33 | 1.30 | | | | | | | | |
| $FLOAT$ | | | | 0.52* | 0.51* | 0.50* | 0.60 | 0.62 | 0.59 | 0.51* | 0.65 |
| $N$ | 476 | 463 | 463 | 463 | 463 | 463 | 463 | 463 | 463 | 463 | 463 |

# Final Remarks

- Good question, stimulating paper
- May want to think more about identification and how to discriminate between alternative hypotheses
- More discussion of the econometrics would help