

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

A presentation prepared for the 2nd BIS CCA Conference on
“Monetary policy, financial stability and the business cycle”

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* This presentation reflects the views of the author and not necessarily those of the BIS or of central banks participating in the meeting.



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

**2nd BIS Consultative Council for the Americas Conference on
“Monetary Policy, Financial Stability, and the Business Cycle”**

May 13, 2011

Dr. Brahim Coulibaly

Division of International Finance
Board of Governors of the Federal Reserve System

Motivation

- Emerging Market Economies (EMEs) loosened MP during the recent global financial crisis
- Departure from previous crisis episodes when they had to raise interest rates to: *defend exchange rate*, *bolster policy credibility*, *contain capital flight*...
- Is this shift signaling that MP in EMEs are evolving to become countercyclical? Is this a unique/transitory experience?

Procyclical Policies in EMEs

- EMEs more volatile=> Significant welfare loss. Historically MP and FP procyclical in EMEs unlike in AEs
- Procyclicality FP documented e.g. Gavin and Perotti (1997), Talvi and Vegh (2004) etc.
- Studies on cyclicity of MP is sparse. Kaminsky and Reinhart (2004), Calderon et al. (2003).
- This study looks at factors affecting MP in the context of crises generally & the 08-09 crisis in particular



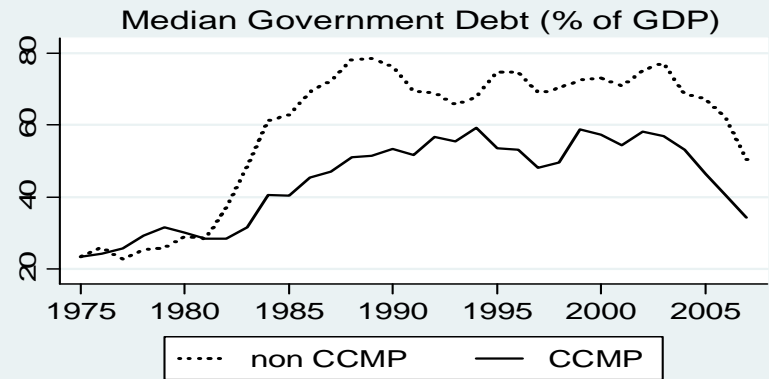
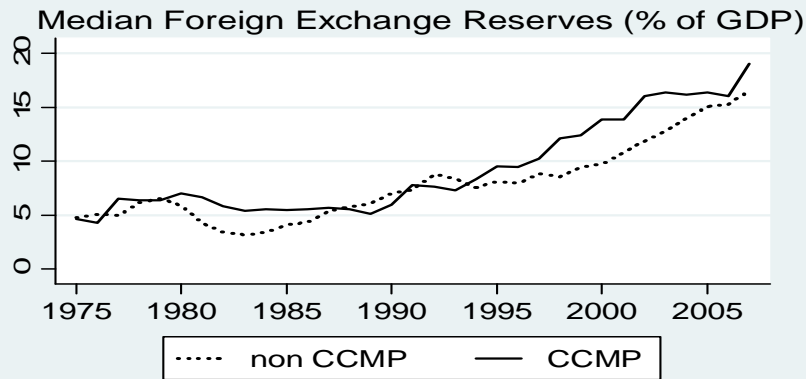
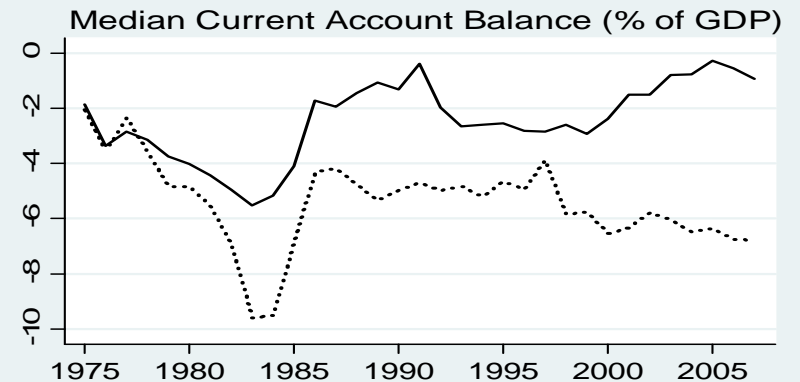
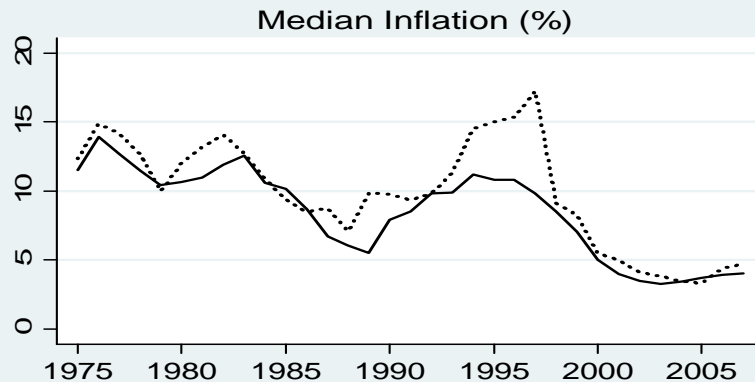
MP in EMEs during the 2008-09' Crisis?

- Of the 132 EMEs in our sample, about 80 percent lowered rates on net at the height of the crisis between early 2008:Q3 and end 2009:Q1

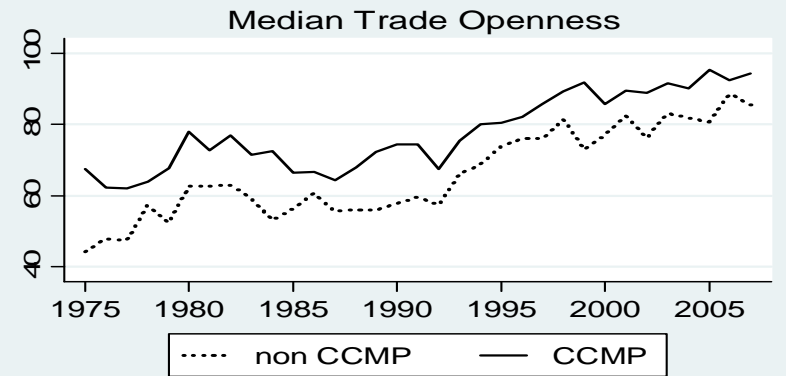
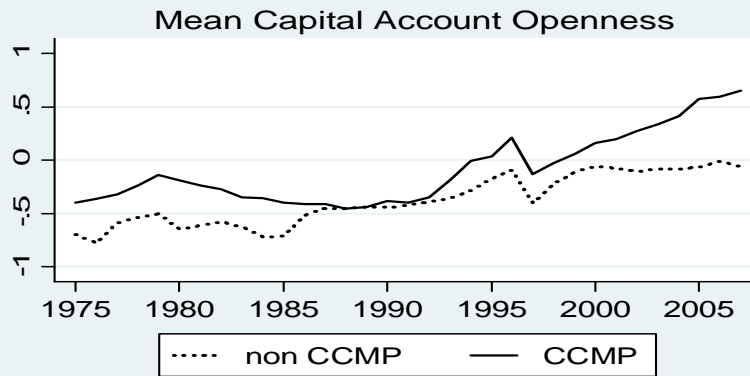
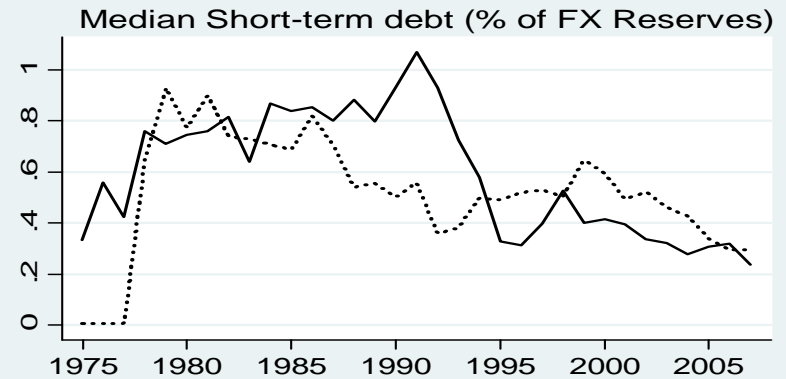
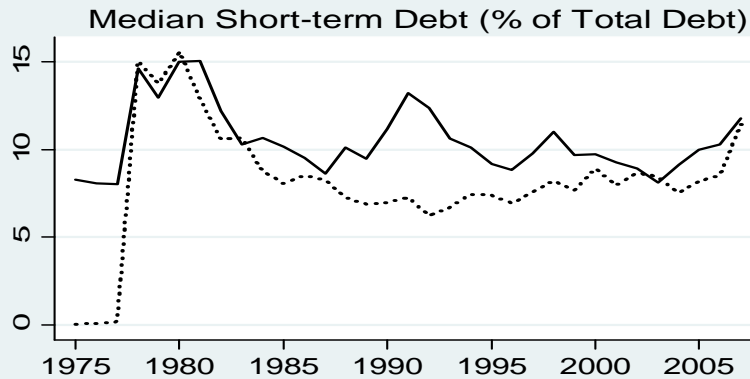
- This study: Explores the factors that influenced ability to conduct CCMP:
 - Macroeconomic fundamentals & vulnerabilities
 - Openness
 - Exchange rate regime and MP policy framework
 - Financial reform and development



Difference b/w CCMP & Non-CCMP (1)

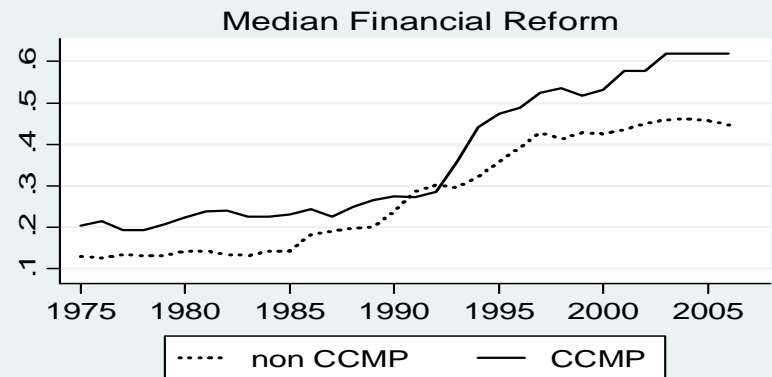
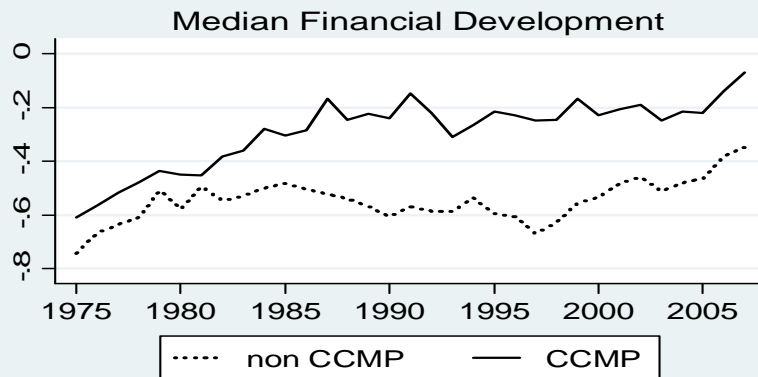
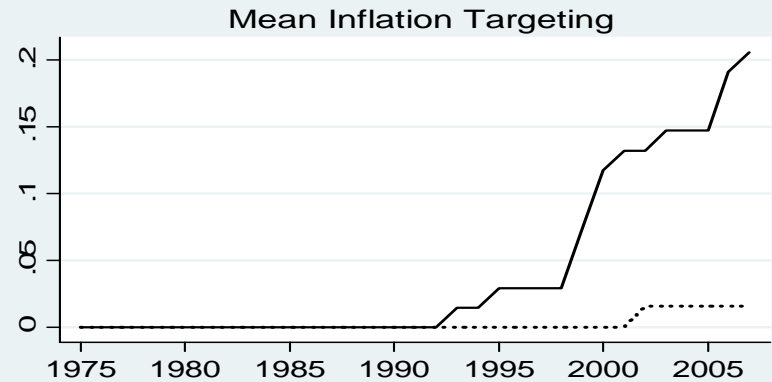
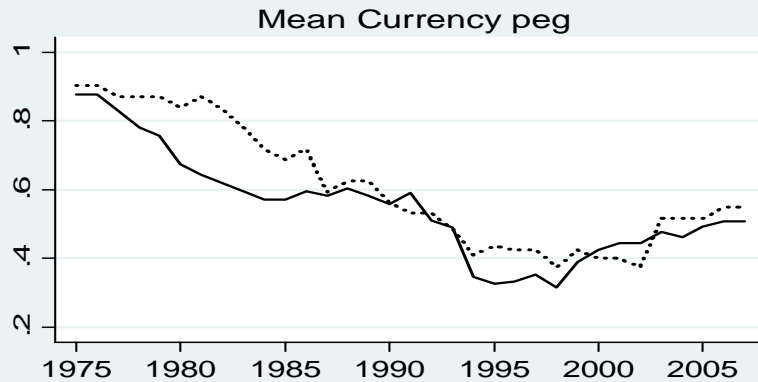


Difference b/w CCMP & Non-CCMP (2)





Difference b/w CCMP & Non-CCMP (3)





LOGIT REGRESSION

	Coef.	P-Value	Odds-Ratio	Nobs
INF – HIGH	-0.82	0.063	0.44	130
CGD2GDP - LOW	0.82	0.056	2.26	126
CAB2GDP – HIGH	1.24	0.006	3.46	118
FXR2GDP – HIGH	0.64	0.120	1.89	126
STDT2EXTDT – LOW	-0.51	0.307	0.60	102
STDT2FXR- HIGH	-0.33	0.486	0.72	102
OPENFIN – HIGH	1.11	0.013	3.03	126
OPENTRADE – HIGH	0.90	0.042	2.45	122
EXCH. REG. - FLOAT	0.62	0.305	1.83	129
INFLATION TARGETING	2.03	0.010	7.58	132
FINREF – HIGH	1.40	0.004	4.04	117
FINDEV – HIGH	0.57	0.165	1.76	122



LOGIT REGRESSION

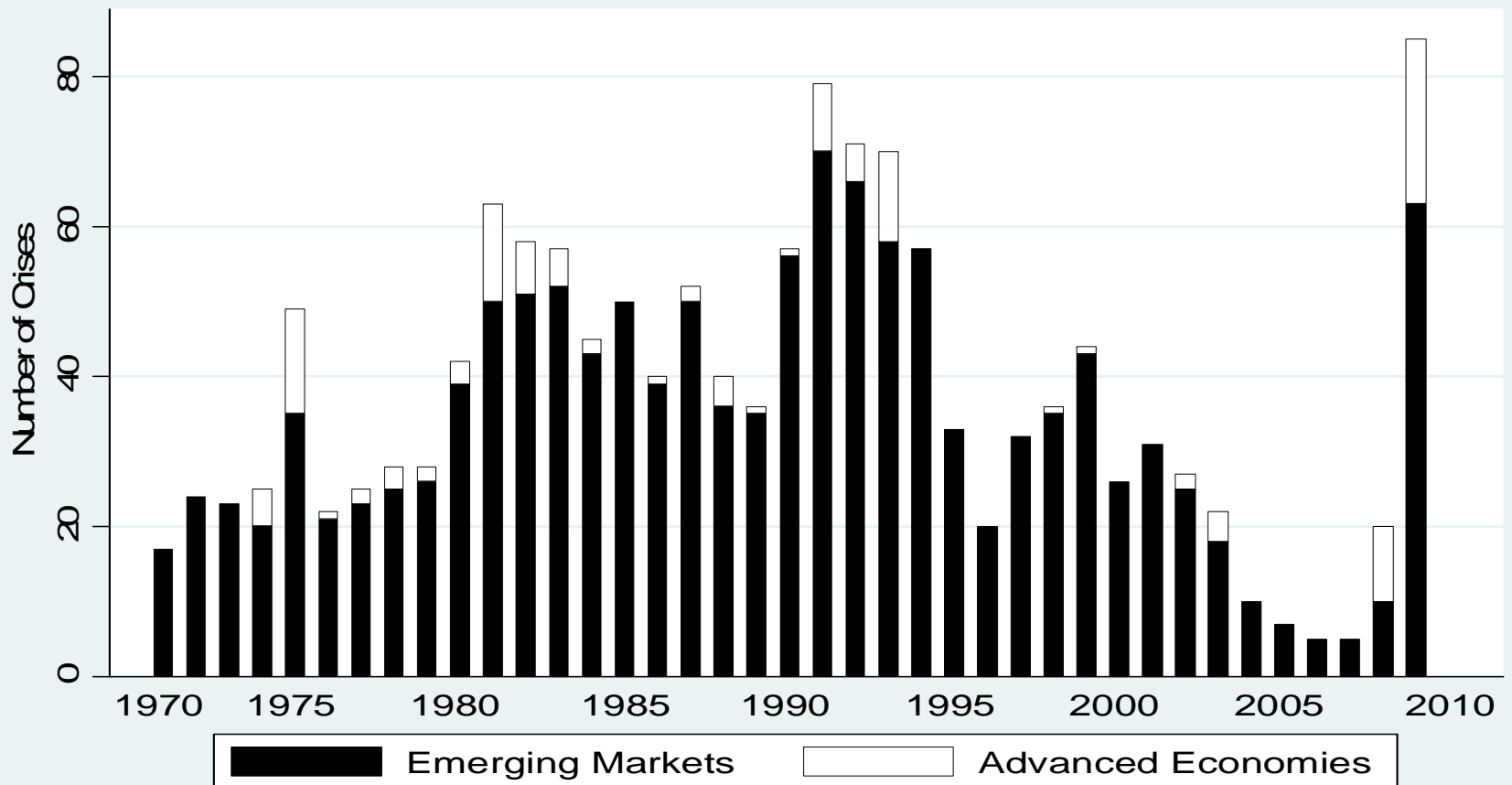
	(1)	(2)	(3)	(4)	(5)	(6)
<i>CAB2GDP</i> - LOW	0.38*	0.22**	0.37*		0.20**	0.28*
<i>CGD2GDP</i> - LOW				8.52**		
<i>CGD2GDP</i> - MID				3.50*		
<i>CGD2GDP</i> - HIGH	0.30*	0.20**	0.28*		0.17**	0.20**
<i>STDT2EXTDT</i> - LOW	0.53					
<i>STDT2EXTDT</i> - MID						
<i>STDT2EXTDT</i> - HIGH						1.24
<i>STDT2FXR</i> - LOW			0.58	1.49		
<i>STDT2FXR</i> - MID				3.87*		
<i>STDT2FXR</i> - HIGH		0.49			0.59	
<i>OPENFIN</i> - LOW	1.13	3.46	1.19	1.44	7.94**	1.45
<i>OPENFIN</i> - MID	0.17**	0.47	0.18**	0.17**		0.21**
<i>OPENFIN</i> - HIGH					2.68	
<i>IT</i>	8.89**		8.95**	8.81*	5.24	11.50**
<i>FINREF</i> - LOW	0.13**	0.07***	0.12**	0.08***		0.13**
<i>FINREF</i> - MID					10.80**	
<i>FINREF</i> - HIGH		8.17**			45.78**	
<i>FINDEV</i> - LOW				0.78		
<i>FINDEV</i> - HIGH					2.90	3.12*
<i>N</i>	88	88	88	90	87	87



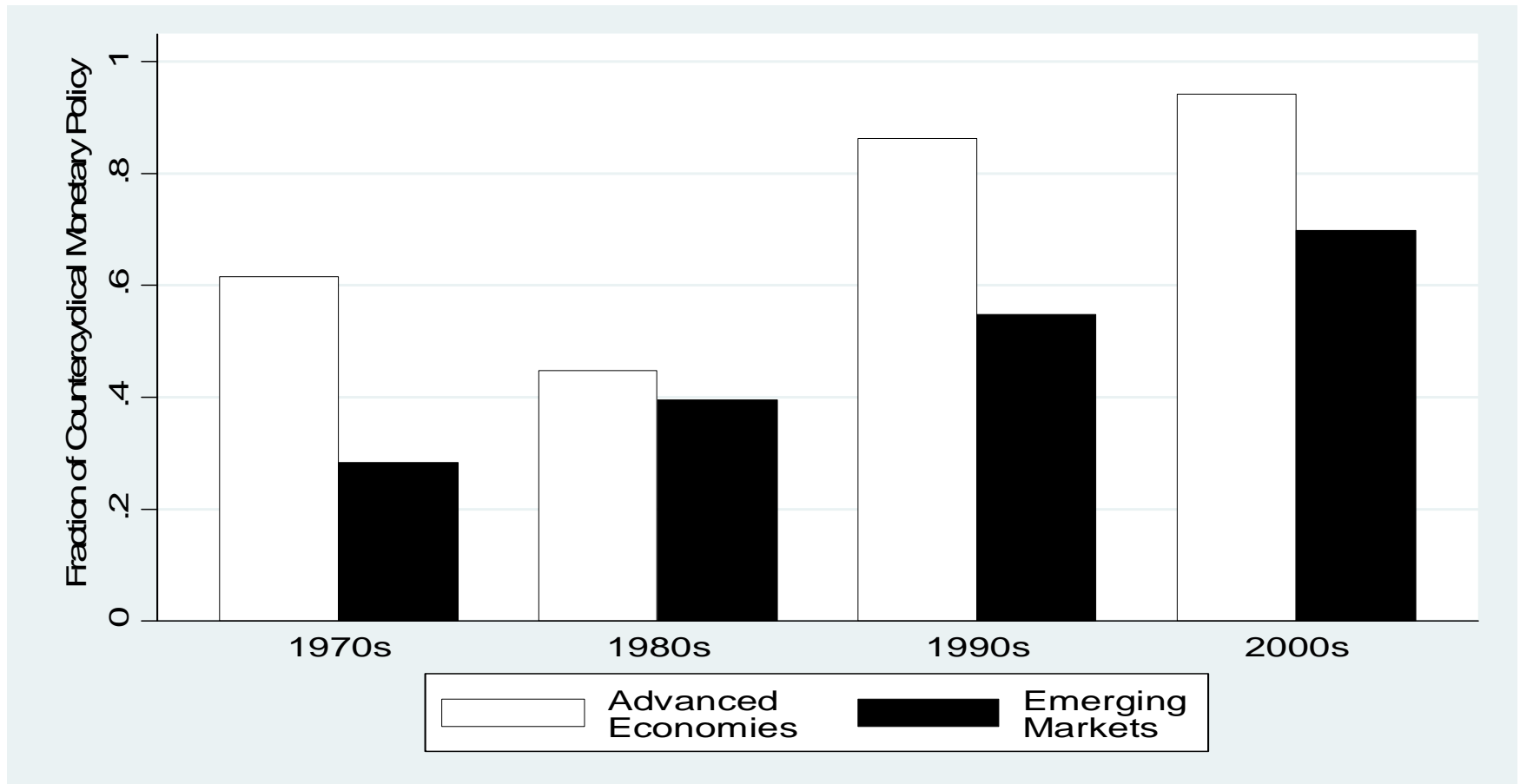
Beyond the recent crisis

- Construct a panel dataset of both EMEs and AEs 1970-2009, annual frequency
- Crisis: Period of sharp and unusual exchange rate depreciation, negative or zero GDP growth

Timeline of Crises in Panel Data



Countercyclical Monetary Policy: AEs vs. EMEs



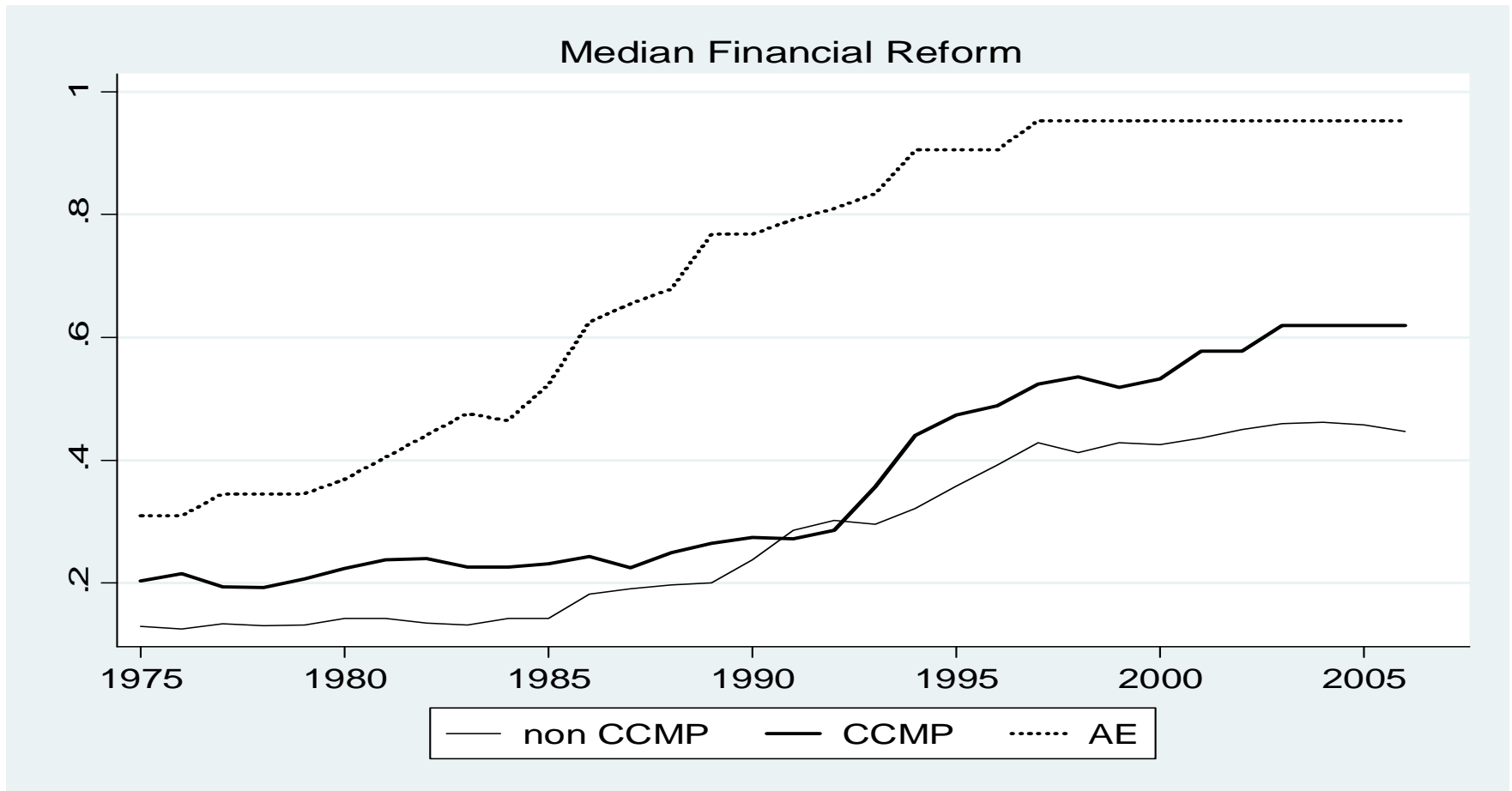


LOGIT REGRESSION

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



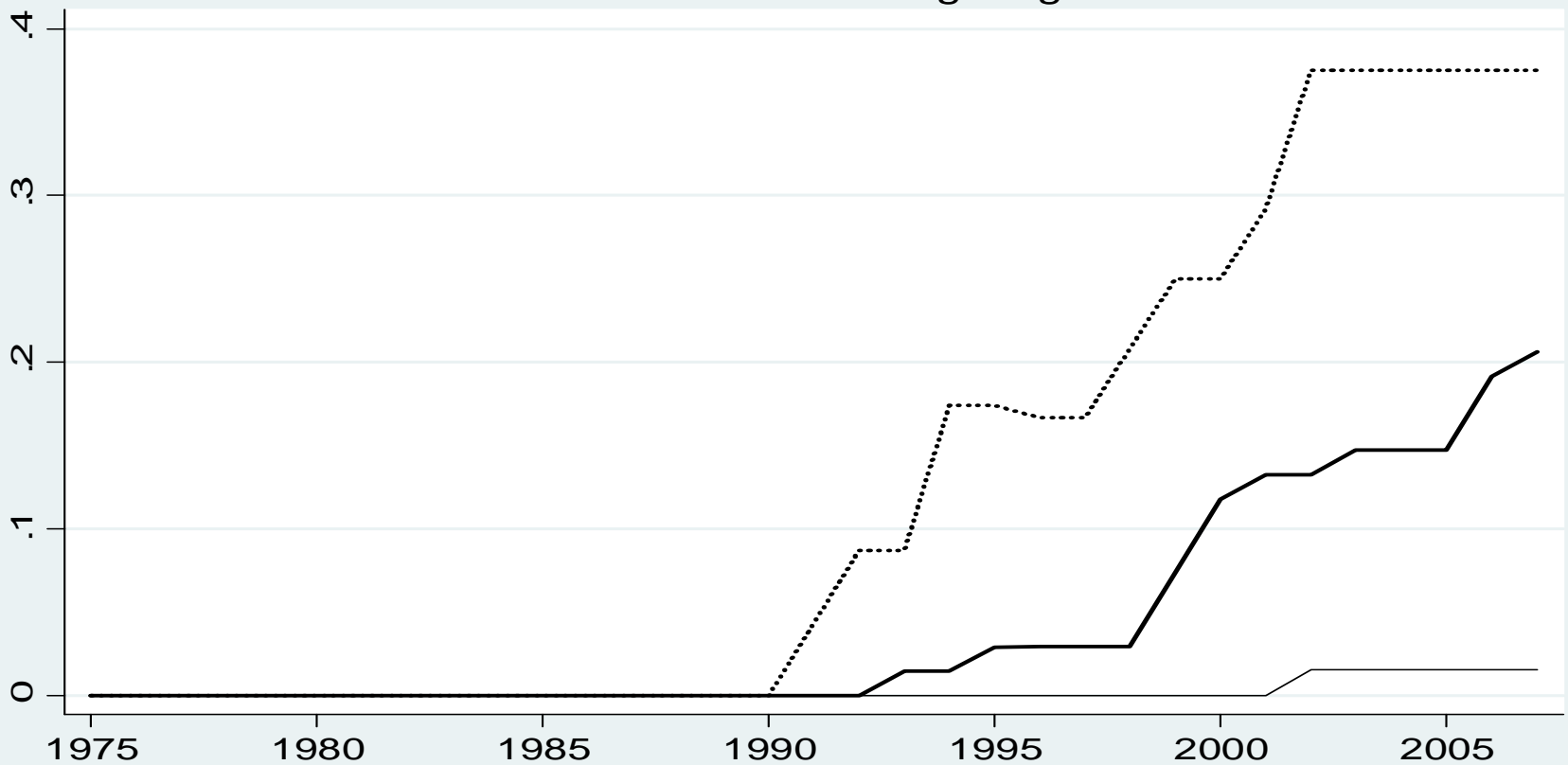
Financial Reforms: AEs vs. EMEs





Financial Reforms: AEs vs. EMEs

Mean Inflation Targeting





Concluding Remarks

- Conduct of countercyclical MP is possible for EMEs

- For that, EMEs have to:
 - Maintain strong macroeconomic fundamentals
 - Reduce vulnerabilities
 - Continue financial reforms (persistent)
 - Improve MP frameworks (IT good track record)

- Could help explain increasing resilience of EMEs to shocks in AEs despite greater integration between the two sets of countries?



Inflation Targeting and Financial Reforms

□ **Financial Reforms**

- Credit & interest rate control
- Barriers to entry in domestic financial system
- State ownership in banking sector
- Capital account restrictions
- Regulation and Supervision of banking sector (-)
- Securities market policy

□ **Inflation Targeting**

- Anchoring of inflation expectations
- Flexibility of MP

Disclaimer

Views Represented

Coulibaly



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