Discussion of: Assessing the Effect of U.S. Monetary Policy Normalization on Latin American Economies

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Summary of Paper

Question: As conventional and unconventional monetary policy in the United States normalizes, what will be the impact on Latin American economies?

- This paper studies this question separately for four Latin American countries: Chile, Columbia, Mexico, Peru.
- Effects are studied for output growth, inflation, credit growth, exchange rates and interest rates

Summary of Paper

Empirical Strategy:

- SVAR analysis
- SVAR is block exogenous with a U.S. block and a Latin American country block.
- Three shocks are identified: U.S. Monetary Policy Shock, U.S. Demand Shock, U.S. Supply Shock.
- A combination of short-run restrictions and sign restrictions are used to identify the shocks.
- Conventional and unconventional monetary policy is captured by using the Wu-Xia shadow federal funds rate and a restricted estimation period (August 2007 - September 2016).

Summary of Paper

Impulse response functions suggest that U.S. monetary tightening will yield the following effects in Latin American economies:

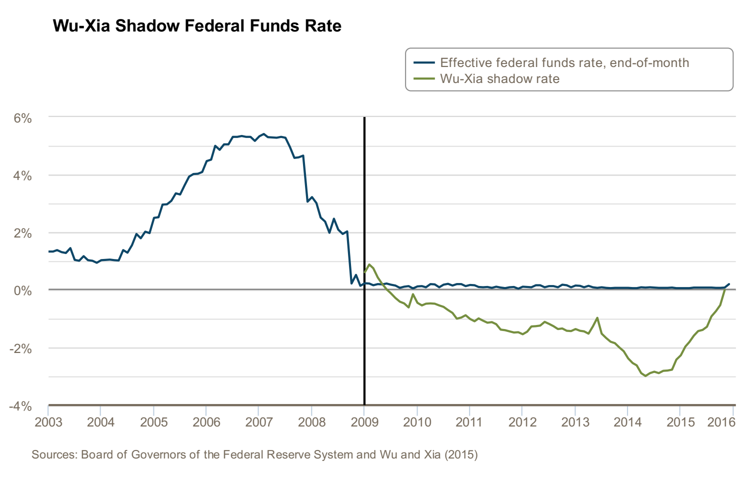
- An increase in inflation (exceptions: Peru (long run) Mexico (short run))
- A decline in output growth (exception: Columbia)
- Mixed effects on interest rates
- A nominal currency depreciation (exception: Columbia)
- An aggregate credit contraction

Discussion and Comments

Conventional and Unconventional Policy

- This paper tells us the effect that U.S. shadow rate shocks, identified over the period 2007-2016, have on Latin American macroeconomic variables.
- How does this speak to normalization of both conventional and unconventional policy measures (federal funds, forward quidance and QE)?
- Justification:
    - The shadow rate accurately represents both conventional and unconventional policy.
    - Estimation over the restricted time period prevents bias from including data over periods without unconventional policy.

Discussion and Comments



Discussion and Comments

Conventional and Unconventional Policy

- Focusing on the shadow rate is a simple approach to measure the effects of policy normalization. This simplicity is appealing.
- However, I found myself wanting a richer picture of normalization that could be obtained from identifying other shocks related to unconventional monetary policy: e.g. term compression shocks.
- Done properly, this could allow us to ask how conventional vs. unconventional monetary policy normalization may affect Latin American countries differently.

Discussion and Comments

Sample Period

- The restricted sample period is motivated by a desire to zero in on the period of unconventional policy.
- However, this comes with typical costs associated with short sample periods and highly parameterized models: 1) Estimation Uncertainty and 2) Questionable Identification.
- An appealing feature of the Wu-Xia shadow rate is its continuity with the pre-ZLB funds rate.
- Did this paper give up on a longer sample too easily? One approach would be to include longer samples, and test for structural changes over the ZLB period.

Discussion and Comments

Asymmetry?

- Unconventional monetary policy actions taken during the sample period were in a regime where:
  1) The U.S. economy was far below potential.
  2) U.S. interest rates were at the ZLB.
- However, normalization will occur largely when the U.S. economy is near potential and away from the ZLB.
- The effects of monetary policy on the U.S. economy may be asymmetric with respect to these regimes. For example, policy actions taken when the economy is near potential have empirically smaller output effects (pushing on a string).
- As a result, spillover effects are likely to be different.
- A longer sample would again be helpful here, in that asymmetries could be incorporated.

Discussion and Comments

What will Normalization Look Like?

- We have been shown the predicted effects of an unanticipated U.S. monetary tightening on Latin American economies.
- But what have we learned about the likely effects of the upcoming normalization episode?
- The total effects of the normalization episode will depend on many things, including:
  - What is the new normal?
  - How much of future normalization is already reflected in macroeconomic variables?
- Some attention to these issues would strengthen the analysis.