AE monetary policy and EMs

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Spillovers and the need for rules?

- Too much loose talk.
- Nearly all macroeconomic policies have spillovers.
- Spillovers do not imply a need for coordination.
- Nash equilibrium. Two targets, two instruments.
  - \((Y, e)\) with \((r, G)\)
- Need to justify why this is not the case.
Effects of capital inflows

Three main effects, given EM policy:

• Exchange rate appreciation. Trade balance

• Exchange rate appreciation. Valuation effects.
  • A function of FX position for assets/liabilities

• Decrease in spreads, increase in asset prices
  • A function of the type of inflows

First negative, second ambiguous, third favorable
Effects of AE monetary policy on flows

Far from obvious, theoretically and empirically

- Theoretically: Incipient inflows.
  - More likely to lead to movement in e, without flows. “No trade” theorem.
  - To get actual flows: Need a difference of opinions across foreign/domestic investors.

- Empirically. Varies a lot. Seems to depend on effect on market risk aversion/VIX

- Explains the complaints against movements both ways.
Rules of the game?

• Skeptical about scope for deviation from Nash, re: monetary policy

• Empirically: For 15 years, empty calls for cooperation at G20 meetings

• Instead: Use macroprudential tools/capital controls on specific inflows.

• Work on the appropriate combination of m policy/FX intervention/macro pru/capital controls.

• Role of the Fund. Help design those tools.