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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.

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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.