International Monetary Fund
May 2017

International Dimensions of Monetary Policy

Eighth BIS CCA Research Conference

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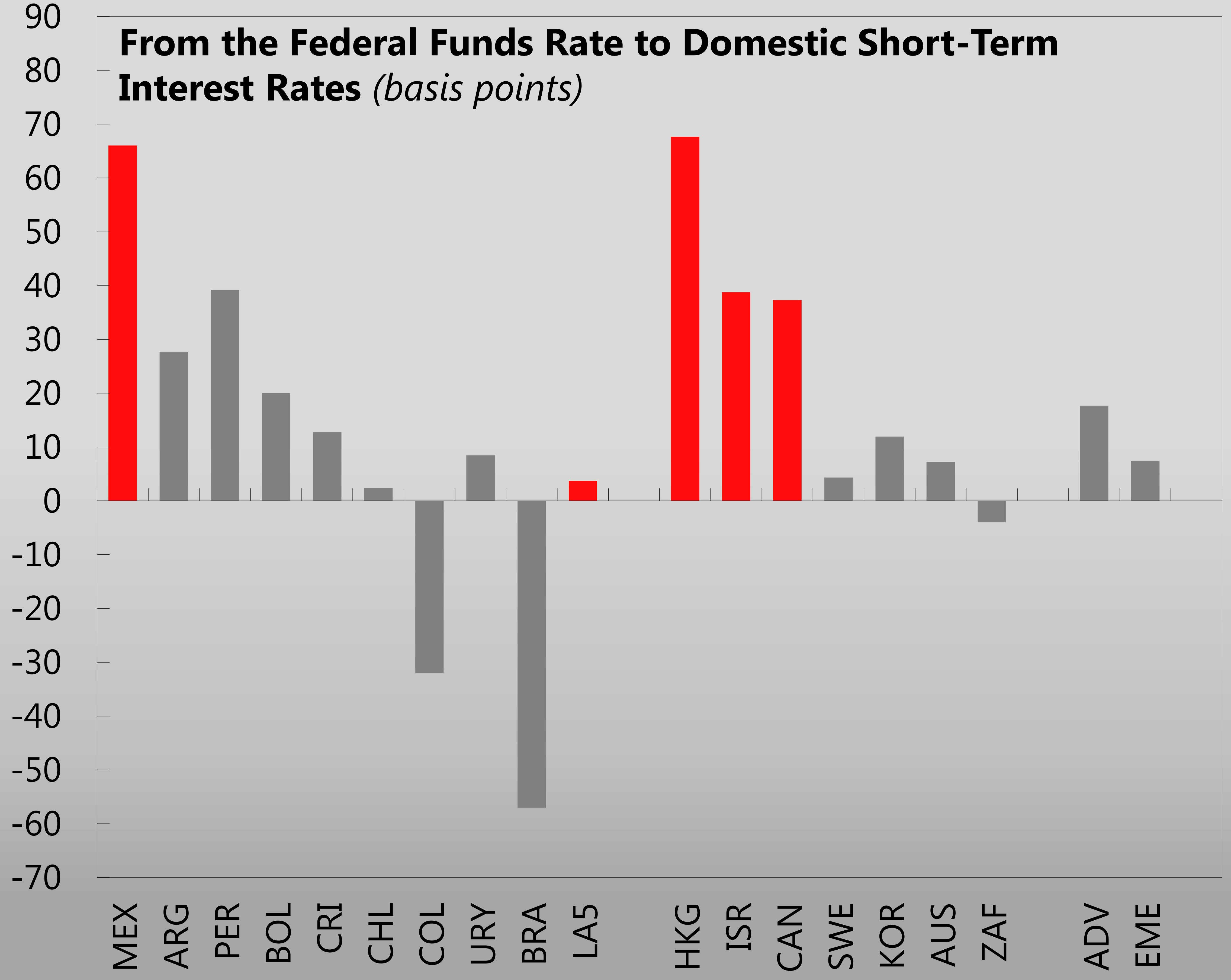
Presentation Outline

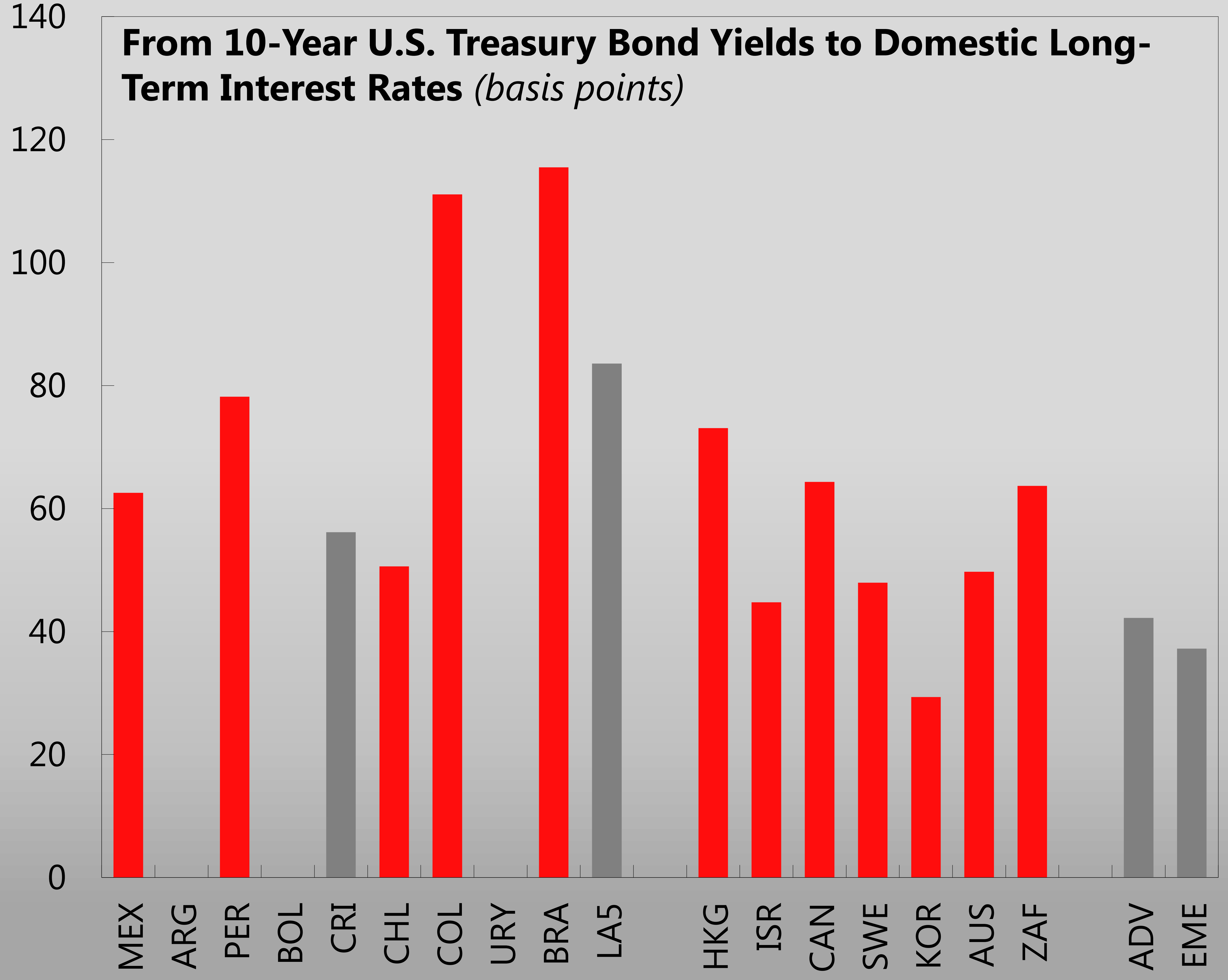
- Spillovers to Domestic Interest Rates
- Spillovers to Capital Flows and Exchange Rates
- Financial Stability Issues

Spillovers to short- and long-term interest rates

While the US policy rate changes affect mainly the Mexican and Canadian short-term rates…



… there are significant spillovers from long-term rates across the board.



Source: Carrière-Swallow, Y. and B. Gruss, "Implications of Global Financial Integration for Monetary Policy in Latin America", chapter 4 in Challenges for Central Banking: Perspectives from Latin America.
Note: Responses in basis points following a 100 basis point increase in the corresponding U.S. rate. Red bars mean statistically significant. ADV = advanced economies; EME = emerging market economies; LA5 = Brazil, Chile, Colombia, Mexico, Peru.

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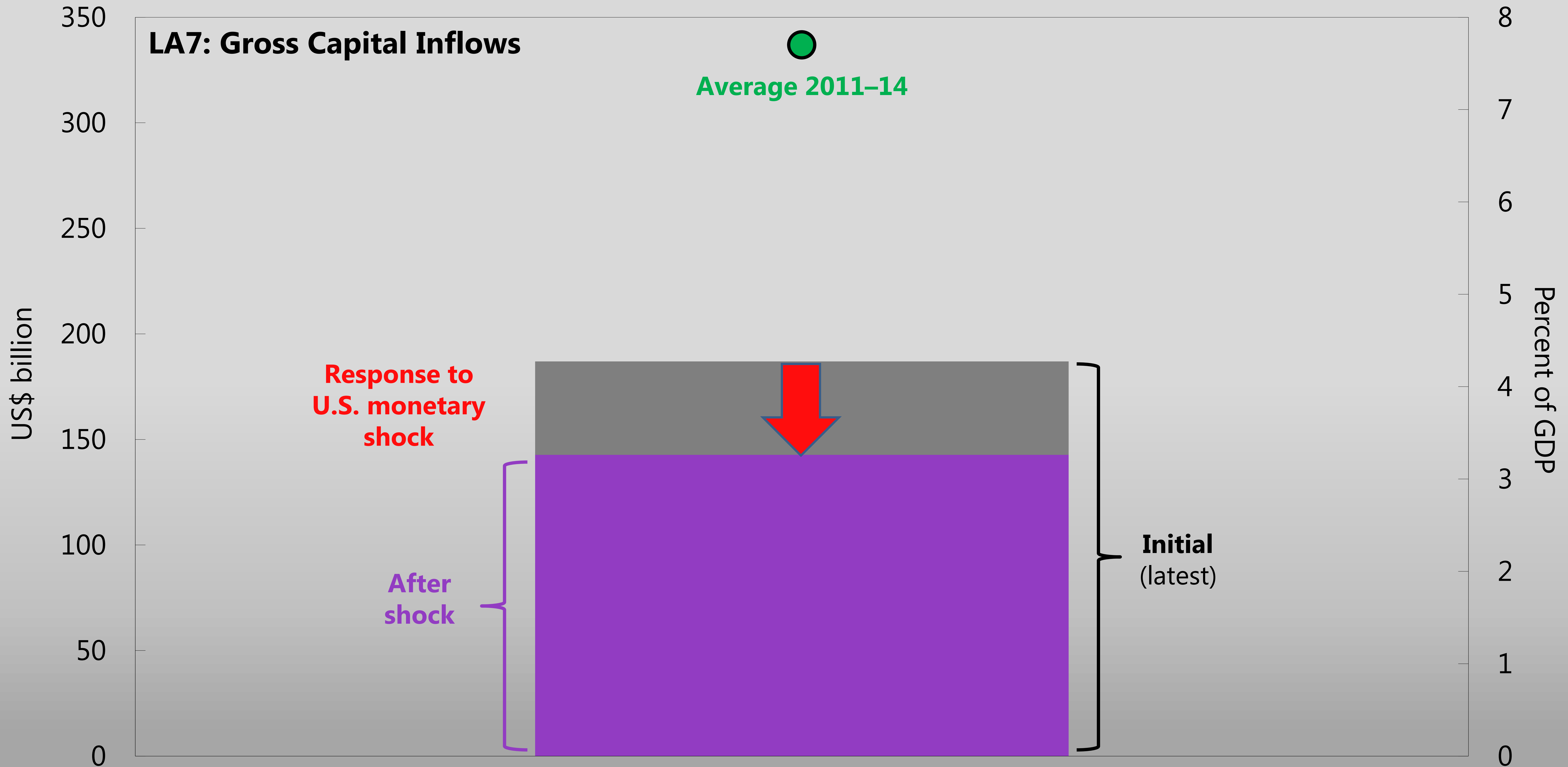
- **Spillovers to Capital Flows and Exchange Rates**
- Financial Stability Issues

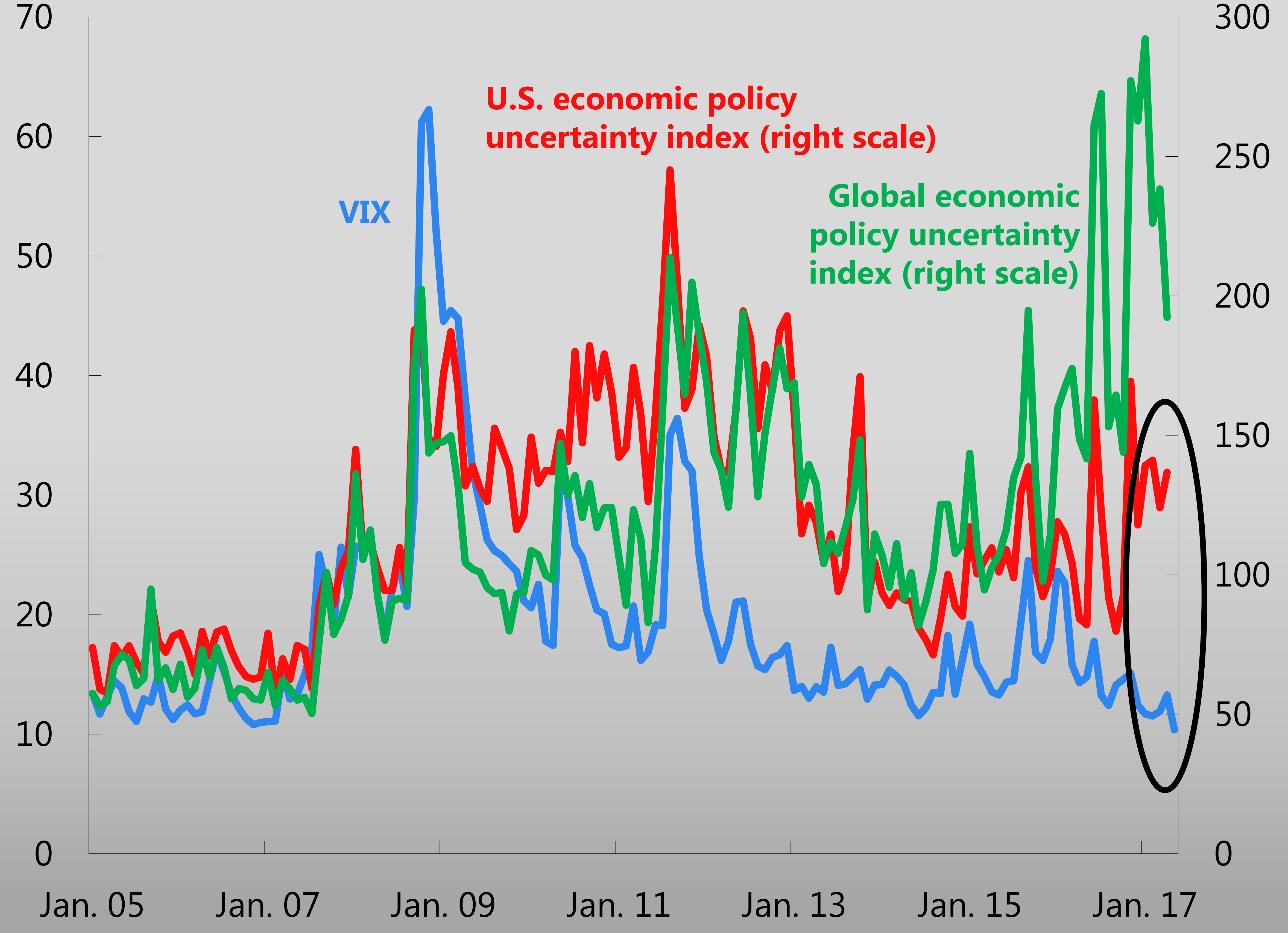
An unanticipated monetary policy tightening in the U.S. could reduce capital inflows to the EMs and Latin America, with implications on the exchange rate



Sources: Haver Analytics; IMF, Balance of Payment Statistics Yearbook database; and IMF staff calculations.
Note: The response to US monetary shock corresponds to the implied change in capital inflows to LA7 countries if US monetary policy tightens unexpectedly by 50 bps. Ratios in percent of GDP refer to trend GDP in U.S. dollars.

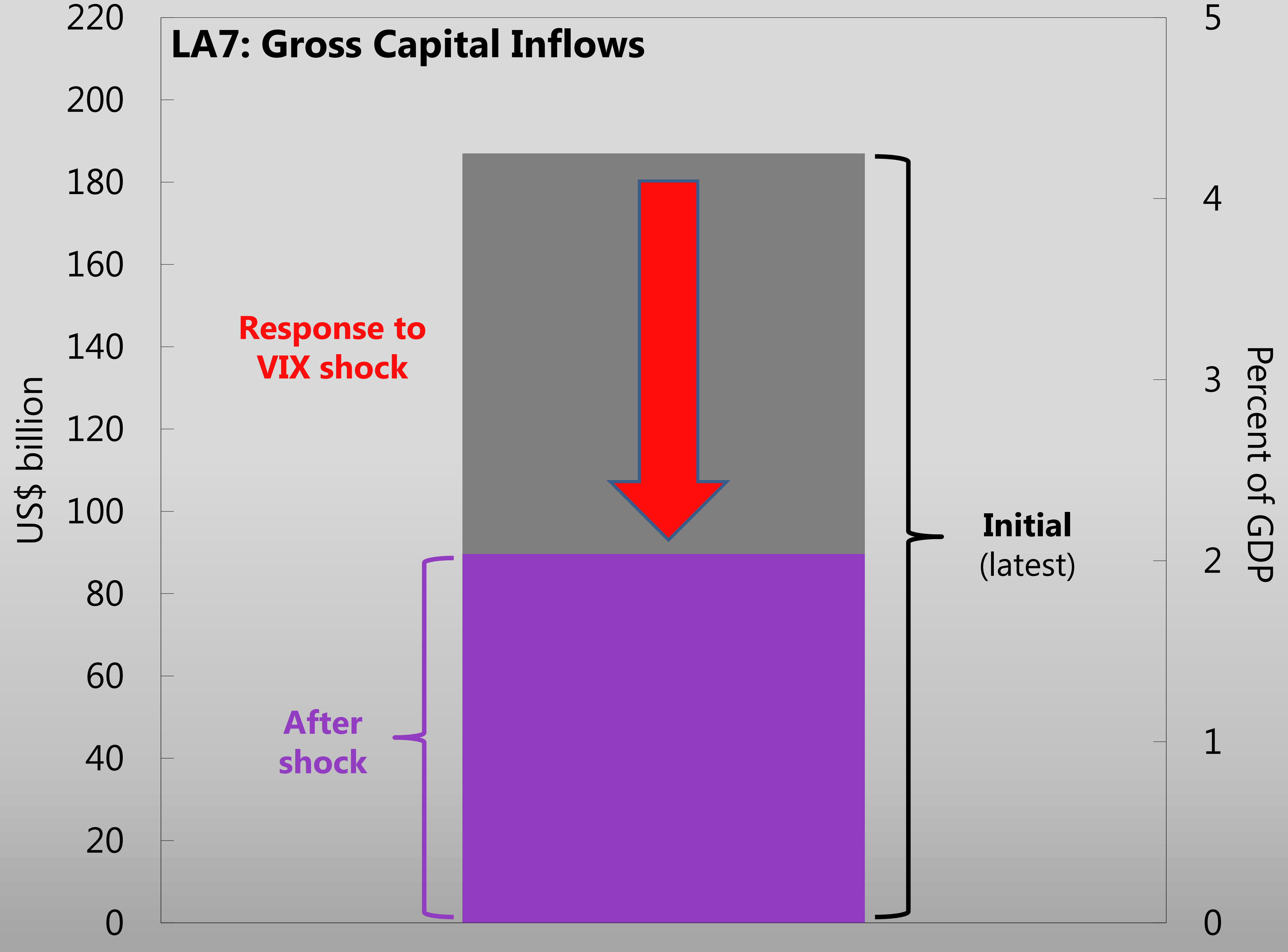
This could be further amplified if market volatility increases from its current depressed levels

Global policy uncertainty have risen noticeably over the past year, seemingly at odds with declining measures of volatility in major equity markets…



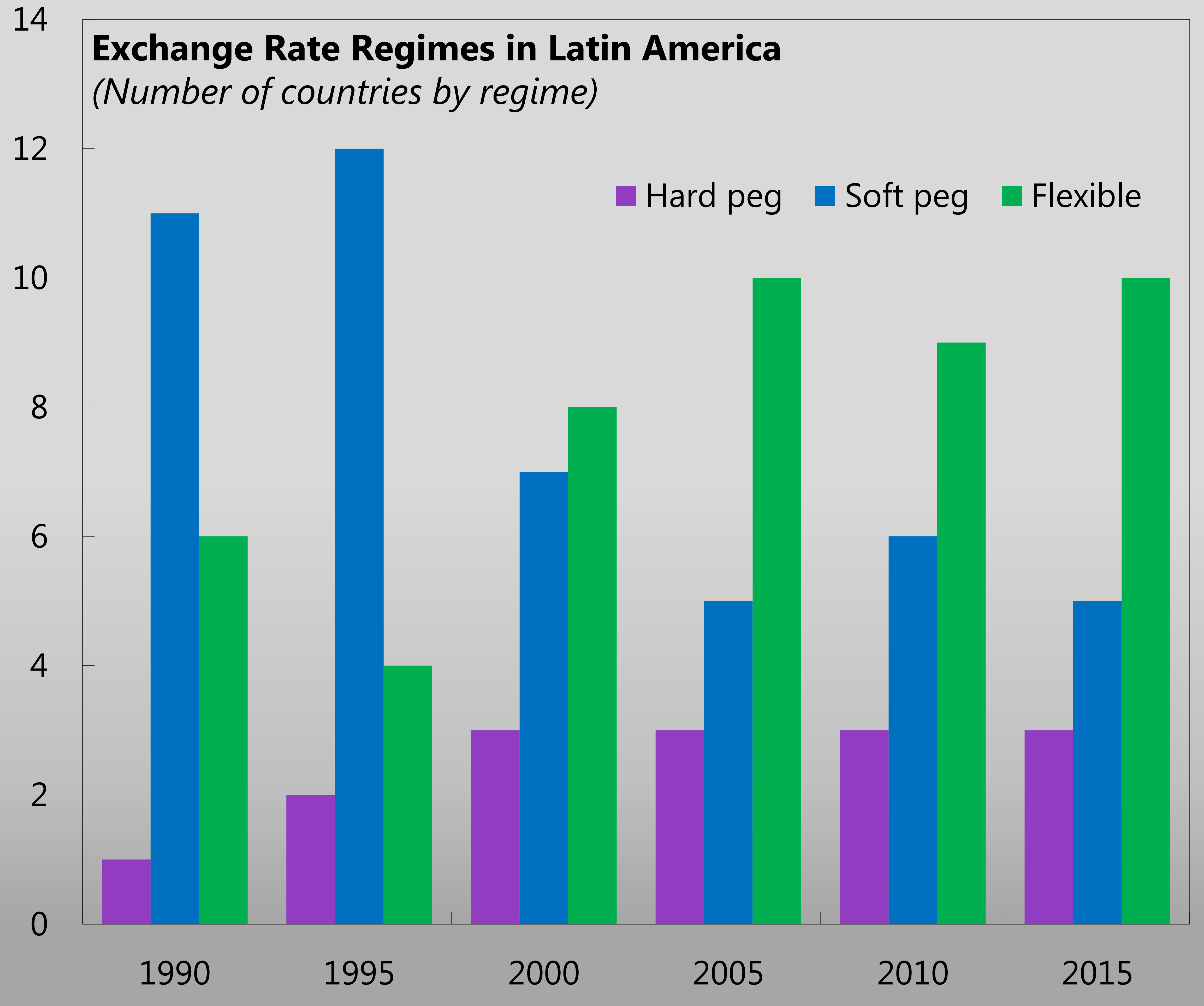
Sources: Bloomberg L.P.; and Haver Analytics;
Note: The economic policy uncertainty index for the United States and Global were developed by Scott Baker and Nicholas Bloom of Stanford University and Steven Davis of the University of Chicago (2012).

… presenting risks to capital flows if market volatility (VIX) catches up with policy uncertainty.

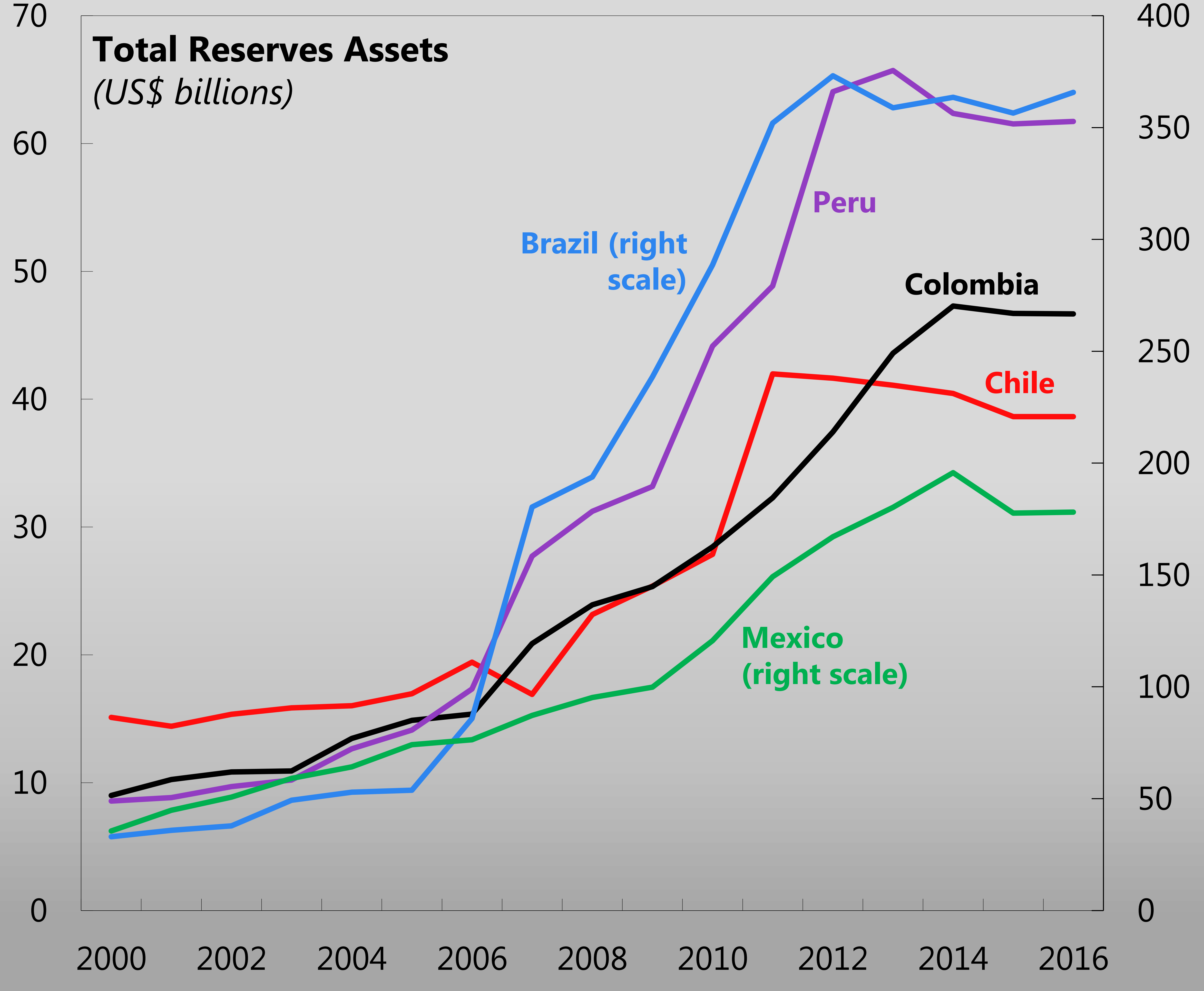


Sources: Haver Analytics; IMF, Balance of Payment Statistics Yearbook database; and IMF staff calculations.
Note: The "response to VIX shock" corresponds to the implied change in capital inflows to LA7 countries if VIX increases to close the gap with the U.S. economic policy uncertainty index (this corresponds to a 10-point shock to the VIX, from its current level ([15] to 25 points). Ratios in percent of GDP refer to trend GDP in U.S. dollars.

Exchange rates would continue to be the first line of defense…



Sources: IMF, Annual Report on Exchange Arrangements and Exchange Restrictions; and IMF staff calculations.

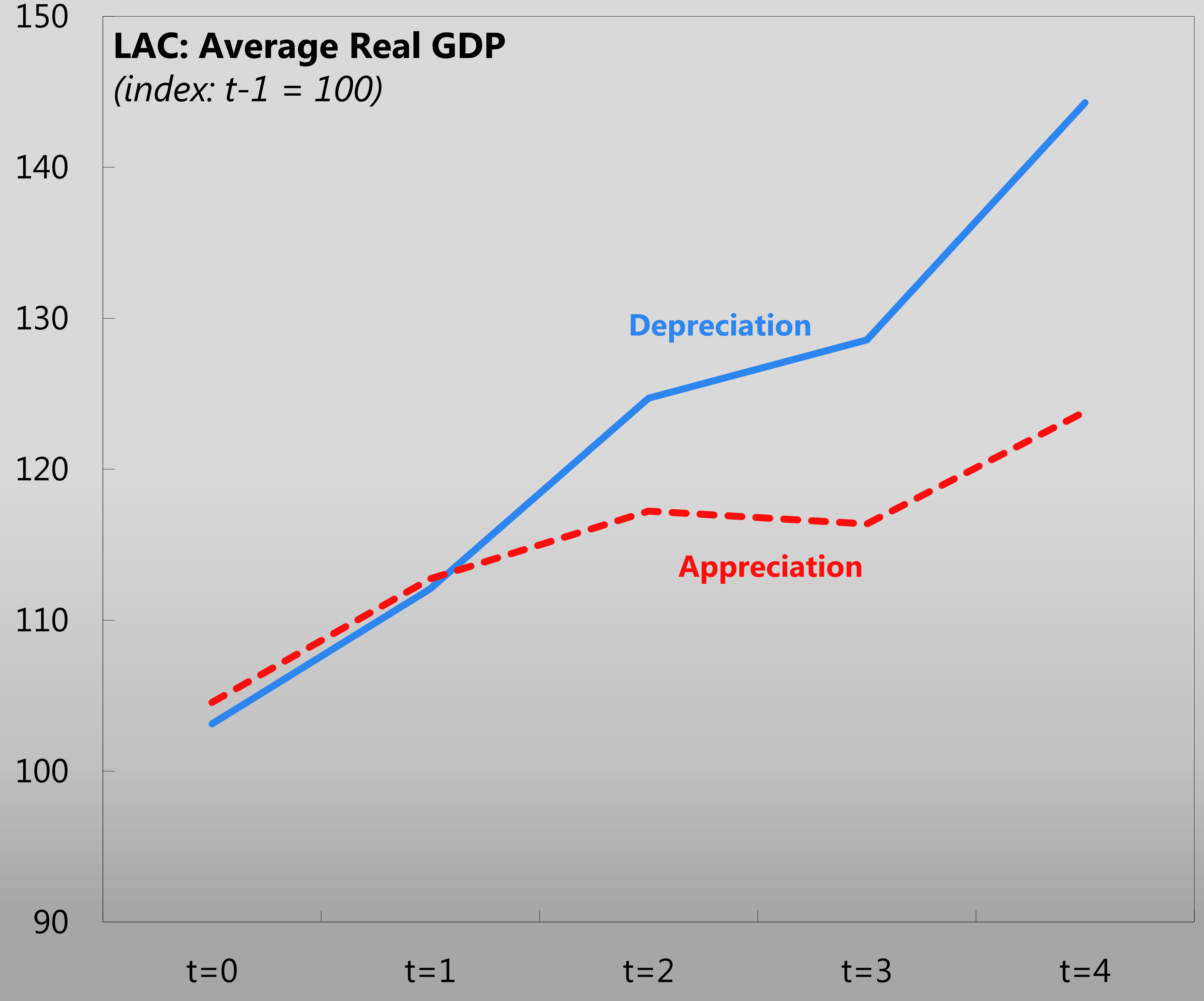


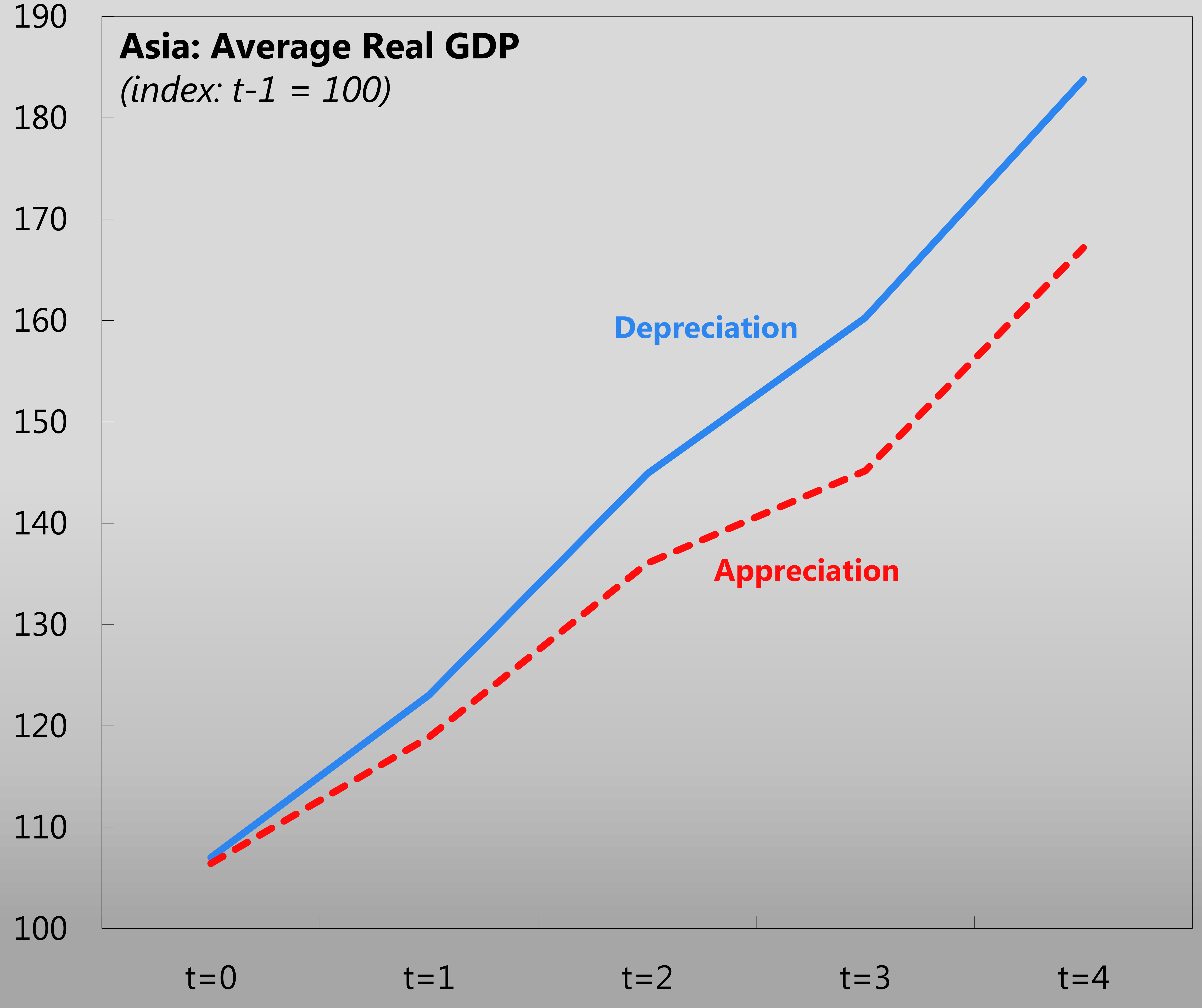
Sources: IMF, World Economic Outlook database; and IMF staff calculations.

…with FX intervention limited to minimizing excess volatility and facilitating smooth transition to permanent shocks

- When coping with inflows and reserve accumulation:
    - Rules-based approach (Colombia and Mexico)
    - Ad-hoc approach
- When coping with outflows/depreciation pressures, largest economies in the region tend to rely on pre-announced rules-based approach for foreign exchange sales
- Announcing the intervention is in principle preferable from a signaling perspective
- Transparent rules can alleviate fears FXI send mixed signals about commitment to inflation target/primacy of inflation objective

More broadly, dollar appreciation episodes are associated with lower EM growth, possibly reflecting negative income effects for commodity exporters and higher costs of imported inputs





Source: Druck, Magud, and Mariscal (2015).
Note: The horizontal axes denote time intervals of dollar appreciation and depreciation cycles of various lengths, sub-divided into four equal parts. These dollar cycles are identified using a regime-switching Markov model. Each cycle is between 3 and 9 years in length. In the source paper, similar charts are shown for other regions.

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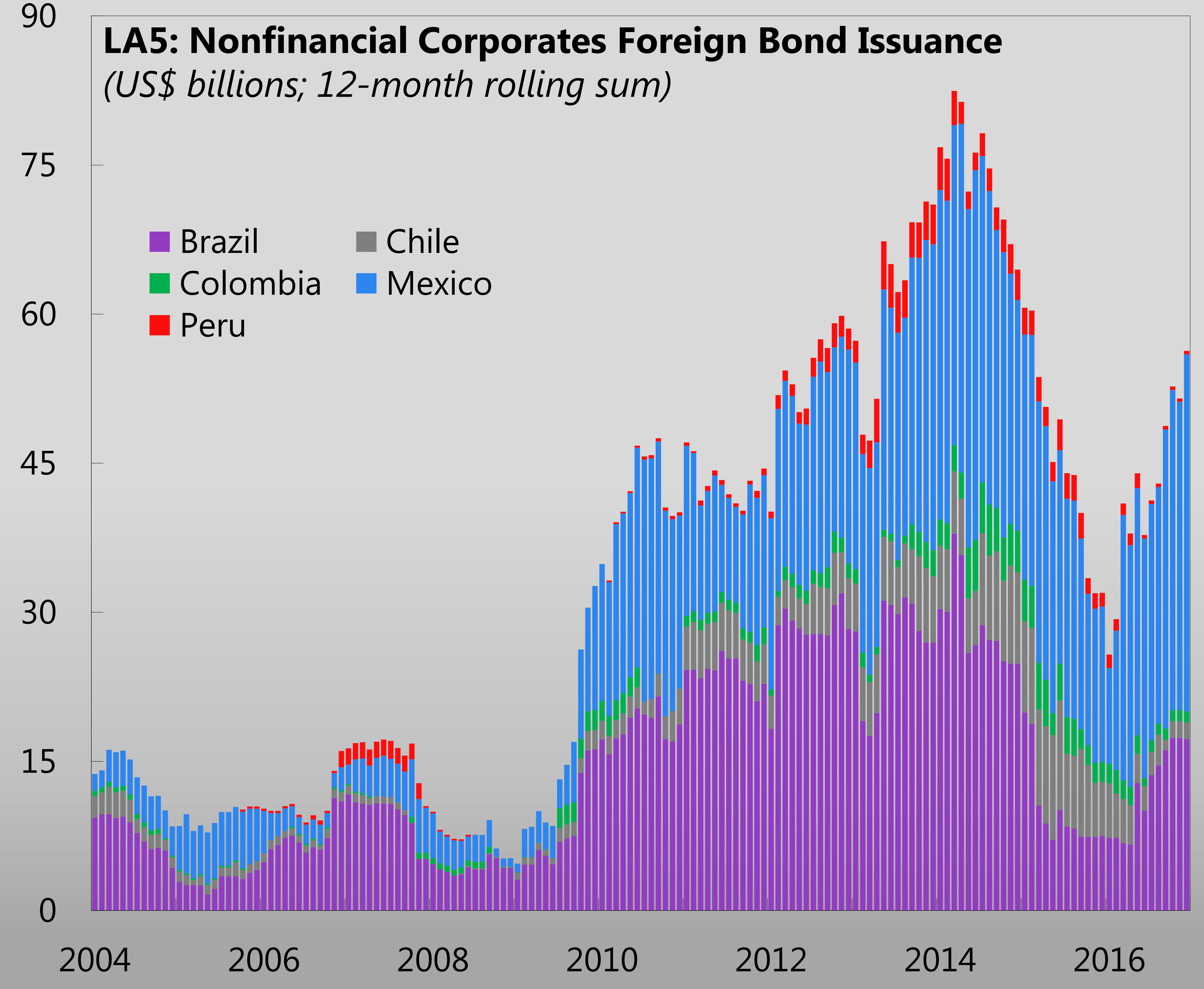
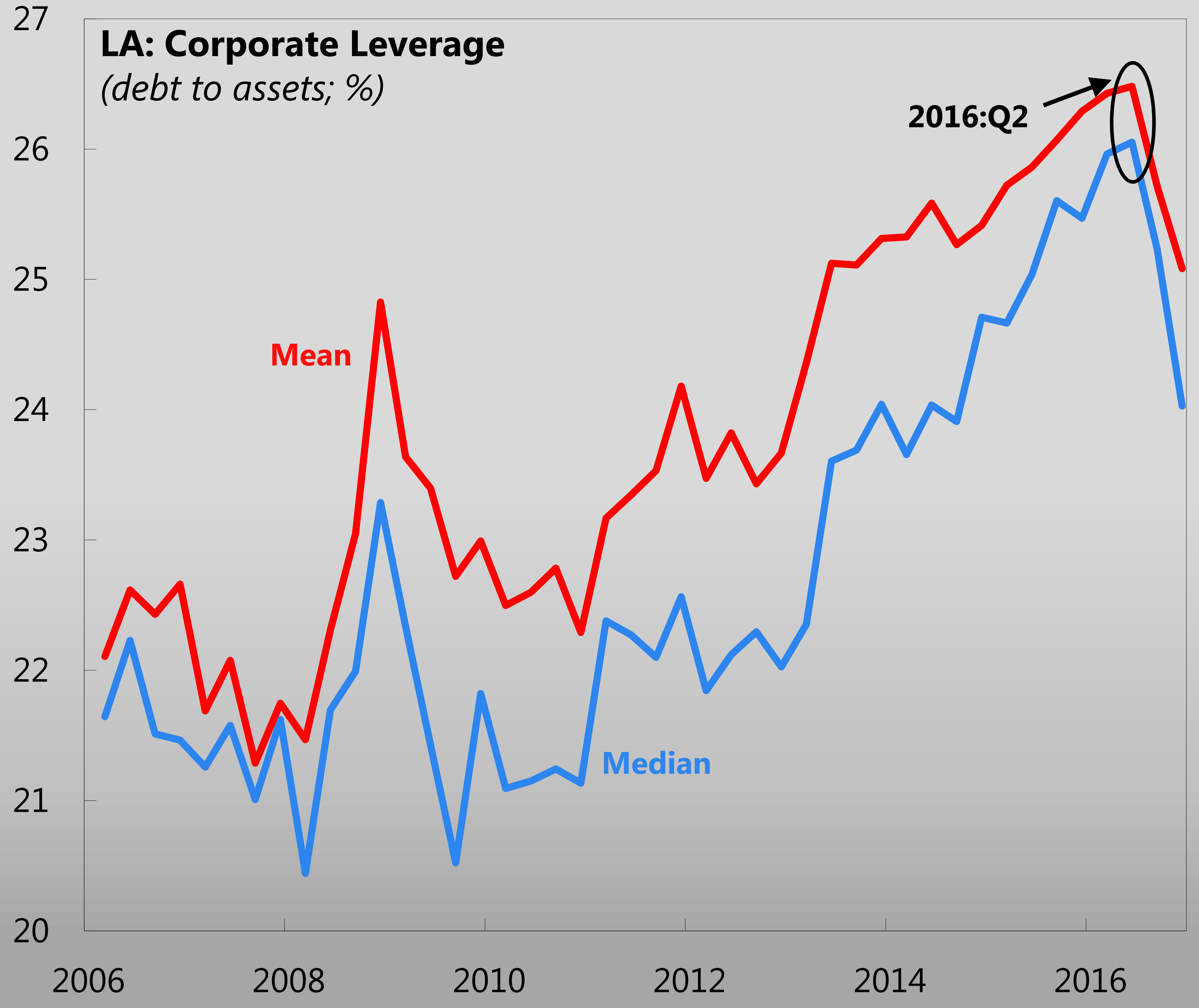
Despite the deleveraging since the second half of 2016, corporate leverage remains high



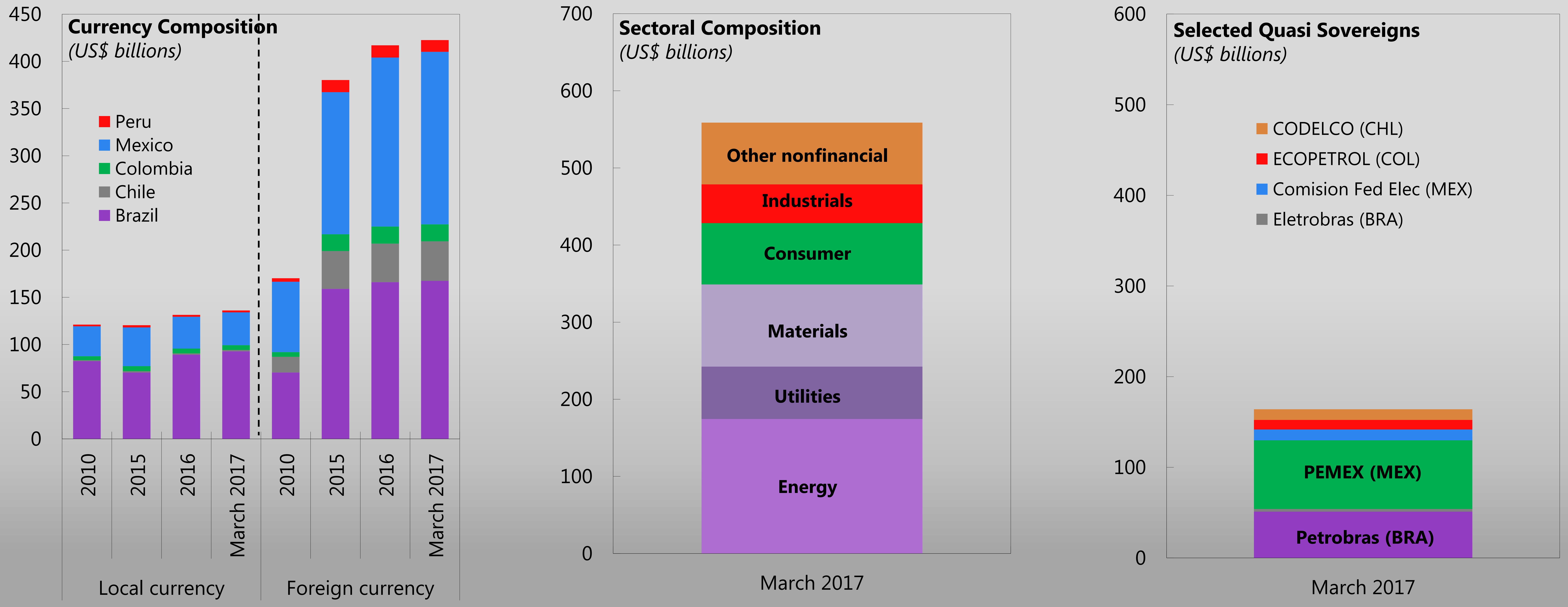
Sources: Dealogic; and IMF staff calculations.
Note: Data for Brazil include issuance by foreign subsidiaries of Brazilian firms.



Sources: Bloomberg L.P., and IMF staff calculations.
Note: The results are the median and mean of the nonfinancial corporates of Argentina, Brazil, Chile, Colombia, Mexico, and Peru.

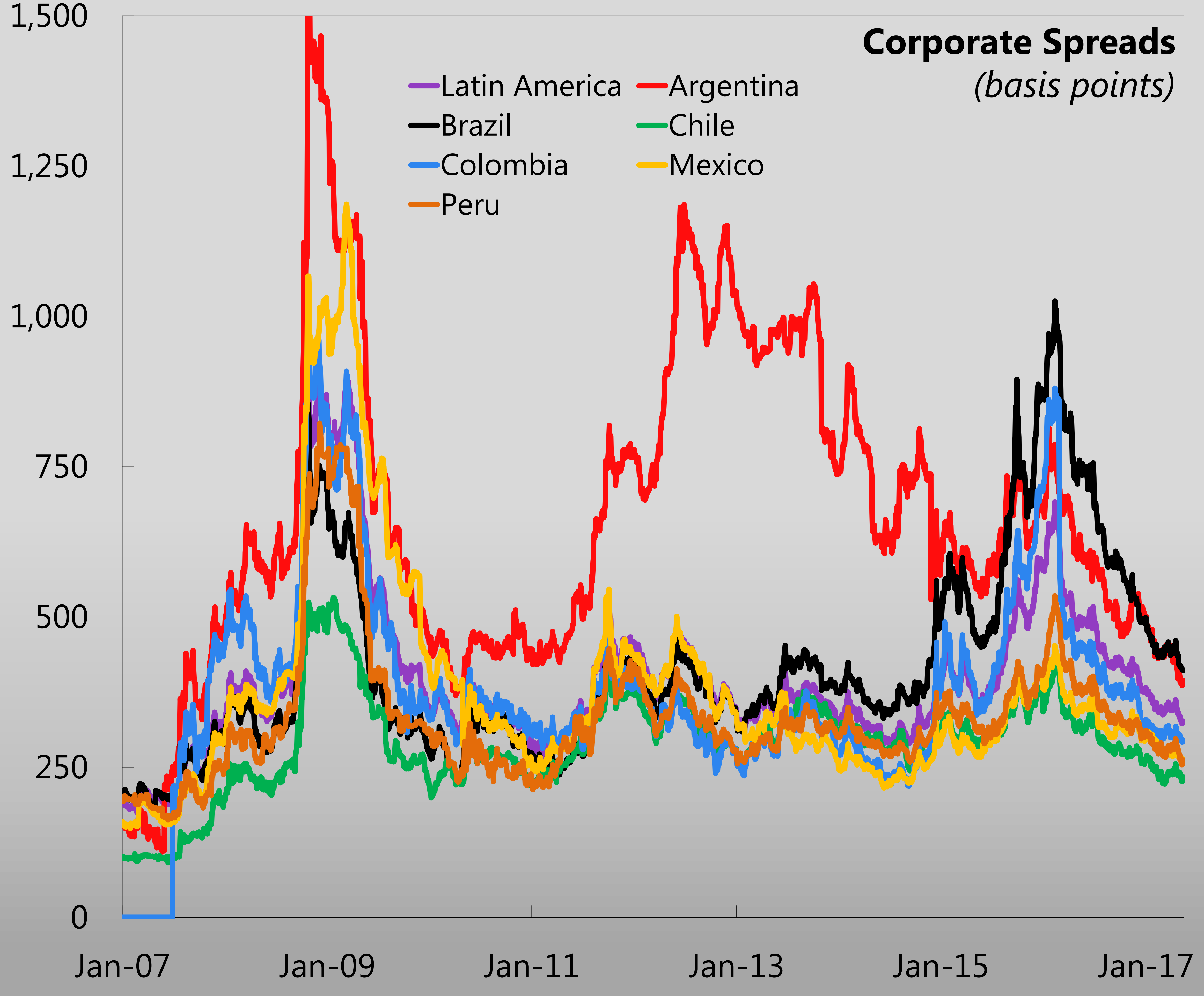
Mostly in foreign currency, concentrated on commodity related sectors, and partly held by quasi sovereigns

Nonfinancial Corporates Bond Debt

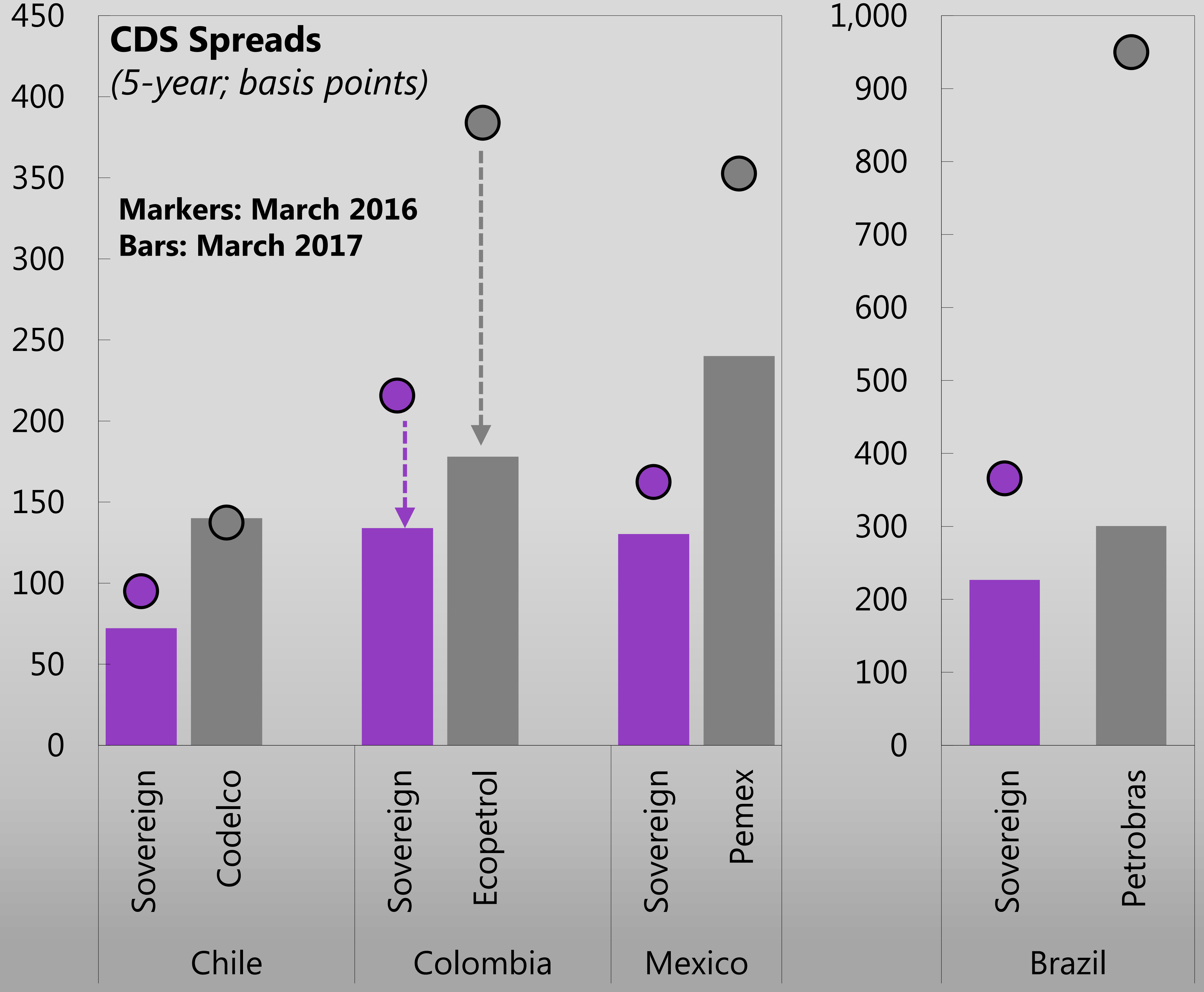


Sources: Bloomberg L.P.; Dealogic; and IMF staff calculations.

With corporate sector spreads currently at low levels …

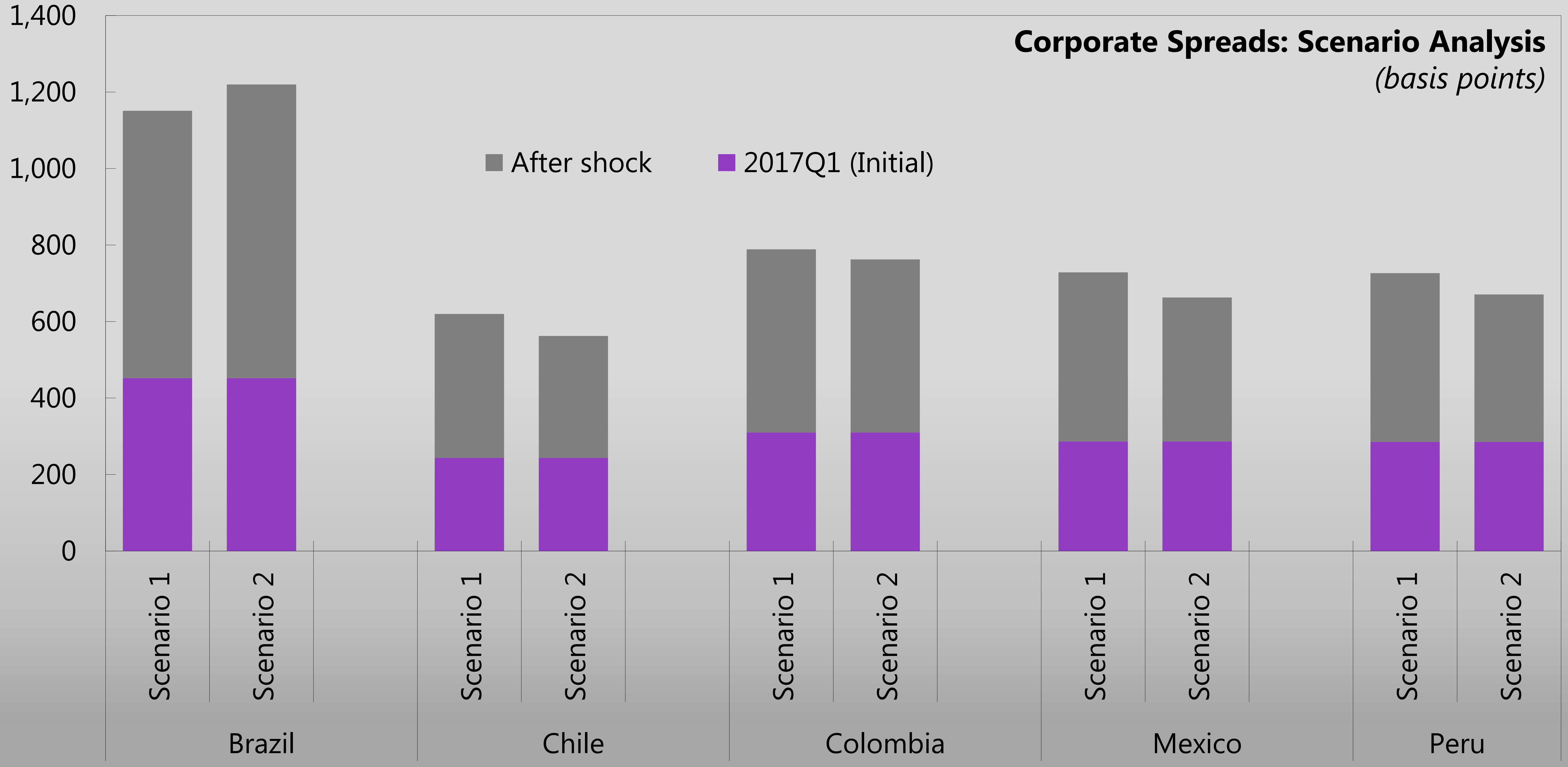


Source: Bloomberg L.P.
Note: J.P. Morgan CEMBI Broad Diversified Index; U.S. dollar-denominated corporate bonds.



Source: Bloomberg L.P.
Note: Ecopetrol data is implied CDS spread calculated by Bloomberg L.P.

… risks remain if long-term yields increase, currencies depreciate, and market volatility picks up



Source: Bloomberg L.P.; and IMF staff calculations.
Note: Scenario 1 = increase global market volatility (doubling of the VIX from its current level). Scenario 2 = increase in sovereign CDS spreads and currency depreciation (based on a reversal of the trend observed in these two variables since 2016Q1, except for Mexico where the currency depreciated further by 11 percent over that period.)

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