Comment on “Global Monetary Spillovers: Shocks and Vulnerabilities”

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The views expressed are those of the author and do not necessarily reflect those of the Bank of England, the Monetary Policy Committee, the Financial Policy Committee or the Prudential Regulation Authority.
The Paper #1: Backdrop

- Hugely relevant paper for international macro & analysis of spillovers from centre country (US) to EMEs

- Appreciation vis à vis USD:
  - easing of the domestic MP stance

- In standard open-economy NK models [Gali & Monacelli (2005)]

- And with fin’l frictions & foreign currency debt [Akinci & Queralto (2019)]

- However: EMEs CB may be tempted to tighten to counteract capital outflows and $ debt burden

- Is there a framework that rationalises this trade-off?

- What are the mechanisms?
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The Paper #2: Framework

- Akinci & Queralto (2019) + hybrid belief mechanism
- Inflation expectations depend on target and on past inflation
- The relevant inflation is CPI \(\rightarrow\) includes imports price
- $ dollar debt + PCP/DCP + anchoring
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Questions:

1. How do EMEs respond to US-originated shocks?
2. Does the (structural) origin of the shock matter?
3. What is the role of vulnerabilities ($ balance sheet exposure)?
4. What if inflation expectations are unanchored?
The Paper #3: Results

- The source of the shock matters
  - $ appreciation because of tighter MP → generally detrimental
  - $ appreciation because of higher demand → trade-off depends on vulnerability

- Country vulnerabilities matter
  - PCP/DCP determines response of exports & output, less CB reaction
  - Anchoring of expectations is crucial for CB response

1. $ appreciation → higher import prices → higher CPI → higher expected inflation

2. Rationalises motive for domestic tightening
The Paper #3: Response to US MP Tightening

D. EME GDP

E. EME Policy Rate

F. EME Corporate Spreads

G. EME Real Exchange Rate (USD per LCU)

H. EME Producer Inflation

I. EME Exports

- Strong Balance Sheets, PCP
- Fragile Balance Sheets, DCP
- Fragile Balance Sheets, PCP
- Fragile Balance Sheets, DCP, Unanchored Inflation Expectations
1. Foreign currency debt burden brings home heterogeneity of CB response without inflation expectation channel

2. Consistency of model predictions with empirical evidence
Comment #1: Clarifying the Mechanism #1

- Standard monetary policy tightening (US)
Comment #1: Clarifying the Mechanism #2

- Hawkish monetary policy stance (US)
Comment #1: Clarifying the Mechanism #2

- Hawkish monetary policy stance (US)

![Graphs showing economic impacts of monetary policies](image-url)
1. Foreign currency debt burden brings home heterogeneity of CB response without inflation expectation channel

2. Consistency of model predictions with empirical evidence
Comment #2: Empirical Evidence #1

a. Monthly regressions

Source: Dedola, Rivolta & Stracca (2017)
Comment #2: Empirical Evidence #2

Figure 10: Median Response of Emerging Economies

Source: Degasperi, Hong & Ricco (2019)
Comment #2: Empirical Evidence #3

Two-year-ahead inflation forecasts

In per cent

Graph 3

1 For all economies except India, forecasts made in January for the following calendar year (i.e., January 2015 for 2016); where January forecasts unavailable, February forecasts are used instead. For India, forecasts made in April for the following 12-month period ending in March (i.e., April 2015 for the April 2016–March 2017 period). Horizontal axis refers to the year being forecast; for India, March years (i.e., 2016 refers to April 2016–March 2017). Median forecast where individual forecasts available; otherwise mean.

Sources: Consensus Economics; national data.

Source: Sousa & Yetman (2016)
Conclusions

- Hugely relevant paper for international macro & analysis of spillovers from centre country (US) to EMEs

- Rich framework permits analysis of relevance of different channels

- Important policy prescriptions

- Consistency of implications with empirical evidence. When does it matter? ➔ Calls for new, more detailed characterisation of the heterogeneous effects of spillovers