Comment on "Global Monetary Spillovers: Shocks and Vulnerabilities"

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The Paper #1: Backdrop

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

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- **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?

The Paper #2: Framework

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

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Questions:

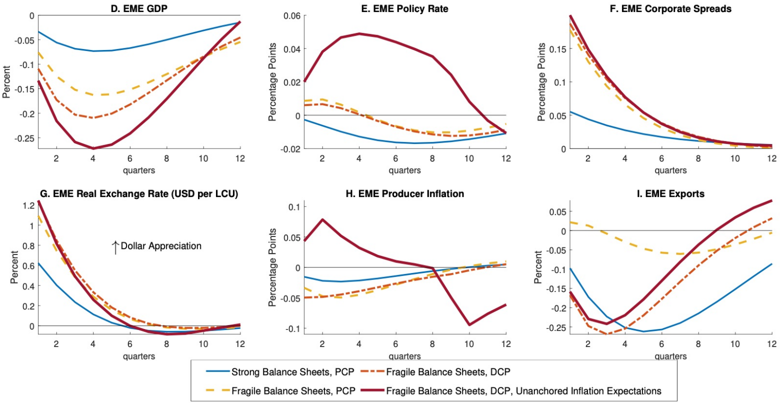
1. How do EMEs respond to US-originated shocks?
2. Does the (structural) origin of the shock matter?
3. What is the role of vulnerabilities (\$ balance sheet exposure)?
4. What if inflation expectations are unanchored?

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



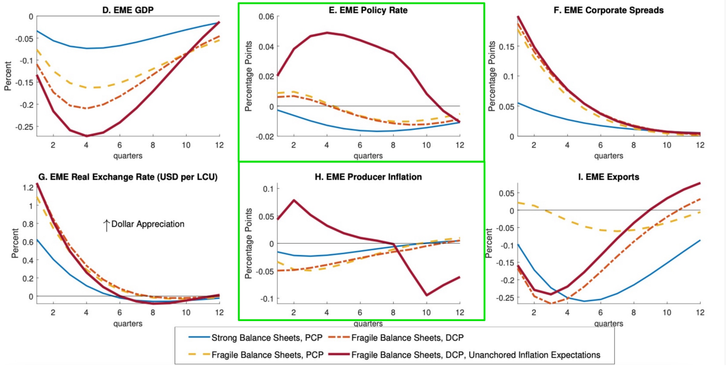
Comments

1. **Foreign currency debt burden brings home heterogeneity of CB response <u>without</u> inflation expectation channel**

2. Consistency of model predictions with empirical evidence

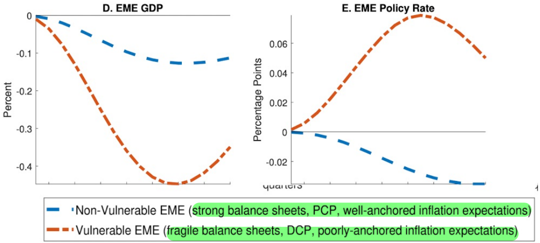
Comment #1: Clarifying the Mechanism #1

▷ Standard monetary policy tightening (US)



Comment #1: Clarifying the Mechanism #2

- ▷ Hawkish monetary policy stance (US)



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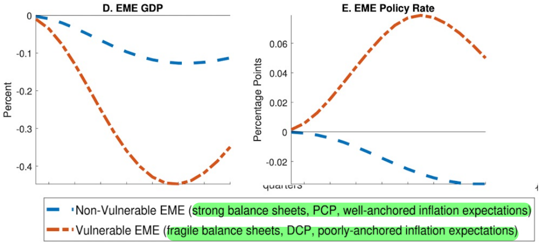

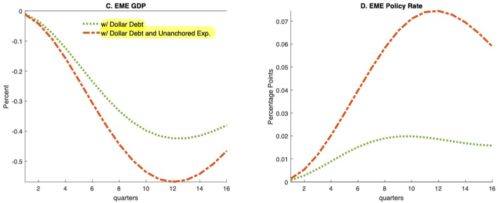

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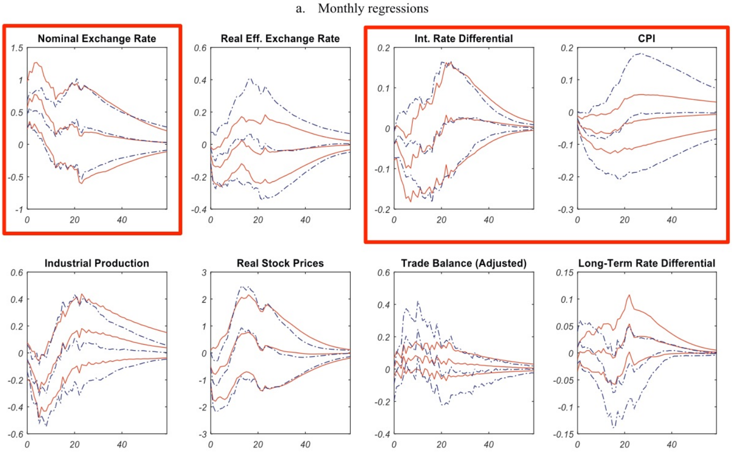
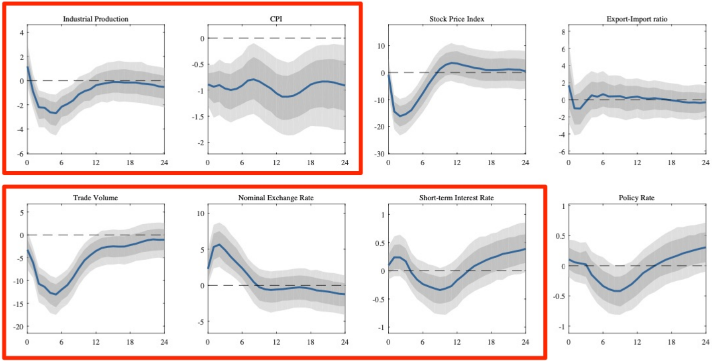
Comment #2: Empirical Evidence #1



Source: Dedola, Rivolta & Stracca (2017)

Comment #2: Empirical Evidence #2

Figure 10: Median Response of Emerging Economies

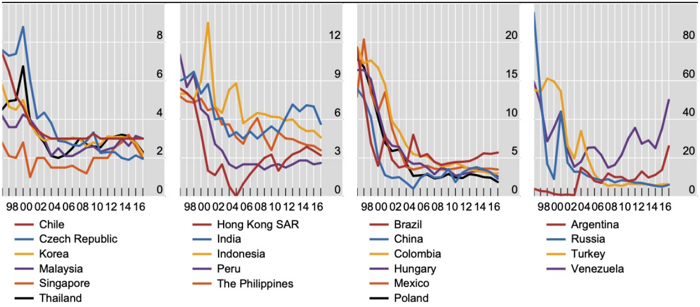


Source: Degasperi, Hong & Ricco (2019)

Comment #2: Empirical Evidence #3

Two-year-ahead inflation forecasts[1]

In per cent Graph 3



[1] For all economies except India, forecasts made in January for the following calendar year (ie 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 (ie April 2015 for the April 2016–March 2017 period). Horizontal axis refers to the year being forecast; for India, March years (ie 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