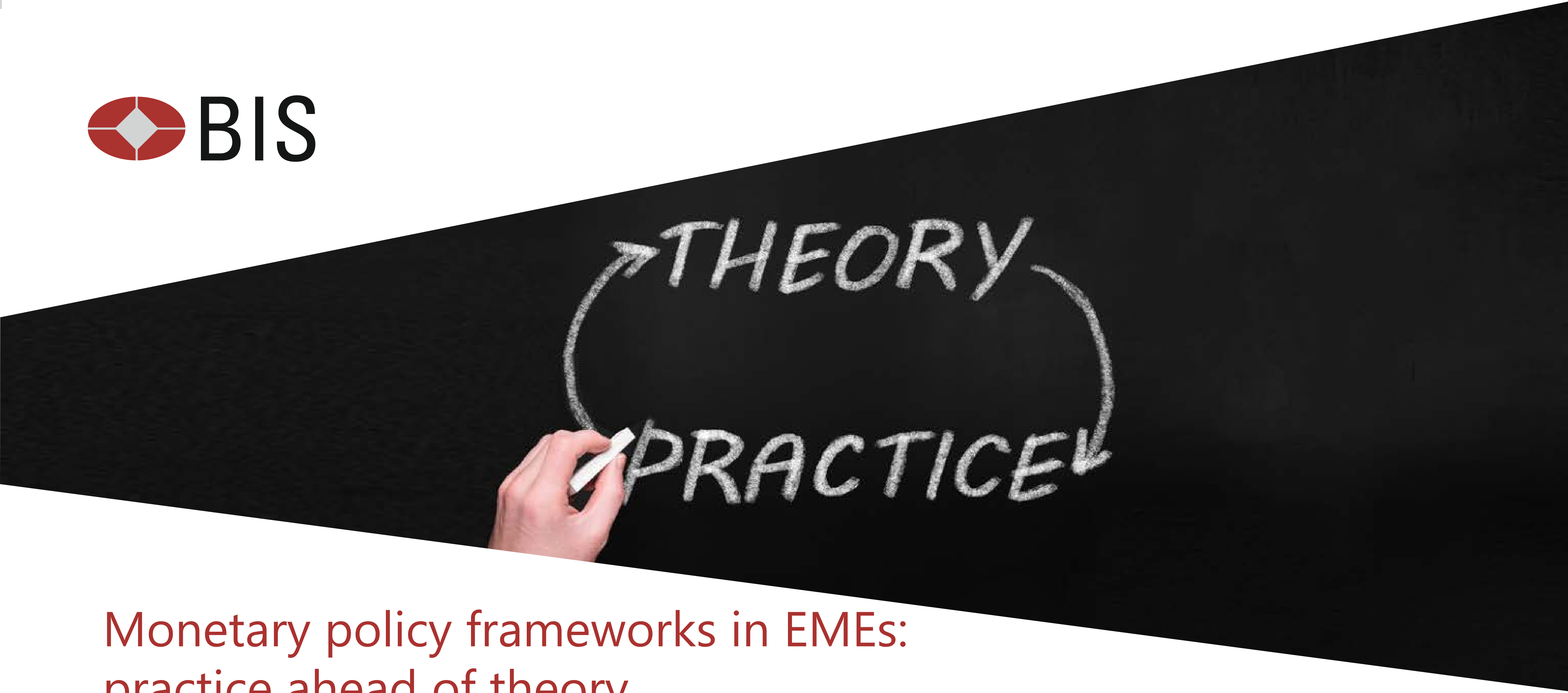
BIS



Monetary policy frameworks in EMEs: practice ahead of theory

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89th Annual General Meeting

One question, three takeaways

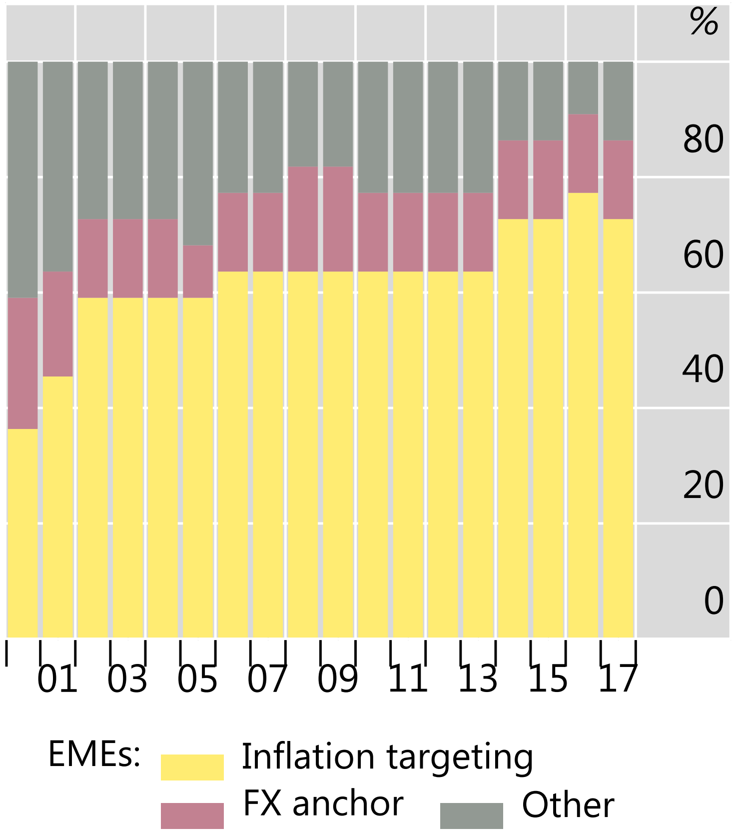
- Why combine IT with FX intervention and macroprudential measures?
- Three takeaways
  - EMEs are more sensitive to capital flows and exchange rates
  - This worsens two potential monetary policy trade-offs
  - FX intervention and macroprudential measures can help

Roadmap

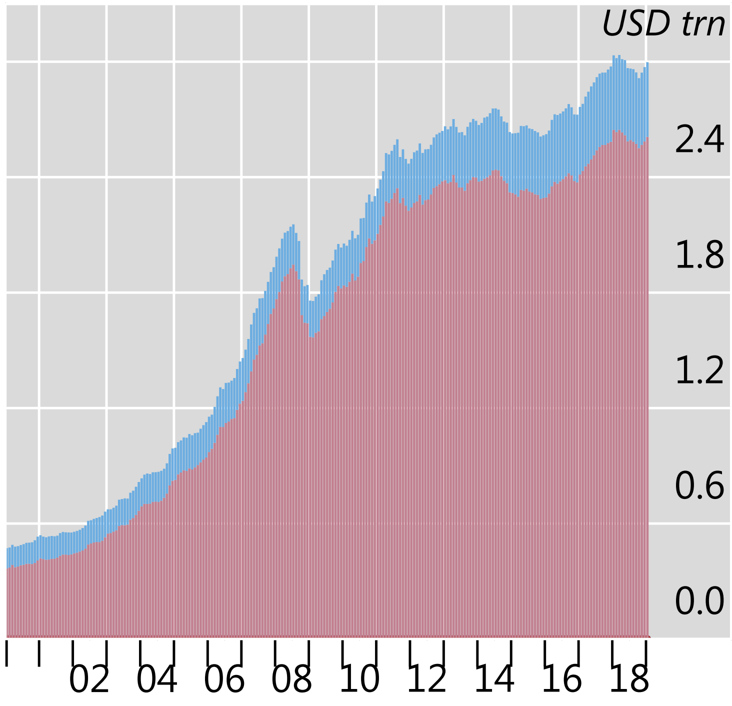
- EMEs are more sensitive to capital flows and exchange rates
- This worsens two potential monetary policy trade-offs
- FX intervention and macroprudential measures can help

EMEs adopt inflation targeting but not free floating

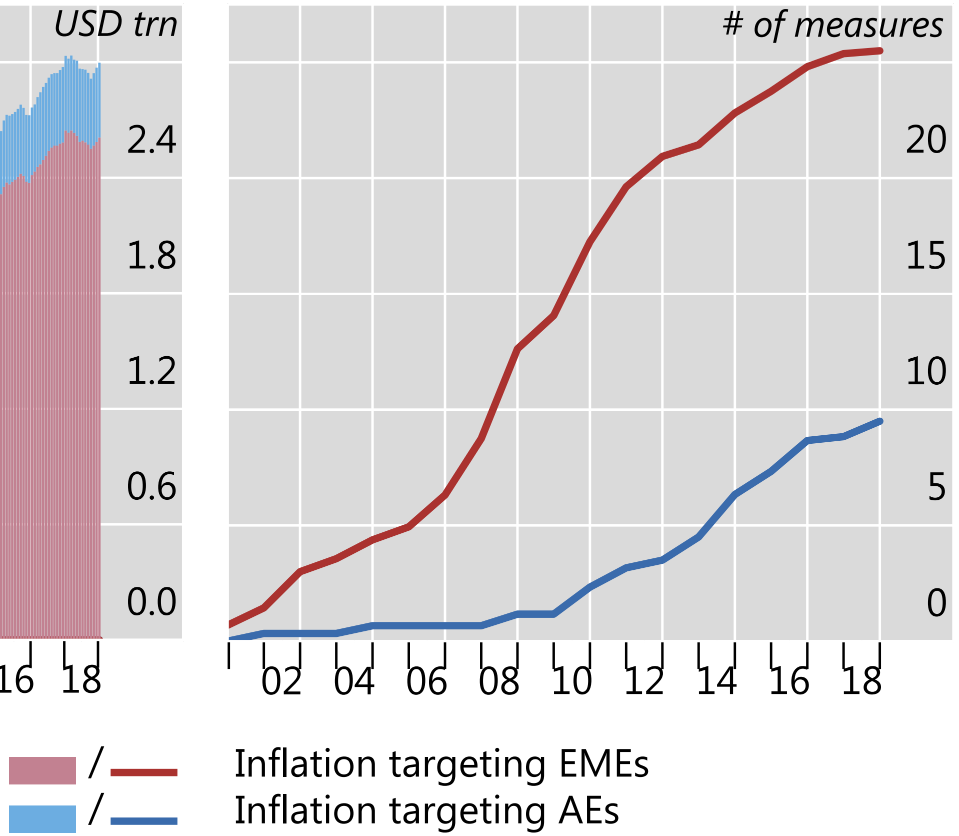
Inflation targeting regimes rise...



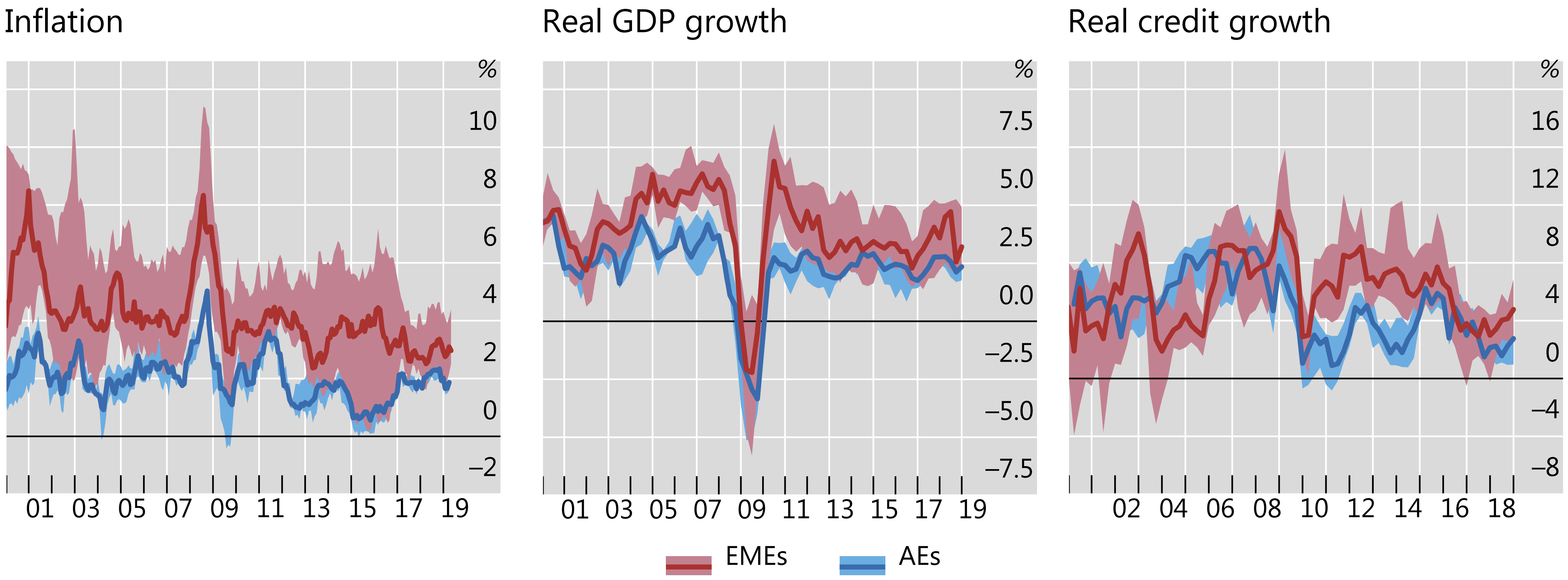
...but so do FX reserves



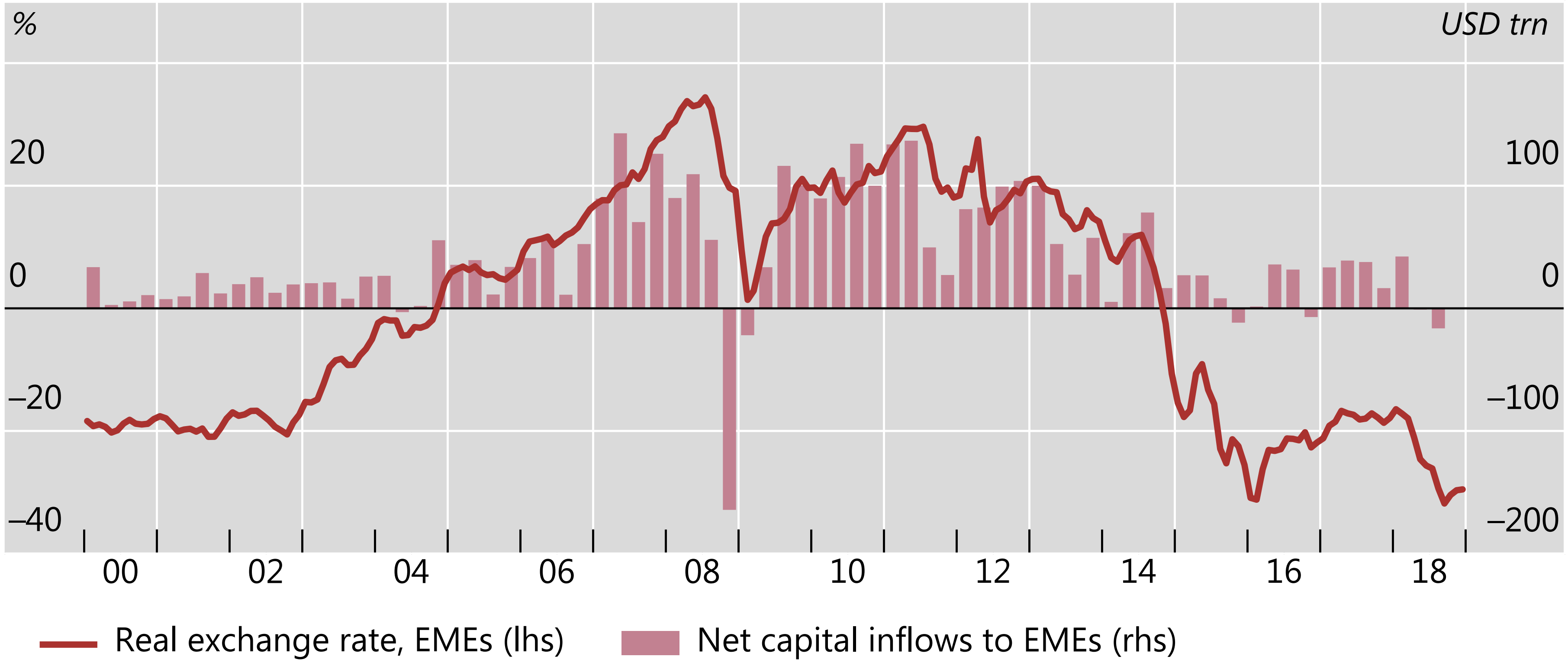
Use of macroprudential tools



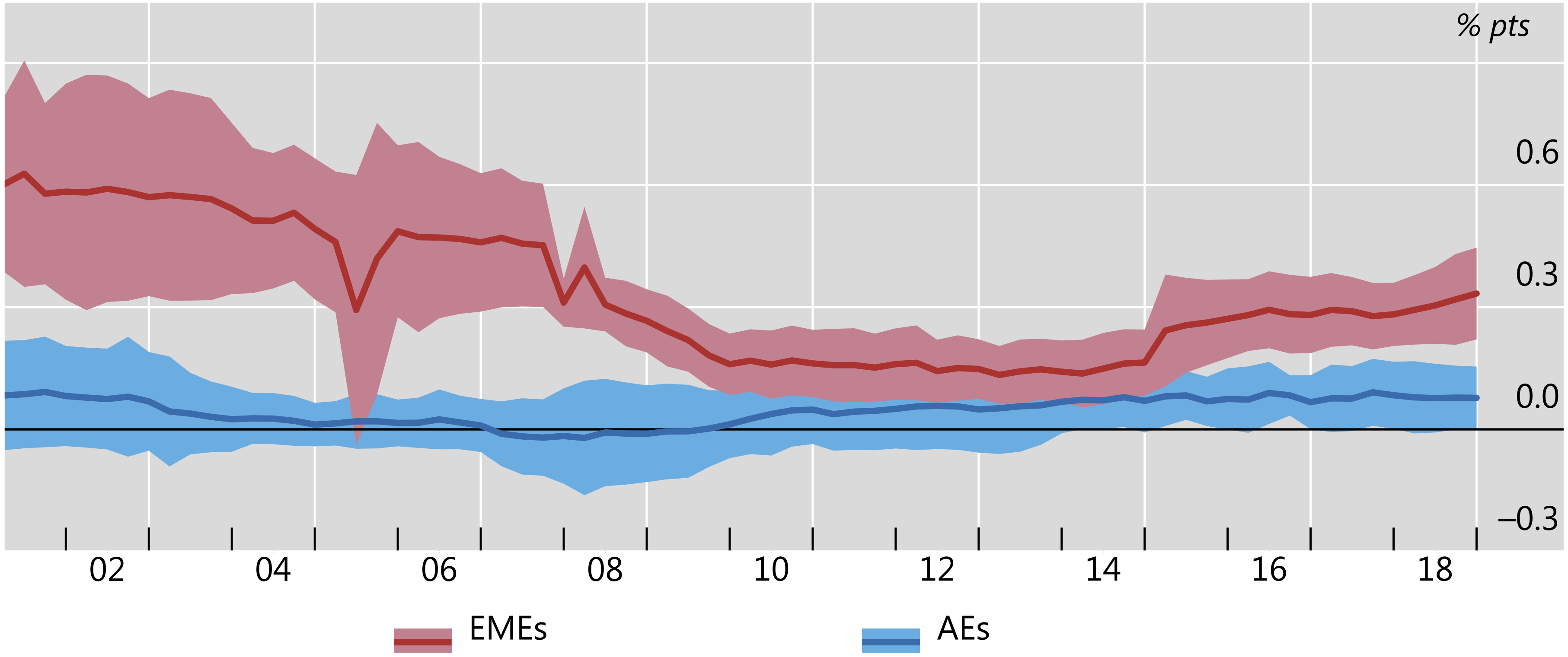
Inflation, growth and credit in inflation targeting economies



EMEs face large exchange rate and capital flow swings

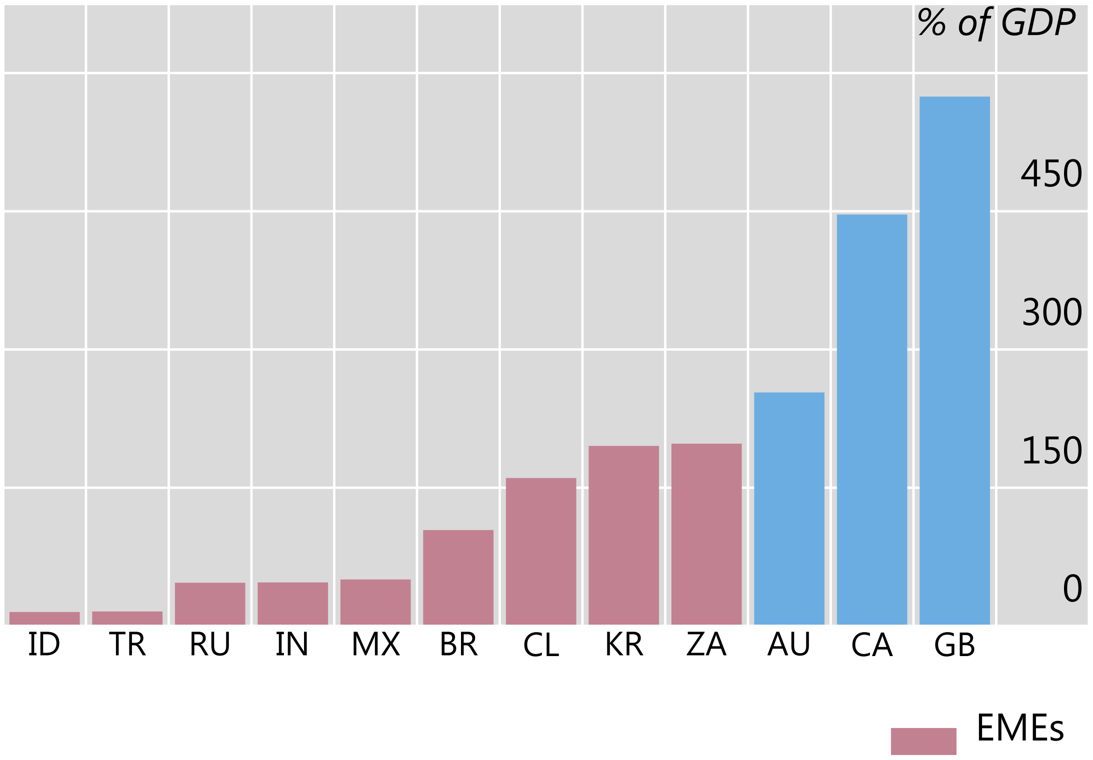


Exchange rate pass-through is higher in EMEs

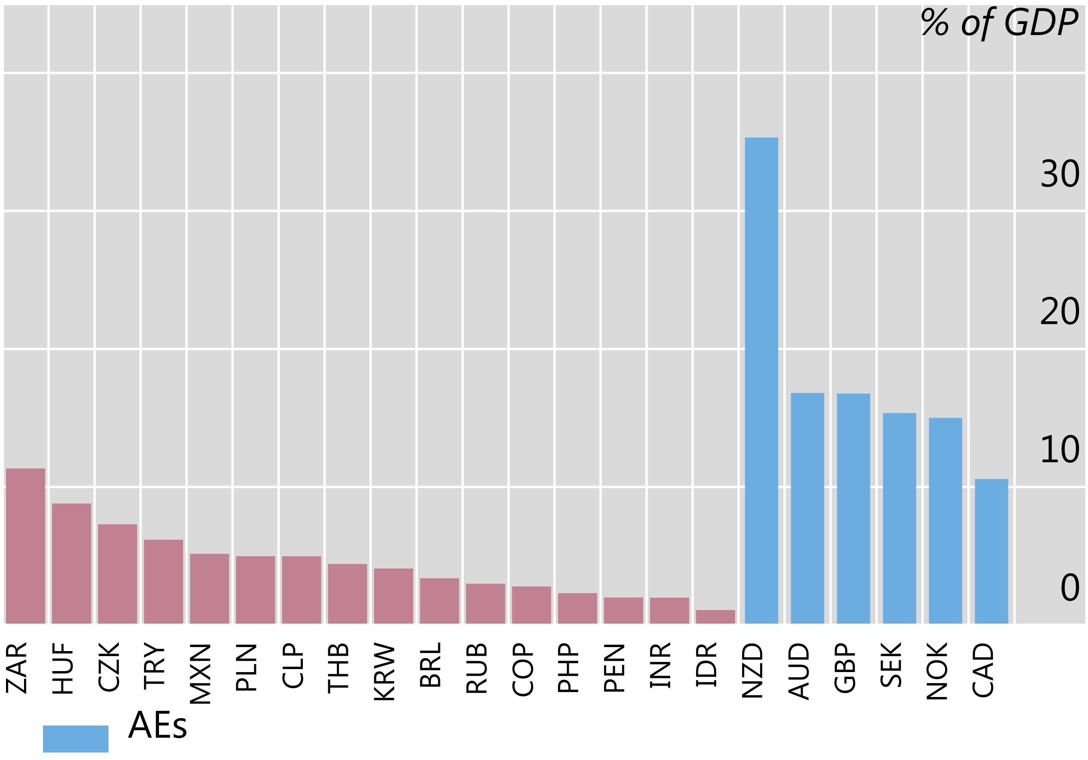


Financial markets are not as developed in EMEs as in advanced economies

Size of institutional investors



Trading in FX derivatives

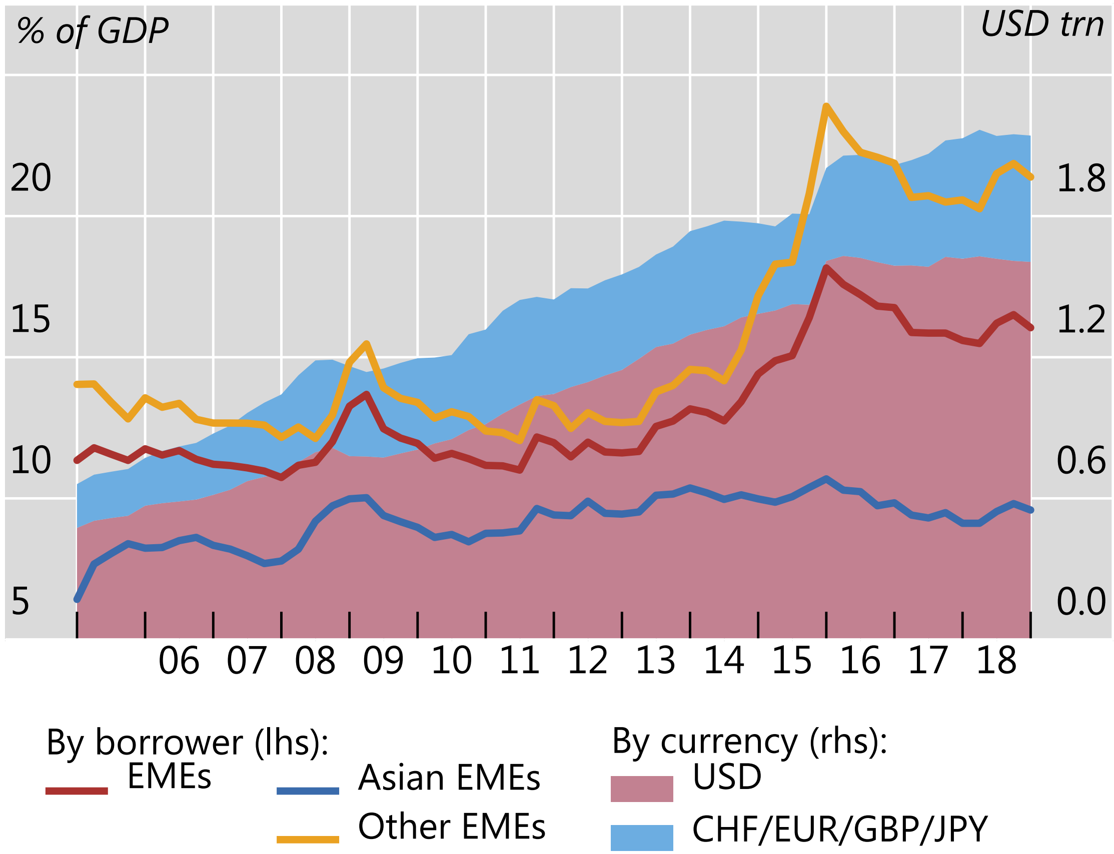


Roadmap

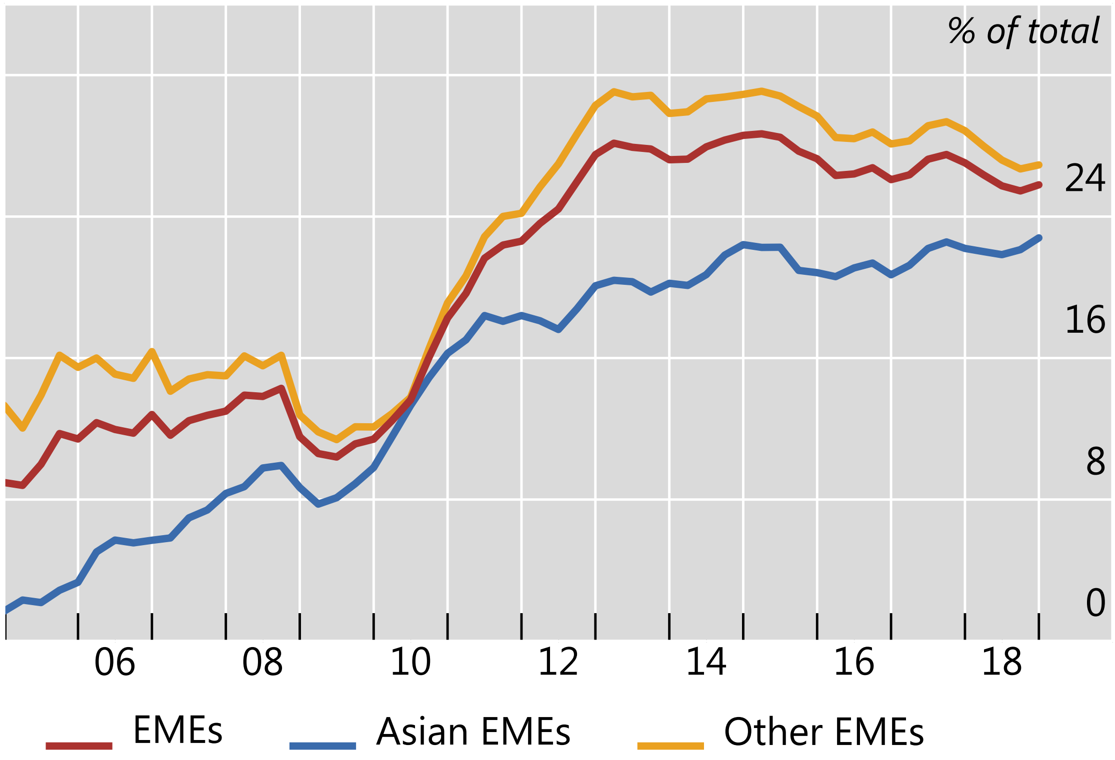
- EMEs are more sensitive to capital flows and exchange rates
  - Currency mismatches
  - The financial channel of the exchange rate
- This worsens two potential monetary policy trade-offs
- FX intervention and macroprudential measures can help

Foreign currency debt and foreign ownership raise vulnerabilities in EMEs

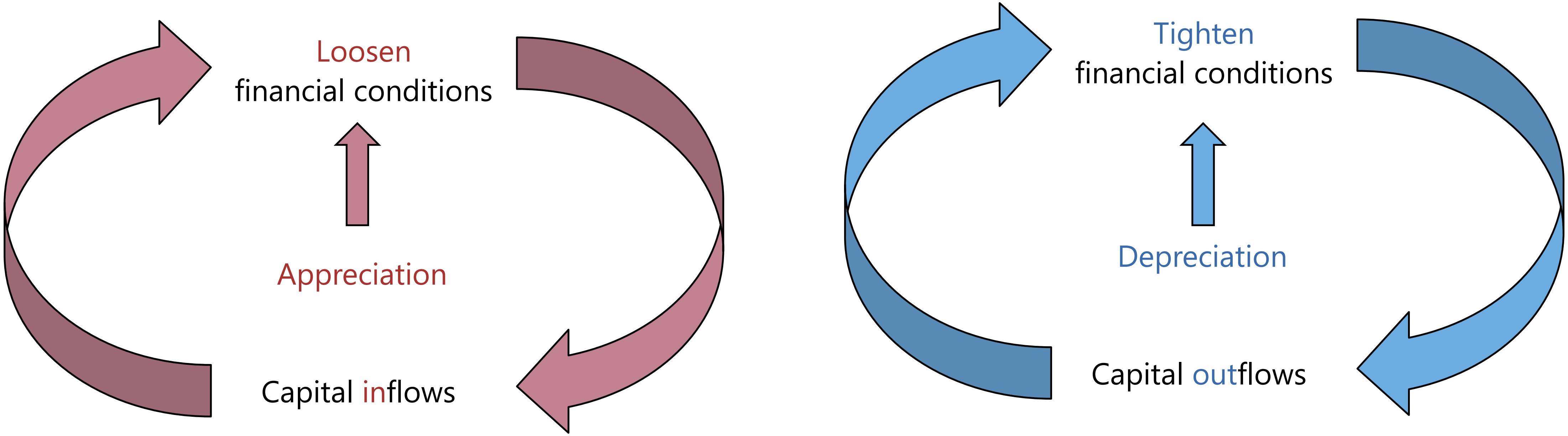
Foreign currency debt



Foreign ownership in EME local sovereign bond markets



The self-reinforcing currency mismatch loop

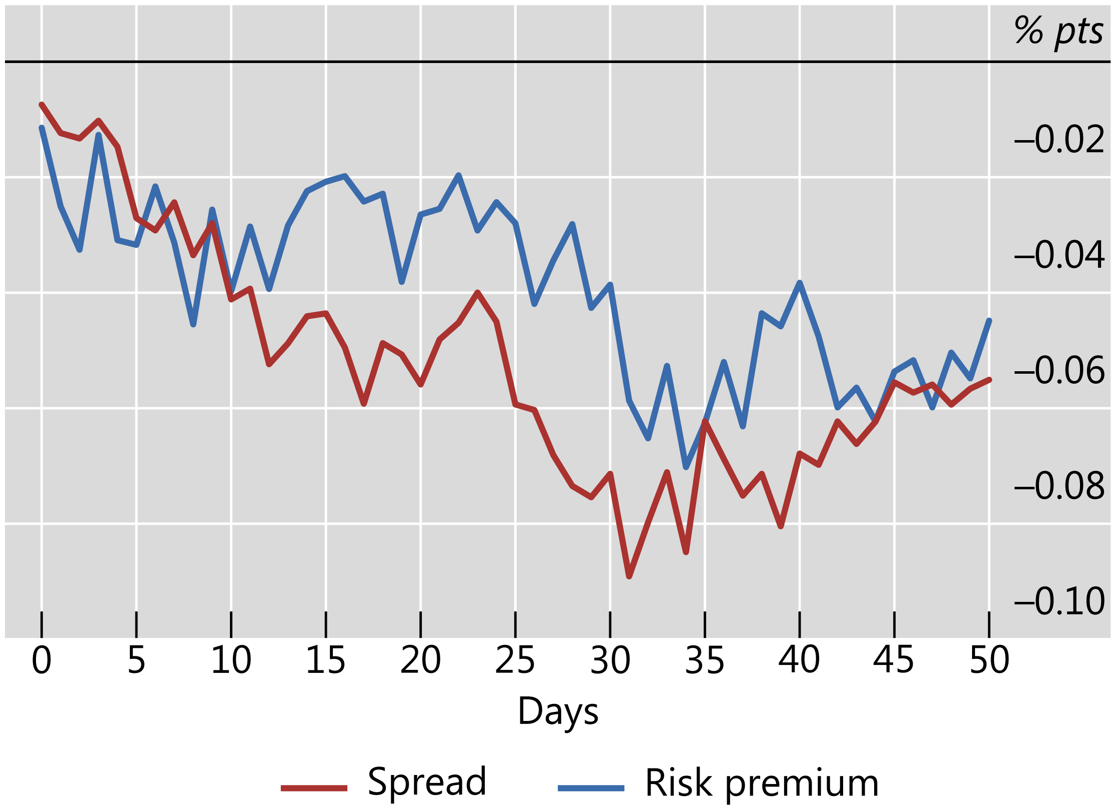


Roadmap

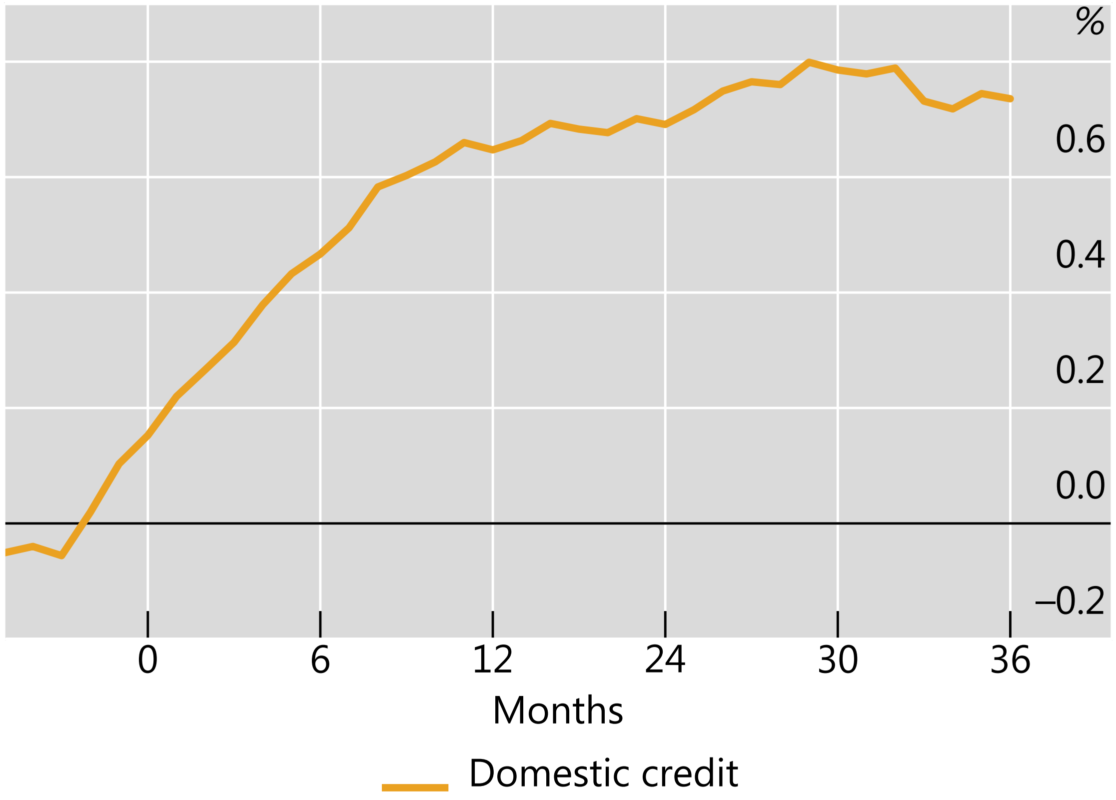
- EMEs are more sensitive to capital flows and exchange rates
- This worsens two potential monetary policy trade-offs
  - Stabilising inflation and output at the same time
- FX intervention and macroprudential measures can help

In EMEs, exchange rate appreciation goes hand in hand with…

…lower bond yields…



…and stronger domestic credit expansion



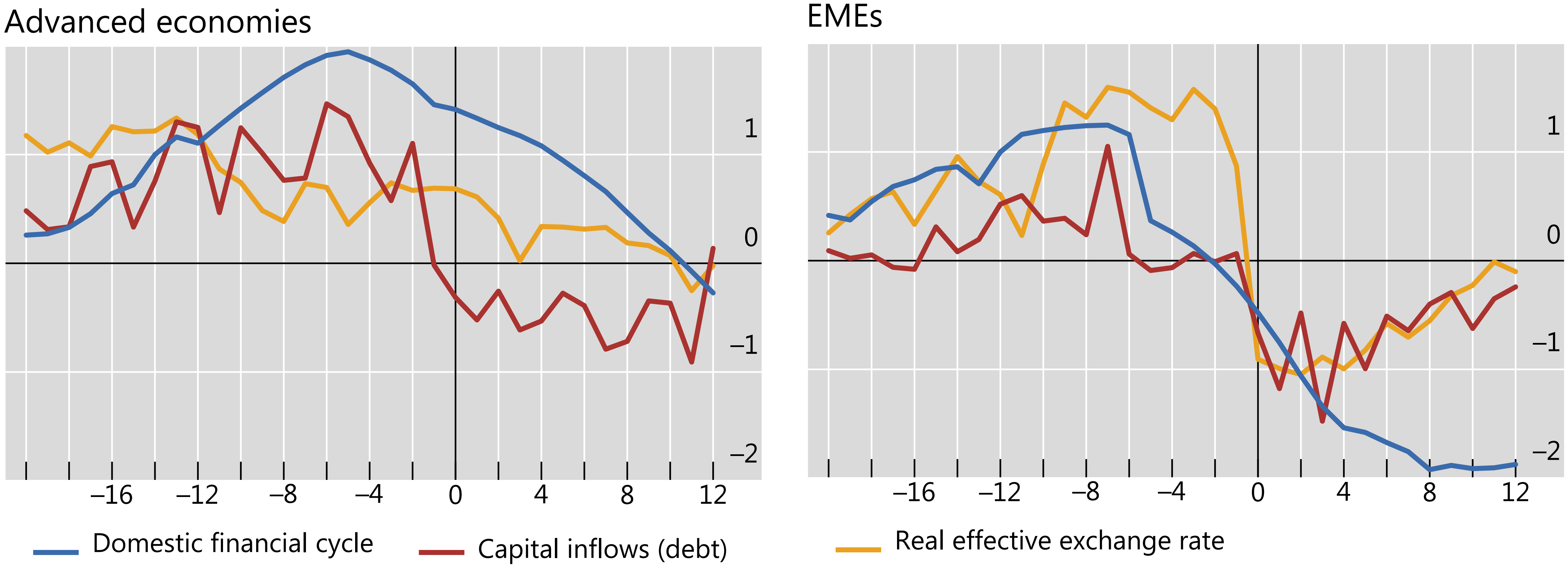
First monetary policy dilemma

Roadmap

- EMEs are more sensitive to capital flows and exchange rates
- This worsens two potential monetary policy trade-offs
  - Stabilising inflation and output at the same time
  - Stabilising the economy today vs stabilising it tomorrow
- FX intervention and macroprudential measures can help

Behaviour of selected variables around crises

Country group medians, in standard deviations



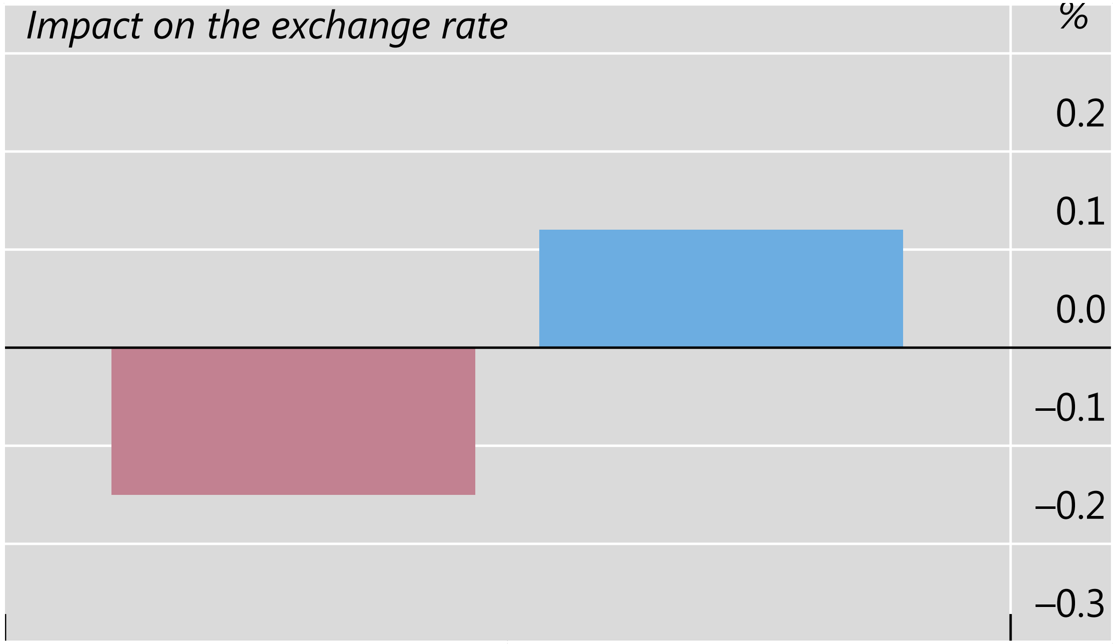
Second monetary policy dilemma

Roadmap

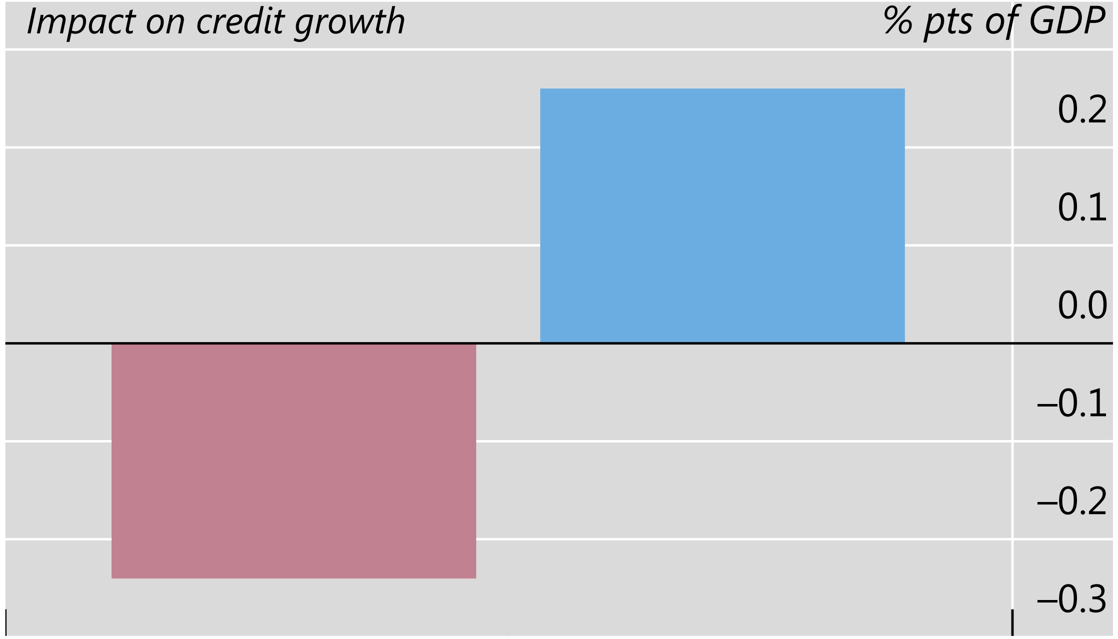
- EMEs are more sensitive to capital flows and exchange rates
- This worsens two potential monetary policy trade-offs
- FX intervention and macroprudential measures can help

FX intervention mutes the financial channel of the exchange rate

FX intervention leans against appreciation, offsetting capital inflows…



….and dampens credit expansion, offsetting the same flows



FX intervention Capital flows

Roadmap

- EMEs are more sensitive to capital flows and exchange rates
- This worsens two potential monetary policy trade-offs
- FX intervention and macroprudential measures can help
  - But FX intervention is no panacea

Roadmap

- EMEs are more sensitive to capital flows and exchange rates
- This worsens two potential monetary policy trade-offs
- FX intervention and macroprudential measures can help
  - But FX intervention is no panacea
  - Need for a macro-financial stability framework

Thank you!