Spillovers of Unconventional Monetary Policy
Theory and Evidence of Spillovers

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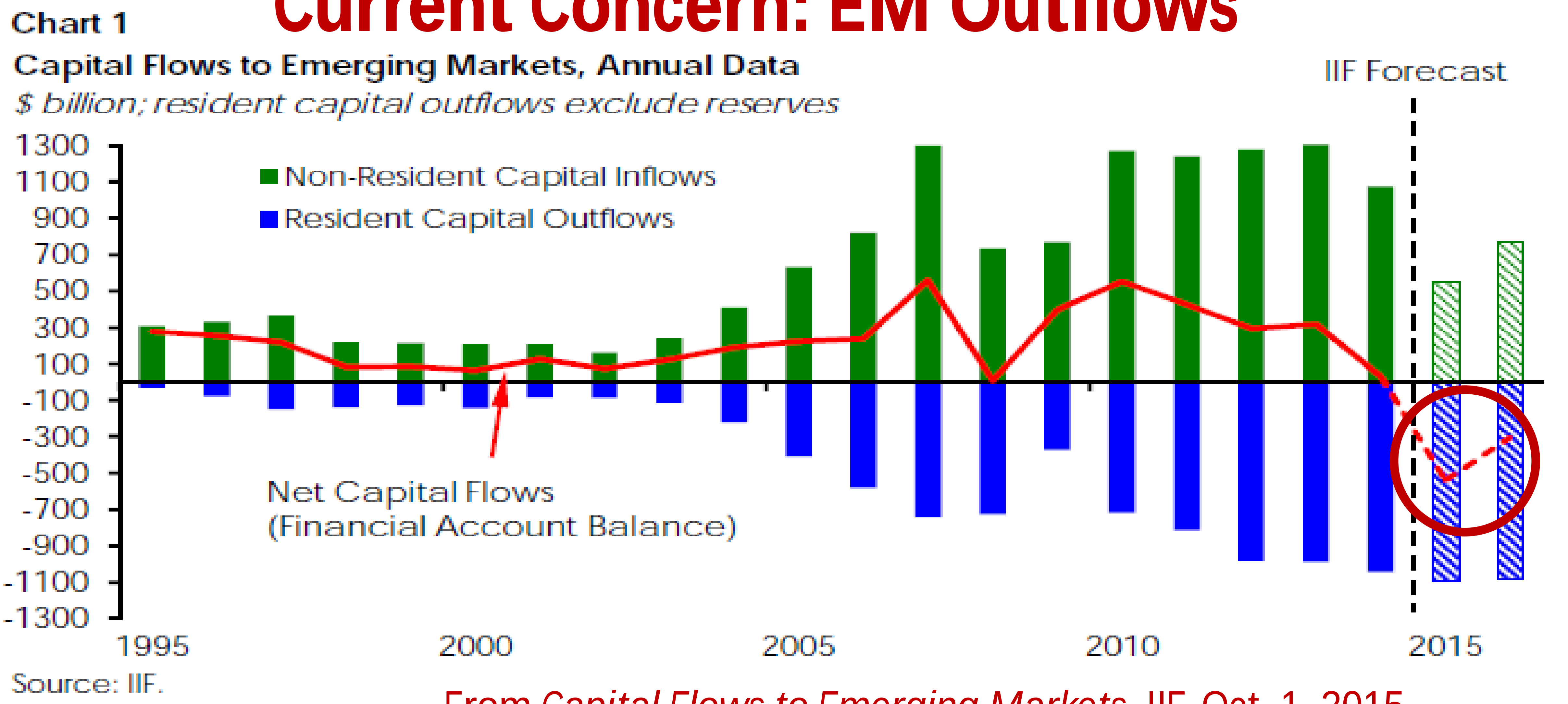
Spillovers: Theory, Evidence (& Policy Responses)

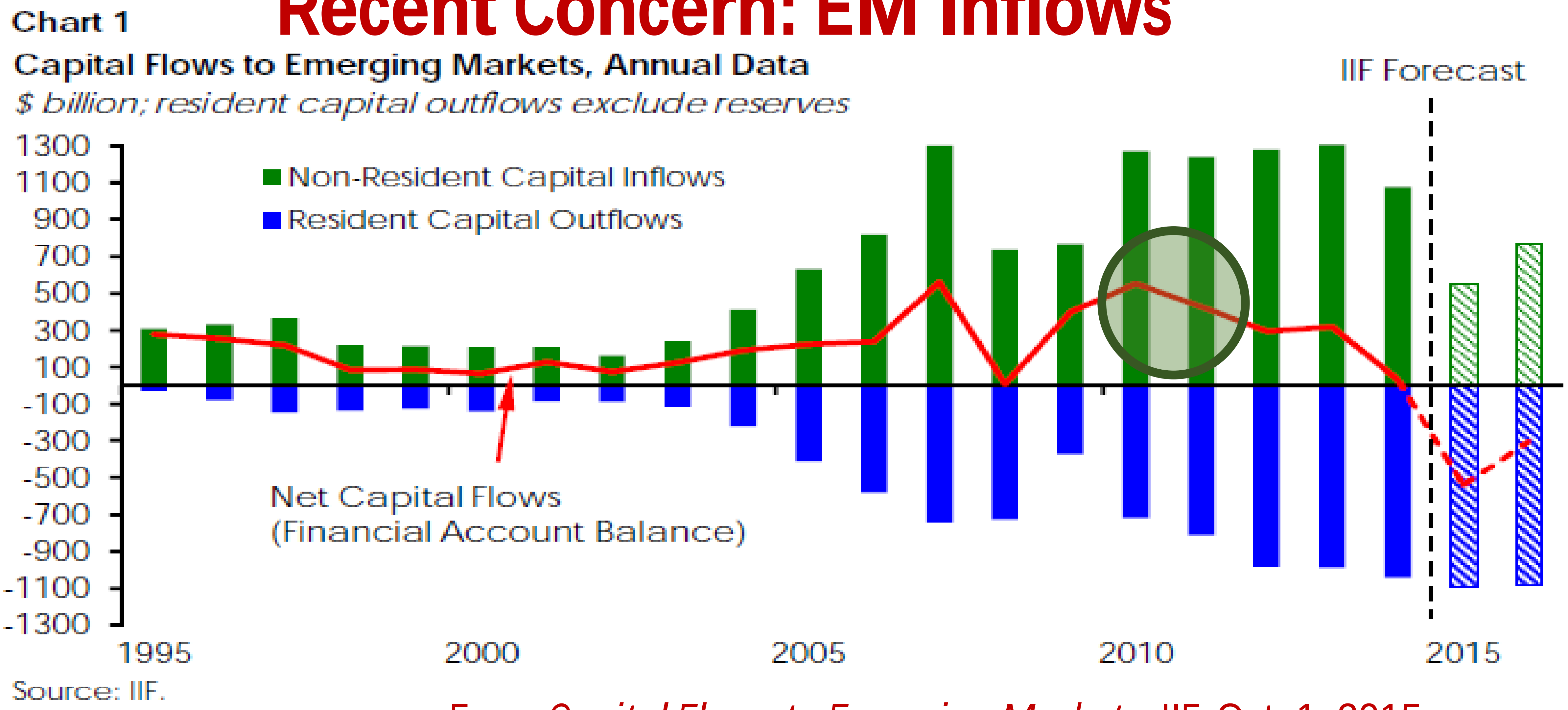
- Theory: A central topic in Int'l Macro. Channels include:
  - Exchange Rates (if floating)
  - Interest Rates (if fixed)
  - Growth & Domestic Demand
  - Financial Market Conditions, Financial Risk, Risk Appetite
- Evidence: Presentations by Kamin, Loungani (& more to come)
- Policy and Policy Responses
  - Policy Trilemma: What can one country do?
  - Policy Coordination: What can groups of countries do?
  - Synchronous cycles? (initial shocks, duration of effects, policies)
  - Scope for alternatives? Capital controls, soft pegs

Current Concern: EM Outflows



2015 Net Outflows ~$540 b., 1st negative since 1988

Recent Concern: EM Inflows



From *Capital Flows to Emerging Markets*, IIF, Oct. 1, 2015

2010 – 2011: Inflows and "Currency Wars"

Main Results from Kamin *et al.*

- Focus on Easing US Monetary Policy: 25 bp decrease in T-bill leads to:
  - Decrease in Interest Rates: UK 12 bp; Germany 9 bp; Japan 5 bp; EM av'g. 13 bp (China 5 bp, India 6bp, Mexico 14 bp, Korea 15 bp)
- GDP effect: Beggar thy neighbor? Effects of different channels
  - **Net positive** ER -0.05 pct; US Demand +0.05 pct, Financial +.25 pct.
- But Fed's actions controversial: Currency Wars, Taper Tantrum
  - Differences Across Countries in Structure
    - ER effect differs in fixed (or managed) vs. floating countries
    - Financial effect differs with capital controls
    - Trade linkages with US, & dependence on trade
  - Differences Across Countries in Phases of Business Cycle
  - Volatility and Uncertainty Make Policy Harder to Plan, Implement

Main Results from Loungani and Vesperoni

- IMF 2015 Spillover Report (Buitron and Vesperoni): Shocks from SAEs, focus on their asynchronous monetary policies, effects on Emerging Market & Nonsytemic Advanced economies (EMNS).
- US – EA spillovers (below) and US & EA spillovers on EMNS (next slide)
- Shocks: Unanticipated
  - Money – tightening
  - Real – Improvement
- Stripped of risk-appetite
  - Rey – VIX & vector of spillover
- Same directions, but could

be in different parts of cycle

Variables *

Shocks	U.S. stocks	U.S. 10yr yields	EA stocks	EA 10yr yields
Real U.S.	+	+	+	
Money U.S.	-	+		+
Real EA	+/= **		+	+
Money EA		+/= **		+

* Variables purged from risk-appetite shocks

** Restriction on lagged variable

US & EA on EMNS

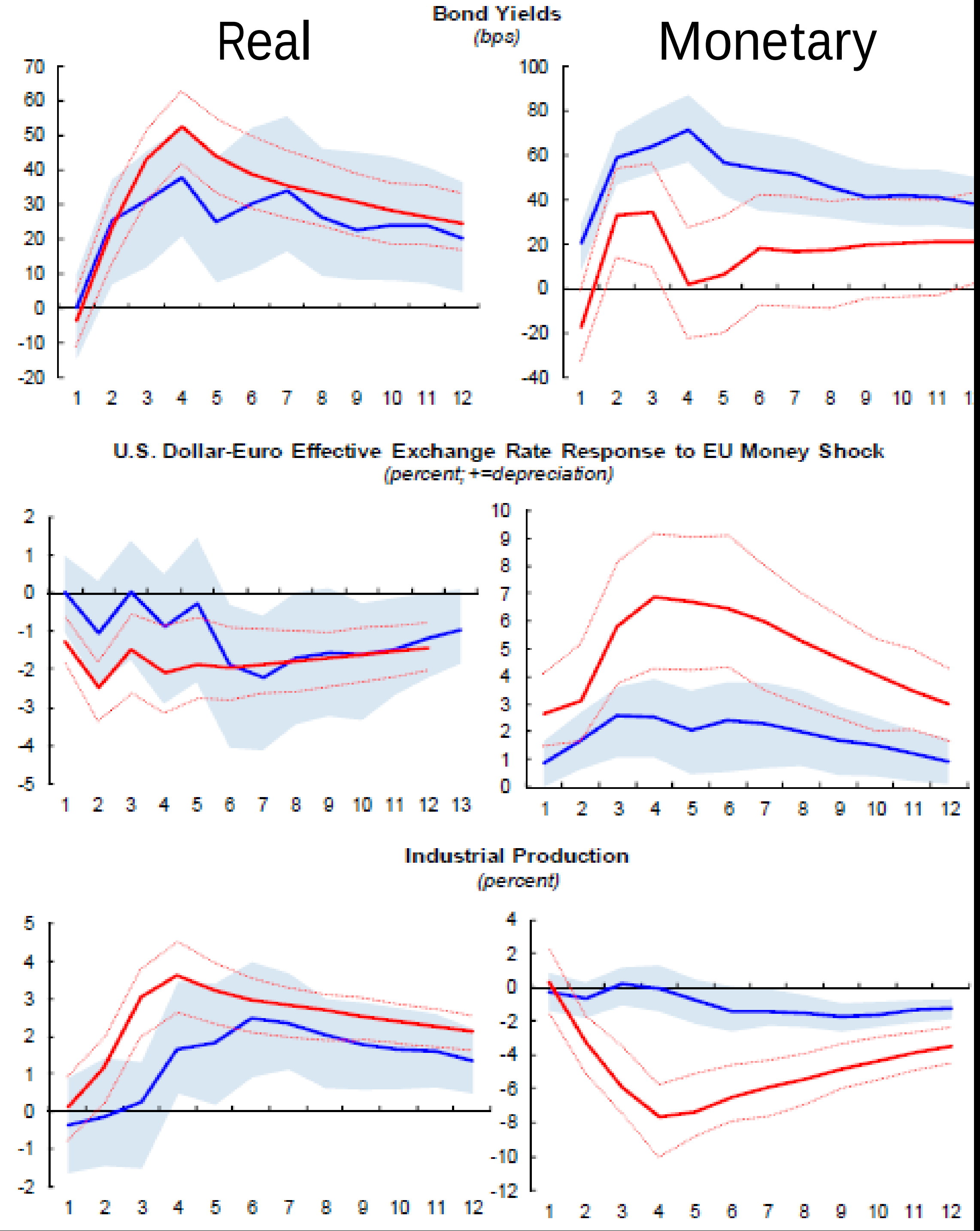
Real: ↑Y→ ↑R.

Monetary: ↓M→↑R

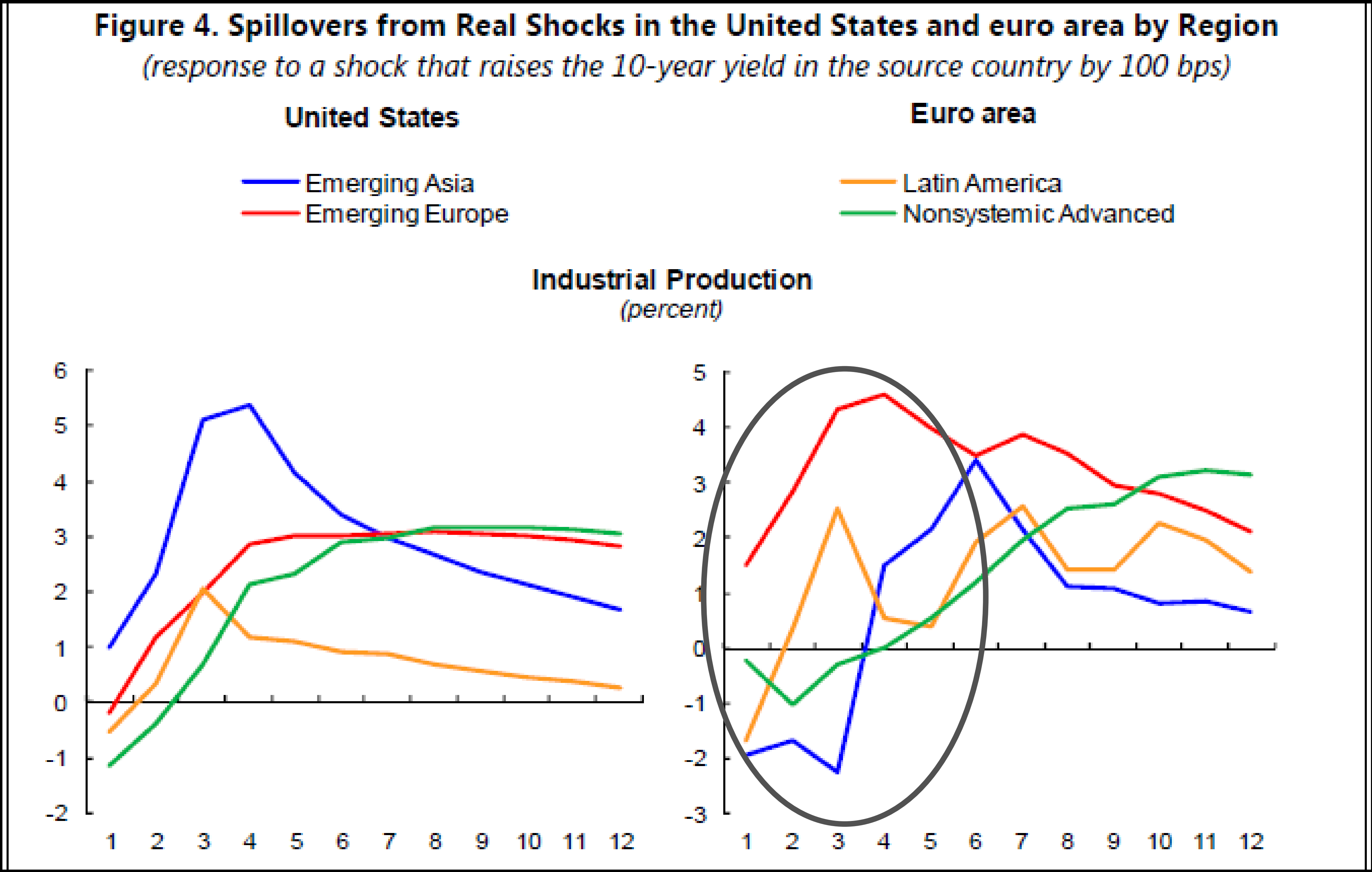
from Buitron and Vesperoni, *IMF 2015 Spillover Report*.

Similar US and EA effects (Red = US, Blue = EA)

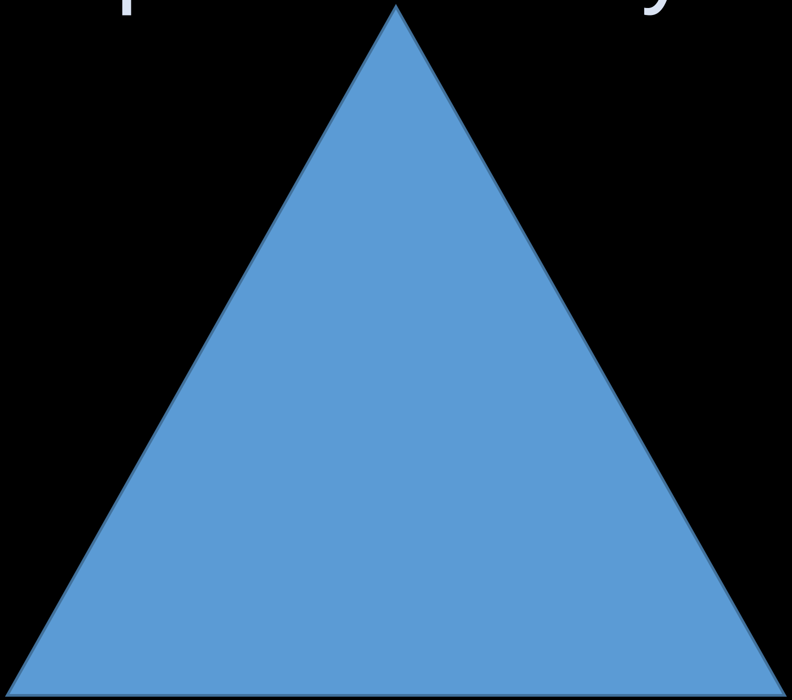
But currently, differences in positions in cycle mean likely differences in outcomes.



Heterogeneity x-EMEs: Heterogenous policy responses?



Conventional View: The Policy Trilemma
Policy Responses Constrained by ERR



- Monetary policy unable to respond with fixed rates
- Exchange rate cannot be managed if want monetary independence
- Empirics (Klein & Shambaugh 2015): Taylor Rules do not fit well if fixed exchange rates

Possibility of Alternative Options?
Rounding the Corners of the Trilemma

Capital Controls: Gates or Walls

Monetary Autonomy

Soft Peg

- Episodic Use of Capital Controls (“Gates”)
- Soft Peg rather than Hard Peg
- Klein & Shambaugh 2015:
    - Walls, not gates, unless gates are comprehensive.
    - Soft peg does give some scope for greater monetary autonomy.

Some Final Thoughts

- Spillovers generate important economic and political debates. But to what extent are problems (or at least vulnerabilities) home-grown?
- Conventional monetary (beggar thy neighbor) and fiscal (engine of growth) spillovers seem to hold.
- Challenges beyond standard international monetary policy games when economies in different phases of cycles
- Alternative channels: VIX and risk, Asset holdings and banking and other financial channels, multiple types of asset flows.
- Alternative policies for alternative channels? Capital controls, cross-national regulation, supervision and LLR