Global Dimensions of U.S. Monetary Policy

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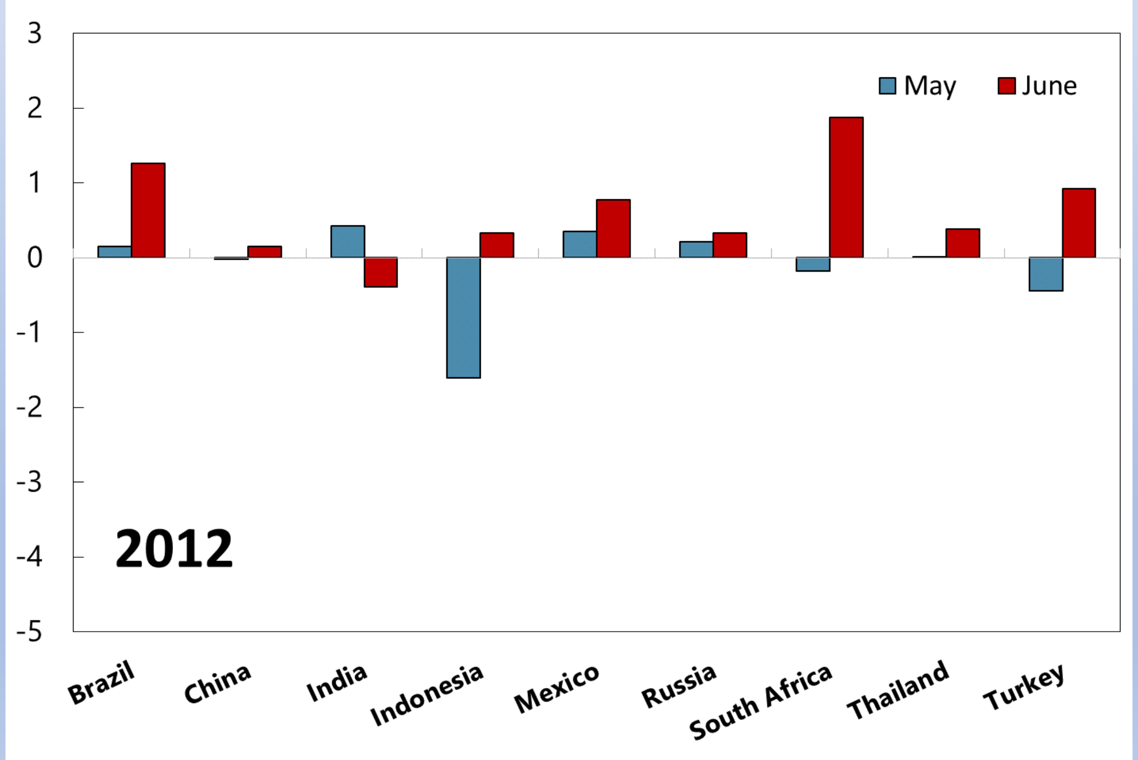
Shocks: Short-term Impact

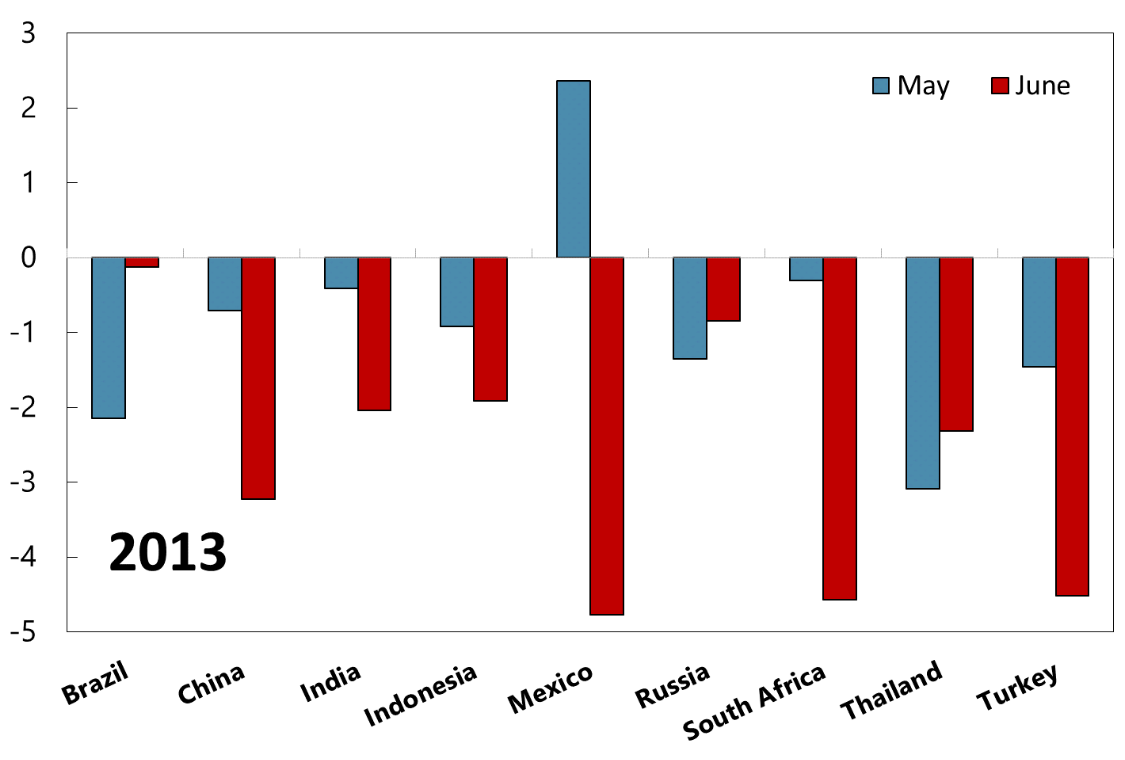
Capital flows behave differently in tranquil and non-tranquil times…

Capital flows
(Z-score)

Tranquil
(1 year before Taper Tantrum)



Non-tranquil
(During Taper Tantrum)

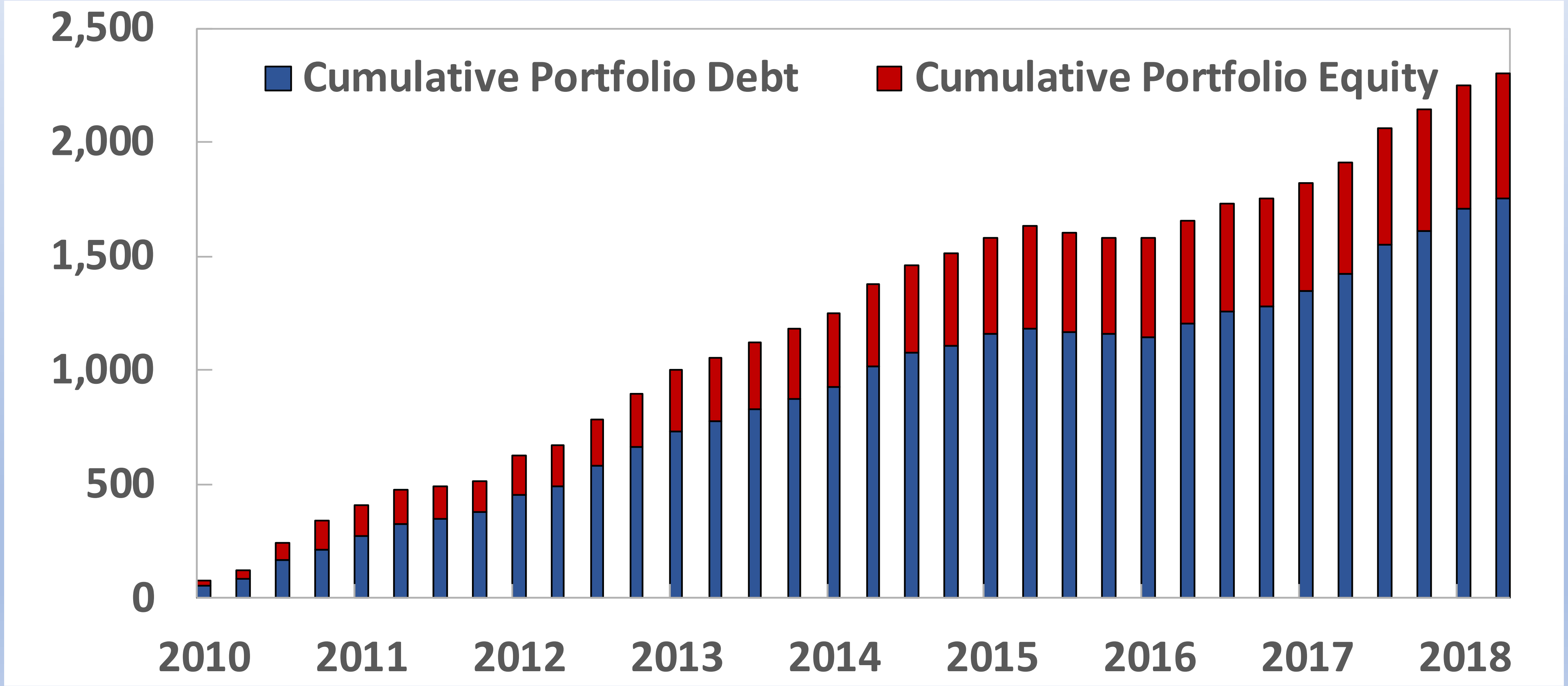


Source: SDN 14/09

Shocks: Medium-term Impact

Vulnerabilities build over time…

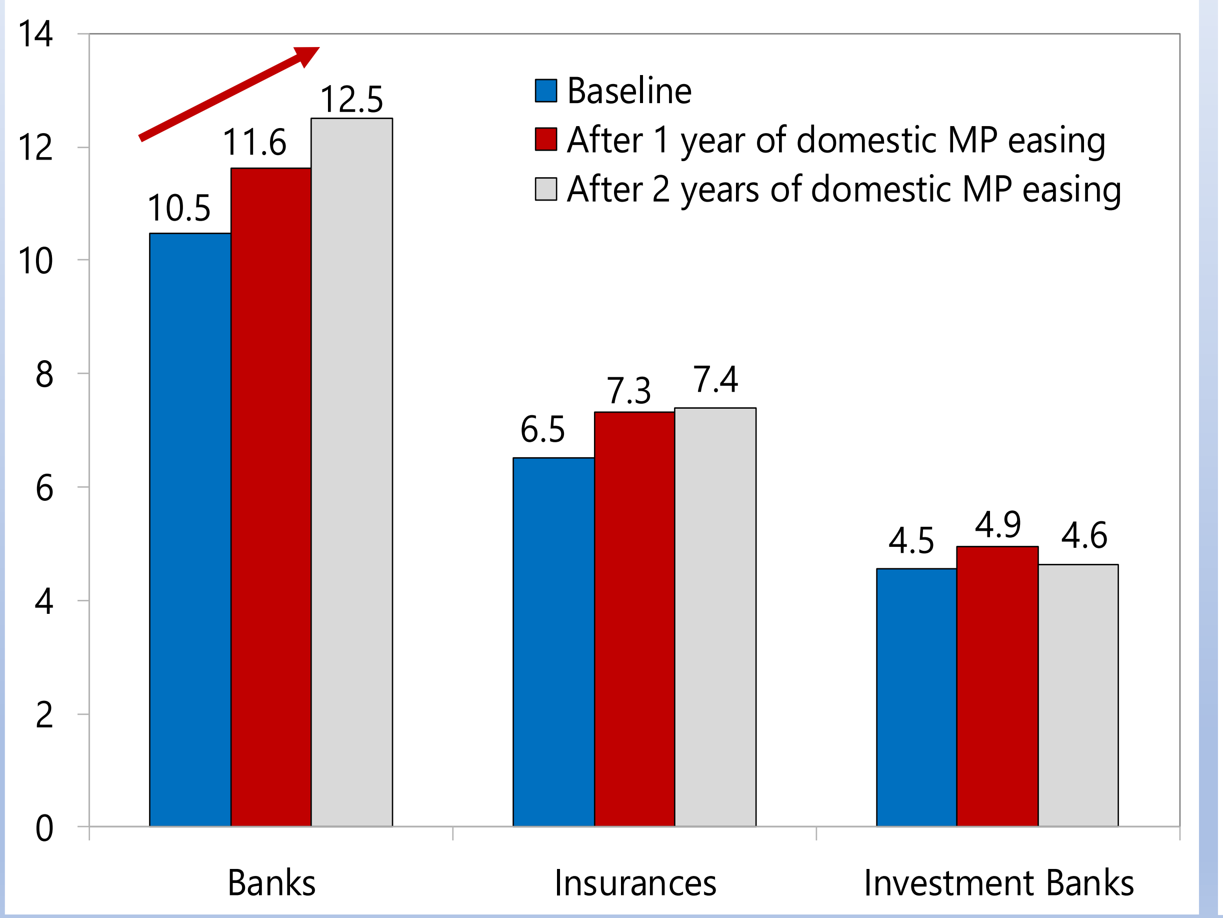
Portfolio Inflows to Emerging Markets (USD, Billions)



Source: IMF FFA database

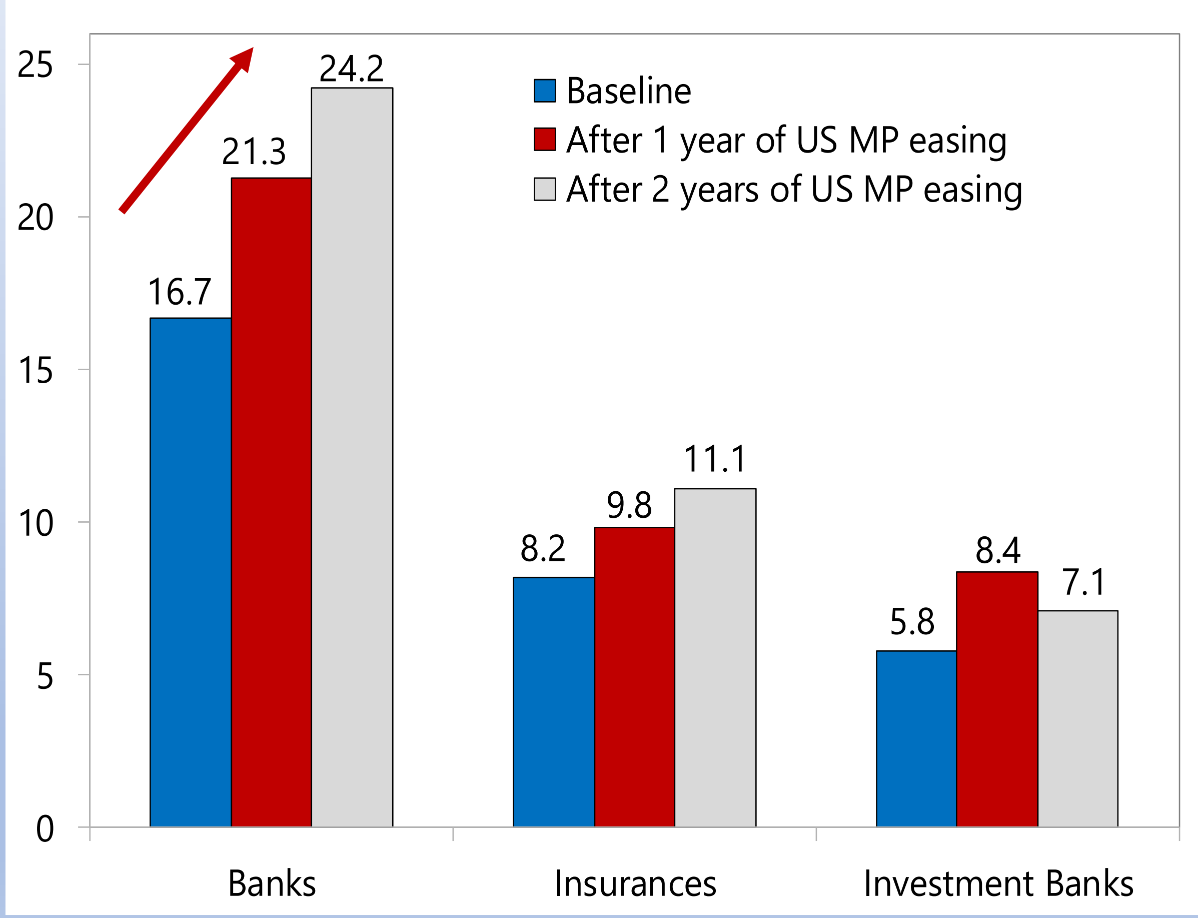
Shocks: Medium-term Impacts (cont.)

Asset-to-equity ratio and prolonged domestic monetary easing



Notes: 988 financial firms from 21 countries.

Asset-to-equity ratio and prolonged US monetary easing



Notes: 613 financial firms from 20 non-U.S. countries.

Sources: Cecchetti, Mancini, Narita, and Sahay (2019).

How do recipient countries respond?

Orthodox camp

(Monetary Policy)

Australia, Chile, Colombia, Russia, South Africa

- Framework has performed well (Australia, Colombia – “happy floaters”)
- FX markets too deep – cannot intervene effectively (South Africa)
- FXI would confuse markets and undermine credibility of recently established IT regime; CFMs undermine investor confidence (Russia)
- Hedging markets won’t develop and balance sheet mismatches will accumulate if central bank keeps intervening (Chile)

Unorthodox camp

(also, FX intervention and capital flow measures)

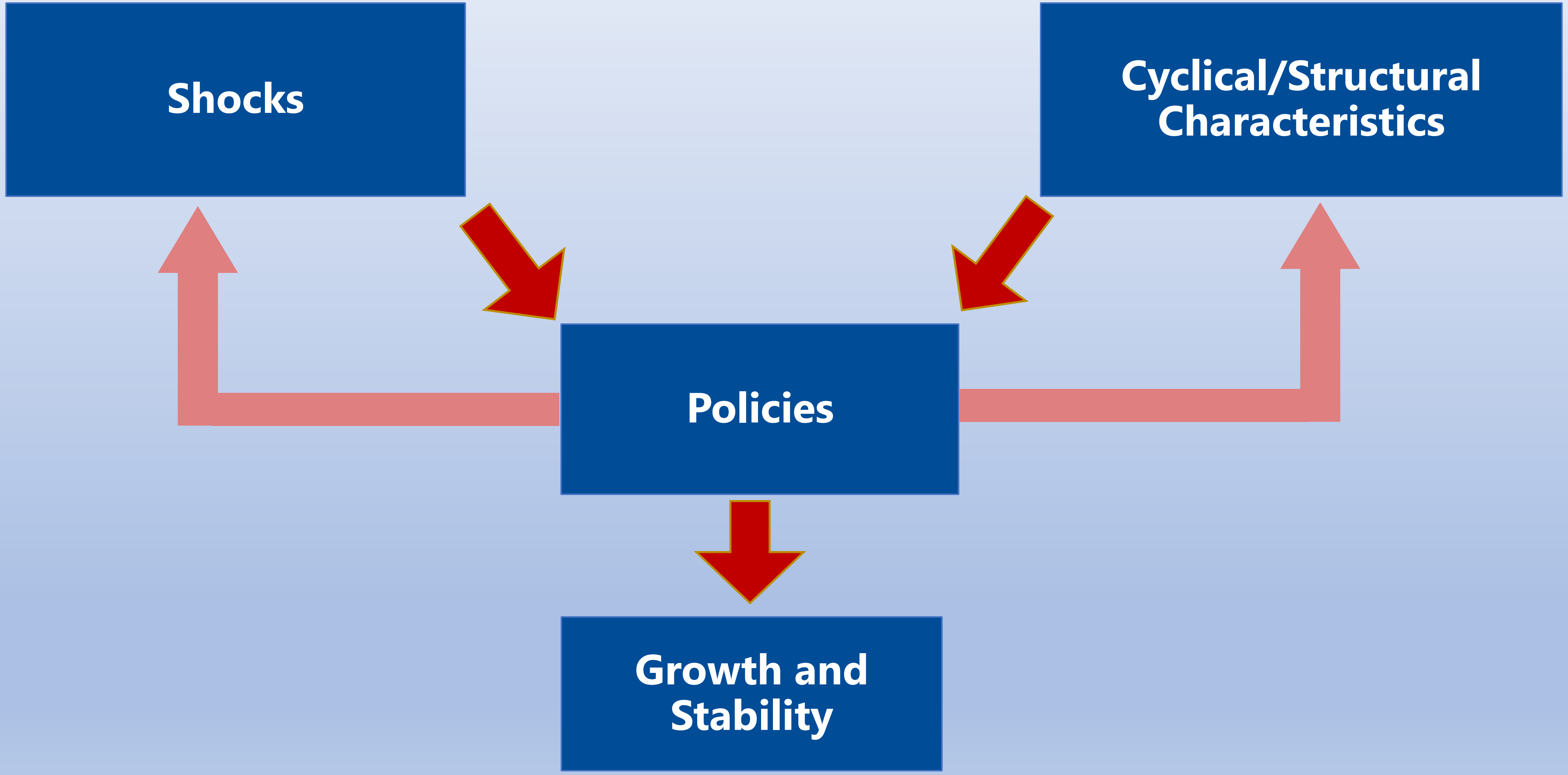
Indonesia, Malaysia, Switzerland, Thailand

- ER response to financial/confidence shocks (as opposed to real shocks) destabilizing (Indonesia, Malaysia)
- Numerous challenges, with real and financial cycles not coinciding, and multiple objectives (including financial stability) – need multiple instruments (Thailand)
- Ran out of room on monetary policy (Switzerland)

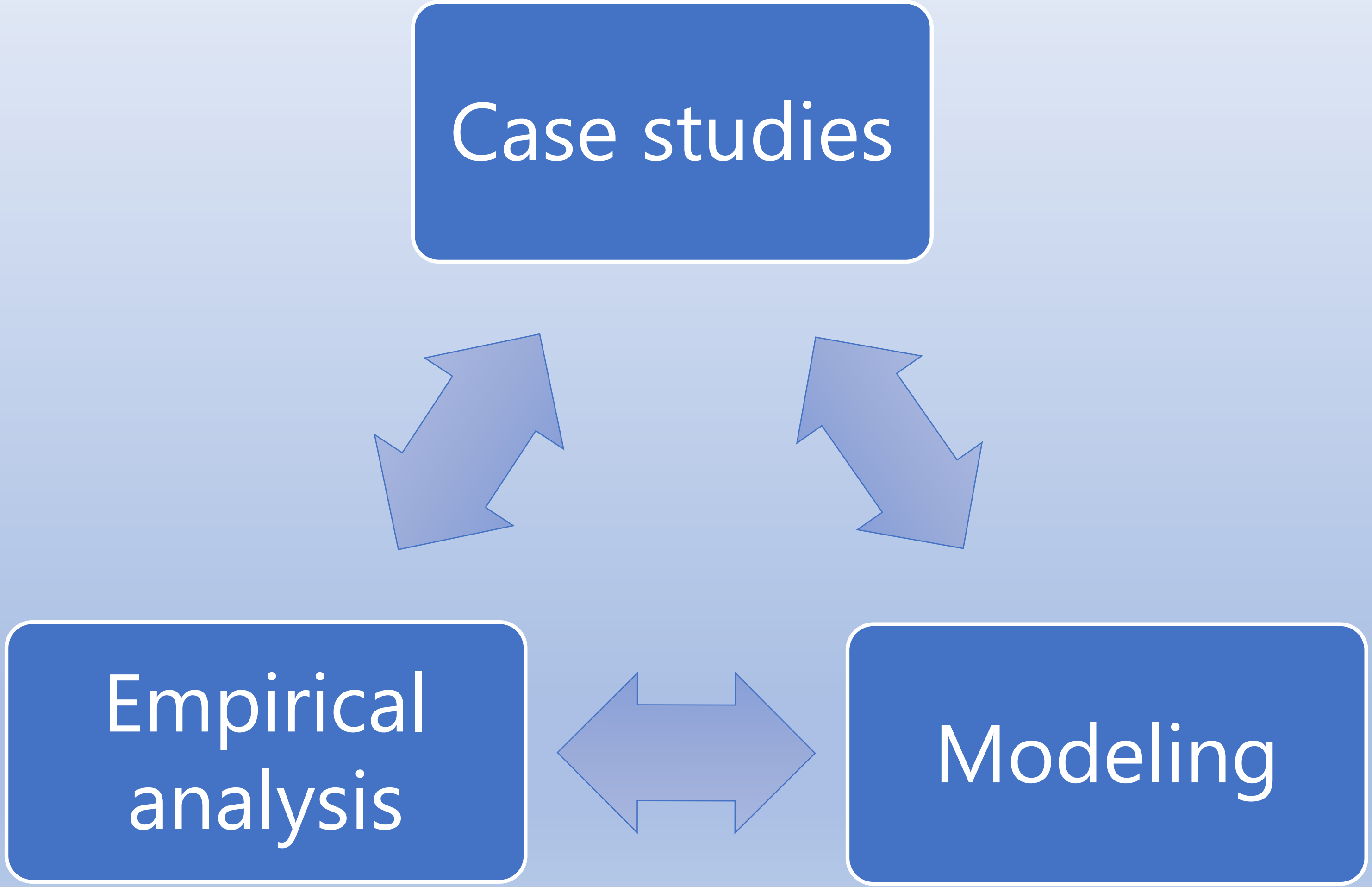
Macroprudential policies used in nearly all countries

What is the IPF?

Linking Shocks, Characteristics, Policies and Objectives

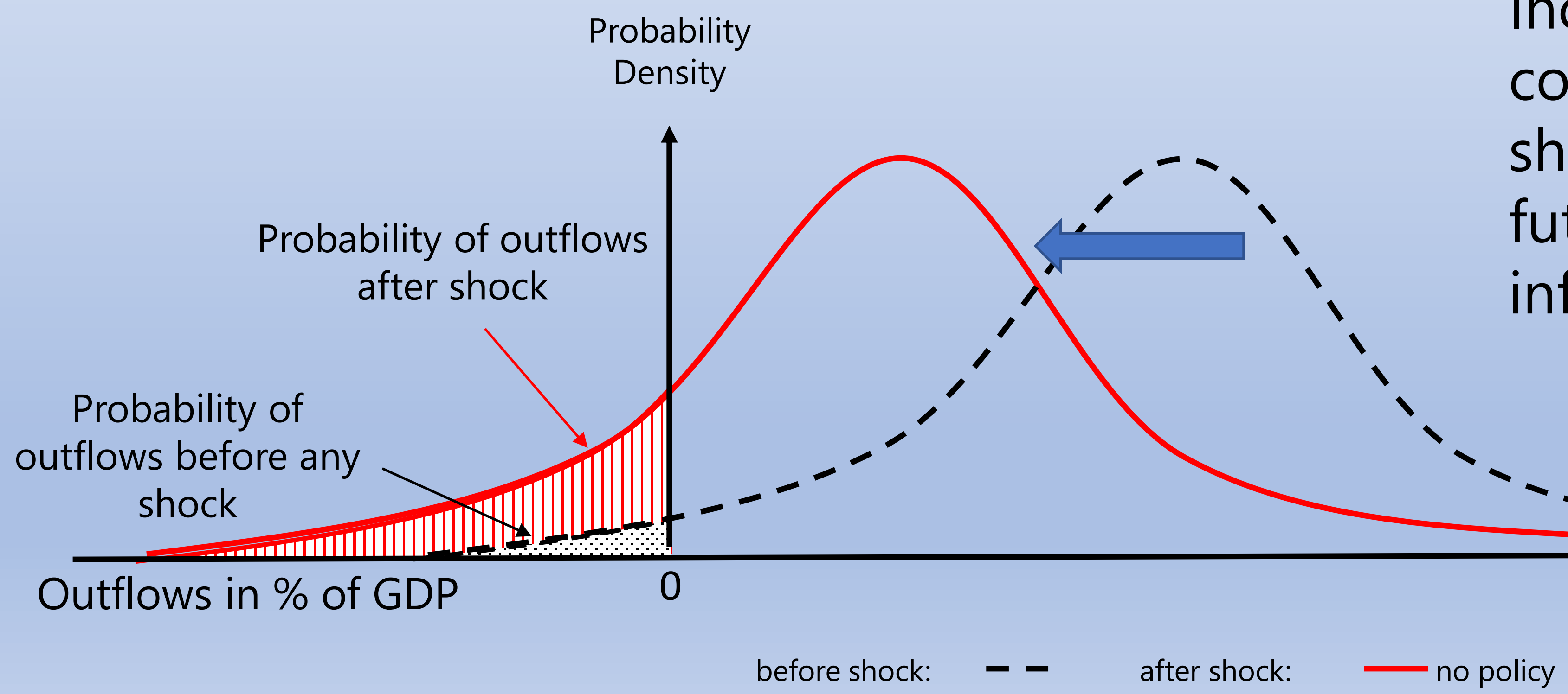


What Is the Approach IMF Is Taking?



Example: Capital Flows at Risk

How do policies affect future distribution of capital flows in response to external shocks?



Increase in the US corporate BBB spread shifts the distribution of future domestic portfolio inflows to the left

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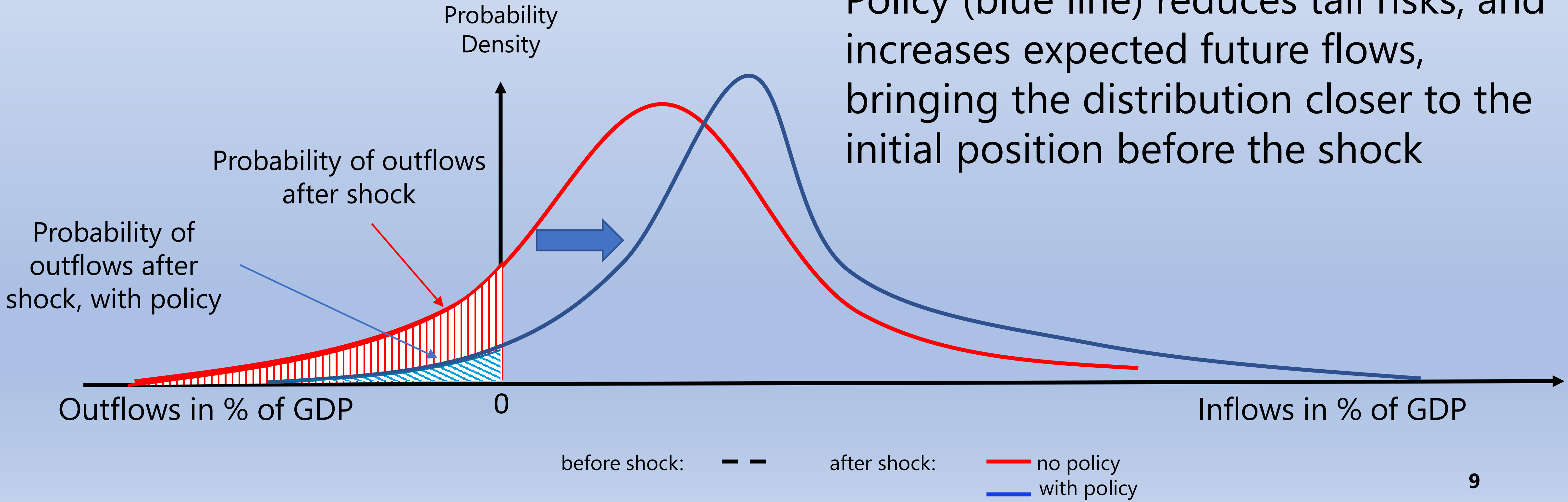

Policy (blue line) reduces tail risks, and increases expected future flows, bringing the distribution closer to the initial position before the shock

Tentative Results So Far

- A number of features seem to increase the resilience of capital flows to external shocks, including better institutions, deeper financial markets, flexible exchange rates, and open capital accounts.
  - While capital flows may be more volatile in the near-term, they bounce back more quickly.
  - FXI appears to reduce the risk of large outflows in the short term, but not CFMs.
- Borrower-based macroprudential tools dampen the build up of financial vulnerabilities.
- Leaning against the build-up of financial vulnerabilities with tighter monetary policy does not seem to reduce medium-term downside risk to growth.