

Monetary Policy Spillovers after the Pandemic

Alan M. Taylor (UC Davis, NBER, CEPR)

Discussion by Woo Jin Choi (KDI)

G20 Global Financial Stability Conference

Sept 2022

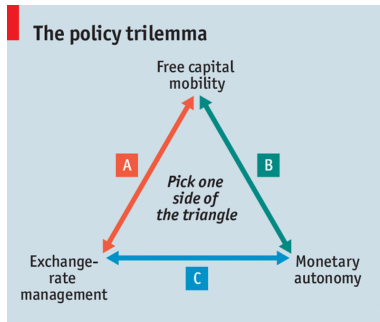
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International Shock Transmission and Global Financial Safety Net

- Various instruments to cope with shock transmission
 - Capital Flow Management, FX Intervention, Macroprudential Policies, FX Swap etc (IMF integrated policy framework (Basu et al 2020))

International Trilemma revisited

- **Can floating exchange rate regime provide the first line of defense?**
- Classic argument, generally known to be better suited for Advanced Economies but also effective for EM
- Corners been rounded? Dilemma? Quadlemma?



Economist.com

International Trilemma (Obstfeld, Shambaugh, and Taylor (2004))

- to stabilize the exchange rate
- to enjoy free international capital mobility
- to engage in a monetary policy oriented toward domestic goals

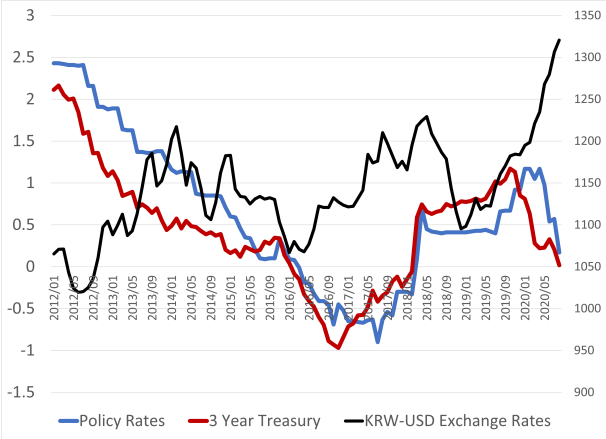
Timely and interesting presentation

- The classic question returns to Korea

(The Bank of Korea Governor) Rhee (Chang-yong) had already signaled his preference for a more gradual pace of tightening, given the impact of higher borrowing costs on record household debt and the gloomier prospects for the global economy Bloomberg, Aug 25 2022

- Monetary tightening in Korea is less aggressive than in the US
 - exchange rate depreciates sharply
 - along with less aggressive FX Intervention
 - and with little capital flow management

Interest Rate Differentials and Exchange Rates



Interesting new episodes, German monetary policy shocks etc

- Peg vs Float, US vs German shock
- spillovers to other European countries

Relevant lessons for Korea

- Coping with two large gravities
 - US business cycle still hot, while import demand (from Korea) to China is sluggish
- Will the Mundell-Fleming adjustment be in place?
 - will the expenditure switching be large enough?
 - possibly through granular players?
 - Let us see..

How much advanced is Korea?

- We are in transition from EM, middle-income, and to advanced economy
 - How (much) can the floating exchange rate regime insulate the economy?
 - How (much) has the institution been improved?
 - Internal / external financial intermediaries?
 - Net creditor with less severe debt dollarization?
- Coordination of policies between the authority in charge of monetary policy and that of external account/exchange rate stability

US Monetary Policy Shock and Foreign Capital Inflows : Before and After the GFC

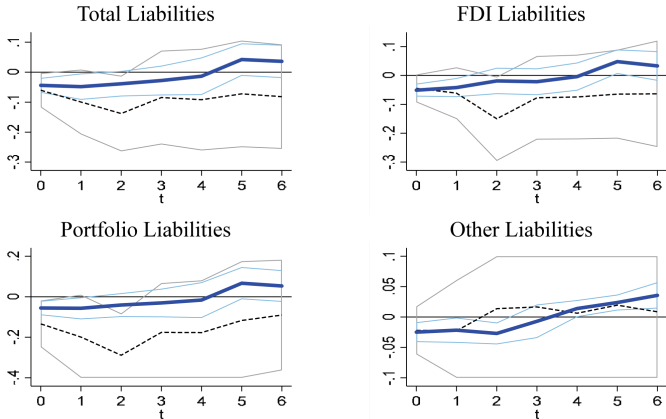


FIGURE 9. IMPULSE RESPONSES TO U.S. MONETARY SHOCKS ON LIABILITIES BEFORE AND AFTER THE GLOBAL FINANCIAL CRISIS

Note: Choi (2020). Solid blue line indicates the results from the after-the-crisis period (2010q1–2019q2), and dashed line denotes the results from the before-the-crisis period (1995q1—2008q4). 90 percent confidence intervals are reported.

Interesting Talk, revisit the classic Trilemma, and It matters at hand!

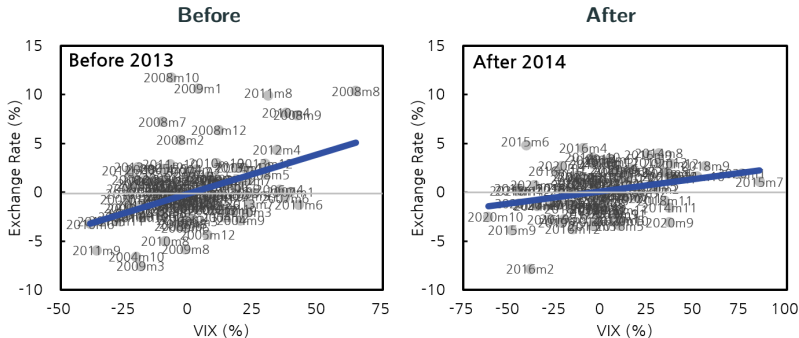
- Broadly, Korea seems to pursue the classic lesson; let the exchange rate float and be the first line of defense
- Maybe we are advanced enough with better institutions?

On going challenges

- coordinations of monetary policy, capital flow managements(CFM), and FX interventions(FXI)
- multiple gravities and internal / external trade offs
- No severe capital outflows at 2017 US tightening. Will it matter this time?
- More details why adjustment of Advanced and EM differ have to be explored

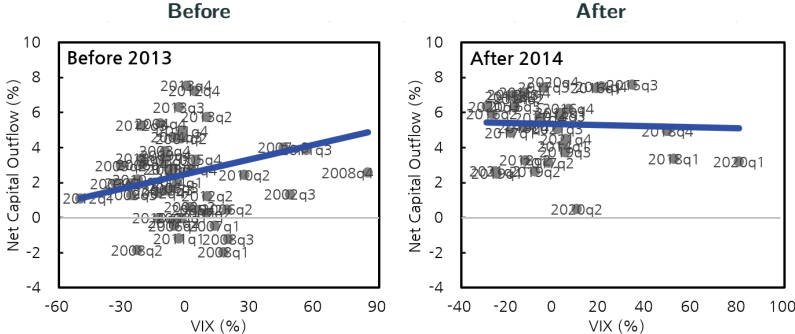
- Basu, Gopinath, Roch, and Unsal (2020) *A Conceptual Model for the Integrated Policy Framework*
- Choi (2022) *The Effect of External Uncertainty on Exchange Rates and Capital Flows*
- Choi (2020) *Effect of US Monetary Policy on Gross Capital Flows: Cases in Korea*
- Obstfeld, Shambaugh, and Taylor (2004) *The trilemma in history: Tradeoffs among exchange rates, monetary policies, and capital mobility*

Scatter Plot: Nominal Exchange Rate



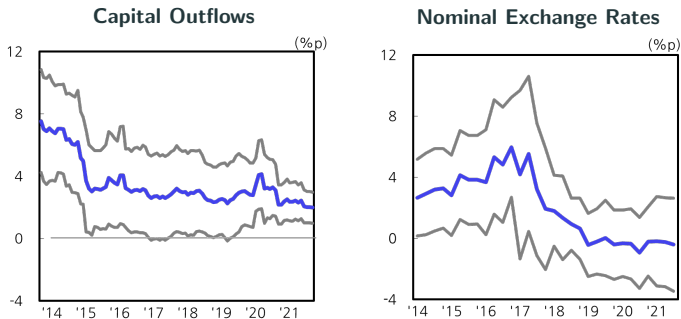
Note: Choi (2022). Augmented UIP regression with VIX.

Scatter Plot: Capital Outflows



Note: Choi (2022). Capital Flow determination.

Declining Responsiveness to VIX



Note: Choi (2022). Rolling coefficients for 5 years of capital flow determination, and nominal exchange rate determination.

Investment Environments in Korea

