

Monetary Policy Spillovers after the Pandemic

Alan Taylor

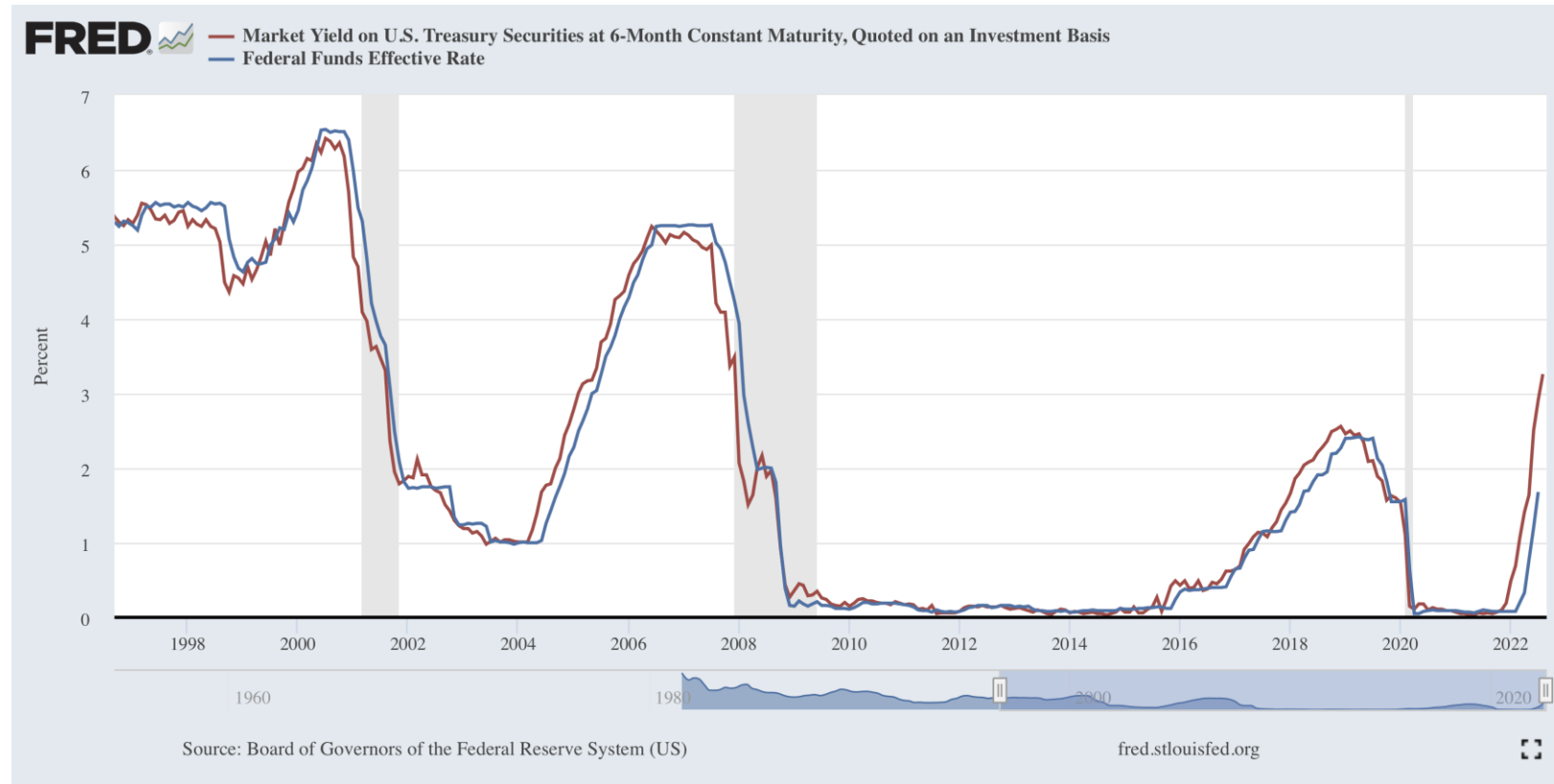
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The trilemma and macro-financial stability in EM

- Outline

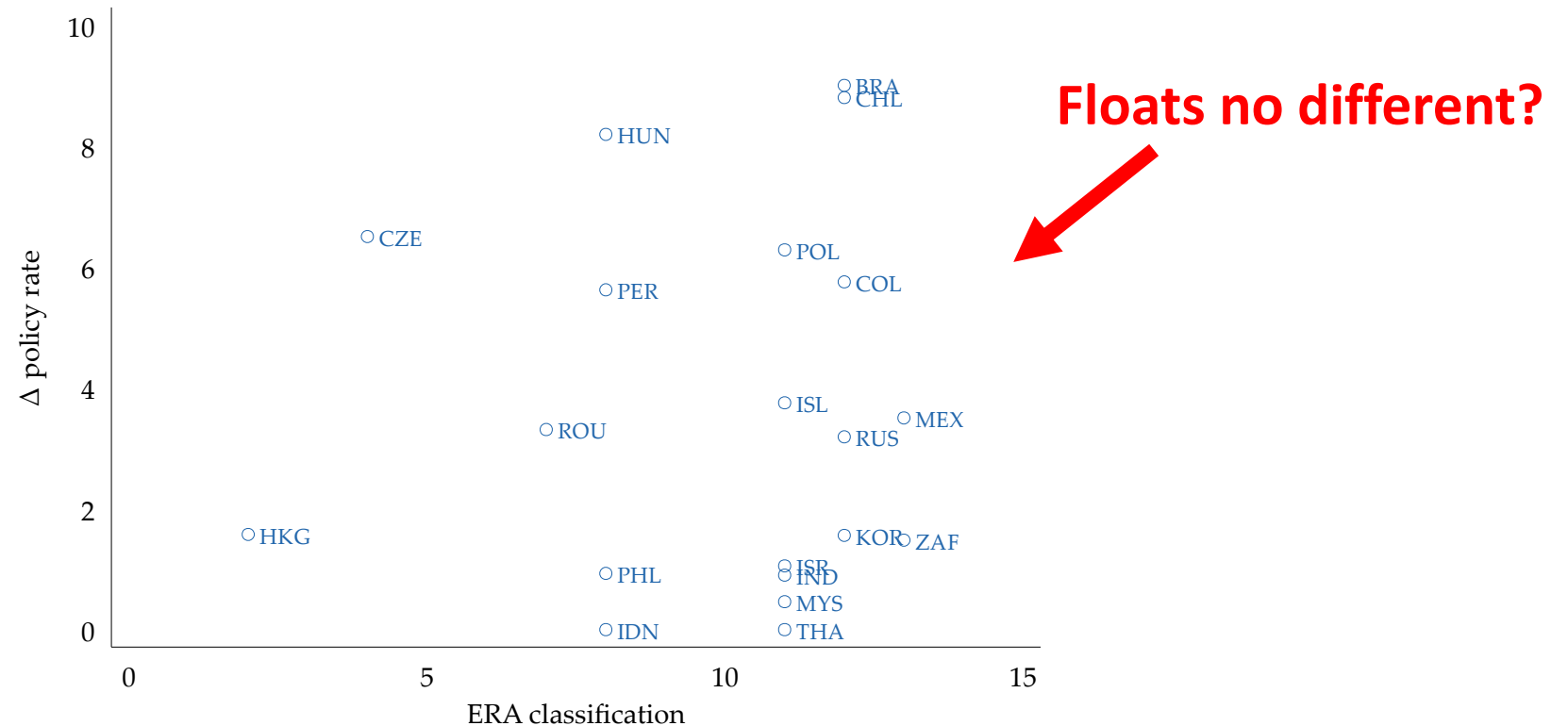
- Has the death of the trilemma been exaggerated?
 - Necessary v sufficient? EM experience in recent Fed hiking cycles
 - Currency irrelevance? “Textbook” view versus dilemma GFC view in DM
 - Where are we now? EM v DM, insights from recent research

Fed hiking cycles



4 cycles in 25 years. The two most recent 2016–18 and 2021-22.

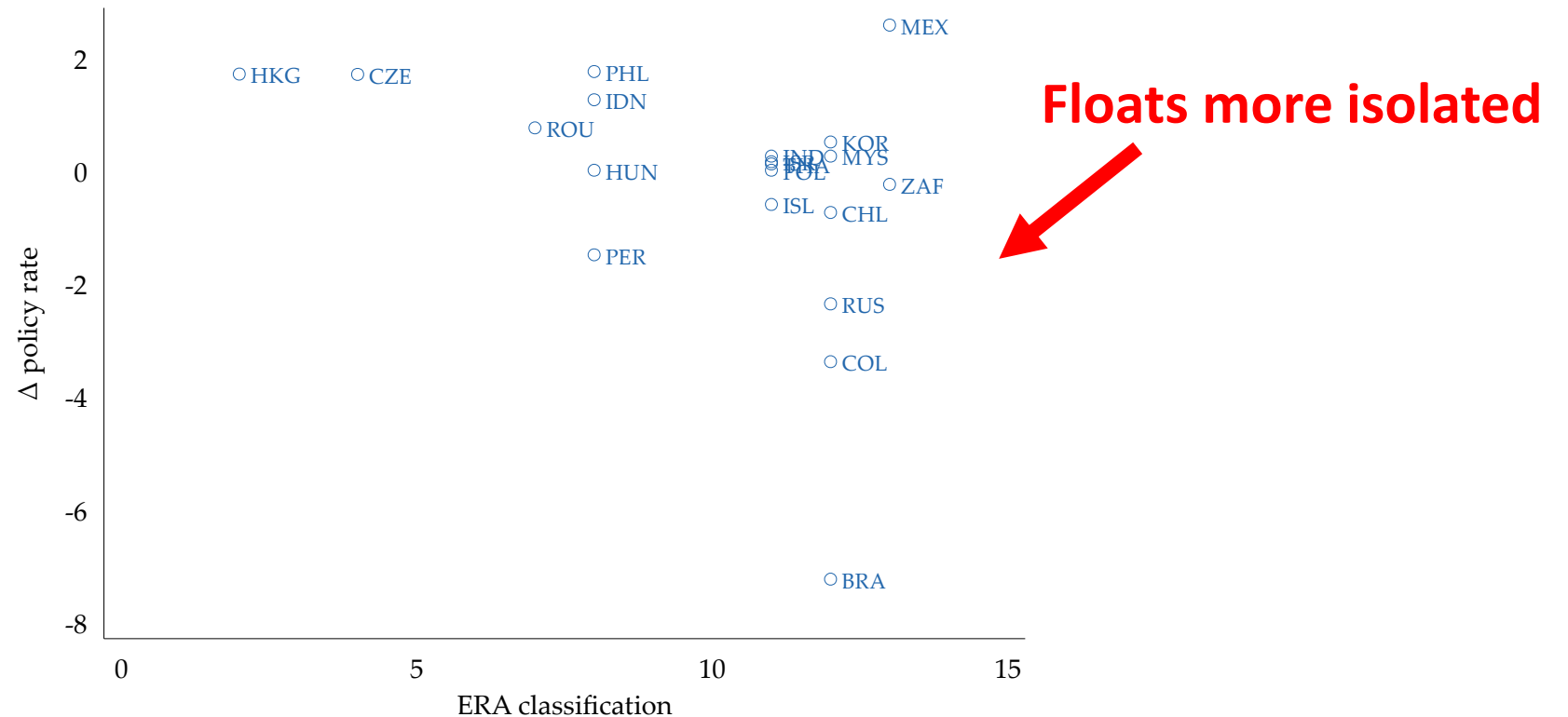
Episode 1: 2021–2022 Fed hiking cycle and EM policy



Positive rank correlation: $p=0.688$

N=21: BRA, CHL, COL, CZE, HKG, HRV, HUN, IDN, IND, ISL, ISR, KOR, MEX, MYS, PER, PHL, POL, ROU, RUS, THA, ZAF₃

Episode 2: 2016–2018 Fed hiking cycle and EM policy



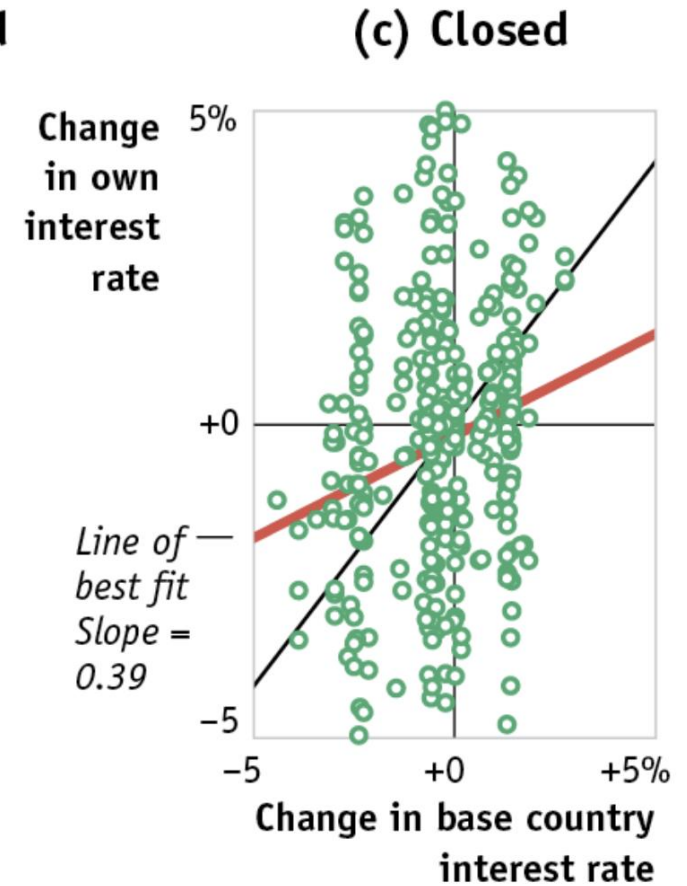
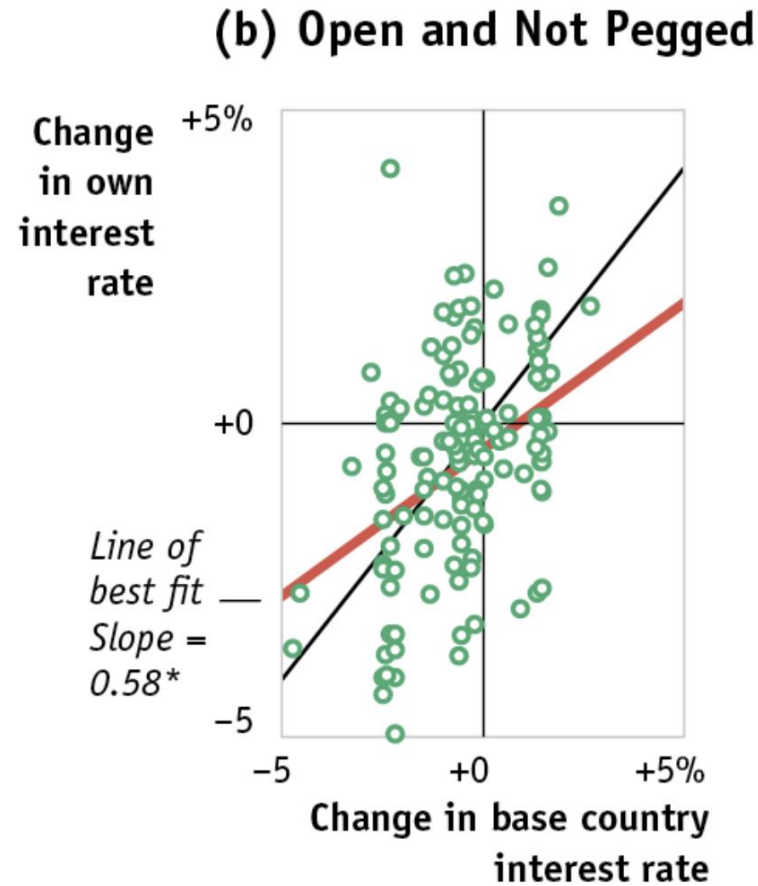
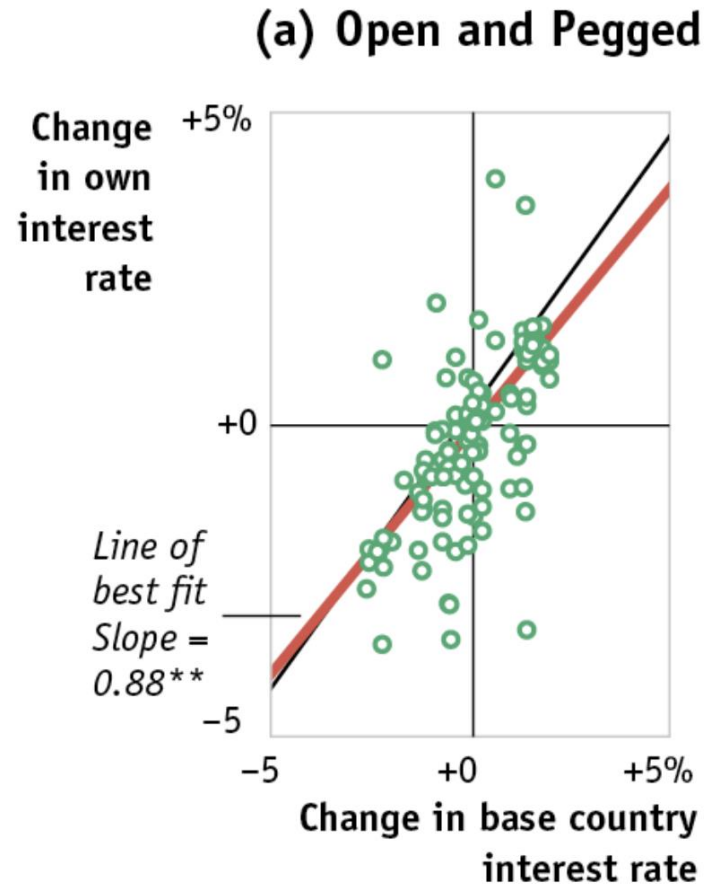
Negative rank correlation: $p=0.066$

N=21: BRA, CHL, COL, CZE, HKG, HRV, HUN, IDN, IND, ISL, ISR, KOR, MEX, MYS, PER, PHL, POL, ROU, RUS, THA, ZAF₄

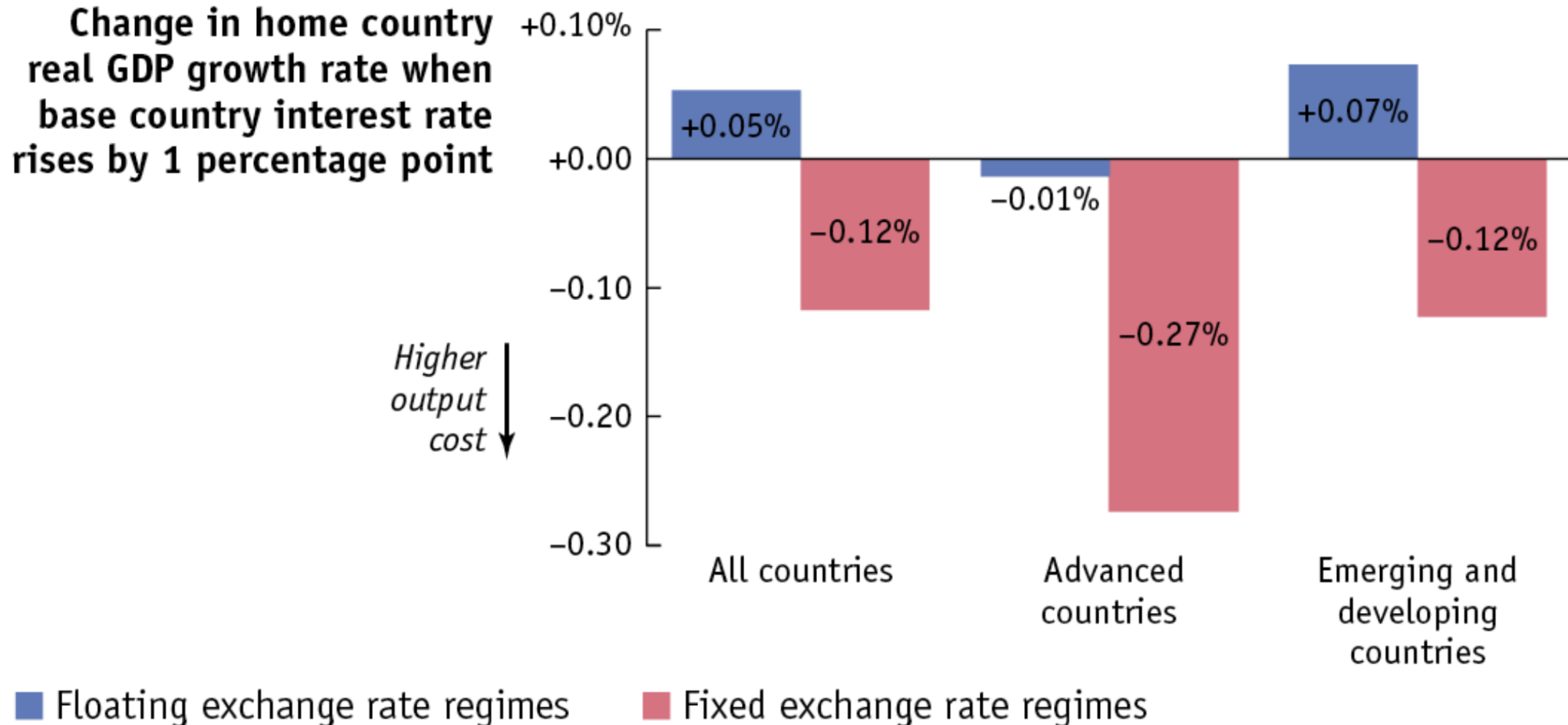
Lessons

- From the outset we always knew...
 - Real world classifications are continuous not binary
 - Autonomy v Independence
 - Fixed v flexible
 - Open v closed
 - Trilemma does not directly predict rate correlations
 - Freedom to deviate \neq desire to deviate
 - Common v global shocks matter
 - Identification (“right” quasi-random experiment) not straightforward

Brief history of the trilemma: textbook, rates



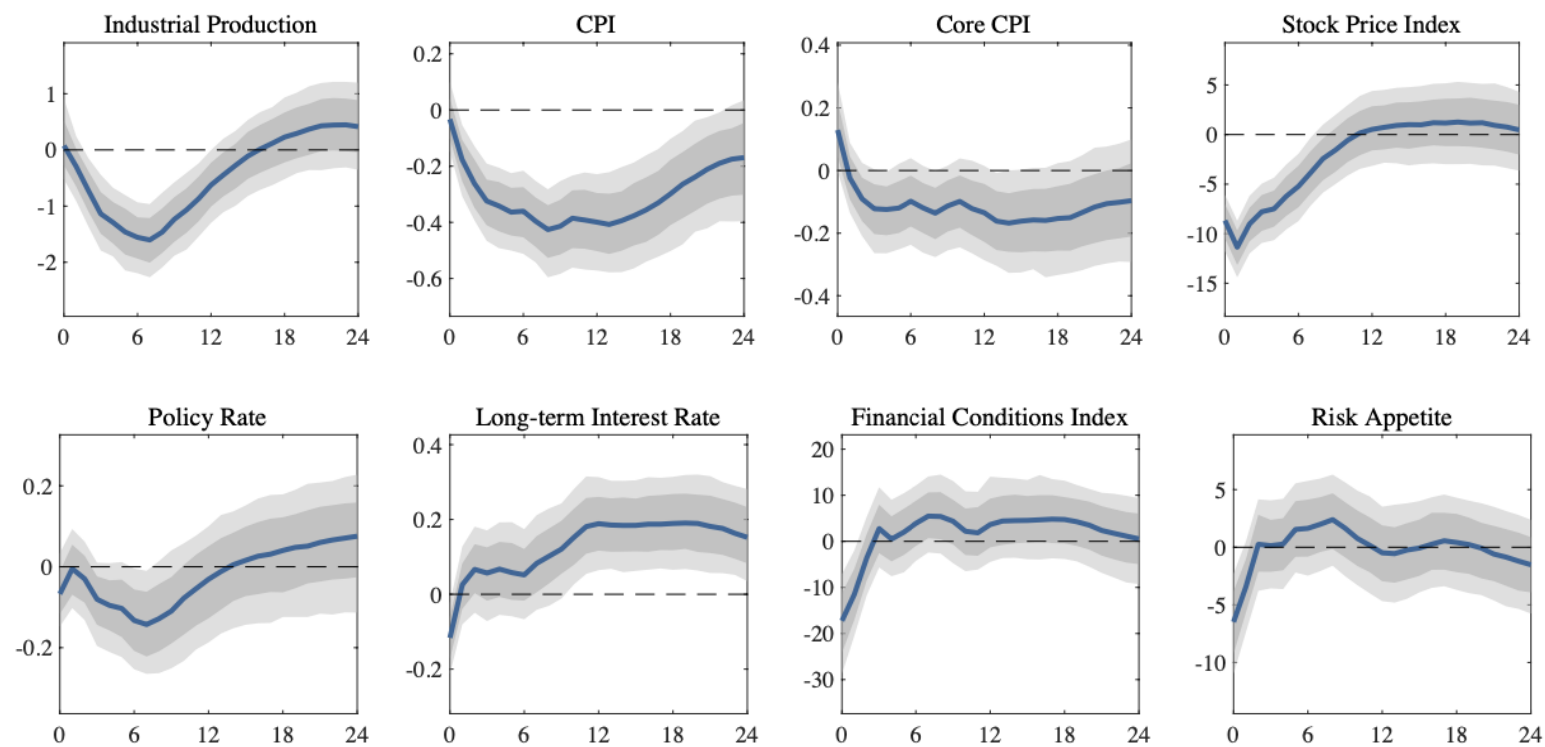
Brief history of the trilemma: textbook, output



Feenstra/Taylor, *International Macroeconomics*, 5e © 2021
Worth Publishers

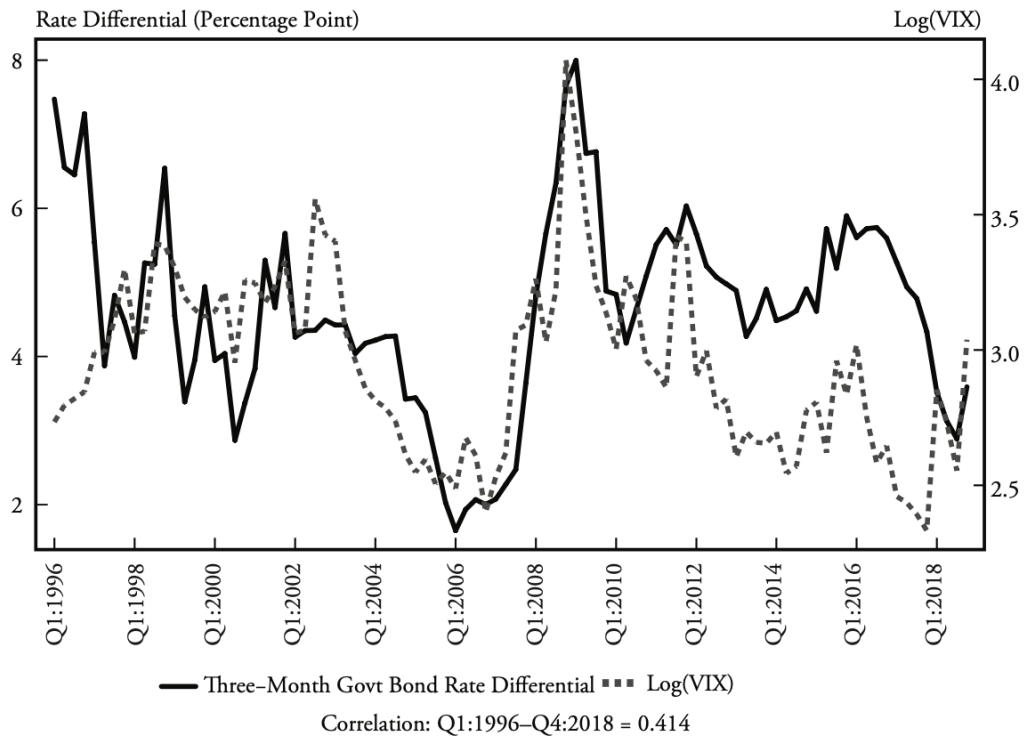
Dilemma? A story of the Global Financial Cycle in DM

FIGURE 5: MEDIAN RESPONSES OF ADVANCED ECONOMIES

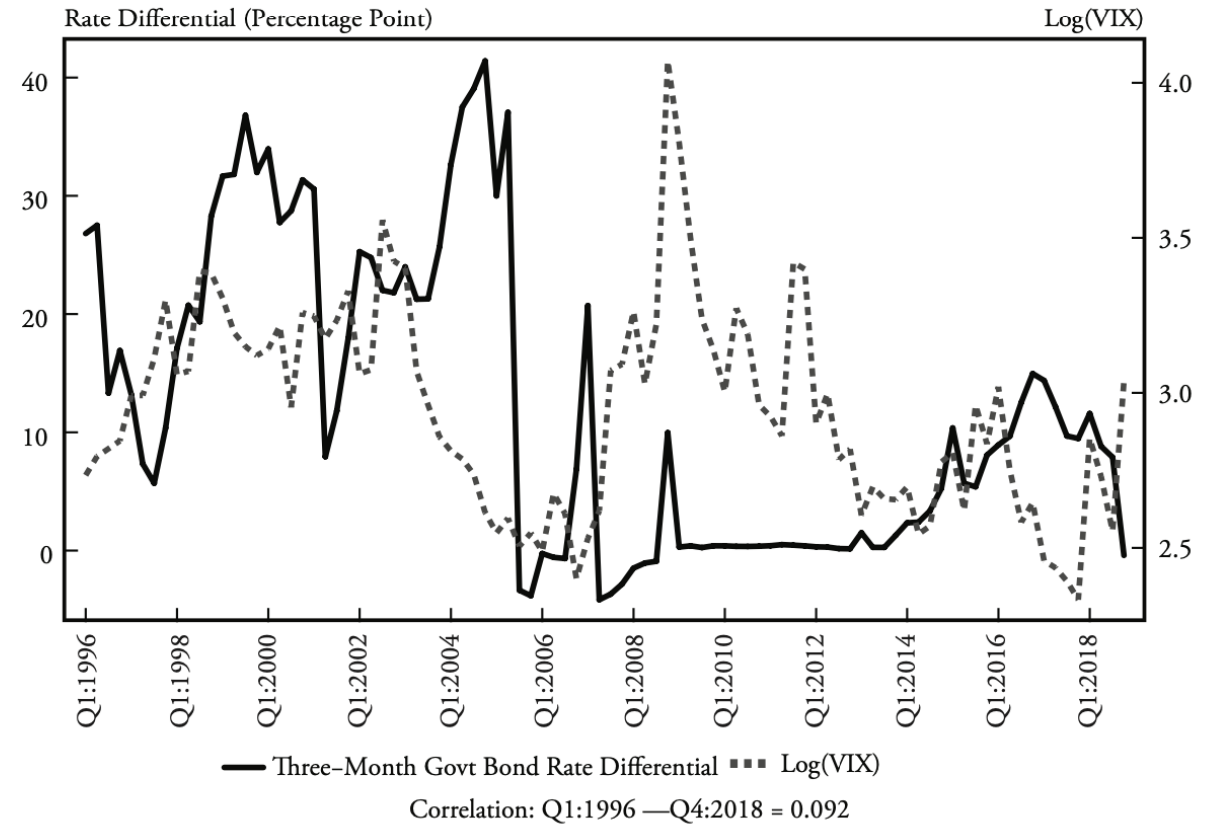


Brief history of the trilemma, EM v DM

A. Managed Floats

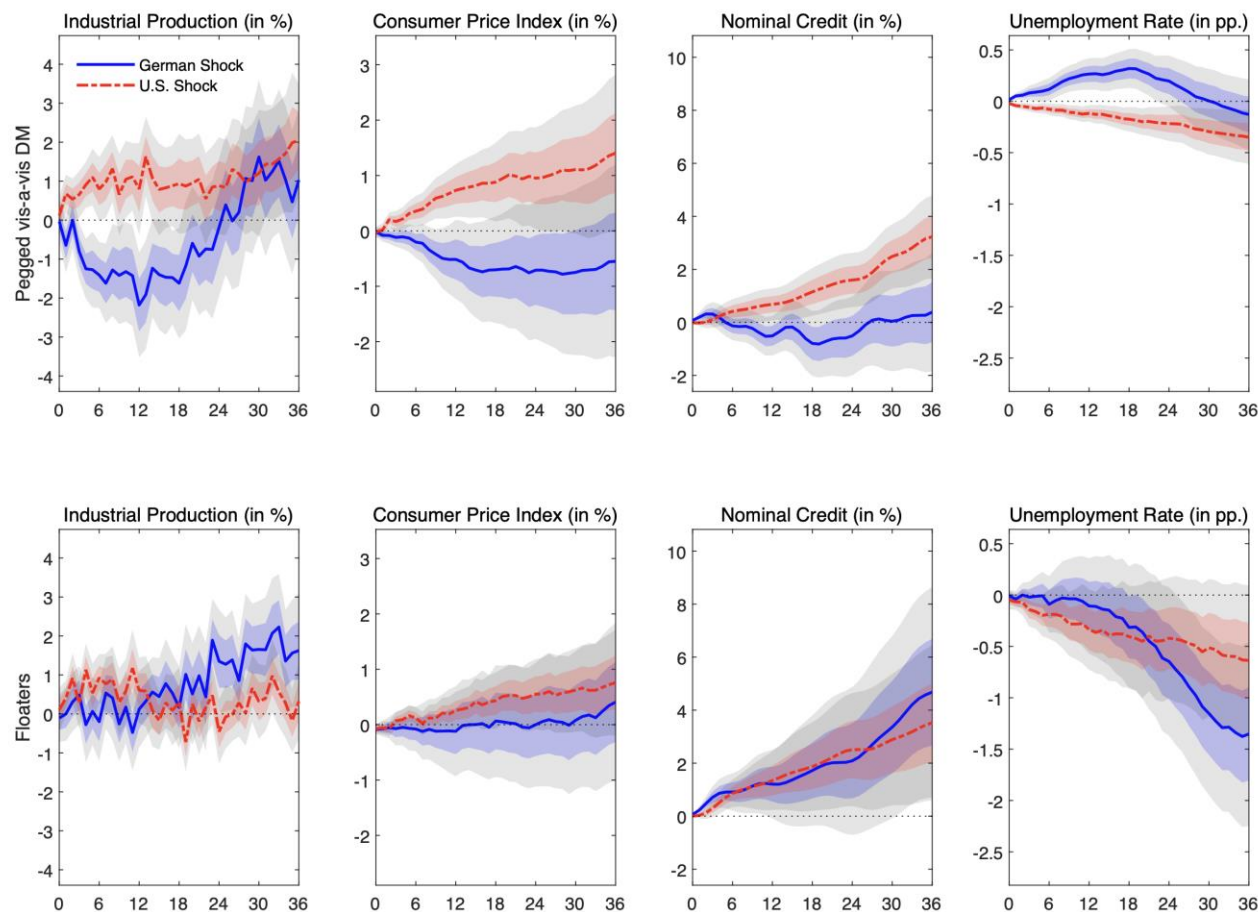


B. Free Floats



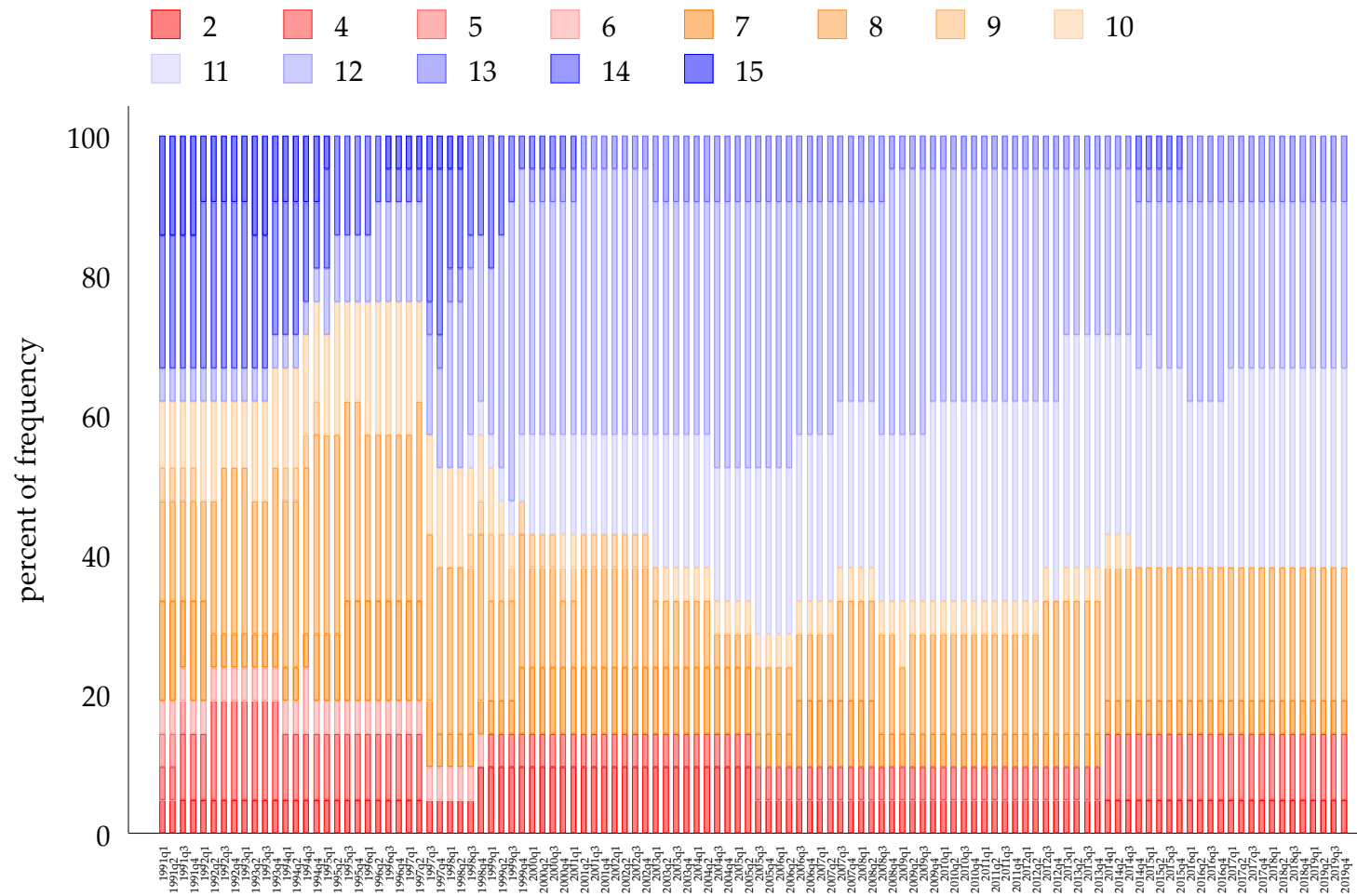
Brief history of the trilemma, a European experiment

Figure 4: *Monetary Spillovers to Major European Economies: Pegs vs. Floats*



Some new evidence

ERA fine classification, EM sample 1991–2019



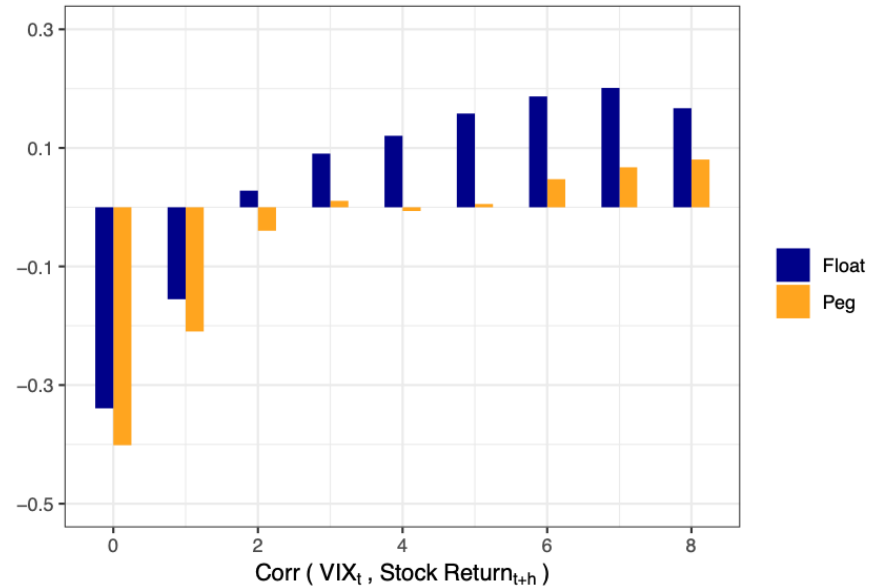
Some new evidence

Regress Q change in local EM policy rate on change in US 6mo TSY rate (OLS or IV using Swanson HF surprises)

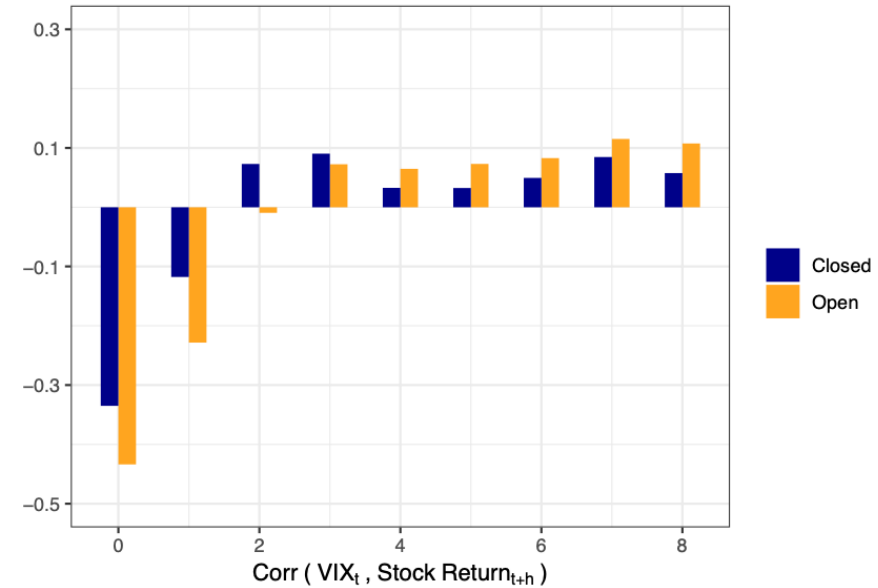
OLS	(1)	(2)	(3)
	Float ERA>=11	Peg ERA<=10	Hard Peg ERA<=6
Change in US 6m TSY rate	0.076	0.157	0.592*
	(0.64)	(1.21)	(2.34)
N	1120	799	255
F	0.41	1.46	5.48

IV	(1)	(2)	(3)
	Float ERA>=11	Peg ERA<=10	Hard Peg ERA<=6
Change in US 6m TSY rate	0.386	0.778*	1.589*
	(1.35)	(2.36)	(2.37)
N	1120	799	255
F	1.83	5.56	5.57
Weak IV F-test	225.68	148.32	43.60

Financial spillovers



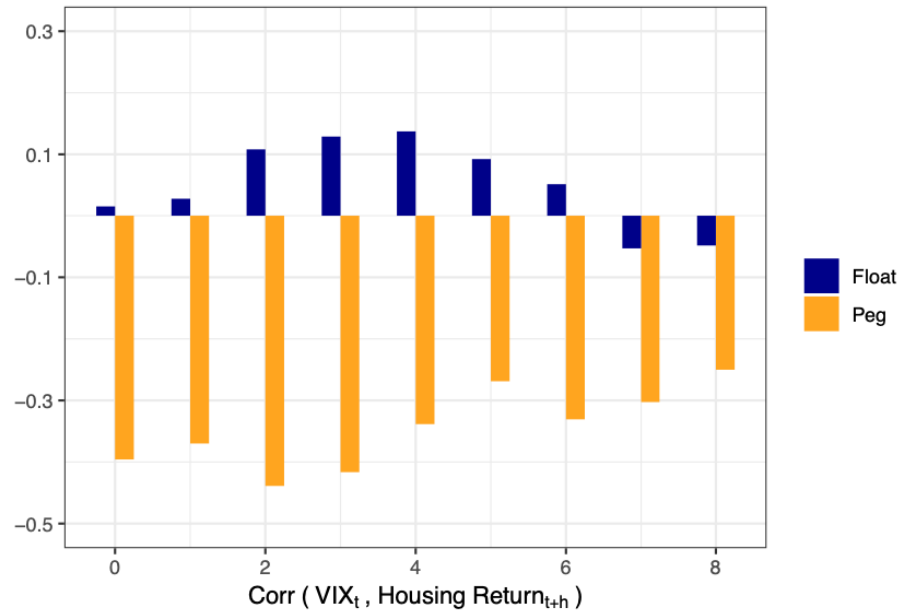
(a) Peg vs. Float



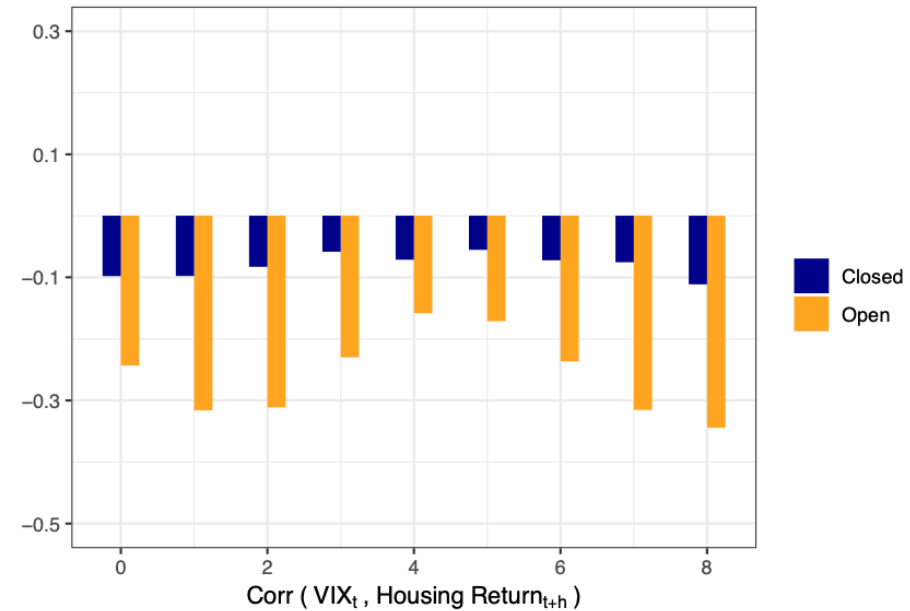
(b) Closed vs. Open

Figure 4: Stock: Serial correlations between the VIX and stock market returns split by exchange rate regime and capital controls

Financial spillovers



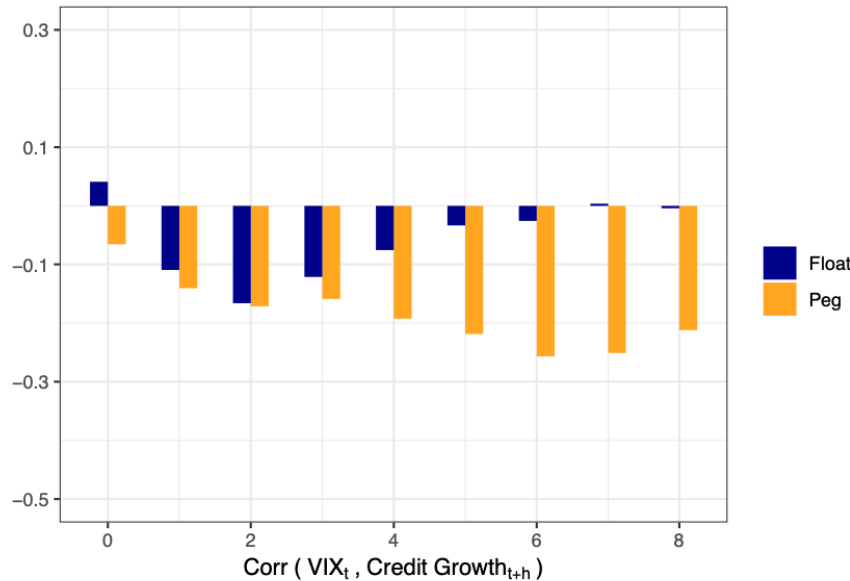
(a) Peg vs. Float



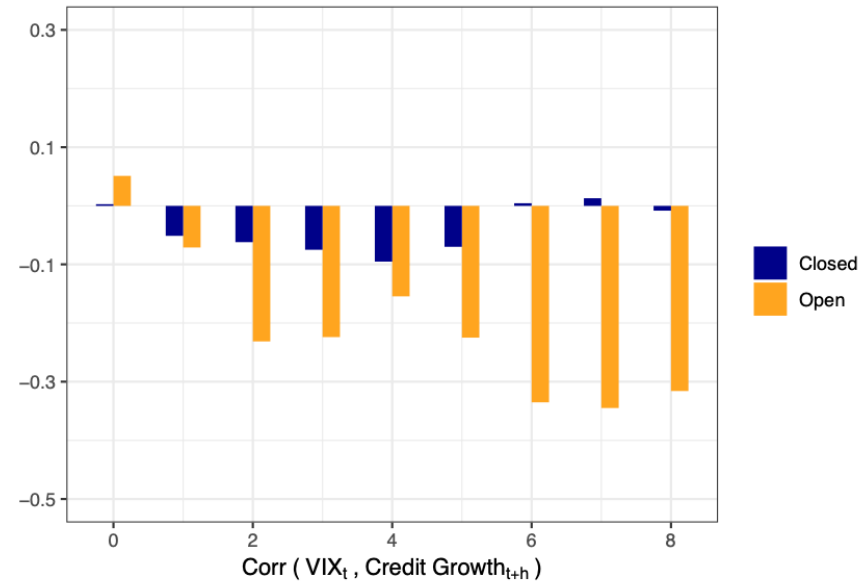
(b) Closed vs. Open

Figure 5: Housing: Serial correlations between the VIX and housing returns split by exchange rate regime and capital controls

Financial spillovers



(a) Peg vs. Float



(b) Closed vs. Open

Figure 6: Credit: Serial correlations between the VIX and credit growth split by exchange rate regime and capital controls

Conclusions

- Lessons of the trilemma still endure
 - Other transmission channels can intervene in DM v EM
 - Lack of natural experiments, tricky identification
 - Newer evidence supportive, maybe more so in EM
- Implications for macro-financial stability
 - Historically large hiking cycle underway
 - Pegs likely to suffer more from unwanted spillovers