



International policy cooperation in a world of policy spillovers

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Panel remarks on "How should monetary, fiscal and financial policies be coordinated?"
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Views expressed are those of the presenter and not necessarily those of the BIS.

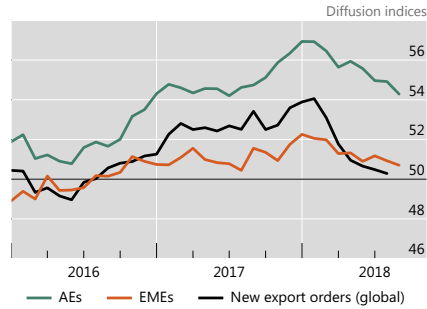


Global conjunctural picture, Q3 2018

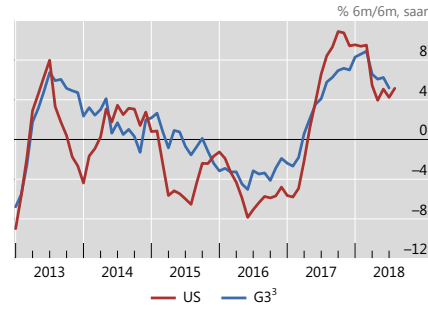
- Global economy at a mature stage of the upswing: output in major economies at or above potential, inflation and wage growth edging up
- Monetary policies in major advanced economies gradually normalising, at different paces
- Fiscal policies turned more expansionary
- Financial conditions still very easy in advanced economies, tightening for some EMEs
- Still lot of public debt in advanced economies (and some EMEs) and private debt in EMEs and advanced small open economies
- Dollar has strengthened, oil and commodity prices have risen

Signs of a softening expansion?

PMIs for manufacturing¹



G3 capital goods orders²



¹ Purchasing managers' indices. A value of 50 indicates that the number of firms reporting business expansion and contraction is equal; a value above 50 indicates expansion. Weighted averages based on GDP and PPP exchange rates: seven AEs and 16 EMEs. ² For Germany, new orders of total capital goods in the manufacturing sector. For Japan, new orders of machinery (excluding volatile orders) in the private sector. For the United States, new orders of non-defence capital goods (excluding aircraft) in the manufacturing sector. ³ Weighted average based on the GDP and PPP exchange rates of Germany, Japan and the United States.

Sources: Datastream; IHS Markit; national data; BIS calculations.



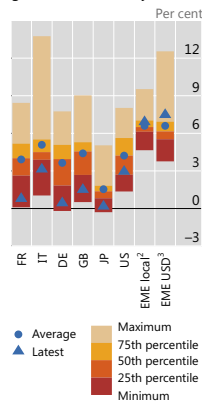
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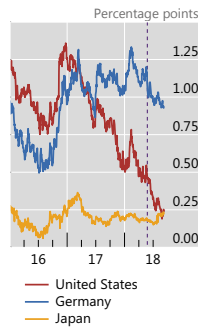
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Global financial conditions remain easy ...

Long-term view of government bond yields¹



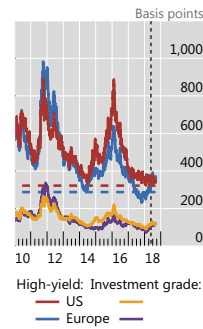
Term spread⁴



US financial conditions⁵



Corporate spreads⁶



The dashed horizontal lines in the right-hand panel indicate averages over the period 1 June 2005–30 June 2007.

¹ Based on long-term historical values of 10-year government bond yields in local currency; for AEs, data since January 1993; for EMElocal data since January 2002; for EMEUSD data since January 2001. ² JPMorgan GBI-EM Index, seven-to-10 year maturity, yield to maturity. ³ JPMorgan EMBI Global, seven-to-10 year maturity, yield to maturity. ⁴ Difference between the 10-year and the two-year government bond yield. ⁵ Federal Reserve Bank of Chicago's National Financial Conditions Index; positive/negative values indicate financial conditions that are tighter/looser than average. ⁶ Option-adjusted spreads.

Sources: Bloomberg; Datastream; ICE BofAML Indices; JPMorgan Chase; BIS calculations.

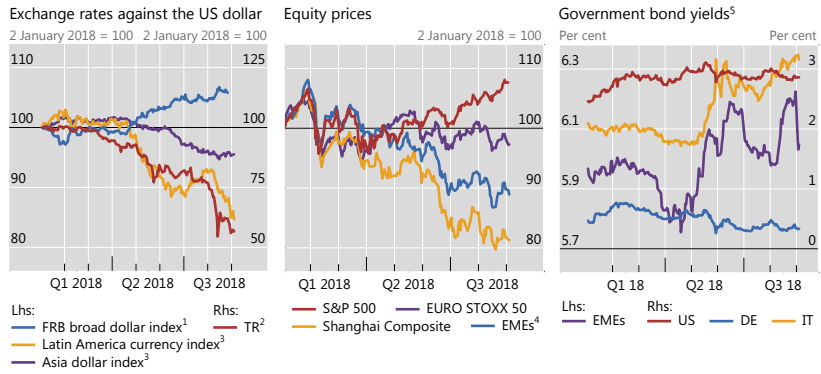


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... but the dollar appreciates and financial conditions in EMEs tighten in Q2 and Q3



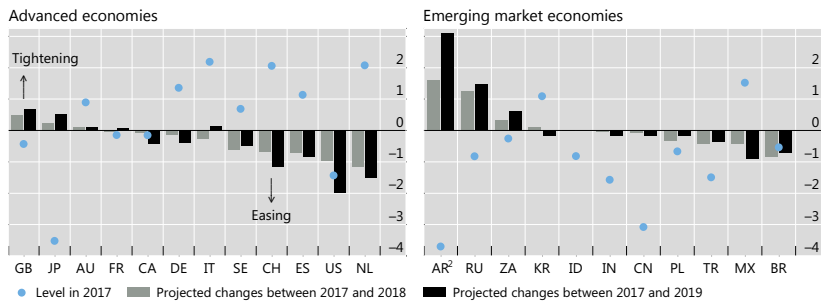
¹ Federal Reserve Board trade-weighted nominal broad dollar index; higher values indicate a stronger US dollar. ² A decrease indicates a depreciation of the local currency. ³ Bloomberg-JPMorgan currency indices. ⁴ MSCI Emerging Markets Index, in US dollars; comprising large and mid-cap stocks across 24 EMEs. ⁵ For EMEs, JPMorgan GBI-EM Broad Composite Index, yield-to-redemption; 10-year yield otherwise.

Sources: Board of Governors of the Federal Reserve System; Bloomberg; Datastream; JPMorgan Chase; MSCI; national data; BIS calculations.



Fiscal easing in a number of economies¹

Forecasts for cyclically adjusted primary balance, as a percentage of potential GDP



Figures comprise only measures reflected in the April 2018 IMF *Fiscal Monitor* and the May 2018 OECD *Economic Outlook*. OECD data for AEs; IMF data for EMEs.

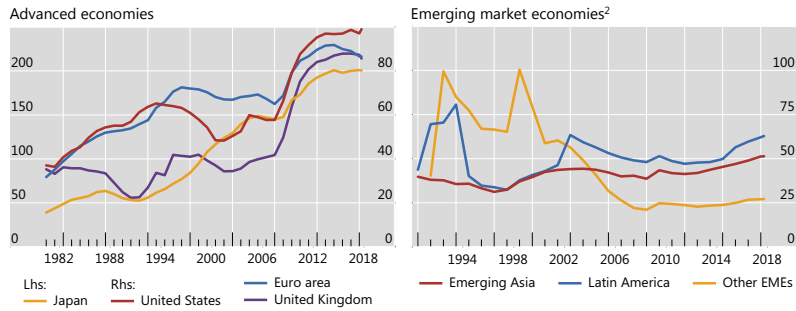
¹ OECD estimates are adjusted for the business cycle and for one-off transactions; IMF estimates are adjusted for the business cycle only. ² Structural federal primary balance; estimated by the IMF after the standby arrangement.

Sources: IMF, press release no 18/245, *Fiscal Monitor*, April 2018; OECD, *Economic Outlook*, May 2018; BIS calculations.



Public debt is close to record highs in many economies¹

As a percentage of GDP

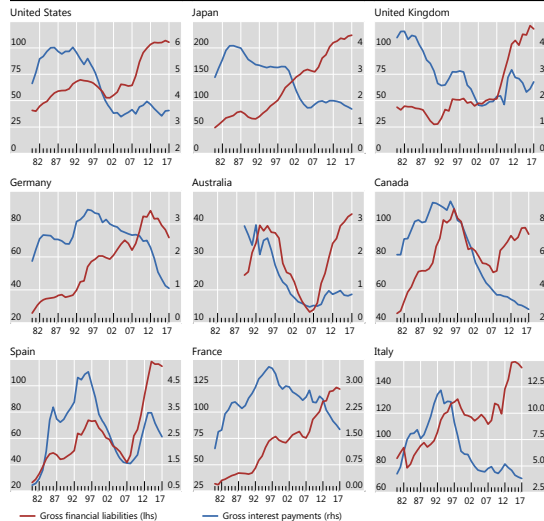


¹ General (if not available, central) government core debt at nominal (if not available, market) value. Backdated using data for core debt at market value, central government debt or public sector debt, based on data availability. Figures for the euro area before 1991 are supplemented with data for the euro area including West Germany. ² Emerging Asia = CN, IN, ID, KR, MY, SG and TH; Latin America = AR, BR and MX; Other EMEs = HU, PL, RU, SA, TR and ZA. Weighted averages based on GDP and PPP exchange rates.

Sources: European Commission, AMECO database; IMF, *World Economic Outlook*; World Bank; Datastream; Global Financial Data; Oxford Economics; national data; BIS total credit statistics; BIS calculations.

Gross interest payments in advanced economies historically low despite elevated public debt¹

As a percentage of GDP



¹ For the general government.
Source: OECD, *Economic Outlook*.

How to coordinate policies against this backdrop?

Domestic policy space

Central bank

- Monetary policy – conventional (interest rates) and unconventional (balance sheet policies)
- Exchange rate policy, capital flows regime
- Banking regulation and supervision (in many countries)

Central bank and other authorities

- Macroprudential policies

Regulation and supervision of financial institutions

- Banking system (central bank or other institution)
- Deposit insurance (central bank or other institution)
- Non-bank financial institutions
- Financial markets

Domestic policy space (cont)

Finance ministry

- Fiscal policy
- Debt management (in some countries: central bank or other agency)

Other ministries

- Structural policies
 - Real sector: competition policy, product market regulation
 - Labour market regulation
 - Social security system (pension system, health care, unemployment, disability insurance)
 - Education, science, R&D
 - Trade policies

Issues for policy coordination

- Domestic
 - Short-term policy mix: assessments of relative stance for MP (pace of normalisation) and FP (extent/withdrawal of stimulus; supports/burdens monetary policy)
 - Developments in asset markets (housing, corporate debt), use of macroprudential tools
 - Medium-/longer-term issues: new normal for monetary policy; fiscal/debt sustainability
 - Institutional, governance arrangements for policy coordination
 - Monetary and financial stability policies
 - Monetary and fiscal policies

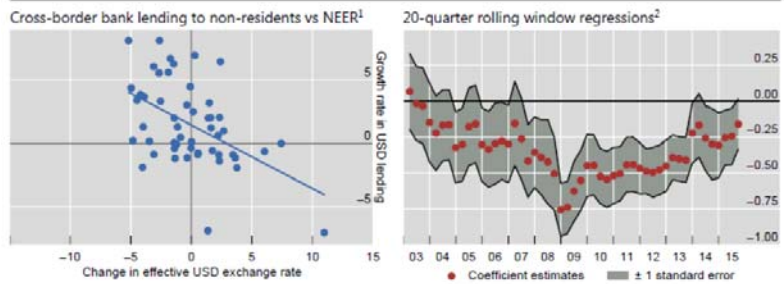
Issues for policy coordination

- International
 - Policies remain too domestically focused ...
 - ... and do not focus enough on financial imbalances
 - We live in a world of global firms, currencies and capital flows
 - Liquidity conditions spill across borders, amplifying domestic imbalances and weaknesses of policy frameworks
 - Direct spillover channel: impact of dollar (and euro) policy rates on interest rates and valuations of dollar debt and assets owed (or held) by non-residents
 - Indirect channel: eg central bank response to exchange rate movements

Financial (“risk-taking”) channel of the exchange rate

Dollar depreciation generally expansionary outside the US: weaker dollar → more dollar lending, lower volatility, more risk-taking
 Dollar appreciation generally contractionary for dollar debtors

US dollar cross-border bank lending and the dollar exchange rate Graph 8



¹ Plot of quarterly growth rate of cross-border bank lending in US dollars on quarterly changes in the US dollar nominal effective exchange rate (NEER) for Q1 2003–Q3 2015. Lending refers to loans by BIS reporting banks to all (bank and non-bank) borrowers outside the US. The line is a fitted regression line. Positive changes indicate an appreciation of the dollar. ² Rolling regression coefficient for 20-quarters window.

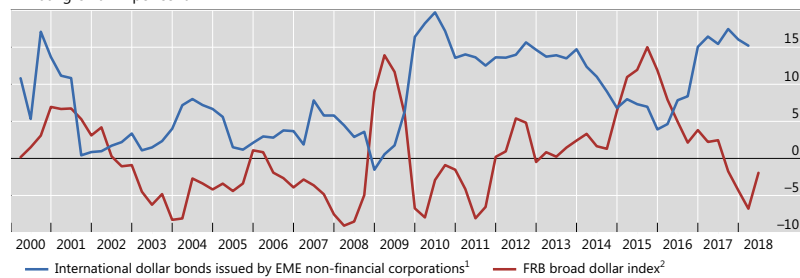
Sources: BIS locational banking statistics; BIS effective exchange rate indices; BIS calculations.

Risk-taking channel of the dollar for EME corporate bonds

Weaker dollar → non-financial corporations from EMEs issue more dollar securities, and vice versa

US dollar and international dollar bonds issued by EME non-financial corporations

Annual growth in per cent



¹ International debt securities issued by EME non-financial corporations in US dollars; based on residency of the issuer. ² Federal Reserve Board trade-weighted nominal broad dollar index; quarterly average. Higher values indicate a stronger US dollar.

Sources: Board of Governors of the Federal Reserve System; Datastream; BIS global liquidity indicators.

How can central banks address domestic and international policy spillovers?

- Keep own house in order
 - Strong anchoring of domestic policies
 - Stability-oriented policy frameworks
 - Taking financial factors into account → cooperation of monetary and other domestic policymakers
 - Using full array of monetary, prudential and fiscal policies to manage the domestic business and financial cycles

How can central banks address domestic and international policy spillovers?

- Keep neighbourhood in order
 - Give more weight to international interactions of domestic policies
 - Reach common understanding of how spillover and spillback channels might work → analytical frameworks
- Broader cooperation issues
 - Improve ongoing cooperation (BIS, FSB, IMF, G20) to help reduce costs of policy spillovers
 - Ad hoc joint actions in times of crisis – joint adjustments of monetary and fiscal policy stances, establishment of international central bank swap lines at the start of the Great Financial Crisis
 - Extending cooperation to crisis prevention: ongoing discussions on global rules of the game for the international monetary and financial system