International Monetary Fund

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Spillovers to Emerging Market Economies

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Global shocks and emerging markets

- Tightening of US monetary policy
  - Strong pro-cyclical fiscal expansion in the US leading to more rapid tightening cycle;
  - USD appreciation since the Spring (especially vis-à-vis EM currencies)

- China slowing
  - Reining in high credit growth, regulatory tightening, anti-pollution….
  - Trade tensions

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- Higher oil prices
  - Primarily supply shocks (collapse in Venezuelan production, sanctions on Iran etc)

General market reaction

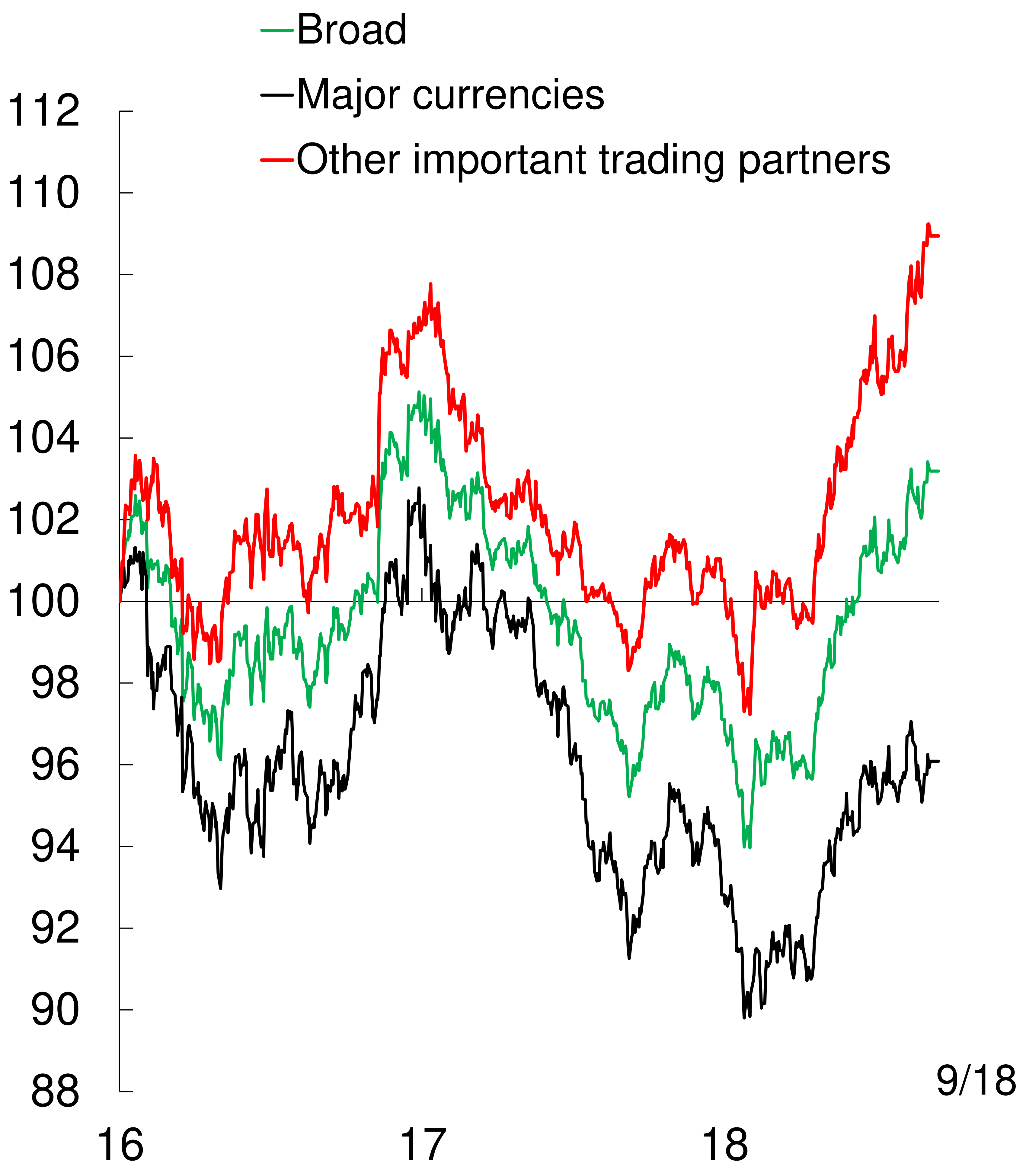
- Weakening of capital inflows, some reversal of portfolio flows (especially retail)

- Financial market conditions have differentially tightened for EMDEs in a setting of high policy uncertainty
    - Idiosyncratic factors (Argentina)
    - Political and policy uncertainty (Brazil, Mexico, Turkey)
    - Geopolitical tensions (Iran, Turkey)

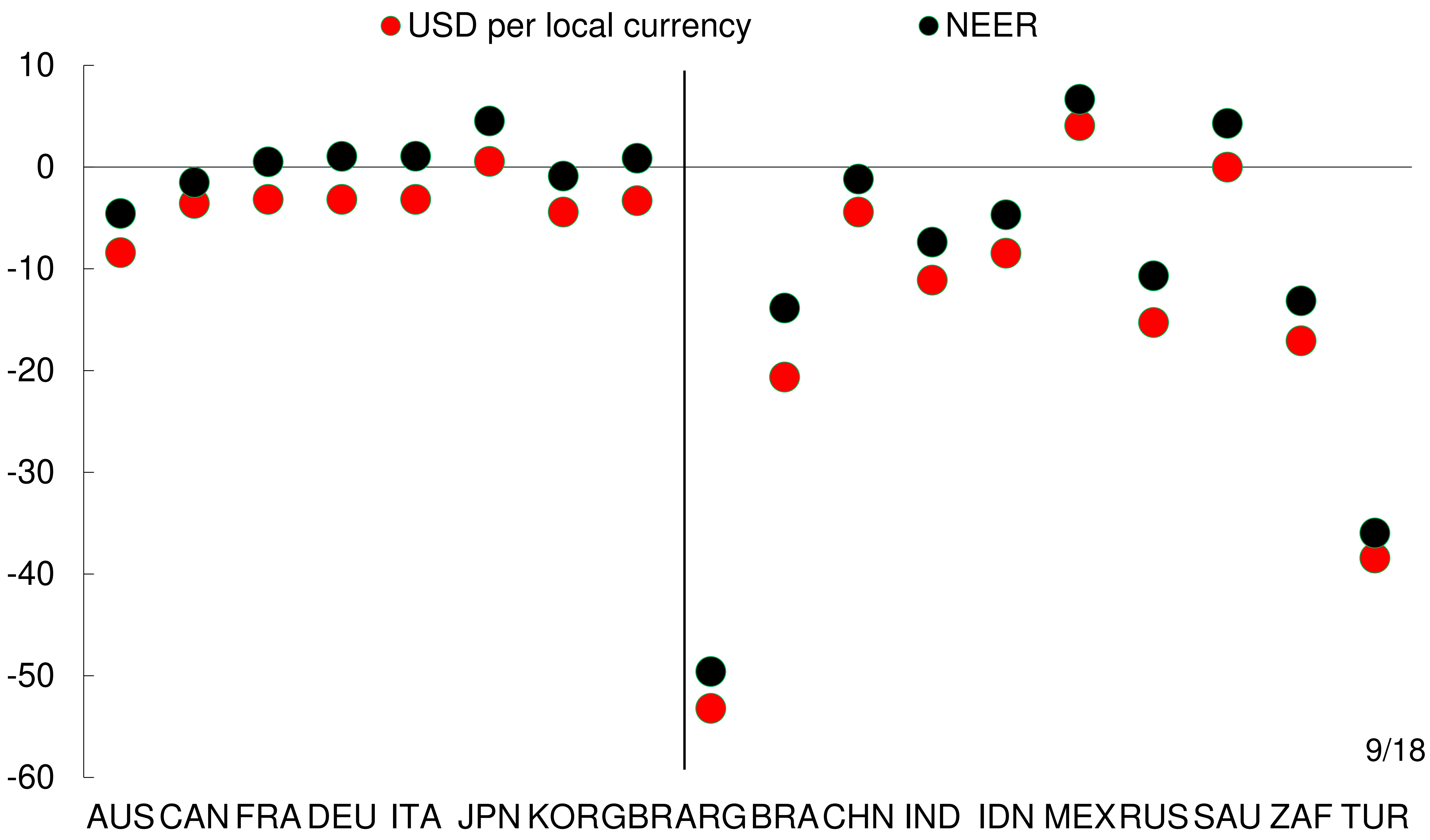
- Differentiation across countries
  – Intensity of the shock
  – Extent/type of policy reaction

Dollar has appreciated against most currencies

U.S. dollar index and NEER
(Jan. 1, 2016=100)

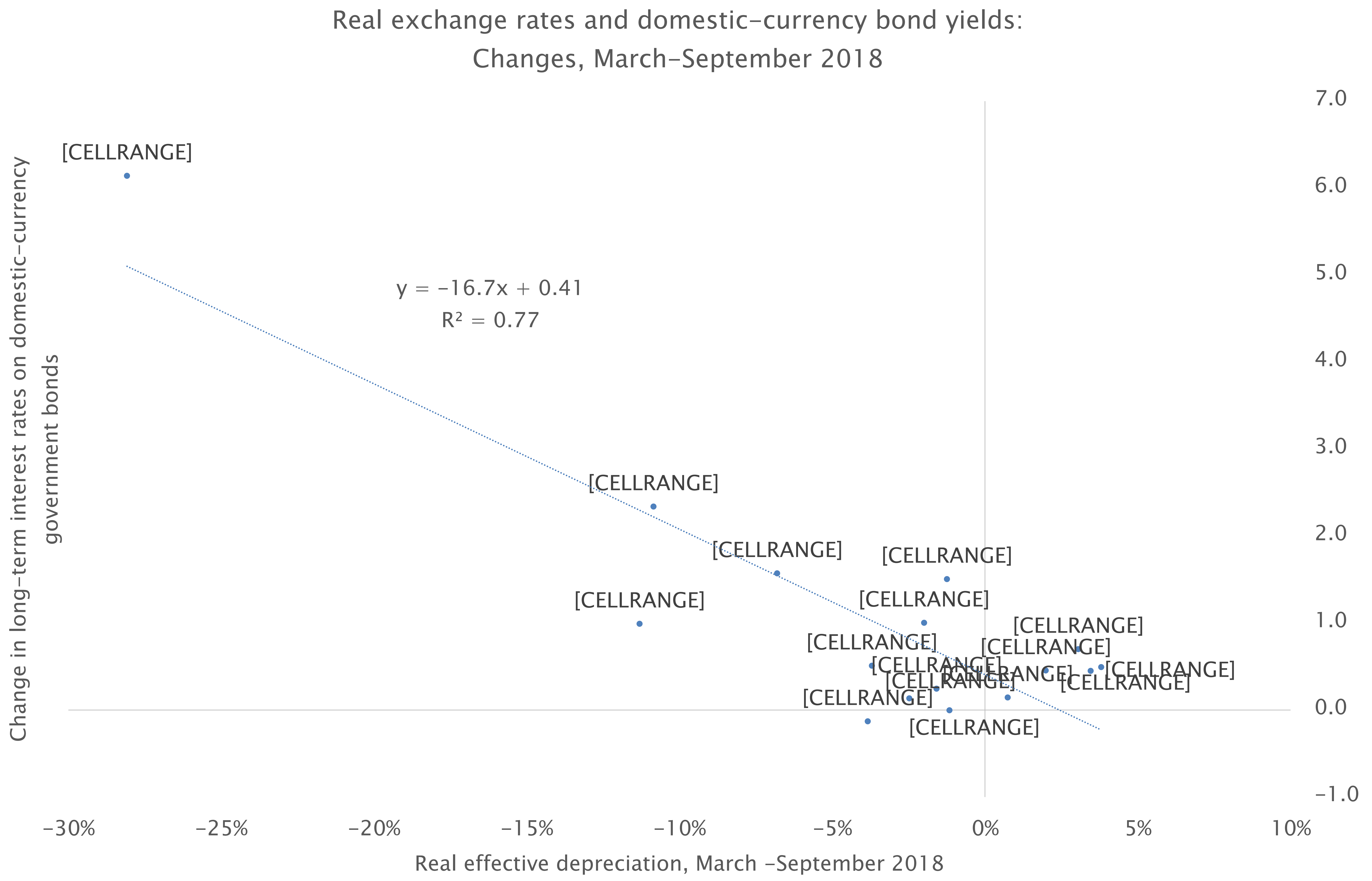


Bilateral exchange rate with U.S. dollar and NEER
(percent change; Jan. 1, 2018 to present)



Sources: IMF, *Global Data Source;* and Federal Reserve Bank of St. Louis.

Tightening of financial market conditions and exchange rate depreciation

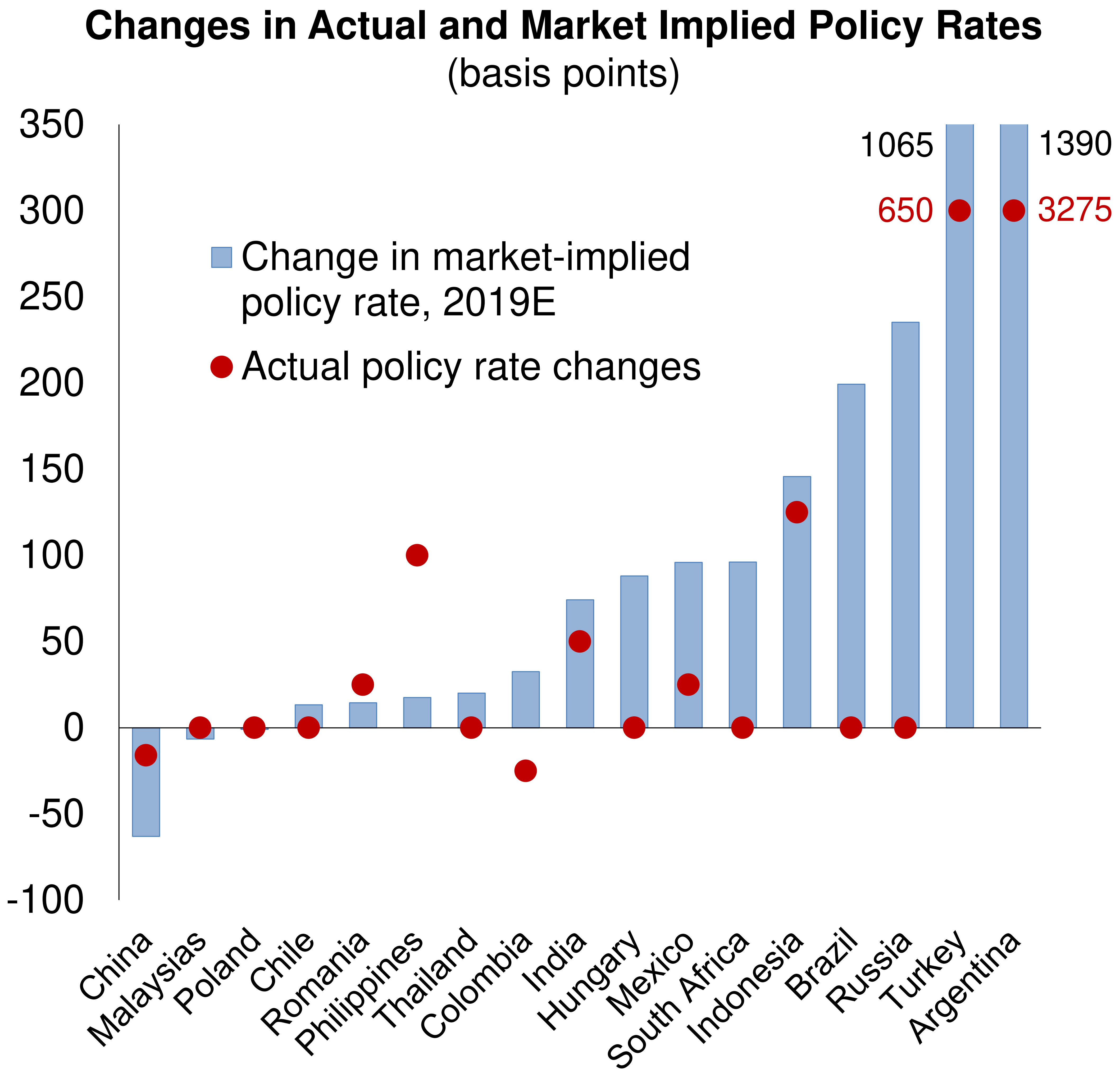


EM spreads capture evolving vulnerabilities

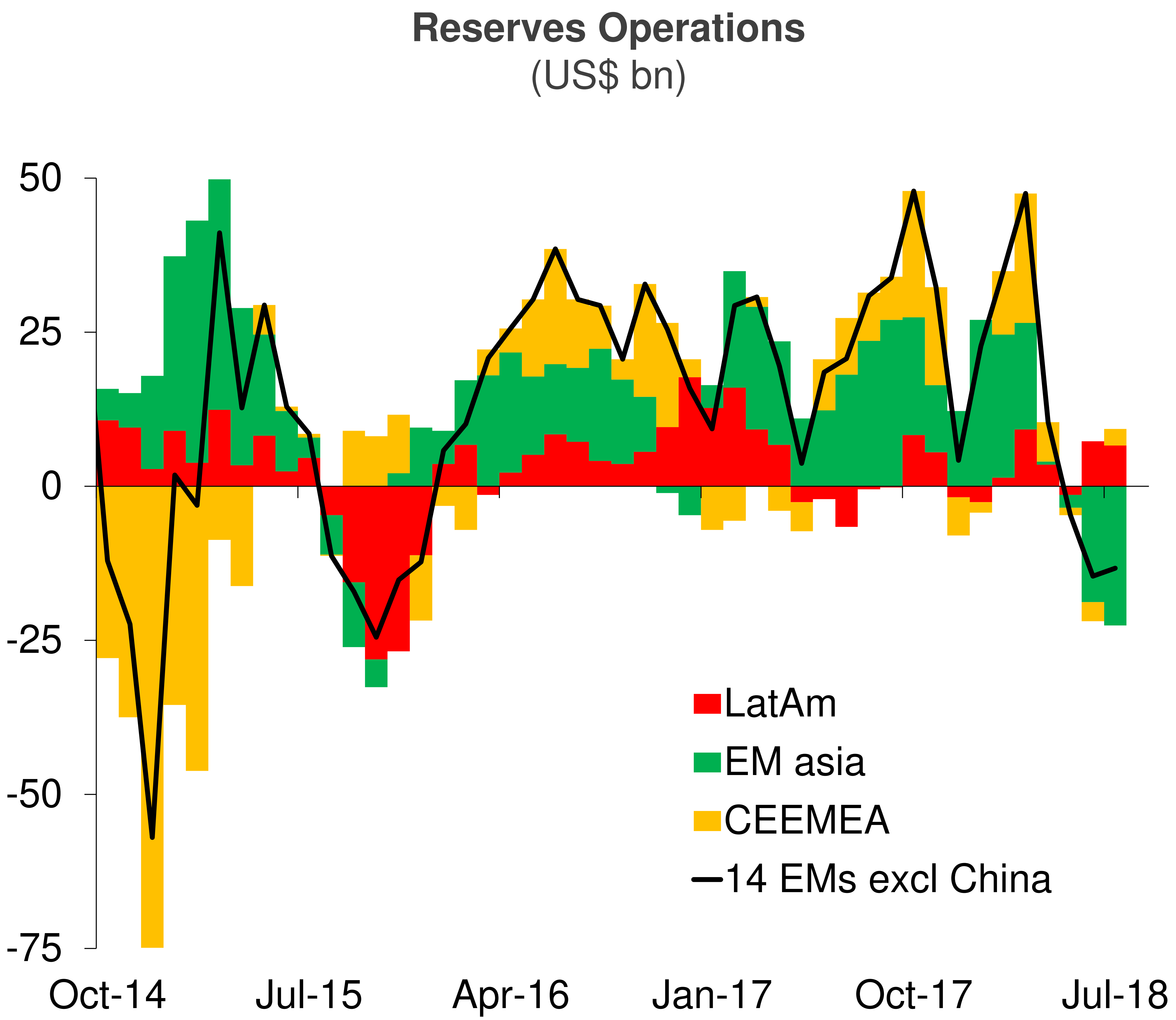
Source: Bloomberg, L.P.
Note: Taper tantrum, Brexit, U.S. Election, Argentina crisis and Turkish crisis dates correspond to May 22, 2013, Jun. 23, 2016, Nov. 8, 2016, May 11, 2018 and Aug. 9, 2018 respectively.

EM Policy Responses to Market Pressures Have Varied

EM policy responses have varied, including policy rate hikes…



…and FX interventions



Something from the forthcoming WEO

- Analytical chapter on inflation in emerging and developing economies

Counter-Cyclicality of Monetary Policy: Empirical Strategy

More anchored => more counter-cyclical monetary policy?

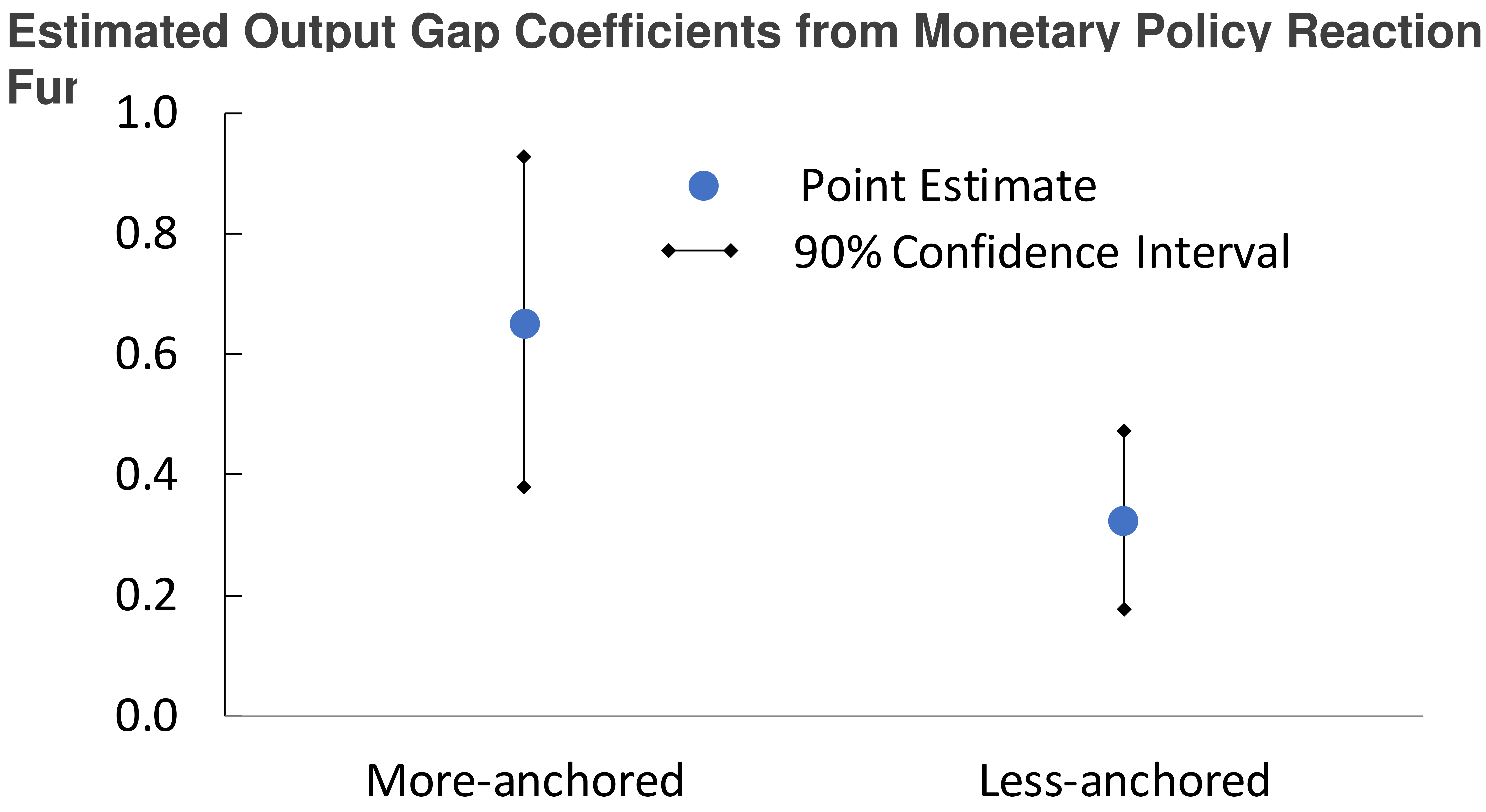
Focus on adverse external shocks that generate output-inflation trade-off

- 2011-2015 slowdown episode in net capital inflows to EMDEs
- Instrument output gap with global risk premium shocks (VIX)

Estimate output gap coefficient of monetary policy reaction function:

$$R_{i,t} = \alpha_i + \rho R_{i,t-1} + \gamma \pi_{i,t} + \beta \hat{Y}_{i,t} + \phi \Delta NEER_{i,t} + \varepsilon_{i,t}$$

Anchoring linked to more counter-cyclical monetary policy



Source: IMF staff calculations.
Note: Positive coefficient implies a countercyclical response to output fluctuations. Timeframe: 2004Q1–2018Q1