

## Summary

**H**ow much influence do countries retain over their domestic financial conditions in a globally integrated financial system? This question has recently been attracting increased interest in policy and academic circles alike. Financial conditions broadly refer to the ease of obtaining finance, and measuring them can be valuable for appraising the impact of policy and economic prospects.

Greater financial integration can complicate the management of domestic financial conditions in several ways. First, policymakers may need to take external factors into greater consideration when pursuing domestic objectives. Second, global financial integration may make it harder for domestic policymakers to control financial conditions at home—for example, it may hamper the transmission of monetary policy.

This chapter examines the evolving importance of common global components of domestic financial conditions. It develops financial conditions indices (FCIs) that make it possible to compare a large set of advanced and emerging market economies. It finds that a common component (global financial conditions) accounts for about 20 to 40 percent of the variation in countries' domestic FCIs, with notable heterogeneity across countries. Its importance, however, does not seem to have increased markedly over the past two decades.

Global financial conditions loom large, but evidence suggests that, on average, countries still appear to hold sway over their own financial conditions—specifically, through monetary policy. Nevertheless, the rapid speed at which foreign shocks affect domestic financial conditions may also make it difficult to react in a timely and effective manner, if deemed necessary. Given that global financial conditions tend to account for a greater fraction of FCI variability in emerging market economies, these countries, in particular, should prepare for the implications of global financial tightening. Governments can promote domestic financial deepening to enhance resilience to global financial shocks. In particular, developing a local investor base, as well as fostering greater equity- and bond-market depth and liquidity, can help dampen the impact of external financial shocks.