Monetary Policy Transmission in Emerging Markets: Proverbial Concerns, Novel Evidence

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High-Frequency Monetary Surprises in Emerging Economies

High-frequency identification of exogenous variation in monetary policy

- Pros
    1. Lets markets control for endogenous variation
       cf. narrative approach, VARs, Romer and Romer (2004)
- Cons
    2. Monetary policy surprise $\neq$ monetary policy shock in a structural model
       Information effects, Fed response to news
    3. Relies on liquid futures markets

This paper
- Uses Bloomberg forecasts to achieve 1, obviating 3
- 2 doesn't seem to be an issue

Overview

This was a great idea! Contributions

- Available for many (18) emerging markets
- Captures the spirit of the high-frequency approach

Comments

- Use the expanded set of shocks to reconcile different findings in the literature
- Report robustness of impulse responses
- Optimal forecast combination

Comparison with other emerging-market high-frequency shocks

Country heterogeneity?

- The authors made a huge, valuable effort to construct shocks for **18** countries

- Compare this to 180? 1800? 18,000? papers using shocks from 1 country (U.S.)

- Instead of seeing whether the perennial concerns of EMs matter *on average*...
  - ▶ limited financial development, weaker institutional credibility, heightened sensitivity to global financial conditions

- ... it would be interesting to see whether any of these concerns matter for monetary policy transmission (e.g. by splitting the sample)

Contemporaneous Literature Suggests Heterogeneous Effects

A couple of papers that use high-frequency identification in EMs

1. García-Schmidt (2024)
   - ▶ Brazil and Chile
   - ▶ Survey data (similar frequency to this paper)
   - ▶ Finds evidence of information effects

2. Witheridge (2024)
   - ▶ Brazil, Chile, Colombia, Mexico, South Africa
   - ▶ High-frequency shocks using interest rate forwards and exchange rates
   - ▶ Finds inflation increases after contractionary monetary shock, rationalized by fiscal-led policy mix, supported by evidence in EMs

Can these results be reconciled with this paper's? Policymakers in EMs likely care about transmission in a country like theirs, not just for the average EM.

Robustness of impulse responses

Robustness of impulse responses

Some good alternative shock constructions in the paper

- Narrower window for forecasts
- Comparison of
  - ▶ this paper's U.S. Bloomberg shocks vs.
  - ▶ high-frequency shocks from other papers

The authors find high correlations between their shocks and these alternatives

Important to check whether estimated impulse responses look similar. Why?

Even if two series are correlated 0.79, the difference between the two (the other 0.21) may reflect economically important differences

Example: Comparison of U.S. Bloomberg and High-Frequency Surprises

Both the Bloomberg shocks and high-frequency shocks are
- Difference between actual announced rate and
- expected announcement

But there are important differences. High-frequency surprises
- Use expectations until a few minutes before the announcement $\Rightarrow$ incorporate more information $\Rightarrow$ less endogeneity
- Weigh each market participant's expectations by their skin in the game, vs. simple averaging for Blue Chip $\Rightarrow$ less noise

Does the difference matter?

$$\Delta \text{S\&P 500}_t = \alpha + \beta \text{MP Surprise}_t + \varepsilon_t$$

where the MP surprise is either

- current-meeting high-frequency shock from futures markets (left column)
- difference between actual rate and average of Bloomberg forecasts (right col.)

High-Frequency	-3.73	
	(1.76)	
Bloomberg: Average		-0.78
		(1.51)
Observations	168	168

NOTE. Sample runs from 1997 (beginning of Bloomberg expectations) through 2019, excluding July 2008–July 2009. Heteroskedasticity-robust standard errors are in parentheses.

Correlation of the two surprises is 0.74, but estimates are much different.

How to combine forecasts?

Aggregating forecasts

Authors construct expected announcement as simple average over forecasters
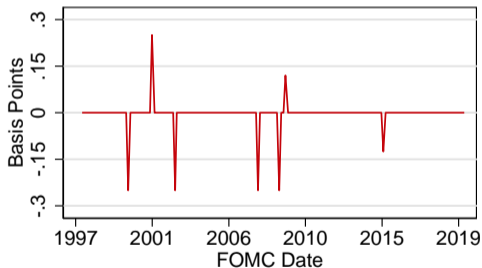
$$\frac{\sum_{a=1}^{N_{c,t}} f_{a,c,t}}{N_{c,t}}$$

In markets, expectations are dollar-weighted. But what can we do here?

Weight each forecast by how good the forecaster has been historically
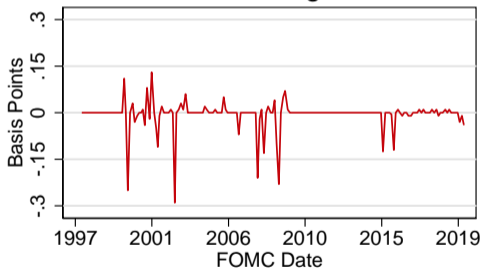(e.g. by average squared forecast error)

Different aggregation could produce different results

U.S. Monetary Surprises to Bloomberg Forecasters

Conclusion

A great paper with a great idea!

- The authors have created a hugely valuable resource for understanding the transmission of monetary policy in EMs

- My main suggestion: Consider using the data to see what factors may make the transmission differ across EMs

END

THANKS!

APPENDIX

References I

García-Schmidt, Mariana, "Is the Information Channel of Monetary Policy Alive in Emerging Markets?," Working Paper, Central Bank of Chile 2024.

Romer, Christina D. and David H. Romer, "A New Measure of Monetary Shocks: Derivation and Implications," *American Economic Review*, 2004, *94* (4), 1055–1084.

Witheridge, William, "Monetary Policy and Fiscal-led Inflation in Emerging Markets," Working Paper 2024.