The Impact of Industrialized Countries' Monetary Policy on Emerging Economies

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Current Policy Challenges Facing Emerging Economies

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$\Rightarrow$ **This paper proposes a model consistent with these empirical observations**

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- Extension: Endogenous growth

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  - Higher leverage $\rightarrow$ higher losses in case of default (wealth redistribution)
  - Lower foreign wealth $\rightarrow$ Default: larger impact on output

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- **Model replicates empirical observations:**

  Lower rates and higher inflows, but lower output

A Decrease in Interest Rates

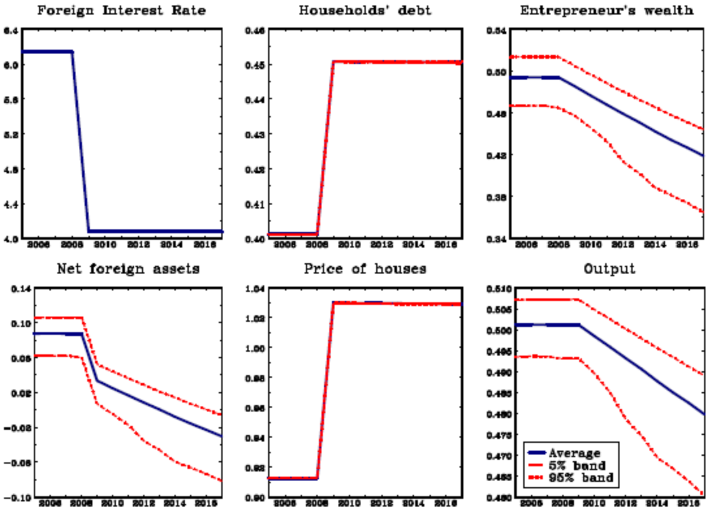


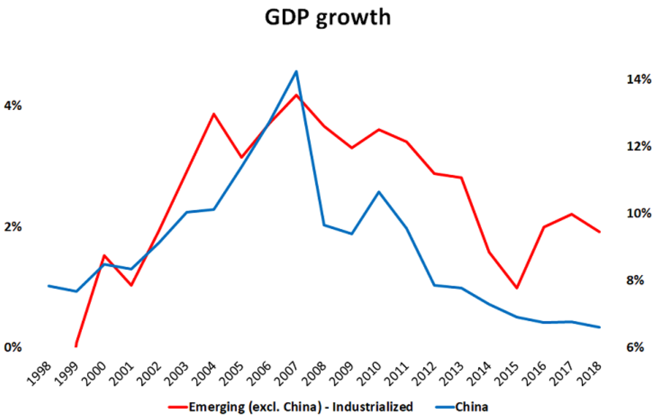
Figure 7: Response to low interest rates in Industrialized Countries, 2005-2017.

My comments

What forces drive poor growth performance in emerging markets in this period?

1. What is the role of China and the price of commodities?
2. What is the relevant borrowing cost in emerging economies?
3. What would have happened *without* fall in world interest rates?

The role of China...



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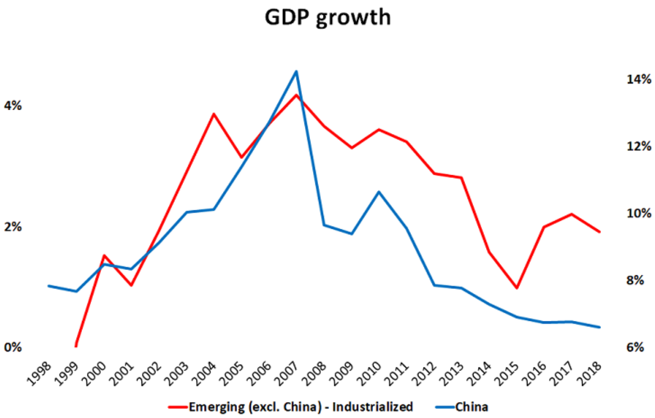

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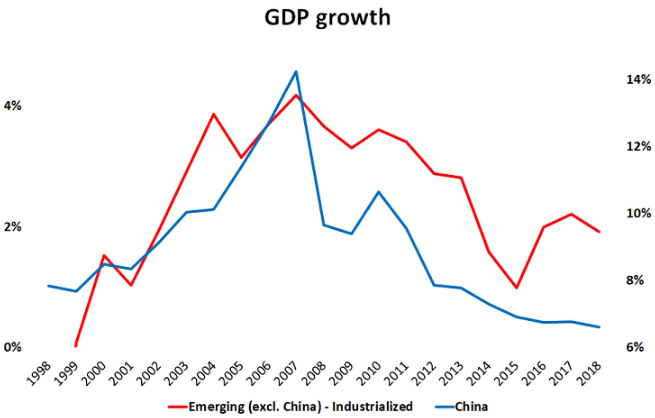

- China's GDP increased from 5% of world GDP in 1990s to 18% by 2017
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- **Might China's slowdown have caused slow growth in EMs?**

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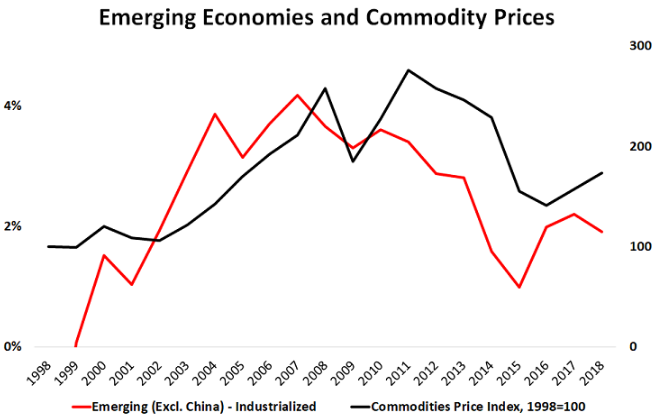

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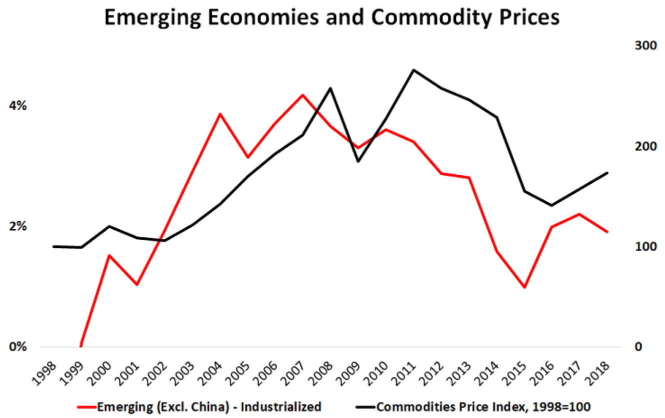

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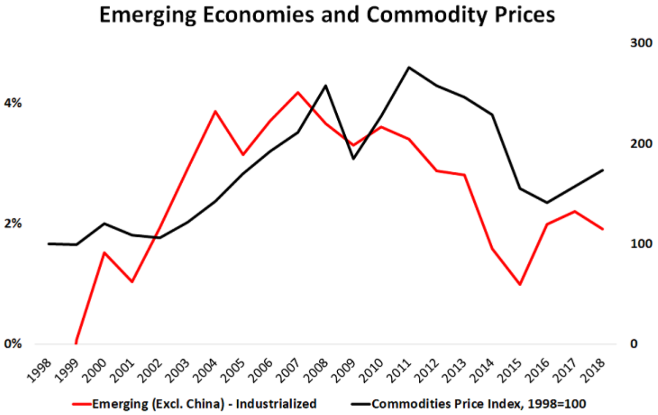

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- **Mechanism? China slowdown $\rightarrow \downarrow$ price of commmodities $\rightarrow \downarrow$ growth in EMs**

What is the role of China and the price of commodities?

World interest rates might not be only drivers of growth over this period...

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- **Control for other forces in the data to isolate role of world interest rates**
  - Exploit cross-country heterogeneity to identify impact of interest rates in countries differentially exposed to commodity price fluctuations or financially integrated.

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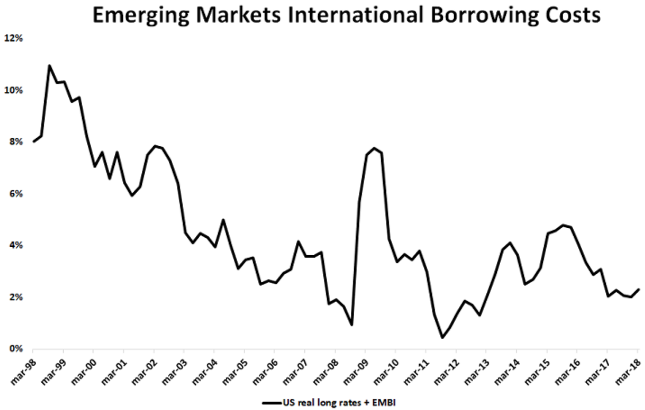

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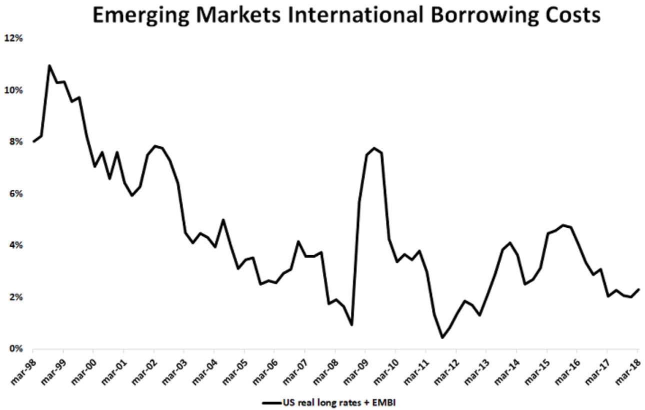

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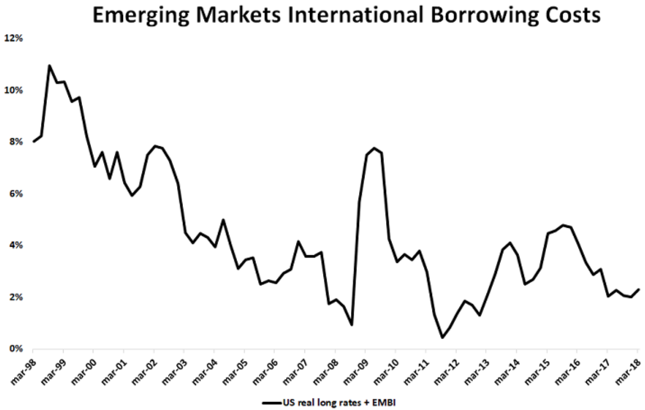

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- **International borrowing costs did not decline as much as US short-term rates**

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- Let's look at Great Depression...

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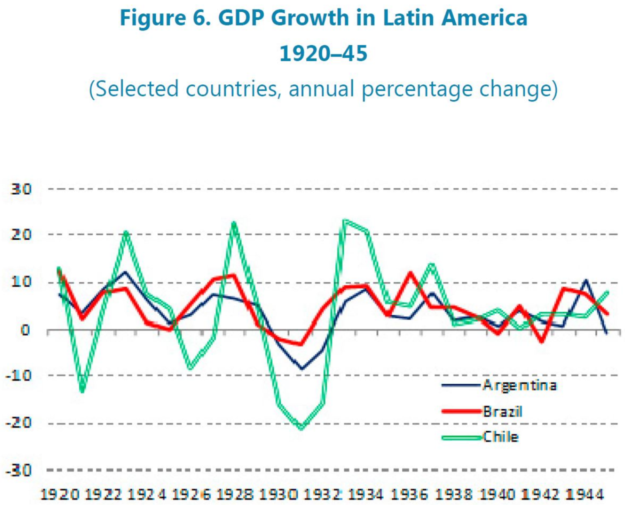

Source: IMF, 2013.

Summing Up

Stylized yet rich model to investigate effects of world interest rate changes

- Introduces role for wealth, wealth distribution, and risk on production
  - Lower interest rates reduce entrepreneurs' savings and increase HHs' borrowing
  - Households borrowing induces housing boom
  - Entrepreneurs reduce financial wealth, hire and produce less
- Alternative mechanism on super relevant topic:
  - Wealth and risk matter
  - Where financial inflows go matters
- A few comments on how the model is taken to the data:
  - (Try to) Remove effect of other shocks in the data
  - Reproduce dynamics of Emerging Markets' international borrowing costs
  - Incorporate positive effect of interest rates to quantify trade-off
  - More evidence on the mechanism?