Central Banking: Perspectives from Emerging Economies

Discussion of Paper by Menzie Chinn

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Main conclusions

• Emerging markets are different
• Inflation targeting has proven a durable framework
• Trilemma binds more strongly
Discussion

• How robust are these conclusion?
• What should be the agenda?
Different, yes, but how much?

- Less developed financial markets
- Susceptibility to rapid capital flow reversals
- Procyclical fiscal policies
- Inability to borrow internationally in domestic currency
- Minimal ability to influence global markets
## Comparison with the eurozone

<table>
<thead>
<tr>
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<th>Emerging Markets</th>
<th>Eurozone</th>
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<tbody>
<tr>
<td>Financial Markets</td>
<td>Have a come a long way</td>
<td>More advanced than emerging, but significantly so?</td>
</tr>
<tr>
<td>Capital Flow Reversals</td>
<td>More prone to reversals but less hurt by Great Recession</td>
<td>Less prone and so policy complacency till big reversal, but same mechanism</td>
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<tr>
<td>Procyclical Fiscal Policies</td>
<td>Yes, but less so over time</td>
<td>Procyclicality is embedded in fiscal framework</td>
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<tr>
<td>Inability to borrow in domestic currency</td>
<td>Less so over time</td>
<td>Yet they borrowed in dollars to create grave peril</td>
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<tr>
<td>Minimal ability to influence financial markets</td>
<td>Yes.</td>
<td>Any more so than emerging markets?</td>
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Inflation Targeting Durable?

• Those that target and don’t target show little difference in response to inflation
• Oddly, those that target inflation pay more attention to the output gap
• Before the crisis, both paid attention to the exchange rate
• After the crisis, inflation is unrelated to interest rate setting
• Inflation targeting: a loose framework that means different things to different people.
The Trilemma Debate Today

• Helen Rey, August 2013
  – US monetary policy determines global financial cycle
  – Imposes binding constraint on domestic monetary policy
  – Independence possible only through capital controls

• Klein and Shambaugh, September 2013
  – Capital controls do not work
  – Even modest exchange rate flexibility helps

• Forbes, Fratzscher, Straub, December 2013
  – Capital controls do not work on macro targets
  – But can help reduce financial vulnerability: credit growth, currency mismatches.
The “Rakesh Mohan View”

- Emerging market policymakers aim for:
  - moderate levels of monetary independence and financial openness
  - some degree of exchange rate stability
- Thus, leaning against the trilemma
  - while accumulating sizable foreign exchange reserves
  - As an integral element of monetary policy management
The debate

- Emerging/advanced distinction is an overstated
- Inflation targeting is a useful rhetorical device
- The real action: dilemma/trilemma
  - US monetary policy may reflect domestic concerns but has global implications
  - Japan and Euro area: smaller but real consequences
  - Global monetary coordination: politically impossible?
  - Rounding the trilemma corners: options?