Monetary policy graduation in emerging markets

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November 10, 2011

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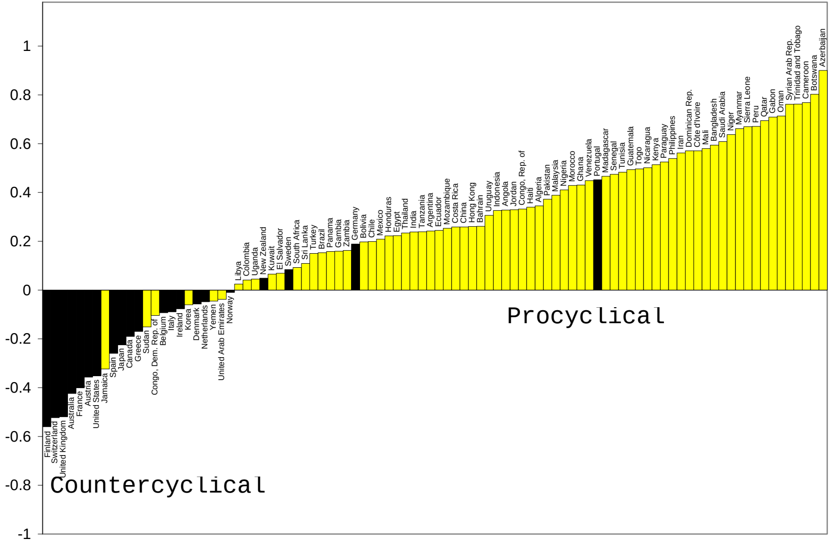
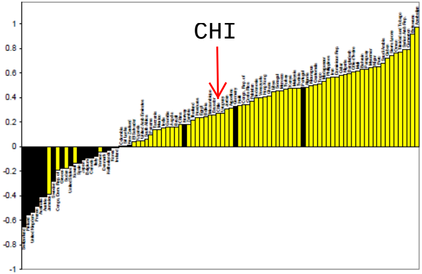
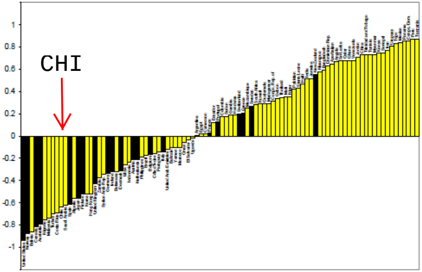
- Such policies amplify the business cycle (the "when it rains, it pours" phenomenon)
- A significant number of emerging countries have graduated when it comes to fiscal policy
- Do we also observe graduation in monetary policy?

Fiscal policy mostly procyclical in emerging countries

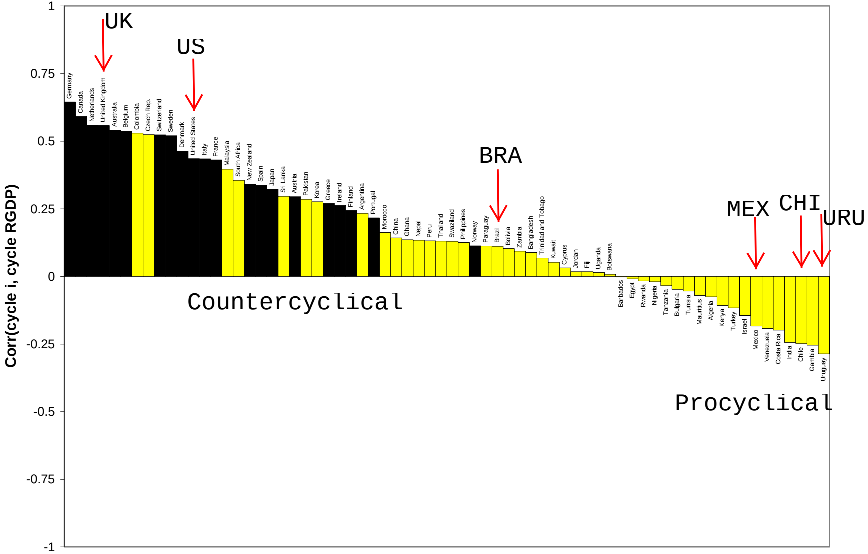


Fiscal graduation: Before and after 2000

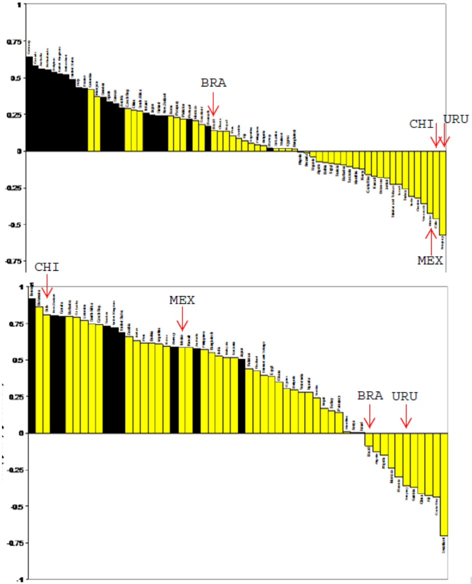




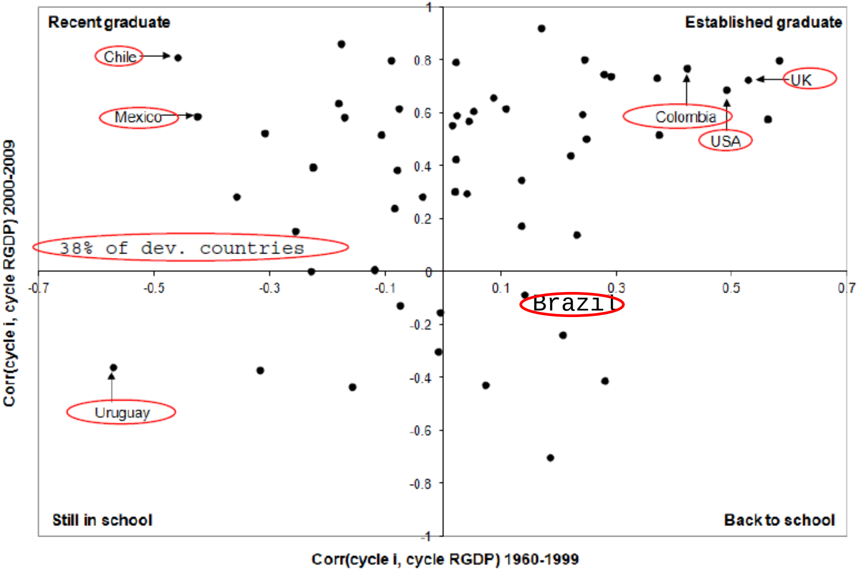
What about monetary policy? (1960-2009)



Who has graduated? (Before and after 2000)



Who has graduated? (II)



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- In terms of a "Taylor rule"

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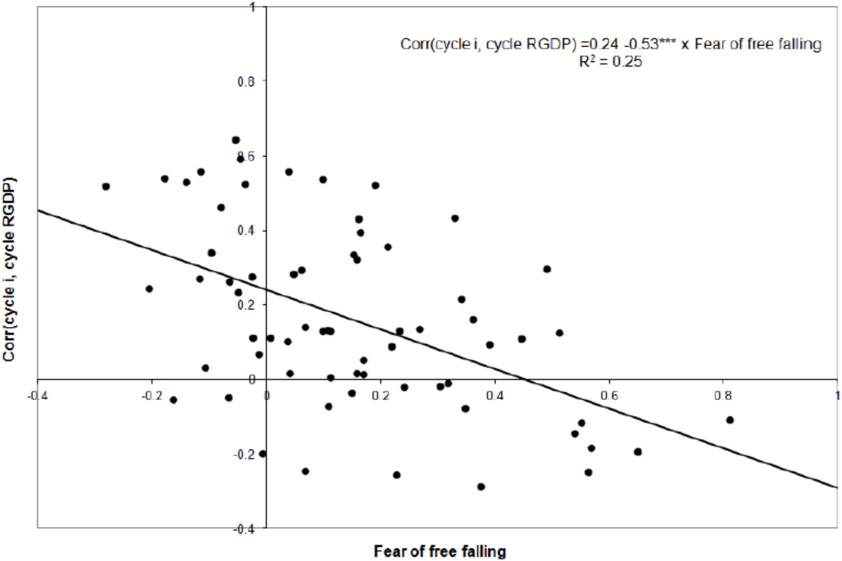
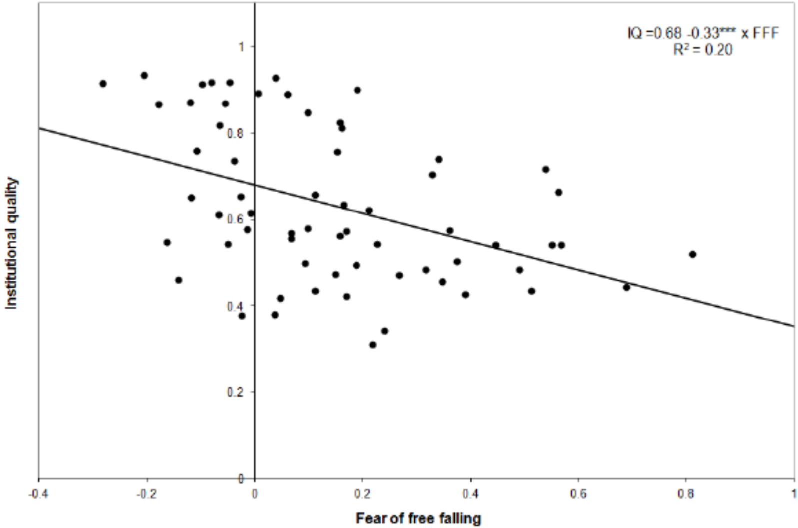
- We measure FFF by the correlation between cyclical components of i and exchange rate depreciation

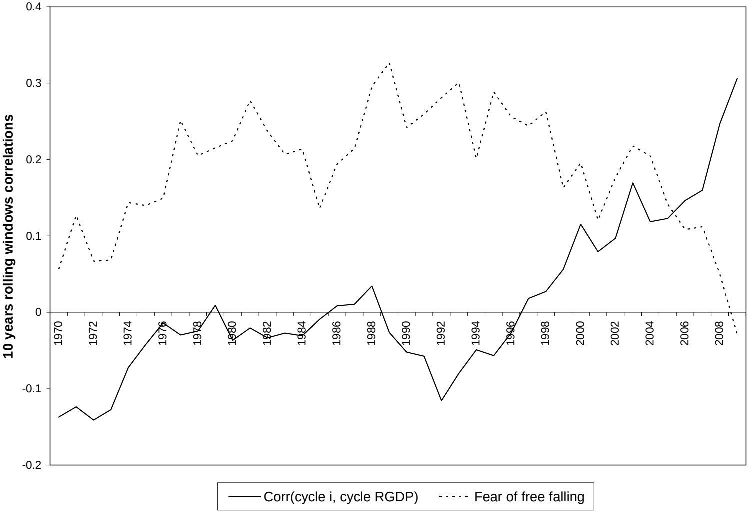
The higher is FFF, the more procyclical is monetary policy



FFF is negatively related to quality of institutions



Over time, FFF diminishes and countercyclicality of monetary policy increases



Regressions confirm the importance of FFF

Panel regressions. Dependent variable is the cyclical component of central bank interest rate				
	All countries		Industrial	Developing
RGDP cycle	0.47***	1.66***	5.92***	0.98***
	[2.7]	[5.6]	[11.4]	[2.7]
Inflation cycle	0.04***	0.04***	0.01	0.04***
	[6.1]	[5.0]	[1.2]	[4.2]
Δ% exchange rate cycle	0.30*	0.33*	26.37***	0.29
	[1.7]	[1.8]	[3.1]	[1.4]
RGDP cycle * Fear of free falling		-3.05***	-2.12	-2.30**
		[-4.1]	[-1.5]	[-2.5]
Number of observations	2669	2037	705	1332
Number of countries	68	67	21	46

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  - 38 percent in monetary policy
  - 33 percent in fiscal policy
- Critical step in ensuring macroeconomic stability during crises/recessions