Summary of Audience Q&A
Session #3: "Global Dimensions of U.S. Monetary Policy"

Date: June 4, 2019

Moderator: Susan Collins (University of Michigan)

Presenter: Maurice Obstfeld (University of California, Berkeley)

Discussant: Kristin Forbes (MIT Sloan School)

Summary Prepared by: Beth Anne Wilson, Deputy Director in the Division of International Finance, Board of Governors of the Federal Reserve System

Following the presentation of "Global Dimensions of U.S. Monetary Policy" by Maurice Obstfeld (University of California, Berkeley) and a discussion by Kristin Forbes (MIT Sloan School), conference attendees offered their comments and questions.

Ken Rogoff (Harvard University) noted that, in terms of the role played by the U.S. dollar, a large number of countries today stabilize their exchange rates relative to the U.S. dollar—for example, countries in the former Soviet Union, countries in Asia and Latin America. In fact, the number of countries today is greater than in the 1950s when many countries officially pegged their currencies to the dollar, making the dollar's role more significant than it was earlier and adding to the importance of the Fed's policy internationally. Professor Rogoff also noted that as the number of monetary policy tools has increased, it has become more challenging to understand how alternatives to the policy interest rate affect the domestic economy, not to mention their spillover effects to other countries.

Beth Anne Wilson (Federal Reserve Board) asked how the international factors discussed by Professor Obstfeld were related to the strategy, tools, and communication practices of the Fed.

Joe Gagnon (Peterson Institute for International Economics) noted that during the Fed's quantitative easing (QE) programs, some foreign countries complained about the effects of QE on exchange rates—raising the prospect of currency wars—although many of these same countries had themselves been purchasing large quantities of U.S. dollar assets. He asked, do central bank operations on longer-term interest rates have different spillover effects than operations on short-term interest rates? That is, does QE have different spillover effects than changes in the federal funds rate? What about cases in which the central bank operates monetary policy entirely in terms of operations in foreign exchange—for example, Switzerland? What are the appropriate limits to QE or to currency intervention?

Professor Obstfeld agreed with Professor Rogoff's points. In response to Ms. Wilson, Professor Obstfeld responded that it is important to understand what a lower neutral rate of interest implies for the external sector but that the research literature has not included the external sector in its analysis. In particular, it is important to capture the effects of Fed policy on emerging-market economies and how those effects feed back on the United States. While speeches by Fed policymakers discuss global developments and their implications for policy, these developments and implications should be considered more formally in an economic model.

In response to Mr. Gagnon, Professor Obstfeld concurred that economists don't have a good understanding of the spillover effects associated with quantitative easing compared with the effects of changes in policy interest rates, especially for emerging markets. He noted that, if the Fed can affect the U.S. economy by purchasing longer-term Treasury securities, then foreign purchases of these securities would also have effects, and agreed that issues raised by QE are similar to those raised by foreign exchange intervention. One question was by how much emerging market countries, particularly smaller ones, should be expected or allowed to use foreign exchange intervention as a policy tool.

Professor Forbes noted that it is sensible for the Fed to judge foreign developments based on how they affect the outlook for the U.S. economy, and commented that the Fed should communicate more frequently about how foreign developments influence U.S. variables. She noted that the questions posed by Mr. Gagnon were good ones—a recent Brookings panel addressing those questions had been inconclusive. In addition, Professor Forbes pointed to anecdotal evidence that QE acts by changing exchange rates. However, if you compare the effects of a change in the policy rate on exchange rates with a comparably sized QE program, it is not clear that QE has a larger effect on exchange rates than a change in the policy rate alone.

Stanley Fischer (BlackRock) commented that the United States was the most important country in the world when it accounted for 50 percent of the global economy and is still the most important even though it now accounts for only 23 percent of the global economy. He asked why was it the case that the U.S. economy remains so important and noted that the capital account is much more important today than it used to be. When communicating with the general public, what variables on the trade or financial side of the balance of payments should be emphasized? David Andolfatto (Federal Reserve Bank of St. Louis) commented on the Fed as a lender of last resort to the rest of the world in light of the growing issuance of U.S. dollar-denominated debt in foreign countries. He asked whether the dollar swap lines had promoted the issuance of dollar-denominated debt outside the United States and about the moral hazard associated with this issuance. Raghuram Rajan (University of Chicago Booth School) asked, if the spillover effects of monetary policy are not fully buffered by changes in exchange rates, does it make sense for central banks to take account of these spillovers and not just pay attention to the effects that spill back on the domestic economy? Moreover, is there a time at which it will make sense for a central bank's mandate to be global rather than purely domestic?

In responding to these questions, Professor Obstfeld observed that assessing whether trade or financial variables are more important depends on the issue at hand. He noted that U.S. trade integration is more limited than financial integration—as a share of GDP, exports and imports are smaller than the aggregate of U.S. dollar transactions in the global financial system. The depth of U.S. financial markets and prevalence of dollar usage are the variables he would highlight.

On the Federal Reserve's role as a global lender of last resort and on the question about moral hazard, Professor Obstfeld responded that the use of the U.S. dollar internationally is not because of lender of last resort but because of network effects. He agreed that it would be problematic if, during a crisis situation, the Fed did not respond but he saw that as unlikely given past central bank cooperation, and coordination via the BIS and Financial Stability Board. In addition, Professor Obstfeld noted that the Fed's dollar swap lines had contracted out moral hazard, in that the Fed might not agree to a swap line with a country that did not have its economic house in order.

With regard to whether central banks should have global mandates, Professor Obstfeld commented that central banks need simple domestic mandates that are easy to explain to the public, although it is important to have trust and an open dialogue among central banks even if there is no explicit policy coordination.

Professor Forbes noted the importance of the central bank swap lines in stabilizing the global financial system in 2008. She hoped swap lines would be used again in crisis circumstances. She observed that much of the recent increase in U.S. dollar-denominated debt issued in other countries had been issued by the private sector, and that it was important—in discussing lender of last resort—to distinguish between the stability of countries and the stability of private sector institutions. Professor Forbes noted that the rise in dollar-denominated debt in the private sector was not being backed by the Fed and should not be.