

**CEMLA's 60th Anniversary Commemorative Conference**  
**Central Bank Cooperation at the Beginning of the 21st Century**  
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**Panel 1: International monetary stability and central bank cooperation**

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**Introduction**

It goes without saying, that the policy stances of the major central banks influence global markets and monetary policy in the rest of the world. But the extent of these spillover effects increased dramatically in the post-crisis period. Stabilization after the crisis began with the extraordinary measures to support US financial markets and the FED's expansion and extension of its bilateral swap program.<sup>i</sup> This program came to include not only the G4 and Canada but a host of European countries in addition to Australia and New Zealand and the main Emerging Markets (EM) financial centers in Brazil, Korea, Mexico, and Singapore. Joint G4 central bank actions up to QE1 in March, 2008 were generally seen as globally benign and constructive.<sup>ii</sup> However, with QE1, which lasted until March 2010, and especially during QE2, from its announcement on August 27<sup>th</sup> 2010 in Jackson Hole, the spillover effects were seen as mainly negative for EM.

Though there is some lingering controversy, research by the Bank of England and the FED have shown, I believe quite persuasively, that QE had significant beneficial effects in the respective domestic economies.<sup>iii</sup> QE caused rallies in asset prices and induced greater financial risk taking leading ultimately to expansions in output and employment. To this extent, it contributed to global growth. We know, from a series of spillover analyses by the IMF that shocks to the US economy and to US financial markets in particular are the single most important potential spillover to the global economy (barring an eventual collapse of the Euro which is today a low probability event).<sup>iv</sup> Thus, actions by the FED and to some extent the Bank of England and later the ECB had important positive spillover effects on global trade.

However, the global liquidity and risk-reducing impacts of “non-conventional” monetary policy had also other effects. Commodity prices shot up, notably post QE2 in 2010. Commodity indices gained about 50% between June 2010 and April 2011, surpassing the levels of the previous peak in 2007.<sup>v,vi</sup> Across EM, in countries ranging from China and Chile to South Africa and Turkey, actual and expected inflation increased rapidly, in some cases leading to premature reversals in the monetary stance. Moreover, the USD depreciated rapidly with a surge in capital flows and speculative currency movements favoring the main EM currencies. Not only in Brazil, Chile and Colombia but in India, Indonesia and across Non-Japan Asia there were large real appreciations made worse by the slow moving adjustment in China's currency. The response was a drive to currency

intervention, re-introduction of capital controls and, in the extreme, in Brazil, Indonesia and Turkey changes in the basic macroeconomic frameworks to far more uncertain and questionable practices away from the tripod of flexible exchange rates, inflation targeting (IT) and relatively solid fiscal anchors.<sup>vii</sup> I am not suggesting that external events drove these policy changes. In the three cases, they were driven by domestic events, primarily. But the external backdrop and especially the policies of the G4 central banks played a role.

In the event, the implosion of the full-blown Euro crisis in the summer of 2011 reversed the course of the global economy and changed the impetus of international transmission from growth to recession and from inflation to deflation. But by then the damage was done and Central Banks across most of EM had changed. To be sure, Chile, Colombia, the Czech Republic, Israel, Korea, Mexico and, arguably, Poland, safeguarded their IT regimes. Chile and Korea even managed to adjust back their fiscal stances to the ex-ante crisis surplus position. On the other hand, as is well known, the Swiss National Bank fixed the exchange rate, taxed deposits by foreigners and acted otherwise to try to protect the Swiss economy from the flood of nervous European monies seeking safe-haven.

The issue of how to treat the exchange rate in IT regimes (whether as endogenous or as an explicit quasi-instrument) has always been a vexing question in the IT debate.<sup>viii</sup> The wholesale transition to regimes with intervention and/or regimes that de-facto let go of the inflation target will be, possibly, a sub text of our discussions. But to be more specific let me finish by paraphrasing a consensus view in financial markets. The “representative” strategist would say some like this:

*“During previous instances of QE, an appreciation in EM currencies has followed due to the excess of liquidity. If QE3 in the US were to materialize, the room to cut rates in Mexico would increase, especially if domestic growth slows down with the loss in competitiveness.”*

So quite clearly interconnectedness in monetary policy is everybody’s mind. I think that most of the market views this as the outcome of dominant CBs doing what they have or think best to do to attend to their domestic mandates. It is not exactly cooperation but the implications are powerful. To discuss these issues and others, CEMLA has brought together an outstanding panel.

Paulo Vieira da Cunha

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<sup>i</sup> For details of the many programs implemented by the FED see, Federal Reserve Bank of St. Louis: *The Financial Crisis – A Timeline of Events and Policy Actions*, <http://timeline.stlouisfed.org/index.cfm?p=home>.

<sup>ii</sup> For an early, positive, assessment of the FED’s bilateral swap programs see, James McAndrews: “Segmentation in the U.S. Dollar Money Markets during the Financial Crisis.” Federal Reserve Bank of New York May 2009. [http://www.frbatlanta.org/filelegacydocs/seminars/seminar\\_mcandrews\\_052009.pdf](http://www.frbatlanta.org/filelegacydocs/seminars/seminar_mcandrews_052009.pdf)

<sup>iii</sup> See, for example, George Kapetanios, Haroon Mumtaz, Ibrahim Stevens and Konstantinos Theodoridis, “Assessing the economy-wide effects of quantitative easing,” Bank of England, Working Paper No. 443, January 2012. <http://www.bankofengland.co.uk/publications/Documents/workingpapers/wp443.pdf> and Jonathan Bridges and Ryland Thomas, “The impact of QE on the UK economy—some supportive monetarist arithmetic.” Bank of England, Working Paper No. 442, January 2012. <http://www.bankofengland.co.uk/publications/Documents/Forms/DispForm.aspx?ID=5416>

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For the US, Michael Bauer and Glenn Rudebusch, “The Signaling Channel for Federal Reserve Bond Purchases.” Federal Reserve Bank of San Francisco, *Working Paper 2011-21*, September 2011 <http://www.frbsf.org/publications/economics/papers/2011/wp11-21bk.pdf> and Hess Chung, Jean-Philippe Laforte, David Reifschneider, and John Williams, “Estimating the Macroeconomic Effects of the Fed’s Asset Purchases” Federal Reserve Bank of San Francisco, *Economic Letter 2011-03*, January 2011 <http://www.frbsf.org/publications/economics/letter/2011/el2011-03.pdf>. See also, Vasco Cúrdia and Michael Woodford, “The Central-Bank Balance Sheet as an Instrument of Monetary Policy.” NBER Working Paper No. 16208, July 2010. <http://www.nber.org/papers/w16208>.

<sup>iv</sup> IMF: “United States - Spillover Report - 2011 Article IV Consultation,” IMF Country Report No. 11/203, July 2011. <http://www.imf.org/external/pubs/ft/scr/2011/cr11203.pdf>. IMF: “Euro Area Policies: Spillover Report for the 2011 Article IV Consultation and Selected Issues,” IMF Country Report No. 11/185, July 2011. <http://www.imf.org/external/pubs/ft/scr/2011/cr11185.pdf>

<sup>v</sup> Bloomberg CICI Composite USD Price Index: The spot price changed by 53.2% between June 7, 2010 and April 8, 2011; the 30 day moving average changed by 44% between June 25, 2010 and May 4, 2011.

<sup>vi</sup> While markets traded on the expected correlation between QE, expanded liquidity and commodity prices, and while ex-post there is a clear correlation between these variables, there is, however, no simple causality between the trend in commodity prices and monetary policy in the G3. Other factors may well have been at work. For arguments in this direction, see for example, Ben S. Bernanke: *Remarks at the International Monetary Conference*; Atlanta, Georgia, June 7, 2011. <http://www.federalreserve.gov/newsevents/speech/bernanke20110607a.htm>. There is also an issue of impact vs. longer-term effects. See, Ruven Glick and Sylvain Leduc, “Central Bank Announcements of Asset Purchases and the Impact on Global Financial and Commodity Markets.” Federal Reserve Bank of San Francisco, *Working Paper 2011-30*, December 2011. “In our analysis, we also show that commodity prices tended to fall, on average, on announcement days, particularly during LSAP1 [QE1]. Our results suggest that market participants viewed LSAP announcements by the Federal Reserve as signaling lower future economic growth in the United States, which jointly lowered long-term interest rates, the value of the dollar, and commodity price on the days that policy news was released.” <http://www.frbsf.org/publications/economics/papers/2011/wp11-30bk.pdf>

<sup>vii</sup> Reversing its long-standing objection to capital controls, the IMF condoned these practices in the special circumstances post-crisis and post-QE. See, Gilbert Terrier *et al* “Policy Instruments to Lean against the Wind in Latin America,” IMF Working paper WP/11/159, July 2011. <http://www.imf.org/external/pubs/ft/wp/2011/wp11159.pdf>

<sup>viii</sup> See, for example, Lars Svensson, “Inflation targeting after the financial crisis,” Sveriges Riskbank, February 2010, <http://people.su.se/~leosven/papers/100212e.pdf> and Kenneth Kuttner and Adam S. Posen, “How Flexible Can Inflation Targeting Be and Still Work?” Bank of England, Discussion Paper No. 34, October 2011. <http://www.bankofengland.co.uk/publications/Documents/externalmpcpapers/extmpcpaper0034.pdf>