U.S. Monetary Policy and Emerging Markets’ Challenges

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Recovery of the global economy continues …

GDP Growth Projections
(In percent)

Source: World Economic Outlook (WEO, October 2013)
... with regional differences

GDP Growth Projections
(In percent)

<table>
<thead>
<tr>
<th>Region</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>European Union</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Japan</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Developing and Emerging Asia</td>
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<td>6.0</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Central and Eastern Europe</td>
<td>2.0</td>
<td>2.0</td>
</tr>
</tbody>
</table>

Source: World Economic Outlook (WEO, October 2013)
Key challenges for emerging markets: internal and external

Emerging Markets - GDP Growth Projections
(In percent)

1.0 2.0 3.0

10 Year U.S. Government Bond Yield


WEO Apr 2013 WEO Oct 2013
Recent market turbulence: temporary or more to come?

**Bond Yield** (basis point)

**Equity** (percent)

**Currency**

- **Appreciation**
- **Depreciation**

**Volatility** (percent)

- **Change since May 21, 2013 to current**
- **Change since May 21, 2013 to peak**
How will the U.S. monetary exit be?

**Smooth**
- Gradual recovery expected
- Tapering smooth and tightening gradual
- Much already “priced in”
- Volatile adjustment largely behind us

**Bumpy**
- Timing of recovery uncertain
- Tapering has not even started, let alone tightening
- Unchartered territory
- Fed doesn’t control long-term rates
- Potentially destabilizing market dynamics
Potential impact on emerging markets

- External conditions
- Quality of domestic fundamentals

Local currency yield tightening (Dec 08 – Dec 12) (basis point)

Yield: -460
External Factors: -320
Domestic Factors: -140
Volatility amplifiers in the U.S. monetary exit process

- Massive shift to fixed income (U.S., EM)
- Increased duration (U.S., EM)
- Structurally lower market liquidity (U.S., EM)
- Foreign investors have crowded in local markets (EM)
- Higher role of cross-over investors (EM)
Rising corporate leverage in emerging markets

New issuance of corporate debt (billions of US dollar)

Nonfinancial Corporate Balance Sheet Metrics

Ratio of Net Debt to Equity

Sources: Bloomberg L.P.; and IMF staff calculations.
Note:Computed as the median of all available firm data. CEEMEA - central and eastern Europe, the Middle East, and Africa. Firms with negative net debt were excluded.
Recent “mini-stress” tests: currencies and bonds hit the most
Recent “mini-stress” tests: fundamentals matter

Exchange Rates vs. Current Account Balance

Exchange Rates vs. Inflation Rate

Current Account Balance, 2012 (in percent of GDP)

Inflation rate (average Jan-Aug 2013, percent)

Change in Nominal Exchange Rate, Aug 30 to May 22, 2013 (LC/USD, in percent, - depreciation)
It takes two to tango

**US**
- Manage tapering and tightening (execute + communicate)
- Prudential policies key for stability

**Emerging Markets**
- Strengthen macro-financial policy frameworks and buffers
- Facilitate orderly market adjustment
Specifically for emerging markets

• In preparation ➔ strengthen fundamentals/keep them in check

• If serious tensions arise:

  ➢ Allow exchange rates to adjust in line with fundamentals
  ➢ Provide liquidity
  ➢ Adjust macroeconomic policies
  ➢ Prudential policies
  ➢ Swap lines, IMF facilities