Tapering Talk: The Impact on Emerging Markets
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Discussion

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Disclaimer: The views expressed are those of the author and should not be taken to reflect those of DNB or of the Eurosystem.

Apologies to the authors of the paper.

The paper and the debate

- Yesterday's discussion: FG and communication about (conventional and) unconventional monetary policy influences financial markets and the macroeconomy.
- This morning's session: international impact ⇨ spillovers
- EMEs were affected by tapering talk ⇨ does effect differ across EMEs? And, if so, why?
- Perspective: tapering talk as a trigger for capital flow reversals/speculative attacks

Conclusions of the paper

- Central bank communication about unconventional monetary policy matters for financial markets in EMEs.
- The impact is not uniform across EMEs.
- What matters most is the size of the domestic financial market, and previous exchange rate and current account dynamics.

Conclusions (cont'd)

- Fundamentals do not matter much. Good fundamentals do not protect economies from financial market stress.
- "Good" policies do not help either
  - capital controls (macroprudential policy?), fiscal prudence).

Praise

- Relevant topic
- Impressive data work
  - Large(st) set of EME countries
  - Large set of variables that have been used in the literature
- Unconventional conclusions

But…

- Strong conclusions based on reduced-form cross-section regression with relatively small sample

⇨ need to dig deeper to understand the dynamics of markets and their drivers

⇨ 3 questions and a conjecture

Question (1)

- Is the impact of tapering (exit) symmetric, i.e. did communication about entry drive up capital inflows into EMEs?
- The search for yield story suggests that this has been the case
- This can be tested with the same empirical method.

⇨ Examine reaction of fin variables at different points in time: QE talk vs tapering talk.

Question (2)

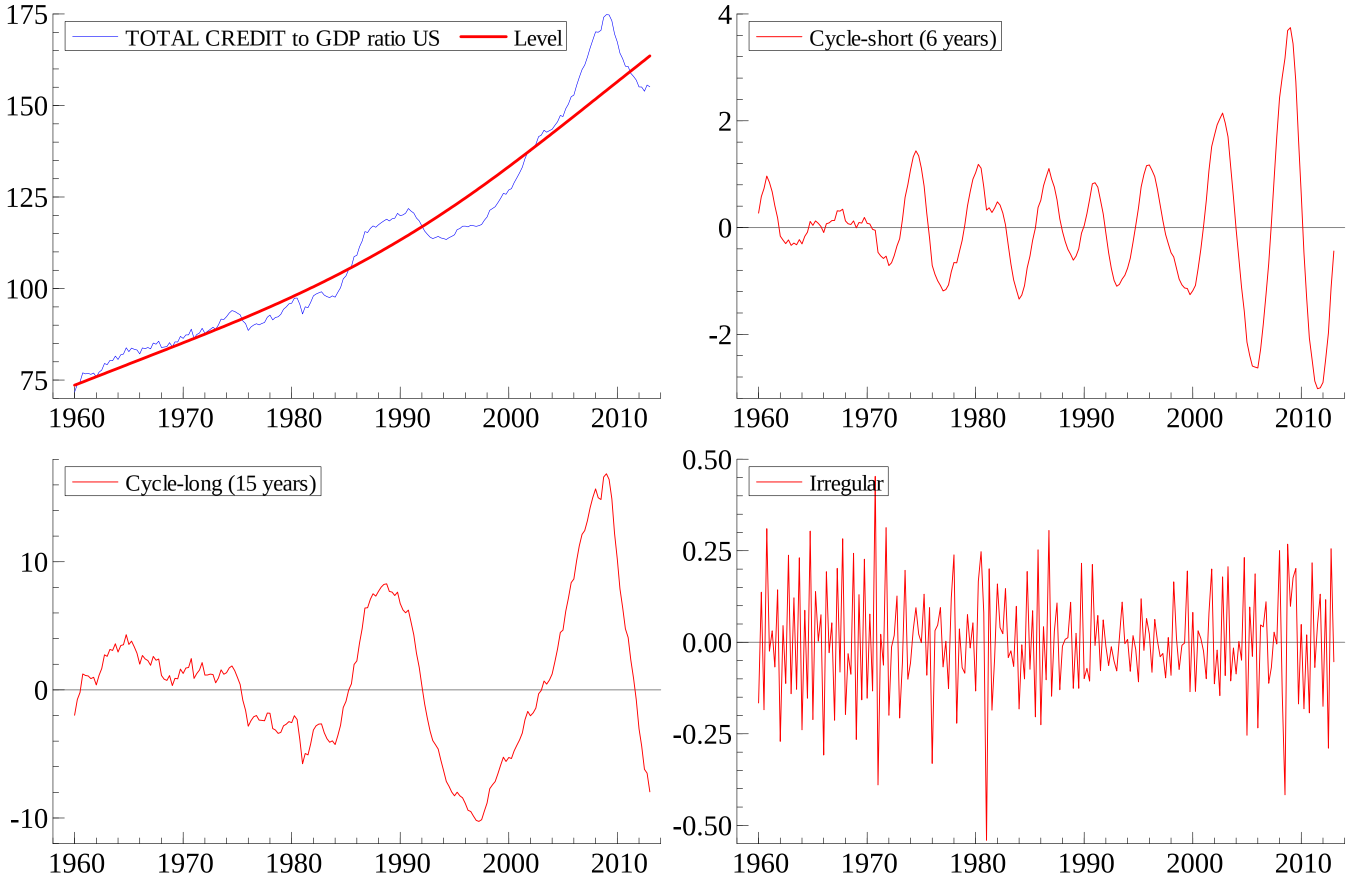
- Why focus on EMEs?
- Rather than covering the whole universe of EMEs, how about comparing the response of different types of countries and check if there is a common story.

⇨ Look at different sets of countries

Question (3)

- Global crisis and policy responses driven to an important extent by financial imbalances.
- Variables in regression analysis partly match those in research on the financial cycle (e.g. Claessens, Kose and Terrones 2010, 2011).
- Is market stress in EMEs following tapering talk initial stage of bust following a booms?

⇨ Look at credit/GDP, gross cross-border flows, leverage, house prices



TOTAL CREDIT to GDP ratio US
Level
175
150
125
100
75
1960
1970
1980
1990
2000
2010
Cycle-short (6 years)
4
2
0
-2
Cycle-long (15 years)
10
0
-10
Irregular
0.50
0.25
0.00
-0.25
-0.50

A conjecture

- A number of EMEs experienced an overextension in the financial sector, which was financed to an important extent by foreign capital
- Overheating of financial cycle + trigger ⇨ market stress ⇨ imbalances start to unwind