

Fed Tightening and International Spillovers

Policy panel:

“Financial markets in turbulent macroeconomy”

Ambrogio Cesa-Bianchi

Bank of England, CEPR, and CfM

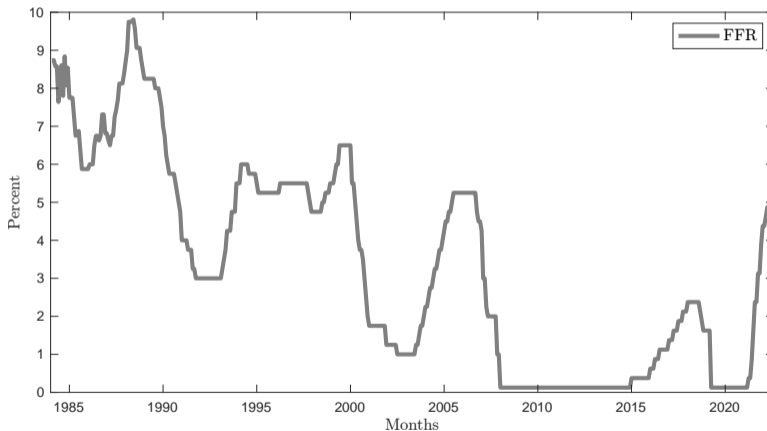
SoFiE 2023 Conference

June 17, 2023

*The views expressed here are mine and do not necessarily represent the views of the Bank of England or of any of its Committees.

The Fed tightening cycle

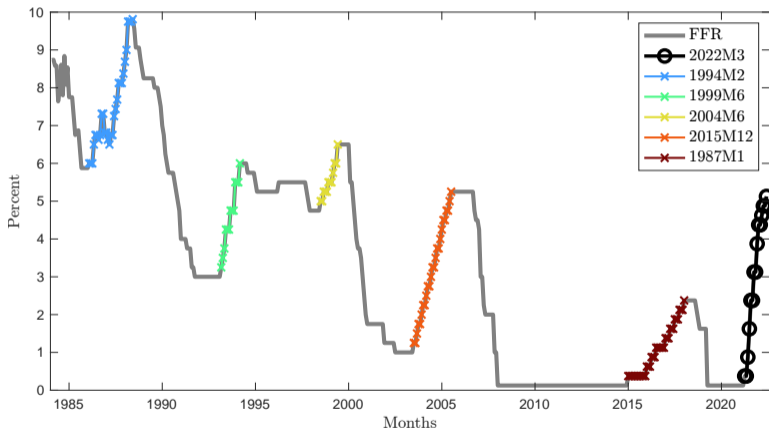
- ▶ Federal Reserve started a series of monetary policy hikes in March 2022



NOTE. Monthly federal funds rate over the period 1985:M1 to 2023:M5. Source: Federal Reserve.

The Fed tightening cycle: Historical perspective

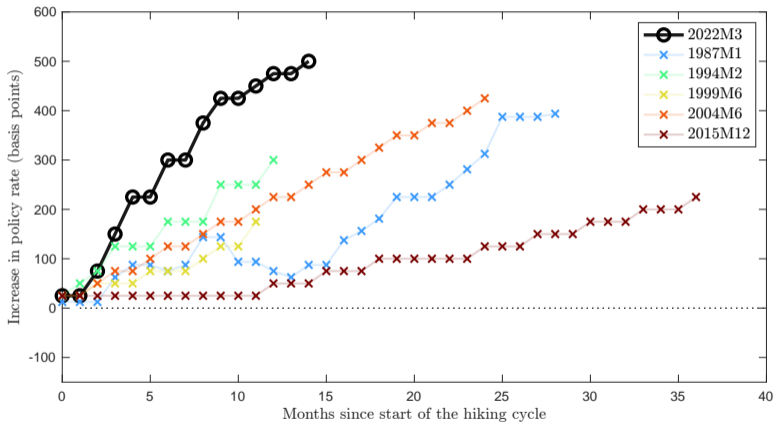
- ▶ Unusually aggressive tightening cycle, in terms of speed and magnitude



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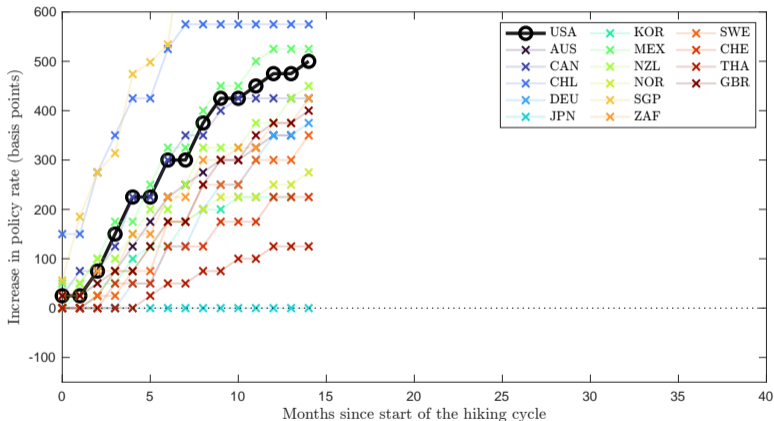
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NOTE. Monthly policy rates over the period 1985:M1 to 2023:M5 for a panel of 15 countries with flexible exchange rates. Source: BIS.

The Fed tightening cycle: International perspective

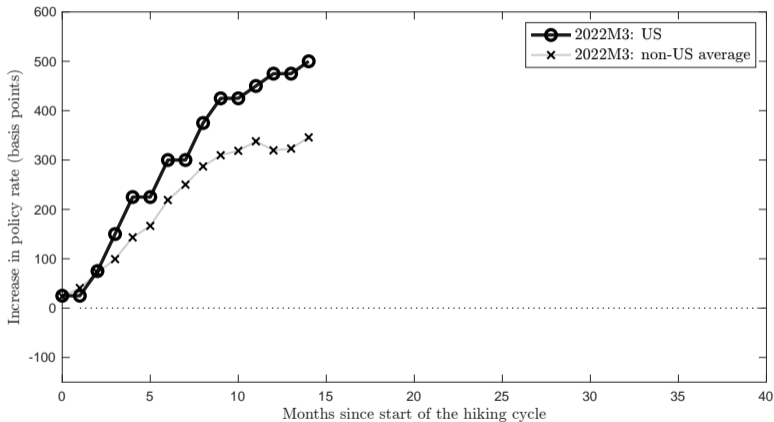
- ▶ Other 'flexible exchange rate-inflation targeting' central banks tightened around same time...



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The Fed tightening cycle: International perspective

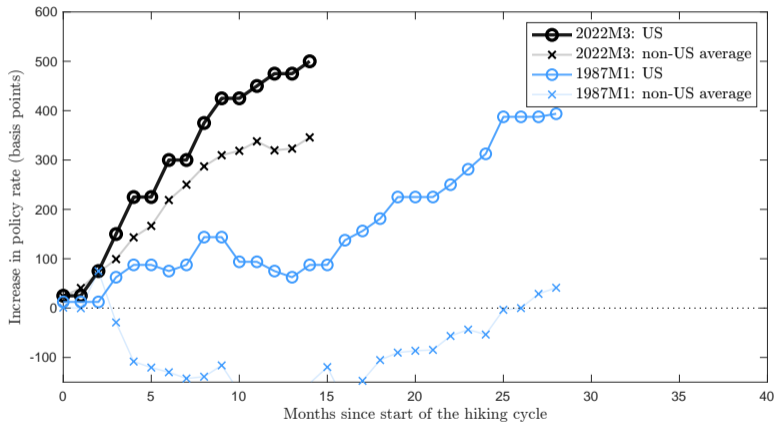
- ▶ ... by a similar speed and magnitude (on average)



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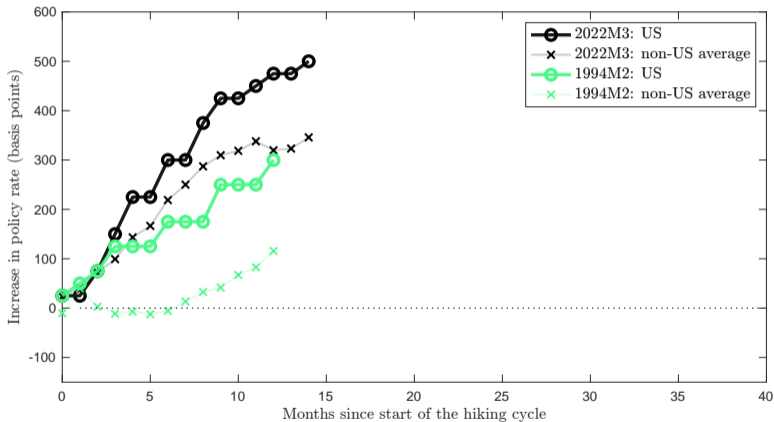
- Unusually synchronized tightening cycle across countries



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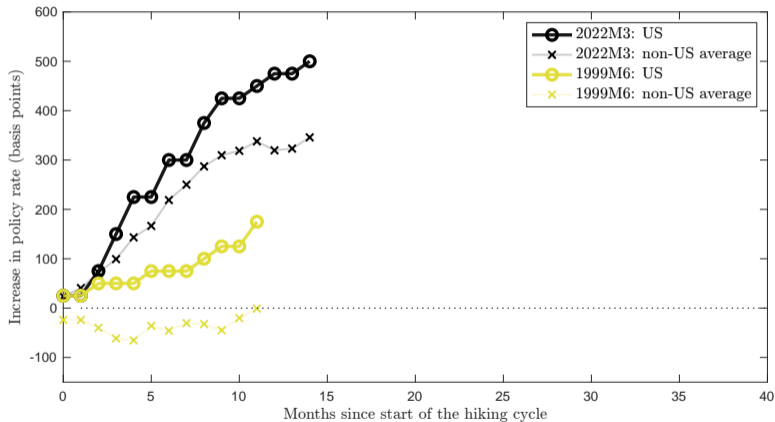
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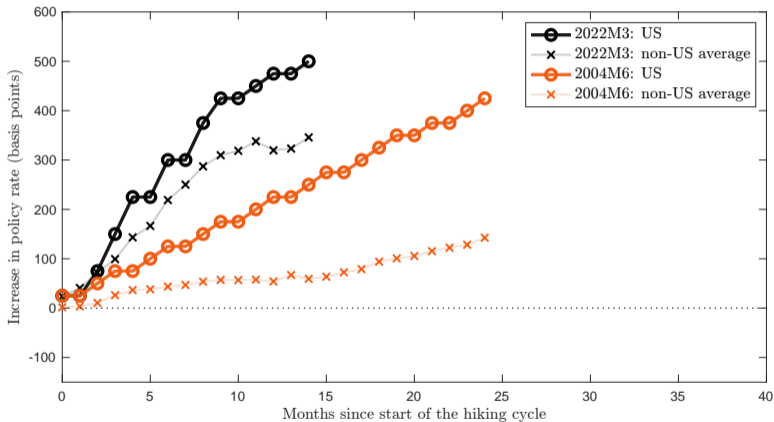
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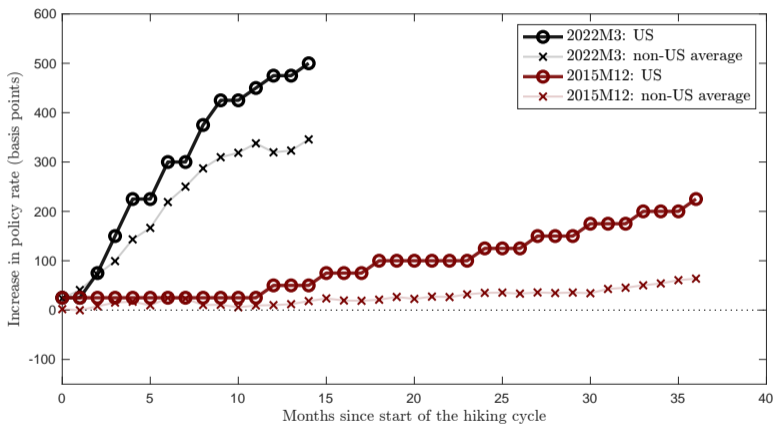
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US monetary policy spillovers

- ▶ **Traditional view** US monetary policy tightening transmits *via* an expenditure switching effect
 - * Depreciation of the local currency
 - * Boost in exports
 - * Higher imported inflation → Concern to domestic policymakers

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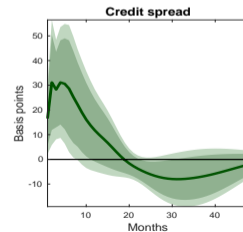
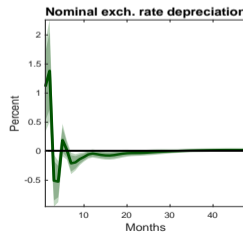
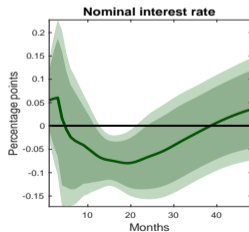
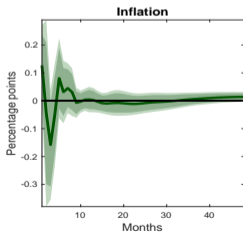
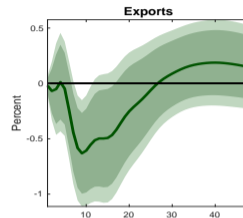
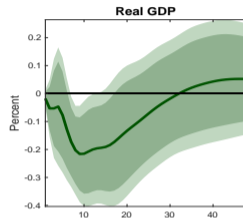
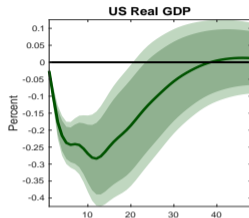
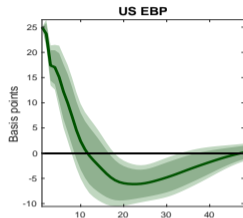
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- Worsening of trade-off?
Competitive rates hikes?

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 - Worsening of trade-off?
 - Competitive rates hikes?
- ▶ Traditional view ignores hegemonic role of US dollar in the international monetary system
 - * Dominant trade invoicing currency → Muted expenditure switching
 - * Dominant funding currency → Balance sheet effects, role for financial conditions

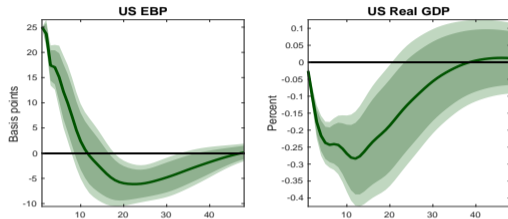
What do the data say?

Cesa-Bianchi, Ferrero, Li (2023)



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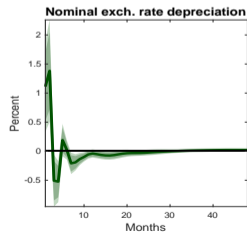


Standard US transmission

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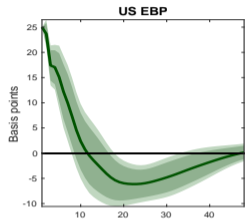
Cesa-Bianchi, Ferrero, Li (2023)

Standard Home FX depreciation

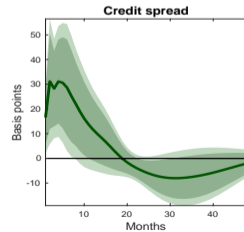


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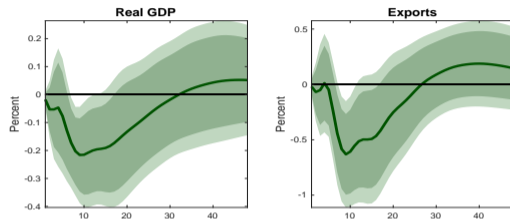


Spreads co-movement



What do the data say?

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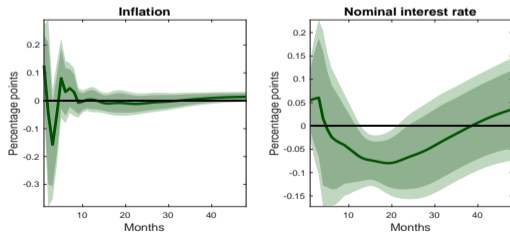


Expenditure-switching effect
does not dominate

What do the data say?

Cesa-Bianchi, Ferrero, Li (2023)

Monetary policy stabilizes inflation



Implications for small open economies

- ▶ Empirical evidence consistent with the global financial cycle hypothesis [Rey (2013)]
 - * Large effects from US monetary policy spillovers
 - * Output and inflation fall in the typical flexible exchange rate small open economy

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 - * Output and inflation fall in the typical flexible exchange rate small open economy
- ▶ Tightening of financial conditions exacerbated by globally synchronized hiking cycle
 - * Can lead to economy-wide or sector-specific financial stress
- ▶ Importance of independent tools to deal with financial stability
 - * Specific tool depends on country characteristics (lots of heterogeneity!)
 - * Not a substitute for sound macroeconomic policy