Policy Interactions and International Spillovers in the Global Economy: an Academic Perspective
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Introduction

This workshop presents two research agendas:

• Interaction between macropru and monetary policies in international context (IBRN)

• Integrated Policy Framework (IMF)

with some conceptual overlap, but very different approaches
Monetary-macropru interaction

• Targets

\[ \text{Max } U(d, c) \]

maximized for \(d^*\) and \(c^*\)

• Instruments (with interactions)

\[ d = D(i, \tau) \]
\[ c = C(i, \tau) \]
Monetary-macropru interaction

- **Tinbergen principle**: because # instruments=# targets, both targets can be achieved simultaneously:

<table>
<thead>
<tr>
<th>Target Instrument</th>
<th>Target</th>
<th>Instrument</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monetary policy</td>
<td>Demand d*</td>
<td>i</td>
</tr>
<tr>
<td>Macroprudential policy</td>
<td>Credit c*</td>
<td>τ</td>
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Policy interactions are not a problem (except if instruments are collinear)

- Many reasons that the policy mix is more complicated in practice
  - one being that one policy instrument might decrease the effectiveness of the other
Monetary-macropru interaction

• The papers in the IBRN package estimate various versions of

\[ c = C(i, \tau) = \alpha_i \cdot i + \alpha_\tau \cdot \tau + \alpha_{i\tau} \cdot i \cdot \tau \]

(where \( c \) is bank credit, for different countries and specifications)

  – remark: to study the impact of \( i^* \), one should keep \( i \)

• Focus is on the sign of interaction term \( \alpha_{i\tau} \)

  – if \( \alpha_{i\tau} > 0 \), a macroprudential restriction mitigates the responsiveness of bank credit to monetary policy
Monetary-macropru interaction

• To understand interaction between policies one needs to look at impact of instrument on each others’ targets

• Monetary and macropru. may have to pull in opposite directions
  – Example: $i^* \searrow$ implies $c > c^*$ and $d < d^*$ implies $i \searrow$ and $\tau \nearrow$

• In this case, what gives?
  – risk of hitting ZLB
Integrated Policy Framework

- IMF staff develops an integrated policy framework (IPF) to study broad policy mix in open economy: interest rate, foreign exchange interventions (FXI), macropru., capital controls
  - interdepartmental effort

- From an academic perspective, Basu et al’s (2019) RES model is state-of-the art
  - analysis is micro-founded and welfare based
  - incorporates frictions that have been studied separately in the literature
Integrated Policy Framework

• What Basu et al try to do is hard

• The academic literature has updated the Tinbergen principle by allocating instruments to frictions

• But the policy instruments that are optimal in theory do not exist or are imperfect in practice
Integrated Policy Framework

• The academic (welfare-based) literature has not been very good at characterizing complex policy mixes in realistic third-best settings

• One important/realistic feature of the RES model: the depth/shallowness of home financial markets

• Work in progress: it will be important to “distill and translate” the results that are robust and relevant

• Will the model look at international spillovers?
References


