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

$$\text{Max } U(\underbrace{d}_{\text{ag. demand}}, \underbrace{c}_{\text{credit}})$$

maximized for d^* and c^*

- Instruments (with interactions)

$$d = D(\underbrace{i}_{\text{monetary policy}}, \underbrace{\tau}_{\text{macropru}})$$

$$c = C(i, \tau)$$

Monetary-macropru interaction

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

	Target	Instrument
Monetary policy	Demand d*	i
Macroprudential policy	Credit c*	τ

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
  - nominal: Correia et al (2013), Farhi et al (2014), etc.
  - financial: Benigno et al (2016), Jeanne and Korinek (2019), etc.

- 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

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