Central Bank of Chile*, *Inter-American Development Bank*, and *Journal of International Economics
Joint Seminar of the Financial Stability and Development Network
"Financial Frictions: Macroeconomic Implications and Policy Options for Emerging Economies"
Opening Remarks by Mario Marcel, Governor of the Central Bank of Chile
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- Dear colleagues, dear friends, welcome to this conference on "*Financial Frictions: Macroeconomic Implications and Policy Options for Emerging Economies*", organized jointly with the Inter-American Development Bank, as part of the agenda of the Financial Stability and Development Network, and the Journal of International Economics. Special greetings to our friends of the IADB, as well as to all the speakers, discussants and moderators that will be attending this event remotely from distant parts of the world. Thanks to the latest technology, this can be possible in these so unusual circumstances.

- Financial frictions can take many forms, such as collateral requirements or interest rate spreads. They can limit the ability of firms to finance productive investments, affecting aggregate growth and the allocation of resources, and can also limit their ability to weather temporary adverse shocks. Financial development can limit the extent of these frictions, fostering productivity and growth, and smoothing out temporary fluctuations but, in the meantime, we have little choice but to live with them and to factor in how they influence the economy.

- The role of frictions in the functioning of the financial system is particularly relevant, because alongside its contribution to intermediation, resource allocation and risk management, financial markets are also a source of macroeconomic risk, either by amplifying the effect of real shocks or by being a source of volatility by itself. There is a large volume of evidence that financial crises in particular can have strong and long-lasting negative effects on output, productivity and welfare overall.

- Financial regulation and macroprudential policies are called upon to balance the need for financial stability and resilience while maintaining the financial system's ability to foster investment, efficiency and innovation.

- Emerging economies, for which financial frictions are prevalent, have traditionally been subject to large macroeconomic shocks which have led to financial instability and oftentimes to financial crises, sudden capital flow reversals and, consequently, drastic output drops.

- In the last two major global crises, emerging economies have been hard hit and financial factors have played a major role in the transmission of shocks to the domestic economy, although in opposite directions. So, while in 2008-09 financial markets originated and amplified the economic shock, in 2020-21 they contributed to contain the impact of the shock to the real economy caused by the pandemic.

- The latter did not happen spontaneously, though, as macro policy responses sought to mobilize the capacity of the financial system to provide liquidity to firms in the brink of insolvency due to the sudden stop of activity because of worldwide quarantines and other harsh sanitary measures. Addressing financial frictions in implementing these policies has been part and parcel of policy design in this juncture, as reflected in the role of government guarantees, liquidity provisioning, conditionality and incentives to lend, collateral management and regulatory forbearance.

- However, there is still much to be learned in the design and use of fiscal, monetary and macroprudential policies under financial frictions. Such is the contribution expected from this Conference, which collects 11 papers that seek to push forward the knowledge frontier on this subject.

- Two papers study how the banking sector and export sector affect and are affected by financial frictions.

- Another two papers focus on FX interventions and international reserve management. This connects with the monetary policy frameworks that provide the first line of defense against financial and foreign shocks. Many emerging economies, among which Chile is a notable example, have adopted inflation targeting regimes along with flexible exchange rate schemes, for which central bank independence is usually a pre-requisite.

- The link between fiscal policy austerity and sovereign spreads is the subject of another paper, with a strong connection with the larger role that fiscal policy takes when the MPR is at the *effective zero lower bound* as in many countries today.

- Finally, six papers in the program focus on the design, transmission mechanisms and macro and micro consequences of macro-prudential policies, which, as we know, emerged from the Global Financial Crisis as an important addition to the macro-financial policy toolbox.

- So these papers and the discussions that should follow will provide much food for thought on the macro and policy implications of financial frictions. This may generate valuable insights to policymakers at a time when the Covid-19 crisis is far from over, and when economic authorities are charting exit strategies where financial markets will continue to play a major role.

- On behalf of the Central Bank of Chile I wish you a fruitful discussion over the next two days.

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