Discussion of

Monetary Policy Responses to External Spillovers in Emerging Market Economies

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The paper

- **Goal:** How to deal with spillovers on SOE of an external shock?
  [higher world interest rates and tightening of the external borrowing constraint]
- Approach: Comparison of policy regimes in a calibrated DSGE to EMs:
  - Flexible exchange rate + Taylor rule
  - Exchange rate peg + Taylor rule
  - Flexible exchange rate + optimal time-consistent monetary policy
- Results:
  - Exchange rate peg does much worse during a crisis but makes crises less likely.
  - No macro-pru role for monetary policy.

Details of the model

- Production requires imported intermediate inputs besides capital and labor.
- Households borrow abroad to finance interm inputs and consumption.
- HH use capital as collateral subject to an *exogenous* credit limit.
- Precautionary savings in domestic and foreign bonds (the latter is taxed).
- Prices sticky *a la* Rotemberg $\rightarrow$ slow real exchange rate adjustment.
- Taylor rule responding to output, inflation and real exchange rates.
- (Extension) Wages indexed to inflation and with downward rigidity.

Intuition for main results

- If the collateral constraint binds, less intermediate inputs $\longrightarrow$ less production.
- If the real exchange rate depreciates, interm. inputs become more expensive.
- If exchange rate is flexible, monetary policy can allow inflation to rise.
  [although nominal interest rate rises because real interest rate rises]
- If exchange rate is fixed, monetary policy has to engineer deflation.

Comments: Preview

- Beautiful paper.
- Stylized yet not simple laboratory for policy evaluation.
- Valuable and useful quantitative exercise for EM economies.
  - Get the exchange rate to float and you'll be fine!
    [if wages are not so sticky]
- Not so sure about the no macro-pru result.

Comment #1/1

- In the model, the external shock translates into a given tightening of the external borrowing constraint.

- Is that so?
  - The (external) borrowing constraint is an equilibrium object!
    [at least this what an optimal contract approach would tell us]
  - A tighting of the external borrowing constraint is not a well-defined shock.
  - Monetary policy then may affect how tightened a borrowing constraint gets.

- Monetary policy may interact with other policies during crises (fiscal?)

Final Remarks

- Important message for EM's monetary policy makers.
  - If wages not too sticky, let the exchange rate to float and you'll be fine!
  - If wages are very sticky, let the exchange rate to float anyways.
- A message to take with caution: Forget about using the interest rate for macro-pru.