Discussion of "U.S. Anti-Inflationary Policy and Emerging Economies: 1980s vs. 2020s"

Kathryn Holston

5 Nov 2024

Five Hypotheses for EME Resilience from Banerjee, Hale, and Shieh

1. Domestic (preemptive) tightening
2. Lower UIP premia
3. Higher degree of financial development
4. Higher level of foreign exchange reserves relative to external debt
5. Initial conditions: lower levels of interest rates (esp. real interest rates)

Hypothesis #6: Shift toward Local Currency Debt

- Growing explanation in the literature, paired with central bank independence and credibility (Kalemli-Özcan and Unsal, 2024)
- Trend building toward greater resilience
- Heterogeneity among EMEs; debt denominated in foreign currencies remains sizable for some

Hypothesis #7: Role of International Insurance

- Expanding role of bilateral swap lines and regional financing arrangements (Nagy-Mohacsi, 2020, 2024)
- Fed FIMA repo facility and expanded swap lines (Choi et al., 2022; Goldberg and Ravazzolo, 2022)
- Linked to EME developments

Importance of Common Shock?

- To what extent did the synchronous nature of inflation shock (and COVID-19 shock) alter EME policy landscape and outcomes?
- Does this inform lessons for the future?
- Risk of divergence if U.S. inflation resurges or global financial conditions tighten
- Was this luck?

Importance of Common Shock?

- To what extent did the synchronous nature of inflation shock (and COVID-19 shock) alter EME policy landscape and outcomes?
- Does this inform lessons for the future?
- Risk of divergence if U.S. inflation resurges or global financial conditions tighten
- Was this luck? No.

Risks Ahead

1. Lack of fiscal space
2. Rollover risk in 2025, 2026
3. Tightening of global financial conditions
4. Divergence of global cycle
5. Political and geopolitical uncertainty
   $\implies$ financial market volatility and trade policy uncertainty