Monetary and Financial Policies in Emerging Markets

R07323001 黃仲翊

1. **What is the question?**
   In this paper, the authors study the interaction between monetary and macroprudential policies in emerging economies. By building on a New Keynesian model, they want to ask: given the international financial integration, how do the external financial and nonfinancial shocks affect the emerging market economies? How should the government respond to these unanticipated shocks from foreign countries?

2. **Why should we care about it?**
   This paper can help us to realize the transmission of financial shocks across different countries. Also, it can provide effective advice with emerging market economies on monetary policies.
   After the Global Financial Crisis, many developing countries had a large amount of capital inflow due to the expansionary monetary policy in main developed economies. It forced the developing countries to adopt a variety of tools to control the rapid credit growth. However, when the FED decided to finish its highly accommodative monetary policy, these countries experienced the reversal effects on output, exchange rate and foreign debt balance. The authors want to propose a general equilibrium to explain these observations.

3. **What is the author's answer?**
   The authors point out that an increase in the foreign interest rate causes a depreciation of the emerging market economies' currency and fosters export. However, this financial shock also worsens the banks' balance sheet and brings higher inflation to the market through the exchange rate. The combination of depreciated currency, declining assets price and inflation put the governments of these economies in the tradeoffs between the macro stability and financial stability objectives.

4. **What are the implication of the answer? What can we learn from this paper?**
   In order to control the riskiness of financial shocks from foreign countries, the authors advise that the government should take a cyclical macro prudential policy on the flow of foreign capital. For example, by introducing a cyclical tax on foreign borrowing, the policy can help banks to stabilize their balance sheets and reduces the movement of capital price when the financial shock occurs.