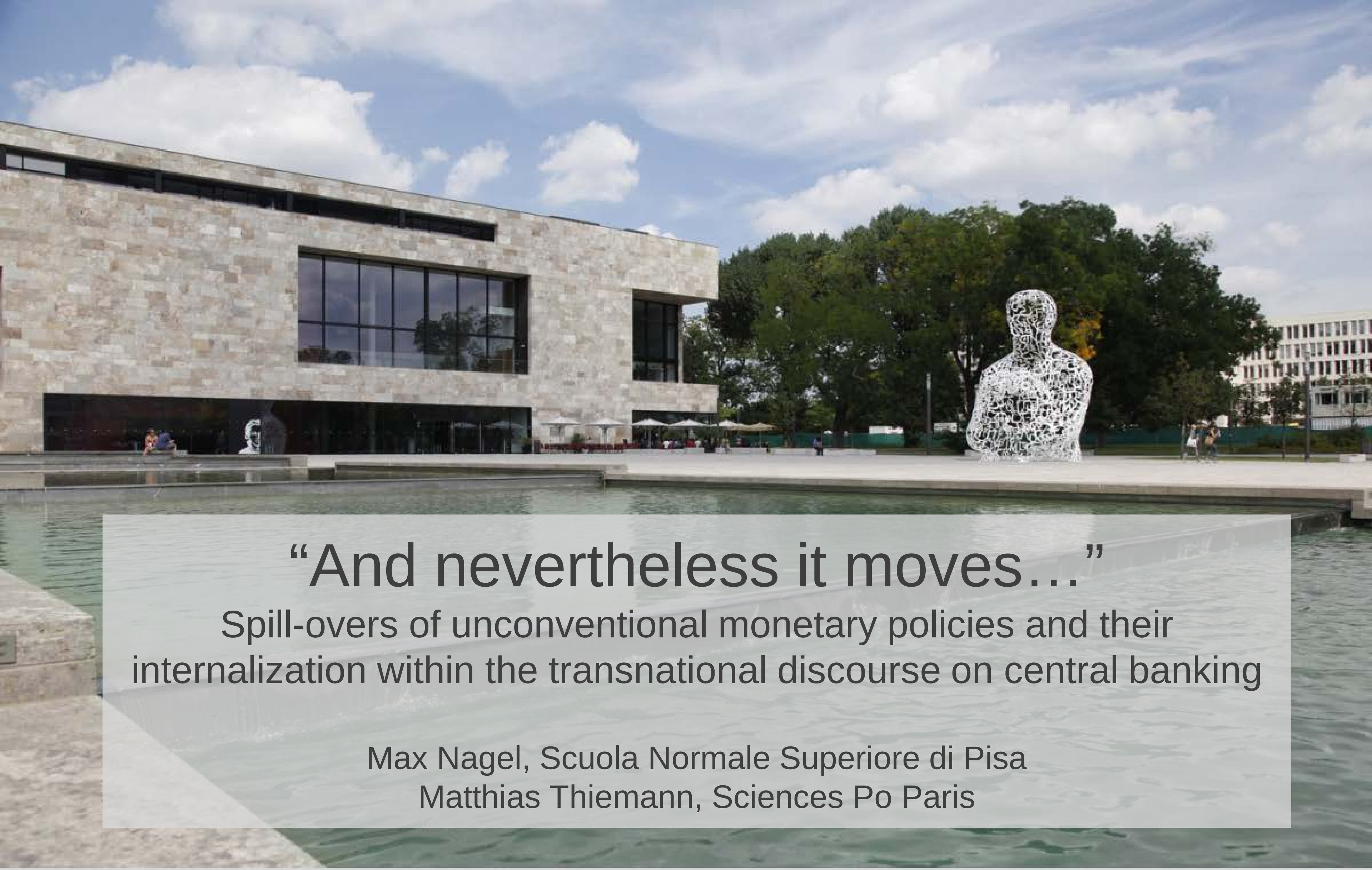

“And nevertheless it moves…”

Spill-overs of unconventional monetary policies and their internalization within the transnational discourse on central banking

Max Nagel, Scuola Normale Superiore di Pisa
Matthias Thiemann, Sciences Po Paris

House of Finance
SAFE
Sustainable Architecture for Finance in Europe
VolkswagenStiftung
A Cooperation of the Center for Financial Studies and Goethe University Frankfurt
Center for Financial Studies
Goethe Universität Frankfurt am Main

International effects of post-crisis monetary policy

- How are unconventional monetary policies and their unintended effects in the international monetary and financial system assessed by technocrats and what are the consequences of this assessment?
- May/June 2013: taper tantrum
- What are the effects of unconventional monetary policies?
  1. real policy spillovers (macroeconomic variables)
  2. financial policy spillovers (financial stability)

International effects of post-crisis monetary policy

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  2. financial policy spillovers (financial stability)

- Epistemic uncertainty particularly regarding financial policy spillovers → analytical focus

What is this a case of?

We are looking at a moment of contestation of the global financial architecture (QE-taper tantrum and spill-over). An important pillar (in terms of ideology) of this Global Financial Architecture has been the Mundell Fleming Model, which has come under attack both in terms of economics as well as in terms of the technocratic expert discourse.

The paper is asking how the expert community processes this event and which larger changes (in terms of central bank coordination, but also in the outlook of these experts on the world) it has. Crucial: Specific framing of global imbalances central for assessing the international implications of domestic monetary policies

Our analysis is informed by the insights of Schmidt's discursive institutionalism (2008, 2011), which emphasizes the role economic ideas have in the coordinative discourse among experts (s. also Wood 2015).

General Observations and Interests of the Paper

-International Monetary and Financial System is subject to changes in the long run

-Current “non-system” (Rajan 2014) is a remnant of Bretton Woods

-Bretton Woods was a system destined to control capital flows, engineering a system of quasi-closed capital accounts (hot money flows problem)

-only from late 70s to 90s: move towards a system of open capital accounts, which peaked in the attempt to change IMF charter (Gallagher 2015)

Role of economists

-in all these periods, e.g. in the period of the founding of BW, economists views, focusing on and blending issues of national and international macroeconomics and international finance (Keynes, Dexter White) were crucial to the evolution of the system

-So where does economic discourse stand today on the merits and drawbacks of the current IMFS? And what, if any, are its impacts?

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Policy field of central bankers and international organizations

- Domestic mandates (macroeconomic objectives)

- Central bankers (including BIS) and arguably IMF form a transnational epistemic community (Marcussen 2006)
- Transnational discursive competition, struggling for epistemic authority
- International effects: real and financial policy spillovers

- How is this tension processed in the discourses of policy institutions in the field?
  1. intra-institutional knowledge production
  2. intra-institutional ideational processes
  3. discursive shifts and inter-institutional competition

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Theory: Ideas matter

- Interests are socially constructed, based on ideas: what is beneficial, what is in my interest is answered according to a certain (economic) understanding of the world (Blyth 2003, monetary policy coordination Widmaier 2004)
- Influence of (new) ideas particularly strong in situations of high uncertainty (Blyth 2003, Widmaier et al 2007)
- Focus on social construction of analytical frames to evaluate policy spill-overs – What is left out? What is included?

Experts and policy making

- Experts construct policy problems and policies to address them strategically within their shared world view and within their shared knowledge of the world
- They do so within a bureaucratic organization with the task of addressing these issues
- Within a transnational field of expertise, within which different professionals are vying for the provision of solutions and different organizations vie for influence (in our case BIS, IMF, national central banks); fight for epistemic authority

Method and Data

- Process tracing of debate, using document analysis and expert interviews to understand the shifting evaluation of unconventional monetary policy in the transnational expert discussion from 2007-2017, seconded by quantitative analysis
- Working papers, official publications, speeches by the Fed (163), IMF (129) and BIS (120), chosen as the central institutions driving the transnational discourse on the global financial architecture
- For textual analysis: 146 (IMF), 122 (BIS), 79 (FED)
- 17 expert interviews with current and former policymakers and economists at the Fed and IMF + ECB and BoJ – further interviews with BIS staffers planned

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The observed period (2007-2017) characterized by a rupture

Pre-2010	Current account view
2010- Taper tantrum	Re-direction of problem frames and problem resolution frames
Post-2013	Current account view Risk-taking channel Capital account view

- Current account view :

  underlying hegemonic macroeconomic viewpoint, based on neoclassical economics

- Capital account view:

  macro-finance, a new economic strand which post-crisis challenges the hegemonic view, emphasizing the role of financial flows impacting the macroeconomy through the risk-taking channel

→ Different frames are crucial for the positioning of policy institutions, and are in turn influenced by Taper tantrum

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Intellectual fights in the field of international macro-economics and finance

Contention: Need to integrate financial and real side effects of globally integrated financial markets in our analysis

Between on the one hand International closed form macroeconomics (focus on real side, trade imbalances, savings imbalances) vs. international macro-finance (financial cycles, balance sheets, gross capital flows are crucial)

-Mundell-Fleming framework (impossible trinity) vs. dilemma (global financial cycle)

Different factors related to different views

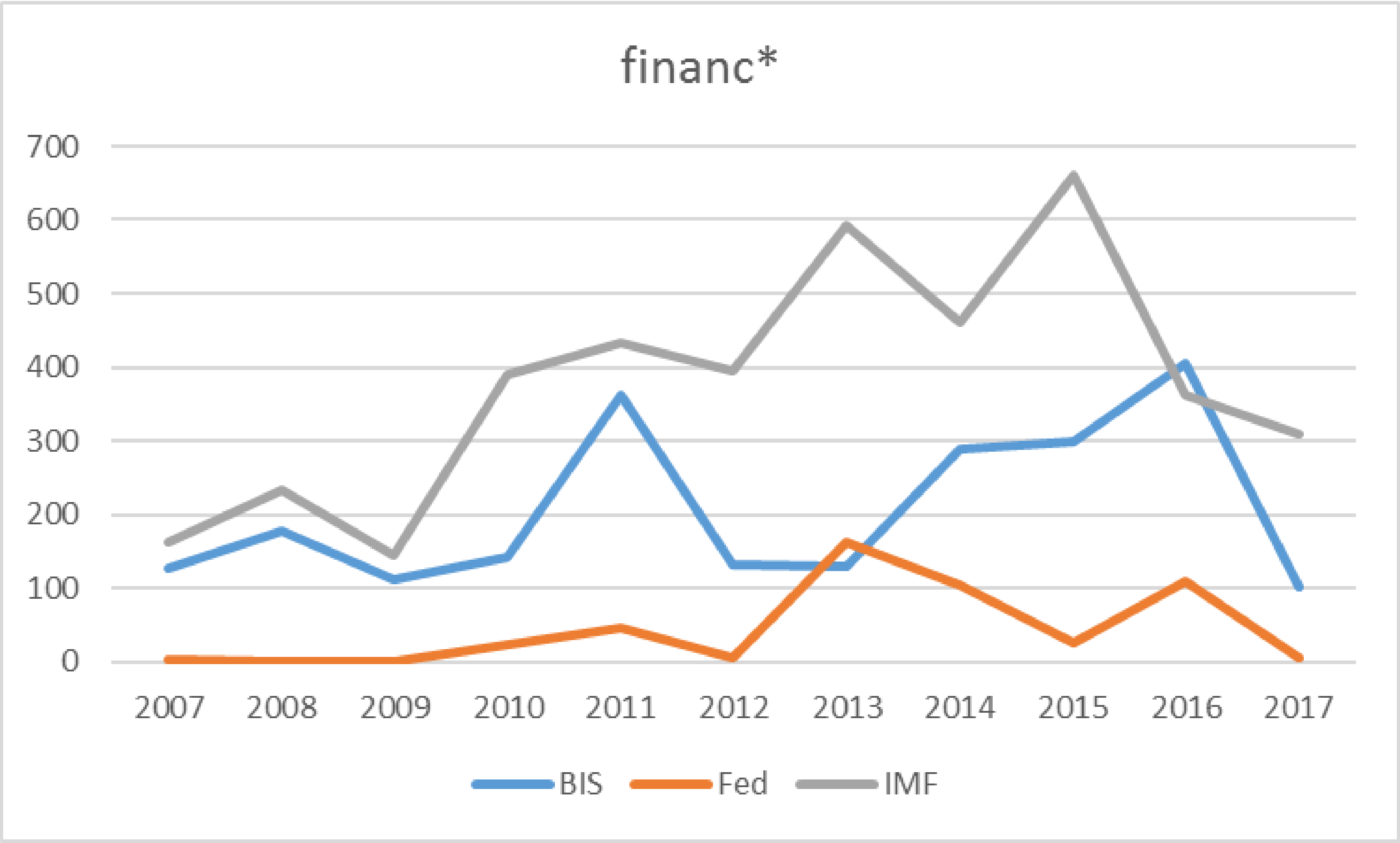
Current account	**Capital account**
Pull factors	Push factors
Interest rate channel	Risk taking channel
Net capital flows	Gross capital flows
Current account imbalance	Capital account imbalances

Pre-2010 view

	Fed	IMF	BIS
Spillovers	Real	Real	Real
Risk-taking channel	No	No	No
Global imbalances	Current account	Current account	Current account
Scope of analysis	Net capital flows	Net capital flows	Net capital flows
Scope of monetary policy	Domestic macroeconomics	Domestic macroeconomics	Domestic macroeconomics
Adjustment	EMEs	EMEs	EMEs
Coordination	House in order	House in order	House in order

Post-2010 evolution

	Fed	IMF	BIS
Spillovers	Real	Real	Financial
Risk-taking channel	No (domestic yes)	Yes	Yes
Global imbalances	Current account	mixed	Capital account
Scope of analysis	Net capital flows	mixed	Balance sheets/gross capital flows
Scope of monetary policy	Domestic macroeconomics	International macro-finance	International macro-finance
Adjustment	EMEs	EMEs	AEs
Coordination	House in order	House in order	Monetary policy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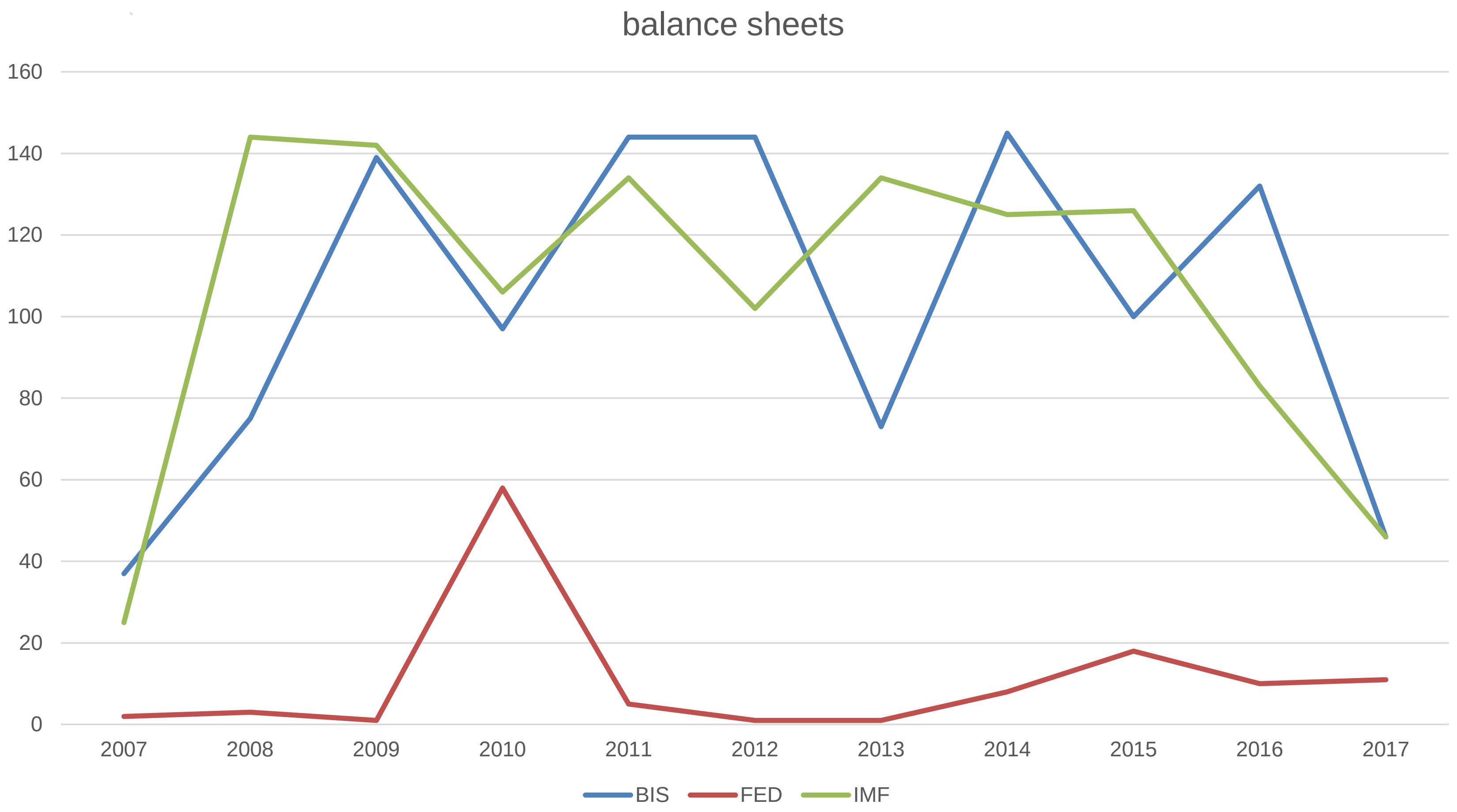
Macrofinancial concept of balance sheets not embraced by Fed



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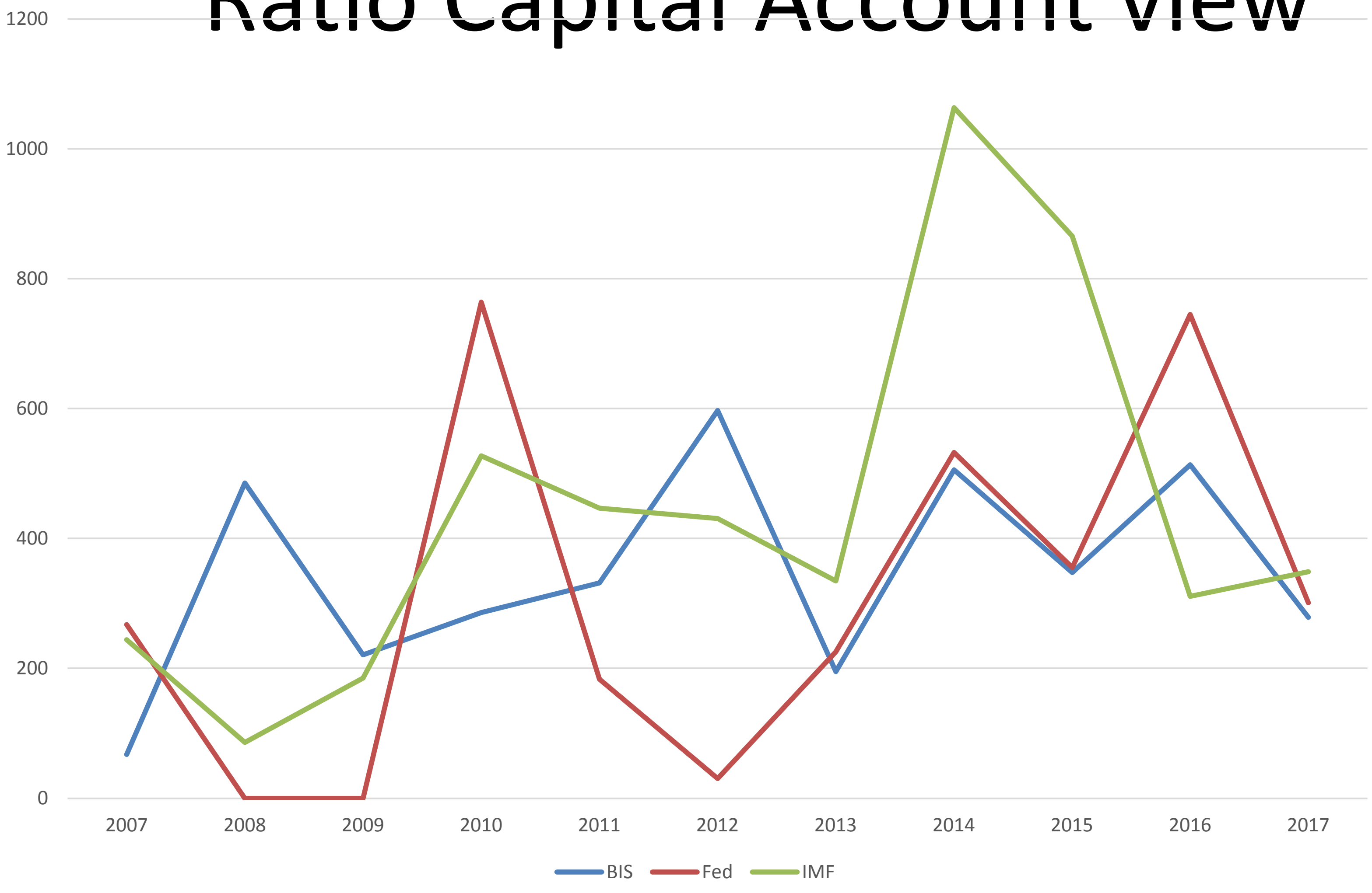
Ratio Capital Account view



The debate over spill-overs among the different actors

Positioning and dynamics

So what is the Problem analysis and what is the proposed Resolution regarding QE?

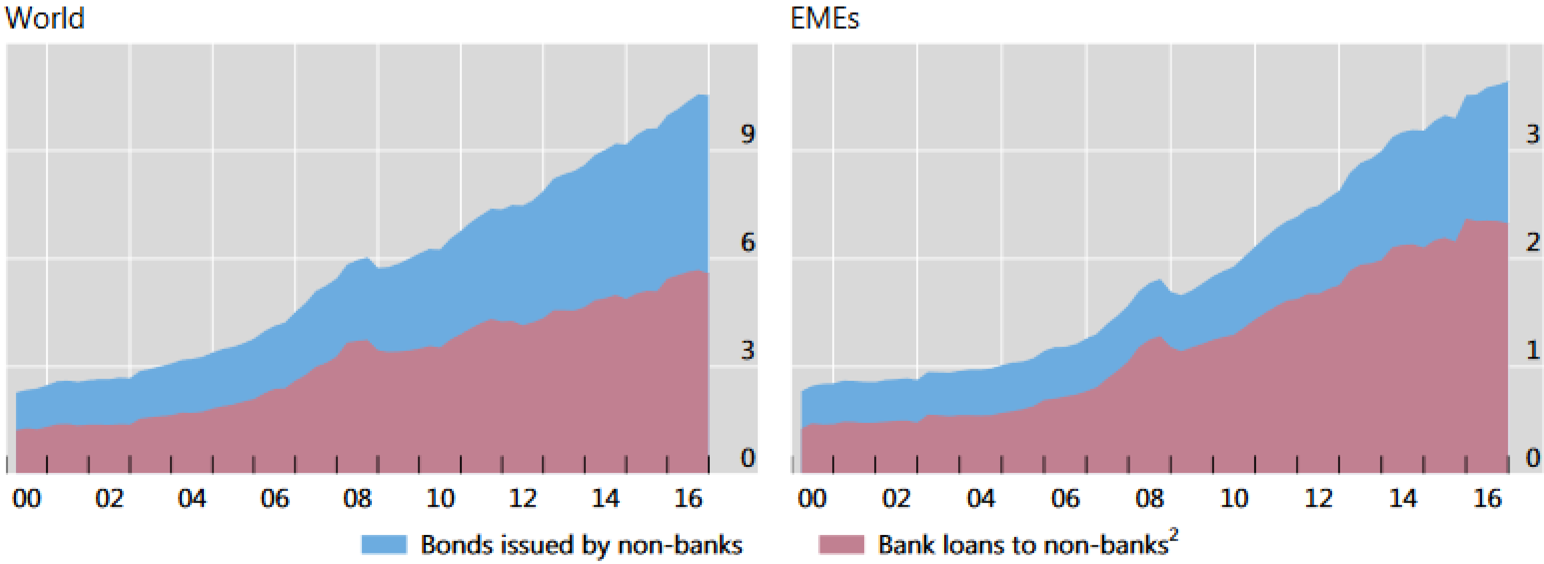
- Spill-overs: size and magnitude is debated
- Spectrum from FED (Bernanke to Yellen): overall spillovers from US UMPs are positive to Reserve Bank of India (Rajan): FED UMPs have large adverse consequences and questionable domestic benefit (Rajan 2014)
- Possible correction of (negative) externalities, if accepted, is debated: internalize negative effects and new rules of the game vs. no cooperation but communication

Position of BIS

- Problem Analysis: Global liquidity, driven by pro-cyclical risk perceptions and monetary policy conditions (allied with CGFS)
- Borio et al. (2011:55): use of currencies outside their borders means direct influence of domestic policies on financial conditions in other jurisdictions
- Development of further measures and indicators, providing empirical work on spill-over
- Main contention: national container-thinking inadequate for global currencies ($, Shin)

US dollar-denominated credit to non-banks outside the United States[1]

Amounts outstanding, in trillions of US dollars Graph E.4

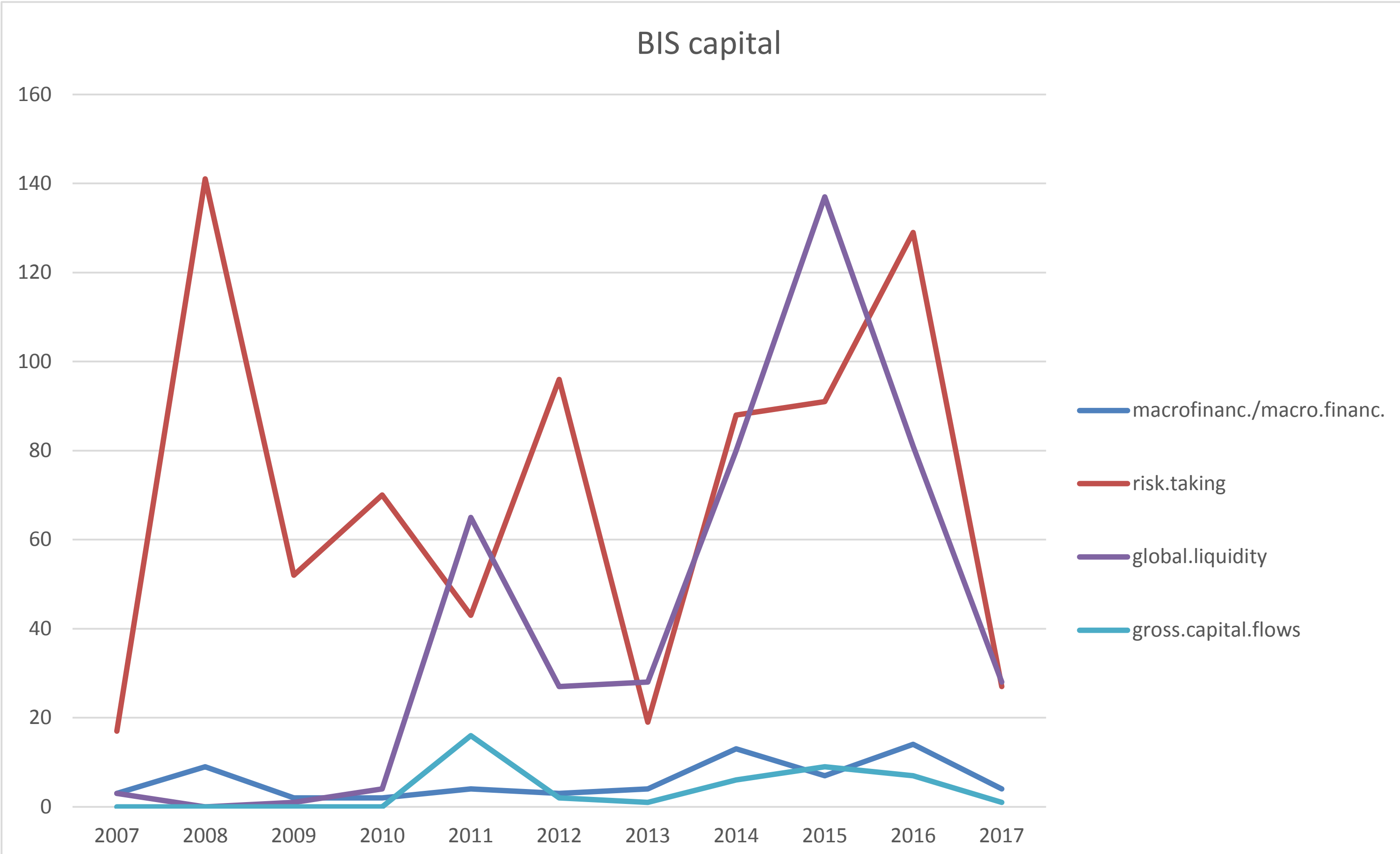


e

[1] Non-banks comprise non-bank financial entities, non-financial corporations, governments, households and international organisations. [2] Loans by LBS-reporting banks to non-bank borrowers, including non-bank financial entities, comprise cross-border plus local loans. For countries that do not report local positions, local loans in USD are estimated as follows: for China, local loans in foreign currencies are from national data and are assumed to be composed of 80% USD; for other non-reporting countries, local loans to non-banks are set equal to LBS-reporting banks' cross-border loans to banks in the country (denominated in USD), on the assumption that these funds are onlent to non-banks.

Sources: Datastream; Dealogic; Euroclear; Thomson Reuters; Xtrakter Ltd; BIS locational banking statistics; BIS calculations.

BIS Quarterly Review June 2017: A21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The current International Financial Architecture (BIS view)

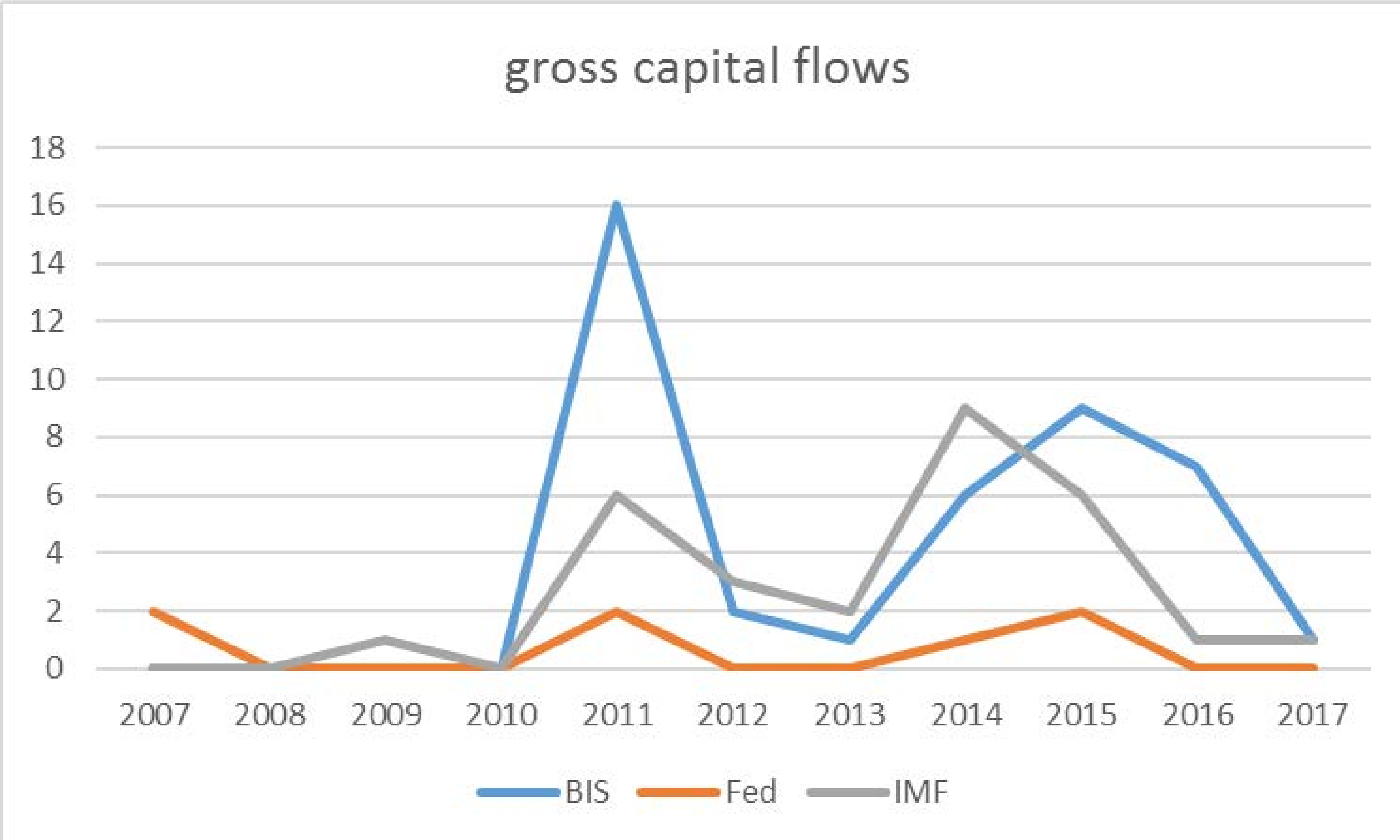
-is dominated by the US dollar, in not only trade of commodities and raw materials, but also financial contracts (most notably bonds, but also bank loans);

-US monetary policy thereby has an impact not only on US, but direct and indirect influence on large parts of non-US jurisdictions (2017 10.7 trillion dollar on-balance sheet debt outside of US jurisdiction)

-critique of a rather ad-hoc system of liquidity provision (US swap lines 2008), which lacks measure of coordination and contains limited measures to constrain financial cycles

Committee on the Global Financial System: 2011 CGFS Report 45

- Concept of "Global liquidity", which exists at least since 1997 as an intuitive concept (BIS 1997) is concretized
- Domestic liquidity conditions, in particular in AE's spills over into global liquidity conditions
- Capital flows, cross-border credit provision and currency trading "main form of materialization of global liquidity"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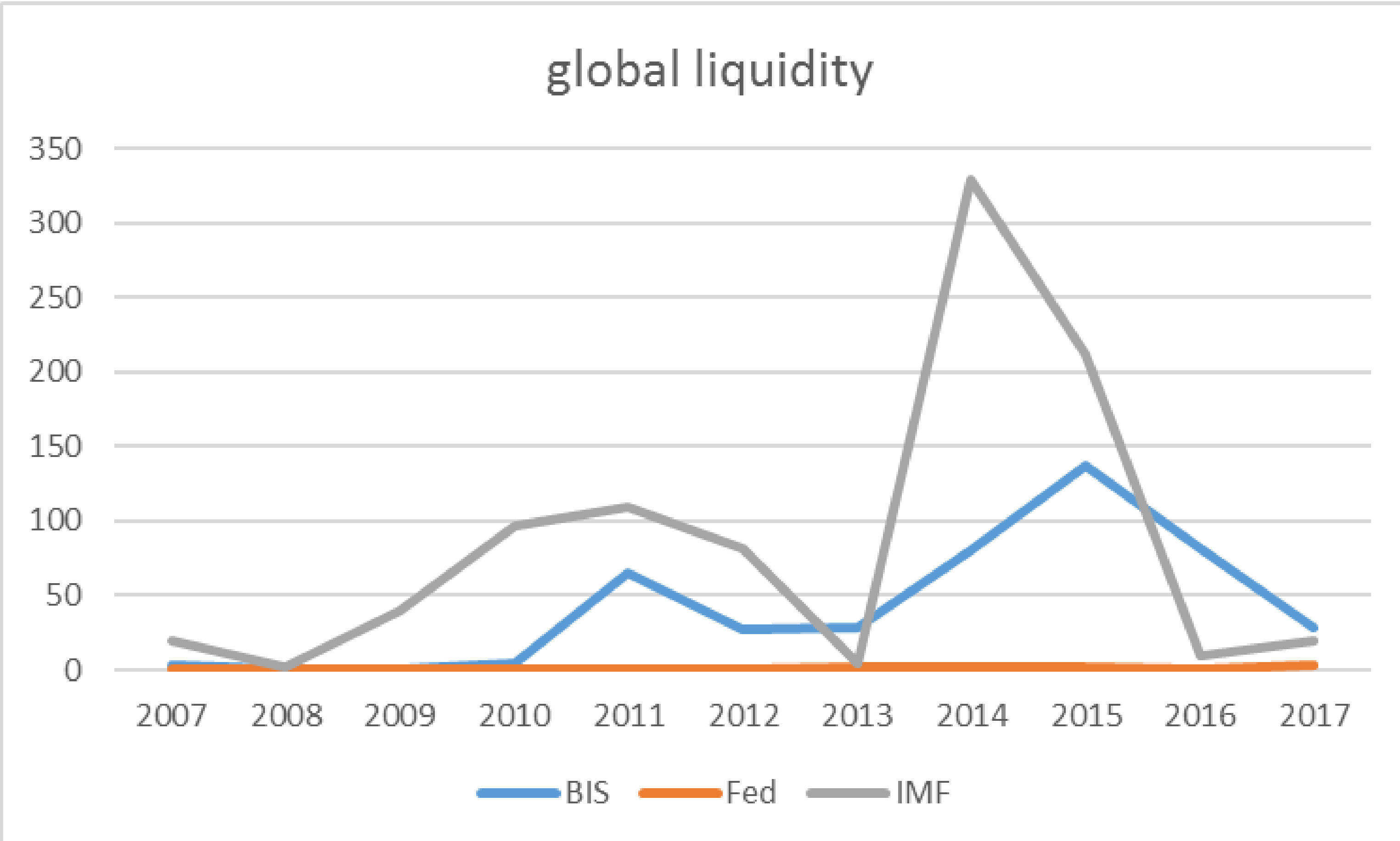

The BIS pushes the cycle and the IMF takes over in 2013

Problem for EMEs according to BIS

Policy dilemma for EMEs when fighting outflows:

- increase of policy rate in order to stabilize exchange rate could dampen credit growth and economic outlook

→but could also increase inflows

→ disorderly unwinding possible (BIS 2014b)

→Central banks have to take into account exchange rate, long-term interest rates and short-term interest rates (Turner 2014)

→ weakening of policy independence

Problem resolution

- Enlightened self-interest: take spill-overs into account, in as far as they lead to spill-backs (insufficient in era of global liquidity)
- Coordination as communication/ ad hoc joint action
- Possibly: rules of the game which constrain domestic policy space (BIS 2015)
- However, quite pessimistic on the latter:

“many reject a global perspective in the realm of monetary policy. Accordingly domestic mandates ask central banks to set policy for a smaller economic domain than that occupied by their currencies (BIS 2015, 99)

Personal Changes of Bank for International Settlements

- Borio becoming Head of the MED in November 2013

→ Inserting frames in the official discourse that were developed by him and colleagues within the MED from the early 2000s onwards

- Significant discursive shift by the adoption of ‚excess financial elasticity' frame:
  1. interdependencies between monetary policies
  2. interdependencies between monetary policies, capital flows and global financing conditions: global liquidity, financial cycle

→ No take up of these concepts by the Fed, but by the IMF

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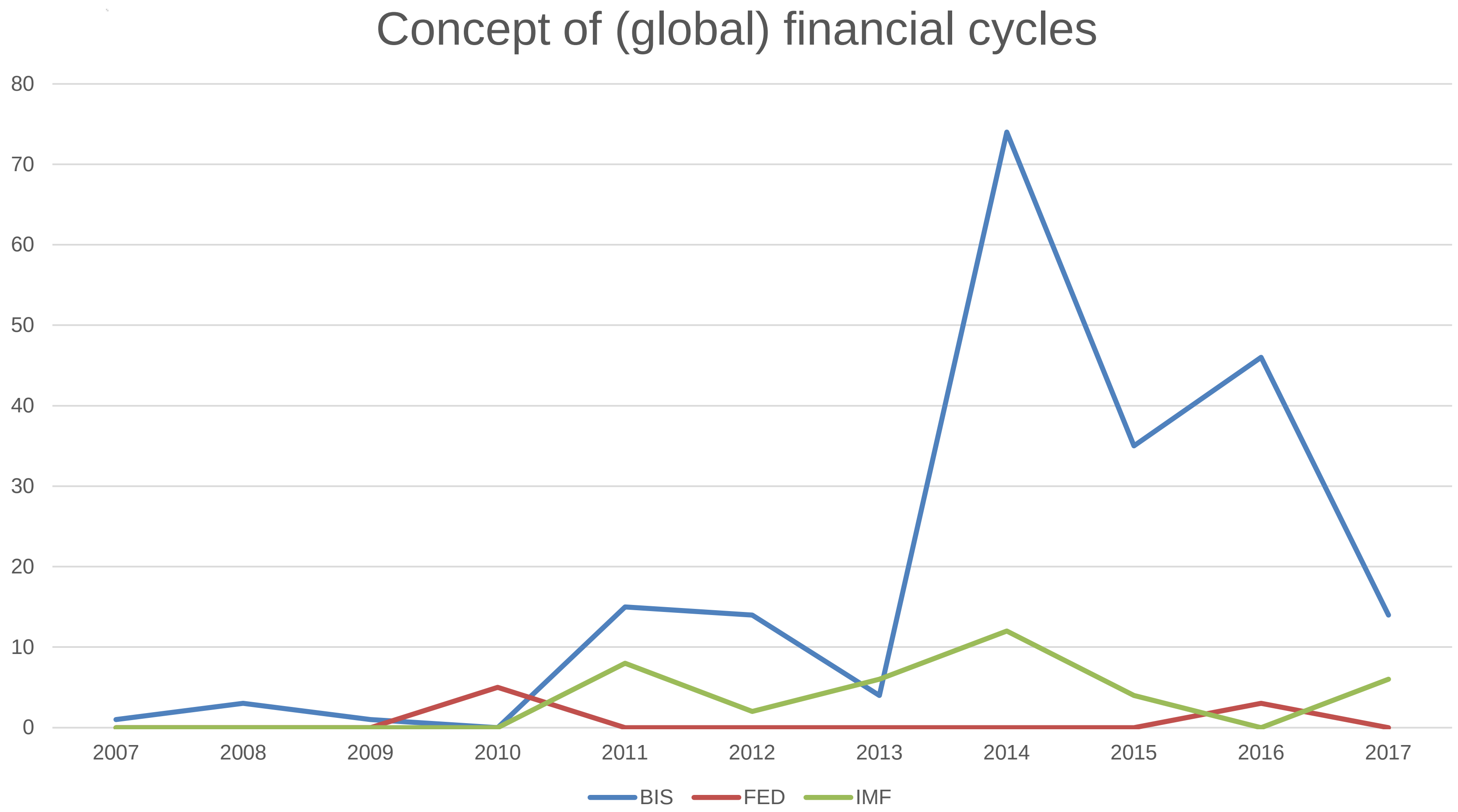
Macrofinancial concepts not embraced by Fed



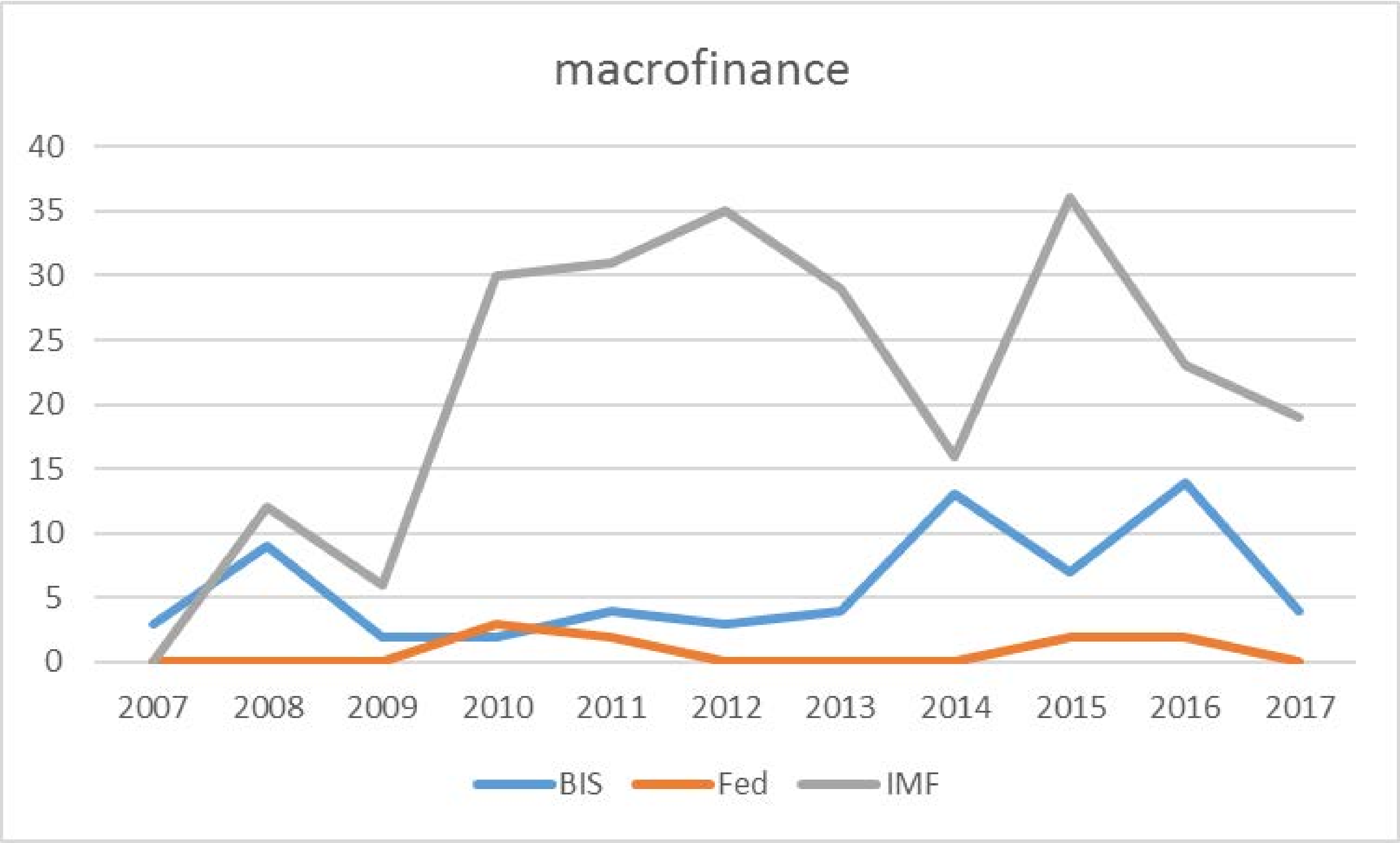
International Monetary Fund

- 2013 shift, increasing awareness of financial policy spillovers from U.S. monetary policy
- Nevertheless, reproduction of separation between monetary policy and financial stability: domestic macroeconomic objectives
- Spillovers need to be handled by emerging market economies: adjustment of fundamentals, financial regulation and, in case of emergency, capital controls

however: increasingly heterogenous knowledge production

IMF Policy Department

- Initial strong support for UMPs (up until IMF 2013a): what is good for US is good for the world
- At the same time, constant worry over volatile capital flows (search for yield, IMF 2011), link to low rates and QE in 04/2012
- 04/2013 GFSR (IMF 2013b): first time spill-overs from QE on EMEs made explicit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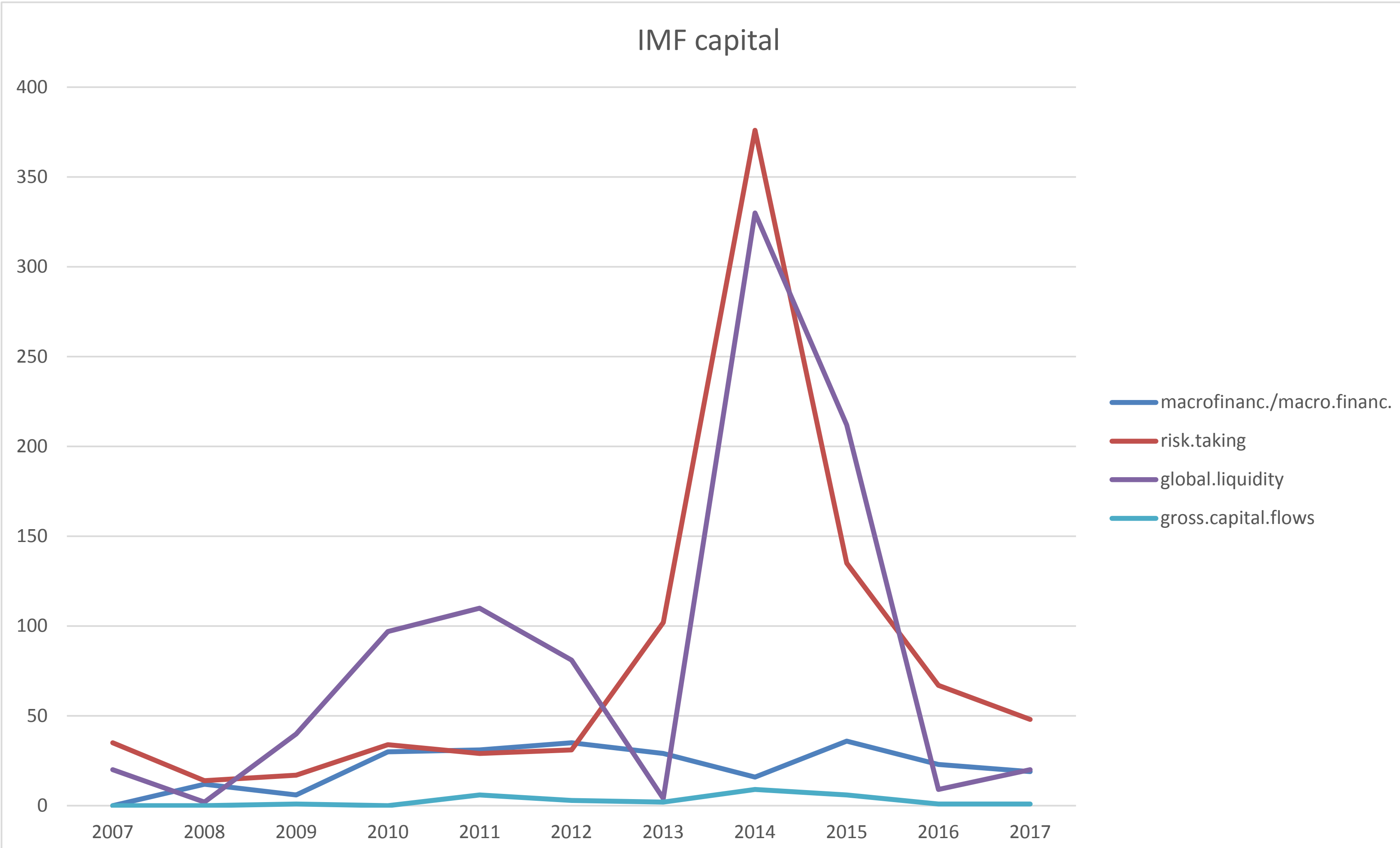
- May 2013: Taper Tantrum
- August 2013: Jackson Hole conference with critical discussion of UMPs by Helen Rey, Jean-Pierre Landau, Pereira da Silva, Lagarde, Borio as a Discussant, bringing together former head of CGFS working on global liquidity, academic critique, IMF, emerging market central banker as well as BIS chief economist



Crucial result for our paper: 2013 IMF takes over

Position of IMF (Policy Report and Research Department, 2013)

- Seek to position IMF, a “forum for international policy cooperation” (Lagarde 2013) as a platform for coordination
- Neutral assessor of spill-overs, facilitating policy trades for global optimum (overcoming model disagreement and model uncertainty and focus on one objective only)
- rules of the road: measuring impacts of UMP through capital account, Fed is asked to internalize negative effects

Spill-backs and coordination

- 2014: spill-backs from EMEs to US first time mentioned in the context of tapering of QE in US by Communiqué of the Twenty-Ninth Meeting of the International Monetary and Financial Committee (IMFC 2014)
- 2011-2014 Spill-over reports (US stops it afterwards)
- 2016 GFSR 04/2016: growth of spillbacks expected, increasing emphasis on coordination, which comes more and more to focus on macro-prudential cooperation (IMF 2016: 75);
- →Action by recipient and source countries required (macroprudential policies, e.g. making carry trades more difficult)

First, second and third bests for this advocacy coalition

- First best: internalizing spill-overs and rules of the game
- Second best: enlightened self-interest (internalize spill-overs that cause spill backs)→ macroprudential regulation from the source country
- Third best: ad hoc emergency measures

Interview IMF I

- Economics as a science very relevant, but searching for policy relevance
- Coordination as an academic game theoretic model vs coordination in real life
- Bring out things in debate, slowly change institutional view
- Integrated surveillance decision, but nobody really expected Fed to budge (problems of coordination)

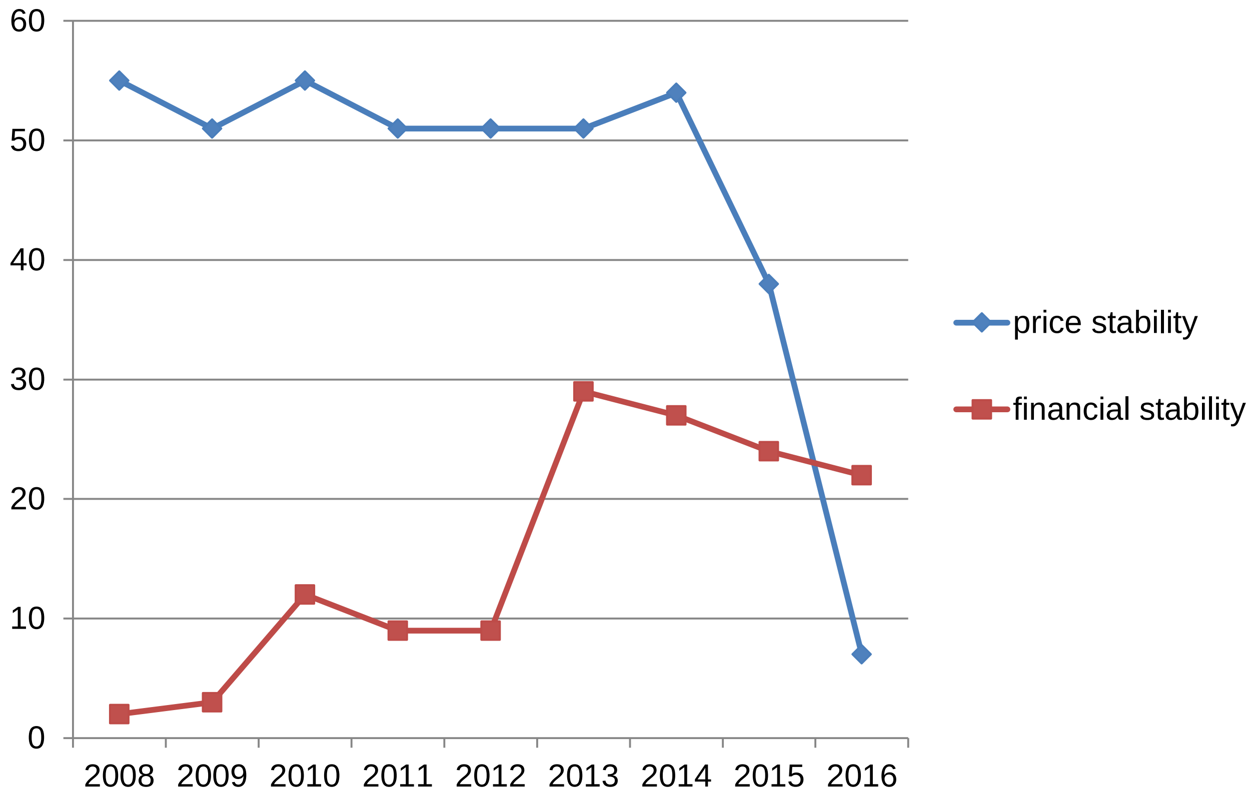
IMF II

- 2013 was high time for talk on coordination
- Since then decline in interest
- Internalization first best option, but will not happen
- Rajan exaggerates: life is complicated

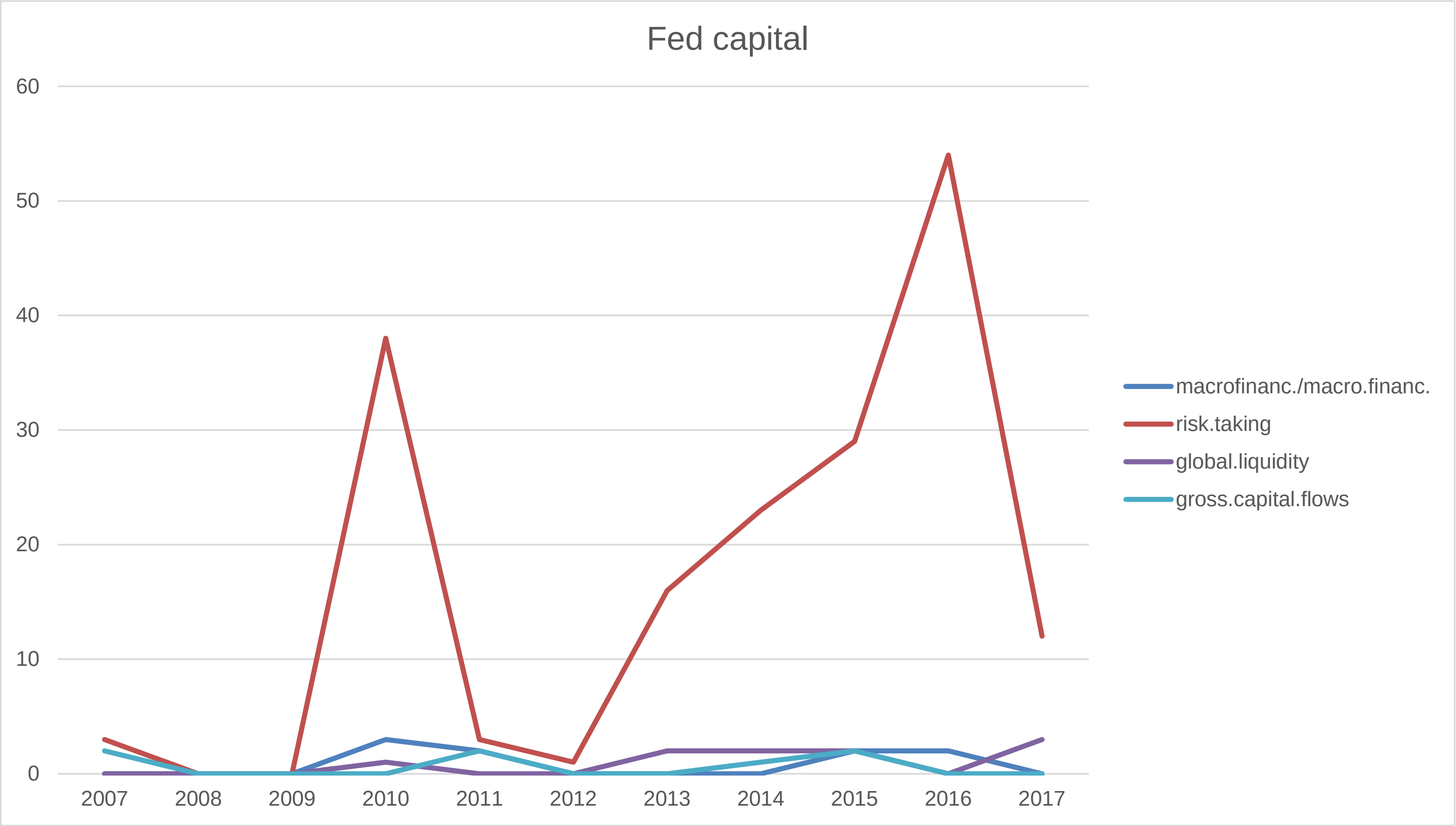
Federal Reserve Post-2013

- Communicative shift that correlates with Yellen taking over the Fed chair
- No substantial change in the framing of the international effects of U.S. monetary policy
  → Focus remains on current account imbalances, macro-variables
  → Monetary policy without effect on capital flows
- Reproduction of the division between monetary policy and financial stability in the official discourse; externalization of the need for adjustment to emerging market economies
- But: internally FSD reports to monetary policy, taking into account expected effects (spillbacks), effects are deemed too low, mandate !!!

Fed and domestic financial stability



Word frequencies in the FOMC minutes 2008-2016



Here we need your stuff on risk taking

Fed (interviewee 1)

- Interview result: There are many many variables, so it is hard to disentangle [→ general pattern to legitimize Fed policy: too complex to model]; QE was one factor of many
- Should the Fed care? What should EMEs do?
- US first, if US economy is well, everyone is better off, you have to make US as strong as possible; so EME fundamentals are already improved + US clearly and gradually communicates policies → no problem, even though there will remain some turbulences

Fed II

- “the international dimension was always there, but got communicated differently”; the financial stability aspects became much more important over the period
- Regarding international responsibilities, interviewees refered to the domestic mandate; only to the extent that spillovers spillback, international considerations are to be taken into account;
- if there is a global crisis that needs for the Fed to act, then they would need to do so anyways because a global crisis always affects the US

FED III

- Financial stability became a bigger issue with larger potential effects;
- Spillbacks were always in the scope of monetary policymaking; Janet Yellen was just more willing to talk about that stuff

Conclusion

- Divergence, but non-rivalry of these competing frames in a world of non-order; only convergence on notion of “spill-backs”
- Why should the Fed care? Lack of structures in the transnational policy field, even though central banks are constantly in touch with each other
- Positioning of different institutions can be derived from their membership and their most powerful stakeholder, as well as attempt to stake out a position in discoursive space
- But instable stability – massive global imbalances →Change is possible: norm entrepreneurs and divergences within policy institutions

Conclusion 2: Taper tantrum and economics

-International Macro-finance is now firmly established in international monetary policy discourse

-Its relative degree of immaturity leads to intense debates over size of spill-overs, in particular struggle over notion of global financial cycle

-From Trilemma to Dilemma: from Jackson Hole 2013 to Mundell lecture IMF 2015 to IMF conference on global financial cycle 2017

-even those disagreeing with Rey cannot ignore her (Obstfeld and Taylor 2017)

Intellectual fights in the field of international macro-economics and finance heightened by 2013 taper tantrum

-Fight between on the one hand International closed form macroeconomics (focus on real side, trade imbalances, savings imbalances) vs. international macro-finance (financial cycles, financing is not equal to saving (anti-loanable fund theory), balance sheets are crucial: gross capital flows matter

-Mundell-Fleming framework (impossible trinity) vs. dilemma (global financial cycle/ global liquidity)

-keep your house in order (Nash equilibrium) vs. what is the optimal global outcome of coordinated monetary policies given integrated financial markets

Contention of international macrofinance: Need to integrate financial and real side effects of globally integrated financial markets in our analysis

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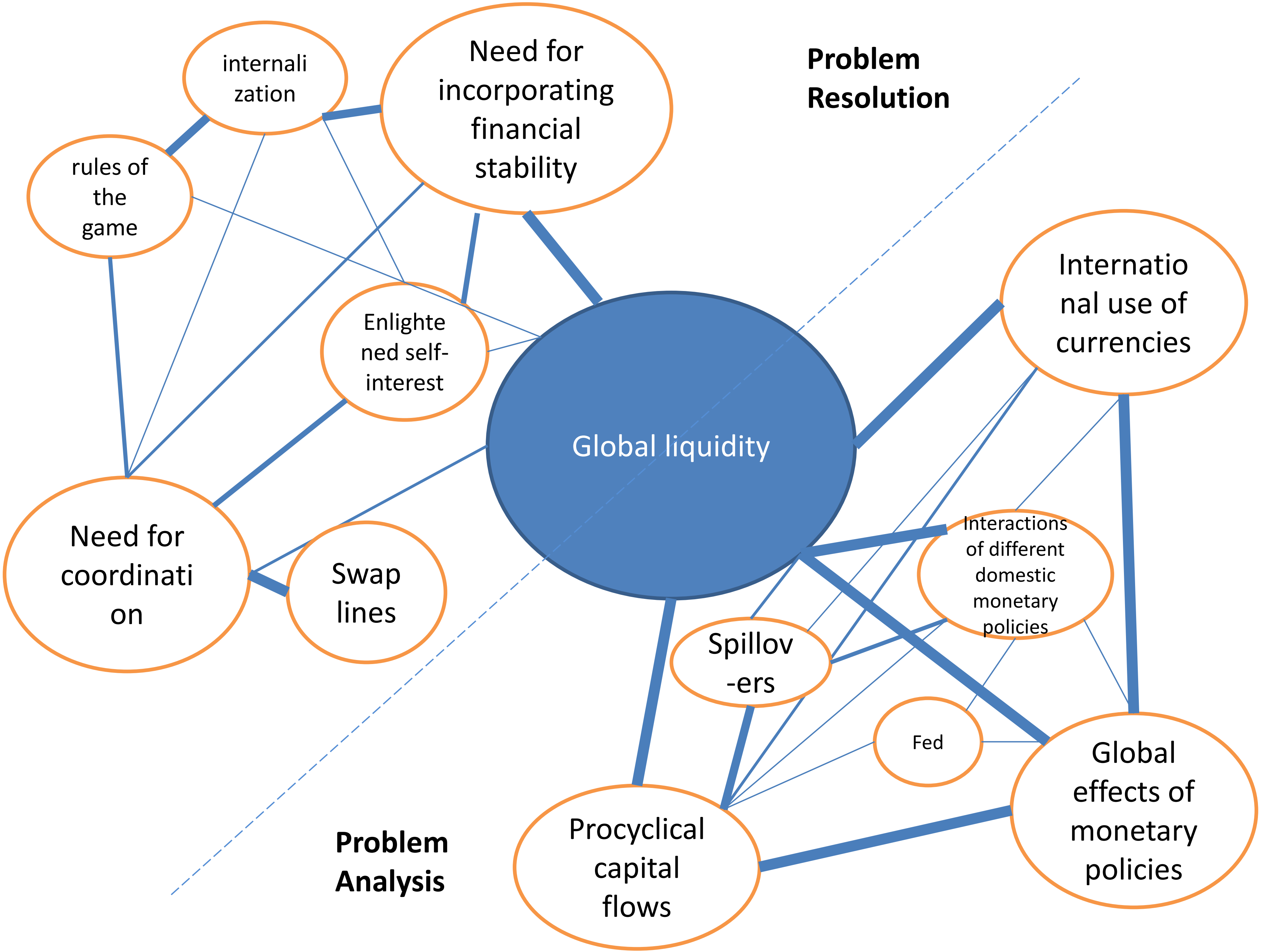
Frames

- From “keeping one’s house in order” (Fischer 2014) to internalizing domestic effects on global capital flows
- Acknowledgement of effects of UMPs on credit and financial stability,
- And of finance on currencies due to “search for yield” vs. “safe haven”
- From Mundell-Fleming Model and the trilemma to the dilemma (impossibility of flexible exchange rate and independent monetary policy for EMEs)

Experts and mandates

- Experts intervene in a world they co-create through their own interpretations
- This is due to the privileged discursive position of expertise: they have “Deutungshoheit” over their areas of expertise
- That is to say: if experts can agree that action a. lies within the mandate of a certain institution, it is very likely that others will defer to that assessment (e.g. judges)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Enlighte ned self-interest
Global liquidity
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Need for coordinati on
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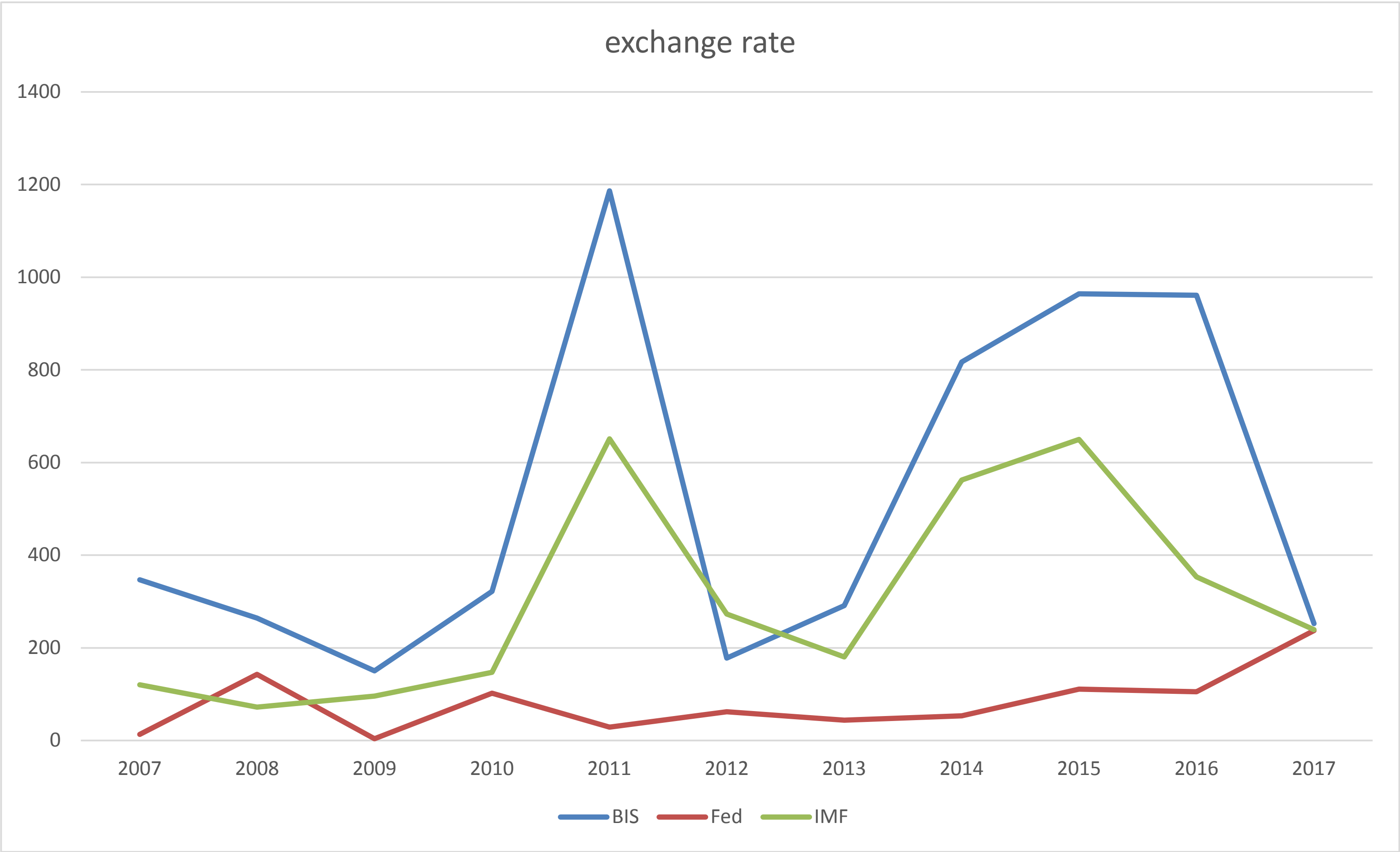
Interactions of different domestic monetary policies
Spillov -ers
Fed
Global effects of monetary policies
Procyclical capital flows
Problem Analysis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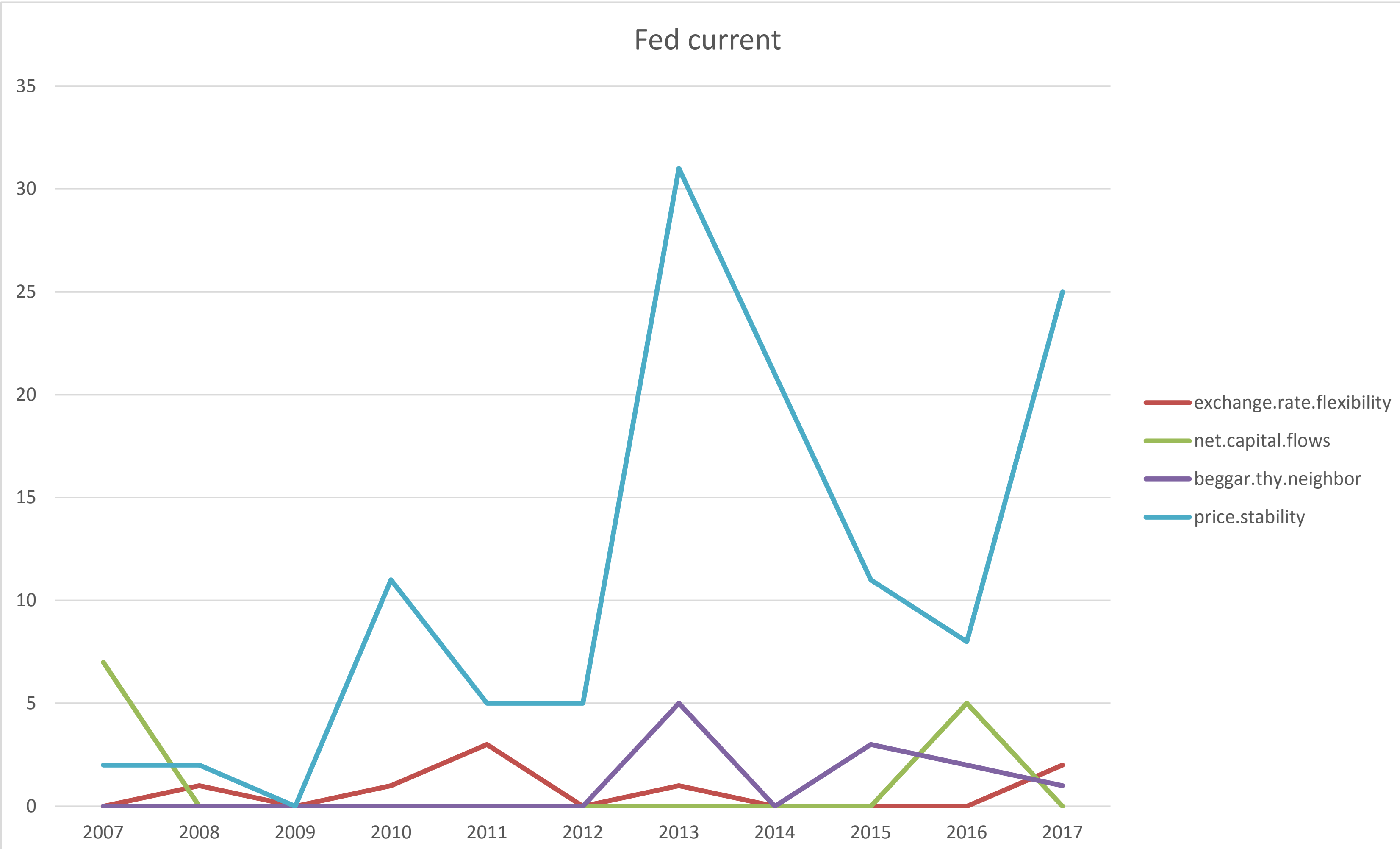
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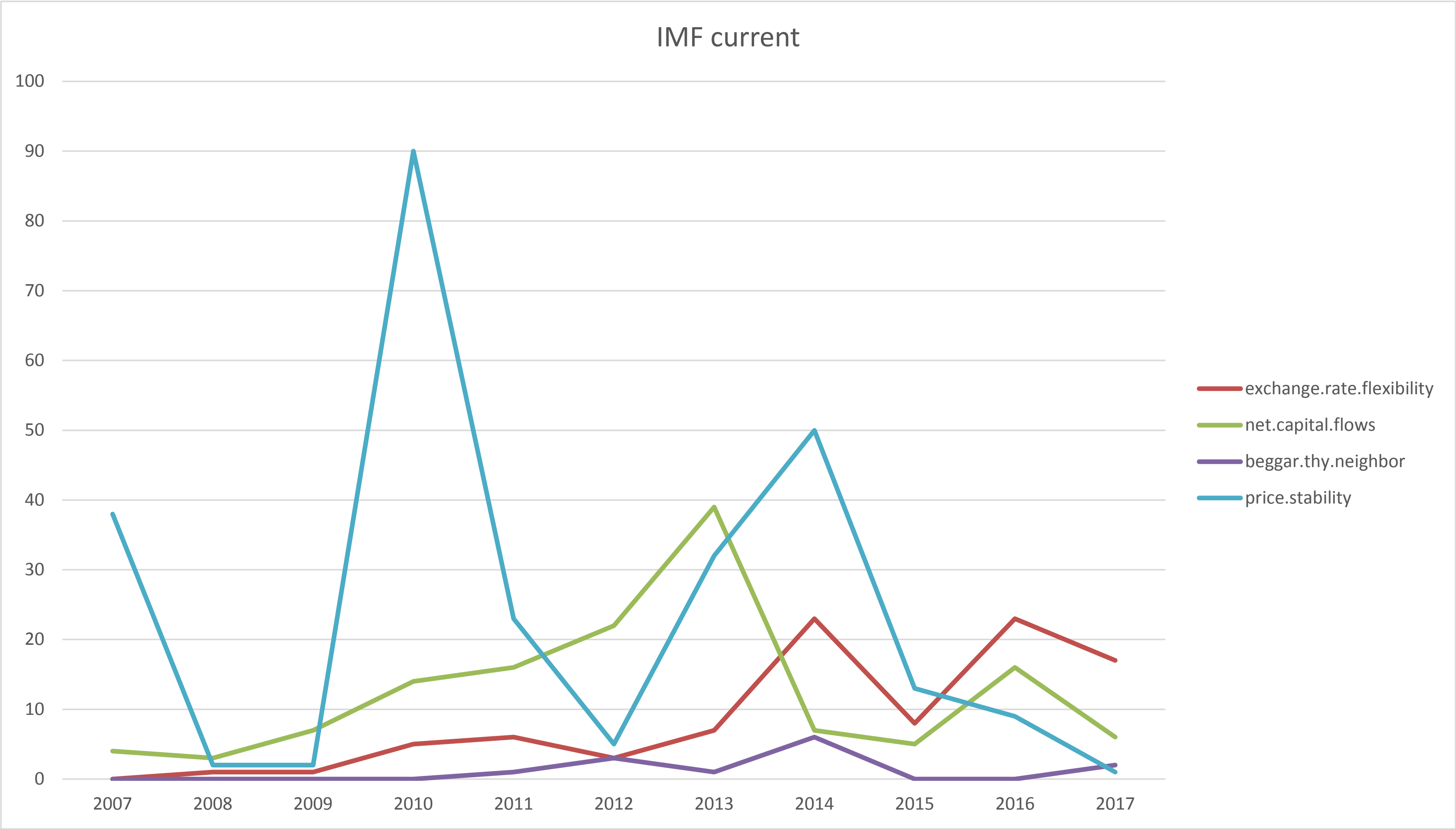
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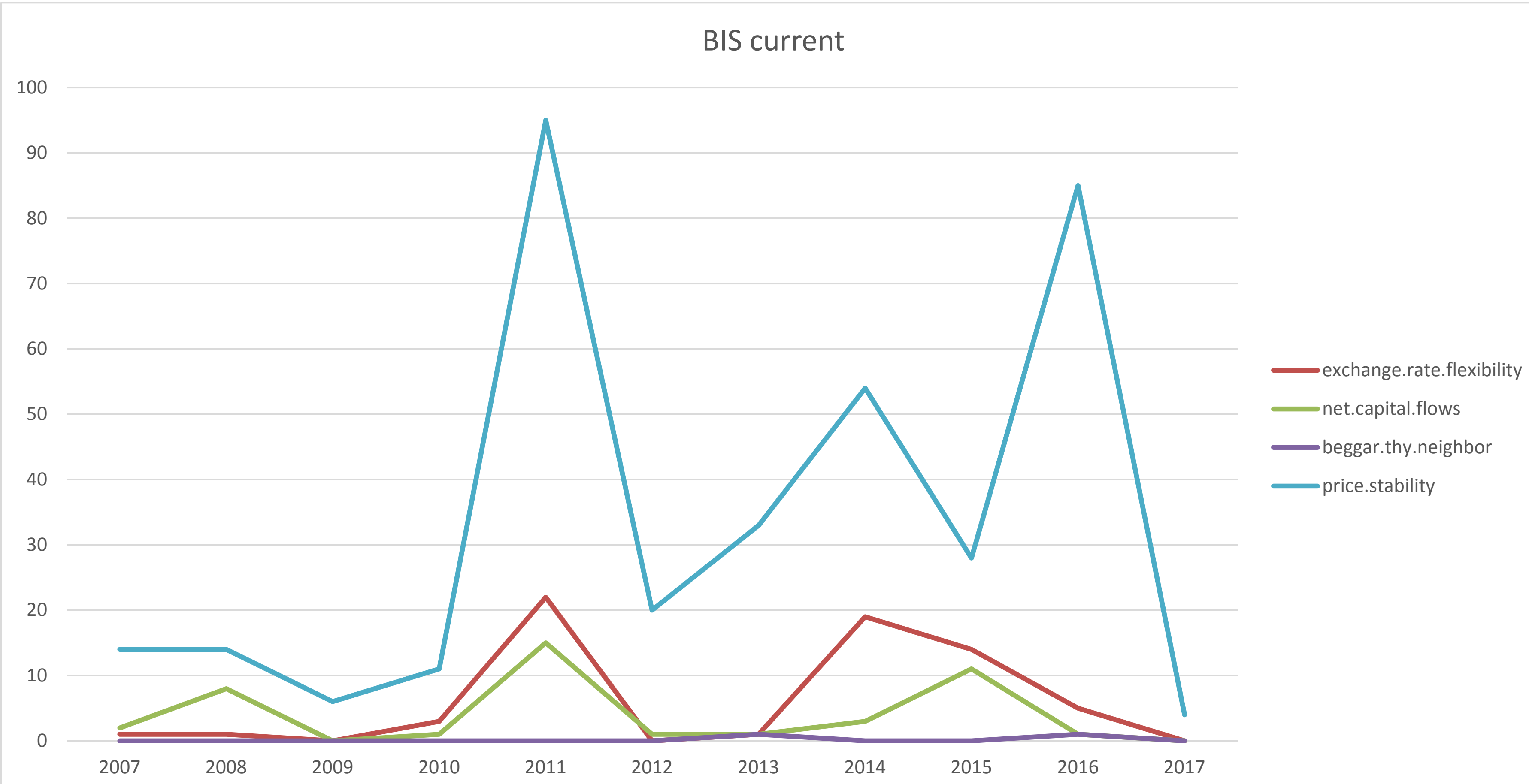

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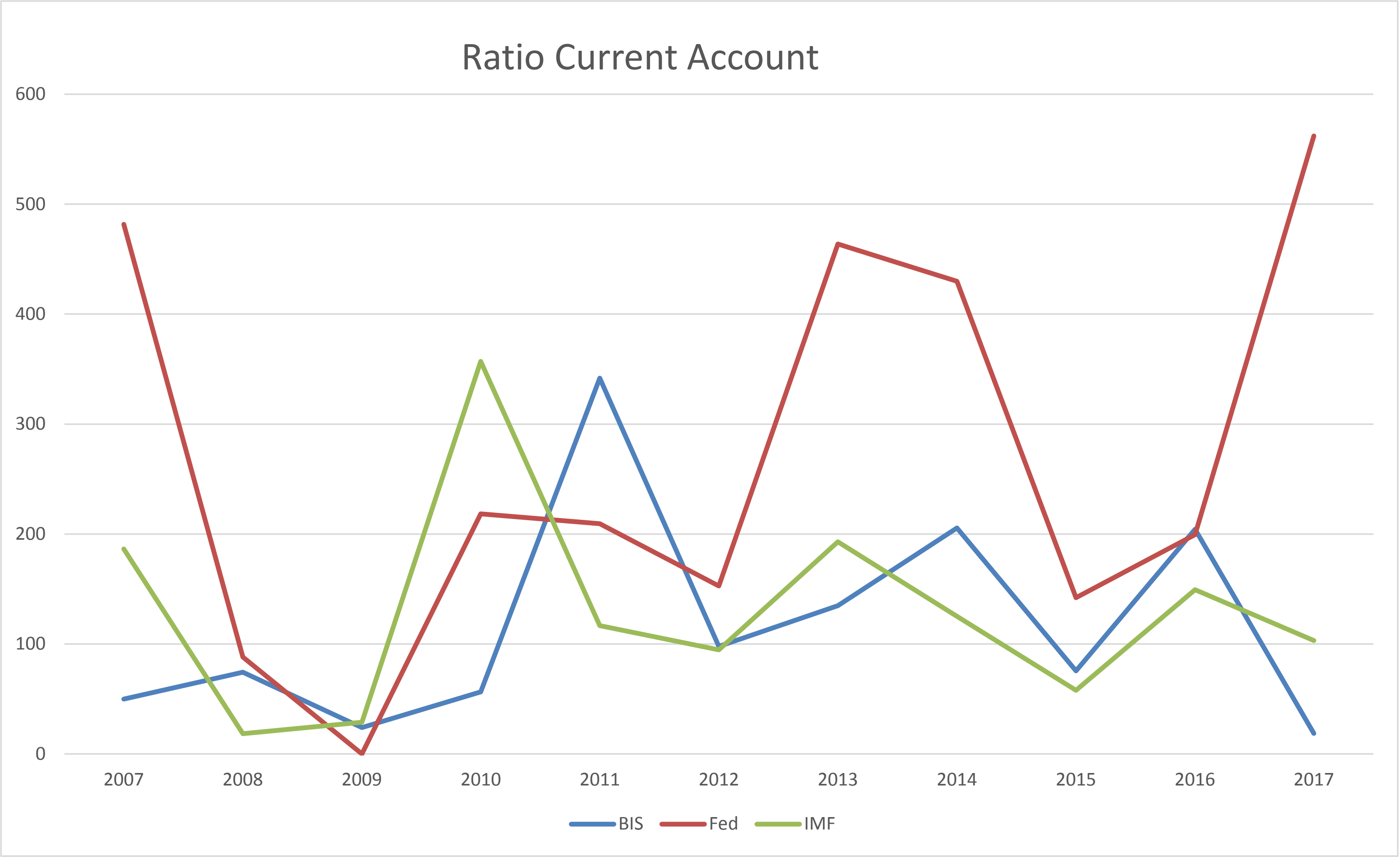
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