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International coordination of central bank policy

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ABSTRACT

This paper surveys the current state of the literature on international monetary policy coordination. It relates recent policy discussions to the lessons from the literature. It proposes several avenues for future research.

1. Introduction

In recent years, there has been increasing interest in international monetary policy cooperation, and, in general, coordination of central bank policies. In September 2010, Guido Mantega, the Brazilian finance minister, commented that “we are in the middle of a currency war”,[1] referring to the depreciation of the major currencies against those of Brazil and other emerging markets. As Fig. 1 shows, the trade-weighted dollar depreciated more than 15% from early 2009 until September 2010. Subsequently, the dollar began to appreciate, which brought further protests from policymakers in emerging markets. In April 2014, Raghuram Rajan, the governor of the Reserve Bank of India, complained about the “initiation of unconventional policy as well as an exit whose pace is driven solely by conditions in the source country,” specifically aiming his remarks at monetary policy in the U.S. and other industrial countries that “hold interest rates near zero for long, as well as balance sheet policies such as quantitative easing or exchange intervention, that involve altering central bank balance sheets in order to affect certain market prices.”[2] Olivier Blanchard, Jonathan Ostry and Atish Ghosh of the

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[1] See Financial Times, 2010.

[2] See Rajan, 2014.

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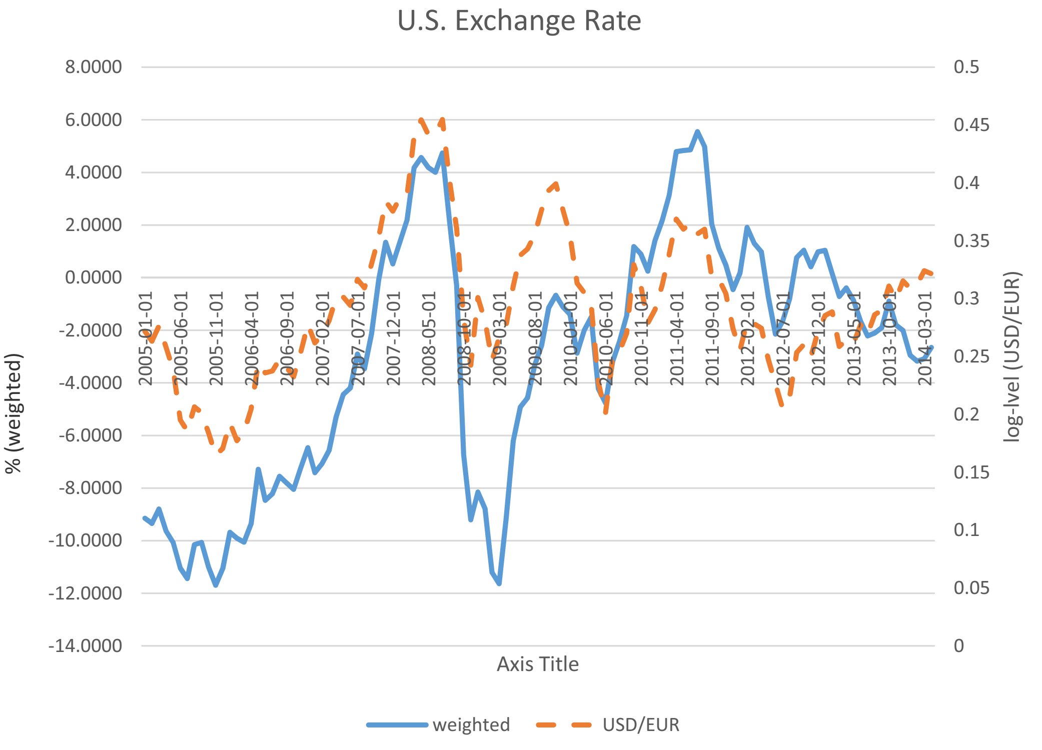

Fig. 1. The vertical axis on the left side measures the trade-weighted dollar index in percentage terms. The vertical axis on the right side measures the log of the dollar/euro exchange rate. Both exchange rates are expressed in dollars per foreign currency, so an increase represents a depreciation of the dollar.

International Monetary Fund comment "if large players in the global economy are responsible for significant adverse spillovers across a swath of smaller countries, this needs to be acknowledged as well, and feasible remedies considered."[3]

Even with this increasing concern about the spillovers from monetary policy, little new research has emerged on this topic. This essay's primary goal is to provide suggestions for directions for future research on this important topic. A secondary goal is to point out the disconnect between the recent policy discussion and what the existing academic literature tells us.

Clearly much of the recent concern about the need for monetary policy coordination stems from the recent behavior of the dollar. Fig. 1 plots the dollar exchange rate relative to the euro and a trade-weighted basket. Much of the initial concern about the external effects of U.S. monetary policy stems from the large depreciation of the dollar index from early 2009 until late 2010. Much of the commentary has attributed this depreciation to the aggressively expansionary policy of the Federal Reserve.

However, it is informative to consider this depreciation in light of the dollar fluctuations before and during the global financial crisis. The depreciation of the dollar in 2009–2010 in effect exactly reversed the dollar appreciation that began in August 2008. By September 2010, the effective dollar exchange rate was at approximately the same point as in August 2008. On the other hand, the 2009–2010 dollar depreciation mirrors the sustained dollar depreciation from late 2005 to early 2008. The relevant question is whether the fluctuations of the dollar can be laid entirely at the doorstep of monetary policy in 2005–2008 and 2009–2010, or whether other forces were at work.

[3] Blanchard, Ostry and Ghosh (2013).