ECB FORUM ON CENTRAL BANKING

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International Spillovers of Monetary Policy

EUROPEAN CENTRAL BANK

EUROSYSTEM

International Spillovers of Monetary Policy: The Role of Currency Compositions

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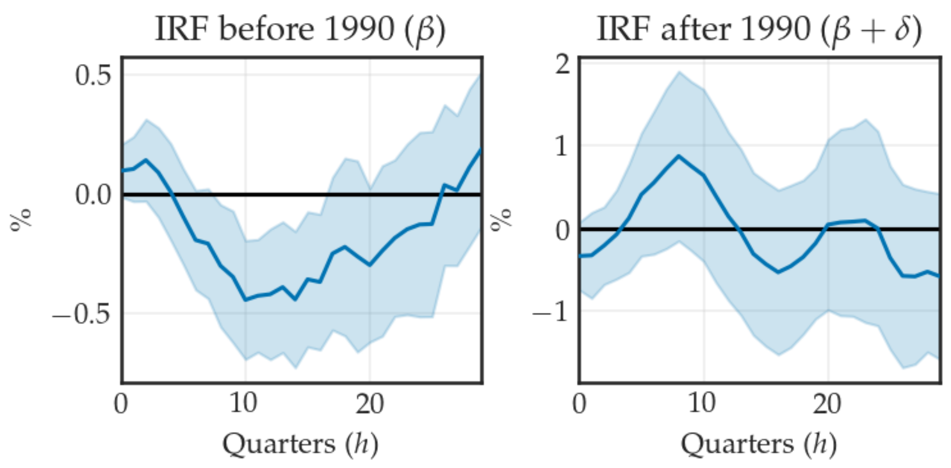
US monetary policy created recessions abroad before 1990 but not today

- What is the effect of a 1 pp. tightening of US MP policy on foreign countries?
- Recession before 1990, but not today.

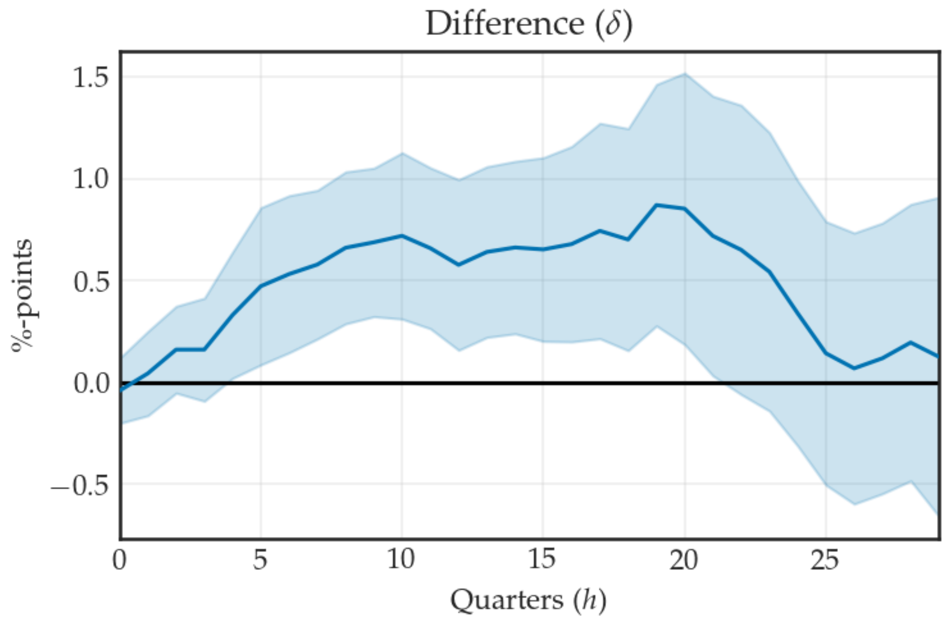


More dollar wealth insulates foreign economies

- Estimate panel local projections:

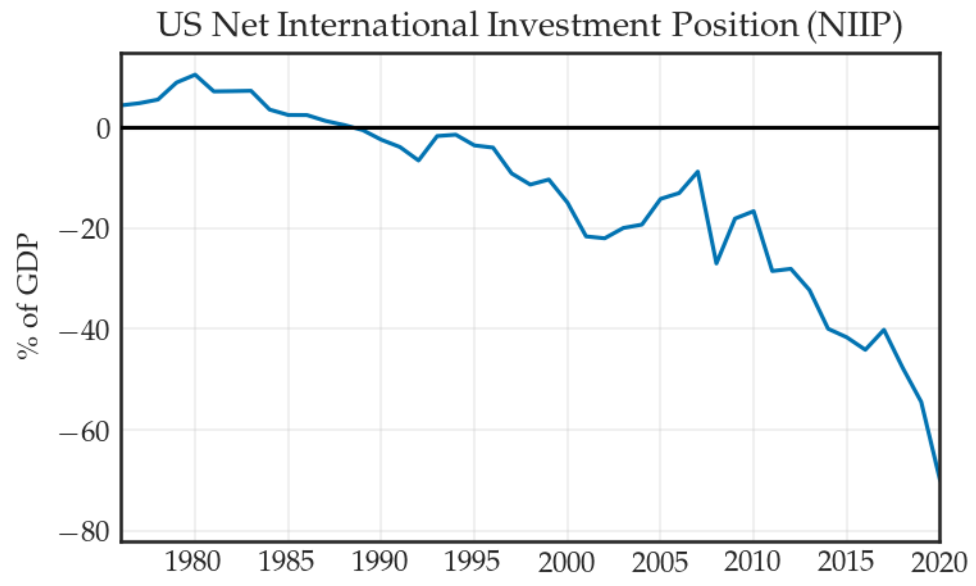
$$\ln GDP = \beta(\text{US MP}) + \delta(\text{US MP})(\text{NWFU}) + \cdots$$

- $\delta > 0$, i.e. a larger NWFU insulates.



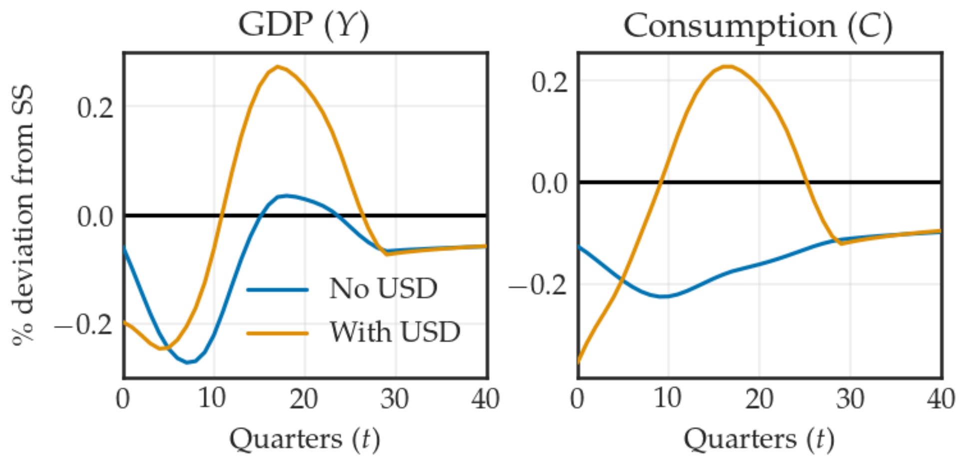
Large expansion of US debt to foreigners since the 1980s

- The US has been running large deficits.
- The US has gone from a net creditor pre-1990 to a net debtor today.



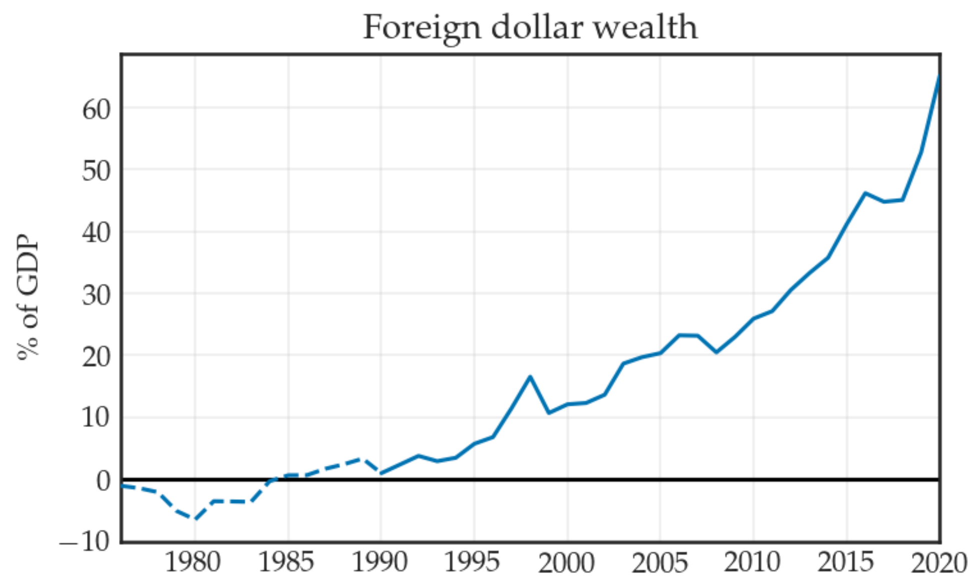
A 3-region HANK model with dollarized balance sheets

- I build a 3-region HANK model with partly dollarized balance sheets.
- Increase USD wealth to post-1990 level.
- Implies insulation.



Increase in dollar wealth abroad since the 1980s

- Counterparty: Large increase in foreign dollar wealth.
- Today: Dollar wealth of 65% of GDP.



The model fits the empirical evidence

- Wealth explains 0.4 pp. insulation.
- This insulation matches the data.
- Explains > half of change in spillovers.

	Pre-1990	Post-1990
Total	−0.6	−0.3
- US demand	−0.5	−0.5
- RoW demand	−0.3	−0.3
- Exchange rate	0.2	0.2
- Dollar wealth	0.0	0.4