

U.S. Monetary Policy and Emerging Market Credit Cycle

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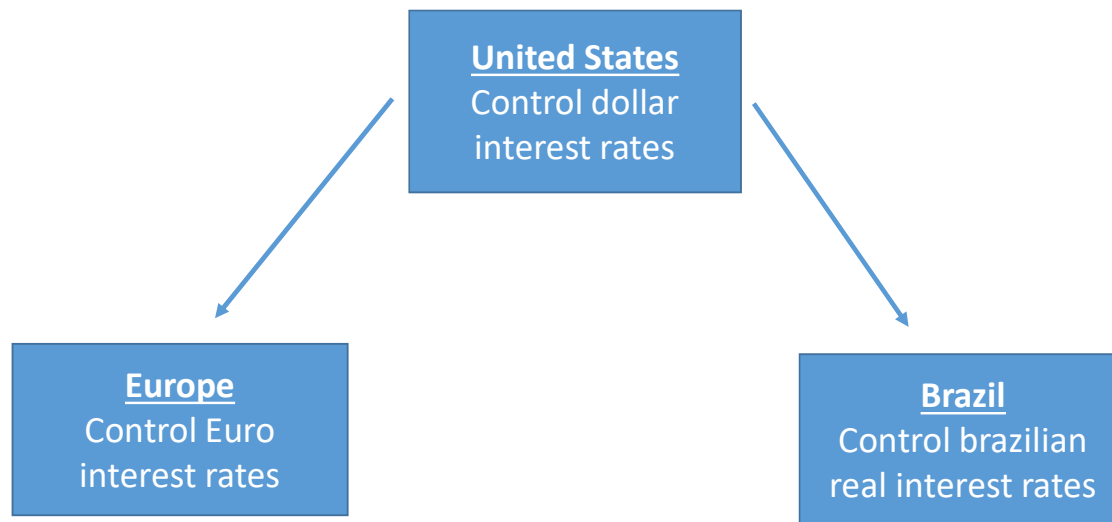
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QUESTION

1. How does monetary policy in the United States affect credit in emerging markets vis-a-vis developed markets?
2. Answer: An interest rate change in the US has a larger impact on dollars credit to firms in emerging markets than in developed markets.

Graphical illustration



EMPIRICAL APPROACH

- Data on syndicated loans by banks to firms in developed and emerging countries.

$$\ln(\text{DollarLoans}_{fbt}) = \beta_d \times \text{FFrate} \times \text{DevelopedDummy} + \beta_e \times \text{FFrate} \times \text{EmergingDummy}$$

COMMENTS

- Interesting empirical finding.
- I do not have reasons to question the empirical approach.
- The paper can do much more: the empirical findings raise more questions than the paper answers.

QUESTIONS

- Why more dollar credit goes to emerging markets than to developed markets?
- Is the increase in 'dollar' credit associated to an increase in 'total' credit to firms?
- Does it affect the real economy of emerging economies?
- Does US monetary policy affect the likelihood of future crises in emerging countries?

Why more dollars go to emerging countries?

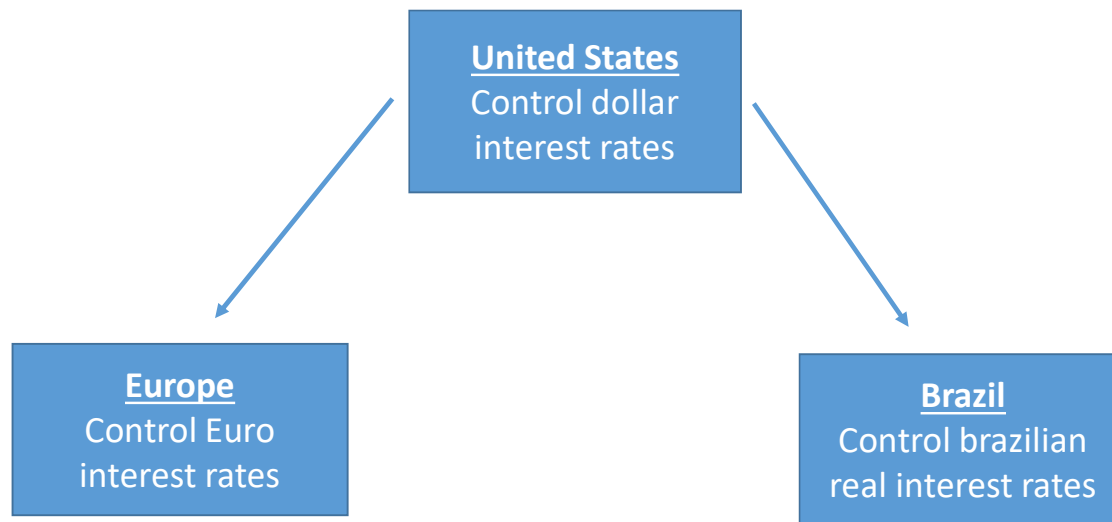
Three possible channels related to:

1. Monetary policy synchronization;
2. Macroeconomic synchronization;
3. Substitution of dollars with other foreign currencies.

Hypothesis I: Monetary policy synchronization

- US monetary policy may be more synchronized with developed countries than emerging countries.
- When the US interest rate falls, interest rates on local currencies also fall in other developed countries, but not necessarily in emerging economies.
- Thus, firms in developed countries do not have an incentive to substitute dollars with local currency loans.
- But firms in emerging markets have an incentive to substitute local currency loans with dollar loans.

Graphical illustration



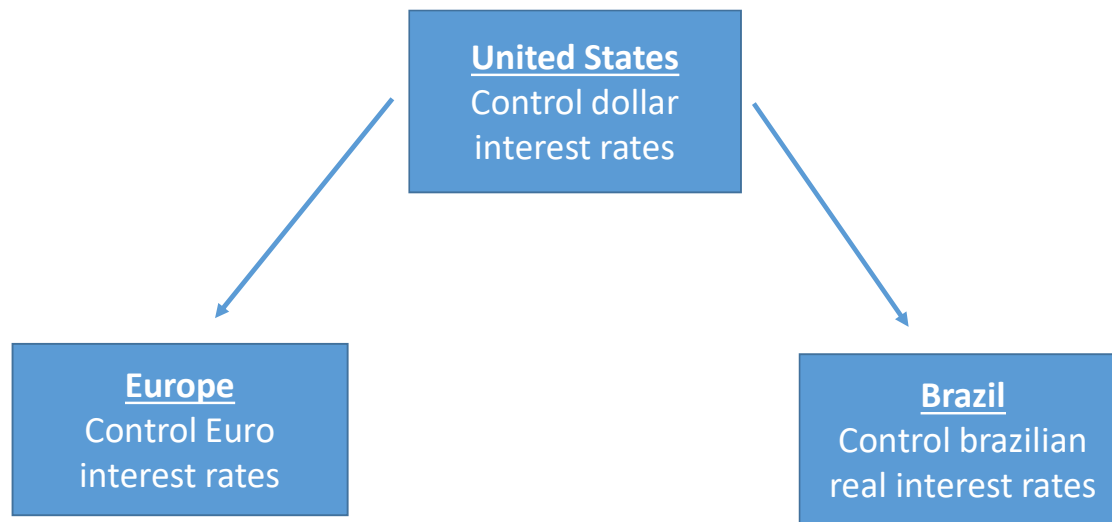
How can this be captured?

$$\begin{aligned} \ln(\text{DollarLoans}_{fbt}) = & \beta_d \times \text{FFrate} \times \text{DevelopedDummy} + \\ & \beta_e \times \text{FFrate} \times \text{EmergingDummy} + \\ & \alpha \times (\text{LocalRate} - \text{FFrate}) \end{aligned}$$

Hypothesis II: Macroeconomic synchronization

- The US economy could be more synchronized with developed countries than emerging countries.
- Monetary policy simply responds to the state of the real economy. So low interest rates in the US may reflect sluggish growth rates in the US (and likely in other developed countries).
- Because emerging economies are less synchronized with the US, banks invest more in still growing emerging economies.

Graphical illustration



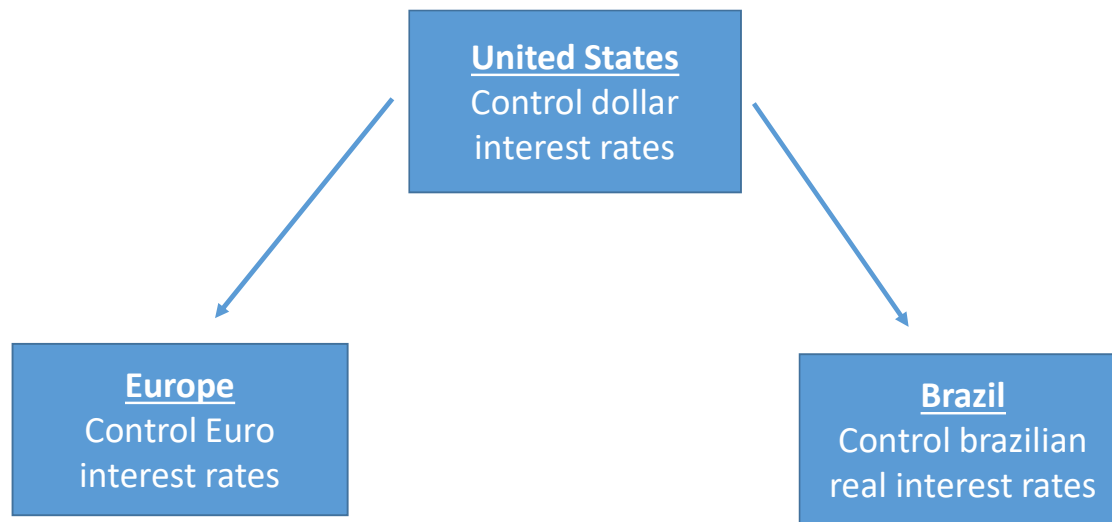
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Hypothesis III: Substitution dollar debt with other foreign currency debt

- Low US interest rates induce a substitution in emerging countries of Euro denominated debt with dollar debt.
- Since emerging countries demand less euro denominated debt, the supply of Euro debt in Europe increases. So European firms borrow more in Euro and less in dollars.

Graphical illustration



CONCLUSION

- Interesting empirical findings.
- However, without further empirical exploration, the contribution of the paper is somewhat limited.
- I am looking forward to see further empirical and possibly theoretical exploration.