



CROATIAN NATIONAL BANK

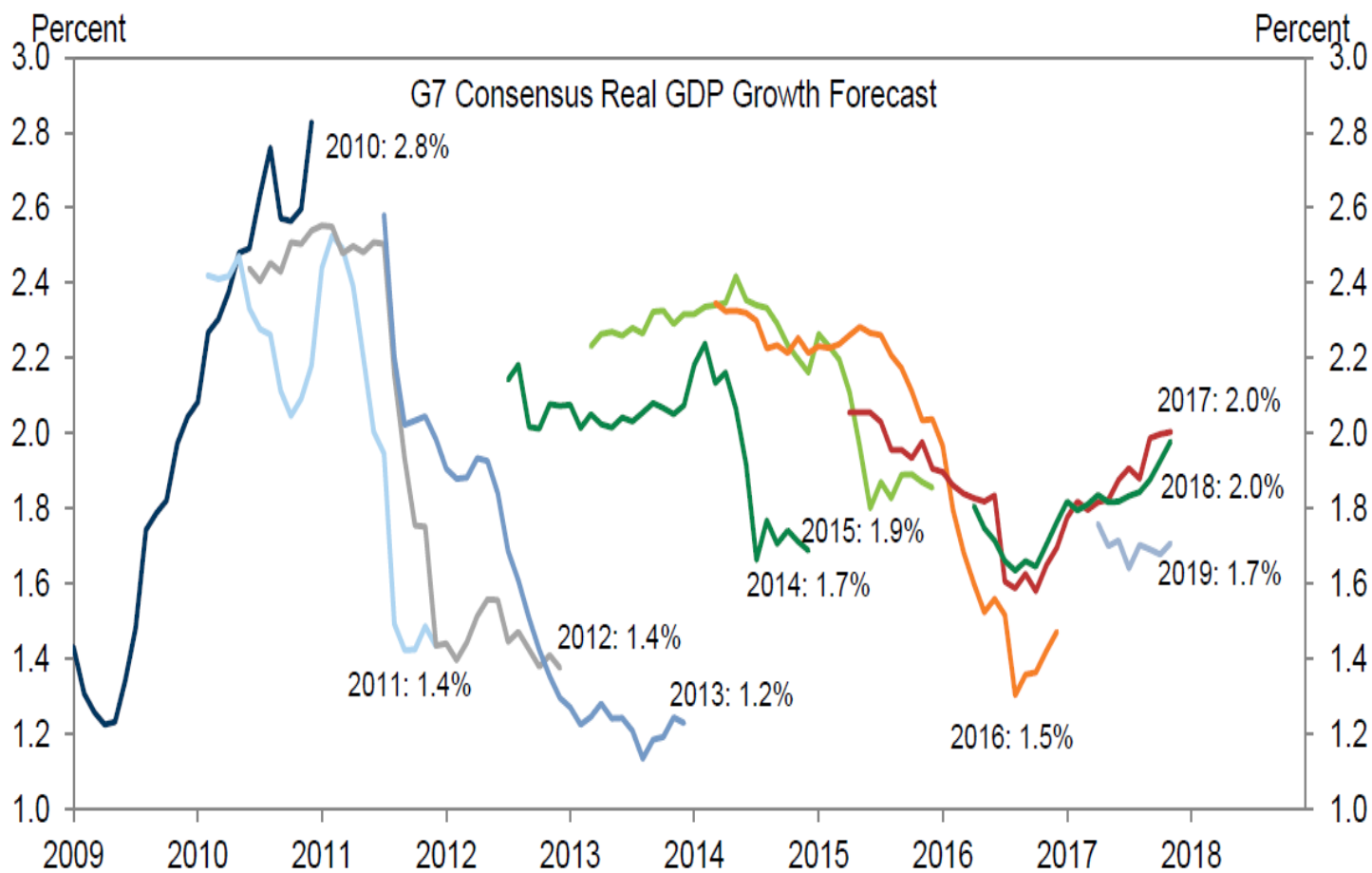
New Age of Monetary Policy: The Global Financial Cycle, Normalization and Implications for Financial Stability

Boris Vujčić

The Dialogue of Continents forum

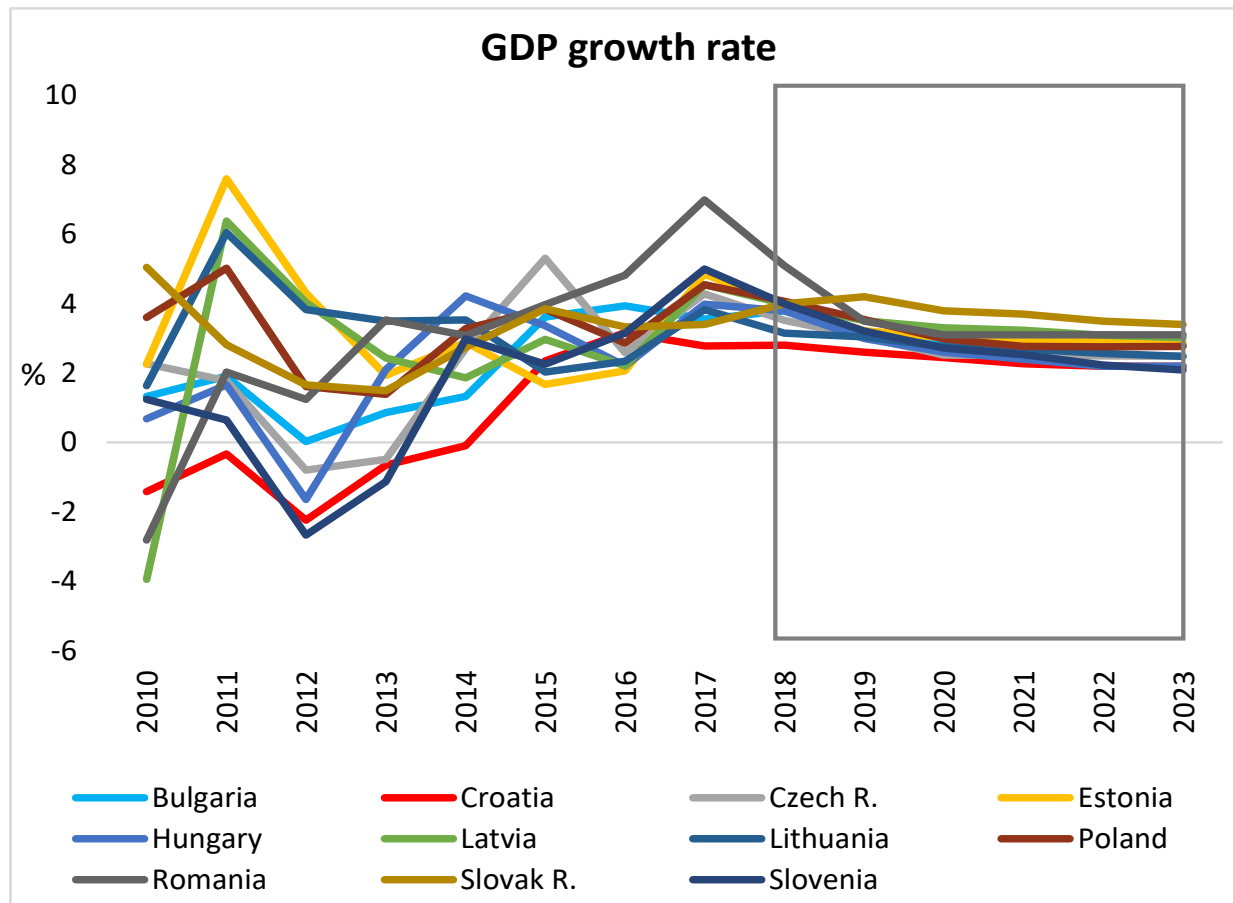
Paris, Sept. 3 – 5, 2018

Global growth projected to reach 3.9 % in 2018 and 2019



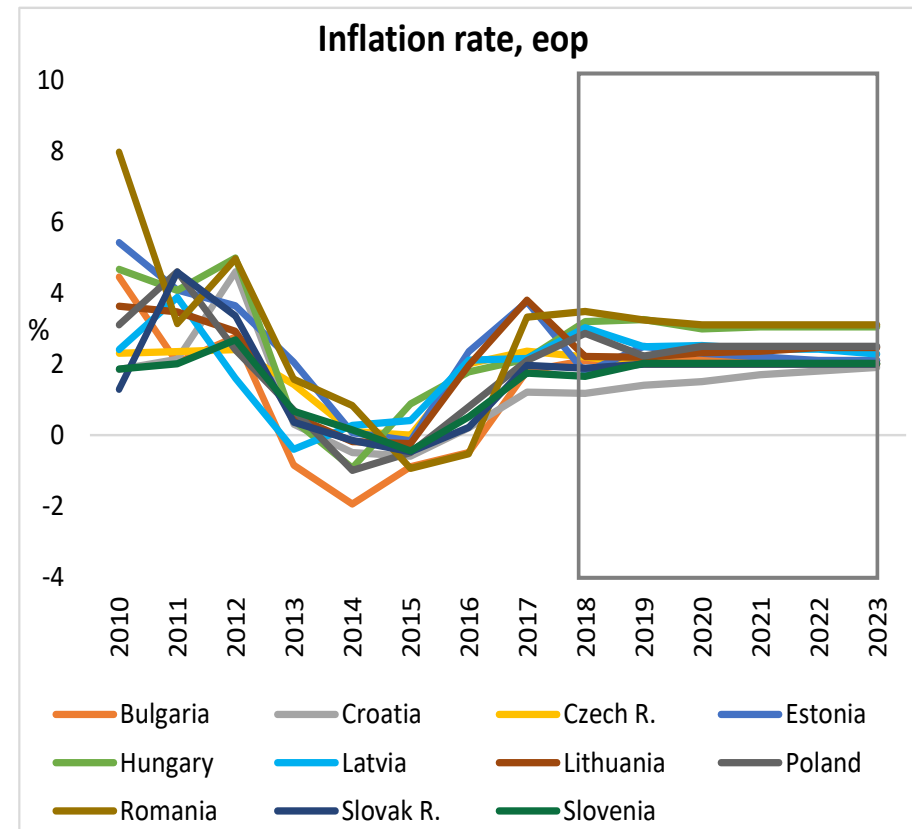
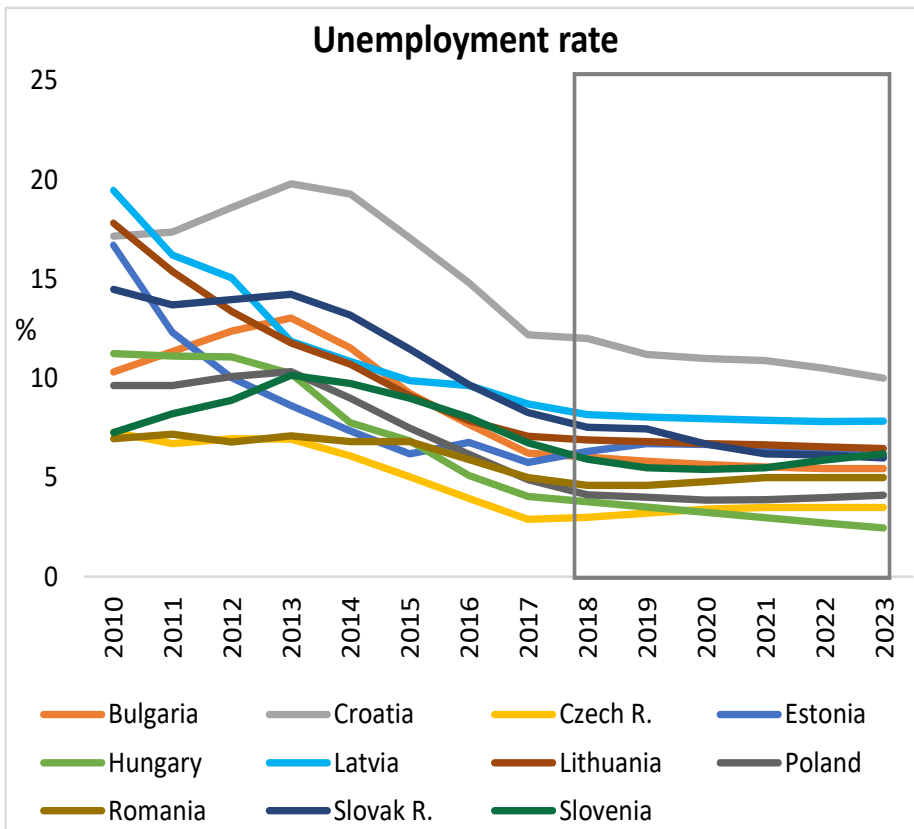
Source: IMF WEO Update, July 2018

Economic recovery in the region



Source: IMF WEO, April 2018

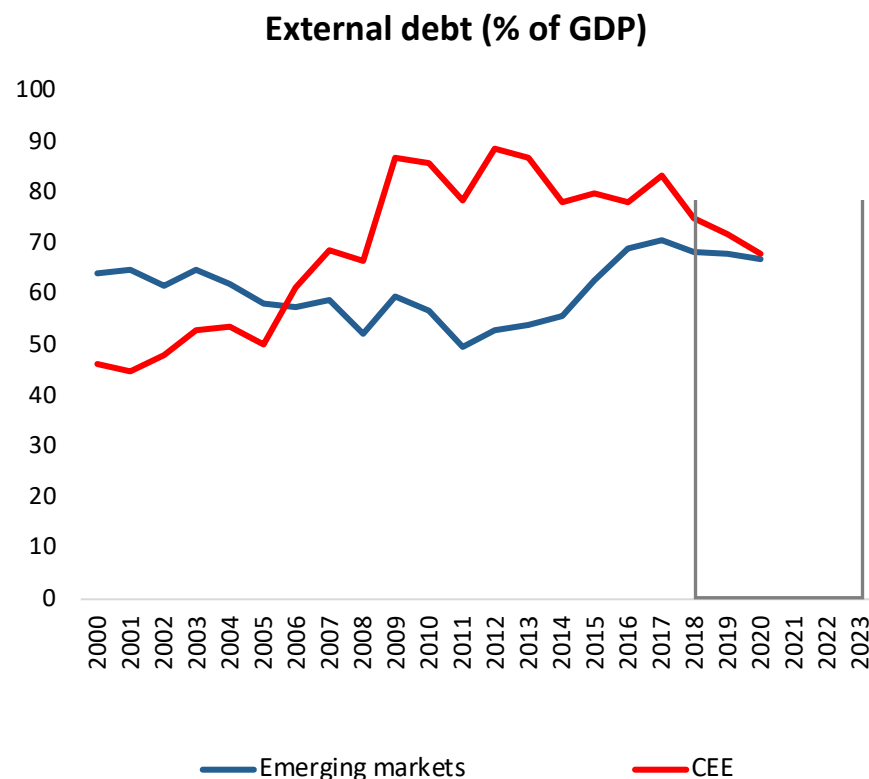
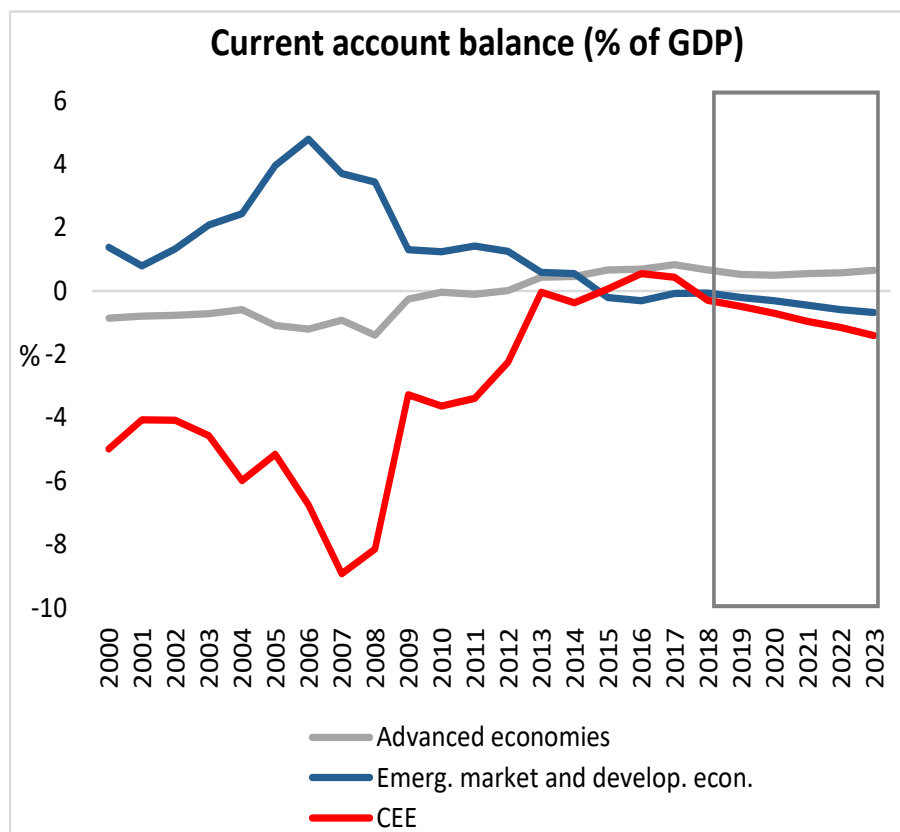
Unemployment and inflation in the region



Source: IMF WEO, April 2018

Sound balance of payment position

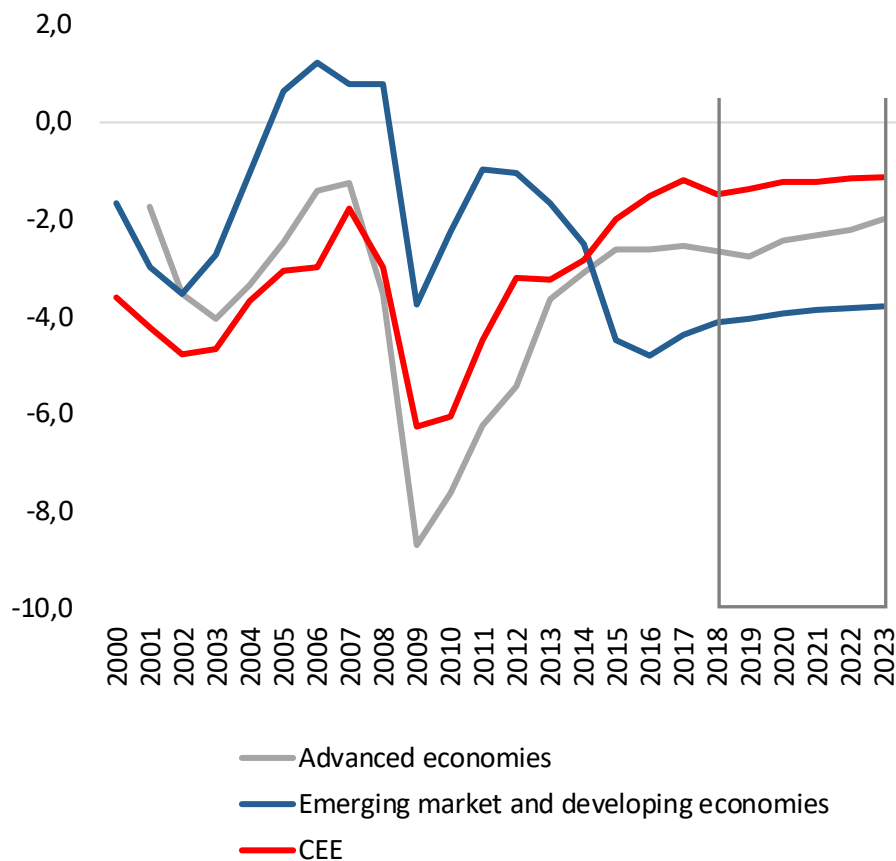
without significant pre-crises imbalances



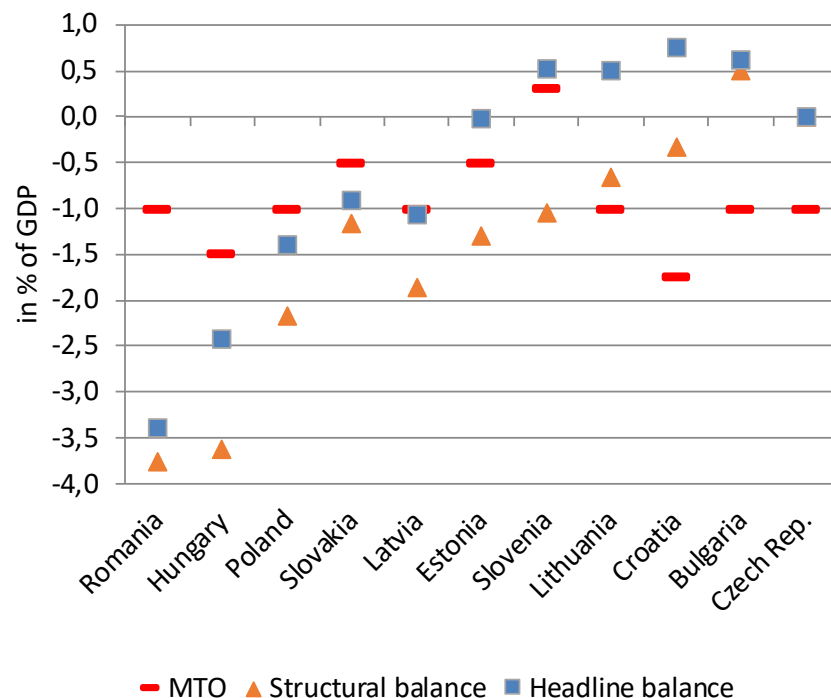
Source: IMF WEO, April 2018

Fiscal position relatively comfortable, although fiscal space relatively limited

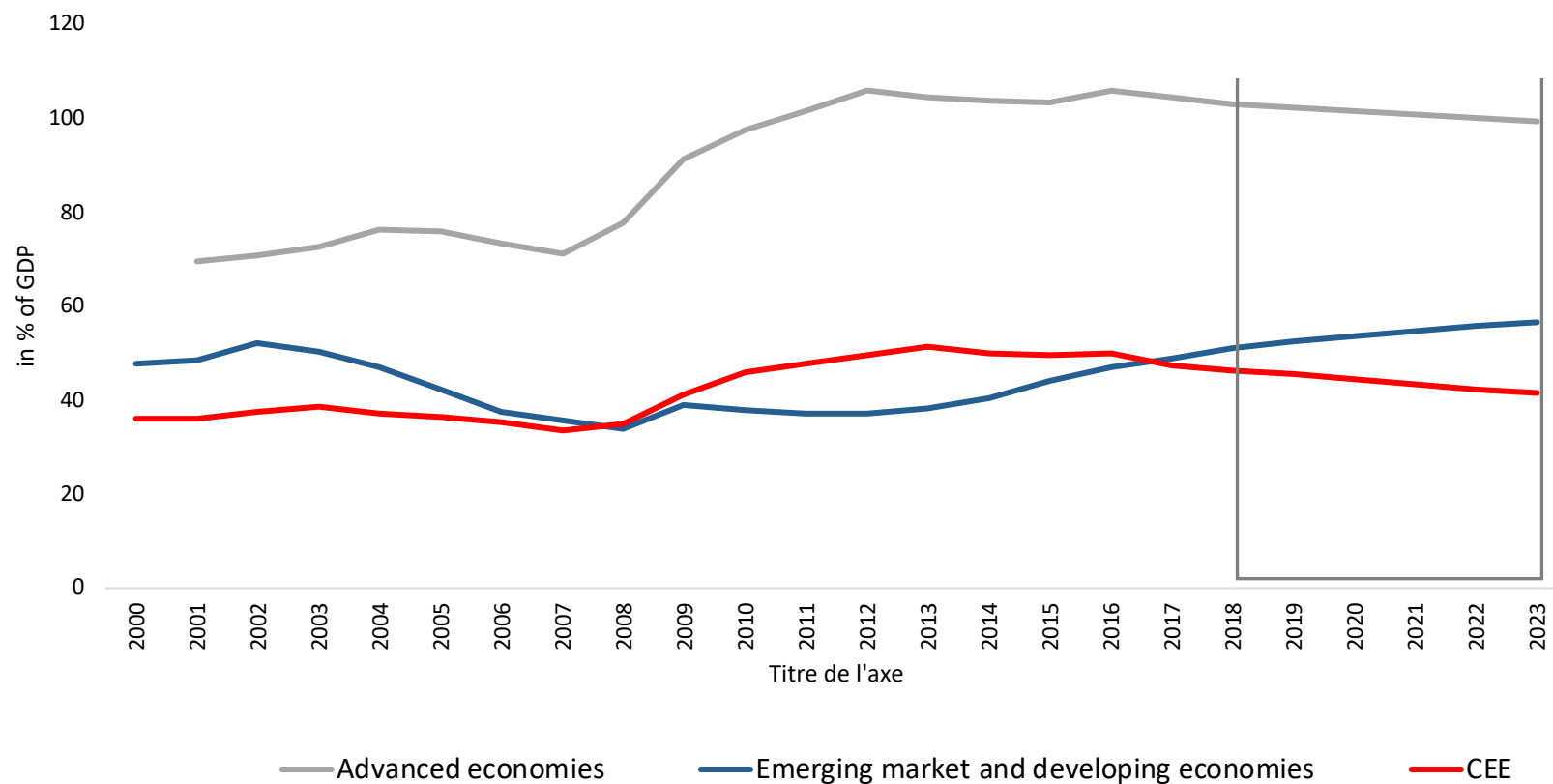
Fiscal balance (% of GDP)



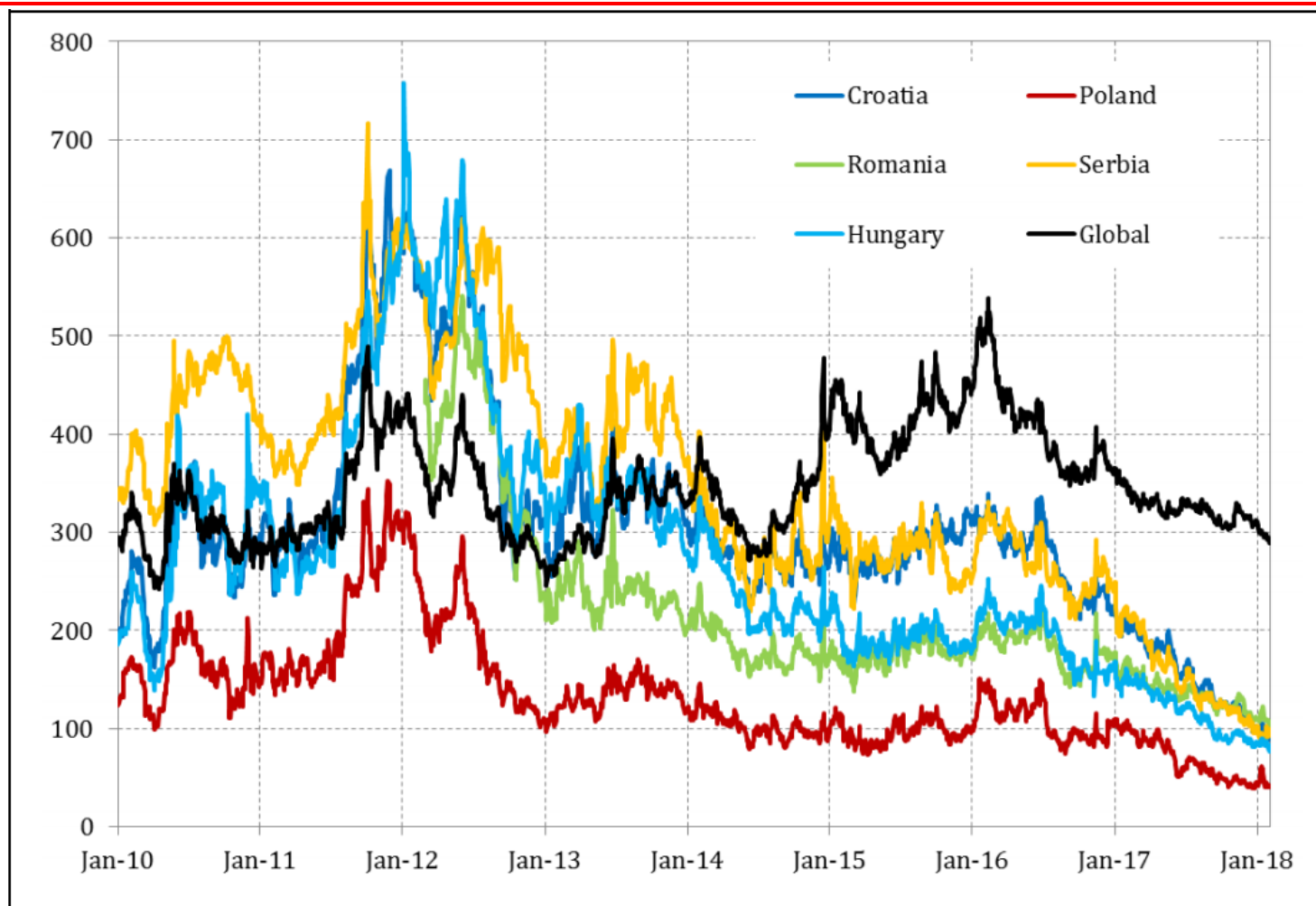
Medium-term objectives and projections of structural and headline balance for 2018



Public debt declining in CEE, also relative to other EMEs



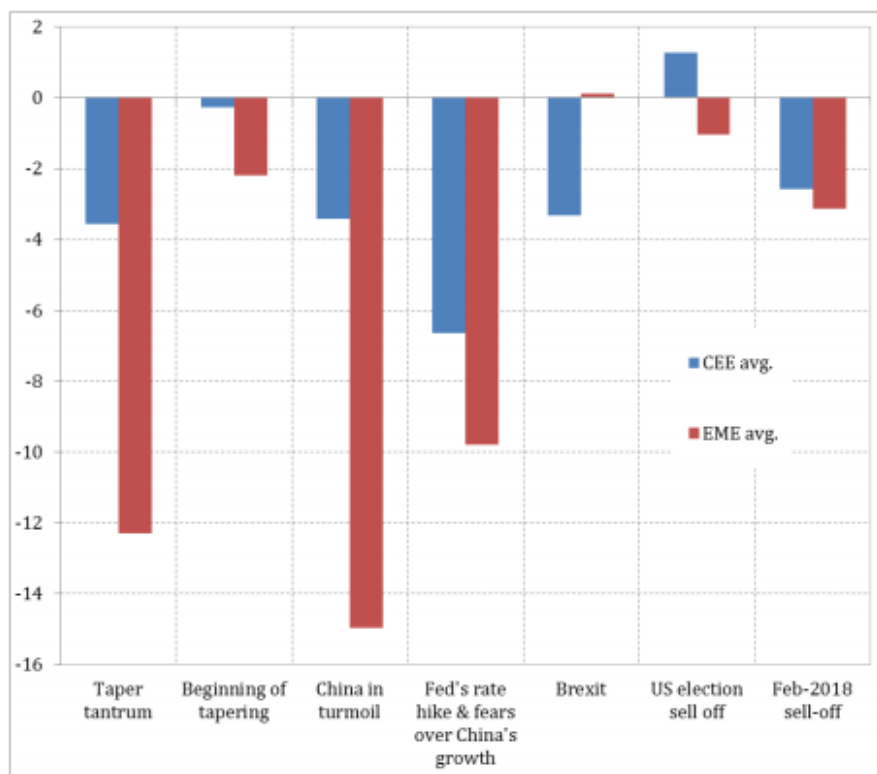
CEE sovereign spreads on a downward trend since mid-2016 seem to have decoupled from EMBI



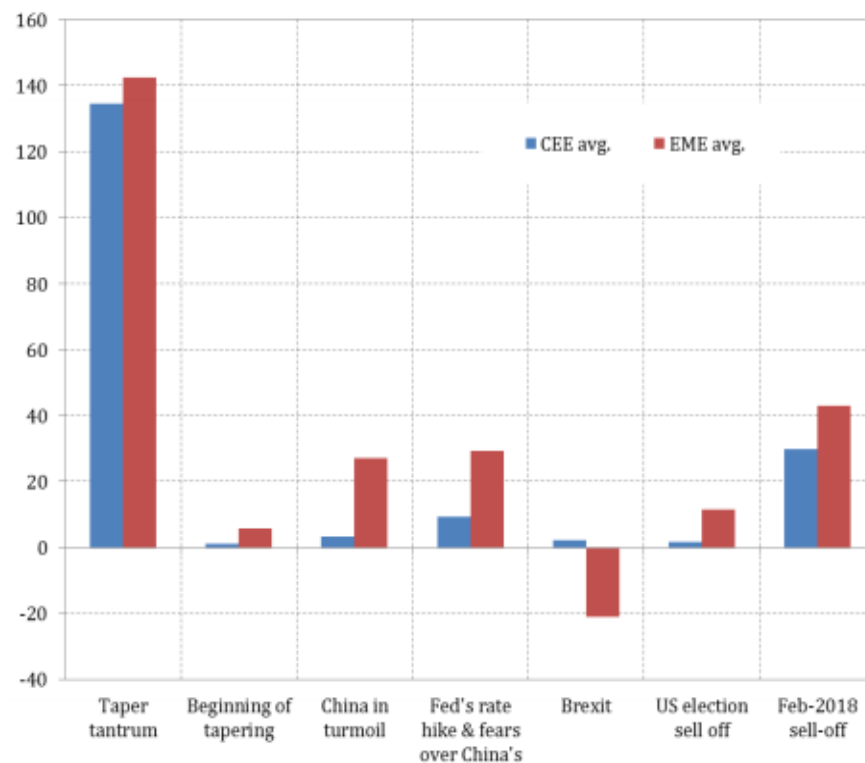
Source: Banca d'Italia (2018) Monetary policy normalization in advanced economies: what implications for CESEE countries? Background note for the meeting of the BIS Working Group on Monetary Policy in Eastern Europe, Zagreb

Improved underlying economic conditions potentially shield from volatility spillovers

Stock market indices (in %)



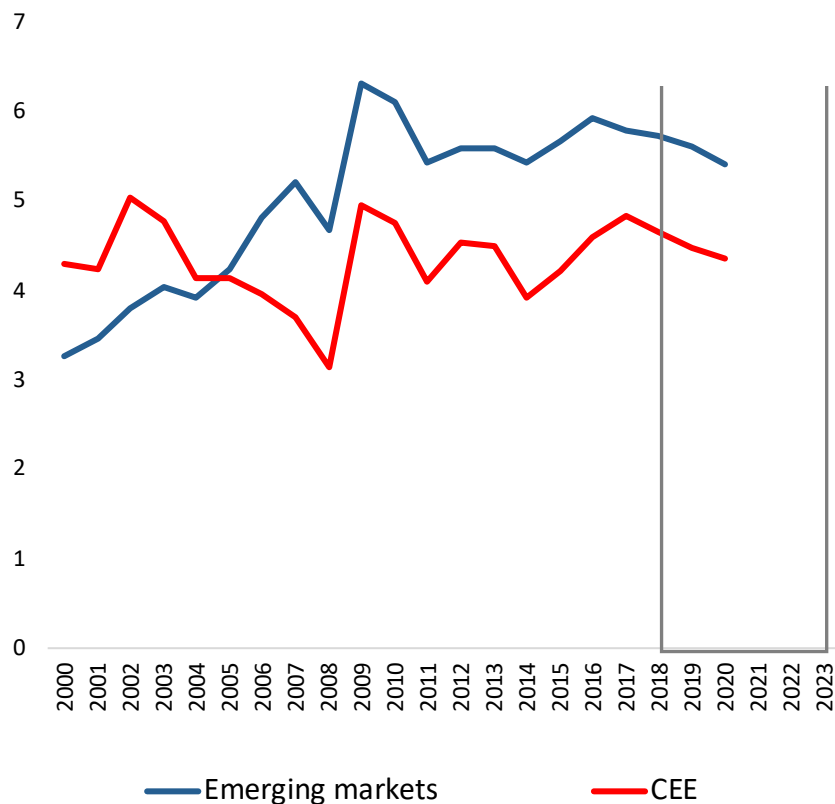
Long-term bond yields: EMBI - global



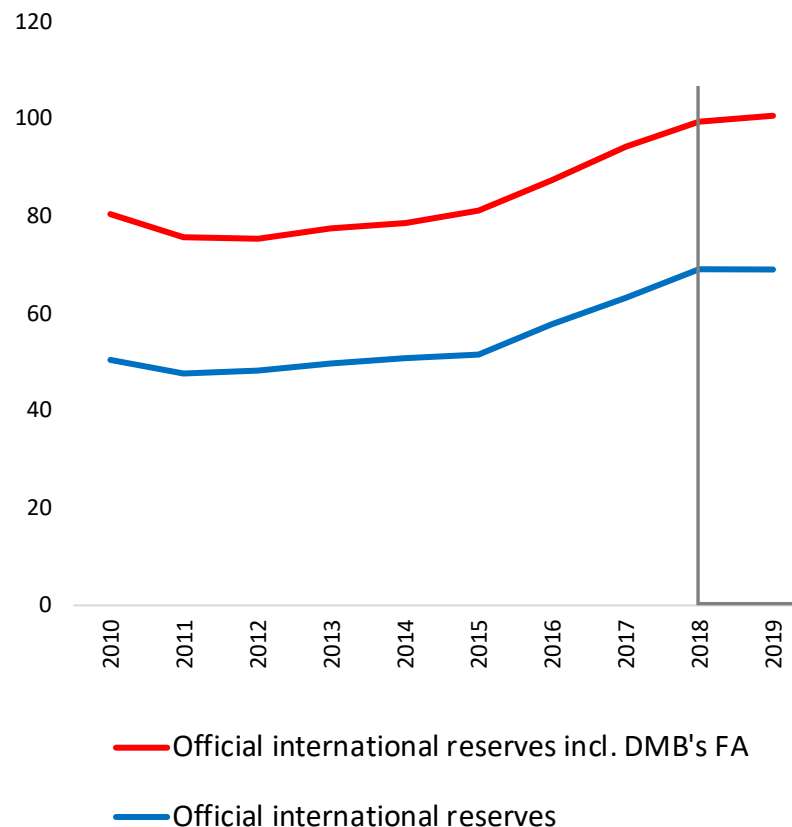
Source: Banca d'Italia (2018) Monetary policy normalization in advanced economies: what implications for CESEE countries? Background note for the meeting of the BIS Working Group on Monetary Policy in Eastern Europe, Zagreb

Solid international liquidity position

Official international reserves (in months of CXP cover)



CEE external liquidity position



Official international reserves incl./not incl. banks' external assets. Liquid external liabilities: scheduled external debt service in the current year, plus the stock of short-term external debt.

CEE generally in good shape to withstand the impact of normalization

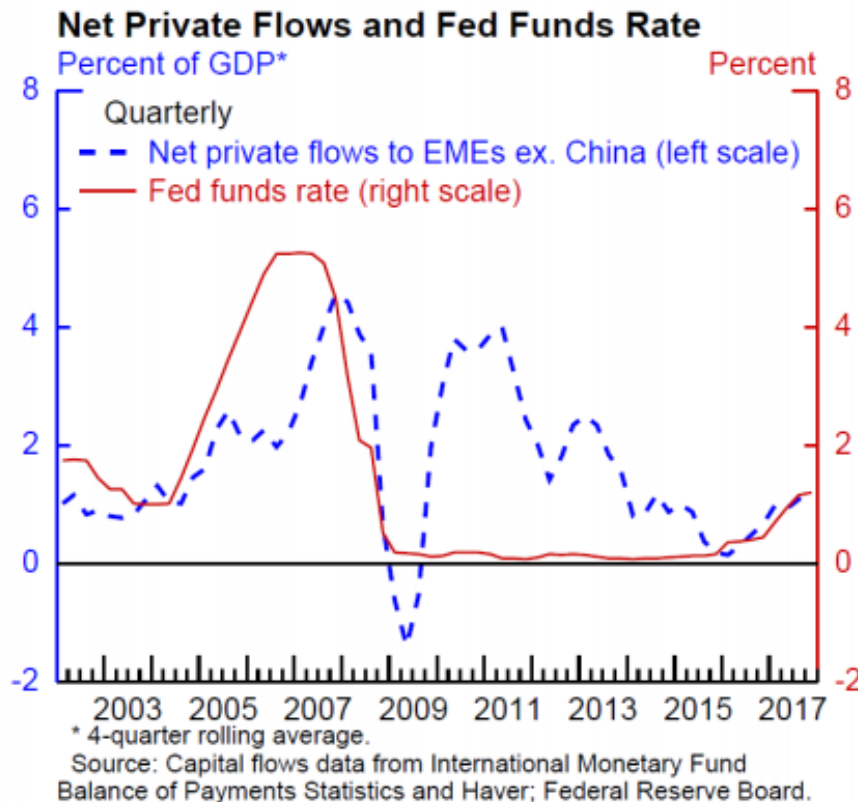
- ❑ CEE is a heterogeneous group of countries, but well positioned even for a significant change of financial conditions
- ❑ CEE foreign debt not very high and has not grown during the unconventional monetary policy era, as opposed to the general debt growth trends
- ❑ CEE vulnerability hinges on external position, fiscal and monetary space – all of which is reasonably balanced

EMEs' view on normalization impact

- ❑ „My call is for **more coordination** in monetary policy... , I propose that large central banks..., both in advanced countries and emerging markets, **internalize** more of the **spillovers**...” (Rajan, 2014)
- ❑ Not likely to happen since...
- ❑ If history is of any guidance, putting in a place an **effective** international **cooperation** among the main central banks **to internalise the spillovers** of their monetary policies on the rest of the world seems **out of reach** (Rey, 2018)

FED's view: Capital flows to EMEs better explained by:

Capital flows to emerging markets were already strong before the Federal Reserve cut its policy rate (Powell, 2018)



Source: Powell, 2018

- Initially strong capital inflow to EMEs gradually normalized, **in spite** of continued QE
- Determinants of capital flows to EMEs :
 1. interest rate differential (+)
 2. commodities prices (+/-)
 3. EME vs AE growth differential (+)
 4. Market sentiment (-)
- Conclusion: „cautious search for yield”
 - with limited impact on spread compression between markets

Policy recommendations are the same in both narratives

- ❑ create fiscal space
- ❑ use window of opportunity to implement structural reforms
- ❑ strengthen macro prudential and financial stability framework
- ❑ monitor underlying vulnerabilities
- ❑ monitor sustainability of debt levels
- ❑ above all, aim at raising the potential growth
- ❑ and last but not least...adapt to change in technological age (digitalization, automatization, cryptoisation...)

Conclusion

- ❑ CEE considerable improvement in macro and financial position
- ❑ due to a combination of sounder domestic policies **but also due to more favourable external conditions** as the euro area economy recovered
- ❑ public deficits are low and public debt levels are coming down; current account positions have improved, in many countries turning to surpluses; and financial systems have withstood well the shocks of the global financial crisis and the European sovereign debt crisis

References

- ❑ Jerome H. Powell (2017): Prospects for Emerging Market Economies in a Normalizing Global Economy, remarks at 2017 Annual Membership Meeting of the Institute of International Finance, Washington, D.C.
- ❑ Jerome H. Powell (2018): Monetary Policy Influences on Global Financial Conditions and International Capital Flows, remarks at „Challenges for Monetary Policy and the GFSN in an Evolving Global Economy”, Eighth High-Level Conference on the International Monetary System, sponsored by the IMF and SNB
- ❑ Raghuram Rajan (2014): Competitive monetary easing - is it yesterday once more? Remarks of the Governor of the Reserve Bank of India, at the Brookings Institution, Washington DC
- ❑ Hélène Rey (2018): Dilemma not trilemma: The global financial cycle and monetary policy independence (update), NBER WP 21162