



CROATIAN NATIONAL BANK

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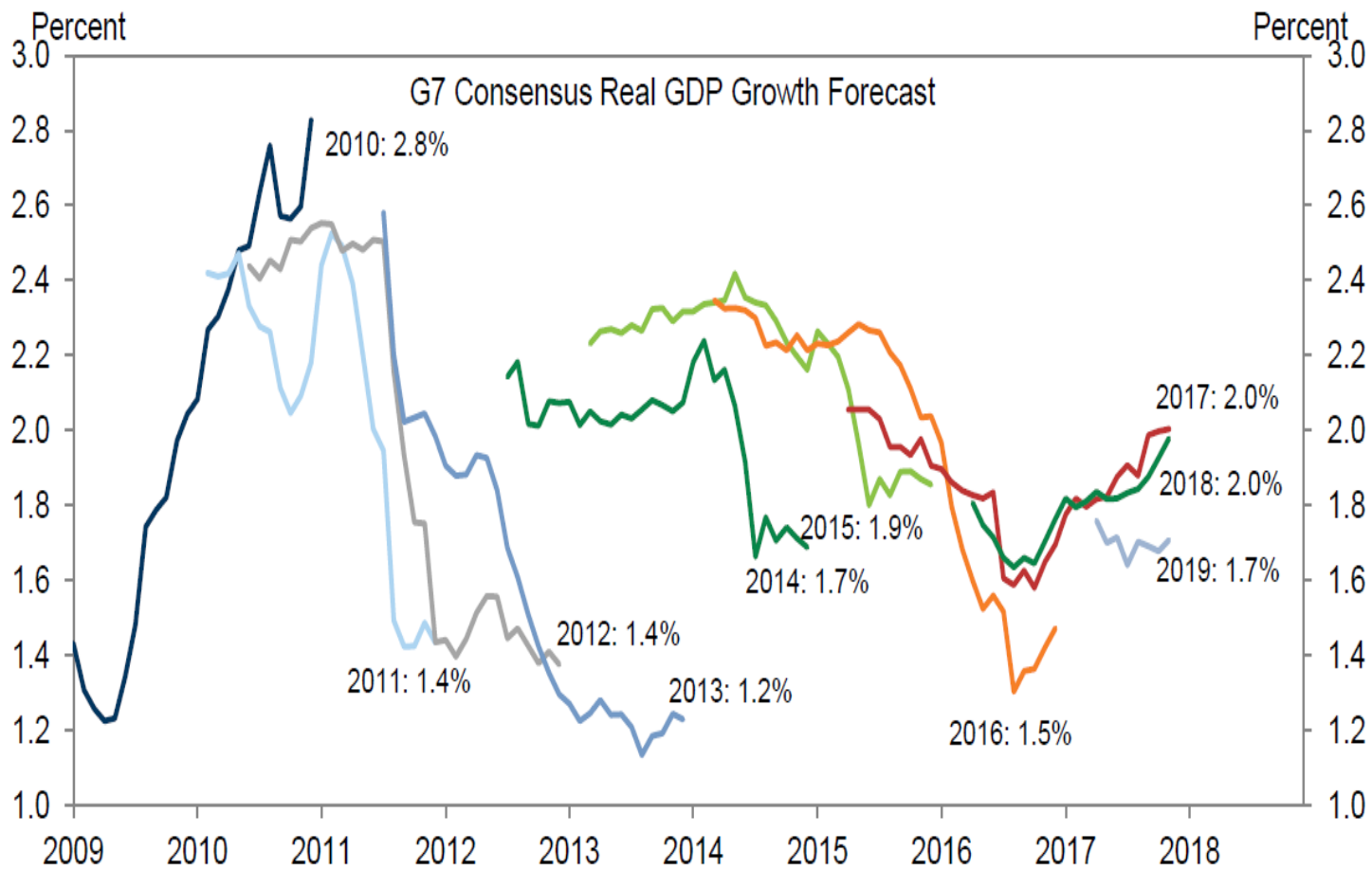
**New Age of Monetary Policy: The Global Financial Cycle,  
Normalization and Implications for Financial Stability**

Boris Vujčić

The Dialogue of Continents forum

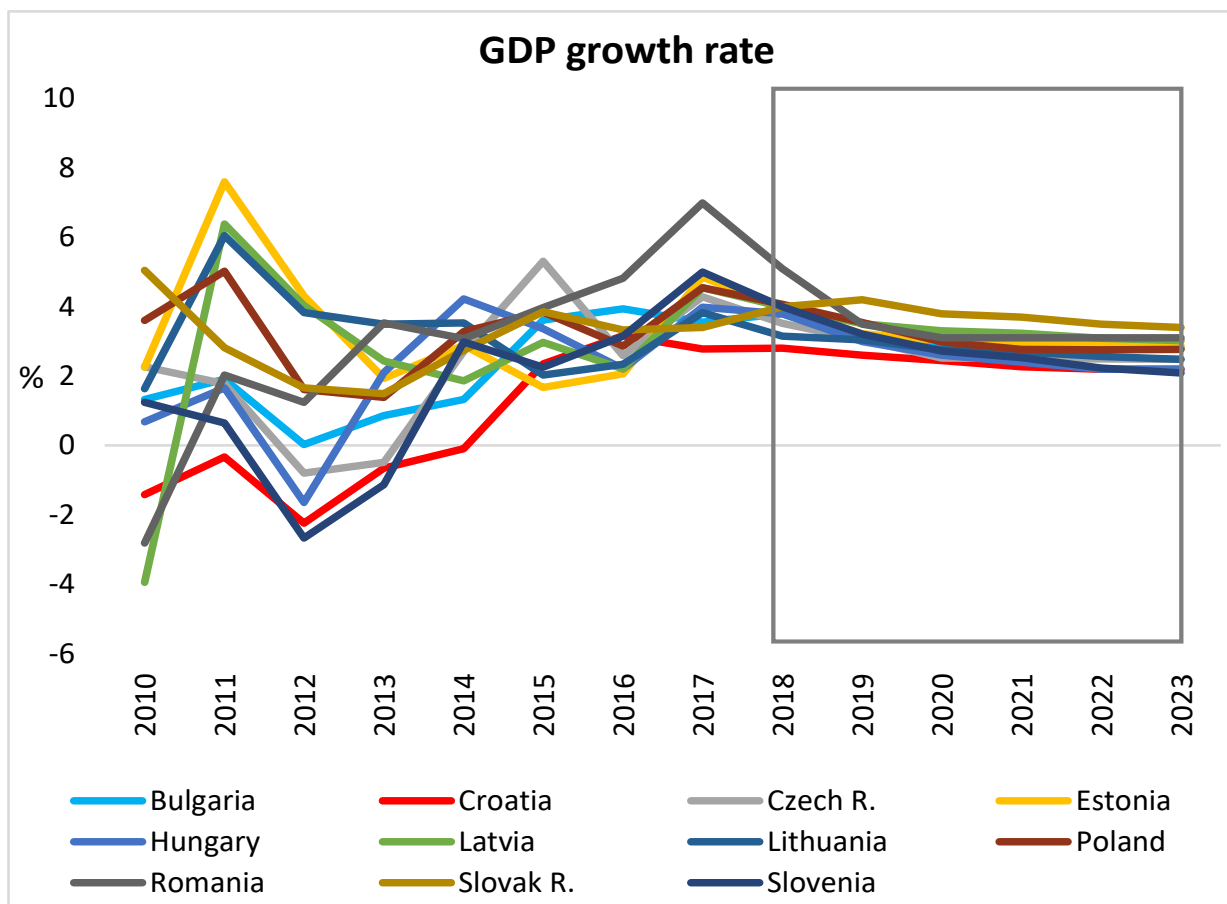
Paris, Sept. 3 – 5, 2018

# Global growth projected to reach 3.9 % in 2018 and 2019



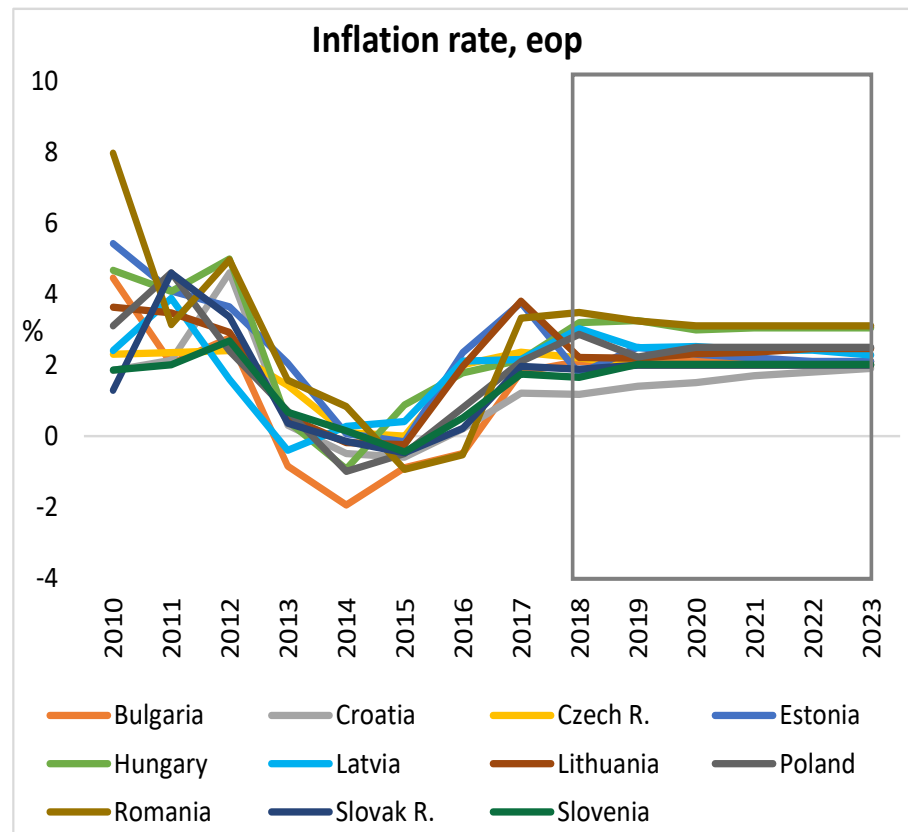
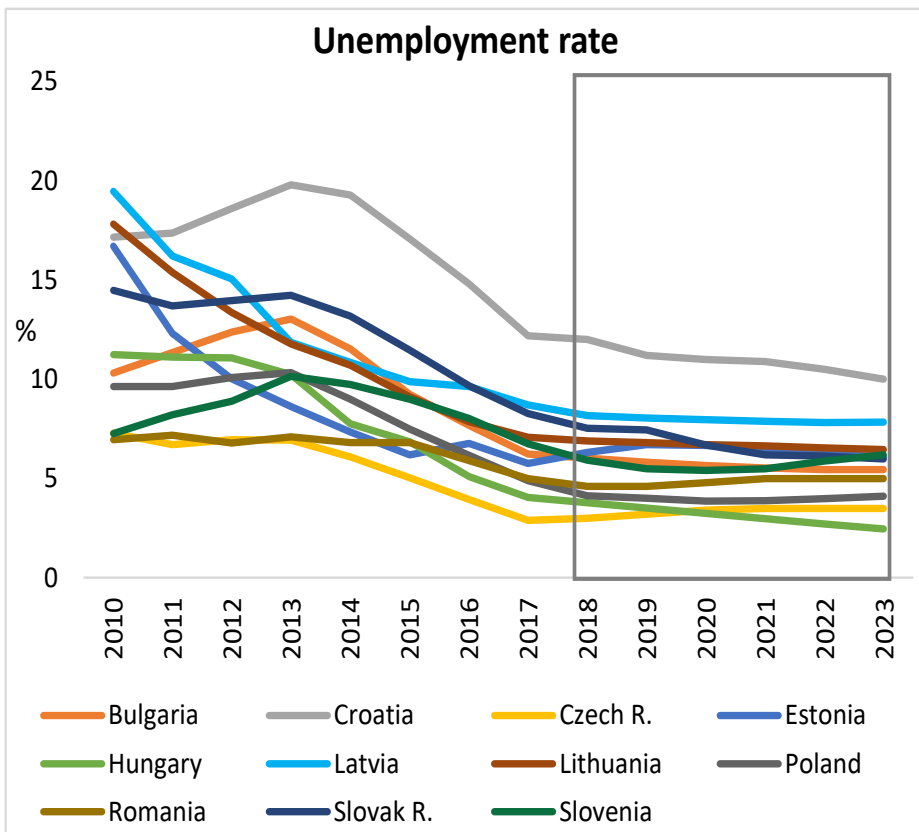
Source: IMF WEO Update, July 2018

# Economic recovery in the region



Source: IMF WEO, April 2018

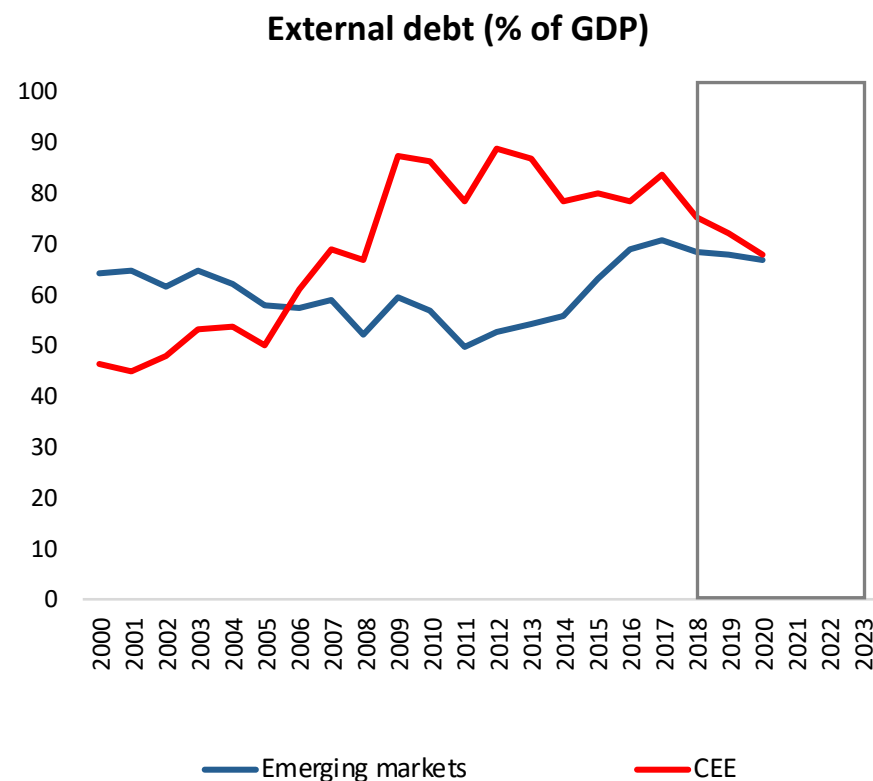
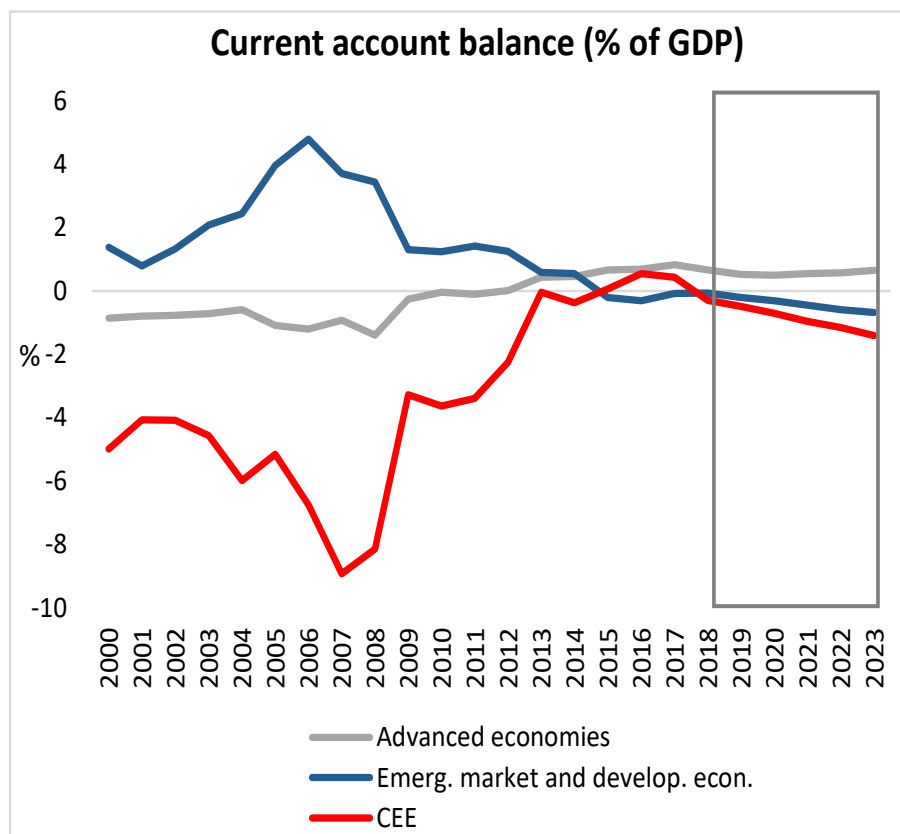
# Unemployment and inflation in the region



Source: IMF WEO, April 2018

# Sound balance of payment position

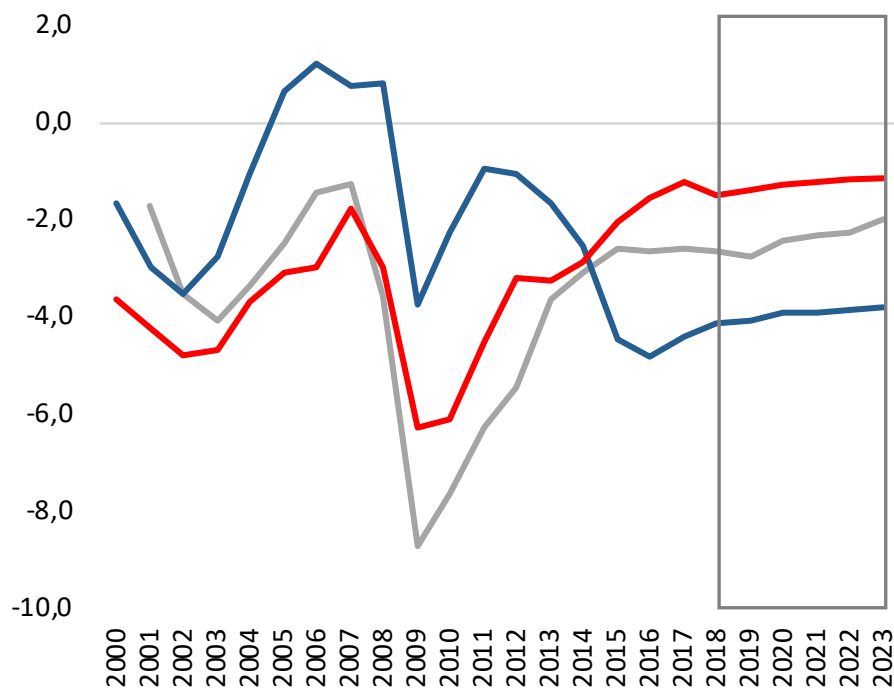
without significant pre-crisis imbalances



Source: IMF WEO, April 2018

# Fiscal position relatively comfortable, although fiscal space relatively limited

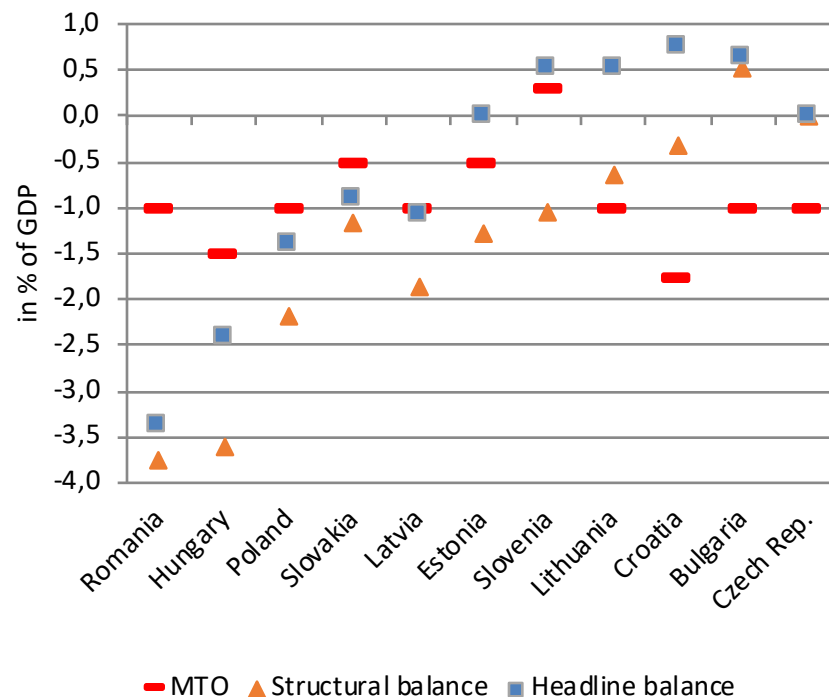
Fiscal balance (% of GDP)



- Advanced economies
- Emerging market and developing economies
- CEE

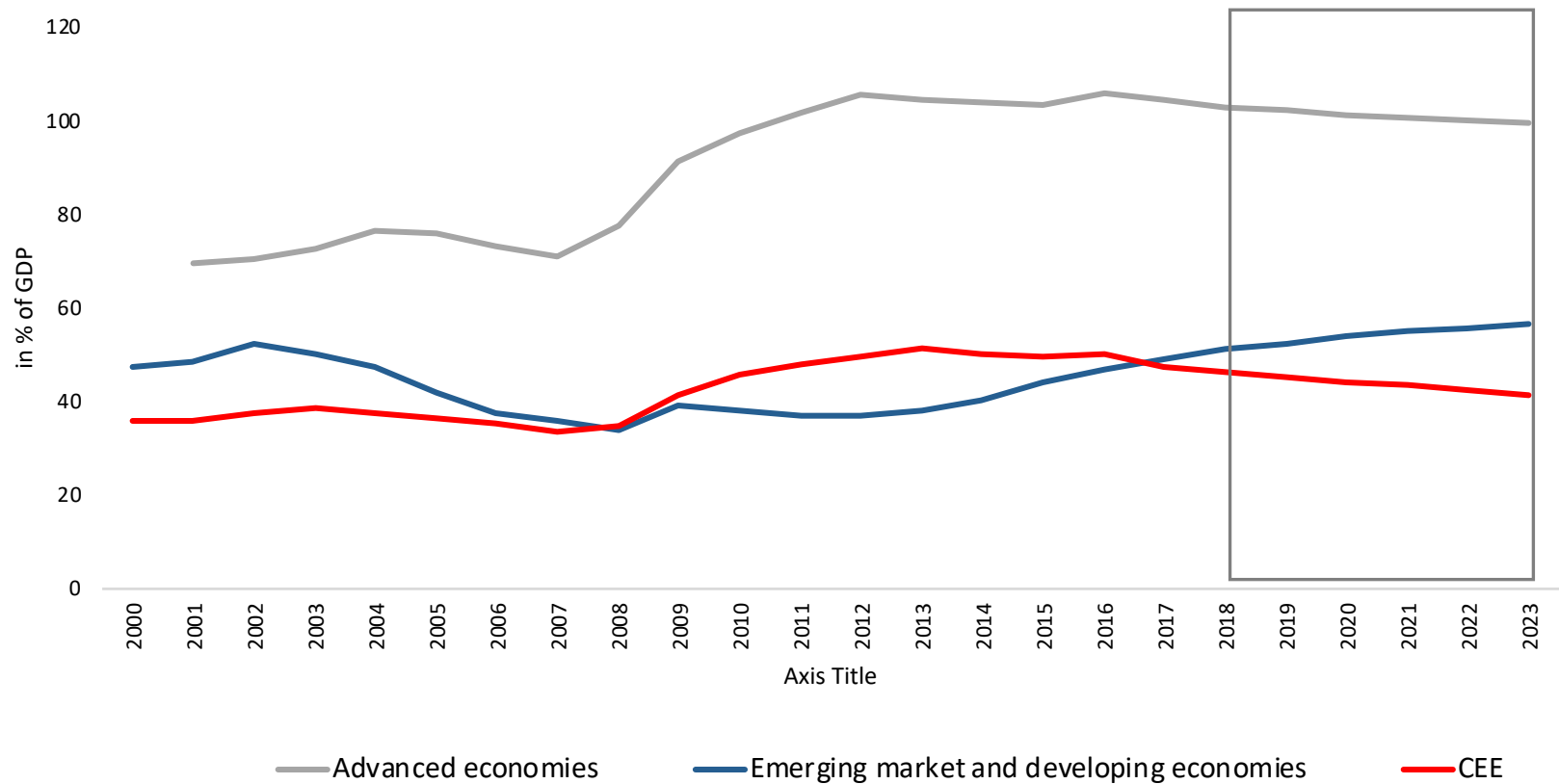
Source: IMF WEO, April 2018

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



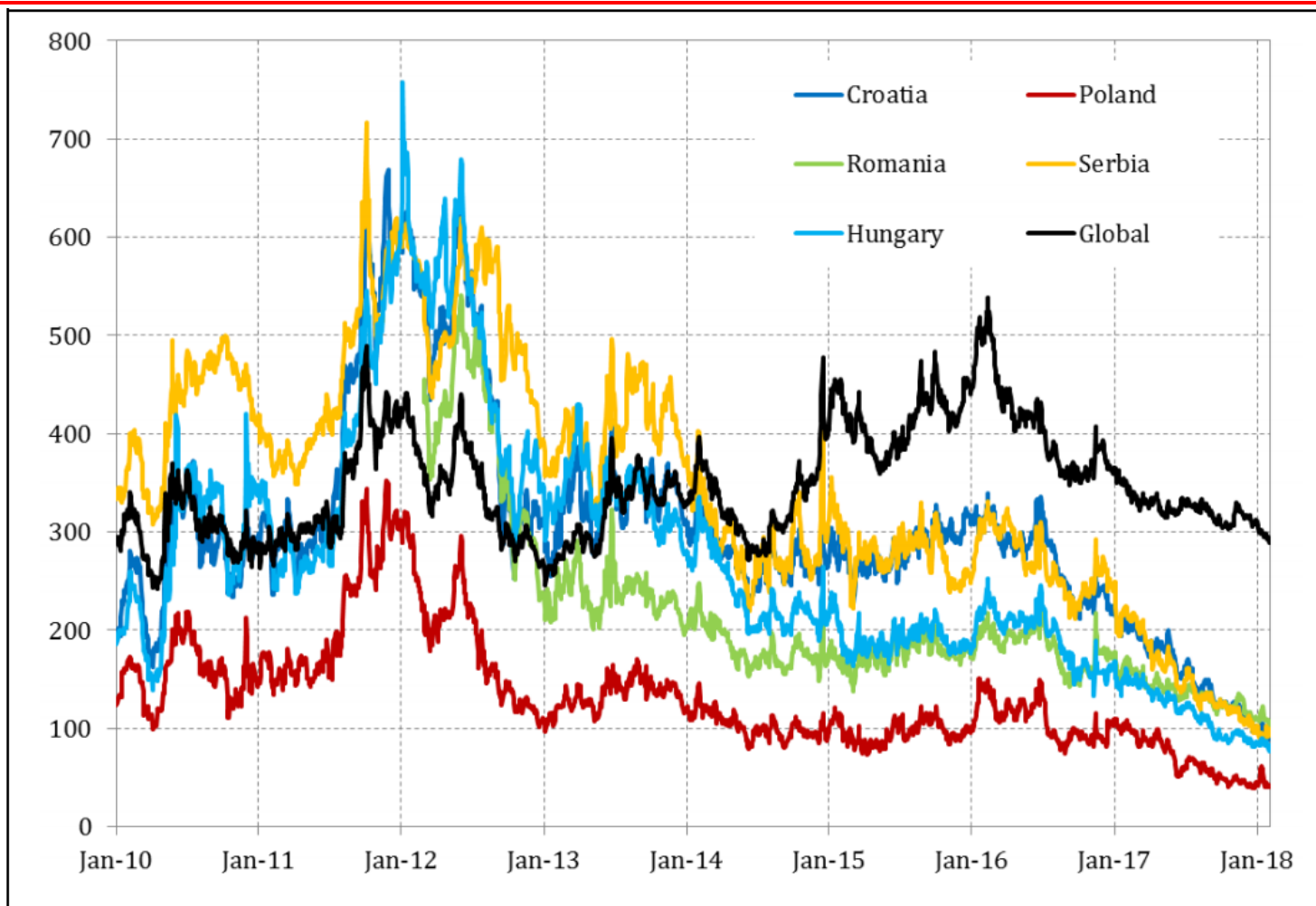
Source: MTO  
[https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/stability-and-convergence-programmes/assessment-programmes-2018\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/stability-and-convergence-programmes/assessment-programmes-2018_en) 6

# Public debt declining in CEE, also relative to other EMEs



Source: IMF WEO, April 2018

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

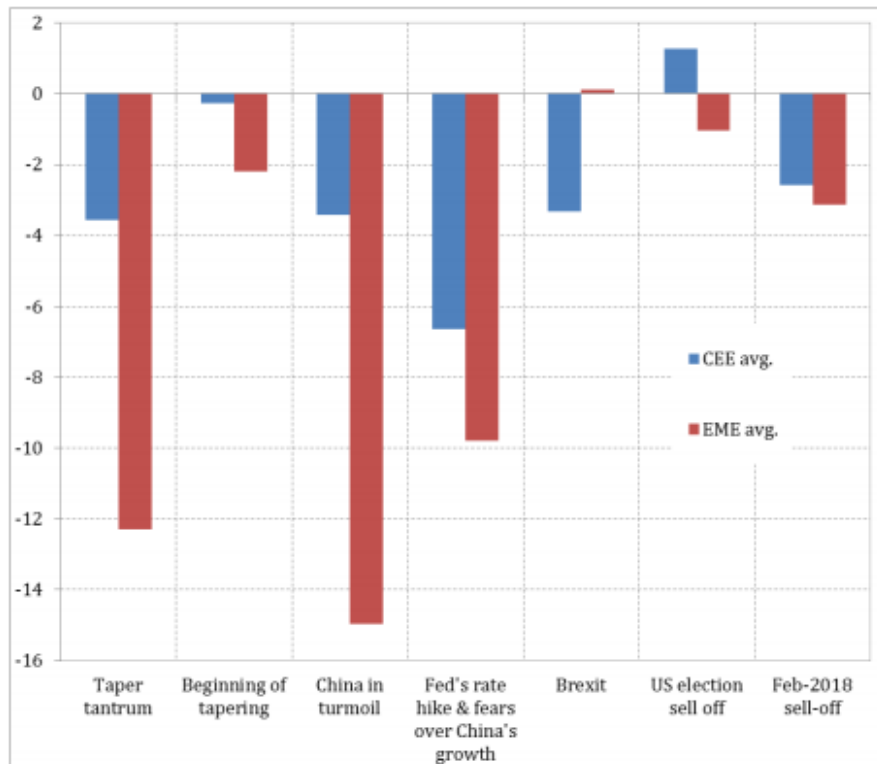


Source: Banca d'Italia (2018) Monetary policy normalization in advanced economies: what implications for CESEE countries? Background note for the meeting of the BIS Working Group on Monetary Policy in Eastern Europe, Zagreb

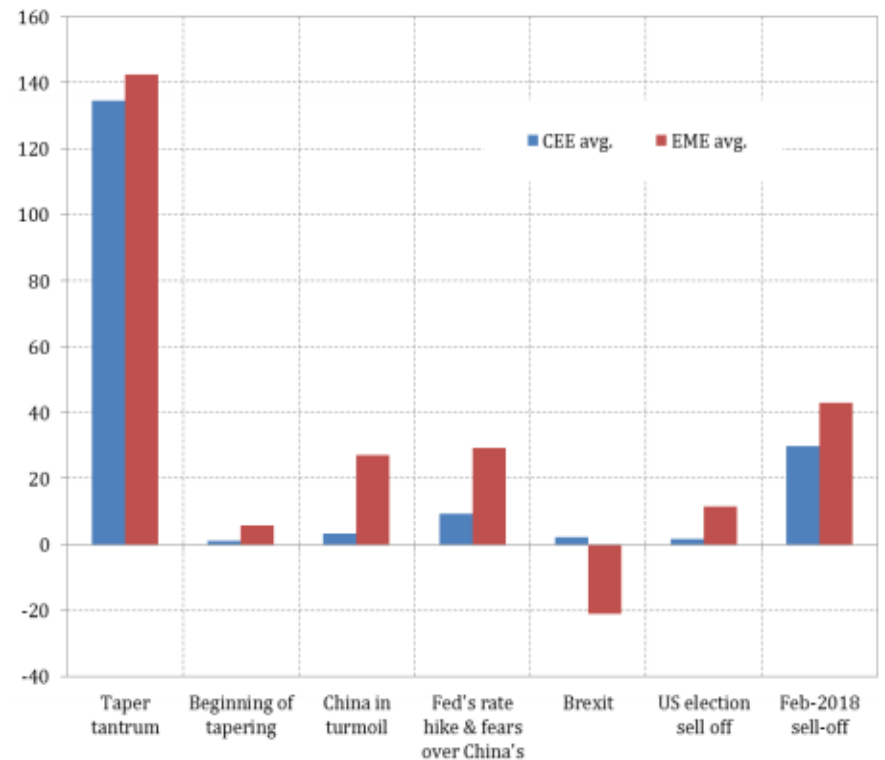


# Improved underlying economic conditions potentially shield from volatility spillovers

Stock market indices (in %)



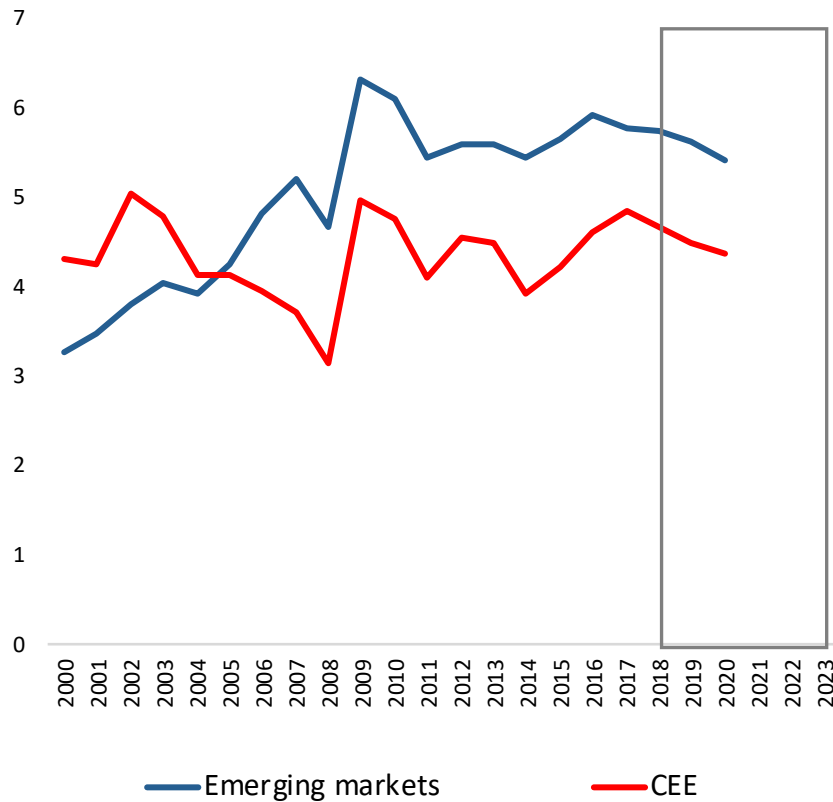
Long-term bond yields: EMBI - global



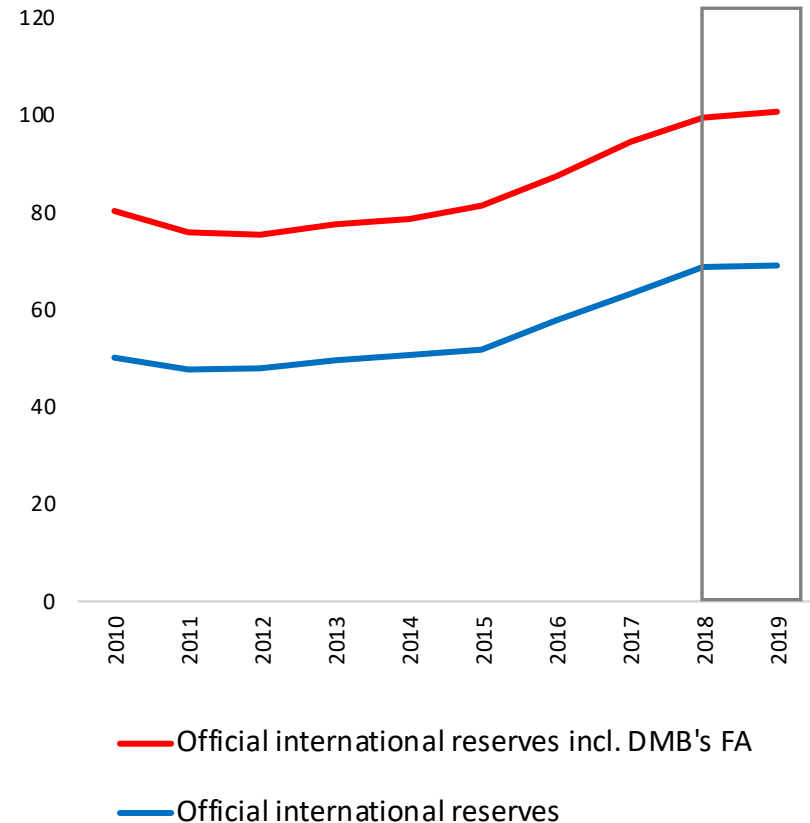
Source: Banca d'Italia (2018) Monetary policy normalization in advanced economies: what implications for CESEE countries? Background note for the meeting of the BIS Working Group on Monetary Policy in Eastern Europe, Zagreb

# 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.

Source: IMF

# CEE generally in good shape to withstand the impact of normalization

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- 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

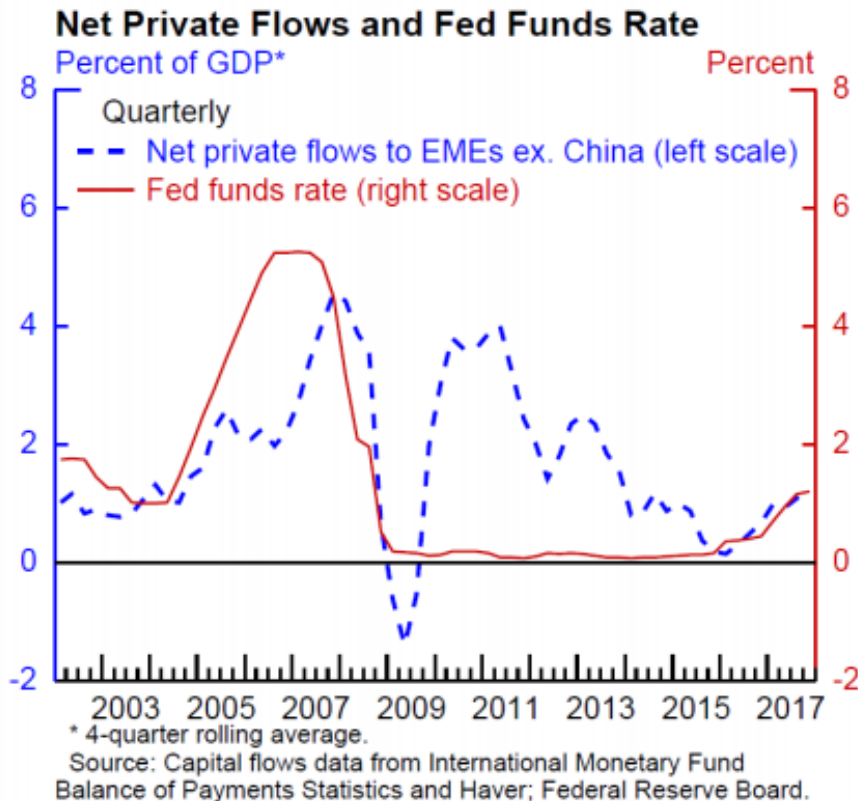
# EMEs' view on normalization impact

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- „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)



- 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

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- ❑ 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

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- ❑ 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

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- 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 trilema: The global financial cycle and monetary policy independence (update), NBER WP 21162