GEORGETOWN AMERICAS INSTITUTE

Comments from LATAM on Monetary Policy and Resilience by Markus Brunnermeier

Alejandro Werner

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1. Is Inflation anchored?

- IT has helped
- But sometimes supported by tightening

2. Stay away from tipping points

- ZLB not a big issue
- Inflation spikes associated to supply shocks and FX shocks percieved to lead to traps: frequent use of FXI

3. How to react to succesive AS shocks

4. Deanchoring

- Do we tighten to decrease OG or to signal type of Cbanker?
- How are expectations formed? Whose expectations?
- Narrative is essential
- Support in key wage setting processes, income policies.

5. Optimal mix of rules and discretion

- IT provides a good framework for constrained discretion

- Sometimes framework not appropiate to specific shocks: Covid 19.Shock on core was supply driven, so construct super core, complex message. Narrative vs ovrtightening

- Complementary instruments not rules-based: is that optimal or FXI should also be undertaken under constrained discretion?

Traditional wage-price spiral: early tightening and some coordination

Fiscal dominance

- Fiscal frameworks
- CB independence

Financial Dominance

- After financial crises of 80 and 90s very conservative regulation (prudential and macroprudential)
- Also, high rates of return make the financial system more robust. Nice to be the prudential regulator of an oligoplistic system
- Diabolic Loop: Partially dealt with, as subsidiaries of foreign banks do not consider sovereign debt risk-free

Currency mismatches

- Floating rate
- Banking regulation + corporate reporting (after FX derivatives crisis)
- FXI vs direct intervention to firms with mismatches: assumption that missmatches justify intervention might not be correct

Challenges in LATAM

- Uncertainty of transmission channels (parameters of the model)
- Understanding r*
- In some countries dealing with FX vol
- Communicating uncertainty

FX intervention/IPF,

- Why,

1. Currency mismatches
2. Risk premmia feedback
3. Microdynamics / Thin markets

- How

1. Spot
2. Derivatives
3. Rule based or discretion

Structured Safe Assets

- Who buys the junior tranche during flight to safety?
- Close to overcollateralized swaps?
- Can FLAR become the structured vehicle accepting sovereign debt as quotas/overcollateralization in period of flight to quality and they keep the junior tranche.

Optimal level of reserves

- Guidotti Rule: Liquidity
- Resilience Rule: Hedge open FX positions to avoid traps

International cooperation

- IMF: Should take more risk

  - ➢ Should act as supersenior
  - ➢ Does not take sufficient risk (even worse for MDB’s)
  - ➢ Introduce uncertainty and optionality into its analysis. Covid example (DSA)
  - ➢ Triple A rating of MDB’s. Does it make sense? Example of COVID19

For EM's different behavior about domestic vs foreign investors

- Different aversion to RER risk, very high for foreigners and low (or 0) for domestic.

- Do pension funds play a stabilizing role (Chile vs Mexico): quality of management or tensions between Investment regulation vs commercial competition mandate.

- Sovereign Debt Restructuring: contractual approach has worked well (Argentina and Ecuador) when no relevant China exposure