Monetary and Financial Policy in Emerging Markets

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1. **What is the question (of the paper)?**

   The global financial environment has become increasingly integrated in recent decades. Given the close connection between the domestic economy and the international financial market, how will foreign shocks affect the domestic economic situation, especially for the developing countries? What is the monetary policy best made for such situation?

2. **Why should we care about it?**

   At the time of the global economic crisis, developed countries adopt large-scale loose monetary policies, and a large amount of funds poured into emerging markets;

   However, when the policies of advanced countries change, emerging markets are facing a sharp reversal of capital movements, which seriously affects the exchange rates (thus, depreciates) and prices of these countries. For example, Fed's announcement that they would raise interest rates causes currency depreciation and inflation in these countries.

   The globalization of financial policy has brought severe challenges to the effectiveness of domestic monetary policy, and the formulation of appropriate response plans has become an important issue.

3. **What is the answer?**

   Author stated that basically a country will face a <u>trade-off.</u> Rise in the foreign interest rates will cause depreciation, yet export is, theoretically, will increase. But another way to see it is the balance sheet will be hurt and brings higher inflation. However controlling inflation itself is not an easy task, the overall welfare of the country will be reduced.

4. **What's the implications of the answer? What do we learn from the paper?**

   This study provides a clear framework for the discussion of the interaction between financial intermediation and the overall economy. The author has pointed out that cyclical macroprudential policy should be considered to be adopted on the flow of foreign capital. Author conclude <u>that the taxation of foreign borrowing can achieve an overall stable goal by stabilizing the balance sheet.</u>

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