Dollar Debt and the Inefficient Global Financial Cycle

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[1] The views are those of the discussant and do not necessarily reflect the views of the ECB or the ESCB.

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- Proposes a tractable model to analyze spillovers of U.S. monetary policy to emerging market economies (EMEs)
  - **Tractable small open economy model with financial frictions and nominal rigidities** to capture the balance sheet effects of dollar-denominated debt & trade-offs faced by emerging markets central banks following a tightening by the Fed
  - Novelty and central mechanism: the **bottleneck externality**

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- $\Rightarrow$ **Imperfect** global financial intermediaries face an increased quantity of capital flows to intermediate from EMEs competing for scarce global intermediary capital $\Rightarrow$ Rise of dollar intermediation premium $\Rightarrow$ Additional domestic depreciation pressures and tightening needs for EMEs
- $\Rightarrow$ Amplification of the Global Financial Cycle
- $\Rightarrow$ Inefficiently low levels of employment and output in EMEs

What the paper does:

- It shows that policy coordination among EMEs can mitigate the GFC inefficiency by reducing the need for excessive tightening
- It also shows that ex-ante macroprudential regulation discouraging dollar-denominated borrowing generates positive spillovers easing the trade-off faced by EMEs central banks during Fed tightening cycles
- Extensions include the welfare properties of FX interventions

Lots to like about the paper!

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- **A classic international macroeconomics topic**: US monetary policy spillovers to EMEs & mechanisms that exacerbate the global financial cycle
- **New angle and mechanism**:
  - The bottleneck externality - original theoretical contribution that formalizes the intuition that synchronized monetary responses in EMEs can worsen financial conditions due to the inelastic supply of intermediary capital

Lots to like about the paper! (cont'd)

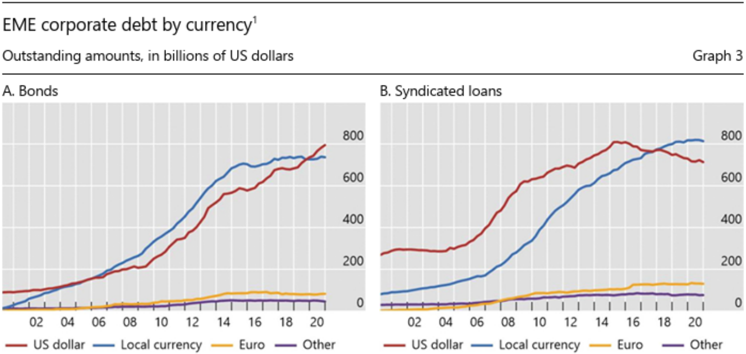
- **Elegant theoretical contribution** of the global financial cycle and the externalities it creates for EMEs:
  - Extension of Bianchi & Lorenzoni (2022) integrating two critical features: financial frictions and nominal rigidities into a tractable framework

Lots to like about the paper! (cont'd)

- **Elegant theoretical contribution** of the global financial cycle and the externalities it creates for EMEs:
  - Extension of Bianchi & Lorenzoni (2022) integrating two critical features: financial frictions and nominal rigidities into a tractable framework
- **Policy insights**: The analysis provides a rationale for monetary policy coordination across EMEs and for targeted macroprudential regulation of dollar-denominated liabilities

Observation #1: EMEs dollar debt vs LC debt

- Similar importance of local currency corporate debt



[1] For an unbalanced panel of firms headquartered in 22 emerging markets (excluding China) since Q1 2000. Includes debt securities and syndicated loans.

Source: Avdjiev, Burger & Hardy (2024)

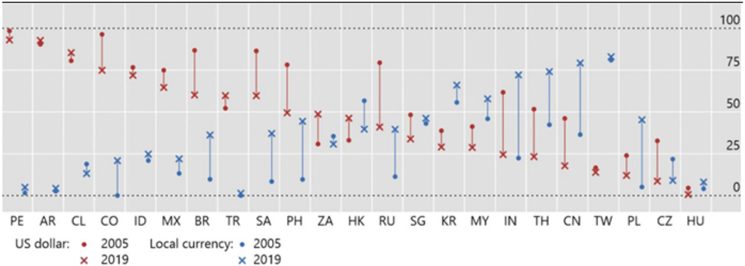
Observation #1: EMEs dollar debt vs LC debt (cont'd)

- Cross-country heterogeneity and time variation

US dollar and local currency share in total debt[1]

As a percentage of total debt outstanding

Graph 5

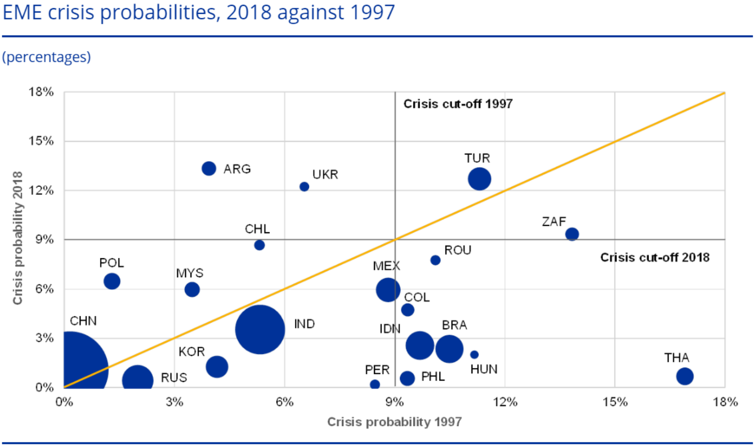


[1] Dates correspond to the fourth quarter of 2005 and 2019. Total debt represents the total outstanding amount of bonds and syndicated loans in the Dealogic dataset.

Source: Avdjiev, Burger & Hardy (2024)

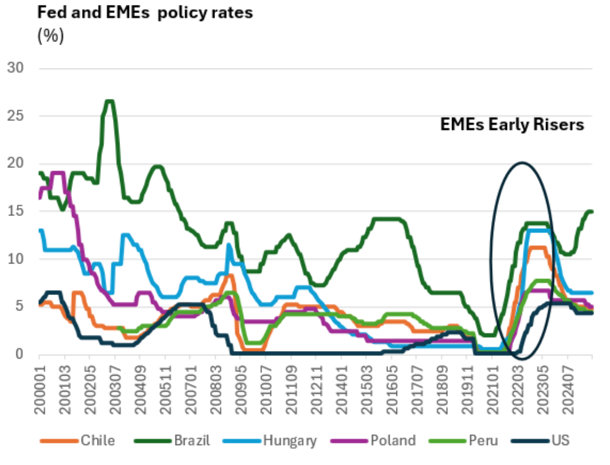
Observation #2: EMEs heterogeneity & the synchronicity assumption

- EMEs heterogeneous in several dimensions



Source: Chițu & Quint (2018)

Observation #2: EMEs heterogeneity & the synchronicity assumption (cont'd)



Source: Haver Analytics.

Observation #3: Empirical validation of the bottleneck externality

- Stylized facts to ground the bottleneck externality mechanism

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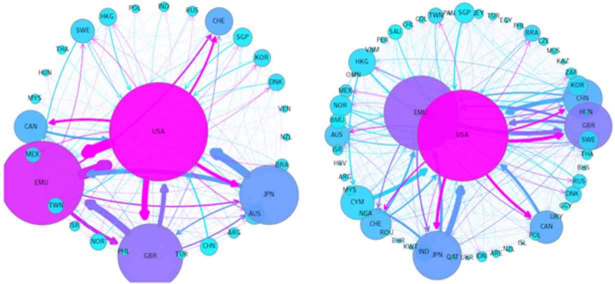
- Stylized facts to ground the bottleneck externality mechanism
- Capital flows are mostly West-West

TIME VARIATION IN NETWORKS: FINANCE (PF ASSETS), 2000 VS 2018

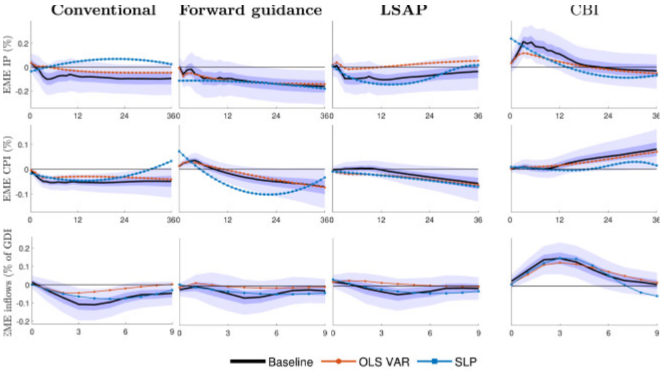


∘ Includes private & official cross-border investment in Eqy + Debt securities

Source: Miranda-Agrippino, Nenova & Rey (2023)

Observation #4: Spillovers to EMEs from multi-dimensional US monetary policy - the empirics

- EME output, consumer prices and inflows fall in response to conventional policy, forward guidance and LSAP tightenings and rise in response to CBI effects
- No monetary policy trade-off in terms of stabilizing output or prices emerges in EMEs conditional on Fed policy tightenings
- Trade-off between macroeconomic stabilization and preserving financial stability: if EME monetary policy were to loosen in order to dampen the contractionary effects on real activity and consumer prices, this might discourage foreign investors and exacerbate the drop in EME inflows



Source: Georgiadis & Jarocinsky (2025)

Conclusion

- **Great paper on a timeless question!**
- **Elegant model with novel theoretical contribution**
- **Benefits from adding empirical grounding**