

Globalization and Monetary Policy

Riksbank Seminar on Globalization

Stockholm, August 15, 2006

Kenneth Rogoff, Harvard University

Overview

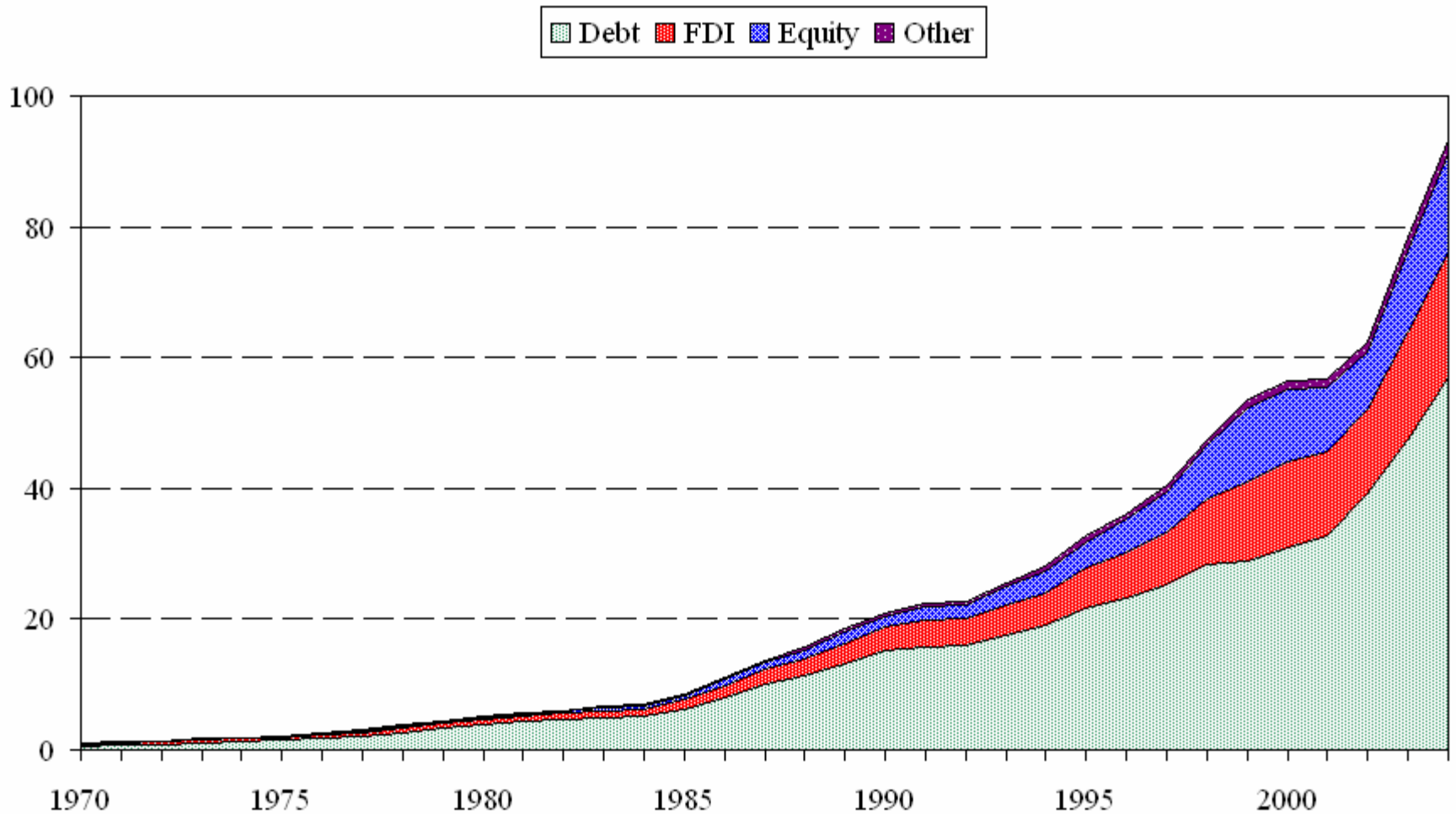
- The Backdrop: Globalization has provided a healthy milieu for monetary policy
- Important impacts
 - Is China exporting deflation (for now)?
 - Effects of Greater Flexibility, Competitiveness
- Output volatility is down dramatically
- But financial volatility persists. Why?
- Has financial globalization helped emerging markets?

PRESENTATION DRAWS ON

- Rogoff, Kenneth, 2006. *The Globalization of Monetary Policy*, Manuscript prepared for Yale University Okun Lectures, August.
- Kose, Ayhan; Prasad, Eswar; Rogoff, Kenneth and Shang-Jin Wei, 2006. “Financial Globalization: A Reappraisal.” International Monetary Fund Working Paper, August, forthcoming.

Globalization has proceeded at an accelerated pace the last two decades, especially post 1995, and especially financial globalization

Figure 1. Gross International Financial Assets and Liabilities: 1970-2004
(trillions of U.S. dollars)
Advanced Economies



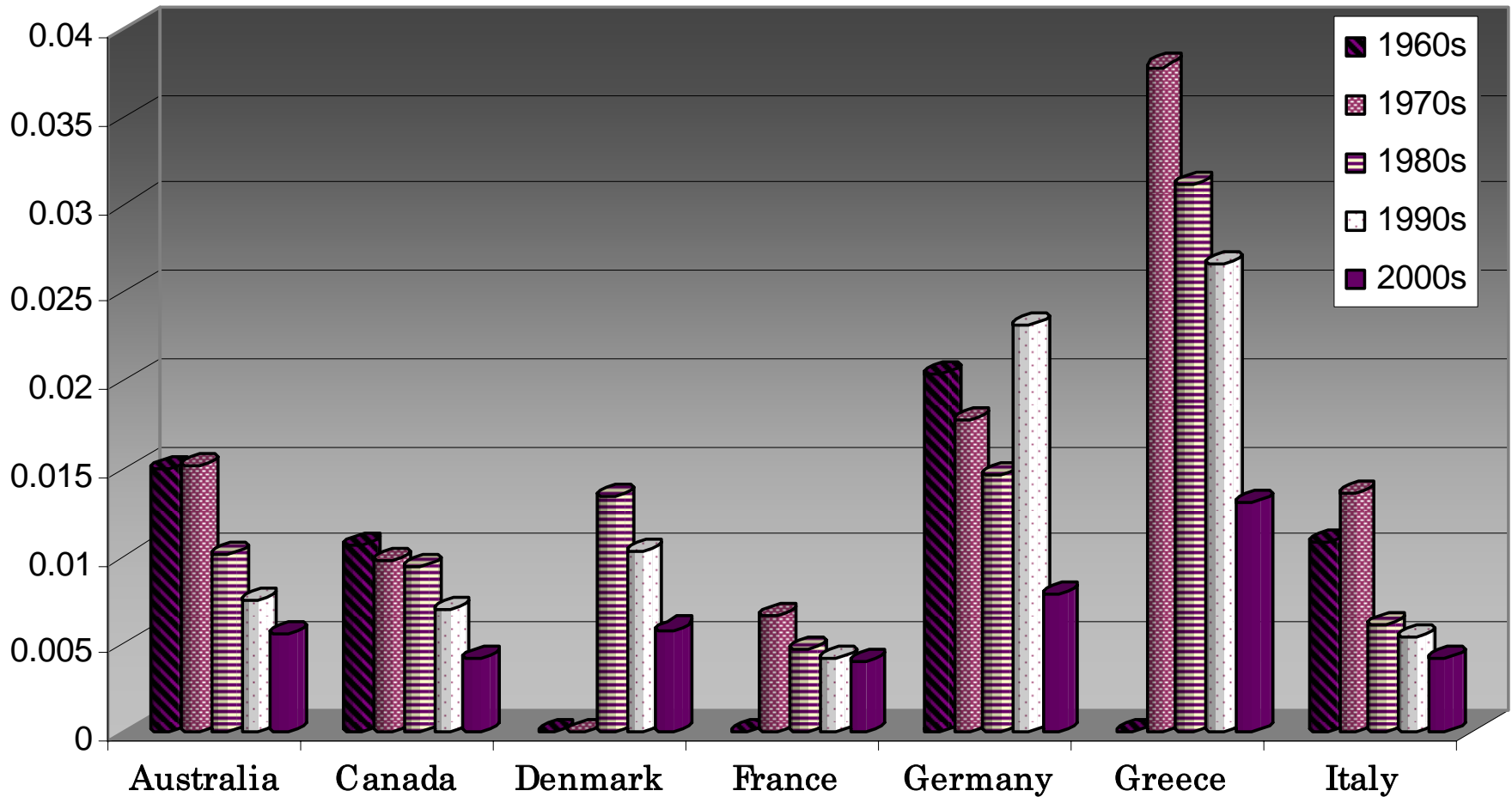
Source: Kose, Prasad, Rogoff and Wei, 2006

The globalization era, especially the last fifteen years, has coincided with spectacular outturns for inflation (well known) and output stabilization (less well known)

The Great Moderation in Inflation Levels

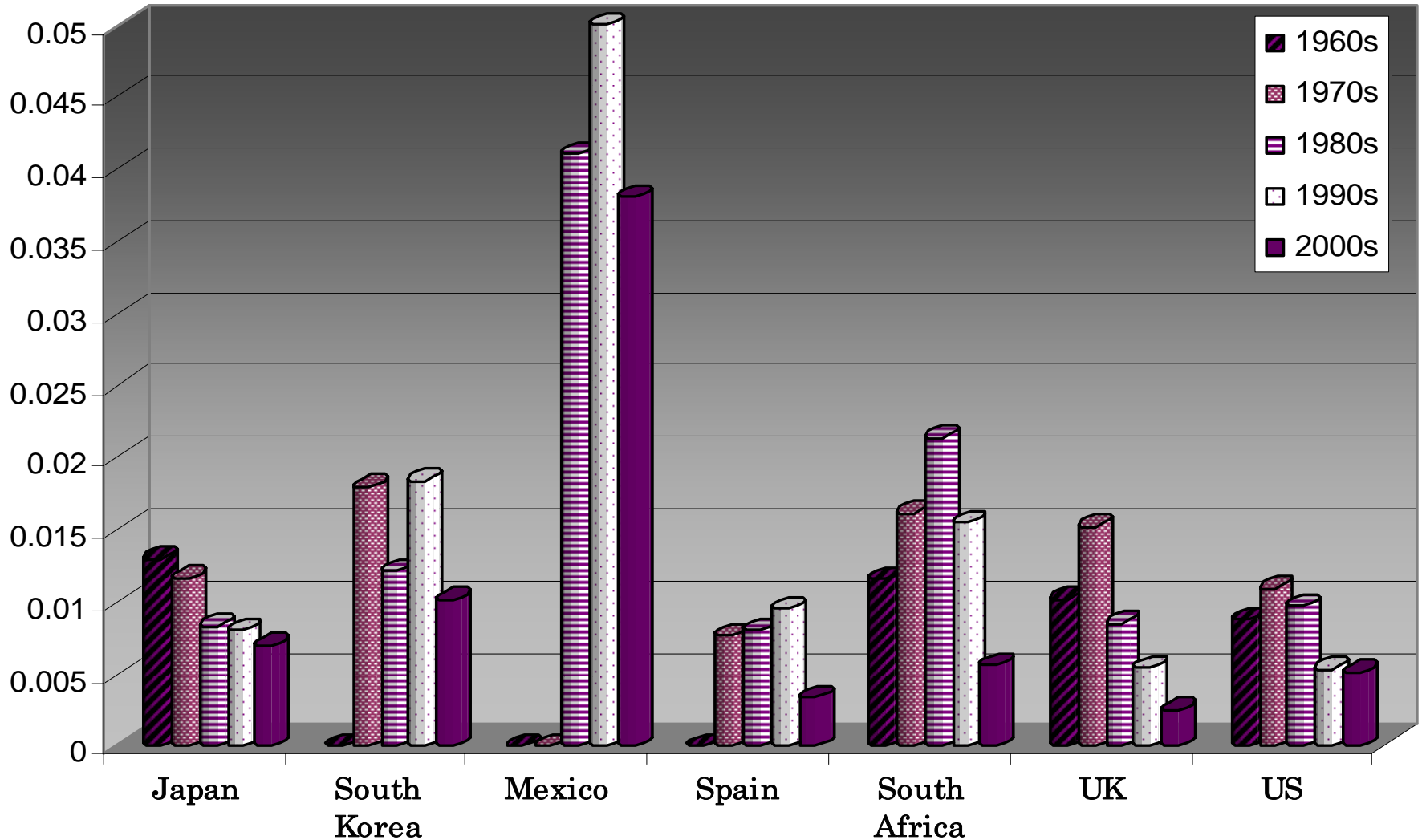
	80-84	85-89	90-94	95-99	00-04	2005-06
World	14.1	15.5	30.4	8.4	3.8	3.6
Industrial economies	8.7	3.9	3.8	2.0	1.9	2.3
Developing countries	31.4	48.0	53.2	13.1	6.3	5.4
Africa	16.8	17.9	39.8	20.6	10.6	8.8
Asia	9.0	11.5	10.5	7.3	2.7	3.7
Central/E. Europe	20.8	31.6	84.5	36.5	14.4	4.5
CIS and Mongolia	2.8	1.4	383.9	66.8	16.1	11.3
Latin America	82.4	185.9	232.6	17.2	7.7	6.0
Middle East	18.6	22.5	30.4	29.6	6.6	8.6

Output Growth Volatility by Decade: The Great Moderation



Standard deviation of quarterly log output changes. Source: Rogoff, 2006 8

Output Growth Volatility by Decade: The Great Moderation



Standard deviation of quarterly log output changes.. Source: Rogoff 2006

Many factors have contributed to the moderation in output volatility

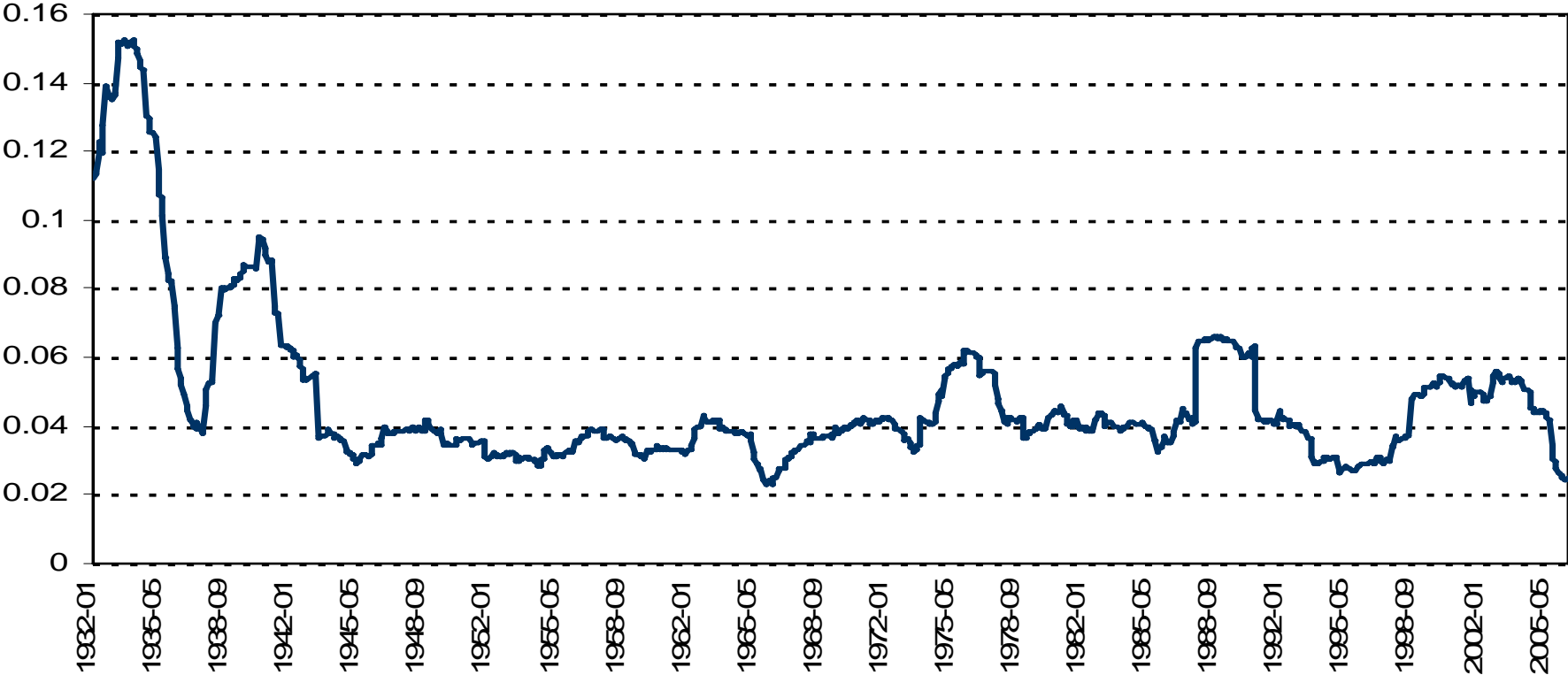
- Improved inventory techniques (McConnell and Perez-Quiros, 2000)
- Better Monetary Policy, More Independent Central Banks (Bernanke, 2004)
- Dumb luck (Stock and Watson, 2002)
- Better Financial Regulation, Deeper Financial Markets (Dyman, Elmendorf and Sichel, 2006)
- Demographics (Jaimovich and Sir, 2006)
- Lower rate of war and civil war, end of cold war (Rogoff, 2006).

But has asset price volatility
come down as fast as
uncertainty in the
real economy?

Monthly Stock Market Return Volatility, 1932-2005

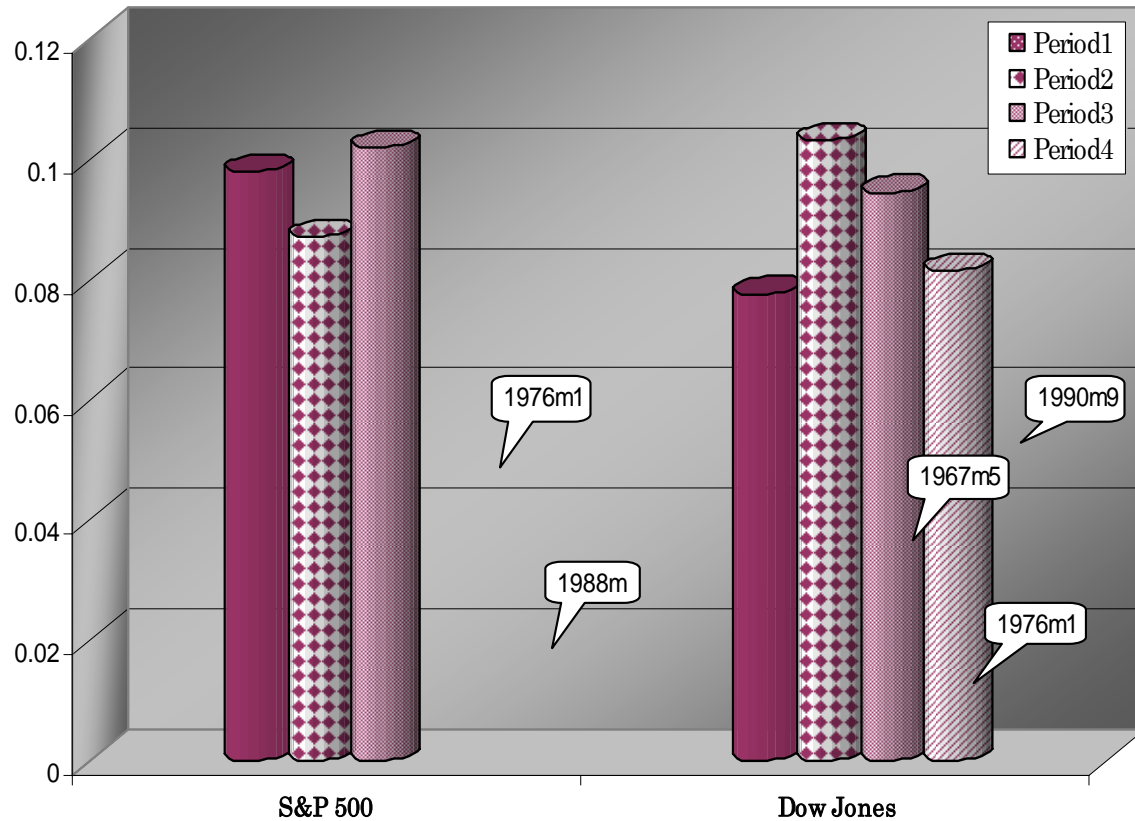
Great moderation?

Dow Jones



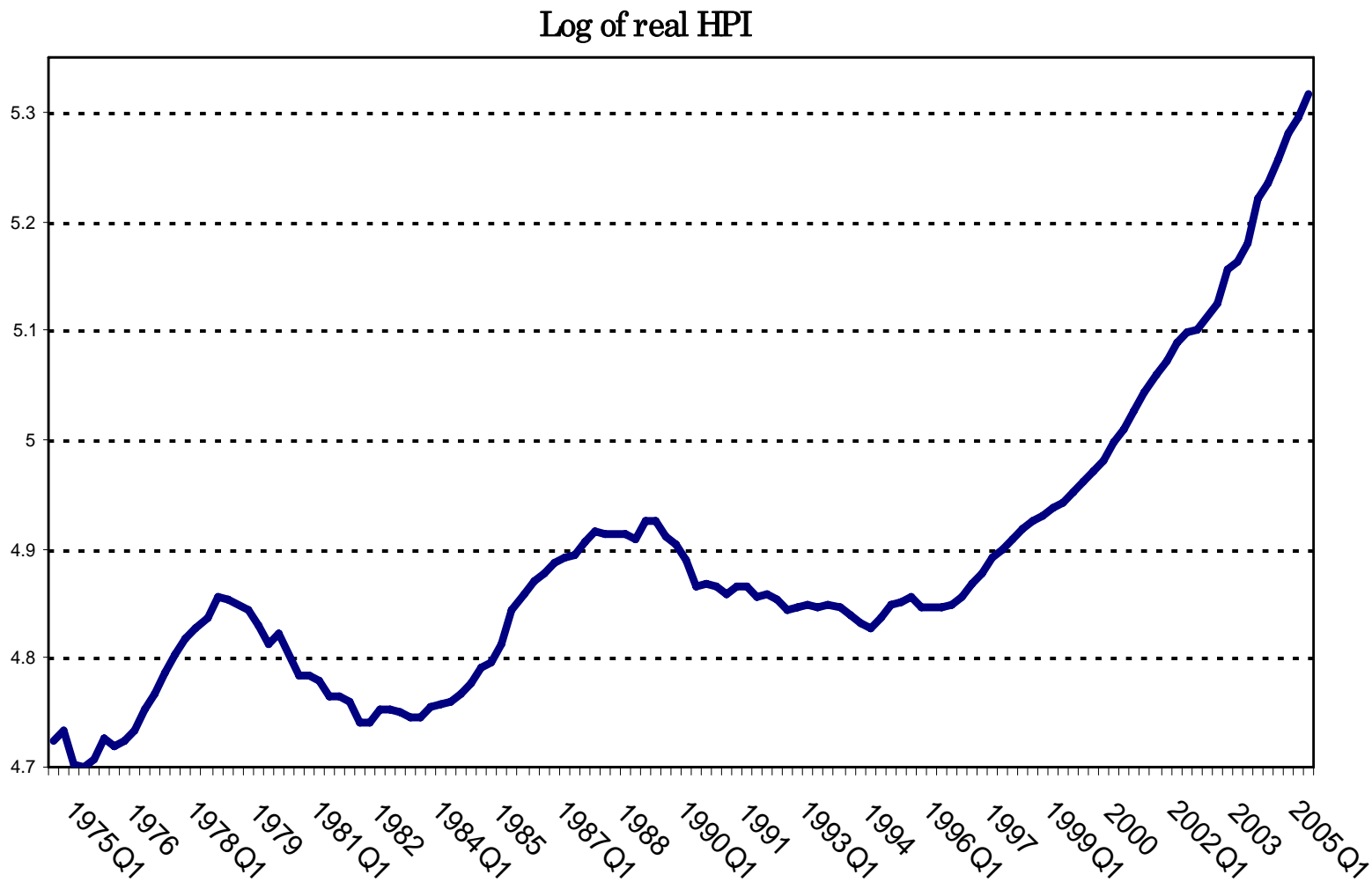
Source: Rogoff 2006

BREAKS IN STOCK MARKET VOLATILITY



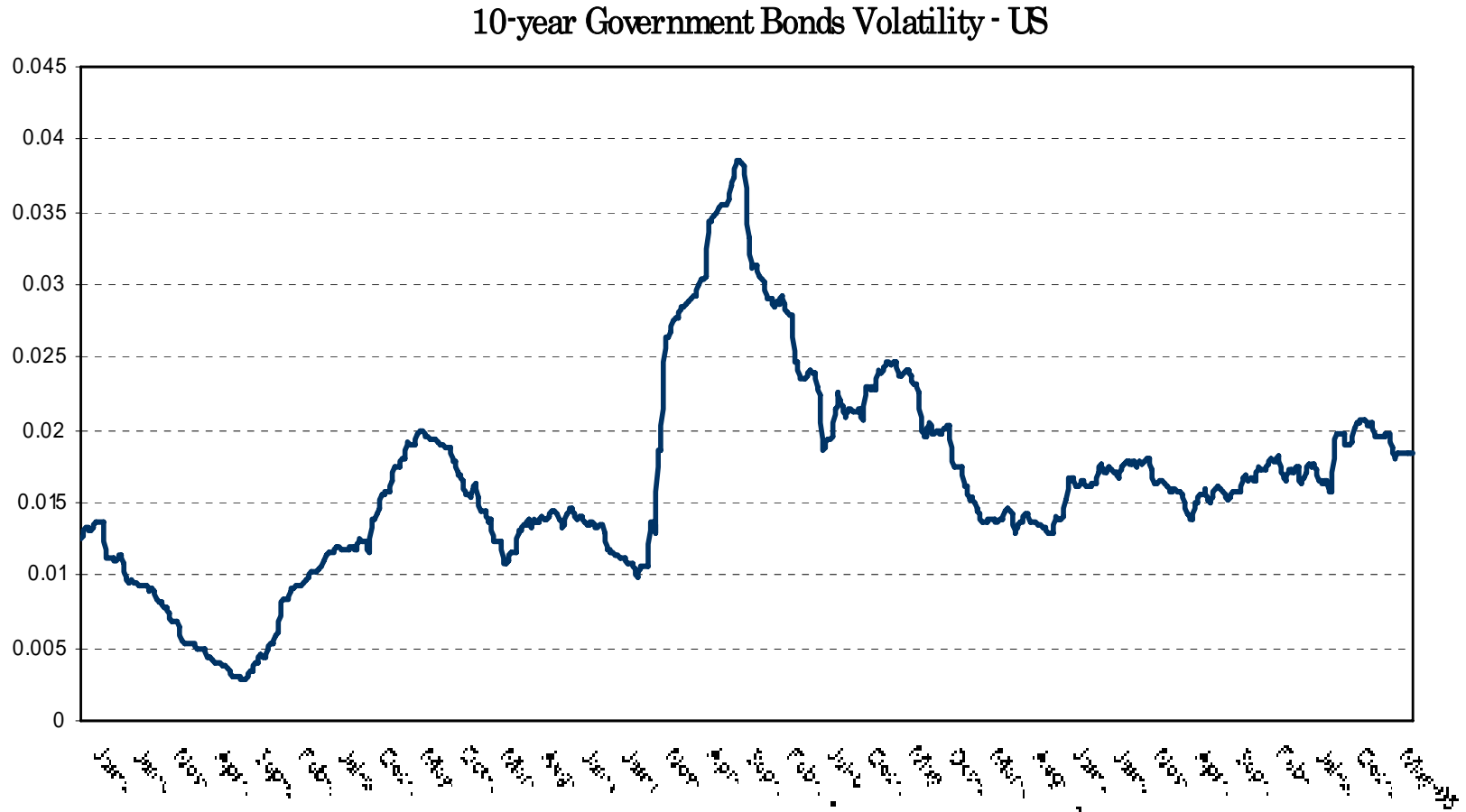
Note: Volatility is measured as the st. dev. of the deviation of the natural log of the stock market index from its HP-filtered trend. Results from Bai-Perron test for multiple structural breaks of unknown timing, see Rogoff, 2006

Housing Price Volatility: Is this Moderation?



Source: Rogoff, 2006

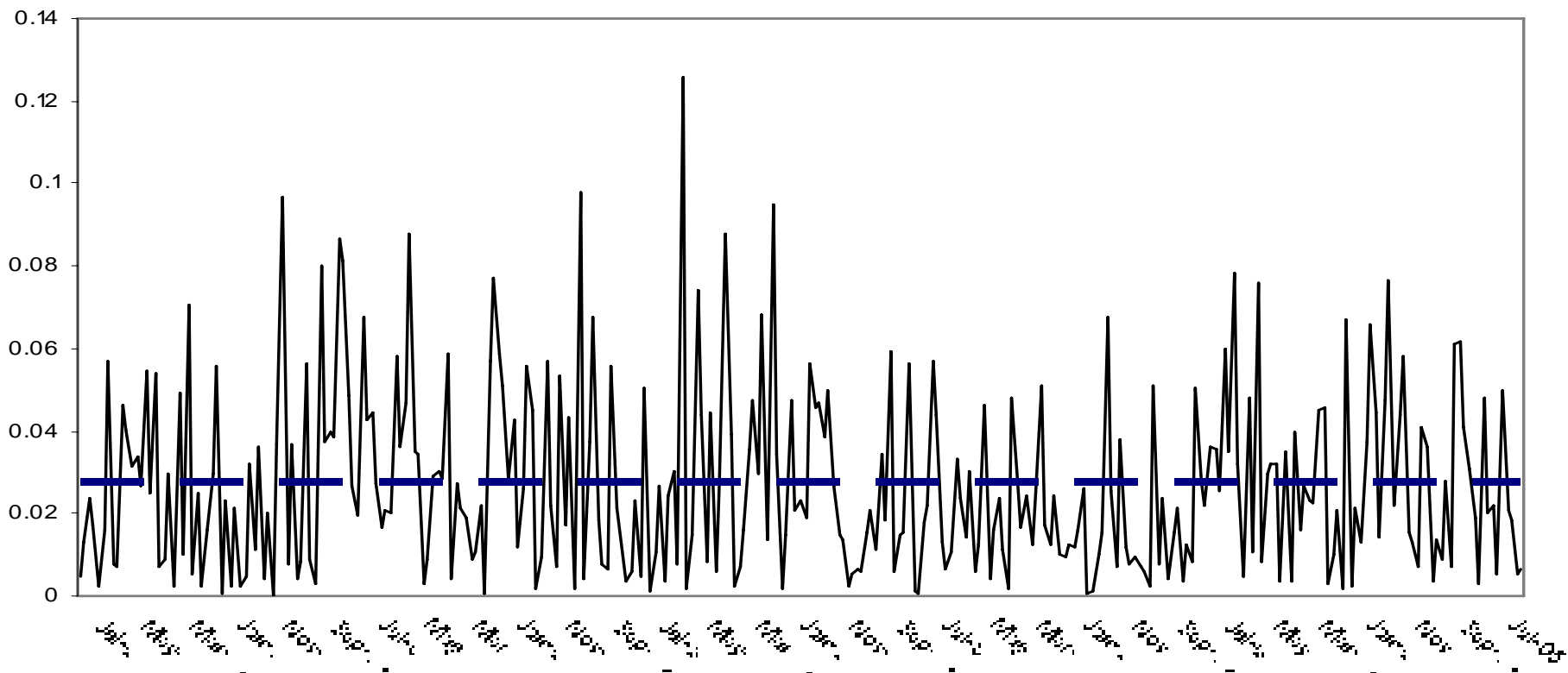
Volatility of Monthly Returns on 10-year US bonds



Source, Rogoff 2006

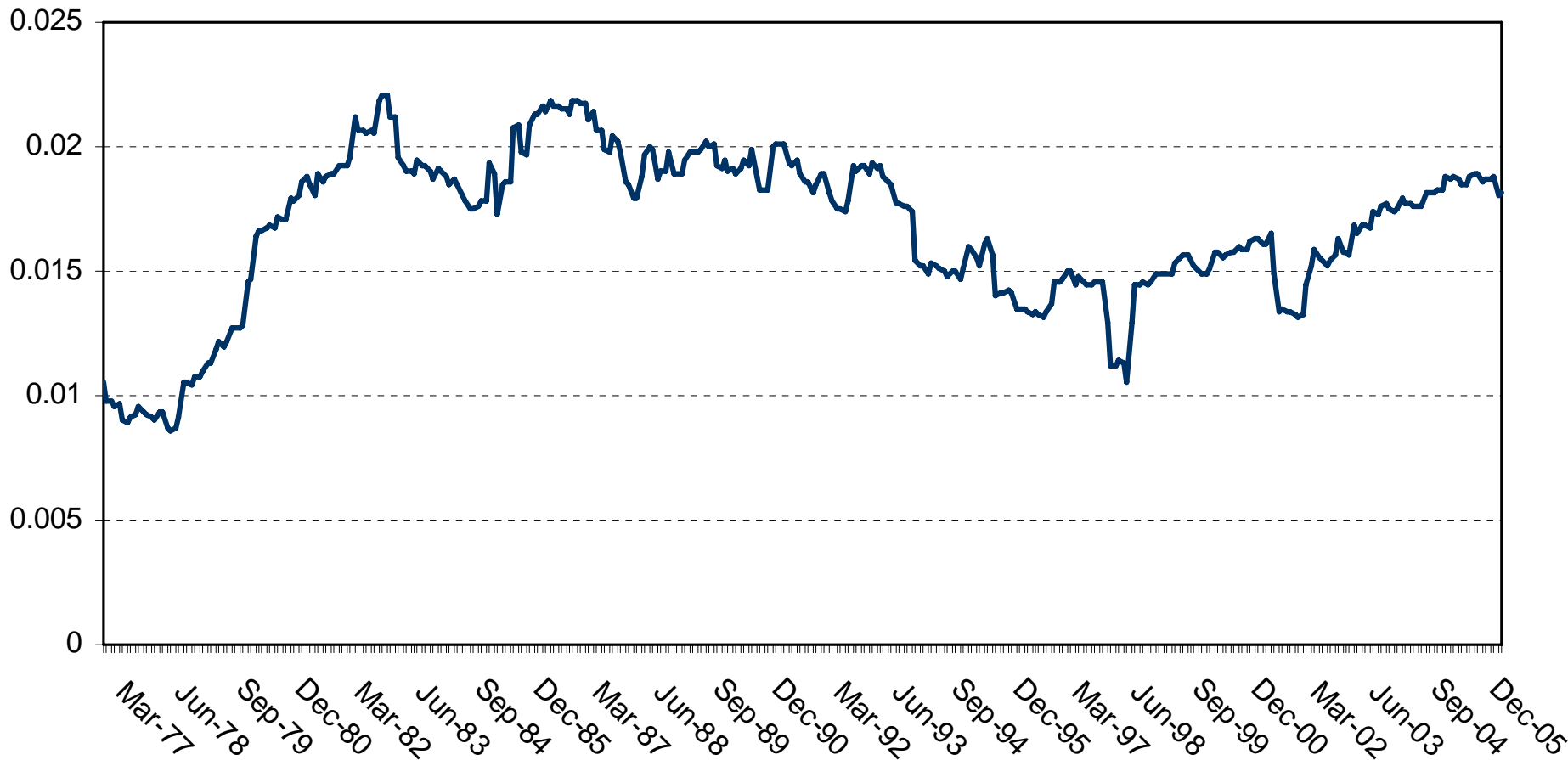
Estimated Euro/Dollar Volatility, 1980-2006: No significant break (Bai-Perron test)

Real EUR/USD



No obvious break in trade weighted real dollar volatility

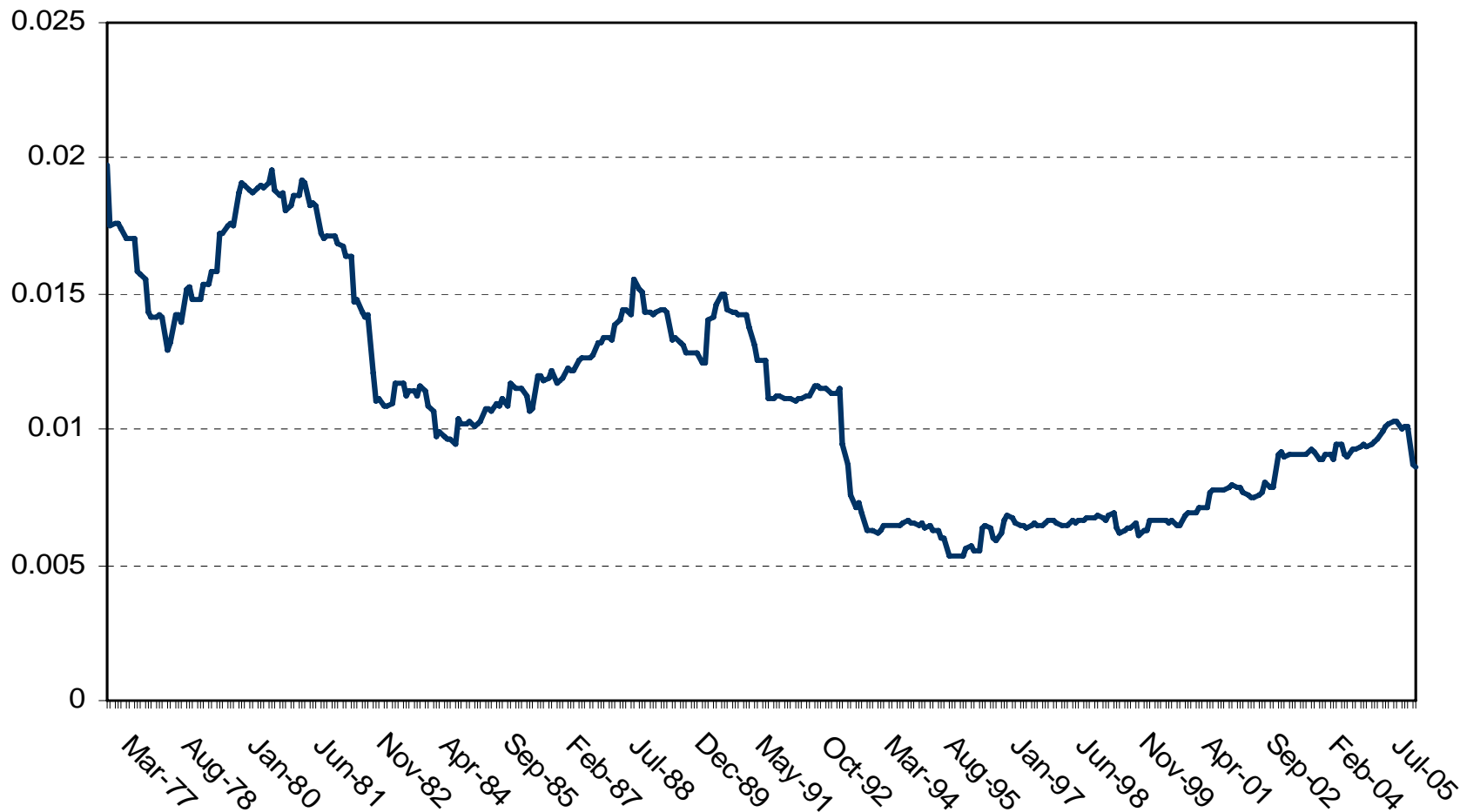
US - Real Major Currencies Index Volatility



Rolling 36 month standard dev.of log exchange rate changes; Rogoff 2006¹⁷

But clear breaks in terms of trade volatility for most trade weighted exchange rates

US Terms of Trade Volatility



Source, Rogoff 2006

ISSUES FOR MONETARY POLICY

- *Is China exporting deflation – or inflation?*
- *Globalization's Deeper and More Durable Impact on Inflation: Rogoff (2003)*
- *Should Central Banks Be Focusing More on Global Excess Capacity when Forecasting Domestic Inflation Trends?*
- *What if Globalization goes into reverse?*
- *Global Real Interest Rate and Asset Price Convergence*

Other issues

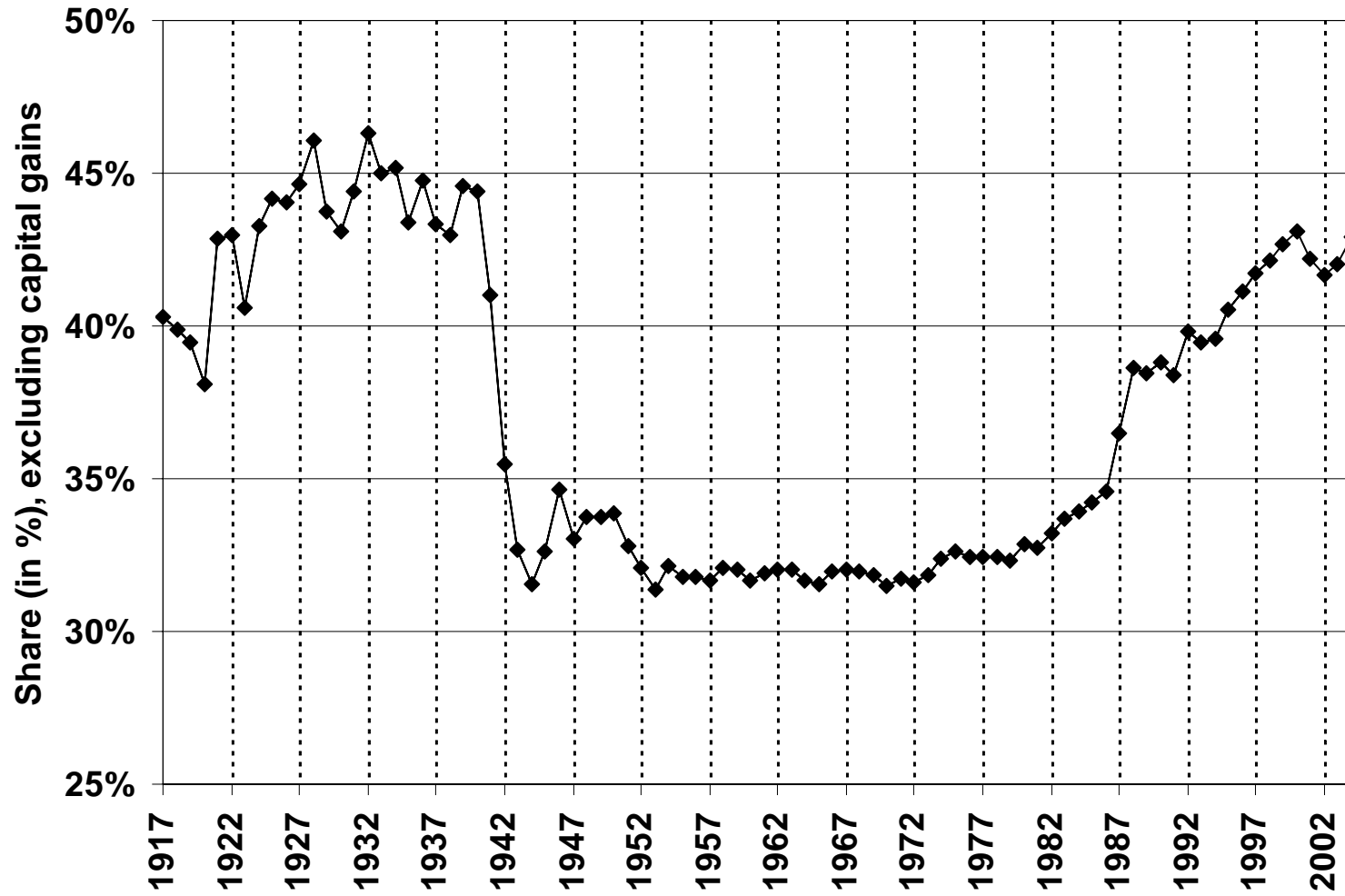
- Should central bank include exchange rate in monetary targeting rule? Continuing academic debate. (Likely answer: No, it behaves too much like an asset price, too little information content.)
- What about including terms of trade in the inflation targeting rule? Academic debate shifting towards **yes**, but many technical issues, still difficult to make systematic.)

How to handle real economy asset price volatility disconnect

- Many causes, of which central bank policy is only one. A larger reason is inflated asset prices due to great moderation.
- PS: What about global imbalances?

Wage and Income Trends: A worrisome and important caveat

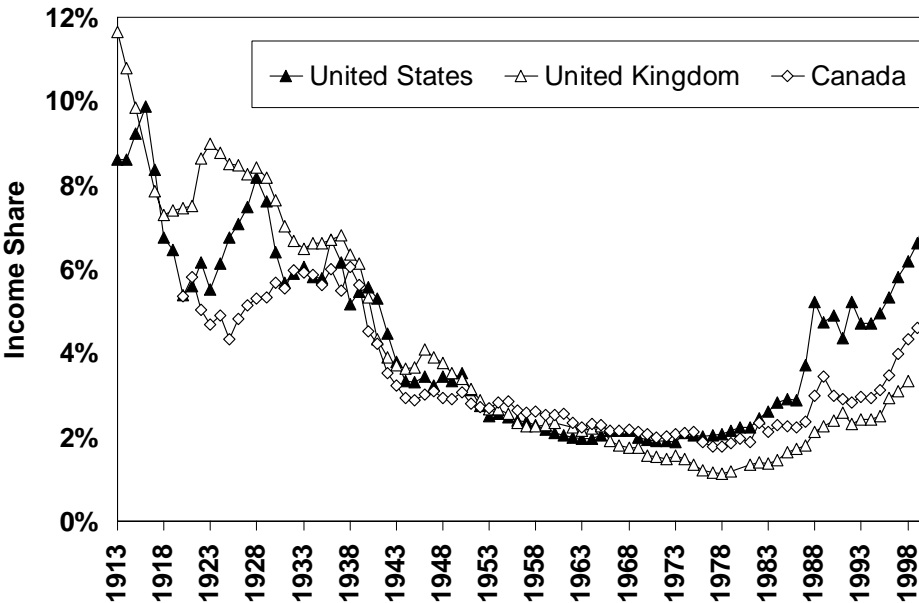
Top 10% Total Income Share for US



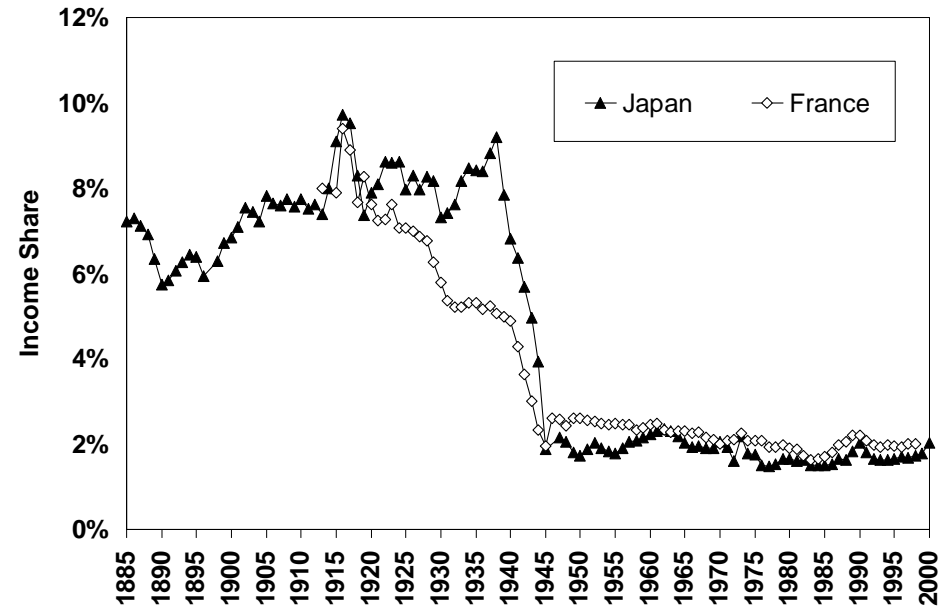
Source: Rogoff, 2006, from Piketty and Saez data set

Pattern Similar for English Speaking Countries, Differs Elsewhere

A. Top 0.1% income share in English Speaking Countries



B. Top 0.1% income share in France and Japan



- Around Great Depression, top income shares declined significantly in most large countries; Ireland and Switzerland did not see similar decline at that time (not pictured)
- Only some of developed countries, however, have seen increase in top income shares since 1980s (Netherlands, France, Japan, etc. all look same)

Source: Rogoff, 2006

What about financial globalization and emerging markets?

- Overwhelming weight of evidence suggests that trade integration is beneficial (Rodrik 2002 is a contrarian view)
- More debate on financial globalization
- **New view:** Indirect POTENTIAL benefits far outweigh direct benefits Kose, Prasad, Rogoff and Wei (2006), Gourinchas and Jeanne (2006)

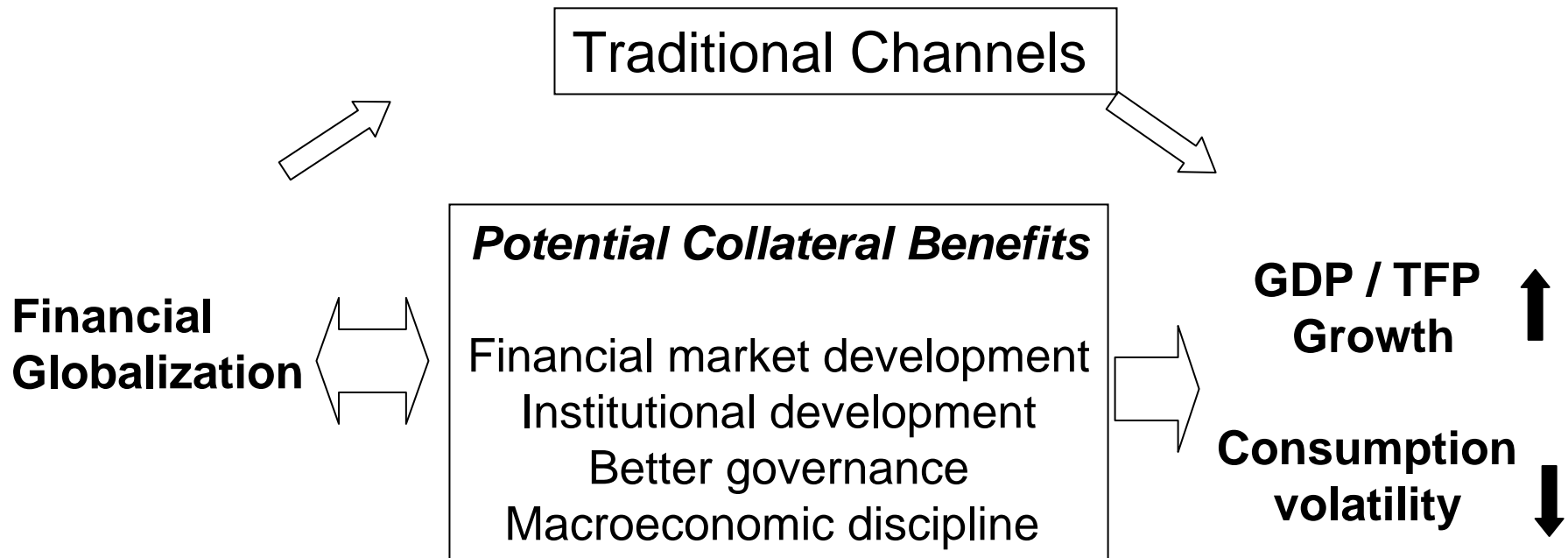
The Traditional View



The traditional view focuses on the importance of channels through which capital flows could directly increase GDP growth and reduce consumption volatility.

Taken from Kose, Prasad, Rogoff and Wei, 2006

A Different Perspective



Newer perspective (e.g., Kose, Prasad, Rogoff and Wei, 2006) sees main role of financial globalization as a catalyst for certain collateral benefits that increase GDP/TFP growth and reduce consumption volatility only indirectly, and only if certain preconditions are met. Short run pain, long run gain?

Conclusions

- Globalization has generally provided a very healthy milieu for monetary policy, to which strong independent central banks have contributed.
- Challenges: How to deal with continuing asset price sensitivity, how to incorporate terms of trade shocks into monetary rules.
- Question: How important are policies to reduce asset price volatility as opposed to volatility in underlying real economy and inflation?

Caveats

- Issues are more subtle and complex for emerging markets and developing countries though direction of change needed is clear
- Pressure on wages and worker's shares of income may last for another decade – or more --placing pressures, raising important equity questions and placing pressures on political support for continuing globalization.