FOCUS · Diverging monetary policy in the emerging economies

Since the financial crisis in 2008, the central banks from the developed economies have dominated monetary policy debate while the actions of their emerging counterparts have taken second place. This article looks at monetary policy in the emerging countries.

Over the past decade, the trend in monetary policy in the emerging economies, measured as the average central bank interest rate for 20 developing countries, has gone through four major phases. A first phase, from October 2008 to mid-2010, when emerging monetary policy was generally and substantially accommodative in response to the financial crisis and relatively weak inflation. A second phase, between the second half of 2010 and the end of 2011, when strong inflationary pressures, with inflation close to 7% for the emerging economies as a whole, forced most emerging central banks to make a radical shift towards more restrictive policies. But this restrictive phase soon reversed when inflationary pressures waned between 2012 and 2013. Finally, since mid-2013, their stance has become slightly restrictive again.

The relatively stable trend observed overall since 2013 nevertheless hides considerable divergence between the emerging economies. Analysed by region, the monetary policy of the main emerging blocs followed a similar path from the outbreak of the financial crisis up to 2013. But as from 2013 emerging monetary policy has clearly diverged, with a more restrictive stance in Latin America and more accommodative approach in Eastern Europe, while Asian monetary policy tended to be restrictive until the end of 2014 and more expansionary afterwards (see the chart).

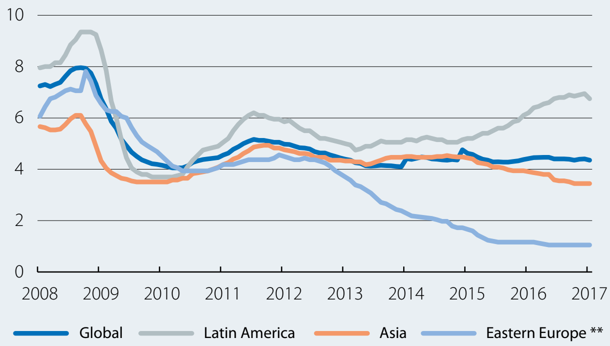
One of the main reasons for this divergence is diminishing global shock caused by the 2008 financial crisis. It is also quite significant that this divergence coincides with the taper tantrum of May 2013, perhaps an early sign that the repercussions of the financial crisis for the global economic cycle were starting to fade.

Such divergence is mainly due to two factors. It reflects monetary policy divergence between the developed bloc's two main central banks and the subsequent impact on their different areas of influence. The Fed's restrictive stance, announcing tapering in 2013, has pushed up the official interest rates of Latin American central banks while the ECB's maintenance of a highly accommodative stance has pushed down official interest rates in Easter Europe. Beyond these external influences, however, the divergence between each country's cyclical conditions is also a factor. The inflation trend in the different regions particularly justifies this divergence of monetary policy within the emerging bloc. Since 2013, contained inflation in Asian and Eastern European countries (except for Russia) has provided space to implement more accommodative monetary policy. On the other hand, the reappearance of inflationary pressure in Latin America as from 2014 has justified keeping a restrictive policy, while the recent shift in stance towards slight accommodation is due to the region's more moderate inflation. In real terms, interest rates in the different regions have therefore remained quite similar.

Continued divergence between the Fed's and ECB's monetary policies in the future will keep emerging monetary policy divergent to some extent. But the synchronicity of real interest rates over the past years suggests that the dominant factor should be shifting inflation dynamics, which will tend to fall in Latin American countries and speed up in Asian and especially Eastern European countries. This will help emerging monetary policy to converge again over the next few years.

Emerging monetary policy index *

(%)



Notes: ** Simple average of 20 emerging central bank interest rates (Brazil, Chile, China, Colombia, South Korea, Philippines, Hungary, India, Indonesia, Israel, Malaysia, Mexico, Peru, Poland, Czech Republic, Romania, Russia, South Africa, Thailand and Turkey).*
*** Not including Russia.*
Source: *CaixaBank Research, based on data from Bloomberg.*