Strategic Macroprudential Policy Setting in Emerging Economies: When Cooperation Pays Off?

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Abstract

I study the usefulness of coordinated macroprudential policy frameworks for emerging economies. Specifically, I look for the long-run gains of cooperative regimes and whether these can shield the emerging economies from external shocks. For this, I set an open economy model of banks with financial frictions in an environment with multiple emerging economies and a center. I verify the cross-border policy effects and the new policy incentives under cooperation, then, I perform a welfare comparison of a number of policy regimes that vary by the degree of cooperation and explore their short-run performance. The results suggest that not every type of cooperation is beneficial with respect to nationally-oriented policies. Instead, only schemes where the financial center acts cooperatively would generate welfare gains. Two mechanisms generate the gains: a cancellation effect of national incentives to manipulate the global interest rates and a new incentive to substitute local with foreign intermediation at the Center. Both channels will improve the financial stability and the second will increase the efficiency of the capital flows. Finally, the short-run dynamics show these mechanisms allow for a better performance of the peripheries after a shock while generating leverage dynamics that favor a faster global recovery.

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