Secular Stagnation and Asia: International Transmission and Policy Spillovers

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Introduction

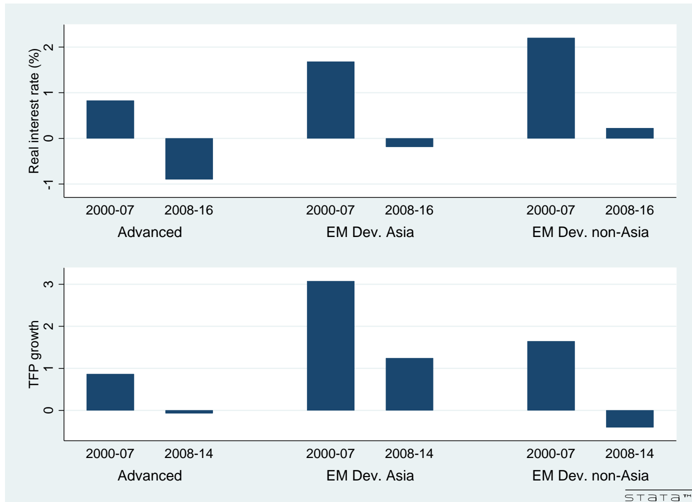


Figure: Pre- and post-crisis real interest rate and TFP growth

Structure

Is secular stagnation contagious?

- Theory
- Interest rates and credit
- Productivity

I use the global financial crisis as a "natural experiment" where transmission was from the countries at the epicenter of the banking crisis to the rest of the world

Theory

Theory (model in the paper)

- Consider a small open economy that is an "innocent bystander" affected by foreign secular stagnation (fall in foreign interest rate and in foreign growth)
- Optimal response: net capital inflows (or reduction in net outflows), lower real interest rates, increase in domestic credit
- These "spillovers" are part of a desirable adjustment
  - demand for home GDP must be rebalanced from external to domestic
- But they might have problematic side effects
  - zero lower bound and liquidity trap
  - credit growth might be excessive

Interest rates and credit

Nominal interest rates before and after the crisis

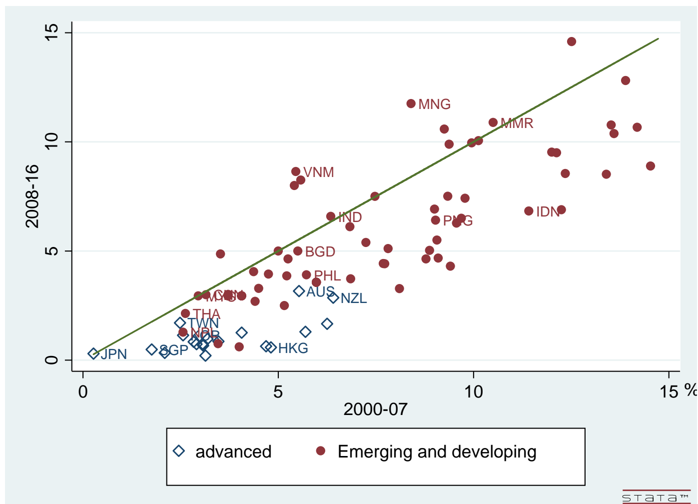
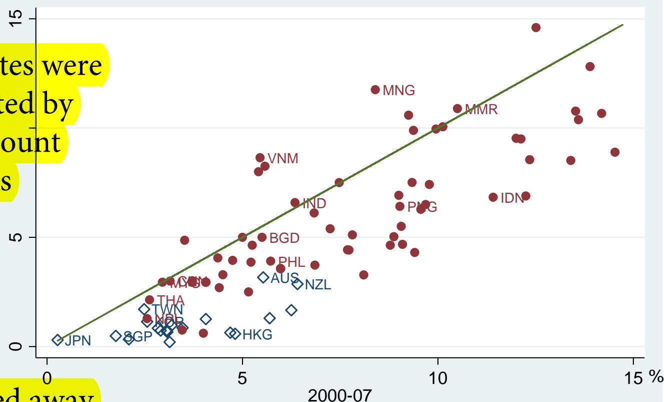


Figure: Pre- and post-crisis interest rate (percent)

Interest rates and credit

Nominal interest rates before and after the crisis



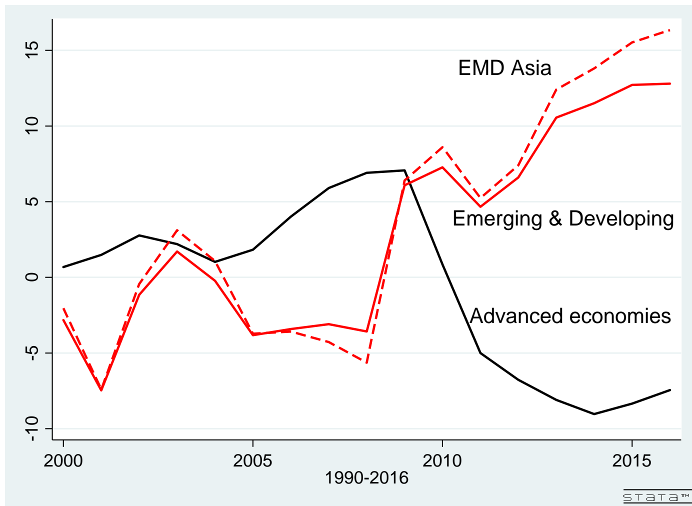
Interest rates were not insulated by capital account restrictions

EMDs stayed away from zero bound thanks to higher real interest rates before the crisis

Interest rates and credit

Credit: the big shift

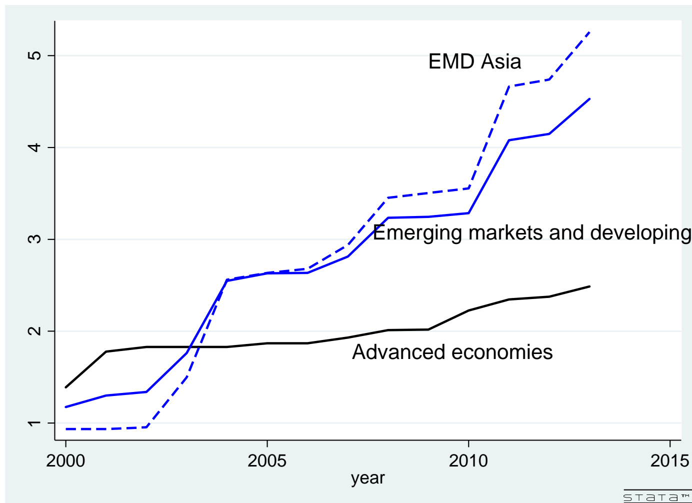
Figure: Credit gap (percent, GDP-weighted, source: BIS)



Interest rates and credit

Macroprudential policy

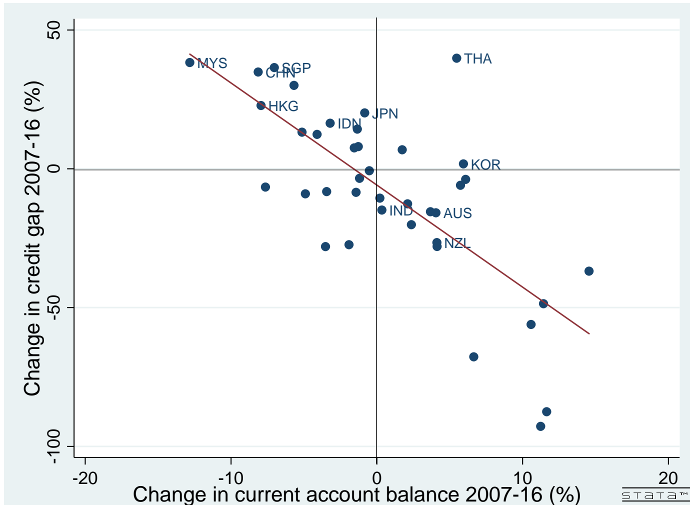
Figure: Macroprudential intensity (Cerrutti, Claessens and Laeven 2015)



Interest rates and credit

Credit growth and demand rebalancing

Figure: Current account balance and credit gap (percent, BIS)



Productivity

- TFP growth fell in emerging markets and developing countries at the time of the global financial crisis: this is difficult to explain by domestic sources of secular stagnation
- Was there transmission through finance or trade channels?
- If there was, countries should be differently affected depending on their openness to capital flows or trade
- In my cross-country regressions the measures of international financial and trade integration are all orthogonal to TFP outcomes
- Falling TFP growth remains a mystery

Conclusion

- Fine line between desirable demand rebalancing and undesirable spillovers
- Demand rebalancing was associated with large changes in domestic credit
    - too large?
- Not clear that the appropriate response is international cooperation or capital flow management
- How can one make demand less debt-creating?
- If this problem cannot be solved then current account balances should be kept small