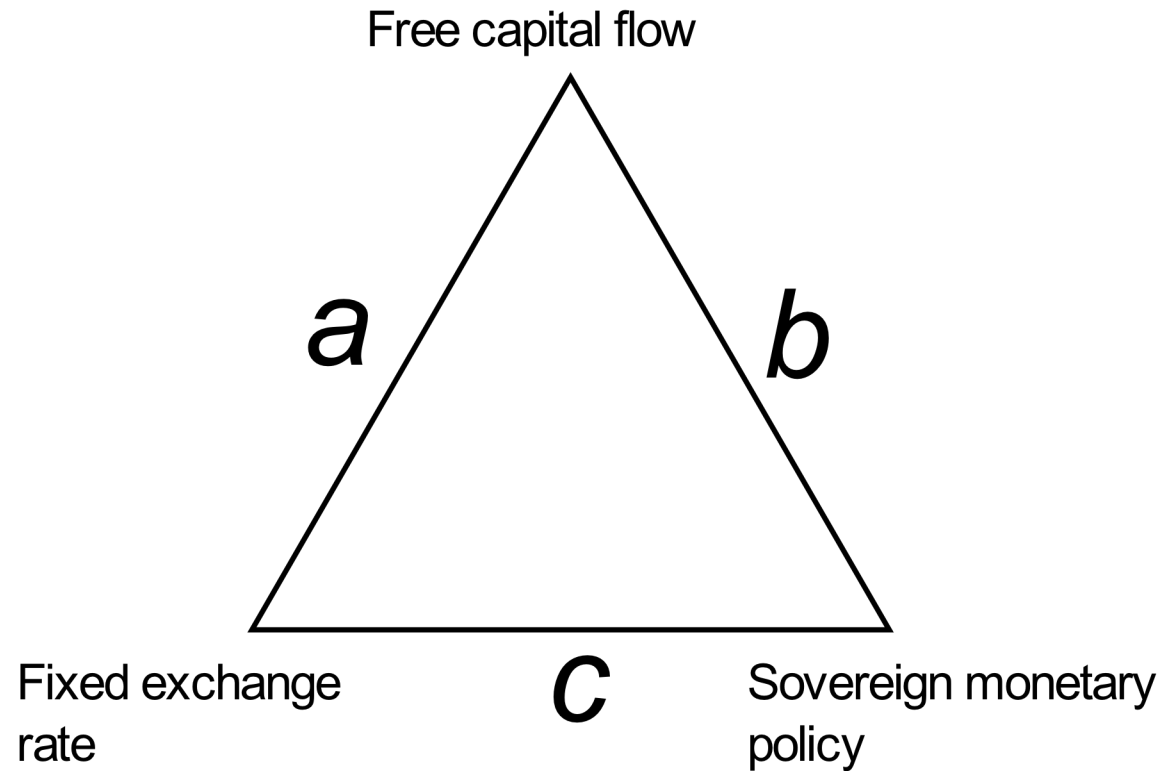


Monetary Policy Spillovers & Optimum Currency Area

Yu Gao

Impossible trinity



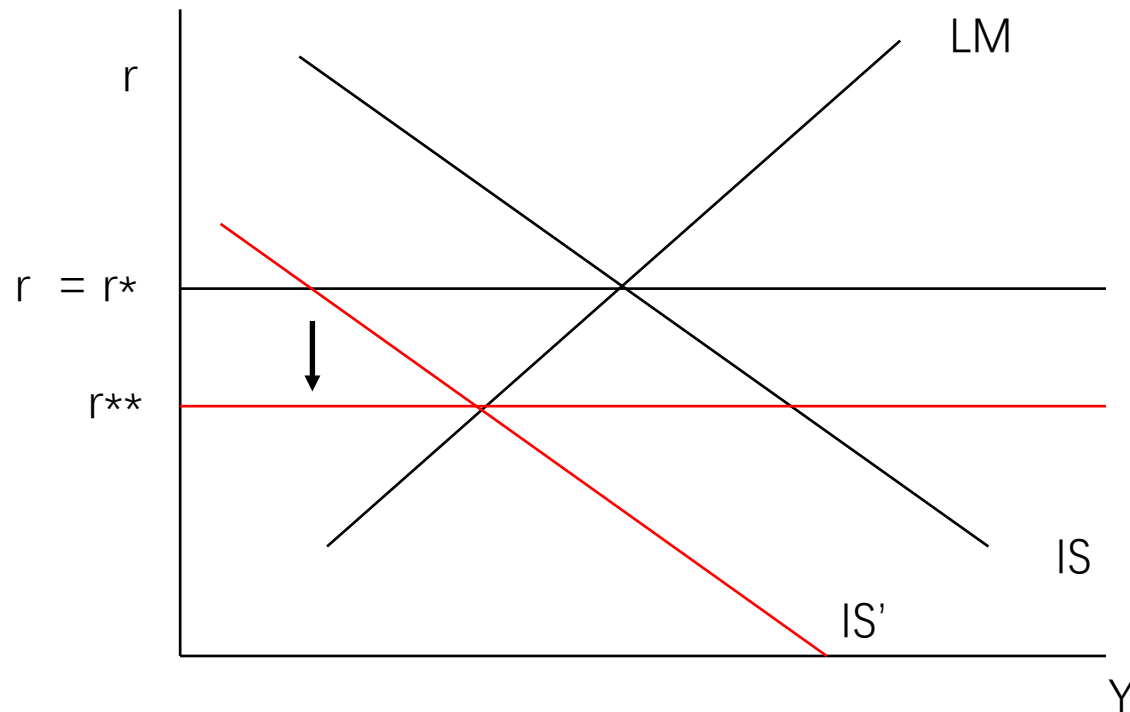
- Mexican Peso Crisis (1994 – 1995)
- Asian Financial Crisis (1997 – 1998)
- Argentine Great Depression (1998 – 2002)

MP Spillovers: Channels

- Exchange rate channel
- Domestic demand channel
- Financial spillovers channel

MP Spillovers: Exchange Rate Channel

- Mundell-Fleming model and its implications



- Country A (small open economy)
- Country B
- Exchange rate not fixed
- Open capital account
- Expansionary MP in country B

Expenditure-shifting effect

MP Spillovers: Domestic Demand Channel

Country A

Exports ↑

GDP ↑

Country B

Domestic demand ↑

Imports ↑

Expenditure-increasing effect

MP Spillovers: Financial Spillovers Channel

Country A

Investment ↑

GDP ↑

Country B

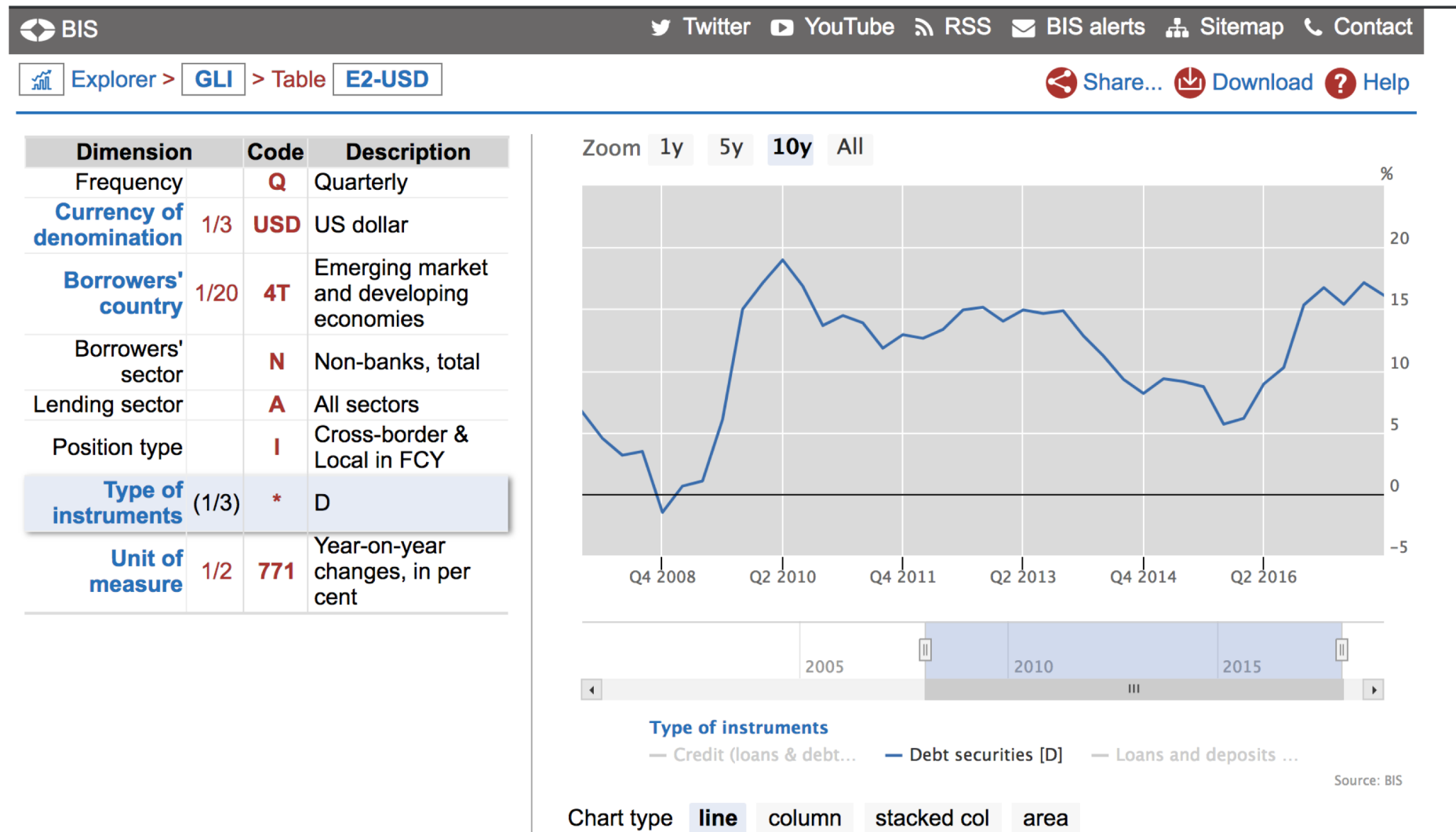
Expansionary MP

Yields on financial
assets ↓

Expenditure-increasing effect

MP Spillovers: Examples

- US
- EMEs



Optimum Currency Area (OCA)

- a geographical region in which it would maximize economic efficiency to have the entire region share a single currency

OCA: Four criteria

- common shocks
- symmetric shocks
- common responses
- idiosyncratic shocks

OCA: Benefits

- Currency convenience
- Transparency of prices
- Cross-border investment

- Additional benefits

OCA: Disadvantages

- No independent stabilisation, growth and other policies
- Common shock, common response
 - Eurozone debt crisis (2010)

OCA: Examples

- Eurozone
- US BEA regions:
 - New England, Mideast, Great Lakes, Rocky Mountains and Far West
 - Southeast, Plains and Southwest

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