Editorial

Monetary policy is back to the fore

Growth prospects for the emerging countries in 2020 (EC) have dimmed with the slowdown in export markets and the climate of uncertainty that reigns with the US-China trade war. This uncertainty has increased the volatility of portfolio investments since last summer, although external financing conditions are still favourable on the whole. The majority of countries have also eased monetary policy, and the pass-through of key policy rates to lending rates is functioning rather well. Yet private sector debt has risen sharply over the past decade, which could hamper monetary easing if credit risk were to rise.

Monetary policy to the rescue

For our selection of 26 emerging countries, real GDP growth hit a record low of only 4.1% year-on-year in Q2 2019, down from 5.2% one year ago. Excluding the financial crisis of 2008–2009, we must look back to 2001 to find such a weak performance. The main causes are the slowdown in export markets and the climate of uncertainty that prevails with the US-China trade war. Uncertainty has fuelled high volatility not only in EM exports, but also in portfolio foreign investments to EM. Yet external financing conditions have not tightened yet, with the exception of Argentina and Lebanon (for very specific reasons). Globally, spreads on sovereign external debt have tended to narrow since Q4 2018, while the ones for corporates have remained flat. Sluggish world growth is also straining commodity prices, which is helping to contain inflationary pressures. Against this backdrop, a large majority of central banks (16 out of 26) had initiated or continued to cut their policy rates at the end of September, compared to only 4 in 2018. The only exceptions are the central banks of the central and eastern European countries, where growth rates exceeded their long-term potential through H1 2018, triggering labour market pressures. Could monetary easing help buffer the impact of the slowdown in exports?

Limited manoeuvring room

Since year-end 2018, if we exclude mainland China (whose government sets the target for credit growth) and countries like Argentina, Brazil and Turkey, which have experienced volatile credit cycles, the growth of domestic bank lending has slowed in the emerging countries. For most countries, however, the effects of the current round of monetary easing have not been felt yet. This does not mean that the monetary policy transmission channel is functioning poorly or not at all. To the contrary, with the notable exception of India and Egypt, the apparent pass-through coefficient between the changes in policy rates and those of bank lending rates is rather elevated or very elevated, i.e. larger than 1 (see table).

Yet a bold monetary policy support, i.e. a decrease in the policy rate stronger than actual or anticipated disinflation, supposes that there exists some room of manoeuvre.

One way to measure the room of manoeuvre is to compare real interest rates with potential growth rate. Looking at key policy rates, few countries have very big differences (Mexico, Egypt and Russia). If we look at bank lending rates, in contrast, numerous countries have significant differences (South Africa, Brazil, Colombia, Turkey and, to a lesser extent, India and Indonesia). Yet a high real lending rate might also reflect a structurally high non-performing loan rate for certain types of credit, as is the case for cash loans and credit card loans in Latin America.

Lastly, private sector debt might also hamper monetary easing if it leads to a deterioration in credit risk. This is obviously the case in China *(see our analysis below)*. But many emerging countries, mostly in Latin America, have reported an increase of more than 50% in their bank lending to GDP ratios since 2010. In Asia, ratios have not risen as strongly, but they stood initially at a higher level. Turkey is a good illustration of an intermediate profile (a rapid rise starting from a relatively moderate level): in case of an external shock, past experiences show that credit risk would rise more rapidly than in countries with relatively heavy debt loads but more moderate credit growth.

Monetary policy stance

	Policy rate evolution	Monetary easing pass-through (*)		
			Date de début	Date de fin
Brazil	↘	103%	19/10/2016	31/05/2019
Chile	↘	162%	17/10/2013	31/05/2019
Colombia	→	81%	16/12/2016	31/05/2019
Mexico	↘	58%	08/02/2017	31/05/2019
China	↘	72%	30/12/2014	31/05/2019
India	↘	39%	14/01/2015	31/05/2019
Indonesia	↘	n.s	-	-
Malaysia	↘	n.s	-	-
Taiwan	→	n.s	-	-
Thailand	↘	63%	16/10/2012	18/12/2018
Poland	→	111%	07/11/2012	31/05/2019
Hungary	→	110%	27/08/2012	31/05/2019
Czech Republic	↗	-	-	-
Romania	→	119%	01/07/2013	31/05/2019
Turkey	↘	n.s	-	-
Russia	↘	116%	31/12/2014	31/05/2019
Egypt	↘	45%	21/02/2018	31/05/2019
Morocco	→	138%	22/09/2014	31/05/2019
South Africa	↘	n.s	-	-

(*) Lending rate change divided by policy rate change during the specified period

Source: IMF, Central Banks, BNP Paribas Group Economic Research

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