What Goes Around Comes Around: How Large Are Spillbacks From US Monetary Policy?

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Summary

The paper assesses the magnitude of spillbacks from US monetary policy based on structural scenario analysis and minimum relative entropy methods applied in a Bayesian proxy structural vector-autoregressive model estimated on data for the time period from 1990 to 2019. We find that spillbacks account for up to half of the overall slowdown in domestic real activity in response to a contractionary US monetary policy shock. Moreover, spillbacks materialise as stock market wealth and Tobin's q effects impinge on US consumption and investment. In particular, a contractionary US monetary policy shock depresses global equity prices, weighing on the value of US households' portfolios; and it depresses foreign sales of US firms inducing them to cut back investment. Net trade does not contribute to spillbacks because US monetary policy shocks affect exports and imports similarly. We also find substantial spillbacks from US monetary policy to US consumer prices, materialising to a large degree through adjustments in global commodity and thereby US import prices. Geographically, we find that spillbacks materialise through advanced rather than emerging market economies, consistent with their relative importance in US foreign equity holdings and in US firms' foreign demand. Finally, we document that while US monetary policy spillovers do not induce

welfare-reducing trade-offs between output and inflation stabilisation in advanced economies, they do so in emerging market economies. Our findings thus imply that global welfare could benefit if spillovers to emerging market economies were internalised by playing a role in the calibration of US monetary policy that is independent from spillbacks.