Policy Rules in Times of Prolonged Crisis: Quantitative Easing Abroad and Fiscal Adjustment at Home*

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May 2018

Summary

This paper studies whether monetary transmission in China is asymmetric. While researchers found an asymmetric transmission in the US and other economies, China offers a specific rationale for This paper examines the international transmission of real and financial shocks which originate in, and are partially offset by, quantitative easing in a large financially-stressed country. Using a two-country model, we evaluate the adjustment in the non-stressed foreign country, following recurring negative shocks (to productivity or financial net worth or both), and the application of QE policies in the stressed country. We find that the non-stressed country can make effective use of tax-rate changes to stabilize asset prices, consumption and investment during the crisis period abroad, if the crisis is generated by productivity shocks or financial shocks, or both. The tax-rate regime in the non-stressed country works best, by generating positive externalities for the stressed country in the face of recurring productivity shocks. Under recurring financial net-worth shocks, the benefits of the tax-rate regime are less global, and more local, more confined to the non-stressed country.