

Research project:

Determinants of monetary policy effectiveness: World-wide empirical analysis

### **Non-technical Summary**

Title of the paper: Monetary Policy Effects on Output and Prices: International Evidence

**Key words:** Monetary policy effects; trade openness; financial openness; exchange rate regime; economic size; international interdependence

This paper explores cross-country variations in the effects of a monetary policy shock on output and prices. The ability of monetary policy to influence output and prices in the short-run is broadly accepted in economic theory and well documented by a number of time series analyses of monetary policy transmission. However, the determinants of monetary policy effects are not well understood.

The main research strategy consists of two steps. First, the structural vector autoregression (SVAR) model is employed in order to estimate the effects of a monetary policy shock for each of the 48 countries in the sample separately. Thereafter, the results obtained in the first step are treated as the dependent variable in a regression analysis which investigates possible sources of cross-country variations in the responses of output and prices to a monetary policy shock.

The results of the paper suggest the following:

- in countries with more flexible exchange rates a monetary policy shock has, on average, a larger effect on output and prices;

- in countries with a larger share of international trade in GDP a monetary policy shock has, on average, a larger effect on output and prices;
- the estimated relationship between trade openness and output responsiveness to a monetary policy shock is larger for countries with more flexible exchange rates;
- the effects of financial openness differ between fixed and flexible exchange rate regimes;
- in countries with more flexible exchange rates the effect of a monetary policy shock on output is, on average, larger for financially more open economies;
- a monetary policy shock on output is, on average, smaller in countries which are more correlated with the global economy;
- the ability of national monetary policies to influence output in the short-run is related to the correlation with the US economy (for non-European economies) and the German economy (for European economies);
- a monetary policy shock has, on average, a larger effect on output in larger economies;
- foreign factors do not undermine the ability of national monetary policies to influence prices in the short-run;
- in countries with a larger size of financial sector a monetary policy shock has, on average, a larger effect on output and prices;
- in countries with a larger share of industry in GDP a monetary policy shock has, on average, a smaller, rather than larger, effect on output.