Challenges That Monetary Easing Brings for Emerging Markets

Ozlem Aytac
Baskent University,Turkey
oaytac@baskent.edu.tr

Abstract

Yield spreads, namely the "risk premium" on emerging market (EM) sovereign bonds measure the premium required by foreign investors to purchase securities issued by EM borrowers as they are perceived to be more likely to default on their debt obligations compared to developed economies. The literature has conducted a vast number of empirical studies examining the relationship between EM sovereign debt spreads and both country specific and global factors. Results prove that country specific fundamentals determine spreads in the long term, but global factors are important both in the short and the long term. Strong country fundamentals however, reduce the impact of global factors. More importantly, sudden changes in global conditions may do affect the strength as well as the direction of the impact that country fundamentals have on yield spreads. Near-zero policy rates coupled with massive quantitative easing in advanced economies after global financial crisis reduced long term interest rates to historically low levels. And EM economies today are integrated with global bond markets like they never have been before albeit with a heightened vulnerability to external shocks. This survey study investigates the interaction between extensive monetary easing and EM borrowers in order to find out the issues that EM authorities might face going forward. Results indicate that a long term interest rate determined by global bond markets has replaced the US policy rate as a new hock propagator for EMs. And policy making might become more challenging than ever before for these countries.

Keywords: long-term interest rate, emerging market economies, bond markets

JEL Codes: E43, E52, E58