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# Exchange Rates and Monetary Policy: Research Insights and Current Challenges

LatAm Economic Forum, Banco de España, May 7-9, 2026

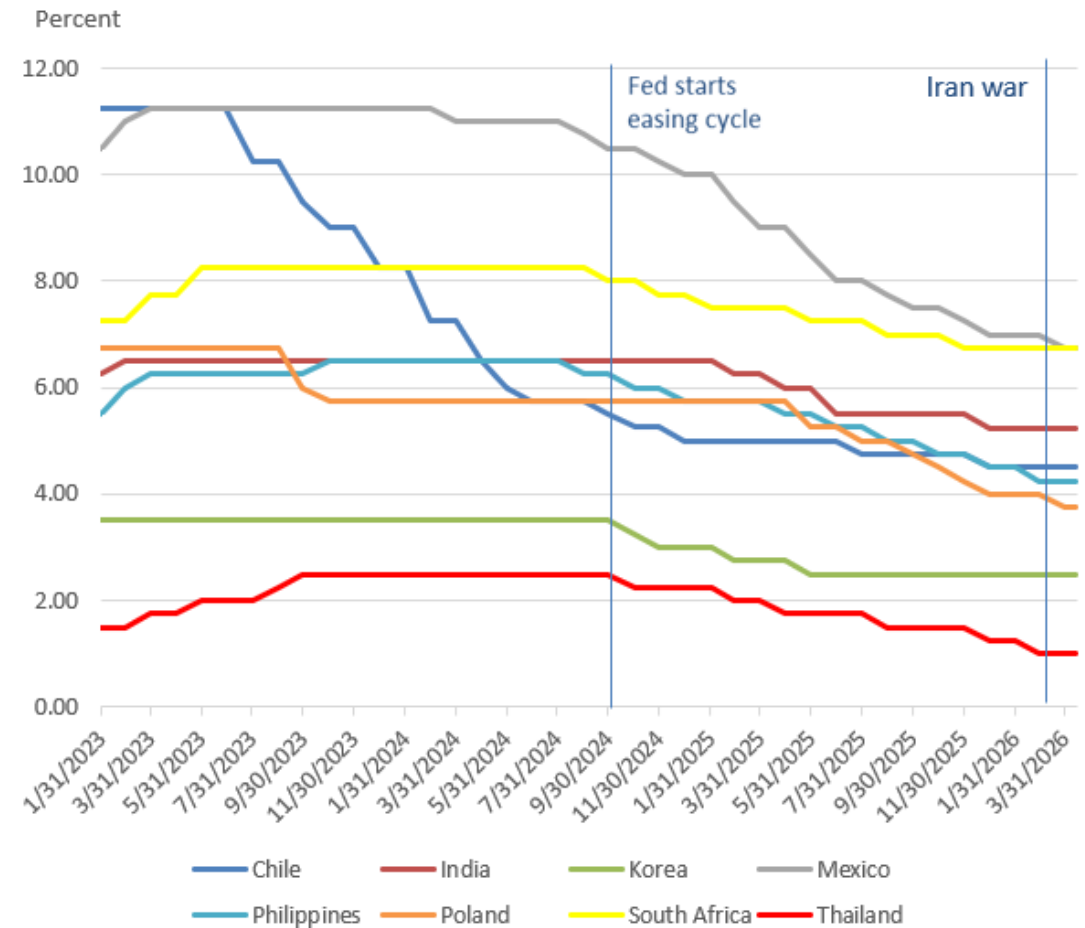
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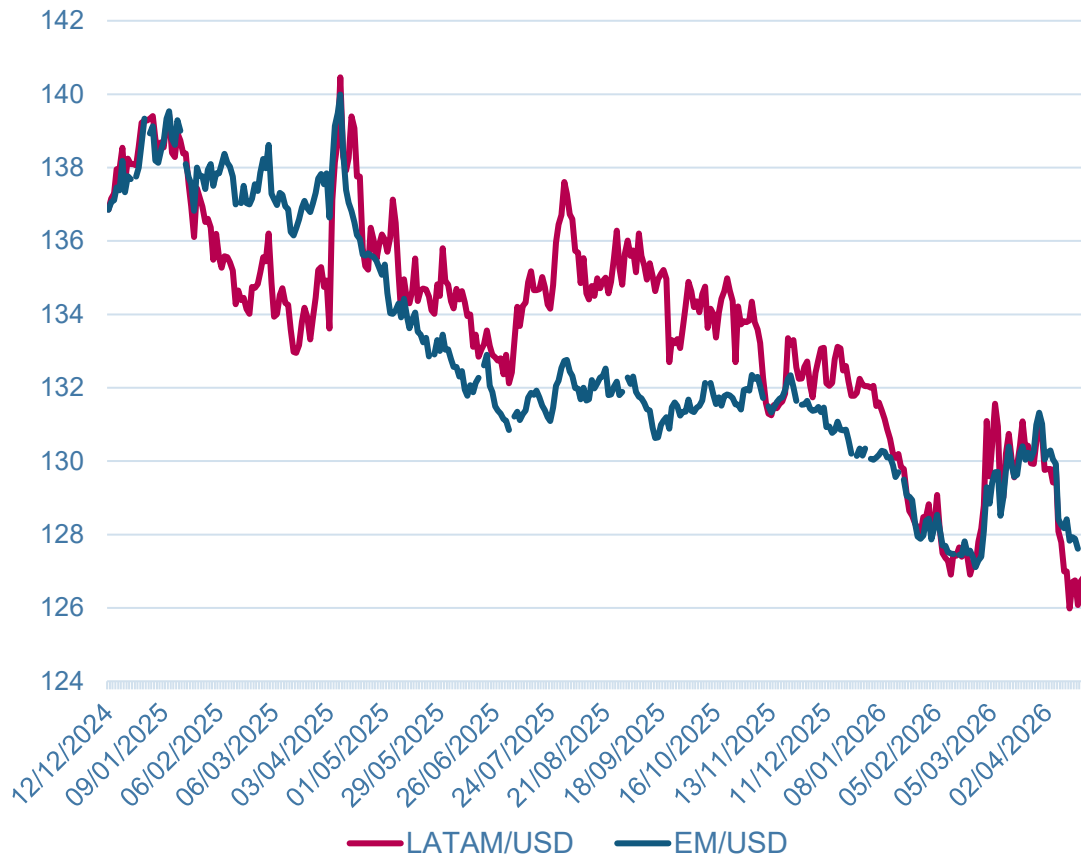
# Iran shock: Exactly 4 years after the Ukraine shock

- Then, many EM central banks were already tightening
- Now, many had been easing and were expecting to ease further
- These hopes were driven by domestic conditions, but also by expectations of Fed policy and the dollar

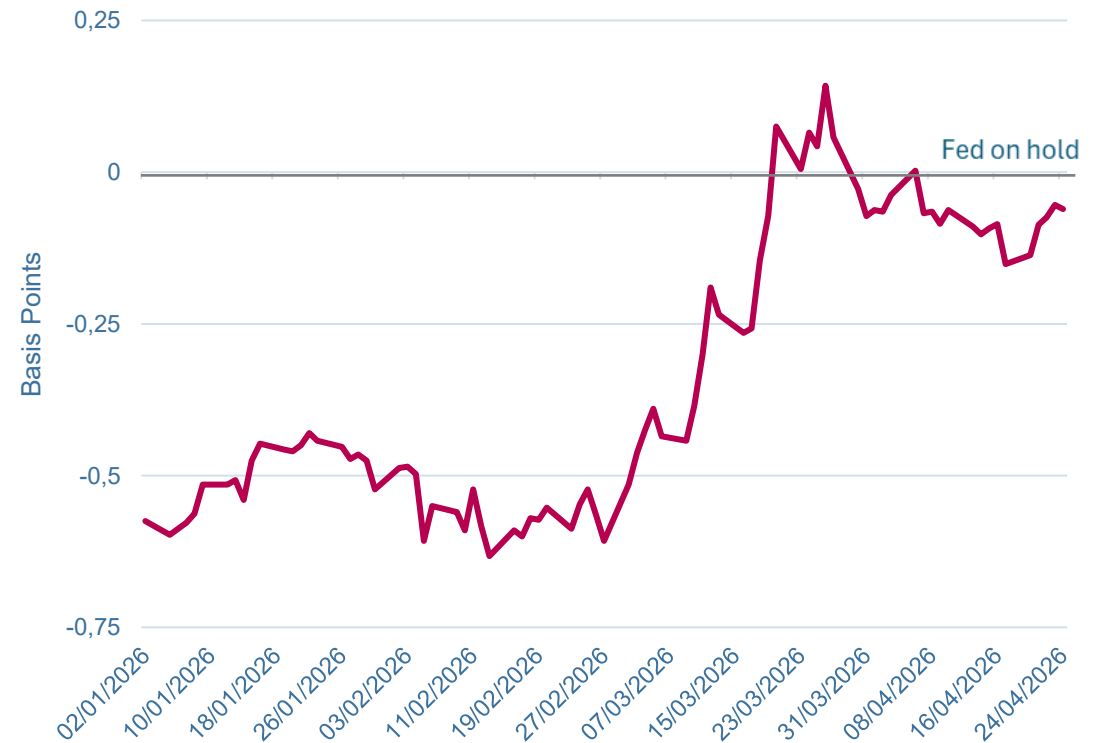


# Dollar was weakening, Fed cuts expected

Strength of USD



Market-predicted Fed cuts by December 2026



Source: Nominal EM dollar index from FRED; equal-weighted LatAm index from Bloomberg; Fed-dated OIS swaps from Bloomberg

# Caution in the face of key challenges

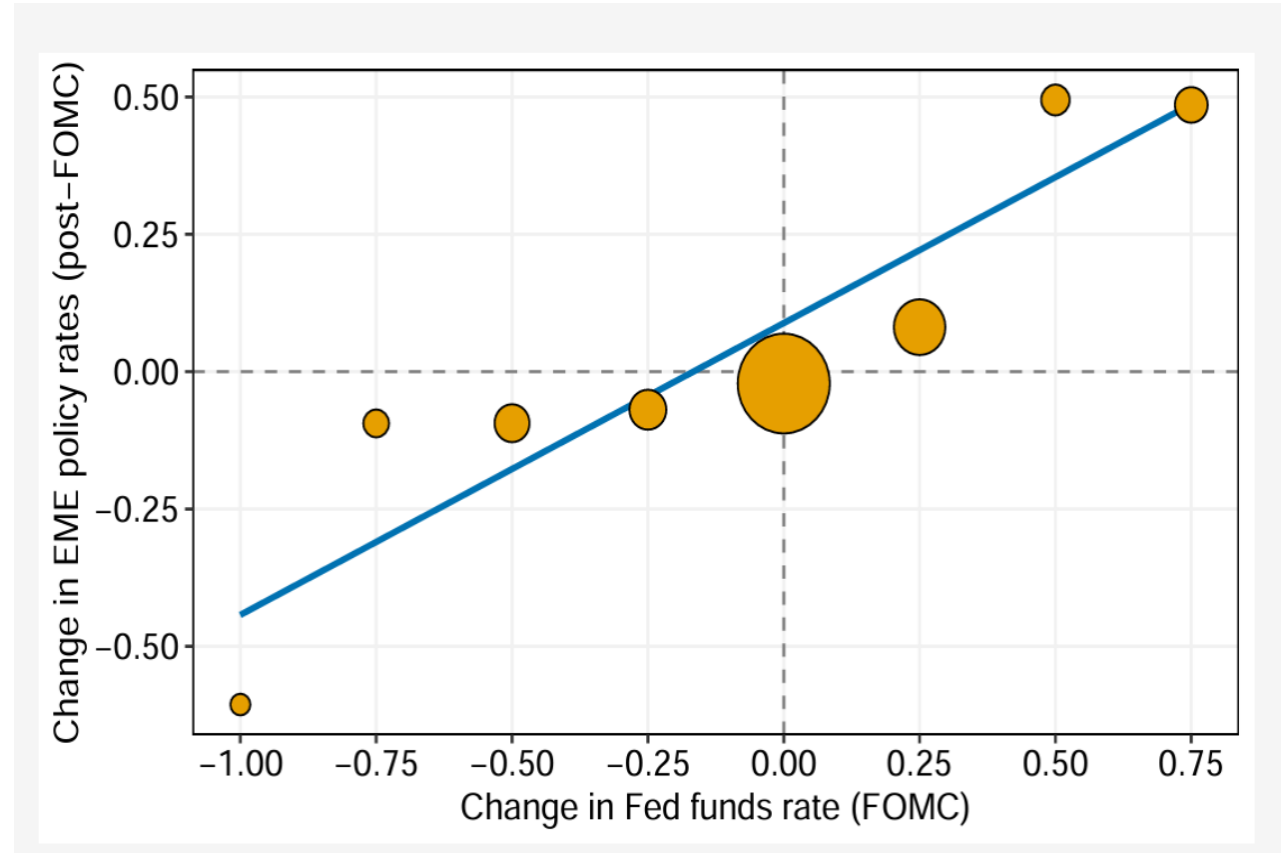
- Many EM central banks hit the brakes
- Or if they proceeded with planned cuts, did so cautiously and with predictions of vigilance
- They faced (and continue to face) several key challenges and unknowns:
  - Impact of oil prices and collateral shortages on *inflation*
  - Impact of the same on output and *employment*
  - Implications for *financial stability*
  - Course of the *dollar*
  - Course of *Fed policy*
  - Prior and continuing *potential economic policy disruptions* to global markets
- **How to preserve price stability without too great an output sacrifice?**

# EM monetary policy frameworks are stronger

- In the last decade, these enabled navigation of:
  - China's surprise devaluation (2015-16)
  - The COVID-19 crisis (2020-22)
  - The Russia-Ukraine crisis (2022)
  - Global inflation surge and rapid Fed tightening (2021-23)
- Relevant assessments include:
  - English, Forbes, and Ubide ([CEPR report](#), 2024)
  - IMF *World Economic Outlook* ([chapter 2](#), October 2025)
  - Mendoza-Fernández and Meyer ([working paper](#), 2025)
  - Kalemli-Özcan and Unsal ([VoxEU](#), April 2026)
- **How do reactions to Fed policies fit into this picture?**

# Detailed data on monetary policy meetings

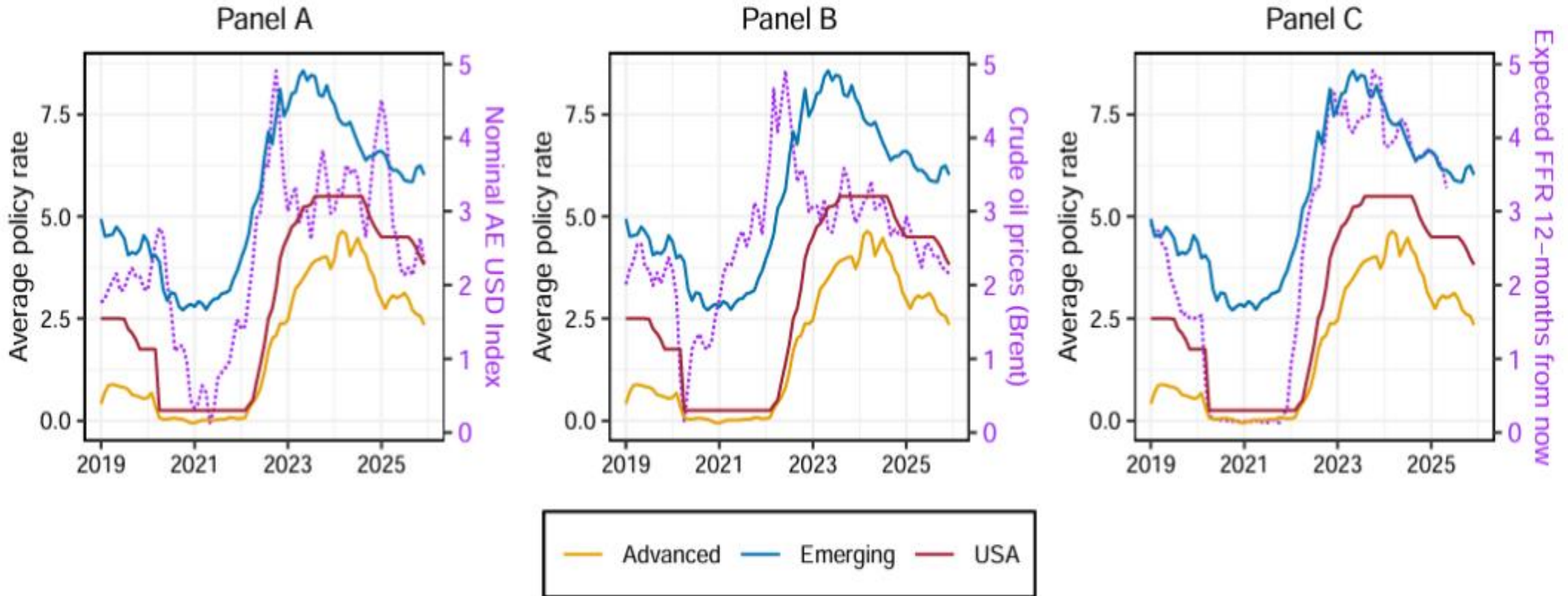
- [Mendoza-Fernández and Pelin](#) assemble global data on 9,500 monetary policy meetings across 59 economies between August 1990 and December 2024
- A central bank's first policy meeting after an FOMC announcement occurs within 14 days in 50–60% of cases
- The unconditional probability of an EM central bank moving in the same direction as the Fed at its next meeting is about 59 percent (much above 1/3)
- Central banks of advanced economies are less likely to follow the Fed



# Complex effects of Fed tightening

- Financial conditions ([Miranda-Agrippino and Rey](#) and [Kalemli-Özcan](#)) and global dollar cycle ([Obstfeld and Zhou](#))
- “Cost channel” of higher US interest rates due to working capital and constrained dollar funding (Cavallo, Bruno, [van Wijnbergen](#))
- Depreciation vs. USD brings CPI inflation, higher input costs
- [Díaz Alejandro effect](#) can dampen consumption via redistribution; more recent papers such as [Campos and Paz](#)
- Dollar invoicing of non-commodity exports can limit competitiveness effect on exports (but see [Tenreyro and McCleay](#)), make bilateral exchange rate more volatile

# In 2021-23, EM central banks followed the dollar

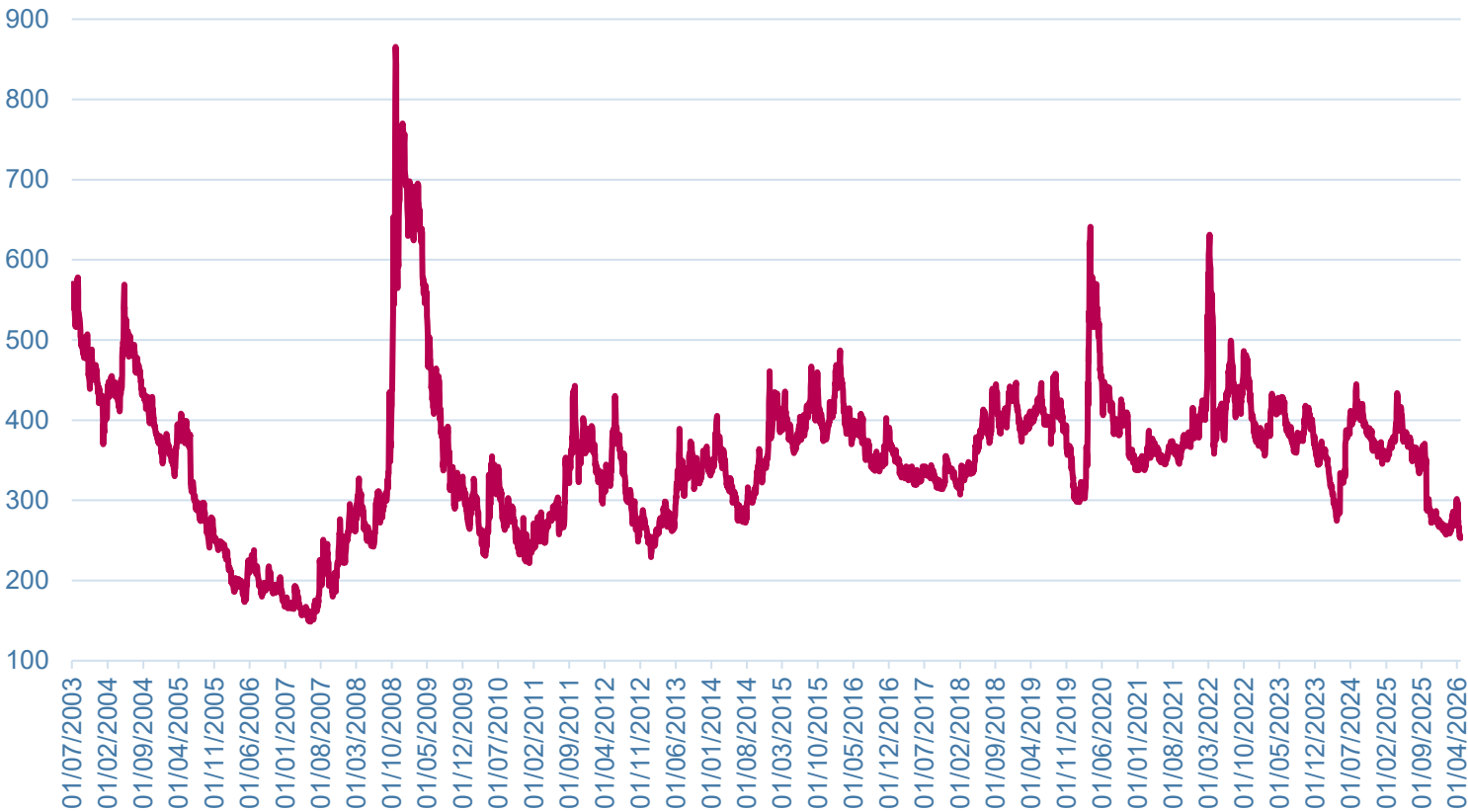


# Keeping expectations anchored means following the Fed, even if at the expense of some growth

- EMs face multiple threats of higher energy prices, hikes in related commodities (e.g., fertilizers), shortages
- But monetary policy cannot fully offset these *real shocks*, and might have to move somewhat pro-cyclically to keep expectations anchored
- Real-side contractionary effects could be muted a bit compared with AEs
- First line of defense to cushion the economy and prevent social turmoil should be fiscal and (if possible) structural policies
- Challenging with limited fiscal space
- Yet more challenging if global financial conditions tighten markedly

# So far, sovereign bond markets seem calm

JPMorgan EMBI+ spread



Source: Bloomberg



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**Thank you.**

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