BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF INTERNATIONAL FINANCE

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To: Federal Open Market Committee

From: Steven B. Kamin

Subject: Effects of U.S. Monetary and Fiscal Policies on EMEs

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The broad-based declines in emerging market asset prices in recent months, along with the more acute distress in Argentina and Turkey, have drawn heightened attention to the effect of U.S. monetary tightening on prospects for the emerging market economies (EMEs). A large team of economists from the Board's International Finance Division, led by Shaghil Ahmed and Chris Erceg, explored this question by drawing on historical case studies, econometric analysis, and model simulations. The attached note, titled "Effects of U.S. Monetary and Fiscal Policies on Emerging Market Economies," summarizes their findings. Broadly speaking, the monetary tightening envisioned in the staff Tealbook forecast should be manageable for most EMEs, although it would pose challenges for the most vulnerable of those economies. However, were higher inflation to require faster tightening on the part of the Federal Reserve, the likelihood of widespread financial and economic distress in the EMEs would rise significantly.