The effectiveness of macroprudential policies in preventing financial crisis in Emerging Market Economies

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This paper aims at how emerging market countries reduce the probability of financial crises. I use the Local Projections model to analyze the effectiveness of exchange rate regimes, capital controls, and macroprudential policies on financial crises based on quarterly data for 20 emerging market economies from 2000-2019, as well as the spillover effects of macroprudential policies on those countries. The study finds that a rigid exchange rate regime increases the probability of financial crisis. Strict capital controls reduce the probability of financial crisis in the short run, while tighter macroprudential policies decrease the probability of financial crisis in the short and medium term. The implementation of stringent macroprudential policies in other countries can help diminish the likelihood of a financial crisis in a given country. This is attributed to the fact that when other economies experience decreased volatility, it subsequently lowers the probability of a financial crisis in the country by mitigating the volatility associated with international trade and financial investments. Therefore, there is a necessity for the emerging market economies to coordinate the operation of macroprudential policies to stabilize their financial market environment.

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