Insights from Monetary Research
IMRD No.1/2023   March 2023

HKIMR

HONG KONG ACADEMY OF FINANCE 金融學院

The Global Transmission of Monetary Policies of Major Economies

After an extended period of low or even negative interest rate environments, central banks around the world have been tightening monetary policy in response to a global surge in inflation. Two recently published HKIMR working papers consider different angles to explore how the monetary policies of major economies, including the US, Europe and Japan, affect the rest of the world.

International Financial Centres (IFCs), such as Hong Kong and London, play a substantive role in intermediating cross-border lending. In the HKIMR working paper no. 07/2023, a research team comprising researchers from five central banks finds that the flow of loans through IFCs represent a relevant channel through which monetary policy can be transmitted from one economy to another. The researchers note that in normal times, foreign banks in IFCs increase cross-border lending when their home country's interest rate fall, thereby transmitting their home country's monetary policy abroad. However, in the wake of the 2007-2008 Great Financial Crisis, Europe and Japan have subsequently enacted negative interest rates, and the lending from European and Japanese banks operating in IFCs became less responsive to their home country's interest rate. This result suggests that unconventional monetary policy, such as negative interest rates, can be less transmissible cross-border.

Along the same theme, Shifu Jiang studies how US monetary policy can be transmitted to eight Asian small open economies, including Hong Kong and Singapore, in the HKIMR working paper no. 05/2023. The study confirms that tightening of the US monetary policy affected these economies by worsening the financial strength of their banks, reducing credit creation and raising the cost of borrowing foreign currencies. The study also notes that the small open economies in Asia were inclined to stabilise their currencies against the US Dollar by setting interest rates higher than what was justified by their domestic economic conditions. But this strategy became ineffective, as capital flows to and from the Asian small open economies induced by US monetary policy shocks dominated the exchange rate determination. This result suggests potential gains for these economies to introduce new monetary policy tools beyond changing the target interest rate.

Assessing the Performance of Green and Sustainable Finance Instruments

Despite the increasing popularity of Green and Sustainable Finance, there is no consensus on whether Green and Sustainable Finance instruments can exhibit satisfactory investment returns or achieve the intended sustainability goals. A set of HKIMR working papers evaluate these issues in the markets for equities and bonds.

In Hong Kong, the ESG-weight-tilted Hang Seng Index was launched as an instrument based on the Hang Seng Index where the constituents with higher ESG ratings were represented in the index with a larger weight. In the HKIMR working paper no. 22/2022, Joseph Fung and Eric Lam show that although the ESG-infused and the original Hang Seng Indices moved in the same direction more than 99 percent of the time, the holding return of the ESG-infused index from 2014 to 2021 was higher by 67%. The researchers attributed the superior return to investors’ preference for equities with high ESG ratings, which makes them less susceptible to selling pressure in stressful market situations without sacrificing the upside potential.

While using ESG ratings to evaluate equities is a common practice, there are growing concerns that different ESG rating methodologies may yield different results. In the HKIMR working paper no. 23/2022, Alexander Bassen, Hao Shu and Weiqiang Tan investigate this problem by exploring the use of objective green revenue data from the US’ FTSE Russell, which measures the percentage of a public firm’s revenue originated from the green economy. The researchers find that equities with high green revenue significantly outperformed those with low green revenue in the equity markets in Australia, Canada, France, Italy, Norway, the US and South Africa. They further show that the higher return on green equities can be connected with social cultures that assign a higher value to equality and harmony with the environment.

Unlike green equities which represent shares of ownership in greener firms, green bonds are specifically issued to fund specific green projects. In the HKIMR working paper no. 01/2023, Victor Leung, Wilson Wan and Joe Wong uncover that one-third of global corporate green bond issuers had a poor environmental performance after their initial green bond issuance. While this observation may naturally point to a greenwashing behaviour on the part of the issuers, the researchers find that investors were able to identify and penalise greenwashing by forcing the issuers into more difficult conditions when re-issuing green bonds. They also show that the establishment of green bond taxonomies and improvement in the environmental disclosure requirements could further foster a healthier green bond ecosystem.

An executive summary and full text are available for every HKIMR working paper mentioned above. All working papers and executive summaries published in the HKIMR Working Paper Series can be viewed and downloaded here or using the QR code below.