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The HKIMR was established by the Hong Kong Monetary Authority (HKMA) in August 1999 to conduct and support research on issues in monetary policy, banking and finance that are of strategic importance to Hong Kong and the Asian region.

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Hong Kong Institute for Monetary Research – *Newsletter*

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Announcements



Professor Leonard Kwok-Hon Cheng, Dean of the School of Business and Management of The Hong Kong University of Science and Technology, has been appointed as a Member of the Board of Directors of the HKIMR, effective 29 July 2010.



Mr. Peter Tung-Shun Wong, Chief Executive of The Hongkong and Shanghai Banking Corporation Limited, has been appointed as a Member of the Board of Directors of the HKIMR, effective 29 July 2010.



Mr. Vincent Hoi-Chuen Cheng, Chairman of HSBC Bank (China) Company Limited, resigned from the Board of Directors of the HKIMR on 29 July 2010. The Institute expresses its gratitude to him for his contributions over the past years.

Recent Activities

Conference on Financial Stability: Towards a Macprudential Approach

The HKIMR and the Bank for International Settlements (BIS) co-organised a two-day conference entitled “Financial Stability: Towards a Macprudential Approach” on 5 and 6 July 2010 in Hong Kong.

The conference aimed to bring together academics, policy makers, and market participants to engage in constructive discussion on a wide range of theoretical and empirical issues related to the macroprudential approach. The two-day conference featured speeches by Professor Douglas Diamond (University of Chicago) entitled “Fear of Fire Sales, Illiquidity Seeking, and Credit Freezes” and Dr. Claudio Borio (Deputy Head of the Monetary and Economic Department and Director of Research



Professor Douglas Diamond (University of Chicago) delivering the keynote speech

Conference on Financial Stability: Towards a Macroprudential Approach

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and Statistics of the BIS) entitled “Implementing a Macroprudential Framework: Balancing Boldness and Realism”. The conference was divided into four sessions with two papers presented in each session. The papers covered various issues including systemic risk, regulatory capital charges, procyclicality of loan-loss provisioning, boom-bust cycles and the framework of prudential regulation.

The conference ended with a panel discussion. The panelists included Arthur Yuen (Deputy Chief Executive of the HKMA), Elbert Pattijn (Chief Risk Officer of the DBS Bank Ltd.) and Mark Lawrence (Managing Director of the Mark Lawrence Group and Co-chairman of the Institute of International Finance Risk Management Working Group).



Discussion during the conference dinner: (From left to right) Dr. Claudio Borio (BIS), Dr. Dong He (Executive Director (Research) of the HKMA and Director of the HKIMR) and Professor K.C. Chan (Secretary for Financial Services and the Treasury of the HKSAR Government)

Macroeconomic Modelling Seminar



Douglas Laxton (IMF), Dong He (HKMA and HKIMR) and Dirk Muir (IMF) (From left to right)

GIMF, and the other on the GPM. In the GIMF course, participants were introduced to the theory and simulation on different versions of the model using TROLL and FAME. In the GPM course, participants learnt how to use Bayesian methods in DYNARE to estimate versions of the model that includes variables such as interest rates, exchange rates, inflation, GDP and unemployment.

The seminar was well-received and was attended by participants from regional central banks including the Reserve Bank of Australia, The People’s Bank of China, HKMA, HKIMR, Bank Indonesia, Bank of Japan, Bank of Korea, Bank Negara Malaysia, Bangko Sentral ng Pilipinas, Monetary Authority of Singapore and Bank of Thailand.

The HKIMR organised a five-day course entitled “Macroeconomic Modelling Seminar” from 15 to 19 March 2010 in Hong Kong for research staff from regional central banks.

The seminar invited four economists from the Research Department of the International Monetary Fund (IMF): Douglas Laxton (Head of Economic Modeling Unit), Ondra Kamenik (Senior Economist), Michael Kumhof (Senior Economist) and Dirk Muir (Senior Economist), to give a full week’s presentation on the Global Integrated Monetary and Fiscal Model (GIMF) and the Global Projection Model (GPM), which are currently the workhorse models at the IMF for analyzing impact and transmission of shocks across economies.

The seminar consisted of two courses run in parallel, one on the



Participants of the GIMF course

Visiting Fellow – Charles Engel



Charles Engel is Professor of Economics at the University of Wisconsin – Madison. He is also a Research Associate at the National Bureau of Economic Research, and a Senior Fellow at the Globalization and Monetary Policy Institute of the Federal Reserve Bank of Dallas. He has been Editor of the Journal of International Economics since 2001. He spent four weeks as a visiting scholar at the HKIMR in August 2010. This is his third visit to the HKIMR – previous visits were in the summers of 2003 and 2006. He has spent time as a visiting scholar at other central banks around the world in recent years: the Federal Reserve Board, the European Central Bank, the Reserve Bank of Australia, de Nederlandsche Bank, and the Bank of England, as well as at the International Monetary Fund and several regional Federal Reserve Banks.

“It is interesting and rewarding to talk about these macroeconomic questions with economists at the HKMA, other visiting scholars at the HKIMR, and many other economists at universities and international organizations in Hong Kong.”

It is always a pleasure to visit the HKIMR. I enjoy coming to Hong Kong with my family and touring the area. Professionally, I get an opportunity to discuss some of the important issues in monetary economics that are of interest to policymakers and scholars of East Asian economies. It is interesting and rewarding to talk about these macroeconomic questions with economists at the

HKMA, other visiting scholars at the HKIMR, and many other economists at universities and international organizations in Hong Kong.

My main line of research in the past few years has concerned the conduct of monetary policy in open economies, with particular emphasis on the role of foreign exchange rates. Just prior to my arrival in Hong Kong this time, I put the finishing touches on my paper, “Currency Misalignments and Optimal Monetary Policy: A Reexamination” which is to appear in the *American Economic Review*. The paper establishes in the context of a modern New Keynesian model that misalignments of the exchange rate are distortionary, and should be a concern of policymakers beyond their focus on inflation and unemployment (or, the “output gap.”) When large exchange rate movements lead to price differences across countries that cannot be explained by the differences in the costs of selling goods in different countries, policymakers may need to set interest rates to bring exchange rates back into alignment.

While that paper was theoretical, my research while at the HKIMR is centered on two related empirical themes. The first concerns the channels through which monetary policy affects real exchange rates. While there is strong evidence that when policymakers increase the interest rate their currency will tend to strengthen, the channels of transmission are still not widely understood. It may be that the higher interest rate attracts foreign investment, thus strengthening demand for the currency. But my empirical work shows that the higher interest rate also affects the value of the currency by influencing the perceptions of the long-run “excess return” or “risk premium” on the country’s assets. That is, tighter monetary policy apparently reduces the perceived risk of the country’s securities, which also works to appreciate the currency.

The second paper I worked on at the HKIMR involves trying to develop a better measure of the target or equilibrium exchange rate that policymakers should aim for. Some policymakers believe that a currency is undervalued if the country runs a trade balance surplus, but my theoretical research suggests that the notion of an equilibrium exchange rate is more closely tied to how well real exchange rates reflects the underlying costs of production across countries. For example, long-established theory has helped us to understand why low-wage countries will have currencies that are much weaker than the purchasing power parity benchmark. Building on those theories, I am working to develop measures of equilibrium exchange rates that can be used to create exchange-rate targets for policymakers.

My wife and two youngest children (ages 2 and 6) came along on this visit. We enjoy walking in the countryside, browsing through local markets, and visiting museums and other landmarks. It is always great to visit – Hong Kong is such a laboratory in international economics!

Columbia – Tsinghua Conference: International Economics after the Crisis



Conference participants

The Institute and the Asian Development Bank (ADB) co-sponsored the Columbia – Tsinghua Conference: International Economics after the Crisis, which was co-organised by Columbia University and Tsinghua University from 30 June to 2 July 2010 in Beijing.

A total of thirteen papers were presented by speakers from various countries and organizations. The papers covered issues on exchange rates, current account adjustments, cross-national interdependence, foreign exchange reserves, macroeconomics, international financial markets, and international trade and crisis. In addition, there was a policy panel session entitled “The Chinese Currency in the World Economy”. The panelists included Jong-Wha Lee (ADB), Shang-Jin Wei (Columbia University) and Yingyi Qian (Tsinghua University and University of California, Berkeley).

The Eighth HKIMR Summer Workshop

The HKIMR held the eighth summer workshop on 17 August 2010. The theme of this year’s workshop was “Recent Developments on Exchange Rate Economics”.

The objective of this workshop was to bring together scholars, central bankers and market practitioners to discuss current economic and financial issues. A total of four papers were presented in this workshop. The first paper was “Global Interest Rates, Monetary Policy, and Currency Returns” presented by Charles Engel (University of Wisconsin – Madison) and discussed by David Cook (The Hong Kong



Charles Engel (University of Wisconsin – Madison) and Dong He (HKMA and HKIMR) (From left to right)



Yin-Wong Cheung (University of California, Santa Cruz) and James Yetman (BIS) (From left to right)

University of Science and Technology). It was followed by the paper “Exchange Rate Dynamics Under Alternative Optimal Interest Rate Rules” presented by Yin-Wong Cheung (University of California, Santa Cruz) and its discussant was James Yetman (Bank for International Settlements). The next paper was “Exchange Rate Policy and LDC Foreign Borrowing” presented by Vivian Zhanwei Yue (New York University) and discussed by Jenny Xu (The Hong Kong University of Science and Technology). The last paper was “Exchange Rate Dynamics, Expectations, and Monetary Policy Fundamentals” presented by Qianying Chen (HKIMR) and its discussant was Yu-chin Chen (University of Washington).

Visiting Fellow – Pierre Siklos

Pierre Siklos is Professor of Economics at Wilfrid Laurier University in Waterloo, Canada. He specializes in macroeconomics with an emphasis on the study of inflation, central banks, and financial markets. He also conducts research in applied time series analysis. He has been a visiting lecturer at several universities around Europe and North America, Australia, and New Zealand. His research has been funded by domestic and international agencies. He has also been an Erskine Fellow at the University of Canterbury, New Zealand and as well as William Evans Fellow at the University of Otago, Dunedin, New Zealand. He was WLU's University Research Professor for the academic year 2000-2001, and became the Director of the Viessmann European Research Centre in July 2005 [<http://www.wlu.ca/viessmann>]. In 2008, he was named to the C.D. Howe Institute's Monetary Policy Council (www.cdhowe.org/index.cfm) where he is also a Research Fellow. In 2008, he was chairholder of the Bundesbank Foundation of International Monetary Economics at the Freie Universitat, Berlin. In December 2008 he became a Senior Fellow at the Centre for International Governance Innovation (CIGI). In September 2009 he was appointed to a three-year term as a member of the Czech National Bank's Research Advisory Committee.



“Since 2006 I have been fortunate to visit on three other occasions, most recently in July 2010. This alone is ample proof of how much I have enjoyed visiting the HKIMR, Hong Kong, and Asia more generally.”

At various times throughout my career I have done some joint research that involved Asian economies. For example, I have examined how equity returns are related to each other in Asian markets. I have also had a long standing interest in Chinese monetary policy. This led to some work on the sources of China's inflation in the mid-1990s followed by its subsequent skirmish with deflation, whether the latter was due to aggregate supply factors, as well as the role of monetary aggregates in driving inflation over time. It was a chance meeting with Hans Genberg several years ago, at a conference soon before he took over as Director of the HKIMR, that prompted me to apply to the Visiting fellows program.

Since 2006 I have been fortunate to visit on three other occasions, most recently in July 2010. This alone is ample proof of how much I have enjoyed visiting the HKIMR, Hong Kong, and Asia more generally. At the HKIMR I have worked on a variety of topics such as measurement of exchange market pressure in select Asian economies and how domestic versus international factors influence the determination of credit spreads. Following my visit in 2008, Hans Genberg and I published a paper that revisits how demand and supply shocks inform us about the suitability of a monetary union in Asia. The idea for the paper came from informal conversations Hans, I, and others at the HKIMR, had in the past about the prospects of monetary union in Asia. We were especially interested in the consequences of ignoring foreign shocks in specifications that are commonly used in the literature and found that this makes a considerable impact in evaluating the suitability of monetary cooperation in the area. As part of my latest visit I have returned to the subject of the relationship between equity returns within Asia and, in particular, the impact of policies aimed at restricting certain types of trades, such as restrictions on the short-selling of stocks. It turns out that, for a variety of reasons, the case of Taiwan is of considerable interest. Obviously, any topic that involves Asian economies will find a receptive audience at the HKMA but researchers who are interested in finance related topics will find Hong Kong an especially attractive location given the central role that finance and financial institutions have in this city. Also very attractive is how active the HKIMR is in organizing seminars and workshops. There are a large number of active researchers who live and work nearby and this also helps stimulate further research. Indeed, in 2007, a very interesting workshop on banking and monetary history in Hong Kong that brought together several interested researchers in the region was held at the HKIMR and, given my own interest in monetary history, I have on my future research agenda a deeper exploration of the economic history database made available by the HKIMR to all researchers. Finally, I would be remiss if I did not mention the efficiency and promptness with which Kenneth Chow, a research analyst at the HKIMR, has been able to make available important data for my research.

On a personal level I cannot emphasize enough how easy and pleasant it is for a Research Fellow to live here. Visitors can, if they wish, find an ideal blend of Asia and the West. I have also been fortunate to bring along my family from time to time and, they too, have enjoyed Hong Kong tremendously. Previous visitors will already have mentioned the stunning views from the IFC where the HKIMR offices are located. I will only add that, among many other possible activities one can enjoy in Hong Kong, the ferry to and from Lamma island and the walks there are not to be missed.

Upcoming Activities

Call for Papers: Conference on Macroeconomic Management in China: Monetary and Financial Stability Issues

The HKIMR will hold its second Annual International Conference on the Chinese Economy in Hong Kong on 13 and 14 January 2011. The first HKIMR Annual International Conference on the Chinese Economy was successfully held in Hong Kong on 11 and 12 January 2010, and the programme is available at the following link:

http://www.hkimr.org/conferences_detail.asp?id=44&callfrom=previous&page=2

The conference is intended to provide a world-class forum for academics, policy makers and business economists to discuss important analytical and policy issues related to the Chinese economy. The theme of this year's conference is **Macroeconomic Management in China: Monetary and Financial Stability Issues**.

Possible topics include (but not restricted to):

- Is there a bubble in China's property market?
- Characteristics of inflation processes in China
- Rebalancing of the Chinese economy toward domestic demand
- Capital flows and domestic monetary and financial conditions
- Financial system soundness and financial market development
- Monetary and exchange rate policies in China
- Fiscal reforms and fiscal policies
- Prospects of China's medium- and long-term growth

Papers that do not fit into these categories, but that are related to the main theme of the conference, are also welcome.

Interested contributors should submit a draft paper (in a Word or PDF file) to the HKIMR by **October 10, 2010** (e-mail to hkimr@hkma.gov.hk). Please use the contact author's name as the name of the file. The HKIMR will select the papers based on originality, analytical rigor, and policy relevance and will contact the authors whose papers have been selected and announce the final program by **November 12, 2010**. Presenters will be reimbursed for travel expenses and accommodation. For further information, please contact Jennifer Tse at jystse@hkma.gov.hk or visit the HKIMR website <http://www.hkimr.org>.

The Eighth HKIMR Conference on the Mainland Economy

The HKIMR will organise a conference on the Mainland economy entitled "The Role of Property Markets in China's Macroeconomic Fluctuations" on 18 November 2010. It will examine the development and risks of the Mainland property market. Currently, the Institute is inviting authors to submit research papers related to the Mainland property market. This conference is the eighth of the Institute's conference series relating to Mainland China.

Application for Visiting Research Fellow

The HKIMR accepts applications for positions as Visiting Research Fellow on an ongoing and highly competitive basis. The Council of Advisers reviews proposals four times a year. The deadline for the next round of applications is 30 September 2010.

Applicants should note that papers produced, partly or wholly under this visiting programme, are required to acknowledge the financial support of the HKIMR if the papers are submitted to any journals.

Please visit our website (<http://www.hkimr.org>) if you are interested in this programme.

Upcoming Visiting Fellows and Seminars

13 September – 8 October
Peter Tillmann (University of Giessen)

17 – 23 November,
 15 – 21 December
Jiandong Ju (Tsinghua University)

22 November – 17 December
Assaf Razin (Tel Aviv University)

30 August 2010 *Bank Efficiency, Market Development and Institutional Environment: Evidence from Chinese Banks* – Baozhi Qu (City University of Hong Kong)

10 September 2010 *Risk Management and Managerial Efficiency in Chinese Banks: A Network DEA Framework* – Kent Matthews (Cardiff University)

Recent HKIMR Working Papers

- No.07/2010** “Gravity in International Finance” by Yohei Okawa and Eric van Wincoop
- No.08/2010** “Micro, Macro, and Strategic Forces in International Trade Invoicing” by Linda S. Goldberg and Cédric Tille
- No.09/2010** “The Role of Human Capital in Imperfectly Informed International Financial Markets” by Isaac Ehrlich and Jong Kook Shin
- No.10/2010** “Vertical Trade and China’s Export Dynamics” by Wei Liao, Kang Shi and Zhiwei Zhang
- No.11/2010** “What Drives China’s Current Account?” by Mathias Hoffmann
- No.12/2010** “Do Derivative Markets Contain Useful Information for Signaling “Hot Money” Flows?” by Joseph K. W. Fung, Robert I. Webb and Wing H. Chan
- No.13/2010** “Leverage Constraints and the International Transmission of Shocks” by Michael B. Devereux and James Yetman
- No.14/2010** “Where to Find Positive Productivity Spillovers from FDI in China: Disaggregated Analysis” by Galina Hale, Cheryl Long and Hirota Miura
- No.15/2010** “Market Liquidity and Funding Liquidity: An Empirical Investigation” by Giorgio Valente
- No.16/2010** “Renminbising China’s Foreign Assets” by Yin-Wong Cheung, Guonan Ma and Robert N. McCauley
- No.17/2010** “The Composition Matters: Capital Inflows and Liquidity Crunch during a Global Economic Crisis” by Hui Tong and Shang-Jin Wei
- No.18/2010** “What Effect Has Bond Market Development in Emerging Asia Had on the Issuance of Corporate Bonds?” by Paul Mizen and Serafeim Tsoukas
- No.19/2010** “What are the Sources of Financing of the Chinese Firms?” by Galina Hale and Cheryl Long
- No.20/2010** “Human Capital, Endogenous Information Acquisition, and Home Bias in Financial Markets” by Isaac Ehrlich, Jong Kook Shin and Yong Yin

and more please visit our website.

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