

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.

Highlights of this issue:

IJCB Financial Stability Conference on “Financial Crises: Causes, Consequences and Policy Options”

Forum on Financial Regulation and Development: Implications for Hong Kong as an International Financial Centre

The Tenth HKIMR Summer Workshop

Renminbi Internationalisation: A Primer

HKIMR Occasional Paper No.8

Visiting Fellow – Roger E. A. Farmer

Visiting Fellow – Nelson C. Mark

Hong Kong Institute for Monetary Research – *Newsletter*

Twenty-Second Issue (August 2012)

Recent Activities

IJCB Financial Stability Conference on “Financial Crises: Causes, Consequences and Policy Options”

The HKIMR hosted the Fourth Financial Stability Conference of the International Journal of Central Banking (IJCB) on 17 and 18 May 2012 in Hong Kong. The theme of this conference was “Financial Crises: Causes, Consequences and Policy Options”.

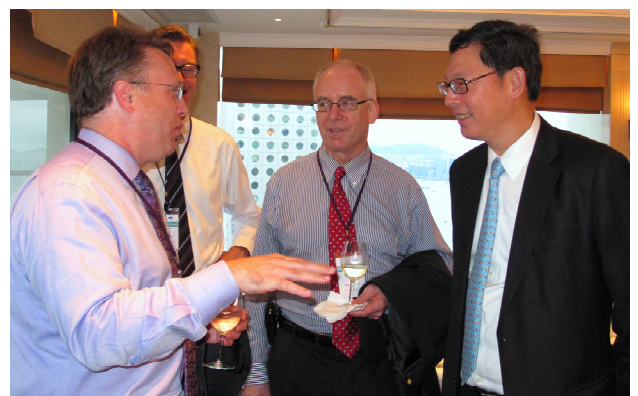


Dr. John Williams (left) (President and Chief Executive Officer of the Federal Reserve Bank of San Francisco and IJCB Managing Editor) delivering the opening remarks, and Dr. Dong He (right) (Executive Director (Research) of the HKMA and Director of the HKIMR)

The second session, which focused on monetary policies and financial crises, was chaired by Professor Douglas Gale (New York University and IJCB Co-Editor). This session started with a paper on “Business Cycles and Financial Crises: The Roles of Credit Supply and Demand Shocks” by Ellis W. Tallman of Oberlin College and the Federal Reserve Bank of Cleveland. Angela Maddaloni of the European Central Bank then analysed the low monetary policy rates paradox and its impacts on banks’ risk-taking behaviour. She presented evidence that low monetary policy interest rates would soften lending standards and sow the seeds for the next credit bubble.

The IJCB is a world-renowned academic journal, with a particular focus on central banking issues. Dr. John Williams (President and Chief Executive Officer of the Federal Reserve Bank of San Francisco and IJCB Managing Editor) was the Chairman of the conference.

This two-day conference was divided into three sessions with two papers being presented in each session. The first session, which was chaired by Professor Harrison Hong (Princeton University and IJCB Co-Editor), focused on the impact of unconventional monetary policy on asset markets. Canlin Li of the Federal Reserve Board presented a paper on applying an arbitrage-free term structure model to evaluate the term premium effects of the Federal Reserve’s Large Scale Asset Purchase programs. Alan Rai of Macquarie University analysed the impacts of various US policies on credit spreads during the 2007-09 financial crisis.



Mr. Norman T. L. Chan (Chief Executive of the HKMA) (right) discussing with President John Williams (left) and Professor Douglas Gale (middle) during the conference dinner

IJCB Financial Stability Conference on “Financial Crises: Causes, Consequences and Policy Options”

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The last session focused on capital and macroprudential regulations, chaired by Professor Rafael Repullo (Center for Monetary and Financial Studies and IJCB Co-Editor). In this session, Alfredo Martin-Oliver (Universitat de les Illes Balears) analysed the long-term effects of demanding higher capital requirements to banks on the interest rates of bank loans and the demand for bank credit. Filiz Unsal of the International Monetary Fund (IMF) delivered a presentation on “Capital Flows and Financial Stability: Monetary Policy and Macroprudential Responses”. She analysed the interplay between monetary and macroprudential policies in an open economy. In addition, the conference featured a presentation by Dr. Dong He (Executive Director (Research) of the HKMA and Director of the HKIMR) entitled “Hong Kong’s Approach to Financial Stability”. This presentation covered the Hong Kong Monetary Authority’s financial stability framework, and macro-prudential regulation and supervision of housing market risks.



Conference speakers and discussants

Forum on Financial Regulation and Development: Implications for Hong Kong as an International Financial Centre



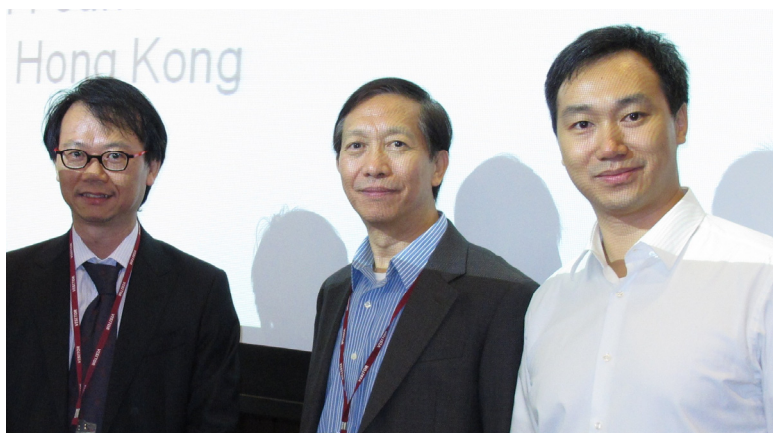
Professor Hyun Song Shin (Princeton University) delivering the keynote presentation



Professor Douglas Arner
(The University of Hong Kong)

The HKIMR organized a forum on “Financial Regulation and Development: Implications for Hong Kong as an International Financial Centre” on 11 June 2012.

This half-day forum featured four presentations by overseas and local scholars. Professor Hyun Song Shin (Princeton University) delivered the keynote presentation on “Global Liquidity and Growth in the Aftermath of the European Crisis”, followed by three presentations: “Post-Crisis International Financial Regulatory Reforms: Implications for Hong Kong” presented by Douglas Arner (The University of Hong Kong), “Regulatory Arbitrage and International Bank Flows” by Chen Lin (The Chinese University of Hong Kong), and “Political Economy of Corporate Governance of Chinese Firms” by Chenggang Xu (The University of Hong Kong).



Professor Chen Lin (The Chinese University of Hong Kong), Professor Chenggang Xu (The University of Hong Kong) and Professor Say Hak Goo (The University of Hong Kong) (From right to left)

The Tenth HKIMR Summer Workshop

The HKIMR held its tenth annual summer workshop on 23 July 2012.

The objective of this workshop was to bring together scholars, central bankers and market practitioners to discuss current economic issues. A total of five papers were presented in this workshop: “Financial Regulation in General Equilibrium” presented by Dimitrios P. Tsomocos (University of Oxford), “Determinants and Dynamics of Price Disparity in Onshore and Offshore Renminbi Forward Exchange Rate Markets” presented by Cho-Hoi Hui (HKMA), “Optimal Monetary Policy under Financial Sector Risk” presented by Scott Davis (Federal Reserve Bank of Dallas), “Perils of Quantitative Easing” by Herakles Polemarchakis (University of Warwick), and “Eurodollar Banking and Currency Internationalisation” by Dong He (HKMA and HKIMR).



Dr. Dimitrios P. Tsomocos
(University of Oxford)



Dr. Cho-Hoi Hui (Division Head (Market Research)
of the HKMA and Adviser of the HKIMR)



Workshop participants

Renminbi Internationalisation: A Primer

Dr. Dong He (Executive Director (Research) of the HKMA and Director of the HKIMR) recently wrote a short article entitled “Renminbi Internationalisation: A Primer”. It aims to provide a succinct introduction to this complex subject. If you are interested in reading the article, it can be downloaded from the HKIMR website at the link:

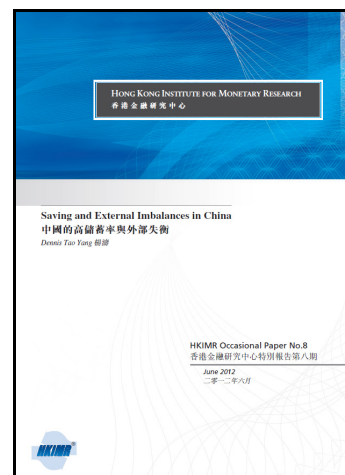
http://www.hkimr.org/cms/upload/news_app/news_0_86_Renminbi%20Internationalisation--A%20Primer.pdf

HKIMR Occasional Paper No.8

The institute has published its eighth occasional paper entitled “Saving and External Imbalances in China” written by Dennis Tao Yang of The Chinese University of Hong Kong.

This paper presents a unified framework for understanding the structural causes of internal and external macroeconomic imbalances in China. This paper argues that the imbalances are attributable to a set of policies and institutions embedded in the economy and that China’s accession to the World Trade Organization has dramatically amplified the effects of these structural distortions. China’s demographics and population control policies are also important factors behind the high saving rate.

The author also documents major trends in aggregate savings, investment, trade, and net foreign asset positions in China, and explores options for policy reforms aimed at rebalancing the Chinese economy.



Visiting Fellow – Roger E. A. Farmer



“The research group at the HKIMR is vibrant and inquisitive. The view over the harbor from the 79th floor is inspiring. This is a great combination for stimulating new ideas.”

Roger E. A. Farmer is Distinguished Professor and Chair of the Economics department at UCLA. He has previously held positions at the University of Pennsylvania, the European University Institute and the University of Toronto. He is a Fellow of the Econometric Society, Research Associate of the National Bureau of Economic Research, Research Associate of the Centre for Economic Policy Research, Fellow Commoner of Cambridge University, and Co-Editor of the International Journal of Economic Theory. In 2000, he was awarded the University of Helsinki medal in recognition of his work on self-fulfilling prophecies and indeterminacy. He is a specialist in macroeconomic theory, monetary and fiscal policy and the author of six books and numerous scholarly articles in leading economic journals.

I was fortunate enough to visit the HKIMR in July of 2012. This was my first time in Hong Kong and I was struck by the vitality and energy of the city. Flying into Hong Kong is like flying into a combination of Vancouver and Manhattan. Like Vancouver, Hong Kong is a Pacific Rim city on an island chain. Like Manhattan it is a city of skyscrapers.

The research group at the HKIMR is vibrant and inquisitive. The view over the harbor from the 79th floor is inspiring. This is a great combination for stimulating new ideas.

During my time at the HKIMR, I completed the work on a new paper ‘The evolution of endogenous business cycles’. This paper explains the connection between two kinds of theories of the business cycle that I call EBC1 and EBC2 models. Both kinds use the idea that general equilibrium models with indeterminacy can be used to explain the real world but they do it in different ways. The main idea of the paper is that EBC2 models represent a return to the key idea in Keynes: that high involuntary unemployment can persist as the equilibrium of a market economy.

In the last hundred years, there have been two major changes in the way that macroeconomists think about their subject. Both of them were triggered by real world events that were hard to understand in terms of contemporaneous economic theory. In the 1930s, the Great Depression led to a shift from classical to Keynesian economics. The economy was no longer seen as a self-stabilizing system and instead, under the Keynesian system, persistent involuntary unemployment was recognized as a possibility.

In the 1970s, with the occurrence of high inflation and high unemployment, macroeconomists reverted to classical ideas of the 1920s, but those ideas were formulated in the language of dynamic stochastic general equilibrium theory. For twenty-five years, from 1982 through 2007, we have been refining DSGE models until, in 2007, macroeconomics arrived at a point where we were able to recreate the classical economics of the 1920s using the mathematics of functional analysis. First generation EBC1 models were an important part of this research agenda.

The Great Recession of 2008 is another game changing event. Although the Recession was declared to be over by the NBER in June of 2009, the U.S. has since experienced more than thirty-six consecutive months of unemployment above 8%. As of July 2012, there are no signs that the economy will recover soon.

One of the most important ideas to come from Keynes' General Theory was that high unemployment can persist as an equilibrium phenomenon. Second generation EBC2 models provide a microfoundation to this idea, and just as EBC1 models were part of the DSGE agenda that provided a microfoundation for the economics of classical ideas, EBC2 models provide a microfoundation for the economics of Keynes. The idea that involuntary unemployment can persist as an equilibrium phenomenon is one that will gain more credence, the longer the current recession persists.



“During my time at the HKIMR, I completed the work on a new paper ‘The evolution of endogenous business cycles’. This paper explains the connection between two kinds of theories of the business cycle.”

Visiting Fellow – Nelson C. Mark

Nelson C. Mark is the DeCrane Professor of International Economics at the University of Notre Dame. He is also the Economics Department's Director of Graduate Studies and the North American Editor of the Pacific Economic Review and has a Ph.D. from the University of Chicago. Before moving to Notre Dame in 2003, he worked through the professorial ranks from Assistant to Full Professor at the Ohio State University. His ongoing research includes the study of Chinese household savings and understanding exchange rate dynamics.

During the spring semester of 2012, I took my first sabbatical leave in 29 years as a university professor. This freed up my schedule to be a Visiting Fellow at the HKIMR where I spent four very enjoyable weeks. I was also happy to time my visit during a cooler time of the year (February and March).

During my visit, the HKIMR supported my work on a project to quantitatively model and to understand the household saving rate (currently about 30 percent) in China. The primary question that the project asks is how much of that 30 percent saving rate is due to the precautionary saving motive? While there are still many computations to be made as well as a good deal of “fine tuning” that needs to be done with the model, preliminary calculations suggest that two-thirds of the 30 percent saving rate is driven by the precautionary motive. This issue also has policy relevance as China seeks to rebalance growth away from investment towards consumption, an important channel to increase consumption is to find ways to lessen the need for precautionary saving.

The research environment at the HKIMR was outstanding and I had valuable interactions with other Visiting Fellows and the HKIMR staff who are both generous and knowledgeable about China's evolving economy and institutional background. I very much enjoyed edifying and stimulating conversations on topics ranging from technical time-series econometrics to Hong Kong politics.

To be completely honest, I appreciated the opportunity to live in Hong Kong as much as the research atmosphere of the HKIMR. Because Hong Kong is such a compact place it was relatively easy for me to interact with many outstanding economists at several Hong Kong universities. I also found the energy and vibrancy from being in one of the world's major financial centers to be both physically and mentally stimulating. They even have Bloomberg TV piped into the elevators, which was sort of cool.

To sum up, I am really grateful to the HKIMR for hosting me. My experience was productive and rewarding.



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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 2012.

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 Activities

Call for Papers: Conference on The Role of Financial System Reforms in Rebalancing the Chinese Economy

The HKIMR will hold its fourth Annual International Conference on the Chinese Economy in Hong Kong on 10-11 January 2013.

The conference is intended to provide a forum for academics, policymakers and business economists to discuss important analytical and policy issues related to the Chinese economy. Past conferences in this series attracted high-quality paper presentations and rigorous discussions, and were attended by researchers and China watchers from central banks and other institutions across the globe.

The theme of the forthcoming conference is “The Role of Financial System Reforms in Rebalancing the Chinese Economy”.

Possible topics include (but are not restricted to):

- Medium-term prospects of China’s external imbalances
- Underlying factors and distortions that contribute to imbalances
- Structure of factor and product markets and entry barriers
- Monetary, exchange rate, and fiscal policies
- Regulatory and supervisory structures and policies
- Efficiency and stability of the banking system and capital markets
- Interest rate liberalisation
- Capital account liberalisation and internationalisation of the renminbi
- Key issues in the housing market and housing finance
- Access to financing by small and medium-sized enterprises
- Informal finance and “shadow banking”
- Financial development and social inequality

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 3 October 2012 (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 are selected by 9 November 2012.

Presenters will be reimbursed for reasonable travel expenses and accommodation. For further information, please e-mail hkimr@hkma.gov.hk or visit the HKIMR website <http://www.hkimr.org>.

The 5th Expert Forum on Advanced Stress Testing Techniques

The HKIMR and the Monetary and Capital Markets Department of the International Monetary Fund will jointly organise the “5th Expert Forum on Advanced Stress Testing Techniques” on 9 and 10 October 2012 in Hong Kong. The forum aims to bring together experts and practitioners from various central banks and international organisations to share their knowledge and experience on best practice tools and techniques for banking system stress testing.

The Tenth HKIMR Conference on the Mainland Economy

The HKIMR will organise a conference on the Mainland economy on 5 and 6 November 2012 in Hong Kong. This conference will be the tenth of the institute’s conference series on the Mainland in *Putonghua*. The theme of this conference will be “Chinese Firms and Capital Going Global: Opportunities and Challenges” (中國企業與資金走出去的機遇與挑戰).

Conference on “The BRICS & Asia, Currency Internationalisation and International Monetary Reform”

The HKIMR plans to co-organise a conference on “The BRICS & Asia, Currency Internationalisation and International Monetary Reform” with The Centre for International Governance Innovation (CIGI) and Asian Development Bank (ADB) on 10 and 11 December 2012. The conference will examine a range of views on the fundamental systemic problems that are pushing countries to seek international monetary reforms, and the views from the BRICS and Asian countries regarding currency internationalisation and orderly adjustment of the international monetary system.

Visiting Fellows and Seminars

6 August – 21 December 2012 (part-time basis)
Julan Du (The Chinese University of Hong Kong)

22 October – 2 November 2012
Juan F. Rubio-Ramírez (Duke University)

31 August 2012 *From World Factory to World Creditor: The External Wealth of China and Excess Returns* – Yi Huang (International Monetary Fund)

Recent HKIMR Working Papers

No.04/2012 “*The Trade Comovement Puzzle and the Margins of International Trade*” by Wei Liao and Ana Maria Santacreu

No.05/2012 “*Financial Innovation: The Bright and the Dark Sides*” by Thorsten Beck, Tao Chen, Chen Lin and Frank M. Song

No.06/2012 “*Sudden Spikes in Global Risk*” by Philippe Bacchetta and Eric van Wincoop

No.07/2012 “*Mega-Banks’ Self-Insurance with Cocos: A Work in Progress*” by George M. von Furstenberg

No.08/2012 “*Productivity Growth of the Non-Tradable Sectors in China*” by Dong He, Wenlang Zhang, Gaofeng Han and Tommy Wu

No.09/2012 “*How would Capital Account Liberalisation Affect China’s Capital Flows and the Renminbi Real Exchange Rates?*” by Dong He, Lillian Cheung, Wenlang Zhang and Tommy Wu

No.10/2012 “*Déjà vu All Over Again: Agency, Uncertainty, Leverage and the Panic of 1857*” by Timothy John Riddiough and Howard E. Thompson

No.11/2012 “*Trilemma Policy Convergence Patterns and Output Volatility*” by Joshua Aizenman and Hiro Ito

No.12/2012 “*How Important are Foreign Ownership Linkages for International Stock Returns?*” by Söhnke M. Bartram, John Griffin and David Ng

No.13/2012 “*The RMB Debate: Empirical Analysis on the Effects of Exchange Rate Shocks in China and Japan*” by Soyoung Kim and Yoonbai Kim

No.14/2012 “*Firm Survival and Financial Development: Evidence from a Panel of Emerging Asian Economies*” by Serafeim Tsoukas

No.15/2012 “*Regulatory Arbitrage and International Bank Flows*” by Joel F. Houston, Chen Lin and Yue Ma

No.16/2012 “*Estimating Option-Implied Correlation between iTraxx Europe Financial and Corporate Sub-Indexes*” by Cho-hoi Hui, Chi-fai Lo and Chun-sing Lau

No.17/2012 “*China’s Outward Direct Investment: Evidence from a New Micro Dataset*” by Wei Liao and Kevin K. Tsui

No.18/2012 “*Capital Inflows and Asset Prices: Evidence from Emerging Asia*” by Peter Tillmann

No.19/2012 “*Innovation, Diffusion, and Trade: Theory and Measurement*” by Ana Maria Santacreu and more please visit our website.

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