

Discussion of “The Impact of US Monetary Policy and Other External Shocks on the Hong Kong Economy: A Factor-Augmented VAR Approach”
by Hongyi Chen and Andrew Tsang

Paul Luk

Hong Kong Baptist University

Outline

- Summary.
- Contribution.
- Discussion.

Summary

- This study uses the FAVAR approach to study the response of the HK economy to the following shocks:
 - US Fed monetary policy tightening.
 - ECB monetary policy easing.
 - BoJ monetary policy easing.
 - Mainland economic slowdown.

Summary

- The data consist of 116 quarterly series on HK economy from 1998q4-2015q2, covering real, financial and housing variables.
- Four external shocks are proxied by:
 - Fed MP: US shadow policy rate (Wu and Xia, 2014).
 - ECB MP: EA shadow policy rate (Wu and Xia, 2014).
 - BoJ MP: BoJ monetary policy stance (Krippner, 2013).
 - Mainland GDP: CEIC and author's estimation.

Summary

- Main findings:
 - US monetary policy tightening affects HK through nominal variables (e.g. HSI, NEER) and interest rate sensitive sectors; small effect on real economic variables.
 - Mainland slowdown affects real quantities in HK such as real GDP growth, import and export, and unemployment.
 - Impact of monetary policy by ECB and BoJ on HK real sector is relatively small.
 - For all shocks, the impact on financial stability variables is moderate.

Contribution and merits

- A timely and important empirical investigation on the extent to which external shocks affect the HK economy.
- Spillover effects of US quantitative easing (QE) to small open economies are still unclear.
 - Theoretical underpinnings of QE are still developing. (Woodford, 2012; Gambacorta et al. 2012)

Contribution and merits

- The FAVAR approach is flexible and allows information to be extracted from a large dataset.
 - FAVAR generates a rich set of impulse responses on different sectors of the HK economy which are of interest to policymakers.
- Scenario analysis useful for policymaker.
- Model passes numerous robustness tests.

Discussion

1. What are the “monetary policy shocks” measuring?

- A large literature is devoted to the identification of the *unanticipated* component of monetary policy shocks. (See the structural VAR literature)
- Since the US shadow interest rate is the *only* US variable in the estimation, to what extent the shock measures the US monetary policy shock?
- To be precise, suppose Fed uses this Taylor rule:

$$R_t = \beta\pi_t + \gamma(y_t - y_t^n) + \epsilon_t$$

- A rise in R_t can be caused by arise in ϵ_t , the unanticipated component of MP, or a cost-push shock which raises US inflation π_t , or say a negative productivity shock which reduces the natural rate of output y_t^n .

Discussion

- 1. What are the “monetary policy shocks” measuring?
- Do the shadow interest rates capture the announcement effect or the actual policy change?
 - For instance, Woodford (2012) argue that announcements of QE themselves contain all relevant information about the Fed’s policy actions.

Discussion

2. Similarly, what does the “Mainland growth slowdown” capture?

- One alternative is to follow Dahlhaus, Hess and Reza (2014) who use both US and Canadian data to identify factors in their two-country model.
- Asymmetric shocks.
 - Nominal US shock and real Chinese shock.
 - Does this assumption of asymmetric shocks drive the result that US shocks affect nominal quantities in HK whereas Chinese shocks affect real quantities?
 - Why not simply use Chinese monetary policy shock? He and Pauwel (2008) for instance proxy monetary policy stance in China.

Discussion

3. ECB and BoJ monetary policy.

- To what extent are they exogenous? Or just endogenous reaction to global shocks?
- “Currency war at ZLB”? (Caballero, Farhi and Gourinchas, 2015)
 - Beggar-thy-neighbour type exchange rate devaluation through QE.
- Some rather counterintuitive results.
 - Opposite responses to NEER and property prices for the two shocks.

Discussion

4. It would be interesting to discuss more regarding the transmission of shocks to HK.

- Fixed exchange rate regime in HK prevents the HKMA to use monetary policy to target the domestic economy. (Trilemma)
- Closely related to Rey (2013) and Bruno and Shin (2016).
- HK has a large banking sector. It would be interesting to discuss the extent to which global liquidity is transmitted to HK through the banking.
- What is the role of macro-prudential policy?

Final remarks

- Excellent and timely work to explore the spillover effects of external shocks to HK as a small open economy.
- Main takeaway: HK's financial stability is resilient to the combined effect of external shocks of a normalisation of the US monetary policy and a slowdown in the Chinese economy.