Comments on:

Determinants of global spillovers from US monetary policy

by

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Question and Answer

- How much does US monetary policy spillover to other countries' real economies?
- Using G-VAR with sign restrictions, finds much support for large <u>economic</u> spillovers
  - US MPO has large impact on GDP, even larger than on US'
  - Effects depend on country's economic, institutional and other characteristics (trade and financial integration), and can differ between Advanced and Emerging Economies
  - But: capital controls do not matter; some policies have costs
  - Robust to different periods, restrictions, measures of Δ MPO

Relevance: Surely a worthwhile topic

- Recent developments have led to large demand for better assessments of (monetary policy) spillovers
- Thinking used to be MPO spillovers were small with just nominal frictions, and limited welfare gains of MPO coordination internationally
- But these models had limited financial frictions and no other non-linearities or convexities
- Some recent models have started to question this
- And much empirical evidence suggests the presence of a global financial cycle influenced in part by monetary policy in advanced countries

Main Comments

- Empirics ahead of theory and data in this area
  - Clearly do not have good model as to what drives what
  - And do not have enough detailed data for channels
- Analysis is very US MPO centric, but why it alone?
  - No obvious reasons to expect only US, or it is a proxy?
  - Could be other than (just) MPO?
- Hard time believing fully magnitudes/robustness
  - Find very large impacts of US MPO: something else?
  - Doing analysis in two stages could be problematic + questions of robustness in 2nd stage given few DOF

Is it US MPO?

- Financial cycle is more general and global
  - Cycle is commonality in: many dimensions - MPO, financial conditions, VIX, etc.; and many countries
- Is it thus MPO?
  - "Cannot rule out US business cycle spills over"
  - Even just financial cycle: can test also the leverage, balance sheets, risks appetite, etc. channels of Rey, Bruno-Shin, etc., using (similar) sign restrictions?
- And is US MPO unique?
  - Test MPO of €, £, ¥, etc. Also to compare sizes

Econometric methodology

- Not obvious two steps is best way to do
  - G-VAR provides impulses. Then take the lowest (trough) in 2nd stage. Regress on number of variables
  - But comes at a cost, very few degrees of freedom in 2nd stage, with many correlated country variables
- Instead: do G-VAR by groups of countries
  - Classify a priori classification, see if coefficients vary
- Or try interactions with prior variables 1st stage
  - E.g., make impact function of capital controls

1st Stage: identification and other questions

- Identification in 1st stage VARX is key
  - Have more faith in methods other than sign restrict
  - UMP vs. MP. Use some quantities?
- A few other, more minor quibbles
  - Careful using euro as numeraire given large exchange rate movements and its endogeneity
  - Consider wider euro area (e.g., also Denmark)
  - Study longer periods (before euro, since US MPO)
  - Odd classifications (e.g., why is Norway non-oil?)

If still using 2nd Stage, then..

- Reconsider dependent variable in 2nd stage
  - Not so obvious should be actual trough in GDP
  - Varies by country. Make timing of trough common?
- Reduce and adapt independent variables
  - Now long list, good on one hand (to do horse races)
  - But correlated (BTW show correlations!)
  - Use uni-variate first to select, then run with those
  - Less attempt to control for all other factors

Relate variables in 2nd stage more to (US) MPO and AEs vs. EMs

- Try variables more obviously related to US MPO
  - Use bilateral financial and trade links with US
- Other suggestions and robustness here
  - Try (other) RHS variables clearly related to monetary policy channels, e.g., state of banking systems, whole-sale (FX) funding, macro-prudential policies, etc.
- Advanced vs. Emerging Economy: not obvious
  - Distinction small once institutional, development etc. variables used; should capture differences AE vs. EM.
  - In other words, what can be left?

Policy Interpretation

- Be more careful here on interpretation
  - Obvious that less financial integration, lower development, "worse" country $\Rightarrow$ more insulated
  - But also hurts local growth and inefficient (globally)
  - And need to know all economic magnitudes
- Policy lessons (to be developed)
  - Formally need to find externalities of (US) MPO
  - Not clear ability to differentiate sufficient this way
- Related literature, other papers on spillovers missing
  - Bruno and Shin; Rey;