

Discussion of

“Trilemma, not Dilemma: Financial Globalisation and Monetary Policy Effectiveness” (by J. Georgiadis and A. Mehl)

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The views expressed in the presentation do not necessarily reflect the views of the Deutsche Bundesbank.

Motivation

- **Monetary trilemma**: trade-offs among choices of monetary independence, exchange rate stability, financial openness.
- Challenged by Rey (2013): Short-term interest rates increasingly determined by global financial cycle. Exchange rate regime does not matter.
- Most studies: To what extent are domestic int. rates driven by foreign int. rates for countries with fixed vs. flexible exch. rates and with restricted vs. unrestricted capital flows?
- Here: study domestic effects of MP shocks and relate effects to financial globalization.

Scope of paper

- Stage 1: Assess domestic transmission of MP shocks on GDP with a Mixed Cross-Section GVAR (Georgiadis (forthc.))
 - EA MP appropriately modelled
 - MP shocks identified using sign restrictions
- Stage 2: Regress trough GDP effects on gross foreign assets and liabilities („the global financial cycle“) and net foreign currency exposure effects (Meier (2013)), among others, for a sample of EA countries (baseline) and a larger country sample.
- Cumulated partial effects over time by applying regression coefficients to financial globalization to assess net effect.

Main findings and policy implications

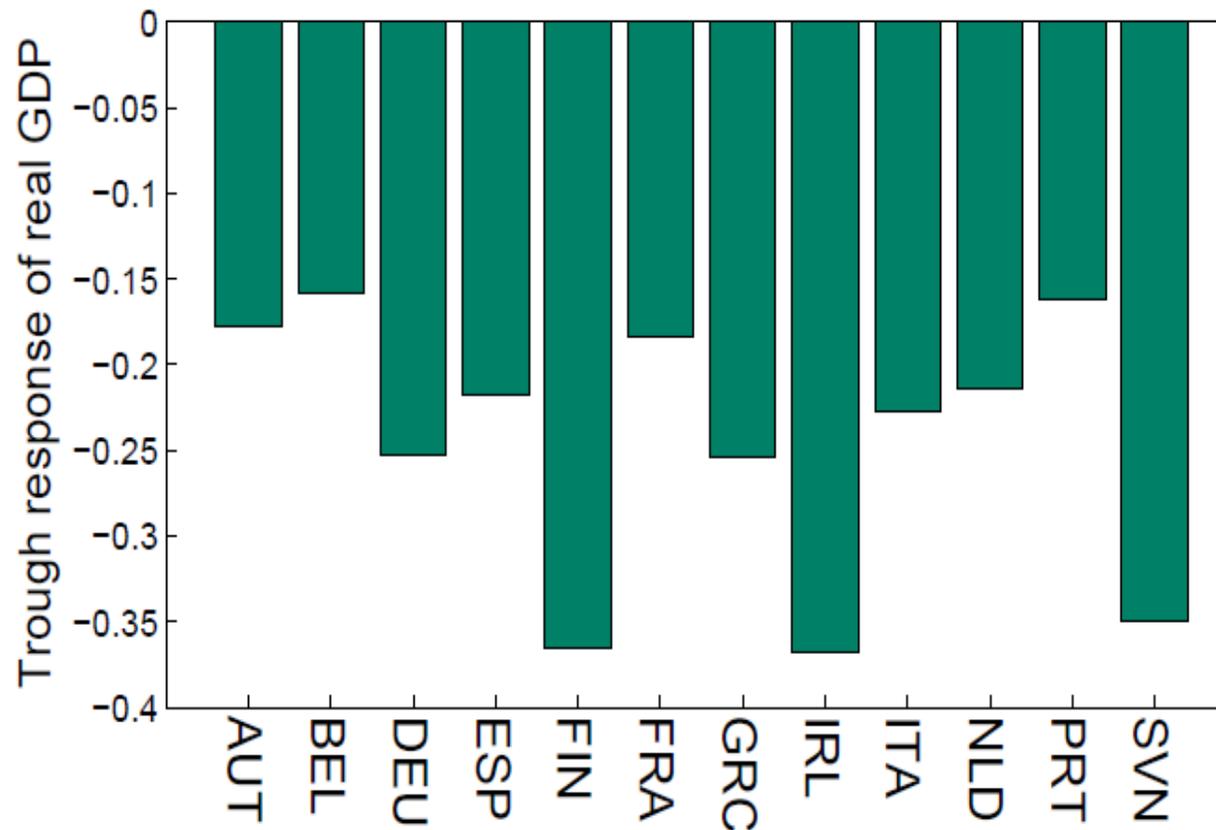
- Global financial cycle weakens the transmission of MP shocks, but net foreign currency exposure strengthens it.
- In net, strengthening of MP effectiveness through financial globalization in EMEs, but not in the EA (on average).
- Policy implications:
 - Flexible exchange rates support MP. → Trilemma valid.
 - Exchange rate channel gains and interest rate channel loses importance.

Assessment and overview of comments

- I much like the paper as it is!
 - (Policy-)relevant topic
 - Interesting results
 - Elaborated model
 - Very careful analysis with an impressive number of sensitivity checks
 - Very well written
- Comments
 - #1 Do estimated effects of MP shocks on GDP really differ across countries, and are they robust?
 - #2 and #3 Issues regarding the GVAR and MP shock identification
 - #4 Variance decomposition vs. IRFs
 - #5 Some (minor) inconsistencies
 - #6 Further comments

#1 How robust are effects of MP on GDP across models? Do they differ across countries?

Figure 2: Trough Response of Real GDP to a Contractionary Euro Area Monetary Policy Shock



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- Overview of results regarding the MP transmission to GDP (country ranking, by eyeballing, here only the four large countries)

<u>Paper</u>	<u>Model</u>	<u>Sample period</u>	<u>DE</u>	<u>ES</u>	<u>FR</u>	<u>IT</u>
Georgiadis, Mehl (2015)	MCSGVAR	1999-2009	1	3	4	2

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Boivin et al. (2008)	FAVAR	1999-2007	1	1	1	1
Mandler et al. (2015)	BVAR	1999-2014	1	4	1	1
Barigozzi et al. (2014)	structural factor model	1999-2007	1	4	3	1
Cavallo, Ribba (2014)	near VAR	1999-2011	1	3	4	2
Eickmeier (2009)	non-stationary struct. factor model	1981-2003	3	1	2	4

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-	local proj., Smets-Wouters	1999-2009	4	3	2	1
-	local proj., Reuters	1999-2009	3	3	2	1
-	local proj., NAWM	1999-2009	3	4	1	1
-	local proj., VAR (Peersman-Smets)	1999-2009	1	4	3	1

#1 How robust are effects of MP on GDP across models? Do they differ across countries?

- Ranking differs across studies.
- Why should we believe in your findings? Why is your model superior?
 - Validity of restrictions imposed in the various models? (factor structure in the data? need to account for heterogeneity in (which) coefficients?)
 - Fit/forecasting performance of models
- May be use local projections (Jorda (2005)) or distributed lag models to obtain largely model-free IRFs.
- Many studies find no statistically significant cross-country differences. Can you assess this formally?

#2 Issues regarding the GVAR

- Variables included
 - Paper is on financial globalization, but, except for exchange rate and short-term interest rate, no **financial variables** enter the GVAR as endogenous variables.
 - In Georgiadis (forthc.) you include as a check stock prices.
 - Boivin et al. (2008) find long-term interest rates to matter for the differential MP transmission in the EA.
 - Boivin et al. (2008): effects on GDP homogenous across countries, but effects on **consumption and investment** differ. Would it be interesting to do your analysis for GDP components?
- All variables, incl. interest rates, enter in first differences (to achieve stability of the system). This may not be appropriate if there is **cointegration**, which the standard GVAR literature (Pesaran and coauthors) takes into account.

#3 MP shock identification

- I would like to have the following information (perhaps in an appendix):
 - Entire shapes of IRFs? Are GDP responses consistent with long-run real neutrality? When do trough effects occur? Results for effects after 1 year? IRFs of other variables?
 - Can you provide details on sign restrictions? How do you deal with model uncertainty? How are sign restrictions implemented? Are MP shocks orthogonal to other domestic shocks, but can be correlated with foreign shocks?
 - Correlations with other countries' (MP) shocks in the GVAR?
 - You use, as a cross-check, MP shocks from SPF and Reuters, defined as (monthly/weekly) forecast errors of short-term interest rates. How did you deal with macroeconomic news?
- Some points tackled in Georgiadis (forthc), but [paper should be self contained](#).

#4 Variance decomposition vs. IRFs

- **Variance decompositions** can shed further light into issue. Has domestic MP been overlaid by other (foreign financial) factors?
- p. 1: *„Specifically, it has been argued that financial conditions in the world's foremost financial centre – namely the US – spill over to other economies through global financial cycles regardless of the exchange rate regime and override the efforts of local monetary policy to steer domestic financial conditions.“*
- ... and most studies cited look at the effects or importance of US MP.

#5 Some (smaller) inconsistencies

- Time-constant effects of MP vs. time-varying financial globalization (used to assess temporal evolution of cumulated partial effects).
 - Could be mentioned as a caveat. For future work (in other modelling frameworks) it would be good to exploit the time dimension as well by estimating time-varying param. models.
- Models estimated over 1999-2009. Cumulated partial effects of financial globalization shown for sample 1999-2012 (using financial globalization data until 2012 and 1999-2009 estimates). Why not estimate the models until 2012 or – easier – assess cumulated partial effects over 1999-2009?

#5 Some (smaller) inconsistencies

- EA cross-section regression estimates applied to non-EA IRFs to recover cumulated partial effects for non-EA countries. Later you also estimate a cross-section regression on the extended country sample, which yields smaller coefficients than for the EA sample. Perhaps do estimation for non-EA countries separately and apply estimated coefficients to gather the cumulated partial effects for these countries.
- EA sample used as baseline because countries are more homogenous and only need to control for few country characteristics. But individual EA countries have limited MP autonomy and exchange rate flexibility. Is it the ideal (baseline) sample to study the trilemma?

#6 Further comments

- How serious is the **generated regressand problem** (Feenstra and Hansen (1997))?
- Can you **relate your study to Rey (2013)** and explain why you obtain different results?
- It would be interesting to show **results for inflation** (has been shown to have an important global component and as there is an emerging literature on the link between financial markets and inflation).

Summary

- Very carefully conducted analysis, polished paper with interesting, policy-relevant results.
- Main point: MP effects in individual countries. Suggestions:
 - Model-free IRFs
 - Formally assess whether cross-country differences are statistically significant
- Further issues which should at least be discussed in paper or which could be addressed in future work.

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