



**Economic and Financial Linkages in the Western Hemisphere
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Spillovers across NAFTA

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Discussion of

Spillovers Across NAFTA

by Andrew Swiston and Tamim Bayoumi

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Summary

- A nice paper on a critically important issue; enjoyed reading it.
- Well executed empirical exercise
- Results are very interesting and topical
- I will: **(1)** provide a brief summary;
(2) raise three simple questions/comments

Why Study NAFTA?

- A natural laboratory environment to study the implications of globalization
- **World:** (1) Large countries, Small open advanced economies and Emerging Markets; (2) Rising trade and financial linkages; (3) Regional trade agreements
- **NAFTA**
 - A large advanced country=United States
 - A small open advanced economy= Canada
 - Emerging Market=Mexico
 - Substantial increase in trade and financial linkages
 - A major trade agreement

How to Study Spillovers?

- Various empirical approaches: Dynamic Panel Regressions; VARs; Factor Models; SDGE Models
- This paper: VARs with an innovative “quasi-Bayesian” approach to the usual problem of identification
- In simple terms, average the results across various Cholesky orderings
- Orderings help assign priors to the direction of causality and weights

What did we learn from the paper?

The paper attempts to answer two questions:

- 1. How large are the spillovers from the major regions of the world to Canada and Mexico?**

Answer:

- *Quite large especially those from the United States*
- *The US originated shocks have become more (less) important in Mexico (Canada) over time*

What did we learn from the paper?

2. How important are the channels of transmission associated with trade and financial linkages?

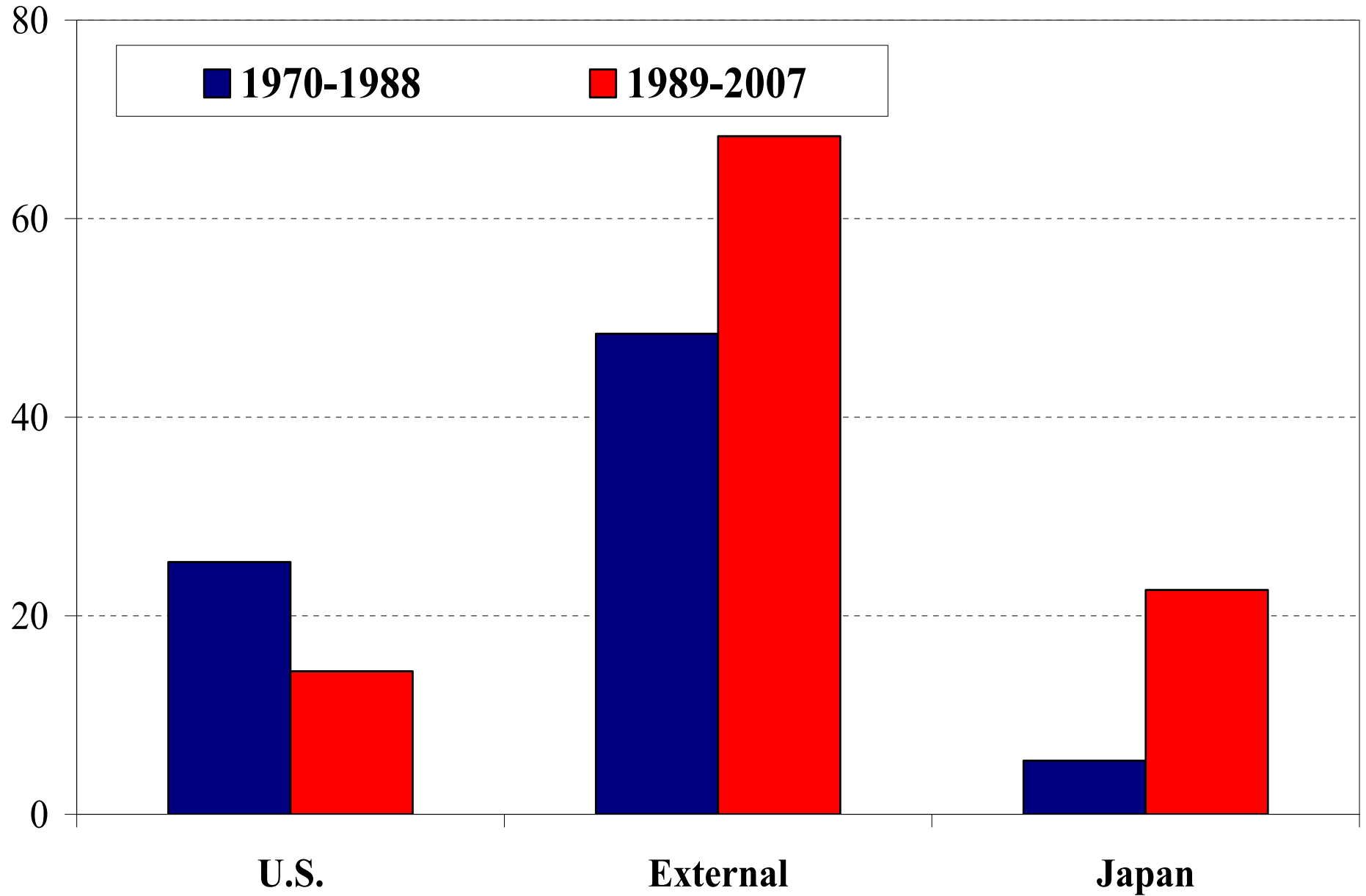
Answer:

- *Both are important for the full sample*
- *The role of financial linkages has become more pronounced over time*

Comment 1: Interesting differences in results for Canada and Mexico

- **Canada:** (1) Spillovers through external shocks have become more important after 1989;
(2) The importance of the U.S. spillovers has actually decreased
- **Mexico:** (1) Spillovers through external shocks have become more important after 1996;
(2) The importance of the U.S. spillovers has increased

CANADA: VARIANCE DECOMPOSITIONS OF GDP



Explaining this interesting result...

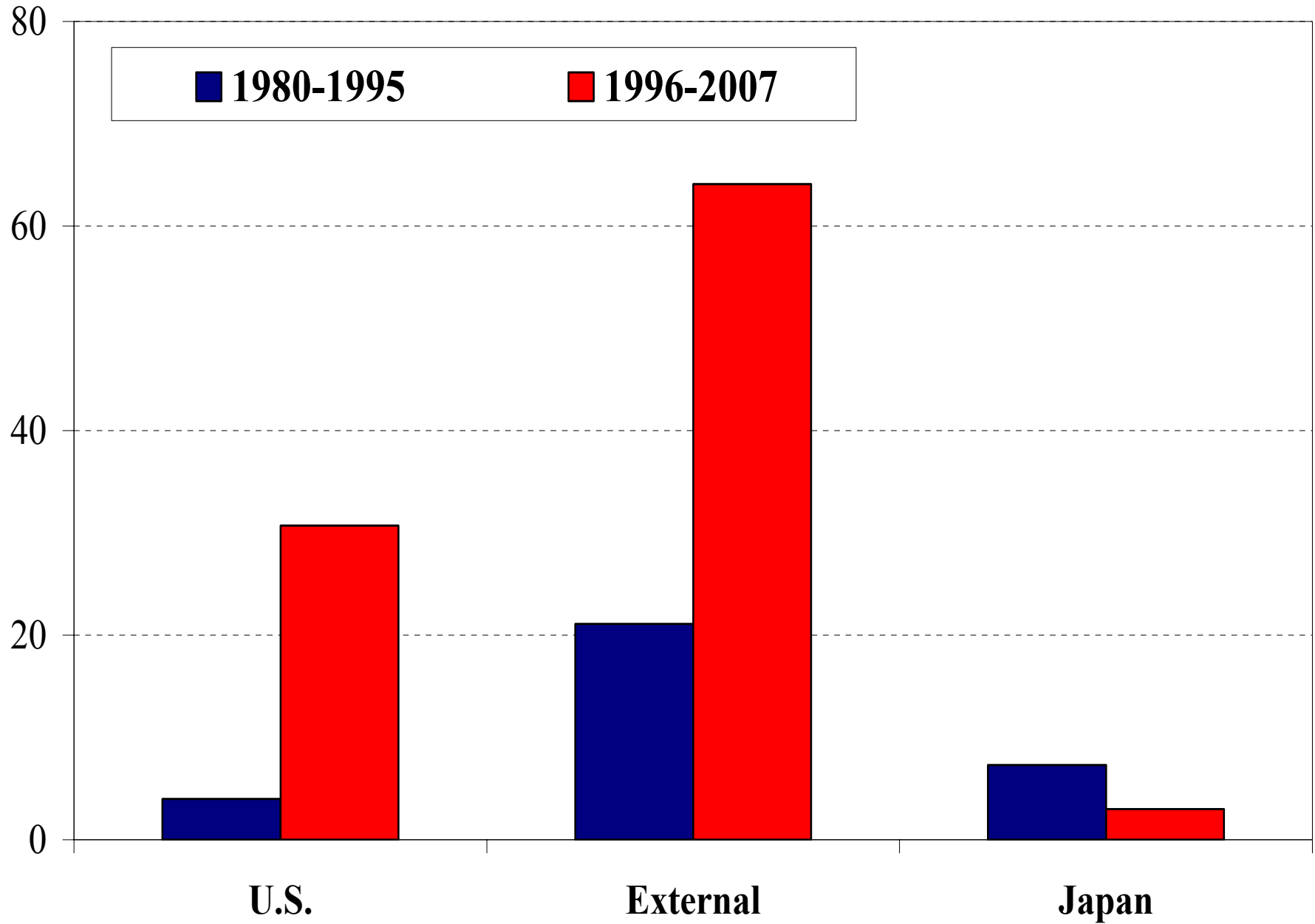
- CANADA
- “*Spillovers from the US to Canada have decreased over time, but not because of a decline in the degree of integration between two countries...”*

but because of the reduction in U.S. output volatility

“as the entire reduction can be attributed to the decline in U.S. volatility” (page 11)

- “*..., surprisingly, the importance of Japan has risen...*”

MEXICO: VARIANCE DECOMPOSITIONS OF GDP



Explaining this interesting result...

- MEXICO
- *“ While the overall importance of other countries on the Mexican economy has risen, the increased relative importance of U.S. spillovers indicates that growing cross-border linkages have tightened business cycle comovements between the two countries”*

Comment 1:

- *How can we explain the decrease in the importance of the U.S. originated shocks for Canada?*
- *A general equilibrium model would probably tell a different story*
 - *External factors becoming more important*
 - *The shocks originating in the main economic partner should be becoming important*
- *Certain changes in the time series properties of data? And what about the result with Japan?*

Comment 2: Focusing on the specific dates...

- US-Canada: 1989; CUSFTA
- US-Mexico: 1996; NAFTA (2 years after; crisis of 1994-95)
- Trade linkages in North America have been increasing since the beginning of the sample (1970)
- What about using alternative dates and rolling window estimates?

Comment 2: Focusing on the specific dates...

- Alternative dates:

 - Canada:**

 - 1984-85 (start of the great moderation in the US 84:Q4 ; for Canada 88:Q1)

 - Canada and Mexico:**

 - 1996 (the same date for both countries)
 - 1988 (the middle of the sample)

- Rolling window estimates:

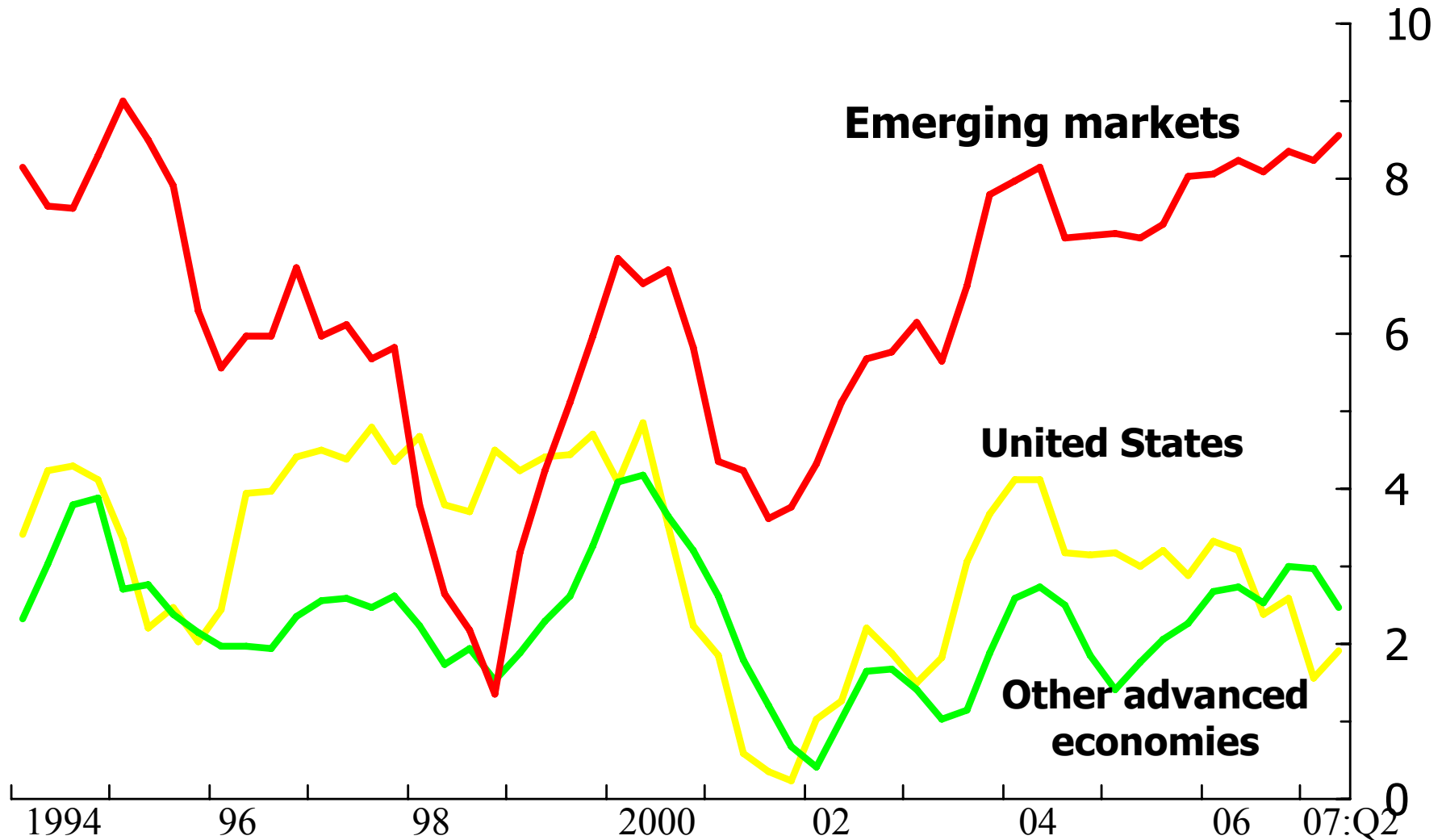
 - Start with the first sub-period, add 1-2 years and plot the responses for certain quarters (1Q, 4Q)
 - Are these responses stable? Changing substantially?

Comment 3: What do we learn about decoupling from this paper?

- The mother of all questions facing the world economy nowadays:
 - Can the rest of the world decouple from the United States?
- *The grandmother of all questions: Will there be a recession in the U.S. next year?*
- What do we learn from this paper about the decoupling question?

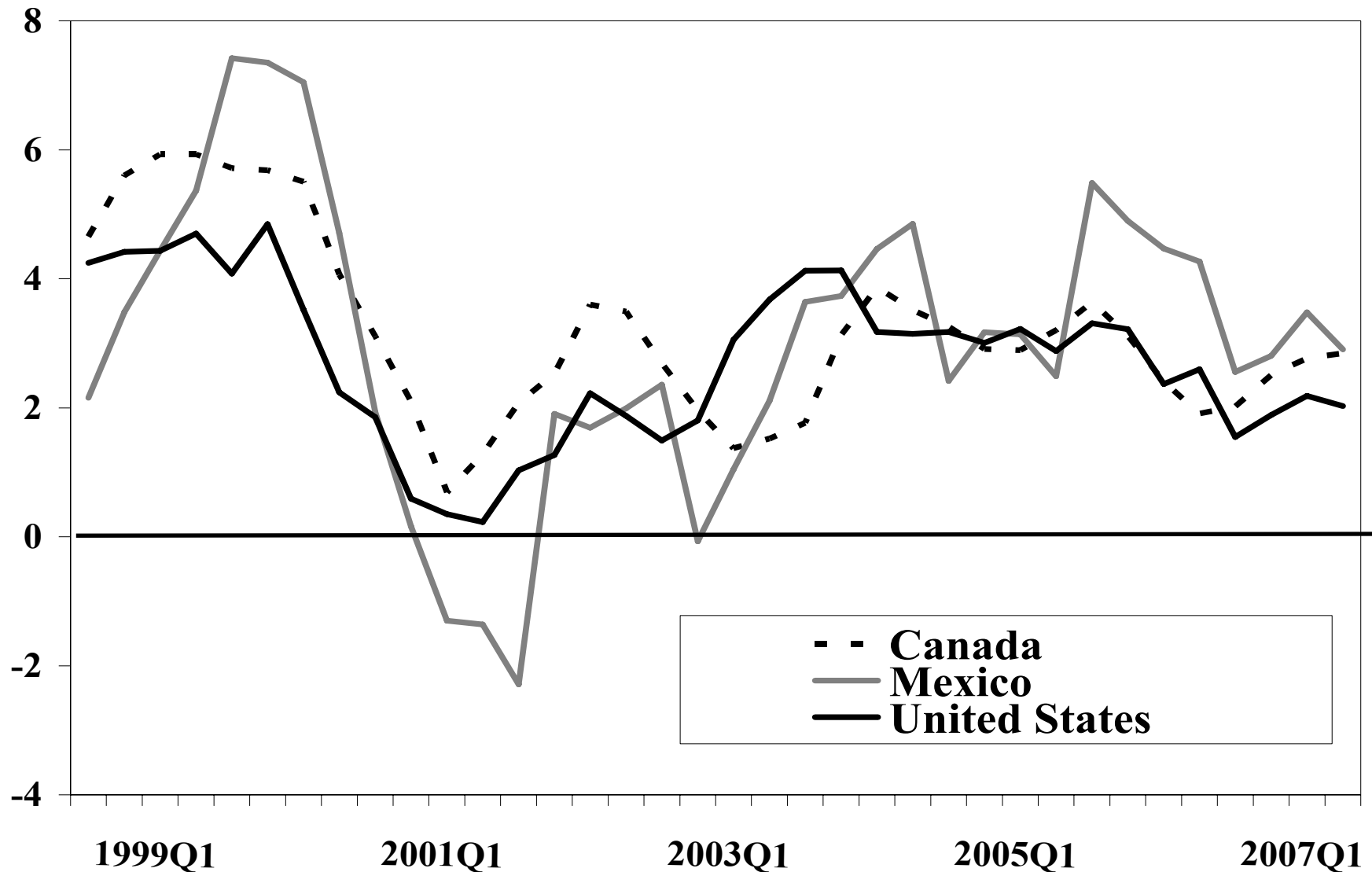
Growth Has Softened in the U.S.; But Remains Strong in Emerging Markets

(Real GDP; percent change from four quarters earlier)



Growth Has Softened in the U.S.; Canada Moderated? Mexico Picked Up?

(Real GDP; percent change from four quarters earlier)



Who believes in global decoupling?

- *An extensive discussion about the merits of global decoupling*
- *“We believe in decoupling” Investment Bank A, August 16*
- *“.. Decoupling (view) has already lost much credibility...” Investment Bank B, August 20*
- *“... The real test for decoupling is yet to come” Investment Bank C, September 4*
- *“... decoupling (view) stands on solid ground” Investment Bank D, September 19*

What about Canada?

- *“The link between Canada and the US has moderated, and a strong Canadian consumer could help cushion the impact... The Canadian economy could now be more resilient to a US slowdown.” Investment Bank A, September 6*
- *“Canada rarely decouples significantly from the U.S. economy, and when it happens, it is usually quite temporary.” Export Bank of Canada, June 6*
- *“If the US has a recession, there is reason to think that there could be scope for a partial decoupling, even though Canada would clearly be slowed as well. Canada is less linked to the U.S. than in the past, and so would not be dragged down as much as the historical norm.”
Investment Bank B, November 23*

What about Mexico?

- *“The Mexican economy is very well equipped to weather a U.S. deceleration but it's not immune”*
Investment Bank B, November 16
- *“There has been a decoupling of sorts if you look at the rate of growth of Mexican exports to non-US destinations... It's pretty striking.”* Investment Bank C,
November 16
- *“Soft September IP show the effect of the US economic downturn... Note that Mexico’s manufacturing companies are fully specialized in the US market and cannot sell their output elsewhere.”* Investment Bank D, November 15

And this paper...

- Has the necessary ammunition to shed some light on the decoupling debate in the context of Mexico and Canada...
- Results would be based on historical estimates (*of course*)
- The question then “What can the paper say about the contemporary/recent/future dynamics in light of its estimates?”

Conclusion

- A nice paper on a critically important issue; enjoyed reading it.
- Well executed exercise; Results are very interesting and topical.
- Has room to expand its already rich findings.