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Comments of "Global Impact of US and Euro Area Unconventional Monetary Policies: A Comparison"

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Discussion on Global Impact of US and Euro Area Unconventional Monetary Policies: A Comparison

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IMF 16th Jacques Polak Annual Research Conference
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Paper and Motivation

Paper tackles very relevant issue, spillovers from US and Euro Area Unconventional Monetary Policies (UMP)

Need for coordination? Authors argue there are different views:

- ✓ UMP address domestic issues, spillovers are unintended consequences. Not much room for improvement if individual players **implement policies to achieve domestic macro stability** (Obstfeld-Rogoff, 2002)

- ✓ Spillovers changed cost-benefit analysis, especially if there are **deviations from rules-based policies** (Taylor 2013). Spillovers may trigger macro instability in recipient economies, depending on their cyclical position

- ➢ **GVECM to analyze domestic and international impact of UMP**

Approach

Focus on impact of monetary policy shocks (MPS)

Is this right?

- ✓Ok, but keep in mind that spillovers from MPS are mostly unintended consequences of unintended shocks
- ✓Are the views in the previous slide so different?
- ✓Even if obvious to state, identification is critical!

A significant part of UMP is an endogenous response to real shocks

IMF (2014 and 2015 Spillover Reports) : underlying drivers matter, positive real shocks in AEs have positive spillovers despite ensuing tighter monetary conditions

- ✓ Conversely, easing UMP dampens the impact of spillovers from negative real shocks in advanced economies

Overview of Main Comments

✓ **Large estimation uncertainty, statistical significance**

✓ **Some results need more discussion, contrast with results in the literature**

Shock Identification

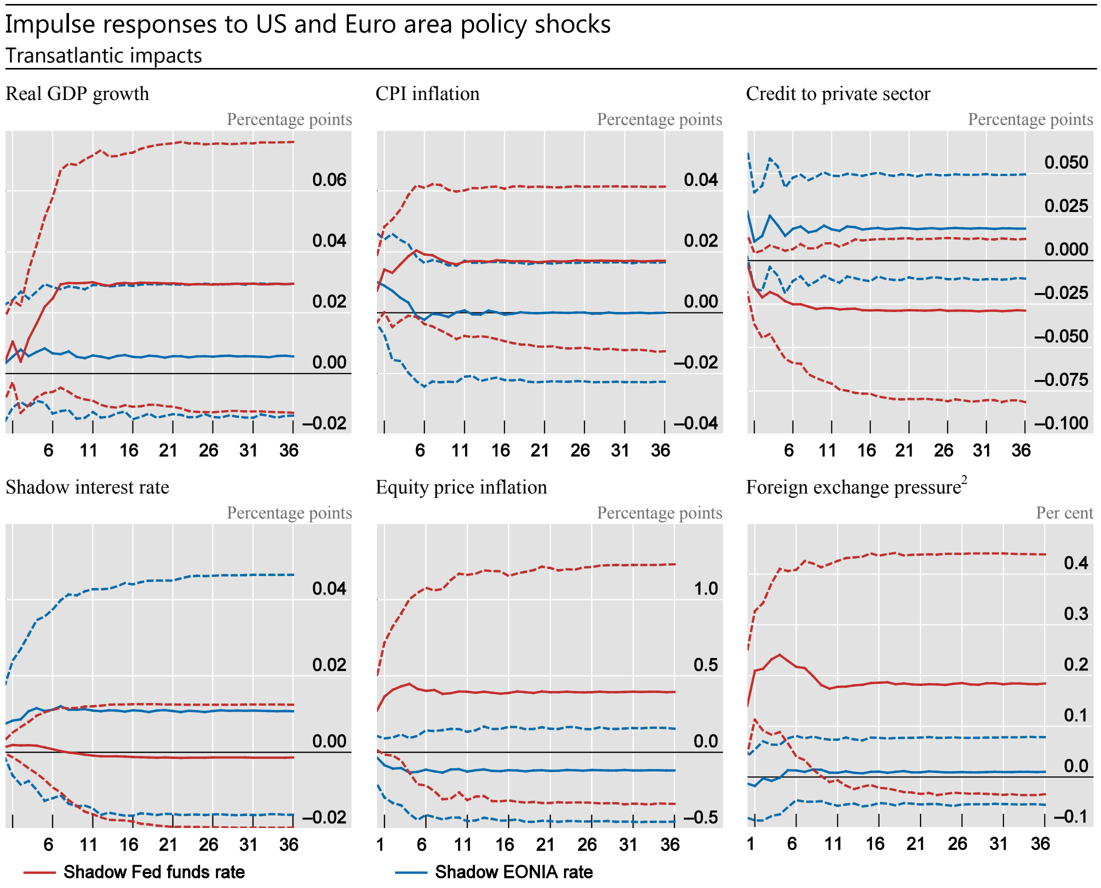
✓Shadow short term interest: unobservable variable to capture MPS

✓Identification strategy assumes US dominance

✓ Are these sensible choices?

Some results → Shadow rate → Identification assumptions → Alternative Approach → Conclusions

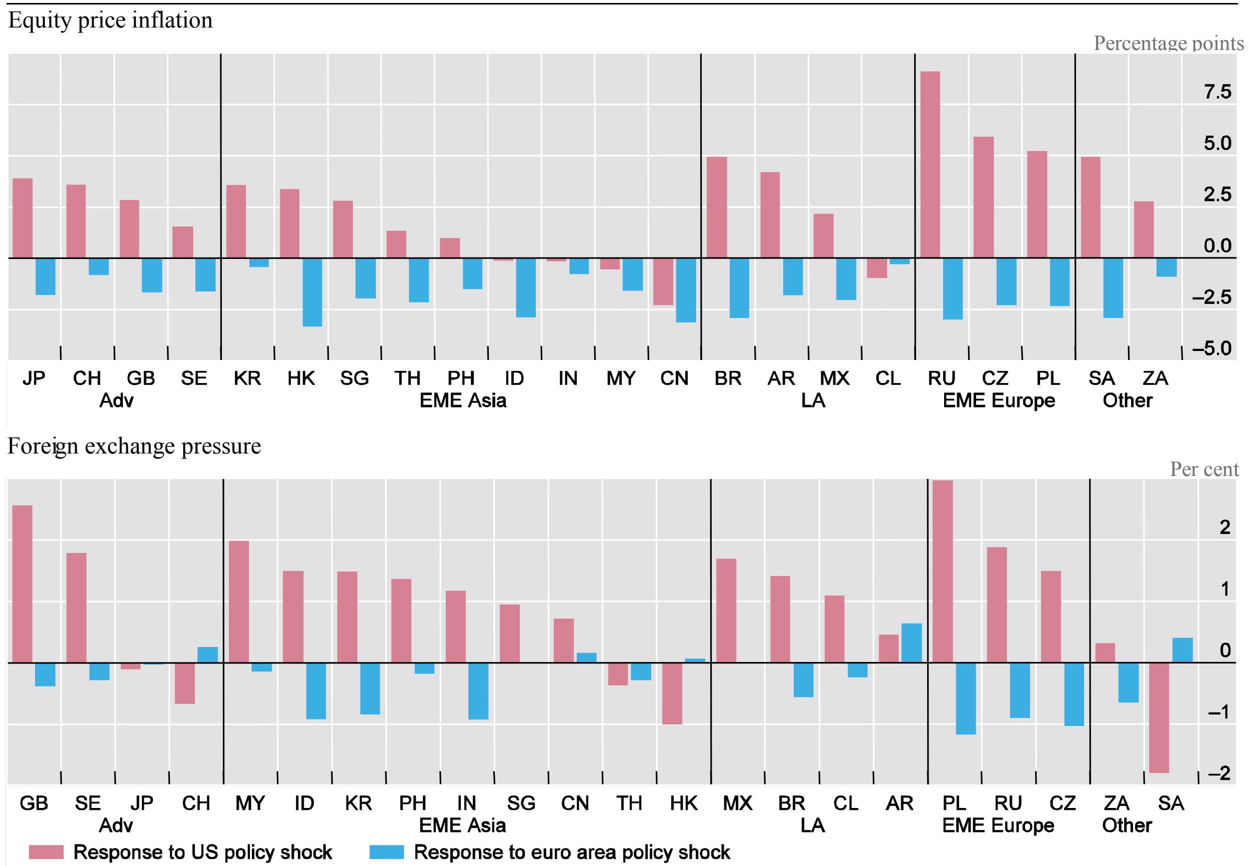
Trans-Atlantic Spillovers: 'Irrelevance' of Euro Area Shocks



- ✓ **In contrast with these results, some papers point to interdependence between the US and the euro area; especially after EMU**
  - **Ehrmann and Fratzscher 2002, 2003 and 2005; Ehrmann, Fratzscher and Rigobon 2011; Scotti 2011; and Osorio-Buitron and Vesperoni 2015**

Why ECB (easing) MPS reduce stock prices and trigger depreciations pressures in other countries?

Cumulative impulse responses to US and Euro area (loosening) monetary policy shock



- ✓ **Is this intuitive? Previous literature suggests that euro area easing UMP boosted equity prices and triggered euro depreciation**
  - **Fratzscher and others 2014; Georgiadis and Grab 2015**

Identification

Is the shadow short term rate a good variable to identify MPS?

- ✓ UMP operate through central banks' balance sheets, whole yield curve gives information about monetary stance
- ✓ Does shadow rate capture adjustments in the term premium well?

✓ A critical asymmetry is assumed—the US is not affected by foreign financial variables, while the euro area is affected by them, in the same way that Emerging Markets are affected

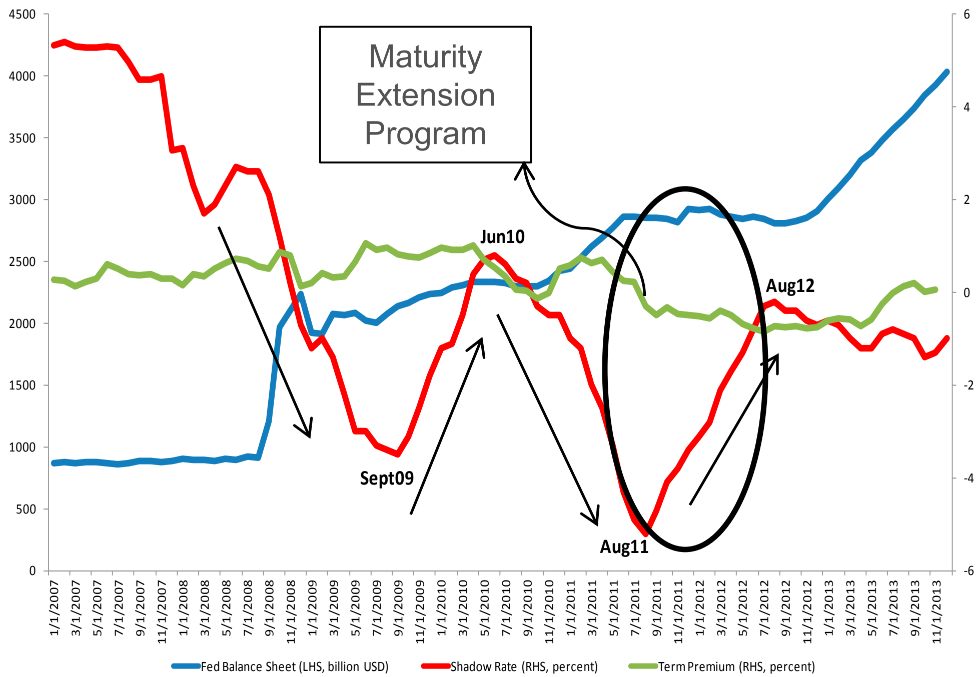
- ✓Other work suggest it may not be a safe to assume no spillovers EA → US
- ✓Is the US shock overestimated?
- ✓If this is the case, assumption is likely driving results on spillovers, notably the relative mild spillovers from euro area shocks

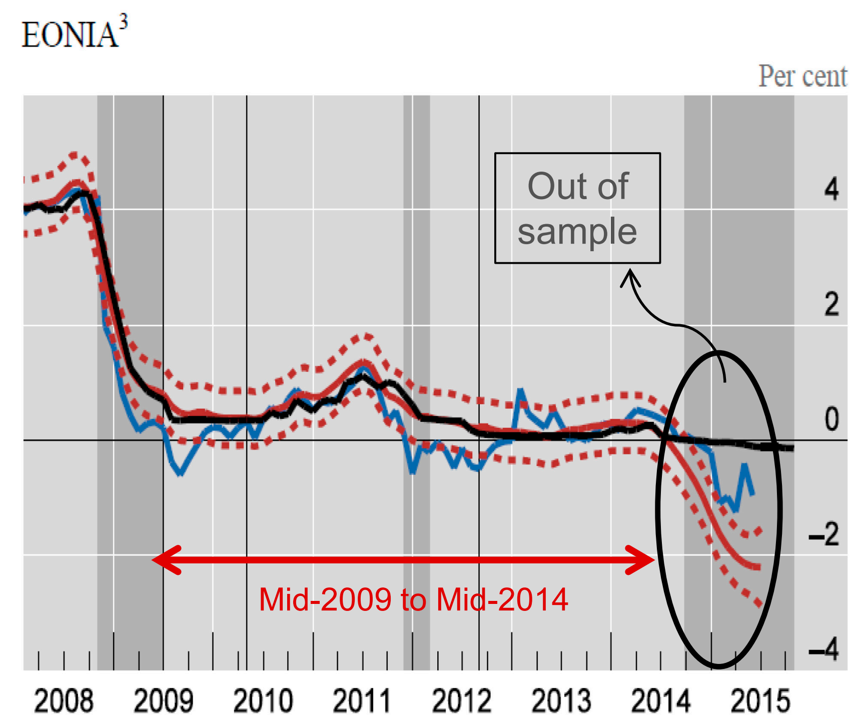
✓ It is critical to identify the source country of the shock

Shadow Short Term Interest Rate

- ✓ Have Fed UMP given place to such a volatile monetary policy stance?
- ✓ Has the MEP triggered such a tightening of the monetary policy stance?

  Maybe not, shadow rate captures impact of treasury bills sales, but not of long term debt purchases—see term premium?
- ✓ Sample is missing the most active ECB policies





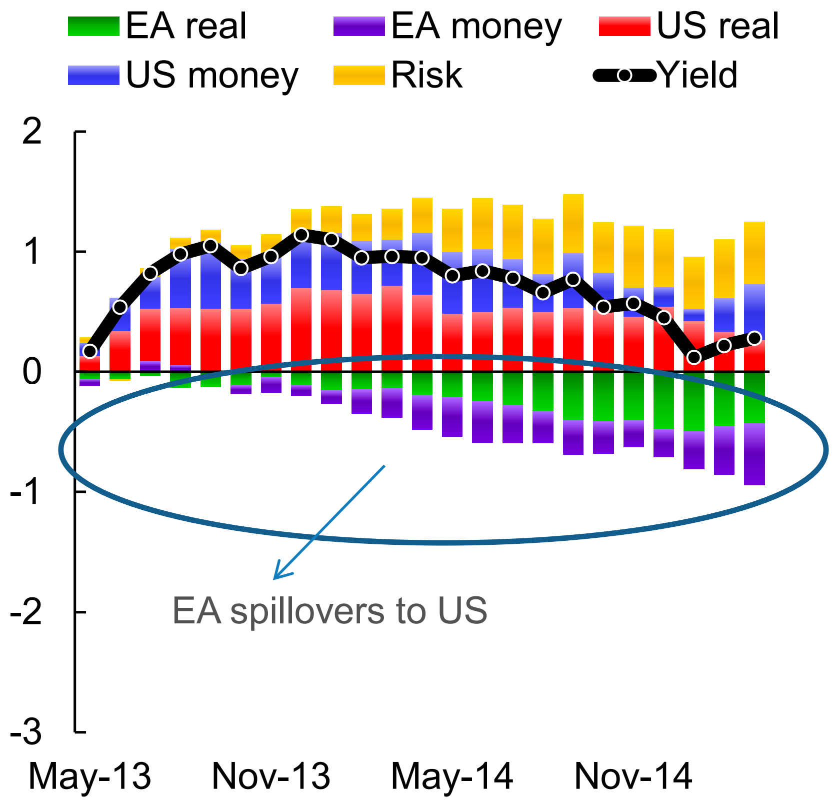
An Alternative: Joint Identification of US and EA Shocks

In the 2015 Spillover Report, we jointly identify country-specific real and money shocks in the US and the euro area, and associated spillovers

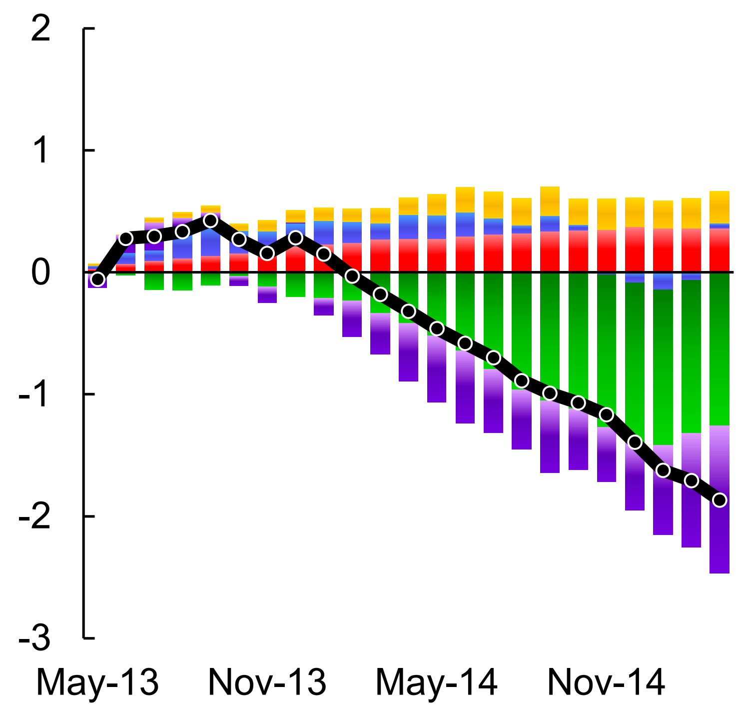
✓Use information on stock prices and long term bond yields

✓Two-country VAR with sign restrictions

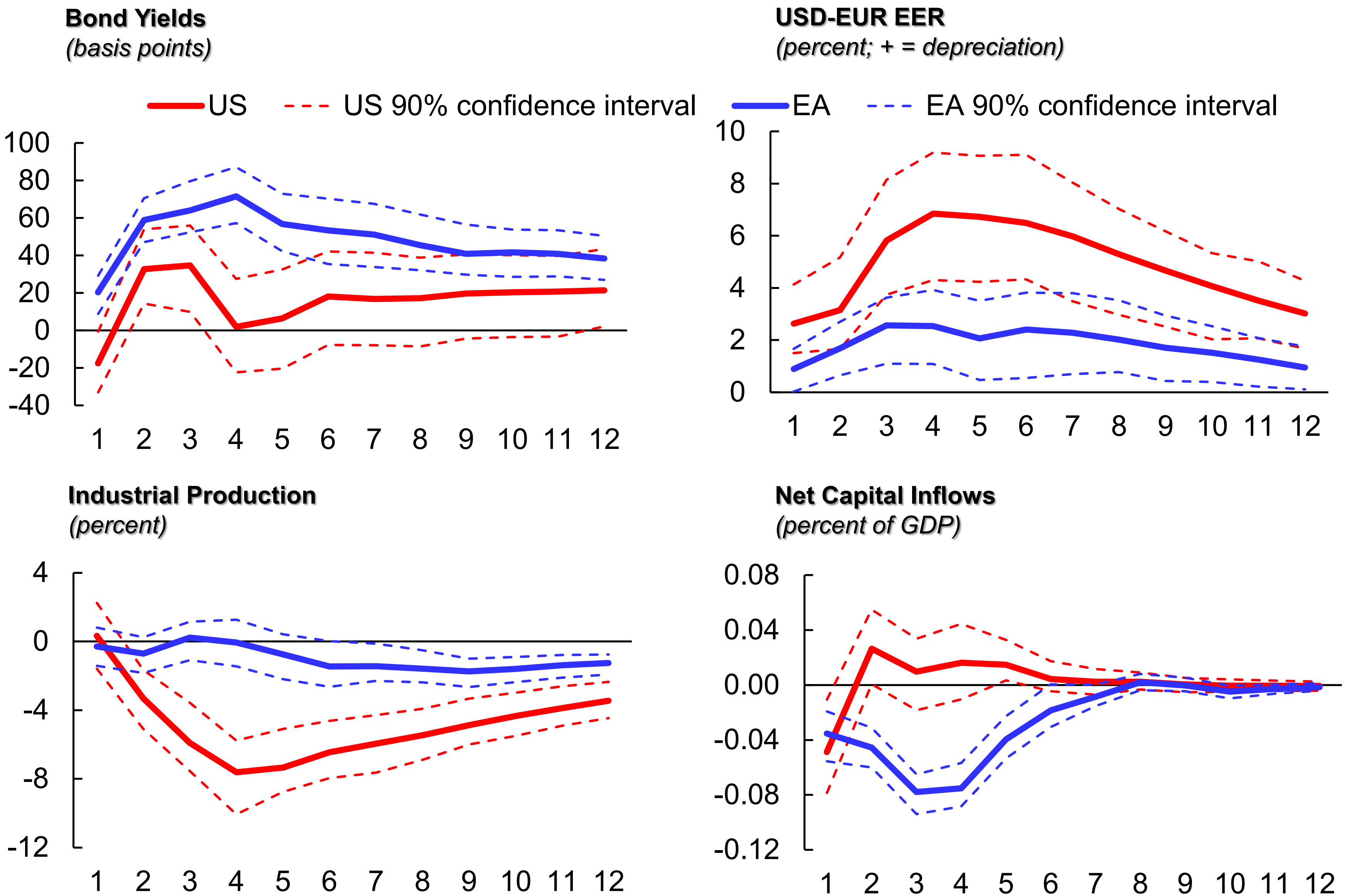
US: 10 Year Yield decomposition
(cumulative change; percent)



EA: 10 Year Yield decomposition
(cumulative change; percent)



Monetary Shocks: Spillovers to EEs and Non-systemic AEs



Source: IMF staff calculations.

Conclusions

- Paper looks into a very relevant issue, a great effort, but be mindful of how contrasting are different views on UMP

- Large estimation uncertainty (statistical significance)—need to address this
- Some results do not look intuitive and contrast with previous work—more discussion needed

- Would be useful to revisit identification:

- Think about the variable to capture monetary policy stance
- Identification approach:
  - Lower bound: check correlation between shocks
  - More ambitious: 'symmetric' approach for identification, no US dominance
  - First best: estimate shocks jointly to identify source