COMMENTS ON THE PAPER

The Responsiveness of Monetary Policy to Financial Stress: A Dynamic Panel Threshold Analysis

Bjorn van Roye, Danvee Floro and Joselito R. Basilio (Authors)

Comments by

Dennis S. Mapa
Professor and Dean
School of Statistics
University of the Philippines Diliman
Research Objectives and Research Questions

The paper wants to quantify central banks’ monetary policy response to financial stress depending on the intensity of the financial stress (“low” and “high”).

In particular,

a) The paper wants to know if there is a “threshold level by which monetary policy responds directly to financial stress.”

b) The paper also wants to know whether central banks behave asymmetrically to output loss effects when financial stress is “low” or “high”.

Econometric Model

- The paper uses the Financial Stress Index (FSI)-augmented Taylor Rule and applies the dynamic panel threshold model to determine the impact of “low” stress regime and “high” stress regime on the short-term interest rate.

- The “low” or “high stress regime is determined based on the value of the FSI.

- Empirical analyses were made on the database of 22 central banks consisting of 10 advanced economies (AE) and 12 emerging markets economies using quarterly data from 1996Q2 to 2013Q3 (full data).

- Sub-analyses were also made for shorter data sets: 2002Q1 to 2013Q3 and 2008Q1 to 2013Q3
Results of the Study

The authors find that,

- For central banks in the AEs, the negative impact of financial stress on interest rate setting is more pronounced when financial stress is low.

- For central banks in the EMEs, the financial stress only figures significantly in the post-2001 estimation period, also when financial stress is low.

- The AE central banks react to output developments counter-cyclically regardless of whether the economy is in low or high financial stress regime.
Overall Comment

The paper has achieved its goals of bringing understanding to the changing dynamics of monetary policy in selected advanced and emerging market economies despite some restrictions to its interpretation due to the imposed assumptions of its model.
Specific Comments

1. Consistency of the threshold value

The results of the analysis depend on the threshold. Are the results robust with respect to the threshold values?

<table>
<thead>
<tr>
<th>Economy</th>
<th>Full Data</th>
<th>Reduced Data</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economy</td>
<td>1996Q2 to 2013Q3</td>
<td>2002Q1 to 2013Q3</td>
</tr>
<tr>
<td>22 Economies</td>
<td>0.656</td>
<td>0.362</td>
</tr>
<tr>
<td>95% CI</td>
<td>[-1.823, 1.673]</td>
<td>[-1.856, 1.516]</td>
</tr>
<tr>
<td>10 AE</td>
<td>0.744</td>
<td>0.996</td>
</tr>
<tr>
<td>95% CI</td>
<td>[0.271, 1.053]</td>
<td>[0.752, 0.996]</td>
</tr>
<tr>
<td>12 EME</td>
<td>0.656</td>
<td>0.362</td>
</tr>
<tr>
<td>95% CI</td>
<td>[-1.479, 1.728]</td>
<td>[-1.531, 1.1228]</td>
</tr>
</tbody>
</table>
2. Issue on reverse causality

The FSI is constructed from indicators that are highly influenced by interest rate.

The authors are suggesting that “low” level of FSI is affecting (negatively) interest rate setting, when the financial stress is low. This “causality” argument will not be valid under the condition of reverse causality.