Estimating Macro-Financial Linkages in Asia

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Motivation and Objective

- **Motivation:** The importance of macro-financial linkages in the light of Global Financial Crisis and the Great Recession.
  - Interactions between financial sector developments and real activity (financial shocks --> business cycles)

- **Objective:** To examine the relationship between financial cycles and real sector cycles in emerging Asian economies
Methodology

1. **Spectral or frequency domain methods:** applied to Emerging Asian economies and the idea was to identify the difference in the macro-financial linkages spectrum in the short, medium and long run period (versus linear filters that will average out across time).

2. **Bayesian VAR analysis with Minnesota prior:** the objective is to overcome the data dimensionality problem which traditional VAR models have.
Findings

- **Spectral or frequency domain methods:** In the long run, financial sector developments are closely associated with economic growth, especially growth in bank lending.

- **Strong interactions between financial cycles and economic cycles**

- **BVAR:** In emerging Asia, financial shocks originated from equity or house prices make considerable contributions to business cycles fluctuations in real activity.
Comments

- There could be greater discussions on the usage of the results in policy-making. While the methodologies are detailed comprehensively, further discussions are lacking in the policy-making areas.

- In view of the rising importance of external shocks, what is the role of monetary policies in mitigating the shocks?
In the paper’s approach, you isolated the shocks independently from one another (orthogonality of the shocks) e.g. external shocks are independent from financial shocks. But in reality, these shocks are very interrelated, hence explaining the small impact of the results.