Financial Globalisation, Monetary Policy Spillovers and Macro-modelling

Tales from One Hundred and One Shocks

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September 2016

Impression

- Paper reflects a lot of hard work.
- Good effort at assessing how far we have come and how far we need to go with DSGE models.
- Paper affirms that the US Federal Reserve is the key central bank of the world.
- News from the FED affects monetary policy actions throughout the world.
- Paper recalls a lot of the literature about monetary policy games in the 80's.

Motivation

- All models are wrong but some are useful–George Box.
- We know that models have specification issues
- Question is: how serious?
- Usually monetary policy is specificed as a Taylor rule
- It is usually a function of domestic inflation and output gap
- Are deviations from the Taylor rule “shocks”?

Taylor rule.

- We know that there is a systematic component
- Are deviations from Taylor rule "shocks" or just discreationary monetary policy?
- Often the disturbance term in the Taylor rule is called the "shaky hand".
- I do not think that Janet Yellen has a shaky hand.
- If central bankers react to what is done in another central bank decision is that a shock?
- For want to a better word, I suggest "news" rather than monetary policy "shocks".
- Somes news is shocking, but is it a shock?

- We live in a world where there is international aribtrage of assets.
- We can see that returns for a variety of international assets adjust quickly to news.
- So if an asset trader sells a Singapore Airlines share and buys an Cathay Pacific share, there where a capital outflow from Singapore to Hong Kong?
- Capital flows represent the flip side of saving-investment balances.
- Not sure that capital mobility, on average, is higher today than it was at the beginning of the last century. Maybe less mobile.
- Jonathan Heathcoate of the Minneapolis FED wrote a paper in JET on financial globalisation and real regionalization
- This was several years ago, so of course stylized facts need to be updated.
- Business cycles are less syncronized globally, more synchornized regionally.

- He attributed this to financial globalization, greater risk sharing.

News: Normal and Crisis Events

- Mendoza has drawn attention that many DGSE models assess policy on the basis of welfare measures.
- Most of the time, the variables are not far from the stochastic steady state.
- This we find welfare comparisons of minor significance for assessing different types of policy regimes.
- He suggested assessing the dynamics during “crisis events”, when GDP, for example, is two standard deviations below its mean
- Then different types of monetary policy actions matter. Blanchard called these episodes “dark corners”.
- For this paper, all shocks are the same. But there are periods when there are big negative shocks, and periods when there are small shocks.
- Is the monetary rule “misspecified” if the actions of the decision makers deviate from the rule when there are big bad shocks impinging on the economy?

Shocks

- Tell us more, lets us visualize
- Of the different models, were they estiamted with Bayesian methods?
- We are told that the DSGE models showed greater evidence of misspecification that VAR models
- What about the hybrid DSGE-VAR models?

Spillover, Contagion and Connectedness

- Lots of discussion about contagion and spillovers.
- Kristin Forbes has clarified much of the discussion.
- Contagion is different from correlation, it is the transmission of negative effects from one country to another.
- Diebold has given us an emirical tool with forecast error decomposition anaylsis to analyze that he calls "inward" and "outward" connectedness among macroeconomic variables.
- This method can be applied across markets within one country, across industries and across countries for financial asset returns as well as changes in monetary policy instruments.
- I suggest that the authors look into this tool as a way to illustrating their findings, both with actual data and model-generated data.