Discussion on "*The Policy Trilemma and the Global Financial Cycle: Evidence from the International Transmission of Unconventional Monetary Policy*"

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Background: Trilemma to Dilemma?

- Trilemma: Economies with flexible exchange rate regime are more insulated to external environment, especially changes in financial conditions or monetary policies in advanced economies.
- "Global Financial Cycles" by Rey (2013).
- She argues that exchange rate regimes no long insulate countries from global financial circles. So the famous "monetary trilemma" reduces to "irreconcilable duo" of monetary independence and capital mobility, or "dilemma".

Trilemma to Dilemma? Or "2.5-lemma"?

- Obstfeld (2014): Financial globalization has worsened trade-offs that monetary policies in emerging market economies face.
- Aizenman et al (2016, 2017) investigated if this is supported by the data. They find that policy arrangements based on the trilemma do affect the extent of the linkage between financial condition in advanced economies and emerging market economies.
- Han and Wei (2018) also document patterns of "2.5-lemma" or something between a trilemma and a dilemma: without capital controls, a flexible exchange rate regime offers some monetary policy autonomy when the advanced economies tightens its monetary policy, yet it fails to do so when they lower their interest rate.
- More importantly, they find capital controls help to insulate emerging market economies from monetary policy shocks from the advanced economies in both cases.

What does the paper do?

- This paper also tries to answer this question from the perspective of international transmission of US monetary policy.
- Using a global-VAR approach, this paper assesses the international spillovers from identified US monetary policy shocks.
    - a) Both exogenous CMP and UMP shocks are identified.

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- Using a global-VAR approach, this paper assesses the international spillovers from identified US monetary policy shocks.
  - a) Both exogenous CMP and UMP shocks are identified.
  - b) A wider set of financial variables, namely equity prices and both short- and long-term interest rates are considered.

Key results

- US monetary policy shocks, including CMP and UMP, significantly drive equity prices worldwide.
- UMP also leads to a generalized comovement in short- and long-term rates across countries.
- Macroeconomic spillovers are also sizable, and in some instances greater than the effects on US economy. But the results exhibit large heterogeneity across countries.
- They also find that countries whose currencies are anchored to USD feature larger spillovers, but this relationship is weak due to high uncertainty.

Motivation

- It is very interesting to identify the international spillover effect of both US CMP and UMP shocks. But what is the motivation to introduce this difference?
- Or more importantly, do we expect that the CMP and UMP shocks will have different spillover effects?
    - GFC of 2008 —> Unconventional monetary policies and QE —> influx of capital from advanced economies to emerging market economies;
- If this paper can show us differentiating CMP or UMP shocks will help to answer the key question; Does the trilemma or dilemma better characterize the international monetary transmission? it will be nice.

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  - GFC of 2008 —> Unconventional monetary policies and QE —> influx of capital from advanced economies to emerging market economies;
  - Now with more hawkish US monetary policies and exit of QE —>capital outflow from emerging market economies to advanced economies with currency depreciation in EM.
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Role of Capital Control/Macroprudential Policies: I

- What is the role of capital control/macroprudential policies?
- Theoretically, several studies find that countercyclical capital flow management and other macroprudential policies help to stabilize domestic financial markets and maintain monetary policy autonomy. For instance, Jeanne and Korinek (forthcoming), Jeanne (2013), Korinek (2011), Korinek (2018) and Farhi and Werning (2014).

Role of Capital Control/Macroprudential Policies: II

- Empirically, as mentioned earlier, Han and Wei (2018) show that capital controls help to insulate emerging market economies from monetary policy shocks originated from the advanced economies when the center country lowers its interest rate or tightens its monetary policy.
- Wang and Wu (2019) provide empirical evidence that emerging market economies (EMEs) tend to adopt countercyclical capital flow management in response to U.S. monetary shocks.
- Aizeman, Chinn and Ito (2018) show that more extensive implementation of macroprudential policies would lead peripheral economics to (re)gain monetary independence from the center economies.

Role of Capital Control/Macroprudential Policies: III

- How will the result change if the capital control measure is included?
    - Fernandez, Klein, Rebucci, Schindler, and Uribe (2016) provide an annual measure of capital control index.
- Including the capital control measure could be helpful in the country-by-country estimation.

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  - The paper documents sizable response of financial variables to the U.S. M.P shocks. Potentially, the change are affected by the openness of financial markets of a country.
  - The capital control index may help to separate whether the response is due to U.S. monetary shock or due to a country's capital control policy.

Identification/Estimation of UMP shocks

- The authors identify the UMP shocks by assuming that these shocks will not affect short-term US interest rates.
- An alternative way is to use the Wu and Xia (2016) shadow rate to estimate or identify the unconventional monetary policies.
- This paper focuses on the effect of UMP shocks on term premium, but some papers in the literature, such as Gilchrist and Zakrajsek (2013) also emphasize the default risk channel by looking at effects on measures of corporate credit risk. Perhaps the author can also take that into consideration
- Finally and more importantly, in this paper the UMP shocks are identified by sign and zero restriction. In the literature on the impact of UMP shocks, event studies and analysis of words and sentences in the FOMC statement are very common.
  - The authors should report the UMP shocks identified in this paper and compare that with those identified in the literature.

Monetary shocks from other Center economies

- The authors focus on the spillover of US Monetary policy shocks. How will the result change if the UMP shock from ECB is considered?
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  - If so, how will this help us to understand the trilemma or dilemma?