Discussion of

Financial Globalisation, Monetary Policy Spillovers and Macro-modelling: Tales from 1001 Shocks

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*The views expressed in this paper do not necessarily reflect the position of the Bank of England.

This paper

- **Fact** Monetary policy shocks implied by a wide range of NK-DSGE models are correlated across countries!
- **Main hypothesis** Monetary policy shock estimates obtained from NK DSGE models are contaminated by a global component
- **Why?** These models do not account for economies' susceptibility to monetary policy spillovers from abroad transmitted via financial channels
  - That is: they erroneously label foreign (F) monetary policy shocks as home (H) ones

This paper: 1-slide summary

- Simulate data from a 3-country semi-structural model that allows for financial spillovers (in a reduced form fashion)
- For each country, filter the simulated data using a ‘mispecified’ single country model
- Show that
  1. Monetary policy shocks are correlated across countries
  2. Correlation is stronger when financial spillovers are stronger
  3. Estimated spillover of small country’s monetary policy shock to big country is implausibly large
- Provide empirical evidence for 1-2-3 using a novel data set of 280 monetary policy shocks for 29 countries

My comments

- Great idea, really liked the paper!
- Also, great service to the profession
  - Data set of monetary policy shocks is now online and available for other researchers
- Empirical analysis very carefully executed and convincing
- My comments
  - The model
  - Interpretation

The model

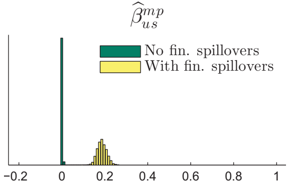
- Multi-country model used as data generating process is quite stylized, financial spillovers are added in a very ad hoc manner
- Little detail about the single-country model used for filtering the simulated data
  - Is this the same multi-country model used for data generation where all bilateral variables are removed?
  - How is the estimation performed?
- **Question** Do Predictions 1-2-3 hold when
  - Data is generated with a more complex, fully structural open economy model with financial channels?

    [Dedola-Lombardo, Deveraux-Yetman, etc]
  - Simulated data is filtered with a more complex, fully structural closed economy model?

    [Smets-Wouters, etc]

Interpretation

- **Question** What is the mechanism through which a F monetary policy shock (transmitted via financial channels) could be (mis)interpreted by the single-country model as a H monetary policy shock?



NOTE. Distribution of Coeffcient Estimates in the Regression of Estimated Euro Area Monetary Policy Shocks on the True Shocks Across Replications of the Monte Carlo Experiment.

Interpretation

- **Question** What is the mechanism through which a F monetary policy shock (transmitted via financial channels) could be (mis)interpreted by the single-country model as a H monetary policy shock?

- The logic of the authors (as I understand it)
  - Credit channel of monetary policy [Bernanke-Gertler, etc]
    - Monetary policy tightens, net worth of agents fall, spreads increase
  - Extend the idea to an open economy context, add international financial integration [Dedola-Lombardo, Deveraux-Yetman, etc]
    - Net worth depends on both domestic and foreign capital/assets
    - Monetary policy tightens, net worth of both F and H agents fall
    - Spread quickly equalize across countries
    - Comovement in long-term (lending) rates

Interpretation (cont'd)

- Look at above example through the lens of a single-country model (from H perspective)
- Inflation and output fall, spreads increase $\Rightarrow$ Monetary policy is likely to loosen
- **Questions**
  - How can the single-country model confound the F monetary policy shock with a H monetary policy shock?
  - Wouldn't a H demand shock do a better job at matching these dynamics?
  - How much is your result driven by the fact that you have long rates in Taylor rule?
  - Are the other structural shocks (demand and PC) also correlated?

Summing up

- Great work, interesting research idea, very relevant for policy
- Empirics are interesting and convincing
  - Correlation of monetary policy shocks across countries is associated with financial integration
- I'd like to understand more the mechanisms through which this happens