



**HKIMR**

Hong Kong Institute for  
Monetary Research

香港金融研究中心

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The HKIMR was established by the Hong Kong Monetary Authority (HKMA) in August 1999 to conduct and support research on issues in monetary policy, banking and finance that are of strategic importance to Hong Kong and the Asian region.

#### *Highlights of this issue:*

Conference on “Diverging Monetary Policies, Global Capital Flows and Financial Stability”

Seventh Annual International Conference on the Chinese Economy

The Thirteenth HKIMR Conference on the Mainland Economy

Visiting Fellow – Harald Hau

Visiting Fellow – Eric Young

# Hong Kong Institute for Monetary Research – *Newsletter*

Twenty-Ninth Issue (March 2016)

## Recent Activities

### Conference on “Diverging Monetary Policies, Global Capital Flows and Financial Stability”

*Together with the Board of Governors of the Federal Reserve System, the European Central Bank and the Federal Reserve Bank of Dallas, the HKMA co-hosted a two-day conference on Diverging Monetary Policies, Global Capital Flows and Financial Stability on 15 and 16 October 2015 in Hong Kong.*

The conference commenced with opening remarks by Mr. Peter Pang (Former Deputy Chief Executive of the HKMA) about central banks around the world carefully weighing the potential impact of the expected divergence in monetary policies on global capital flows and financial stability. The two-day conference featured a keynote speech by Vítor Constâncio (Vice President, European Central Bank) entitled “Divergent Monetary Policies and the World Economy”.

In addition to the featured speech, the conference consisted of four sessions, with a total of nine high quality papers presented. The first session was chaired by Dr. Lillian Cheung (Executive Director (Research) of the HKMA). In this session, Francis E. Warnock of University of Virginia presented his paper “The Two Components of International Portfolio Flows” while Signe Krogstrup of Swiss National Bank gave a presentation of the paper “Capital Flows and Domestic Financial Market Structure”. In the second session, chaired by Dr. John Rogers (Board of Governors of Federal Reserve System), Eric Wong of the Hong Kong Monetary Authority presented his paper “Asynchronous Monetary Policies and International Dollar Credit” and Soyoung Kim of Seoul National University delivered his paper on “Offshore EME Bond Issuance and the Transmission Channels of Global Liquidity”.

The third session, chaired by Dr. Luca Dedola (European Central Bank), began with a presentation of “Capital Controls and Monetary Policy Autonomy in a Small Open Economy” by Scott Davis of the Federal Reserve Bank of Dallas. After that, Stephanie Curcuru of the Board of Governors of the Federal Reserve System presented her paper “International Capital Flows and



Mr. Peter Pang  
(Former Deputy Chief Executive,  
HKMA) delivering welcome remarks



Mr. Vítor Constâncio (Vice President,  
European Central Bank) giving the  
keynote speech

On the second day, the fourth session, chaired by Dr. Mark Wynne (Federal Reserve Bank of Dallas), started with Viktors Stebunovs of the Board of Governors of the Federal Reserve System’s presentation on “Risk Taking and Interest Rates: Evidence from Decades in the Global Syndicated Loan Market”. Then Andrei Zlate of the Federal Reserve Bank of Boston delivered his paper “International Financial Spillovers to Emerging Market Economies: How Important Are Economic Fundamentals?” followed by a paper “Trilemma, not Dilemma: Financial Globalization and Monetary Policy Effectiveness” by Georgios Georgiadis of the European Central Bank. The discussants included James Yetman (Bank for International Settlements), Yin-Wong Cheung (City University of Hong Kong), Woon Gyu Choi (Bank of Korea), Martin Bodenstein (National University of Singapore), Ine van Robays (European Central Bank), Mico Loretan (Swiss National Bank), Ji Zhang (Tsinghua University), and Hans Genberg (The SEACEN Centre). The conference completed successfully after the closing remarks.

The conference programme, opening remarks, papers and slides can be accessed through the following link:  
[http://hkimr.org/conferences\\_detail-id91](http://hkimr.org/conferences_detail-id91)



Dr. Lillian Cheung (Director of the HKIMR and Executive Director (Research) of the HKMA)



Dr. John Rogers (Board of Governors of Federal Reserve System)



Prof. Francis E. Warnock (University of Virginia)



Dr. Luca Dedola (European Central Bank)



Dr. Mark Wynne (Federal Reserve Bank of Dallas)



Dr. Scott Davis (Federal Reserve Bank of Dallas), Prof. Martin Bodenstein (National University of Singapore), Dr. Stephanie Curcuru (Board of Governors of the Federal Reserve System) and Dr. Ine van Robays (European Central Bank) (from left to right)

## Seventh Annual International Conference on the Chinese Economy

The HKIMR held its Seventh Annual International Conference on the Chinese Economy in Hong Kong on 14 and 15 January 2016. The theme of the conference was "The Growing Influence of China in the World Economy".

This conference series aims to provide a world class forum for academics, policy makers and business economists to discuss important analytical and policy issues related to the Chinese economy. It was launched in 2010 and has been well received.

This year's conference included eight high quality research papers, covering a wide variety of issues including rebalancing and potential for growth in China, economic spillovers from China, global and regional influence of the RMB, and carry trade dynamics and information flow between RMB markets.

The conference was attended by over 100 participants including representatives from central banks around the world. The conference programme, the papers and presentation slides can be accessed on the HKIMR website at the following link:

[http://hkimr.org/conferences\\_detail-id92](http://hkimr.org/conferences_detail-id92)



Prof. Yiping Huang (Peking University and the People's Bank of China Monetary Policy Committee Member)



Ivan Roberts (Reserve Bank of Australia), Frank Song (University of Hong Kong), Tao Wang (UBS) and Feng Zhu (Bank for International Settlements) (from left to right)

## The Thirteenth HKIMR Conference on the Mainland Economy

In line with its effort to maintain dialogue with researchers and policy makers on Mainland economic issues, the Institute held the Thirteenth HKIMR Conference on the Mainland Economy on 14 September 2015 in Hong Kong. The theme was "Fiscal Reforms and Local Government Financing in China". It was the thirteenth conference of the HKIMR's conference series on the Mainland economy in Putonghua.

The issues covered at this year's conference included fiscal reforms, the latest developments on local government financing in China and its challenges. The conference featured presenters from the financial services industry and think tanks, such as Dr. LIU Shangxi (President of the Research Institute for Fiscal Science, Ministry of Finance, P.R. China), Ms. E Zhihuan (Deputy General Manager of BOC Hong Kong Planning and Development Department) and Dr. LU Zhengwei (Chief Economist of Industrial Bank Co., Ltd). It was attended by over 100 participants.

The conference programme and slides can be accessed at the following link: [http://hkimr.org/conferences\\_detail-id90](http://hkimr.org/conferences_detail-id90)



## Visiting Fellow – Harald Hau

*Harald Hau is a professor at the School of Economics and Management of the University of Geneva, holds a senior chair of the Swiss Finance Institute, and is currently the interim director of the Geneva Finance Research Institute (GFRI). He is a research fellow at the Center for Economic Policy Research (CEPR), London, and the Center for Economic Studies (CES), Munich. He was previously a visiting scholar at the International Monetary Fund (IMF), the Wim Duisenberg Fellow at the European Central Bank, and a visiting fellow at the HKIMR twice, in January 2013 and in March 2015. His research focuses on international finance and financial stability issues.*

Even though I was a frequent visitor to (South-East) Asia when teaching in the MBA and executive programs at INSEAD's Singapore campus, it was only my visit to the HKIMR in 2013 which heightened my interest in economics issues relating to China. This had to do with actually being in China, the research atmosphere at the HKIMR with its wide range of visitors, and also a superb conference organized at the HKIMR during my stay. In January and March 2015, I had the fortunate opportunity to return to the HKIMR.

The primary research project during my latest visit was on the role of investor risk taking during times of low interest rates: Do low real rates as currently experienced worldwide increase households' willingness to engage in risky investments? My colleague Sandy Lai from the University of Hong Kong, and I thought of a new empirical strategy to address this important policy issue.

The idea was to look at the Eurozone, which has a single short-term nominal interest rate and monetary policy conditions (as measured by real short-term interest rates) which vary substantially across countries. We decided to use this cross-country variation in the (local) tightness of monetary policy to examine its influence on equity and money market flows. Such flows can be measured quite accurately using fund level data from each country. Due to the geographic segmentation of the European market for fund investment, most fund investors use local investment funds as their preferred investment vehicles. In line with a powerful risk-shifting channel, we find that fund investors in countries with decreased real interest rates shift their portfolio investment out of the money market and into the riskier equity market, causing significant equity price inflation in countries where investment home bias is the strongest. My visit to the HKIMR allowed Sandy Lai and I to perfect this line of research, and to successfully submit a paper to a top finance journal; it will appear in 2016 under the title "Asset Allocation and Monetary Policy: Evidence from the Eurozone" in the *Journal of Financial Economics*.

But during my last visit I also started to reflect more on a China focused research project. A key policy issue is how to evaluate the efficiency of credit allocation across Chinese firms. Its (in-) efficiency may well represent one of the key determinants of China's growth prospects. I decided to work on this issue jointly with Yi Huang from the Graduate Institute in Geneva. We hope to have interesting results soon and would certainly enjoy presenting those in Hong Kong and at the HKIMR.



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## Visiting Fellow – Eric Young



*Eric Young is Professor of Economics at the University of Virginia. Prior to Virginia, he was an Assistant Professor of Economics at Florida State University. He received his Ph.D. from Carnegie Mellon University in Pittsburgh, Pennsylvania. He has consulted for the International Monetary Fund and the Federal Reserve Banks of Cleveland, Kansas City, and Minneapolis, and taught graduate courses in computational economics at Johns Hopkins and UC Santa Barbara.*

My visit to HKIMR in the summer of 2015 was not my first trip to Hong Kong, but it was the longest I have spent there (and the first time in the summer; the humidity is formidable, even for someone raised in the southern US!). Although we did not plan it that way, my co-author Changhua Yu visited at the same time, so we had a productive collaboration; in fact, it was the first time we had met in person! And since Changhua had already been there for two weeks, he was able to show me all the good places to eat.

My research visit involved the study of economies that are exposed to “Sudden Stops”, which are large rapid reversals in current accounts that are usually associated with sharp, severe recessions. Many emerging economies have suffered from Sudden Stops, including Mexico (the Tequila Crisis), Southeast Asia (the Asian Flu), and Argentina (too many to give catchy names). Our goal (working with Mick Devereux) was to characterize the optimal government response to these crises. The study of such economies involves new tools that

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**"My visit was fantastic, and I encourage others to apply. The view from the Institute is amazing, but beware the summer!"**

are needed to deal with collateral constraints that only occasionally bind, which I have developed in other work with Gianluca Benigno, Alessandro Rebucci, and past HKIMR visitor Chris Otok.

Our results, while abstract, do have some practical value. We found that abandoning strict inflation targeting is optimal during a crisis; my guess is that no one is surprised by this result, given the actions of the Fed during the Great Recession and the ECB during the European PIIGS (Portugal-Italy-Ireland-Greece-Spain) crisis. A little inflationary burst helps by deflating some of the debt burden; since most debt is denominated in foreign currency, though, this inflation has only minor effects. More importantly, we found that capital controls, which are taxes on international debt flows, are both (i) used if available to reduce the likelihood of future crises and (ii) worse than doing nothing!

The last result may seem surprising, since the government should not undertake actions that make the citizens worse off (at least, not in our model!). But when governments lack the power to commit to future policies, capital controls are quite seductive – the current government thinks the economy consumes too little today, so by taxing debt it can encourage consumption provided it taxes more than the government tomorrow will. It is easy to see that such a situation could spiral out of control and lead to excessively high capital controls and excessively *low* consumption, which is exactly what the government was trying to prevent! In our model it is better to “tie Odysseus to the mast” by preventing the use of capital controls entirely.

In ongoing work we are assessing whether capital controls that “leak” are better; perversely, if capital controls are partially ineffective the government’s incentive to overuse them may be blunted. We think these lessons are important given an emerging consensus among policymakers (like the IMF and the World Bank) that capital controls are a useful tool – if they are, the existing models do not tell us why! Some of the models tell us to use capital controls if we have no better alternatives, which is a bit like saying you should treat the symptoms if you can’t treat the disease – it is hardly surprising. But our results, along with related results in my other work, point to better options; capital controls are at best second-best solution and at worst perversely destructive.

I also met my long-time collaborator Yulei Luo (Hong Kong University) on several occasions, where we worked on the dynamics of consumer decision-making in the presence of informational distortions. We have worked for years trying to understand how households can make choices when they either (i) distrust the model they use to forecast the future and/or (ii) cannot observe the current situation without error. Over the summer we applied this framework (working with Jun Nie) to measure the gains from international diversification via the opening of financial markets, and found that these gains can be very large. A key fact that allowed us to measure these gains is the relationship between growth and volatility. Yulei and his wife took me to a fantastic dinner as well.

In the end, my visit was fantastic, and I encourage others to apply. The view from the Institute is amazing, but beware the summer!

## Upcoming Activities

### HKUST-Keio-HKIMR Conference on Exchange Rates and Macroeconomics

The HKIMR, Hong Kong University of Science and Technology, and Keio University will jointly hold the HKUST-Keio-HKIMR Conference on Exchange Rates and Macroeconomics on 17-18 March 2016. The Institute will host the first day of the conference on 17 March 2016 in Hong Kong which will feature a keynote speech from Pierre-Olivier Gourinches of University of California-Berkeley entitled “Global Imbalances and Currency Wars at the ZLB”. In addition, five papers covering the topics on “Cross-Country Exposures to the Swiss Franc”, “The Shocks Matter: Improving our Estimates of Exchange Rate Pass-Through”, “A New Dilemma: Capital Controls and Monetary Policy in Sudden Stop Economies”, “Sustainable International Monetary Policy Cooperation, and “The First Arrow Hitting the Currency Target: A Long-Run Risk Perspective” will be presented. The second day will be hosted by the Hong Kong University of Science and Technology on its campus.

The full programme can be accessed at the following link:

[http://hkimr.org/conferences\\_detail-id94](http://hkimr.org/conferences_detail-id94)

### Call for Papers: Conference on Real Estate and Financial Stability

The Institute, City University of Hong Kong and the Global Research Unit will jointly hold a conference entitled “Real Estate and Financial Stability” on 22-23 August 2016. Real Estate plays an important role in recent issues, including the Global Financial Crisis, the explosive growth and apparent slowdown of the China economy, etc. Academics, market practitioners, and government agencies (particularly central banks) are especially concerned that fluctuations in real estate markets could affect the financial stability through many channels. They include (but not limited to):

- wealth effect of households;
- collateral constraint effect of households and firms;
- adjustment in bank loan quality and quantity;
- securitization of real estate-related assets;
- portfolio management of institutional investors (such as Pension Fund and Retirement Fund) in real estate-related assets, etc.

We intend to bring together experts on these topics and provide a platform for an in-depth and at the same time insightful discussion in a 2-day conference.

Those interested in presenting at the conference should send a completed paper or a two-page detailed abstract in WORD or PDF format via email to [hkimr@hkma.gov.hk](mailto:hkimr@hkma.gov.hk) by March 15, 2016. Authors of accepted papers will be notified by June 1, 2016. Presenters from academia will be reimbursed for economy class airfare and accommodation. For further information, please email [hkimr@hkma.gov.hk](mailto:hkimr@hkma.gov.hk) or visit the HKIMR website <http://www.hkimr.org>.

Presenters may apply for financial support for economy class airfare and local accommodation expenses. Final versions of the accepted papers will be posted on the conference website. Selected conference papers will be invited to be considered for publication in the *Pacific Economic Review*. Conference webpages can be viewed at:

[http://www.cb.cityu.edu.hk/ef/events/upcoming/2016\\_CREFS](http://www.cb.cityu.edu.hk/ef/events/upcoming/2016_CREFS)

[http://www.hkimr.org/conferences\\_detail-id93](http://www.hkimr.org/conferences_detail-id93)

## Launch of the Thematic Study Fellowship Programme

The Institute is pleased to announce the launch of the “Thematic Study Fellowship Programme” in addition to the existing “Regular Research Fellowship Programme”. Under the new programme, we are seeking empirical and theoretical studies specifically on the topics which are of priority to the Institute and the HKMA. Preference will be given to comparative studies that take global and regional perspectives to address critical policy issues and have significant global and regional implications. Compared to the Regular Research Fellowship Programme of the Institute, more flexibility will be given to the duration of visit and form of research undertaking and there is possibility of collaboration with staff at the Institute and HKMA.

The HKIMR welcomes applications for positions as Visiting Research Fellow on an ongoing and highly competitive basis for both programmes. The Council of Advisers reviews proposals four times a year. The deadline for the next round of applications is 31 March 2016.

Please visit our website (<http://www.hkimr.org/content-id13>) if you are interested in this programme.

*Applicants should note that papers produced partly or wholly under this visiting programme are required to acknowledge the financial support of the HKIMR if the papers are submitted to any journals.*

## Visiting Fellows and Seminars

23 November – 18 December 2015  
**Eric van Wincoop** (University of Virginia)

25 January – 19 February 2016  
**Chun-Yu Ho** (Shanghai Jiao Tong University)

27 January – 23 February 2016  
**Chicheng Ma** (Shandong University)

**17 February 2016**  
*Modes of Foreign Bank Participation and Domestic Bank Efficiency: Evidence from China* – Chun-Yu Ho, Shanghai Jiao Tong University

**22 February 2016**  
*History, Culture, and the Rise of Informal Finance in China* – Chicheng Ma, Shandong University

## Recent HKIMR Working Papers

**No.03/2016** “A New Dilemma: Capital Controls and Monetary Policy in Sudden-Stop Economies” by Michael B. Devereux, Eric R. Young and Changhua Yu

**No.02/2016** “SOE and Chinese Real Business Cycle” by Kang Shi, Daoju Peng and Juanyi Xu

**No.01/2016** “Do Banks Extract Informational Rents through Collateral?” by Bing Xu, Honglin Wang and Adrian van Rixtel

**No.27/2015** “China: Credit, Collateral, and Commodity Prices” by Shaun K. Roache and Marina Rousset

**No.26/2015** “Elastic Attention, Risk Sharing, and International Comovements” by Wei Li, Yulei Luo and Jun Nie

**No.25/2015** “The Nexus of Official and Illicit Capital Flows – The Case of Hong Kong” by Yin-Wong Cheung, Kenneth K. Chow and Matthew S. Yiu

**No.24/2015** “Accounting for Sovereign Tail Risk in Emerging Economies: The Role of Global and Domestic Risk Factors” by Tom Fong, Ka-Fai Li and John Fu

**No.23/2015** “Exploring Determinants of Firms’ Participation in the New Offshore Renminbi Debt Securities Market” by Paul Mizen and Serafeim Tsoukas

**No.22/2015** “Fundamentals and the Volatility of Real Estate Prices in China: A Sequential Modelling Strategy” by Yongheng Deng, Eric Girardin and Roselyne Joyeux

**No.21/2015** “Term-Structure Modelling at the Zero Lower Bound: Implications for Estimating the Term Premium” by Tsz-Kin Chung, Cho-Hoi Hui and Ka-Fai Li

**No.20/2015** “Effectiveness of Loan-To-Value Ratio Policy and Its Transmission Mechanism – Empirical Evidence from Hong Kong” by Eric Wong, Kelvin Ho and Andrew Tsang

**No.19/2015** “Asynchronous Monetary Policies and International Dollar Credit” by Dong He, Eric Wong, Andrew Tsang and Kelvin Ho

**No.18/2015** “Measuring Contagion-Induced Funding Liquidity Risk in Sovereign Debt Markets” by Cho-Hoi Hui, Chi-Fai Lo, Xiao-Fen Zheng and Tom Fong

and more ..... please visit our website.

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