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Comments on:

"Effects of Quantitative Easing on Asia: Capital Flows and Financial Markets" by Dongchul Cho and Changyong Rhee

Summary:

QE1 contributed to the rebounding of capital inflows to the region after the onset of the crisis by lowering domestic yield rates as well as CDS (Credit Default Swap) premium. Economies with stable exchange rates coincide with those in which house prices have been rising, suggesting that monetary easing of advanced countries have affected Asian countries through either appreciation of currency values or increases in the prices of housing.

Comments:

<u>Do QE contribute to stabilizing the global financial market and turning capital flows back to Asia?</u>

- P.10: "*The quick rebound of capital inflows in 2010, despite the heightened uncertainties and massive credit constraints of financial institutions in advanced economies, suggests that QE contributed to stabilizing the global financial market and turning capital flows back to Asia*."
  I am not sure if the statement has the right connotation implying that QE is good for Asia. It is true that QEs have thrown out a huge amount of capital inflows to recipient countries in Asia and the global financial market.
- ▪ Siregar (2013) shows that a slightly above 20 per cent of total capital outflows from QE1 and QE2 were eventually absorbed in by the Asia Pacific economies. The biggest share of the increase in the private outflows during QE1 and QE2 was in the form of "other private claims", namely via international bank lending (more so than through direct investment and portfolio investment).
- ▪ However, an integrated banking system can become a transmission channel of monetary policies such as the QE beyond capital flows, namely: policy rate adjustment, exchange rate adjustment, increased cross-border lending activities of foreign banks that stimulate credit expansion and caused asset bubbles and an increase in headline inflation, external fiscal financing through banks facilitating foreign investors' holding of local sovereign bonds which affect the yield of sovereign bonds, etc..
- Siregar (2013) have shown that capital inflows absorbed by recipient Asian countries have resulted in (1) domestic currency appreciation (Korean won, Indonesia Rupiah etc.), (2) interventions by the central banks to manage the appreciation pressures and volatility of the local currencies that are costly and reduced international reserves through sterilization, (3) fuelled a rise in the residential property price, (4) an increase in unanchored inflation expectation.
- QE is an unorthodox monetary instrument to stimulate the economy. The impact of QE is only a temporary phenomenon that causes "artificial stimuli" (and not structural economic

expansion) and excessive volatility in balance of payments, exchange rates, inflation, international reserves, etc. Dis-acceleration of QE may result in reversal of capital and other unintended consequences. Transmissions of QE through an integrated banking system between the US and Asia have made monetary and exchange rate policies become more complex.

Methodology and How to Separate Impacts of QE by ECB, BoE and BoJ

- I also wonder if the methodology used has taken into account that at the time QEs were being implemented by the Fed, other central banks including the European Central Banks, the Bank of Japan, and the Bank of England were also conducting QEs. It is not obvious how impacts of QEs by ECB, BoE and BoJ have been disintegrated from impacts of QEs by the Fed. Otherwise, the results shown in this paper also reflect impacts of QEs by ECB, BoE and BoJ.
    - The Federal Reserve (The Fed):
        - QE1: A large-scale asset purchase (LSAP) was carried out between November 2008 and March 2009, extended to March 2010.
        - QE2: On November 3, 2010, the Fed announced an additional purchase of Longer-term Treasury Securities by the end of the second quarter of 2011.
        - QE3: September 2012 – at least mid-2015 (depending on development of labor market). The Fed continued with its Operation Twist Program which started in late 2011 and expanded in June 2012.
    - The European Central Bank:
        - Announced Outright Monetary Transactions (OMT) in August 2012 as the latest easing efforts to improve financial conditions and stimulate growth.
        - The OMT would replace the Securities Market Programmes (SMP) which was originally introduced in May 2010.
    - The Bank of Japan:
        - The Asset Purchase Program was first established in October 2010.
        - BoJ boosted the Asset Purchase Program in April and in September 2012.
        - BoJ has adopted zero-interest rate policy since October 2010.
    - The Bank of England:
        - The Extended Collateral Term Repo (ECTR) is a contingency liquidity facility launched in December 2011 that enables the BoE to provide liquidity with a much wider range of collaterals.
        - BoE activated ECTR in June and increased the Asset Purchase Facility in July 2012.

Could Policy Rate Coordination between the Fed, ECB and BoE Affect the Result?

- There were also some monetary policy coordination among the Fed, ECB, and BoE, if we look at their policy rates. This policy rate coordination was led by the Fed. Will this affect the result?

Rationalizing the correlation between housing price hikes and stable ER

- P.20: Housing Price. There is no elaboration or rational explanation as to why economies with housing price hikes roughly coincided with those in which ER have been stable or rigid. Is it a mere coincidence? Is it due to the structure of the banking and financial system of the respective economies? Or is there a deeper monetary, banking and/or financial explanation behind this result? Reference: Siregar (2013). "Foreign bank lending potentially contributed to the general rising residential house price level in ASEAN+3 economies. The annualized quarterly growth of residential house price in selected ASEAN+3 economies since 2005 are found to be positively related to the exposure levels of those economies to the foreign bank lending." (p.27)

Monetary coordination is still lacking

- P.1: "This has prompted the IMF to come out with regular spillover reports for G20 meetings." However, according to those attending G20 high-level Finance Ministers and Central Bank Governors Meetings, monetary coordination has not happened at the G20. The question is how to coordinate monetary policy such as the implementation of QE? Possible options: Countries conducting QE must inform other countries a priori before conducting QE, implement measures in recipient countries to counteract potential adverse effects of QE.
- For Concluding Remark, P.22, it is suggested that the authors could make recommendation to the G20 to better coordinate monetary policies. How it is done, it is not clear to me.
- P.23: Concluding Remark. Maybe the authors could also discuss about capital control and IMF stance on capital control following the 2008 North-Atlantic financial crisis.