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Discussion on Luan, Luo & Xiao “The spillover channel of the Federal Reserve's quantitative easing on China's long-term interest rates under capital account liberalisation”

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Summary (1)

- Topic: US MP's spillovers to China's r^L.

- Question: Did China's bond market liberalization in Feb. 2019 change the pattern?

- What's new:
  - Decompose r^L into two components.
  - Distinguish two channels of spillovers.

Summary (2) Key equation

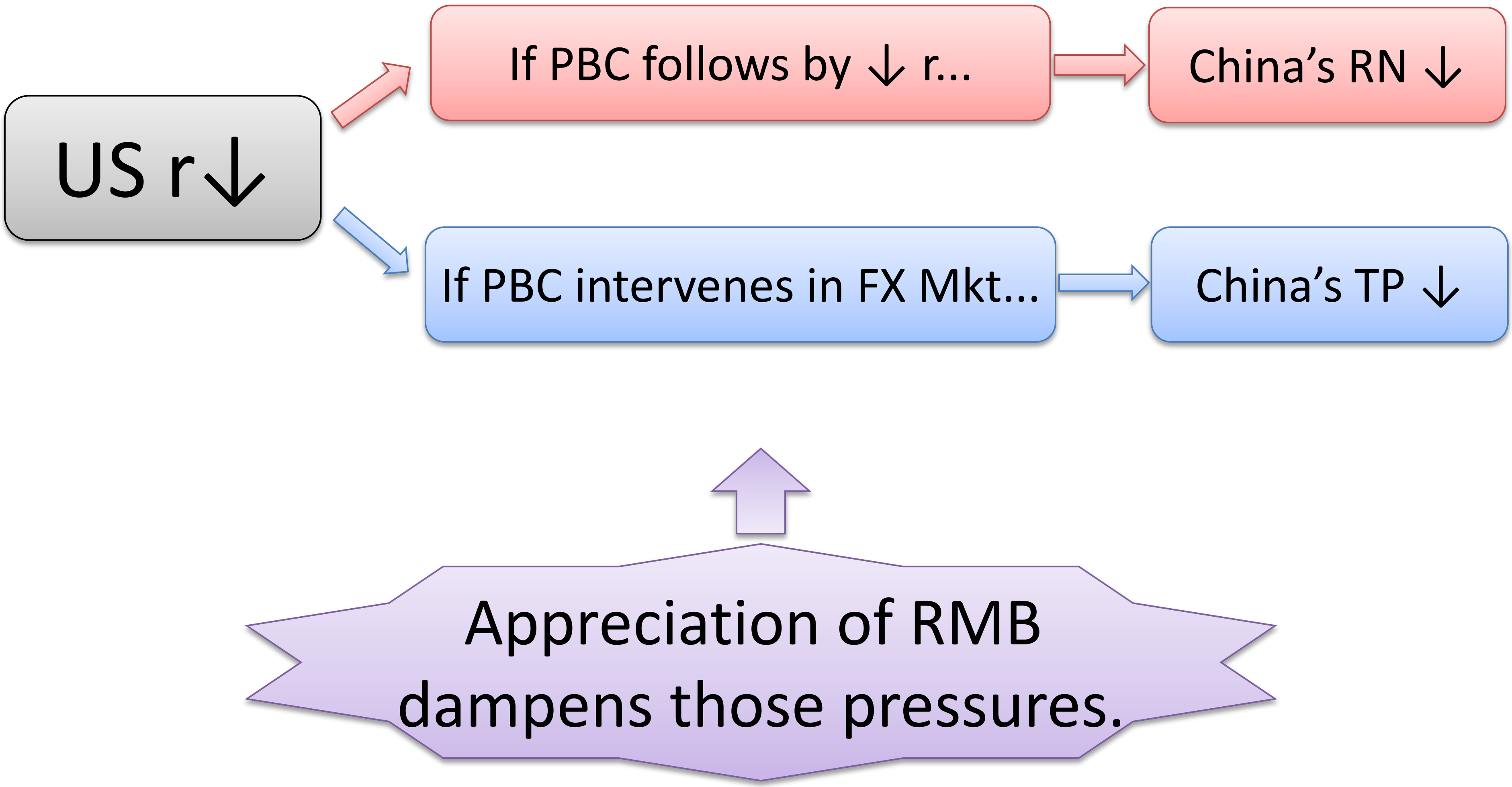
$$r^L = RN + TP$$

Long Rate — Risk Neutral Rate — Term Premium

≈ Rate determined by the expectations hypothesis

Current and future path of MP

Summary (3) Asset Portfolio Channel



Summary (4) Risk Taking Channel

US r↓ → Risk Taking Abroad↑ → China's TP ↓

(The authors say it also lowers RN, but why??)

Why??

Appreciation of RMB encourages further risk taking

Summary (5) Two approaches

[1] "Event" Approach

- Focus on the day of the FOMC Meeting
- **Static**

[2] Local Projection

- Compute impulse responses.
- **Dynamic**

Overall comments

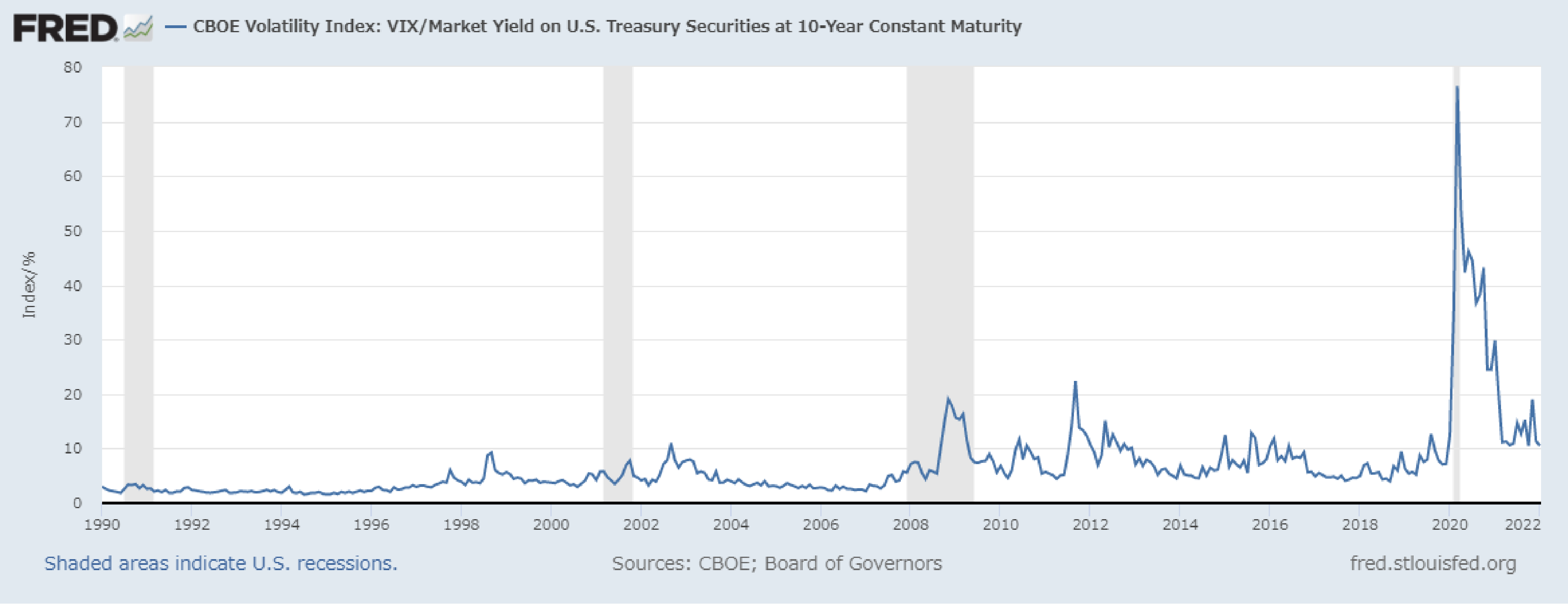
1. Important topic

2. Challenge: limited number of days since the policy change in 2019
   - Tries to overcome it by utilizing daily data.

Good idea!

3. Still, the time period is short…
   - Results may be influenced by covid-related events.

VIX on US Gov Bonds



Overall comments, continued

4. Personally, I prefer the dynamic specification.
   – Spillovers may not happen within a day or two.
   – The results are easier to understand.

5. However, this Local Projection seems to have its own problem…
   – Needed to take three year(?) moving averages.

I will thus focus on the first approach.

Main comment (1)
Most important result: Table 5

- Coef on (MP^{US})*(Exchange rate) is POSITIVE for Chinese TP since capital mkt liberalization.

- US monetary easing pushes down Chinese TP, and **this effect is strengthened when accompanied by a currency appreciation**!

- But I still do not understand…
- Why is this a test for the risk taking channel?

Main Comment (1), continued

My suggestion:

Why not decompose **US** r into RN and TP?

- When US MP lowers **TP in the US**

  -> encourages risk taking abroad.

  - Example: Fed announces unlimited bond buying on March 23, 2020: ends the panic.

Main Comment (2)

- Does Table 3 really refute the information channel?

- On the day of a major macro data news…

- Chinese 10 year yields do not react much.
- But 3 and 5 years react **very** strongly!

(Info channel: Chinese rates are not really reacting to the US MP itself, but to hidden information about the state of the Chinese economy revealed by the policy.)

Minor comments

1. Are daily data “high frequency” enough?
2. Why not try using the shadow rate?
3. Show us the data, esp. the two measures of capital account openness.
4. I did not find any explanation on Table 4 in the main text.
5. Table 5: why is there no result for the period before 2019?
6. This paper needs page numbers.

Summary

- Already a very good paper with some great ideas.
- Will be a great paper when polished.

Good luck!