

Discussion of "China's Financial Linkages with Asia and the Global Financial Crisis" by Reuven Glick and Michael Hutchison

Rajeswari Sengupta (IFMR, India)

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- Over past three decades, China has emerged as a major global trading power.
- Engaging in sequenced capital-account opening; albeit a cautious path towards financial liberalization.
- Also a gradual drive towards '*internationalization*' of the Renminbi (rmb): permitting use in trade and financial transactions outside China's borders.
 - Bound to have repercussions for trade and financial partners in East Asia.
 - Analyze the extent of China's financial linkages with Asian neighbors.

- Investigates linkages for 5-yr govt. bond rates and equity prices between China and 8 Asian countries.
- Evolution of asset-market linkages over time, especially around global financial crisis (GFC).
- Effect of global and domestic turbulence on these correlations.
- Responses of equity prices to changes in Chinese reserve requirements.
 - Use daily data from June 2005 to October 2012.
 - Split sample into 3 sub-periods: June 2005-June 2008; July 2008-May2010; June 2010-October2012.
 - Use graphical illustrations; correlations; time series and fixed effects panel regression methods.

- In case of both bond and equity markets, correlations with US declined sharply during GFC and recovered somewhat in the post GFC period.
- In case of equity markets, correlations with China increased dramatically during GFC and remained at high levels.
- Same not true for bond rates—weak linkages.
- Extent of transmission is bolstered by rising global and national uncertainty.

- Disconnect between motivation and analysis
 - Motivation: How has liberalization of capital controls and RMB internationalization affected Asian financial markets.
 - Analysis: Does not focus on changes in China's capital account regime or currency regime-say by using structural break points etc.
 - Instead focus seems to be more on GFC and comparison of asset-market linkages with China vis-a-vis the US.
 - Maybe the correlations and changes thereof, are exclusively driven by changes in global environment and not so much by China's liberalization policy.
 - Maybe due to the crisis, Asian countries have decoupled from the West (US) and become more closely integrated with each other.
 - Evidence: Sensitivity to Chinese equities has increased as global risk has gone up.

- Control for other global and domestic factors such as global growth, commodity prices, domestic financial development, financial depth, bilateral linkages with China (and US) through trade and FDI, exchange rates etc.
- Maybe use Johansen's co-integration test.
- Economic significance of the coefficients—what is the magnitude of the sensitivity?
- Since the focus is on China, why not add Chinese and US equity prices and bond rates separately/sequentially in regressions to help understand the sensitivity of Asian markets to China alone.

- Section 2 on China's capital control liberalization does not seem connected with the main analysis of the paper—reserves, forex intervention, monetary policy, types of capital flows etc.
- To motivate, it may help to understand how linkages between China and Asian countries may have changed as a result of GFC in other spheres such as trade etc thereby leading to changes in financial linkages as well.
- Results on reserve requirement are not statistically significant—not adding much value to the discussion.

- A discussion on why bond rate correlations maybe so weak whereas equity price linkages have gone up—East Asian bond markets are small and relatively closed.
- 'Equity market arbitrage working through capital markets' does not drive these linkages—China's size, economic activity, trading relationships etc play a dominant role. But no empirical evidence to establish this.
- Policy Implications

- Process of China's opening up and internationalization has just begun.
- At the same time China is plagued by domestic financial issues, banking problems etc.
 - Interesting to see what happens to these linkages if the global uncertainty continues.
 - What do these growing linkages mean for the Asian economies? Are they becoming more exposed to China's domestic policies? Is their vulnerability to regional shocks going up?

Thank You