Comments on Bun & Singh Heterogeneous Patterns of Financial Development: Implications for Asian Financial Integration

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No simple story

- Growth comes from a messy process
- Even the precursors to growth come from messy processes
- This paper embraces the complexity of financial development
- For interactions between economies, complexity is important to consider

Main premise: To promote financial integration you need similar <u>patterns</u> of financial development

- Usually we FIRST aggregate across many measures of financial development, THEN look for similar levels
  - This is OK when we're asking questions about domestic processes like economic development
  - But financial integration requires finer match between the 2 economies
- This paper FIRST looks for similarity across many measures, THEN aggregates
- Shows very different results between the 2 approaches for 14 Asia-Pacific countries

My central takeaway: beware of indices

- Paper's stated central message: "pattern distance" contains information beyond usual "level distance"
  - May be too early to say it has information

- Definitely shows the need for caution about indices of financial development
  - Lack of relationship between level distance and pattern distance says levels are masking potentially important complexity

Motivation?

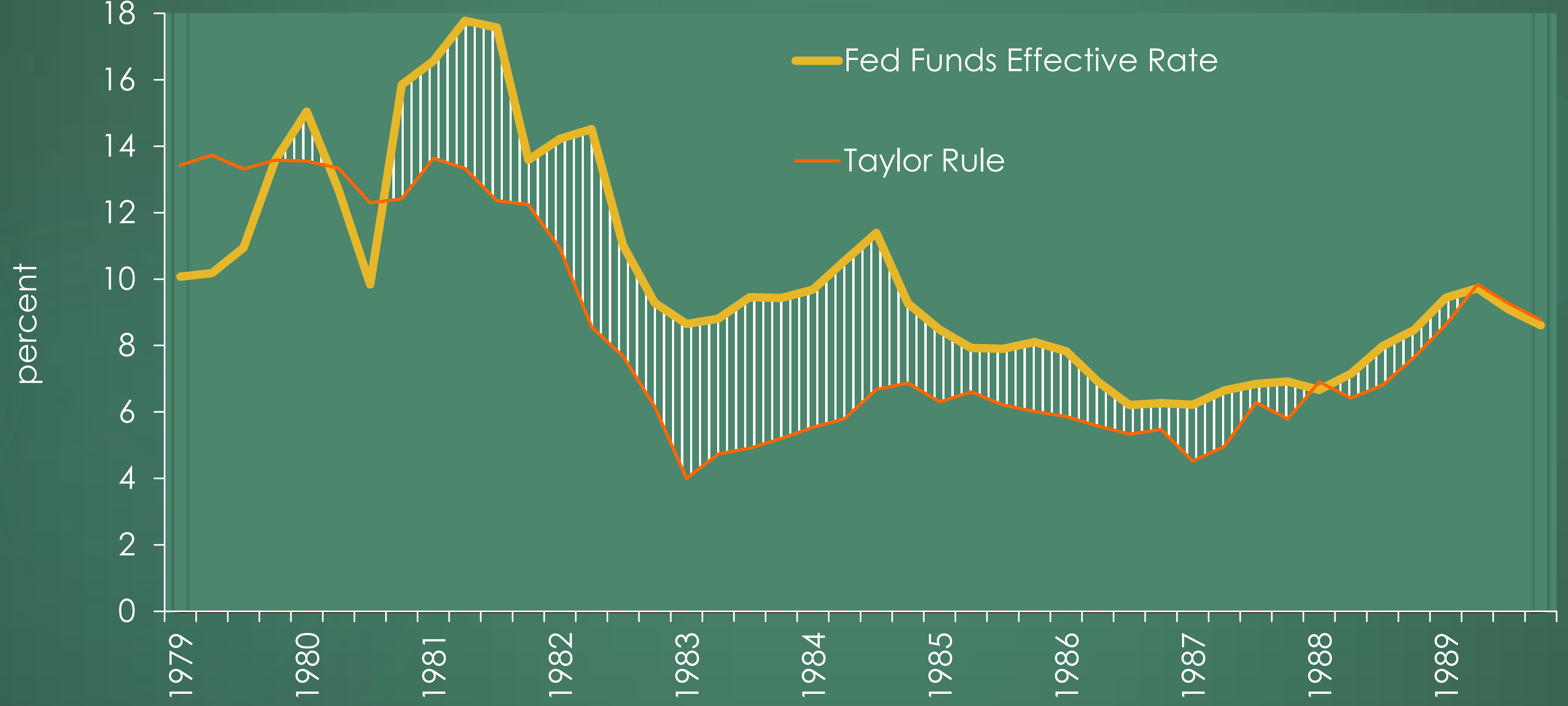
- Do we know that similar patterns of financial development promotes financial integration?
  - Implies complementarities of, say robust banking systems
  - What if they are substitutes?
    - E.g. European banks pre-crisis lending to US capital markets
  - Does the pattern matter at low levels of financial development?

- Why do we care about financial integration?
  - Double edged sword
  - Why regional integration?

Suggestions

- Work on link between financial development and financial integration
  - Model
  - Tangible examples
- Color in the picture
  - Detail the match/mismatch pattern for one country pair
  - Detail of the “legal rights” component and why it shifts the results?
- Where do we stop disaggregating?
  - Even the 10 sub-components are coarse measures that may gloss over important details

Interest Rates above Taylor Rule = Policy Space to Loosen



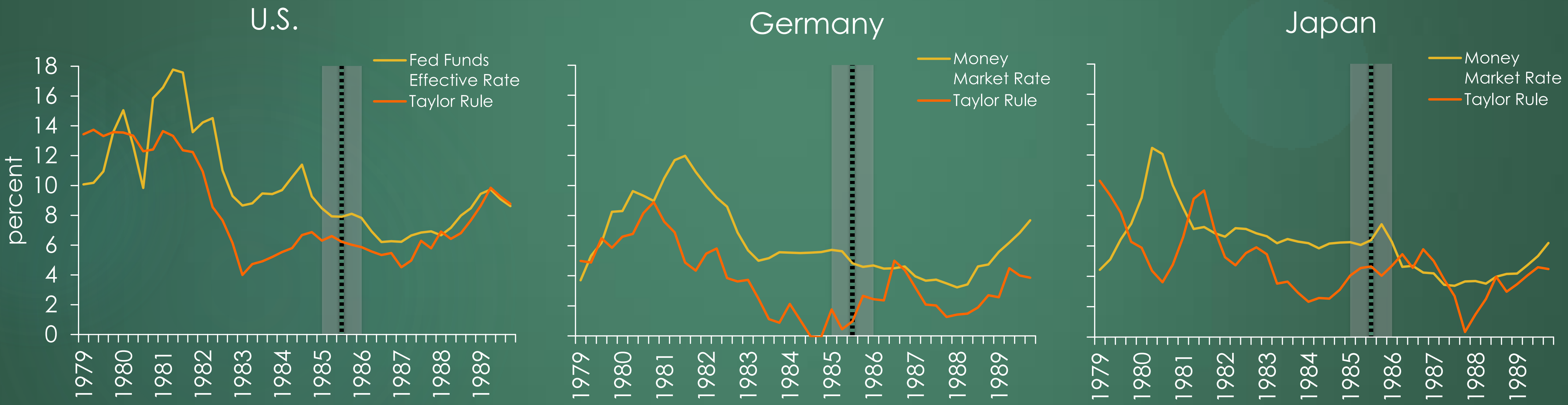
Was Intervention Consistent with Monetary Policy?

- For the Plaza Accord to have been consistent with monetary policy, we would need to see:

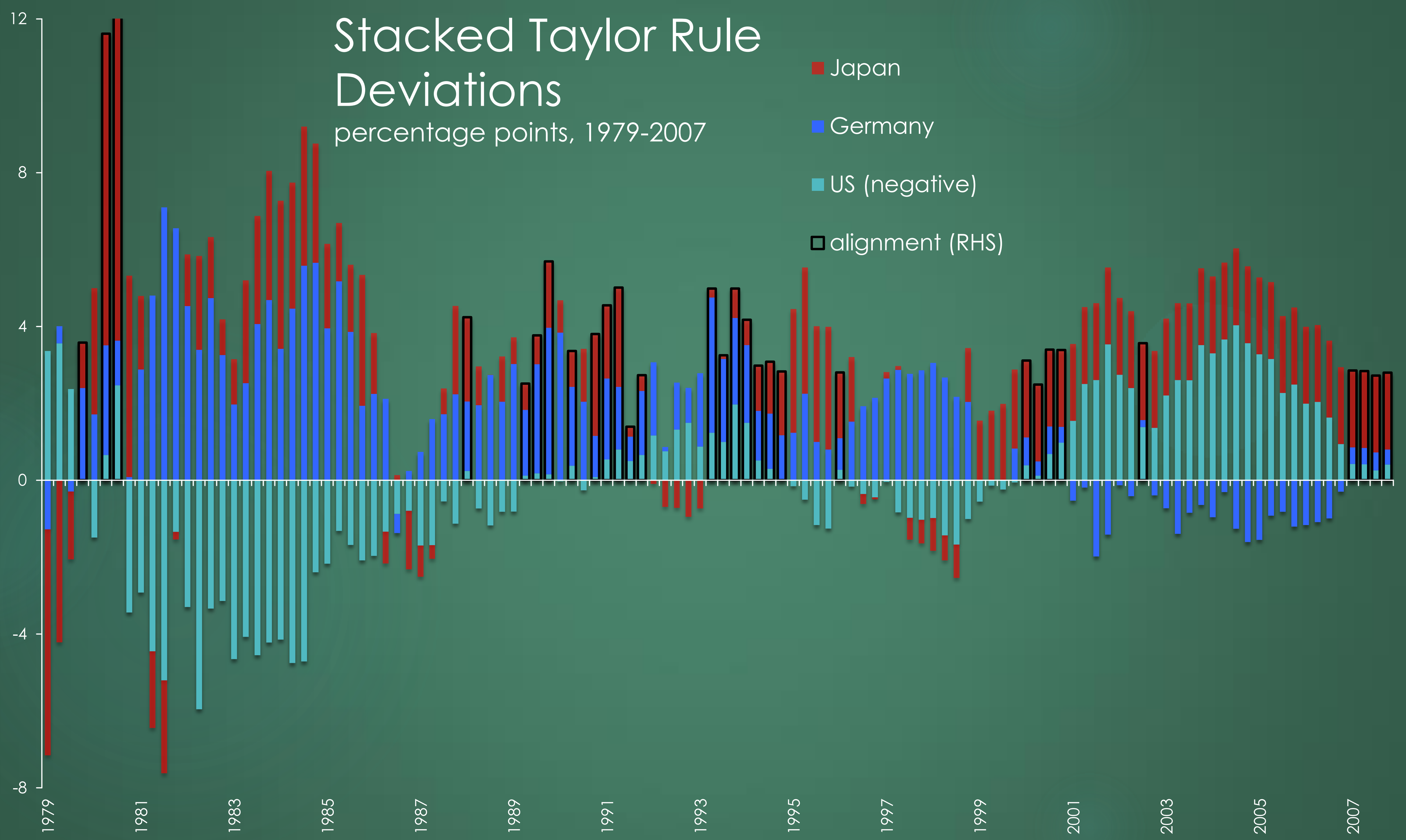
1. Does the U.S. have policy space to loosen?
   - Consistent with FX intervention to weaken the dollar

2. Do Germany and Japan have policy space to tighten?
   - Consistent with FX intervention to strengthen the mark and yen

Consistent?



U.S.
Germany
Japan
Fed Funds Effective Rate
Taylor Rule
Money Market Rate
Taylor Rule
Money Market Rate
Taylor Rule
percent
18
16
14
12
10
8
6
4
2
0
1979
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989



Stacked Taylor Rule Deviations
percentage points, 1979-2007
Japan
Germany
US (negative)
alignment (RHS)
12
8
4
0
-4
-8
1979
1981
1983
1985
1987
1989
1991
1993
1995
1997
1999
2001
2003
2005
2007

The U.S. Was the Main Story at the Plaza Hotel

- We interpret the evidence that the Plaza effectiveness was driven by the U.S. story
  - Along with monetary policy consistency, there was the big switch in FX policy
- Maybe markets believed that Japan and Germany consider exchange rate factors in their monetary policy
  - Taylor rule may need an exchange rate term
- Maybe the Plaza intervention had no effect
  - Monetary policy consistency was irrelevant

Today

- Similarities
  - Dollar is strong
    - Not quite as strong
  - ECB and Japan should not want to tighten
- Differences
  - US is not going to loosen
  - Protectionist momentum is much lower

- Little chance of another Plaza soon