

World Financial Cycles

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Discussion:

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Main idea

- Like (some) previous work
 - common shocks to the “supply of funds”
- Unlike previous work
 - no “black-box” international stochastic discount factor
 - analyze North-South joint growth dynamics

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 - transitory shocks
 - persistent shocks
 - shocks to volatility of persistent shocks
- Cross-country correlations of
 - transitory shocks is 0.4 for both NS and SS (calibrated)
 - persistent shocks is 0.4 for NS (calibrated) and 1 for SS (assumed)
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- Epstein-Zin preferences
- Stock markets
 - segmented
 - reflect persistent rather than transitory shocks (assumed)

Results

- Spreads increase in all of South when
 - negative persistent shock in South (recall corr is 1)
 - negative persistent shock in North (small effect. why negative? should this not lead to a fall in r^* ?)
 - positive shock to volatility in North and South (recall corr is 1)
- Overall, SS correlation of growth is quite low (0.16)
 - despite perfect correlation of persistent shocks and volatility
- Great job matching
 - serial correlation of output growth
 - cross-country correlation of NS growth
- Use data on stock markets, growth rates, and spreads to infer time series of shocks

Understanding three episodes

- 1998-2001 Emerging Market Crises
 - high stock prices \Rightarrow positive persistent shock in North
 - high spreads \Rightarrow positive shock to volatility in North and South
- 2003-2007 Great Spreads Moderation
 - stable stock prices \Rightarrow neutral persistent shock in North
 - low spreads \Rightarrow negative shock to volatility in North and South
- 2007-2009 Great Recession
 - low stock prices \Rightarrow negative persistent shock in North
 - high spreads \Rightarrow positive shock to volatility in North and South

Comments I

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 - many papers emphasize shocks to output/productivity,
 - but many do not (e.g. Lizarazo, 2013, Arellano, Ramanarayanan, 2012, Broner, Lorenzoni, Schmukler, 2013)
 - what’s new (and very interesting!) is that you analyze North-South joint growth dynamics

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 - what’s new (and very interesting!) is that you analyze North-South joint growth dynamics
- Why not calibrate correlations of SS persistent shocks and NS and SS volatility shocks instead of setting them to 1?
 - this would be particularly useful for NS volatility shocks
 - * volatility in North increases risk aversion
 - * volatility in South increases risk
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- The role of the stock market is somewhat unclear
 - is it just a signal for (unobserved) persistent shocks?
 - can you test that it is in fact a good signal?
 - why not assume stock market is a claim on GDP? (still more affected by persistent shocks)

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 - why not assume stock market is a claim on GDP? (still more affected by persistent shocks)
- How about persistent, possibly correlated, shocks to cost of default?

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- Overall, very nice paper: realistic, novel, effects and highly relevant!