

**Discussion of Joshua Hausman – Jon Wongswan  
paper  
“Global Asset Prices and FOMC  
Announcements”**

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**The usual disclaimers apply.**

# Contribution

- Very nice and intuitive paper
- Effects of US monetary policy shocks
  - on *foreign* asset prices – exchange rate, short-term & long-term interest rates, equity returns
  - Determinants – exchange rate regime, finance versus trade
- Why is it important?
  - Results show significant, but also highly heterogeneous effects of US monetary policy shocks on foreign asset prices
- Neat contribution to literature – difficult to discuss

# I. Main query: Monetary policy shocks

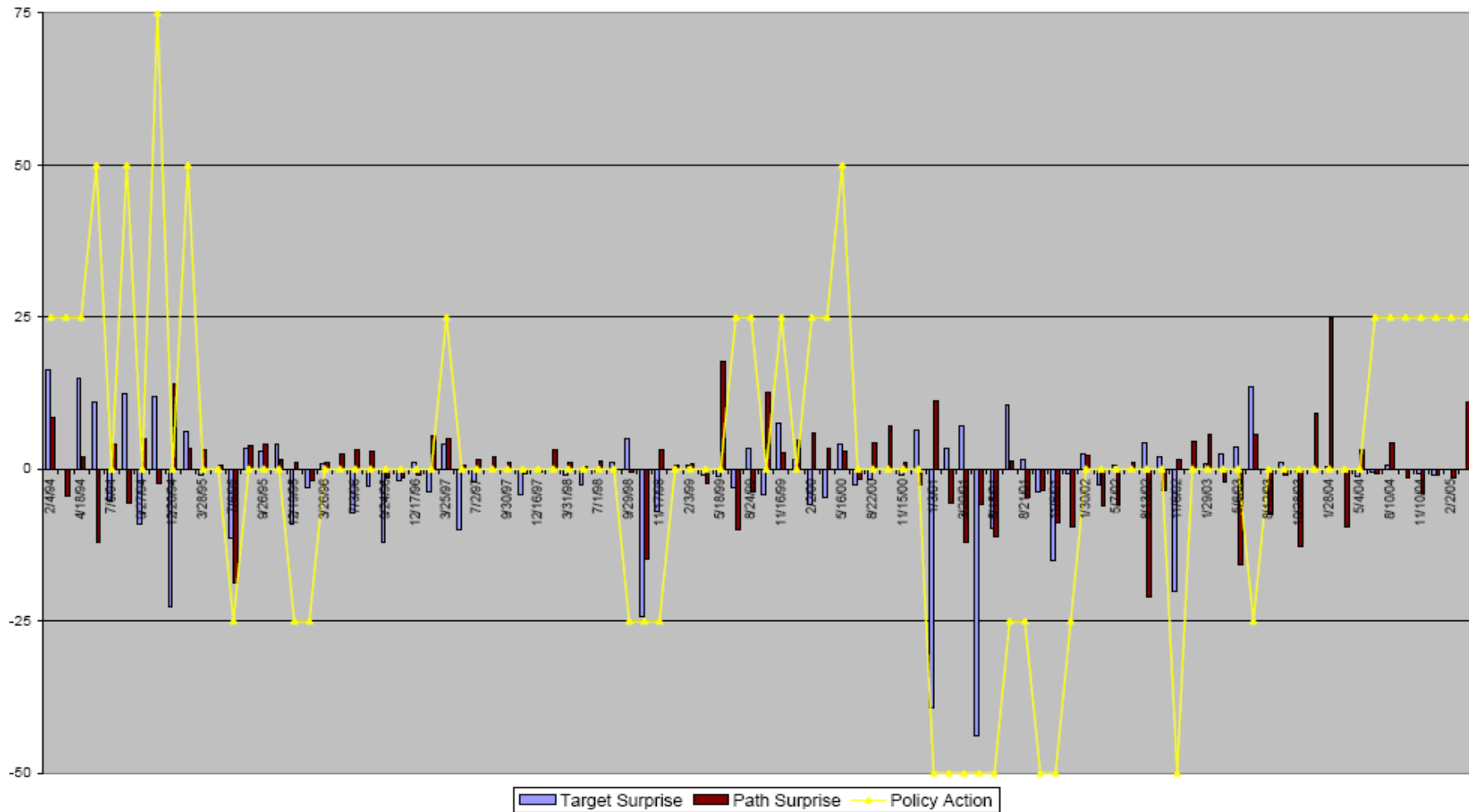
- Identification of monetary policy shocks (Gürkaynak, Sack and Swanson 2005)
  - Based on response of interest rates in 30-minute window around FOMC announcements
  - Distinction between *target surprise* (TS, from current-month fed funds futures) and *path surprise* (PS, from one-year ahead eurodollar futures)
- Key finding:
  - TS affects equity returns & short-term interest rates, but not exchange rates or long-term interest rates
  - PS impacts exchange rate and short-term & long-term interest rates, but not equities

# Main query: Monetary policy shocks

- Question: What explains different effects of TS versus PS of US monetary policy ?
  - My initial prior: TS effects should be larger than PS effects because – from a “discount factor” perspective – they reflect an immediate & realised change in policy rates
  - By contrast: PS → expected change in future policy
  - Puzzling: why TS does not affect exchange rate or foreign long-term interest rates?
  - How should we rationalise this? What is possible mechanism?
- Relation between TS and PS:

$$PS I_t = -0.64 + 0.49 * TS_t + PS II_t$$

# Main query: Monetary policy shocks



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- Orthogonality between TS and PS II: about half of the time both have opposite sign – possible interpretation:
  - When *opposite* sign of TS and PS II: PS II is “timing” surprise
  - When *same* sign of TS and PS II: PS II is “level” surprise about expected policy path
- Using PS I vs. PS II makes a big difference for most asset price responses (bar equities) ! → as they should !
- Open questions are:
  - How shall we understand the different effects of TS vs. PS?
  - Distinguishing between “timing” surprise and “level” surprise may help us in understanding this

## 2. Two minor queries

- Control for other US shocks:
  - Some US macro announcements frequently occur on same days as FOMC meetings
  - Shouldn't matter as shocks should be orthogonal, but would be good to confirm this empirically, esp. as relatively limited sample of policy shocks
- Inclusion of US asset price returns problematic

$$R_{i,t} = \alpha + \beta_i TS_t + \gamma_i R_t^{US} + \varepsilon_{i,t}$$

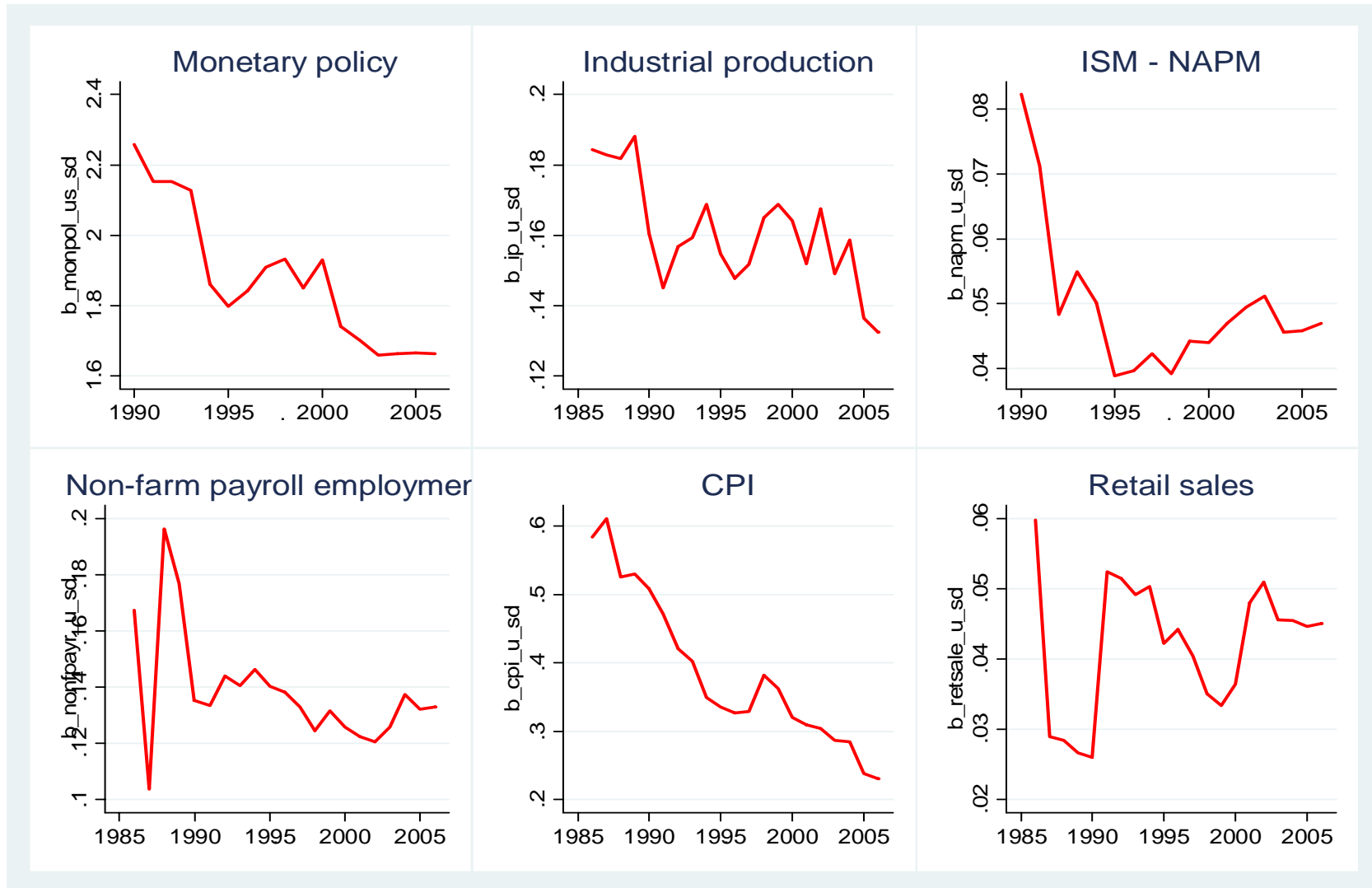
- Cleaner alternative would be to include the unexplained US return component, similar to the construction of PS II

## 3. A few suggestions/extensions

1. *Asymmetries: variations over time*
  - HW paper nicely illustrates asymmetries across types of policy surprises (action–no action; inter-meeting – scheduled)
  - Heterogeneity has changed strongly over time -- Figures
2. *Is heterogeneity in response patterns different across asset prices?*
  - Are some asset prices much more sensitive to US monetary policy shocks than others?
  - Evidence: a cautious “yes”

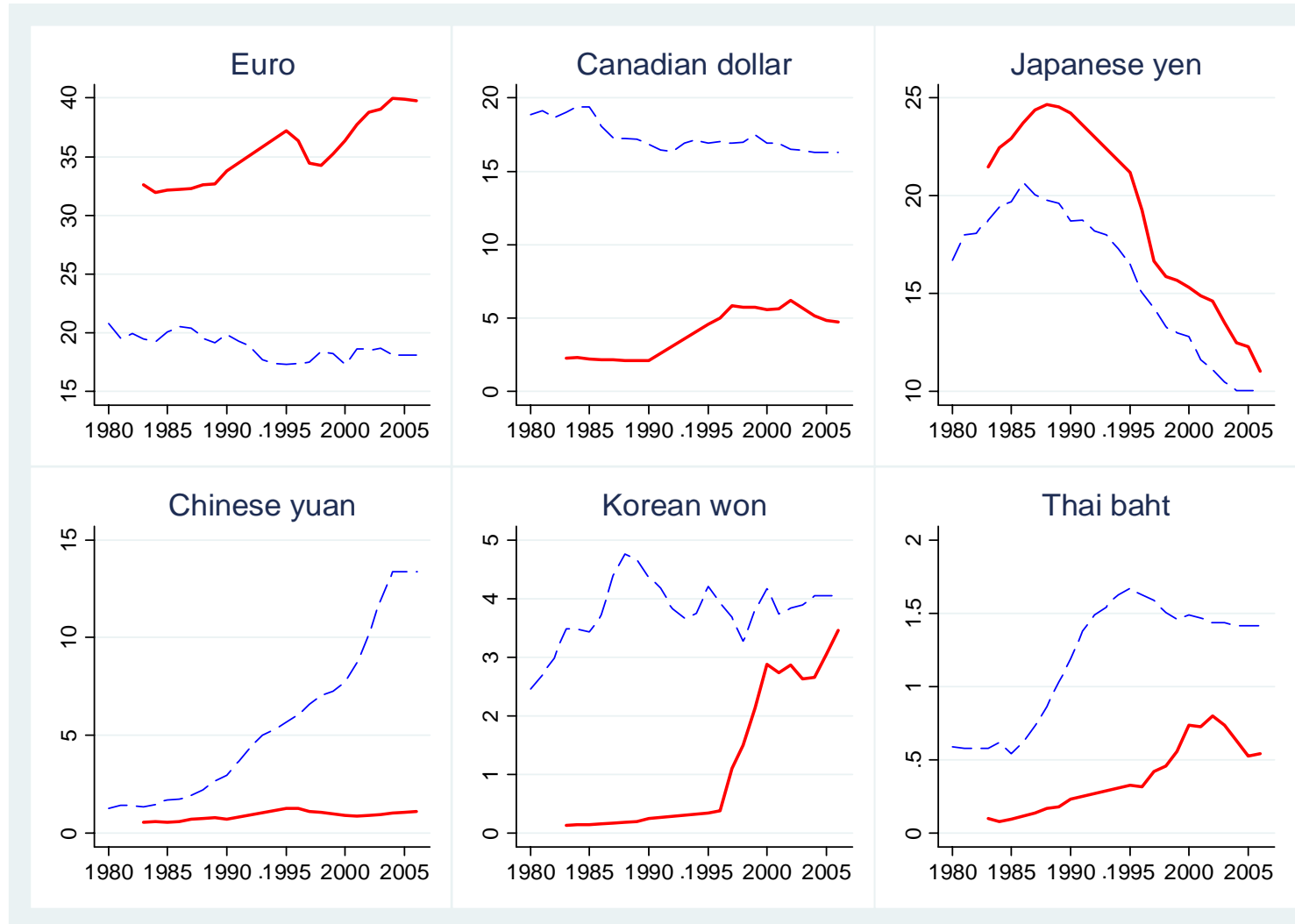


# Heterogeneity over time – flexible currencies



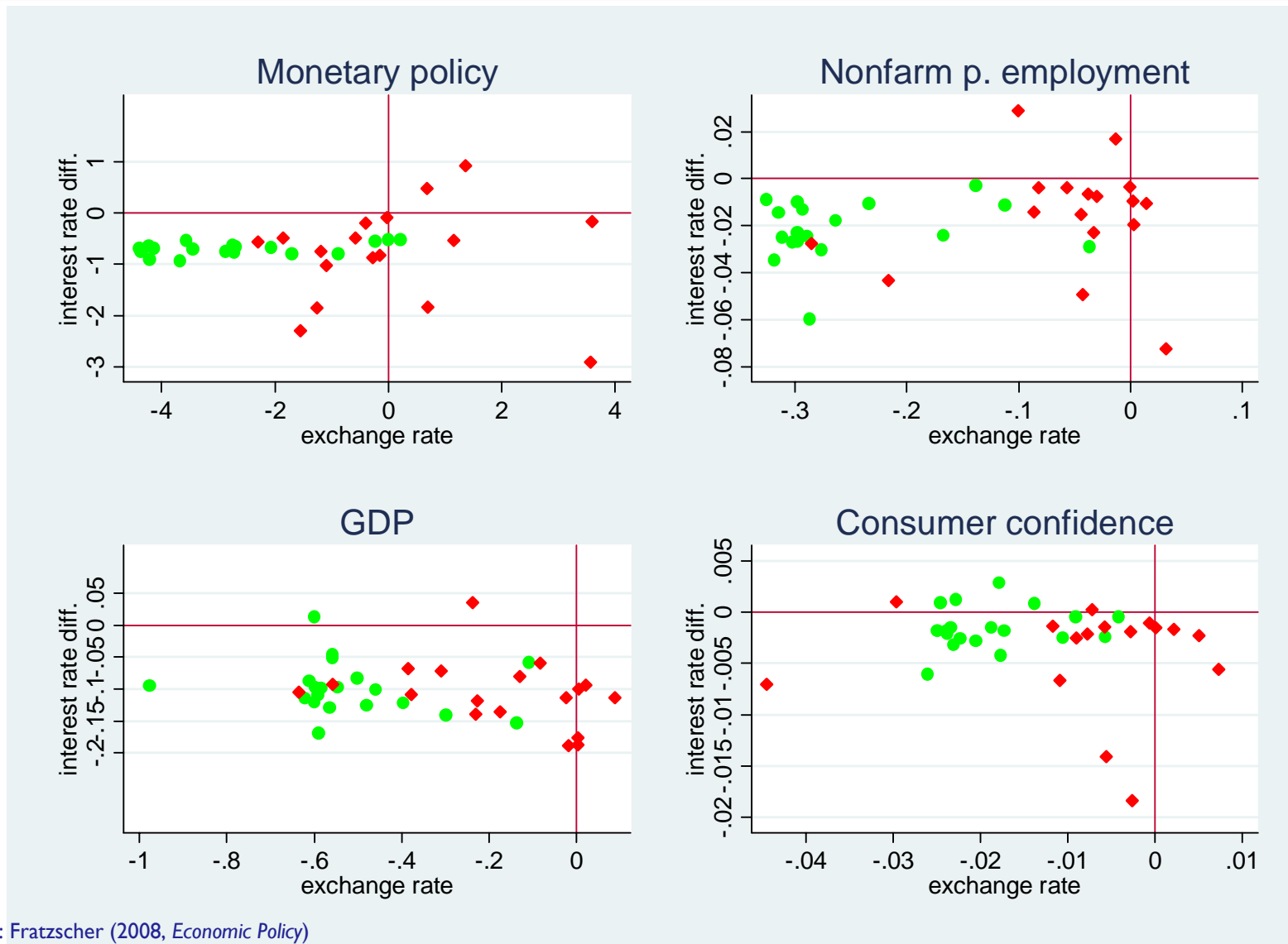
Source: Fratzscher (2008, *Economic Policy*)

# Exchange rate responses to US shocks



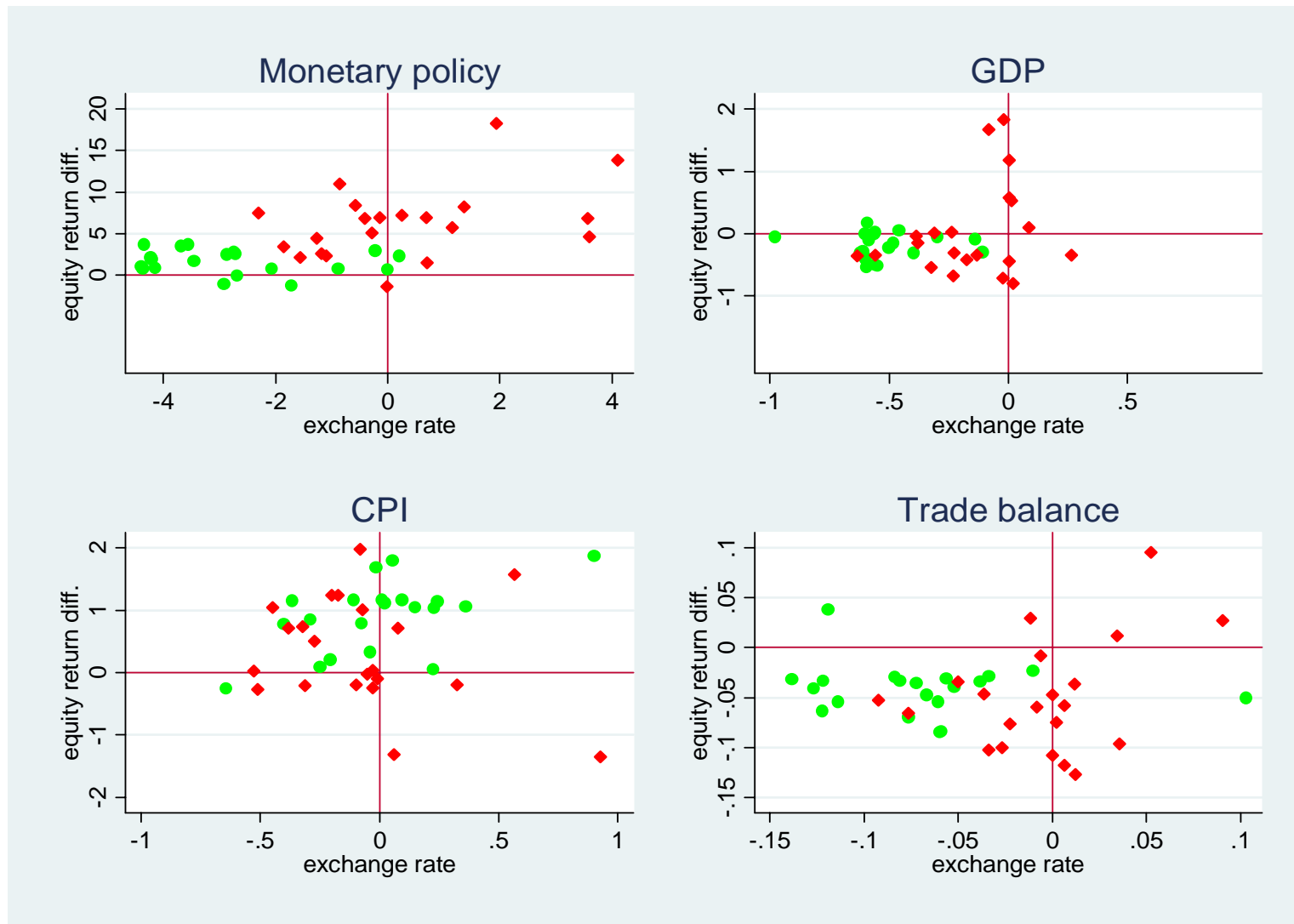
Source: Fratzscher (2008, *Economic Policy*)

# Interest rate diff. vs. exch. rate reaction

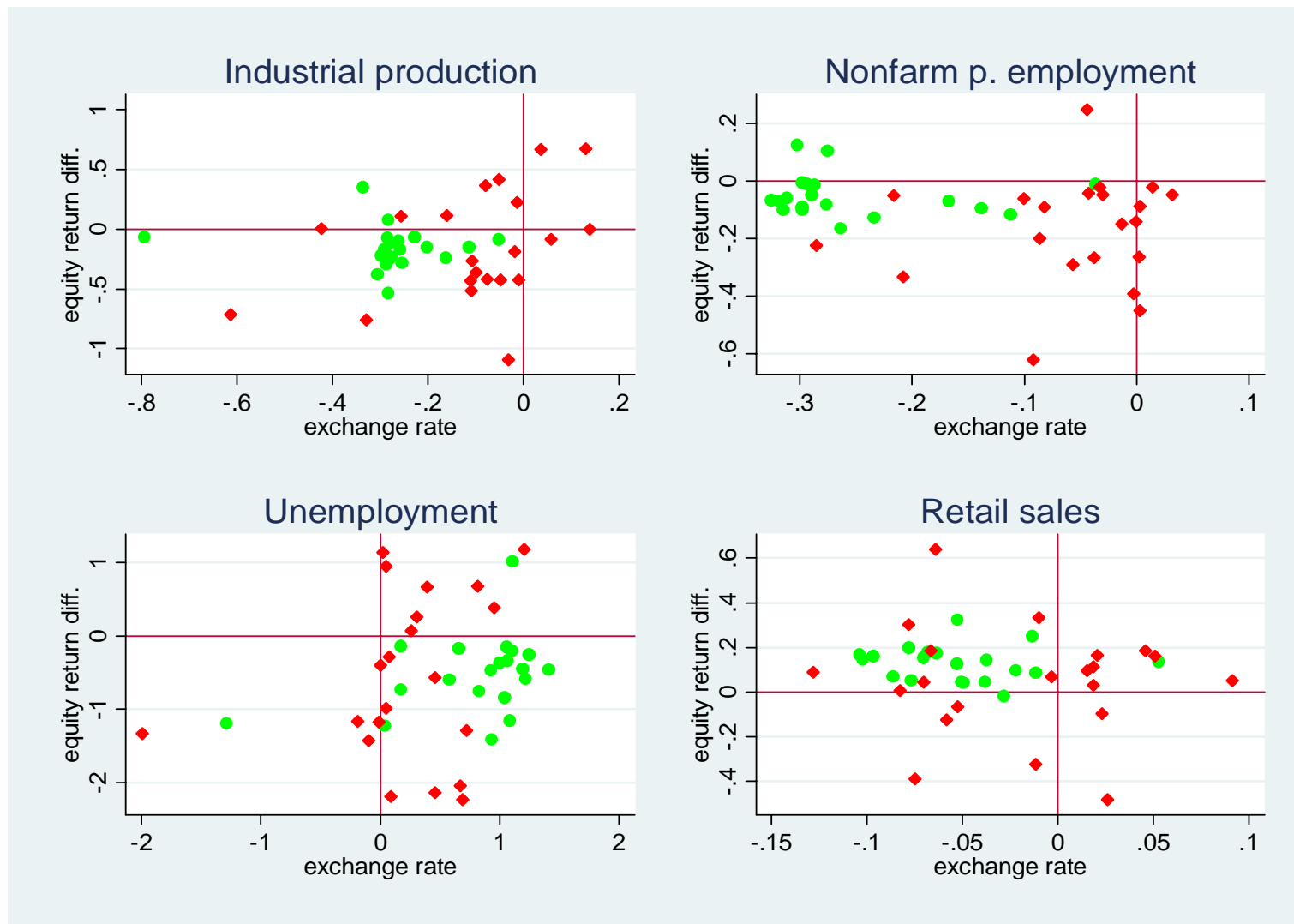


Source: Fratzscher (2008, *Economic Policy*)

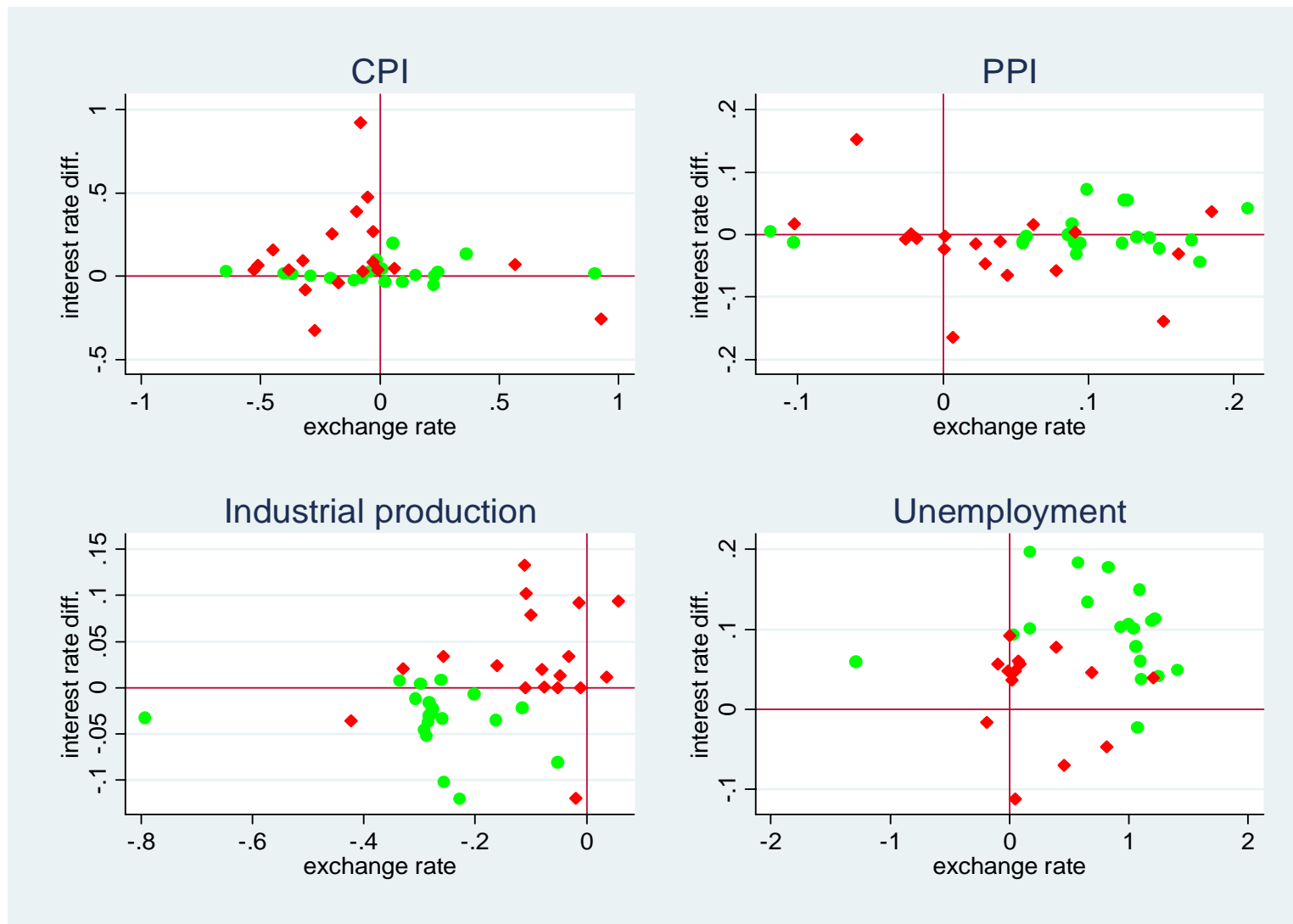
# Equity return diff. vs. exch. rate reaction



# Equity return diff. vs. exch. rate reaction



# Interest rate diff. vs. exch. rate reaction



# A few suggestions/extensions

3. Is there a trade-off across asset price responses?
  - Q: The currency of which country do you expect to react most to US shock ?
    - Canada and Mexico vs. Europe vs. other ?
  - Exchange rate vs. interest rate
    - Faust et al. (2007): expected depreciation (based on UIP)
    - Evidence here: higher exchange rate response coincides with higher foreign interest rate response
    - But exception for Canada & Mexico: strong interest rate reaction, but little exchange rate response to US shock

# Trade-off in asset price responses

	Euro area	Canada	Mexico	Japan
<b>1. Monetary policy</b>				
Monetary policy	-4.262 ***	-0.859 **	5.316	-2.716 ***
<b>2. Real activity</b>				
Industrial production	-0.389 ***	-0.044	0.130	-0.117
GDP	-0.605 ***	-0.145	-0.247 **	-0.415 ***
NF payroll employment	-0.299 ***	-0.040	0.027	-0.170 ***
Unemployment	0.968 ***	0.233 *	-0.366	0.590 ***
Retail sales	-0.086	-0.011	0.047	-0.008
Workweek	-0.778	0.190	0.049	-0.170
<b>3. Confidence / forward-looking</b>				
NAPM / ISM	-0.087 ***	-0.005	0.061 **	-0.021
Consumer confidence	-0.022 ***	-0.004	0.009	-0.007
Housing starts	-0.001 *	0.000	0.000	-0.001 *
<b>4. Prices</b>				
CPI	0.139	-0.052	-0.181	-0.365
PPI	0.090	0.039	-0.389	-0.088
<b>5. Net exports</b>				
Trade balance	-0.144 ***	-0.010	0.139 *	-0.071 **
Observations	6515	6515	6515	6515

Source: Fratzscher (2008, *Economic Policy*)



# A few suggestions/extensions

## 4. Heterogeneity across types of US shocks

- Transmission mechanism of US shocks to foreign asset prices crucially depends on type of US shock
- Discount rate shocks dominate in expansions; cash flow shocks in recessions (Boyd, Hu & Jagannathan 2006)
- Substantial effect on exp. cash flows also by monetary policy shocks (Bernanke & Kuttner 2005, Ehrmann & Fratzscher 2005)
- Strong time variations in stock-bond correlation over time (Baele, Bekaert & Inghelbrecht 2006)
- Type of shock matters for exp. depreciation (Faust et al. 2007)

## 5. Other determinants – e.g. business cycle dependence?

# Summary

- Neat contribution to literature
- Main query: Can we go a step further and find an explanation for effect of monetary policy on asset prices?
- Various suggestions for open questions and extensions...
- ...but only suggestive for an already very nice paper