

Central Banks and the Absorption of International Shocks (1891-2019)

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An ambitious and interesting paper

- Remarkable data set comprising data on balance sheets of 23 central banks and production, prices, interest rates, exchange rates, money market rates, equity prices and long-term government bond yields over the time period 1891-2019.
- In the paper, the authors address a large number of interesting questions.
 - This data set could be used to study many other important questions.
- Two parts to the paper:
 - Theoretical part discusses interest rate determination in different settings.
 - Empirical part provides estimates of the effect of exogenous shocks to the “international rate” on the domestic portfolio of central banks.

Theory: the role of policy

- How interest rates and exchange rates respond to foreign financial shocks depend on the macroeconomic backdrop and policy reactions:
 - Suppose the Fed raises interest rates “exogenously” in response to a commodity boom.
 - Canada and other commodity exporters are likely to be affected by the same boom, so the BoC may raise rates irrespectively of financial flows.
 - The depreciation of the Canadian dollar may raise inflation, requiring the inflation-targeting BoC to raise rates.
- Not enough to distinguish merely between fixed and floating regimes, but also on how monetary policy is conducted under floating rates.

Tell us more about the data

- The data set is formidable, but the authors do not provide much insight into it.
 - Some time series plots and tables would be helpful.
 - Co-movement in interest rates, central banks' domestic portfolios.
- More information about how foreign assets are accounted for.
 - Are they held at book value, market value, something else?
 - Exchange rate movements matter if they are valued at market prices!
 - Are central banks valuing them in the same way?
- How do the Lennard (2018) and Romer and Romer (2004) shocks compare to the shocks that the authors estimate?
- What do the financial openness indices look like?

Summing up

- An ambitious and hugely interesting paper that will no doubt be followed by a series of others.
- It would be useful to have a longer description and discussion of the data.
- Important to have a better understanding about:
 - The sources of “exogenous” shocks, and whether they are correlated internationally.
 - Monetary policy reacts under floating exchange rates.