Habib, Stracca, and Venditti (2019) "The making of global safe assets: does the shock matter?"

A discussion at City University Hong Kong

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* Views herein are my own and not HKMA's or its staff's.

An interesting and potentially important paper

- **Answer to the question in the title: yes and no.**
  - Some country characteristics help alleviate sovereign spread widening, regardless of the type of (global) shock.
  - There are also country fundamentals are helpful in buffering against a specific type of shock.

- **Is this a paper about how to become a safe asset, or how to "get one's house in order"?**
  - Seems semantic, but very different policy implications: how can I run faster than Usain Bolt, vs. how can I run faster.

- **Does the market differentiate EMEs?**
  - Results in this paper suggests "not really", but there are recent evidence that says "yes".

- **Minor/technical comments**

Bird's eye view of the results

Specification:

$$\Delta Yield_{i,t} = \beta' X_{i,t-1} + \gamma' X_{i,t-1} \Delta shock_t + country\ FE + time\ FE + error_{i,t}$$

Signs of statistically significant γs:

	Safe-havenness	Political rating	Size of economy	Other stuff?
VIX shock	+	-	-	**None**
Monetary policy shock	+	-		**Openness (+), Inflation (-)**
Financial shock	+	-	-	**Openness (+), NFA (-)**
Geopolitical shock			-	**Current account (-)**

Is this paper about how to become a safe assets, or how to "get one's house in order"?

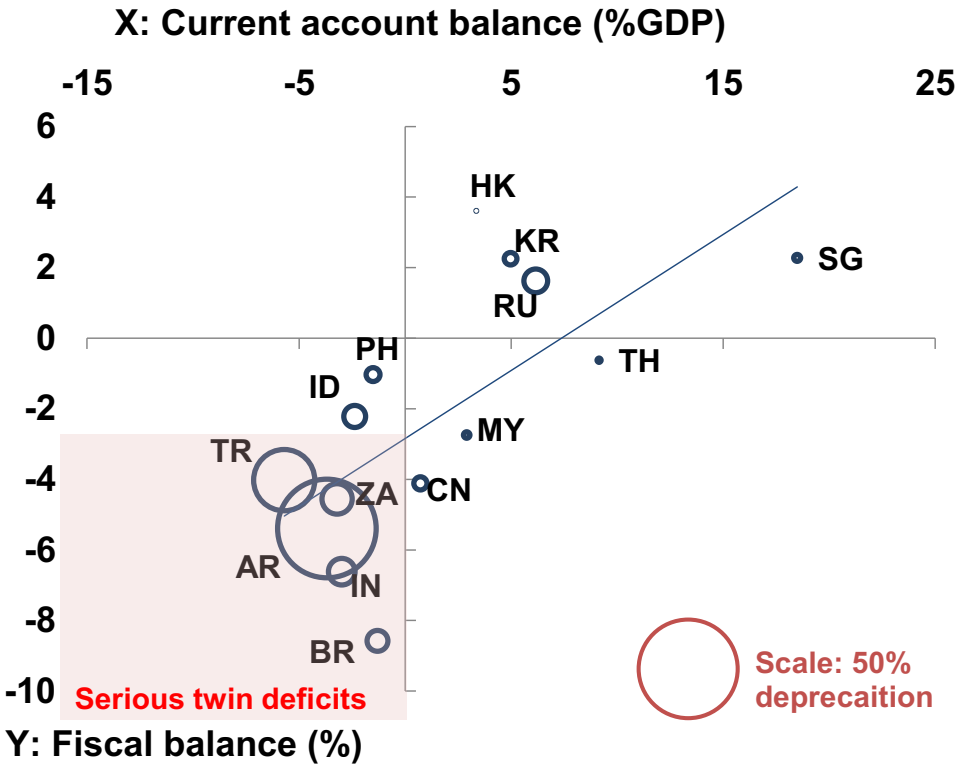
- **Safe assets: low default risk, low private information, low volatility in valuation, high liquidity.**
  - Pretty high bar!
  - If we believe in He et al. (AER 2019), *relative* fundamentals determine safe assets, more so than *absolute*.
  - Other very persistent factors in safe asset determination—e.g., exorbitant privileges brought about by being a reserve currency, institutional arrangements, regulations.
  - Not everything can be a safe asset, even if they become less prone to shocks over time.

- **The paper provides a "playbook" for sovereign debt to be less prone to shocks.**
  - Tells countries how to "get one's house in order" in the face of different types of shocks.
  - I'm very curious what the results would look like if EMEs are specifically studied—investor perceptions are just difficult to shake; some characteristics that might bother EMEs do not bother AEs.

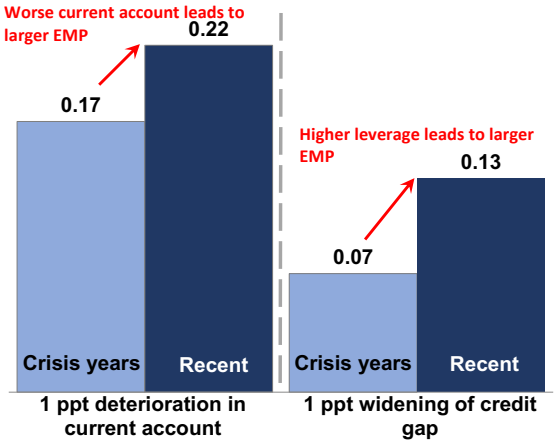
Paper suggests that investors don't really differentiate EMEs, but there are reasons to believe that has changed…

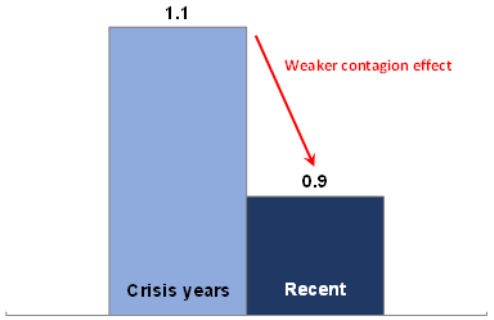
"Twin deficit" in focus during the recent EME selloff

Currency depreciation (Jan-Oct 2018) vs, fundamentals



More differentiation, less contagion





1 ppt increase in the "contagion" factor

Source: CEIC, HKMA staff estimates.

Source: Tam (2019).

Minor/technical comments

- **Standard errors.** The “shocks” are estimated. How’re statistical errors taken into account when they’re used as interactive regressors?

- **My “nitpicking” of the shocks.** Why’s geopolitical risk so low currently (vis-à-vis say Caldara and Iacoviello’s index), and why was MP shocks so tame during the taper tantrum? Is a unified way of identifying shocks needed—e.g., everything identified using sign restrictions + narrative?

- $Yield_{i,t-1}$ **in regression.** How should we interpret the negative level coefficient and positive interacted coefficient? Are both levels and changes stationary?

- **Dependent variable.** Why yields, and not spreads? If excluding the U.S. doesn’t change results materially, can use spreads.