Discussion of "Endogenous Global Risk" by Hao Hu and Ji Huang

Discussant: Ding Dong (HKUST)

2022 AFR International Conference

Big Picture

- Global Financial Cycle (GFC): comovement of
 - International capital flow
 - Financial variables (leverage, asset price, risk-premium etc.)
- Hu and Huang (2021): Financial accelerator theory of GFC
 - Two types of agents (savers & firms) in two countries
 - Financial friction I: firms cannot issue equity to household
 - Financial friction II: only home firms can do FDI
 - Accelerator: (Home) capital quality shock: net worth↓ → leverage ↑ → risk-bearing ↓ → demand for foreign asset ↓
 - Co-movement: (Foreign) firm equity issuance↓ → debt issuance (to domestic savers) ↑ → demand for home debt ↓

Mechanism

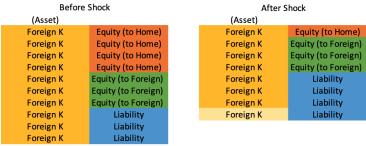
Before Shock		After Shock		
(Asset)		(Asset)		
Equity (from Foreign)	Equity (to Home)		Equity (from Foreign)	Equity (to Home)
Equity (from Foreign)	Equity (to Home)		Home K	Equity (to Home)
Equity (from Foreign)	Equity (to Home)		Home K	Equity (to Home)
Equity (from Foreign)	Equity (to Home)		Home K	Equity (to Home)
Home K	Equity (to Home)		Home K	Liability
Home K	Equity (to Home)		Home K	Liability
Home K	Equity (to Home)		Home K	Liability
Home K	Liability			
Home K	Liability		(Loss from Shock)	
Home K	Liability			

(simplified) constraints: 1. Debt < 0.5*K; 2. Adj Cost

Figure: Balance Sheet of Firm in Home Country (developed)

(ロ)、(型)、(E)、(E)、 E) の(()

Mechanism



(simplified) constraints: 1. Debt < 0.5*K; 2. Adj Cost; 3. No FDI

Figure: Balance Sheet of Firm in Foreign Country

▲ロ ▶ ▲周 ▶ ▲ 国 ▶ ▲ 国 ▶ ● の Q @

Comments

• One-way foreign direct investment: Home \rightarrow Foreign

- Story: less developed financial market at foreign country
- Alternative story: more financial barrier at home country
- Comment: provide evidence to support this key assumption
- Origin of GFC
 - This paper: capital quality shock (extensive margin)
 - Huo, Levchenko, & Pandalai-Nayar (2021) decompose comovement into correlated shocks vs. global transmission of shocks.
 - $1. \ \mbox{Correlated shocks}$ accounting for most co-movement
 - 2. TFP/labor supply shocks more important (intensive margin)

▲□▶ ▲□▶ ▲□▶ ▲□▶ ■ ●の00

Calibration important but missing

Summary

- Interesting, inspiring and ambitious paper!
 - Intriguing framework on an important topic (GFC)
 - Powerful theory accounting for many important facts
 - Could be further strengthened with supporting evidence

▲□▶ ▲□▶ ▲□▶ ▲□▶ ■ ●の00

- Good luck with the paper!
 - Can't wait to see more follow-up works