

Discussion of “Endogenous Global Risk” by Hao Hu and Ji Huang

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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 \downarrow \rightarrow leverage \uparrow \rightarrow risk-bearing \downarrow \rightarrow demand for foreign asset \downarrow
 - Co-movement: (Foreign) firm equity issuance \downarrow \rightarrow debt issuance (to domestic savers) \uparrow \rightarrow demand for home debt \downarrow

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		
Home K	Liability		
		(Loss from Shock)	

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

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

Mechanism

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

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

Figure: Balance Sheet of Firm in Foreign Country

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. Correlated shocks accounting for most co-movement
 2. TFP/labor supply shocks more important (intensive margin)
- 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
- Good luck with the paper!
 - Can't wait to see more follow-up works