Discussion of
Claessens Kose Terrones
“How Do Business and Financial Cycles Interact?”

Frank Warnock

FRBNY Conference
“Global Dimensions of the Financial Crisis”

University of Virginia
Darden School of Business

What the paper sets out to do (1)

- Systematically dates recessions/recoveries and fin'l upturns/downturns for a long, broad dataset (44 countries, 1960 or 1978 until 2009).
  - Identify turning points in macro and financial variables using a Harding/Pagan business cycle dating algorithm.
  - Label severe episodes
    - Fin'l up/downturns in 1^{st} and 4^{th} quartiles are labeled disruptions and booms.

What the paper sets out to do (2)

- Analyze the interactions between business and financial cycles.
  - Sychronization (concordance stat), conditional likelihood of being in a recession when also fin’l disruption
  - Are recessions (recoveries) associated with financial disruptions (booms) different?
  - Is there an empirical link between duration and amplitude of recessions/recoveries and financial market events?

- Say something about the current episode.
  - Was the severity of 2007-09 recessions to be expected based on the extent of financial market disruptions?

Main results (1)

- The systematic coding of fin'l upturns/downturns and booms/disruptions

- FCs longer and sharper than BCs
  - Recessions/recoveries typically last 4-6 quarters; Financial downturns/upturns can be 6-18 quarters
  - Recessions/recoveries: change in GDP of 2-9 percent; Financial downturns/upturns changes of 6 to 60 percent

Main results (2)

- BCs and FCs synchronized, with BCs being more synchronized with credit and house price cycles than with equity price or exchange rate cycles
  - 80% of the time, the credit and business cycles are in same phase.
  - About twice as likely to be in a recession (recovery) if in a credit crunch (boom).

- FCs play an important role in shaping recessions and recoveries
  - Recessions assoc w/ fin'l disruptions longer/deeper.
  - Recoveries assoc w/ rapid FC recovery stronger.

The paper's contribution

- Across a large set of countries, <u>systematically</u> identify BC and FC episodes and explore their interactions.
- Much of the literature focuses just on the recession phase or on a limited set of countries.
  - Example: CKT (2009 EP). For OECD countries, focuses on recessions and finds that recessions assoc. w/ credit crunches and house price busts longer/deeper.
- Much of the literature identifies FC episodes in a manner that is subject to debate (see, for example, Reinhart Rogoff v. Lopez-Salido Nelson).
  - This paper uses an easily understood econometric approach.

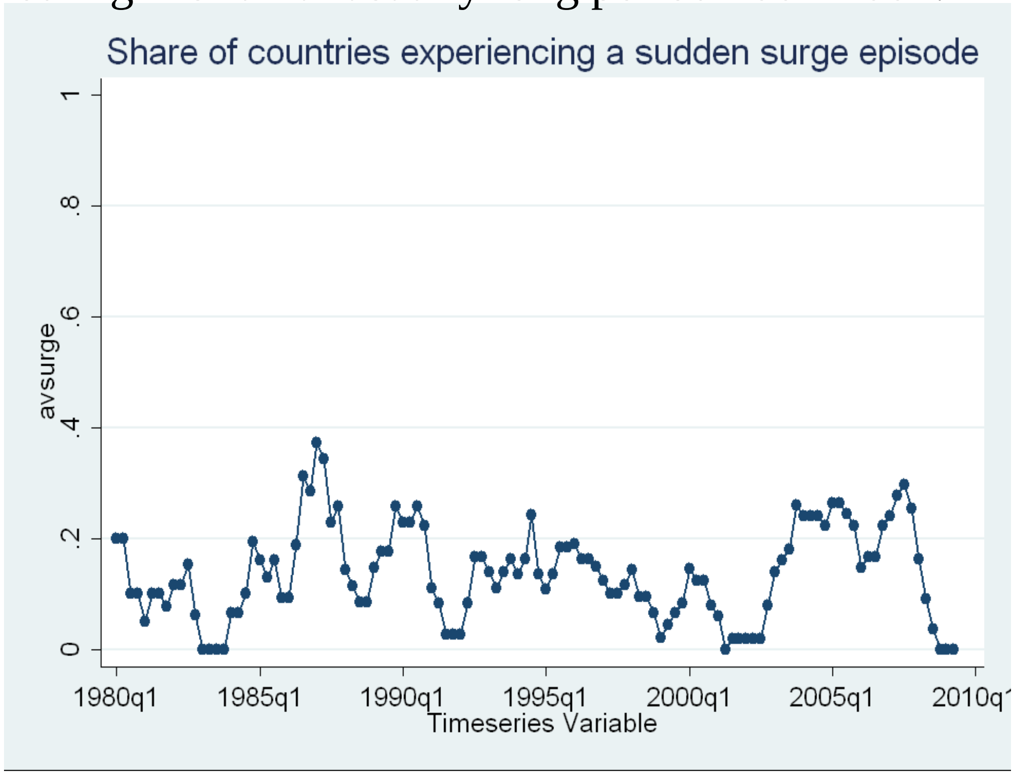
What I'd like to see more of

- It is mentioned in the conclusion that the stylized facts present a challenge for theorists.
  - I'd prefer some reweighting toward implications for existing theories. Flesh this out more.

- The paper is still focused on the recession/downturn episodes (and the periods immediately following…the recovery/upturn).
  - The periods just prior to recessions/downturns are also important.

"…abnormal increase in gross flows should be a warning sign."

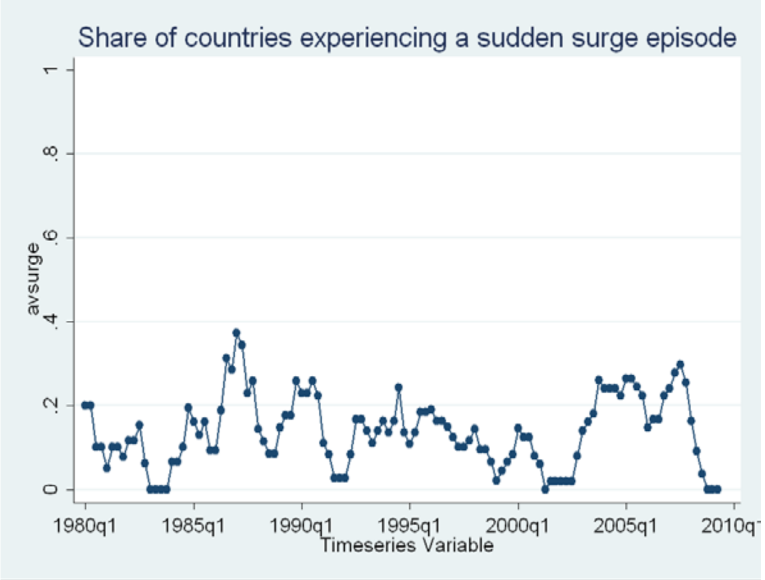
The percent of countries experiencing abnormal "surges" in gross capital inflows remained high for an unusually long period 2004-2007.

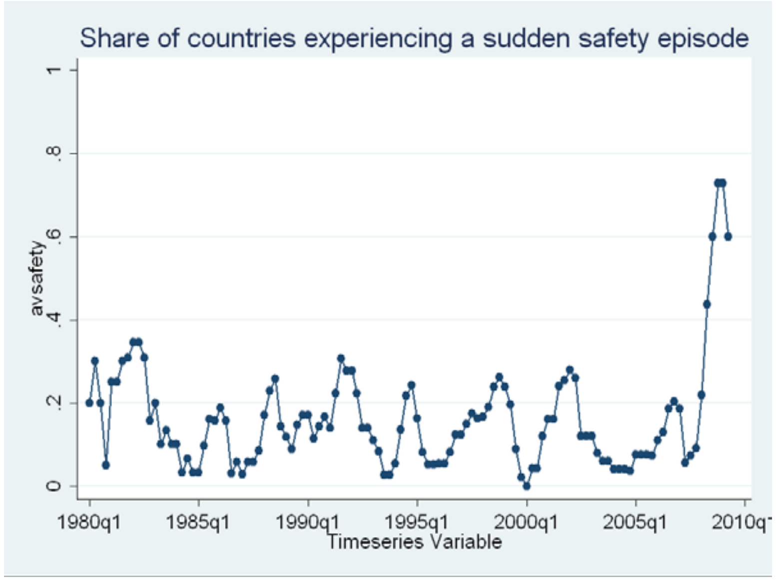


Forbes and Warnock (2010)

"…abnormal increase in gross flows should be a warning sign."

This of course ended in mass retrenchment…





Forbes and Warnock (2010)

My take on the paper

- Carefully executed paper, exhaustive attempt to systematically create important stylized facts on BC and FC episodes.

- The paper is useful for
  - empiricists looking to code recession/recovery and fin'l upturn/downturn episodes in a wide range of countries.
  - theorists looking for stylized facts to inform their modeling.

The final slide

- It’s an important topic
- Empiricists and theorists will find it useful.
- I enjoyed the paper.