

# THE FINANCEMENT

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## About the Research Study

Title: Impact of economic policy uncertainty shocks on China's financial condition

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## Introduction

### A few things before we dive in

- A financial conditions index considers the state of an economy based on the average of a set of variables to look at monetary policy and aggregate demand.
- A major factor that impacts this financial condition index is economic policy uncertainty (EPU) shocks or sudden changes in economic policy.
- Some factors affected include
  - (1) a reduction in housing prices
  - (2) lower real mortgage rates
  - (3) increase in asset price volatility
- Rather than looking at a single factor, these researchers looked at how economic policy uncertainty in China and other countries affected the overall state of financial markets in the country.

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## Methodology

So here's what they did

- To track the impact of EPU on the financial conditions, the researchers used a Vector Autoregressive model, which tracks the relationship of variables over

time. In this case, those variables were the (1) economic policy uncertainty and (2) financial condition index.

- The economic policy uncertainty was calculated based on a previous study, while the financial conditions index used a Reduced Aggregate Demand Equation model, which considered 4 variables:
  - Real interest rate
  - Real effective exchange rate
  - Real house prices
  - Real share prices
- Data was recorded for all variables with monthly data from January 2004 to December 2018 (included global financial crisis of 2008 and the European sovereign debt crisis of 2010).

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## Key Takeaways

**So what does all of this mean?**



### Spillover Effects

Spillover effects (effects from unrelated events) from within China itself were the major source of disruption in the financial conditions of the country, followed by effects from the United States, Japan, and Europe, in that order.



### US-China Trade Relations

The US-China trade war couldn't be more important than it is now: from national security to monetary policy, during the COVID-19 crisis, the US economic landscape has been very sensitive to any changes in its relationship with China.



### Crises Periods

The spillover effects were concentrated in crisis periods (2008-2010) but had little impact during normal periods (2015-2017). Essentially, policy uncertainty becomes much more influential during crises.



### Investment Consideration

Companies including Bytedance, Tencent, and Huawei are a few of many companies that facing extreme uncertainty now because of the economic and geopolitical landscape we face. And with these findings, the trade war can have an even greater impact on these stocks today.

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