Nguyen Hoang Lan

Monetary Policy and Stock Returns: The case of Vietnam

National Graduate Institute for Policy Studies

Summary

It is important for policy maker to understand and quantify the links between monetary policy changes and financial market performance. This dissertation contributes to the discussion by studying the monetary policy transmission mechanism in Vietnam. In particular, we explore whether monetary policy can have an impact on equity prices and real variables and whether monetary policy reacts to changes in the stock market, in inflation or in output growth.

Using the macroeconomic data collected from the International Monetary Fund's International Financial Statistics and the Bloomberg database, we analyze the link between monetary policy and equity returns in Vietnam with a Vector AutoRegressions (VARs) approach in chapter 3 and a DSGE framework in chapter 4.

In Chapter 3, we assess the impact of monetary shocks on Vietnamese financial market with the use of Vector AutoRegressions (VARs) during the period of July 2001 – Dec 2011. A Cholesky decomposition of the variance-covariance matrix of the residuals is performed in VARs in which stock returns is ordered last in the ordering, after slow moving variables, i.e. GDP, inflation, and the monetary policy instrument. The impulse

response suggests that the key drivers of the stock market are shocks generated from within the financial sector and money supply. We also find out that monetary shocks exert strongest impacts on small firms and the impacts lessen as firm size grows. Financial firms are found to respond faster and stronger to changes in policy than their counter parts in other industries such as Technology, Materials and Consumer Goods.

In Chapter 4, we estimate Nistico (2012)'s DSGE model with Vietnam data following the estimation strategy proposed by Castelnouvo (2013). We fit the model to Vietnam data from 2001Q2 to 2011Q4 with Bayesian techniques in DYNARE. As an empirical proxy for Vietnam financial market condition, we employ stock returns which is the most readily available data in Vietnam that intuitively connects financial market with household's wealth and consumption decision. The empirical results point out that monetary policy shocks drive fluctuations in the financial market, so do non-fundamental shocks, preference shocks and inflation shocks. We also find that monetary tightening is effective in curbing inflation and moderate financial market and output growth. Our results reveal that the asset price channel, via stock returns and wealth effect, is weak in Vietnam. Positive shocks to the financial market do not significantly improve aggregate consumption or output gap. This means that the possibilities of influencing household behavior in Vietnam via monetary policy are limited, probably due to 1) high risk associating with a volatile financial market and 2) limited financial holdings.