

Do Domestic and US Economic Policy Uncertainty Increase China's Macro-Financial Connectedness?

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While economic policy uncertainty (EPU) has been shown to increase systemic risk within financial institutions, there is limited knowledge about the role of EPU in influencing the risk connectedness (spillover) between financial markets and macroeconomic sectors. This paper provides a systematic analysis and comparison of how macro-financial risk connectedness in China's economy responds to an increase in domestic and US EPU. The results suggest that: (i) an increase in domestic EPU leads to a significant rise in macro-financial total risk connectedness for at least two years; (ii) specifically, the increase in domestic EPU elevates the risk connectedness from financial markets (foreign exchange and bond market) to other sectors and from other sectors to the macroeconomic sectors (GDP, consumption, and import); (iii) categorical EPUs exhibit a similar pattern to the overall EPU, with China's monetary policy uncertainty (MPU) having the largest effects and China's trade policy uncertainty (TPU) having the smallest effects; (iv) US EPU also increases China's macrofinancial risk connectedness, though the impact is lower in magnitude and shorter in duration; (v) however, during the US-China trade conflict, a rise in US TPU causes a more significant and persistent increase in China's macro-financial risk connectedness.