

Discussion of 'Capital Flows at Risk: Taming the Ebbs and Flows'

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Summary

The paper in one slide

1. Use quantile regression to model entire probability distribution of capital flows to EMs at various horizons
 - Based on correlations with global financial conditions and domestic structural characteristics and policies
2. Estimate effect of (i) policy actions (FXI, CFM, MaPru, MP) and (ii) structural characteristics on these distributions in face of tightening global financial conditions

A discussion in five acts

1. The motivation
2. The shock
3. The effect of policy
4. The econometrics
5. What have we learnt?

The motivation

1. Useful to look at entire distribution of capital flows to EMs
 - Yes! Increasing number of papers agree (Chari et al, 2020; Eguren-Martin et al, 2020)
 - Would be useful to place contribution in relation to these
2. Focus on (non-resident) portfolio flows because *'banking flows [...] have been dwarfed by portfolio debt flows in the post-crisis period'*
 - Less obvious

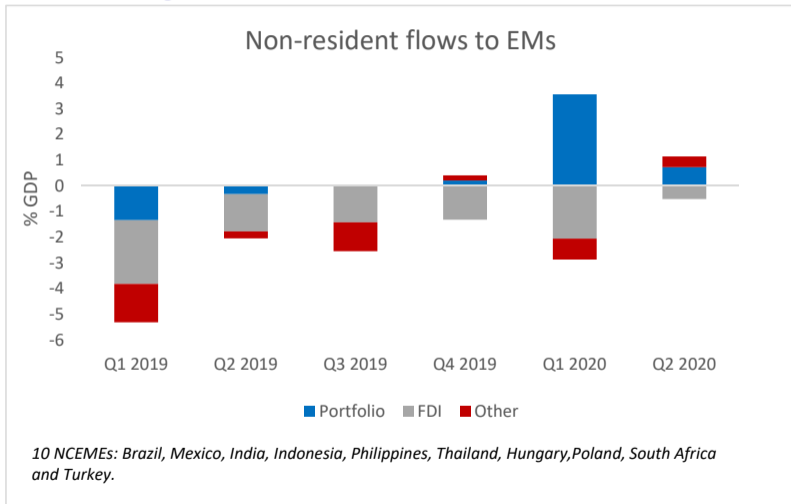
The motivation

Type of flows considered

1. Not-so-dwarfed banking flows
2. Banking flows also flighty
3. Heterogeneity within portfolio flows

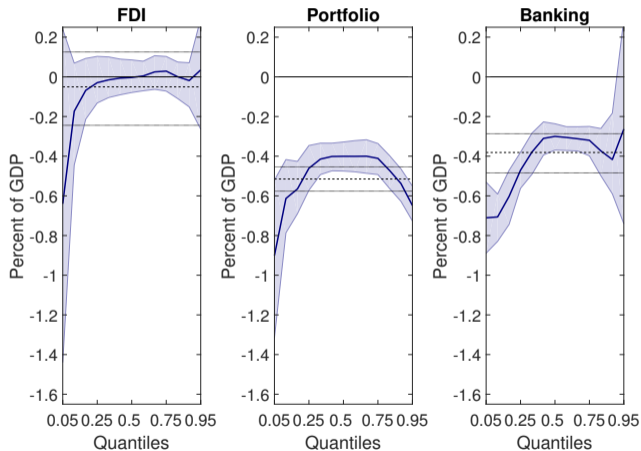
The motivation

Not-so-dwarfed banking flows



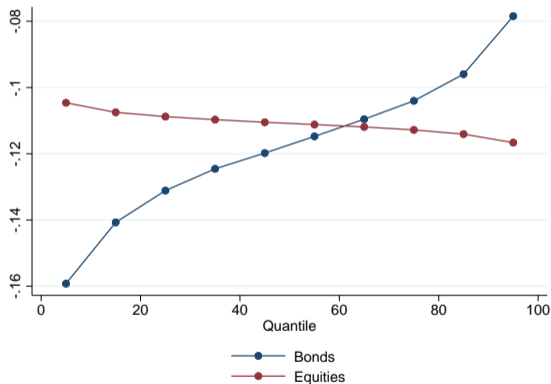
The motivation

Banking flows also flighty (Eguren-Martin et al, 2020)



The motivation

Heterogeneity within portfolio flows (Chari et al, 2020)



The shock

- Focus on effect of archetypal 'push'-type shock (i.e. exogenous to EMs)
 - Proxy: US BBB corporate bond spreads
- But ... does it matter? Better proxies?

The shock

Not-so-shocking

Dependent variable: average gross debt portfolio inflows to the EMs (% of GDP) in the next two quarters

Variable	10	20	30	40	50	60	70	80	90
US corporate BBB spread	-0.31 (0.34)	-0.09 (0.10)	-0.07 (0.10)	0.00 (0.15)	-0.03 (0.14)	-0.05 (0.14)	-0.02 (0.15)	-0.06 (0.14)	0.04 (0.23)
10-Year US Treasury yields	-0.66* (0.37)	-0.53 (0.32)	-0.83*** (0.27)	-0.44* (0.25)	-0.45* (0.24)	-0.26 (0.23)	-0.04 (0.23)	-0.08 (0.21)	0.01 (0.32)
US Dollar Index (DXY)	0.01 (0.02)	-0.01 (0.02)	-0.01 (0.02)	-0.03** (0.01)	-0.03*** (0.01)	-0.04*** (0.01)	-0.04**** (0.01)	-0.04**** (0.01)	-0.01 (0.03)
EM ex. China Growth	0.04 (0.06)	0.04 (0.06)	0.06 (0.05)	0.02 (0.04)	0.03 (0.03)	0.03 (0.03)	0.02 (0.04)	0.02 (0.04)	0.05 (0.07)
Lagged gross portfolio inflows (in % of GDP)	0.22 (0.36)	0.16 (0.37)	0.39 (0.32)	0.10 (0.26)	-0.06 (0.20)	-0.07 (0.19)	0.06 (0.20)	0.09 (0.19)	0.14 (0.24)

*** p<0.01, ** p<0.05, * p<0.1

The effect of policy

- Focus of paper is on role of policy in face of push shocks
- First-order, but also bold: policy is endogenous
- Authors attempt to recover '*well-identified policy shocks – namely, residuals from estimated policy rules*'
 - But we do not know how / how well they do / how do shocks look (unless we go to Appendix II.A, which has brief description)
 - Some results raise flags (e.g. tighter CFMs lead to higher risk of sharp capital outflows)

The econometrics

What's in there

$$X_t = [1_{(i)}, y_{i,t-1}, BBB_t^{US}, P_{i,t}, P_{i,t} \times BBB_t^{US}, Domestic_{i,t-1}, g_{i,t-1}^{US}]$$

- Interaction between country fixed effects and 'structural' characteristics (e.g. transparency and quality of domestic institutions, financial development) given shortish sample?
- Serial correlation in errors
 - 'We apply bootstrapping methods'
 - How? What block length?

The econometrics

What isn't

- Measure of general significance of policy actions:
 - Can check significance of interaction terms in tables
 - But hard to tell from distribution charts (more “integral” way)
 - Measure distance/divergence between distributions and assess whether significantly different from zero?

What have we learnt?

- Analysis suggests:
 - FX regime and institutions can affect tails of capital flows distribution facing global financial shocks
 - Same for some policy actions (FXI, CFMs), not so much others (MP, MaPru)
- Effects look quantitatively small from distributions
 - Are they?
 - Intuitive way to quantify?
 - Calibrate to realised shocks / countries + counterfactuals?
- Explore trade-offs more rigorously? Framework ideally designed for it (heterogeneity across quantiles/horizons)
 - Could even hypothesise about some type of loss function / policymakers' preferences

Summary

- Really good idea, much needed improvement over traditional sudden-stop identification methods
- Paper could benefit from:
 - More discussion about policy shock identification
 - More quantitative assessment of policy effects
 - More discussion of policy trade-offs (leveraging on estimate of entire distribution)