Capital flows at risk: push, pull and the role of policy.

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Summary

- Do global/domestic macro risks shift the probability distribution of capital flows?

  ▶ Answer: Yes, they do, but the effect varies across flows and risk types.

  ▶ Method: Apply the Growth at Risk (GaR) method to capital flows on 13 EMEs.

- The paper speaks to a literature that compares local (pull) vs. global (push) drivers.

  ▶ What do we know? ⇒ Push factors matter and interact with pull factors.

  ▶ However, local market structures matter more than institutions to compensate for push shocks (Cerutti et al., 2019).

  ▶ A pecking order of capital flows' sensitivity: FDI, Bank flows, portfolio flows.

Summary

Anecdotal evidence: capital flows to Turkey seem to react differently depending on push (red) vs. pull (green) shocks (Source: BIS LB-Statistics).
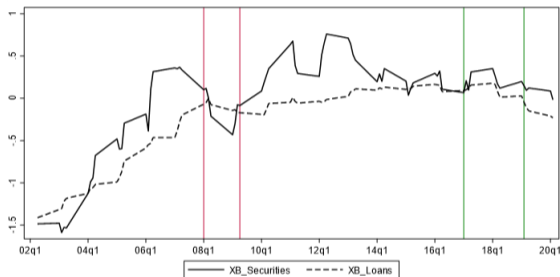
- Hypothesis: portfolio flows react more to push shocks while banking flows are more sensible to pull shocks.
- This paper verifies this conjecture by looking at shifts in probability distributions!

Summary

GaR aims at estimating how probability of tail events increases conditional on the stance of macro risks.
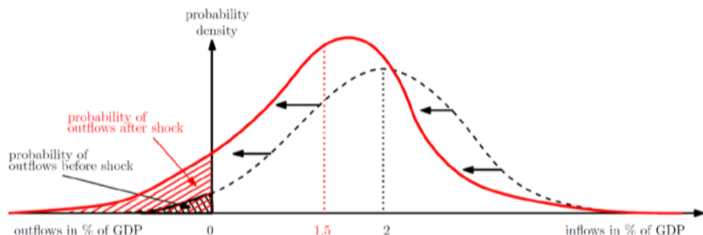
- The authors find significant shifts following fluctuations in domestic and global financial stability indices (Gelos et al., 2019).

Comment # 1 — Computing a global factor

- The methodology is based on constructing Financial Condition Indices using pools of domestic and global asset prices.

  - ▶ Challenge 1: global and domestic indices are likely related.
  - ▶ Challenge 2: is the global factor really ´global'?.

- Are the results qualitatively different if...

  - ▶ ...the global and domestic factors enter Eq. 1 separately?
  - ▶ ...the global factor is replaced by a 'US' factor as in Gelos et al. 2019?
  - ▶ ...the domestic factor enters Eq. 1 directly without using the residual of the first-order regression?

Comment # 2 — Interpreting the results

- The core of the results is the fact that FDI, portfolio, and banking flows present different sensibilities to macro risk.

  - ► This finding matches previous work in the field, but...

  - ► ...little discussion is provided about underlying channels explaining this figure.

- The results could be further explored as follows.

  - ► Local presence and exposures to pull factors
    ⇒ Idea: compare effect for XB vs. local lending via branches by foreign banks.

  - ► Maturity of investments
    ⇒ Idea: compare equity vs. bonds in portfolio flows.

  - ► Omitted variables
    ⇒ Idea: show whether the heterogeneous responses can be verified for sub-samples with high vs. low financial development.

Comment # 3 — can we generalize the results?

- The GaR method can be subject to similar critiques as those about the VaR.

  - ▶ *'...an airbag that works all the time, except when you have a car accident...'*
  - ▶ Are the results a backward-looking picture of rare events from the past, or do they contain forward-looking information?

- Authors could introduce a more critical discussion on the issue...

  - ▶ Show the conditional probabilities of large capital outflows over time.
  - ▶ Provide charts with the time series of capital flows by category.
  - ▶ Report the share of left-tail observations (below the 5th ptile) that correspond to the period around, i.e., the global financial crisis.

Final remarks

- Tying-up a few loose ends...

    ▶ Differentiating the analysis from Gelos et al. (2019) will be a challenge.

    ⇒ Instead of highlighting different data, the authors could focus on unraveling the channel of the heterogeneous responses.
    ⇒ The authors could provide insights about why the get different results than those of Gelos et al. (i.e. on capital controls).

    ▶ Results on the interaction between CC and GFCI deserves some attention...

    ⇒ Are there rationales for why controls on inflows are more effective?
    ⇒ If controls on inflows are mostly in place when GFCI is low and capital flows are booming, why is this not pinned-down in the interaction model?

- This is a very nice paper with a strong contribution on how to improve financial stability monitoring tools!