Discussion of:

The Shifting Drivers of International Capital Flows

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Overview

- Broad question
  - How does the covariance between international debt flows and economic/policy indicators change after the Great Recession?
- Novel and detailed data allows
  - Decomposition by type of debt (bank versus securities), by type and location of recipient
  - Analyzing changes in lender composition
  - Analyzing (statistical) determinants of the covariances
- Results (22 tables, 6 plots)
  - Covariance between international debt flows and US monetary policy (Fed funds rate) increased

Discussion

- Format
  - Follow the steps of the analysis (Fed funds rate only)
  - What do we learn? What else could we learn?
- Summary of comments
  - Interpretation on covariances as "impact" is difficult to justify
  - Structural break: 3 regimes?
  - Multiple drivers of change in covariance
  - Capital $\neq$ Debt (Equity?)

Step 1: Covariances

- Country-time panel regression:

$$DebtGrowth_{jt} = \alpha_i + \beta_1 \Delta FFRate_t + X_t + \epsilon_{jt}$$

Debt instrument	Loans	Securities
ΔFRR	-1.88***	-1.35*
	(0.41)	(0.78)
N	2,903	2,903

- From the paper: "US federal funds rate has a sharply negative impact on loans"
  - These coefficients are not measures of impact of monetary policy
  - Although informative, coefficients are very difficult to interpret
  - Paper: "plausible assumption that Fed funds rate" is "exogenous when controlling for" X_t
  - No such thing as random monetary policy: If X_t were the same and monetary policy is different, omitted variable is most likely

Step 1: Covariances (minor comment)

- Country-time panel regression:

$$DebtGrowth_{jt} = \alpha_i + \beta_1 \Delta FFRate_t + X_t + \epsilon_{jt}$$

Debt instrument	Loans	Securities
$\Delta FFRate$	-1.88***	-1.35*
	(0.41)	(0.78)
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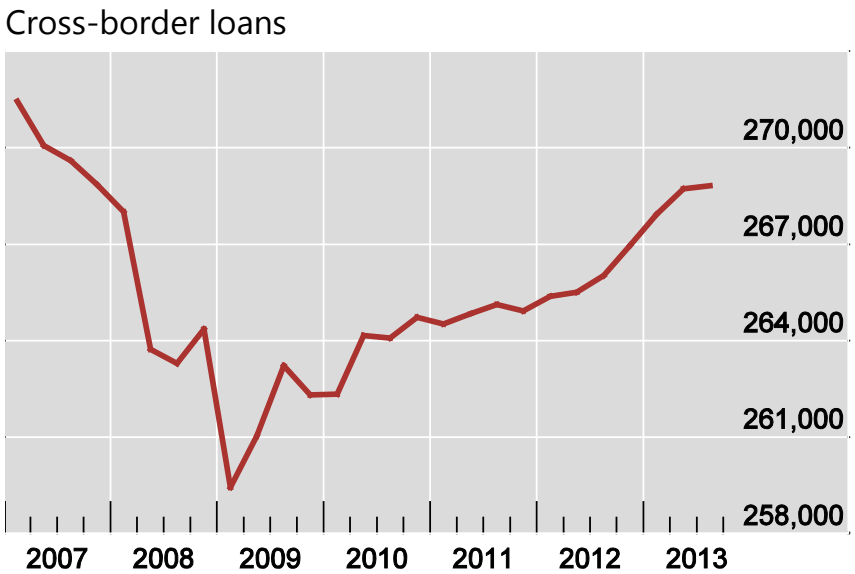
- Loans from 64 countries to each other and other countries
  - Is lending from US to UK independent from lending from UK to US?
  - Gross versus net flows?

Step 2: Structural break

- Authors avoid staking a stance on whether of when the structural change occurs
  - Instead, let the data say when it happens: Plot of the predictive power of $FFRate_t$ and X_t (Sum of Square Residuals)



- There could be periods of low and high predictive power (3 regimes)
  - Makes you want to see time series of the covariance β_1 (instead of just two estimates)

Step 3: β_1 before and after 2009

- How does the coefficient of debt growth on monetary policy change after the structural break?

	Before 2009 Q1	After 2009 Q1
$\Delta FFRate$	-2.07***	-6.59***
	(0.36)	(0.84)

- Where could this change come from?
  - This paper: Debt flows react more to monetary policy
  - Fed funds rate reacts less to fundamentals, or lower variation in Fed funds rate, e.g. due to zero lower bound

    (Recall that : $\beta_1 = \frac{cov[DebtGrowth^*, \Delta FFR^*]}{var(\Delta FFR^*)}$)
  - Debt flows react more to fundamentals (e.g., global trade to GDP ratio is lower since the crisis)
  - Composition of lending changes (e.g., less to more sensitive lenders)

Step 4: Use bank level data

- Allows controlling for borrower country characteristics (results essentially unchanged)
- Covariance decomposition: how much of the change β_1 is due to
  - Changes in the covariance for a given bank
  - Changes in the weight of each bank in the aggregate covariance
- Paper correlates these to policy variables (e.g., pre-break capital ratios)
  - I missed a purely descriptive part
  - For example: How much of the total variation in β_1 is explained purely by composition? How much by changes in bank behavior?

Conclusions

- The covariance between international debt flows and economic/policy variables changed substantially after the crisis
  - Important next question: Why?
- Paper concludes: "we show that the aftermath of the global financial crisis has been characterized by a shift in the composition of international capital flows from bank lending toward direct market financing"
  - Very interesting (but I could not find this in the paper!)
  - Substitution towards equity?