Common Drivers in Emerging Market Spreads and Commodity Prices

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Discussion by

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what are the common international exogenous variables (factors) that explain both commodity prices and capital flows in EEs?

in which direction?

simultaneously?

common factors affect simultaneously commodities and spreads

a positive link between the two mkts.

the economic structure not orthogonal to financial integration.

if global common factors affect with opposite signs spreads and commodities → negative association between these series.

scope and scale to complex policy instruments and counter-cyclical macro.

factors: push (exogenous) vs pool (endogenous).

methodology: common factor analysis, FAVEC (two steps).

data: 13 EEs (EMBIGlobal, JP Morgan) min 20% primary exports to total.

common factor explains 70% of spreads and commodities.

Results:

- negative correlations between spreads and commodities.
- ↑ international liquidity (↓ interest rate and ↑ liquidity quantitative) → commodity prices and ↓ spreads).
- ↑ investors' confidence and ↓ global risk aversion (↑ S&P 500 index and ↓ VIX index) → ↑ commodity prices and ↓ spreads.

policy:

- ↑ global liquidity (loose monetary policy) and ↑ commodities → ↓external financing cost in EMBIG → ↑ capital inflow → ↑ GDP.

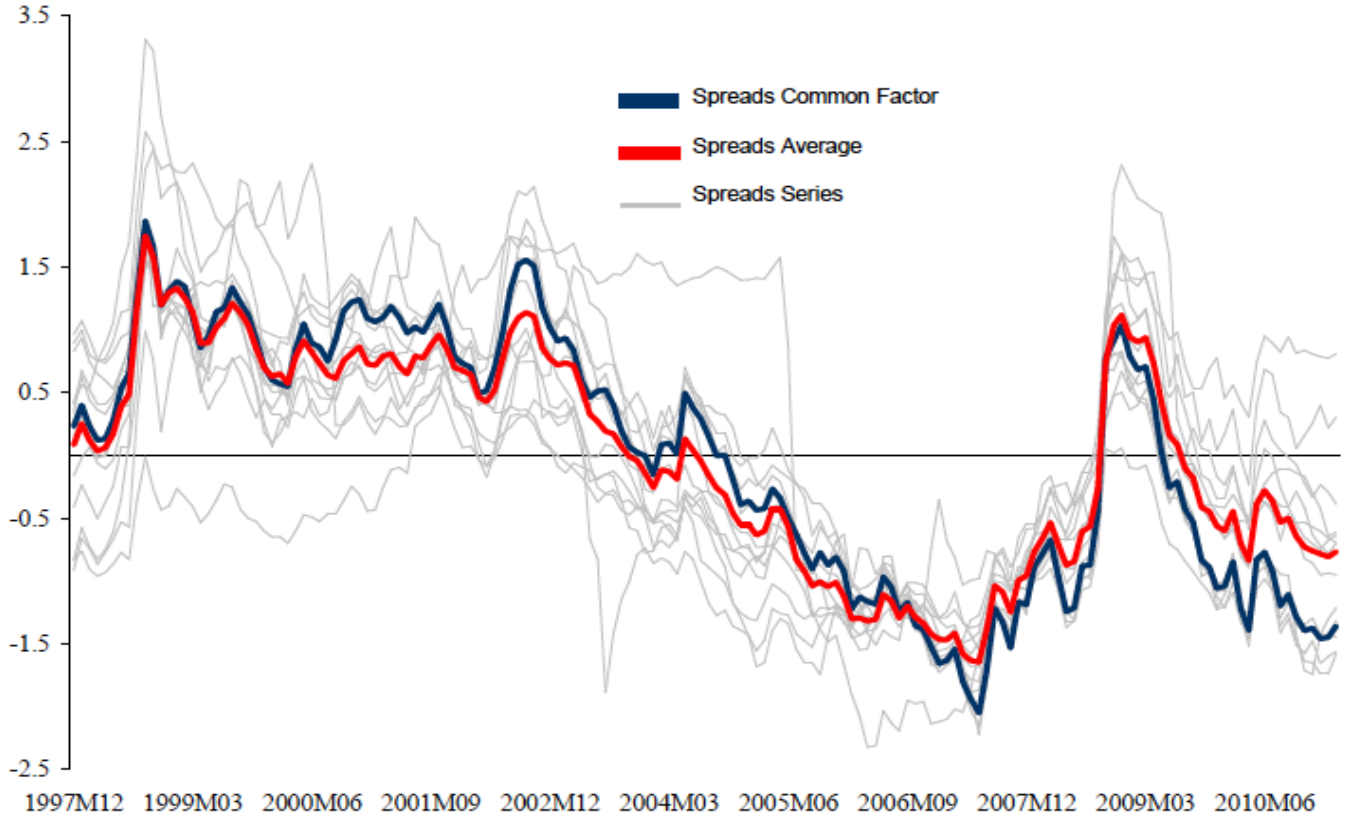
- if global common factors favorable → EMBIG significant appreciation (due to ↑ commodity prices through current account and ↑ capital inflows through capital account).

  - accumulation of international reserves
  - counter-cyclical fiscal policy

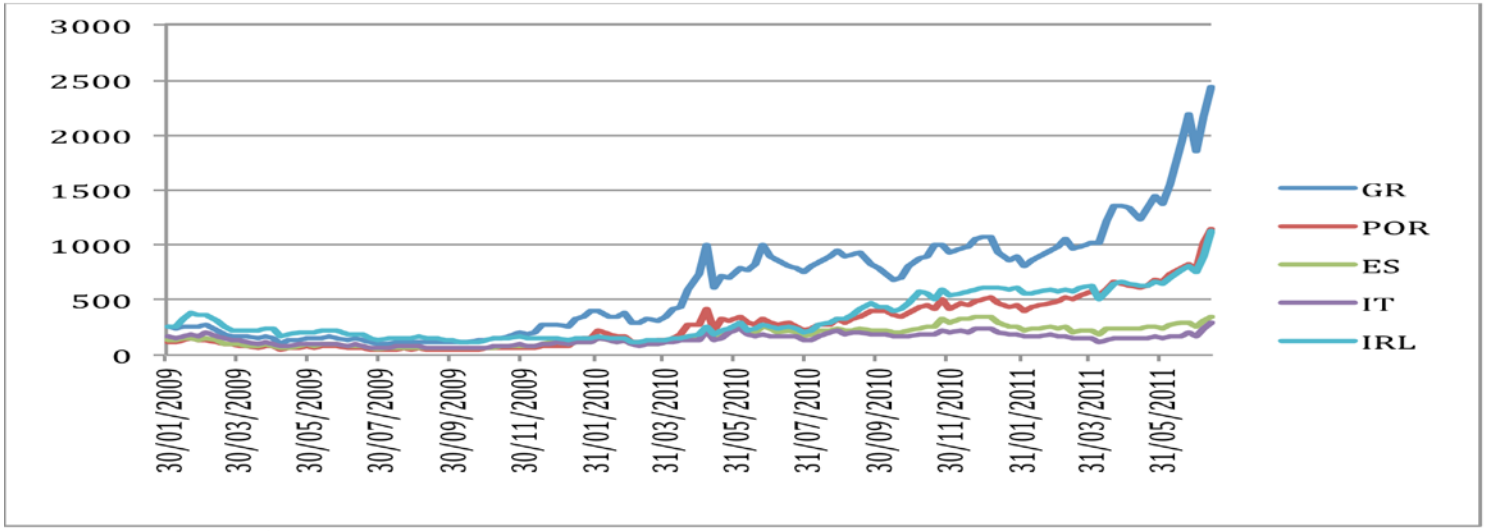
- asymmetry (not tested) if commodity importer.

are EEs spreads affected by the recent financial crisis?

Figure 5. Bond spreads in commodity producer EEs, common factor and simple average

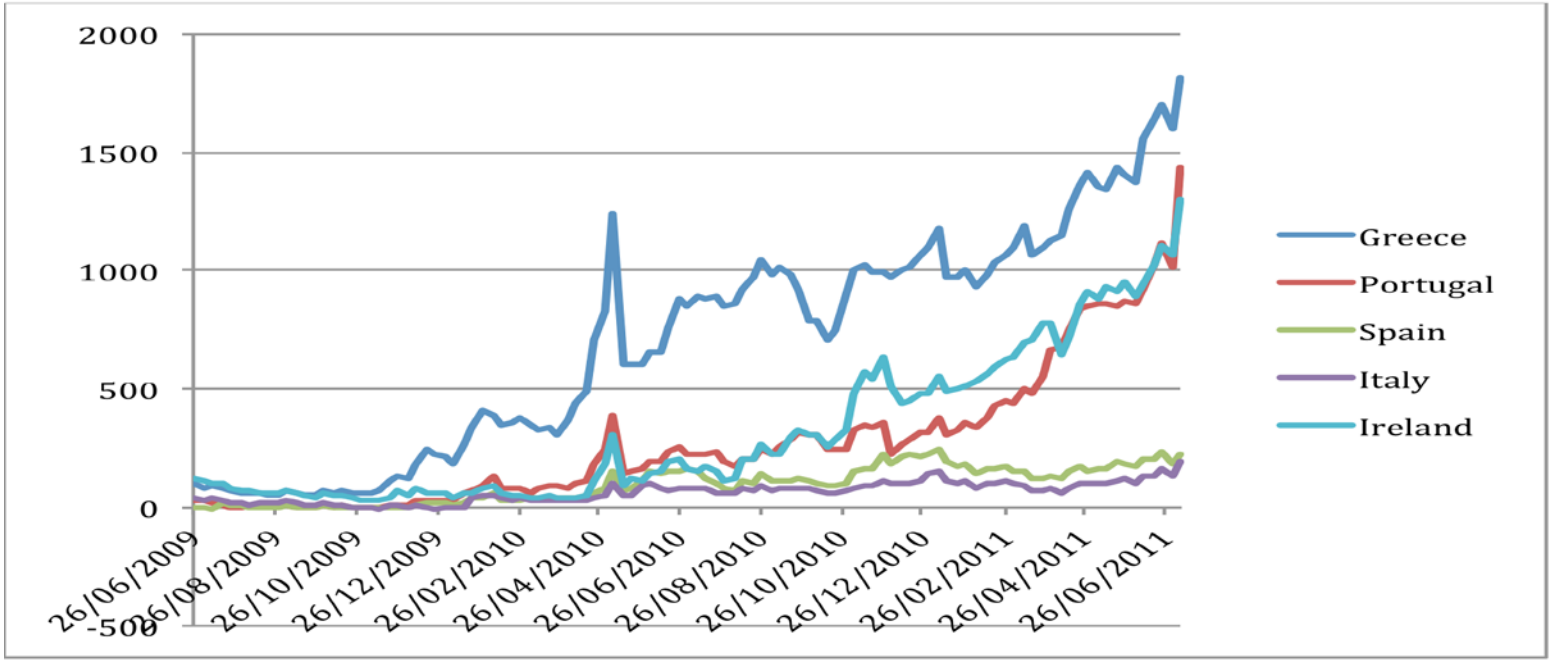


Credit Default Swaps, 5 years maturity, weekly.



Source: Bloomberg.

Spreads over Swaps, 5 years maturity, weekly.



Source: Bloomberg.

high sovereign SCDS in euro-area during crisis:

- declining risk appetite,
- falling market liquidity,
- global financial stress has fed through to the eurozone government bonds
- credit rating downgrades (migration risk),
- economic catastrophe risk,
- not so much principal losses on outstanding debt.

recent fin. turmoil little effect (if any) on EEs spreads,

- the role of macro fundamentals and structural reforms (↓ risk of default, risk premium, and spreads),
  - i.e. ↓ inflation, ↓ long and short term debt, ↑exports, ↑reserves to GDP.
  - financial integration, business and labour regulation, fiscal institutions, fiscal rules, structural deficit.
- debt management (longer maturities, lower external debt levels, debt servicing, issue dent in local currency).

some further comments:

common factor vs PCA,

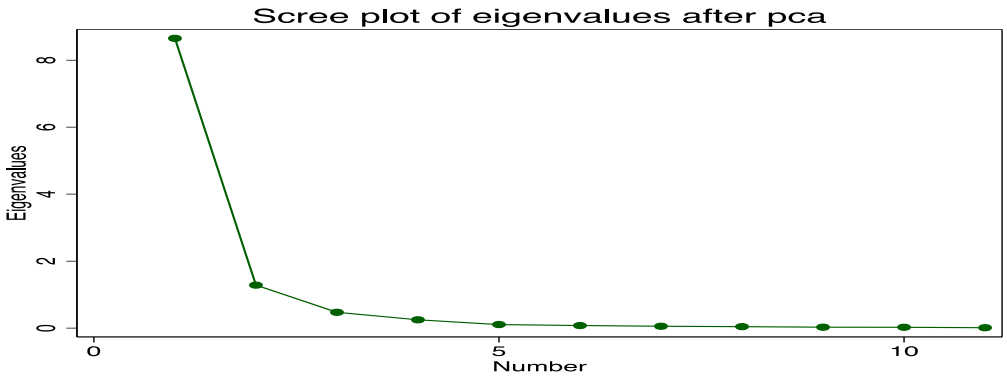
common factors in VECM,

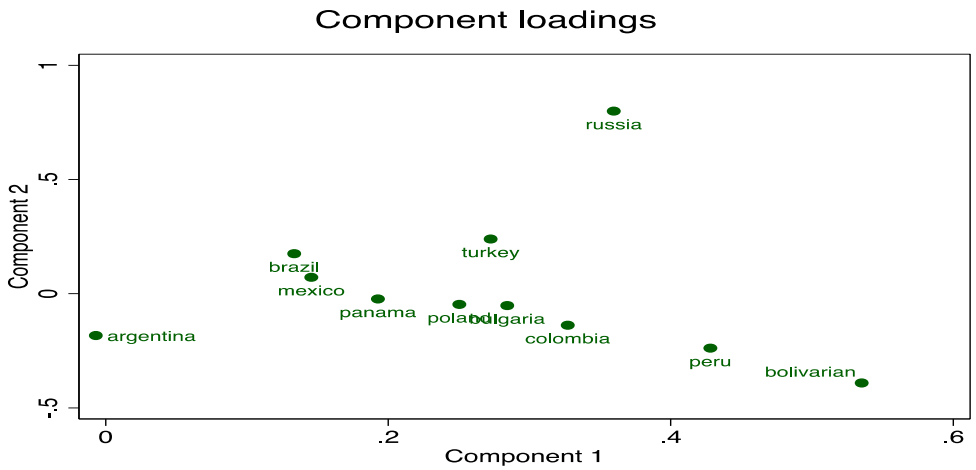
all variables in logs and the deflate by CPI (US), I(1)?

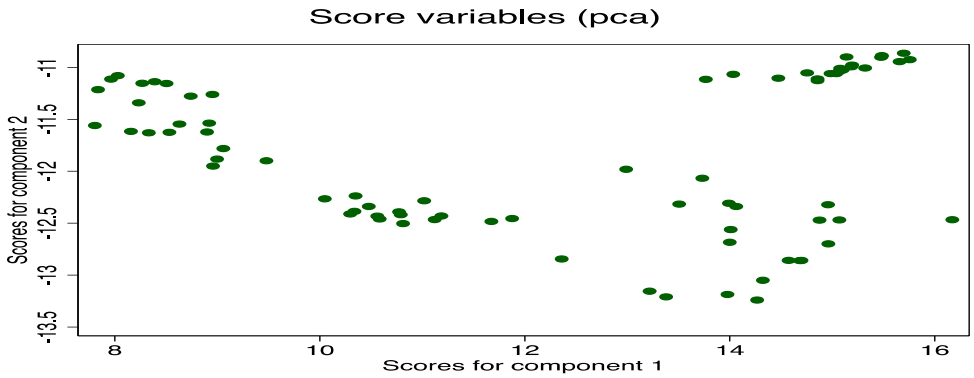
common factors also found to be I(1)?

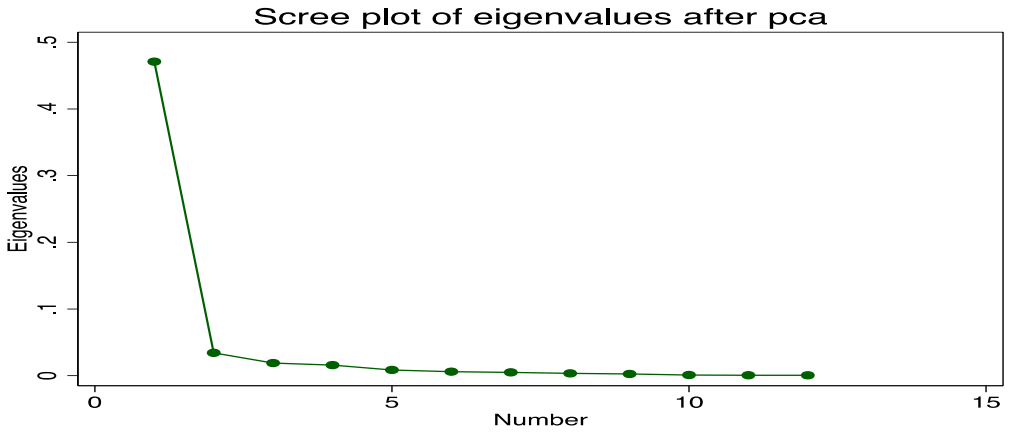
high frequency time series, ARCH, GARCH?

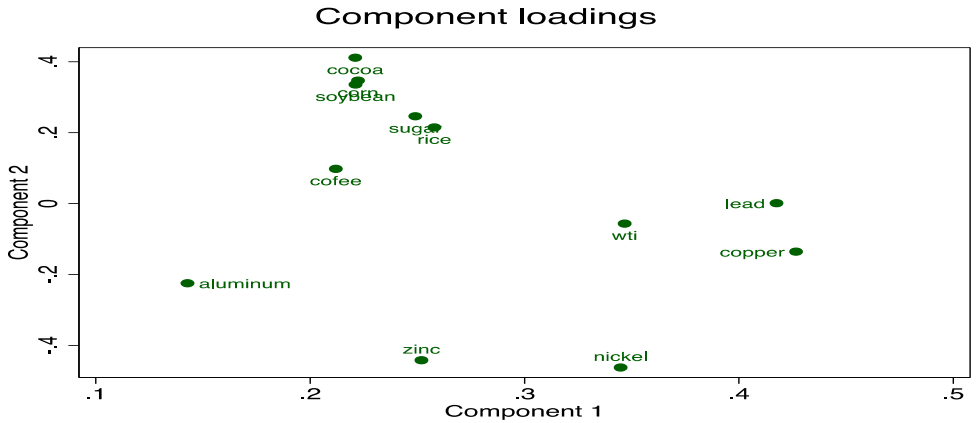
spreads: yields over swap rate?

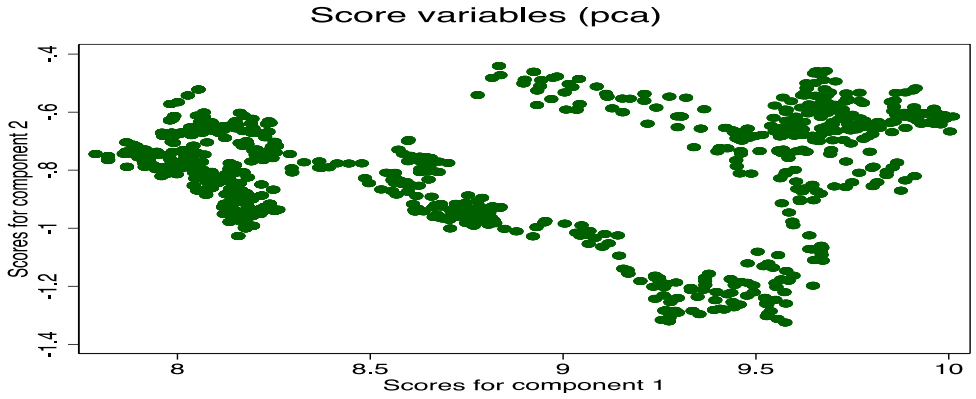

Scree plot of eigenvalues after pca
Eigenvalues
0
2
4
6
8
0
5
10
Number

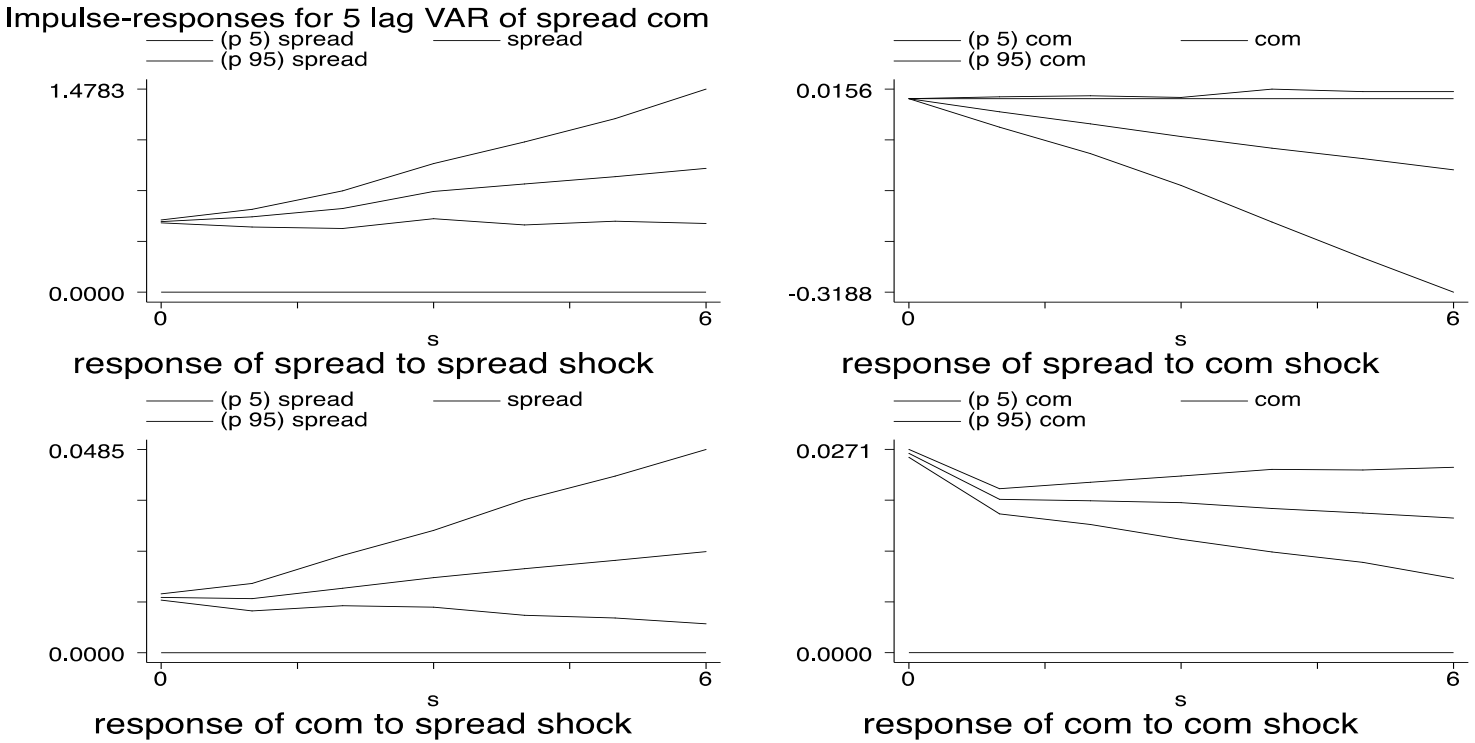

Component loadings
Component 2
1
.5
0
-.5
russia
turkey
brazil
mexico
panama
poland
bulgaria
colombia
argentina
peru
bolivarian
0
.2
.4
.6
Component 1


Score variables (pca)
Scores for component 2
-11
-11.5
-12
-12.5
-13
-13.5
8
10
12
14
16
Scores for component 1


Scree plot of eigenvalues after pca
Eigenvalues
0
.1
.2
.3
.4
.5
0
5
10
15
Number


Component loadings
cocoa
corn
soybean
sugar
rice
cofee
lead
wti
copper
aluminum
zinc
nickel
Component 2
.4
.2
0
-.2
-.4
.1
.2
.3
.4
.5
Component 1


Score variables (pca)
Scores for component 2
-.4
-.6
-.8
-1
-1.2
-1.4
8
8.5
9
9.5
10
Scores for component 1



Errors are 5% on each side generated by Monte-Carlo with 100 reps

	s	spread	com
spread	10	0.983884	0.016116
com	10	0.558798	0.441202
spread	20	0.961067	0.038933
com	20	0.83509	0.16491