The Shifting Drivers of International Capital Flows by Stefan Avdjiev, Leonardo Gambacorta, Linda Goldberg and Stefano Schiaffi

Discussion

Matthieu Bussière
Banque de France

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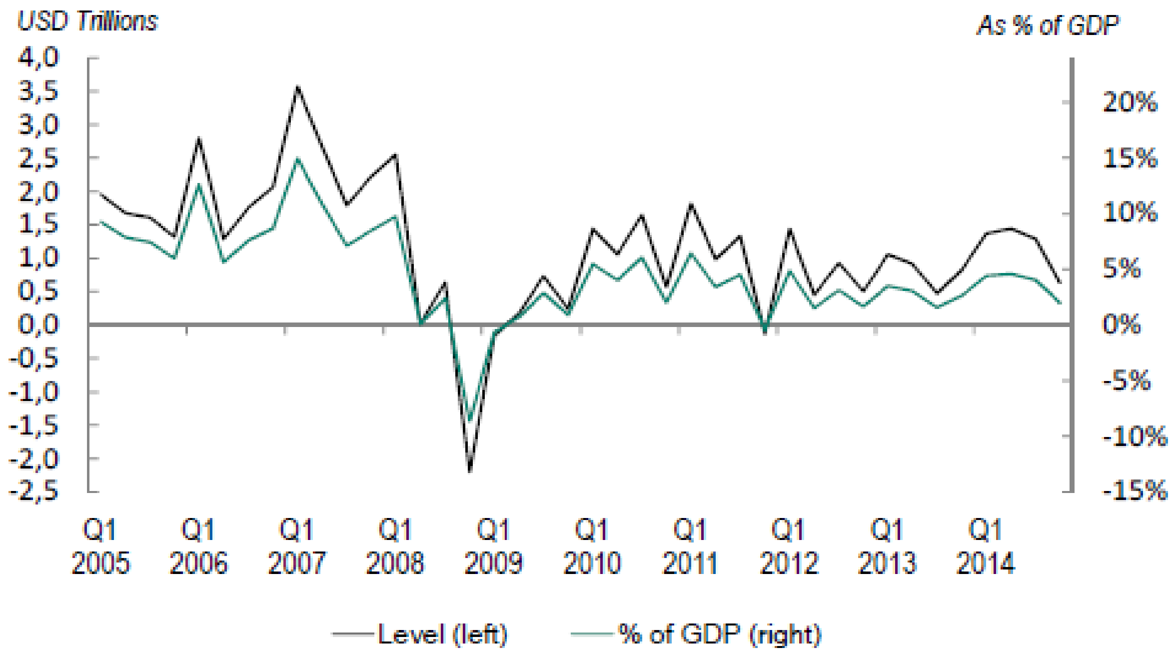
General considerations

- The changing patterns of international capital flows is one of the key policy questions in the global policy agenda
  - Newly created G20 IFA WG, work by IMF, OECD, BIS, etc
  - Procyclicality and volatility of capital flows: do we need a new framework? New EWE? Strengthen GFSN?
- What drives international capital flows? Push vs pull factors, role of monetary policy, risk aversion, regulation, relates also to global financial cycles (Borio, Rey…).
- In spite of extensive research, the literature is very inconclusive, partly because the drivers are changing
- The paper therefore makes a very timely contribution to this debate

International capital flows: the « Great Retrenchment » is very persistent

Chart 3 – Post crisis, global gross financial flows settled at a lower level
(quarterly data)



Source: IMF Balance of Payments (BoP) statistics and authors' calculations.

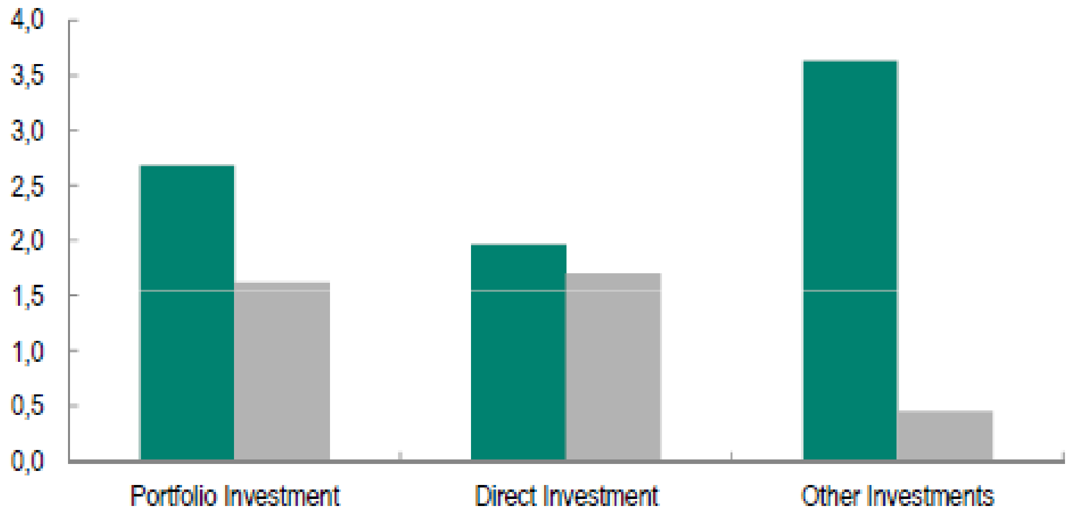
Source : Bussière, Schmidt and Valla 2016, « International financial flows in the New Normal : Key patterns (and why we should care) »

Chart 7 – The resilience of direct investment and equity flows contrasts with the contraction in bank flows and portfolio debt

(% GDP)

Chart 7a: Breakdown between portfolio, FDI and other investment

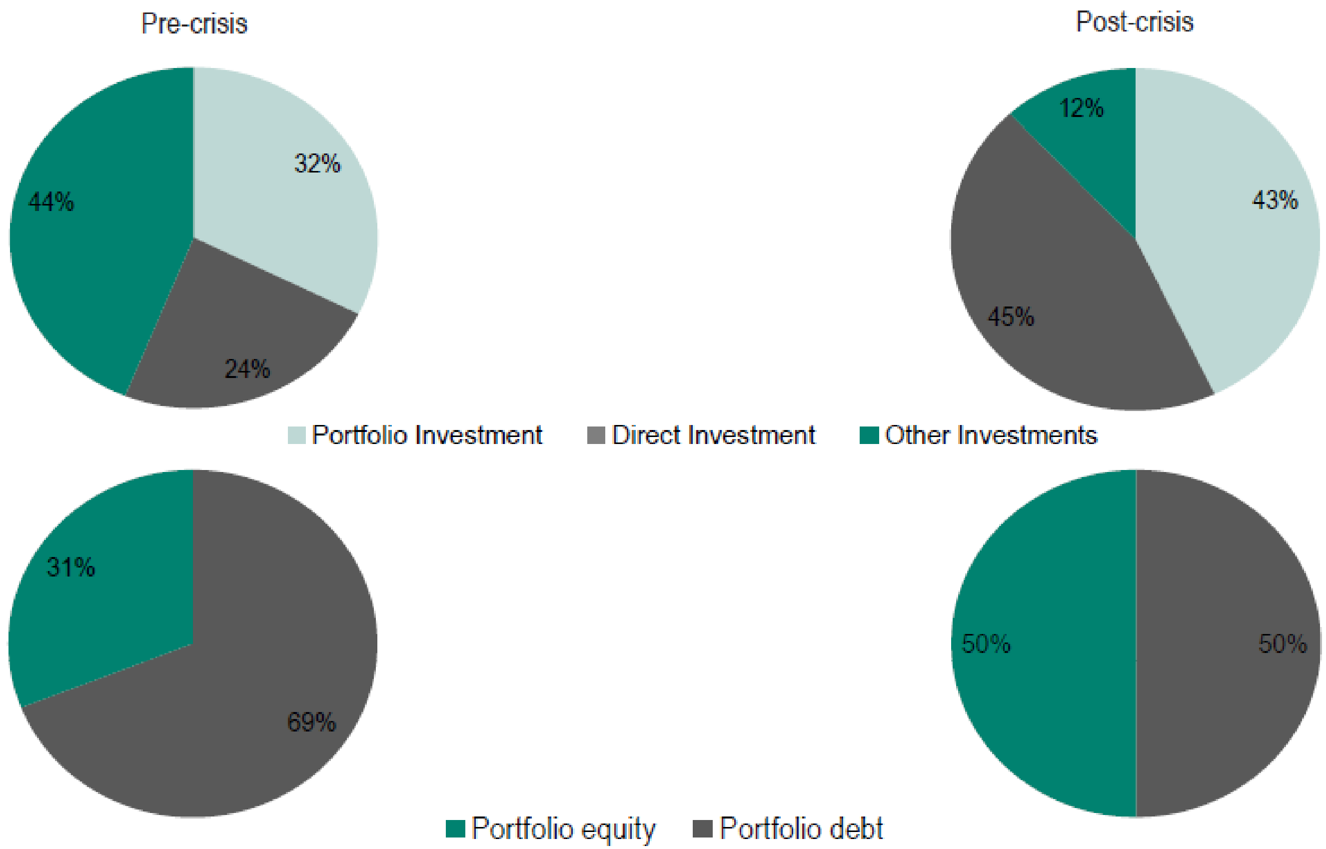
(full sample)



Source : Bussière, Schmidt and Valla 2016, « International financial flows in the New Normal : Key patterns (and why we should care) »

Changing composition of international capital flows

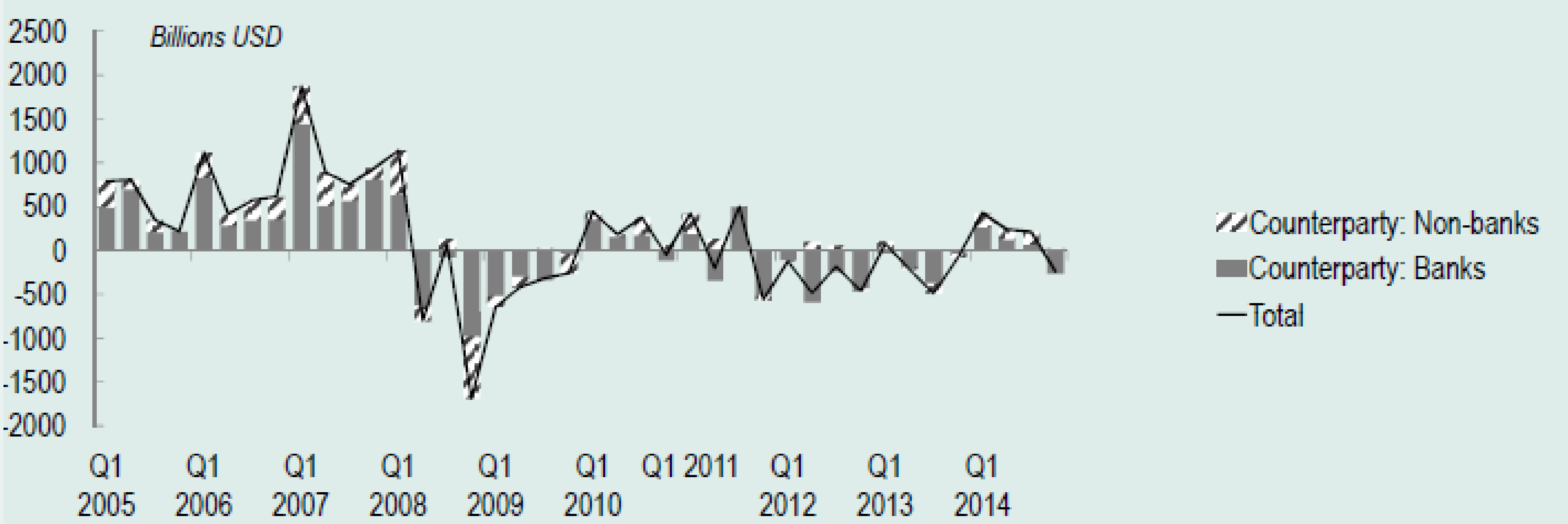
Chart 8 – Composition of global financial flows by categories before and after the crisis*



Source : Bussière, Schmidt and Valla 2016, « International financial flows in the New Normal : Key patterns (and why we should care) »

What is going on with bank flows ?

Figure A2 – Disaggregation of bank loans and deposits, world *



* The included countries are the BIS reporting countries.

Source: Locational Banking Statistics (by residence), Bank for International Settlements.

Source : Bussière, Schmidt and Valla 2016, « International financial flows in the New Normal : Key patterns (and why we should care) »

Main results and take-away

- Focus on cross-border loans and international debt securities using BIS statistics; large panel of countries over 14 years
- Results show that the sensitivity of international financial flows to **US monetary policy** has <u>increased</u> since GFC
- The impact of global **risk** conditions has <u>increased</u> for international bond flows but <u>declined</u> for cross-border bank flows
- In turn, the latter can be related to prudential policy changes in recent years (LTV, capital requirements, reserve requirements, "impulse" and cumulative functions): shift of risk-taking activities from banking sector to market-based financing

Key assets of the paper

- Very timely and topical question
- The paper relies on a rich database, which enables rigorous testing of key hypotheses (incl. Cerutti et al. 2015)
- State of the art estimation techniques
- Right focus on the *changing* drivers of capital flows; use of structural break tests
- The results are plausible, yet sufficiently original to trigger debate
- Nice work in the interpretation of the results: the paper does not stop at describing the results but seeks further explanations (work in progress)

A few questions: monetary policy

- How to measure the (US) monetary policy stance?
- Here, FFR
- But other alternative variables (all of them subject to uncertainty)
- Could try for instance (different measures of) shadow rates (NB significant dispersion and uncertainty around these estimates)
- Is the shifting driver due to changing nature of monetary policy (from unconventional to UMP). Hard to test, but possible.
- Endogeneity issue? Global crisis…

A few questions: monetary policy

- Risk taking channel. Summarized page 17
- *Since a contractionary US monetary policy shock tends to result in an appreciation in the US dollar (see Eichenbaum and Evans (1995) among others), an increase in the federal funds rate would result in an appreciation of the US dollar, which would in turn have a larger impact on the net worth of borrowers with currency mismatches on their balance sheets during the post-crisis period than before the crisis.*
- Is it still true? More recent references? Do we have (good) data on currency mismatches? Perhaps need further illustration

A few questions: risk aversion

- On risk aversion / uncertainty. Important work by the CGFS (2011 report on global liquidity).
- Focus on cross-border bank loans
- VIX was a key driver: clear negative correlation between VIX and global liquidity. But not anymore: fall in VIX did not revive cross-border bank loans
- What is the theory behind this? Why more global than domestic?
- Is VIX the right measure? Maybe test for other measures (work by Nick Bloom et al.)
- Other factors? Right focus in the paper on regulation. What about deleveraging?

More general considerations and questions

- Changing composition away from bank flows (and portfolio debt) and towards equity and FDI
- Is it a good thing?
- Bank flows have been historically more volatile. Debt portfolio flows are more volatile than equity portfolio. FDI very stable (+ other benefits).
- But in the "new normal", will the old patterns continue to prevail? Transfer to asset managers is a completely new ballgame. We do not have as much hindsight. Different regulatory framework. Even for collection of statistics.
- Bank flows also have benefits (part of global liquidity).

Thank you for your attention!