International Capital Flows and Unconventional Monetary Policy

N. Converse S. Curcuru A. Rosenblum C. Scotti

Discussion by U. Szczerbowicz (Banque de France)[1]

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[1] This presentation does not necessarily express the views of Banque de France.

Paper's summary

- Objectives:
  - evaluate the effects of unconventional monetary policies (UMP) in the advanced economies (Fed, BCE,BOE, BOJ) on int. capital flows;
  - examine the asymmetric effects of UMP tightening and easing.
- Method: regression of changes in 2-day bond and equity flows on UMP surprises (Event Study)
- Findings:
  - MP easings are generally associated with inflows into developed market funds, particularly equity funds.
  - Fed's QE ***did not*** cause a reallocation toward emerging market assets.
  - During the normalization period, Fed's tightening is still associated with inflows into US equity funds and outflows from all other funds.

Method

- Event-based regressions (January 1, 2008 - December 30, 2018)
- Capital Flows:
  - Data: daily bond and equity flows from EPFR
  - 6 aggregates constructed from net flows and total assets of country-dedicated funds: US bond funds, US equity funds, DM bond funds, DM equity funds, EM bond funds, and EM equity funds.
  - 2 measures of Capital Flows: traditional flow measures (as a share of initial assets) and an active portfolio reallocation measure, which controls for increasing financial wealth, and movements in asset prices.
  - Dependent variable: changes in 2-day flows before and after UMP announcements.
- Monetary policy surprises: 2-hour changes in LT government bond futures yields around monetary policy announcements:

Policy-relevant paper

- UMP impact on capital flows is an important policy topic:
  "...global liquidity conditions became very easy as major central banks adopted unconventional monetary policies. This led a number of emerging markets to deploy capital flow management and macroprudential measures out of concern for upward pressure on their exchange rates and risks of excessive credit growth and over-heated asset markets"

Interesting research question

- This paper brings a novel and challenging insight into debate on the effects of the monetary policy on capital flows.
    - Other studies: use indicator dummies on policy announcement dates to capture the announcement effect when studying capital flows.
    - This paper: UMP identification accounts for the magnitude of the shock, and for the announcements that are more or less accommodative than expected.
    - Authors isolate active portfolio reallocations from passive reallocations (result of the addition of new wealth or reallocations resulting from differences in returns).
    - Authors show that flows into EM assets during the QE period did not shift portfolios toward EM assets, because flows into DM assets were even greater.

Comments

- Interpretations of the results and transmission channels
- Identification of UMP shock
- Other comments

Interpretation of the results

- Flow regression results seem broadly in line with conventional wisdom:
  - ECB *easing* generates *inflows* into US Bonds, US Equity, DM bonds and ***EM equity***.
  - BOE *easing* generates *inflows* into DM equity.
  - BOJ *easing* generates *inflows* into DM bonds.
  - Fed's *tightening* generates *outflows* from US bonds and EM bonds.
- Active allocations regression results seem puzzling:
  - Both Fed's *tightening and easing* generate outflows from all regions and US bonds, and inflows into US equity.
  - This pattern does not hold for the ECB and BOE: easing and tightening do not both generate inflows (or outflows).
  - Each CB affects capital flows in different way.
- Can we draw general conclusions about the UMP effects on capital flows?

Several transmission channels at work

- *Portfolio balance channel* - Fed's purchases of LT bonds drives up demand for substitute risky assets: EM bond and equity $\Uparrow$ (but also US and DM equity $\Uparrow$)
- *Signaling channel* - Fed's purchases seen as a commitment to keep yields low boosts carry-induced demand for EME bonds and equity $\Uparrow$ (but also DM bonds and equity $\Uparrow$)
- *Confidence channel*
  - UMP *easing* seen as "whatever it takes" commitment to support growth: demand for the US bonds and equity $\Uparrow$
  - UMP *tightening* seen as "good news" - Fed is optimistic about prospects for the US economy: demand for the US bonds and equity $\Uparrow$

  $\rightarrow$ Is it a UMP channel or information shock?

UMP Identification

- Central banks announcements convey MP news but also news about economic growth and risk premia (Cieslak and Schrimpf (2018), Jarociski and Karadi (2018)).
    - In particular the information about risk shock can move longer interest rates in direction opposite to UMP shock (Cieslak and Schrimpf (2018) show thet Draghi's "whatever it takes" speech increased German yields as the flight to quality subsided).
- Further decomposition of CB announcements, between MP and information shocks, could shed some light on results.

Other comments

- Figure 2 shows correlation between Fed's QE and inflows to EME. Increased EM flows: result of allocations of new savings rather than an active reallocation (Ahmed et al. (2015)). Why would active portfolio reallocation react differently to UMP than portfolio growth?
- The motivation/economic intuition for why the impact of UMP easing / tightening could be asymmetric could be more developed.
- QE seemed to work the best when the financial conditions were tight. Could you check for that? (interaction variable with VIX?)
- What is a persistence of the Event Study results? You coefficients assume that MP-induced flows continue at the same rate for 30 days.
- It would be interesting to see the results with 1 day changes in capital flows.