



Discussion of “The two components of international portfolio flows” by Ahmed, Curcuru, Warnock and Zlate

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Disclaimer: the views expressed are those of the presenter and are not necessarily shared by the BIS

1. Measuring portfolio flows: not all roads lead to Rome

Portfolio flows are measured in many different ways:

- Flows normalised by past flows
- Log changes in portfolio positions
- Flows as percent of lagged portfolio size
- Changes in portfolio share
- Flows scaled by local market capitalisation
- Flows scaled by assets under management
- Flows scaled by local GDP

The authors propose a new measure...

1. Measuring portfolio flows: passive vs active

- Valuation effects \neq new flows
- Use relative weight to correct for this:

$$RW_i^{US} = \omega_i^{US} / \left(\frac{MC_i}{MC_{world}} \right)$$

- Price effects (substantially) cancel out
- But still affected by price changes if:

$$\text{Portfolio}^{US} \neq \text{Portfolio}^{world}$$

1. Measuring portfolio flows: removing price sensitivity

- Correct for home bias:

$$NormRW_i^{US} = RW_i^{US} / RW_{US}^{US}$$

- Removes prices completely:

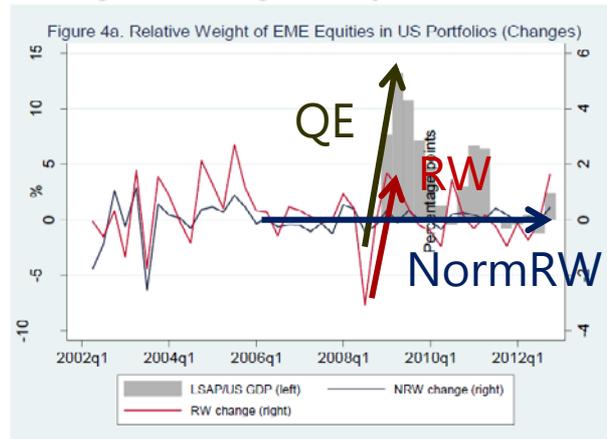
$$NormRW_i^{US} = (Q^i / \bar{Q}^i) / (Q^{US} / \bar{Q}^{US})$$

- Size of shock related to:

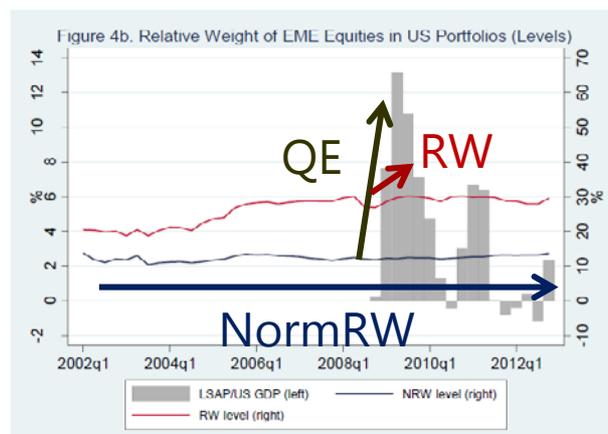
$$\left| \Delta NormRW_i^{US} \right|$$

2. The effect of QE: growth rates

Figure 4. Relative Weight of EME Equities in US Portfolios



2. The effect of QE: levels



2. The effect of QE: what's going on?

$$\overline{NormRW}_i^{US} = \frac{\left[\omega_i^{US} / \left(\frac{MC_i}{MC_{world}} \right) \right]}{\left[\omega_{US}^{US} / \left(\frac{MC_{US}}{MC_{world}} \right) \right]}$$

$$\omega_{US}^{US} \uparrow \text{ and / or } \left(\frac{MC_{US}}{MC_{world}} \right) \downarrow ?$$

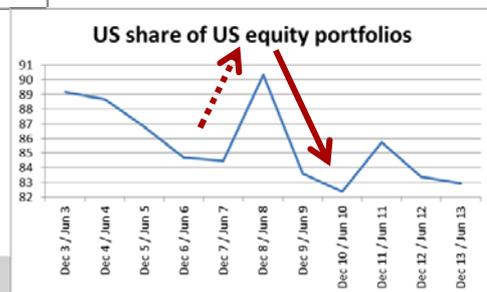
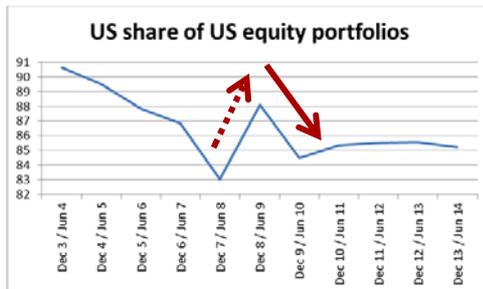
2. The effect of QE: market cap



*Bloomberg calculations

<http://www.anirudhsethireport.com/percent-of-world-stock-market-cap-by-country/>

2. The effect of QE: portfolio shares



2. The effect of QE: overall

$$\text{Norm}RW_i^{US} = \frac{\omega_i^{US} \left(\frac{MC_i}{MC_{world}} \right)}{\omega_{US}^{US} \left(\frac{MC_{US}}{MC_{world}} \right)}$$

Does that mean that QE didn't matter for EMs?

"... robust inflows experienced by EMEs were due more to equity portfolio growth than active reallocations between EME equities and other equities"

Warnock et al 2015

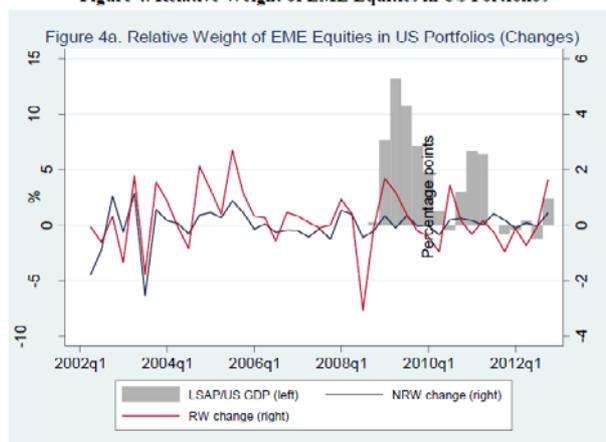
"... the post-global crisis capital flows into emerging markets have been huge, despite the best efforts of emerging markets to push them back by accumulating reserves."

Rajan 2015

<https://rbidocs.rbi.org.in/rdocs/Speeches/PDFs/GB2815FB19320144404340B74F7C2DAEDC6D93.PDF>

Quibble 1: aggregation

Figure 4. Relative Weight of EME Equities in US Portfolios



Quibble 2: the meaning of passivity

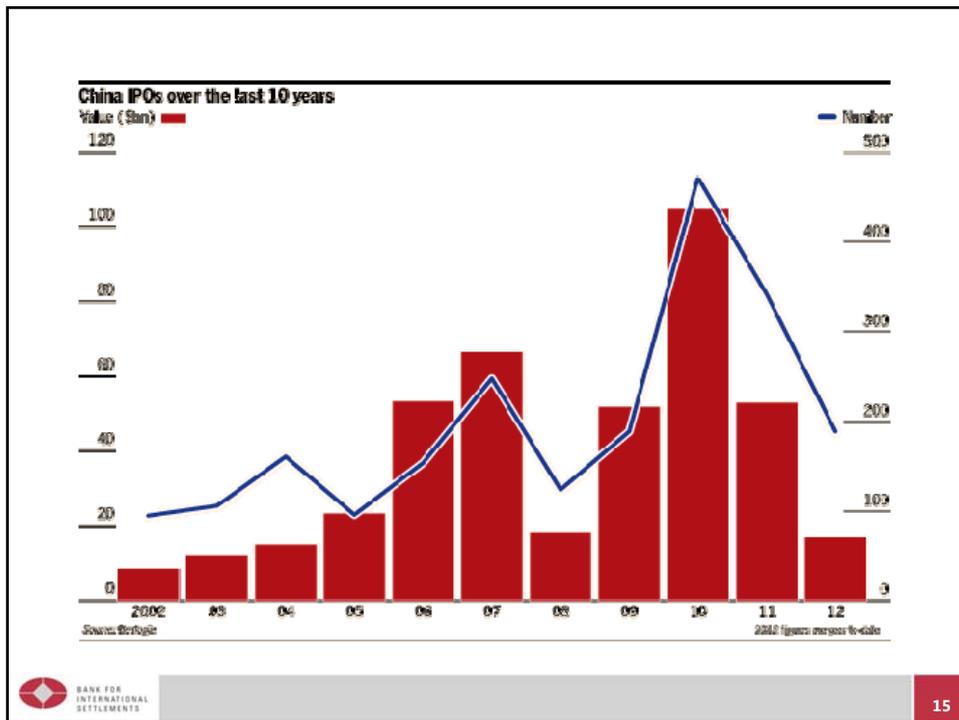
$$NormRW_i^{US} = (Q^i / \bar{Q}^i) / (Q^{US} / \bar{Q}^{US})$$

- Passivity here implies:
 - No reallocations in response to price changes
 - Fully reallocating in response to quantity (supply) changes
- Is this "passive" or "passive-aggressive"?

Quibble 3: reverse feedback

- Is the supply of EM assets endogenous?
 - Does \bar{Q}^i respond to Q^i ?

$$\overline{NormRW}_i^{US} = (Q^i \uparrow / \bar{Q}^i \uparrow) / (Q^{US} / \bar{Q}^{US})$$



Quibble 4: the wrong benchmark

- QE was intended to have an effect on US asset markets
- Suppose it had an equivalent effect on EME asset markets:

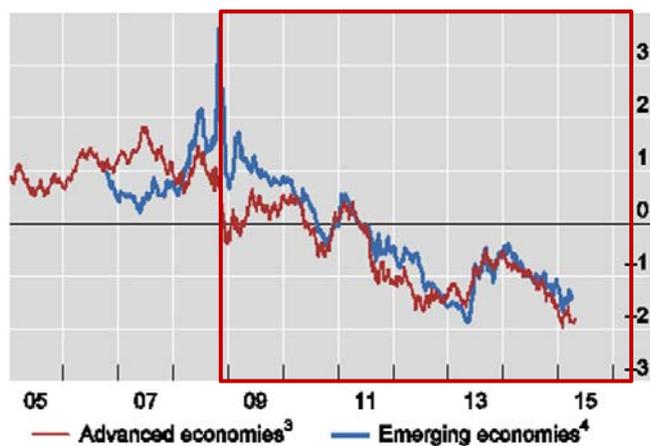
$$\overline{NormRW}_i^{US} = (Q^i \uparrow \bar{Q}^i) / (Q^{US} \uparrow \bar{Q}^{US})$$

- Then the NormRW would indicate no change!
 - The better benchmark would be no effect on EMEs; not equal effect

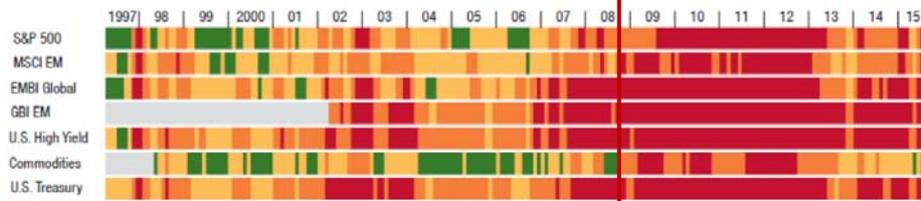
Quibble 5: prices also matter

- Prices can change without a change in quantities, especially in the short term (due to market imperfections)
- Even long term, small changes in quantities are likely to be associated with large price changes (elasticities matter)
- Price changes = wealth effects etc
- Cannot look only at quantities (ie portfolio flows) to assess spillovers

Ten-year government bond yields: common components



¹ The common component is the first principal component across each group of economies, and ignores country-specific factors.



Sources: Bank of America Merrill Lynch; Bloomberg, L.P.; and IMF staff estimates.
 Note: The correlation index summarizes the median daily cross-asset correlations of Sharpe ratios across all of the following asset classes: U.S. Standard & Poor's 500, MSCI Emerging Markets, U.S. Treasuries, EMBI Global Bond Index, GBI Emerging Markets Bond Index (local currency), U.S. High Yield, and Commodities. The heat map displays the underlying median correlation for each of the seven asset classes against the remaining six asset classes. The correlation of U.S. Treasuries, being a "risk-free" asset, is expressed in absolute terms, as it is typically negative vis-à-vis risk. Correlation key: green 0.00–0.30; yellow 0.31–0.50; orange 0.51–0.65; and red 0.66–1.00.

Conclusion

- Useful measure of portfolio flows
- Prediction: won't persuade EM governors that QE spillovers don't matter
- Optimal for some other purpose?
- The "holy grail" price-free spillover measure?
 - Q^i ?
 - Hard to measure
 - All proxies likely to have limitations