International capital flows and unconventional monetary policy

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DISCUSSION

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The views expressed in this discussion are solely those of the author and cannot be attributed to the European Central Bank or the Eurosystem.

Summary of the paper

- **Topic: Analyse the effects of unconventional monetary policy (UMP) on capital flows**

- **Methodology: event-study regression, using the UMP announcement shocks identified in Rogers et al. (2014, 2015) on developed market (DM) and emerging market (EM) equity and bond flows. Use EPFR data, 2-daily flows.**

- **Main contributions:**
  - **Analyse the effect of UMP actions of the Fed, ECB, BoE, BoJ**
  - **Evaluate whether there are asymmetries between MP easing and tightening announcements**

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Summary of the paper

- **Main findings:**
  - **Symmetric model: monetary policy easings are generally associated with capital flows into DM funds, particularly equity. No much evidence for reallocation toward EM assets.**
  - **Asymmetric model: easings and tightenings have broadly similar effects. Some evidence that tightening might shift portfolios out of EM funds.**

Overview discussion

Nice paper which focusses on policy-relevant question!

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Main comment: general insignificance of the results

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Illustration: general insignificance of the results

Symmetric model results

Dep. Variable (2-day change in flows/NAV)	Fed	BoE	ECB	BoJ
DM Equity	+	-	+	+
DM Bond	+	-	+	+
EM Equity	-	-	+	-
EM Bond	+	+	+	+

Table 2 of the paper; + is inflow; - is outflow

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Illustration: general insignificance of the results

Symmetric model results

Flows do not respond to Fed and BoJ actions, and only EME equity flows react

Dep. Variable (2-day change in flows/NAV)	**Fed**	**BoE**	**ECB**	**BoJ**
DM Equity				
DM Bond				
EM Equity		-	+	
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Asymmetric model results: EXPANSION

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Asymmetric model results: EXPANSION

No response following Fed actions

Dep. Variable (2-day change in flows/NAV)	**Fed**	**BoE**	**ECB**	**BoJ**
DM Equity				+
DM Bond			+	
EM Equity		-		
EM Bond			-	

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Four suggestions

1. **Set of announcements studied**
2. **Monetary policy shocks in this application**
3. **Country aggregation**
4. **2-daily flows versus weekly flows**

Mainly focus on the Fed announcements

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1. Set of announcements studied

Comment 1: set of announcements studied

Literature has indicated that concerning UMP, different types of central bank actions can have different effects (e.g. Fratzscher et al. 2013)**.** Not surprising given differences in the CB`s objective and variation in the economic state; causes UMP to work through different transmission channels that have different effects on capital flows.

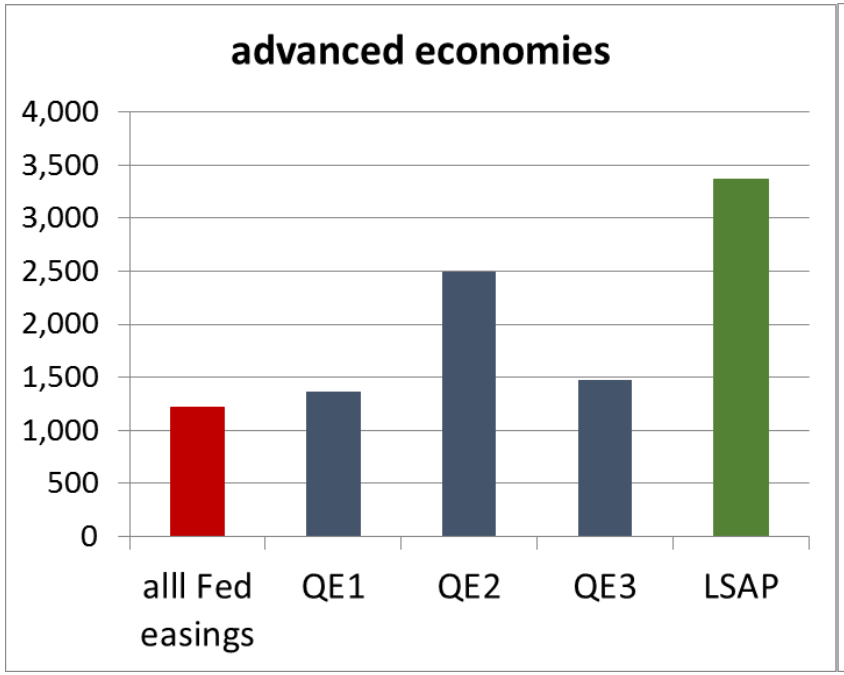
This paper; different approach by trying to find a more systematic reaction following UMP announcements

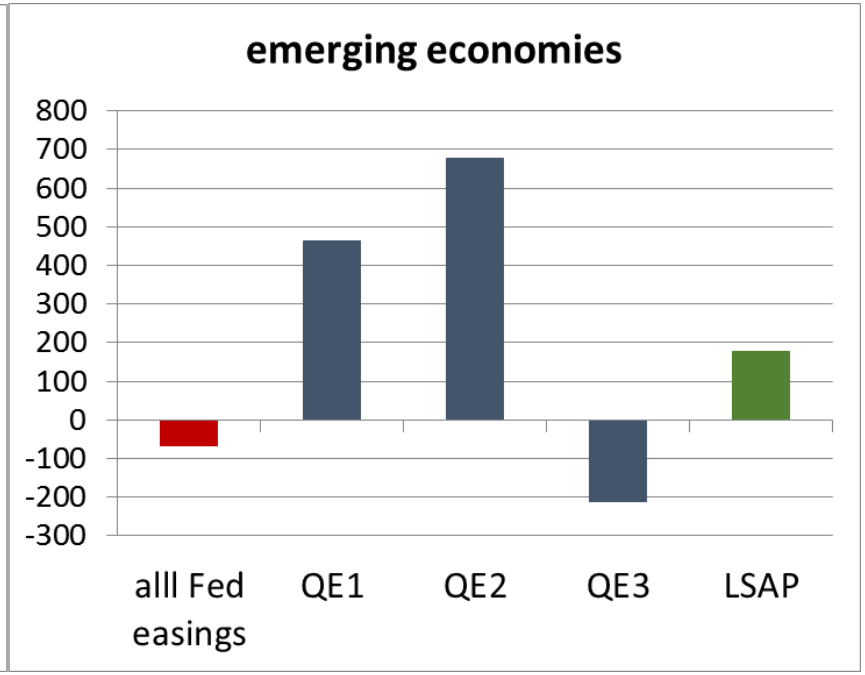
However, this might average out important variation specific to certain events

1. Set of announcements studied

Illustration: all Fed announcements versus different phases on UMP

Monetary policy EASING: equity flows (average 2-daily flows, + is inflow)





On average, always inflows

Average hides important variation; might lead to conclusion that there are generally no inflows into EM equity

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II. Choice of monetary policy shocks

Comment 2: Choice of monetary policy shocks

This paper: use of MPS shocks of Rogers et al. (2014, 2015), meaning focus on the <u>changes in intraday long-term bond yields</u> in narrow window around the announcements. This is in contrast to event-study (dummy variable approach) often used in the literature.

<u>Advantages</u> compared to dummy-variable approach: exogenous, focusses on surprise component, allows for asymmetry in the effects (tightening versus expansions) etc.

However, three points related to potential caveats of using for these shocks for analysing capital flows.

II. Choice of monetary policy shocks

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First, the results become dependent on the magnitude of the interest rate response

- **In contrast to dummy-variable approach, using the MPS shocks implies that one want to establish a relationship between bond yield changes and capital flows**

- **However, the 'size of the shock' seems to decline over time** (i.e. the absolute change in the yields)**.** This can be because there was less room for long-term yields to decline further, or UMP became less effective in lowering them.

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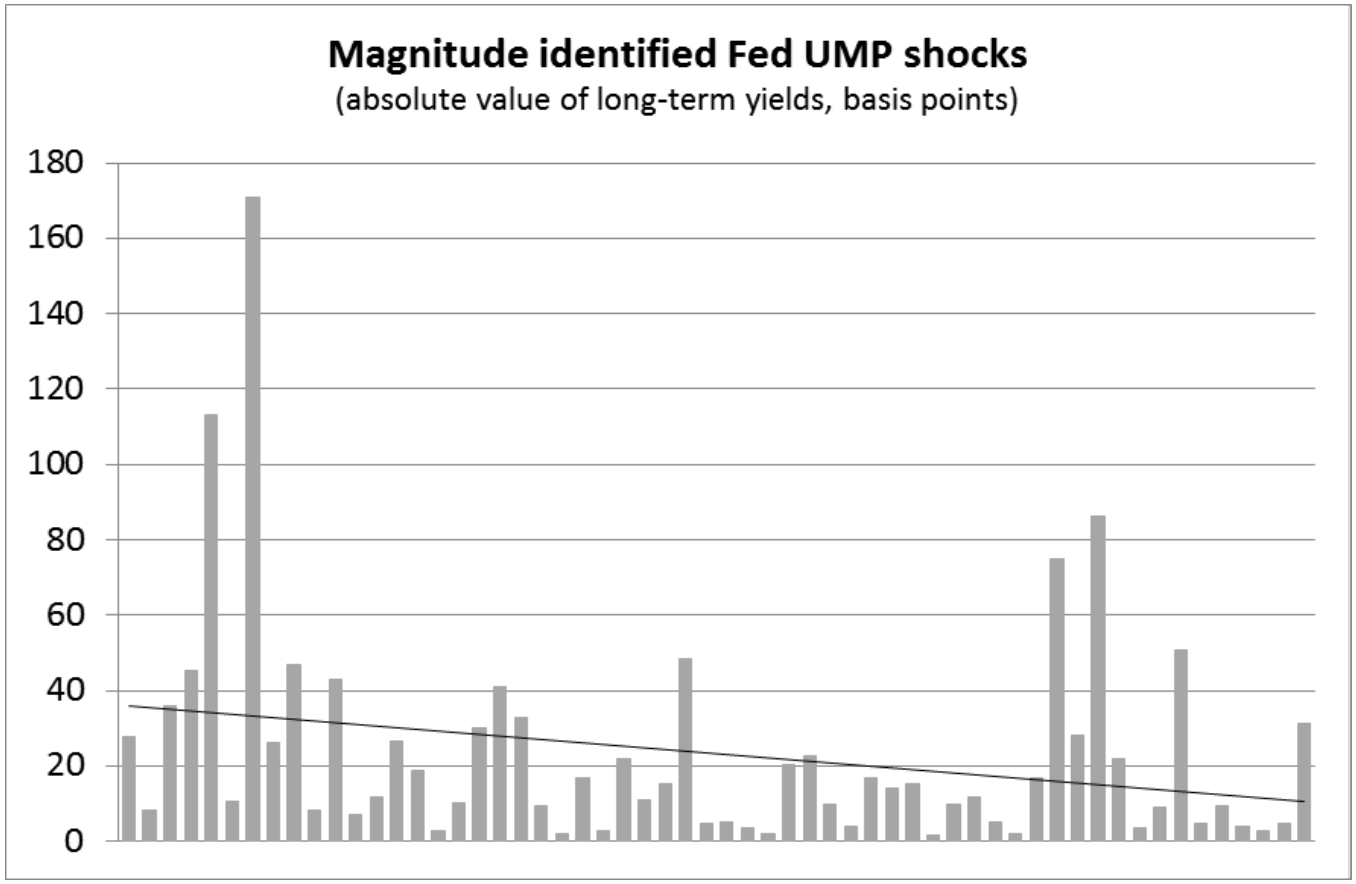
However, the 'size of the shock' seems to decline over time.



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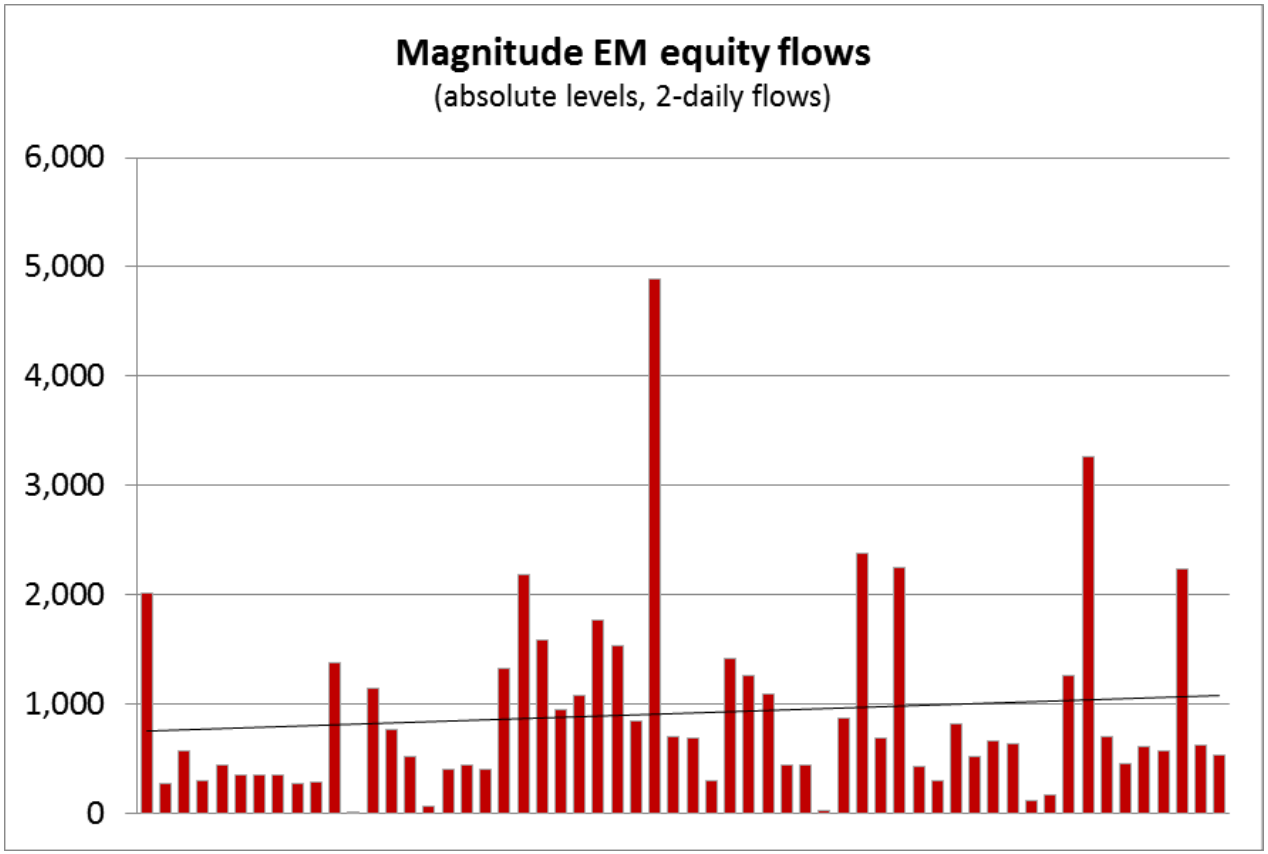
At the same time, for example, the absolute magnitude of EM equity flows became slightly larger over time.



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Taken together, implies that over time smaller interest rate responses were associated with larger EM equity capital flow reactions; relative response of capital flows became larger

On average, **this might bias the results towards the reaction of capital flows in times when UMP did not have large effects on bond yields** (or was more anticipated/less effective).

Illustrate by looking at EM equity flows following a normalised shock (e.g. 25bp easing in LT-rates)

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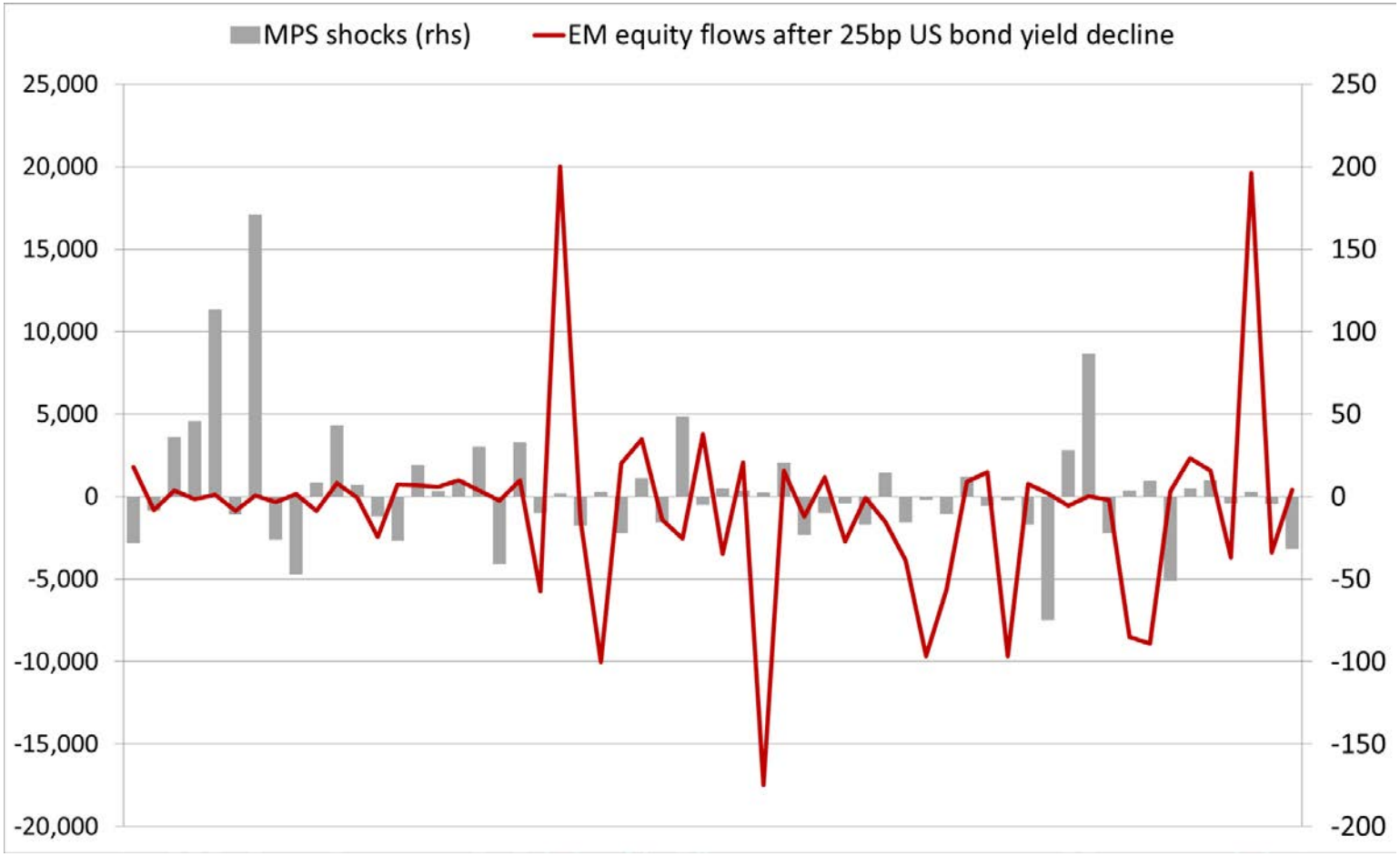

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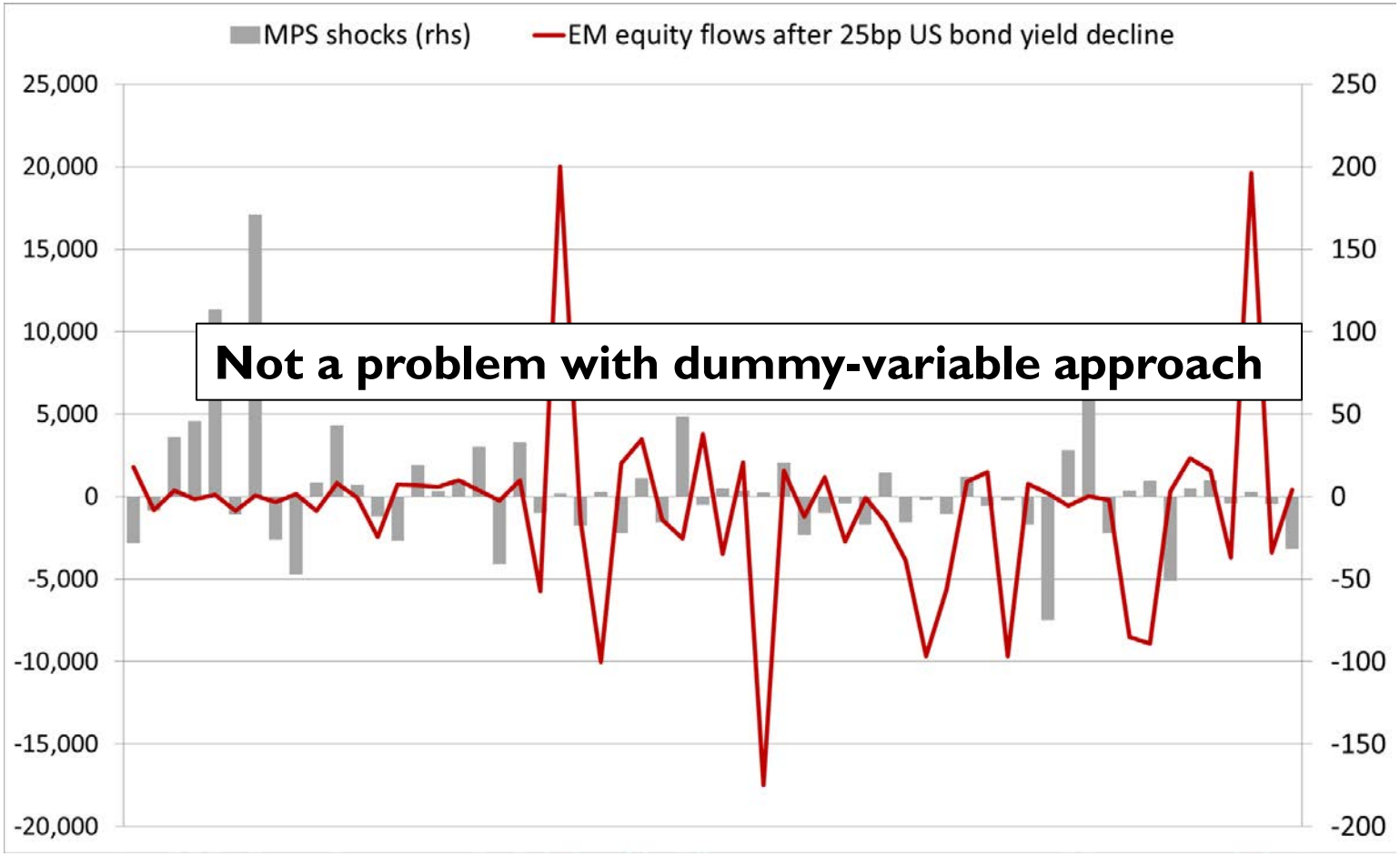

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Second, advantage of using MPS shocks is that this allows for evaluation of possible asymmetric effect. **However, generally find the same effects after easings and tightenings.**

Third, identification of ECB MPS shocks (based on the spread between German and Italian bond yields) might work for studying financial conditions, but **might be less appropriate for evaluating the effect of capital flows** (what happens to euro area flows?)

In sum, not so clear to me which identification approach is preferable for this application.

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III. Country aggregation

Comment 3: country aggregation: developed versus emerging

- **Two main groups : developed versus emerging markets**
- **However, would be useful to have the country in which the shock originates separately;** (1) home, (2) developed excl. home, (3) emerging
- This is because, for example, Georgiadis and Gräb (2015) find that ECB's EAPP led to equity inflows into EA whereas other advanced economies witnessed outflows
- **Capital flows might be averaged out when grouping advanced economies together**

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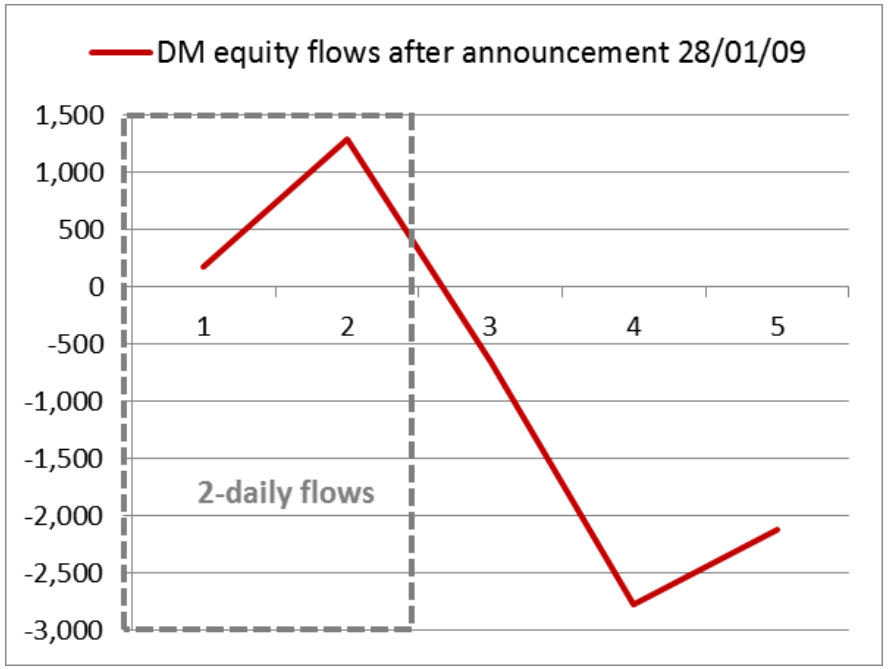
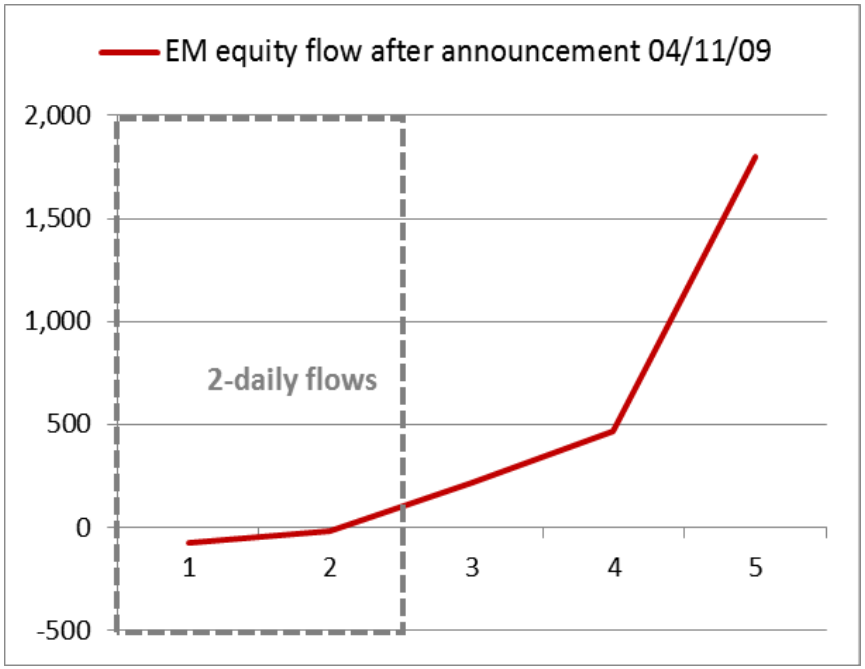
IV. 2-daily flows versus weekly flows

Comment 4: 2-daily flows versus weekly flows

Daily EPFR data tends to be noisy and funds might need more time to react. For example:





If properly add controls for expected capital flows, weekly data might provide clearer results

Conclusion

Nice paper that addresses relevant policy question

General comments; lack of significance in results

Four main suggestions:

- Might consider splitting up the analysis for different UMP phases, otherwise might average out too much information
- More justification on the choice of UMP shocks for this specific application would be welcome
- Might see clearer patterns in capital flows if distinguish between home and other developed economies
- Try to see whether weekly data, in combination with proper controls, might give a different/clearer picture