Taper Tantrums: QE, its Aftermath and Emerging Market Capital Flows

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1. "free flow of international capital has many benefits such as reducing the cost of capital, increasing investment and economic growth (…), and international diversification gains for foreign investors (…)"

It's fair to say that this issue remains debatable. See

- "The elusive gains from international financial integration" **Gourinchas & Jeanne**, Review of Economic Studies, 2006
- **Prasad, Rajan & Subramanian**, 2007. "Foreign Capital and Economic Growth," Brookings Papers on Economic Activity, etc.

  The Eurozone crisis is another illustration that it's easy to overstate the gains from financial flows, and to understate their costs…

2. The DATA is from the US Department of Treasury International Capital System (TICS).

It provides data on US transactions with foreigners in long-term domestic and foreign securities by type and country on a monthly basis.

The countries in the panel include Argentina, Brazil, Chile, Colombia, India, Indonesia, Korea, Malaysia, Mexico, Peru, the Philippines Russia, South Africa, Thailand and Turkey.

Question: Is there a reason for ignoring short term flows, hot money, etc.? Flows and stocks of short term bonds may matter for balance sheet exposure and the impact VIX, TED spreads as much (and probably more) than the long-term securities.

3. Concluding remarks:
"The advantage of extracting the magnitude of the monetary surprises directly from the Fed Funds Futures data is that we can conduct exercises such as the one above to directly estimate a dollar amount in terms of US investor position and flow changes to emerging markets controlling for a variety of push and pull factors." **Agree**

4. "The goal going forward is to do an in-depth exploration of the magnitudes of the policy surprises and the impact on a variety of US holdings and flows measures. …Similarly, we can quantify the cumulative effect of monetary shocks during the QE period or the taper talk on US emerging-market holdings and flows. In particular, given the imminent rate increases by the Federal Reserve in the coming months, the

exercise potentially has significant policy relevance especially for emerging-market central bankers."

MIND the GAP

I doubt if the authors can detect the big story of the GFC, where the pre-crisis dynamics led to a huge dollar-funding gap in the EU:

"the estimate of their US dollar funding gap in mid- 2007 would be $2.0–2.2 trillion. Were all liabilities to non-banks treated as short-term funding, the upper-bound estimate would be $6.5 trillion… the funding pressures were particularly acute among European banks." From BIS WP 291, 2009.

Second and third party effects may be as large as the direct effect of any US interest hike.

FT of December 9th notes:

"UK banks' exposure to emerging markets could prove critical if the US raises interest rates, the Bank of England warned on Wednesday. The BoE's Financial Policy Committee said it was still difficult to predict how markets might react to the widely expected first rise in the US Federal Funds rate in almost a decade…

UK banks are particularly exposed to emerging markets, although they have decreased their holdings by 20 percentage points since last year, according to BoE data. Their exposure to emerging market economies and Hong Kong totalled 340 per cent of their so-called Common Equity Tier 1, the safest kind of bank capital