Transmission of Shocks to Emerging Market Economies: How Important are Economic Fundamentals

Discussant

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Summary

- ➢ **<u>Question</u>**
- Do markets differentiate across emerging economies?
  - – 2013 tapering announcement episodes
  - – Past episodes of stress
- ➢ **<u>Methodology</u>**
- Simple country-level OLS regressions (14-20 observations)

Summary (contd.)

➢ **Findings**

- Macro fundamentals matter in 2013
  - CA/GDP; government debt/GDP
  - composite index of vulnerability
    - CAD; ST external debt / reserves; gross government debt, run-up in bank credit
  - more vulnerable, greater market reaction

- Within 2013 – differentiation started early, **reversed in Sep-Oct**, but eased by end of the year.
  - Less vulnerable reacted less around "positive" events as well.

- Historical episodes of stress
  - Unusually high periods of volatility [VIX; exchange rate and stock market indices]
  - Episodes since GFC were unique in terms of market differentiation

Question / motivation

- Important question
  - Accepted wisdom that EMs represent an asset class
  - Evidence of differentiation questions this wisdom

- Nascent but growing literature

Literature

Paper	Method	Finding
Eichengreen and Gupta (2013)	Country level correlations	Macro fundamentals do not matter; exchange rate appreciation and CA deficit do matter; deeper financial markets were hit more
Aizenman, Binci, and Hutchinson, 2014	Event study; daily data; country fixed effects	“Robust” group was more exposed to news about tapering
Ahmed, Coulibaly, and Zlate, 2015	Country level correlations: different time horizons and historical episodes	Countries with stronger macro fundamentals were affected less
Mishra et. al., 2014	Event study; daily data; country fixed effects	Stronger macro fundamentals and deeper financial markets experienced less market reaction.

Literature (contd.)

- **Market differentiate across EMs; EMs no longer a single asset class**
- Less agreement on what variables matter and in what direction
- What are the magnitudes

Contribution of Ahmed, Coulibaly, and Zlate, 2015

- Sheds new light on the same question

- Different time horizons within 2013 episode
  - New finding
  - General wisdom – initial herding of investors followed by discrimination

- Historical episodes of stress
  - Method to identify historical episodes of volatility
  - No evidence for differentiation in early episodes before GFC
  - [Results different from GFSR April 2014]

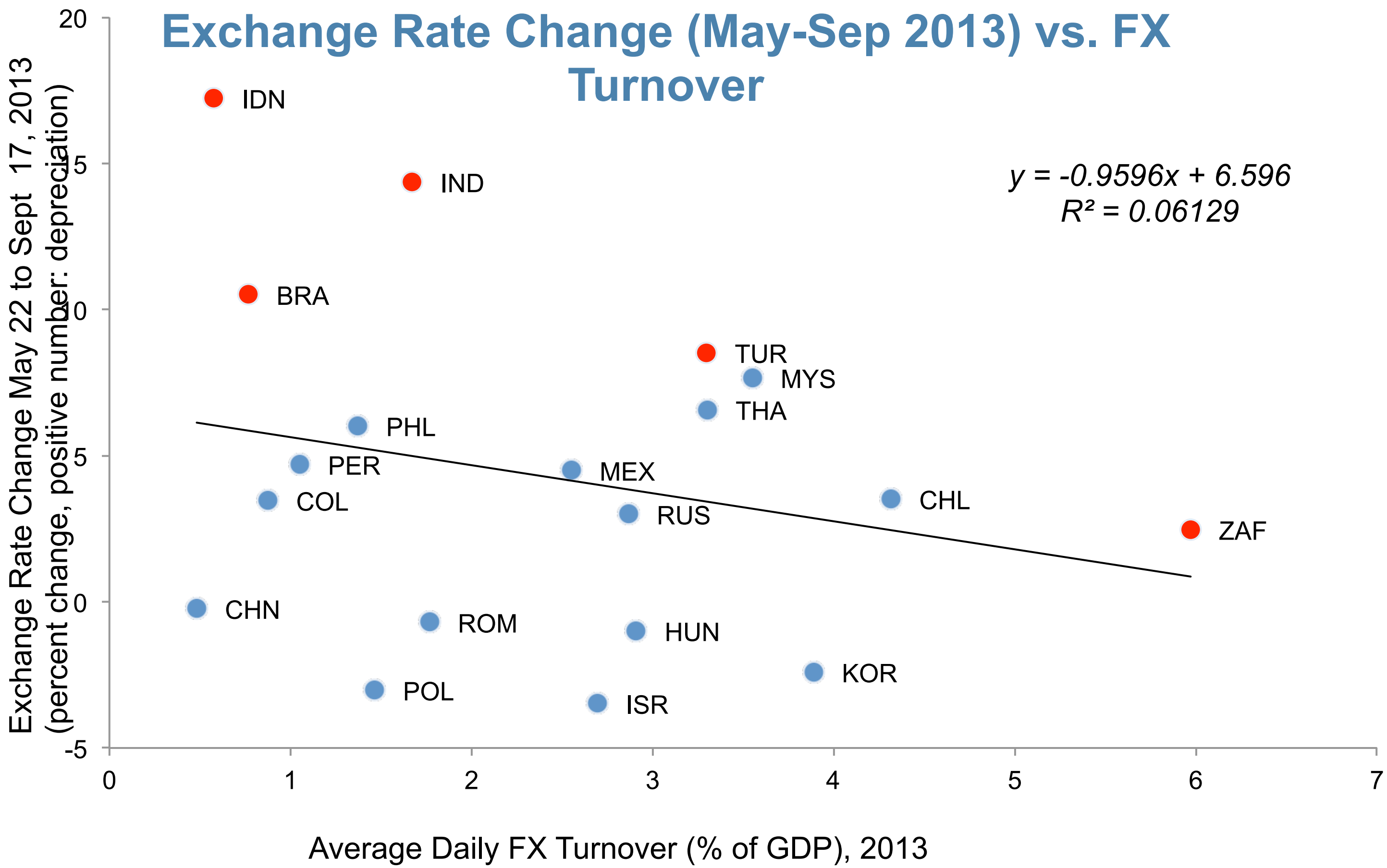
Comment 1: Methodology

- What is the null?
  - Changes in variables over a 1-2-3 month period; and correlate it with characteristics.
  - Does not tell us anything how fundamentals matter relative to usual times?
    - Pooling events (even within a year)
- Looking at long time horizon (one month or more)
  - Confusing the impact of other events

Comment 2: Why results differ across studies?

- Difference in results due
  - Different methodology / specification
  - Sample
  - Different definition of "events"

Comment 3. Does financial depth matter?



Note: Exclude Singpapore
Source: BIS, Datastream and IMF Staff Calculations

Comment 4: Digging deeper into comparison with historical episodes

- Why are markets differentiating this time around?
  - Nature of the shock
    - Shock originating in US?
    - Since end-2013 .. additional bursts of volatility related to other factors: China's shadow banking system, idiosyncratic developments in Argentina, and rising political and policy risks in Turkey
  - Change in investor behavior?
    - Micro/ fund-level data on investor behavior
      - [GFSR April 2014 Chapter 2]

Comment 5: Herding vs differentiation

- Does the evidence of increased importance of macroeconomic fundamentals rule out herd behavior?
- Is it either / or story? Or a mix of the two phenomenon?
- GFSR Chp 2: Micro data
  - For equity funds: herding behavior – measured by extent to which certain group of investors trades in the same direction more often than one would expect if they traded independently and randomly – has increased continuously since 2000

Conclusion

- Overall important question
- New / interesting results
- Scope for further work
  - Methodology
  - Reconciling with other studies
  - New measures of financial depth
  - Dig deeper why differentiation more recent phenomenon
  - Can we really rule out herding?