

Comments on “Financial Integration in Emerging Market Economies”

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Main points

- + Very nice paper on an important topic
- + Very nice application of the data
- + More work welcomed in different directions

Main points

- + Clarify analysis, findings, and contribution
 - Compare integration with other estimates
- + Give additional twist to the analysis
 - + Some comparison of integration that gives an edge
 - More integration now than before?
 - Comparison with developed countries then and now?
 - + More detail on factors that affect integration
 - + Identify factors more clearly for testable implications
 - + Crises
 - + Capital controls
 - + Default risk
 - + Currency risk
- + Some examples of these points follow

Rest of the comments

- + Highlight what measure the paper studies
- + Type of analysis that could be done in more detail
- + Some of the issues in need of more clarifications

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What measure the paper studies

Forward discount (fd)

i^0 : Expected appr.

$$\delta_t = P \left(\frac{F_{t+k} - S_t}{S_t} \right) \underbrace{i^0 + \underbrace{(i_{t+k}^i - i_t^{US})}_{\text{Foreign - US}}}_{i^0} = 0 \quad ?$$

$$i_{t+k}^i = i_t^{US} - \underbrace{P \left(\frac{F_{t+k} - S_t}{S_t} \right)}_{i^0: \text{Exp. depr.}}$$

What measure the paper studies

✚ “Broad” CIP

$$\left(i_{t+k}^{P, Arg} - i_t^{Doll, US} \right) = \underbrace{\left(i_{t+k}^{P, Arg} - i_t^{Doll, Arg} \right)}_{\text{Curr. risk}} + \underbrace{\left(i_{t+k}^{Doll, Arg} - i_t^{Doll, US} \right)}_{\text{Country risk}}$$

$$\underbrace{-P \left(\frac{F_{t+k} - S_t}{S_t} \right)}_{\text{0: Exp. depr.}} \neq \underbrace{\left(i_{t+k}^{P, Arg} - i_t^{Doll, Arg} \right)}_{\text{Curr. risk}} + \underbrace{\left(i_{t+k}^{Doll, Arg} - i_t^{Doll, US} \right)}_{\text{Country risk}}$$

What measure the paper studies

- + Paper tests failure of CIP
- + Factors
 - Transaction costs - spreads
 - Capital controls (existing or anticipated)
 - Reserve requirements
- + Many more factors
 - + Default risk (issuer risk)
 - + Confiscation risk (jurisdiction risk)
 - + Dual agency problems
 - + Forward contracts in both markets
 - + Liquidity
 - + Who does the arbitrage

What measure the paper studies

- + Paper uses different instruments involved in of CIP
- + Has problems to capture financial integration
- + Using same assets like bonds or equity has some advantages
 - Identical assets, identical risks
- But some drawbacks in terms of data coverage

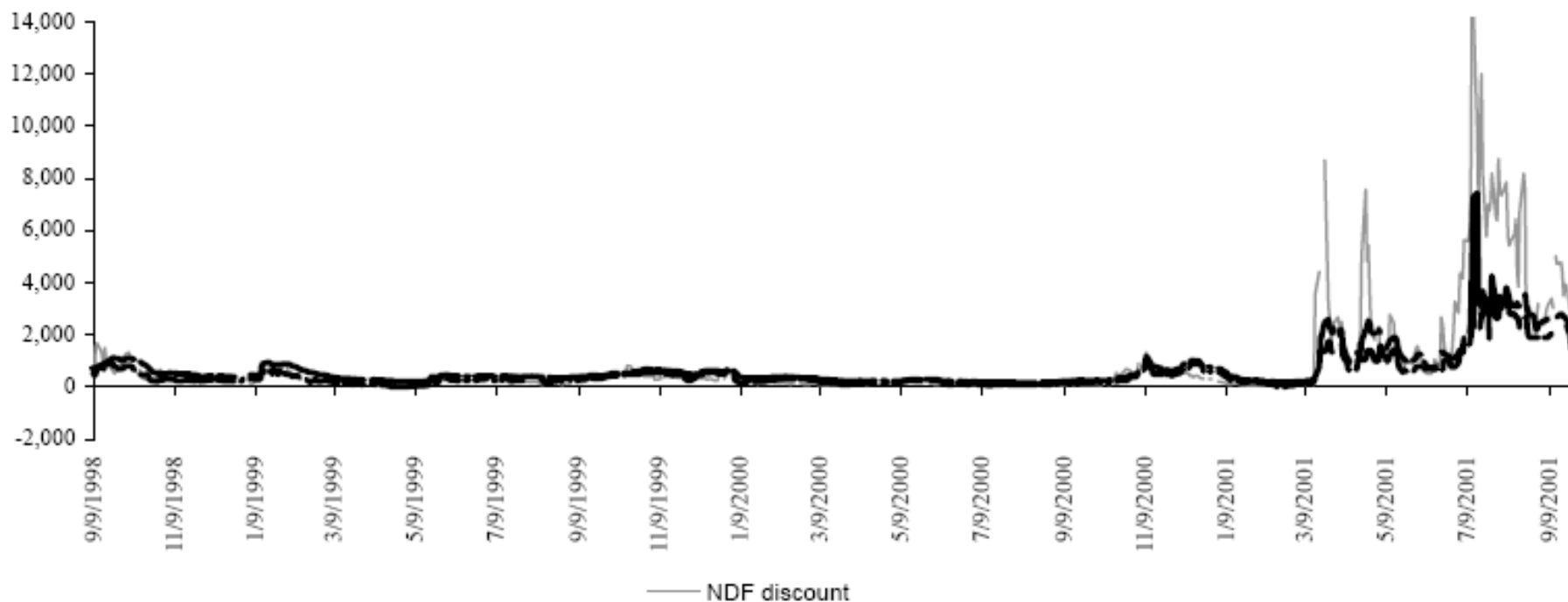
Rest of the comments

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FD and arbitrage bands

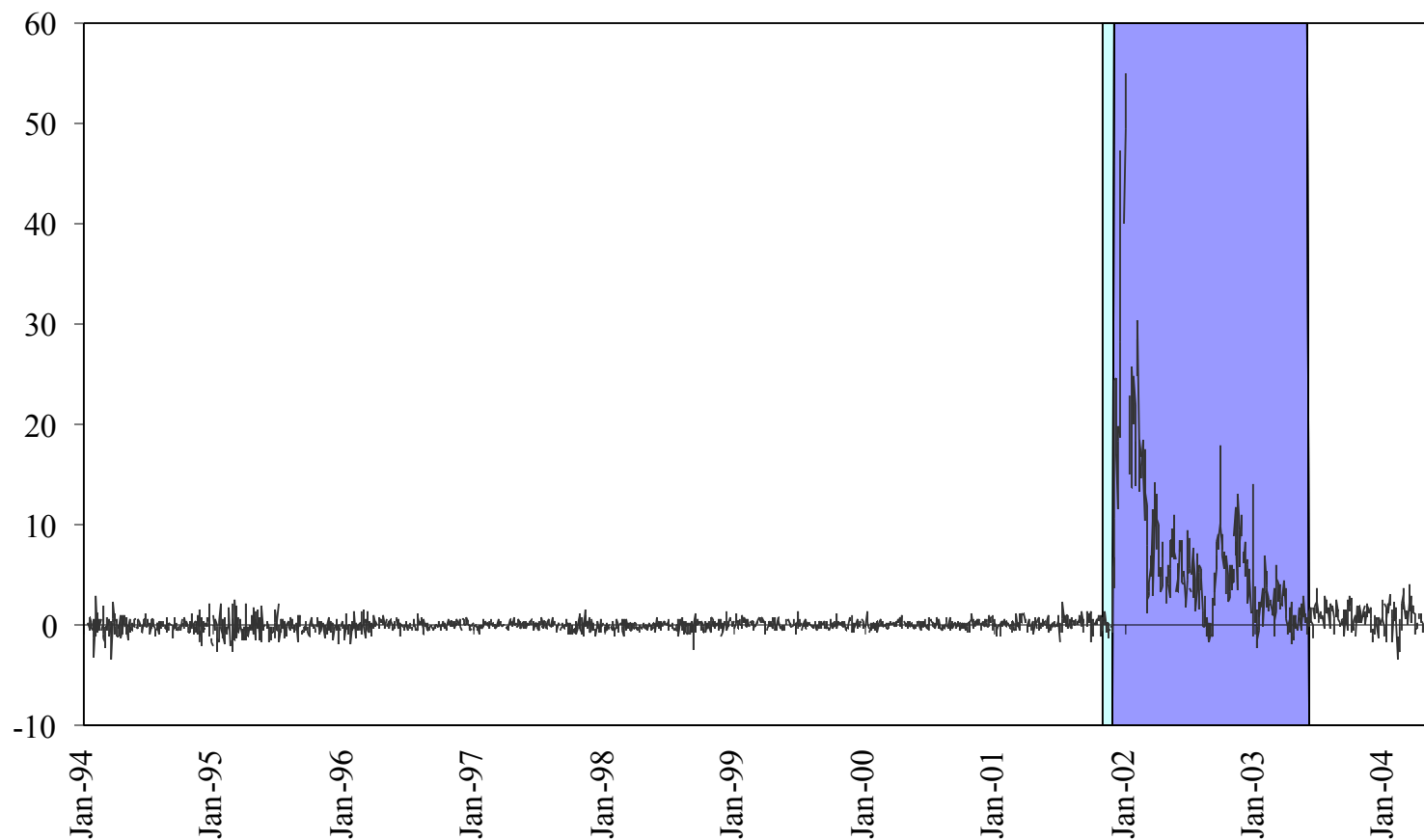
Argentina: CIP as crisis approached

Case 3:
$$\underbrace{(j_{t,k}^{\text{lending}} - \text{offshore } i_{t,k}^{\text{deposit},*})}_{\text{upper band}} \geq f d_{t,k} \geq \underbrace{(i_{t,k}^{\text{deposit}} - \text{offshore } j_{t,k}^{\text{lending},*})}_{\text{lower band}}$$



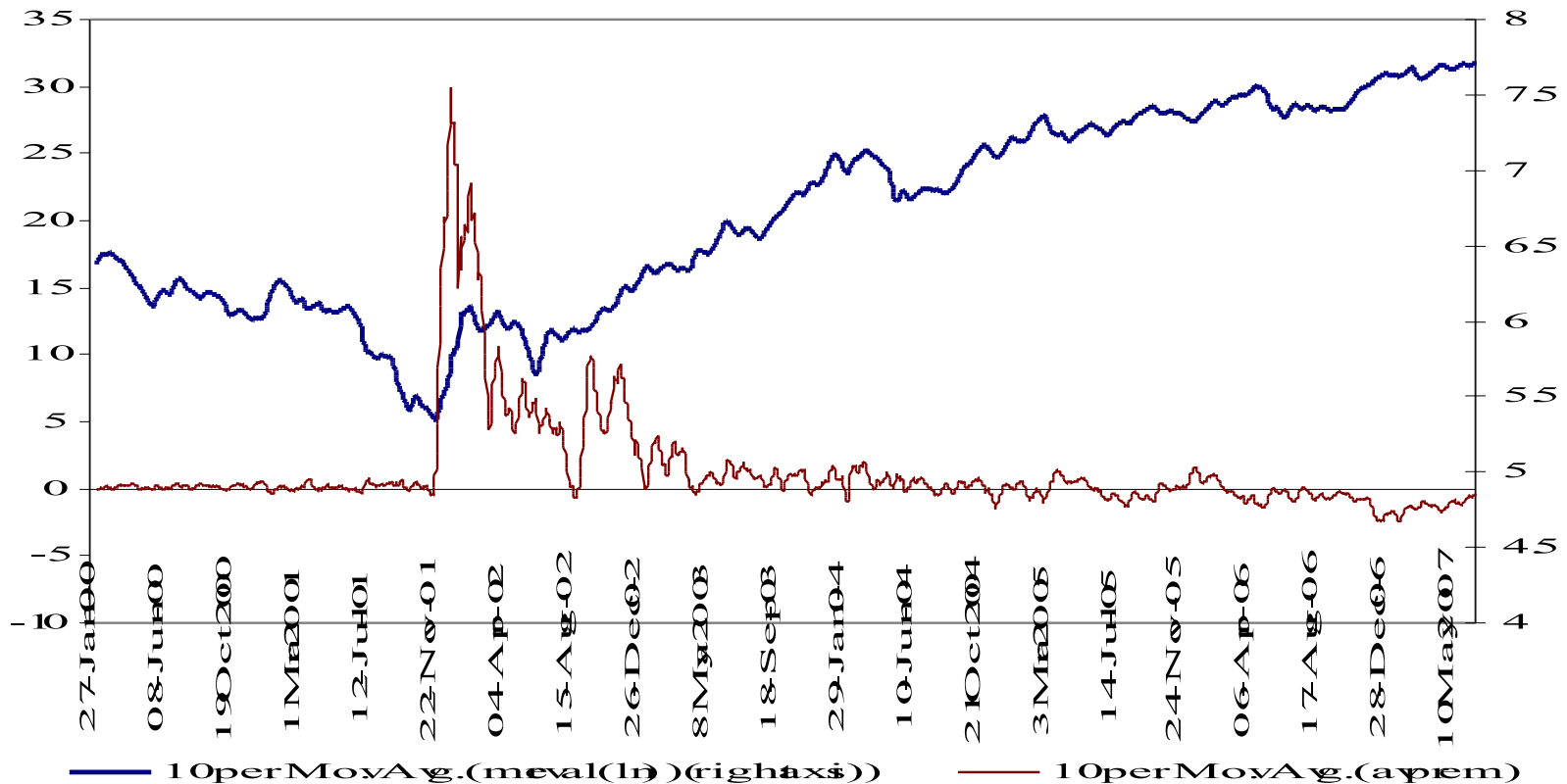
ADR Cross-market premium

Argentina: controls on outflows



ADR Cross-market premium

Argentina: controls on outflows and inflows

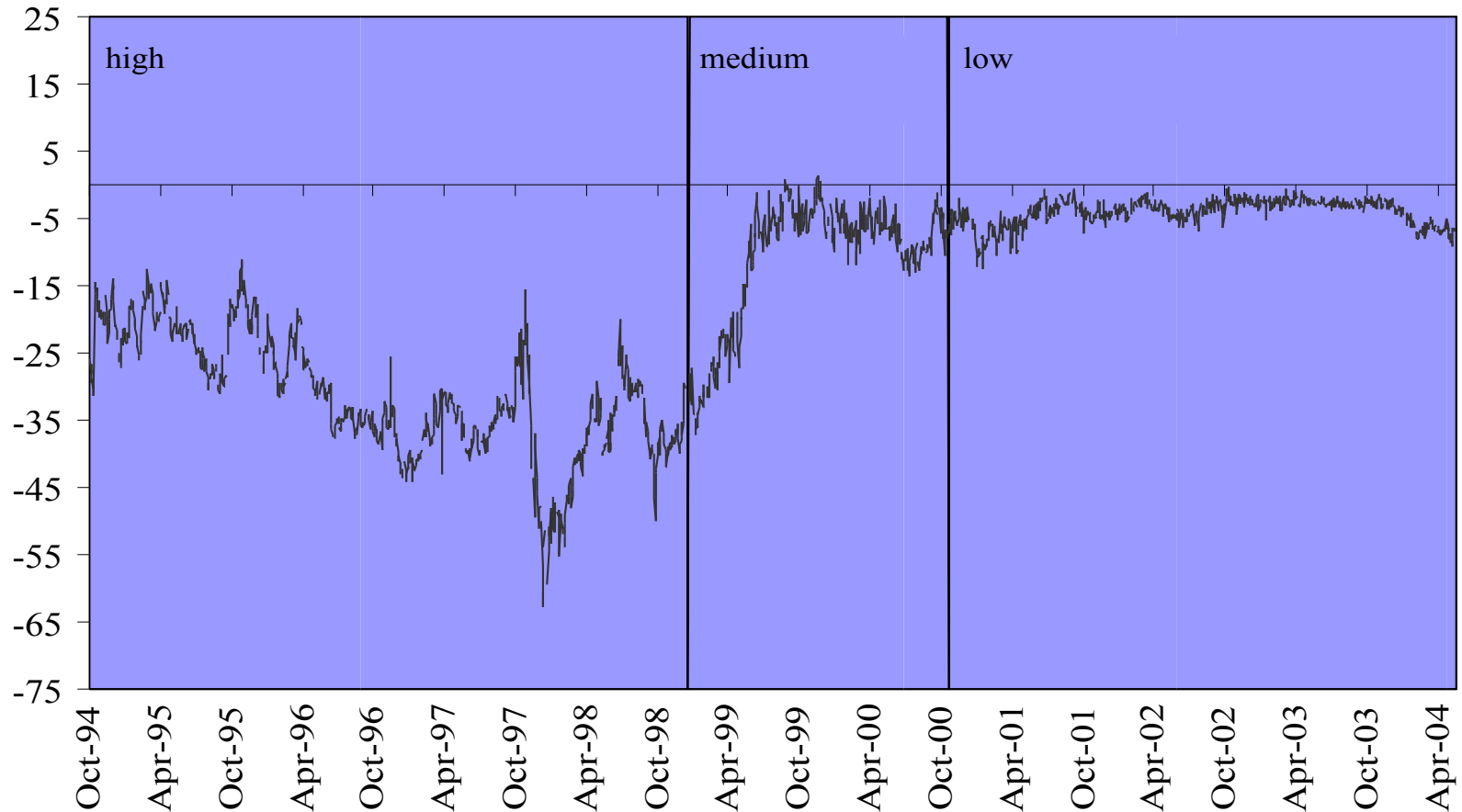


$$\text{Prem-fit} = 2.28 * \text{ret} + 12.73 \text{control_return} - 2.22 \text{control_in} + 0.89 * \text{control_in}$$

(2.39) (0.05)

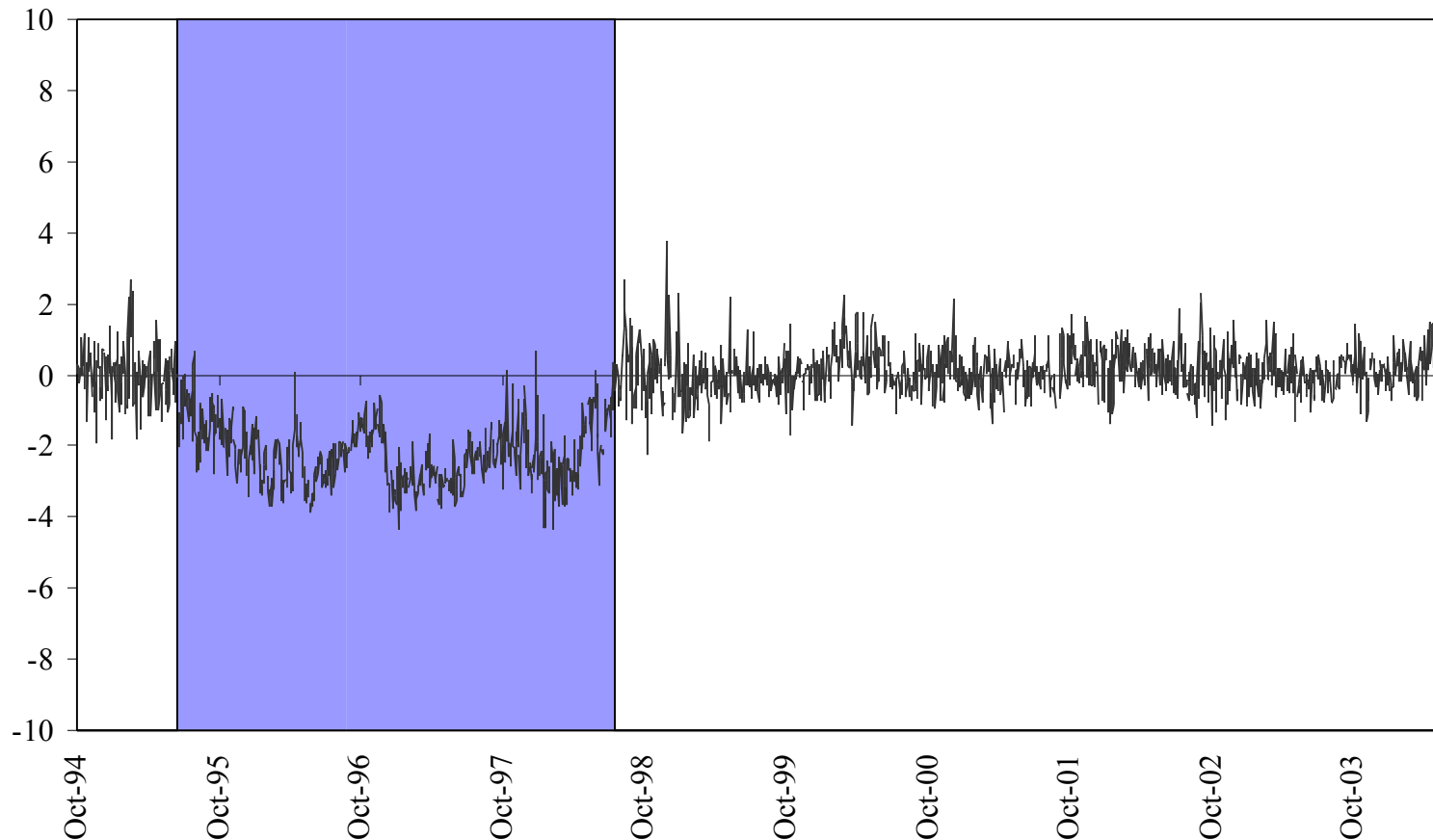
ADR Cross-market premium

Korea: quantitative controls on inflows



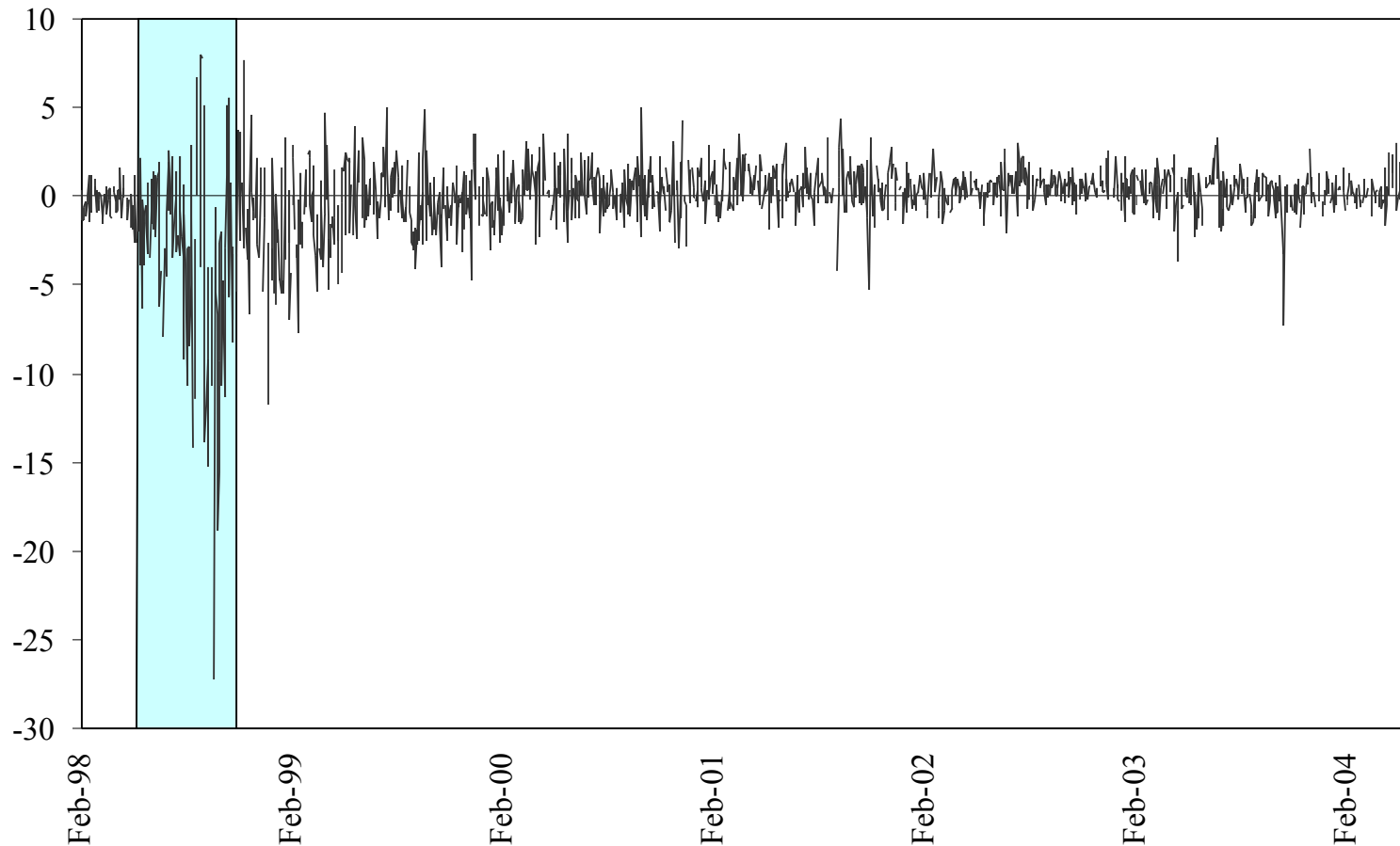
ADR cross-market premium

Chile: tax on capital inflows



ADR cross-market premium

Russia: crisis



Rest of the comments

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- **Some of the issues in need of more clarifications**

More clarifications

- + Better clarify analysis and substantiate some of the statements
- + Links to the literature on both developed and developing countries
- + What data are exactly used?
- + Why are bandwidths so different for 1-month and 3-month rates?

More clarifications

- ✦ Measure of financial integration
 - ✦ What is the benefit of using a combined measure that has several indicators?
 - Bandwidth
 - Percent out
 - Median deviation
 - Continuous runs outside
 - ✦ Is this what the literature does?
 - ✦ These measures are related
 - ✦ What about speed of convergence?
 - ✦ What about using only one aspect like the bandwidth?
 - ✦ The rankings do not seem to be always the same

More clarifications

- ✦ Correlations with indexes of financial integration
 - ✦ What is expected?
 - ✦ More correlation with de-facto or de-jure measures?
 - ✦ What type of measures are the relevant ones?
 - ✦ LMF?
- ✦ Controls: why only affect one band?
 - ✦ Case of capital inflows: tax paid when entering country
 - ✦ Expected appreciation not priced in (i^* not low enough)
 - Foreign investors don't come in because of the tax
 - ✦ Expected depreciation (i^* not high enough)
 - ✦ Foreign investors don't come in
 - ✦ Domestic do not necessarily leave if they pay tax upon return

More clarifications

+ Use of AR vs. TAR

- How powerful and valid are the non-linearity tests?

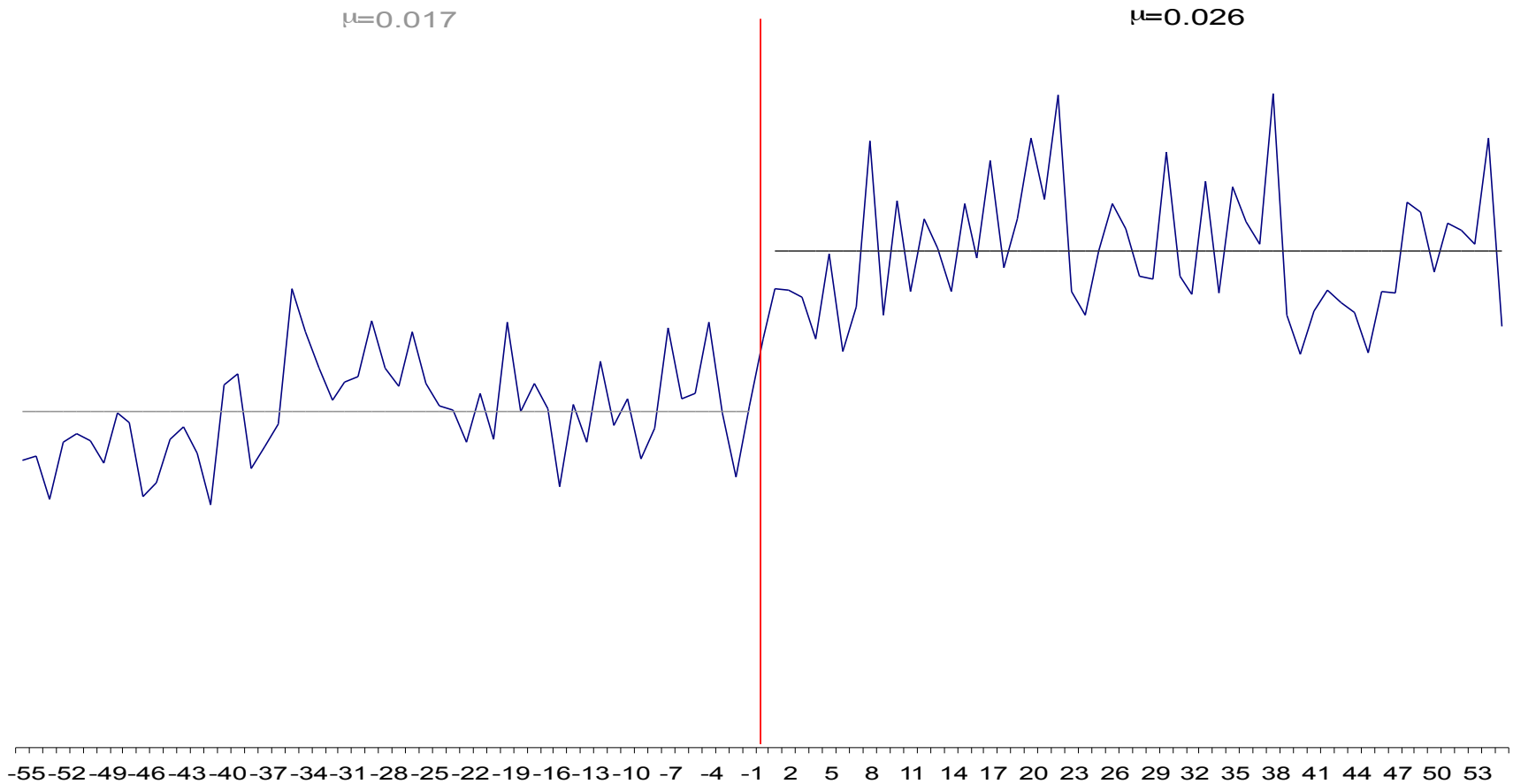
+ Crises

+ “Crisis period:”

- Is definition optimal?
- What is the beginning and end?
- Effect?
- Why not test effect?
- Why considering only non-crisis periods?
- Relation to spreads (in equity markets)

Equity bid-ask spreads during crises

Evolution of Bid-Ask Spreads - SM crisis



Thank you