Финансовые потоки и глобальный финансовый цикл

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global financial cycle

Asset prices strongly co-move across countries

- two factors explain more than half of time-series variation on average across countries

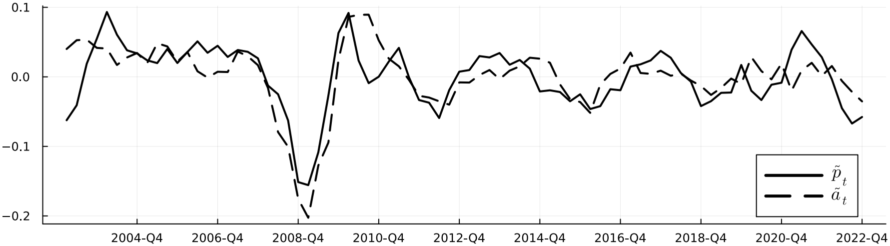
Capital flows also co-move across countries

- main factors are equally powerful and co-move with the main factors in prices

Main components in both are strongly related to financial variables

- various measure of risk-taking capacity

asset prices and capital flows



- $\tilde{a}_t$: net purchases of foreign assets relative to stock one quarter before (from IMF)
- $\tilde{p}_t$: average capital gains on equities in USD (from MSCI)

gross financial flows

Common variation in capital flows is very pronounced in gross flows

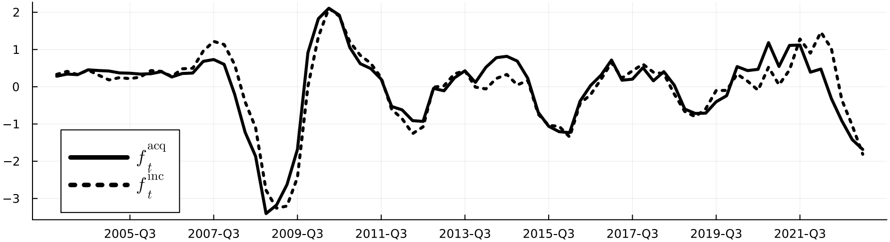
- gross outflows: net purchases of foreign assets by domestic agents
- gross inflows: net purchases of domestic assets by foreign agents

Net flows add up to zero across countries, gross flows do not

Gross outflows and inflows co-move on the country level, partly offset each other

- as a result, gross flows are 2-4 times larger than net

main factors in gross flows



- f_t^{acq}: principal component in gross outflows
- f_t^{inc}: principal component in gross inflows

heterogeneity across countries

We can measure exposure differences across countries:

$$f_{it}^{\text{acq}} = \alpha_i^{\text{acq}} + \beta_i^{\text{acq}} f_t^{\text{acq}} + \epsilon_{it}^{\text{acq}} \tag{1}$$

$$f_{it}^{\text{inc}} = \alpha_i^{\text{inc}} + \beta_i^{\text{inc}} f_t^{\text{inc}} + \epsilon_{it}^{\text{inc}} \tag{2}$$

Here $(\beta_{it}^{\text{acq}}, \beta_{it}^{\text{inc}})$ measure co-movement of individual countries' flows with global components

- f_{it}^{acq} is net purchases of foreign assets (normalized by stock) by domestic agents
- f_{it}^{inc} is net purchases of domestic assets (normalized by stock) by foreign agents

advanced economies lose more foreign investors

	β_i^{inc}	β_i^{inc}
is advanced economy	0.018	
	(0.006)	
foreign assets to GDP		0.006
		(0.004)
Observations	103	103
R^2	0.03	0.05

- investors leave advanced economies more actively (not seen in net flows)

advanced economies retrench more

	β_i^{acq}	β_i^{acq}
is advanced economy	0.027	
	(0.010)	
foreign assets to GDP		0.010
		(0.006)
Observations	106	106
R^2	0.03	0.04

- investors in advanced economies bring assets to home markets (retrenchment)

this pattern is robust

The pattern remains with other definitions of the global financial cycle

- when measures of global risk-taking capacity are low, advanced economies lose more foreign investors and retrench more actively
- the relationship to foreign asset holdings is even stronger

Same holds for net purchases of foreign assets normalized by stock of liabilities

- in advanced economies, investors return more assets relative to their countries' liabilities
- higher chances to smoothly replace foreign investors when they leave

squaring capital flow and asset price dynamics

Active retrenchment seems to protect domestic assets from global crises

I show this mechanism in a model of global economy with a financial cycle

Main ingredients:

- segmented markets: domestic assets are special for all investors
- foreign assets are only accessible through global intermediaries
- intermediaries face shocks to risk-taking capacity: episodes of capital flight

main results

Prices of risky assets include a risk premium

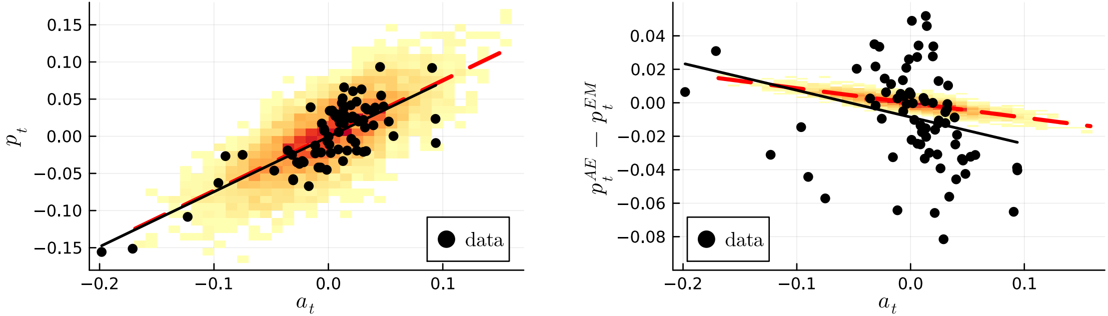
- in countries with high foreign wealth, risk premia are low
- in countries with high foreign wealth, risk premia are less sensitive to foreign investors

Domestic investors naturally replace foreign ones

- foreign demand shocks lead to adjustment in quantities in advanced economies
- adjustment happens through prices in emerging markets

Model explains 50% of relative performance of advanced economies and emerging markets assets

capital flows and asset prices



(a) Average risky asset returns against total normalized outward flows.

(b) Relative risky asset returns in advanced economies in emerging against total normalized outward flows.

summary

Gross financial flows respond to crises more in advanced economies

- massive exit of foreign investors, strong <u>retrenchment</u>

Financial market segmentation helps explain this pattern

- simple model generates half of relative performance of asset-rich economies to asset-poor ones
- retrenchment helps markets adjust to demand shocks through quantities rather than prices