Capital Flow Cycles: A Global Long View

Discussion

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Plan

1. What we knew (or thought we knew) before RRT
    - ➢ Quite a lot.
2. What RRT bring to the table
    - ➢ Quite a lot!
3. Two comments
    1. “This is just the beginning”
    2. *Global* cycle vs. (possibly multiple) center-periphery cycles

What we knew (or thought we knew)

1. International finance is characterized by a sequence of center-periphery boom-bust cycles. From the 1820s until today, there were 9-10 *major* cycles of this type
2. Financial conditions at the center and commodity prices are powerful drivers that can start and end such cycles.
3. “Periphery shocks” and policies also matter: independence/decolonization, collapse of communism, revolution, stabilization and reform, end or start of wars.
4. Almost all major cycles were followed by waves of default. This is why sovereign debt crises tend to be clustered.

References: Lindert and Morton (1989), Marichal (1989), Suter (1989, 1992). See Sturzenegger & Zettelmeyer (2006), pp. 3-10 for a summary.

What RRT bring to the table

1. A new dataset of gross debt flows for 1815-1868, allowing identification of pre-1870s cycles with higher granularity.
2. Identification of commodity price cycles since late 1700s.
3. Nice job sorting our peculiarities of Euro area member capital flow measurement (treatment of TARGET balances).
4. Confirmation of key stylized facts, using a more systematic approach to identifying cycles based on extended data.
5. A convincing plea to broaden the definition of "global financial conditions" (but no index yet).
6. A discussion of the latest bust cycle, pointing out that *this time is different* (really!): bust with almost no (new) defaults.

Comment 1: this is just the beginning!

Given wealth of new information/data (and particularly given two/potentially three cycles series), there is much more that the paper (or broader project) can do.

Examples:

- Disentangle the role of external (commodity price, financial conditions) and domestic factors in various cycles.
- Disentangle causality between commodity prices, financial conditions, flows. What is really exogenous?
- Use all available information (length, magnitude of cycles, driver, extent commodity price swing …) to predict how booms will end. Use this to redo out-of-sample forecast of defaults in ongoing bust.

Comment 2: maybe focusing on *global* cycles is not always useful (particularly after 1973).

The powerful concept is *center-periphery* flows. But there may not be a unique “center” (origin of capital flows in the boom) and “periphery” (destination of capital flows). When there is not:

- the “global cycle” view may be too aggregate – it may miss some really interesting center-periphery cycles
- the global cycle may be misidentified. Supposed “peaks” and “troughs” may represent averages without much meaning. The potential for misidentification is greater when operating with net flows

Example for a non-global center-periphery cycle: the Euro boom and bust

1. “Good news” in the periphery

   [EMU ➞ permanently lower macro risks!]
2. … triggers large-scale capital inflows

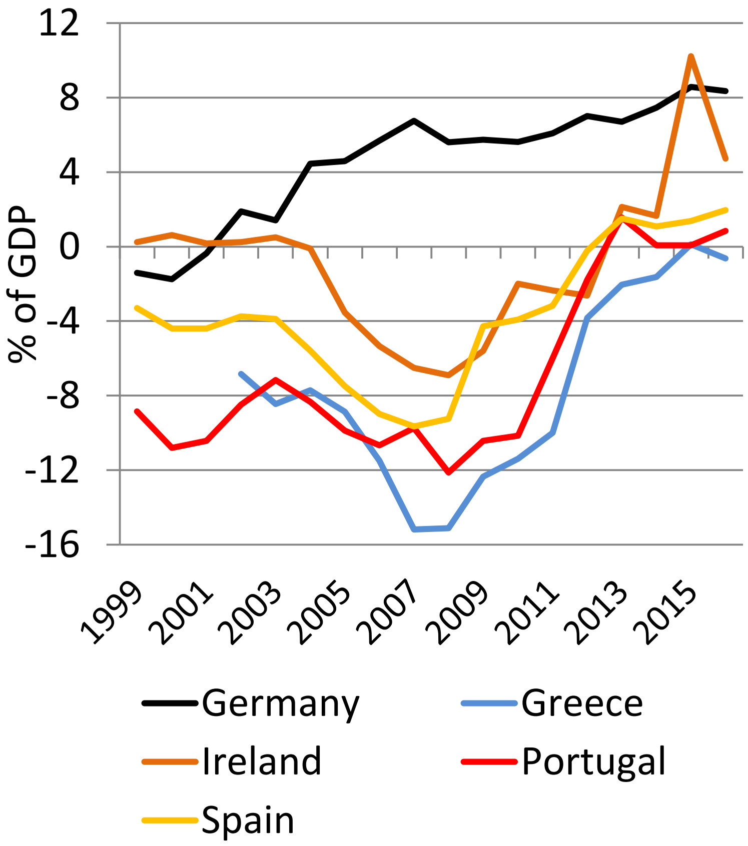
   [indeed!]
3. ... leading to growing vulnerabilities

   [housing or sovereign debt accumulation; losses in competitiveness]
4. ... until an external or domestic shock

   [Lehmann in 2008; truth on Greek deficit in 2009]
5. … causes a sudden stop, forcing a currency, banking and/or sovereign debt crisis

   [ESP: banking; IR/PT: banking+sovereign; GR: banking, sovereign and repressed currency crisis]

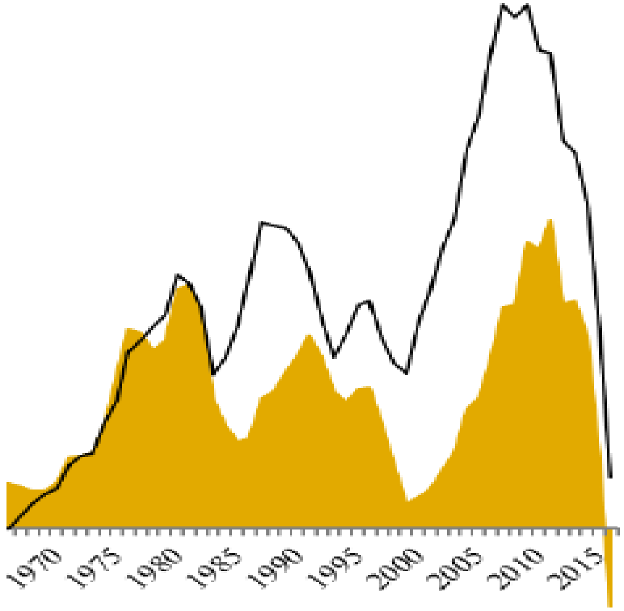
Current accounts in percent of GDP



Source: AMECO, European Commission

Worries about misidentified timing of cycles after 1990: example 1 (1990s)

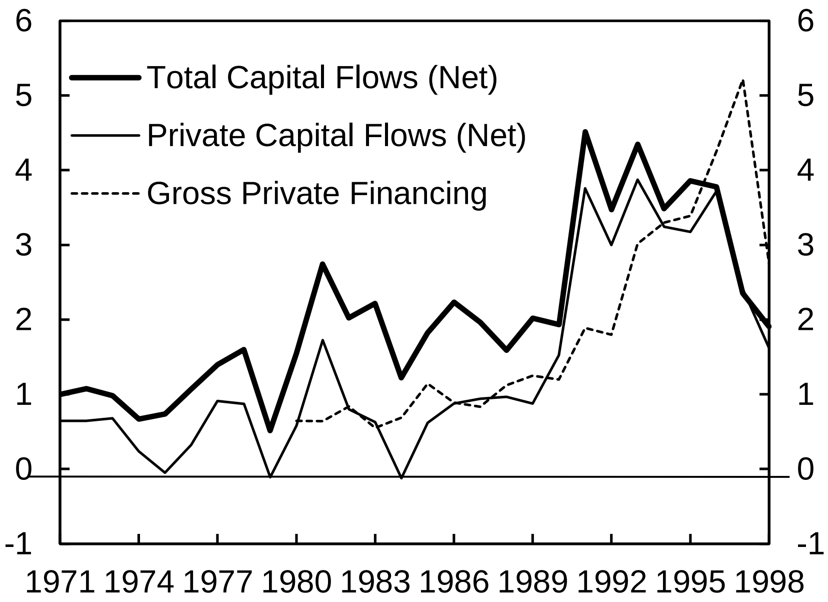
1. Net capital inflows to 60 countries, 1970-2016 (KKT 2017; % US GDP)



Post debt crisis boom starts in 1986, ENDs in 1991.

1991-1999 is a **bust** phase.

2. Capital Flows to developing countries, 1971-1998 (Mussa et al, 2000; %GDP)

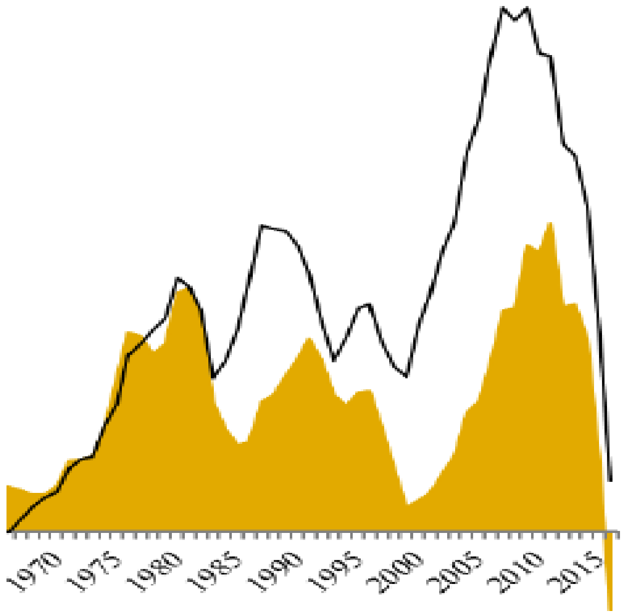


Post debt crisis boom starts in 1990, ENDs in 1997.

1991-1997 is a **boom** phase.

Worries about misidentified timing of cycles after 1990: example 2 (most recent turning point)

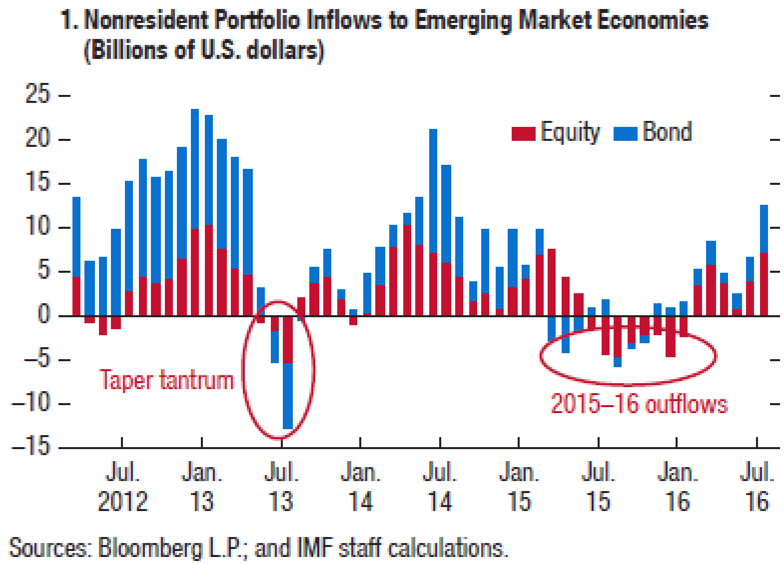
1. Net capital inflows to 60 countries, 1970-2016 (KKT 2017; % US GDP)



Latest boom ends in 2011.

2012-2013 is part of the new **bust** phase

2. Gross flows to EMEs according to GFSR, 2012-2016



Latest boom ends in 2013, or maybe 2014.

2012-2013 is still part of the **boom** phase

Takeaways

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1. Very nice paper – great new data work.
2. Largely consistent with IMF folk wisdom about causes and consequences of center-periphery boom-bust cycles
3. “Global cycle” concept may be too aggregate in recent decades. Likely conflates:
   - Boom bust cycle to emerging markets/developing countries
   - Center-periphery cycle inside Euro area
   - Swings in the US current account, fed by Europe and Asia
4. Timing of peaks and troughs likely sensitive to:
   - Gross vs. net flow data
   - Definition of “recipient country” group
5. A parting thought: to the extent that one seeks to identify a “global cycle”, maybe this should be based on the global factor in a dynamic factor model, not on the raw data.