Discussion: Capital Flows and the Real Effects of Corporate Rollover Risk

Authors: Leonardo Elias

Xiang Fang

The University of Hong Kong

August 17, 2023
EFA, Amsterdam

Causes and Consequences of Capital Flows

- Net capital flows: equal to net trade balance by BoP

Causes and Consequences of Capital Flows

- Net capital flows: equal to net trade balance by BoP
- A recent literature highlighting the importance of gross capital flows
  - Obstfeld (2012): Gross flows matter
  - Forbes and Warnock (2012): surges, stops, flight and retrenchment
  - Avdjiev, Hardy, Kalemli-Ozcan and Serven (2023): gross capital flows by banks, corporates, and sovereigns
  - Dou and Verdelhan (2016): a quantitative GE international model has a hard time matching capital flow volatility

Causes and Consequences of Capital Flows

- Net capital flows: equal to net trade balance by BoP
- A recent literature highlighting the importance of gross capital flows
  - Obstfeld (2012): Gross flows matter
  - Forbes and Warnock (2012): surges, stops, flight and retrenchment
  - Avdjiev, Hardy, Kalemli-Ozcan and Serven (2023): gross capital flows by banks, corporates, and sovereigns
  - Dou and Verdelhan (2016): a quantitative GE international model has a hard time matching capital flow volatility
- Empirically, identifying the real consequences of capital flows is hard because capital flows are endogenous
- This paper advances the literature by utilizing a plausibly exogenous variation in firms' exposure to "capital flow" sudden stop shock

Sudden Stop in Aggregate Data: Mendoza (2010)

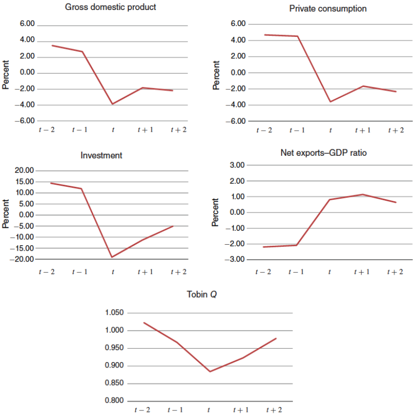

Figure 1. Macroeconomic Dynamics around Sudden Stop Events in Emerging Economies
(cross-country medians of deviations from HP trends)

- In aggregate: fundamentals drive both capital flows and real activities
- The causal effect of capital flow is hiden

This Paper: Research Design

- Utilize exogenous different cross-sectional capital flow exposure
  - Capital flow shock: episodes with large **gross debt** capital inflow drops
  - Exposure: the share of long-term debt maturing in the next year
  - A side note: no need for a "exogenous" capital flow shock
  - A cross-country panel of 39 countries (both AE and EM)
- Examine the behavior of firms with different exposures

This Paper: Main Results

- Exposed firms reduce investment more (10%) than non-exposed firms
- Persistent effect: investment, hiring and assets are lower even 3 years after the shock
- The real effect is present even when there is no significant macroeconomic contractions

Comment 1: The Use of Gross Inflows

- Why gross inflows?
  - Identify episodes of "sudden stops" not associated with net flow drop
  - The different role of foreign vs. domestic capital to firms

Comment 1: The Use of Gross Inflows

- Why gross inflows?
  - Identify episodes of "sudden stops" not associated with net flow drop
  - The different role of foreign vs. domestic capital to firms
- A more detailed comparison is helpful
  - How many episodes are "gross inflow" sudden stops only? How many are sudden stops in both gross inflow and net flow?
  - How will your result change if you focus on periods of net flow drop?

Comment 1: The Use of Gross Inflows

- Why gross inflows?
  - Identify episodes of "sudden stops" not associated with net flow drop
  - The different role of foreign vs. domestic capital to firms
- A more detailed comparison is helpful
  - How many episodes are "gross inflow" sudden stops only? How many are sudden stops in both gross inflow and net flow?
  - How will your result change if you focus on periods of net flow drop?
- The role of "retrenchment" and "flight"
  - Results similar in episodes with domestic retrenchment
  - How about flighty episodes when domestic capital flies out?

Comment 1: The Use of Gross Inflows

- Why gross inflows?
  - Identify episodes of "sudden stops" not associated with net flow drop
  - The different role of foreign vs. domestic capital to firms
- A more detailed comparison is helpful
  - How many episodes are "gross inflow" sudden stops only? How many are sudden stops in both gross inflow and net flow?
  - How will your result change if you focus on periods of net flow drop?
- The role of "retrenchment" and "flight"
  - Results similar in episodes with domestic retrenchment
  - How about flighty episodes when domestic capital flies out?
- Fundamentally, why are domestic and foreign capital different?
  - Technology? Not likely as they are portfolio flows
  - Affect expectation?

Comment 2: The Aggregate Consequences of Capital Flows

- A very interesting finding: even though there is no macro contraction (most of cases), the real effect of capital flow is similar
- How to aggregate the micro results to the macro level?
    - Is there a composition effect? Exposed firm reduce investment/hiring while non-exposed firms increase investment/hiring? Other reasons?
    - From the macro perspective, it is useful to discuss on the broad macro implications (e.g.,the distributional effect)
    - Ultimately, should policymakers care about capital flows?

Comment 3: Reversal

- The lack of reversal: investment stays low even after 3 years
- What is the possible mechanism? Can we test in the data?

Comment 3: Reversal

- The lack of reversal: investment stays low even after 3 years
- What is the possible mechanism? Can we test in the data?
  - In typical macro financial accelerator models, the persistence comes from GE (asset price, net worth), but here the evidence is at the firm-level, so GE shouldn't be first-order important
  - Size effect? If a firm is exposed and has a liquidity problem, the firm becomes smaller and thus invests less. How about using I/K instead?
  - The loss of collateral in turn affects future financing capacity?
  - ...

Minor Comments

- The comparison of sudden stop episodes with placebo years
  - Try different inflow cutoffs, quantify when inflow drops have real effect
- Are AEs and EMs different? Subsample analysis can be informative

Conclusion

- A great paper with convincing causal effects and interesting findings
- Find evidence for real effect of capital flows (**gross** debt inflows)
- Some more discussion on the nature of domestic/foreign capital helps us better understand the results
- More discussion on the macroeconomic side of capital flows
  - Do they really matter at the macro level and how?
  - Why do they persist?