Discussion of:

Early Warning for Currency Crises: What is the Role of Financial Openness?
based by Jon Frost and Ayako Saiki (DNB)

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THE PAPER

- Literature on EWS vast and diverse, but still difficult to come up with a system of indicators that would reliably predict the “next crisis”.

- Large number of variables studied for their potential to be leading indicators of crises e.g. Kaminsky et al (1998), Rose and Spiegel (2011), Frankel and Saravelos (2012).

- This paper augments a standard EWS with two financial openness variables and finds that:
  - More open economies are less likely to experience currency crises, although this may not be the case for EMEs.
  - Surges in capital flows are associated with a higher probability of c.c.
  - Out-of-sample performance is “moderate”.
Could KA openness stand for something else?
- Quality of institutions, level of development

De jure measure of KA openness may not be the most appropriate:
- Slow moving – not useful to signal accumulation of vulnerabilities
- In cross-section, comparisons may be misleading
- De facto measures, capturing the actual exposure to international capital markets, might be more useful

I like your robustness checks more than your baseline regression!

Results square with the existence of thresholds effects à la Kose et al (2011).
VARIABLE NO.2: GROSS CAPITAL FLOWS

- Unusual definition of “surges” in capital flows.

- No significant association between surges in capital flows and vulnerability to crises in EMEs.

Suggestions:

- Distinguish between inflows and outflows (i.e. “surges” and “flights”)
- Look at whether shifts in the composition of capital flows signal vulnerability to crises.
- Deal with the huge heterogeneity of data on capital flows (e.g. eliminate hubs, de-mean and standardize).
- Increase the sample of EMEs by reallocating some of the countries to this group.
OTHER COMMENTS

- I miss a better discussion of where in the literature this paper is.
  - e.g. Glick, Goi and Hutchins (2006)

- Crises often combine - twin, triple crises.
  - Babecky et al (2012) show that leading indicators of crises depend on which type of crisis sets on first.

- RE probit
  - How realistic is the assumption of lack of correlation between country effects and the independent variables?

- What happens to the growth in private credit?
SUMMARY

- Interesting paper, very relevant topic, timely contribution.

- I see a stronger case for including capital flows rather than KA openness in an EWS.

- Contribution should be better placed in the literature.

- Could go a long way with just a bit more refinement of the results already in the paper.

- Several avenues to advance on.
THANK YOU FOR YOUR ATTENTION