Portfolio Investment and U.S. Monetary Policy Announcements: an event study analysis using high frequency data from Mexico

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QUICK SUMMARY

Research question: How unexpected monetary policy announcements in U.S. (QE3 and taper tantrum 2013) affect foreign inflows of debt and equity in Mexico (Jan 2013-July 2015).

Relevance: Observed increase of gross portfolio inflows from 3% of total capital inflows before the crises to 60% after crises. What' s the problem?

QE in US: Search for yield => inflow of capital in EME (portfolio rebalancing)

Tapering => capital flow reversals: destabilizing effect on EME

Contribution: extend Park and Um 2016

- One country focus

- Novel dataset: foreign net inflows of debt and equity, daily frequency, maps BoP

- Different frequencies: daily – decrease endogeneity concerns, weekly - delayed reactions

- Additional financial variables: omitted variables

Priors about effects:

QE => positive effect on inflows

Tap => negative effect on inflows

Counterintuitive results at daily frequency while results on weekly data more in line with priors and heterogeneous impact between debt and equity flows: debt reaction stronger and delayed – domestic fundamentals are more relevant and portfolio rebalancing.

CHANNELS OF IMPACT OF U.S. UMP ON EMERGING MARKETS:

Portfolio balance channel: QE => decrease supply => decrease return => investors turn to riskier assets for higher risk-adjusted returns.

Signalling channel: commitment to keep future policy rates lower than previously expected => risk-neutral component of bond yields may decline => large interest rate differentials with respect to EMEs will be expected to persist which => triggers carry trades and capital flows into EMEs (Bauer and Rudebusch (2013)).

Liquidity channel: Large-scale of assets purchase => increased reserves of private banks => decline in the liquidity premium => enabling liquidity-constrained banks to extend credit to investors => increased overall bank lending, including cross-border lending.

KEY ASSUMPTIONS

- **Key identification assumption:**

- ❖ News about the economy on the announcement date does not affect the policy choice. Only information available the previous day is relevant.

    =>daily data (✓)

- ❖ Announcements do not affect other confounding factors that are not controlled for. However:

- ➢ Intraday noise: forex intraday trading, etc.. & one-day lag could capture other announcements/events

- ➢ Weekly data: omitted variables and simultaneity are more likely

- ➢ Cross-listed firms (US firms that are also listed in the Mexico) are also affected by US UMP directly =>Focus on Mexican assets that are purely local (municipalities bonds)?

- **Unexpected announcements:** Difficult to believe it for tapering June 2013. Narrative (a la Aizenman et al. 2014) to convince the reader or test for leads?

- **Identification of persistence of the impact:** Only one-day lag, one-week lag: are there information frictions? Why not contemporaneous (Gertler and Karadi AER 2015) or same week? Why not a distributed lag model?

HETEROGENEITY

Heterogeneous effect between equity and debt?

•Two different channels: bonds are affected by portfolio channel while equity is not (Fratzscher et al. 2013, Lim et al. 2014, Dahlhaus and Vasishtha 2014) – test?

•Size of positions and the liquidity of markets play a role (Eichengreen and Gupta, 2014).

•Different risk aversion of agents in equity and bond market

Heterogeneous effect across episodes?

•Degree of uncertainty (Dahlhaus and Vasishtha 2014) …how important is the first moment versus the second moment?

•Deviation from expectations.

ADDITIONAL COMMENTS

Why focus on aggregates? Effects on the yield curve among Mexican assets: test channels

Debt issued by Federal Gov't, public institutions, parastatal companies, deposit insurance institute, banks, corporation and all transactions in equity in Mexican stock market.

Improve identification and model specification:

- Narrative of the news - Aizenman et al. (2014): (27/11/2012 – 3/10/2013) 29 Tap and 33 QE news
- VAR with high frequency identification (Gertler and Karadi AEJ 2015)
- Gallagher AEJ 2014: event study. Learning about infrequent events (flood).

Secondary points: external validity, adjusted R2 negative, dropped/interpolated variables, discussion.

Thanks for your attention

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