EUROJÄRJESTELMÄ
EUROSYSTEMET

Comments on ”Sovereign risk and international portfolio dynamics”

Iikka Korhonen
Bank of Finland

September 2009

What the paper does?

- Looks at empirical determinants of gross capital flows, i.e. is there a difference between gross inflows by residents and foreigners
- This is important and interesting, because much of the existing literature concentrates on net capital flows, but *GIR* and *GIF* may have different determinants
- Differentiates between three classes of countries: 1) high income, 2) medium income and 3) low income
- This is important and interesting, because the determinants of gross capital flows may very well differ between them

Some comments on the possible drivers of gross capital flows

- First the authors regress gross capital flows by residents and foreigners on each other, fixed term (is there a typo in the slides, α_c?), time dummies, fixed term and country-specific trends, and then they add some control variables
- One could think that the size of the local financial sector and its integration with the rest of the world is an important driver of capital flows (see e.g. the chart on UK flows)
- Further indicators of a country's international integration, exports/GDP or something similar?

Further comments

- It could be instructive to also report regression results for the full sample, often the coefficients are similar
- Are the differences between country groups statistically different?
- If some high income countries provide financial services to the rest of the world, perhaps the negative correlation of GIF and GIR is not so surprising; the local financial invests the funds it receives
- It seems that for crisis episodes in middle and low income countries other investments (roughly the same as cross-border bank lending) are significantly linked to the crisis

Small comment on the econometrics

- Just looking at the data in different countries, isn’t it at least possible that some time series are non-stationary?
- Including time trend may alleviate the problem, but should one also test for cointegration? (At least for high income countries.)
- If there is cointegration, estimating vector error models might yield some interesting dynamics