

**What do we Learn about Contagion Channels  
From Decomposing Country Equity Portfolios?**

**Comments on Chinn and Forbes**

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## Good Stuff!

- An enormous effort in terms of both data and estimation
- Comprehensive coverage of different channels for contagion
  - Do trade (direct and indirect), bank lending and FDI simultaneously
  - Nice (for Eichengreen-Rose and Glick-Rose) that trade does well.
  - Mystery that indirect (third-country) trade does so poorly.

## Disappointments

- Basically weak empirical results on channels of transmission
  - Very unstable results
  - “Old-fashioned” channels message somewhat hard to believe for many
- Would like even more channels (market cross-holdings)
  - Severe data problems

## Concern #1: Country Factors

- How important is the omission of country factors from first-stage empirical model?
  - Critical to purge all common shocks in first stage; otherwise common shocks will look like contagion
  - Would country factors be correlated with contagion?

Open question in practice.

- Long international finance tradition implies that country factors are critical (often dominate sectoral/international factors)

Solnik (p 130): “The behavior of the domestic market is by far the most important factor affecting individual stock returns; on the average, this factor explains 42% ... world and industrial factors explain 18% and 23% ...”

- Can be remedied by shifting to firm-level data, adding country effects (Forbes, 2000)

## Concern #2: Frequency

- High frequency makes global factors (oil, gold, ...) in first stage all financial; no macroeconomic variables (inflation, output, etc.) exist at all.
  - Good for “denominator” issues, worse for numerators
  - One reason for second stage fit problems?

## Minor Issues

- Would like more controls in second stage
  - Exchange Rate Regime?
  - Other gravity-like controls
- Some over-kill with the tech, given weak results
- Slight overstatement of result, given poor fits in second stage
- There's got to be a better way to present statistical data than these tables