What do we Learn about Contagion Channels

From Decomposing Country Debt Portfolios?

Comments on Chinn and Forbes

Andrew K. Rose

UC Berkeley, NBER and CEPR

Good Stuff!

- An enormous effort in terms of both data and estimation

  o Complementary to Chinn-Forbes (2003) on Equity

- Comprehensive coverage of different channels for contagion

  o Do trade (direct and indirect), bank lending and FDI

    simultaneously

  o Nice (for Eichengreen-Rose and Glick-Rose) that trade

    does well.

  o Mystery that indirect (third-country) trade does so poorly.

Disappointments

- Basically weak empirical results on channels of transmission

    o Very unstable results

    o "Old-fashioned" channels message somewhat hard to

      believe for many

- Would like even more channels (market cross-holdings)

    o Severe data problems

Concern #1: Country Factors

- How important is the omission of country factors from first-stage empirical model?

    o May be 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% …"

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

  o This mostly an equity result; debt less certain

Concern #2: Frequency

- High frequency makes global factors (oil, gold, …) in first

  stage all financial; no macroeconomic variables (inflation,

  output, etc.) exist at all.

  o Good for "denominator" issues, worse for numerators

  o One reason for second stage fit problems?

Concern #3: Quality of Debt Prices

- Many bonds even in large markets are traded infrequently;

  illiquidity implies stale prices

  - More of an issue outside US, especially LDCs?

  - But perhaps many large movements (crises), so

    measurement error unimportant in practice.

Minor Issues

- Would like more controls in second stage

  o Exchange Rate Regime?

- Some over-kill with the tech, given weak results