

Discussion of
***“Currency-Induced External Balance Sheet
Effects at the Onset of the COVID-19 Crisis”***
By Hale and Juvenal

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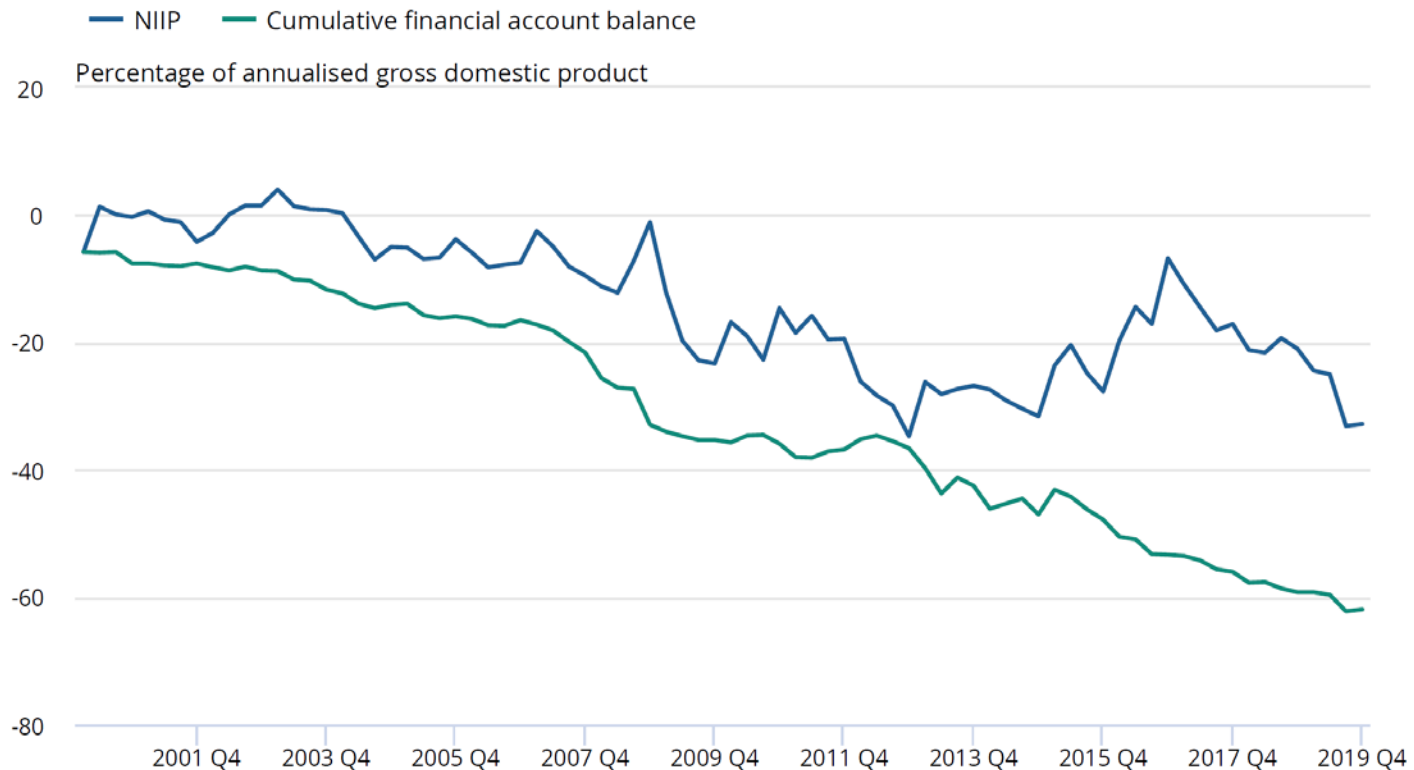
Comments

1. Big Picture
2. Easy Suggestions
3. Harder Suggestions
4. Important Questions Raised



This Matters!

Example: Changes in UK NIIP Valuation



Source: Office for National Statistics - Understanding the UK's net international investment position



Example: Simple Decomposition

$$\Delta NIIP_{i,t} = TB_{i,t} + INVINC_{i,t} + \Delta VAL_{i,t} + E_{i,t}$$

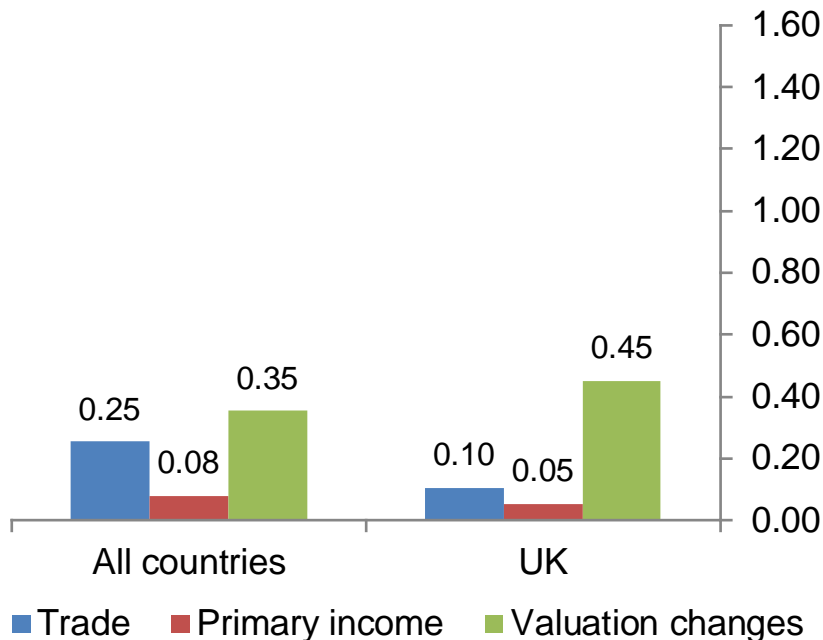
- $NIIP$ = net international investment position
- TB = trade balance
- $INVINC$ = net international investment income
- ΔVAL = valuation adjustments on international portfolio
- E = everything else (other income, other adjustments to the NIIP)
- For country i at time t



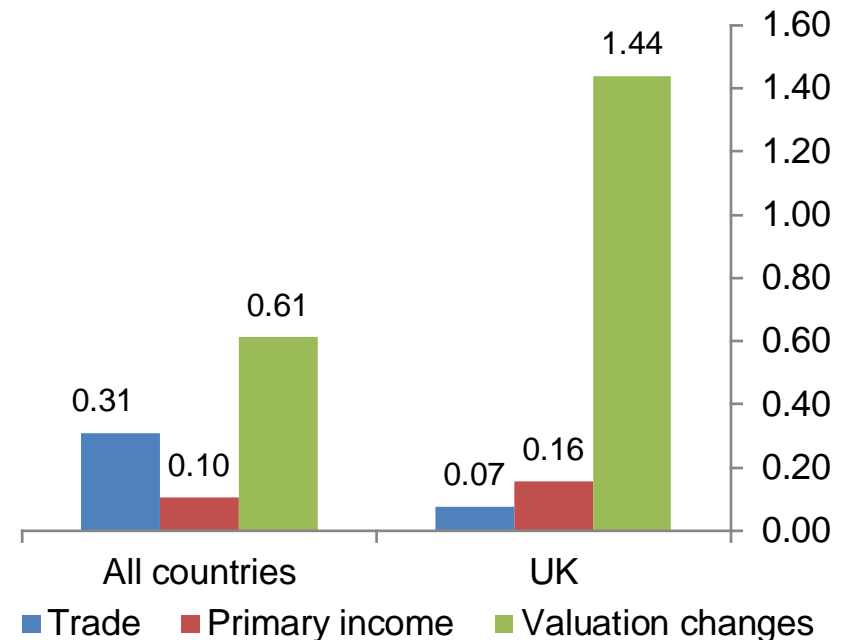
Growing Importance over Time

Ratios of the variances in trade, primary income and valuation changes to the overall NIIP variance

(a) 1980 - 2014



(b) 2004 - 2014



Easy Suggestions

1. Build on existing work/frameworks

- Lane & Milesi-Ferretti (2007), Lane & Shambaugh (2010), Benetrix et al. (2015)
- Gourinchas & Rey (2007), **Gourinchas Rey & Truempter (2012)**
- Forbes, Hjortsoe & Nenova (2017)

2. Rethink estimates in last section

- **Banks tend to hedge currency risk**

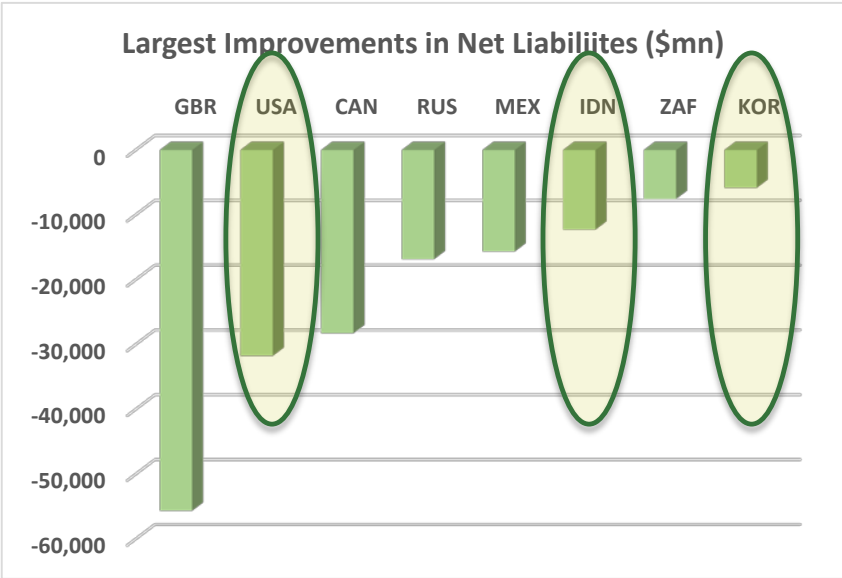
3. Importance for individual countries?

- Need to adjust scale relative to GDP

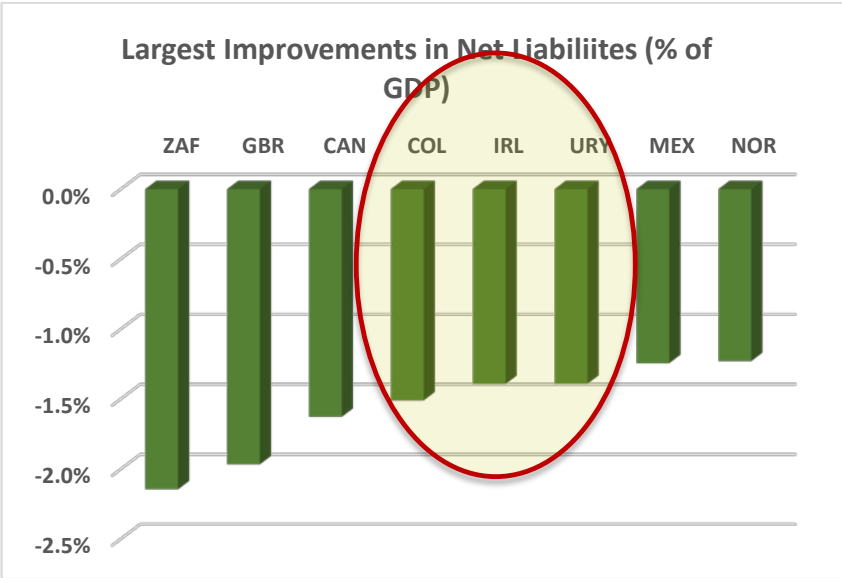


Rescale by GDP

Rankings in Hale/Juvenal

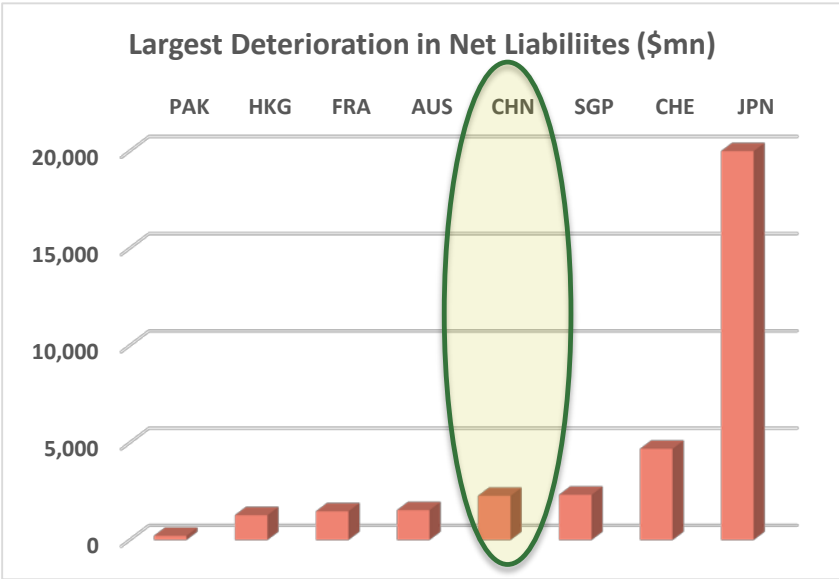


Ranked by % of GDP

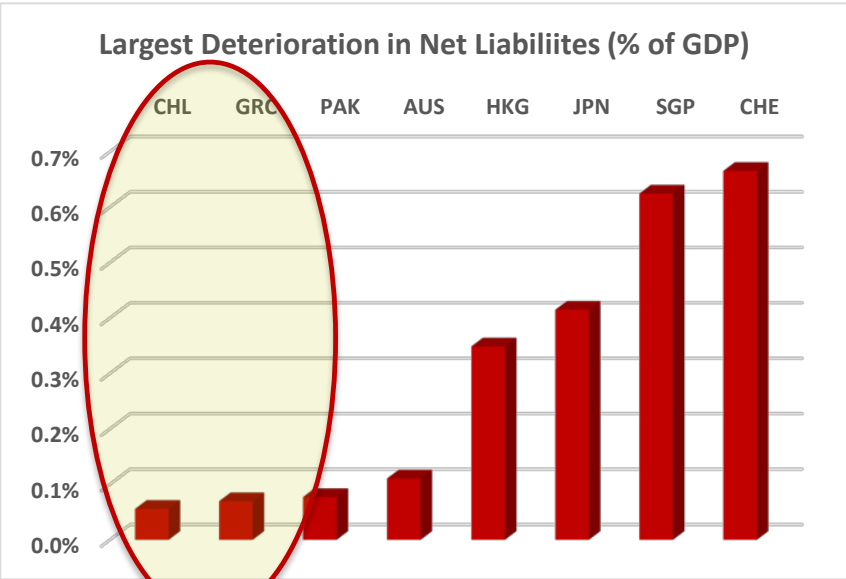


Rescale by GDP

Rankings in Hale/Juvenal



Ranked by % of GDP



Harder Suggestions

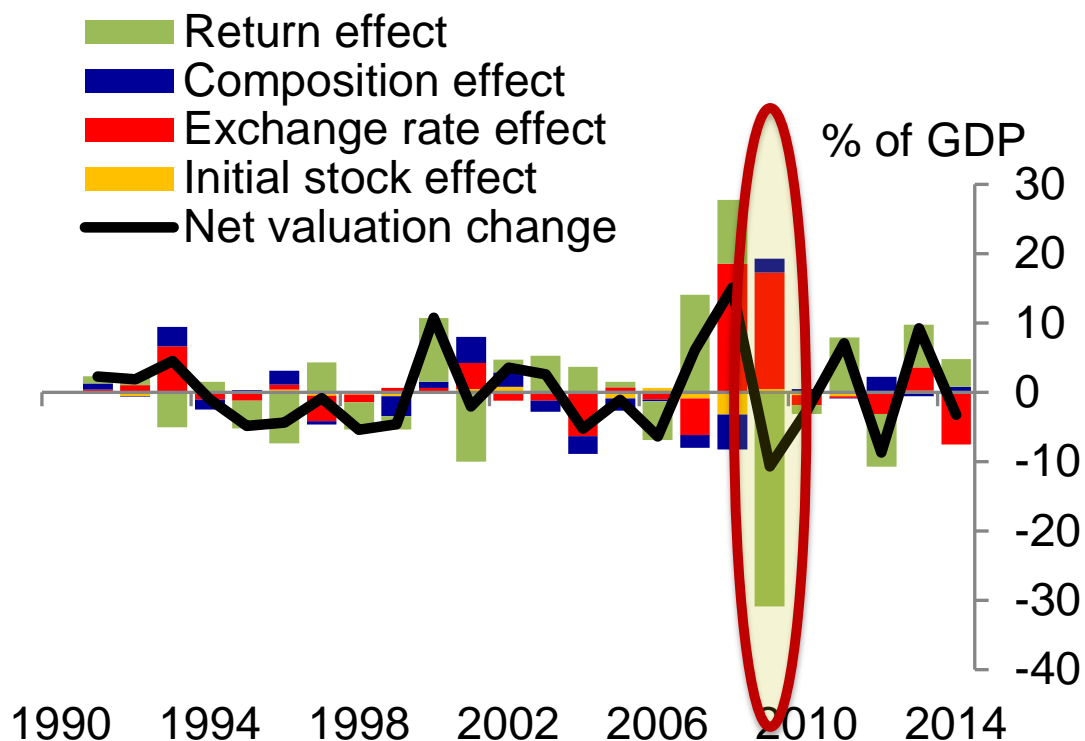
1. *Hardest: Add exposure by sector*
2. **Easier (but some work):**
 1. Add equities (and other asset classes)
 2. **Add returns/valuation changes**

$$\Delta VAL_{i,t} = \sum_c \left[\frac{A_{i,t-1}^c}{\Delta ER_{i,t}^{A,c}} \left(kg_{i,t}^{A,c} - (\Delta ER_{i,t}^{A,c} - 1) \right) \right] - \sum_c \left[\frac{L_{i,t-1}^c}{\Delta ER_{i,t}^{L,c}} \left(kg_{i,t}^{L,c} - (\Delta ER_{i,t}^{L,c} - 1) \right) \right]$$



Can Change the Key Results.....

UK: Changes in NIIP Valuation



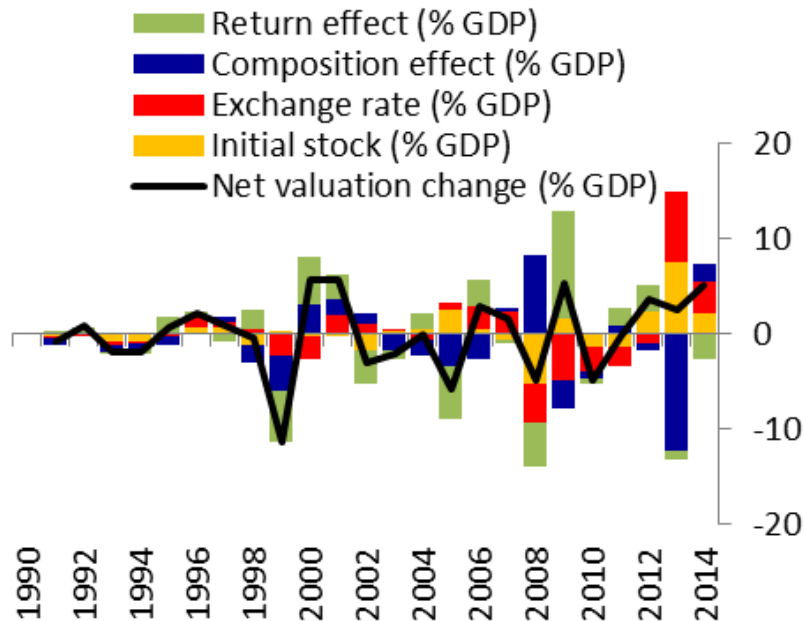
Source: *Forbes*, Hjortsoe and Nenova (2017), "Current Account Deficits During Heightened Risk: Menacing or Mitigating," *Economic Journal*



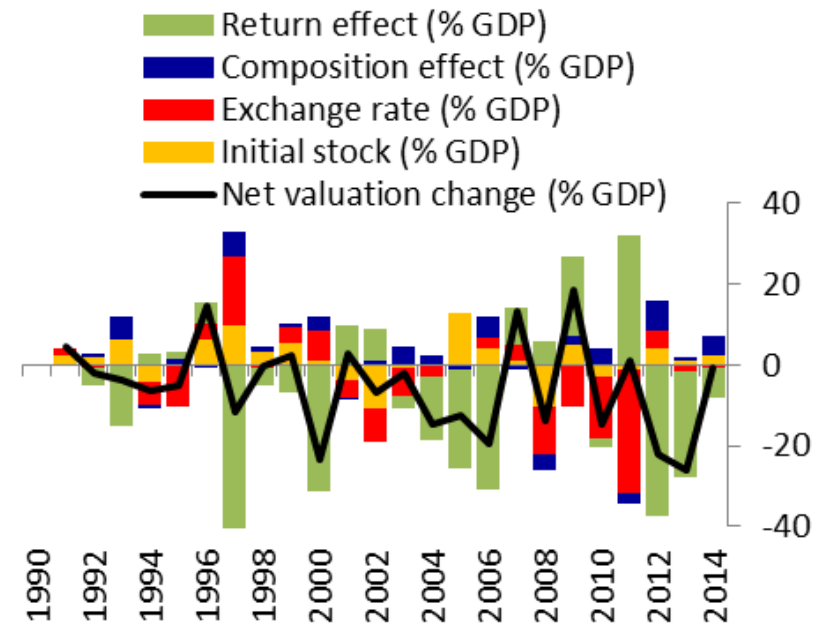
Other Examples

Changes in NIIP Valuation

Japan



Switzerland



Source: *Forbes, Hjortsoe and Nenova (2017), "Current Account Deficits During Heightened Risk: Menacing or Mitigating," Economic Journal*



Return Effects Particularly Important and Correlations with ER Effects

	Correlations of Valuation changes with:			
	Initial stock effect	ER effect	Composition effect	Return effect
UK	-0.50	0.25	-0.33	0.72
US	-0.60	-0.04	0.31	0.89
Australia	-0.07	-0.12	0.32	0.54
Canada	-0.12	0.25	0.28	0.71
Japan	0.34	0.30	0.03	0.70
Korea	0.54	0.25	0.50	0.45
New Zealand	0.25	0.51	0.47	0.57
Norway	0.76	0.64	0.34	0.69
Sweden	0.28	0.46	-0.01	0.41
Switzerland	0.10	-0.13	-0.33	0.72
AVERAGE	0.10	0.24	0.16	0.64
MEDIAN	0.17	0.25	0.30	0.70
AVERAGE of absolute correlations	0.36	0.29	0.29	0.64

Key:
Correlations
between
effects with
risk shocks

Source: *Forbes, Hjortsoe and Nenova (2017), "Current Account Deficits During Heightened Risk: Menacing or Mitigating," Economic Journal*



Important: What Explains This?

Why are effects (from ER movements) modest?

- Reduction in global bank flows?
- Tighter macroprudential regulations?
- More flexible ERs (stimulated more hedging)?
- Shift to equities/other types of capital flows?



Final Thought

- **Timely analysis of important issue during current crisis, applying new dataset to long-standing concerns**
- **Look forward to future version that brings in additional (important) layers**

