BROOKINGS

Discussion of Cedric Tille and Giovanni Donato,

“International investment income: patterns, drivers, and heterogeneous sensitivities”

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What the paper is about

Main question:

- What factors drive investment income flows?

Approach:

- *Accounting framework linking income and yields on external portfolio to exchange rates, portfolio composition etc*.
- *Broad set of regressions relating yields on external assets and liabilities to many potential drivers:*
    - *Exchange rates*
    - *Interest rates*
    - *Global and domestic macro and financial conditions*
- *Simulations of impact of higher global interest rates and other shocks on trade and income flows*

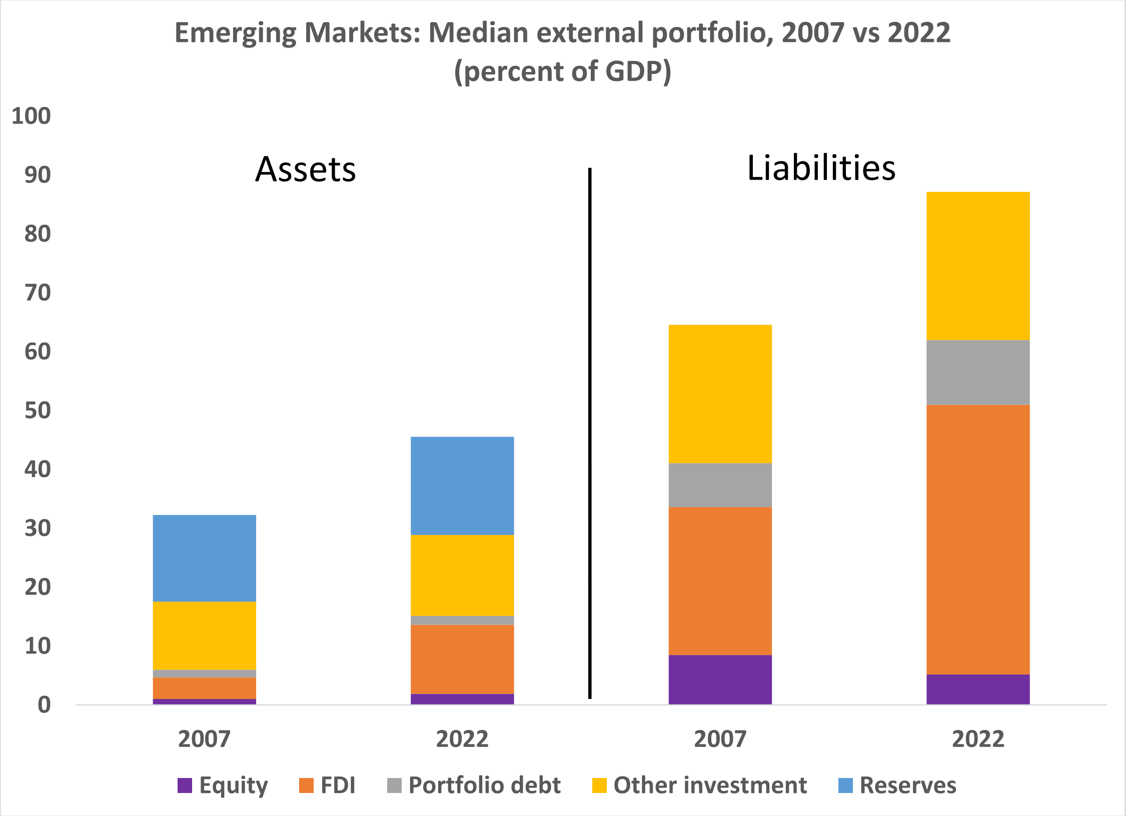
General comments

- Important question (including understanding potential impact of higher global interest rates)
- Interesting stylized facts
- Rich set of empirical results….
- …but a lot of them!! Difficult to pick what to discuss

- Discussion focuses on countries in regression sample:
  1. *Characterization of external portfolios*
  2. *Role of valuation effects*
  3. *Assessing the impact of higher interest rates*
  4. *Data issues (stylized facts, evidence)*

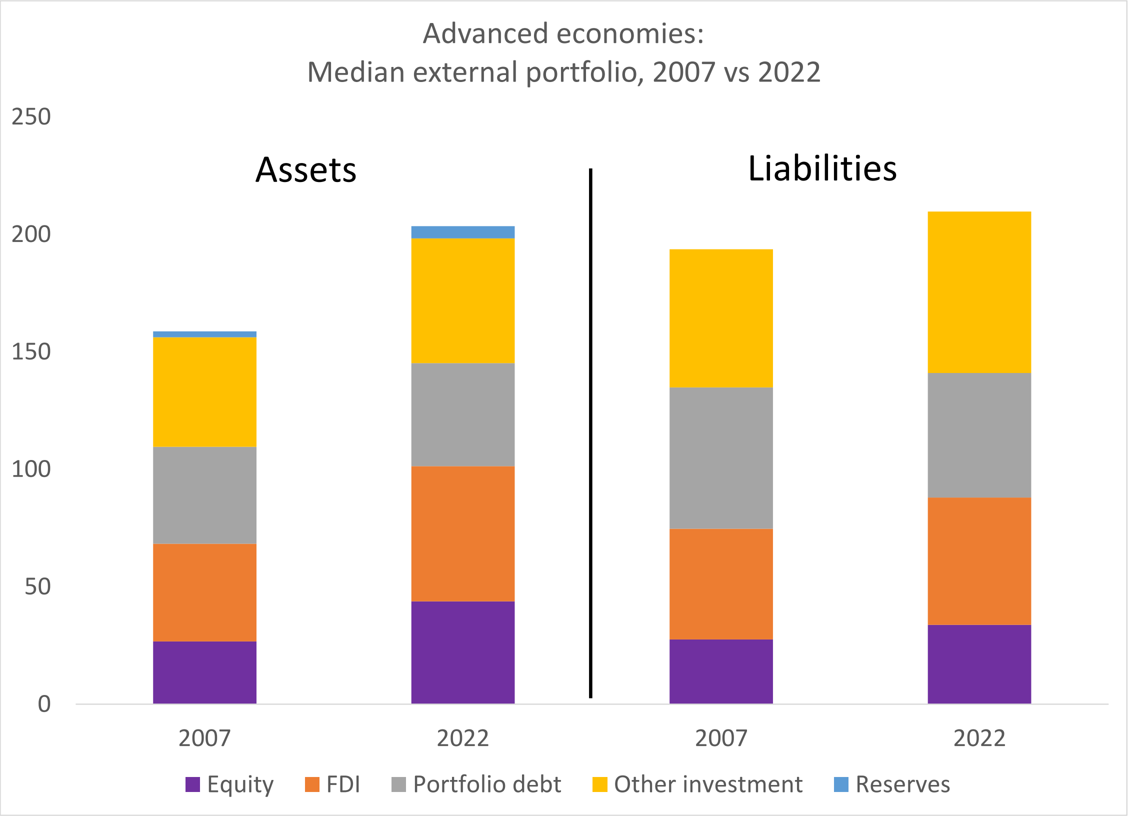
(i) External portfolios (emerging economies)

- A country's portfolio structure is key to thinking about its income flows. For EMs in the sample, shift towards FDI. Note also that the sample excludes China and includes a few countries facing a sharp deterioration in their net external position and external difficulties (Sri Lanka, Tunisia, Egypt, Pakistan…)



(i) External portfolios (advanced economies)

- A country's portfolio structure is key to thinking about its income flows. Advanced economies tend to be long equity instruments, short debt



Valuation effects

- The paper focuses on the impact of a wide menu of variables on income flows.
- But valuation effects are also very important in driving IIP dynamics (eg ARC paper from last year) and in determining rates of return on assets and liabilities (especially for equity)
- Some of these effects are "systematic". Think of local currency borrowing by EMs, that have on average higher inflation than AEs but some currency depreciation. Higher investment income payments, but reduced value of principal at maturity (capital gains)
- The shocks considered in the empirical analysis can have sizable valuation implications that ought to be considered

Projections

- Are fitted values from panel analysis the most effective way to project income flows?

- There are likely sizable differences across countries in responses of yields to shocks
  - Impact of VIX shocks on high vs low beta countries
  - Impact of US interest rates on spreads

- It would seem more natural to look at country-specific data to establish sensitivity to shocks

Data suggestions and caveats

1. Presentation of stylized facts
    - Choose focus. Suggest using larger economies (as in regression sample). Median EM in broad sample is smaller than Guatemala. If sample is broad, include other BOP income sources (eg remittances), not just trade flows.
        - How do things look for the main creditors and debtors in the world economy?
        - The US has a positive income balance despite a net IIP which is very negative. What is happening elsewhere and why?
2. Currency composition of “equity” assets and liabilities
    - In principle a geographical breakdown is available (CPIS, CDIS)
    - In practice not very helpful for countries that invest through investment funds, and for FDI where there is a long chain of entities before the final destination of investment is reached
3. Valuation issues: i) portfolio investment
    - Many countries report portfolio debt in the IIP at market value (eg Argentina) which imply inflated estimates of yields during periods of turmoil
4. Valuation issues: ii) FDI
    - Methods differ across countries (book value, historical cost, market value) and this can mean sharp differences in yields

The US investment income balance