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
  - Complementary to Chinn-Forbes (2003) on Equity
• 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?
  
  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% …”

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

  ○ 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