

Comments on “The Global Credit Cycle”

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**Ninth ECB Annual Research Conference 2024
19 and 20 September 2024
European Central Bank, Frankfurt am Main**

Questions, Approach, Answers of Paper

- ▶ Q. Do global credit conditions affect local credit and business cycles?
- ▶ Approach: use formal asset pricing applied to a large cross-section of international equity and bond returns, and then use derived factors to study financial and real outcomes
- ▶ A1: Yes, through a Global Credit Factor and Global Risk Factor
 - ▶ Which are two distinct factors in pricing equity and bond returns
- ▶ A2: Global credit cycle translates into financial and real effects
 - ▶ A tightening predicts extreme capital flows and less private local credit
 - ▶ And leads to extreme, left tail GDP outcomes

1. Relevance of and praise for paper

- ▶ Important to know how global financial conditions affect real variables
- ▶ Goes beyond other work as it:
 - Employs rigorous asset price modelling
 - Separates credit from risks factors
 - Explicitly allows for non-linearities
 - Takes a predictive approach
- ▶ Thus, adds value in theory and practice
 - ▶ Many papers document a common component (Global Financial Cycle, GFCy) in asset prices, capital flows, credit, real outcomes but without modelling
 - ▶ Empirically shows newly developed risks factors add to other GFCIs



2. Main comment: many moving mechanisms!

1. International equity and bond excess returns pricing
 - Assumed to be based off VIX and Duration Match Spread (DMS)
 2. Characteristics of the Global Credit and Global Risk Factors
 - Non-linearities. Exposures across country and assets classes as expected. Two separate (but no rotation nor scale)
 - But also lining up with other FCIs, MAR, etc. And betas are like CAPM
 - Key value added is the predictability (?)
 3. Financial and real activity (switches in approach and data)
 - Capital flows (episodes). 2. GDP and credit (GVAR+LP). 3. Recessions (0,1)
- Lay out theory, channels and steps more explicitly to show the value added over “traditional” GFCy approaches!

3a. Methodology and Data

- ▶ Have (implicit) US as the core country
 - All rate of returns excess to US 3-month Treasury
 - Assumes/builds in that US factors drive global rates of return
- ▶ Uses the general equity index but individual bond prices
 - You say you control for firm 'fundamentals' in bonds, but how?
 - And why not in equity too? Or price equity and bond jointly?
- ▶ Number of observations varies greatly
 - From more than 300K for US to a few 100s for asset classes EMEs/ASOEs (could do some more robustness tests)
 - Liquidity must be issue for some bonds (and equities)



3b. Methodology and Data

- ▶ What is the prior in predicting? Can one do better w/ a simple EWE?
 - In the paper, horizon for predicting is the start.. Too late for policy
- ▶ Averaging of RHS and financial and real outcomes become coarse
 - Understand need to average, but large loss of information
 - Capital flows episodes are 1,0, where only sudden stops work (not surges)
 - Similar on the real side credit and “recessions”
 - Why not the full spectrum of outcomes, fits non-linearity approach
- ▶ Useful to break capital flows down by type? (portfolio flows most)
 - Total capital flows will drive real effects? So, what do we learn?
- ▶ Data stops in December 2022: effect of interest rate rise?
 - Explore more why this global shock was relatively benign

4. Presentation

- ▶ Do a flow of reasoning chart (for the non-asset pricing reader)
- ▶ Show explicit Global Credit Factor varies from Global Risk Factor
- ▶ Relate extremes more to events, in text and charts
 - e.g., Fig 8 patterns: are extremes global financial crises, Covid, or US
 - Text says: “[some] results seems to be driven by crisis episodes”
- ▶ Do more X vs Y, e.g., Figure 5 to show (lack of) mapping
- ▶ Text, tables and charts not always line up
 - e.g., Fig 7b does not show much of patterns ($R^2 = 0?$)
- ▶ 5 \neq Real activity (covers capital flows, credit and GDP)
- ▶ Provide quantitative importance (see next)

Comparison: much more commonality in asset prices than in credit and capital flows

Commonality in:

- > interest rates 75%
- > house prices 60%
- > equity prices 40%
- > credit 30%
- > capital flows 25%

