Discussion of "How do FMOC Actions and the US Macroeconomic Data Announcements Move Brazilian Sovereign Yields and Stock Prices" by Patrice Robitaille and Jennifer Roush

Francesco Zanetti
CCBS, Bank of England

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Summary: Three questions & one conclusion

1. Effect of an increase in US rates on the Brazilian C-Bond spread

   Finding 1: positive

2. Effect of an increase in US rates on the Brazilian stock prices

   Finding 2: negative

3. Effect of US macrodata announcements on Brazilian spread and stock prices

   Finding 3: positive

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- Conclusion:

P. 5: “higher expected US interest rates…impose greater financial risks to Brazil from higher borrowing costs than it implies economic benefits through trade channels”

P. 29:“financial linkages played a greater role than real economic linkages in determining the response of Brazil asset values to US news”

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A very interesting paper

- The authors tackle three important questions, they use a daily data set, and their approach does not need restrictive identifying assumptions as the VAR
- Not many studies have attempted to investigate the effect of US monetary policy on EME stock prices

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Finding 1

- $\uparrow R^{US}$ $\uparrow$C-Bond spread

Let's look into the box:

C-bond spread = C-bond yield – US yield

If $\uparrow R^{US}$ then $\uparrow$US yield, but what about C-bond yield?

If $\uparrow$default then $\uparrow$C-bond yield

This supports finding 1

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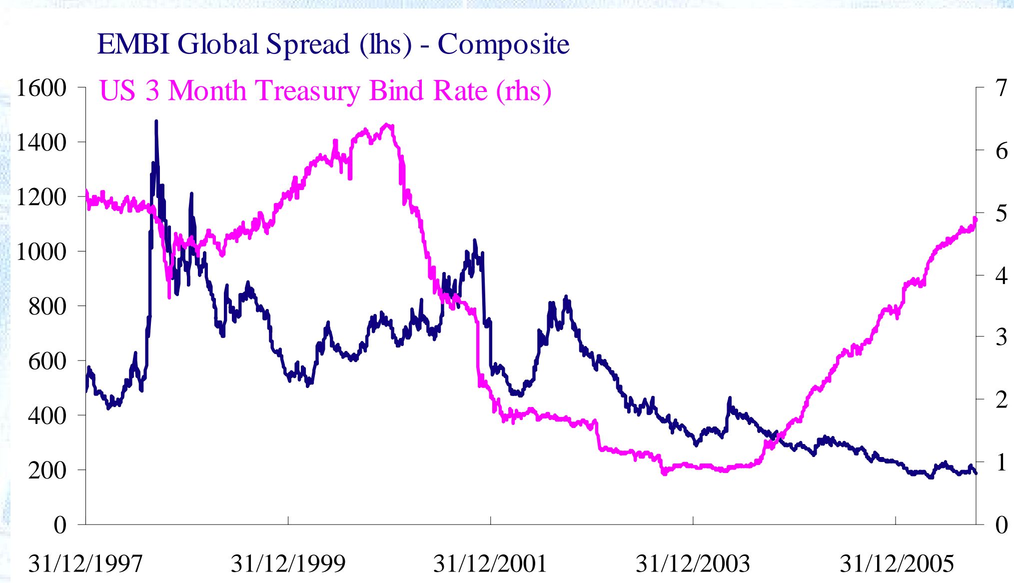
- In the past two years US monetary policy was tight, but the spread pretty much stable…



…maybe the relationship is weakening…

…extending the series beyond 2005 may be quantitatively important

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Finding 2

- ↑R^{US} ↓Brazilian stock prices

Again, let's look into the box:

Theory suggest that if ↑R^{US}, US stock prices should decrease:

$$S_t = \frac{\sum_{t=0}^{\infty} D_t}{(1 + R_t)^t}$$

Then US investors may search for profits elsewhere so to ↑Brazilian stock prices…moreover, higher default risk may ↑Brazilain stock prices

Finding 2 is not totally backed up by theory

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- To what extent are country fundamentals important compared to default risk? From Felices and Yang (2006)

Table 1
Estimated Model Coefficients

Dependant Variable:LSP
Estimation Period

	(1) Jan. 1998- Feb. 2003	(2) Jan. 1998- Feb. 2004	(3) Jan. 1998- Sep. 2006
RAT	-0.11	-0.12	-0.48
	(-3.44)	(-3.80)	(-16.79)
TBY	1.68	2	-0.889
	(3.30)	(4.25)	(-2.26)
VIX	0.01	0.02	0.127
	(12.80)	(15.06)	(14.59)
α	3.48	3.54	3.735
	(10.46)	(10.69)	(38.42)
R^2	0.60	0.74	0.84

LSP: Log spreads

RAT: (Country-weighted) sovereign credit ratings

TBY: Short-term US dollar nominal interest rates

VIX: A forward-looking measure of equity price volatility

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- Needs for theory
- Would be valuable to specify the microfoundations of country-spread behaviour
- Nothing is said to what extent the country stock prices depend on default risk or trade volumes
- A simple theoretical model may provide some supportive argument for this ambiguous finding

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- Conclusion may be too premature…

…the exercise here is carried out over a short period of time over FOMC announcements…

…but trade needs some time to show its benefit.

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Conclusion

- This paper represents a very nice start to what will be an extensive and productive line of research

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