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Is Trouble Brewing for Emerging Market Economies? An Empirical Analysis of Emerging Market Economies' Bond Flows^{1,2}

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Abstract

This paper explores the bond flows dynamics for a set of Emerging Market Economies. It documents that these flows have, in general, positive co-movements, and exhibit risk-reversals, and negative feedback with their associated risk premiums. A number of mechanisms could explain these features. However, we find evidence that lends support to the presence of the risk-taking channel. In particular, we find indications that unexpected changes in US monetary policy affect such dynamics, and that their effects seem to have grown with the size of the international investors' position in Emerging Market Economies' bonds. The main results are robust to different measures of the US monetary policy stance, and to the use of macroeconomic and financial variables as controls. Our broader interest is the potential financial stability risks building up, which could materialize as US monetary policy normalizes.

Key Words: Bond flows, emerging market economies, US monetary policy, risk-taking channel, financial stability.

JEL Codes: F3, F4, G1, E5, and C7.

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