Discussion of ‘Identifying the early warnings of currency crises in India’ by Balaga and Padhi

Ajay Shah
http://www.mayin.org/ajayshah

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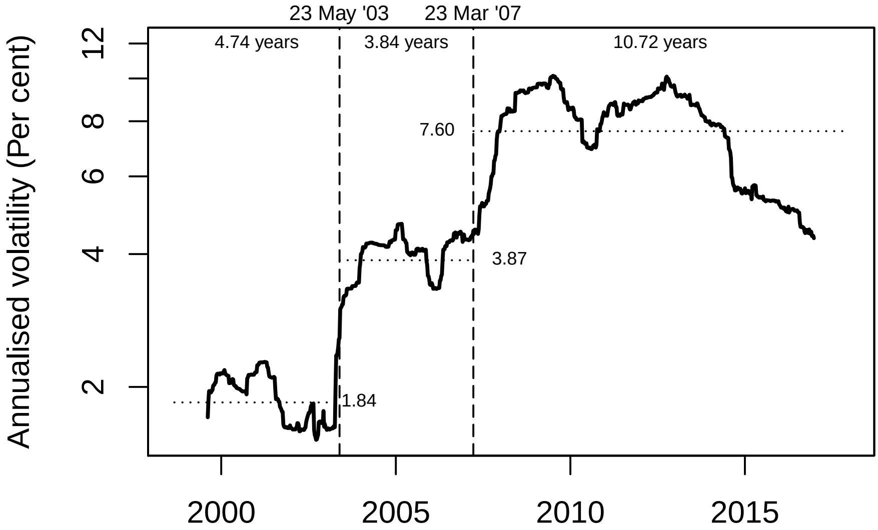
1. What is a crisis?

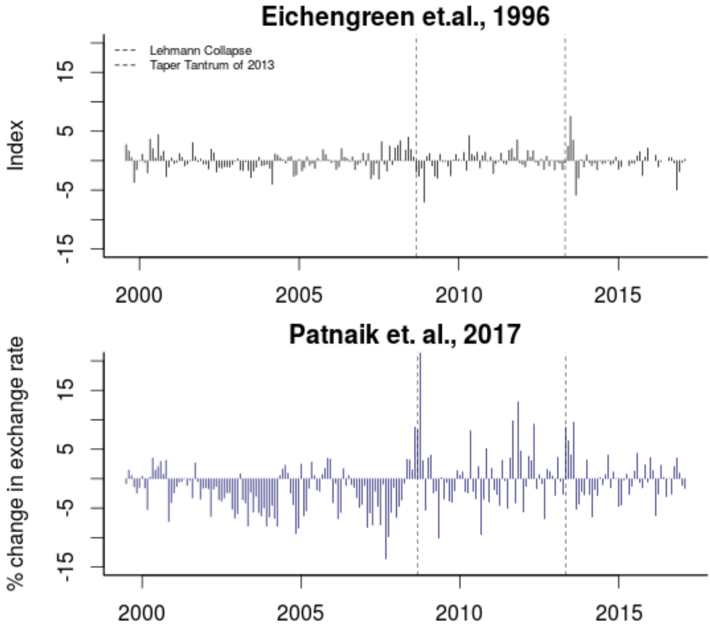
- A crisis within the regime vs. a breakdown of the regime.
- E.g. if there is a large movement in the exchange rate, in a floating exchange rate, that's not a crisis.
- India has been through major changes in the exchange rate regime.
- Zeileis, Shah, Patnaik, CSDA, 2010.
- We should ask:
  1. Why did the exchange rate regime change?
  2. Within a given exchange rate regime, what explains the outlier months?

The Indian saga of the exchange rate regime



2. Exchange market pressure

- There are problems with measurement of traditional EMP methods
- E.g. in your version, ΔR is in the denominator, so in the floating period, you will get very large EMP values.
- Methodological progress: Felman, Patnaik, Shah, JIMF, 2017.


Eichengreen et.al., 1996
Lehmann Collapse
Taper Tantrum of 2013
Index
15
5
-5
-15
2000
2005
2010
2015
Patnaik et. al., 2017
% change in exchange rate
15
5
-5
-15
2000
2005
2010
2015

Understanding currency crises

- There is an $I - S$, which is being financed by foreign capital inflow.
- The risk perception changes. The foreign capital chokes.
- In the short term, the exchange rate adjusts.
- By how much? By enough to excite short term debt flows.
- In the short run, the only thing that stabilises a free falling currency is short term debt.

So what factors might matter?

Sudden changes in risk perception

1. Asymmetric information : Gaps between perception and reality.
2. Trust in local institutions, predictability.
3. Jittery government responses.
4. Exchange rate management that gives currency mismatch (either corporate or government).

Responding to a situation

1. Openness to short term debt
2. Deep and liquid currency spot and derivatives market
3. Maturity of government response : sound fiscal, financial and monetary institutions.

Numerous articles on the 2013 crisis on my blog.

Thank you.
http://ajayshahblog.blogspot.com