

Workshop on Sovereign Investment Funds and Macroeconomic Policies



To Control or Not Control Some Insights Into Domestic and Foreign Investments of Sovereign Wealth Funds

Jean-Yves Gnabo (CeReFIM, University of Namur),
Malik Kerkour (Universities of Namur and Maastricht),
Christelle Lecourt (CeReFIM, University of Namur)
Hélène Raymond (EconomiX, University of Paris Ouest, Nanterre)

Workshop on Sovereign Investment Funds and Macroeconomic Policies

To Control or Not Control: Some Insights Into Domestic and Foreign Investments of Sovereign Wealth Funds

- A research project in progress, following up two previous papers:
 - **Are Sovereign Wealth Funds' Investments Determined by Macroeconomic Factors?** Bertrand Candelon, Malik Kerkour and Christelle Lecourt.
 - **Sovereign Wealth Funds as domestic investors of last resort during crises**, International Economics (2010), H el ene Raymond.
- Involving a small working group in international finance (Namur – Nanterre):
 - Members: Malik Kerkour (working on a PhD Thesis on SWF), Jean-Yves Gnabo, Christelle Lecourt, H el ene Raymond.
 - Some work done to gather data on SWFs investments and strategies.

Outline of the presentation

- As the first paper has just been presented by Malik Kerkour, this presentation will be brief and will focus on:
 - The second paper on SWFs as domestic investors of last resort during crises.
 - Some issues that we have to tackle to achieve our new research project *To Control or Not Control: Some Insights Into Domestic and Foreign Investments of Sovereign Wealth Funds* ... and on which we would be very thankful for your insights and for your help.

Workshop on Sovereign Investment Funds and Macroeconomic Policies

SWFs as domestic investors of last resort during crises (1/5)

- Domestic investments of SWFs were first considered as marginal \Rightarrow they could be disregarded \Rightarrow the literature on SWFs focussed mainly on their foreign investments.
- Indeed, one of the main criteria that differentiates SWFs from other sovereign investment vehicles is that they should at least be partly invested abroad ... which is consistent with the fact that the most prominent SWFs were founded to invest external surpluses.
- Therefore some papers such as Aizenman and Glick (2008) first modeled SWFs by opposition with FX Reserves funds. FX Reserves are invested in short term liquid foreign assets and designed to provide emergency liquidity during “sudden stops” of foreign capital inflows, whereas SWFs are supposed to invest in illiquid risky foreign assets with a long run horizon.

Workshop on Sovereign Investment Funds and Macroeconomic Policies

SWFs as domestic investors of last resort during crises (2/5)

- But the global crisis revealed that SWFs tend to act as investors of last resort when their home economy is struck by a crisis.
- As Bodie and Brière (2011) state: “When a government is short of liquidity to meet its debt payments, the SWF’s assets are automatically available to substitute for the funds initially earmarked for this purpose.”
- However, the action of SWFs as investors of last resort in their home countries during crises is a clear departure from their long run objective of saving (though not necessarily of stabilization), which it may jeopardize.

Workshop on Sovereign Investment Funds and Macroeconomic Policies

SWFs as domestic investors of last resort during crises (3/5)

- Therefore it is not so clear that all the funds managed by SWFs may become available in all cases for home rescue operations.
- Some strict rules may prevent it (Norway).
- If SWFs are invested in illiquid assets (as long run saving funds), then it might be unfeasible (or undesirable) to proceed to fire-sales of their assets (entailing heavy losses) during financial crises to provide liquidity to the government.
- Besides the reaction of financial markets to these interventions may be negative (a signal that the crisis is worsening and that the government is panicking).

Workshop on Sovereign Investment Funds and Macroeconomic Policies

SWFs as domestic investors of last resort during crises (4/5)

- In our paper on *SWFs as domestic investors of last resort* we find that even if it is not quite systematic, a large number of the Governments owning SWFs have used them to support their economies during the last global crisis. Bodie and Brière mention Russia, Ireland, Kazakhsan and Qatar. Kuwait, Saudi Arabia, China, Singapore, Russia, Australia and France have also intervened through Sovereign Funds to support their domestic economies.
- These domestic interventions of SWFs during crises are far from marginal: over 40% of the deals by SWFs were targeted towards their domestic markets in Q4 2008.
- Finally the interventions of SWFs to support their home economies cannot be interpreted as just a passing innovation of the last global crisis. There have been similar interventions during the Asian crisis of 1997-1998 and during the Gulf Stock market crash of 2006.

Workshop on Sovereign Investment Funds and Macroeconomic Policies

SWFs as domestic investors of last resort during crises (5/5)

- In some cases (France, Saudi Arabia) the interventions were targeted on non financial firms, to make up for the reluctance of banks to lend during the crisis (in this case domestic investments of SWFs appear as a byproduct of the dysfunction of the banking system ?!).
- Contrary to FX Reserve Funds, SWFs can hold a large portion of illiquid assets and thereby may provide long run financing during crisis. They may be easily used to manage the government stakes in domestic firms, as well as in foreign firms.
- During the year 2008, many SWFs refrained from risky investments and hoarded cash. Therefore they had large amounts of liquidity at hand, when they were asked to invest at home by their governments. But had it not be the case, it would have been difficult for these SWFs to sell their assets during the crisis to provide an emergency funding to their home economies.

Workshop on Sovereign Investment Funds and Macroeconomic Policies

An empirical case study of the short term efficiency of Gulf SWFs' interventions as shareholders of last resort (1/2)

- Objective = assess the impact of some Gulf SWFs investments in 2006 and 2008 on their domestic Stock market prices and volatility by means of an augmented Market Model - EGARCH-X model.
- Our focus on some interventions by the Qatari and the Kuwaiti SWFs has 3 motivations:
 - 1) The stated objective of these investments was to support the local stock market, which was plummeting because of a crisis: it is therefore legitimate to assess their success by quantifying their impact on the home stock market.
 - 2) These interventions can be precisely dated as they were immediately reported by press agencies and acknowledged by Government officials.
 - 3) Gulf countries have been amongst the first to set up SWFs and account for about 40% of the total assets under SWFs' management; accordingly they have also been amongst the first to use their SWFs as rescue funds during crises.

Workshop on Sovereign Investment Funds and Macroeconomic Policies

An assessment of the short term efficiency of Gulf SWFs' interventions as shareholders of last resort (2/2)

- We find that the Qatari and Kuwaiti SWFs both succeeded in boosting up their home stock markets, although the interventions of the Kuwaiti SWF had a more limited positive impact.
- We explain this difference by the fact that the Qatari intervention (to buy stocks of local banks) in October 2008 was closely coordinated with policy moves of neighboring countries (UAE and Saudi Arabia) and involved a long term commitment to recapitalize local banks.

Workshop on Sovereign Investment Funds and Macroeconomic Policies

QIA's intervention in October 2008 (1/2)

- QIA was one of the SWFs which played white knights to distressed Western banks during the Subprime crisis, between July 2007 and July 2008. It contributed to the recapitalization of Credit Suisse in February 2008 and of Barclays in June 2008 (for, respectively, US\$ 600 million and US\$ 2800 million) at a time when Gulf countries seemed well preserved from the crisis and the Qatari stock market still boomed.
- But after the failure of Lehman Brothers in September 2008 the Gulf Stock markets plummeted. The Qatari Stock market price index had begun to recede since June 2008, with the drop in energy prices and the growing expectations of a world recession, but the turmoil set off by the news of Lehman Brothers' failure on September 15th accelerated its descent.
- The Qatari DSM Stock price index lost 25% over the short period 11/09/2008-12/10/2008 (just before QIA's intervention) and it became quite apparent that Qatar, as well as the other Gulf countries, would not be spared by the crisis.

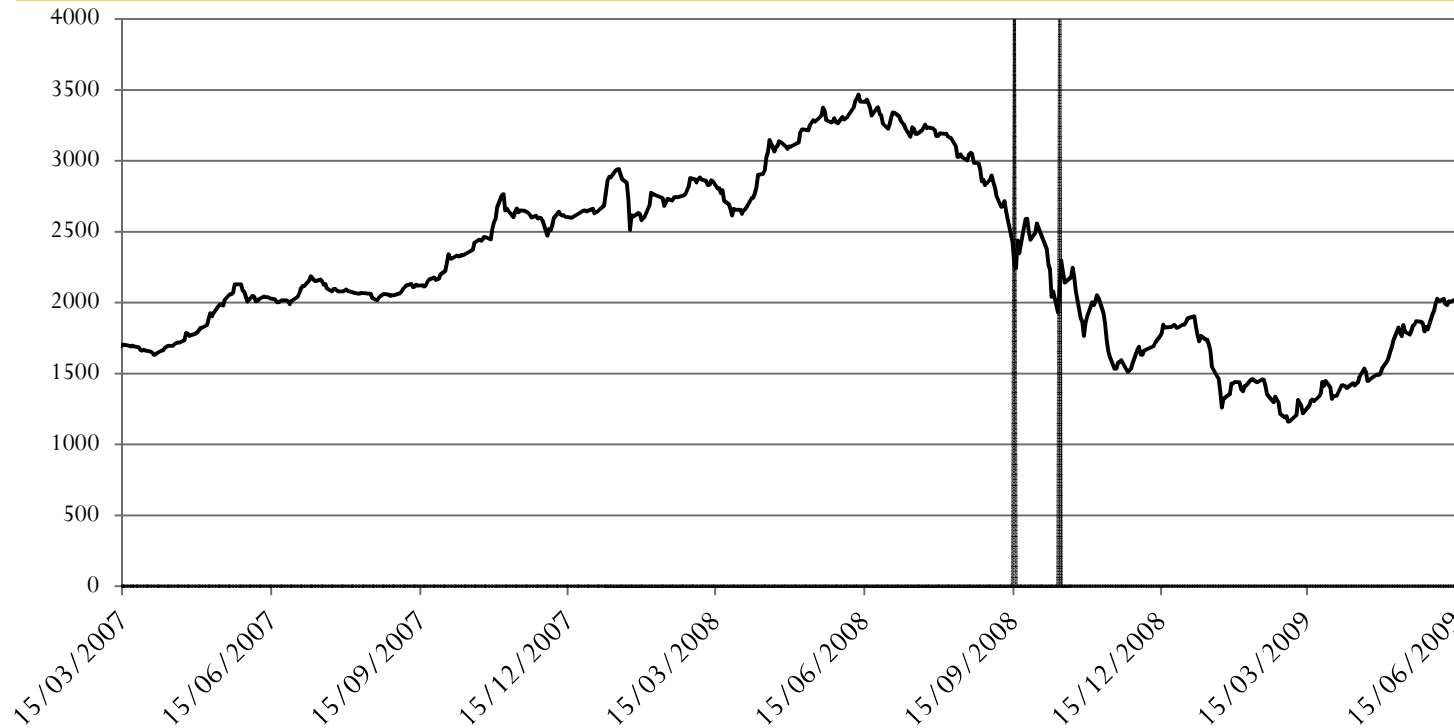
Workshop on Sovereign Investment Funds and Macroeconomic Policies

QIA's intervention in October 2008 (2/2)

- The Qatari government then took action through its SWF QIA and adopted a US\$ 5.3 billion plan to buy up to 20 percent of the capital of local banks on the Qatari stock market.
- The plan was launched on Monday the 13th October 2008, with the objectives of strengthening the confidence in the banking system and of fighting the decline in the equity market (IMF, 2009).
- QIA's intervention was closely coordinated with two monetary policy moves by the United Arab Emirates (UAE) and Saudi Arabia. A few hours only before the news of QIA's intervention, the UAE announced a plan to guarantee deposits, including foreign units, and the Saudi Central Bank surprised the markets by cutting its benchmark repo rate by 50 basis points. => These three coordinated interventions were all targeted on supporting the Gulf banking system.

Workshop on Sovereign Investment Funds and Macroeconomic Policies

Qatar's Stock Price Index (DSM Index): A positive reaction of +4.23% on Qatar's stock return to the news of the intervention of QIA in October 2008



Source: Bloomberg.

The first Vertical line represents the day of the announcement of Lehman's Brothers Failure. The second vertical line represents the day when QIA's plan was launched.

Research project: Some Insights Into Domestic and Foreign Investments of Sovereign Wealth Funds (1/2)

- SWFs tend to invest more at home during troubled periods, when their home economies are hit by a crisis.
- But apart from this emergency funding some SWFs may sometimes invest at home.
- A set of macroeconomic determinants play probably a major part in the choice of investing at home rather than abroad.

Workshop on Sovereign Investment Funds and Macroeconomic Policies

Research project : Some Insights Into Domestic and Foreign Investments of Sovereign Wealth Funds (2/2)

- Therefore we face a challenge in our research project:
- The discrepancy between
 - the daily frequency we need to account separately for each investment of a SWF and its motivations and
 - the monthly, quarterly or even annual frequency of macroeconomic data.
- We would be thankful for your suggestions on this issue.

... Thank you for your attention