Home-Country Drivers of International Investment in Safe and Risky Bonds

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Drivers of Cross-Border Portfolios

• Dramatic increase in external wealth of nations since 1970.

• This paper sheds some interesting light on foreign holdings of U.S. bonds (corporate and sovereign)

• Paper uses high-quality (security level) data. Golden rule!!

• Main finding: some evidence of (possibly non-linear) reallocation towards U.S. bonds when local currency home yields are low.

• Is it ‘search for yield’? ‘flight to safety’? can it be both?
The Broader Context I: Financial Globalization

Source: Maggiori, Neumann & Schreger (2017): share of corporate debt owned by foreigners increased from 1% in 1978 to 28% in 2015.
The Broader Context II: The Global Financial Cycle

Figure 3: The Figure plots the estimates of the global factor for the 1975:2010 sample (dotted line) together with the estimates on the wider, shorter sample 1990:2012 (thick line). Shaded areas denote NBER recession dates.

Should we worry that variation in local yields comes from small/crisis countries? Japan?
A few worries

• Measurement

• Identification

• Interpretation
Measurement: Residency vs. Ultimate Owner

• Residency Principle and Tax havens: large increase in share of MNC profits booked abroad (Tørsløv, Wier & Zucman (2017))

• Could it explain the weird negative coefficient on trade share? (increasing shift towards Tax Havens)
Identification & Interpretation

- Specification:
  \[
  \frac{H_{jt}}{GDP_{jt}} = \alpha SOV_{j,t} + \beta i_{t}^{US,3m} + ... 
  \]

  Why use local currency yield \(SOV_{j,t}\)? Why not a synthetic dollar rate?

- How should we interpret a low domestic yield?
  - low policy rate (local recession)?
  - low U.S. rate & high pass through (global recession)?
  - low default or credit risk (local expansion)?

- Shouldn’t we instead put global and local factors on the RHS?

- Should we be surprised?

  \[
  share_{it} = \frac{E(r_{us,t} - r_{it})}{\gamma \sigma^2}
  \]

Portfolio re-balancing towards higher yielding assets

Conclusion

• An important topic.

• Data is extremely rich and detailed, but is this sufficient?

• Results consistent with simple re-balancing but hard to interpret