Home-Country Drivers of International Investment In Safe and Risky U.S. Bonds

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Comment by **Joshua Aizenman, USC and the NBER**

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The paper looks at US bond holdings of private investors from 33 countries during 2003 - 2016. Evidence shows that a lower home interest rate leads to greater investment into the U.S., especially in higher yielding and longer duration corporate bonds.

Comment I: The regressions don't control for the impact of risk at home on the international portfolio allocation. Why?

$$\mathrm{H}_{j,t}/\mathrm{GDP}_{j,t} = \kappa + \alpha \mathrm{SOV}_{j,t} + \beta \mathrm{U.S\ 3ms}_t + \gamma \mathrm{U.S.\ CDS\ HY}_t + \zeta \mathrm{X}_{j,t} + c_j + \epsilon_{j,t}$$

SOV = local-currency sov. Bond; CDS HY=high-yield U.S. corporate CDS index

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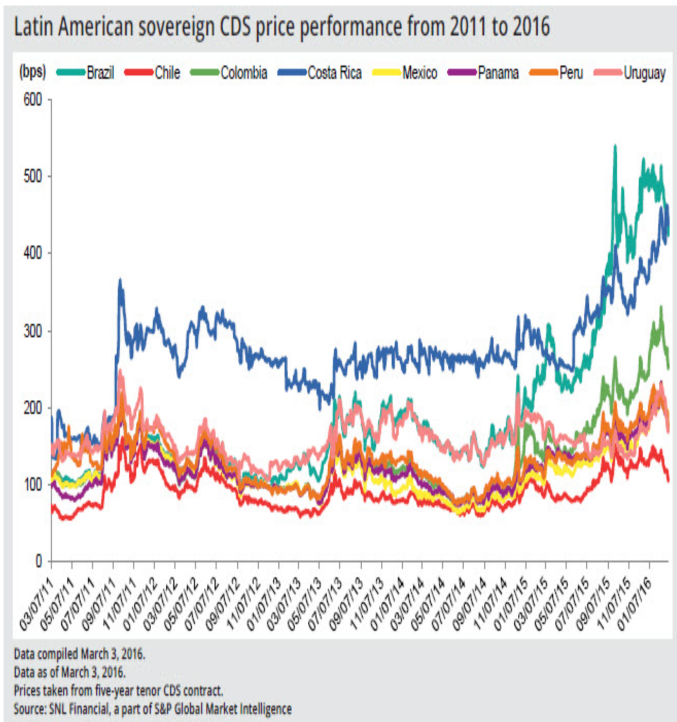

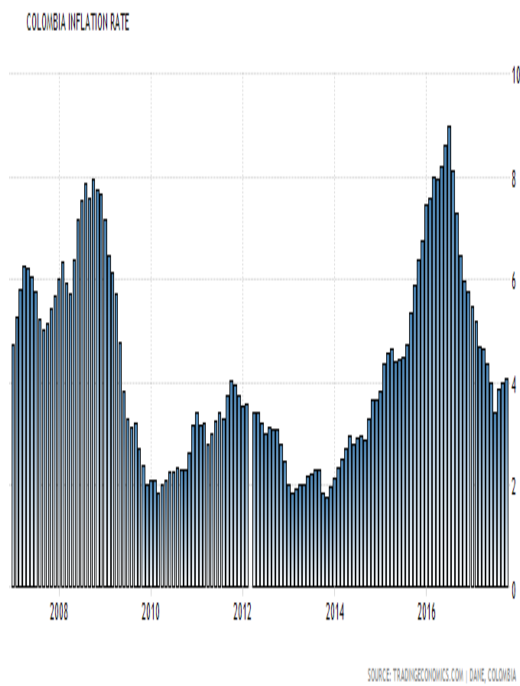

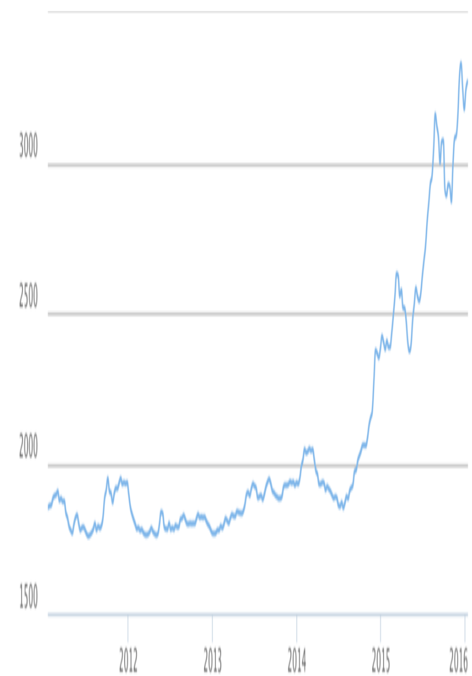

LATAM Sovereign CDS Spreads; inflation rate [COL]; peso/USD [COP/USD]
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Comment 2: **“**Our findings have important policy implications -- declining interest rates can lead to shifts towards riskier types of investments.” What are these policy implications?

Chances are that before the GFC, the search-for-yield was magnified by *agency and moral hazard* problems, increasing the GFC costs [see Rajan (2005)].

Ex-post, following the GFC and the Euro Crisis, Central Banks exploited the search-for-yield to magnify the impact of the unconventional policies [see Draghi’s QE policies].

Suggestions:

1. Compare the results between 3 sub-samples: 2003 -2007; 2008-2010; 2011-2016
2. Add better controls for risk at home [sovereign CDS spreads, inflation and exchange rate volatility, VIX, etc.].

Comment 3: "We use unique, security-level data…" Chances are that the data used by the authors understates yield chasing.
The data set overlooks:

1. US banking system's safe haven services to foreign parties.
2. International investors prime real estate activities in prime markets [Miami, NY City, SF, LA, Seattle, etc.],
3. Foreign 'shell corporation' activities in several states [Nevada, Wyoming and South Dakota], and the like.

AP, 4/6/2016, **"The US is becoming one of the world's best havens for tax dodgers"** http://www.businessinsider.com/ap-us-is-emerging-as-a-tax-haven-alongside-switzerland-caymans-2016-4

- 'American lawmakers "do not want to hurt the U.S.'s banking industry". "It is no secret that U.S. banks, particularly in Miami, are awash in undeclared Latin American money.'

- ‘The United States ranks third in the world in financial secrecy, behind Switzerland and Hong Kong but ahead of notorious tax havens such as the Cayman Islands and Luxembourg.’
- Swiss banks report that “many of their tax-dodging clients are talking about moving to the U.S.”

The narrowness of the data set used in the paper may account for the inability to find some of the common gravity factors.
“Trade links with the United States, for example, appear to be associated with a lower share of investments.”
To conclude: Interesting study, can be pushed further to provide a fuller picture of yield chasing.

Thanks for your attention!

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https://www.professionalplanner.com.au/featured-posts/2017/09/19/telstra-the-signal-to-put-yield-chasing-on-hold-58270/