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

J. Ammer, S. Claessens, A. Tabova & C. Wroblewski

Discussant: P-O Gourinchas

UC Berkeley, NBER & CEPR

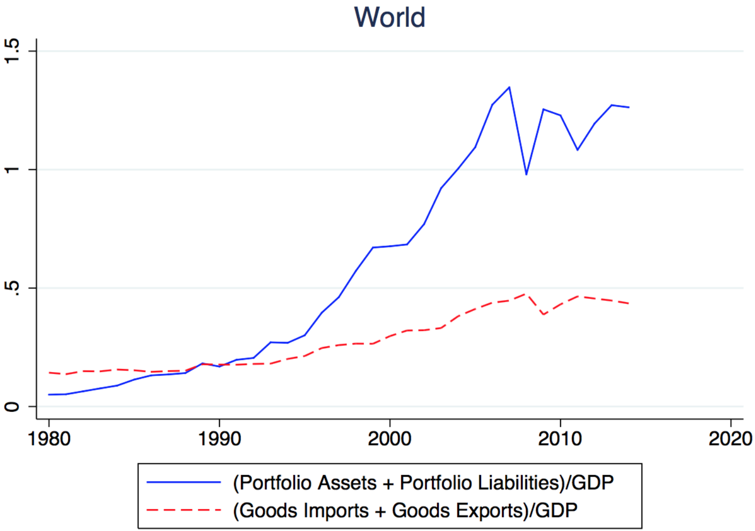
Federal Reserve Bank of San Francisco, AEPC

November 2017, San Francisco

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



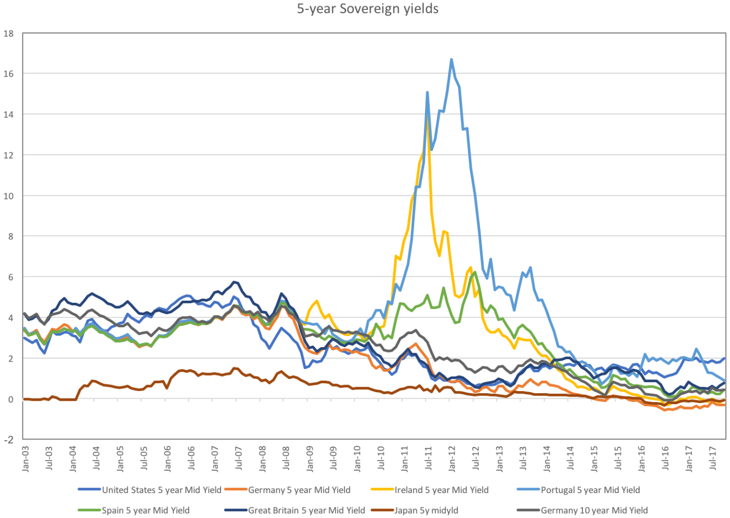
Source: Maggiori, Neimann & Schreger (2017): share of corporate debt owned by foreigners increased from 1% in 1978 to 28% in 2015.

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.

Source: Miranda-Aggripino & Rey (2017). Co-movements in asset returns & flows (?).

The Broader Context II: The Global Financial Cycle



Source: JP Morgan.

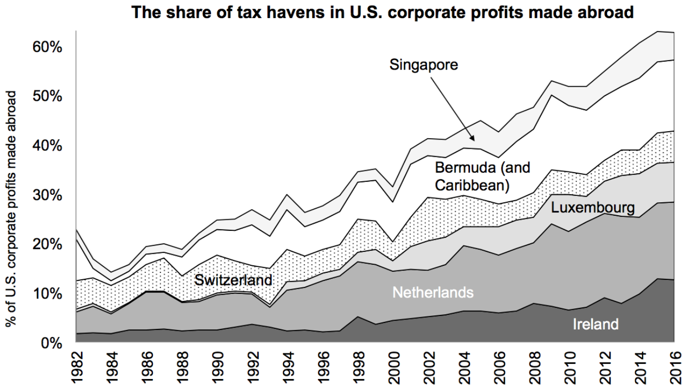
Should we worry that variation in local yields comes from small/crisis countries? Japan?

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))



Notes: This figure charts the share of income on U.S. direct investment abroad made in the main tax havens. In 2016, total income on U.S. DI abroad was about $450bn. 16% came from the Netherlands, 8% from Luxembourg, etc. Source: author's computations using balance of payments data, see Online Appendix.

- Could it explain the weird negative coefficient on trade share? (increasing shift towards Tax Havens)

Identification & Interpretation

- Specification:

$$\frac{H_{jt}}{GDP_{j,t}} = \alpha SOV_{j,t} + \beta i_t^{US,3m} + \ldots$$

  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

- Are U.S. bonds special? Maggiori et al (2017) suggests they are. Dollar effect.

Conclusion

- An important topic.

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

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