Discussion of:

Currency Matters: Analyzing International Bond Portfolios

by Burger, Warnock, and Warnock

Brent Neiman
University of Chicago

IFM Fall Meeting 2017
What Do We Know About Global Bond Portfolios?

- Portfolios exhibit home bias
- Investors hold more assets of countries that are closer, bigger trading partners, and have less bilateral FX volatility
- EMs historically issued in foreign currency, increasingly in LCU

How Do We Know It?

- Source: Country-specific multilateral data
- Problem: No-bilat, often no currency, no domestic
- Source: IMF's CPIS portfolio survey
- Problem: Insufficient currency info, no domestic
- Source: BIS issuance data
- Problem: Insufficient currency info post-'11, can't see who buys LCU debt
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Burger, Warnock, and Warnock: Currency Matters!

They show this in two ways:

1. Indirect Approach

   - Compare bilateral holdings (from CPIS) with share of total issuance in the currency of the investor:

   \[ x_{ij} = \phi_i + \phi_j + \beta \left( \frac{i's \text{ issuance in } j's \text{ currency}}{i's \text{ total issuance}} \right) + \epsilon_{ij} \]
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- \( \beta > 0 \) implies that a country's portfolio is skewed toward countries that issue in that country's currency.
They show this in two ways:

2. Direct Approach (US only)

- Home-bias measure comparing U.S. bilateral holdings with issuance data from that country:

\[ \Theta_{i,USA} = \frac{i'\text{’s bonds share in US portfolio}}{i'\text{’s bonds share of world portfolio}} \]

- If \( \Theta_{i,USA} < 1 \), “bias” away from \( i' \)’s assets. If \( \Theta \approx 1 \), no bias.
- Well known that \( \Theta_{i,USA} < 1 \).
- What’s new?: Calculate \( \Theta_{i,USA}^{LCU} \) and \( \Theta_{i,USA}^{USD} \)
Burger, Warnock, and Warnock: Currency Matters!

They show this in two ways:

2. Direct Approach (US only)

- Home-bias measure comparing U.S. bilateral holdings with issuance data from that country, currency-by-currency:

\[
\Theta_{LCU}^{i,USA} = \frac{\text{i’s LCU bonds share in US portfolio}}{\text{i’s LCU bonds share of world portfolio}} \text{ vs. }
\]

\[
\Theta_{USD}^{i,USA} = \frac{\text{i’s USD bonds share in US portfolio}}{\text{i’s USD bonds share of world portfolio}}
\]
Burger, Warnock, and Warnock: Currency Matters!

\[ \Theta_{L CU}^{i, USA} = \frac{i's \ LCU \ bonds \ share \ in \ US \ portfolio}{i's \ LCU \ bonds \ share \ of \ world \ portfolio} \]
Burger, Warnock, and Warnock: Currency Matters!

\[ \Theta_{LCU}^{i,USA} = \frac{i's \ LCU \ bonds \ share \ in \ US \ portfolio}{i's \ LCU \ bonds \ share \ of \ world \ portfolio} \]

\[ \Theta_{USD}^{i,USA} = \frac{i's \ USD \ bonds \ share \ in \ US \ portfolio}{i's \ USD \ bonds \ share \ of \ world \ portfolio} \]

Graphs showing the share of bonds in US and world portfolios from 2006 to 2011 for different regions and categories.
Burger, Warnock, and Warnock: Currency Matters!

• Authors deserve great credit for suggesting prominence of previously understudied issue. A very substantial contribution.

• So, what does currency matter for? The authors focus on:

  • Home Bias. If it’s home currency bias, argues against many stories from voluminous literature (e.g. information, law, etc.)

  • Inference about roles of trade and FX vol. Omitted variable bias implies variation in USD shares impact our estimates.

  • Drivers of time-series variation in flows. USD and non-USD flows respond differently to shocks.
Some Key Limitations (Acknowledged by Authors)

- **Example 1 (Corporate Debt):**
  - Commodity firms work in USD and price their debt in USD.
  - Americans like foreign investment in commodity firms.
  - Implies Chile has more USD-debt and US investment

- **Example 2 (Government Debt):**
  - Argentina needs to issue under NY law, easiest done in USD.
  - Americans value the protections of US law bonds.
  - Implies Argentina has more USD-debt and US investment

- Non-US analyses are only suggestive. Is US is special?

- Implications beyond better understanding of portfolio shares?
Maggiori, Neiman, and Schreger (2017)

- We assemble novel security-level data on $27 trillion in global mutual fund holdings domiciled in dozens of countries

- CUSIP-level, so can separate by currency, maturity, coupon rate, industry, jurisdiction. Can even separate by firm!

\[ s = \alpha + \beta \cdot \text{Currency Dummy} + \omega_{\text{firm}} + \phi \cdot \text{Controls} + \epsilon \]

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Skewed Allocation of Foreign Capital to Domestic Firms

Issuers of Only Local Currency (GBP) Debt

Issuer’s Rank in Domestic Market

GBR USA

GBR: Great Britain
USA: United States of America
Skewed Allocation of Foreign Capital to Domestic Firms

Issuers of Only Local Currency (EUR) Debt

Issuer’s Rank in Domestic Market

EMU USA

EMU  USA
No Skewed Allocation For International Currency Issuers

Issuers of Only Local Currency (GBP) Debt

Issuers of Only Local Currency (EUR) Debt

Issuers of Only Local Currency (USD) Debt
No Skewed Allocation For International Currency Issuers

Issuers of Only Local Currency (GBP) Debt

Issuers of Only Local Currency (EUR) Debt

Issuers of Only Local Currency (USD) Debt
Portfolio Differences, Firms with only LC Debt

- Log Portfolio Ratio
- Density

Overweight in Domestic Portfolio
Overweight in Foreign Portfolio

USA
EMU
GBR
Portfolio Differences, Firms with only LC Debt

Overweight in Domestic Portfolio

Overweight in Foreign Portfolio
Portfolio Differences, Firms with only LC Debt

Overweight in Domestic Portfolio
Overweight in Foreign Portfolio
Conclusion

- Use standard public data to suggest critical importance of factor that’s been under our noses all along!

- Effect not well identified, but neither was original home bias, and led to voluminous empirical and theoretical literature

- Results suggest big payoff for us all to turn attention to currency – MNS (2017) isolates role of currency in micro data, explores implications for capital allocation within countries

- Great Paper!