Discussion of:

Currency Matters: Analyzing International Bond Portfolios

by Burger, Warnock, and Warnock

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IFM Fall Meeting 2017

What Do We Know About Global Bond Portfolios?

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- Source: BIS issuance data
  Problem: Insufficient currency info post-'11, can't see who buys LCU debt

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:

   $$x_{ij} = \phi_i + \phi_j + \beta \left(\frac{i\text{'s issuance in } j\text{'s currency}}{i\text{'s total issuance}} \right) + \epsilon_{ij}$$

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   - $\beta > 0$ implies that a country's portfolio is skewed toward countries that issue in that country's currency

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2. Direct Approach (US only)

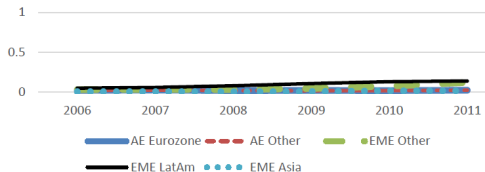- Home-bias measure comparing U.S. bilateral holdings with issuance data from that country:

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

- If $\Theta_{i,\text{USA}} < 1$, "bias" away from i's assets. If $\Theta \approx 1$, no bias..
- Well known that $\Theta_{i,\text{USA}} < 1$.
- What's new?: Calculate $\Theta_{i,\text{USA}}^{\text{LCU}}$ and $\Theta_{i,\text{USA}}^{\text{USD}}$

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2. Direct Approach (US only)

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

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

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

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

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$$\Theta^{\text{LCU}}_{i,\text{USA}} = \frac{i\text{'s LCU bonds share in US portfolio}}{i\text{'s LCU bonds share of world portfolio}}$$

$$\Theta^{\text{USD}}_{i,\text{USA}} = \frac{i\text{'s USD bonds share in US portfolio}}{i\text{'s USD bonds share of world portfolio}}$$
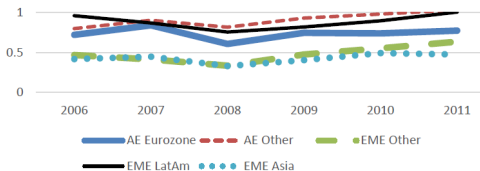
Burger, Warnock, and Warnock: Currency Matters!

- 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!:

$$s = \alpha + \beta \cdot \textit{Currency Dummy} + \omega_{firm} + \phi \cdot \textit{Controls} + \epsilon$$

|	CAN	CHE	EMU	GBR	SWE	USA
Currency	0.922***	0.660***	0.580***	0.529***	0.803***	0.611***
	(0.010)	(0.011)	(0.008)	(0.015)	(0.014)	(0.008)
Obs.	34,457	34,457	34,457	34,457	34,457	34,457
R^2	0.952	0.934	0.824	0.830	0.954	0.851
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes	Yes	Yes

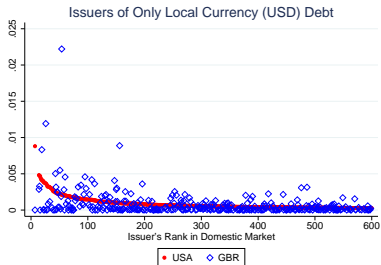# Skewed Allocation of Foreign Capital to Domestic Firms
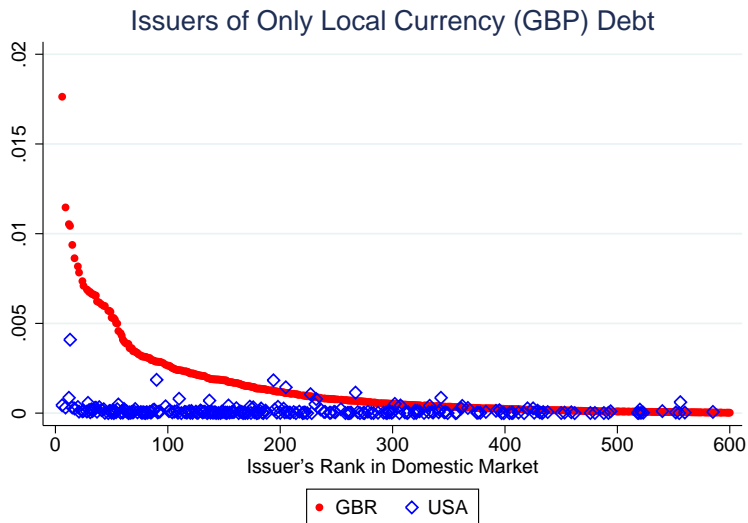
Issuers of Only Local Currency (GBP) Debt
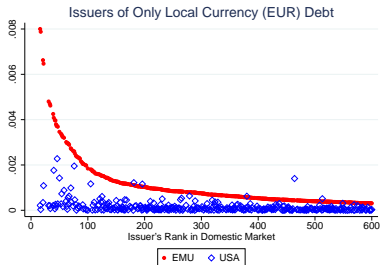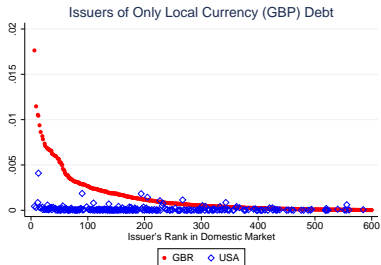
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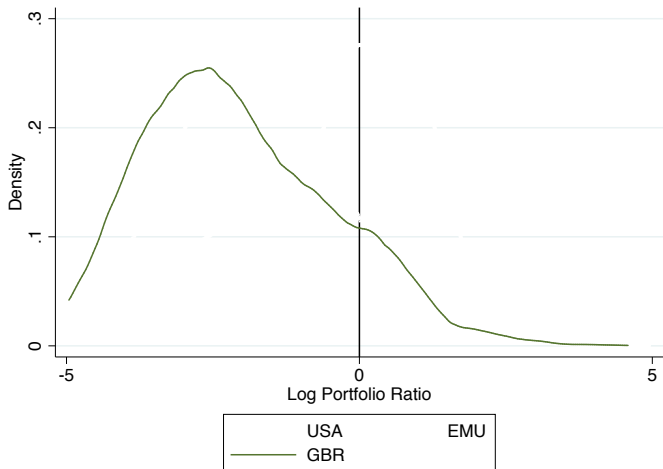Issuers of Only Local Currency (EUR) Debt
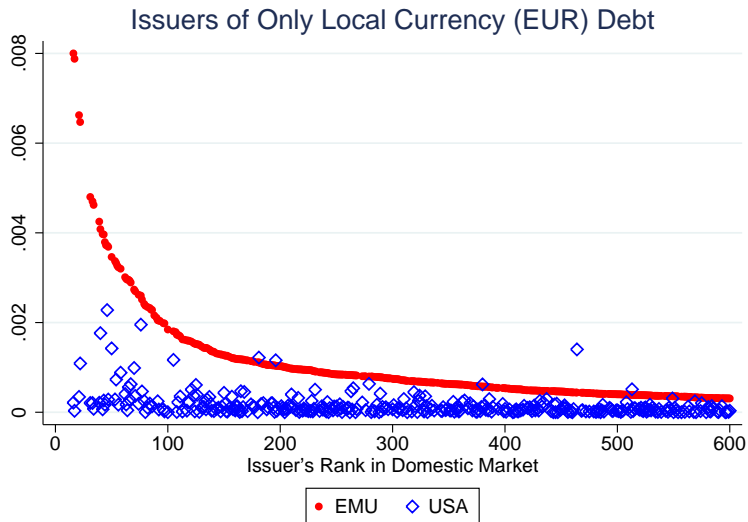
No Skewed Allocation For International Currency Issuers
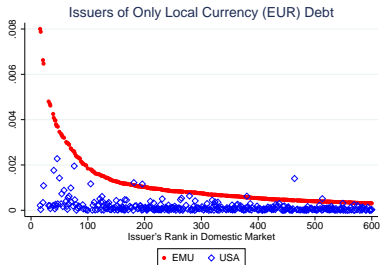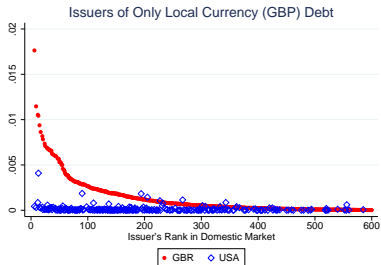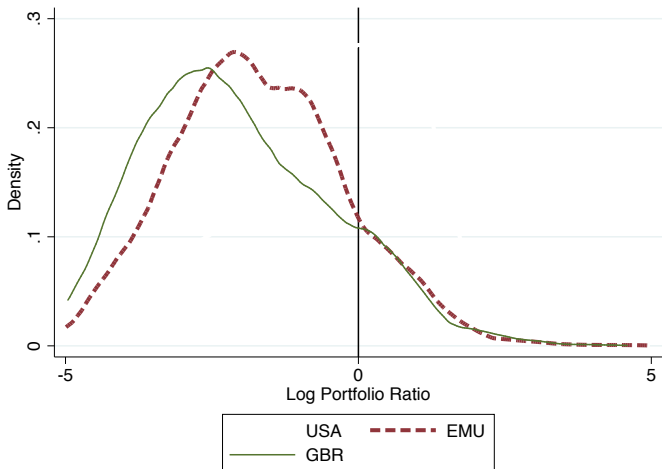
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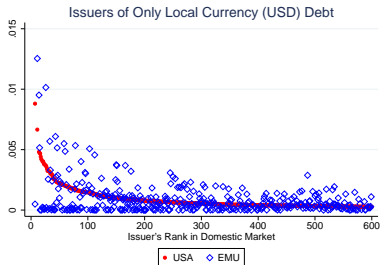
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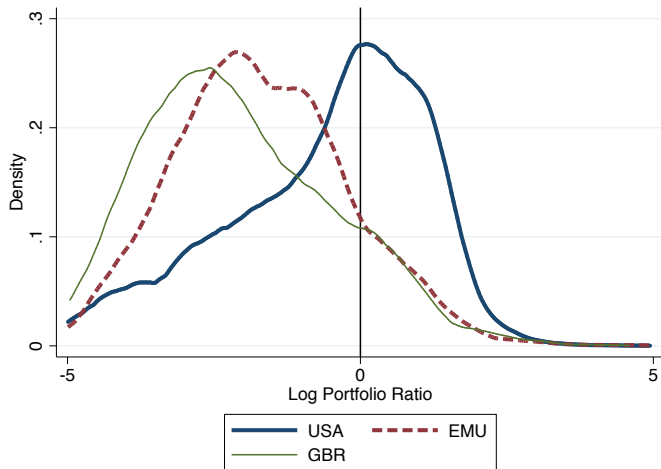
Conclusion

- Use standard public data to suggest cricital 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!