International Portfolio Frictions

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Discussion
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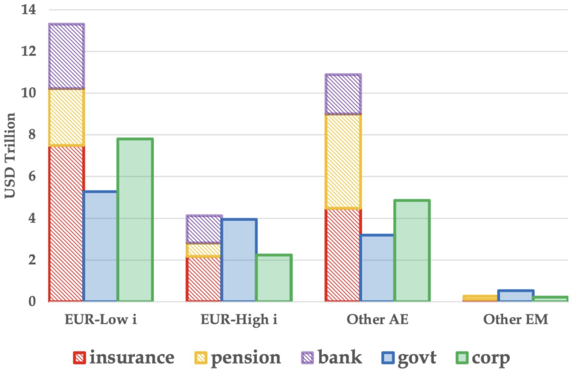
- This paper: study the **intersection of ICPFs + banks and fixed income markets**
  - Fixed income markets matter for the real economy (e.g., Gilchrist & Zakrajsek, 2012)
  - ICPFs matter for bond yields (e.g., Greenwood & Vissing Jorgensen, 2018; Jansen 2023)
  - Role for ICPF sector for the development of corporate bond markets (Scharfstein, 2018)
- Main contribution: provide **new stylized facts** using novel firm-level holdings data
  - Solvency II data on ICPFs from the European Insurance and Occupational Pensions Authority
  - Confidential version of the BIS Locational Banking Statistics

Bond Supply and ICPF Market Size



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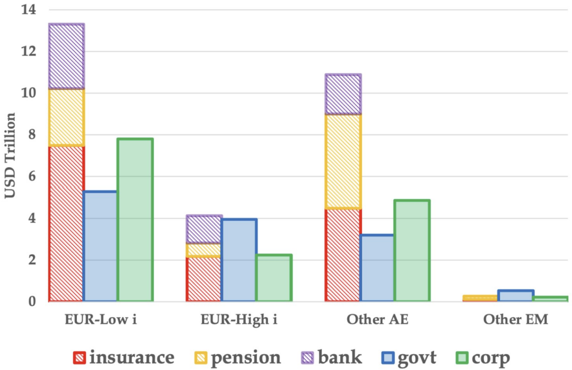

	(1) Ratio Corp/FI	(2) Ratio Corp/FI
Log(ICPF/GDP)	0.219***	0.103**
	(0.0290)	(0.0470)
Log(Per Capita GDP)		0.138***
		(0.0380)
Log(Bank Securities/GDP)		
Log(Bank Assets/GDP)		
Constant	0.556***	-1.794**
	(0.0346)	(0.650)
Observations	28	28
R-squared	0.588	0.658

- Fact 1: **Size of ICPF sector + banks > government bond supply**
  - ICPF and banks like government bonds b/c (unlike corporate bonds) they carry 0 risk weights
- Fact 2: **Larger ICPF sector correlates with larger corporate bond market**
  - Strong demand for fixed income assets $\Rightarrow$ lower yields $\Rightarrow$ more issuance (supply is elastic)

International Portfolio Frictions

	(1) Overall Port.	(2) Home Port.	(3) Foreign Port.	(4) Domestic Firm	(5) Foreign Firm
			(A) Insurers		
Corp/FI Outstanding	0.485***	0.769***	0.239**	0.364***	0.496***
	(0.0907)	(0.0977)	(0.0986)	(0.106)	(0.0842)
Constant	0.263***	0.112**	0.449***	0.358***	0.249***
	(0.0461)	(0.0472)	(0.0483)	(0.0637)	(0.0418)
Observations	29	29	29	29	29
R-squared	0.488	0.631	0.202	0.277	0.590

- Fact 3: **Domestic projection bias**: Home country supply shapes FI portfolio abroad
  - Null: Investors offset low domestic government bond supply by investing more elsewhere
  - The opposite is the case! Higher share of corp bonds in foreign FI portfolo! (column 3)

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- Fact 4: **Going native bias**: Local branches of foreign firms look like domestic firms
  - The corporate bond allocations of Italian firms and Italian branches of French firms similarly depend on Italian government bond supply

Comment 1: Maturity Segments

- ICPF and banks typically operate in specific maturity segments
  - ICPF: very long maturity, banks (relatively) shorter maturity
- What matters is not the overall supply of domestic government bonds, but the **supply in the right maturity segment**
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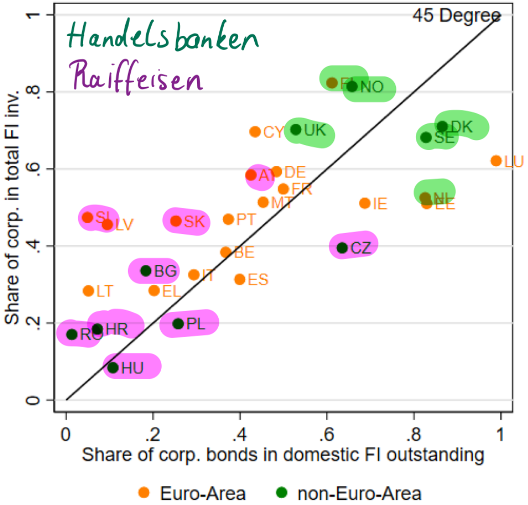
  - What matters for international portfolio frictions is the supply of *long-term* government bonds
- Limits alternative explanations (needs to explain both the overall fact and why it lines up with maturity)

Comment 2a: Home Region Bias



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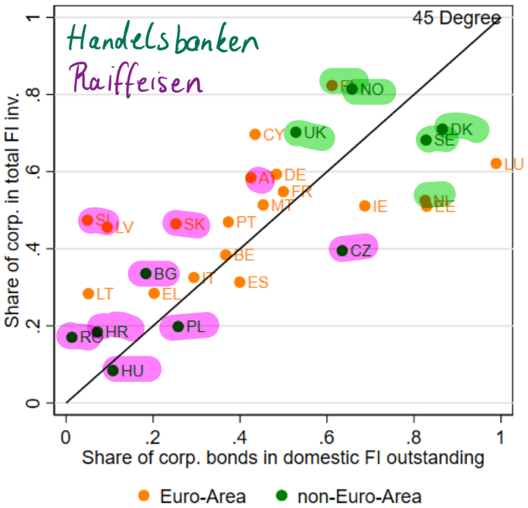

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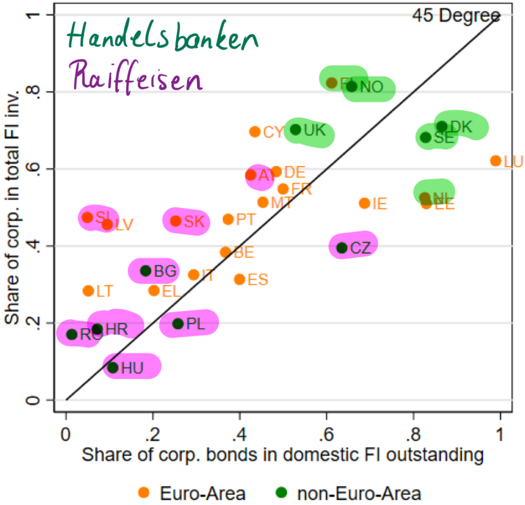

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- Countries in same region *cluster* on share of corporate bonds relative to total supply
- **Home region bias** as unified explanation
  - *Domestic projection* as supply in home & foreign country within region similar
  - *Going native bias* because pool of firms with region is homogeneous

Comment 2b: Home Region Bias

- Do *domestic projection* & *going native bias* follow mechanically from *home region bias*?

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- Don't look at Svenska Handelsbanken, but look at Raiffeisen
  - Handelsbanken's home country is Sweden and otherwise it operates in the same region of similar countries $\Rightarrow$ there is **no interesting variation** in corporate bond supply to exploit
  - Raiffeisen's home country is Austria, but it's business is largely Eastern Europe
    - ★ **Not** the same region as Austria (east versus west of the Iron Curtain)
    - ★ There is **variation** in corporate bond supply between Austria and Eastern Europe
    - ★ Does the supply of bonds in Austria drive Raiffeisen's portfolio in Eastern Europe?

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- More formally: separate the share of corporate bonds in the foreign fixed income portfolio into *foreign country - home region* and *foreign country - foreign region*
  - *Home region bias*: Corporate portfolio share in home region depends on home country supply, but portfolio share in foreign regions does not
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- Standard errors in cross-country regressions: correlated errors within **regional clusters**
  - Even if there are only 29 observations in total...

Comment 3: Make Theory & Policy Implications Concrete

1. The paper has a concrete model (following Koijen and Yogo, 2023)
   - Large ICPF sector $\Rightarrow$ demand for corporate bonds high $\Rightarrow$ more issuance
   - But doesn't feature *domestic projection bias* and *going native bias*
   - Potential microfoundations are discussed loosely (internal risk, risk shifting, skill, inertia, local regulators)
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2. **Capital market deepening and integration across Europe impacted from international portfolio frictions, reducing substitutability across countries**
   - Average portfolio tilts $\neq$ how investors substitute across countries
   - Missing capital market integration might be the driver of low substitutability
   - What precisely is the problem here? Don't just say findings have 'important implications." **Spell it out. Quantify it.**

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3. Transmission of Monetary Policy differs across countries because of varying bond supplies
   - Maybe. But again, **be concrete.**

Comment 4: Frictions?

Why is the paper titled "International Portfolio Frictions"?

- To understand if it's frictions, you need to understand the precise mechanism...
  - ... But ultimately, that's not what the paper does (nor claims to do)
- Documenting "puzzles" or "biases" in the international portfolios of ICPFs and banks describes the paper better
  - The two frictions are *domestic projection bias* and *going native bias*

Conclusion

- Amazing paper! Great data!
- A lot of new stylized facts on sector demands & bond supply + new international portfolio biases (*domestic projection bias* + *going native bias*)
- Beyond stylized facts, need to better understand mechanism (e.g., home region bias)...
- ... Which is also needed to flesh out policy implications