

Discussion of Milesi-Ferretti et al's

“Bilateral Cross-Border Holdings and Global Imbalances”

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Fin'l Globalization: Shifting Balances

Madrid, July 2010

What the paper sets out to do

- Create a dataset on bilateral positions – FDI, Portfolio Equity, Portfolio Debt, Other Investment (short-term stuff), Reserves – for a wide range of countries as of 2007.
- Learn from the dataset.

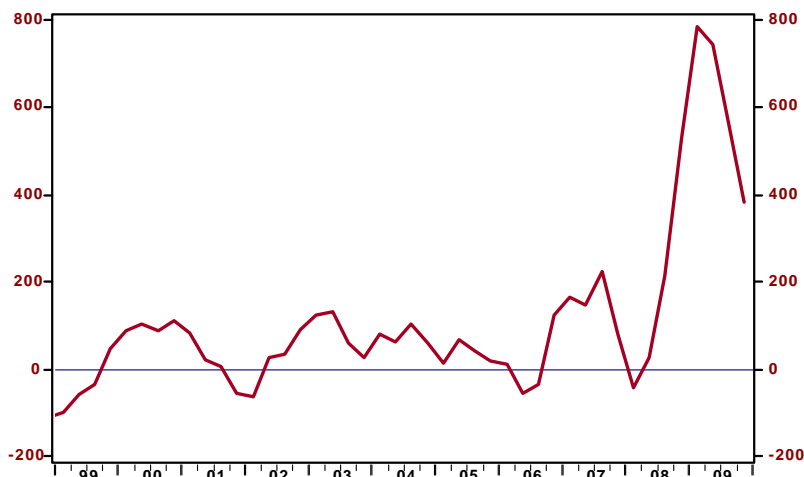
The emphasis is on bilateral positions

- I like the emphasis on bilateral positions (although ‘bilateral’ scares me a bit).
 - Portfolio issues are inherently about bilateral positions, not net flows (eg current account balances).
 - This paper’s look at global imbalances from a bilateral positions perspective is useful.
- That’s not to say that net flows aren’t informative.

With flows data, the massive surge (and then decline) in net debt inflows into the eurozone is readily evident...

Debt Instruments: Net inflows into the euro area

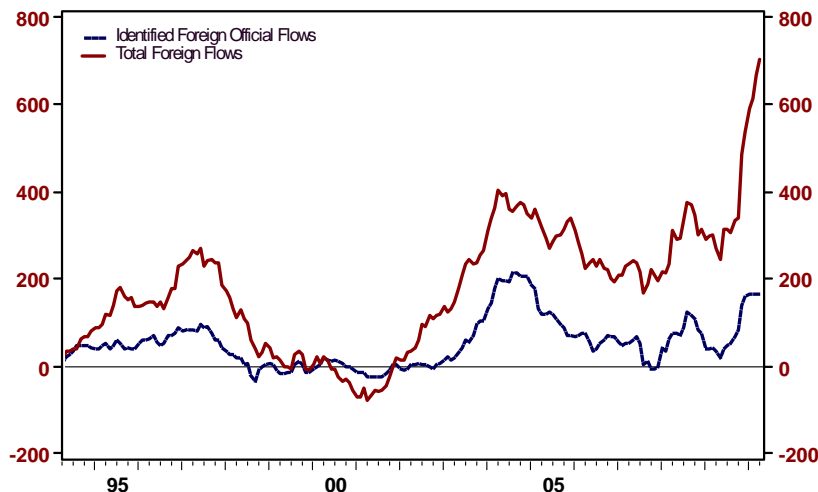
4-qtr moving total (USD billions)



Source: Haver Analytics

Net Foreign Flows into US Treasury Bonds

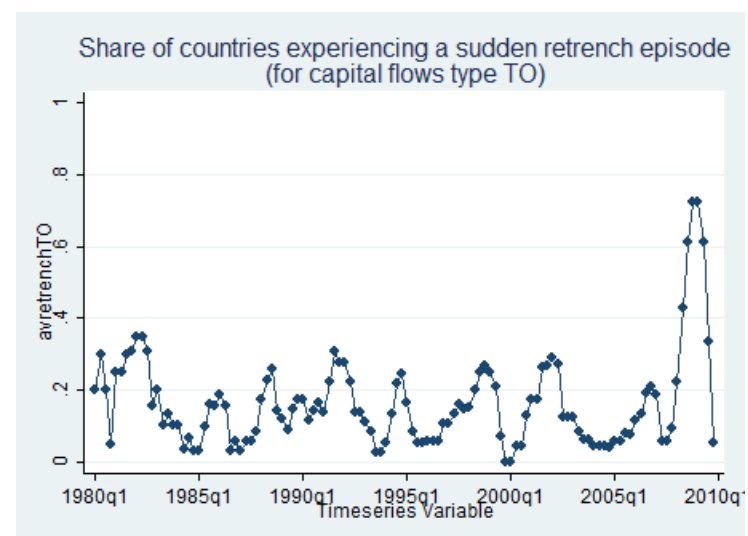
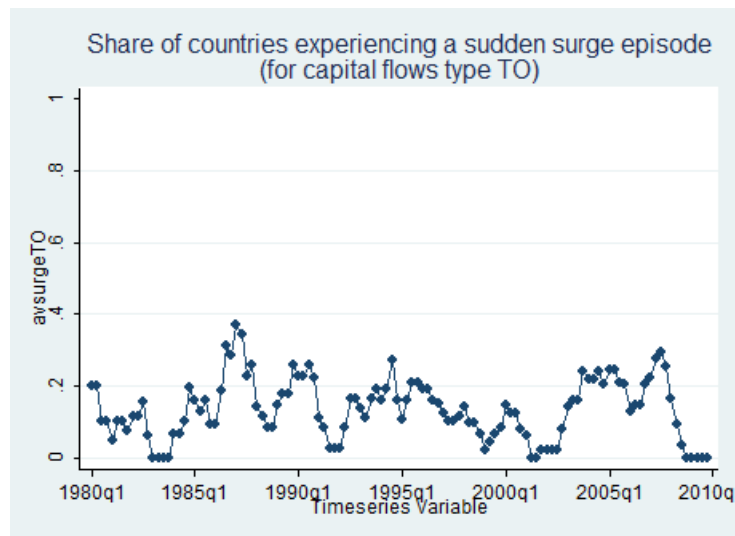
12-month total \$ billions



Source: US Treasury / Haver Analytics

...as are the recent enormous flows into US Tbonds.

With flows data, the high number of countries experiencing abnormally large inflows in the 2003-2007 period is immediately evident...



...as is how those “surges” in inflows ended (mass retrenchment).

How I'll approach this discussion

- Current draft of paper is preliminary (first draft last week) and incomplete (no data appendix, for example), so I'll focus not so much on the evidence presented but on what I'd like to see.
- Focus#1: Data issues
 - I like the idea behind the paper. But I want to fully understand the dataset before I am willing to internalize any results it produces.
- Focus#2: Potential applications
 - The first draft is descriptive. Are there interesting applications for this dataset?

Data Issues

- Main data components in the paper
 - Banking: Check with Patrick McGuire at BIS
 - FDI: Find your favorite expert
 - Portfolio debt and equity: the focus of my discussion
- I think the authors know about everything I'll raise, so view this as a plea for more description of these issues (perhaps in an appendix).

Data Issues:

Bilateral data are exciting, but have known problems.

CPIS-Reported Euro Area Equity Holdings in Luxembourg as of end-2008

	holdings in Lux (\$bill)	% of country's foreign equity holdings
Austria	14.1	26%
Belgium	113.0	56%
Finland	10.0	16%
France	82.9	18%
Germany	350.7	59%
Greece	4.4	27%
Ireland	27.6	6%
Italy	187.4	61%
Neth	48.4	12%
Port	7.7	24%
Spain	27.3	30%

59% of Germans' foreign equity holdings being in Lux is either (i) poor quality data or (ii) due to German holdings of mutual funds based in Lux.

If (ii), can eurozone data see through the Lux-based holdings?

Best case scenario: ECB gets it right for eurozone as a whole, but CPIS data for equities is flawed (from a user's perspective) because

- (a) it correctly counts German investment in Lux-based mutual funds as an equity investment
- (b) even though, as it turns out, many of those funds are bond funds (ie it's actually German investment in foreign bonds, not equities).

(a)+(b) along with quality ECB data means ECB numbers ok but CPIS data are confusing (Total PI in CPIS would be fine, but debt/equity split is troublesome for researchers).

I'm not sure what Gian Maria uses...CPIS or ECB?

Data Issues:

Massive improvements in eurozone positions data.

Evidence: Talk to the experts, or look into the large “other adjustments” for 2008.

Eurozone Net Foreign Assets: Portfolio Debt and Equity						
	2007	2008				
	outstanding	net inflows	price changes	ER changes	other adjustments	outstanding
	1924.9	350.5	-160.1	48.9	150.4	2314.6

As in the US, “other adjustments” usually pop up when there are data improvements. For the eurozone, in 2008 other adjustments mainly reflected the introduction of a new data collection system for portfolio investment in one (presumably major) eurozone country.

A portion of the 150 billion euro “other adjustments” owes to the new use of security-by-security surveys to estimate positions...a huge improvement.

With s-b-s data, *and by aggregating to eurozone as this paper does*, perhaps problem evident in CPIS data for individual eurozone countries is alleviated. Perhaps.

Data Issues

- My guess is that the authors know about all of these, and others.
 - See, for example, their ‘gaps’ analysis. Enormous gaps related to Lux and Irish data and eurozone liabilities data.
- Given so many known problems with bilateral data, I’d like to see a detailed appendix.
 - Some of the past problems might now be alleviated, but I’m not sure. Take the opportunity to inform us!

Potential Research Applications

- Once the bilateral data is solid (or at least we have a good understanding of its potential weaknesses), from a research perspective the low hanging fruit is in reassessing past int'l macro papers that have used older bilateral data.

Some examples (there are many others!): Past analyses using bilateral CPIS bond data

- Lane (2006): 1000+ country pairs, analyzes bilateral investment (as of 2004, as well as change in investment from 1997 to 2004)
 - Holdings greater for country pairs that are in the **euro area**, have more **bilateral imports**, and have a tax treaty or common legal origin.
 - Distance matters for the level of, but not the change in, investment.
- Fidora, Fratzscher, and Thimann (2008): 1000+ country pairs, analyze average 2001-2003 bilateral holdings
 - Bilateral bond investment greater between country pairs that have less **real exchange rate volatility**, that are closer, and that have a common legal origin.
 - **Bilateral imports** are rarely significant.
- So which is it, is it bilateral imports or ER vol that impacts cross-border holdings (or both or neither)?

If include another variable (currency denomination of bond issuance) to Lane or Fratzscher et al type regressions...

Imports still important but ER Vol isn't.

Depvar:

Portion of country i 's foreign bond portfolio invested in country j 's bonds (old CPIS data)

Issuance: portion of country j 's bonds denominated in currency i	0.057 (0.010)
Imports: portion of country i 's imports that originate from country j	0.672 (0.000)
ER Volatility: nominal volatility between the currencies i and j	-15.5 (0.575)
	N 1271
	Adj. R ² 0.725

**Old data.
Please draw
no
conclusions
from this.**

Potential research applications

- What conclusions would you draw from Lane (2006) or Fidora, Fratzscher, and Thimann (2008) analysis with a new and improved dataset?
 - Problem: I'm not sure your dataset is able to identify currency denomination of bond holdings.
- Here's another one...Some (but certainly not all) older datasets can be used to show a positive relationship between bilateral trade in goods and bilateral trade in assets.
 - But there are skeptics out there...If your data are better than what we've had in the past, provide strong evidence in favor of this notion.
- In general, pick a favorite older paper that uses CPIS-type data and reassess.
 - It'll inform us, but won't make you any friends, so feel free to ignore this suggestion.

Potential policy applications

- In the paper they go through an analysis of the geography of pain in the face of asset price shocks.
- I'm sure there are many others, but I am not sure how convincingly the dataset can be used to assess exposures.

My take on the paper

- It could be extremely useful, but I need to know more about the data before I can properly assess its contribution.
 - There are known problems with bilateral data, so it would be helpful to know which past problems have been fixed and which remain.
 - I have full faith in the ability of these authors to make this a solid dataset. For example, I had serious questions about the original LMF Mark I dataset; my concerns, and more, were addressed in Mark II.
 - Once readers are comfortable with the data, the descriptive analysis will be very informative.
 - There are a number of potential research and policy applications.
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The final slide

- It's an important topic and has the potential to be a major contribution.
- I enjoyed the paper and look forward to the next draft.