Discussion of "A Portfolio Approach to Global Imbalances"

- interesting paper
- aims to answer what are underlying drivers are of the U.S. NFA, CA, returns on external assets and liabilities
- uses a global demand system for equity, short and long-term debt from Koijen and Yogo (2020)
- sensible approach
- can potentially answer many questions, including policy related (impact of monetary policy, FX intervention etc.)

Theoretical Framework

- one can summarize the global asset demand=supply system as

$$f(p, x, \varepsilon) = 0$$

p: endogenous asset prices (equity, debt, exchange rates)
x: observed exogenous drivers: asset supplies, savings in the 31 investors countries, short-term interest rates (monetary policy), foreign exchange reserves, exogenous asset characteristics
ε: unobserved latent portfolio shocks

- *x* and ε are the exogenous drivers of the system
- first held constant at their values at the start of the sample
- then, one at a time, changed to their actual values to determine effect on NFA, CA, prices, 2002-2019

Current Account

- for example, the main drivers of US current account deficit are

1. increase in U.S. asset supplies, which depress U.S. asset prices and therefore lead to inflows
2. rise in saving in Asia and even more so in Europe (standard saving glut story)
3. latent asset demand shocks partially offset the previous two drivers (lead to a reallocation away from U.S. assets)

Basic Questions

- which are the countries in sample?
- what about the role of oil exporters (whose CA often mirrors that of the US)?
- what about India and China?
- suggestions:

1. show times series NFA, CA and their drivers (instead of changes over entire sample 2002-2019, decade subsamples)
2. separate the effect of changes in saving from asset supplies

Endogeneity

- the exogenous drivers are not fully exogenous
- saving, investment depend on equity prices, interest rates
- foreign exchange intervention depends on the exchange rate (which has frustrated a large literature on the topic)
- monetary policy is not fully exogenous either

- even if we consider fully exogenous shocks to the drivers, the impact depends on how asset prices feed back to saving, investment, FX intervention, etc.

Portfolio Choice

- the results depend critically on the portfolio choice expressions
- two issues:

1. even if the model is correct, what are the standard errors of impact of drivers on NFA/CA/prices, taking into account standard errors of parameter estimates
2. misspecification of portfolio choice model can very significantly affect results

- in frictionless portfolio choice models, portfolios are excessively sensitive to expected returns, e.g. Giglio et al (2021)
- lots of evidence that portfolio adjustment is gradual (portfolio shares depend on lagged portfolio shares)

Price Impact

- external validation of the model is important, e.g. impact of asset demand shocks on asset prices, impact saving and investment shocks on asset prices and CA
- Gabaix and Koijen show that exogenous asset demand shocks have much larger price impact (for equity) than implied by frictionless models
- Maggiori (2021) reviews the broader price impact literature for the Handbook of International Economics
- related: growing literature finds that asset prices predominantly driven by latent asset demand shocks, e.g. Itskhoki and Muhkin (2021) for exchange rates

Price Impact

- in recent work with portfolio frictions I find that saving and investment shocks have small price impact; not sure why the opposite is the case here
- end of paper addresses how much additional long term debt a country can issue until its long-term yield increases by 1%
- this is a price impact question as well
- to connect to the price impact literature, I suggest measuring the change in debt supply as a percent change instead of dollar value or share of GDP

Conclusion

- interesting paper that addresses the drivers of capital flows and returns on external assets and liabilities in a global asset demand and supply framework
- natural application of the work by Koijen and Yogo
- can potentially answer many interesting questions, including policy questions (e.g. effect of monetary policy on capital flows and asset prices)
- the results are very sensitive though to the precise asset demand specification
- external validation is needed to determine how sensible the results are (e.g. price impact)