Discussion of:

The Portfolio of Euro Area Fund Investors & ECB Monetary Policy Announcements
by Johannes Bubeck, Maurizio M. Habib & Simone Manganelli

Discussant: Peter G. Dunne
Central Bank of Ireland

June 30, 2017

GLOBAL FINANCIAL LINKAGES AND MONETARY POLICY TRANSMISSION – BANQUE DE FRANCE
Usual disclaimer applies!
Transmission of Mon Pol via rebalancing of Equity/Bond Funds

- Examined the impact of short & long interest rate surprises on portfolio rebalancing
  - Across 8 categories of funds domiciled in LUX
    - 2 TYPES: Equity & Bond
    - 4 GEOGS: WE, USAPJ, EM & GLOB
  - Pre-EAPP & Through-EAPP
- Distinction between active and passive:
  - Passive are a result of valuation changes and FX movements.
  - Active are flows (daily!)
- They find a muted (active) portfolio rebalancing response but strong (passive) price/FX effects.
Good analysis on good data but...

- HF Interest rate surprises to capture monetary policy surprises...
  - Loose association between surprises and the types of shocks
    - Are FG, TLTRO, Liquidity, Signalling, Risk & Term effects all equal?
    - APP & TLTRO most effective [Altavilla, Pagano, Simonelli (2016)].
    - Would be interesting to assess by type.

- Initial Conditions & Timing matter for shock-sizes + shock effects
  - TVPs & interaction with state variables would be possible
    - Bayesian TVP methods (Various approaches by Chan et al.).

- Low volatility of rate near ZLB is a concern
  - Shock size relative to Stochastic-Volatility might be better.
  - Also, could be merit in using a shadow rate at the effective ZLB?
Other...

- You assumed the long rate captures UMP shocks but...
  - This could introduce endogenous policy reaction effects (GMM).
- Active / passive distinction is clearly important.
  - But...shouldn’t these be allowed to interact?
    - See Calvet, Campbell & Sodini QJE (2009)
    - They find that active rebalancing corrects for passive!
- What about controlling for UMP surprises abroad?
  - Use of controls good - but foreign *event* innovations may be necessary as controls - otherwise Omitted Variable Bias
Concentration of the data is in Equity Funds

EA Bond Funds were most directly affected by EAPP
  Your result for this category is not significant...perhaps “Western-European” is too wide to capture EAPP asset holders.

Note that exchange rate valuation effect is not really reflecting the FX diversification of the portfolios
  Rather just the denomination in which they are reporting!

Data is converted to USD by compilers and back to Euro for study.
  Care is required here due to time differences (markets in Europe only overlap with US for a few hours).
    Differences in conversion times could produce spurious significance in long-run effects for converted passive price effects.
Linking to the Literature

  - Some of these focus more on portfolio managers
    - But Bua & Dunne also have redemptions/issues of fund units.
    - We find significant active rebalancing by funds that held EAPP assets (and rebalancing by investors).
    - We find stronger rebalancing by funds where they experience net redemptions.
  - All of these papers seem to be finding the same general result.
    - Most active rebalancing is to non-European assets (with Euro weakness and asset price rises at times of shocks).
      - Isn’t it worrying that investors are unwilling to back all of these asset price supports by investing in EA assets?
Final thoughts

- Why the reluctance to rebalance towards European MFIs and NFCs?
  - Wider literature on...regulation (Borio et al., Rey et al.),
    debt-overhang/debt-Supercycle/zombies, cautious fiscal policy.
  - We seem to be relying entirely on structural adjustment & austerity
to eventually return us to health.
    - Perhaps we have to creatively destroy some ‘hoped-for’ asset value
      recovery to get growth (and take a risk with moral hazzard).
  - Lower-bound rates, asset price bubbles & ex ante SDF volatility is a
dangerous mix from a markets’ perspective.
  - If EAPP is reversed before growth starts to occur then you are only
giving investors price declines combined with growth headwinds!
  - If you show that you don’t understand this (or have the skill to time
it) then you will generate a lot of instability in markets (blips)
  - If these issues are widespread internationally we probably need more
than just UMP to achieve growth and inflation objectives?

- Overall, interesting and well-executed paper that contributes significantly
to the extant and emerging literature.
Other minor!

- Model
  - Could be benefits from SURE structure (error correlations across 8 equations)
  - Experiment with the lag length (maybe just test-down to the best one)?
  - Structural stability could be an issue (perhaps test for breaks).
    - TVPs should be possible with daily frequency.
  - Interactions between controls and strength of responses.
    - Consider Pedroni (2017) small nonlinear effects panel.
- Endogeneity - could be an issue even at this frequency.
- Method is good for short horizon effects.
  - Is there a way to bring in ECM for return to longer term trends?
- Allowing different effects for different types of shocks should be possible?
  - It is assumed that EAPP period is all QE type shocks (not necessarily so).