Discussion of:

“Flight to Climate Safety”

by Fabrizio Ferriani, Andrea Gazzani, Filippo Natoli

FRANK WARNOCK
FRBNY, NOV 2022
Opening Thoughts

Nice paper on an important underexplored topic.

I’ll focus on things that would help me understand/internalize the main findings.
I’ll Focus on These Questions

Why, according to the authors, is the paper important? What is the stated contribution?

What is done?

Did the authors deliver on the stated contribution?

What are the opportunities to move this literature forward?
Why, according to the authors, is the paper important? What is the stated contribution?

(1) Paper is important because little is known about how climate-related shocks affect global portfolio allocation.
   ◦ Climate shocks are potentially an omitted pull factor.
   ◦ That’s essentially it for motivation – that the topic is underexplored.
     ◦ I urge the authors to explore additional motivation. Otherwise it becomes yet another paper emphasizing a particular push/pull factor using a short list of control variables. A tough sell that would acquire much work.

(2) Contribution: Find significant effects of disasters on global portfolio allocation.
   ○ Shortfall of flows to the affected (EME) countries.
   ○ Reallocation of flows from affected economies to AEs.
What is done?

(1) Estimate dynamic causal effect of disasters on portfolio allocation using local projections.
   ◦ Add a disasters variable to push/pull analysis of EPFR weekly equity flows for 35 countries for the period 2009-2019.
   ◦ Examine various “splits”: AEs v EMEs, active v passive funds, retail v institutional investor, disasters severity.

(2) Investigate whether natural disasters in EMEs induce reallocations to AEs.
Did the authors deliver on the stated contributions?

Not yet, but perhaps in the next draft. Some small questions, which I’ll frame as opportunities, before I can internalize the results.
What are the opportunities to move this literature forward?

1. Provide more details on the dependent variable.
   b. Are country-level EPFR equity flow data representative?
   c. Are flows/lagged AUM equivalent to “reallocations”?

2. Right now the focus is solely on disasters, but what about disasters vis-à-vis other variables?
1b. Should EPFR country-level data be used?

Pg. 11: “the EPFR data have been found to be a highly reliable proxy of more comprehensive BoP portfolio data; see Koepke and Paetzold (2020).”

From that paper: “EPFR also publishes estimates of country-level fund flows, which are constructed by applying the monthly average of a fund group’s country specific portfolio allocation share to the flows reported by that fund group. These estimates rely on several simplifying assumptions. For example, valuation changes affecting the change in country allocations from one period to the next are assumed to be zero. Moreover, not all funds make available the country-level portfolio allocations needed to estimate country flows at the fund level, so EPFR applies the average country allocation of one fund group to all funds in this group. Therefore, EPFR’s data on country-level flows are considerably less robust than its data on flows to emerging markets as a group and typically differ greatly from country-level portfolio flows data.”
1c. Are flows and portfolio reallocations equivalent?

Paper mentions allocations and reallocations.

But depvar is flows / lagged AUM, and flows are not reallocations.

Three ways forward:
-- omit allocations / reallocations language ("change in flows")
-- extract reallocation flows
-- use portfolio data and isolate active reallocations
Flows have two components (Tille and van Wincoop). One ("portfolio growth flows") is due to new savings being deployed. The other is reallocations. Could calculate portfolio growth and reallocation flows. KF* provides a way.

Actual minus KF* is a measure of reallocation flows.

Source: Burger Warnock Warnock (2022)
Cleaner, if the goal is to speak about portfolio allocations, is to use portfolio data to calculate reallocations.

Reallocations within US investors’ global equity portfolios
Active reallocations are small. Portfolio reallocations are almost all passive (i.e., due to relative price changes).
1c. Are flows and portfolio reallocations equivalent?

Paper mentions allocations and reallocations, but depvar is flows / lagged AUM, and flows are not reallocations. This point applies to the entire paper, but even more so for analysis of spillovers (ie reallocations to AEs).

Three possible ways forward:
-- omit allocations / reallocations language (“change in flows”)
-- extract reallocation flows (could use KF* for that)
-- use portfolio data and isolate active reallocations
Taking 1b (EPFR) and 1c (data that can speak to reallocations) into account, what data should be used?

Quarterly BOP data would take care of 1b (representativeness) but not necessarily 1c (portfolio) unless extract reallocation flows.

A dataset that is good for 1c but less so for 1b is the U.S.-focused monthly “BTBJ” data (Bertaut Tryon 2007 spliced with Bertaut Judson 2014). Can more precisely measure reallocations.

My advice:

- If willing to eliminate allocations/reallocations language, given the lack of representativeness of EPFR country-level flows, I’d go with BOP data.
- If want to keep allocations/reallocations language, use the US-focused BTBJ.

Either way, point 1a applies: I’d include bonds (unless there is a good reason not too) and lengthen the sample period.
2. Other variables and effect of disasters

The Cerutti Claessens Rose (2019) critique of capital flows papers that focus on one variable seems relevant here.

We never see regression tables and effects of other variables.

Do we start with a reasonable set of other variables? (Should exchange rate vis-à-vis USD have a positive or negative effect?)

What are other variables’ impacts?

Taking everything into account, is the disaster dummy important?

Does it explain a fair amount of the variation in flows?

Does it help us understand flows?

My advice: Include more push/pull factors, show regression results, examine impact of disasters and other variables.
What are the opportunities to move this literature forward?

1. Provide more details on dependent variable
   a. Make the case for the chosen sample period, but better to extend the sample period. Consider bringing in bond flows.
   b. Move to a dataset that is more representative country-level EPFR flow data.
   c. Use a measure that can speak to reallocations.

2. Focus more on effects and impact of other variables.
Back to the Questions

Why, according to the authors, is the paper important? What is the stated contribution?
- Little is known about how climate-related shocks affect global portfolio allocation, climate shocks are potentially an omitted pull factor in capital flow analysis, find significant effects of disasters on global portfolio allocation.

What is done?
- Estimate dynamic causal effect of disasters on portfolio allocation using local projections, add a disasters variable to push/pull analysis of EPFR weekly equity flows for 35 countries for the period 2009-2019, examine various “splits”: AEs v EMEs, active v passive funds, retail v institutional investor, disasters severity. Investigate whether natural disasters in EMEs induce reallocations to AEs.

Did the authors deliver on the stated contribution?
- Not yet, because of the opportunities.

What are the opportunities to move this literature forward?
- More thinking on dependent variable: data source and its form (flows / lagged AUM vs a measure of (re)allocations). More analysis of other variables and how important disasters are vis-à-vis other variables.
Important topic. With some modifications the paper can be a meaningful contribution to the literature.