

Discussion of

# **Granular Expectation Shocks and International Financial Contagion**

by K. Benhima, E. Bolliger, & M. Davenport

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Bank of England, CEPR, and CfM

**Global Shocks, Macroeconomic Spillovers and Geopolitical Risks: Policy Challenges**

European Commission - 8 April 2025

\*The views expressed here do not necessarily represent those of the Bank of England or of any of its Committees.

# This paper

- ▶ Matches investor-level GDP expectations with mutual fund holdings
- ▶ Shows that:
  - \* Flows into funds respond strongly to portfolio-level expected growth
  - \* But funds adjust allocations only weakly to country-specific expectations
- ▶ Interprets the evidence as co-ownership spillovers
  - \* Contagion across countries that are simply co-owned via the same fund
  - \* Not necessarily due to correlated fundamentals!
- ▶ Develops a portfolio choice model with sticky country allocations that matches evidence
  - \* Co-ownership spillovers explain 30% of the variation in expectation-driven capital flows

# My comments

## ▶ The praise

- \* Rich new dataset linking expectations to fund-level flows
- \* Thoughtful empirical design with granular instruments to address endogeneity
- \* Clear mechanism combining investor beliefs with sticky allocations

## ▶ The comments

[#1] Missing forecasts

[#2] Potential fixes

# [#] Missing forecasts

# Main idea

- ▶ Fund  $j$ 's growth expectations by investor  $i$ :  $E_t^i[g_{j,t}] = \sum_{k \in K(i,j)} w_{k,t-1}^{i,j} E_t^i[g_{k,t}]$

Country	BlackRock		
	$\Delta$ Forecast	Global Fund	AEs Fund
US	2%	0.5	0.5
Euro area	1%	0.3	0.5
Brazil	5%	0.2	0
<i>Fund-level forecast</i>		2.3%	1.5%

- ▶ Then estimate

$$\log(A_{jt}^i) = \beta E_t^i[g_{j,t}] + \lambda_j + \lambda_t^i + \varepsilon_{jt}^i$$

- ▶ If Black Rock's expectations improve for Global Fund, do we see money flowing to that fund?

# Main challenge

- ▶ Country growth expectations  $E_t^i[g_{k,t}]$  by investor  $i$  available for a subset of countries

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<i>Fund-level forecast</i>		1.3%	1.5%

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- ▶ Then estimate

$$\log(A_{jt}^i) = \beta E_t^i[g_{j,t}] + \lambda_j + \lambda_t^i + \varepsilon_{jt}^i$$

- ▶ Global Fund's growth expectations are now lower than AEs' growth forecast!

# Main challenge

- ▶ This can generate all sorts of problems....
- ▶ No scale invariance
  - [1] No cross-sectional comparability across funds
- ▶ Biases (I can think of)
  - [2] Growth forecasts may be driven by a common factor
  - [3] Growth forecasts may be more likely to be available for fast- (or slow-) growing countries
  - [4] Growth forecasts may be more likely to be available for more optimistic investors
- ▶ Composition effects
  - [5] If countries  $k \in K(i, j)$  change over time, growth forecasts fluctuates due to data coverage

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- ▶ **Authors' fix** Granular and super granular forecasts

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- ▶ **Question** Unclear which of above issues the paper addresses with granular approach?

## Example: Factor structure in growth expectations

- ▶ Assume growth expectation follow a factor structure:  $E^i[g_{k,t}] = \lambda_k E_t^i[g_t] + \tilde{E}^i[g_{k,t}]$
- ▶ What happens to the granular residual?

$$\Gamma_{j,t}^i = \underbrace{\left( \sum_k w_{j,k,t-1}^i (\lambda_k - \bar{\lambda}) \right) E_t^i[g_t]}_{\text{granular exposure to global shock}} + \underbrace{\sum_k w_{j,k,t-1}^i \left( E_t^i[g_{k,t}] - \bar{E}_t^i[g_{k,t}] \right)}_{\text{granular local shocks}}$$

- ▶ Granular component co-moves with global growth forecast, even if demeaned across the fund
  - \* What looks like contagion from local shocks, is actually heterogeneous exposure to a global belief
- ▶ Same story for super-granular residual  $E_t^i[g_t] = \lambda_i E_t^i[g_t] + \tilde{E}_t^i[g_t]$
- ▶ **Question** How likely are  $\lambda_k$  (and  $\lambda_i$ ) to vary across countries?

## [#2] **Potential fixes**

## Fix 1: Control for 'coverage'

- ▶ Define coverage ratio:

$$\text{Coverage}_t^{i,j} = \frac{\sum_{k \in K(i,j)} w_{k,t-1}^{i,j}}{\sum_k w_{k,t-1}^{i,j}}$$

- ▶ Tests whether  $\Gamma$ 's effect depends on how much of the portfolio is observed
- ▶ Include as control or interaction in regressions

$$\log(A_{jt}^i) = \beta \Gamma_{j,t}^i + \gamma \left( \Gamma_{j,t}^i \times \text{Coverage}_t^{i,j} \right) + \lambda_j + \lambda_t^i + \varepsilon_{jt}^i$$

## Fix 2: Restrict sample to high coverage sample

- ▶ Keep only observations with, say, coverage > 80%
- ▶ Helps isolate settings where  $\Gamma$  is reliably constructed
- ▶ Check robustness of results to varying coverage thresholds

## Fix 3: Simulate Coverage Effects

- ▶ Take full-coverage portfolios
- ▶ Randomly mask expectations for 80% of countries
- ▶ Recompute  $\Gamma$ , see how it changes
- ▶ Reveals sensitivity of results to data gaps

# In sum

- ▶ A very nice paper, with many interesting avenues for further research
- ▶ Suggestions:
  - \* Provide a more detailed discussion of how granular forecasts help address the challenge of not observing all forecasts
  - \* Add some additional robustness checks for the empirical results

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