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FINLANDS BANK
EUROSYSTEMET

Geopolitical risk: When it matters; Where it matters. Evidence from international portfolio allocations - Discussion

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Short recap

- Does geopolitical risk lead to financial fragmentation?
 - Fund managers reduce portfolio weights of countries more exposed to geopolitical risk, results stronger for EMEs and in high overall risk environment
 - When global geopolitical risk increases, portfolios become more concentrated, number of destination countries and political distance of portfolios drop
 - End investors also react: fund flows decline sharply but recover quickly after the initial shock

Overall impression

- Interesting paper!
- Comprehensive fund-level data on portfolio allocations of international bond funds
- Credible setup and estimations, thorough work, compelling results
- Comments:
 - Measuring geopolitical risk
 - UN voting patterns
 - End investors

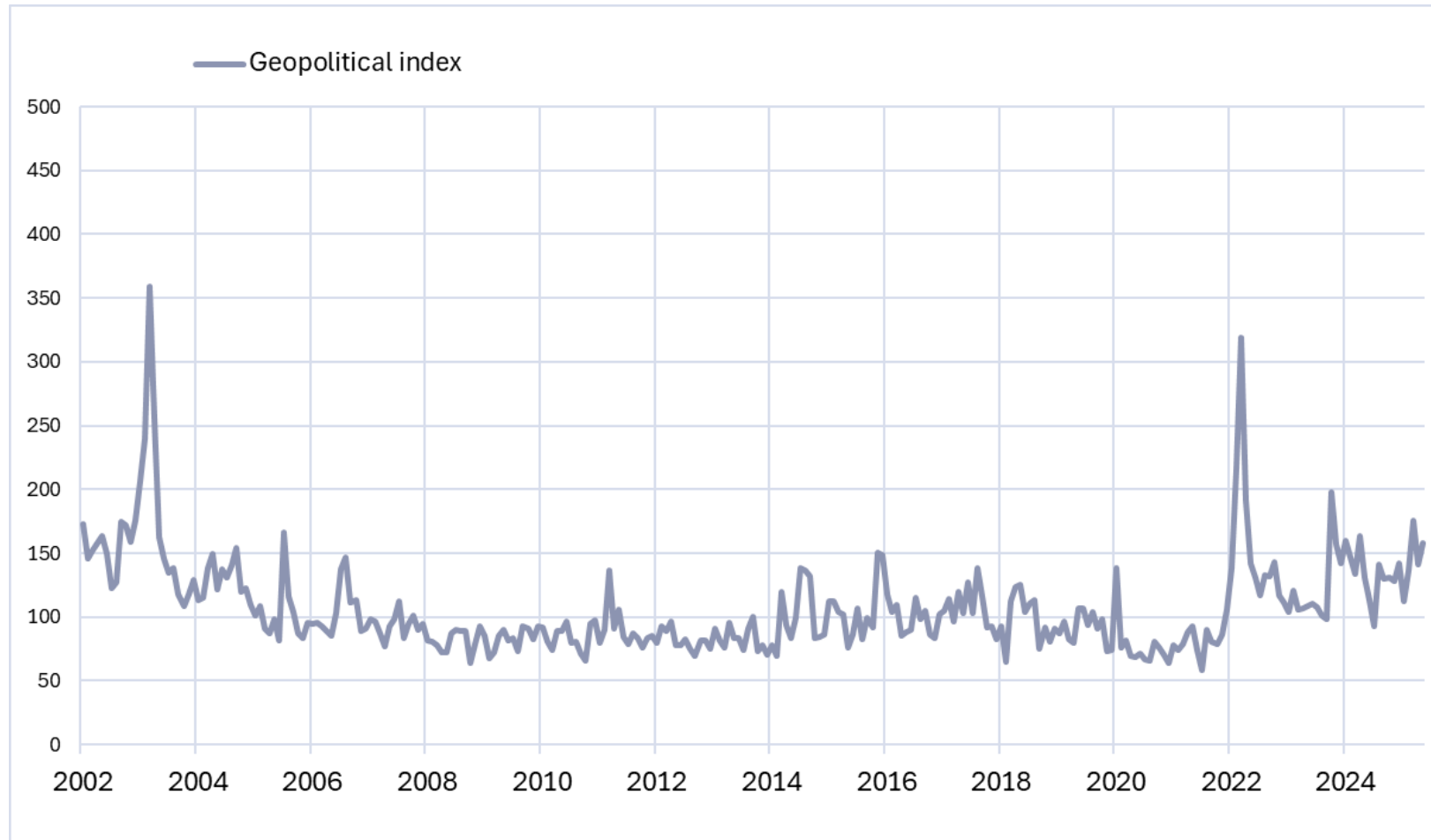
Comment #1: Geopolitical risk index

1) Geopolitical risk: a threat or an act?

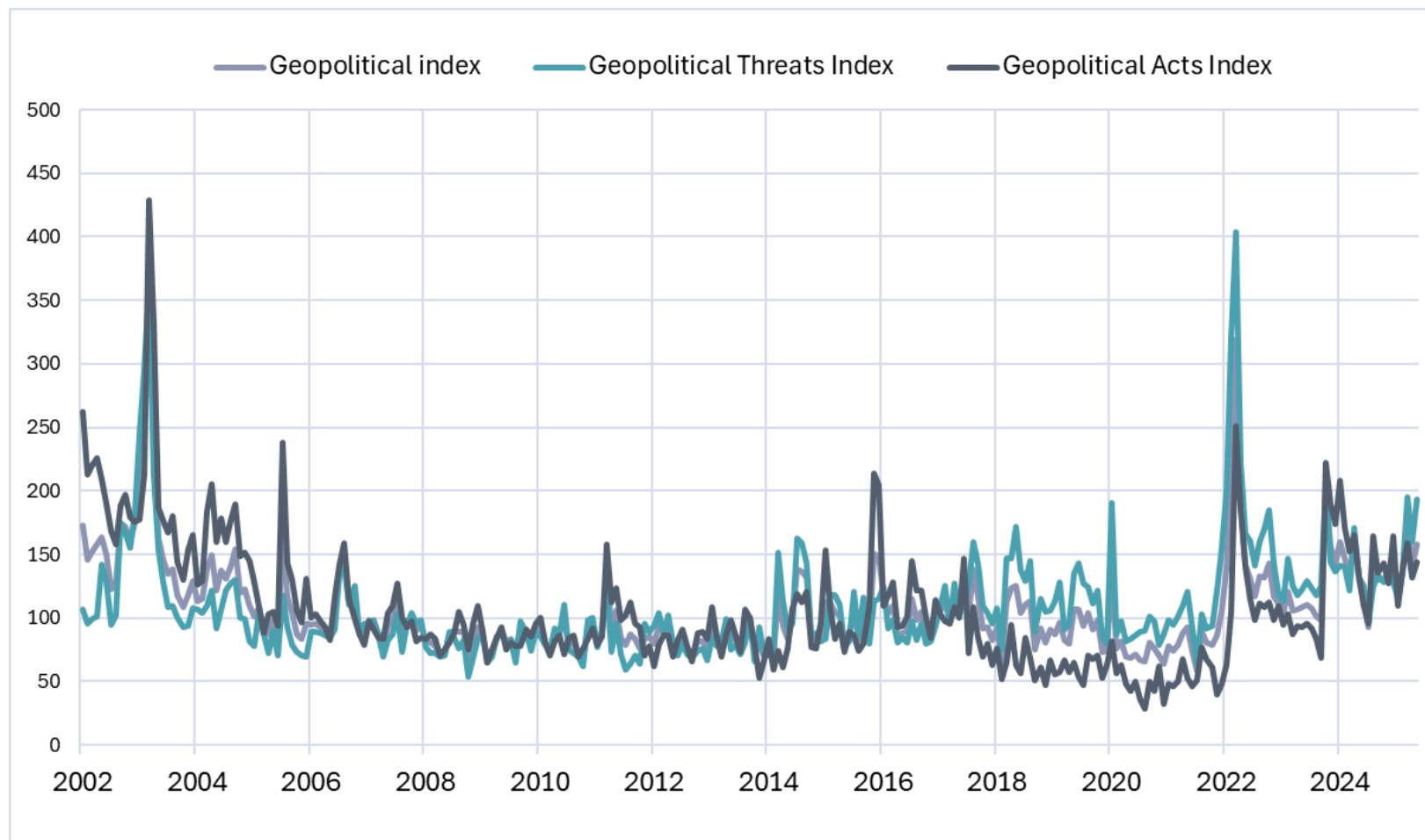
- Stage of tensions: the biggest market impacts occur when tensions are still at the stage of threats or escalating rhetoric due to higher uncertainty and volatility (Astvansh et al., 2022)
- Pricing geopolitical risks: very challenging to accurately price geopolitical risks until something significant happens
 - When tensions - no matter how serious - materialize, uncertainty decreases and markets begin to gradually recover

2) Country-specific GPR indices can sometimes be problematic

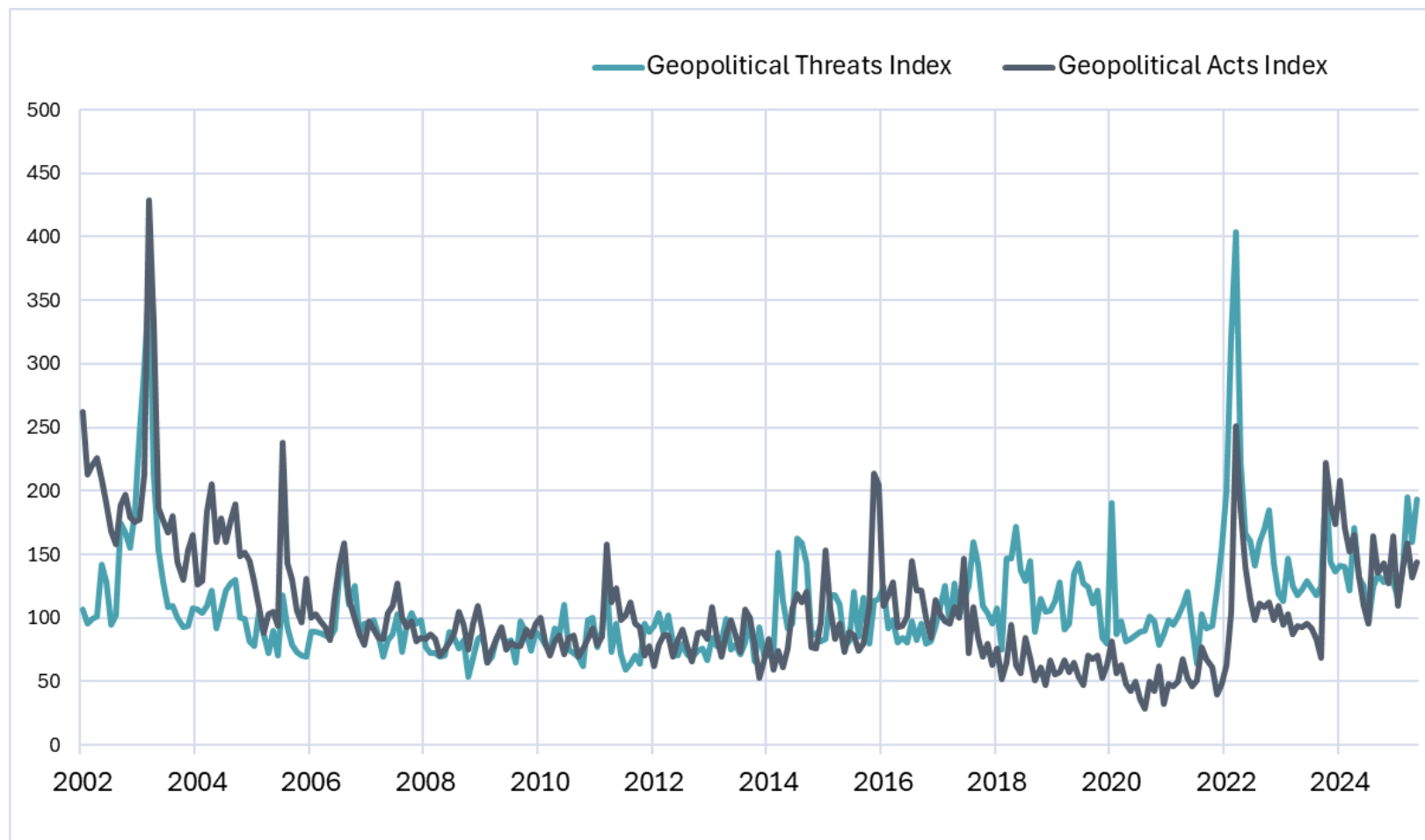
Geopolitical risk: threat or act?



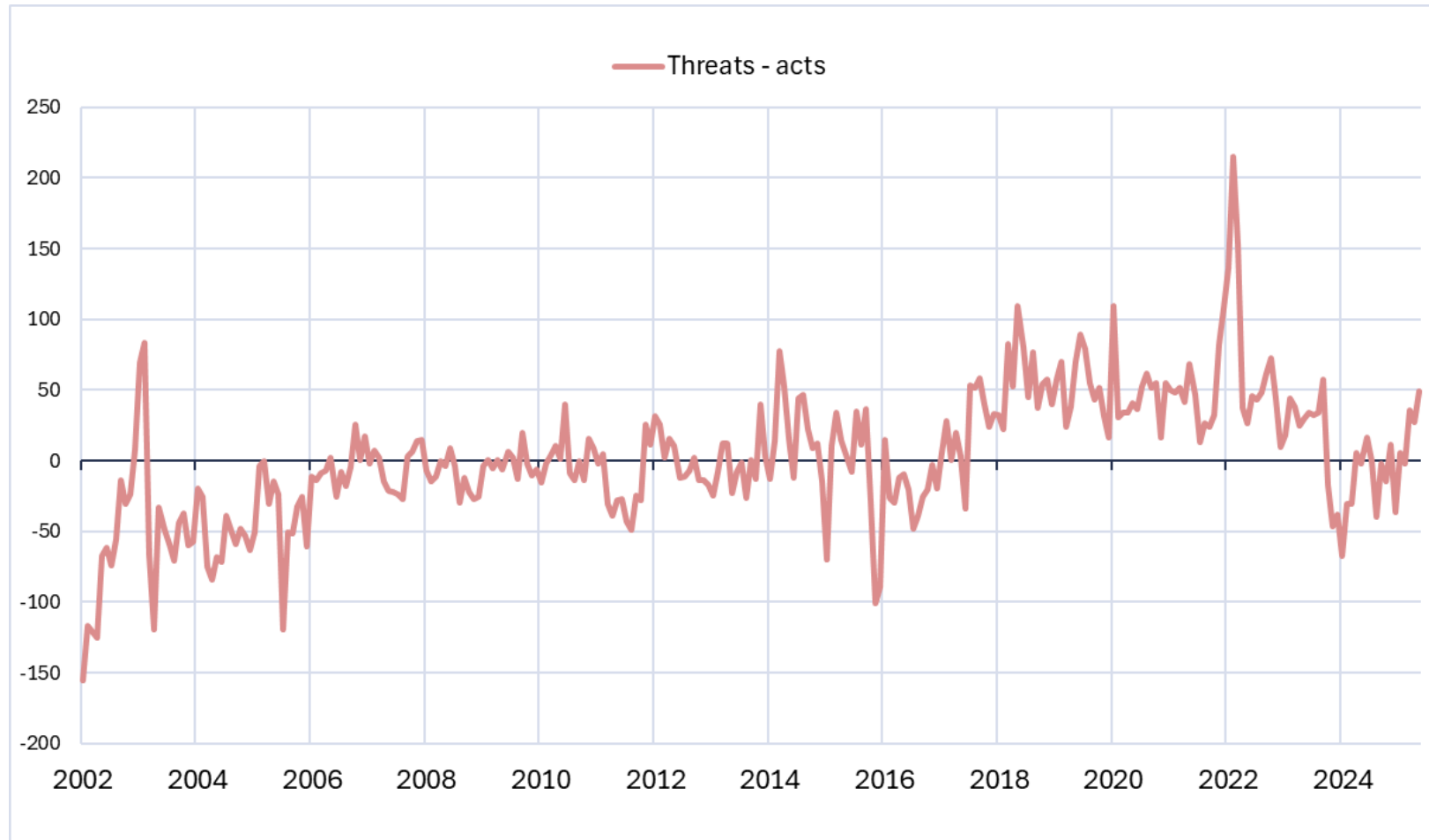
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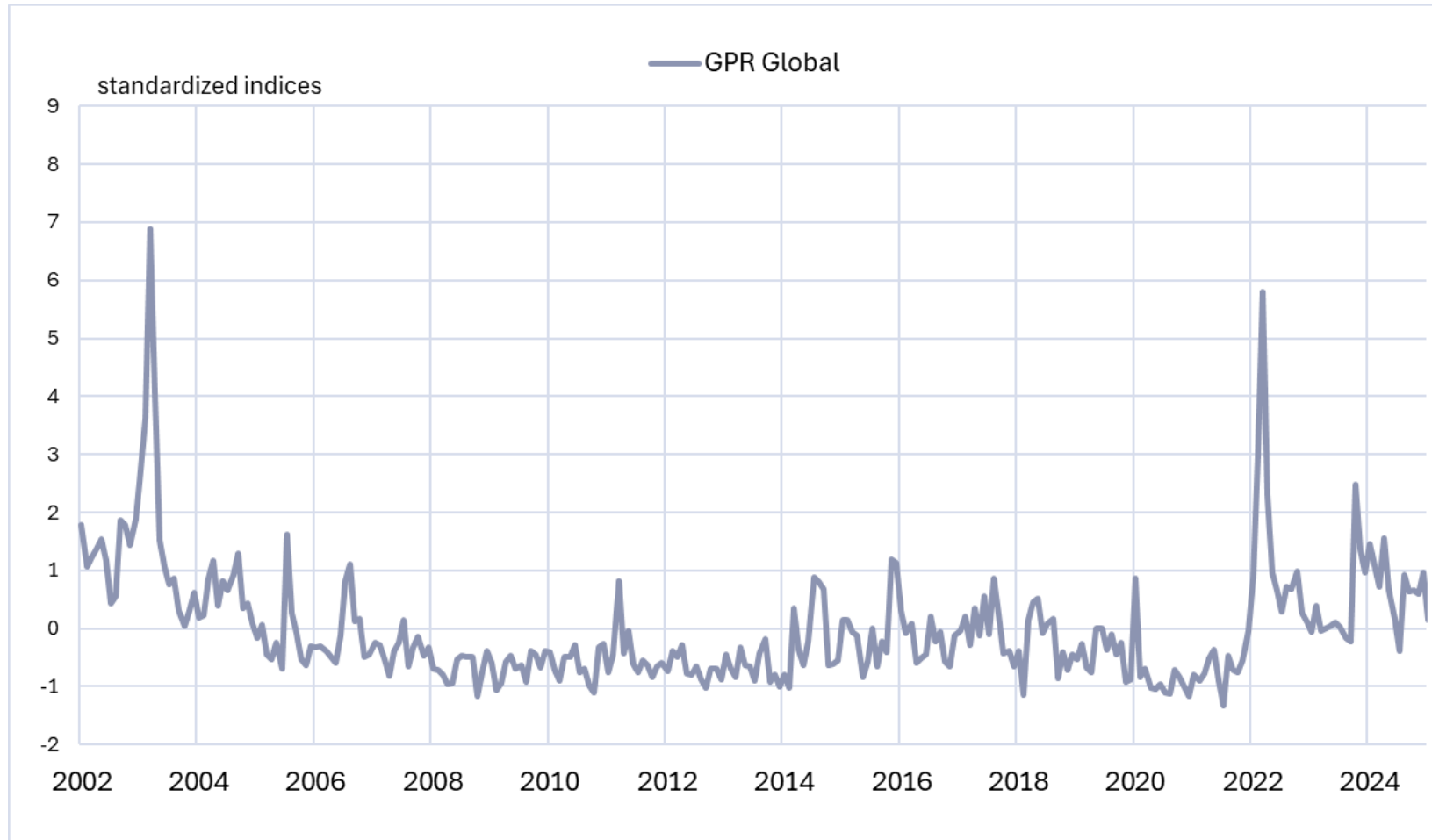
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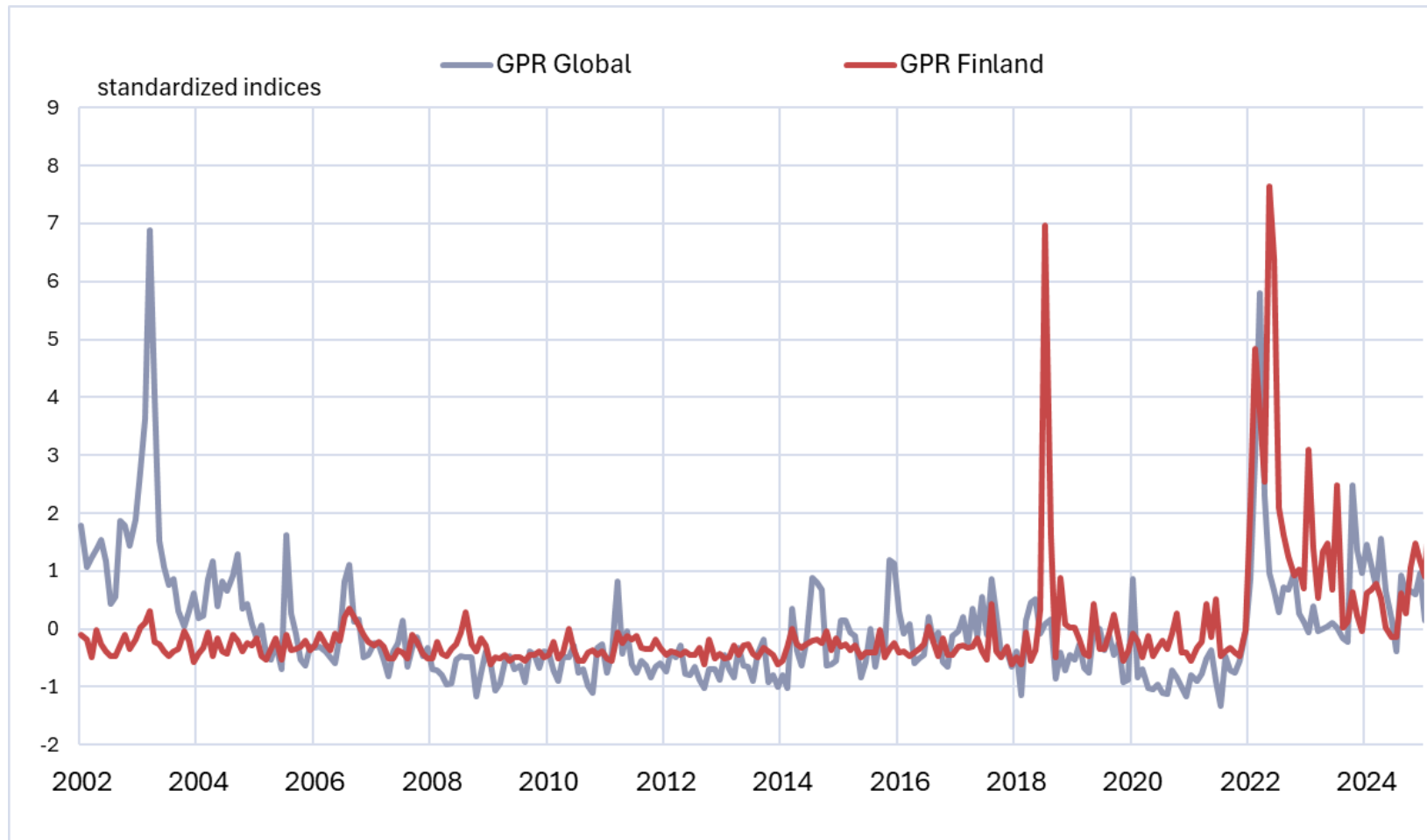
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Geopolitical risk: country-specific indices



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2018 Russia–United States summit



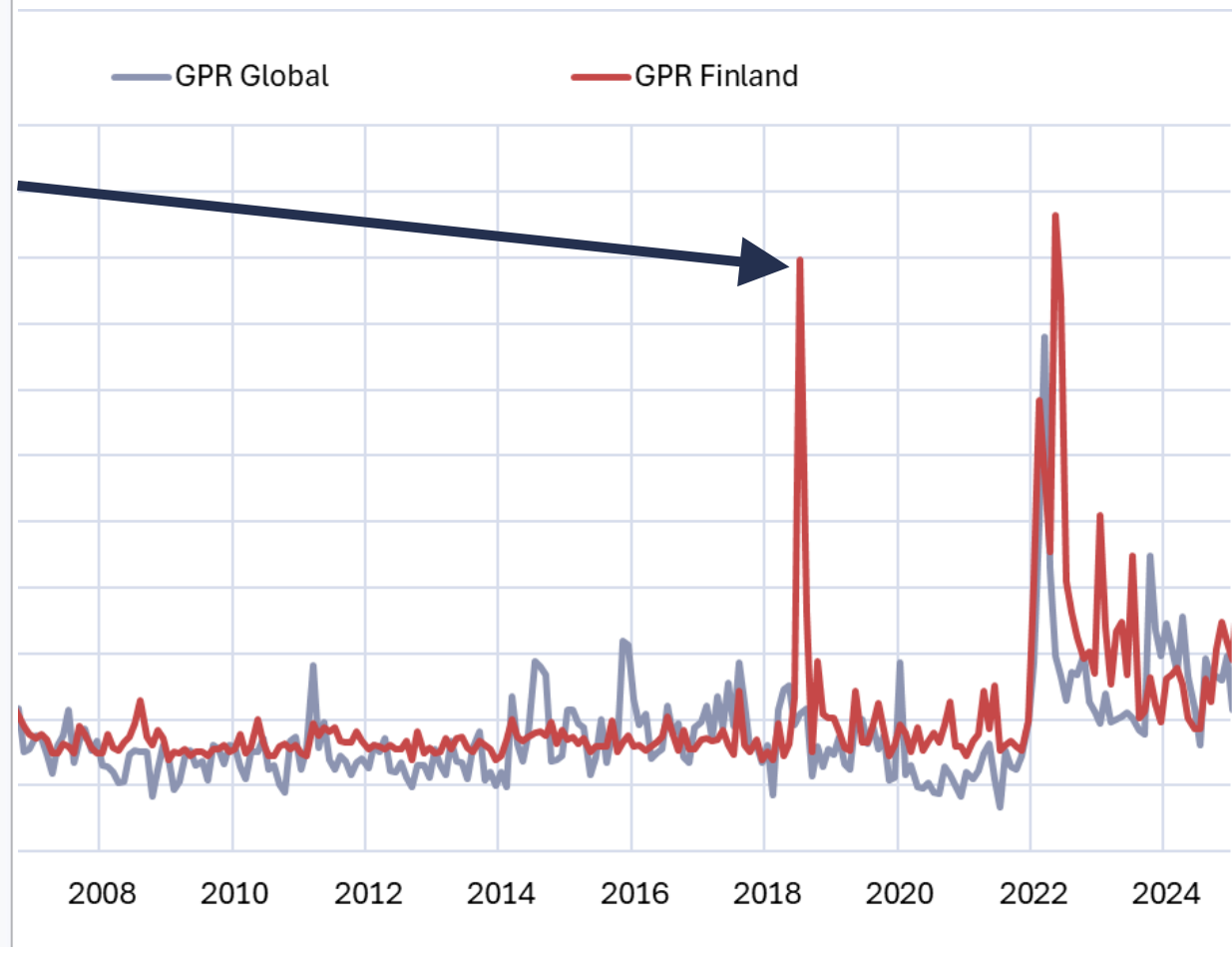
Donald Trump and Vladimir Putin during the summit

Host country  Finland^[1]

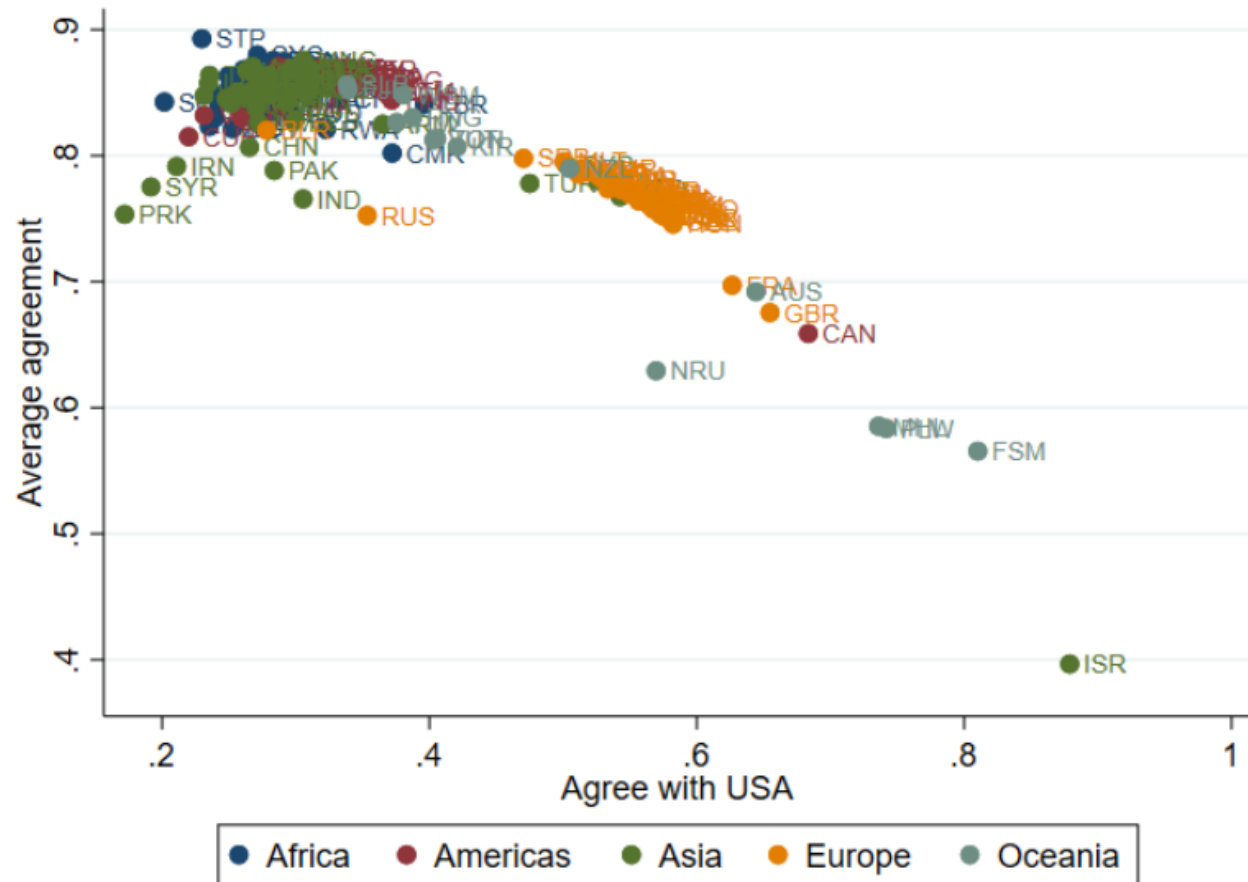
Date 16 July 2018^[1]

Venue(s) Presidential Palace

Cities Helsinki



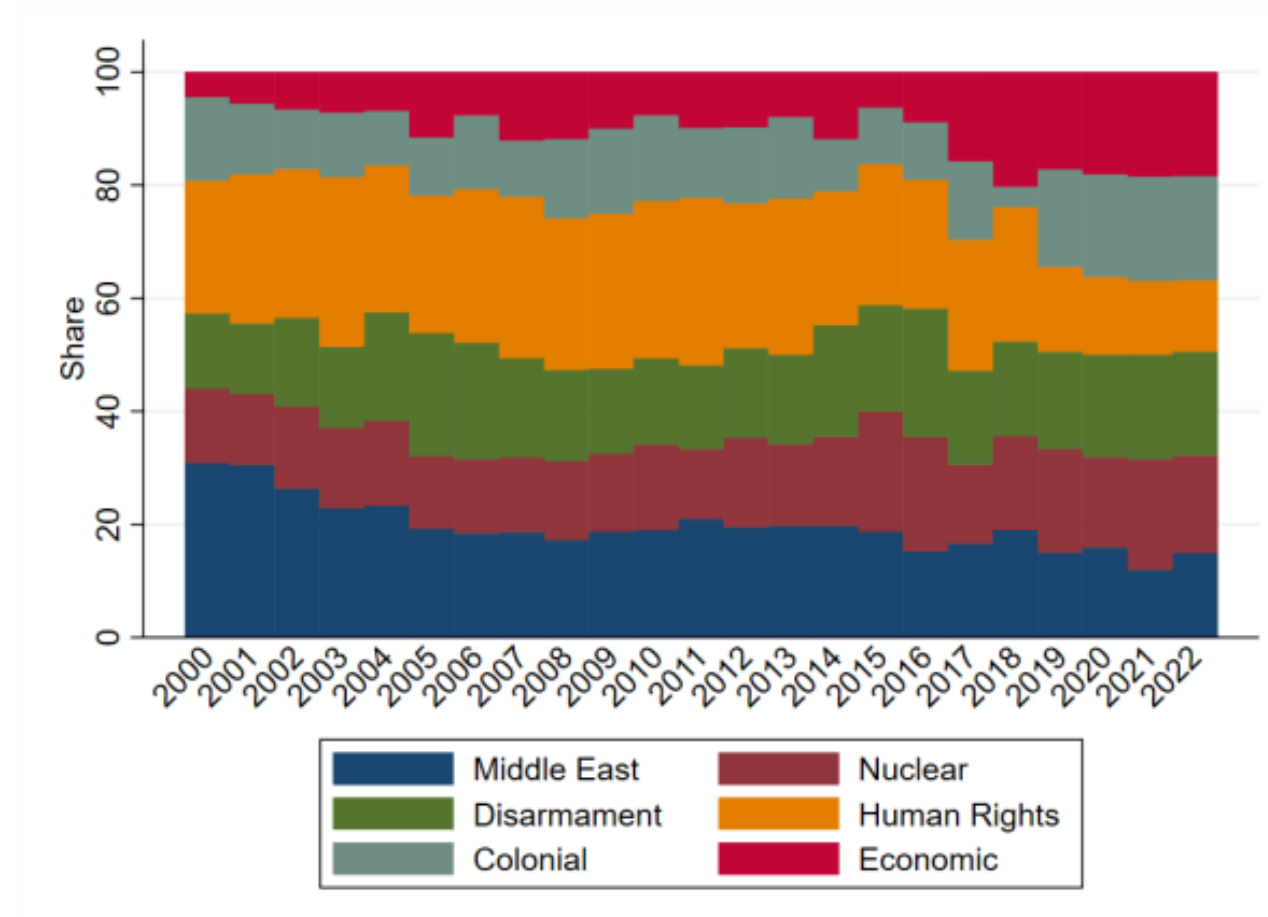
Comment #2: UN Voting patterns



- The figure plots the average voting agreements with all countries and the USA from 2000-2022.
- Countries are color-coded by region.

Comment #2: UN Voting patterns

Figure 7. Share of Resolutions Across Categories at the UNGA over Time

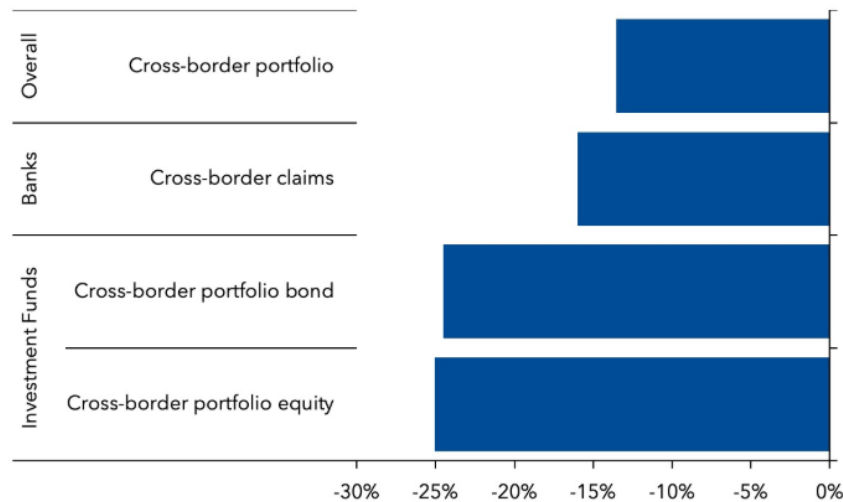


Comment #2: UN Voting patterns

Geopolitics and capital allocation

Greater tensions are associated with reduced cross-border allocation of portfolio investment and bank claims.

Response to a one-standard-deviation increase in the geopolitical distance between investing and recipient country



Sources: United Nations; Bank for International Settlements; EPFR Global; FinFlows; IMF, Coordinated Direct Investment Survey; IMF, Coordinated Portfolio Investment Survey; and IMF staff calculations.

Note: Distance between an investing and recipient country is based on their votes in the UN General Assembly.

IMF

- IMF Global Financial Stability Report (April 2023) Chapter 3

Comment #3: End investors

- End investors' net flows recover quickly: why or why not?
 - Do they simply react to the reallocation of funds that is well underway after one quarter?
- Is the reaction of the end investors different depending on the initial weights /allocation of the fund?
 - Do the initial allocations differ significantly in the first place?
- Would it be possible to track down the end investors?
 - Could the geographical composition of end investors impact fund managers' reactions/ allocation decisions?

+ couple of smaller ones:

- Who benefits from fragmentation?
 - Geopolitical risk leads to fragmentation: funds' portfolios become more concentrated, and the number of destination countries drop → Where do they concentrate their portfolios?
- What about cross-border issuance?
 - Foreign firms' bond issuances on US exchanges (Yankee bonds) are affected by their home countries' political ties with the US. A one standard deviation improvement in political ties → 7-12% lower spreads (Ambrocio et al., 2022)



Thank you!

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