# Global Imbalances: The Crisis That Didn't Occur…Yet

Frank Warnock
Darden and NBER

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University of Virginia
Darden School of Business

# The Plan

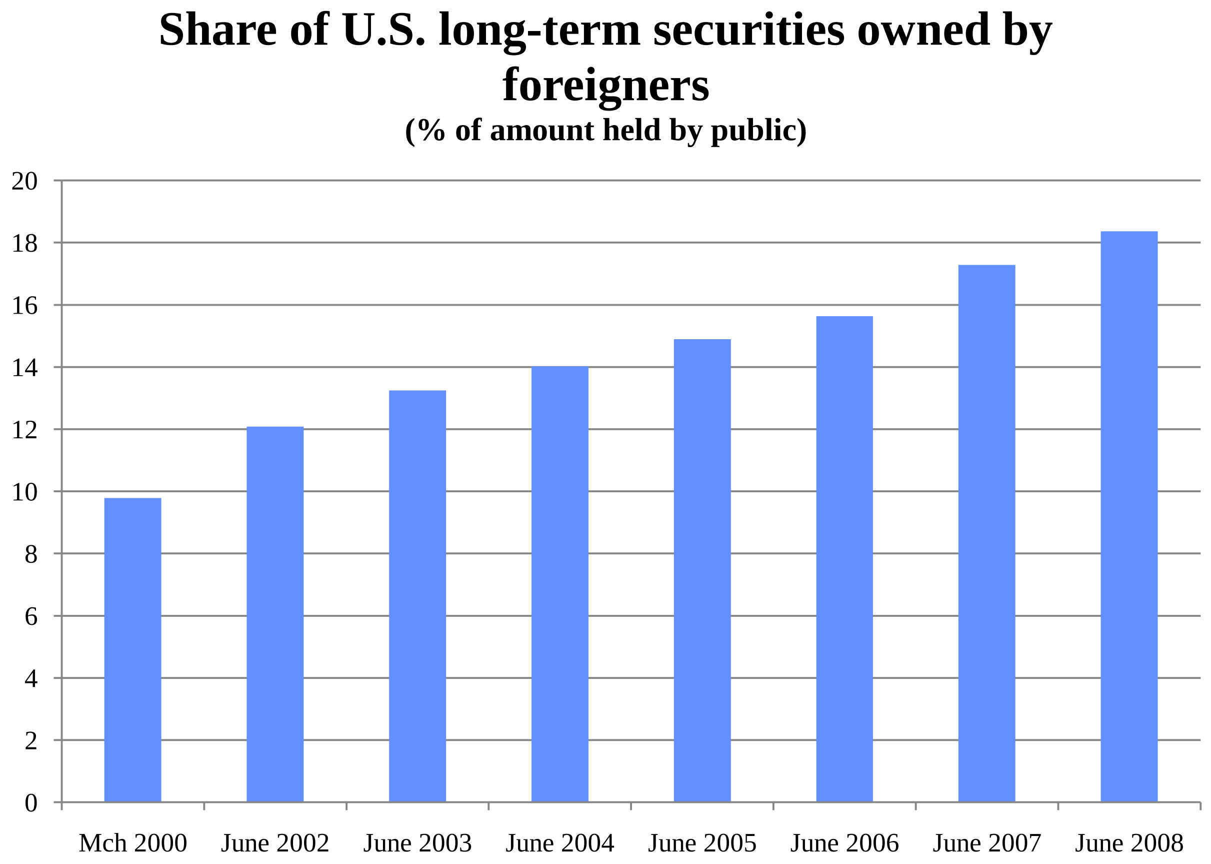
- Discuss global imbalances from a portfolio/capital flows perspective, focusing on three periods:

  - Pre-Crisis
  - The Crisis
  - The Future

# Pre-Crisis

- Many, including Roubini and Setser (2004) and Feldstein (2006), warned of a possible U.S. external crisis.
  - The stability of BW2 hinged on the willingness of Asian central banks to continue to add to their huge holdings of U.S. securities.
  - When the day of reckoning arrived, U.S. long-term interest rates would spike and the dollar would plummet.

# Pre-crisis, foreigners held a steadily increasing share of U.S. securities…

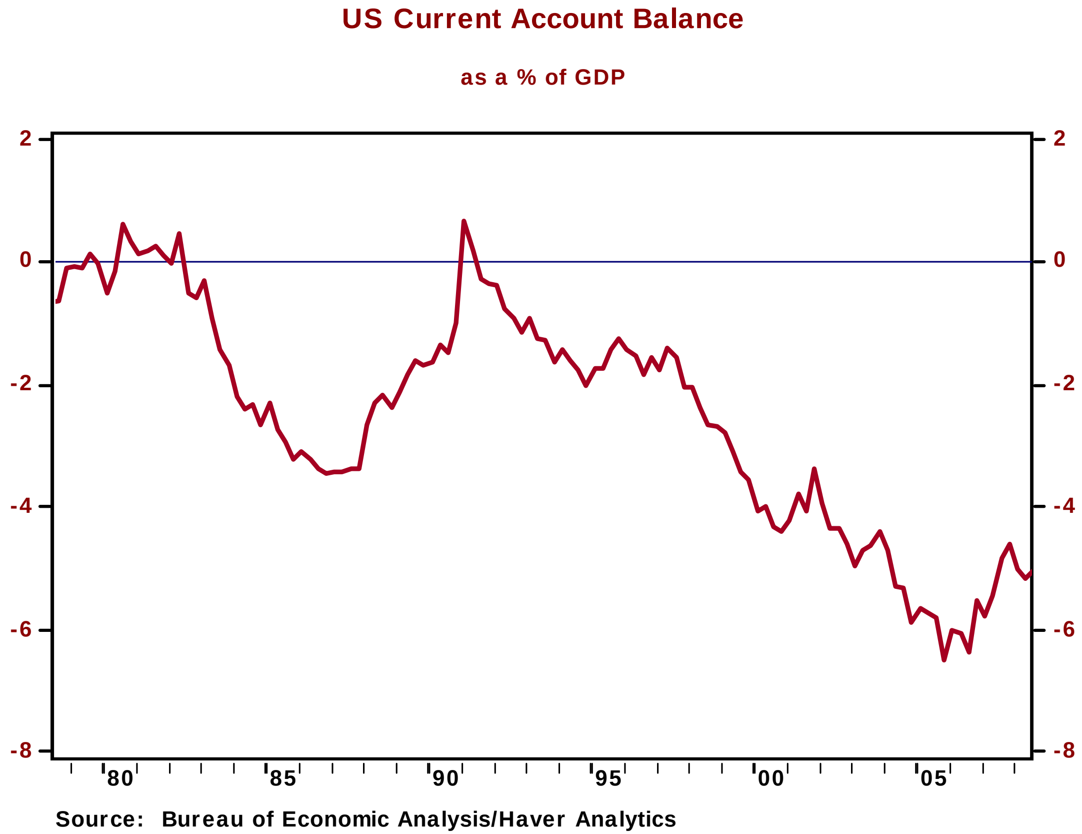


# …and almost two-thirds (!) of all marketable US Treasurys held by the public.

| | Mch 2000 | June 2002 | June 2003 | June 2004 | June 2005 | June 2006 | June 2007 | **June 2008** |
|---|---|---|---|---|---|---|---|---|
| Equity | | | | | | | | |
| Total outstanding | 24,861 | 18,485 | 18,639 | 22,006 | 23,947 | 26,367 | 31,450 | **28,435** |
| Foreign-owned | 1,709 | 1,395 | 1,564 | 1,930 | 2,144 | 2,430 | 3,130 | **2,969** |
| % foreign-owned | 6.9 | 7.5 | 8.4 | 8.8 | 9.0 | 9.2 | 10.0 | **10.4** |
| Marketable US Treasury | | | | | | | | |
| Total outstanding | 2,508 | 2,230 | 2,451 | 2,809 | 3,093 | 3,321 | 3,454 | **3,621** |
| Foreign-owned | 884 | 908 | 1,116 | 1,426 | 1,599 | 1,727 | 1,965 | **2,211** |
| % foreign-owned | 35.2 | 40.7 | 45.5 | 50.8 | 51.7 | 52.0 | 56.9 | **61.1** |
| US government agency | | | | | | | | |
| Total outstanding | 3,575 | 4,830 | 5,199 | 5,527 | 5,591 | 5,709 | 6,202 | **6,986** |
| Foreign-owned | 261 | 492 | 586 | 619 | 791 | 984 | 1,304 | **1,464** |
| % foreign-owned | 7.3 | 10.2 | 11.3 | 11.2 | 14.1 | 17.2 | 21.0 | **21.0** |
| Corporate and other debt | | | | | | | | |
| Total outstanding | 5,411 | 6,954 | 7,692 | 8,381 | 9,410 | 10,425 | 11,747 | **12,501** |
| Foreign-owned | 703 | 1,130 | 1,236 | 1,455 | 1,729 | 2,021 | 2,738 | **2,820** |
| % foreign-owned | 13.0 | 16.2 | 16.1 | 17.4 | 18.4 | 19.4 | 23.3 | **22.6** |

($ billions, except where noted)

# The substantial foreign accumulation of US securities helped finance (and maintain) the US current account deficit…




Through 2008Q2

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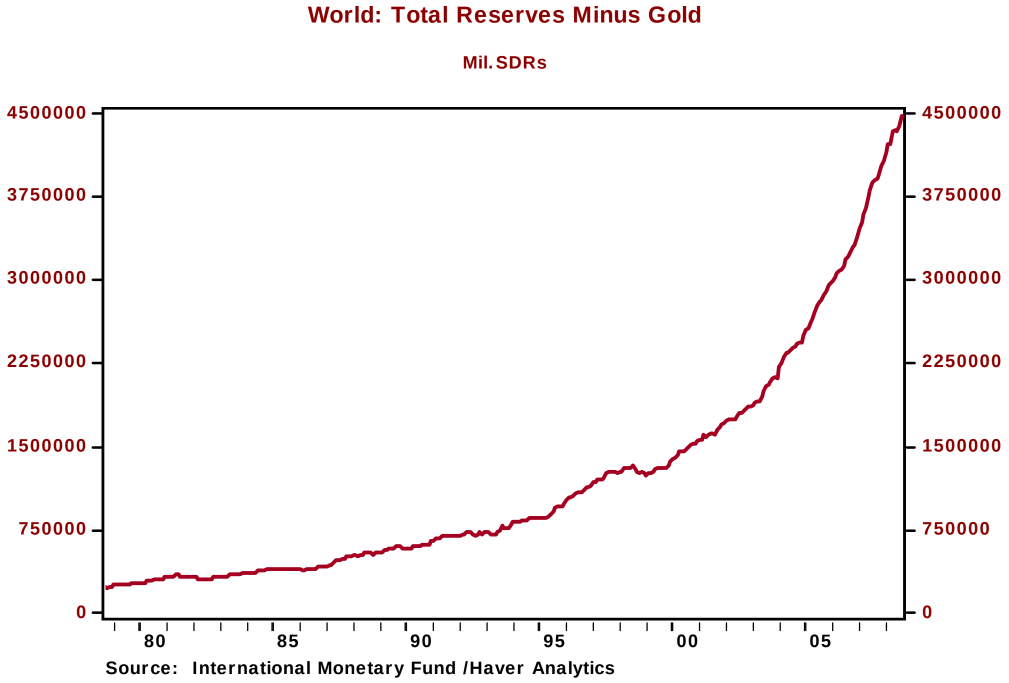
# …and depressed U.S. long rates.

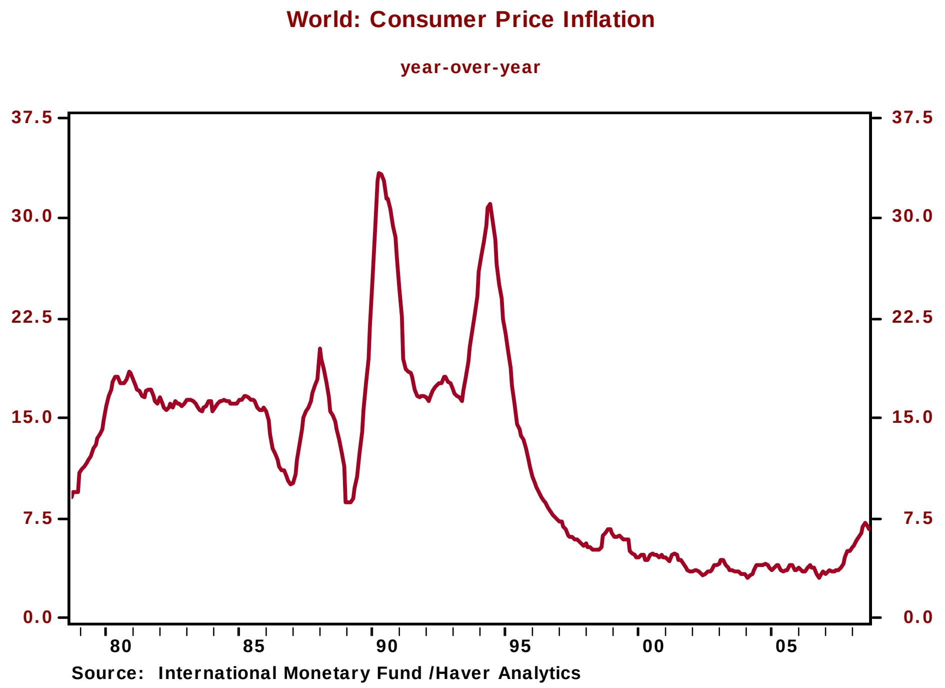

Through 2008 Aug

# Associated with this was a massive increase in international reserves…




Through 2008 Aug

# …and a spike in global inflation (and food-price riots in three dozen countries).




Through 2008 Aug

# Pre-Crisis

- Pre-crisis, foreigners held a steadily increasing share of U.S. securities, including almost two-thirds (!) of all marketable US Treasurys held by the public.
- The substantial foreign accumulation of US securities helped finance (and maintain) the US current account deficit and depressed U.S. long rates.
- Associated with this was a massive increase in international reserves and a spike in global inflation (and food-price riots in three dozen countries).

# The crisis

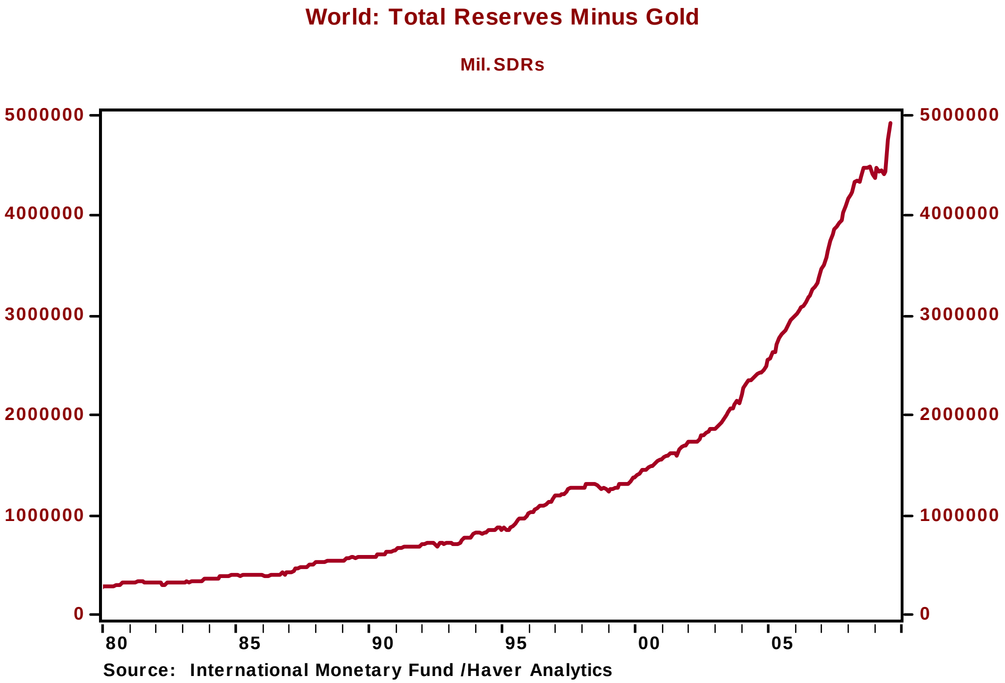
- The scene was set for a U.S. external crisis, but the crisis that hit clearly wasn’t that.
  - During the darkest moments of the crisis, the dollar surged and U.S. long rates fell.
- The Question: How likely is a U.S. external crisis going forward?

# Going forward

- "Global imbalances" is clearly a choice variable for emerging market governments.
  - We wouldn't have global imbalances were it not for conscious decisions by EME governments.
    - Yes, the US consumer is voracious, but if the dollar was much weaker that demand would likely fall on US goods.
  - Qu: What would cause EME governments to give up this arrangement?

- "Global imbalances" is also the result of choices made by US and foreign investors.
  - Qu: Has the crisis brought about a change in their preferences?

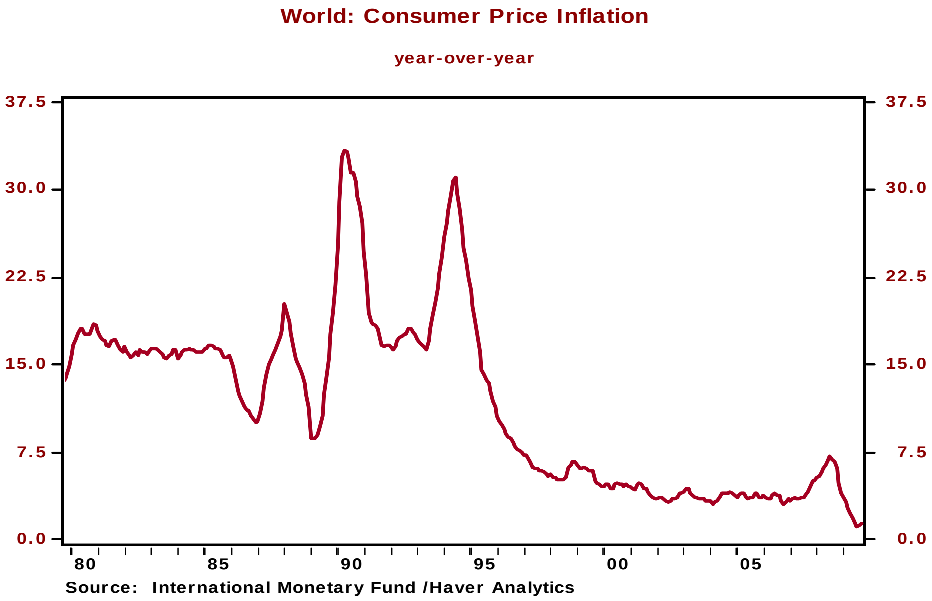
# Any indication EME governments will cease to accumulate reserves?

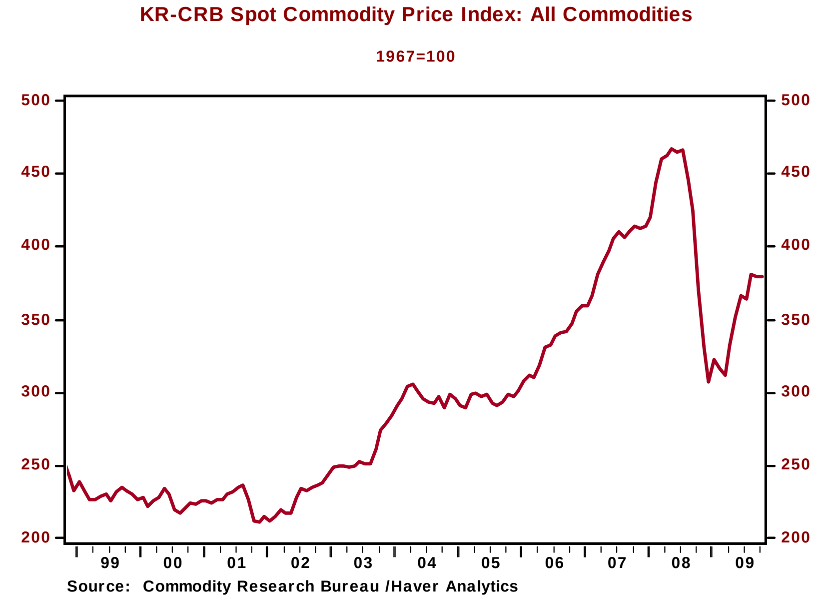



Paused during the crisis, but have since resumed.

Through 2009 Aug

# What would prompt EME govts to cease to accumulate reserves?
# (i) A return of inflation




Inflation has fallen sharply and has yet to increase, although commodity prices are rising.

Through 2009 Sept/Oct

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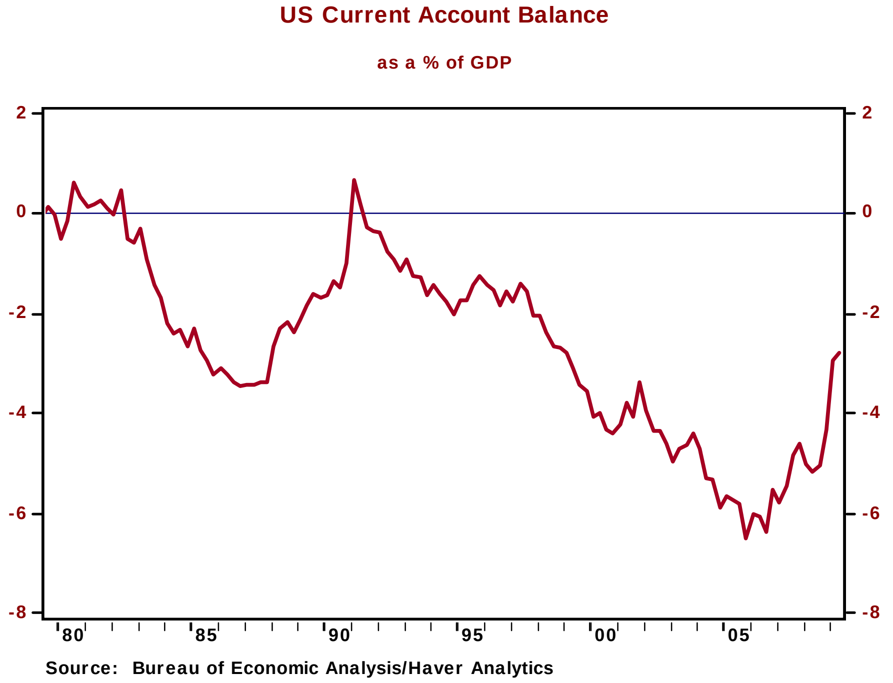
# What would prompt EME govts to cease to accumulate reserves?
# (ii) A shift to domestic demand

# The view from investors' perspectives

U.S. has gone through a "current account reversal" or "true sudden stop", during which there have been substantial shifts in the size and composition of financial inflows and outflows.

# For a developed country, we'd call this sharp improvement in the current account balance a "current account reversal".




Through 2009 Q2

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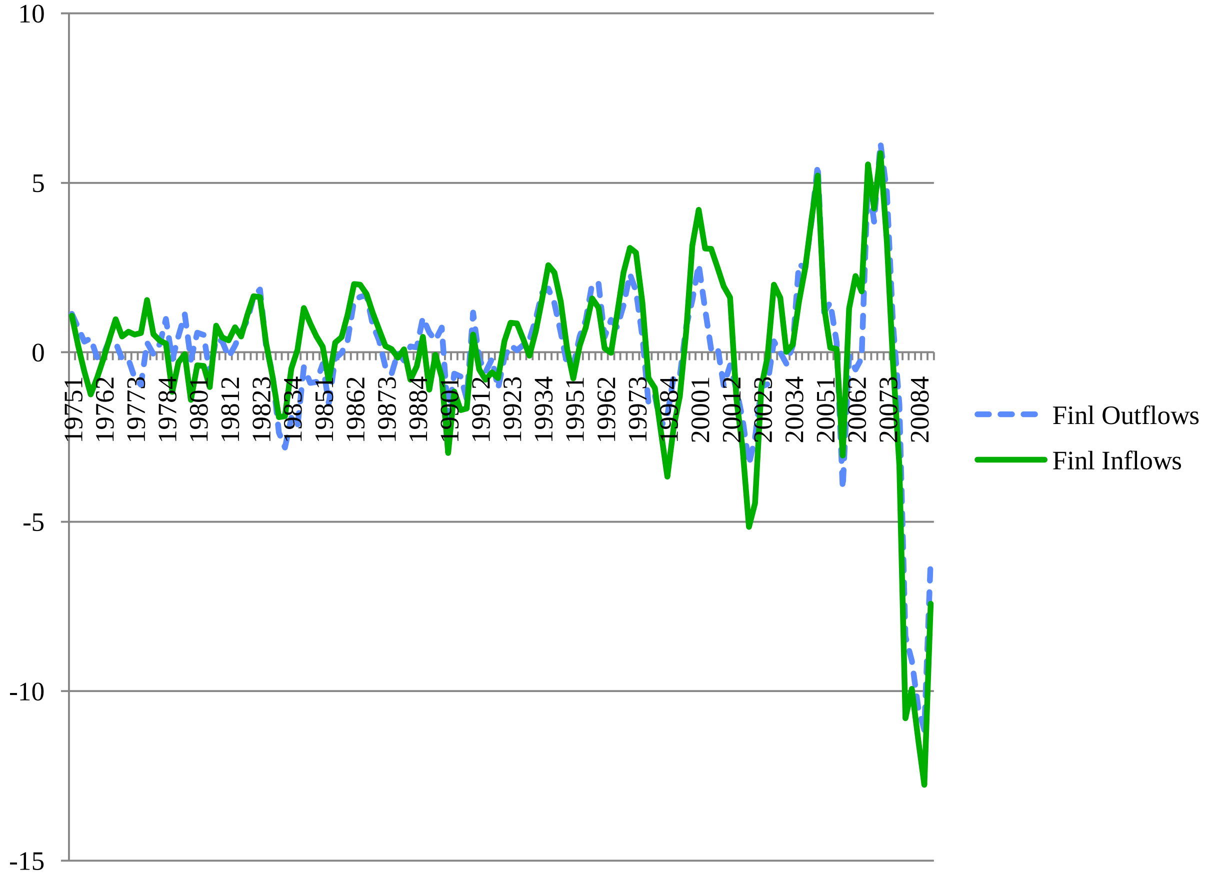
# Were the US an emerging market, the episode would be labeled a "true sudden stop".




*Fin'l inflows plummeted.*

*Net inflows supported by repatriated funds.*

Through 2009 Q2. 4-quarter sum of flows scaled by GDP.

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# Some striking changes in US BOP:
## (i) Sharp decrease in CAD as imports fall faster than exports.

| | 2004-2007 | 2008 | 2009 H1 | |
|---|---|---|---|---|
| Current Account Balance | -727 | -706 | -371 | *Sharp decrease in current account deficit…* |
| Trade Balance | -697 | -696 | -319 | *…sharp decrease in trade deficit, as imports fell faster than exports.* |
| Income Balance | 70 | 118 | 72 | *Income balance still positive.* |
| Current Transfers | -100 | -128 | -124 | |
| Capital Account Balance | 2 | 1 | -3 | |
| Statistical Discrepancy | 49 | 200 | 204 | *The discrepancy is quite large, suggesting there should be some combination of more net inflows and smaller current account deficit.* |

$billions, annualized

# Some striking changes in US BOP:

## (ii) Net fin'l inflows held up in 2008 because US investors' flows abroad were zero. Sharp decline in net fin'l inflows in 2009H1.

| | 2004-2007 | 2008 | 2009 H1 | |
|---|---|---|---|---|
| Financial Account Balance | 667 | 534 | 153 | *Sharp decrease in financial account balance* |
| US Outbound Flows | -1076 | 0 | 254 | *US flows abroad plummeted to zero in 2008 and went negative in 09H1* |
| US DI Abroad | -249 | -332 | -190 | *US DI abroad has maintained a reasonably high level.* |
| US Flows into For. Securities | -288 | 61 | -257 | *US investors sold foreign secs in 08, but resumed net purchases (esp. of foreign bonds) in 09H1.* |
| Foreign Equities | -139 | -1 | -78 | |
| Foreign Bonds | -149 | 62 | -179 | |
| US Flows into Foreign Banks | -541 | 806 | -166 | *Net flows into the US banking system (ie when combined with inflows, below) were very positive in 08 and very negative in 09H1.* |
| US Government Assets | 2 | -534 | 867 | *Unprecedented flows of US govt assets abroad, but across time sum to zero.* |

$billions, annualized

# Some striking changes in US BOP:

## (iii) Private flows into the US were near zero in '08 and negative in 09H1. FOI inflows held up, but foreigners no longer purchase agency or corp bonds.

| | 2004-2007 | 2008 | 2009 H1 | |
|---|---|---|---|---|
| **Current Account Balance** | **-727** | **-706** | **-371** | ***Sharp decrease in current account deficit…*** |
| **Financial Account Balance** | **667** | **534** | **153** | ***sharp decrease in financial account balance*** |
| **US Outbound Flows** | **-1076** | **0** | **254** | ***US flows abroad plummeted to zero in 2008 and went negative in 09H1*** |
| **US Inbound Flows** | **1744** | **534** | **-100** | ***Flows into the US fell sharply in 08 and went negative in 09H1.*** |
| **FOI Flows into the US** | **406** | **487** | **392** | ***Foreign official inflows have held up…*** |
| Treasury Securities | 173 | 478 | 484 | ***…as flows into Treasurys, especially Tbills, surged…*** |
| Treasury Bonds and Notes | 181 | 205 | 276 | |
| Treasury Bills | -7 | 272 | 208 | |
| Other FOI Inflows | 233 | 9 | -92 | ***…offsetting the sharp decline in official purchases of Agency bonds.*** |
| **Private Flows into the US** | **1337** | **47** | **-492** | ***Private flows into the US plummetted to zero in 08 and were negative in 09H1.*** |
| FDI in the US | 194 | 320 | 102 | ***FDI in the US held up…*** |
| Treasury Securities | 59 | 197 | 62 | ***…and private flows into Treasurys haven't plummeted…*** |
| Treasury Bonds and Notes | 47 | 13 | 74 | |
| Treasury Bills | 11 | 184 | -12 | |
| Agency Bonds | 34 | -185 | -99 | ***…but private foreigners now sell US agency bonds…*** |
| US Equities | 130 | 57 | 84 | |
| US Corporate Bonds | 367 | 1 | -69 | ***…as well as US corporate bonds.*** |
| Private Flows into US Banks | 551 | -372 | -593 | |
| Financial Derivatives | 9 | -29 | . | |
| Statistical Discrepancy | 49 | 200 | 204 | *The discrepancy is quite large, suggesting there should be some combination of more net inflows and smaller current account deficit.* |

$billions, annualized

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# The peak in foreign ownership of US securities?

- Striking changes in US financial flows
  - True Sudden Stop
  - Private flows into the US were near zero in '08 and negative in 09H1. FOI inflows held up, but foreigners no longer purchase agency or corp bonds.
  - Net fin'l inflows held up in 2008 only because US investors' flows abroad were zero.

- Two Questions
  - Have we seen the peak in foreign ownership of US securities?
  - Are zero US outflows likely to persist?

# Have we seen the peak in foreign ownership of U.S. long-term securities?

| | Mch 2000 | June 2002 | June 2003 | June 2004 | June 2005 | June 2006 | June 2007 | June 2008 | June 2009 |
|---|---|---|---|---|---|---|---|---|---|
| Equity | | | | | | | | | |
| Total outstanding | 24,861 | 18,485 | 18,639 | 22,006 | 23,947 | 26,367 | 31,450 | 28,435 | 23,140 |
| Foreign-owned | 1,709 | 1,395 | 1,564 | 1,930 | 2,144 | 2,430 | 3,130 | 2,969 | 2,199 |
| % foreign-owned | 6.9 | 7.5 | 8.4 | 8.8 | 9.0 | 9.2 | 10.0 | **10.4** | **9.5** |
| Marketable US Treasury | | | | | | | | | |
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| Foreign-owned | 884 | 908 | 1,116 | 1,426 | 1,599 | 1,727 | 1,965 | 2,211 | 2,629 |
| % foreign-owned | 35.2 | 40.7 | 45.5 | 50.8 | 51.7 | 52.0 | 56.9 | **61.1** | **57.3** |
| US government agency | | | | | | | | | |
| Total outstanding | 3,575 | 4,830 | 5,199 | 5,527 | 5,591 | 5,709 | 6,202 | 6,986 | 7,243 |
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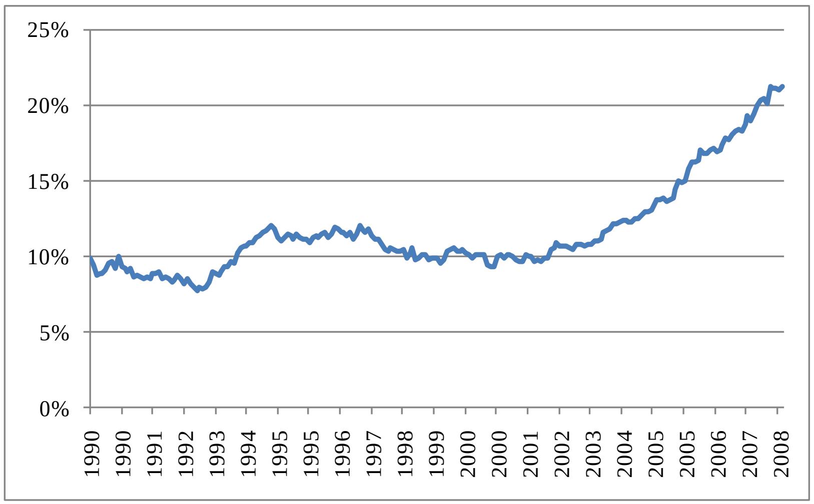
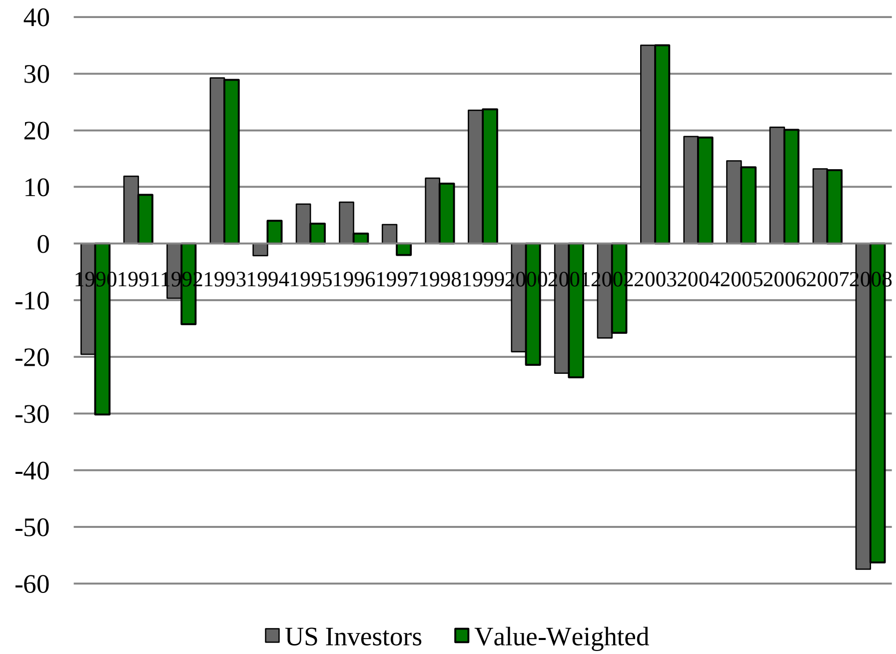
| % foreign-owned | 13.0 | 16.2 | 16.1 | 17.4 | 18.4 | 19.4 | 23.3 | **22.6** | **19.2** |
| Total US long-term securities | | | | | | | | | |
| Total outstanding | 36,355 | 32,499 | 33,981 | 38,723 | 42,041 | 45,822 | 52,853 | 51,543 | 47,804 |
| Foreign-owned | 3,557 | 3,925 | 4,502 | 5,430 | 6,263 | 7,162 | 9,137 | 9,464 | 8,567 |
| % foreign-owned | 9.8 | 12.1 | 13.2 | 14.0 | 14.9 | 15.6 | 17.3 | **18.4** | **17.9** |

# Zero outflows likely to persist?

Share of Foreign Equities in US Investors’ Equity Portfolio




ROW Portfolio Returns
(excess returns, in percentage points)




US investors’ foreign equity portfolios have performed quite well over the past few decades. About to see a surge in int’l portfolio diversification?

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# Summary

- US has gone through a "true sudden stop" (a sharp decline in gross inflows, mitigated only by a surge in repatriation) in which the composition of capital flows has changed dramatically.
  - Inflows into the US have declined
    - Foreign official flows have held up, but a switch toward shorter-term securities (i.e., TBills).
    - Foreigners selling agency and corp bonds; huge shift from past *x* years.
  - Outflows from US about to surge?
    - US investors have resumed adding to their foreign portfolios
  - (There is, though, the perennial question: If not US, where?)

- Bottom line: After any crisis there is a reassessment of the riskiness of asset classes. US won't look good in that reassessment. While imbalances are building up again, sharp changes in portfolio preferences are more likely than in the past.

Thanks!