The International Monetary System: Onshore and Offshore

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Global Capital Allocation

The basic question of how capital is allocated globally

Who gets it? Who provides it? Which risks are shared? Which new risks are created?

Non-Bank Financial Intermediaries (e.g. mutual funds and insurance companies) now play a major role in allocating capital globally

- Some interesting aspects:
  - The exceptional role of the US dollar
  - Massive expansion of (US) dollar debt and global financial stability
  - The opening up of Chinese financial markets
  - The raise of offshore financial centers

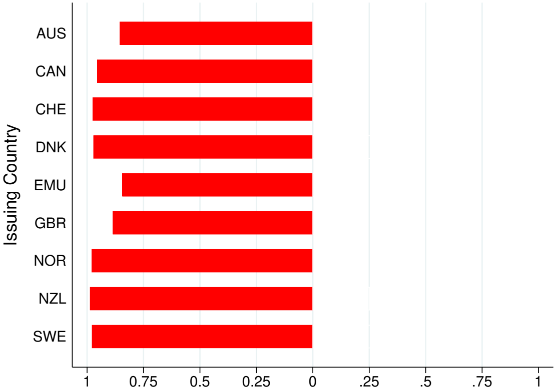
Global Capital Allocation

- Last 15 years dominated by severe crises and policy interventions in capital markets
- Realization that "*who owns which assets*" is an important macro question
- Advances in data availability and ability to analyze it brought new answers
- My research agenda aims to shed light on how capital moves around the world and design better policies to improve outcomes
- Today we'll dig into macro patterns of US, China, Euro Area, and offshore centers

Home-Currency Bias and Dollar Exceptionalism

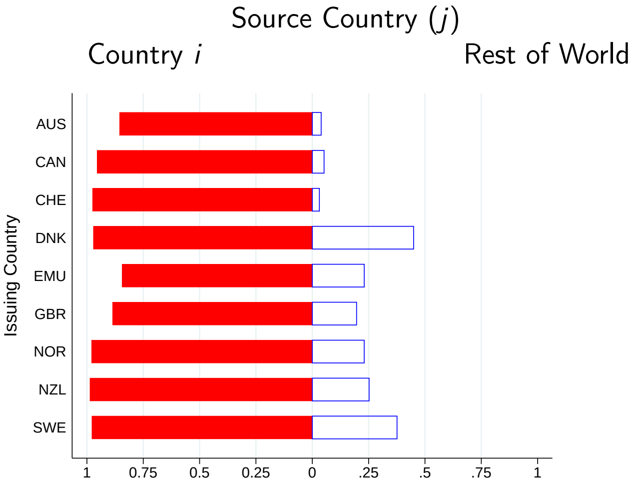
Source Country (j)

Country i



Share of Investment in Country i's Corporate Debt in i's Currency

Home-Currency Bias and Dollar Exceptionalism



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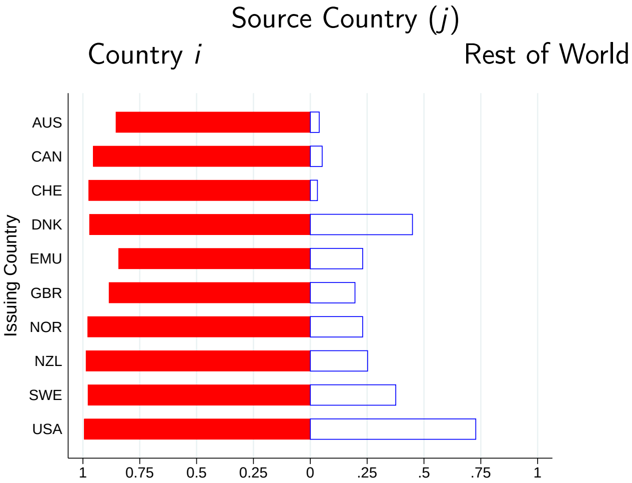
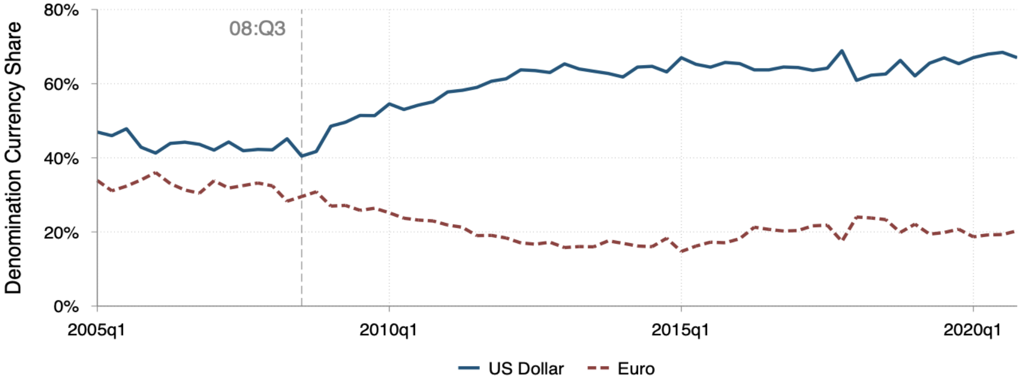


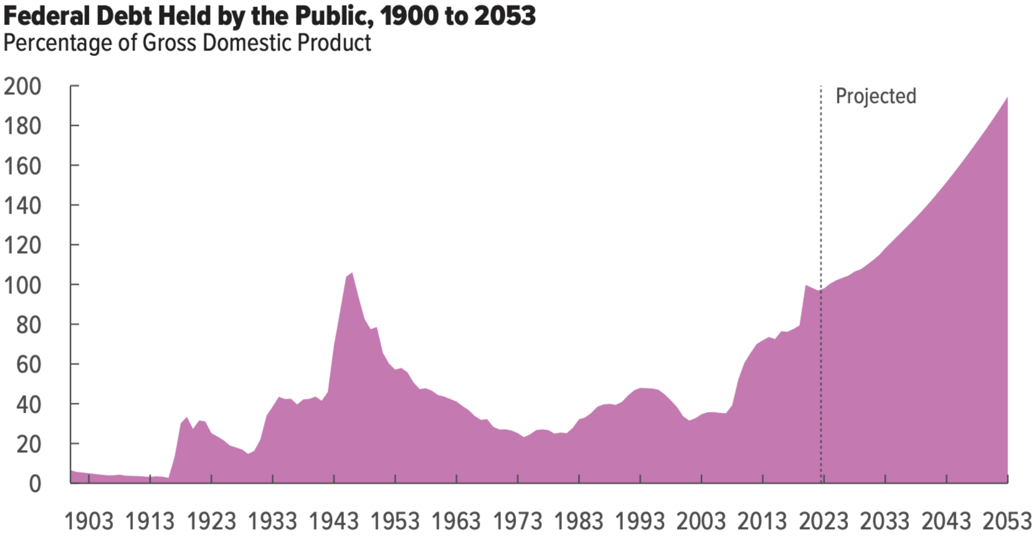
Share of Investment in Country i's Corporate Debt in i's Currency

Changes in International Use of Currency

Corporate Bonds held by Mutual Funds and ETFs: Cross-Border Positions



The Raise of Debt in the Post-Covid World

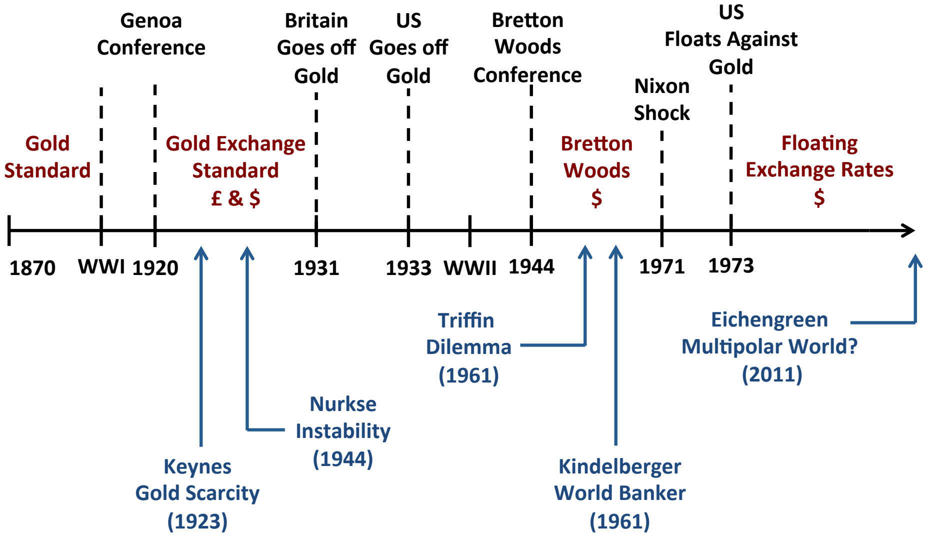


Source: CBO

High Debt and Low Rates: Is it Sustainable?

- Until Recently: Despite higher debt levels, interest rates have fallen so much that interest expense on the existing debt has fallen
- Most Recently: Unexpected Inflation is eroding some of the debt, interest rates jumped up
- Is there a fiscal limit? What are the concerns for global financial stability?
- Modern Triffin Dilemma:
  - Too little debt: perfectly safe, but scarcity and recession prone given ZLB
  - Too much debt: possibility of self-fulfilling panics and worse recession
- Implications for policy: A risk-management view of the debt problem
- Implications for markets: is this the end of the bond bull market?

Markets Generally Do Not See the Crisis Coming: It's a Run

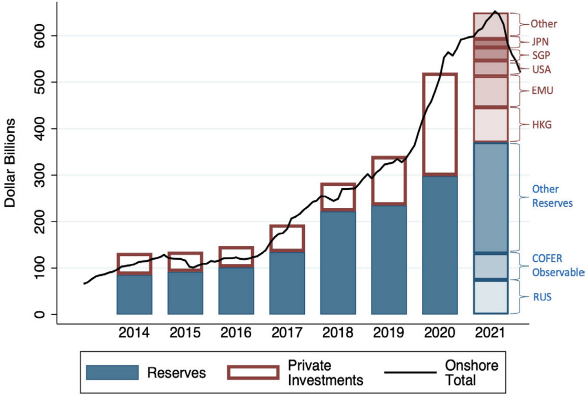


The Emerging Competition from China

- China is already the third largest bond market in the world (>20trn dollars)
- Largely shut off from foreign investment (foreign holdings about 3%)
- China buying US Treasuries a big macro pattern of the 2000s. Asset demand increase $\Rightarrow$ low rates in US
- Now opposite pattern. As China opens up: shock to investable assets supply $\Rightarrow$ where will it show up in rates?
  - In short run: a substitute for US treasuries or for EM Debt?
  - In long-run: a multipolar world, a new reserve currency?

Rise in Foreign Participation in China Domestic Bond Market

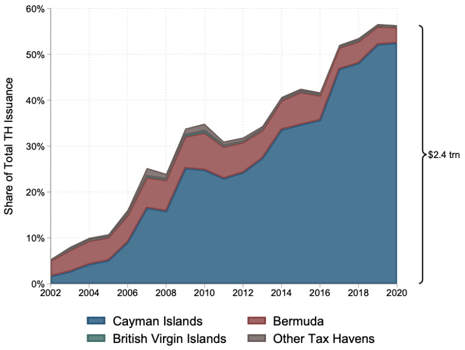
- 2014-2017: mostly official investors inflows
- 2017-2022: surge in inflows from foreign private investors
- 2022-present: outflows



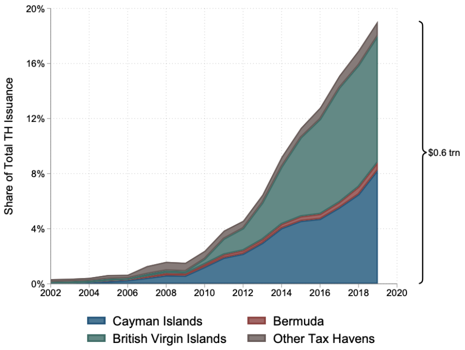
The Rise of China in Offshore Markets

Share of Securities Outstanding in Offshore Markets Accounted for By Chinese Entities

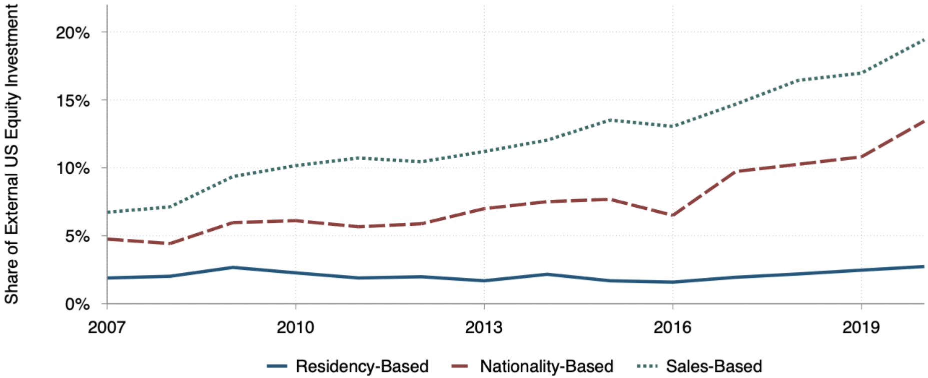
(a) Securities Outstanding: Equities



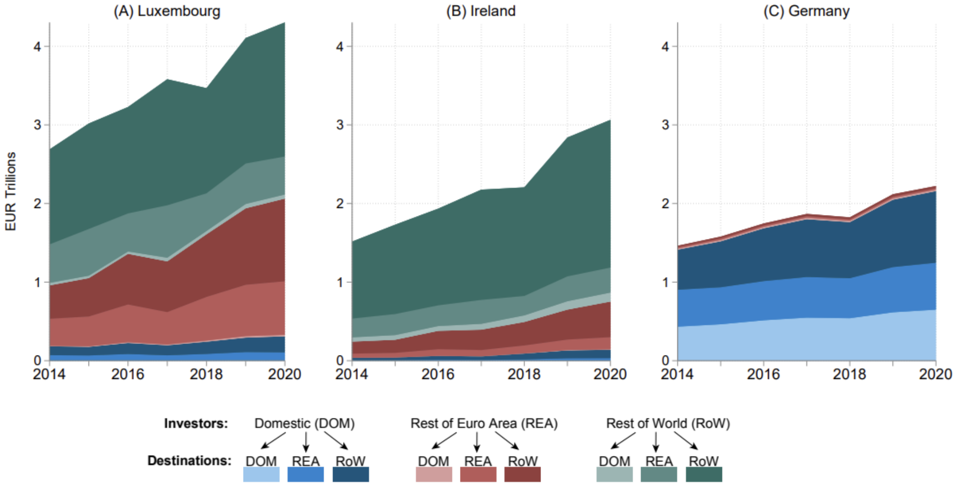
(b) Securities Outstanding: Corporate Bonds



The Rise of China Exposure in the US External Portfolio



The Rise of Luxembourg and Ireland As International Fund Centers



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