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 $i$

1 0.75 0.5 0.25 0 0.25 0.5 0.75 1
SWE NZL NOR GBR EMU DNK CHE CAN AUS

Share of Investment in Country $i$’s Corporate Debt in $i$’s Currency
Home-Currency Bias and Dollar Exceptionalism

<table>
<thead>
<tr>
<th>Source Country (j)</th>
<th>Country i</th>
<th>Rest of World</th>
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<tr>
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</table>

Share of Investment in Country i’s Corporate Debt in i’s Currency
Home-Currency Bias and Dollar Exceptionalism

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

![Graph showing changes in international use of currency for corporate bonds held by mutual funds and ETFs. The graph compares the US Dollar and Euro denominations over time from Q1 2005 to Q1 2020. The US Dollar line shows a steady increase in share, while the Euro line remains relatively flat.]
The Rise of Debt in the Post-Covid World

Federal Debt Held by the Public, 1900 to 2053
Percentage of Gross Domestic Product

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

1870  Gold Standard
WWI  Gold Go...  £ & $
1920  Gold Exchange Standard
Genoa Conference
1931  Britain Goes off Gold
1933  US Goes off Gold
1944  Bretton Woods Conference
Nurkse Instability (1961)
Triffin Dilemma (1961)
Kindelberger World Banker (1961)
1971  Nixon Shock
1973  Floating Exchange Rates $
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 ⇒ low rates in US
- Now opposite pattern. As China opens up: shock to investable assets supply ⇒ 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

- Share of Total TH Issuance
- Cayman Islands
- Bermuda
- British Virgin Islands
- Other Tax Havens

- $2.4 trn
- $0.6 trn
The Rise of China Exposure in the US External Portfolio

![Graph showing the rise of China exposure in the US external portfolio from 2007 to 2019. The graph plots the share of external US equity investment over time, with different lines representing resideny-based, nationality-based, and sales-based investment methods. The line for sales-based investment shows a significant increase from 2007 to 2019.]
The Rise of Luxembourg and Ireland As International Fund Centers
References


