GLOBAL ECONOMIC OUTLOOK – SEPTEMBER

2012

Monetary and Statistics Department
External Economic Relations Division

CZECH NATIONAL BANK

CONTENTS

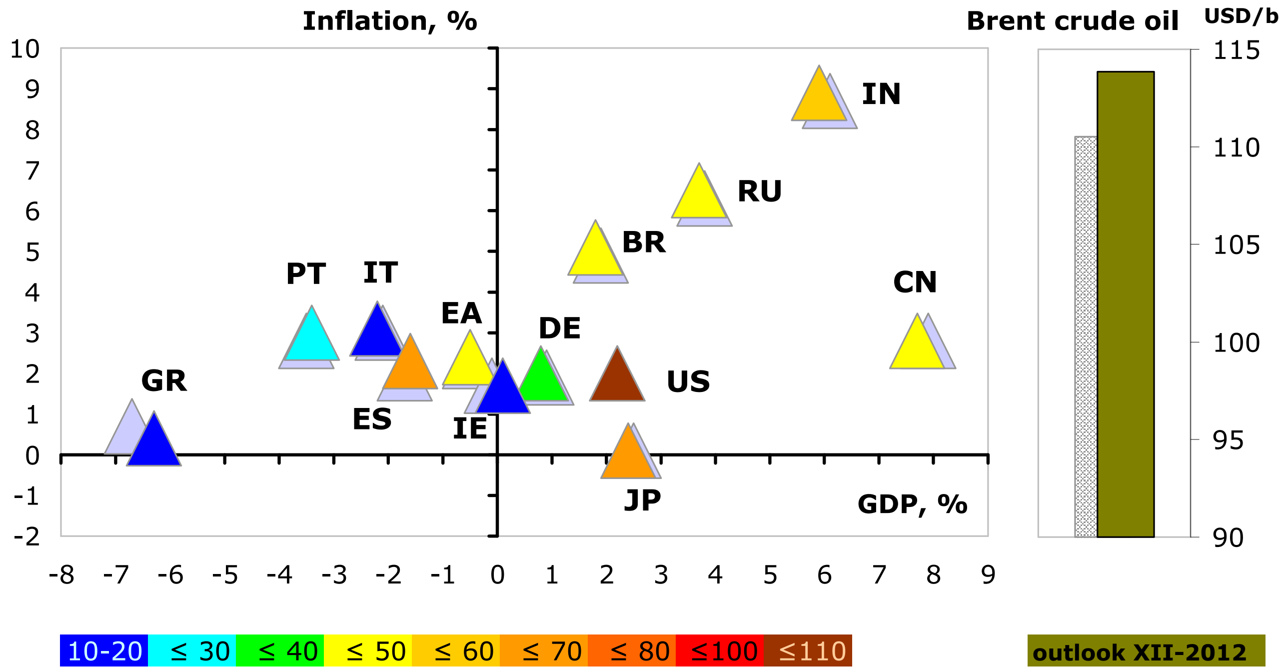
Authors:	Oxana Babecká	II.
	Milan Klíma	III.
	Soňa Benecká	IV., V.
	Tomáš Adam	VI.
	Luboš Komárek	Summary
	Narcisa Kadlčáková	Focus
Editor:	Tomáš Adam	
	Oxana Babecká	
Editor-in-Chief:	Luboš Komárek	

The September issue of Global Economic Outlook presents its regular overview of recent and expected developments in selected territories, focusing on key economic indicators such as GDP, inflation, leading indicators, interest rates, exchange rates and commodity prices. In this issue, we also focus our attention on the analysis of trends in US holdings of foreign securities and foreign holdings of securities in the USA. The description of the trends takes into account a classification based on instrument type, geographical representation, major holders of the instruments and their market share.

Although the leading indicators are still signalling deterioration, the outlook for economic growth was little changed in September for both the euro area and the United States. A further deterioration of the outlook was recorded for the German economy, which is, however, still playing the role of a driver of the heterogeneously evolving euro area. By contrast, the condition of the US economy should not worsen any further thanks to another wave of quantitative easing (QE3). However, global economic growth continues to be driven mainly by the BRIC countries (Brazil, Russia, India and China), see the Figure. The inflation forecasts increased slightly for Germany and the euro area as a whole and remained unchanged for the USA and China. Despite a global economic downturn, only a slight decrease towards 2% is expected in Europe. Inflation should fall faster in the USA and China.

In the near future, the global economy could be hit by the recent rise in oil prices, which was chiefly due to a slow growth in extraction capacity in OPEC countries, rising geopolitical tensions in the Middle East and the measures taken by major central banks to stimulate the economy. The exchange rate of the US dollar will play a key role in any materialisation of the inflation risks stemming from oil prices (but also prices of other commodities, food in particular). The current outlook expects the euro to depreciate by the end of 2012 and stand at USD 1.23/EUR in 2013. The interest rate outlook indicates that rates in both the euro area and the USA will start rising in 2014.

Economic outlook for selected countries in 2012



Market capitalisation (% of GDP)

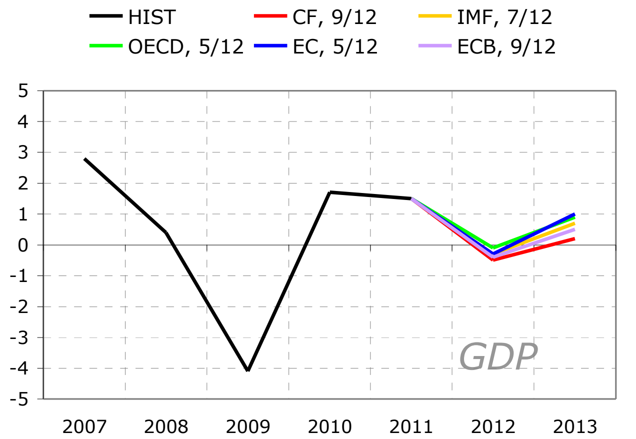
Note: EA – euro area, DE – Germany, US – United States, JP – Japan, CN – China, IN – India, BR – Brazil, RU – Russia, GR – Greece, IE – Ireland, IT – Italy, PT – Portugal, ES – Spain. The points are coloured according to the size of the significance of market capitalisation in per cent of GDP in 2011. The grey colour is the CF forecast (GDP, inflation) or Bloomberg survey (oil price) from the previous month. [Cut-off date for data: 15 September 2012]

Source: CNB calculation using Bloomberg, Consensus Economics and EIU.

II.1 GDP

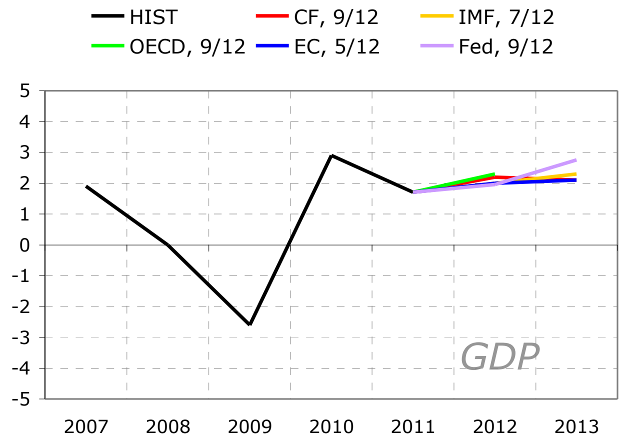
The euro area and the USA are trying to boost the weakening economic growth by further easing of monetary policy. China eased its monetary policy in March and early summer. However, the government is cautious about further easing because of the difficulties in the banking sector and heightened uncertainty in the property market following the first wave of easing in 2008–2009. According to the outlooks published in the first half of September, the fall in the euro area economy will deepen **this year**, to 0.4%–0.5% (CF, ECB). Although Germany is still showing above-average GDP growth (from the euro area point of view), the outlook for German growth was reduced to 0.8% (CF, OECD) due to slower external demand and the crisis in the region. The US growth is expected to be at 2.0%–2.3% (CF, Fed, OECD); GDP growth in China will reach 8.0%–8.1% (BOFIT, CF). **Next year,** euro area growth should be between 0.2% and 0.5% (CF, ECB). Growth in Germany will rise to 1% (CF) and US growth to 2.1%–2.8% (CF, Fed). Growth in China will pick up to 8.1% (CF) or remain at the previous year's level, i.e. 8% (BOFIT).

EURO AREA



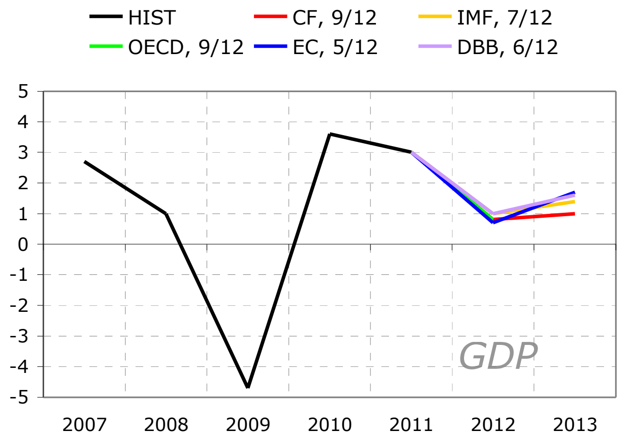
	HIST	CF	IMF	OECD	EC	ECB
2011	1.5					
2012		-0.5	-0.3	-0.1	-0.3	-0.4
2013		0.2	0.7	0.9	1.0	0.5

USA



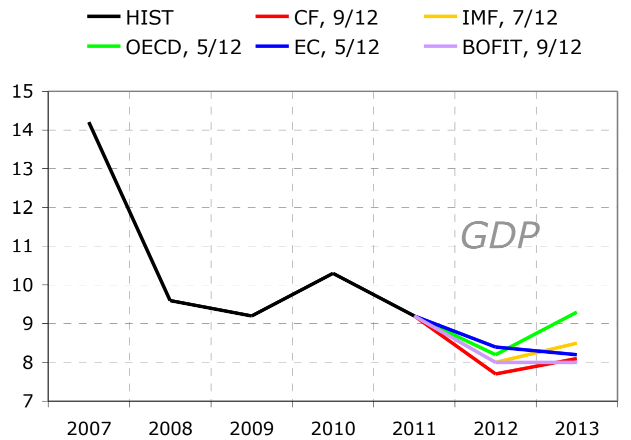
	HIST	CF	IMF	OECD	EC	Fed
2011	1.7					
2012		2.2	2.0	2.3	2.0	2.0
2013		2.1	2.3		2.1	2.8

GERMANY



	HIST	CF	IMF	OECD	EC	DBB
2011	3.0					
2012		0.8	1.0	0.8	0.7	1.0
2013		1.0	1.4		1.7	1.6

CHINA

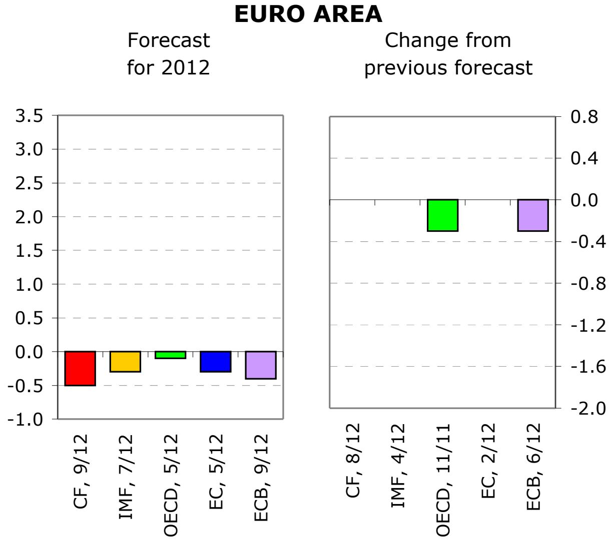


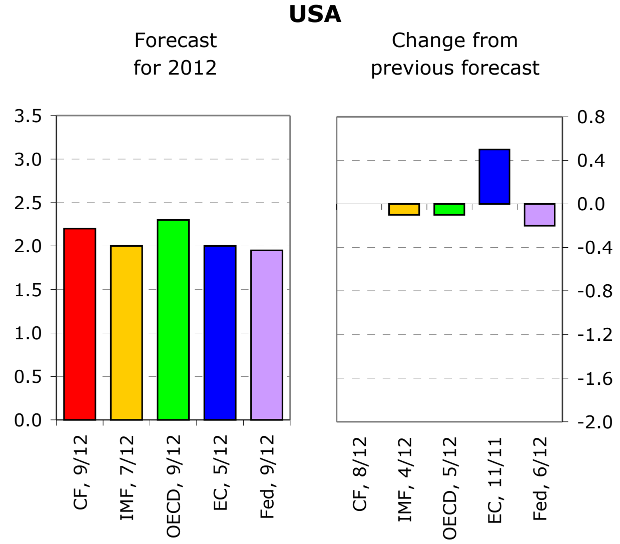
	HIST	CF	IMF	OECD	EC	BOFIT
2011	9.2					
2012		7.7	8.0	8.2	8.4	8.0
2013		8.1	8.5	9.3	8.2	8.0

Note: Legend shows latest forecast data in format „Source, month/year of forecast publication". HIST: historical value. ECB and Fed: midpoint of range. [Cut-off date for data: 15 September 2012]
Source: CNB calculation using Eurostat, CF, IMF, OECD, EC, ECB, Fed, DBB and BOFIT databases.

II.2 Current GDP forecast and change from the previous forecast

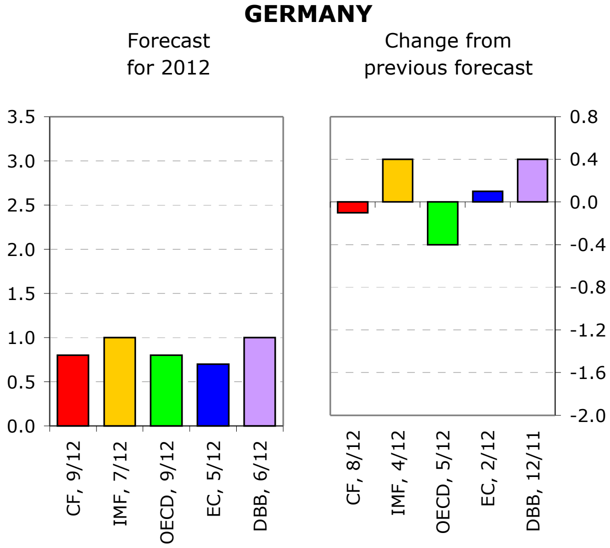
The September CF outlook for euro area and US growth **in 2012** was the same as in August. CF expects economic growth in Germany and China to slow by 0.1 and 0.2 pp respectively. The ECB revised its outlook for the euro area downwards by 0.3 pp compared to the June outlook. The OECD also lowered the growth outlooks for Germany (-0.8 pp) and the USA (-0.1 pp) and the Fed for the USA (-0.2 pp). The new BOFIT outlook for China was unchanged compared to the March outlook.

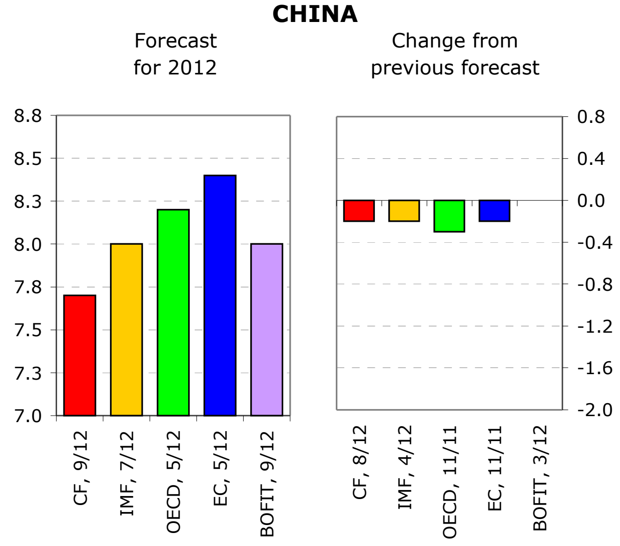




	2011	CF	IMF	OECD	EC	ECB
Forecast	1.5	-0.5	-0.3	-0.1	-0.3	-0.4
Change		0.0	0.0	-0.3	0.0	-0.3

	2011	CF	IMF	OECD	EC	Fed
Forecast	1.7	2.2	2.0	2.3	2.0	2.0
Change		0.0	-0.1	-0.1	0.5	-0.2





	2011	CF	IMF	OECD	EC	DBB
Forecast	3.0	0.8	1.0	0.8	0.7	1.0
Change		-0.1	0.4	-0.4	0.1	0.4

	2011	CF	IMF	OECD	EC	BOFIT
Forecast	9.2	7.7	8.0	8.2	8.4	8.0
Change		-0.2	-0.2	-0.3	-0.2	0.0

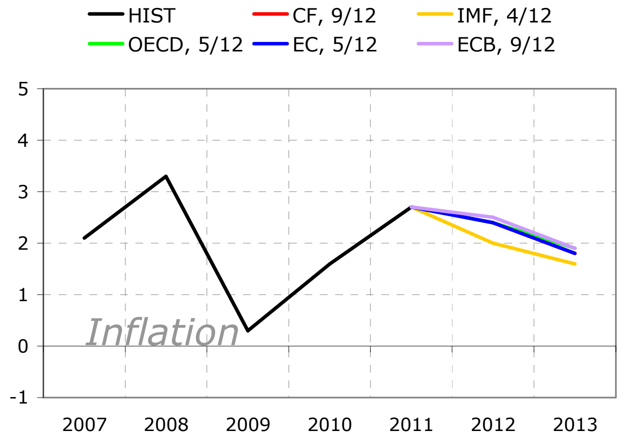
Note: Horizontal axis of left-hand (right-hand) chart shows latest (previous) forecast data in format "Source, month/year of forecast publication". HIST: historical value. ECB and Fed: midpoint of range.
[Cut-off date for data: 15 September 2012]

Source: CNB calculation using Eurostat, CF, IMF, OECD, EC, ECB, Fed, DBB and BOFIT databases.

II.3 Inflation

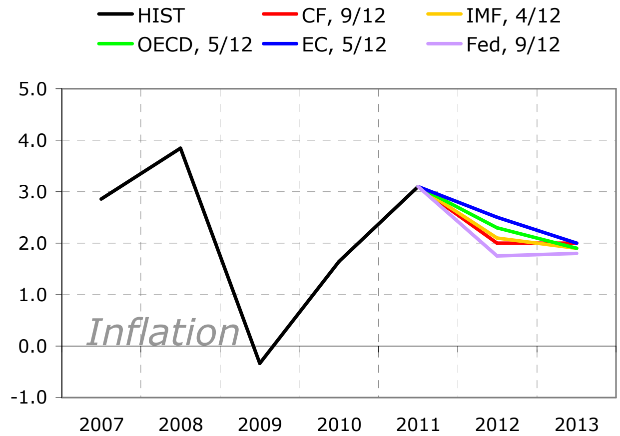
The September outlooks are broadly in line with the August outlooks. Euro area inflation will stay between 2.4% and 2.5% **in 2012** (CF and ECB forecast midpoint). Inflation in Germany will reach 2% (CF). US consumer prices will grow at the same rate (1.8%–2.0%) according to CF and the Fed. Inflation in China will reach 2.8% (CF). **Next year,** inflation will fall below 2% in both the euro area and Germany. US consumer prices will remain at this year's level. By contrast, inflation in China will pick up to 3.4%.

EURO AREA



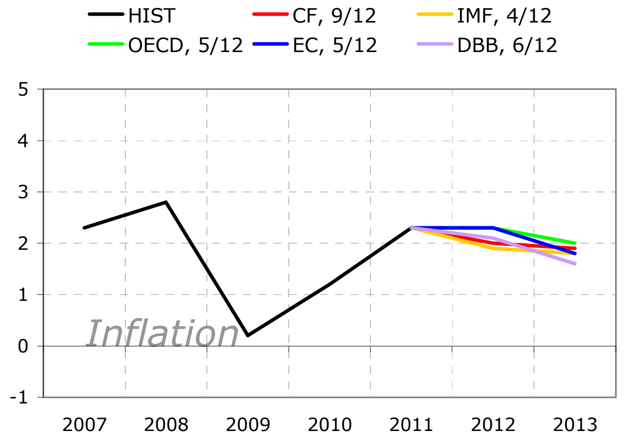
	HIST	CF	IMF	OECD	EC	ECB
2011	2.7					
2012		2.4	2.0	2.4	2.4	2.5
2013		1.8	1.6	1.9	1.8	1.9

USA



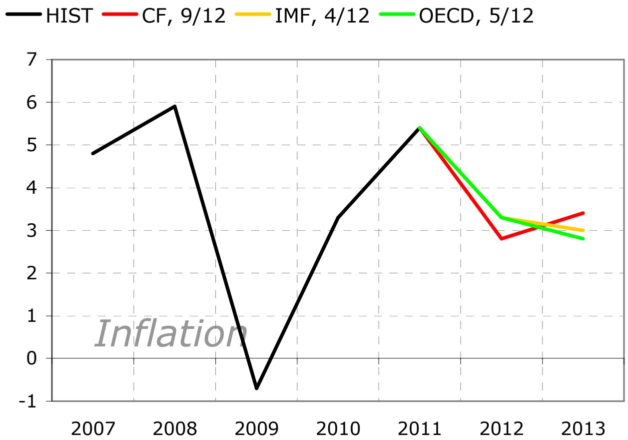
	HIST	CF	IMF	OECD	EC	Fed
2011	3.1					
2012		2.0	2.1	2.3	2.5	1.8
2013		2.0	1.9	1.9	2.0	1.8

GERMANY



	HIST	CF	IMF	OECD	EC	DBB
2011	2.3					
2012		2.0	1.9	2.3	2.3	2.1
2013		1.9	1.8	2.0	1.8	1.6

CHINA



	HIST	CF	IMF	OECD
2011	5.4			
2012		2.8	3.3	3.3
2013		3.4	3.0	2.8

Note: Legend shows latest forecast data in format „Source, month/year of forecast publication". HIST: historical value. ECB and Fed: midpoint of range. [Cut-off date for data: 15 September 2012]

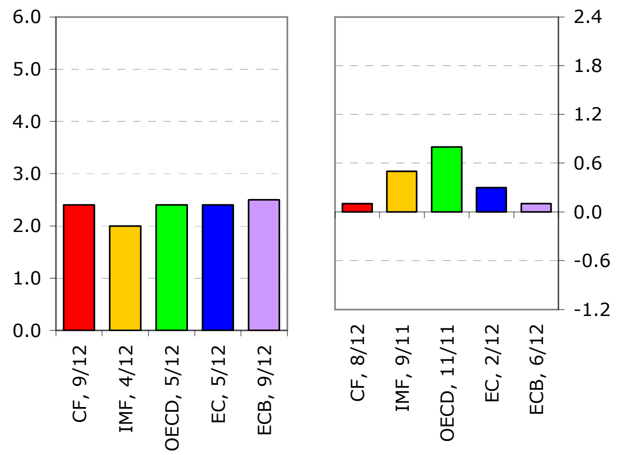
Source: CNB calculation using Eurostat, CF, IMF, OECD, EC, ECB, Fed, DBB and BOFIT databases.

II.4 Inflation forecast and change from the previous forecast

According to the new outlooks, **this year's** inflation has risen slightly compared to the previous forecasts. Price growth is expected to be 0.1 pp higher in the euro area and Germany (CF and ECB) and 0.3 pp higher in the USA (Fed). The CF outlook for the USA and China is an exception, as it is the same as in August.

EURO AREA

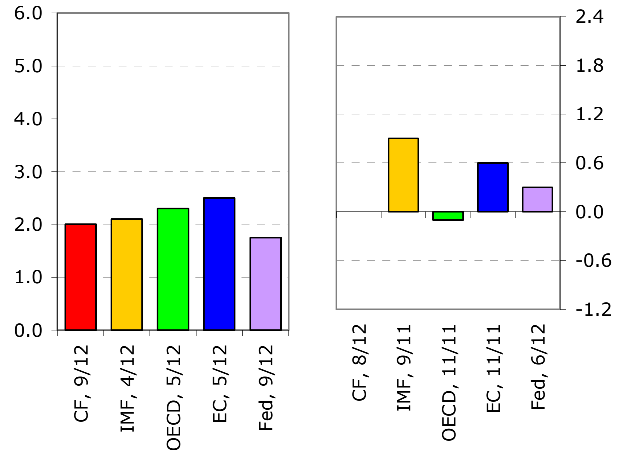
Forecast for 2012 | Change from previous forecast



	2011	CF	IMF	OECD	EC	ECB
Forecast	2.7	2.4	2	2.4	2.4	2.5
Change		0.1	0.5	0.8	0.3	0.1

USA

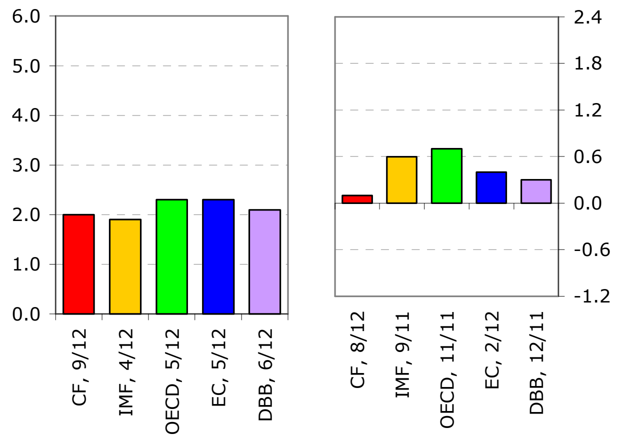
Forecast for 2012 | Change from previous forecast



	2011	CF	IMF	OECD	EC	Fed
Forecast	3.1	2.0	2.1	2.3	2.5	1.8
Change		0.0	0.9	-0.1	0.6	0.3

GERMANY

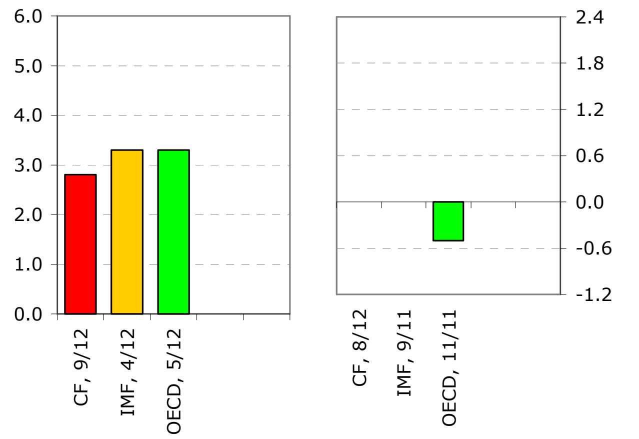
Forecast for 2012 | Change from previous forecast



	2011	CF	IMF	OECD	EC	DBB
Forecast	2.3	2	1.9	2.3	2.3	2.1
Change		0.1	0.6	0.7	0.4	0.3

CHINA

Forecast for 2012 | Change from previous forecast



	2011	CF	IMF	OECD
Forecast	5.4	2.8	3.3	3.3
Change		0.0	0.0	-0.5

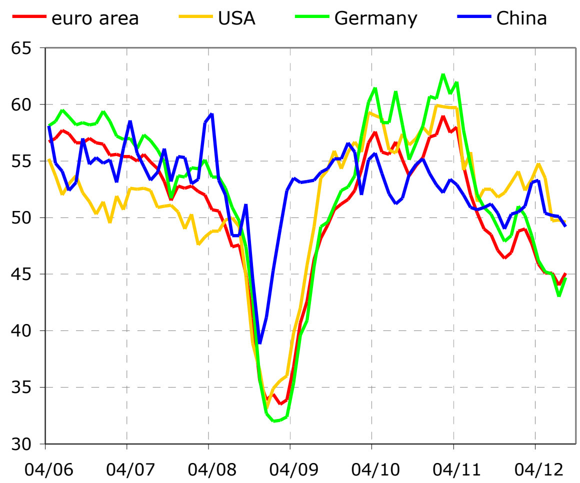
Note: Horizontal axis of left-hand (right-hand) chart shows latest (previous) forecast data in format “Source, month/year of forecast publication”. HIST: historical value. ECB and Fed: midpoint of range.

[Cut-off date for data: 15 September 2012]

Source: CNB calculation using Eurostat, CF, IMF, OECD, EC, ECB, Fed, DBB and BOFIT databases.

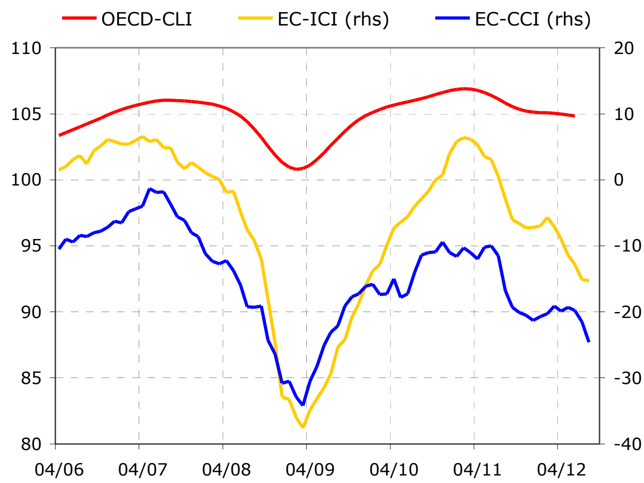
From the perspective of leading indicators, the message of the outlook for the global economic situation is not clear. Some leading indicators have improved and some have declined in each region under review, including Germany. It is evident that the outlook for global industrial production is unfavourable, as the PMI (Purchasing Managers' Index) in industry fell below the 50% threshold separating growth from contraction in all regions. In China this happened for only the second time since February 2009. Moreover, the leading indicators, which increased in the previous month or months, are very low, indicating a future decline rather than growth. Overall we can say that the global economic outlook in 2012 H2 is not favourable.

PMI IN MANUFACTURING



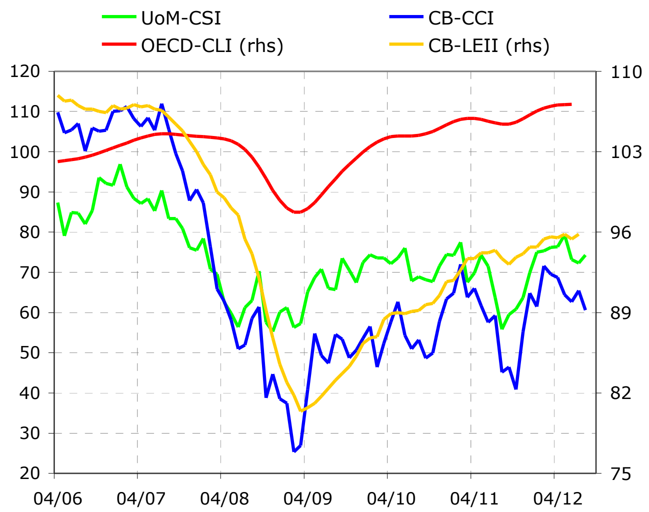
	EA	US	DE	CN
6/12	45.1	49.7	45.0	50.2
7/12	44.0	49.8	43.0	50.1
8/12	45.1	49.6	44.7	49.2

EURO AREA



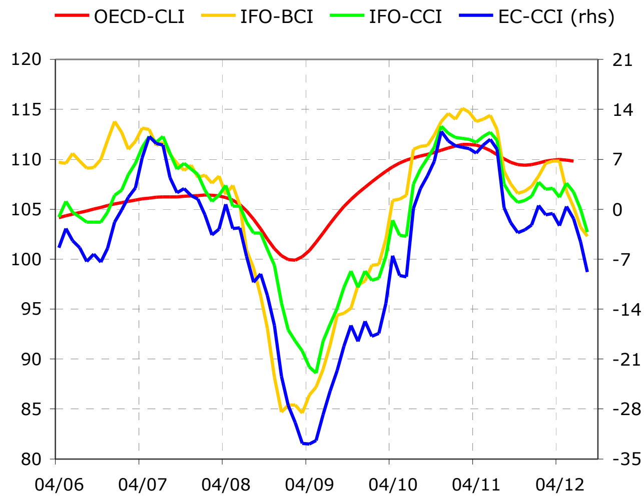
	OECD-CLI	EC-ICI	EC-CCI
6/12	104.8	-12.8	-19.8
7/12		-15.1	-21.5
8/12		-15.3	-24.6

USA



	OECD-CLI	CB-LEII	UoM-CSI	CB-CCI
6/12	107.1	95.4	73.2	62.7
7/12		95.8	72.3	65.4
8/12			74.3	60.6

GERMANY



	OECD-CLI	IFO-BCI	IFO-CCI	EC-CCI
6/12	109.8	105.2	106.7	-1.3
7/12		103.2	105.0	-4.6
8/12		102.3	102.7	-8.8

Note: OECD-CLI stands for OECD Composite Leading Indicator, EC-ICI (right-hand scale) for European Commission Industrial Confidence Indicator, EC-CCI (right-hand scale) for EC Consumer Confidence Indicator, CB-LEII for Conference Board Leading Economic Indicator Index, CB-CCI for CB Consumer Confidence Index, UoM-CSI for University of Michigan Consumer Sentiment Index, IFO-BCI for Institute for Economic Research – Business Climate Index, and IFO-CCI for IFO Consumer Confidence Index. [Cut-off date for data: 14 September 2012]

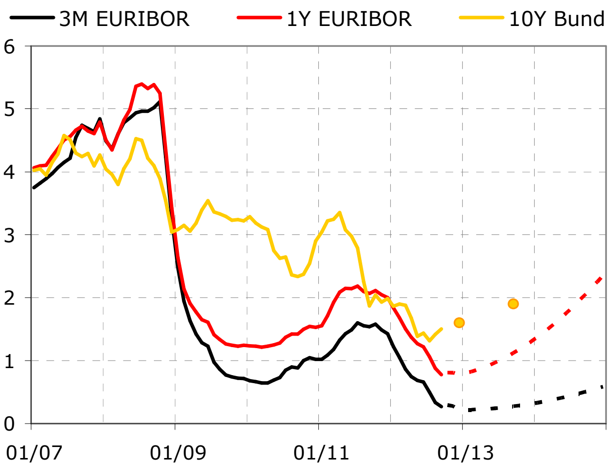
Source: CNB calculation using OECD, EC, IFO and UoM databases.

IV.1 Outlook for short-term and long-term interest rates: Euro area

The 3M and 1Y EURIBOR interbank rates decreased in August, as in the last 12 months. In the first half of September, the 3M rate was 0.25% and the 1Y rate was 0.75%. The fall to new historical lows was largely due to the July reduction in the key ECB interest rates. Risk premia for both maturities declined as well. The forecast based on implied rates again shifted downwards compared to the previous month, mainly at the one-year horizon. The 3M rate should be below 0.3% next year, which is foreseen also by the new CF outlook.

The yields on the 10Y German government bond showed an upward trend in August as the ECB announced more radical measures to resolve the debt crisis. A decline in risk aversion was reflected also in the spreads for Italian and Spanish bonds. The new CF forecast left expected rates unchanged; the yield on the 10Y Bund one year ahead should be around 0.5 pp higher than it is now.

EURO AREA



	08/12	09/12	06/13	12/13	06/14	12/14
3M EURIBOR	0.33	0.27	0.24	0.31	0.43	0.58
1Y EURIBOR	0.88	0.77	0.97	1.30	1.77	2.35
	08/12	**09/12**	**12/12**	**09/13**		
10Y Bund	1.42	1.50	1.60	1.90		

Note: Forecast for EURIBOR rates is based on implied rates from interbank market yield curve (FRA rates are used from 4M to 15M and adjusted IRS rates for longer horizons). Forecast for German government bond yield (10Y Bund) is taken from CF. Dashed lines and points represent outlook. [Cut-off date for data: 10 September 2012]

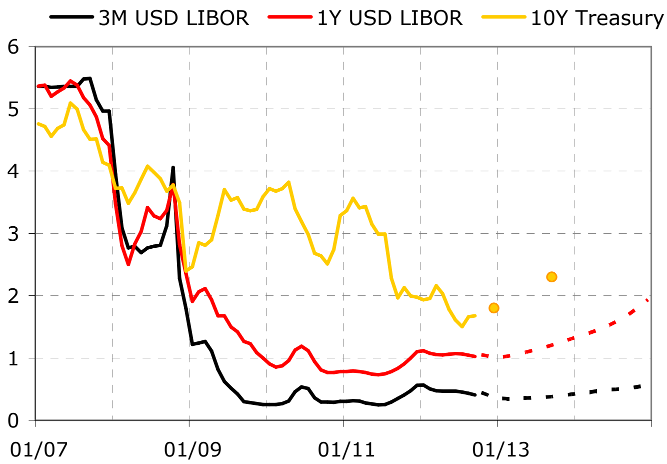
Sources: Thomson Reuters (Datastream), Bloomberg, CNB calculations.

IV.2 Outlook for short-term and long-term interest rates: USA

The 3M and 1Y USD LIBOR rates continued falling slightly in August, standing at 0.4% and 1% respectively in mid-September. The outlook for 3M rates based on implied rates is stable until the end of 2013. The 1Y LIBOR is expected to start rising in early 2013.

The yields on "safe" US bonds were also affected by euro area developments in August. The ten-year government bond yield thus approached the May 2012 level (1.8%) in mid-September. Similarly as for Bunds, the outlook for 10Y Treasury rates showed no changes compared to the previous month. The yield should increase to 2.3% at the two-year horizon.

USA



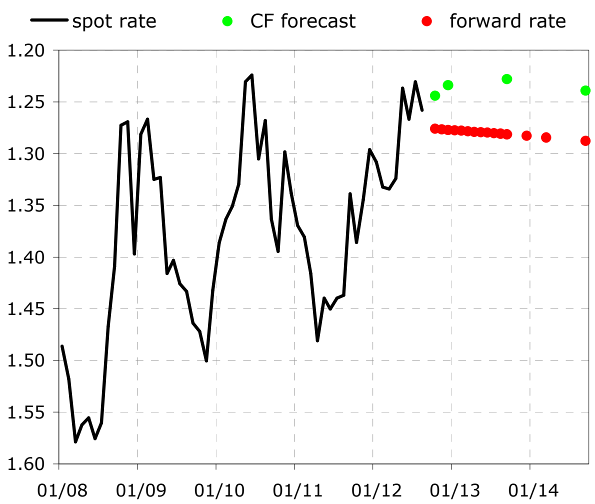
	08/12	09/12	06/13	12/13	06/14	12/14
3M USD LIBOR	0.43	0.41	0.36	0.41	0.49	0.56
1Y USD LIBOR	1.04	1.02	1.12	1.30	1.53	1.94
	08/12	**09/12**	**12/12**	**09/13**		
10Y Treasury	1.66	1.68	1.80	2.30		

Note: Implied LIBOR rates are derived from London interbank market yield curve. Forecast for 10Y Treasury yield is taken from CF. Dashed lines and points represent outlook. [Cut-off date for data: 10 September 2012]

Sources: Thomson Reuters, Bloomberg, CNB calculations.

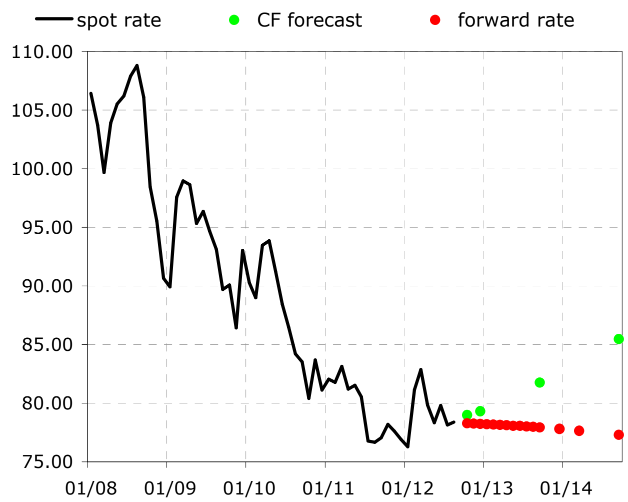
In August, the euro appreciated against the dollar thanks to verbal communication in favour of the euro and the announcement of the programme of buying bonds from countries hit by the crisis. After overcoming the major barrier to the ESM establishment (approval of ratification by the German Constitutional Court) and due to speculation about another round of quantitative easing in the USA, the euro appreciated to the strongest level in the last four months (USD 1.29/EUR). However, the September CF outlook expects the euro to depreciate by end-2012 and stand at USD 1.23/EUR in 2013. The British pound appreciated against the US dollar in August, but the outlook for the British economy did not improve and CF expects the pound to depreciate before year-end. The yen appreciated at end-August due to euro area and US developments, but the new forecast expects it to depreciate by 4.2% during the year. The announcement of the government bond purchase programme by the ECB had a strong effect on the Swiss franc, which depreciated for the first time below the minimum exchange rate of CHF 1.2/EUR set a year ago.

US$ per Euro



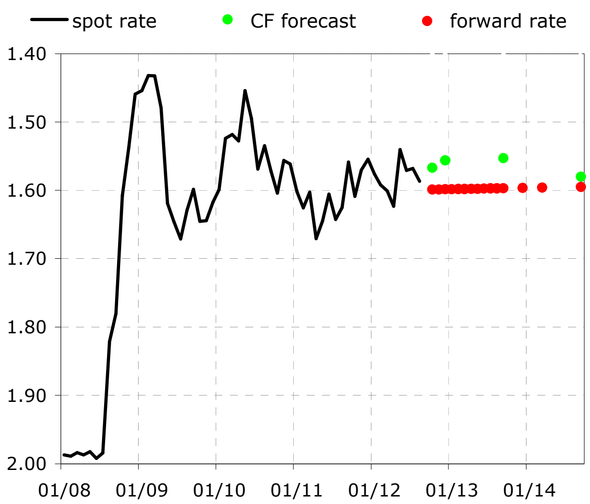
	10/9/12	10/12	12/12	09/13	09/14
spot rate	1.276				
CF forecast		1.244	1.234	1.228	1.239
forward rate		1.276	1.277	1.281	1.288

Yen per US$



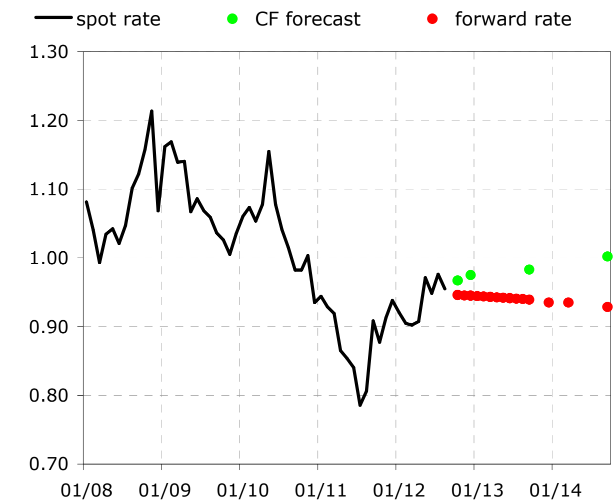
	10/9/12	10/12	12/12	09/13	09/14
spot rate	78.29				
CF forecast		78.98	79.31	81.76	85.46
forward rate		78.27	78.23	77.93	77.28

US$ per UK£



	10/9/12	10/12	12/12	09/13	09/14
spot rate	1.599				
CF forecast		1.567	1.556	1.553	1.580
forward rate		1.599	1.598	1.597	1.595

Swfr per US$



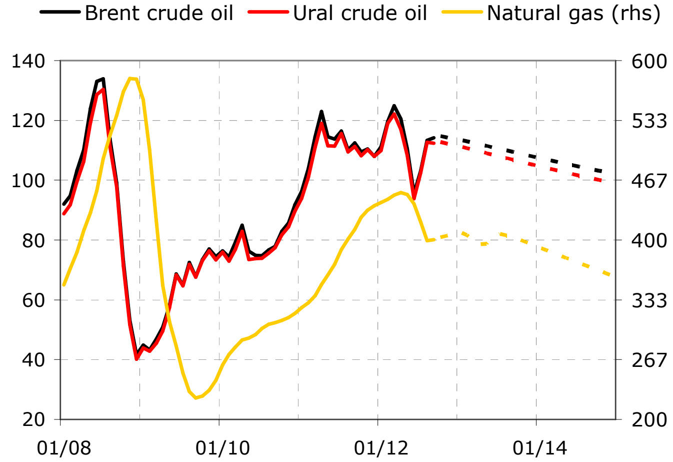
	10/9/12	10/12	12/12	09/13	09/14
spot rate	0.946				
CF forecast		0.967	0.975	0.983	1.002
forward rate		0.946	0.945	0.939	0.929

Note: Increase in currency pair represents appreciation of US dollar; data as of the last day of the month. Forward rate does not represent outlook; it is based on covered interest parity, i.e. currency of country with higher interest rate is depreciating. Forward rate represents current (as of cut-off date) possibilities for securing future exchange rate. [Cut-off date for data: 10 September 2012]
Source: CNB calculation using Bloomberg and Consensus Forecasts databases.

VI.1 Oil and natural gas

The price of Brent crude oil continued to follow the July upward trend, standing just below USD 117 a barrel in mid-August. Since then it has stayed between USD 112–116 a barrel. The price increase is chiefly due to low growth in production in July and its decline in August (particularly in the OPEC countries) despite record extraction in Saudi Arabia. Other factors behind the price growth are rising geopolitical tension in Iran and Syria, and recently also in other Middle East countries, and the expectations regarding major central banks' measures to stimulate the economy. These expectations are also behind the rising activity of financial investors, whose open long positions have grown strongly in the last two months according to the OPEC. The outlook for oil prices has shifted slightly upwards compared to the previous month over the entire horizon. A higher increase was recorded at the shorter end of the forward curve. By contrast, the outlook for natural gas prices has shifted towards lower levels, reflecting with a lag oil price developments in Q2.

OUTLOOK FOR PRICES OF OIL AND NATURAL GAS



	09/12	06/13	12/13	06/14	12/14
Brent crude oil	114.2	111.0	108.0	105.0	102.2
Ural crude oil	112.3	108.5	105.2	102.0	99.1
Natural gas	400.3	403.2	394.4	377.1	360.2

Note: Brent oil price in USD/barrel (ICE quotation). Price of Russian natural gas at German border in USD/1,000 cubic m (IMF database). Future oil prices are derived from oil prices. Dashed line represents outlook.

[Cut-off date for data: 11 September 2012]

Source: Bloomberg, IMF, CNB calculations.

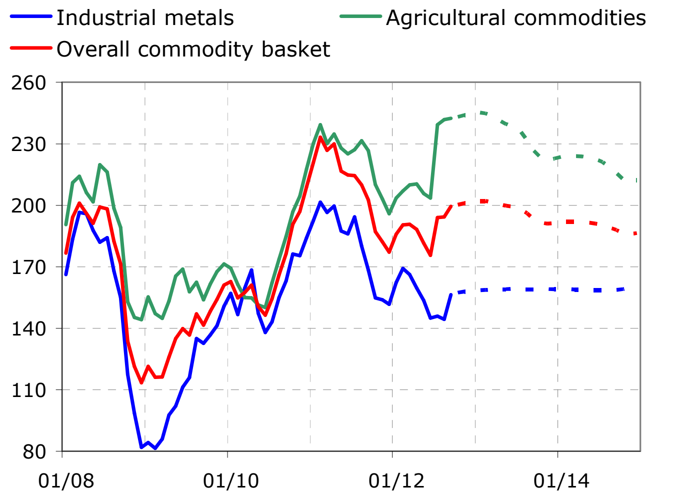
VI.2 Other commodities

The overall index of non-energy commodity prices increased in the last month and its outlook has shifted upwards. A similar trend, i.e. an increase and a positive shift in the outlook path, was recorded by both components of the total index.

Following the July one-off jump, food commodity prices saw just a modest growth in August and are standing at historical highs. Their outlook is falling in the medium term. The outlook is falling mainly for harvests outside the USA (wheat, maize, soy) and attention has turned to harvest in the southern hemisphere, which is expected to offset the bad harvest in the USA caused by drought.

Industrial metals prices are more volatile as the uncertainty surrounding global economic developments increases. They grew more strongly in late August and early September in connection with the expected new round of quantitative easing. Cotton prices rose modestly in August, while rubber prices fell slightly. The outlook for both commodities remains stable.

OUTLOOK FOR OTHER COMMODITY PRICES



	09/12	06/13	12/13	06/14	12/14
Industrial metals	156.3	159.2	159.0	158.8	160.2
Agricultural commodities	242.3	238.2	222.7	222.5	212.2
Overall commodity basket	199.4	199.2	191.3	191.1	186.4

Note: Chart shows price indices, year 2005 = 100. Dashed line represents outlook based on futures.

[Cut-off date for data: 11 September 2012]

Source: Bloomberg, outlooks based on futures.

US HOLDINGS OF FOREIGN SECURITIES VERSUS FOREIGN HOLDINGS OF SECURITIES IN THE US: WHAT IS THE TREND?[1]

This article examines security investment into and out of the US from a longer-term perspective. The description of the general trends further takes into account a classification based on instrument type, geographical representation, major holders of the instruments and their market share.

Introduction

This article compares the patterns of investment in US securities by foreigners versus investment in foreign securities by US citizens. The comparative analysis of these two portfolio investment patterns sheds light on one issue that has received increased attention in policy circles since the inception of the global financial crisis. The ability of US markets to attract funds from abroad is crucial for meeting the funding needs of the corporate sector and for financing US budget deficits. However, some have argued that the over-reliance of the US economy on foreign savings (especially from China) might have been one cause of the financial crisis that started in 2007.

The analysis that follows describes general trends in securities investment into and out of the US. A classification based on instrument type, geographical representation, major holders of the instruments and their market share is further considered. Although older information is available and included in this note, data at annual frequency become available in 2002–2003. For this reason the relevant time horizon considered here is roughly 2002–2012.

The data are compiled on an annual basis (with gaps at the beginning of the period) from two documents jointly published by the US Treasury Department, the Federal Reserve Bank of New York and the Board of Governors of the Federal Reserve System.[2] They are collected through annual surveys in which participation is compulsory for all the respondents meeting several reporting criteria. Given that they represent the aggregated market value of the holdings, value changes reflect both adjustments in positions and changes in securities prices.

1. General investment patterns

Security holdings comprise equity, long-term debt (with an original maturity longer than one year) and short-term debt (with an original maturity shorter than one year). In the US case, long and short-term debt securities are issued either by (a) the Federal government (Treasury securities), (b) other federal agencies and government-sponsored companies (agency securities) or (c) corporates (corporate securities). For foreign securities such a breakdown is not available and a distinction can be made only among equity, long-term debt and short-term debt. Figure VII-1 depicts the mentioned investment patterns at the aggregate and component level.

Figure VII-1 a) shows that the market value of US holdings of foreign securities strongly increased from USD 2.3 trillion in 2001 to USD 6.8 trillion in 2010. Under the impact of the global financial crisis it displayed quite a volatile pattern. On average it increased by 23% annually during 2003–2007, only to fall strongly by 41% in 2008 following the

---

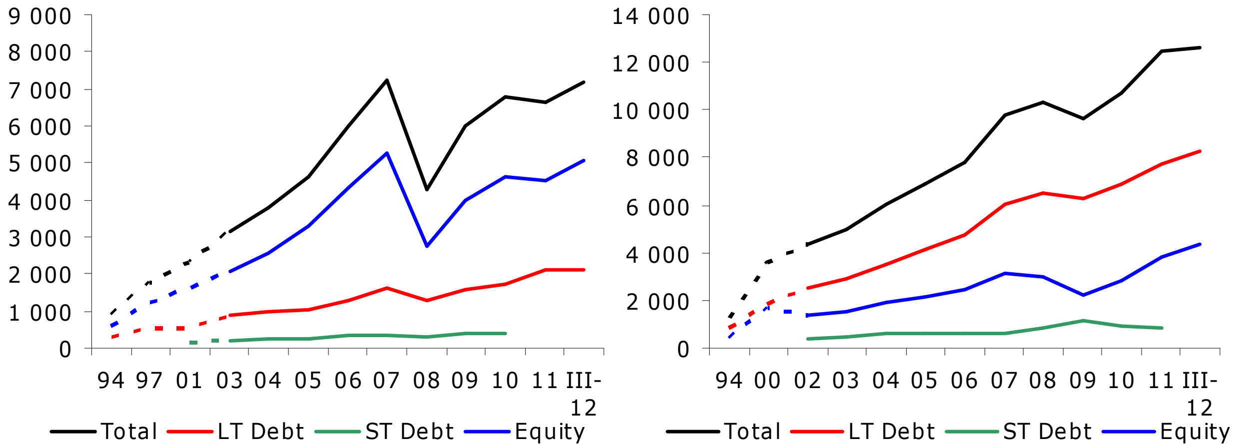
[1] Author: Narcisa Liliana Kadlčáková (Narcisa.Kadlcakova@cnb.cz). The views expressed in this article are those of the author and do not necessarily reflect the official position of the Czech National Bank.

[2] The *Report on U.S. Portfolio Holdings of Foreign Securities* is published in December each year while the *Report on Foreign Portfolio Holdings of U.S. Securities* is issued early in June. Given the different publishing dates of the two documents, assessing net positions might in general be inappropriate.

global spread of the financial crisis. Although it recovered strongly afterwards, at the end of 2010 it still stood below the value reached at the end of 2007. The dominant component of US portfolio investment abroad has traditionally been equity, representing around 70% of total holdings. Long-term debt has accounted for 20% to 30% of total investment and short-term debt for roughly 6%. The 2008 decrease reflected primarily a 48% fall in equity value; however, both long-term and short-term debt fell in value by roughly 20% that year. In 2009–2010 all three components returned to solid growth.

Figure VII-1: Security holdings at the aggregate and component level

a) US holdings of foreign securities (USD bn) b) Foreign holdings of US securities (USD bn)



Note: Short-term debt data are not available for 1994 and in the left window for 1997, 2011 and March 2012 and in the right window for 2000 and March 2012. The dashed lines indicate that data at annual frequency are not available.

Source: Department of the Treasury website and author's own calculations

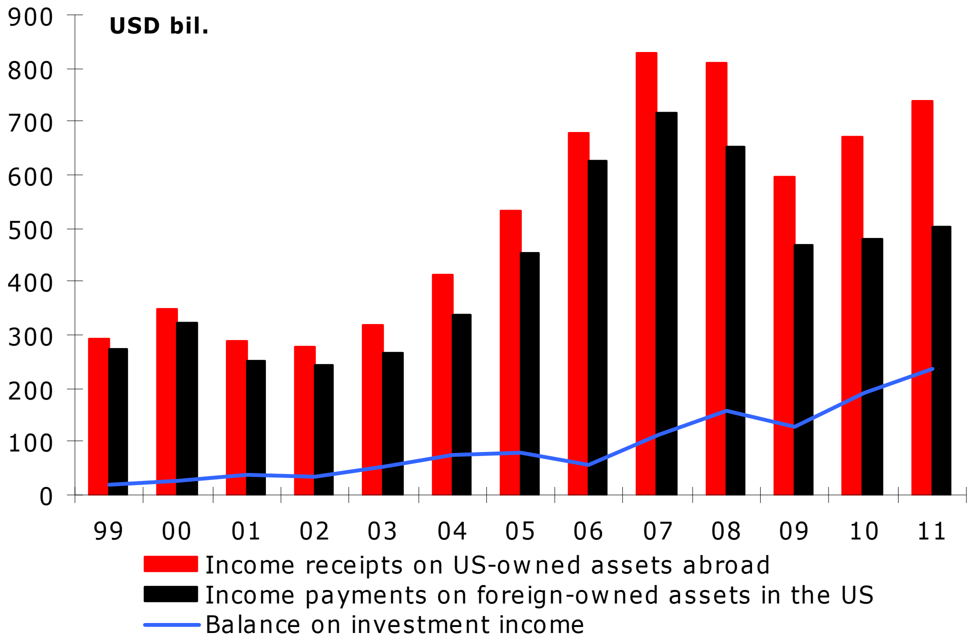
The right-hand figure displays the market value of holdings of US securities by foreigners. This variable strongly increased from USD 4.3 trillion in 2002 to USD 12.4 trillion in 2011. As a rule, its growth pattern was much less affected by the crisis, proving that the US securities market remained attractive for foreigners during this turbulent period. Unlike US investors abroad, foreign investors in US securities have traditionally kept around 60% of their US portfolio in long-term debt, 10% in short-term debt and 30% in equity. During 2008–2009 investors substituted away from equity and long-term debt into short-term debt, only to reverse this strategy during 2010–2011.

As already mentioned, computing net positions using the data sources mentioned above is not appropriate. Nevertheless, what catches the eye is the big and negative discrepancy between the amounts invested abroad by US investors and the inward investment flowing into the US. It is then natural to ask why the US still represents such an attractive investment destination, given that different US liability indicators against the outside world have already reached prohibitive levels.

At least a partial answer to this question is provided by the "dark matter" debate. The reasoning is that accounting rules based on book value might not properly capture the real value of the assets. There is a multitude of hidden asset characteristics that influence their returns and thus make them worth more or less than what is rendered by the book value. The difference between these two types of valuations is the so-called "dark matter" (Hausmann and Sturzenegger, 2005).

To obtain an idea of whether the "dark matter" effect might indeed still be present, we compare aggregate receipts on US-owned foreign assets and aggregate income payments on foreign-owned assets in the United States (see Figure VII-2). The data, at annual frequency, were obtained from the US Bureau of Economic Analysis (BEA).

Figure VII-2: Income payments and receipts on investment into and out of the US



Source: Bureau of Economic Analysis (BEA)

As Figure VII-2 shows, income receipts on outward US investment have consistently exceeded payments on foreign-owned assets in the US.[3] With two exceptions in 2006 and 2009, the net return on the US financial position has continuously grown and reached USD 235 billion in 2011. One should keep in mind that these receipts and payments were produced by inward and outward investment stocks of substantially different sizes. For example, the BEA data show that the US net international investment position at the end of 2011 was approximately USD -4 trillion, which is the (book) value by which total foreign investment in the US exceeded total US investment abroad.

If the stock values of investment into and out of the US differ by such a big amount, what causes the returns on these investments to evolve in an inversely proportional manner? It is probably "dark matter" that makes the difference. In Hausmann and Sturzenegger's view, this is a result of the know-how, risk-taking and liquidity-providing features associated with US investment abroad that make these investments worth more than they may look based on mere book-value accounting. Figure VII-2 suggests that the "dark matter" effect has successfully survived the crisis and may currently be even stronger than at the time when Hausmann and Sturzenegger's original paper appeared (2005).

Additionally, securities investment into and out of the US has been influenced by factors outside the conventional risk-return tradeoff. The role of China as a major investor in (low-yield) US Treasuries arose naturally given China's huge accumulation of foreign reserves and its consequent need to manage these reserves. On the contrary, China's financial account is still not fully liberalised (Benecká, 2011), thus making US portfolio investment in this country subject to serious barriers.

[3] The BEA data contain returns on total foreign investment (thus including direct investment, official reserve assets, etc.) and not only on portfolio investment as discussed in this article. Unfortunately, returns on portfolio investment are not available from the Treasury Department data.

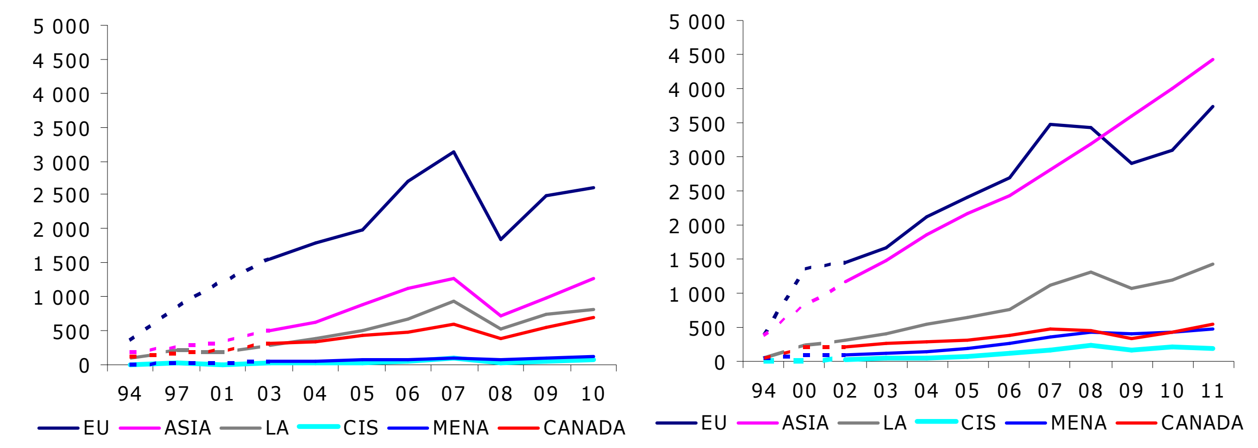
2. Regional investment patterns

The following figure displays the geographical distribution of investment. The grouping differentiates among the countries of the European Union (EU), Asia, Latin America and the Caribbean (LA), the Commonwealth of Independent States (CIS), the Middle East and North Africa (MENA) and Canada. On the left-hand side is the stock value of US securities investment in each of the mentioned regions at the end of each year, while on the right-hand side is the investment value in the US owned by investors from the mentioned regions in June each year.

The EU is the preferred investment area for US investors over the entire time horizon (left-hand figure). The next three investment destinations by market value are Asia, Latin America and Canada. The CIS and the MENA regions have attracted an insignificant portfolio investment share from the US compared with the other regions. As regards the development in time, the relatively solid growth of 2001–2007 was strongly reversed in 2008, especially in the EU case, but positive growth returned in 2009–2010.

Figure VII-3: Geographical classification of investment

a) US holdings of foreign securities (USD bn) b) Foreign holdings of US securities (USD bn)



Note: The EU membership does not reflect the historical one. Aggregate data for the current member states are considered over the entire period.

Source: Department of the Treasury website and author's own calculations

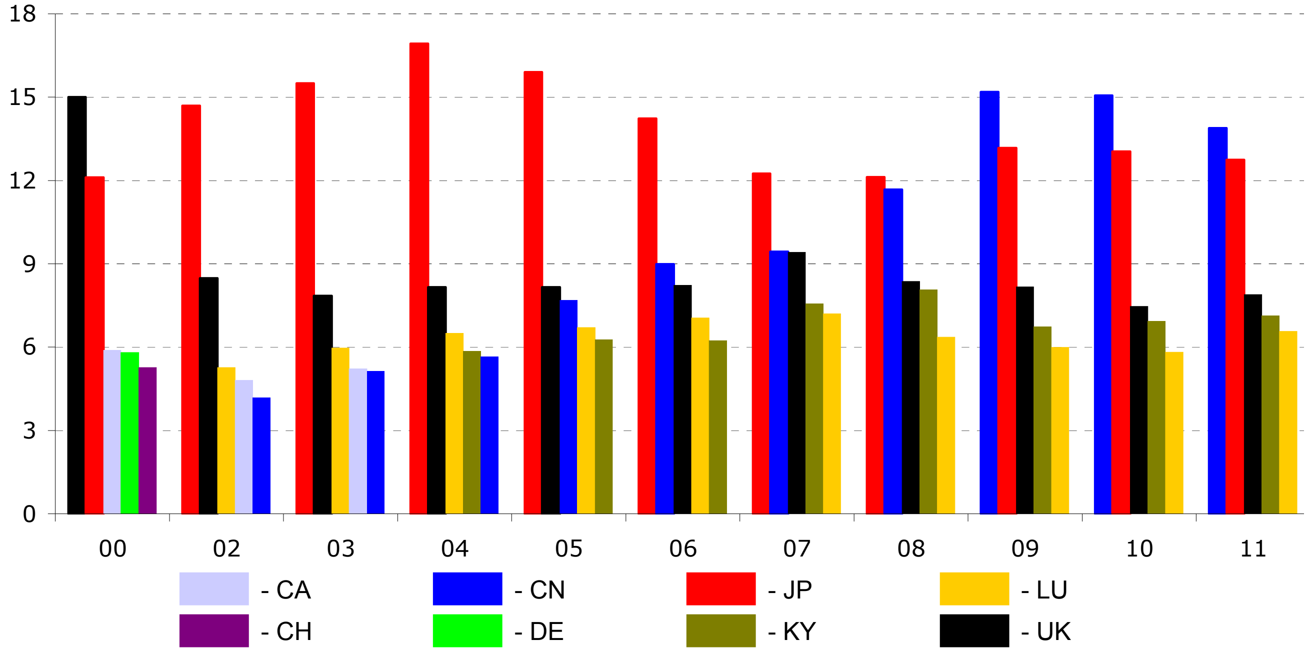
A different picture emerges from the right-hand figure. Portfolio investment in the US was led by the EU until 2008, but this region was overtaken in 2009 by Asia. This latter relative ranking of these two main players was maintained during 2009–2011. Latin America (strongly supported by Caribbean offshore centres) has maintained third position, while the remaining regions have shared rather similar positions among themselves. The aggregate portfolio exposures of the CIS region and Canada to the US contracted the most during 2008–2009, followed by Latin America, the EU and the MENA. This effect did not occur in the Asian case. On the contrary, portfolio investment by this region in the US grew by 13% at the peak of the global crisis in 2008–2009 and continued at a similar pace thereafter.

3. Major holders of US securities

In this section the evolution and investment preferences of the top investors in US securities are briefly described. Figure VII-4 presents the evolution of the top five investors over the period 2000–2011. Figure VII-5 emphasises differences in investment patterns characteristic of the top ten holders of US securities over the same period.[4]

Figure VII-4 shows the strong interest of Asian investors in buying and holding US securities. Over 2002–2008, Japan was the top holder of such securities, with a market share oscillating around 15%. It moved to second position in 2009, although its market share still remained close to 13% over 2009–2011. China emerged as the biggest holder in 2009, with a market share of 15%, and kept that rank from then on. In fact, the rise of China as the top holder of US securities over 2000–2011 was rather spectacular. Starting from tenth position with a mere 3% market share in 2000, it acquired fifth rank in 2002–2004, rose to third position in 2005, then to second over 2006–2008 and finally overtook Japan in top position in 2009.

Figure VII-4: Top five holders of US securities (as a percentage of total foreign holdings of US securities)



Note: The abbreviations used in this figure are CA for Canada, CH for Switzerland, CN for China, DE for Germany, JP for Japan, KY for the Cayman Islands, LU for Luxembourg and UK for the United Kingdom. Data for 2002 are not available.

Source: Department of the Treasury website and author's own calculations

Concomitant to the rise of Asia, a change can be seen in the role of non-Asian countries. The UK switched from the first-rank investor in 2000 to third rank over 2006–2011, although its share fluctuated around 8% for almost the entire period. The Cayman Islands (an offshore financial centre with a strong UK link) was ranked fifth at the beginning of the decade and more recently fourth (2007–2011). The only euro area member belonging to the top five investors has been Luxembourg. It ranked fifth over 2007–2011 with a market share of around 6%. Other European countries (Germany and Switzerland) and Canada left the top of the hierarchy at an early stage in 2000–2003.

It is worth noting once again that besides adjustments in positions (buying and selling assets, expiration at maturity, etc.) securities prices have also exerted a major impact on imposing the above hierarchy. It is very likely, for example, that the fall in equity prices experienced during the financial crisis has reduced the stock value of overall

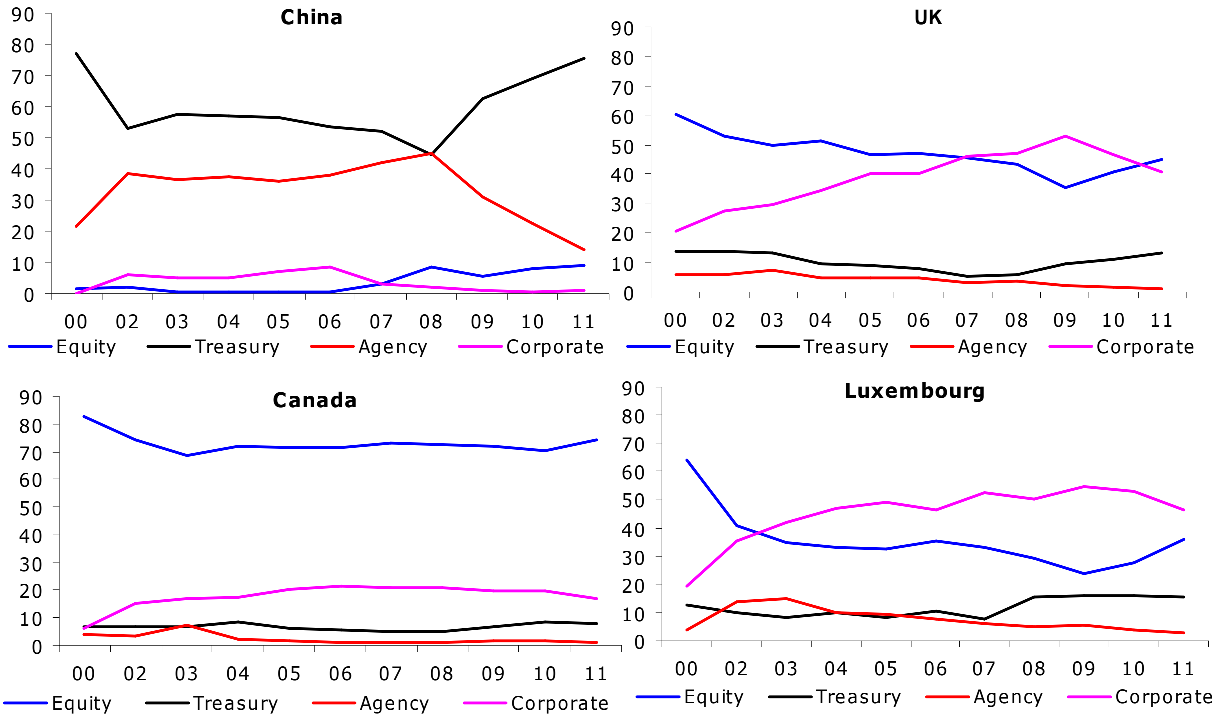
[4] The top ten investors in 2011 were China, Japan, the UK, the Cayman Islands, Luxembourg, Canada, Switzerland, Belgium, Ireland and Hong Kong.

investment for countries with massive exposure to equity investment (the UK for example). Unfortunately, the available data do not allow us to disentangle the price effect from other portfolio composition effects.

Some idea about portfolio composition at the country level can, however, be obtained by employing the four-item classification mentioned at the beginning: equities, Treasury, agency and corporate securities. The data in the last three cases are aggregated to include both short-term and long-term securities. This is depicted in Figure VII-5 for some of the top ten investing countries into the US.

Four different investment strategies can be distinguished from Figure VII-5. Firstly, the Asian countries display an obvious preference for US government securities (either Treasury or agency). In the case of China, Treasury and agency securities maintained significant and comparable portfolio shares until 2008, but the stock of investment in agency securities has been falling considerably since 2009 to the benefit of Treasury securities. Japan and Hong Kong (the corresponding figures are not shown here but are available upon request) show a similar preference for Treasury securities. However, for these two countries the remaining three components are more balanced than in the Chinese case, and in the Hong Kong case one can see a significant increase in the share of agency securities starting from 2009.

Figure VII-5: Representative investment patterns among the top ten investors, %



Note: Data for 2001 are not available

Source: Department of the Treasury website and author's own calculations

The second type of investment strategy has been preferred by the UK and the Cayman Islands. Equity and corporate debt have maintained significant and comparable portfolio shares in this case, while government securities have been less represented, with shares of around or even less than 10%. Countries such as Canada and Switzerland can be included in the third category. The equity share has significantly exceeded the shares of the other three items in these two cases. However, Switzerland has maintained a more balanced portfolio since 2009, with its equity share decreasing to 40% and

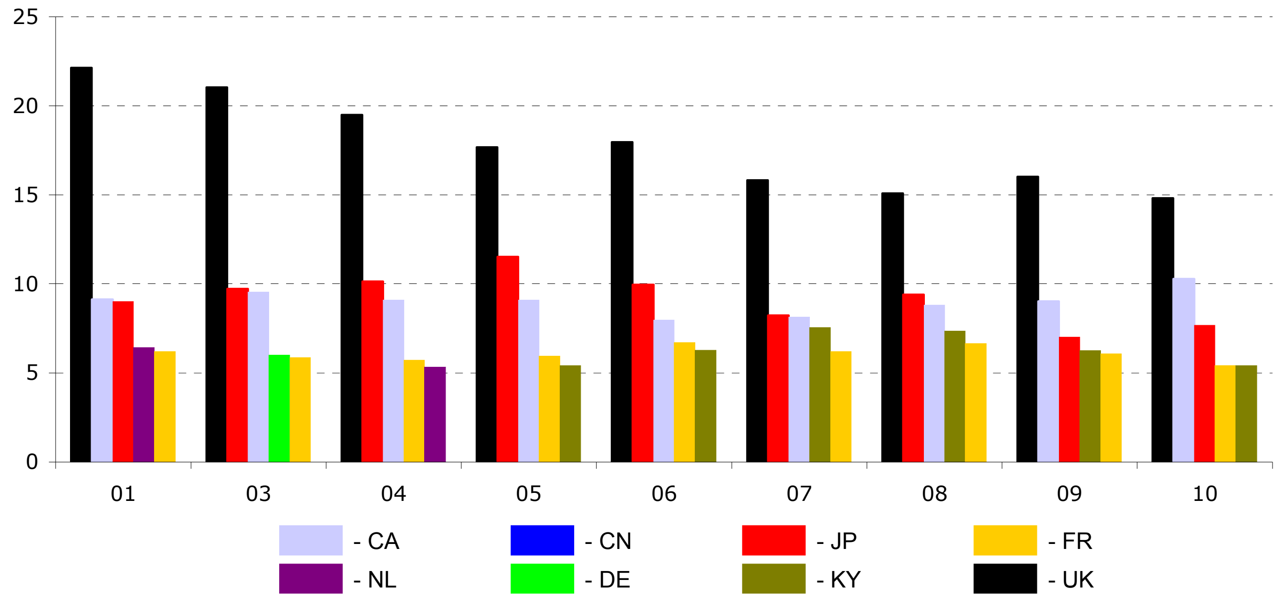
Treasury and corporate securities' shares each moving up to close to 30% that year. Finally, all the remaining European countries (Luxembourg, Belgium and Ireland) have shown a preference for US corporate debt and eventually for equity as the second choice.

Therefore, overall one can distinguish two polar cases. Asian investors have shown a persistent preference for US government securities and a much lower investment penchant towards the US corporate sector. On the contrary, all other top ten investor countries have significantly favoured investing in the corporate sector in the US through either equity or corporate debt.

4. Major recipients of US investment

Similarly, we would like to point out the preferred destination countries for US investors. Figure VII-6 shows the evolution of the top five recipients of US security investment over the period 2001–2010.

Figure VII-6: Top five recipients of US investment (as a percentage of total US holdings of foreign securities)



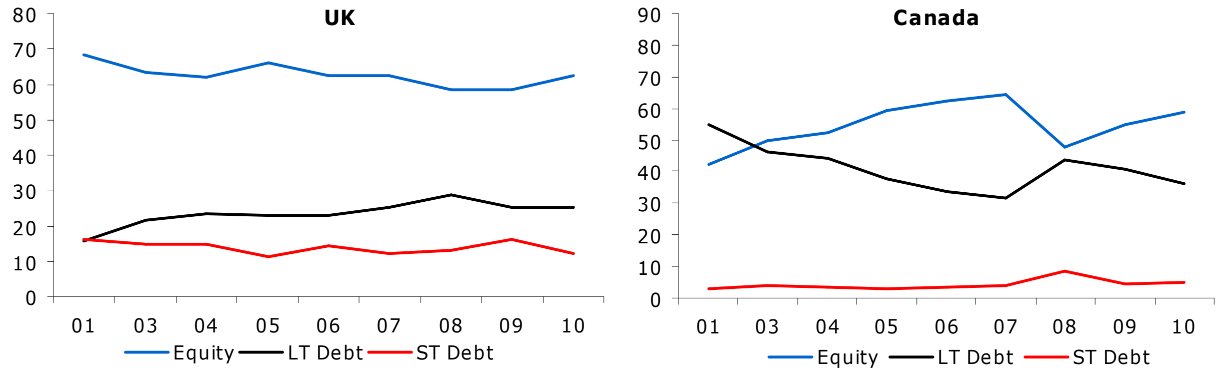
Note: CA is Canada, CN is China, DE is Germany, FR is France, JP is Japan, KY is the Cayman Islands, LU is Luxembourg, NL is the Netherlands and UK is the United Kingdom. Data for 2002 are not available

Source: Department of the Treasury website and author's own calculations

Although the UK has been the most preferred investment destination, its share in total investment has gradually decreased from 22% in 2001 to 15% in 2010. The competition for second and third places has been led by Canada and Japan, with shares of between 7% and 12%. France and the Cayman Islands have been placed in fourth and fifth positions since 2005, with frequent interchanges between the two. Their share in total US securities investment abroad has remained within the 5% to 8% range. During 2001–2004 some European countries (the Netherlands and Germany) rose into the top five, but they were replaced by the Cayman Islands in 2005. Overall, US investment abroad has been quite stable in terms of top country destination. US holders of foreign securities have remained committed to basically five major country destinations and they switched little within this configuration even during the crisis.

Regarding the instrument type, it is only possible to distinguish among equity, long-term debt and short-term debt. Two typical investment strategies adopted by US investors abroad are shown in Figure VII-7 below.

Figure VII-7: Typical investment strategies of US investors abroad



Note: Data for 2002 are not available

Source: Department of the Treasury website and author's own calculations

As a rule, preponderant US holdings of equity in these countries, as shown here in the case of the UK, were also characteristic for Japan and France. US investment in Canada, done predominantly through equity, favoured long-term debt only marginally less. Only in the Cayman Islands case can one observe a more important role for long-term debt than for equity.

Conclusion

The overall propensity to invest in foreign securities has been strong, both into and out of the US. However, the global crisis starting in 2007 has significantly affected the value of US securities investment abroad. On the contrary, the value of US securities holdings owned by foreigners decreased only slightly in 2009 and quickly caught up with the trend again during the following years.

In terms of instrument type, the US has maintained its largest share of investment in equities. The same is true for the holdings of US securities of some European countries and Canada, which have traditionally invested in the US corporate sector. On the contrary, the major Asian holders of US securities have shown a strong preference for US government debt.

China rapidly acquired the top position as a holder of US securities over the decade. Its massive holding of Treasuries has tended to provoke tension in the policy circles of both countries (Morrison and Labonte, 2011). In the US, China's role as a creditor of the US federal deficit has been viewed with suspicion as a way of offering China strong leverage over US policies. China, on the other hand, has been concerned by the easing of the money supply in the US. In its view, this would reduce the real value of its US security holdings if inflation or depreciation of the US currency occurs. Beyond these topical issues, the claim that China had a significant role in provoking a boom and bust episode in the US at the origin of the global crisis gets weak support. China's leading role as a holder of US securities arose in 2009, rather a long time after the crisis broke out.

In terms of geographical and country destination, US investment has been quite conservative. Europe has remained basically the principal destination, with the UK and France consistently among the top five country recipients. Asia (with Japan in the top five) and the Caribbean (including the Cayman Islands) have also attracted significant

US investment. In all these cases equity and (much less often) long-term debt have been the main investment vehicles. On the contrary, foreign holdings of US securities have not followed a consistent trend. Europe was the main investor in the US securities market until 2008, but it was overtaken by Asia in 2009. Some consistency, however, prevails with regard to the investment strategies adopted by different countries and regions. Asia has followed the trend of buying government securities, while all other major investor countries have favoured the corporate sector in the US.

References

Benecká S. (2011): Monetary Policy of the People's Bank of China. Global Economic Outlook, Czech National Bank, April 2011, at http://www.cnb.cz/miranda2/export/sites/www.cnb.cz/en/monetary_policy/geo/geo_2011/gev_2011_04_en.pdf

Hausmann R. – Sturzenegger F. (2005): U.S. and Global Imbalances: Can Dark Matter Prevent a Big Bang? at www.cid.harvard.edu

Morrison W. M. – Labonte M. (2011): China's Holdings of U.S. Securities: Implications for the U.S. Economy. Congressional Report Service Report for Congress, September 2011, at www.fas.org

Report on Foreign Portfolio Holdings of U.S. Securities as of June 30, 2011, at http://www.treasury.gov/resource-center/data-chart-center/tic/Pages/fpis.aspx

Report on U.S. Portfolio Holdings of Foreign Securities as of December 31, 2010, at http://www.treasury.gov/resource-center/data-chart-center/tic/Pages/fpis.aspx

BOFIT	Bank of Finland Institute for Economies in Transition
BR	Brazil
BRIC	Brazil, Russia, India and China
CA	Canada
CB-CCI	Conference Board Consumer Confidence Index
CB-LEII	Conference Board Leading Economic Indicator Index
CBOT	Chicago Board of Trade
CF	Consensus Forecasts
CH	Switzerland
CIS	Commonwealth of Independent States
CN	China
CNB	Czech National Bank
DBB	Deutsche Bundesbank
DE	Germany
EA	euro area
EC	European Commission
ECB	European Central Bank
EC-CCI	European Commission Consumer Confidence Indicator
EC-ICI	European Commission Industrial Confidence Indicator
EIU	The Economist Intelligence Unit database
ES	Spain
EU	European Union
EUR	euro
EURIBOR	Euro Interbank Offered Rate
Fed	Federal Reserve System (the US central bank)
FR	France
FRA	forward rate agreement
GBP	pound sterling
GDP	gross domestic product
GR	Greece
CHF	Swiss franc
ICE	Intercontinental Exchange
IE	Ireland
IFO	Institute for Economic Research
IFO-BCI	IFO – Business Climate Index
IFO-CCI	IFO – Consumer Confidence Index
IMF	International Monetary Fund
IN	India
IRS	Interest rate swap
IT	Italy
JP	Japan
JPY	Japanese yen
KY	Cayman Islands
LA	Latin America
LIBOR	London Interbank Offered Rate
LU	Luxembourg
MENA	Middle East and North Africa
N/A	not available
NL	the Netherlands
OECD	Organisation for Economic Co-operation and Development
OECD-CLI	OECD Composite Leading Indicator
PT	Portugal

RU	Russia
UoM	University of Michigan
UoM-CSI	University of Michigan Consumer Sentiment Index
UK	the United Kingdom
US	United States
USD	US dollar

2012

	Issue
Liquidity risk in the euro area money market and ECB operations (Soňa Benecká)	2012-1
The euro area bond market during the debt crisis (Tomáš Adam and Soňa Benecká)	2012-2
A macrofinancial view of asset price misalignment (Luboš Komárek)	2012-3
Property price misalignment around the world (Michal Hlaváček and Luboš Komárek)	2012-4
An overview of the world's most frequently used commodity indices (Jan Hošek)	2012-5
A look back at the IIF spring membership meeting (Filip Novotný)	2012-6
Annual assessment of the forecasts included in the GEO (Filip Novotný)	2012-7
Changes in the Czech Republic's balance of payments caused by the global financial crisis (Vladimír Žďárský)	2012-8
US holdings of foreign securities versus foreign holdings of securities in the US: What is the trend? (Narcisa Kadlčáková)	2012-9

2011

	Issue
International integration of the Chinese stock market (Jan Babecký, Luboš Komárek and Zlatuše Komárková)	2011-1
The link between the Brent crude oil price and the US dollar exchange rate (Filip Novotný)	2011-2
A look back at the IIF spring membership meeting (Jan Hošek)	2011-3
Monetary policy of the People's Bank of China (Soňa Benecká)	2011-4
Winners and losers of the economic crisis in the eyes of European investors (Alexis Derviz)	2011-5
How have global imbalances changed during the crisis? (Vladimír Žďárský)	2011-6
Assessment of the forecasts monitored in the GEO (Filip Novotný)	2011-7
Eurodollar markets (Narcisa Kadlčáková)	2011-8
Increased uncertainty in euro area financial markets (Tomáš Adam and Soňa Benecká)	2011-8
Monetary policy of the central bank of the Russian Federation (Oxana Babecká)	2011-9

	Issue
Where to look for a safe haven currency (Soňa Benecká)	2011-9
A look back at the IIF annual membership meeting (Luboš Komárek)	2011-10
The widening spread between prices of North Sea Brent crude oil and US WTI crude oil (Jan Hošek and Filip Novotný)	2011-11
An empirical analysis of monetary policy transmission in the Russian Federation (Oxana Babecká)	2011-12