The Financial Crisis and the Geography of Wealth Transfers

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Gourinchas, **Rey**, and **Truempler** construct a new dataset that allows them to analyze the geography of bilateral wealth transfers during the global crisis of 2007-9, which led to massive changes in relative asset prices. The researchers build quarterly estimates of net and gross bilateral external positions, flows, and valuation changes from 2007:4 to 2008:4 for a sample of countries covering most of the world's financial landscape. They then provide a global heat map of external gains and losses and decompose the effect of exchange rates and asset prices in these valuation changes.

The valuation changes are sizable, even when compared with the massive domestic wealth losses brought about by the crisis. The heat map highlights a very diverse set of outcomes depending on the structure of countries' external portfolios. Some countries saw the value of their net assets plunging, others benefitted from large capital gains. The countries whose net international asset positions deteriorated provided wealth transfers to the others at a time when the marginal utility of consumption was very high. For that reason, they can be regarded as "global insurers".

Interestingly, the United States, which was at the center of the international monetary system and was an issuer of the main reserve assets, U.S.Treasuries, provided most of the insurance during the crisis, while its international investment position deteriorated significantly. Indeed, between 2007:4 and 2009:1, the U.S. net foreign asset position deteriorated by 21 percent of GDP, of which about 16 percent represents a net valuation loss. This valuation loss amounts to roughly $2,200 billion.

Other countries, perhaps regarded more like regional insurers, also joined in, including Switzerland, the Euro area, and even China. A general pattern in the data is that most countries long in equity or direct investment faced losses on their net positions, because risky assets dropped lost the most value during the crisis.

For portfolio debt, the exact structure of the portfolio matters; in particular, the relative weights of government bonds versus toxic corporate debt made an important difference for the outcomes. Countries were simultaneously hurt by their exposure to the U.S. financial markets (especially structured credit products) and sheltered from the global financial storm through their holdings of Treasuries and Agencies debt.

These authors also study the determinants of valuation changes on international positions. They find a clear positive correlation in the data between the countries with losses on their net debt portfolios vis-a-vis the United States and those that set up ABCP conduits. Although the sample coverage is relatively small, there is also a positive correlation observed between countries that set up ABCP conduits and measures of the U.S. dollar shortage, which suggests that the lack of dollar liquidity in the banking system was associated with important losses on external debt portfolios.

Consistent with those results, the researchers uncover a positive correlation between various measures of the regulatory environment that they interpret as reflecting market friendliness and losses. Finally, it is important to emphasize that data limitations induce substantial uncertainty in any exercise of this nature. This study underlines important data issues regarding cross-country coverage, offshore financial centers, and the measurement of international investment positions and flows.