Firms, Investors, and Global Capital Allocation

Brent Neiman, Professor, University of Chicago
Booth School of Business

Global Portfolios and External Positions

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Capital Flows Accumulate into Positions

- Net Foreign Asset (NFA) Position = Foreign Assets (A) - Foreign Liabilities (L)

- Example of A? Example of L? Reminder: NFA is not about wealth.

- In open-economy macro models, NFA is key state variable. Why? NFA entitles you to negative future current accounts (CA).

- CA < 0 means net imports (i.e. negative trade balance, TB) and/or negative net income from foreign factors (NFI) and/or negative unilateral transfers (UT):

\[ CA_t = TB_t + NFI_t + UT_t \]  (1)
Dynamics of Net Foreign Asset Positions

- Law of Motion for \( NFA \):

\[
NFA_t = A_t - L_t = A_{t-1} - L_{t-1} + CA_t + VC_t
\]  

- Dynamics due to net purchase of foreign assets (\( CA \)) and valuation changes (\( VC \)). (Note: See Curcuru, Thomas, and Warnock, 2008, on “other adjustments”.)

- So, a country with \( NFA << 0 \) is likely to:
  - Have positive trade balances and/or positive net factor income and/or positive unilateral transfers in the future
  - Experience valuation gains
  - Some combination of both

- \( NFA/Y \neq 0 \) can persist, but shouldn’t explode
Who Has Big/Small NFAs? Levels

Source: IMF, Author’s Calculations
Who Has Big/Small NFAs? Shares of GDP

Source: IMF, Author’s Calculations
### How Has US NFA Adjusted?

<table>
<thead>
<tr>
<th>Year</th>
<th>NFA</th>
<th>Accumulated CA</th>
<th>Accumulated VC</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>0.4</td>
<td>0.2</td>
<td>0.0</td>
</tr>
<tr>
<td>1990</td>
<td>0.2</td>
<td>0.4</td>
<td>0.2</td>
</tr>
<tr>
<td>2000</td>
<td>0.0</td>
<td>0.2</td>
<td>0.4</td>
</tr>
<tr>
<td>2010</td>
<td>0.2</td>
<td>0.4</td>
<td>0.6</td>
</tr>
<tr>
<td>2020</td>
<td>0.4</td>
<td>0.6</td>
<td>0.8</td>
</tr>
</tbody>
</table>

**Source:** US BEA, Author’s Calculations

Source: US BEA, Author’s Calculations

Source: US BEA, Author’s Calculations
How Has US NFA Adjusted?: 1975-2019, With the Current Account

Source: US BEA, Author’s Calculations
How Has US CA Adjusted?

Source: US BEA, Author’s Calculations
How Has US CA Adjusted?: Mostly through Trade

Source: US BEA, Author’s Calculations
Features that Matter for Dynamics? Composition and Currency

- A and L can be classified into four categories:
  1. (Foreign) Direct Investment \((FDI)\). Think about control and ownership.
  2. Portfolio Investment \((PI)\). Stocks and bonds.
  3. Other Investment \((PI)\). Bank loans, also currency, trade credits, etc.
  4. Derivatives \((D)\). Less related to transfers ...

- \(FDI\) might be less quick to adjust than \(PI\), often referred to as “hot money”
- \(PI\) stocks likely to track foreign stock market index
- \(PI\) bonds will *mechanically* move with exchange rate
Related Topics and Controversies

1. Phantom FDI! Damgaard, Elkjaer, and Johannesen (2019)
3. Missing Valuation Changes! Coppola, Maggiori, Neiman, Schreger (2020)
4. Exorbitant Privilege
5. Policy Issues: Value of US Dollar, Border-Adjustment taxes, etc.