The Financial Crisis and The Geography of Wealth Transfers

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Non-technical Summary

The global crisis of 2007-2009 led to massive changes in relative asset prices. We construct a new dataset that allows us to analyze the geography of bilateral wealth transfers during the crisis. We build quarterly estimates of net and gross bilateral external positions, flows and valuations changes from 2007:4 to 2008:4 for a sample of countries that covers most of the world's financial landscape.

We provide a global heatmap of external gains and losses and decompose the effect of exchange rates and asset prices in these valuation changes. Those valuation changes are sizable, even when compared against the massive domestic wealth losses brought about by the crisis. Our heatmap highlights a very diverse set of outcomes depending on the structure of countries' external portfolios. Some saw the value of their net assets plunging, others benefited from large capital gains. The countries whose net international asset positions deteriorated provided wealth transfers to the others at a time where marginal utility of consumption was very high. For that reason they can be regarded as "global insurers".

Interestingly, we find that the United States, the country at the centre of the international monetary system and issuer of the main reserve assets, the US Treasuries, provided most of the insurance during the crisis, as its international investment position deteriorated massively. Indeed, between 2007:4 and 2009:1, the US net foreign asset position deteriorated by 21% of GDP, of which about 16% represents a net valuation loss. This valuation loss amounts to roughly $2,200 billion. But other countries, which may be regarded more like regional insurers joined in, such as Switzerland, the Euro area or even China. A general pattern in our data is that most countries long equity or direct investment faced losses on their net positions, as risky assets took some of the sharpest valuation falls in the crisis. For portfolio debt, the exact structure of portfolio matters, and 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 US financial markets (especially structured credit products) and sheltered from the global financial storm through their holdings of Treasuries and Agencies debt.

We also study the determinants of valuation changes on international positions. We find a clear positive correlation in the data between the countries with losses on their net debt portfolios vis-a vis the US and those who set-up ABCP conduits. Though the sample coverage is relatively small, we also find a positive correlation between countries who set up ABCP conduits and measures of US dollar shortage, suggesting that the lack of dollar liquidity in the banking system was associated with important losses on external debt portfolios. Consistent with those results, we also uncover a positive correlation between measures of regulatory environment that we interpret as reflecting market friendliness and losses.

Finally, it is important to emphasize that data limitations induce substantial uncertainty in an exercise of this nature. Our study underlines important data issues regarding cross-country coverage, offshore financial centres and the measurement of international investment positions and flows.