COUNCIL on FOREIGN RELATIONS

Maurice R. Greenberg Center for Geoeconomic Studies

Quarterly Update: Foreign Ownership of U.S. Assets

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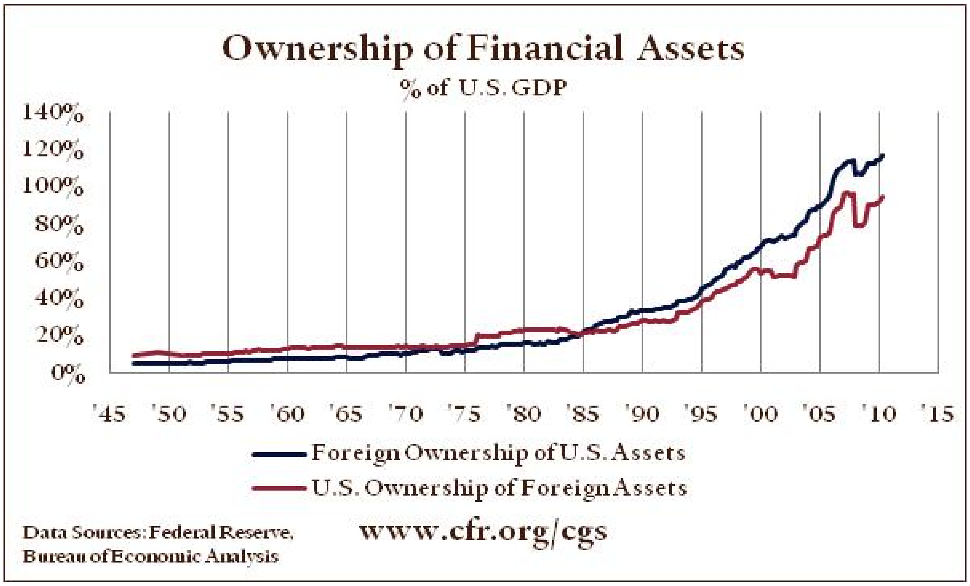
The recent downgrading of U.S. government debt by Standard & Poor's triggered Chinese mockery of "the debt-ridden Uncle Sam" and raised questions about America's continued ability to attract capital inflows. As the following charts show, foreign ownership of U.S. assets has increased significantly since 1945, growing especially quickly over the past two decades. This growth is the result of a general increase in cross-border investment, with rising foreign ownership of U.S. assets being almost balanced by rising U.S. ownership of assets abroad. Although the Chinese government is a significant U.S. creditor, capital flows into the United States draw some resilience from their breadth, both in terms of the sources of international financing and in the U.S. assets that foreigners purchase.

Things to look for in these graphs:

- Since 2002, the increase in foreign ownership of Treasury bonds has been driven almost entirely by government buyers. Until the 2007–2009 crisis, the same was true for bonds issued by government-sponsored enterprises (agencies). In the postcrisis recovery, foreign private holdings of agencies are rising, while foreign government holdings continue to fall.
- From 2005 to early 2007, foreign governments' Treasury purchases were driven by China's purchases. However, China became less significant during the crisis as other investors crowded in. Today, China's purchases have remained elevated while the rest of the world is purchasing less than during the crisis peak.
- The Net International Investment Position (NIIP), meaning foreigners' holdings of U.S. assets minus U.S. holdings of foreign assets, has remained remarkably resilient, even though the large U.S. current account deficit reflects a steady flow of net foreign purchases of U.S. assets. This trend is likely to persist if the dollar depreciates, since dollar depreciation results in gains in the dollar value of U.S. holdings of foreign assets.
- The U.S. portfolio of foreign assets is relatively risky, with a significant share of holdings in equities that generate gains during a boom but suffer losses when crisis strikes. By contrast, foreign holdings of U.S. assets are less volatile because of the concentration in treasuries. Following a sharp decline in 2008, the U.S. net international investment position recovered in 2009 due to strong equity market performance.

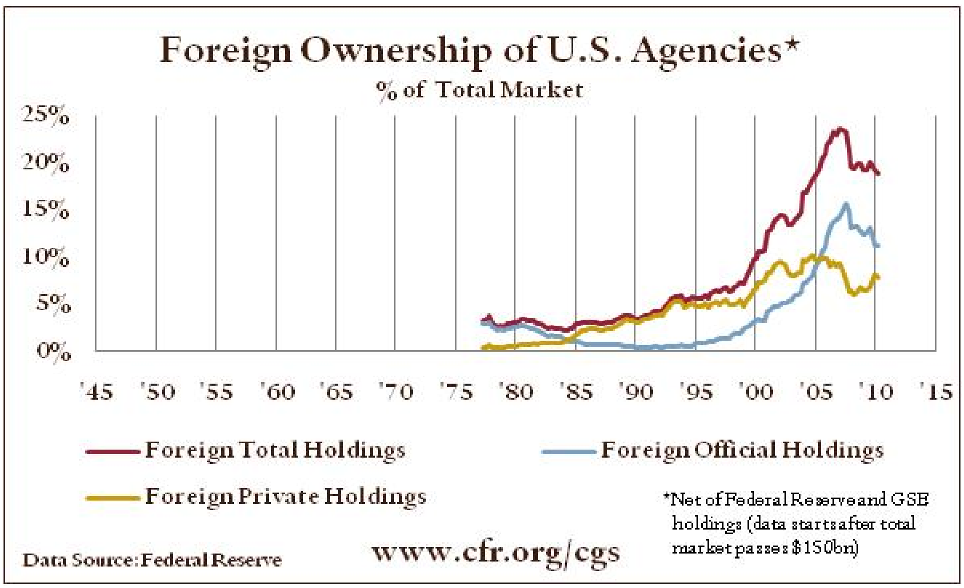


- Cross-border investment has grown as the world has become increasingly globalized.
- Foreigners own more U.S. assets than Americans own foreign assets.
- In the latest quarter, foreign ownership of U.S. assets and U.S. ownership of foreign assets both registered slight increases.

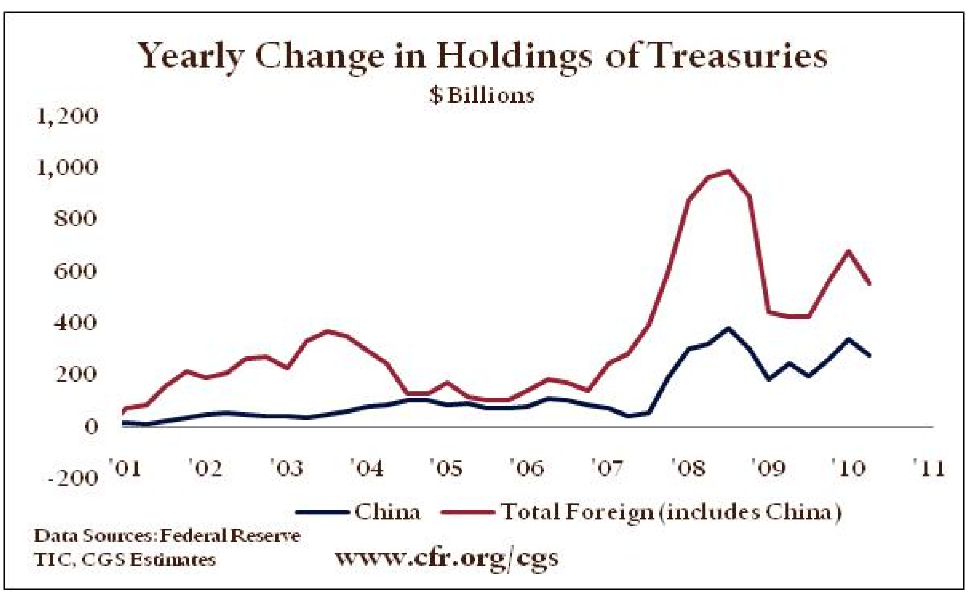
- Foreigners own a significant share of all outstanding treasuries and less significant portions of other asset markets. Their holdings of equities, while large in dollar terms, are small relative to the size of the equity market.

- Foreign ownership of U.S. treasuries has grown sharply since the middle of the 1990s. After falling slightly from a Q4 2007 peak, it is now turning up again.
- Foreign ownership of the agency market has grown significantly as well. But it fell after the 2007–2009 crisis and has yet to pick up.

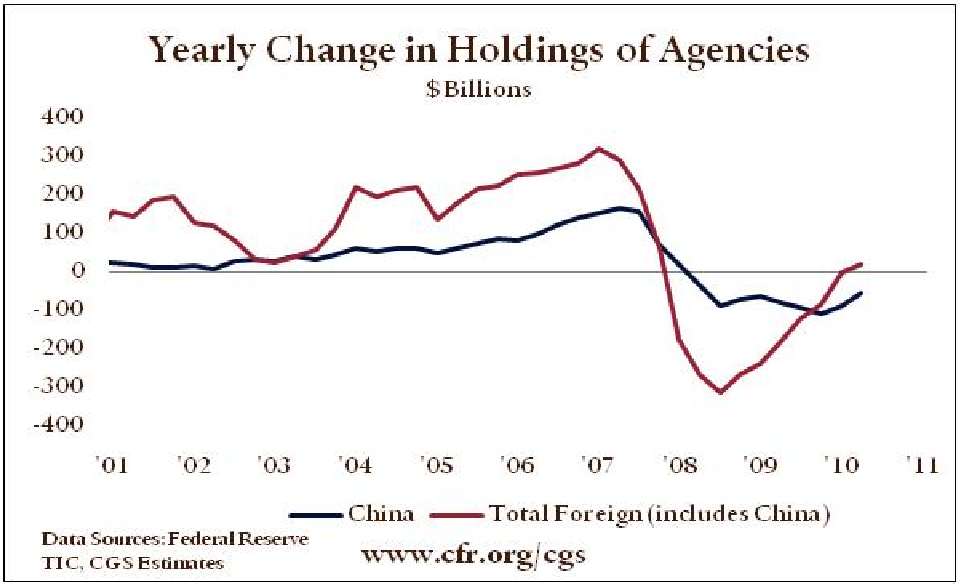
- Much of the growth in foreign ownership of treasuries has come from official buyers (i.e., foreign central banks and sovereign wealth funds), raising the risk of policy-driven selling.
- Foreign private holdings have not grown as a share of the market over the past ten years.



- As with treasuries, a significant portion of growth in foreign ownership of agencies has come from official buyers.
- After a flight from agencies during the financial crisis, foreign private investors are now increasing their holdings; foreign official investors continue to sell.



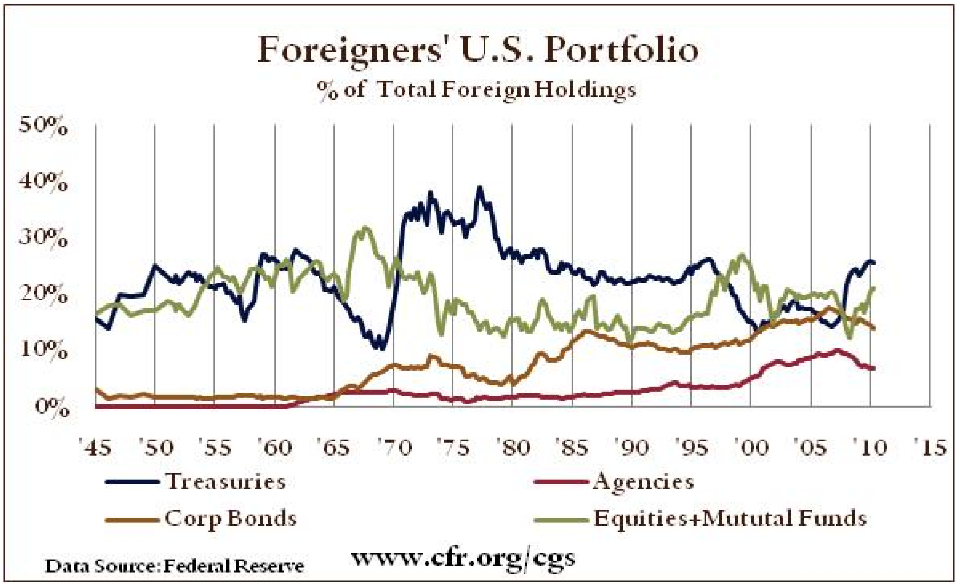
- From 2005 to 2007, China made up a significant part of the total change in foreign holdings of treasuries.
- The flight to safety during the crisis reduced China's importance, but in the current recovery China has regained its status as a driver of total foreign holdings.
- After the crisis, China's purchases of treasuries slowed, even as its purchases of long-term Treasury bonds remained elevated. This reflected sales of short-term Treasury bills.



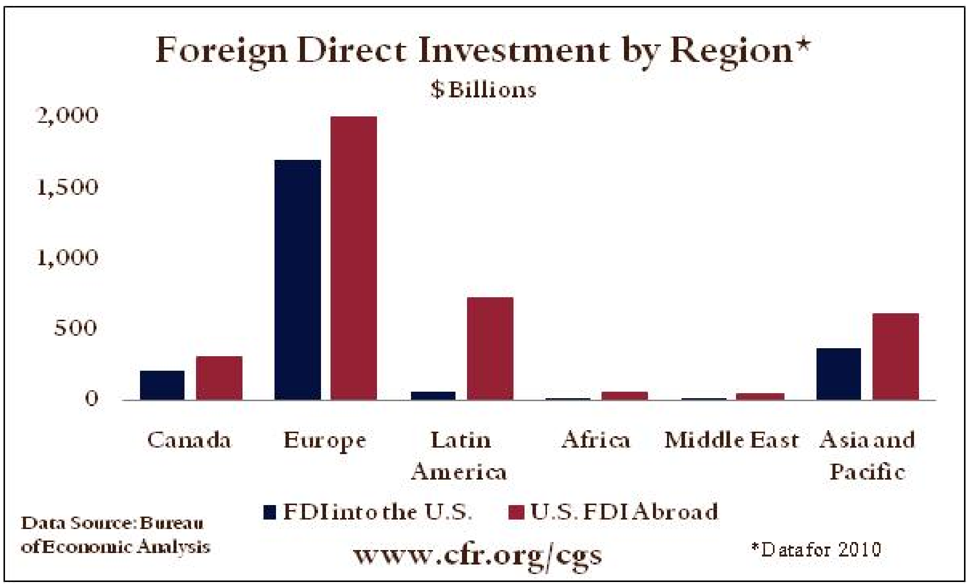
- China sold agencies during the crisis, but most of the selling pressure came from the rest of the world.
- However, in the first quarter of 2011 China was continuing its steady sales of agencies; the rest of the world has now stopped selling.

- In the midst of the crisis, Russia sold agencies more aggressively than China, reducing its holdings to almost zero.

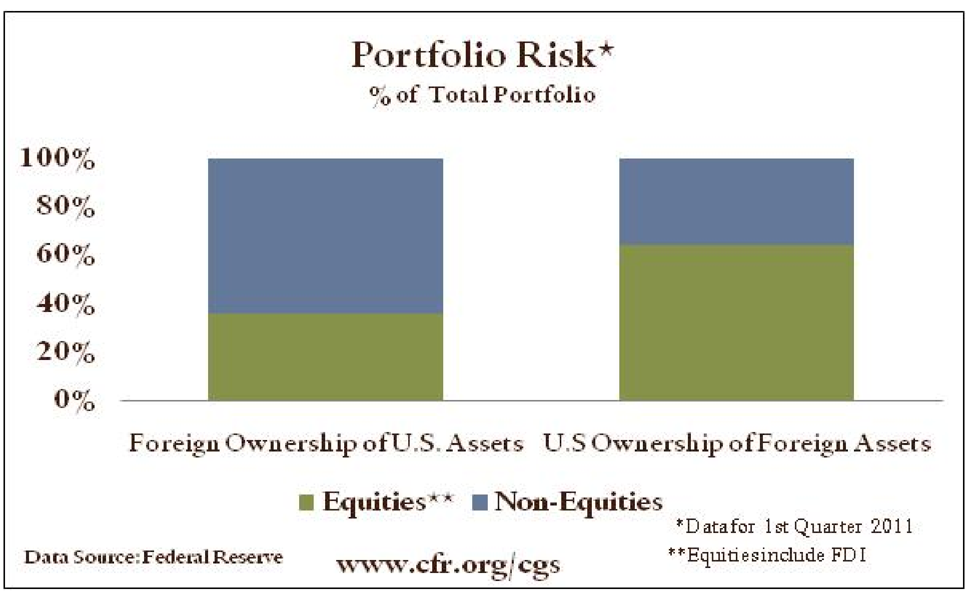
- Foreign ownership of corporate bonds as a percentage of the total has grown significantly since 1945. Although growth has been modest over the past two decades, Q1 foreign holdings are at levels not seen since the mid 1980s.
- Foreign ownership of U.S. equities has grown slowly but steadily since the 1970s.



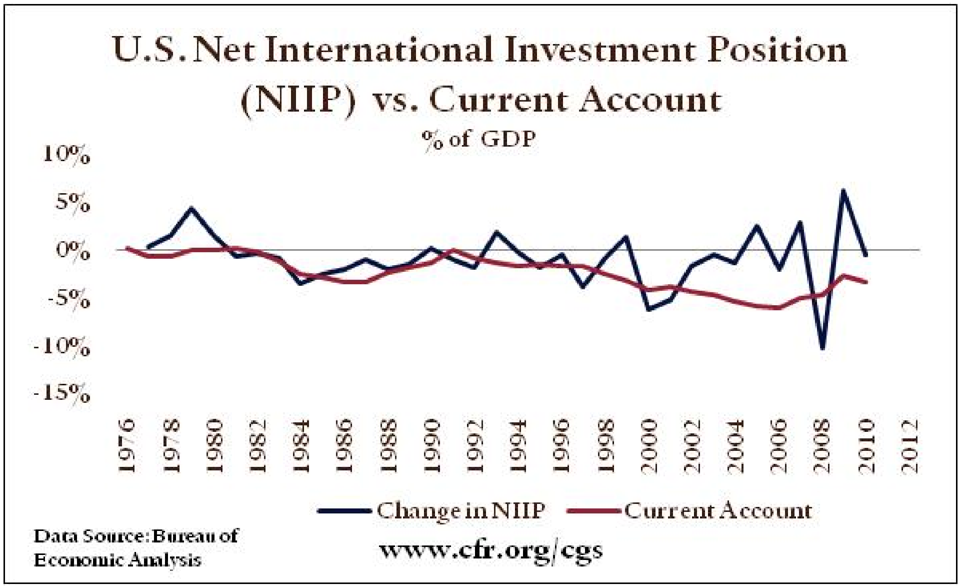
- The foreign preference for Treasury ownership had been waning over the past forty years but has returned since the crisis.



- The United States invests more directly into enterprises abroad than do foreigners into the United States.
- The sharpest contrast relates to Latin America.



- The United States tends to hold riskier assets abroad (equities) than foreigners hold in the United States.



- Because of persistent U.S. current account deficits and corresponding capital inflows, foreigners buy more U.S. assets than vice versa. But because U.S. holdings abroad have usually yielded higher returns than foreign holdings in the United States, the U.S. net international investment position has deteriorated less—although there was a sharp decline in 2010.