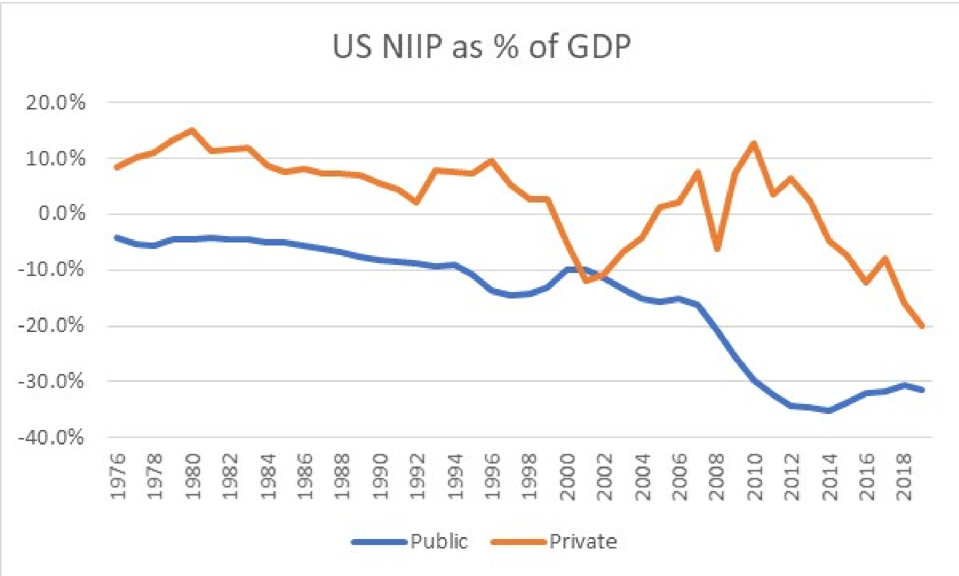
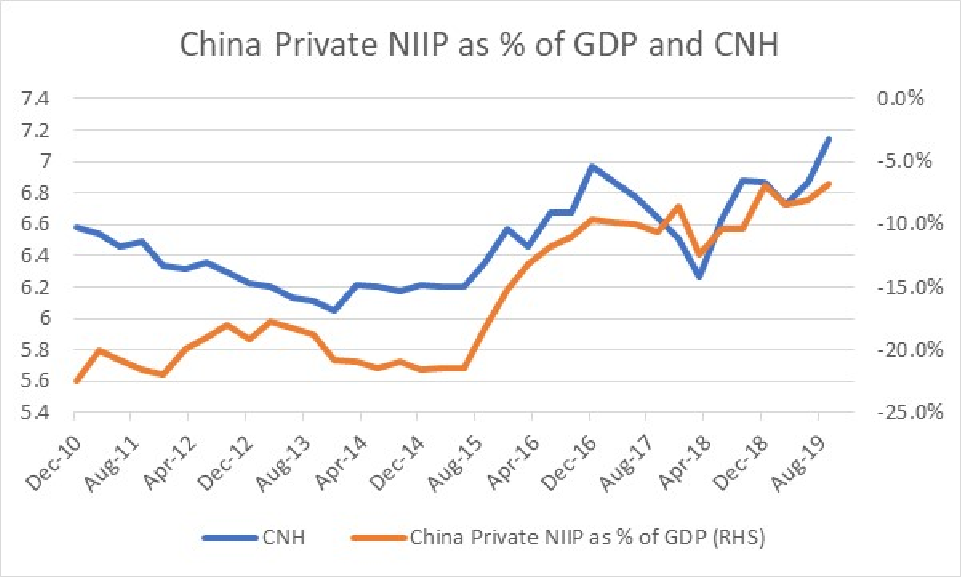
WHEN DOES THE BUYING OF US ASSETS END?

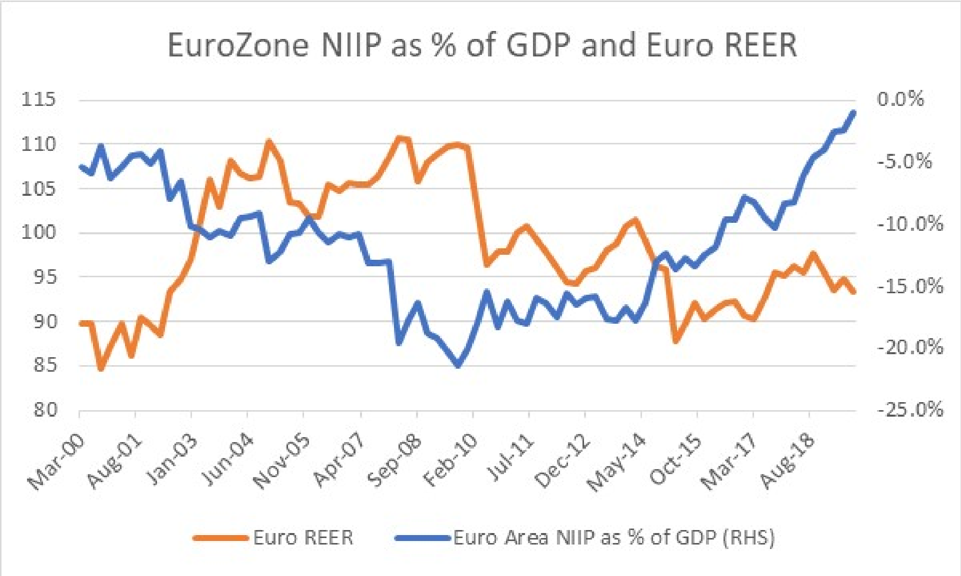
Net International Investment Position (NIIP) data can offer a guide to where the extreme asset flows are and when they are about to end. In recent years, US NIIP has deteriorated rapidly. We show that both the private sector and public sector have reached record deficits as a percent of GDP in recent years.



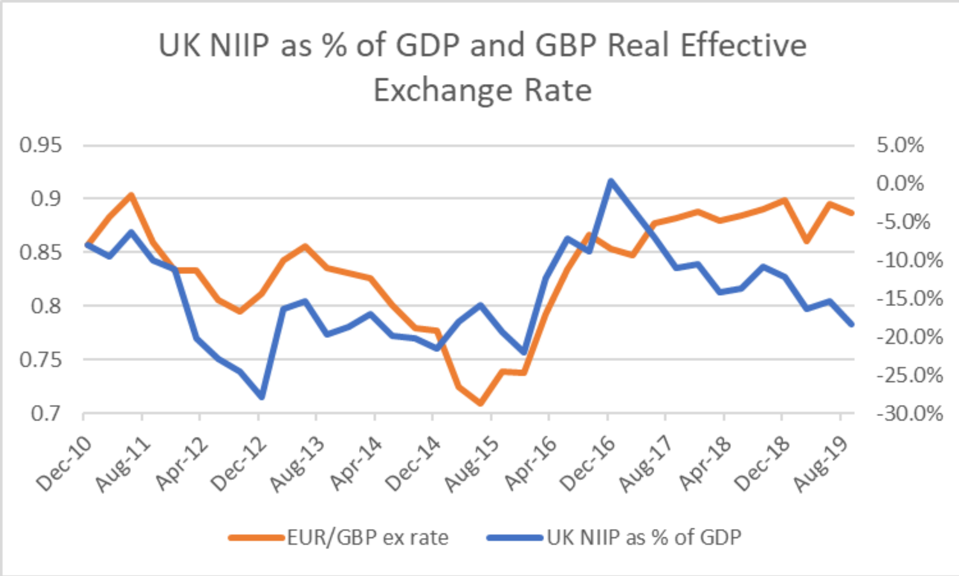
Can we gauge when fund flows will end? While the US has NIIP data back to the 1970s, for most other regions it is more recent. We can look at various financial and currency crises to get an idea of how extreme NIIP positioning can get. First, we can look at China as a guide. After the financial crisis there were heavy flows into Chinese assets, and it saw a deterioration in its private sector NIIP (we exclude foreign reserves from NIIP) to USD 2.5 trillion or roughly 20% of GDP before the Renminbi was forced to devalue.



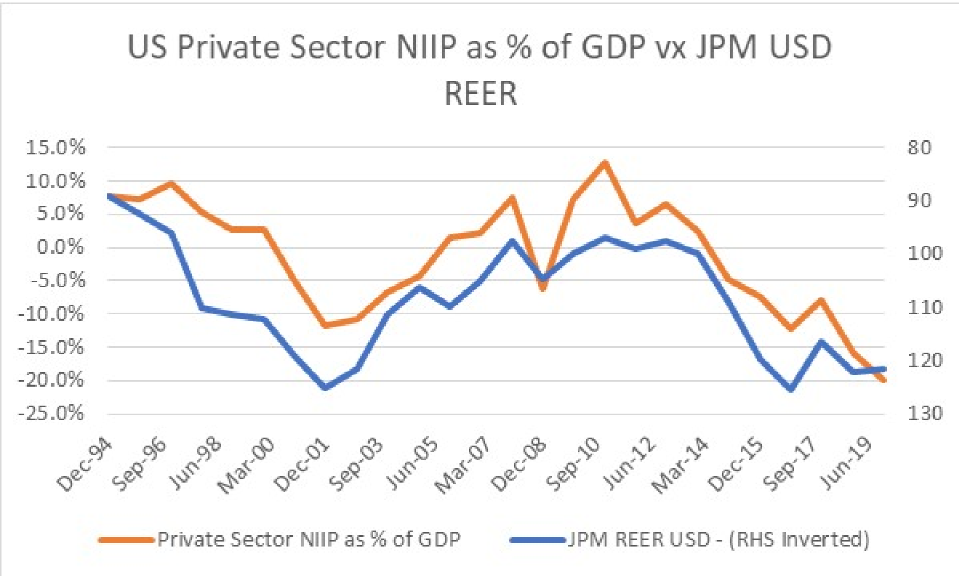
Prior to the Global Financial Crisis, Europe received a significant amount of credit flows as the convergence trade of the periphery to the core as well as the entrance of Central European countries to the EU drove huge credit flows. The Euro Zone NIIP reached a deficit of 20% of GDP before the Eurocrisis and its subsequent devaluation.



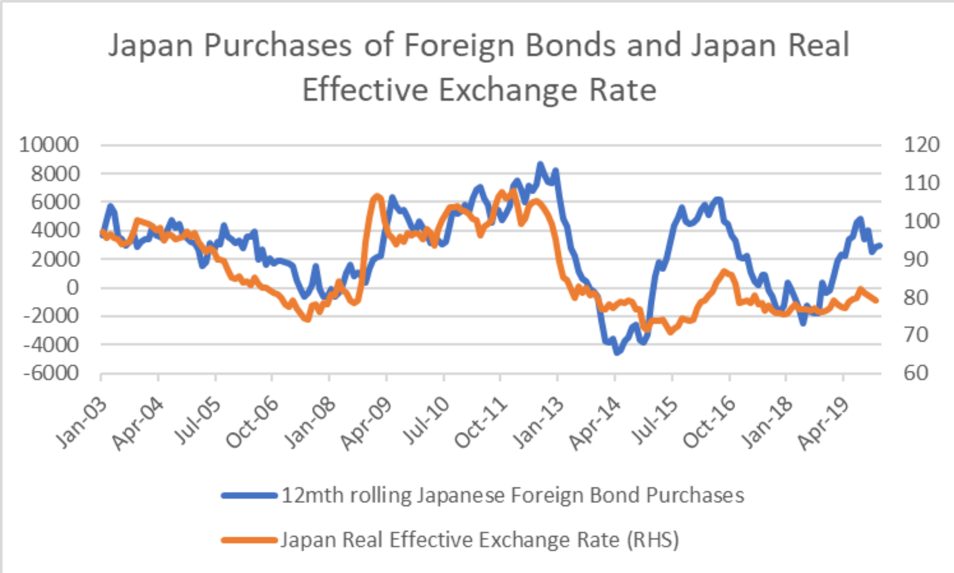
Prior to the Brexit Referendum in 2016, the UK was running a 20% NIIP deficit. This has moved to balance with a 20% fall in the exchange rate against the Euro, the major trade partner of the UK.



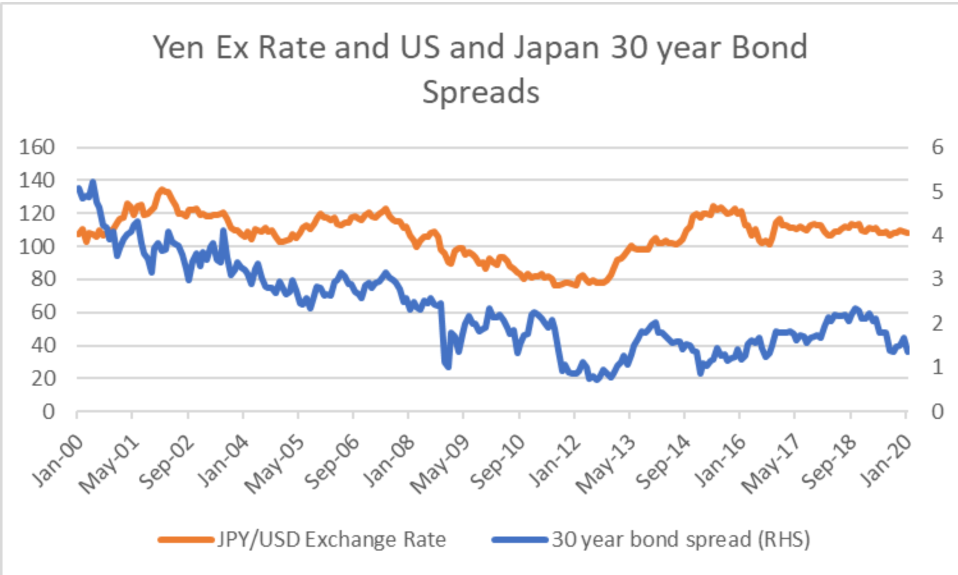
Today the US is sucking in huge amounts of capital. Its Private Sector NIIP (NIIP less foreign treasury holdings) is running a 20% deficit while the public sector is running a 30% deficit. The top seen in the 2000-2001 period of US NIIP deficit was followed by dollar weakness. The US dollar, as proxied by the JP Morgan Nominal Broad Effective Exchange Rate, also looks to be topping out.



So who is buying US assets? One of the usual suspects is Japan. Intriguingly, generally the Japanese used to buy foreign bonds when the Yen was strong and sell them when the Yen was weak. Since 2013, Japanese purchasing of foreign bonds has been strong even without the Yen strengthening. This is exactly what Abenomics and Bank of Japan activism was intended to do. That is, Japanese fund flows would be less counter-cyclical and more pro-cyclical. In other words, fund flow was not meant to take advantage of Yen strength, but to stop Yen from strengthening in the first place.



This has caused the traditional relationship between Japanese and US 30 year bond spreads against the Yen exchange rate to breakdown.



The US NIIP as a percentage of GDP is running at close to a 50% of GDP deficit, while private sector deficits in China and Europe are close to zero, implying almost all flows from Japan are to the US. In absolute numbers, China Private NIIP deficit topped out at USD 2.5 trillion, Europe was also at USD 2.5 trillion, while the US quarterly data just passed USD 4 trillion. With the US running USD 1 trillion fiscal deficits, even the Japanese may not have enough money to keep the US dollar strong.

INFORMATION

Issue Date: 20th February 2020
Source: Bloomberg, unless otherwise stated
Investor Relations: Samantha Dunn
Email: info@horsemancapital.com
Telephone: +44 (0)20 7838 7580
Website: www.horsemancapital.com
Business and registered address: Horseman Capital Management Limited, 9 Chester Close, London SW1X 7BE, United Kingdom.
Registered in England and Wales - Company number: 04034280

DISCLAIMER