Fed Paper Argues U.S. Misstates Global Capital Flow Data
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NEW YORK -(Dow Jones)- Capital flow data may substantially overstate the amount of foreign purchases of U.S. bonds and understate the total of foreign equities purchased by U.S. investors, according to a paper published Thursday by the Federal Reserve Board.

The distortion of data would have significant consequences, including an underestimation of gross national product, overestimation of the current account deficit and an underestimation of national savings, according to the report. The paper was written by Francis Warnock, an economist, and Chad Cleaver, a research assistant, at the Fed Board of Governors.

The overstatement of foreign holdings of U.S. bonds is particularly stark.

"Our overestimation of foreign holdings of U.S. bonds is very large (23%), suggesting that there are significant problems with the data on foreign purchases and sales of U.S. bonds," the report states.

It further adds that "The apparent overestimation of bond inflows and underestimation of equity outflows imply that the U.S. net debt position is not likely as large as official estimates indicate."

"If, for example, end-2000 U.S. holdings of foreign securities were underestimated by 10 percent and foreign holdings of U.S. securities were overestimated by 10 percent - not inconceivable amounts given our analysis - the U.S. position as a net debtor was overstated by about $600 billion, or over 30 percent," the authors wrote.

The report cites the attributes of asset-backed securities as one likely reason for the overstatement of foreign purchases of U.S. debt.

Many U.S. debt securities are backed by pools of loans, such as residential mortgages, automobile loans or credit card receivables placed in trust, otherwise known as asset- or mortgage-backed securities. Because both the principal and interest of these securities are repaid on a regular basis, usually monthly, the amount of principal held by foreign investors also decreases regularly.

"If these principal paydowns are not accurately captured in the transactions data, net purchases of asset-backed securities will be overstated."

Exemplifying this, the report's authors estimate that foreign holdings of U.S. agency debt, much of which is backed by residential mortgages, is overstated by 57%.

But at the same time, the report also finds that holdings of U.S. corporate and Treasury debt by non-U.S. investors is overstated by 14% and 20%, respectively, "suggesting that a miscounting of principal paydowns is not the whole story."

Overcounting of securities involved in repurchase and securities lending agreements is offered as another possible factor behind the inaccurate data, the report says.

Other plausible, though not yet investigated, possibilities include short-term debt securities being reported as long-term, dollar-denominated foreign bonds, and flows into bond mutual funds incorrectly reported as bond inflows, a footnote to the report says.
The report also says that individual country statistics can be quite inaccurate because the data only account for where the securities initially travel, not their final destination. For example, if a German investor buys a U.S. bond via a broker in London - a global financial hub - the data will indicate that the bond went to an investor in the United Kingdom, not Germany.

As a result, holdings of U.S. debt by U.K investors are overestimated by $448 billion, or over 200%, and their holdings of U.S. equities is overestimated by $176 billion, or 54%, according to the paper.

"For bonds, there are also sizable overestimations of holding by Japan and the Caribbean."

"For U.S. holdings of foreign securities, valuation adjustments depend crucially on the country of the issuer of the security, and holding estimates have been wildly off the mark," it adds.

Looking forward, however, the inaccuracies of the data are not likely to persist, the report states. That's because so-called "benchmark surveys" conducted by the Treasury Department, which produce very accurate data on security ownership globally and which the authors made use of in researching their paper, will become more frequent. Those surveys will in turn provide benchmarks on which to base trackings of international capital flows.

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