The Geography of Capital Allocation in the Euro Area*

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* Views are those of the authors and do not necessarily reflect those of the ECB.

Luxembourg, Ireland, Netherlands: Onshore Offshore Financial Centers

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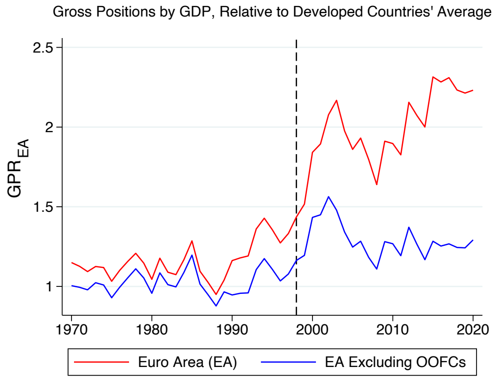
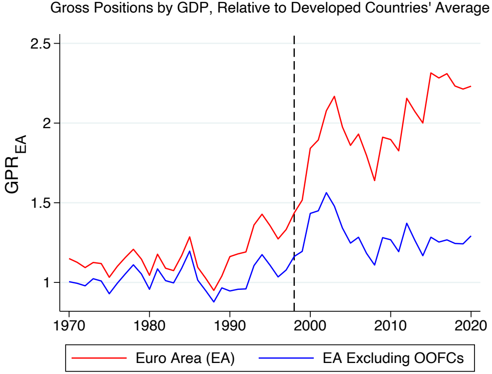


(a) Excess growth of Euro Area gross positions

Luxembourg, Ireland, Netherlands: Onshore Offshore Financial Centers



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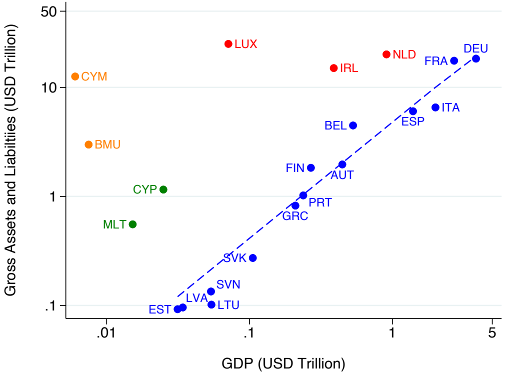

(b) Specialness of OOFCs

$$\mathrm{GP}_{\mathrm{EA}} = \frac{\sum_{i \in \mathbf{EA}} (A_i + L_i)}{\sum_{i \in \mathbf{EA}} \mathrm{GDP}_i} \quad \rightarrow \quad \mathrm{GPR}_{\mathrm{EA}} = \frac{\mathrm{GP}_{\mathbf{EA}}}{\sum_{i \in \mathbf{DM}} \mathrm{GP}_{\mathbf{i}} \frac{\mathbf{GDP}_i}{\sum_{i'} \mathbf{GDP}_{i'}}}$$

DM = {USA, JPN, GBR, CHE, AUS, NZL, KOR, NOR, CAN}

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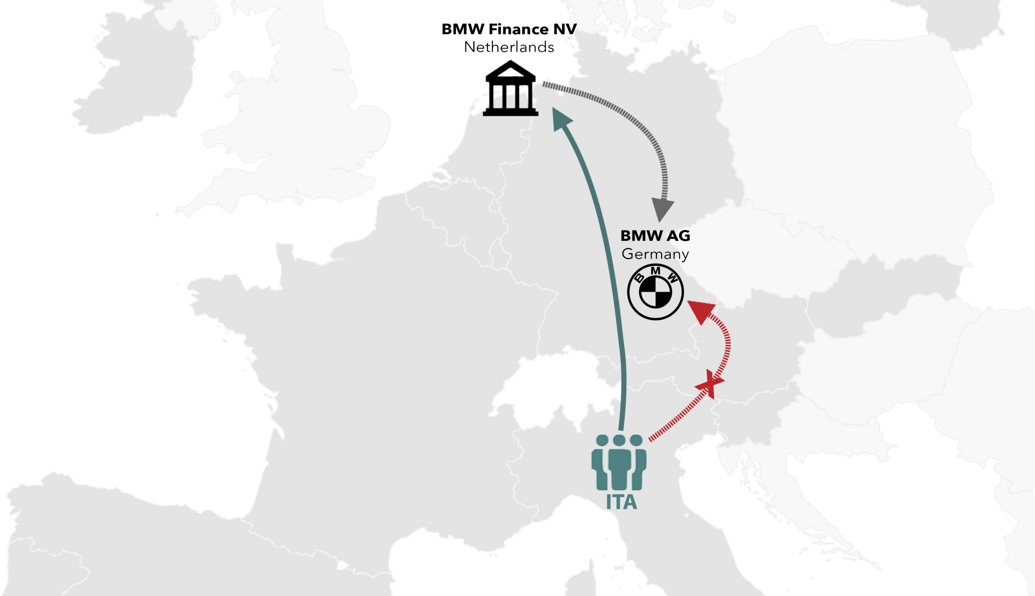

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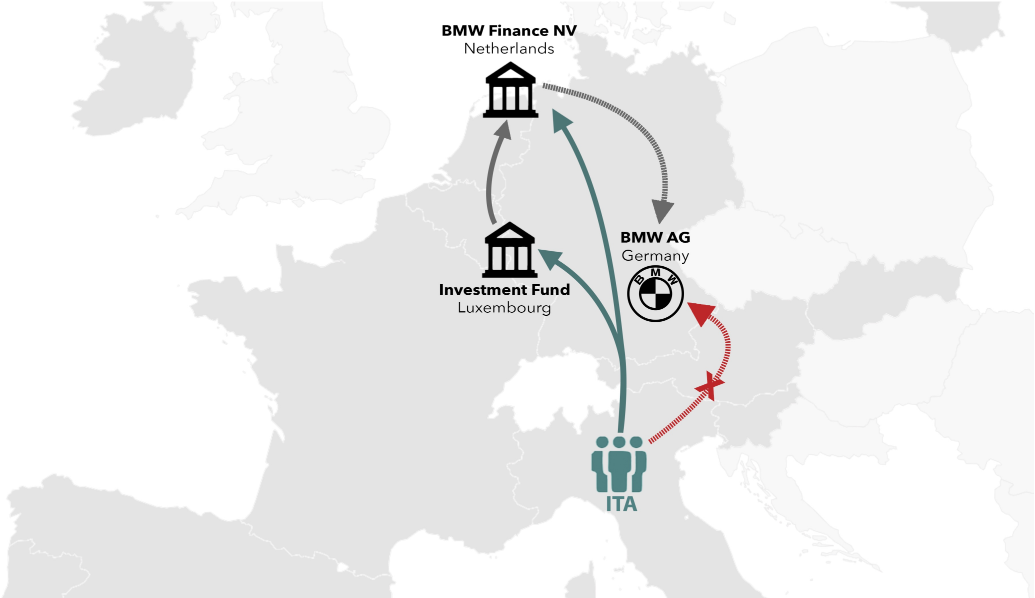

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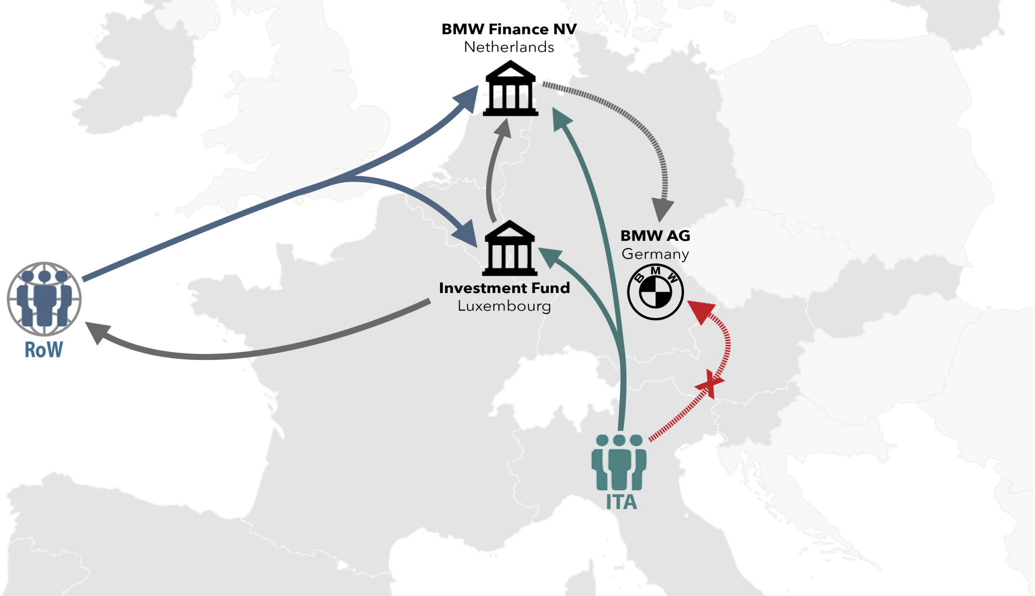

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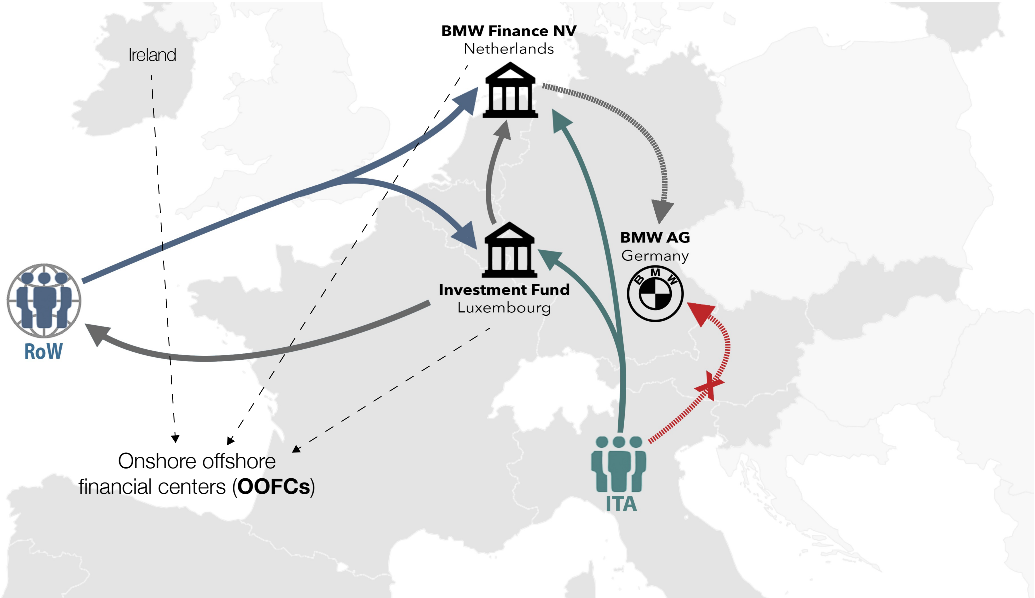


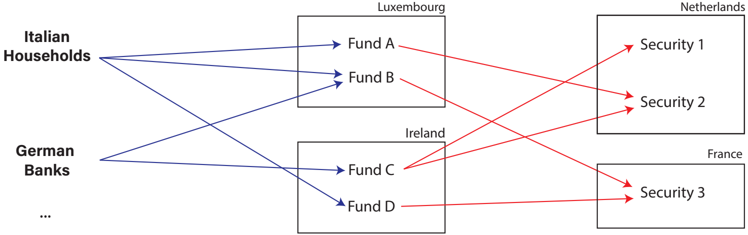
How Big of a Deal Is This?

- Not possible to assess cross-border holdings in Euro Area without addressing these issues
- **LUX and IRL funds** manage 40% of cross-border equity and bond holdings of Euro Area
  - LUX and IRL fund assets €7.5tn, compared to €2tn for Germany, €240bn for Italy
- **Securities issuance**: 33% of cross-border corporate bond holdings in Euro Area in OOFCs
- Opaque ownership: 43% of LUX, IRL fund shares have unknown owners in int'l statistics

Methodology: Unwinding Holdings Intermediated Through OOFCs

- Throughout, we rely on multiple data sources:
  - **ECB SHS**: Each EA country's security holdings, including of fund shares in LUX and IRL
  - **Morningstar**: Each fund's complete holdings of securities worldwide

- Merging them allows us to look through entire intermediation chain



Stats Aggregation

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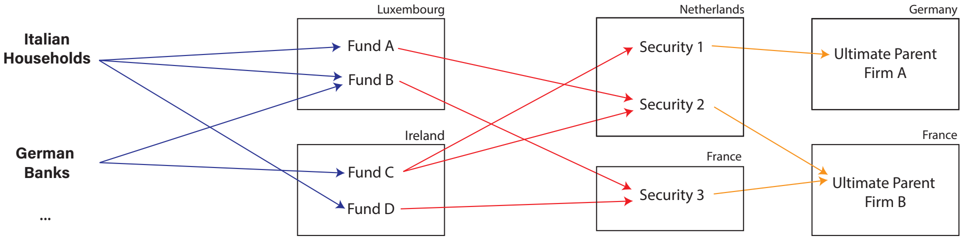

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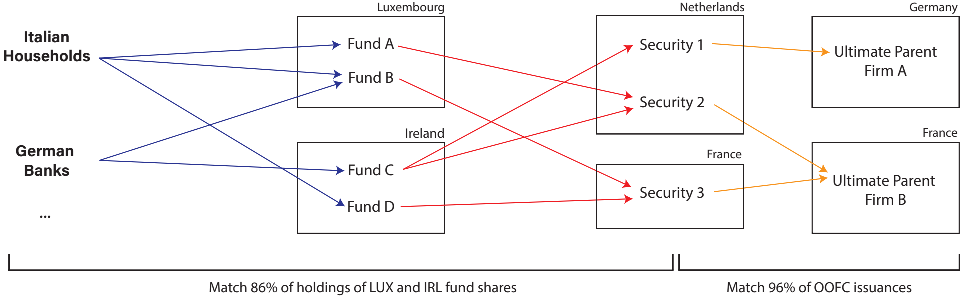

Stats Aggregation

The Impact of Our Fund Unwind on Portfolios

		1		2		3
Observed EA Portfolio	=	*Direct Portfolio* of EA Investors	+	*Indirect Portfolio* of EA Investors	+	*Indirect Portfolio* of RoW Investors

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Increasing portfolio tilt towards RoW and non-EUR assets →

Consequences at aggregate EA level: ← Removing portfolio 3

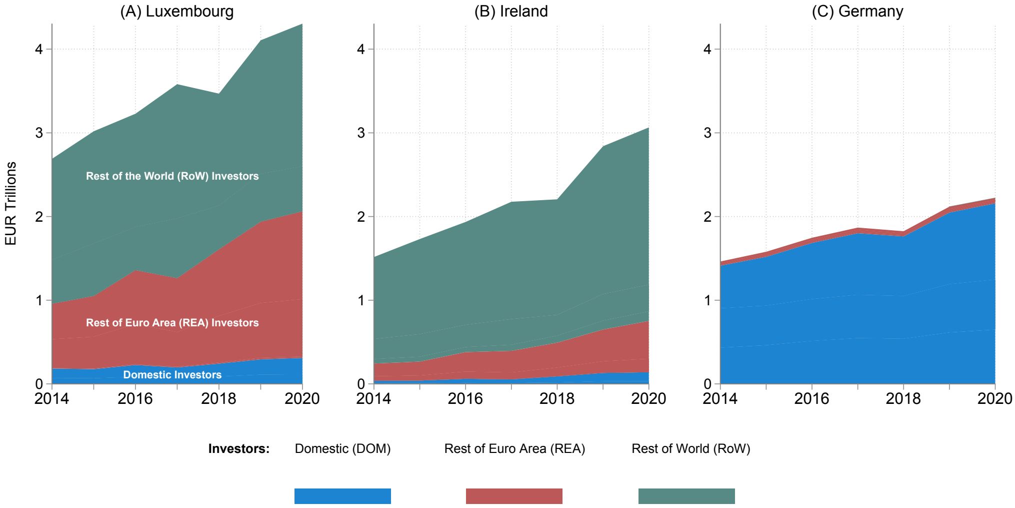
1. Gross external position smaller
2. Euro and domestic exposures larger

Consequences at individual EA country level:* ← Adding portfolio 2

1. Increased diversification through OOFC holdings
2. Euro and domestic exposures smaller

* Excluding Luxembourg and Ireland

RoW and Euro Area Investors: Different Destinations via LUX, IRL Funds



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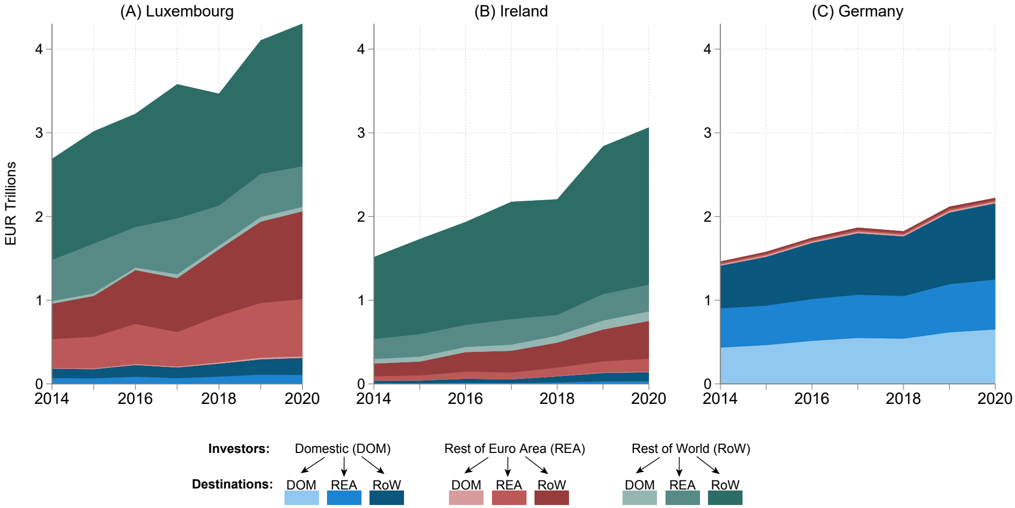

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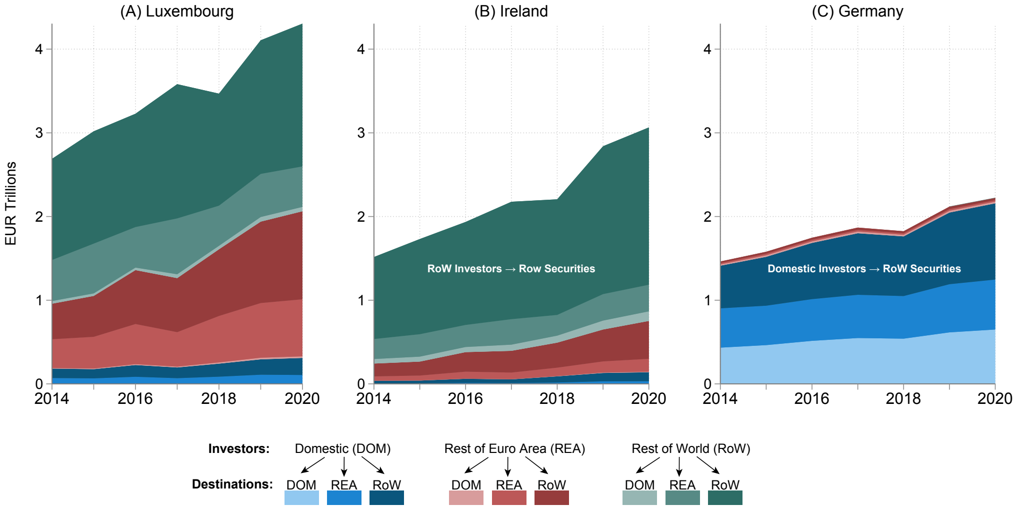
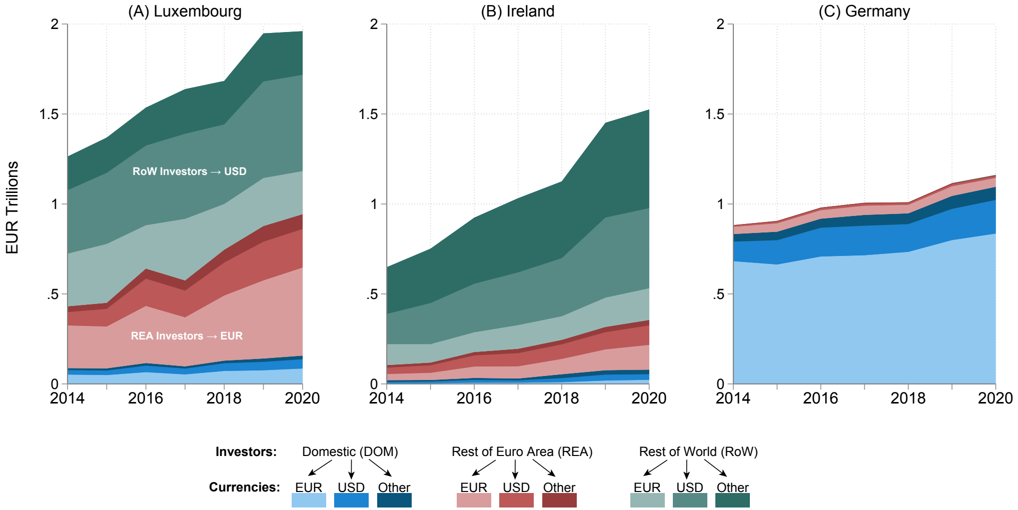
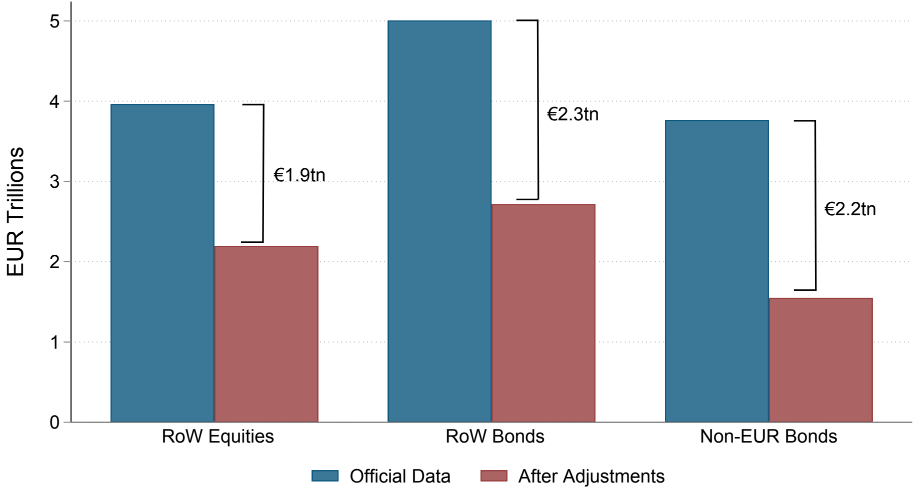


RoW and Euro Area Investors: Different Currencies via LUX, IRL Funds



Issuance

Aggregate Consequences for the Euro Area's External Position



$\Longrightarrow$ Euro Area's gross external position substantially smaller, with larger Euro exposure

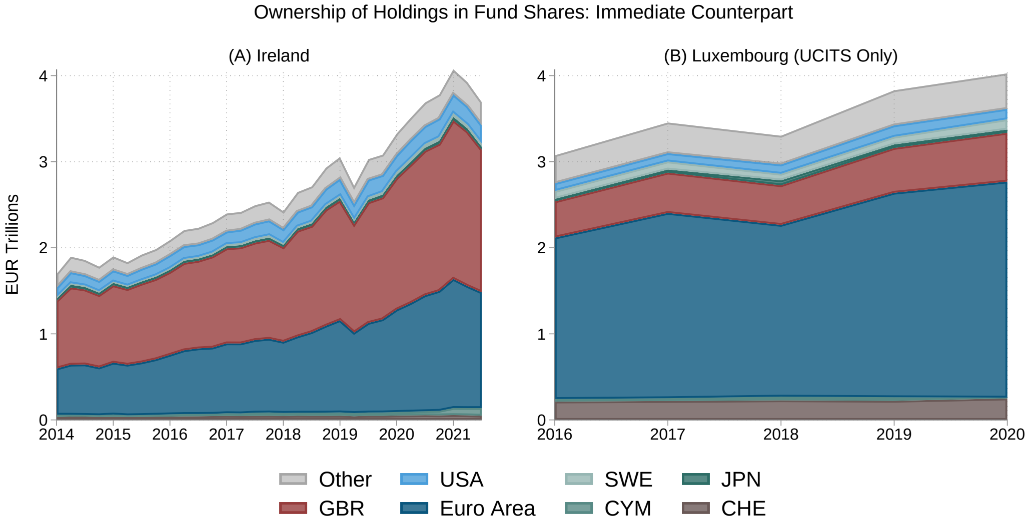
Time Series

Who Are the RoW Investors in Luxembourg and Ireland Funds?

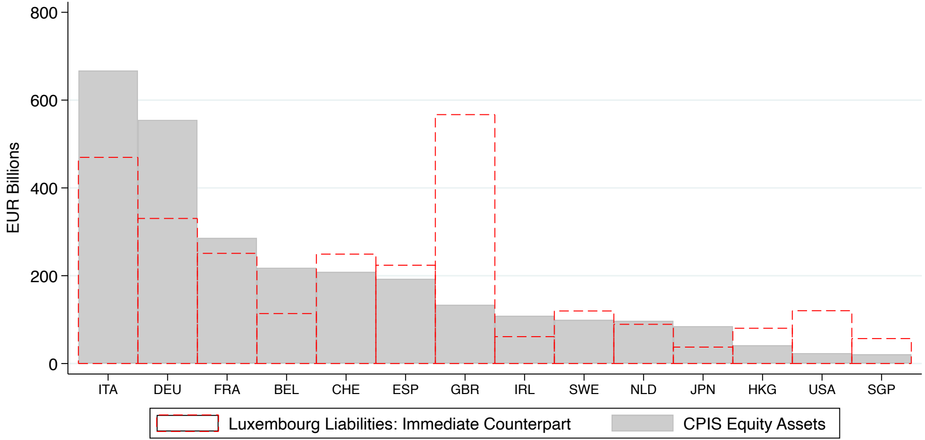
- Well-known discrepancy: countries' declared holdings in LUX and IRL fund shares far below LUX and IRL declared liabilities, difference $>$ €3 trillion
  - Zucman (2013): might be accounted for by hidden wealth in Switzerland
- The IIP statistical problem:
  - Missing custodial data:
    - LUX and IRL record liabilities (fund shares) on immediate counterparty basis
    - Ultimate owner country does not report since it is unaware assets exist
  - Incomplete coverage by reporting countries
- What we show:
  - Largest non-EA immediate counterparty for IRL and LUX is GBR, major tax havens small
  - GBR-held funds similar to observed GBR portfolio (e.g., GBP-biased)
  - UK incomplete coverage: in IMF CPIS does not include households and non-profits

Who Are the RoW Investors in Luxembourg and Ireland Funds?

- New administrative data on immediate owner of fund shares



Who Accounts for the Missing Wealth? Evidence for Luxembourg Funds



- Switzerland underreporting present, consistent with Swiss custodial data
- Similar pattern for Ireland funds, GBR large outlier, total gap > €1 trillion

Much More in the Paper

1. North-South asymmetries

2. Allocative effects of OOFC use

3. Formal analysis of portfolios in micro data

Conclusion

- A new view of capital allocation in the Euro Area
  - Large role of **onshore offshore financial centers**: Luxembourg, Ireland, Netherlands
- New estimates allow proper assessment of Euro Area countries' exposures
  - Resolve intermediation chains through OOFCs using new data and methods
- Takeaways:
  - Only 50% of wealth in OOFCs has known EA holders, who are less globally diversified
  - Euro Area gross external position up to 50% smaller, more inward-looking
  - Biases in portfolio allocation in the union: North-South asymmetry, integration tilted towards firms present in OOFCs