From the World's Factory to a World Creditor: China's External Wealth and Excess Returns, 1997-2016

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Summary

We study China's external wealth, its net foreign assets position with valuation adjustment, and its excess returns. The net foreign assets of China, which are mainly dominated by foreign reserve assets and foreign direct investment liabilities, have grown rapidly since its entry to the World Trade Organization in 2001 and exceeded 14 percent of its gross domestic product at the end of 2016. In contrast, the excess returns of gross assets over gross liabilities, which mostly correspond to the sizable capital gains from the latter, are negative. These results occur mainly because of the composition effect between risky liabilities and safe assets, where China takes a short position in equity and a long position in debt. Our findings help elucidate the mechanism through which a high-growth economy like China transfers its external wealth to the rest of the world when the domestic financial markets are less developed and safe assets are scarce in the international monetary system.