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Luxury buildings are under construction in the outskirts of Madrid. The bubble that was once Spain's red-hot property market has emitted its loudest pop yet: A real estate company that symbolized an era of easy money sought protection from creditors in the largest such filing in Spanish corporate history. The collapse the day before developer and builder Martinosa-Fadesa, saddled with \$8 billion in debt, illustrates the vulnerabilities of interlocked credit-based economies when confidence evaporates.

Global capital obeys own law of gravity

America's credit crisis flu sickens rest of the world, suggesting perils, power of globalization

As Americans struggle with the rising price of gasoline and food, few realize that the dynamics of everyday prices lie in global phenomena.

Yes, \$4 gas is related to the price of oil which is driven by global supply and demand and the value of the dollar. The value of the dollar is linked to U.S. economic conditions and to those abroad.

Economic conditions abroad are, in turn, linked to economic conditions in the United States, and global economic conditions drive global demand and supply. This is the world of financial globalization that we must come to grips with.

Globalization is not merely about the exchange of people, ideas and cultures across international borders. It has even more to do with an increasingly integrated global economy marked especially by the free flow of capital.

CAPITAL WITHOUT BORDERS

The rising tide of cross-border flows of capital or financial globalization has been a hallmark of the last quarter century.

A barometer of the magnitude of such cross-border flows is the foreign exchange market. A 2007 survey by the Bank for International Settlements shows an unprecedented rise in average daily trading in global foreign exchange to over \$5 trillion.

The foreign exchange market has transitioned from a market dominated by importers and exporters to a market dominated by investment flows as investors shop globally for yield.

U.S. companies build factories in China, while Americans buy Latin American stocks. Middle East oil exporters buy equity stakes in American banks and private equity firms. Asian central banks buy U.S. Treasury securities while Chinese companies buy portions of African commodities producers. European insurance companies acquire Latin American bonds, while Japanese households invest in higher-yielding currencies.

This newspaper reported that 112,298 Tennessee workers are employed by one of 694 foreign-based businesses operating in the Volunteer State. The distinction between "foreign" and "domestic" investment is becoming blurred as international conglomerates and business markets cross national boundaries.

The real action in cross-border capital has been in what are called portfolio flows, i.e.



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The global credit crisis has shaken public confidence so badly that officials are talking up the prospect of mass bank runs. Here, depositors of the West Coast's lender IndyMac wait to pull cash from the bank after it collapsed and went into federal receivership.

UTC professor, students analyze finance trends



Bento Lobo



Christina Chavez



Matt Cline



Drew Holland



Seth Smithson

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the investments in stocks and bonds, bank deposits and other financial assets, what many call financial globalization.

As investors everywhere search for yield, a natural consequence is that domestic assets come to be globally held. The McKinsey Global Institute estimates that foreign investors own one in three government bonds around the world, one in four equities and one in five corporate bonds.

While, the United States holds the most foreign assets of any single country, foreign ownership of American assets has been growing consistently over the last two decades, led by Japan, China and the United Kingdom.

What began as a problem of poor lending practices in the United States metastasized into credit dislocations around the world, with Britain's Northern Rock bank the first to fail.

In 2007, the United States attracted nearly 25 percent of global capital flows even as foreigners came to own \$768 billion more in U.S. assets than Americans owned in foreign assets.

According to the U.S. Treasury, foreign investors own more than 11 percent of all U.S. equity securities, 57 percent of U.S. Treasuries, 21 percent of government agency and 24 percent of corporate debt securities.

The coming together of advances in information technology and financial innovation has facilitated a phenomenal rise in the movement of funds across borders.

Spurred by securitization, the growth of hedge funds and the widespread use of offshore special purpose vehicles, investors today have opportunities to participate in global markets more so than ever before.

Witness the growth of exchange-traded funds (or ETFs) which enable investors to invest in currencies, gold, oil and other commodities. ETF assets, according to the Investment Company Institute, have grown to \$600 billion.

The hunger for yield has deepened the connection between economies previously thought to be unrelated. Moreover, as markets get more volatile, they tend to move together.

VISION OR TONIC?

When the current U.S. credit crisis first came to light, many analysts called it a domestic problem — one that would only affect U.S. housing markets,

However, almost a year later, it can be seen that this is not the case. The reverberations from the financial crisis in the U.S. have left no region of the world untouched.

The Wall Street Journal points out that stock markets from Germany to Japan and India to Iceland have fallen and experienced their worst January-March quarter in years. China's second largest bank announced in August of 2007, that it held \$9.7 billion dollars of U.S. subprime debt.

An International Monetary Fund study suggests "that the worldwide losses stemming from the U.S. subprime mortgage crisis could run to \$945 billion."

What began as a fairly contained deterioration in portions of the U.S. subprime market, has metastasized into severe dislocations in broader credit and funding markets.

In a sign of the times, it was not an American bank that was first to feel the effects of the U.S. mortgage crisis. Rather, it was Britain's fifth largest mortgage lender, Northern Rock, that had to be bailed out by the Bank of England.

Northern Rock does no lending overseas. Nevertheless, its fate was determined by the distant turmoil in America's mortgage market.

The problem that first emerged in nonprime mortgage markets spread to global money markets and then moved up the credit spectrum from low- to high-grade corporate and municipal debt markets, to prime residential and commercial mortgage markets, and even to student loan markets.

The money markets that Northern Rock had depended on for years dried up in a single day at the start of August 2007. But, as the credit crunch took hold in mid-2007, foreign

investors seemed to take on a new role in the form of providing emergency funding to Wall Street firms reeling from liquidity problems and large write-downs on mortgage-backed securities.

In November 2007, Citigroup sold \$7.5 billion or 4.9 percent of itself to the Abu Dhabi Investment Authority, a sovereign wealth fund in the United Arab Emirates. One month later, Morgan Stanley raised \$5 billion by selling a 9.9 percent stake to the Chinese government's China Fund. Similar funds in Kuwait, Singapore, and South Korea have bought portions of Merrill Lynch.

THE TYRANNY OF GLOBAL CAPITAL

Capital flows can respond quickly to changes in economic and financial conditions, and exercise a primary influence on exchange rates and through those rates on global flows of goods and services.

No wonder that in contrast to the growing consensus among economists that trade liberalization is, by and large, beneficial, debate rages about the costs and benefits of financial globalization.

Some argue that increased openness to capital flows has proved essential for global growth and financial stability. Domestic investment in any country is less dependent on local saving. Foreign funds can help spur economic growth and raise living standards.

Others view unfettered capital flows as disruptive, significantly complicating policy making and regulation. Capital flows can vary sharply from one year to the next. A flood of liquidity in good times can quickly turn into an outflow at the first sign of trouble.

A recent BBC World Service poll revealed that in 22 out of 34 countries around the world, the weight of opinion is that "economic globalization, including trade and investment," is growing too quickly. On average one out of two individuals held this view.

Another manifestation of the forces of financial globalization is the Sovereign Wealth Fund, i.e. assets held by foreign governments. For instance, in May 2007, through its state investment fund, the Chinese government bought a 10 percent stake in The Blackstone Group, an American private equity firm, shortly before the firm went public.

These sovereign funds have existed at least since the 1950s, but their total size worldwide has increased dramatically over the past 15 years. Over half of these assets belong to countries that export significant amounts of oil and gas.

Norway through a large sovereign fund, as do places as disparate as Canada, Russia, and Trinidad and Tobago. About one-third of total assets are held by Asian and Pacific countries, including Australia, China, and Singapore.

The richest sovereign funds include the Abu Dhabi Investment Authority (\$875 billion), the Government of Singapore Investment Corp. (\$330 billion), and Norway's Government Pension Fund Global (\$322 billion).

Everyone welcomes foreign

investment. Some of the state's biggest business additions in the past couple of years have come from companies headquartered in Europe or Asia.

But when the money belongs to other governments, people are not always so sure. The idea that secretive foreign governments are up to no good exerts a powerful hold on the collective imagination.

Congress seemed not to mind that Wall Street was taking foreign cash, but concern has surged over recent investments beginning with the takeover of the personal computer operations of IBM by Chinese firm Lenovo. The debate intensified in 2005 with the (subsequently withdrawn) bid by the China National Offshore Oil Corp. to buy U.S. oil firm Unocal.

The furor in Congress intensified in early 2006, when Dubai Ports World bought the port operations of the UK-based Peninsular and Oriental Steam Navigation Co., which would have given Dubai Ports World control of operations at six U.S. ports.

IT'S A FLAT WORLD AFTER ALL

In light of the current credit crisis at home, there is unease as financial risk is spread more widely and as new investors around the world gain influence. And there is growing concern in some quarters about the lack of any clear international authority to regulate new activity and players in global capital markets.

The knee-jerk reaction is to build fences. In January 2008, President George W. Bush signed an executive order that tightened controls on the inflow of foreign direct investment.

However, the growing discomfort on Capitol Hill over

The implosion of the U.S. credit sector is an invitation to foreign sovereign wealth funds to buy stakes in domestic companies.

Chinese, Arab and other foreign investments must be tempered by the fact that without continued and growing inflows of foreign investment, U.S. manufacturing, employment, competitiveness and innovation will be at risk. It will become harder to attract the massive amounts of foreign capital needed to finance the large and growing U.S. current account deficits.

Legendary investor Warren Buffett was quick to point out that the rise of sovereign wealth funds and foreign ownership of U.S. assets is largely of the United States' own doing and is not "some nefarious plot by foreign governments." As we consume more, save less and run huge trade deficits, we become more dependent on foreign capital to finance our consumption and savings shortfall.

Financial power is spreading beyond the United States as other markets mature. Financial protectionism will only isolate an environment for foreign investment is in itself deeply in the national security interest of the United States.

While some coordinated regulation of financial markets is necessary, building walls around the country will only serve to alienate, not protect, this bastion of modern capitalism. To paraphrase former United Nations Secretary General Kofi Annan, globalization is the new law of gravity.

Coming

This week

In rare cases, story selections may change to accommodate breaking news.



Tuesday

■ Business at local candy stores is as sweet as ever, with stores faring well despite a down economy.



Thursday

■ Vision Hospitality soon will raise the Doubletree flag over its newly renovated hotel on Chestnut Street that now is operating as a Clarion.