Investors dump $89B in U.S. securities in historic fire sale

By David J. Lynch, USA TODAY

The deep river of private money that helped knit together the global economy has abruptly dried up, new government figures show.

As the global financial crisis grew more severe this summer, foreigners sold almost $90 billion of U.S. securities — the greatest quarterly fire sale by overseas investors since the government began keeping track in 1960. U.S. investors also are retrenching; they unloaded about $85 billion worth of foreign holdings in the quarter, says the Commerce Department's Bureau of Economic Analysis.

"We've had a global panic. Everyone is pulling their money home," says economist Adam Posen of the Peterson Institute in Washington, D.C.

That's bad for economic growth in the U.S. because it threatens to starve capital-hungry companies and entrepreneurs. But it's especially serious for emerging-market countries that rely heavily on outside financing. Capital flows into countries such as South Korea, Turkey and Brazil were evaporating even before the mid-September Lehman Bros. bankruptcy made things worse.

The reversal of private capital flows signals an abrupt end to a nearly two-decades-long era of financial globalization, says economist Brad Setser of the Council on Foreign Relations. Private flows into and out of the U.S. for purchases of stocks, corporate bonds and federal agency bonds have dropped from around 18% of economic output to near zero "in a remarkably short period of time," Setser says.

The past five quarters — roughly since the August 2007 onset of the financial crisis — private foreign investors have been net sellers of U.S. securities. The turnabout represents a dramatic change from the first half of 2007 when foreign purchases of U.S. securities other than Treasuries averaged about $250 billion per quarter.

The past two quarters also have seen an about-face in cross-border bank flows as institutional investors found lenders unwilling to extend credit. In the first quarter of 2008, foreigners deposited more than $79 billion with U.S. banks. That flow reversed in the second quarter, as foreigners withdrew a staggering $256 billion, and the outflow continued in the third quarter with an additional $147 billion. Likewise, banks in the U.S. brought home more than $151 billion in the quarter, as overseas institutions repaid loans.

"Institutional investors, including banks, across the board are pulling their capital back home," says economist Eswar Prasad of the Brookings Institution.

One bright spot: Foreign central banks continue to spend heavily on U.S. government securities, allowing the U.S. to finance the gap between what it produces and consumes.

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