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Capital flows and cross-border investment

Security through stability.

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(De)globalization monitor: capital flows and cross-border investment

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Deglobalization has taken media and think tank circles by storm. So far there is little consensus in the literature on whether deglobalization is taking place or not. Against this background, we focus on recent developments in global and bilateral capital flows and cross-border investment. Our analysis produced the following main findings:

While global capital flows, measured relative to global GDP, increased substantially before the financial crisis, they decreased afterward and have failed to recover so far. Measures of capital flow concentration show that capital moves to fewer destinations, albeit on a small scale.

Measures of source countries' investment stocks, differentiated by destinations and relative to their global investment activity, reveal interesting patterns for the period 2018–2022: First, regarding foreign direct investment (FDI), the United States (USA) and the euro area show no signs of near-shoring while China significantly increased its FDI stock in Asia compared with its stock in other regions. Second, regarding portfolio investment (PI), there are signs of near-shoring of China's stock of PI as well as Asia's stock of PI (within Asia and China). We do not see signs of near-shoring for the USA or the euro area.

More (analytical) research is clearly needed to properly assess the role of geopolitical fragmentation in the global allocation of capital and investment.

In the wake of the pandemic, war and inflation, deglobalization and its cousins near-, friend-, re- and on-shoring as well as de-risking have taken media and think tank circles by storm. Globalization, as documented in a report by the ECB (2021), has transformed the economic landscape by benefiting emerging and developing countries, altering interrelationships between economies and influencing the efficacy of monetary policy. These changes include the impact of globalization on global productivity, its (modest) influence on inflation trends, implications of global spillovers in the financial cycle and their potential to bring about extreme and synchronized global uncertainty shocks. The ECB report also suggests that while globalization helped central banks achieve price stability, it affected trade-offs between monetary policy goals over shorter horizons, prompting central banks to use additional instruments like asset purchases and forward guidance to navigate changing dynamics in monetary policy transmission, financial spillovers and increased asset price correlations.

Globalization affects the transmission of monetary policy via interest rate, wealth effect, exchange rate, credit and risk-taking channels. For instance, it has weakened the interest rate channel of monetary policy by reducing the natural interest rate and increasing the influence of global factors on long-term interest rates. In addition, globalization has had mixed effects on the exchange rate channel of monetary policy, with factors such as financial globalization and the decline in exchange rate pass-through to import prices strengthening the exchange rate channel, while factors like

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This publication is part of a larger project on (de)globalization, the (De)Globalization Monitor or GloMo, conducted at the OeNB's International Economics Section. The project comprises analyses of capital flows and cross-border investment (CapMo), trade (TradeMo) and migration (MigMo). Members of the project team are Ana Abeliansky, Christian Alexander Belabed, Jonathan Fitter, Julian Mayrhuber, Anna Katharina Raggl and Paul Ramskogler (all OeNB, International Economics Section).

deepening global value chains have contributed to the decline in exchange rate pass-through, affecting the sensitivity of net exports and exchange rate effects on consumption (ECB, 2021).

Assessments of geopolitical fragmentation and of the channels through which it would work can be found in Góes and Bekkers (2022), IMF (2023a) and Aiyar et al. (2023a). Our main goal is to assess whether geopolitical tensions give rise to major changes in the (de)globalization process, affecting capital flows and cross-border investment, trade and migration. Careful reading of the recent literature suggests that there is not (yet) any clear guidance as to whether deglobalization is happening or has already happened.[2] Studies focusing on aggregate global capital flows and investment may also miss that inter- or intraregional shifts may leave the overall volume of capital flows unchanged. Capital flow concentration tendencies, a measure of how many destination countries are receiving capital flows from a source country, are becoming more important, especially in the context of geopolitical fragmentation.

We organize the remainder of this analysis as follows: In section 1, we provide a global view on capital flows. Did aggregate flows change and can we trace these changes to a particular investment type? In section 2, we dive deeper into the regional perspective, including a bilateral perspective on global capital flows and stocks. Section 3 concludes.

1 The changing tides of globalization and cross-border investment

Determining the exact turning points during the process of (de)globalization is quite elusive. For the time being, we work on the assumption – inspired by a nonexhaustive review of the literature[3] – that the global economy went through four distinctive phases of globalization during the last almost 25 years:

- The *"goldilocks" phase* (phase 1), covering the early 2000s to the financial crisis in 2008, including the accession of China to the World Trade Organization (WTO), the accession of former communist countries to the European Union and a rapid increase in all types of capital flows (see, for instance, D'Urbino, 2019; Gupta and Kumar, 2021; ECB, 2021).
- The "*hangover" phase* (phase 2) from 2009 to 2013, including a massive rebalancing between euro area countries, global balance sheet repair efforts of households, firms and financial institutions such as banks and a decline of capital flows and trade (see, for instance, Brawley, 2021; Gupta and Kumar, 2021; Tian et al., 2018).
- The "*return of imperialism" phase* (phase 3) from 2014 to 2018, starting with Russia's annexation of Crimea, the Brexit referendum and the emergence of US-China trade disputes following the election of Donald Trump as president of the United States in 2016 and comprising, moreover, the spreading of the Belt and Road Initiative and China's

[2] See e.g. Bordo and James (2019), Witt (2019), Della Posta (2021), Gupta and Kumar (2021), Owen (2021), Ripsman (2021), Dadush (2022), Goldberg and Reed (2023), Aiyar et al. (2023a) arguing for (partial) deglobalization. See Kobrin (2017), Tian et al. (2018), O'Rourke (2019), Antras (2020), Brawley (2021), Williamson (2021), Emter et al. (2023), Di Sano et al. (2023), Kaaresvirta et al. (2023), Cevik (2023) for opposing views. Aiyar et al. (2023b) provide an overview of works on fragmentation, trade, capital flows and technology dispersion. However, most of the studies mentioned above focus on trade. Only a few studies focus at least partly on capital flows and cross-border investment. Hence, there is a gap in the literature which we attempt to fill.

[3] The IMF (2023b) and Aiyar et al. (2023a) used a different classification based on trade, starting with "industrialization" in 1870 and ending with "slowbalization" following the financial crisis. Our phases 2 to 4 are, thus, a refinement of the last phase in these two studies. The shorter time span is also due to data restrictions, which significantly shorten the time period we are able to investigate.

activities in the South China Sea (see, for instance, Kobrin, 2017) or in the Indian Ocean (see, for instance, Grare and Reuter, 2023).

- The *"multiple crises" phase* (phase 4) from 2019 to 2022, including the COVID-19 pandemic, the return of inflation, war in Europe and indications of geopolitical fragmentation (see, for instance, Ripsman, 2021).

Chart 1

Global capital flows by investment type (1995–2022)

Source: Balance of Payments (IMF).
Note: Includes 123 countries reporting for the whole period.

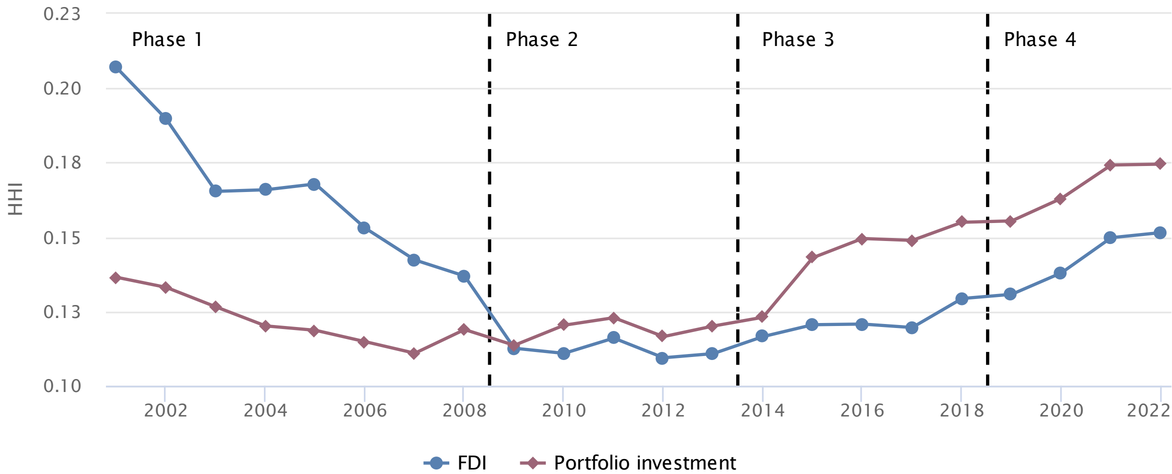
Global capital flows declined in 2022, following an upward move in 2020 and 2021 and a significant decline after the financial crisis. While overall capital flows peaked at more than 15% of world GDP in 2007, they dropped to less than 5% in 2008, as chart 1 shows.[4] In the decade following the financial crisis, global capital flows did not recover to pre-crisis levels, with the possible exception of foreign direct investment (FDI). Most recently, global capital flows decreased once again, mainly owing to portfolio investment (PI) and reserve accumulation. According to the United Nations Conference on Trade and Development (UNCTAD, 2023), global FDI flows decreased by 12% in 2022. The increase in FDI flows to developing countries (+4% from 2021) was not sufficient to compensate the drop in FDI flows to developed countries (–37% from 2021). Other investment, which includes bank-related flows such as loans, suffered the biggest blow early in phase 2 and remained subdued throughout phase 3. Most recently, other investment flows recovered somewhat during phase 4. PI reached pre-crisis levels in 2014 and declined again in 2015 and 2016 (phase 3), with a subsequent recovery especially following the

[4] This post-crisis trend was also observed by Forbes (2014), who also linked it to the ebbs and flows of investors' home bias. The pre-crisis period (roughly 1995–2007) was characterized by a significant drop in the domestic correlation of investment and saving, Forbes' measure of home bias. Intuitively, that makes sense if we recall European banks becoming more exposed to the US real estate bubble during this period.

outbreak of the pandemic (phase 4). Reserve accumulation dove into negative territory in 2015 and 2016, the time of the Chinese stock market crash and the Brexit referendum. Interestingly, global capital flows rose even after the pandemic struck in early 2020, increasing by around one-third, mainly driven by FDI and reserve accumulation. Global capital flows indicate a slowdown during phases 2 and 3. Most recently, during phase 4, global capital flows increased at first, only to decrease again in 2022. While this does not constitute a strong indication of a deglobalization of capital flows, neither does it allow us yet to talk about fragmentation or a concentration of global capital flows.

Using a simple concentration index, we find that bilateral capital flows – once again – have shown signs of higher concentration across countries since 2012. We use the Herfindahl-Hirschman index (HHI), a common concentration measure, calculated for individual countries' bilateral FDI and PI stocks and then weighted by countries' share in global investment to obtain a global index (see chart 2).

Chart 2



Source: Coordinated Portfolio Investment Survey (IMF), Coordinated Direct Investment Survey (IMF), FinFlows.
Note: An increasing HHI indicates a rise in concentration. Figures show the average HHI across all countries, weighted by their respective shares in global investment.

Deglobalization may take place even without altering the level of capital flows by re-shifting between countries and regions. For instance, if a company decides to move its investment from a few less aligned to one or two more aligned countries, this may have no impact on the aggregate level of capital flows, but it may have an impact on the concentration of capital flows. This is precisely what we observe starting in 2012 and accelerating in 2014. FDI was more concentrated at the beginning of the 2000s and spread across more countries until the financial crisis (phase 1). PI followed suit, although starting from a lower level of concentration. Recently, during phases 2 and 4, PI showed significantly higher concentration, even higher than FDI. Taken together, capital flows show higher concentration than at the start of our data series in 2001. This increased concentration coincides with rising geopolitical tensions but also with other important drivers of capital flows such as very accommodative monetary policies across advanced economies, which

may have contributed to a higher concentration of PI flows during phases 2 and 3 due to a search for yield. While useful in a first approximation, a single index such as the HHI does not reflect the complexity of capital flows, especially not on a global level. We need to take a closer look at source and destination regions and countries to gain a clearer picture.

Charting capital flows by the level of economic development and the four phases of globalization described above yields a heterogenous picture. Looking at advanced economies in chart 3 and starting with FDI, we see a continuous decline in FDI after the financial crisis during phases 2 ("hangover"), 3 ("return of imperialism") and 4 ("multiple crises") that became most pronounced during phase 4 between 2019 and 2022. This development appears to be strongly driven by the euro area, where FDI inflows turned negative in phase 4 after experiencing only a minor drop after the financial crisis (phase 2). These negative FDI inflows occurred at a time when portfolio and other investment inflows to the euro area recovered significantly (phases 3 and 4). The United Kingdom (UK) constitutes the most extreme example, with no investment category recuperating any losses from the financial crisis with the moderate exception of other investment inflows. Interestingly, the inflow of PI into advanced economies (AEs) remained comparatively constant through phases 2 to 4. Other investment (which includes banking-related capital flows) showed the most significant recovery in phases 3 and 4, perhaps owing to improved oversight and regulation restoring at least some of the lost trust in the banking system combined with other measures to keep banks afloat after the global financial crisis (GFC). The United Kingdom remains the exception to the rule. These developments indicate that investment relations with (and between) AEs – particularly with the euro area – have become somewhat more capricious.

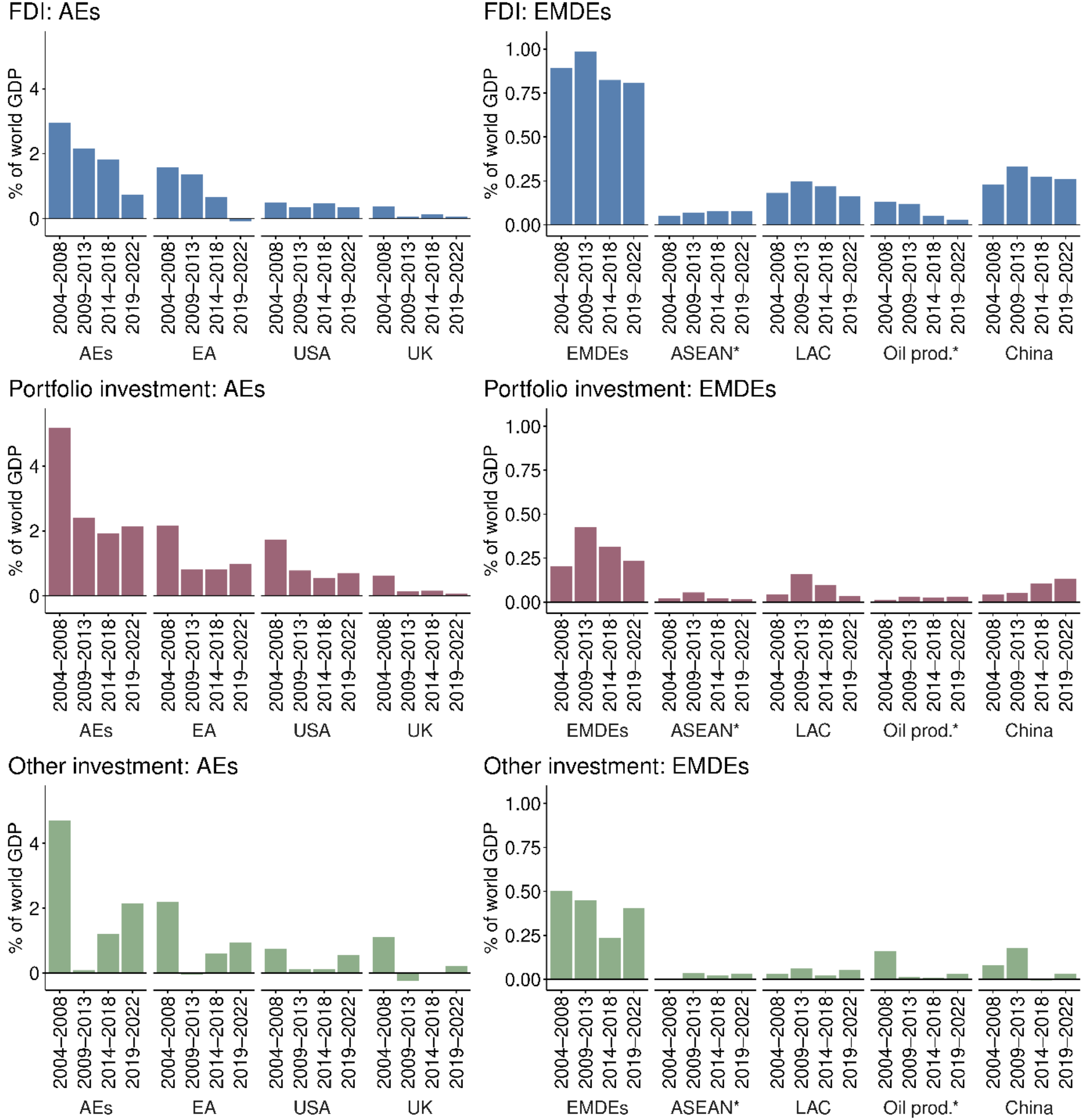
Turning to capital inflows to emerging and developing markets (EMDEs), we find substantially different dynamics. First, direct investment rose during phase 2, especially in China, but with the exception of oil-producing emerging markets. During phases 3 and 4, however, FDI declined to levels close to or below those measured before the financial crisis. Looking at the countries of the Association of Southeast Asian Nations (ASEAN), we see that direct investment inflows increased slightly in phases 2 to 4 while all other regions or countries, i.e. China, the oil producers and Latin America and the Caribbean (LAC), experienced declining FDI inflows. PI to EMDEs rose after the financial crisis, possibly owing, among other factors, to a search for yield of international investors or increased uncertainty in AEs such as the euro area. ASEAN and LAC experienced patterns consistent with the EMDE aggregate, while the oil producers and China diverged from the group's overall trend. Notwithstanding the turbulences around the crash of the Chinese stock market in 2015, PI to China rose significantly over all phases. Other investment including banking-related flows show no clear pattern across countries or groups of countries. In the aggregate, other investment declined in phases 2 and 3 and recovered significantly in phase 4 between 2019 and 2022. ASEAN and LAC countries experienced comparatively common and stable patterns. Oil producing EMDEs saw other investment inflows dry out during phases 2 and 3 and only a minor recovery in phase 4. Inflows to China doubled after the financial crisis while they dried out during phase 3, contrary to portfolio inflows. Lately, other investment inflows have recovered somewhat but remain significantly below the levels observed earlier.

Summarizing, in advanced economies (AEs), there was a continuous decline in FDI after the financial crisis, especially in the euro area, while portfolio and other investment inflows showed some recovery. However, the United Kingdom remained an exception with limited recovery. In emerging and developing markets (EMDEs), FDI increased during phase 2, especially in China, but declined during phases 3 and 4. PI rose, with variations across regions. Other investment flows were inconsistent, and geopolitical tensions in phases 3 and 4 may have hindered recovery.

In the next section, we will take a closer look at the euro area, ASEAN countries and the LAC region.

Chart 3

Global capital flows by region, investment type and globalization phase



Source: Balance of Payments (IMF), World Development Indicators (World Bank).
Note: AEs = advanced economies; ASEAN* = Association of Southeast Asian Nations excluding AEs (Singapore); EA = euro area; EMDEs = emerging market and developing economies; LAC = Latin America and the Caribbean; Oil prod.* = oil producers (IMF definition) excluding AEs (Canada, Norway).

2 Regions between the centrifuges of (de)globalization

In the previous section, we covered global and regional capital flows, leaving aside bilateral flows and also stocks. This section discusses a bilateral point of view for FDI and PI flows and stocks. Charts 4.1 and 4.2 introduce a bilateral perspective, in relative terms, which allows us to identify

relative "winners" and "losers" of shifting capital flows and potential indications of fragmentation.[5] They should be read from the perspective of source countries (left-hand side, row by row). The figures represent percentage point deviations of a source country's change of assets held in a particular region from the change of a country's assets vis-à-vis the rest of the world between 2018 and 2022. Starting with FDI, let us look at the case of the USA in chart 4.1: The growth of the country's share of assets in the Americas (excluding the USA) was stronger than the change of its overall assets, namely by 6 percentage points. At the same time, the US share of direct investment stock in Asia (excluding China) grew at a moderately weaker pace (–2 percentage points) than total US investment stock. The USA's direct investment stock in China (and the euro area) developed at a moderately stronger (weaker) rate than aggregate FDI stocks. Therefore, there is no clear indication of near-shoring in case of the USA. The euro area's stock of direct investment in the Americas (excluding the USA) developed at a weaker pace than its overall stock of investment (–11 percentage points). Its stock of direct investment in Asia and China grew much more strongly than its aggregate (+11 percentage points and +27 percentage points, respectively) and to a lesser extent than that in the USA (+3 percentage points). Hence, there have been no strong signs of near-shoring for the euro area so far. The development of China's bilateral stocks of investment, relative to its aggregate, on the other hand, shows clear signs of near-shoring: China's stock of direct investment in the Americas (excluding the USA), the euro area and the USA developed at a much weaker rate than its aggregate stock. The change of China's outward FDI stock to the euro area was 22 percentage points lower than the change of China's aggregate FDI stock, perhaps due to more thorough investment screening in Europe. It developed more strongly only in Asia – perhaps a sign of Chinese near-shoring.[6] Another region showing signs of near-shoring are the Americas (excluding the USA). The change of their bilateral stock of FDI developed at a much weaker rate than their aggregate stock in all regions except the United States.

Chart 4.2 applies the same logic to PI, showing an even greater scale of reallocation of investment across regions between 2018 and 2022. Again, from a source country's perspective, it becomes clear that there was a relative shift of US stock of PI from the Americas and Asia (excluding China) to China and, to a lesser extent, to the euro area. The euro area's bilateral stock of PI in the Americas (excluding the USA) and other euro area countries grew at a weaker pace than the euro area's stock in China and the USA. China's stock of portfolio investment in the Americas, the USA and the eura area changed at a much weaker rate than its aggregate stock of PI, while its stock of PI in Asia developed much more strongly than its aggregate stock, suggesting near-shoring as well. The change of bilateral stocks of PI showed a significantly stronger indication for near-shoring, especially in the case of Asia (excluding China) and China, while this is not the case for the USA, the euro area and the Americas (excluding the USA).

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[5] Near-shoring is a geographical concept applying to countries that wish to redirect parts of the value chain closer to their domestic economy. Friend-shoring is a concept that applies if parts of the value chain are redirected toward geopolitically more aligned countries. These "friends" must not necessarily be in the close vicinity of the domestic economy concerned.

[6] Nedopil et al. (2024) recently documented an increase of China's investment activities in the Asia-Pacific region based on project-level data.

Chart 4.1

FDI reallocation across regions (2018 vs. 2022)

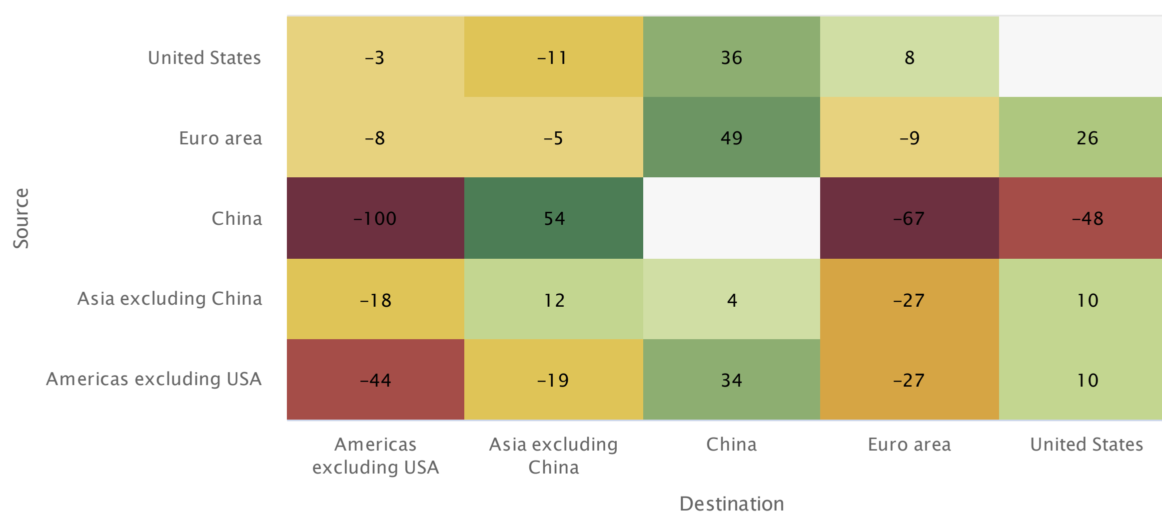
Percentage point deviation from source country's aggregate change in outward FDI

Source: Coordinated Direct Investment Survey (IMF).
Note: Deviations are calculated as the difference between the change in outward FDI for source/destination country pairs and the overall change in outward FDI for the source country across all counterpart countries shown. Offshore financial centers (Eurostat definition excluding Hong Kong and Singapore) are not included in the regions.

Chart 4.2

Portfolio investment reallocation across regions (2018 vs. 2022)

Percentage point deviation from source country's aggregate change in portfolio investment assets



Source: Coordinated Portfolio Investment Survey (IMF).
Note: Deviations are calculated as the difference between the change in portfolio investment assets for source/destination country pairs and the overall change in portfolio investment assets for the source country across all counterpart countries shown. Offshore financial centers (Eurostat definition excluding Hong Kong and Singapore) are not included in the regions.

Summarizing, charts 4.1 and 4.2 provide a relative perspective on bilateral investment changes between 2018 and 2022. Regarding FDI, the only regions showing signs of near-shoring are China

and the Americas excluding the USA. There are no clear signs of near-shoring for the remaining regions. Regarding PI, the reallocation of investment across regions was more pronounced. The United States and the euro area do not show strong signs of near-shoring. China does show signs of near-shoring as its investment in Asia clearly increased relative to its global activities.

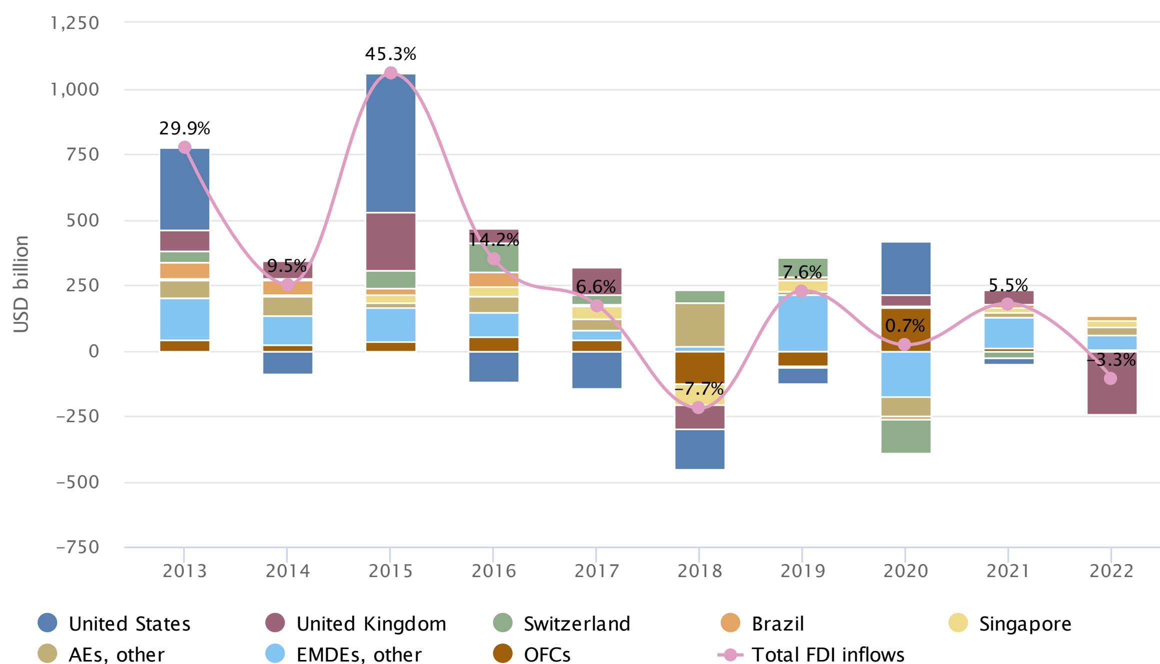
In the previous subsection, we identified the ASEAN and LAC countries as regions warranting a closer look on investment relations. Inter- or intraregional capital flows may follow different patterns than global capital flows, and deglobalization may simply consist of a redirection of capital flows to more aligned or less "hostile" countries and not necessarily of a reduction of global capital flows and stocks. We focus on FDI, as we believe it is more strongly affected by geopolitical fragmentation than the more volatile flows of PI, which may move for a myriad of reasons including interest rate differentials due to monetary policy divergence between countries. We will take a regular look at the euro area and remain agnostic about other regions or countries. Two regions seem to stand out in terms of potential beneficiaries of near-shoring: first, the ASEAN countries, not least due to their proximity to China or recent episodes of capital inflows, as the Banque de France (2023) reports; second, the LAC countries due to their proximity to the United States and Canada, two G7 economies, as well as their increasing economic cooperation with China. In a recent report, the Banco de España (2023) notes that LAC continue to attract portfolio inflows in significant amounts – USD 20 billion in the first five months of 2023. The UNCTAD's latest World Investment Report (UNCTAD, 2023) corroborates our focus on ASEAN and LAC countries as well. While global FDI flows in 2022 fell by 12% compared to 2021, Southeast Asian and Latin American countries experienced a significant increase of inward FDI by 4.7% and 50.1%, respectively. The other outlier is India, where inward FDI increased by 10% in 2022 against 2021. According to UNCTAD (2023), the country now ranks eighth among the most important destination countries for inward FDI worldwide.

2.1 FDI inflows to the euro area decreased and became more volatile in recent years

Zooming in on the most important direct investor countries, we find that offshore tax havens play an important role for FDI to the euro area. Inward direct investment used to be driven by the United States and the UK – the euro area's two single most important investors – and other AEs (see chart 5). It is also interesting to note that inflows from the UK declined quite significantly following the 2016 Brexit referendum. While capital inflows exhibit considerable variation over time, stocks of investment give us a less dynamic picture of the main FDI investors in the euro area (see chart 6). The United States and the United Kingdom are still the two most important investors in the euro area. The share of the USA in total FDI stock is 26.5%, followed by the UK's share of 17.2%. Other emerging and developing economies (EMDE, other) hold around 13% of the inward stock of FDI. The shares of Russia and China are not negligible but comparatively small. Going forward, and taking increasing geopolitical tensions into account, we assume that these shares should at least not rise any further, perhaps even decline.

Chart 5

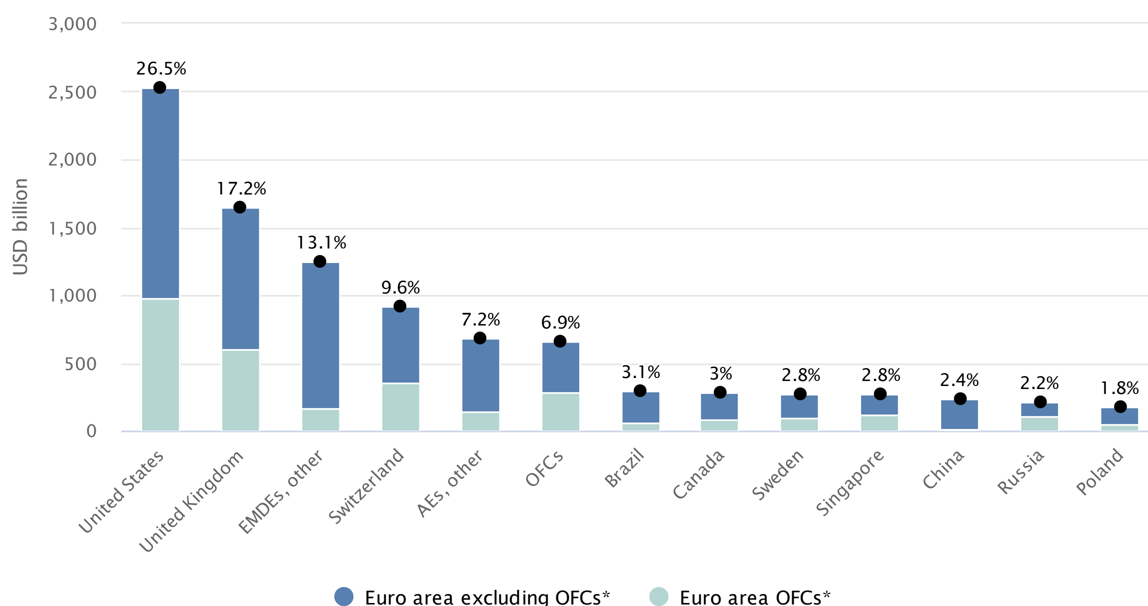
Euro area: extra-euro area FDI inflows by source country (2013–2022)



Source: Eurostat.
Note: Shows top 5 source countries. Percentage shares of euro area gross fixed capital formation (GFCF) are shown on top of bars. OFCs = offshore financial centers (Eurostat definition excluding Hong Kong and Singapore); AEs = advanced economies; EMDEs = emerging market and developing economies; AEs, other = AEs excluding OFCs and countries shown; EMDEs,other = EMDEs excluding OFCs and countries shown.

Chart 6

Euro area: extra-euro area inward FDI stock by source country (2022)



Source: Eurostat.
Note: Total extra-euro area inward FDI: USD 9,536 billion, percentage shares of which are shown on top of bars. Shows top 10 source countries excluding OFCs. Euro area OFCs* are euro area countries categorized as OFCs by Di Nino et al. (2020): Belgium, Cyprus, Ireland, Luxembourg, Malta, Netherlands. OFCs = offshore financial centers (Eurostat definition excluding Hong Kong and Singapore); AEs = advanced economies; EMDEs = emerging market and developing economies; AEs, other = AEs excluding OFCs and countries shown; EMDEs, other = EMDEs excluding OFCs and countries shown.

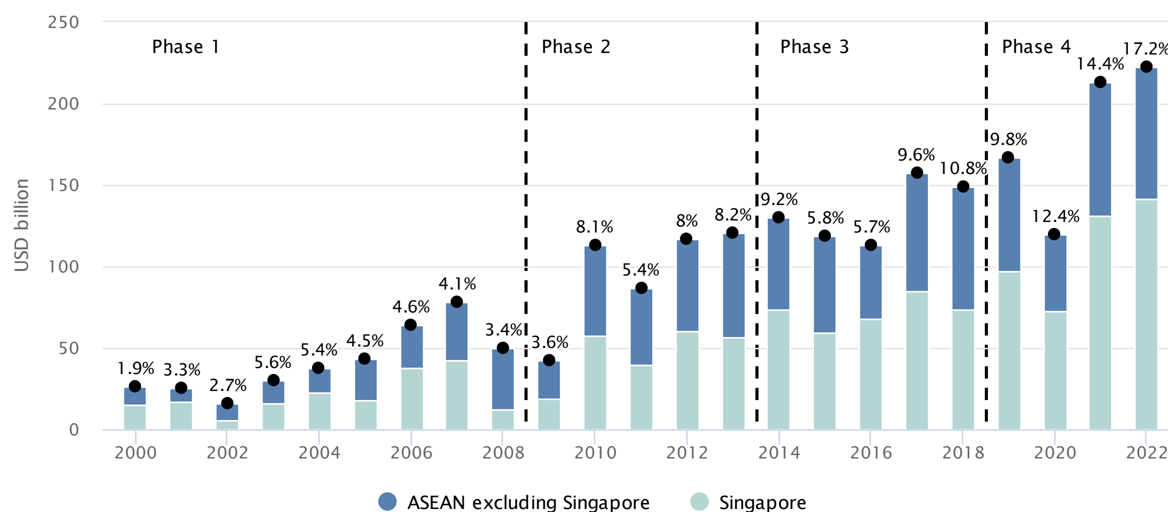
Euro area financial centers (Belgium, Cyprus, Ireland, Luxemburg, Malta, Netherlands) play a significant role in funneling investment into the euro area. For instance, around one-third of the investment stock of the USA and the UK goes to these financial centers but investment from EMDEs less so. Overall, the data suggest that inward FDI into the euro area is largely coming from a group of countries which can be considered geopolitically well aligned with the euro area.

2.2 FDI inflows to the ASEAN region have increased significantly as of late

Mirroring the remarkable integration of the ASEAN countries into the global economy, FDI inflows have increased significantly since 2000, see also Banque de France (2023) or Kaaresvirta et al. (2023). The region benefits from the proximity to the second largest economy (China), open seaways to the United States and a regional financial hub – Singapore. Chart 7 shows FDI inflows to the ASEAN countries from 2000 to 2022, singling out Singapore as the region's major financial hub (light blue bars). Foreign direct investment flows to the region, both in USD billion and in shares of global inward FDI, increased approximately tenfold since 2000 from USD 26.3 billion to USD 222.3 billion and from 1.9% of global FDI inflows to 17.2%. Singapore strengthened its role as a regional financial hub especially in phase 2 of our framework, the post-crisis phase of (de)globalization. During phases 3 ("return of imperialism") and 4 ("multiple crises"), Singapore accounted for at least half of all FDI inflows to the ASEAN countries, which highlights its growing importance as a financial hub. Within Asia, where FDI inflows stagnated in 2022, the ASEAN region is one of the power houses, attracting a significant and increasing share of FDI inflows. The increased importance of ASEAN countries is underscored as well by calculations from the Banque de France (2023), according to which the ASEAN region and China attract most capital flows to Asia with the ASEAN countries tracking China's performance (measured as a percentage of total global FDI inflows since 2012). While the share of China's FDI flows into the ASEAN region – 8% of all inflows – seems quite low, the French central bank cautions that China's making use of financial centers (e.g. Hong Kong) might lead to a significant underestimation of Chinese FDI inflows into the region (see also Coppola et al., 2021). Ceteris paribus and notwithstanding some volatility across investment types, we expect the share of FDI flows going to the ASEAN countries to increase going forward, especially if geopolitical tensions continue to persist or increase even further.

Chart 7

ASEAN: FDI inflows (2000–2022)

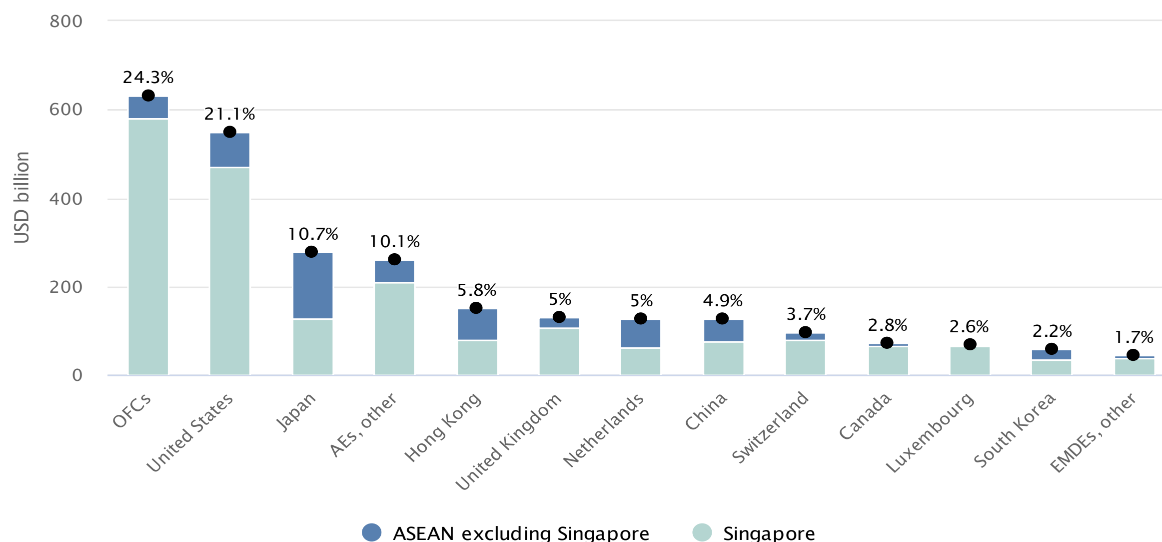


Source: UNCTAD FDI statistics.
Note: Percentage shares of global FDI inflows are shown on top of bars. ASEAN = Association of Southeast Asian Nations.

Taking a look at direct investment stocks, the USA remains the single most important investor in the ASEAN region. Its total stock of inward FDI in 2022 was USD 2.6 trillion (see chart 8), of which the United States holds USD 548 billion, i.e. more than one-fifth of the region's overall inward FDI stock. Japan holds USD 277.4 billion or 10.7%, followed by other AEs, China's main financial hub Hong Kong and the Netherlands, another major financial hub. The role of Singapore as the region's most important financial hub is emphasized by the light blue bars, which show the share of the ASEAN FDI stock held in Singapore (e.g. close to 90% of inward FDI stock in the ASEAN region coming from the USA are held in Singapore). China's share of total inward FDI (4.9%) is small but not negligible, with more than half of it being held in Singapore. We reckon that the share of Hong Kong and – to some extent at least – of the Cayman Islands may be attributed to China as well (see Coppola et al., 2021). To sum up, the ASEAN region has certainly been one of the relative winners in the most recent past and may be one of the regions first affected by increasing geopolitical tensions and fragmentation depending on its geopolitical positioning.

Chart 8

ASEAN: extra-ASEAN inward FDI stock by source country (2022)



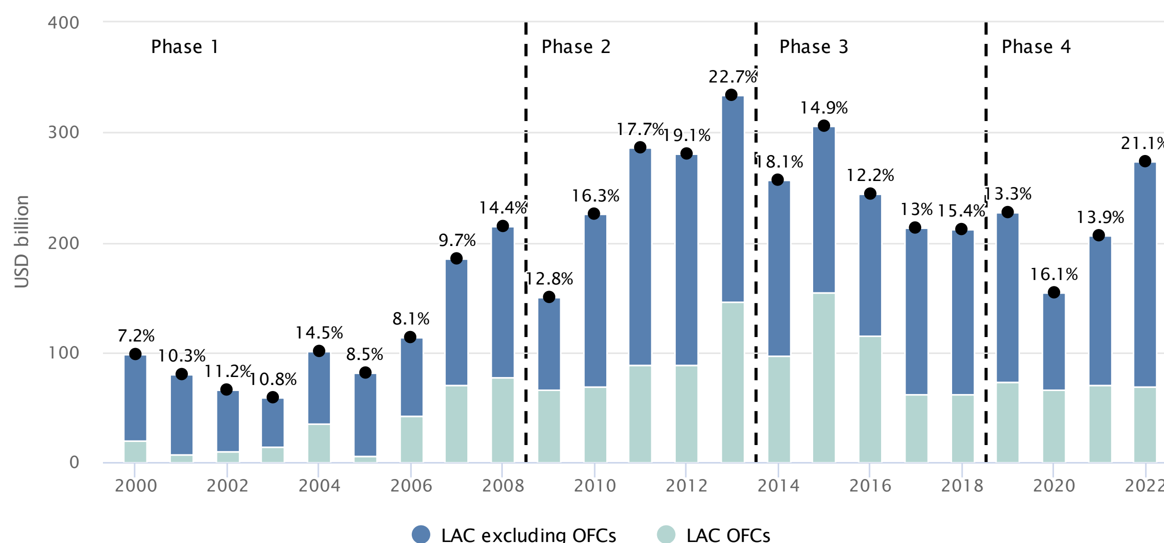
Source: Coordinated Direct Investment Survey (IMF).
Note: Total extra-ASEAN inward FDI: USD 2,595 billion, percentage shares of which are shown on top of bars. Shows top 10 source countries excluding OFCs. OFCs = offshore financial centers (Eurostat definition excluding Hong Kong and Singapore); ASEAN = Association of Southeast Asian Nations; AEs = advanced economies; EMDEs = emerging market and developing economies; AEs, other = AEs excluding OFCs and countries shown; EMDEs, other = EMDEs excluding OFCs and countries shown.

2.3 FDI inflows to LAC have increased lately but remain below previous levels

High commodity prices influenced record FDI inflows to LAC. Chart 9 presents data on inward FDI for the region since 2000. While the region experienced a drop of inward FDI at the beginning of phase 2 ("hangover phase"), FDI inflows recovered quickly and surpassed pre-financial crisis levels already in 2010. Phase 3 ("return of imperialism") was characterized by a significant decline of FDI inflows to the LAC region. In phase 4 ("multiple crises"), FDI inflows recovered, and while they remain below previous levels, they amounted to USD 273.8 billion in 2022 (USD 205.7 billion when offshore financial centers (OFCs) are excluded). The region now attracts more than 21% of global FDI inflows. According to UNCTAD (2023), the LAC region benefits from investment activities of foreign affiliates in the extractive industries during last year's increase in energy and commodity prices. Within the region, South America attracted USD 160 billion in 2022 and managed to grow its inward FDI flows by 73% (compared to the LAC region's 51%, when excluding OFCs) from the previous year. Almost half of all inward FDI flows to LAC (excluding OFCs) go to Brazil, while Chile recorded another USD 20 billion of inward FDI last year. Mexico received around USD 35 billion (+12% from 2021) of FDI. Standard gravity models suggest that proximity to the USA and Canada as well as their "gravity" (GDP) certainly played a role, while we do not dismiss the possibility that international investors from the Americas wish to reduce their exposure in Asia and move their capital closer to home.

Chart 9

Latin America and the Caribbean: FDI inflows (2000–2022)

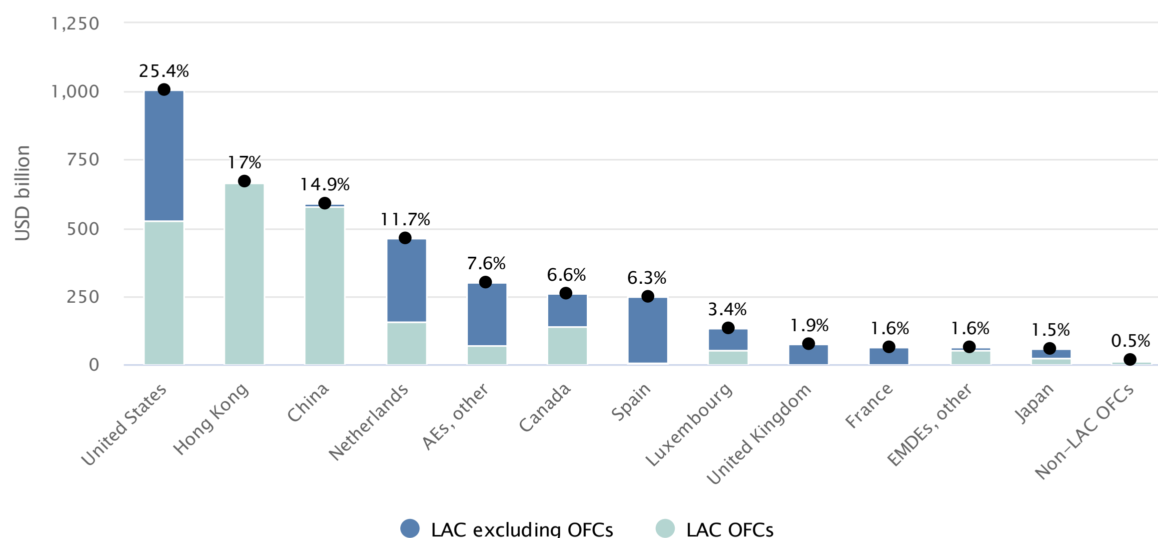


Source: UNCTAD FDI statistics.
Note: Percentage shares of global FDI inflows are shown on top of bars. LAC = Latin America and the Caribbean; OFCs = offshore financial centers (Eurostat definition).

Regarding the stock of FDI, the USA is by far the largest investor in the LAC region, followed by Hong Kong and China. The US stock of inward FDI in LAC constitutes 25.4% of the region's total FDI (see chart 10). Euro area countries such as the Netherlands, Spain, Luxemburg and France seem to play a larger role in LAC than in ASEAN countries, holding a significant stock of assets in the LAC region, but they are not nearly as significant as Hong Kong (17% of total assets) and China (14.9% of total assets). In both cases, almost all FDI assets are held in the region's financial centers. About half of all US FDI assets in LAC are held in financial centers, while the share is significantly smaller for the stock of FDI from the euro area countries. As a final remark, we would like to add that given the region's dependence on commodities, any fragmentation of commodity markets will most likely add to negative effects for LAC.

Chart 10

Latin America and the Caribbean: extra-LAC inward FDI stock by source country (2022)



Source: Coordinated Direct Investment Survey (IMF).
Note: Total extra-ASEAN inward FDI: USD 3,961 billion, percentage shares of which are shown on top of bars. Shows top 10 source countries excluding OFCs. OFCs = offshore financial centers (Eurostat definition excluding Hong Kong and Singapore); LAC = Latin America and the Caribbean; AEs = advanced economies; EMDEs = emerging market and developing economies; AEs, other = AEs excluding OFCs and countries shown; EMDEs, other = EMDEs excluding OFCs and countries shown.

Overall, in this section we provided a detailed examination of flows of FDI and PI from a bilateral point of view, providing insights into relative changes in assets for source countries during the period from 2018 to 2022. Our analysis allows us to identify relative winners and losers, which is indicative of potential signals related to near-shoring or fragmentation. For the United States, there is no clear indication of near-shoring in FDI, and the euro area does not show any strong signs, either. However, China's bilateral investment data suggest clear signs of near-shoring, particularly in Asia. Our analysis extends to PI, revealing an even more pronounced reallocation of investment across regions, with China showing strong indications of near-shoring.

Additionally, this section offers a well-nuanced and relative perspective on bilateral investment changes, emphasizing the potential impacts on global capital allocation based on the strategic decisions and preferences of individual source countries. The ASEAN countries have experienced a substantial increase in FDI since 2000, benefiting from a redirection of capital flows. FDI inflows into the ASEAN region have risen tenfold and its share in global FDI inflows has surged. The United States remains the predominant investor in the ASEAN region. Singapore has notably strengthened its role as a regional financial hub during the post-crisis phase of (de)globalization, attracting a significant share of FDI inflows. So far, the ASEAN region stands out as a relative winner, attracting foreign capital at a time when many other regions are implementing stricter regulations on FDI. Although the USA remains the primary investor, China is increasing its share of investment in the region. Our analysis suggests that the ASEAN region may be among the regions most exposed to rising geopolitical tensions and fragmentation.

3 Concluding remarks

The analyzed data and discussions provide insights into the shifts and patterns of global capital flows and investment, with a focus on bilateral investment changes and their potential implications for near-shoring or fragmentation. The key findings are:

- First, global capital flows have experienced fluctuations over the years, with periods of increase and decrease, possibly influenced by factors such as financial crises, economic policies and geopolitical tensions. Despite these fluctuations, there is no strong indication of deglobalization or significant fragmentation in capital flows.
- Second, there is evidence of a higher concentration of capital flows across countries since 2012, indicating potential shifts in the direction of investments. This concentration coincides with rising geopolitical tensions, which may influence investment decisions.
- Third, there are substantial differences between regions regarding the global allocation of capital. For instance, the euro area has seen a decline in extra-euro area FDI inflows, particularly from the United Kingdom, possibly due to the economic impact of Brexit. Offshore tax havens play a significant role in FDI to the euro area, with increasing investments from other advanced economies and offshore financial centers. ASEAN countries, on the one hand, have benefited from the proximity to China, which is a sign of China's near-shoring activities. On the other hand, the ASEAN region also benefits from good relations to the United States, which remains the major investor in the ASEAN group of countries – a possible sign of friend-shoring on behalf of the United States. Singapore has emerged as a key financial hub attracting a substantial share of FDI inflows. The Latin American countries have seen fluctuations in FDI inflows, likely influenced by commodity prices and investment activities in extractive industries. While the United States remains the primary investor, China's share in the LAC region's FDI stock is increasing, indicating shifting investment patterns.
- Fourth, if we analyze a source country's investment activities, differentiated by destination countries and relative to its aggregate investment activities, we find interesting patterns that provide insights into potential near-shoring or fragmentation trends. China shows clear signs of near-shoring in both FDI and PI, while the United States and the euro area do not exhibit strong indications of near-shoring. The ASEAN region appears to be a relative winner in attracting foreign capital while facing potential exposure to rising geopolitical tensions and fragmentation.

Overall, our analysis highlights the complex interplay of factors shaping global capital flows and the need for the continued monitoring of investment trends at regional and bilateral country levels. It underscores the importance of understanding the dynamics of global capital flows and investment, especially in the context of geopolitical developments and regional economic (dis)integration, when it comes to anticipating potential shifts in investment patterns and their implications for economic stability and growth. It also highlights the need for more rigorous assessments of the interplay of geopolitical fragmentation and capital flows and cross-border investment.

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