Global Financial Cycle: a multinational channel perspective

Global Financial Cycle (GFC) is a term that was introduced by Helene Rey at Jackson Hole in 2013 and, later, received noteworthy attention by both the academic community and policy circles. In short, GFC refers to the fact that, nowadays, global financial markets follow a common cycle which was not observed prior to 1980s, 1990s. Rey (2013, 2016) and subsequently Miranda-Agrippino and Rey (2020) among others argues that the US monetary policy is one of the main drivers of GFC.

Why did a GFC emerged following the 1980s-1990s? And what is the link between the FOMC decisions and the GFC? While there are a few conjectures, the most common ones are (i) the international financial landscape has undergone massive transformations and financial globalization and international capital flows took off starting 1980s-1990s (see Jorda et al. 2019; Gourinchas and Rey 2014; Lane and Milesi-Ferretti 2007), (ii) in parallel to this trend, the US dollar holdings of global banking system and international financial intermediaries exploded over this period (see Rey 2016; Bruno and Shin 2015) in line with the international reserve currency role of the dollar, (iii) an increase in US interest rates, nowadays, have significant balance sheet effect on global banks and international financial intermediaries which leads to tighter lending conditions all around the world and, in turn, a GFC (see Rey 2016; Miranda-Agrippino and Rey 2020; Bruno and Shin 2014, 2015; and several policy papers by BIS and Hyun Song Shin).

Most of the literature has mainly looked at the role of the banking system and banking balance sheets to explain the GFC. In our previous research, "Cross-Country Stock Market Co-movement: a Macro Perspective", we looked at the role of the multinationals in making stock prices more correlated in the 90s and 2000s. We now do a step forward and look at the contribution of multinationals to the GFC, a research angle still unexplored. Looking at some preliminary figures we find that the corporate sector is highly leveraged, both in the US and in rest of the world (ROW). In line with this trend, we see that US affiliates of ROW multinationals are highly leveraged and intercompany debt of US affiliates coming from a parent company constitutes roughly 20% of their total debt. Moreover, around 80% of the total debt of US affiliates are raised by the US affiliates themselves from US persons (see BEA's FDIUS survey - which classifies source of debt under three categories: from parent, other foreign persons, from US persons). ROW multinationals may be then exposed to US monetary policy through the balance sheet of their affiliates. This may potentially have an impact on the dividends distribution that will affect stock prices and also risk premia.

The aim of the project is to look at the contribution of multinationals to the GFS and the effect of US monetary policy on global stock prices from the empirical point of view. During last term we have explored the existing literature and in particular the data availability. We have not collected all the data yet. This is hopefully going to be completed this term.