Wider international use of emerging market currencies, in particular the Chinese renminbi, has revived interest in the role of offshore markets (He & McCauley 2010; Maziad et al. 2011; Frankel 2011; BIS 2011). In this special feature, we review the patterns of international flows of funds in the eurodollar market, focusing on the importance of residents and non-residents in offshore activity and the market’s role as a conduit for capital flows.

Distinguishing gross flows from net flows, we find that most eurodollar flows do not finance the US current account (Borio & Disyatat 2011; Shin 2011). This finding puts into doubt assertions that international use of the renminbi requires China to run a current account deficit. It also suggests that one-way speculative positioning, taken by some critics (Yu 2011) as the main impetus for international use of the renminbi, will prove to be temporary.

Rather, we expect that the offshore renminbi market will play the usual role of intermediating between non-residents, especially as non-Chinese become willing renminbi borrowers. As He and McCauley (2010) have argued, offshore markets perform essential economic functions, including separation of currency and country risks and the diversification of operational risks.

From a residency perspective, offshore markets can feature four types of flows (Figure 13.1). In pure offshore markets, non-residents borrow from and lend to each other in the home currency (in the eurodollar market example in the graph, US dollars). In round-trip transactions, residents deposit home currency with banks offshore and residents borrow it back in a loop. Finally, the offshore market can be a conduit for net flows in domestic currency between the domestic economy and abroad.

With this typology in hand, we consult BIS data on the eurodollar market, covering 38 years.¹ We find that this market has played all of
Figure 13.1 Eurodollar banking transactions