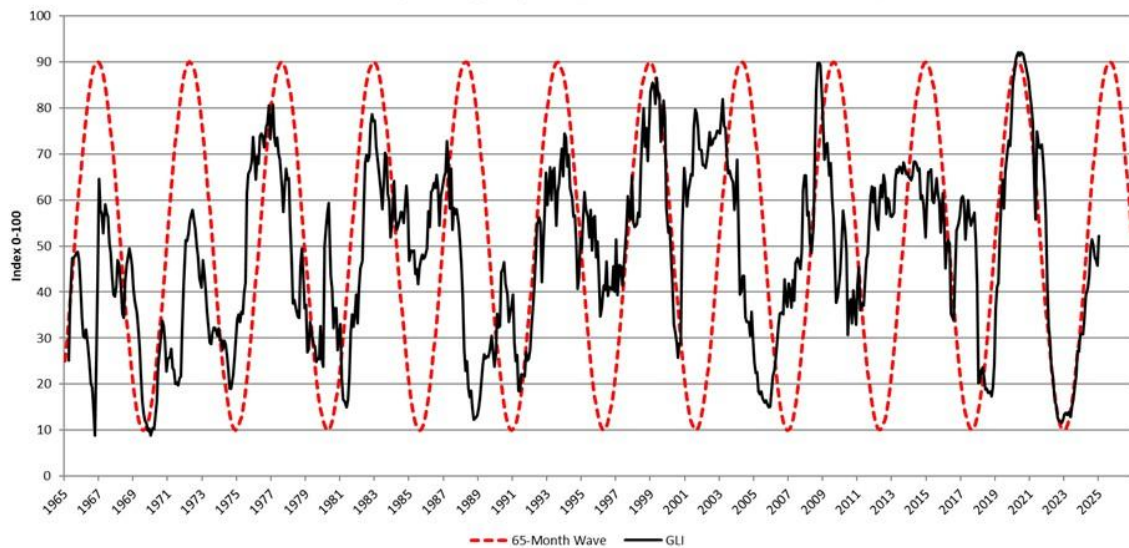


# The Global Liquidity Cycle

*CrossBorder Capital's* approach to finance focuses on how large investors and credit providers behave within system-wide constraints—such as liability durations, regulatory limits, and collateral scarcity—rather than analyzing individual securities in isolation. It views financial markets primarily as a vast debt-refinancing mechanism rather than a new capital-raising system, where liquidity (the ratio of financial asset supply to their duration) becomes the key metric, transcending traditional focus on interest rates. This framework highlights how collateral shortages, pro-cyclical feedback loops, and the dominance of safe assets (like U.S. Treasuries) shape global liquidity cycles, with refinancing demands driving a roughly 65-month periodicity that aligns with global debt maturity structures. The approach explains phenomena like the dollar premium, volatility spikes during "Risk-Off" episodes, and why monetary policy transmission often differs from textbook models.



**Global Liquidity Cycle (Advanced Economies)**



Source  
CrossBorder Capital, US Federal Reserve, People's Bank of China, ECB, Bank of Japan, IMF

We take what might be dubbed an institutional view of finance by studying the behaviour of investors and credit providers, rather individual securities. This is an important difference because financial markets, today, act as giant debt refinancing systems, rather than the textbook World of capital-raising vehicles for new investment projects. Interest rates, the cost of capital in the textbook models, has become secondary to balance sheet capacity and liquidity.

Modern investors are constrained by their future liabilities, especially the timing, or duration, of these liabilities. Credit suppliers, in turn, are constrained by policy makers and regulators, and by their access to collateral to backstop loans. Liquidity measures the effective supply of financial assets divided by their average duration. It is fungible between markets and asset types, which make Global Liquidity the key metric. The Global Liquidity cycle is dominated by debt refinancing demands, which may explain why its 65-month average periodicity lies close to the average maturity of World debts.

Nearly 80% of all lending since the 2008/09 GFC is now collateral-based. The collateral pool is dominated by 'safe' assets, which are in scarce supply and often supplemented by more volatile and more risky private sector credit instruments. This can explain the premium on US dollar assets, and why 'Risk Off' moves can worsen collateral shortages and lend a pro-cyclical bias to the financial system. Evidence how 'safe' asset yields can trend higher when re-financing needs increase, leading to cash shortages just when more liquidity is needed.

The Global Liquidity Cycle is calibrated with data from some-90 financial systems Worldwide. We break the Global Liquidity Cycle down into its main constituents, namely Central Bank Liquidity, private sector liquidity and cross-border flows. Shocks can occur through any of these channels. However, typically private sector refinancing demands are reflected and reinforced by cross-border flows, and, in turn, reacted to by policy makers through changes in Central Bank Liquidity. Because most policy makers aim to stabilize or target their currencies, their interventions are often asymmetric, giving an upward bias to Global Liquidity over time.

## Key Arguments

### 1. Institutional/ Behavioural View vs. Traditional Finance Theory

- Focus on the **behaviour of large investors and credit providers**, not individual securities
- Challenges the conventional view of markets primarily serving capital allocation for new investment projects
- Highlights how **debt refinancing** now dominates market activity (estimated at 70-80% of transactions)

### 2. Constraints Driving Market Behaviour

#### Investors':

- Liability-driven investing (LDI) strategies dominate pension/insurance allocations
- Duration-matching needs create inelastic demand for long-dated assets

- Increasing use of passive asset allocation strategies (e.g. target age funds) that implicitly embed these constraints

#### Credit Suppliers':

- Basel III/IV and Solvency 2 regulations impact bank and insurance companies' balance sheet capacity
- Collateral scarcity (especially post-GFC) alters lending dynamics

### 3. Global Liquidity Framework

- 'Liquidity' = Supply of Financial Assets /av. Duration
- Explains why interest rates, traditional money supply measures and Central Bank balance sheets alone cannot measure true liquidity
- Cross-market fungibility creates new transmission channels (e.g., repo market stresses, rapid outflows from EMs) that often reverse the polarity of traditional financial system

### 4. Collateral Economy Dynamics

- US\$23 trillion 'safe' asset shortage (BIS estimates) creates structural demand

Hence, private sector collateral expansion through:

- Securitization (ABS, MBS)
- Credit derivatives (volatility swaps, total return swaps)
- Rehypothecation chains

Pro-cyclicality risks (collateral values fall → margin calls → fire sales → further drops)

### 5. The Refinancing Cycle

65-month **Global Liquidity Cycle** periodicity aligns with:

- Typical corporate debt maturity walls
- Mortgage refinancing cycles
- Sovereign debt rollover patterns (especially EM)

Creates reflexive interactions with monetary policy (e.g., Fed tightening → refinancing crunch)

### 6. Dollar Premium Drivers

- 60% of global trade invoicing
- 75% of FX transactions (BIS Triennial Survey)

- Network effects in collateral chains (80% of repos are USD-denominated)

This framework reveals how market microstructure now dominates fundamental valuation in many asset classes, with important implications for portfolio construction and risk management. It also helps explain several modern paradoxes:

- Why high street inflation stayed low despite QE (liquidity trapped in asset economy and refinancing transactions)
- How 'Risk-Off' events trigger dollar shortages (collateral scramble)
- Greater pro-cyclicality in finance and greater need for Central Bank interventions
- How finance dominates the real economy and why the business cycle has typically shortened in length from a 9/10-year capex cycle to a 5/6-year debt refi cycle
- Why yield curves behave differently from traditional models predictions ('safe' asset demand overrides rate expectations)