Net Inflows versus Gross Inflows: Which Is a Better Predictor of US House Prices?

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Discussion on whether net capital flows or gross capital flows are the appropriate measure of international capital transactions is a notable issue, especially, after the great financial crisis. In the post-crisis period, the number of papers emphasizing the relative importance of gross flows has increased. However, these studies may focus less on the correlation between gross inflows and gross outflows. Due to the correlation, certain parts of the variation in gross inflows (external borrowing) are canceled out by the co-movement of gross outflows (foreign lending) in aggregate term. Considering this, current account deficits and net inflows can be a better measure than gross inflows when we assess the external funds available for domestic investments that seem to be related to financial conditions and, therefore, asset prices. To present empirical evidence supporting the conjecture and show an example that current accounts and net flows still matter, this note reveals that current account deficits or net inflows outperform gross inflows as a predictor of the US house price.