

## Box 12

## RECENT DEVELOPMENTS IN THE GROSS EXTERNAL DEBT OF THE EURO AREA

On the basis of newly compiled data recently released by the ECB, this box reviews the latest developments in the level and composition of the gross external debt of the euro area and compares them with those in other major advanced economies.<sup>1</sup> The box shows that the gross external debt positions of major advanced economies have increased considerably since the start of the financial crisis in the summer of 2007. In the euro area, for example, total gross external debt vis-à-vis the rest of the world increased by 15 percentage points in the period from the end of 2006 to the end of 2009, to 116.5% of GDP (see the table). Similarly, gross external debt positions widened in most of the other advanced economies, particularly in the United States, the United Kingdom, Canada and Japan. A notable exception was Switzerland, the gross external debt position of which decreased slightly compared with 2006.

The gross external debt of an economy represents the outstanding amount of its actual (i.e. non-contingent) current liabilities that require payment of principal or interest to foreign investors. These liabilities include debt assets, such as bonds and notes, money market instruments, loans and currency deposits, as well as trade credits and advances due to non-residents. For the euro area as a whole, the stock of gross external debt excludes debt holdings by residents in other euro area countries. These intra-euro area debt holdings account for about one-third of the total unconsolidated gross external debt of all euro area countries. As a result, the gross external debt-to-GDP ratios of the individual euro area countries are generally higher than the euro area aggregate ratio.

Part of the rise in gross external debt in major advanced economies in the period from 2006 to 2009 reflects the increased borrowing undertaken by many governments as a result of the financial crisis. Over this period, the gross external debt of the general government sector in the euro area increased by 8.3 percentage points of GDP, to reach around 21.3% of GDP at the end of 2009 (see the table). In the United States the increase was more pronounced (9.5 percentage points of GDP); in addition, the gross external debt of the general government at the end of 2009 was higher than in the euro area, at 26% of GDP. The increase in gross external debt positions of the general government in major advanced economies between 2006 and 2009 may also reflect a

<sup>1</sup> See the ECB press release entitled “Euro area balance of payments in February 2010 and international investment position at the end of 2009” of 20 April 2010 and Table 7.3.8 in the “Euro area statistics” section of this issue of the Monthly Bulletin.

## External debt indicators for selected economies

(percentage of GDP)

	2006	2007	2008	2009
<b>Gross external debt</b>				
Canada	54.3	56.5	52.1	70.4
Japan	34.7	40.4	45.6	42.0
Switzerland	266.2	334.6	245.9	245.0
United Kingdom	378.2	402.1	339.3	419.2
United States	83.6	95.4	95.2	96.6
Euro area	101.5	110.8	118.2	116.5
<b>Gross external debt of general government</b>				
Canada	11.3	10.3	9.4	15.3
Japan	9.5	13.8	14.6	13.3
Switzerland	7.1	6.1	4.5	3.9
United Kingdom	11.5	12.1	12.2	18.4
United States	16.5	17.4	21.5	26.0
Euro area	13.0	13.8	18.3	21.3
<b>Net external debt</b>				
Canada	21.4	20.7	18.2	-
Japan	-50.6	-55.7	-48.4	-
Switzerland	-130.1	-143.3	-115.8	-
United Kingdom	70.3	60.3	44.4	-
United States	42.6	49.6	52.5	-
Euro area	6.4	6.6	14.6	12.6
<b>Net interest payments</b>				
Canada	1.4	1.4	1.2	1.2
Japan	-1.9	-2.3	-2.2	-
Switzerland	-2.7	-3.1	-3.0	-
United Kingdom	1.7	1.9	1.6	-
United States	1.3	1.5	1.5	-
Euro area	0.0	0.1	0.2	0.2

Sources: ECB, IMF and ECB staff calculations.

portfolio reallocation on the part of investors from equities to debt against the backdrop of higher global risk aversion at the time.

Turning to the composition of the euro area's gross external debt by instrument type, debt securities with an original maturity of over one year and intra-group lending comprised almost half of the total gross external debt at the end of 2009. Moreover, around two-thirds of the euro area long-term debt securities held by non-residents were denominated in euro. This was partly the result of strong foreign demand for euro-denominated securities, including for international reserve purposes. The euro denomination eliminates the currency risk associated with the issuance of debt by euro area residents.<sup>2</sup>

It is important to note that gross external debt per se only captures one dimension of an economy's exposure to external creditors. In effect, the net external debt position, obtained by subtracting gross external debt assets from the liabilities, provides additional insights into debt (re)financing and the external debt sustainability of an economy. The net external debt position of the euro area at the end of 2008 (about 14.6% of GDP) was significantly lower than its gross external debt position and well below the net positions of the United States and the United Kingdom. Countries in which the financial sector is relatively large and has an important

<sup>2</sup> For further details on euro-denominated debt securities see "The international role of the euro", ECB, July 2009.

international role, such as the United Kingdom and Switzerland, tend to have high levels of gross external debt. However, the financial sector of such countries usually also holds a large amount of assets in the form of cross-border debt securities, which means that the level of net external debt is substantially lower. In this context, the net interest payments (i.e. interest payments minus interest receipts originated by the debt positions) are critical, as they show how much of the income generated by an economy in one year is to be allocated to servicing the costs of net external debt. The net interest payments of the euro area amounted to 0.2% of GDP in 2008 (and also in 2009), which was significantly lower than the respective net interest payments of 1.5% of GDP for the United States and 1.6% of GDP for the United Kingdom (see the table).

In summary, the global financial crisis was associated with an increase in gross external debt in most of the major advanced economies, including the euro area. This increase was partly driven by higher financing needs on the part of governments as a result of the financial crisis, but also by heightened global risk aversion on the part of investors.