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Factors driving the recent improvement in the euro area's international investment position

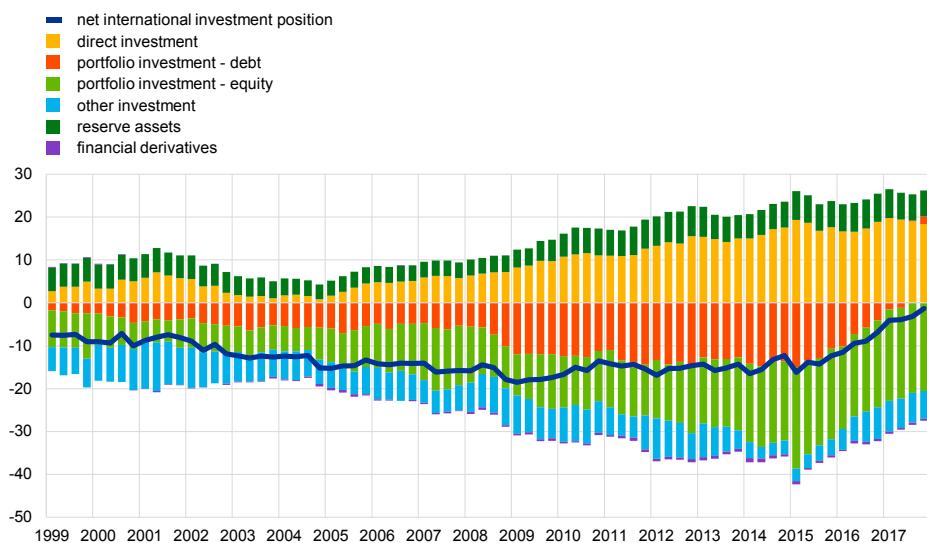
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The euro area's international investment position (i.i.p.) improved further in 2017 (see Chart A). At the end of the year it showed net liabilities of 1.3% of euro area GDP – historically their lowest level. This followed a significant improvement of 15 percentage points of GDP which occurred since the first quarter of 2015, largely due to a reduction in net liabilities of portfolio debt securities. Before this recent improvement, the euro area's net i.i.p. had hovered around levels of -15% of GDP for more than a decade. Since 1999 the euro area has been a net creditor in direct investment and reserve assets, and a net debtor in portfolio equity investment, other investment and financial derivatives. It also recorded a net liability position in portfolio debt investment until 2015. This net liability position (of 15% of GDP in the first quarter of 2015) has since turned into a net asset position of 2% of GDP as at the end of 2017.

Chart A

Main components of the euro area's net international investment position

(outstanding amounts at end of period as a percentage of four-quarter moving sums of GDP)



Source: ECB.

Note: The latest observation is for the fourth quarter of 2017.

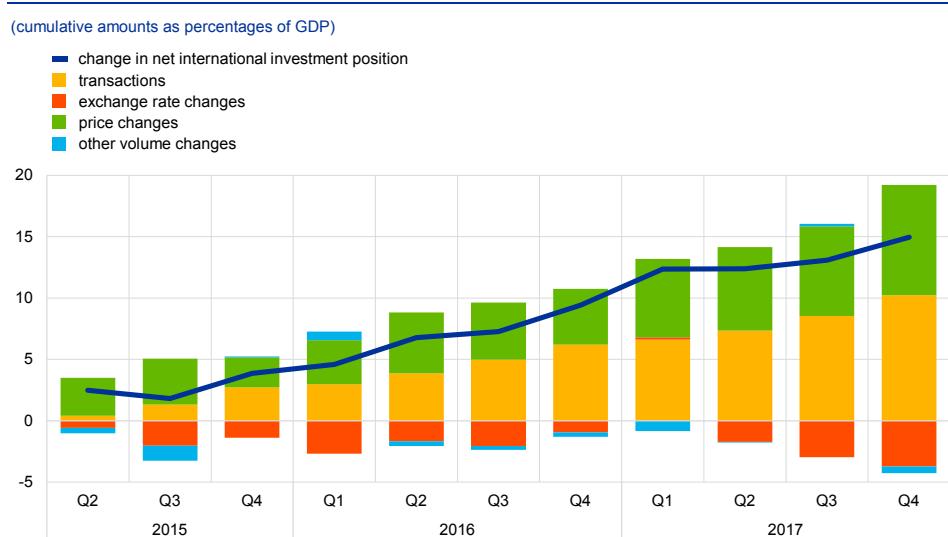
The recent improvement in the euro area's net i.i.p. was mainly driven by net financial transactions – reflecting the euro area's current account surplus – and developments in asset prices (see Chart B). Changes in the net i.i.p. can be broken down into net financial transactions (broadly mirroring developments in the current account balance), valuation effects due to changes in exchange rates and other asset prices, and other volume changes.¹² Since the first quarter of 2015, the

¹² "Other volume changes" include, for example, reclassifications, write-downs, "breaks" arising from changes in sources and methods, as well as changes in the residency of companies.

euro area's current account surplus contributed about 10 percentage points of GDP to the reduction in net external liabilities. From the financial account perspective this reflected, to a significant extent, net outflows in portfolio debt investment including those that occurred in the context of the public sector purchase programme (PSPP). At the same time, the contribution of asset prices (excluding exchange rate effects) to the reduction in net external liabilities was around 9 percentage points of GDP. This latter figure reflects the performance of euro area investments abroad relative to that of investments in euro area assets by non-euro area residents. Since the first quarter of 2015, two-thirds of these positive net valuation gains in the euro area's i.i.p. were accounted for by portfolio equity, as euro area investments in global stock markets outperformed foreign portfolio equity investments in the euro area. The remaining one-third of the net valuation gains was accounted for by portfolio debt investment. These positive contributions to developments in the euro area's net i.i.p. were only partly offset by net valuation losses arising from exchange rate movements (of around 4 percentage points of GDP) as the euro appreciated by 9% in nominal effective terms over the same period.¹³

Chart B

Breakdown of changes in the euro area's net international investment position since the first quarter of 2015



Sources: ECB and Eurostat.

Notes: "Other volume changes" include, for example, reclassifications, write-downs, "breaks" arising from changes in sources and methods and changes in the residency of companies. The latest observation is for the fourth quarter of 2017.

As regards financial instruments, the improvement in the euro area's net i.i.p. was mainly due to a shift in portfolio debt securities from a net liability to a net asset position. While portfolio debt securities recorded a net liability position of 15% of GDP in the first quarter of 2015, this changed to a net asset position of 2% of GDP by the end of 2017. Over the same period, the other components of the i.i.p.

¹³ The euro area's net i.i.p. typically records valuation gains when the exchange rate of the euro depreciates (and valuation losses when it appreciates). This is because the euro area's foreign assets are mainly denominated in foreign currencies, whereas the largest share of the euro area's foreign liabilities is denominated in euro.

fluctuated much less, with net liabilities in portfolio equity shrinking by 3 percentage points of GDP and those in other investment increasing by 4 percentage points of GDP.¹⁴

The shift to a net asset position in portfolio debt securities resulted from both a reduction in liabilities vis-à-vis non-euro area residents and – albeit to a lesser extent – an increase in euro area residents' holdings of non-euro area debt securities (see Chart C). Specifically, the outstanding amount of euro area debt securities held by non-euro area residents declined from 55% of euro area GDP in the first quarter of 2015 to 42% of GDP at the end of 2017. At the same time, euro area residents increased their holdings of non-euro area debt securities from 40% of GDP to 44% of GDP.¹⁵ On both the asset and liability sides these developments were driven almost exclusively by long-term debt securities, i.e. those with an original maturity exceeding one year.

Non-euro area investors broadly reduced their holdings of euro area debt securities issued by all sectors; the largest reduction was in debt securities issued by euro area governments. This reduction amounted to close to 8 percentage points of euro area GDP since the first quarter of 2015 and largely reflected net sales of euro area sovereign bonds by non-euro area residents, including those that occurred in the context of the Eurosystem's PSPP.¹⁶ In the light of low interest rates in the euro area compared with other advanced economies, non-euro area residents also reduced their holdings of debt securities issued by euro area monetary financial institutions (MFIs) by 3 percentage points of GDP and reduced their holdings of debt securities issued by other sectors by over 2 percentage points of GDP.¹⁷ The increase in euro area residents' holdings of non-euro area issued portfolio debt securities was entirely due to euro area resident "other financial corporations"; this includes investment funds, insurance corporations and pension funds. The largest part (65%) of the increase in the holdings of non-euro area issued portfolio debt securities by euro area residents was accounted for by securities issued by non-euro area governments.

¹⁴ Net investment positions in direct investment, financial derivatives and reserve assets changed by 1 percentage point of GDP, or even less, over the same period.

¹⁵ In terms of nominal amounts in euro billions, the relative contributions of assets and liabilities to the decline in net foreign liabilities were more similar. Expressed as ratios to GDP, however, GDP growth effects mitigated the impact of an increase in outstanding amounts (as observed in the case of assets), while amplifying a decrease in outstanding amounts (as observed in the case of liabilities).

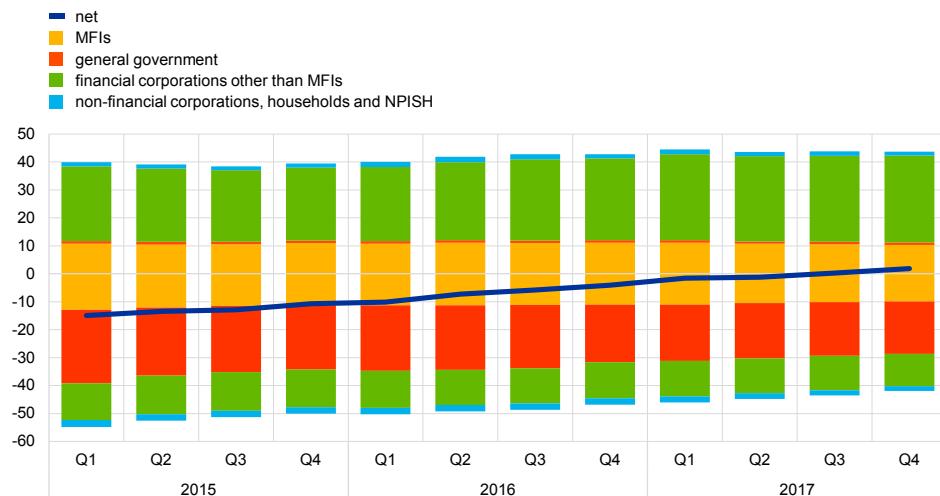
¹⁶ See the box entitled "Which sectors sold the government securities purchased by the Eurosystem?", *Economic Bulletin*, Issue 4, ECB, 2017.

¹⁷ See the box entitled "Analysing euro area net portfolio investment outflows", *Economic Bulletin*, Issue 2, ECB, 2017.

Chart C

Breakdown of euro area portfolio debt positions by resident sector

(outstanding amounts at end of period as a percentage of four-quarter moving sums of GDP)



Sources: ECB and Eurostat.

Notes: Negative figures indicate euro area liabilities, while positive figures indicate assets. The latest observation is for the fourth quarter of 2017. NPISH stands for "non-profit institutions serving households".

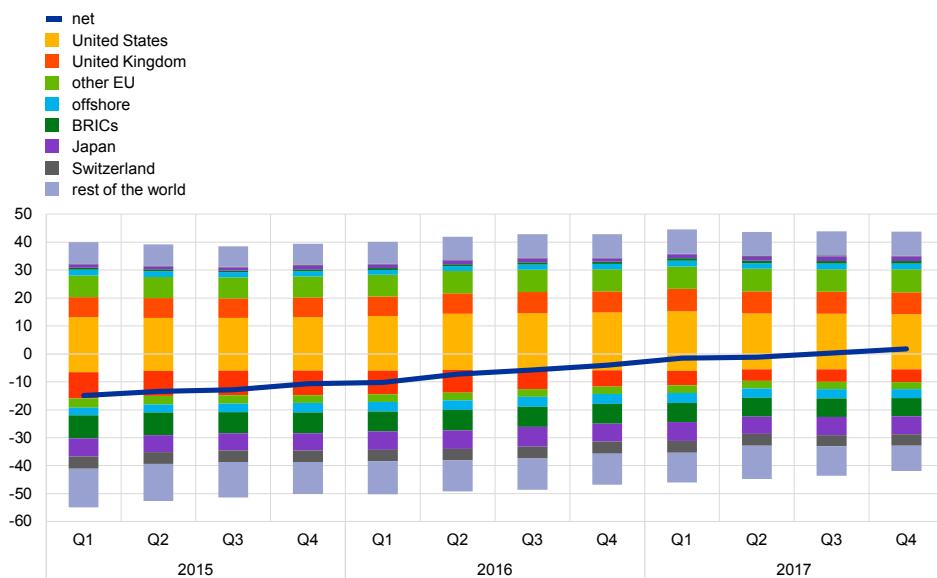
Since the first quarter of 2015 Japanese residents have become the largest foreign holders of euro area debt securities, surpassing residents of the United Kingdom and the United States (see Chart D). At the end of 2017 Japanese holdings of euro area debt securities were at the same level (6% of euro area GDP) as in the first quarter of 2015, while during that period the most significant reductions in holdings of euro area debt securities were by investors from the United Kingdom (a reduction of 5 percentage points of GDP), followed by investors from the "BRIC" countries (a reduction of 2 percentage points of GDP) and the United States (a reduction of 1 percentage point of GDP).¹⁸

¹⁸ The "BRIC" countries comprise Brazil, Russia, India and China.

Chart D

Breakdown of euro area portfolio debt positions by geographic area of counterparts

(outstanding amounts at end of period as a percentage of four-quarter moving sums of GDP)



Sources: ECB and Eurostat.

Notes: Negative figures indicate euro area liabilities, while positive figures indicate assets. The "BRIC" countries comprise Brazil, Russia, India and China. The "rest of the world" includes all other countries not otherwise identified, as well as any unallocated positions. Data for liabilities are based on ECB estimates. The latest observation is for the fourth quarter of 2017.

The most pronounced increase in foreign debt securities holdings by euro area investors was in securities issued by entities resident in the United States, followed by those in the United Kingdom and Japan. The United States thus remained the most important destination country for investment in debt securities by euro area residents (14% of euro area GDP), followed by the United Kingdom (8% of GDP). The aggregate holdings by euro area investors of securities issued by residents of other non-euro area EU countries (excluding the United Kingdom) amounted to 8% of GDP at the end of 2017.