

Box 5

Developments in net financial flows between the euro area and the United States

International financial flows have increased significantly in the past five years. Moreover, there have been marked changes in the composition and direction of financial flows among major economies. The purpose of this box is to provide some stylised facts about these changes for the United States and the euro area, and in particular to describe how financial flows between the euro area and the United States have evolved over time.

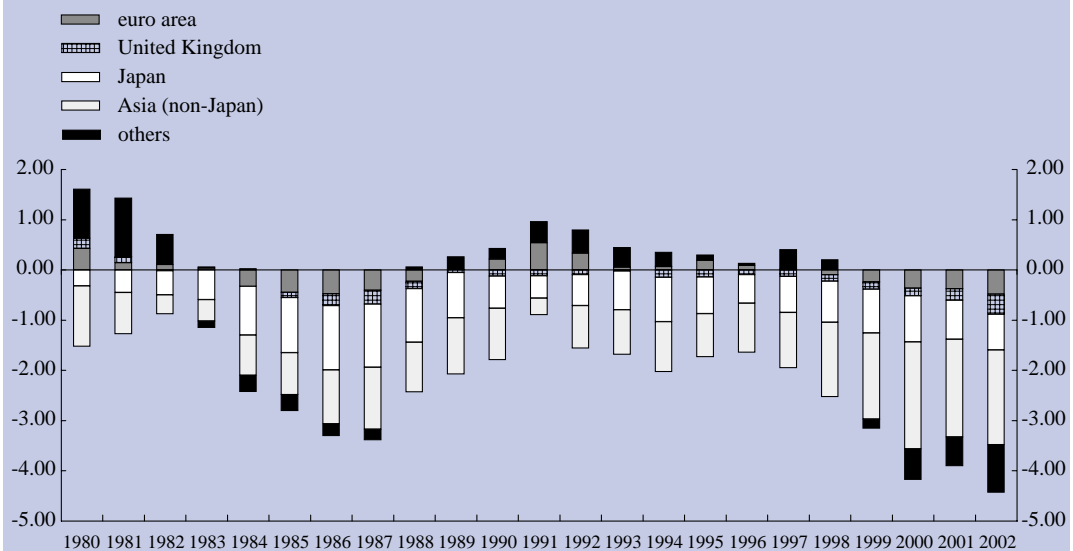
The geographical breakdown of financial flows for the United States

The US Bureau of Economic Analysis (BEA) provides a geographical breakdown of financial flows for the United States (such a breakdown is not yet available for the euro area).¹ These capital inflows have been associated with an increase in the US current account deficit since the early 1990s and have averaged 4.3% of GDP in the past three years. The geographical composition shows that the US current account deficit with the euro area has been relatively small in recent years. By contrast, it has been by far the largest with Asia and Japan (see Chart A below).

¹ In its geographical breakdown, the BEA reports data for the European Union as a whole and, separately for the United Kingdom. Therefore, in this box data for the euro area includes financial flows for Denmark and Sweden, except for portfolio investment data in Chart C where the US Treasury International Capital (TIC) system has been used. Note that US portfolio investment data are not directly comparable with those of the euro area balance of payments, as they rely on different data collection methods and definitions. The US TIC reporting system, in particular, identifies the first counterpart, thus tracking the place of transaction and not the ultimate owners of securities.

Chart A: US current account: geographical composition

(% of GDP)



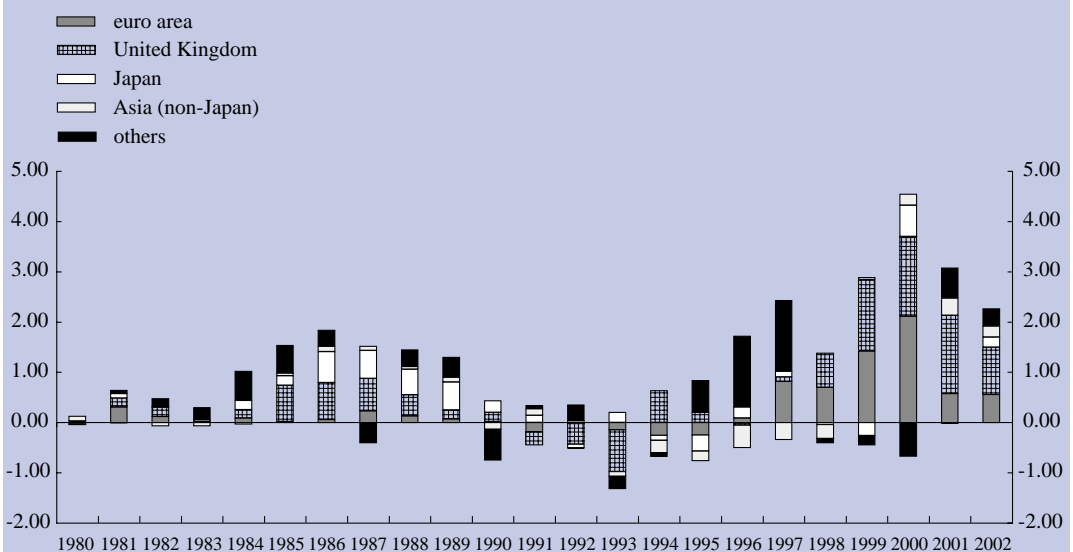
Sources: BEA and ECB calculations.

Note: 2002 figures for the first six months of the year are annualised.

However, the geographical composition of the current account deficit is very different from the geographical composition of capital flows on the financial account side. The United States has, in recent years, received substantial net capital inflows from the rest of the world. Net inflows in direct and portfolio investment into the country increased from close to balance in the early 1990s to around 2.5% of US GDP in the first six months of 2002 – the latest data available. The peak of net direct and portfolio investment flows occurred in 2000, amounting to 4.3% of US GDP. According to the data provided by the BEA, by far the largest share of inflows into the United States over the past five years has come from the euro area and the United Kingdom, while capital inflows from Asia including Japan have been substantially smaller (see Chart B below). However, it is important to note that the large share of the net financial flows from the United Kingdom to the

Chart B: US net direct and private portfolio investment: geographical composition

(% of GDP)



Sources: BEA and ECB calculations.

Note: 2002 figures for the first six months of the year are annualised.

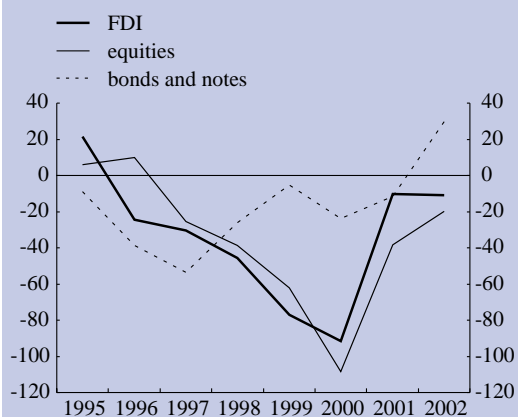
United States may also be due to the importance of London as a global financial centre rather than the activity of British firms and investors alone. In general, this suggests that the geographical breakdown of cross-border financial flows should be interpreted with caution, as the existence of intermediary countries makes it difficult to accurately identify the location of the original counterpart.

Main features of bilateral euro area – US financial flows

Looking at a finer decomposition of the financial flows between the euro area and the United States there are some marked differences between categories. Two-thirds of net flows in direct and portfolio investment from the euro area into the United States in the past decade has been in the form of portfolio investment.

Chart C: Net financial flows between the euro area and the United States

(EUR billions)



Sources: US Bureau of Economic Analysis, US Department of the Treasury and ECB calculations.

Note: 2002 figures for the first six months of the year are annualised. A negative sign indicates net financial outflows from the euro area and net inflows into the United States.

financial flows between the euro area and the United States in 2001 and the first half of 2002 has returned to the levels observed in the mid-1990s.

The exception to this finding were the years 1998-2000 when net direct investment flows from the euro area into the United States rose significantly. Chart C shows that net flows in foreign direct investment (FDI) from the euro area to the United States reached €91 billion in 2000 (0.9% of US GDP). The largest net flows from the euro area to the United States until 2000, however, occurred in the category of equity securities, which reached €108 billion in 2000. By contrast, net financial flows in bonds and notes were less sizeable. Since 2000, financial flows between the euro area and the United States have undergone substantial changes. First, net financial flows in direct and portfolio equity investment declined markedly in 2001 and levelled off in the first six months of 2002. Second, flows in bonds and notes turned from net inflows into the United States to net inflows into the euro area in the first six months of 2002 (see Chart C, above). Overall, the magnitude of net