

Box 6

CHANGES IN THE EURO AREA INTERNATIONAL INVESTMENT POSITION IN 2008

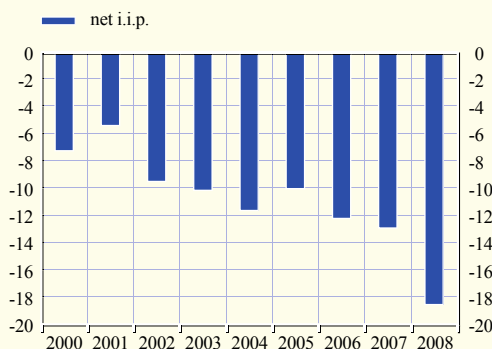
The international investment position (i.i.p.) measures the net creditor or debtor position of a country or group of countries vis-à-vis the rest of the world and is the difference between outstanding financial assets and liabilities valued at market prices at the end of a given period. A change in the i.i.p. can be explained primarily by two factors: (i) net financial flows (“transaction” effect), which in theory are the counterpart of the current and capital account balances¹, and (ii) revaluations as a result of variations in exchange rates and asset prices and other adjustments (“other changes” effect).

The net liability position of the euro area has been increasing almost continuously since the end of 2000 (see Chart A). According to preliminary estimates, the i.i.p. of the euro area recorded net liabilities of 18.6% of GDP at the end of 2008, compared with 13.0% a year before.

In the period 2000-07, “other changes” was the most important factor in shaping the euro area’s i.i.p. developments, accounting for, on average, about 60% of the annual changes. This was most pronounced in the period 2002-05,

Chart A Net i.i.p. of the euro area

(percentage of GDP)



Source: ECB.

1 In practice, distortions are reflected in the “errors and omissions” item.

when the effects of “other changes” almost exclusively explained the annual changes in the net i.i.p., with revaluations due to exchange rate movements playing a dominant role. However, more than half of the increase in the euro area’s net international liability position in 2008 was accounted for by financial transactions, as net purchases of euro area financial assets by non-residents largely exceeded net purchases of foreign financial assets by euro area residents. The impact of “other changes” on the i.i.p. was also significant and contributed to the increase in the net liability position.

The breakdown of financial transactions by type of instrument (see Chart B) reveals that the main contribution to the developments in the i.i.p. in 2008 came from increased net inflows of portfolio investment into the euro area (€439 billion, 4.7% of GDP). This reflects the combined outcome of (i) euro area residents repatriating funds from abroad and (ii) non-residents continuing to invest in the euro area. The latter concerned debt instruments only, and money market instruments in particular. At the same time, there were significant net sales of euro area equity securities. The sizeable increase in the purchase of euro area money market instruments by non-residents reflected mainly a global trend in portfolio re-allocation of funds towards more liquid and shorter-maturity assets, as uncertainty increased. There were also net sales of equity securities by both euro area residents and non-residents, which is consistent with the shift in investors’ preferences towards less risky assets in the midst of the financial and confidence crisis. “Other investment” (comprising mostly deposits and loans) also saw positive net inflows of €160 billion (1.7% of GDP), stemming from the strong liquidation activity by resident MFIs, partly as a result of their deleveraging. In contrast, direct investment contributed positively to the i.i.p., recording a net outflow of €251 billion (2.7% of GDP), as euro area firms continued to invest abroad.

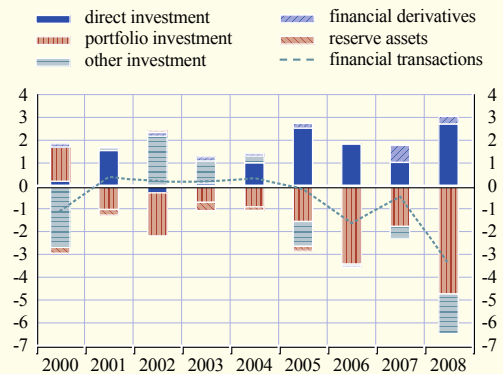
Preliminary estimates of the breakdown of “other changes” show that the appreciation of the euro in nominal effective terms (3% by the end of the year), given the euro area’s currency composition of foreign assets and liabilities, contributed to the increase in the net liability position in 2008. However, revaluations resulting from financial asset price changes partly offset that effect. This can be explained, to some extent, by the fact that the capital losses incurred by euro area residents in foreign stock markets, particularly those in the United Kingdom and the United States, were smaller than the losses incurred by foreigners in the euro area capital markets.

The size of the increase in the euro area’s net liability position in 2008 should be interpreted with caution, as the i.i.p. figures may be revised when more complete data become available in the course of the year.²

² To illustrate this point, net inflows in securities in 2008 are less pronounced when compiled using the methodology for the euro area accounts.

Chart B Breakdown of financial transactions

(percentage of GDP)



Source: ECB.