

Box 2

RECENT DEVELOPMENTS IN THE FINANCIAL ACCOUNT OF THE EURO AREA BALANCE OF PAYMENTS

This box analyses recent developments in the financial account of the euro area balance of payments, focusing primarily on the second quarter of 2011. Net inflows in the euro area increased further in the second quarter of 2011, supported mainly by substantial investment in euro area securities. The instrument composition of portfolio flows into the euro area non-MFI sectors changed considerably in the second quarter of 2011, with an increase in net inflows in debt securities more than compensating for foreign investors' disinvestment in euro area equity securities. Moreover, the larger net inflows resulting from transactions with the money-holding sector since the beginning of the year account for the expansion in MFIs' net external asset position.

Net inflows in the euro area increased further in the second quarter of 2011. Larger net inflows in portfolio investment were the main driver of this increase and were only partially offset by larger net outflows in foreign direct investment and other investment (see table below).

The larger net inflows in portfolio investment mask significant changes in investment patterns between the first and second quarters of 2011. In fact, developments in portfolio investment were relatively volatile, with market sentiment changing significantly. Net inflows in debt securities increased substantially, while equity securities shifted from net inflows to net outflows.

These developments in portfolio investment were concentrated in the non-MFI sector and should be viewed against the backdrop of increased tension and volatility in financial markets. Concerns about the strength of the global recovery and the reintensification of the sovereign debt crisis led

Financial account of the euro area balance of payments

(EUR billions; non-seasonally adjusted data)

	2011		Three-month cumulated figures				12-month cumulated figures	
	May	June	2010 Sep.	Dec.	2011 Mar.	June	2010 June	2011 June
Financial account¹⁾	18.6	10.3	3.9	1.3	12.8	31.0	9.0	48.9
Combined net direct and portfolio investment	51.9	93.9	-47.8	92.8	121.8	165.8	107.1	332.6
Net direct investment	-3.8	5.6	-30.8	59.2	-11.5	-26.0	-105.3	-9.0
Net portfolio investment	55.8	88.3	-17.1	33.6	133.3	191.8	212.4	341.6
Equities	-21.7	13.1	29.1	15.4	93.9	-50.4	45.4	88.0
Debt instruments	77.4	75.2	-46.1	18.2	39.3	242.2	167.0	253.6
Bonds and notes	40.1	63.9	-97.1	43.0	11.6	181.7	51.4	139.4
Money market instruments	37.4	11.3	50.9	-24.8	27.7	60.5	115.6	114.2
Net other investment	-31.8	-87.9	54.3	-91.7	-93.9	-144.4	-102.5	-275.7
<i>Of which: money-holding sector²⁾</i>								
Net direct investment	-2.8	3.6	-32.0	62.9	-6.8	-20.8	-101.4	3.3
Net portfolio investment	8.3	50.7	-72.2	-88.7	61.3	51.4	57.2	-48.2
Equities	-20.8	15.8	15.1	25.5	86.7	-46.7	64.5	80.6
Debt instruments	29.0	34.9	-87.3	-114.3	-25.4	98.2	-7.3	-128.8
Net other investment	-8.4	-9.8	40.7	-31.8	34.0	-46.1	-26.8	-3.2

Source: ECB.

Note: Figures may not add up, owing to rounding.

1) Figures refer to balances (net flows). A positive (negative) sign indicates a net inflow (outflow).

2) General government and other sectors of the balance of payments.

to greater uncertainty and a renewed increase in investors' risk aversion. This, in turn, triggered two divergent developments as regards foreign investment in securities issued by the euro area non-MFI sector. On the one hand, non-residents significantly increased their investment in bonds and notes. This increase was probably related to safe-haven flows targeting bonds and notes issued by core euro area countries. On the other hand, non-euro area residents disinvested in equity securities, bringing to an abrupt end the favourable momentum observed in the first quarter of 2011. Foreign investors restructured their portfolios by reducing their exposure to equity securities and investing in debt securities in apparent flight-to-safety behaviour.

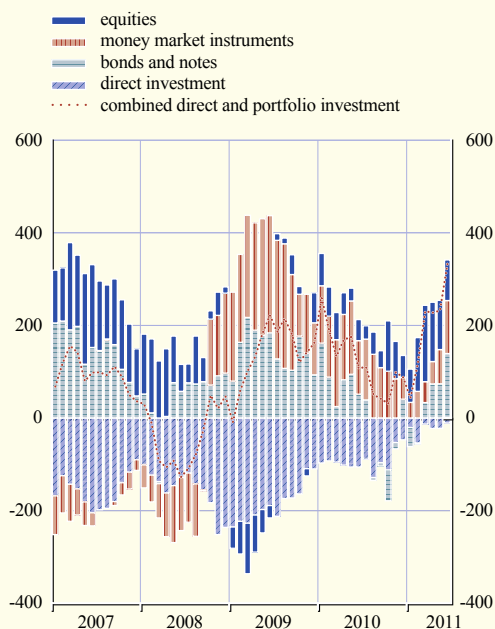
The larger portfolio investment inflows resulting from transactions with the non-MFI sector in the first two quarters of the year are also related to the available stock of monetary liquidity in the euro area. As can be seen from the monetary presentation of the balance of payments, the aforementioned larger net inflows in portfolio investment in securities issued by the money-holding sector are a mirror image of the gradual increase observed in MFIs' net external asset position in 2011.¹ These flows have made a positive contribution to the liquidity available in the euro area and are partly reflected in developments in the broad monetary aggregate M3.

Focusing on the MFI sector, inflows in debt securities issued by the MFI sector increased further in the second quarter of 2011. Foreign investors stepped up their purchases of bonds and notes issued by euro area credit institutions. This development is in line with banks' increased issuance and seems to suggest an easing of general funding conditions. Net inflows were also supported by euro area banks' ongoing disinvestment in foreign debt securities, which is probably related to efforts to restructure balance sheets. At the same time, flows into money market instruments issued by MFIs remained broadly unchanged from the first quarter of the year, suggesting that short-term funding from non-resident sources remained available to the euro area MFI sector as a whole.

Net outflows in foreign direct investment increased in the second quarter of 2011. This was the result of investment by non-euro area residents declining more strongly than investment by euro area residents, mostly

Main items in the financial account

(EUR billions; 12-month cumulated net flows; monthly data)



Source: ECB.

¹ To the extent that they are settled via resident banks, transactions carried out by the money-holding sector have an impact on the external assets and liabilities of the banking sector, which is one of the counterparts of M3. The money-holding sector comprises households, non-financial corporations, non-monetary financial intermediaries, and general government other than central government. For more information on the monetary presentation of the balance of payments, see Duc, L.B., Mayerlen, F. and Sola, P., "The monetary presentation of the euro area balance of payments", *Occasional Paper Series*, No 96, ECB, 2008. See also the article entitled "The external dimension of monetary analysis", *Monthly Bulletin*, ECB, August 2008.

in the equity capital and reinvested earnings component. The loss of momentum in foreign direct investment compared with the first quarter of the year might reflect a rise in uncertainty concerning the outlook for the global economy.

Turning to longer-term developments, in the 12-month period to June combined net direct and portfolio investment inflows increased considerably to stand at €332.6 billion, up from €107.1 billion in the previous year (see table and chart). This reflected larger net inflows in portfolio investment, combined with a substantial reduction in net outflows in foreign direct investment. Net inflows in both equity and debt securities increased, with the latter growing more strongly. Net inflows in debt securities were driven mainly by an increase in foreign investors' investment in euro area securities, whereas the larger net inflows in equities reflected the moderation of euro area residents' investment in foreign securities. Looking at other investment, which mainly comprises deposits and loans, net outflows increased substantially in the 12-month period to June. A more detailed look at developments in this component reveals that these net outflows were the result of euro area residents' increased investment in foreign assets, together with foreigners' disinvestment in euro area assets (which was, however, weaker than in the past).