

## Box 3

**DEVELOPMENTS IN THE FINANCIAL ACCOUNT OF THE EURO AREA BALANCE OF PAYMENTS UNTIL MARCH 2012**

This box analyses recent developments in the financial account of the euro area balance of payments until the first quarter of 2012. Net outflows were recorded for combined net direct and portfolio investment in the 12-month period to March 2012 and were broadly offset by net inflows in other investment (see table and chart). Following the reduction of cross-border holdings of securities by both domestic and foreign investors in the second half of 2011, signs of normalisation in portfolio investment emerged in the first quarter of 2012 with the resumption of net purchases of both euro area and foreign securities. In particular, euro area MFIs invested in foreign securities for the first time since the pre-Lehman collapse period and were able to raise liquidity in the form of loans and deposits.

## Main items in the financial account of the euro area balance of payments

(EUR billions; non-seasonally adjusted data)

	2012		Three-month cumulated figures				12-month cumulated figures	
	Feb.	Mar.	2011			2012 Mar.	2011 Mar.	2012 Mar.
			June	Sep.	Dec.			
<b>Financial account<sup>1)</sup></b>	0.3	-19.0	21.2	3.5	-44.0	-8.3	-15.0	-27.6
Combined net direct and portfolio investment	16.0	-53.8	107.2	15.8	-59.1	-87.6	168.9	-23.6
Net direct investment	-3.4	-18.4	-31.8	-19.2	-57.3	-28.2	-111.7	-136.5
Net portfolio investment	19.4	-35.4	139.1	35.0	-1.8	-59.4	280.7	112.8
Equities	-1.6	13.4	-31.1	31.4	79.0	18.8	201.2	98.2
Debt instruments	21.0	-48.8	170.1	3.6	-80.8	-78.2	79.5	14.7
Bonds and notes	22.3	-25.6	145.3	19.9	-9.9	-55.8	66.7	99.5
Money market instruments	-1.3	-23.2	24.9	-16.4	-70.9	-22.4	12.8	-84.9
Net other investment	-18.9	38.5	-94.1	-1.2	31.0	84.5	-183.9	20.1
<i>Of which: money-holding sector<sup>2)</sup></i>								
Net direct investment	-7.7	-17.4	-25.2	-18.8	-56.0	-28.6	-99.8	-128.6
Net portfolio investment	22.0	-4.7	79.7	19.9	-11.3	-16.9	30.9	71.4
Equities	1.6	16.6	-23.5	29.1	40.9	20.4	198.1	67.0
Debt instruments	20.4	-21.3	103.2	-9.2	-52.2	-37.3	-167.2	4.4
Net other investment	-0.5	-12.3	-17.3	24.6	10.1	-11.3	-5.4	6.2

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).

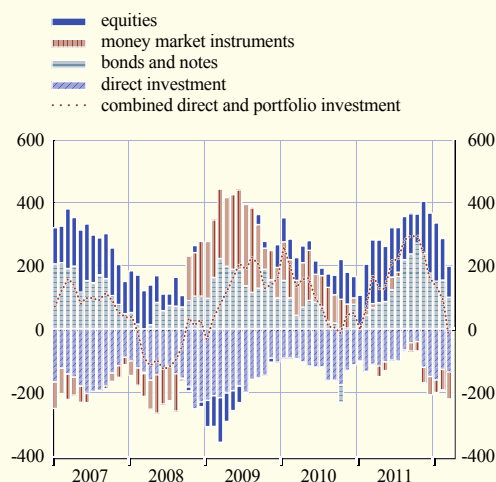
2) General government and other sectors of the balance of payments.

Net outflows of €23.6 billion were recorded for combined net direct and portfolio investment in the 12-month period to March 2012, which stands in contrast to net inflows of €168.9 billion a year earlier. This shift was mainly due to lower net inflows in portfolio investment in the second half of that year, most notably in the last quarter – a period characterised by exceptionally high volatility and abrupt changes in market sentiment and investor behaviour. A two-way repatriation process then emerged, whereby euro area investors repatriated funds previously invested in foreign securities and non-residents moved out of euro area securities, mostly out of debt securities issued by the general government sector. As the repatriation by foreign investors somewhat exceeded that by domestic investors, net inflows in portfolio investment shifted to net outflows. The emergence of this two-way repatriation process should be seen against the backdrop of mounting financial market tensions, as well as volatile and declining stock market prices at the global level. These factors seem to have weighed on market sentiment amid increasing concerns about the global economic outlook and to have caused heightened risk aversion.

In the first quarter of 2012, however, investment by euro area residents in foreign securities resumed. Net purchases of euro area securities by foreign investors also resumed but were lower than the net purchases

## Main items in the financial account

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



Source: ECB.

of foreign securities by euro area investors. As a consequence, there was an increase in net outflows from portfolio investment. An easing of financial market tensions, on the back of policy measures taken to address the sovereign debt crisis, seems to have had a positive impact on market sentiment and to have led to some reduction in risk aversion. Whereas both the MFI and the private non-MFI sectors in the euro area resumed investing, foreign investors in the euro area mainly targeted securities issued by the non-MFI sector. Moreover, the net outflows recorded for portfolio investment by the euro area non-MFI sector have contributed negatively to the liquidity available in the euro area, as is partly reflected in the evolution of the broad monetary aggregate M3. In fact, as can be seen from the monetary presentation of the balance of payments, these transactions involving the money-holding sector are a mirror image of the decrease observed in the MFI's net external asset position at the beginning of 2012.<sup>1</sup>

Turning to the MFI sector, in the first quarter of 2012 euro area banks interrupted their continued and sustained net sales of foreign securities for the first time since the pre-Lehman collapse period. The easing of the pressures on euro area banks to sell foreign assets is probably the result of two factors. On the one hand, the introduction of the Eurosystem's unconventional liquidity measures as well as the coordinated interventions by the ECB and five other central banks – in the form of reciprocal currency arrangements (swap lines) – aimed at providing liquidity to the global financial system. On the other hand, the interruption in net sales of foreign securities by euro area banks presumably also reflects the resumption of foreign investment in euro area MFIs. Most notably, MFIs' other investment liabilities increased considerably in the first quarter of 2012. The fact that euro area banks were able to roll over maturing short-term deposits and loans together with the resumption of foreign investment in securities issued by euro area banks – although still at subdued levels – suggests an easing of the funding conditions. Both factors therefore seem to have mitigated the need for euro area MFIs to mobilise funds by shedding non-core foreign assets, in a context of balance sheet restructuring.

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-MFI 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 external dimension of monetary analysis", *Monthly Bulletin*, ECB, August 2008.