

Box 4

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

This box analyses recent developments in the financial account of the euro area balance of payments until the second quarter of 2012. In the 12-month period to June, the combined balance on direct and portfolio investment in the euro area recorded net outflows of €68.6 billion, compared with net inflows of €220.6 billion a year earlier. To a large extent, these were offset by a shift, over the same period, in other investment from net outflows to net inflows of €64.8 billion (see the table below). At the end of the period under review, however, the euro area recorded sizeable net inflows of portfolio investment and net outflows of other investment on account of developments in both the MFI and the non-MFI sectors. After resuming net purchases of foreign securities in the first quarter of 2012, euro area investors reduced their cross-border holdings of securities in the second quarter, presumably on the back of funding pressures that are reflected in net outflows from other investment.

The shift in the combined direct and portfolio investment balance to net outflows over the 12-month period up to June 2012 was due mainly to lower net inflows in portfolio investment as foreign investors substantially reduced their purchases of equity securities issued by non-MFIs and also disinvested from debt securities issued by euro area MFIs. The withdrawal of funds from foreign portfolio investment was accompanied by the repatriation by euro area residents of funds that had previously been invested in foreign securities (especially equity securities). The two-way repatriation process should be seen in the light of substantial financial market tensions and volatile global stock market prices. The reduction of net inflows in portfolio

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	
	May	June	2011 Sep.	Dec.	2012 Mar.	June	2011 June	2012 June
Financial account¹⁾	-0.2	-17.5	3.5	-40.2	3.3	-19.5	-1.5	-52.9
Combined net direct and portfolio investment	36.6	29.0	15.8	-59.4	-82.4	57.3	220.6	-68.6
Net direct investment	9.9	-30.6	-19.2	-54.9	-5.3	-30.3	-98.9	-109.7
Net portfolio investment	26.7	59.7	35.0	-4.5	-77.1	87.6	319.5	41.0
Equities	6.0	34.2	31.4	82.6	18.4	24.4	155.9	156.8
Debt instruments	20.7	25.4	3.6	-87.1	-95.5	63.2	163.6	-115.8
Bonds and notes	13.7	30.8	19.9	-7.5	-60.3	47.6	123.4	-0.3
Money market instruments	7.0	-5.4	-16.4	-79.6	-35.2	15.7	40.2	-115.5
Net other investment	-29.1	-40.6	-1.2	35.8	92.7	-62.5	-227.6	64.8
<i>Of which: money-holding sector²⁾</i>								
Net direct investment	9.1	-31.6	-18.8	-54.2	-7.1	-33.4	-82.8	-113.5
Net portfolio investment	32.0	46.9	19.9	-18.8	-46.6	56.8	32.5	11.3
Equities	-3.0	40.9	29.1	43.3	14.7	24.4	153.4	111.6
Debt instruments	35.1	6.0	-9.2	-62.2	-61.3	32.4	-120.9	-100.3
Net other investment	-22.8	-13.7	24.6	13.7	9.6	-28.2	28.3	19.7

Source: ECB.

Notes: 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.

investment was largely compensated for by a shift in other investment, which comprises mainly deposits and loans, from net outflows to net inflows. This shift resulted primarily from resident banks in the euro area repatriating funds from abroad in order to support the restructuring of their balance sheets. Liquidity-providing transactions conducted by the Eurosystem in connection with the temporary reciprocal currency arrangement (swap line) also contributed to the net inflows in other investment.

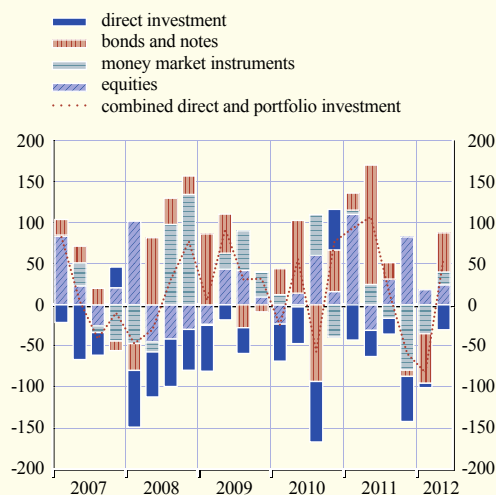
More recently, in the second quarter, there have been noticeable changes in the pattern of financial flows. While both euro area investors and foreign residents had temporarily resumed their net cross-border purchases of securities at the beginning of 2012, that momentum waned in the second quarter as euro area investors reduced their exposure to foreign securities. As a result, net outflows of combined direct and portfolio investment shifted to net inflows between the first and the second quarters of 2012 (see the chart below). Net outflows of foreign direct investment increased as from the first quarter of the year, due to cutbacks in the acquisition of euro area equity capital by non-residents, while the portfolio investment balance returned to positive territory in the case of both the MFI and the non-MFI sectors.

As regards the MFI sector, net inflows in portfolio investment turned positive as euro area residents resumed their repatriation of funds previously invested abroad in both debt and equity securities. The disinvestment largely involved sales of short-term money market instruments and, to a lesser extent, bonds and notes. This shift from net outflows of portfolio investment to net inflows should be seen in conjunction with a switch in other investment from net inflows to net outflows, so that it presumably reflects pressure on euro area banks to sell foreign securities in order to mobilise funds. As uncertainty related to the sovereign debt crisis deepened and risk-aversion re-emerged, euro area banks faced difficulties in raising liquidity in the form of loans and deposits, and in rolling-over maturing short-term deposits and loans. This resulted in a sharp decline in other investment liabilities of the banking sector.

Where the non-MFI sector is concerned, foreign investors' acquisition of euro area securities remained broadly unchanged in the second quarter, while euro area investors scaled down their net purchases of foreign debt securities (primarily bonds and notes) and moved out of foreign equity securities. Therefore, the net outflows in portfolio investment observed at the beginning of the year turned into net inflows in the second quarter. The net portfolio investment inflows in the non-MFI sector in the euro area contributed positively to the liquidity available there, as partly reflected in the evolution of the broad monetary aggregate M3. As can be seen from the monetary presentation of the balance of payments, these transactions involving the money-holding sector were an important determinant of the increase observed in the MFIs' net external asset position in the second quarter of 2012.

Main items in the financial account

(EUR billions; quarterly net flows)



Source: ECB.