

## Box 3

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

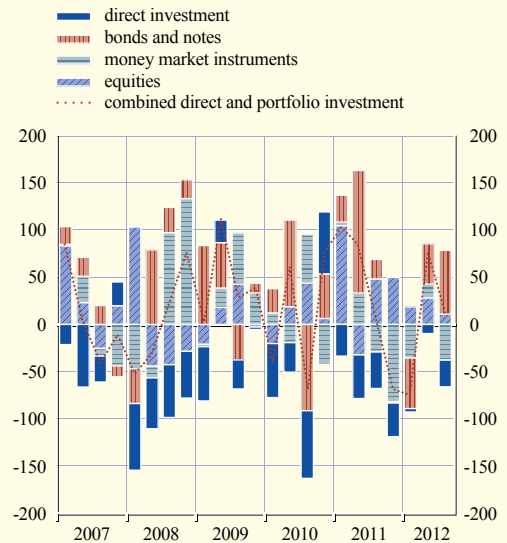
This box analyses recent developments in the financial account of the euro area balance of payments until the third quarter of 2012. In the 12-month period to September the combined balance on direct and portfolio investment in the euro area recorded net outflows of €55.8 billion, compared with net inflows of €265.9 billion a year earlier. These were to some extent offset by

net inflows of €19.0 billion in other investment (see the table below). Sizeable net outflows in other investment and concomitant net inflows in portfolio investment (on account of the repatriation of funds invested in foreign securities) were recorded in the second quarter of this year as financial market tensions in the euro area intensified. These tensions have recently eased somewhat following the ECB's announcement of the Outright Monetary Transactions (OMTs). As a result, euro area residents resumed their net purchases of cross-border securities in the third quarter, while non-residents increased their exposure to euro area securities.

The shift in the combined direct and portfolio investment balance to net outflows over the 12-month period to September 2012 was mainly due to lower net inflows in portfolio investment as foreign investors substantially reduced their purchases of equity securities issued by non-MFIs, disinvested from bonds and notes issued by euro area MFIs and liquidated money market instruments issued by the general government sector. Furthermore, there were outflows from MFIs' other investment liabilities, implying that they had difficulty in rolling over deposits and loans that were maturing. These developments exerted additional funding pressure on euro

## Main items in the financial account

(EUR billions; quarterly net flows)



Source: ECB.

## 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	
	Aug.	Sep.	2011 Dec.	2012			2011 Sep.	2012 Sep.
				Mar.	June	Sep.		
<b>Financial account<sup>1)</sup></b>	-9.7	-7.1	-42.2	3.6	-24.3	-24.1	-10.1	-87.1
Combined net direct and portfolio investment	-2.2	-3.6	-69.7	-74.5	76.0	12.4	265.9	-55.8
Net direct investment	-12.1	-8.9	-35.7	-3.5	-9.7	-28.2	-53.3	-77.1
Net portfolio investment	9.9	5.3	-34.0	-71.0	85.7	40.6	319.2	21.3
Equities	15.1	0.3	49.8	18.6	28.3	10.9	127.2	107.6
Debt instruments	-5.2	5.0	-83.7	-89.6	57.4	29.7	192.0	-86.3
Bonds and notes	28.1	36.1	-1.5	-53.8	42.9	67.8	226.7	55.4
Money market instruments	-33.3	-31.1	-82.3	-35.8	14.5	-38.1	-34.7	-141.7
Net other investment	-5.7	-1.8	45.1	86.9	-81.7	-31.3	-284.3	19.0
<b>Of which: money-holding sector<sup>2)</sup></b>								
Net direct investment	-11.0	-9.8	-38.2	-6.3	-13.2	-27.5	-34.0	-85.2
Net portfolio investment	7.0	20.3	-48.2	-43.7	41.0	34.0	70.0	-16.9
Equities	7.2	1.1	10.6	14.3	32.4	9.6	139.4	66.8
Debt instruments	-0.2	19.2	-58.8	-58.0	8.7	24.5	-69.4	-83.7
Net other investment	2.2	-3.9	23.8	6.0	-36.8	-1.0	1.9	-7.9

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.

area MFIs. The reduction in net inflows in portfolio investment and disinvestment from euro area MFIs' deposits and loans was largely offset by euro area resident banks repatriating foreign assets. This was reflected in a substantial shift from net purchases to net sales of short-term assets in other investment, which resulted in small net inflows in other investment, compared with net outflows in the previous period.

There were marked changes in the pattern of financial flows in the third quarter, compared with the second quarter. Specifically, while net inflows of portfolio investment in the second quarter were mainly driven by euro area investors reducing their exposure to foreign securities, euro area residents resumed their net purchases of cross-border securities in the third quarter. As a result, net inflows of portfolio investment edged down despite an increase in net purchases of euro area securities by foreign investors. This return to the pattern of portfolio investment flows that prevailed prior to the outbreak of the sovereign debt crisis has occurred at a time of improving financial market confidence. Net outflows of foreign direct investment increased from the second quarter of the year onwards, owing to non-residents acquiring less equity capital and other capital issued by euro area non-financial corporations. In the meantime, there was only a marginal reduction in net acquisitions of foreign equity by euro area investors.

It should be noted that there were remarkable differences between portfolio investment flows in the MFI and non-MFI sectors. As regards the MFI sector, net inflows of portfolio investment were recorded for the second quarter in a row, owing to the ongoing process of liquidating foreign securities, which had briefly been reversed in the first quarter of 2012. Euro area MFIs continued to reduce their exposure to foreign securities amid persistent net outflows of other investment from euro area financial institutions. However, they reduced their holdings of bonds and notes to a much lesser extent in the third quarter than in the second quarter and eventually stopped decreasing their holdings of other portfolio investment instruments. Thus there was still pressure on euro area banks to liquidate foreign assets in order to mobilise funds, but this pressure eased somewhat.

In the meantime, euro area non-MFIs resumed their net purchases of foreign equity securities and money market instruments, as well as increasing their purchases of foreign bonds and notes. Likewise, foreign investors' acquisition of securities (mainly bonds and notes) issued by euro area non-MFIs increased significantly. Net portfolio investment remained in positive territory in the third quarter, thus contributing positively to the liquidity available in the euro area. This was 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 in MFIs' net external asset position in the third quarter of 2012.