

Box 1

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

This box analyses developments in the financial account of the euro area balance of payments in 2012. Net inflows in the combined balance on direct and portfolio investment in the euro area decreased to €13.2 billion in 2012, from €119.2 billion a year earlier (see the table below). These inflows were more than offset by net outflows in other investment, which remained almost unchanged from 2011. After the short-lived resumption of net purchases of cross-border securities by both euro area and foreign investors in the first quarter of 2012, the second quarter saw net inflows in portfolio investment (on account of the liquidation of foreign securities) and concomitant net outflows in other investment, as financial market tensions in the euro area intensified again. In the second half of the year these tensions eased somewhat following the announcement of the Outright Monetary Transactions (OMTs) in September. As a result, euro area residents resumed their net purchases of cross-border securities, while non-residents increased their exposures to euro area securities.

The decrease in net inflows in the combined balance on direct and portfolio investment in the euro area in 2012 was supported by lower net inflows in portfolio investment, as euro area

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	
	Nov.	Dec.	2012				2011 Dec.	2012 Dec.
			Mar.	June	Sep.	Dec.		
Financial account¹⁾	-22.7	-47.0	3.6	-20.4	-55.0	-81.6	-45.3	-153.5
Combined net direct and portfolio investment	30.3	-20.7	-74.5	77.9	-34.9	44.8	119.2	13.2
Net direct investment	13.7	-8.6	-3.5	-16.3	-25.7	-5.5	-154.8	-50.9
Net portfolio investment	16.5	-12.1	-71.0	94.2	-9.3	50.2	274.0	64.1
Equities	13.0	-10.1	18.6	24.9	14.2	24.7	170.7	82.4
Debt instruments	3.6	-2.0	-89.6	69.2	-23.4	25.5	103.3	-18.3
Bonds and notes	26.5	-3.0	-53.8	35.7	12.6	33.4	177.7	28.0
Money market instruments	-22.9	0.9	-35.8	33.5	-36.1	-7.9	-74.5	-46.3
Net other investment	-62.4	-28.9	86.9	-80.3	-19.4	-140.0	-149.5	-152.8
Of which: money-holding sector²⁾								
Net direct investment	11.4	-5.9	-6.3	-19.9	-27.8	-3.8	-142.2	-57.8
Net portfolio investment	41.7	19.4	-43.7	51.6	-2.4	81.9	124.3	87.4
Equities	14.2	13.5	14.3	29.4	15.1	57.3	134.6	116.1
Debt instruments	27.5	5.9	-58.0	22.2	-17.5	24.6	-10.3	-28.7
Net other investment	-14.9	-11.3	6.0	-38.8	14.1	-41.0	51.9	-59.7

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.

investors again took up their purchases of foreign securities. The resumption of purchases of foreign securities concerned mainly euro area non-MFIs, which increased their exposures to both equity and debt securities, while euro area MFIs continued deleveraging in line with their balance sheet restructuring. Net outflows in other investment remained almost unchanged in comparison with 2011. While net outflows in other investment in 2011 had been driven mainly by euro area residents investing in foreign assets, those recorded in 2012 were determined by the disinvestment of non-residents from euro area MFIs' deposits and loans. The latter was reflected in a sharp decline in other investment liabilities of the euro area banking sector. However, these developments in portfolio and other investment masked considerable volatility in investment patterns throughout the year, following shifts in market sentiment.

In the first quarter of 2012 euro area investors (both MFIs and non-MFIs) resumed their purchases of foreign securities (especially debt instruments) after a period of heightened financial market tensions related to the intensification of the sovereign debt crisis. This resumption followed an announcement presenting policy measures aimed at addressing the crisis and calming financial markets. In the second quarter, however, the positive effects faded as uncertainty returned. Funding pressures emerged on account of the repatriation of funds foreign investors had in euro area MFIs, as reflected in the sharp decline in other investment liabilities. Consequently, euro area residents had to reduce their cross-border holdings of securities, but the announcement of OMTs in September managed to calm markets. Net flows in portfolio investment turned negative in the third quarter, as euro area investors increased their exposures to cross-border securities.

In the fourth quarter of 2012 financial market conditions improved further. Net inflows of €44.8 billion were recorded in the combined balance on direct and portfolio investment,

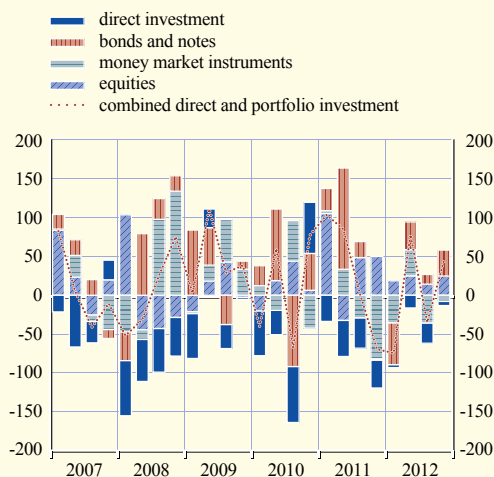
following net outflows of €34.9 billion in the third quarter, mainly on account of a substantial expansion of net purchases of euro area securities by foreign residents. The latter was driven by an increase in net acquisitions of euro area equity and debt securities, and was only partly offset by a rise in net purchases of cross-border equity securities by euro area investors. Net outflows in foreign direct investment declined, as compared with the third quarter, owing to euro area investors from the private non-MFI sector acquiring less equity capital and other capital issued by foreign companies. In the meantime, there was a reduction, albeit to a lesser extent, in net acquisitions of capital issued by euro area non-MFIs.

As in previous quarters of the same year, there were remarkable differences between portfolio investment flows in the MFI and non-MFI sectors in the fourth quarter. In the MFI sector, euro area banks continued to reduce their exposures to foreign debt securities on account of balance sheet restructuring, but resumed their purchases of foreign equity securities. Non-residents of the euro area, however, continued to repatriate funds previously invested in both equity and debt securities issued by euro area MFIs. It should be noted, however, that the process of repatriation by euro area investors slowed down somewhat in the fourth quarter, against the background of a normalisation of financial market conditions. At the same time, euro area MFIs substantially reduced their exposures to cross-border deposits and loans amid a persistent reduction of their other investment liabilities. These two-way repatriation flows reached particularly high levels in December 2012.

With regard to the non-MFI sector, euro area investors increased their net acquisition of foreign equity securities and money market instruments in the fourth quarter, while their purchases of foreign bonds and notes edged down slightly. In the meantime, an increase in foreign investors' acquisition of the aforementioned instruments issued by euro area private non-MFI and general government sectors was even more pronounced, with amounts invested in euro area securities not seen since mid-2011. Together with the outflow of short-term deposits from euro area MFIs, these developments may imply an improvement in investors' confidence in the future prospects of the euro area, given that non-residents withdrew their funds from euro area MFIs and invested them in equity securities issued by euro area private non-MFI companies and in government bonds. All in all, net portfolio investment was positive in the fourth quarter, thus contributing 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, transactions involving the money-holding sector were an important determinant of the increase in MFIs' net external asset position in the fourth quarter of 2012.

Main items in the financial account

(EUR billions; quarterly net flows)



Source: ECB.