

Box 3

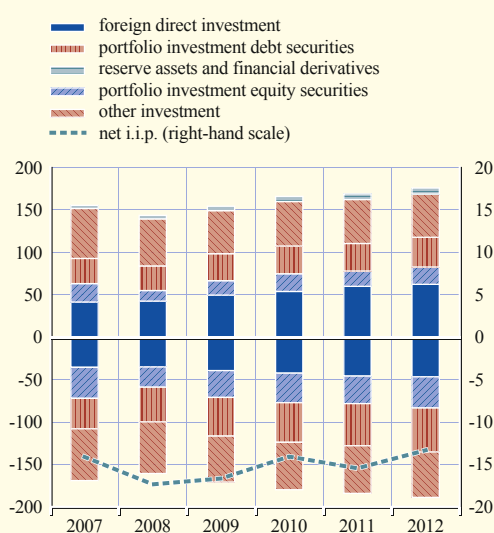
**DEVELOPMENTS IN THE INTERNATIONAL INVESTMENT POSITION OF THE EURO AREA SINCE THE OUTBREAK OF THE FINANCIAL CRISIS**

The international investment position (i.i.p.) shows total holdings of foreign assets by domestic residents (“assets” in the i.i.p.) and total holdings of domestic assets by foreign residents (“liabilities” in the i.i.p.) at the end of the period in question. The net position (assets minus liabilities) measures the net creditor or debtor position of a country, or group of countries (e.g. the euro area), vis-à-vis the rest of the world. This box reviews developments in the euro area i.i.p. between 2007 and 2012 in order to shed light on how it has evolved since the beginning of the financial crisis.<sup>1</sup>

Between 2007 and 2012, assets and liabilities in the euro area i.i.p. both increased by around 20% of GDP (see Chart A). The breakdown presented in Chart A reveals that at the end of 2012 assets and liabilities across most instruments of the i.i.p. exceeded the levels recorded in 2007, with the exception of a slight decline in the asset position of portfolio investment equity securities and falling asset and liability positions for “other investment”, which mainly consists of deposits and loans. The fall in the latter primarily reflected the deleveraging process taking place in the MFI sector from the onset of the financial crisis. Increases in outstanding amounts were most pronounced for foreign direct investment on the asset side (by 21% of GDP), and for portfolio investment debt securities on the liability side (by 16% of GDP), with the latter driven by a rise in the outstanding amount of holdings of government debt securities from 2009.

**Chart A Euro area i.i.p. and its breakdown by instrument**

(end-of-year positions as a percentage of GDP)



Source: ECB.  
Note: Negative figures reflect euro area liabilities while positive figures reflect assets.

<sup>1</sup> The full set of data on the euro area i.i.p., including the geographical breakdown, is only available up to the end of 2012. For an analysis of recent developments in net international investment positions in a number of euro area countries, see the box entitled “Net foreign liabilities in selected euro area countries”, *Monthly Bulletin*, ECB, April 2013.

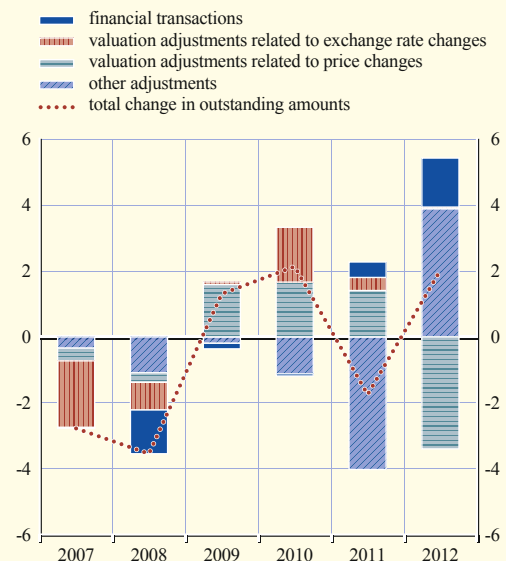
The net international investment position of the euro area remained negative and relatively stable from 2007 to 2012. Following a decline from -14% of GDP in 2007 to a low of -17% of GDP in 2008, it improved to -13% of GDP at the end of 2012. The improvement seen from 2008 onwards was mainly driven by an increase in the euro area's net asset position in terms of direct investment, from 7% of GDP in 2008 to 15% of GDP in 2012. In addition, reserve assets increased slightly to 7% of GDP and the net liability position in other investment contracted somewhat to 3% of GDP over the same period. These developments were partly counterbalanced by a growing net liability position for portfolio investment (equity and debt securities), which reached 33% of GDP in 2012, up from 23% of GDP in 2008.<sup>2</sup>

Changes in the net i.i.p. can be explained by three factors: (i) net financial transactions, (ii) valuation effects due to changes in exchange rates and asset prices, and (iii) "other" adjustments.<sup>3</sup> Before cross-border investment positions started to increase rapidly during the 1990s, net financial transactions (as the mirror image of current account balances) were the main determinants of changes in the net i.i.p. However, valuation effects and other adjustments gained in importance thereafter. Net financial transactions by euro area residents with the rest of the world closely followed developments in the euro area's current account balance from 2007 onwards (Chart B). In 2008, when the euro area recorded a current account deficit, net financial transactions exerted a negative effect on the net i.i.p. By contrast, in 2011 and 2012, the euro area's growing current account surpluses and the associated net capital outflows had a positive impact on the net i.i.p.

The euro area tends to record exchange rate-induced valuation gains when the exchange rate of the euro depreciates, as foreign assets are mainly denominated in foreign currency, whereas the largest share of the euro area's foreign liabilities is denominated in euro. The appreciation of the euro in nominal effective terms observed in 2007 and 2008 was associated with exchange rate-induced losses on euro area assets (Chart B), whereas, in years when the euro broadly depreciated, exchange rate-related gains arose – for instance in 2010. Valuation effects also arise from asset price movements. They depend on the performance of euro area investments abroad relative to the performance of domestic assets held by foreign investors. In 2007 and 2008, price-induced valuation effects were relatively small, as prices of the euro area's foreign assets and liabilities evolved in a similar manner. From 2009 to 2011, however, the euro area recorded positive

**Chart B Breakdown of changes in the net i.i.p. of the euro area**

(end-of-year positions as a percentage of GDP)



Source: ECB.

<sup>2</sup> As the components of the i.i.p. are expressed as a percentage of GDP, a "growth" effect is present. However, these changes in GDP are common to all components.

<sup>3</sup> "Other" adjustments include reclassifications, company write-downs, and changes in data sources or compilation practices (e.g. survey coverage).

valuation gains from asset price developments as the foreign investments of euro area residents outperformed the investments of foreign residents in the euro area. Conversely, the euro area recorded substantial valuation losses in 2012 (3.4% of GDP), as the general improvement in euro area financial markets increased the value of foreign residents' investments in the euro area to a larger extent than the valuation gains euro area investors recorded on their foreign portfolios. Notably, in 2012 these price-induced valuation losses more than offset the positive contribution of net financial transactions, which mirrored the current account surplus. The largest contribution to changes in the euro area's net i.i.p. in 2011 and 2012 came, however, from "other" adjustments, which amounted to -4.0% of GDP in 2011 and 3.9% of GDP in 2012. These were mostly related to the introduction of new data sources and compilation practices, which are being developed by national compilers ahead of the changeover to the new international statistical standards in late 2014.<sup>4</sup>

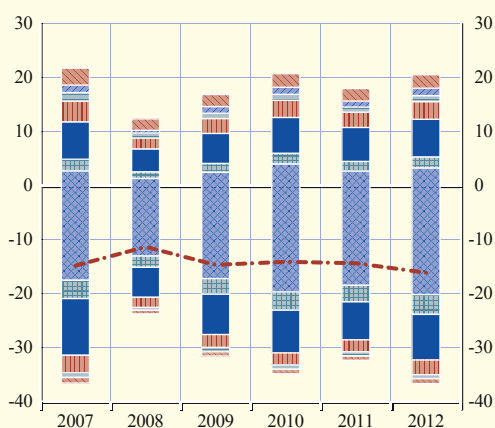
The geographical breakdown of assets in portfolio investment equity securities showed a rather stable development from the beginning of the financial crisis onwards (Chart C).<sup>5</sup> The geographical distribution of equity liabilities changed considerably, however, with the surge

Chart C Country breakdown of euro area portfolio investment positions

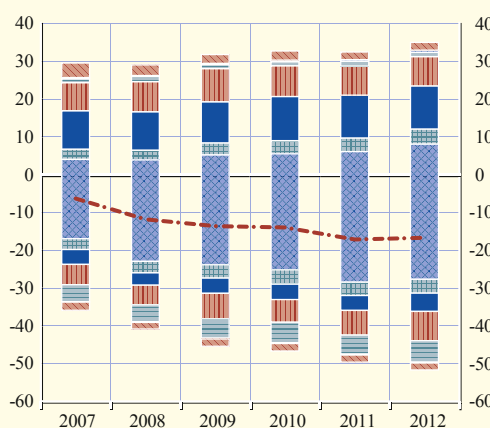
(end-of-year positions as a percentage of GDP)



Portfolio investment equity securities positions



Portfolio investment debt securities positions



Sources: ECB and IMF Coordinated Portfolio Investment Survey (CPIS).

Notes: Negative figures reflect euro area liabilities, while positive figures reflect assets. As China does not report its portfolio investment assets in the IMF survey, it is included in "other", which is calculated as a residual.

4 For more detail on the changeover to the new international statistical standards, consult the relevant ECB webpage: <http://www.ecb.europa.eu/stats/external/bpm6/html/index.en.html>

5 The country-specific data on liabilities of equity and debt investment are retrieved from the IMF Coordinated Portfolio Investment Survey (CPIS), while data on the total extra-euro area assets and liabilities and the country-specific data on assets are constructed by the ECB. The countries/country blocks that are included in the calculations are: the euro area 17, offshore financial centres, Denmark, Sweden, the United Kingdom, other EU countries, Switzerland, Canada, the United States, Japan, Brazil, India and Russia. More information on the geographical detail of the euro area international investment position is presented in Table 9 of Section 7.3 of the "Euro area statistics" section of the Monthly Bulletin and in the ECB's Statistical Data Warehouse.

of investments from the residual (“other”) group of countries.<sup>6</sup> After a drop in 2008, the euro area’s net liability position in portfolio investment equity securities increased by 5 percentage points, to reach around 16% of GDP in 2012.

As regards debt instruments, portfolio investment assets of euro area residents continued to be invested mostly in North America (predominantly the United States) from 2007, while the period from 2008 to 2012 also witnessed rising investments in the residual “other” region, promoting it to the second most important destination for euro area portfolio debt investment at the end of the period.<sup>7</sup> Developments on the liability side of euro area portfolio debt were also dominated by “other” countries, with the United Kingdom and North America playing a rather limited role. In fact, from 2008 investments by residents of “other” countries accounted for more than half of total debt security liabilities in the euro area.

<sup>6</sup> The country group “other” includes China and all the main oil-producing countries – except for Russia – and is calculated as a residual from the total extra-euro area data.

<sup>7</sup> The impact of offshore financial centres, already of minor importance, decreased further in the period under review.