

# EURO AREA BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION VIS-À-VIS MAIN COUNTERPARTS

## ARTICLES

Euro area  
balance of payments  
and international  
investment position  
vis-à-vis  
main counterparts

*In January 2005 the ECB published, for the first time, a geographical breakdown of the euro area's balance of payments (b.o.p.) and international investment position (i.i.p.). The b.o.p. and the i.i.p. are disaggregated by individual countries (namely Denmark, Sweden, the United Kingdom, Canada, Japan, Switzerland and the United States) and counterpart groupings (namely "other EU Member States", offshore financial centres, EU institutions and international organisations). Statistical data on quarterly b.o.p. transactions are available from the first quarter of 2003 to the third quarter of 2004, while data on the annual i.i.p. are available for end-year 2002 and 2003. The geographical breakdown of the euro area b.o.p. and i.i.p. reveals the importance of trade and financial flows with the United Kingdom, Switzerland and the United States.*

## I INTRODUCTION

The ECB has compiled monthly and quarterly balance of payments (b.o.p.) and annual international investment position (i.i.p.) statistics for the euro area since 1999, with data going back to 1997.<sup>1</sup> The b.o.p. and the i.i.p. give an account of the cross-border transactions and positions of the euro area as a single economic entity and exclude transactions and positions between countries participating in the euro area. The data are collected by the national authorities of the euro area countries.<sup>2</sup>

The data presented in this article and published for the first time in January 2005 provide a geographical breakdown in terms of the main non-resident counterparts to the euro area's external transactions (b.o.p.) and positions (i.i.p.). They cover b.o.p. quarterly data from the first quarter of 2003 to the third quarter of 2004 and the i.i.p. at end-year 2002 and 2003. The geographical breakdown of the euro area's b.o.p. and i.i.p. aims to offer a greater understanding of the links between the euro area and other economies.

This article describes the approach taken with the new data, setting out briefly the methodology used to compile them and describing the latest developments in the current and financial accounts as well as the i.i.p.

## 2 APPROACH AND METHODOLOGICAL ISSUES

The geographical breakdown relates to the main items of the b.o.p. and i.i.p. and provides more

detailed information on investment income and the financial account than on the rest of the current and capital accounts. No geographical breakdown of financial derivatives, reserve assets or transactions in portfolio investment liabilities is given (Box 1 describes alternative sources of positions on portfolio investment liabilities and related income).

The breakdown of the quarterly b.o.p. and annual i.i.p. identifies a number of different counterparts and counterpart groupings: three main partner countries within the European Union but outside the euro area (Denmark, Sweden and the United Kingdom); the other ten EU Member States together; Canada, Japan, Switzerland and the United States individually; offshore financial centres<sup>3</sup>; and all other countries. The breakdown also identifies as counterparts international organisations outside the European Union, as well as EU institutions and other bodies (for example the European Commission and the European Investment Bank) that are, with the exception of the ECB itself, treated statistically as non-residents of the euro area irrespective of their physical location.

Tables 1 and 2 show the geographical breakdown of the current, capital and financial

1 Estimates of the euro area current account since 1980 are available on the ECB's website (<http://www.ecb.int>).

2 See the ECB Guideline of 16 July 2004 on statistical reporting requirements in the field of balance of payments and international investment position statistics, and the international reserves template (ECB/2004/15), OJ L 354, 30. 11. 2004, p. 34). Article 2.4 and Annex II refer to the geographical breakdown.

3 The list of offshore centres is maintained by the European Commission (Eurostat) and the OECD.

accounts of the euro area b.o.p. for the year to the third quarter of 2004. Table 3 shows the corresponding breakdown for the i.i.p. at end-2003.<sup>4</sup>

The concepts and definitions used in the euro area b.o.p. and i.i.p. are in line with the IMF's Balance of Payments Manual, 5th edition (1993). The collection and compilation of the b.o.p. and i.i.p. statistics are described in the recent ECB publication entitled "European Union balance of payments/international investment position statistical methods" (November 2004).

Goods exports are broken down geographically by country of destination, while imports are allocated to country of origin. The data for extra-EU transactions are taken from customs documentation, whereas the Intrastat reporting system is used for transactions with EU Member States that are not part of the euro area. Trade in services is broken down according to service provider or service acquirer. For

<sup>4</sup> The ECB's website provides additional tables showing a geographical breakdown of the quarterly b.o.p. from the first quarter of 2003 to the third quarter of 2004 and of the i.i.p. at end-year 2002 and 2003, including data for Canada as well as appropriate methodological notes.

**Table 1 Geographical breakdown of the euro area current and capital accounts**

(EUR billions; cumulated transactions, Q4 2003-Q3 2004)

	Current account					Capital account
	Total	Goods	Services	Income	Current transfers	
<b>Credits</b>						
<b>Total</b>	1,767.5	1,104.1	344.4	236.7	82.4	25.3
Denmark	35.3	24.3	6.9	3.8	0.4	0.0
Sweden	57.3	39.7	9.8	7.3	0.5	0.0
United Kingdom	354.5	197.2	89.7	58.2	9.4	0.6
Other EU Member States	148.9	122.2	15.7	9.8	1.2	0.1
EU institutions	58.5	0.2	4.3	4.8	49.2	22.1
Japan	46.9	32.5	9.9	4.1	0.3	0.0
Switzerland	121.0	62.1	34.4	18.9	5.6	0.4
United States	298.9	167.3	69.7	54.8	7.1	1.2
Other countries	646.3	458.7	104.0	74.9	8.8	1.0
<b>Debits</b>						
<b>Total</b>	1,722.3	989.6	321.6	275.0	136.1	6.2
Denmark	33.3	23.5	6.1	3.4	0.3	0.0
Sweden	54.4	37.3	7.7	8.7	0.7	0.0
United Kingdom	287.9	137.9	66.9	75.2	7.9	0.3
Other EU Member States	126.8	102.7	18.5	4.0	1.5	0.2
EU institutions	81.7	0.0	0.2	3.6	78.0	0.4
Japan	81.2	50.3	7.0	23.6	0.3	0.0
Switzerland	115.6	50.2	28.3	32.2	5.0	0.2
United States	255.0	107.2	74.0	64.2	9.6	0.4
Other countries	686.2	480.4	113.0	60.1	32.7	4.6
<b>Net</b>						
<b>Total</b>	45.3	114.6	22.8	-38.3	-53.8	19.2
Denmark	2.0	0.8	0.8	0.4	0.0	0.0
Sweden	2.9	2.4	2.0	-1.3	-0.2	0.0
United Kingdom	66.5	59.3	22.8	-17.0	1.4	0.3
Other EU Member States	22.2	19.5	-2.8	5.8	-0.3	-0.1
EU institutions	-23.2	0.2	4.1	1.2	-28.8	21.7
Japan	-34.4	-17.8	2.9	-19.5	-0.1	0.0
Switzerland	5.4	11.8	6.1	-13.3	0.6	0.2
United States	43.9	60.1	-4.2	-9.4	-2.5	0.8
Other countries	-39.9	-21.8	-9.0	14.8	-23.9	-3.6

Source: ECB.

current and capital transfers, allocation is to the donor's country or the recipient's country, as appropriate.

The breakdown of financial transactions and positions and related investment income follow the debtor/creditor principle, i.e. the euro area's financial claims are allocated to the debtor's country of residence, while the euro area's liabilities are allocated to the non-resident investor's country of residence. In the case of direct investment, the geographical breakdown refers to the residence of the foreign affiliate (outward investment) or of the non-resident investor company (inward investment).

Multinational companies may route their financial transactions through affiliates or intermediaries located in financial centres, although the main activities of the group may be conducted elsewhere. For example, many corporations channel direct and portfolio investments through special-purpose enterprises or vehicles, often to increase efficiency in administrative or accounting activities, or for tax reasons; intra-group cash management may be centralised in a special-purpose company.

Offshore centres are therefore treated statistically as financial counterparts of the euro area.

The practice of lodging securities with a custodian in a third country (where neither the holder nor the issuer is resident) complicates the task of identifying non-euro area holders of securities issued by euro area residents. Indeed, the geographical breakdown of portfolio investment liabilities cannot be assessed from the new data published in January 2005. An alternative approach to portfolio investment liabilities is described in Box 1.

In addition to the IMF's portfolio investment and related surveys, the United Kingdom, Japan and the United States publish geographical breakdowns of their own external transactions and/or positions. Some of the euro area's other partner countries publish a breakdown of certain items, as do the European Commission (Eurostat) and the Bank for International Settlements. Despite important limitations<sup>5</sup> – notably differences in coverage,

<sup>5</sup> Some of the counterpart countries allocate b.o.p. transactions according to buyer of the securities or intermediary. This approach leads to the overestimation of purchases by international financial centres where custodians are located.

**Table 2 Geographical breakdown of the euro area financial account**

(EUR billions; cumulated transactions, Q4 2003-Q3 2004)

	Direct investment		Portfolio investment assets				Other investment	
	Abroad	In the euro area	Total	Equity securities	Bonds and notes	Money market instruments	Assets	Liabilities
<b>Total</b>	-100.2	60.2	-270.3	-77.9	-139.2	-53.2	-304.7	267.6
Denmark	-0.7	1.6	-0.4	2.1	-0.3	-2.1	-7.8	7.5
Sweden	-5.8	3.9	-9.8	-1.4	-5.6	-2.8	-17.4	1.8
United Kingdom	-38.8	9.8	-73.8	-7.8	-48.1	-17.8	-202.2	133.0
Other EU Member States	-3.1	1.6	-12.9	-1.1	-9.3	-2.4	-12.3	11.7
EU institutions	0.0	0.1	-5.5	-0.1	-5.7	0.3	0.3	8.9
Japan	-9.1	2.7	-36.1	-17.7	-7.6	-10.8	-1.1	9.6
Switzerland	4.0	10.8	-0.3	0.6	-0.8	-0.1	-2.3	4.9
United States	-0.5	10.9	-60.3	-16.6	-38.4	-5.3	-18.4	54.7
Offshore financial centres	-19.6	13.9	-20.2	-13.0	2.5	-9.6	-36.5	-7.3
International organisations	0.0	0.0	4.1	0.0	3.1	1.0	-4.0	6.2
Other countries	-26.8	5.0	-55.2	-22.7	-29.0	-3.4	-3.0	36.5

Source: ECB.

Note: A positive (negative) number indicates a decrease (increase) in euro area assets or an increase (decrease) in euro area liabilities.

## METHODOLOGICAL ASPECTS OF PORTFOLIO INVESTMENT

The ECB applies the internationally recommended “debtor/creditor” approach to the euro area’s b.o.p. and i.i.p. statistics. Thus assets (holdings of securities) are allocated geographically according to issuer or borrower (the actual debtor) and not according to seller of the securities (whether the previous holder or an intermediary). The application of this approach is not difficult, since the holder of securities can usually identify the debtor.

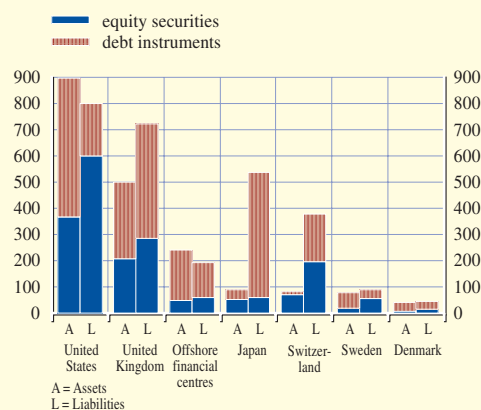
In the case of liabilities, geographical breakdown is more difficult because reporting agents in the euro area often cannot identify the current holder of securities that they have issued (the actual creditor). The source for estimating the breakdown of liabilities is the Coordinated Portfolio Investment Survey (CPIS), which was first conducted by the International Monetary Fund (IMF) at end-year 1997 and which, since end-year 2001, is conducted annually. 68 countries supplied a geographical breakdown of their residents’ portfolio claims abroad at end-year 2002, using information provided by the resident asset holders or by resident custodians. All euro area countries (as well as ten other EU Member States) contribute to the survey. Their liabilities are reported as claims by counterpart countries. The survey distinguishes between debt securities (long and short-term) and equities held as portfolio investment. Further details are available from the IMF’s website ([www.imf.org/external/np/sta/pi/cpis.htm](http://www.imf.org/external/np/sta/pi/cpis.htm)).

The CPIS provides a reliable geographical breakdown of most securities held as portfolio investment. It does not, however, cover (mostly debt) securities held by monetary authorities and international organisations. The IMF therefore conducts two complementary annual surveys – entitled “Securities held as Foreign Exchange Reserves” (SEFER) and “Survey of Securities held by International Organizations” (SSIO) – to establish the geographical breakdown of securities held as reserve assets. The SEFER and SSIO cover around one-fifth of euro area debt securities held outside the euro area. Based partly on estimates (because the SEFER and SSIO are not broken down by holding countries/organisations), the three sources provide a geographical breakdown of euro area portfolio investment liabilities, euro area equity and euro area debt securities.

The IMF surveys are only annual and the results become available well after the reference period; end-2003 data will become available in the course of 2005. The results of the latest available surveys relate to end-2002 and were used for allocating i.i.p. liabilities as at end-2002 and the related income in the b.o.p. since then. They show that the United States held the largest portfolio claims on the euro area, followed by the United Kingdom, Japan and Switzerland. While the United States held mainly equity, the United Kingdom and (especially) Japan held mainly debt securities.

### Geographical breakdown of euro area portfolio investment

(EUR billions; outstanding amounts at end-2002)



Source: Assets – ECB; Liabilities – IMF Coordinated Portfolio Investment Survey 2002 (as of August 2004); ECB calculations.

**Table 3 Geographical breakdown of the euro area international investment position**

(EUR billions; outstanding amounts at end-2003)

	Direct investment		Portfolio investment assets				Other investment	
	Abroad	In the euro area	Total	Equity securities	Bonds and notes	Money market instruments	Assets	Liabilities
<b>Total</b>	2,110.4	2,030.7	2,607.4	1,054.6	1,317.0	235.8	2,587.3	2,902.1
Denmark	25.9	24.2	48.3	8.3	37.5	2.5	49.9	16.3
Sweden	63.5	74.6	91.7	26.0	53.6	12.0	49.1	31.0
United Kingdom	485.0	831.2	568.3	223.5	262.3	82.4	1,064.8	1,041.4
Other EU Member States	108.8	3.2	45.0	9.6	34.9	0.6	72.5	60.3
EU institutions	0.0	0.1	46.1	0.0	45.5	0.6	4.5	168.2
Japan	53.6	48.7	117.5	80.7	35.2	1.6	86.4	72.3
Switzerland	231.6	160.4	84.7	75.7	7.9	1.2	170.6	223.1
United States	492.8	496.2	960.3	441.6	423.6	95.0	368.4	440.1
Offshore financial centres	218.5	258.7	284.5	74.9	197.0	12.5	229.7	469.3
International organisations	0.0	0.1	27.8	0.5	26.2	1.1	38.9	45.6
Other countries	430.5	133.3	333.2	113.8	193.3	26.2	452.6	334.4

Source: ECB.

periodicity and timeliness – these sources provide complementary “mirror” data, referred to on the ECB’s website.

### 3 GEOGRAPHICAL BREAKDOWN OF THE EURO AREA BALANCE OF PAYMENTS

#### CURRENT ACCOUNT

Based on cumulated flows between the fourth quarter of 2003 and the third quarter of 2004, the geographical breakdown of the euro area b.o.p. shows that the euro area recorded a current account surplus vis-à-vis all partner countries/counterpart groupings considered, with the exceptions of Japan, EU institutions and the “other countries” category (see Table 1). The overall surplus in the current account over this period reflects surpluses in trade in goods and services that were partly offset by deficits in income and current transfers.

The pattern of the euro area’s surplus in trade in goods resembles that of the current account, with the United States, the United Kingdom and “other EU Member States” – in that order – as the main counterparts. By contrast, the euro area had a deficit in its trade in services with the United States and “other EU Member States”, while it showed a small surplus vis-à-

vis Japan. Much of the euro area trade surplus in services was vis-à-vis the United Kingdom. Finally, the euro area deficit in the income account reflects deficits primarily vis-à-vis the United Kingdom and Japan and, to a lesser extent, Switzerland and the United States.

Given the importance of trade in euro area current account developments, it is worthwhile to look into the credit and debit sides of the euro area trade balance to gain a better understanding of the relative importance of countries and regions in euro area trade flows. To this end, the geographical breakdown of the euro area b.o.p. indicates that the United Kingdom is the largest importer of euro area goods, with a share of 18% of total euro area exports, followed by the United States (15%), Switzerland (6%), Sweden (4%), Japan (3%) and Denmark (2%) (see Chart 1). Over the same period, the share of the goods exported to “other EU Member States” amounts to 11%, while “other countries” accounts for the remainder.

No quarterly geographical breakdown of euro area exports of services had been published prior to January 2005. It appears that the three largest importers of euro area services are the same as those in the case of goods. The United Kingdom imports 26% of euro area exports of

services, followed by the United States (20%), Switzerland (10%), Japan (3%), Sweden (3%) and Denmark (2%). The share of services exported to “other EU Member States” amounts to 5% (see Chart 2).

A comparison of the geographical structure of exports of goods with that of exports of services shows that euro area exports of services are more concentrated than those of goods, as the corresponding share of the three largest partners is much larger (56% compared with 39%). The share of “other EU Member States” in euro area exports of goods (11%) is much larger than the corresponding share in euro area exports of services (5%).

Turning to the debit side of the euro area goods balance, the United Kingdom accounts for 14% of total goods imports, with the United States close behind with 11%. Switzerland and Japan each account for 5% of the total, while the shares of Sweden and Denmark are 4% and 2% respectively. As a grouping, “other EU Member States” has a weight similar to that in goods exports (about 10%). However, the “other countries” category accounts for a larger share of goods imported by the euro area than exported. This difference is partly related to the

importance of oil products in total goods imports.

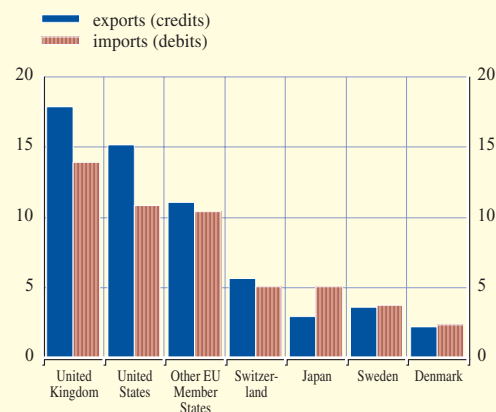
In the case of services imports, however, the United States emerges as the main supplier to the euro area with 23%, followed by the United Kingdom and Switzerland with shares of 21% and 9% respectively. As on the export side, services imports are geographically more concentrated than goods imports. The three largest partners, i.e. the United Kingdom, Switzerland and the United States, together account for 54% of the euro area’s total services imports compared with 25% of its total goods imports. Finally, the share of “other EU Member States” in the services imported by the euro area is lower than the corresponding share in the imports of goods (6% as opposed to 10%).

## FINANCIAL ACCOUNT

Based on cumulated flows between the fourth quarter of 2003 and the third quarter of 2004, the euro area recorded net outflows in foreign direct investment (FDI) vis-à-vis almost all partner countries/counterpart groupings considered, with the notable exceptions of Switzerland and the United States (see Table 2). Overall euro area cross-border

**Chart 1 Geographical breakdown of euro area trade in goods**

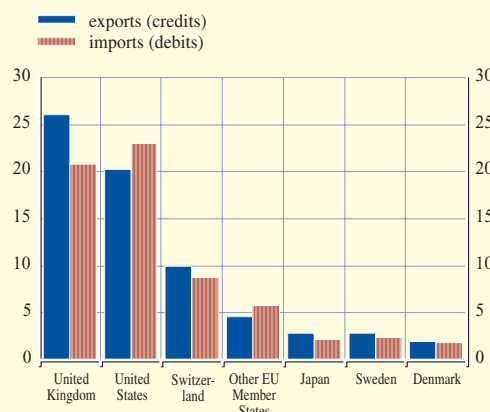
(as a percentage of total cumulated transactions in Q4 2003 - Q3 2004)



Source: ECB.

**Chart 2 Geographical breakdown of euro area trade in services**

(as a percentage of total cumulated transactions in Q4 2003 - Q3 2004)



Source: ECB.

activity in this period was of a relatively small magnitude,<sup>6</sup> which is consistent with the slowdown of cross-border flows across all regions of the world in 2003. This may relate to a higher risk aversion and a consolidation of investment positions by international investors in the aftermath of the burst of the investment technology bubble in 2001 and 2002, as well as increased geo-political risks in the first half of 2003. In terms of assets and liabilities, the United Kingdom and offshore financial centres were the main recipients or channels of euro area FDI abroad, while offshore centres, Switzerland and the United States were the main investors in the euro area.

As stated above, the geographical breakdown of portfolio investment is available only on the asset side. It shows that euro area portfolio investment abroad was directed primarily towards the United Kingdom and the United States, particularly in the form of investment in bonds and notes. Euro area investors were also large net purchasers of Japanese equity securities, especially given the relatively low level of their stocks of these securities, as reflected in the i.i.p. (see Table 3). The strengthening of the Japanese economy and market expectations of improved corporate profitability in Japan may have contributed to the developments during this period.

With regard to other investment, the geographical breakdown indicates large net inflows from the United States and large net outflows to the United Kingdom and offshore financial centres in the reference period.

#### 4 GEOGRAPHICAL BREAKDOWN OF THE EURO AREA INTERNATIONAL INVESTMENT POSITION

##### FOREIGN DIRECT INVESTMENT

At end-2003 the outstanding amount of euro area holdings of FDI was €2.1 trillion, 56% of which was invested in the United Kingdom, Switzerland and the United States (see Table 3). The United Kingdom and the United States

each attracted almost one-quarter of all euro area FDI. They were followed by Switzerland and “other EU Member States” (see Chart 3). The sizeable direct investment in the United Kingdom and the United States is linked to the technology boom and the rise in equity prices over the 1990s, which encouraged very large cross-border merger and acquisition activities vis-à-vis these two countries.<sup>7</sup> Euro area FDI in “other EU Member States” was fuelled in the 1990s by privatisation, economic liberalisation, deregulation and the prospect of EU membership. The low wage costs and the intention of firms to establish a strategic position within these new markets were additional important pull factors behind euro area FDI in these countries.

On the liability side, the outstanding amount of FDI holdings in the euro area was €2.0 trillion at end-2003, 73% of which originated from the United Kingdom, Switzerland and the United States. The United Kingdom was the source of 41% of all FDI in the euro area. It was followed in size by the United States, Switzerland and Sweden (see Chart 3). Geographical proximity, established trade links, further development of the single market and perhaps the establishment of EMU are often seen as the main potential factors behind the significant UK direct investment in the euro area.

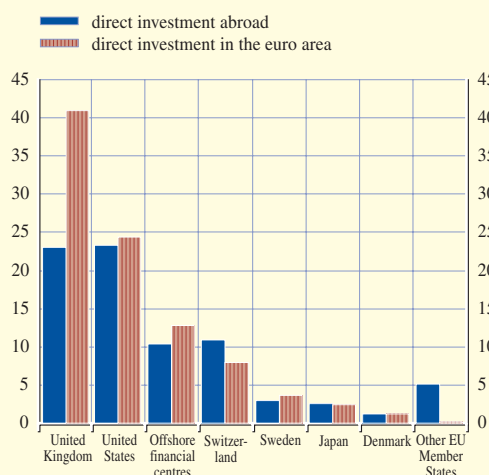
Offshore financial centres attracted €219 billion from and invested €259 billion in the euro area. The importance of the offshore centres probably relates to the large number of special-purpose entities that are financial holding companies or

<sup>6</sup> Between the fourth quarter of 2003 and the third quarter of 2004, euro area FDI outflows amounted to €100.2 billion, while FDI inflows amounted to €60.2 billion. This represents a decrease in cross-border FDI activity compared with the previous four quarters, when the flows amounted to €156.5 billion and €172.2 billion respectively.

<sup>7</sup> See “Understanding the impact of the external dimension on the euro area: trade, capital flows and other international macroeconomic linkages” by R. Anderton, F. di Mauro and F. Moneta, April 2004, *ECB Occasional Paper Series* No 12; and “On the determinants of euro area FDI to the United States: the knowledge-capital-Tobin’s Q framework” by R. A. De Santis, R. Anderton and A. Hijzen, April 2004, *ECB Working Paper Series* No 329.

**Chart 3 Geographical breakdown of euro area direct investment**

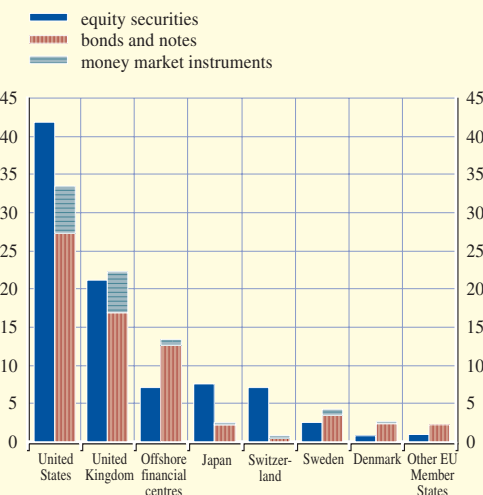
(as a percentage of total outstanding amounts at end-2003)



Source: ECB.

**Chart 4 Geographical breakdown of euro area portfolio investment assets**

(as a percentage of total outstanding amounts at end-2003)



Source: ECB.

serve to issue debt instruments and channel the funding to various affiliates.

### PORTFOLIO INVESTMENT

The outstanding amount of euro area holdings of portfolio investment was €2.6 trillion at end-2003, 63% of which was invested in the United Kingdom, Japan and the United States (see Table 3). The United States and the United Kingdom attracted respectively more than one-third and one-fifth of all euro area portfolio investment.

The disaggregation of portfolio investment by type of securities shows that the United Kingdom and the United States were the main recipients of euro area investment abroad in both equity securities and bonds and notes and money market instruments (see Chart 4). Slightly over 5% of euro area equity securities were held vis-à-vis Japan, Switzerland and offshore financial centres; 13.5% of euro area debt instruments were held vis-à-vis offshore financial centres.

The sizeable portfolio investment in the United Kingdom and the United States reflects

the economic importance of these two countries. Conversely, the relatively large portfolio investment vis-à-vis offshore financial centres probably relates to the low tax rates to be paid on the issuance of portfolio securities. A further point of interest is that euro area holdings of Swiss equities amount to €76 billion, whereas those of debt instruments amount only to €9 billion. This finding reflects the relatively important role played by the Swiss equity market for Swiss corporations.

### OTHER INVESTMENT

At end-2003 the outstanding amount of euro area holdings in the “other investment” category (mainly positions vis-à-vis banks abroad) was €2.6 trillion, 41% of which was vis-à-vis the United Kingdom and 14% vis-à-vis the United States (see Table 3). On the liability side, the outstanding amount of other investment claims on the euro area (mainly the claims of banks abroad) was €2.9 trillion at end-2003, 36% and 15% of which originated from the United Kingdom and the United States respectively.