Box 2

NET FOREIGN LIABILITIES IN SELECTED EURO AREA COUNTRIES

On the eve of the financial crisis in 2007, Estonia, Greece, Spain, Portugal and Slovakia recorded sizeable net foreign liabilities, together with large current account deficits (see the table below).[1] Despite significant improvements in their current account balances, the net international investment position (i.i.p.) of these countries deteriorated further during the crisis, except in the case of Estonia. Sizeable net foreign liabilities also built up in Ireland, Cyprus and Slovenia. This box briefly reviews developments in the net i.i.p. of these countries between 2007 and 2012.

A closer look at the composition of the net external positions

In Greece, Spain and Portugal, a significant proportion of net foreign liabilities in 2012 was accounted for by "other investment", which included private sector loans, EU-IMF programme loans and the foreign liabilities of monetary authorities (see Chart A). Spain also recorded sizeable net liabilities in portfolio debt instruments, partly as a result of the covered bonds issued by Spanish banks during the housing boom. In the "catching-up economies", i.e. Estonia, Slovenia and Slovakia, direct investment played a more important role. Ireland was a special case in that its net liabilities were entirely in equity securities and its net assets mainly in portfolio debt instruments, partly on account of the activities of mutual funds.

Drivers of recent developments in the net external positions

Among the euro area countries with high net foreign liabilities, only Estonia saw an improvement in its net i.i.p. between 2007 and 2012. This improvement was partly due to positive "transaction effects" on the back of a rapid current account correction (see Chart B). The other countries witnessed a deterioration in their net i.i.p., as they continued to record current account deficits after the start of the financial crisis, at least for some time. In addition, some of these countries saw a decline in nominal GDP, which mechanically worsened their net i.i.p.-to-GDP ratio.

1 In the context of the Macroeconomic Imbalance Procedure, net foreign liabilities in excess of 35% of GDP are seen as a sign of a potential external imbalance.

Current account balance and net international investment position

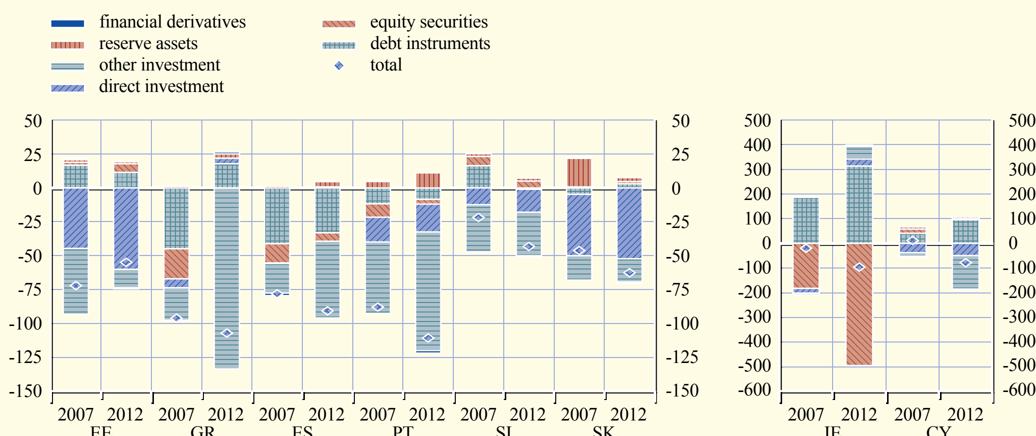
(percentages of GDP)

	2007 1)		2012 2)	
	Current account balance	Net international investment position	Current account balance	Net international investment position
Estonia	-15.9	-72.0	-0.3	-54.9
Ireland	-5.4	-19.6	4.3	-96.0
Greece	-14.6	-96.1	-4.8	-107.1
Spain	-10.0	-78.1	-2.2	-90.4
Cyprus	-15.6	-15.1	-5.5	-78.4
Portugal	-10.1	-87.9	-2.4	-110.7
Slovenia	-4.8	-21.8	1.1	-43.2
Slovakia	-6.2	-59.4	1.4	-62.6

Source: Eurostat.
1) 2008 for Cyprus and Slovakia.
2) Data refer to the four quarters up to and including the third quarter of 2012.

Chart A Breakdown of the net international investment position in 2007 and 2012, by instrument

(percentages of GDP)



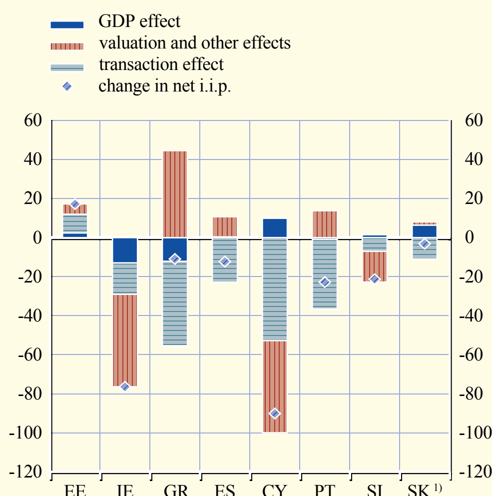
Source: Eurostat.
Note: 2012 refers to Q3, except in the case of Spain, where it refers to Q2.

In Ireland, Cyprus and Slovenia, negative valuation effects also contributed to the deterioration in their external positions. This partly reflected unfavourable asset price movements, which can have particularly large effects in financial centres with high gross foreign assets and liabilities.[2] By contrast, Estonia, Greece, Spain, Portugal and Slovakia recorded net valuation gains. The valuation gains of Greece, for instance, mainly arose from a marked decline in the value of Greek securities held by foreign investors. Euro area countries also tend to record net valuation gains when the euro depreciates, as foreign assets are partly denominated in foreign currency, whereas the largest share of foreign liabilities is denominated in euro. Between 2007 and 2012, the euro depreciated by 4% in nominal effective terms.

In summary, while substantial progress has been made in correcting excessive current account deficits in a number of euro area countries, little, if any, improvement has thus far been seen in their net i.i.p. Reducing the net foreign liabilities of these countries will require further current account improvements and a return to positive GDP growth, highlighting the need for decisive efforts to improve competitiveness.

Chart B Factors contributing to the change in the net international investment position between 2007 and the third quarter of 2012

(percentages of GDP)



Sources: Eurostat and ECB calculations.
Notes: A change in the net i.i.p.-to-GDP ratio can be due to a change in nominal GDP ("GDP effect"), unbalanced financial transactions with the rest of the world ("transaction effect") or "valuation and other effects", which include the revaluation of foreign assets and liabilities owing to asset price and exchange rate movements.
1) For Slovakia, the starting point is the fourth quarter of 2008.

2 Valuation effects also encompass other effects, such as changes in data collection methods and the correction of past errors in the data.