



International investment position

Ing. Peter Jánošík
Národná banka Slovenska

International investment position represents the balance (sum) of foreign financial assets and liabilities. It serves as the indicator of the financial openness index of a country and the sustainability of foreign debt, and as an ancillary tool for financial stability monitoring.

The international investment position (hereinafter referred to as the IIP) represents quite a new indicator because up to the issuing of the fifth issue of the Balance of Payment Manual of the International Monetary Fund in 1993, there was no complete international methodology for its preparation. Even at present, only a few countries are able to submit the IIP to international institutions on a quarterly basis. Quite a slow development of IIP statistics relates to many methodological problems at its preparation, considering problematic issues relating to the method of financial positions' valuation and their harmonisation with financial flows.

The extensive growth of international financial private transactions relating to the general tendency of capital markets liberalisation over the last thirty years points to the necessity of preparing detailed IIP statistics as an indicator of financial development both from the functional structure point (direct investments, portfolio investments, credits, deposits, etc.) and from the sector structure point (government, central bank, commercial banks, enterprises, etc.). In spite of that, the IIP as a significant financial indicator does not have any major use in economic analyses, and is often quite a poorly known economic term. Although the need and helpfulness of IIP data is indisputable, the situation described is in fact caused by objective causes:

- IIP data in fact represents a short time sequence (absence of historic data)
- limited possibility of higher periodicity of IIP reporting (annually or quarterly)
- complicated procedures of IIP preparation and the resulting significant lag of data publishing
- significant differences in reporting methodology significantly complicate data interpretation and international comparison.

IIP STRUCTURE AND ITS STANDARD COMPONENTS

The basic methodological regulation for IIP preparation is the fifth issue of the Balance of Payments Manual issued by the IMF in 1993. The IIP data classification and its changes have two dimensions. In rows there is a primary distribution to assets and liabilities and their difference represents a net position. In columns there are factors having an impact on the position change.

The IIP represents an additional balance of payments statistics, and because of that the structure of the standard IIP components is equal with the structure of the financial account of the balance of payments, i.e. it includes direct investments, portfolio investments, financial derivatives, other investments divided into assets and liabilities, and reserve assets.

Direct investments are classified primarily based on the investment's direction, i.e. direct investments to abroad under assets, and direct investments from abroad under liabilities. The portfolio and other investments are divided in terms of sectors into: central bank, government, commercial banks, and other sectors.

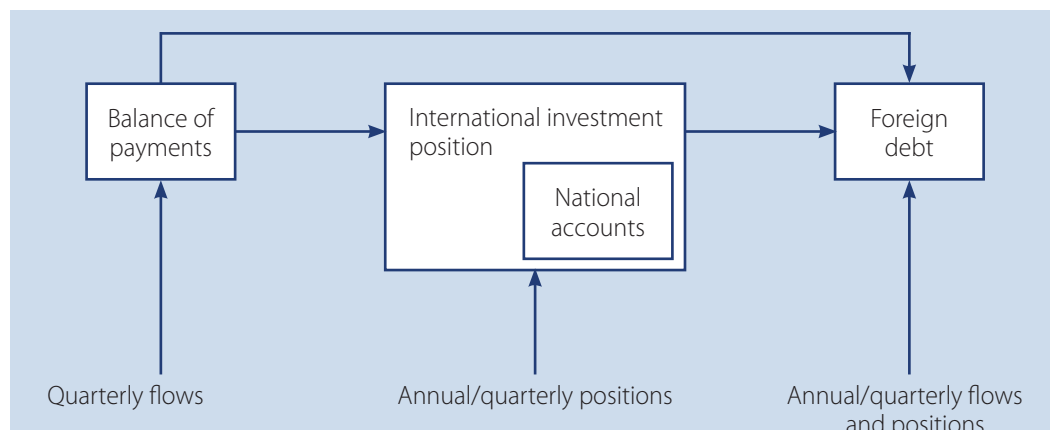
The columns structure includes items with an impact on position change:

- transactions – representing in fact transactions recorded on the financial account of the balance of payments
- exchange-rate differences – representing the impact of exchange-rate changes on the position of assets and liabilities compared to the previous period
- price differences – representing differences in the prices of tradable securities. A significant change in the position of individual IIP items may occur without the performance of financial transactions as a result of significant price changes on the market
- other differences – representing recording of reclassification of financial assets and liabilities, SDR allocation, or potential debt cancellation without any compensation.

All foreign financial assets and liabilities should in principle be valued at market price, i.e. based on the current market price applicable on the appropriate day of the IIP preparation. However, in reality this principle is often avoided and for the needs of assets and liabilities valuation it is needed to estimate the market price and/or replace it by the accounting value. The problem of market price determination applies especially to the valuation of non-tradable securities and financial derivatives. The valuation disunity and complicated market price determination for the property part of direct investments leads in practice to using the accounting value for the valuation of direct investments, when the market price estimate is used as ancillary information.



Relation between the balance of payments, the IIP and national accounts



IIP preparation includes the use of data from many various resources including the central bank, government, commercial banks, securities dealers, management companies, the non-financial sector, etc. and brings about similar problems as the preparation of the balance of payments but in a more extensive scope.

The main issue when preparing the IIP from the point of data resources is accuracy, availability, and the timeliness of data for non-financial sectors.

In addition to the balance of payments, the IIP also has close links to other main statistical aggregates. Foreign debt is in fact a subgroup of IIP data and includes all liabilities of the IIP except for investments in direct and portfolio investments, re-invested profit, and liabilities in financial derivatives. Considering the need for improved transparency and the legibility of foreign debt structure also from the point of maturity, the international institutions also require reporting foreign debt as a separate category.

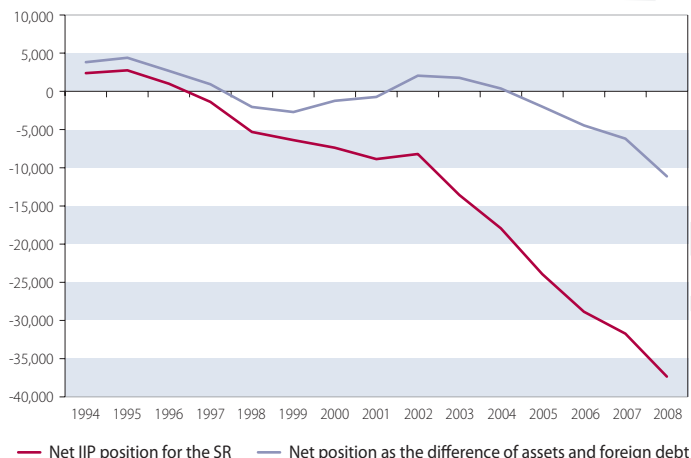
IIP data is also integrated into the national accounts system for the preparation of the financial account of “the rest of the world”, although institutional structure by sectors provides more detail in national accounts and is not in full compliance with the data on balance of payments and the IIP.

IIP OF THE SLOVAK REPUBLIC

The NBS has prepared the IIP for the Slovak Republic from 1994 on an annual basis. The data is prepared in compliance with the methodology of the fifth issue of the Balance of Payments Manual of the IMF. In 2001, the Slovak Republic fulfilled the criteria relating to the structure, scope, periodicity, and deadlines for publishing the statistical indicators within the SDDS IMF Project. The IIP is one of 17 basic statistical aggregates included in this project. The SDDS represents a special format of statistical data publishing in which the countries undertake to comply with the required structure, periodicity, and timeliness of the relevant data and publishing the metadata for the relevant categories.

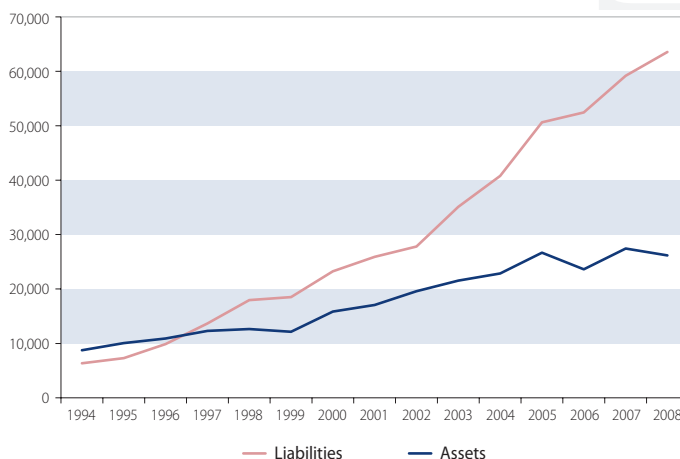
From 2001, the NBS has prepared and published the IIP in compliance with SDDS requirements on a quarterly basis 6 months after the end of the reported period. A part of data published is also the site of metadata describing the basic

Chart 1 Net position of the SR (in EUR millions)

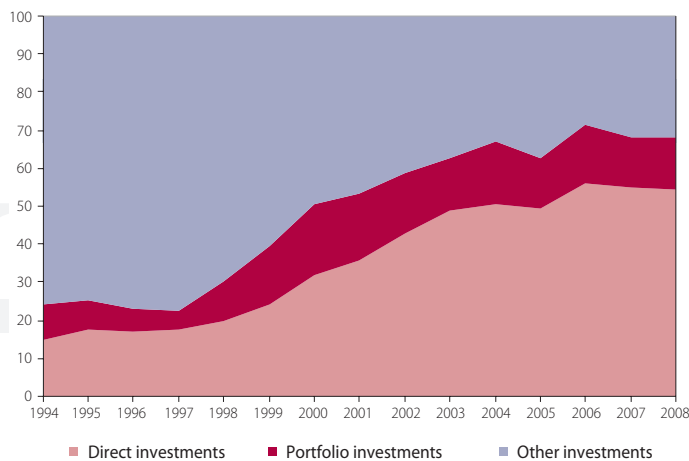


Source: NBS.

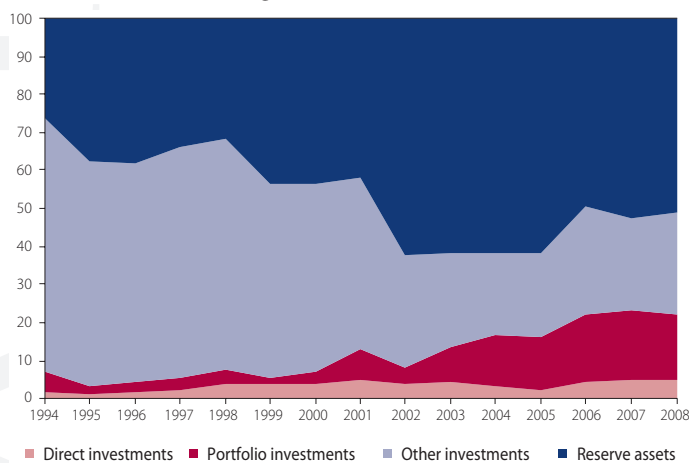
Chart 2 Development of the position of foreign financial assets and liabilities of the SR (in EUR millions)



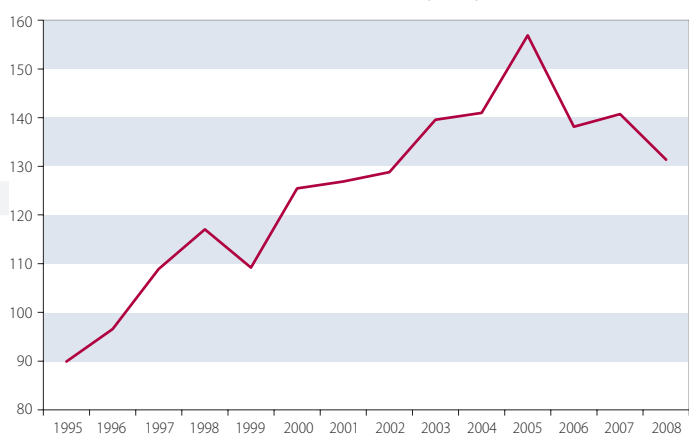
Source: NBS.

**Chart 3 Structure of financial liabilities in the SR (in %)**

Source: NBS.

Chart 4 Structure of foreign financial assets of the SR (in %)

Source: NBS.

Chart 5 Gross assets and liabilities / GDP (in %)

Source: NBS.

characteristics of data, methodology applied, basic data resources, periodicity, and deadlines for publishing.

In respect to the SR access into the euro area the necessity emerged to fulfil the ECB require-

ments also in the field of the IIP statistics, which causes higher demands on the scope and quality of statistics presented.

The basic change is represented by the requirement of reducing the deadline for preparation and publishing to three months after the end of the reported period, and preparing the IIP in geographical structure. The quarterly IIP is prepared in addition to the overall position against abroad also separately for countries outside the euro area, which is an essential condition of preparing the euro aggregates of the ECB against the rest of the world. The annual IIP for ECB needs is also prepared separately for selected countries outside the euro area representing the major economic parties to the euro area or risk areas (the U.S.A., Russia, Canada, China, Japan, Switzerland, Norway, Brazil, Hong Kong, India, offshore centres, Great Britain, Sweden, Denmark and other EU countries outside the euro area). The fulfilment of the above criteria required major changes in the system of IIP preparation and represented a significant increase of activities relating to data collection and processing, and especially the preparation and control of the required statistics.

An essential condition were the major changes in the statistical reports for respondents in the area of commercial banks, securities dealers, and management companies, but also for the non-financial sector that significantly increased workload in the area of statistics. The NBS fully complies with ECB requirements relating to the scope, structure, periodicity, and timeliness of data in the area of IIP statistics.

BASIC ANALYTIC VIEW OF IIP

IIP data provides for analysis both from the point of gross position and the analysis of net items. The difference between foreign financial assets and liabilities in the IIP represents the net position of the economy which in fact shows what the relevant economy owns against what it owes. To describe the net position, the term net debtor or net creditor is often used in respect to non-residents. Although the stated term may be useful in some instances, for analytical purposes for the calculation of the net position it is more appropriate to understand as a debt only the non-equity items of the position, i.e. to determine the net position as a difference of financial assets and foreign debt. In the case of the IIF, the difference between the net position of the IIF and the net position counted to the foreign debt in 2008 represents the value of EUR 26 billion.

Over the last 15 years, the foreign financial assets of the Slovak Republic increased three-fold and liabilities almost ten-fold. The most significant share of the growth of liabilities was the increase of the position of direct foreign investments, the position of which increased up to 35 times and in the structure of liabilities represents 55% (15% in 1994). At present, direct foreign investments – as can be seen from Chart 3 – represent the main foreign resource of economy financing – unlike in



1994 when up to 76% of liabilities were foreign credits. From the point of economy financing the resources structure has improved significantly, because direct foreign investments do not put pressure on increasing foreign indebtedness.

On the side of assets, the most significant increase was recorded in reserve assets and it related to the sterilisation of foreign exchange incomes from privatisations and the NBS intervention policy on the foreign exchange market.

IIP AS THE ECONOMY'S FINANCIAL OPENNESS INDEX

IIP data represents one of the most significant indices of the economy's financial openness index. Considering the significant growth of international financial transactions of the private sector over the last thirty years, the ratio of gross foreign financial assets and liabilities to GDP in the economically most developed countries has been rising sharply (in the Economic and Monetary Union countries several times).

A similar development was also recorded in the case of the SR, where in spite of a short time sequence the trend of the economy's financial openness growth is evident, as the ratio of gross foreign assets and liabilities to GDP increased from 89% in 1995 to 135% in 2008.

CONCLUSION

The IIP provides a complex database about international financial relations in a detailed structure. The practical problems of preparing it and the missing detailed geographical and especially monetary structure, make its use for analytical purposes in the monetary policy area more difficult.

IIP analysis provides for better ex post identification of the occurrence and development of financial crises caused by the insufficient monitoring of financial openness or non-sustainable level of foreign debt. It is still a question whether this aggregate can be used ex ante as the indicator for corrective measures' implementation.

Practical experience shows that the IIP is more useful for reverse analyses and explanation of past events than for predicting future economic development or implementation of economic and monetary decisions, which is significantly influenced by the low periodicity of preparing and the significant time lag of final data publishing.

It is clear that the expected or real steps of monetary institutions influence the investment behaviour of individual entities and their net foreign asset position. It is quite difficult to estimate the size of this impact considering the necessity to consider several parameters. Monetary policy influences more gross financial assets and liabilities than the net position. Moreover, such influences must be differentiated from the point of length and liquidity of relevant investments and type of economic entity.

From the point of IIP use in the monetary policy area, the analysis of gross assets and liabilities (especially their individual sub-items) is much more significant than the value of net IIP position, also because of the fact that its value and trend can be hardly predicted. More serious inclusion of the IIP among operating indicators is conditioned in addition to the already fulfilled condition of data timeliness within the Economic and Monetary Union countries (months after the end of the quarter), especially by the improvement of comparability between the aggregates of individual countries relating mostly to the harmonisation of the method of investment valuation and the better quality and accuracy of data.

The ECB therefore stresses the data quality improvement of euro area Member States, harmonisation of methodology of preparing and valuating individual IIP items especially in the area of direct and portfolio investments, and the implementation of a more detailed graphical structure of data as well as structuring data according to the currency at least for the main counter parties which gives better options for the analytical application of the IIP.