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TRENDS IN NET INTERNATIONAL INVESTMENT POSITIONS DURING THE PANDEMIC PERIOD

SUMMARY

- Between the end of 2019 and the end of the first half of 2021, net international investment position (NIIP) has improved in 58 countries and deteriorated in 49 countries. The number of countries which held positive NIIP increased from 27 to 30 during this period.
- Among G20 countries, the main driver of the rapid growth of external assets and liabilities is external portfolio investments, particularly in equities. Meanwhile, the data of 13 least developed countries (LDCs) shows that the NIIP dynamics of LDCs reflect current account balances directly due to minimal portfolio investment flows.
- Given G20 countries' significant exposure to US financial assets, the anticipated monetary tightening in the United States and associate asset price adjustments may improve the NIIP of the United States while deteriorating other G20 countries' NIIP. The spillover through markets is unlikely to influence the NIIP of the LDCs directly. However, the LDCs are already highly indebted with fewer prospects of improving their current account balances, and the repercussion may further deteriorate the NIIPs of LDCs.

The *World Economic Situation and Prospects 2022* highlighted potential financial market corrections to monetary policy tightening in developed economies, particularly the United States, as a downside risk factor to the world economy. The Federal Reserve Board is expected to raise the Federal Funds Rate, its primary policy interest rate, in March this year. This monthly briefing reviews the recent trends in net international investment positions of a number of countries, and the backdrop of the impending policy rate hike and monetary tightening by the central bank of the United States.

What is net international investment position?

The net international investment position (NIIP) of a country measures the gap between the stock of external assets held by the residents of the country (external assets) and the stock of domestic assets held by the non-residents (external liabilities) at a particular point in time. A country with a positive NIIP is classified as a "net creditor" and a negative NIIP as a "net debtor". However, the concept of an international investment position covers much broader financial transactions than simple cash lending and cash borrowing. Instead, it reports a country's ownership of economic assets on a net basis. A negative NIIP means that the non-residents own more domestic assets of the country compared to its residents' ownership of foreign assets. NIIP is one of the metrics to measure a country's external vulnerability, along with foreign reserves.

What determines the level of net international investment position?

Usually, the level of NIIP reflects a country's balance of payments. If a country runs successive current account surpluses over the years, those surpluses accumulate as external assets. In the opposite case, a country's current account deficits need to be financed by foreign financial inflows, accumulating liabilities to non-residents. Many countries with positive NIIP have strong export sectors, either industries (for example, Germany and Japan) or commodities (for example, major oil-exporting countries). Since the changes in NIIP and current account balances are accounting identities, the causation can go the other way round. A country may run current account deficits due to successive foreign financial inflows through foreign direct investments, portfolio investments and other types of investment.

The correlation between the current accounts balance and the changes in NIIP can sometimes break down due to a change in the market valuation of assets/liabilities. For example, even though a country runs a current account surplus, the NIIP can deteriorate with a revaluation of non-residents' investments in domestic equities if the country's stock prices increase faster relative to the rest of the world. Also, as the available data are in US dollar terms, a change in the country's exchange rate can influence the NIIP through the currency composition of its assets and liabilities.

Overview

For this March Monthly Briefing, the data on international investment positions are available for 82 countries until the third quarter of 2021 and for 107 countries until the second quarter. This section reviews the data set for the second quarter of 2021 for a more extensive country coverage, including 13 least developed countries.

The World Economic Situation and Prospects Monthly Briefing is part of the monitoring and analysis activities of Global Economic Monitoring Branch, Economic Analysis and Policy Division, UN DESA. This issue was prepared by Yasuhisa Yamamoto under supervision of Hamid Rashid (Chief, Global Economic Monitoring Branch) and general guidance of Shantanu Mukherjee (Director, Economic Analysis and Policy Division)
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At the end of the second quarter of 2021, the largest net creditor was Japan, with an NIIP equivalent to positive $3.5 trillion. The largest net debtor was the United States, with a negative $15.9 trillion of the NIIP. For Japan, the positive NIIP stood at 3.9 per cent of total financial assets, domestic and external combined. For the United States, the negative NIIP stood at 4.8 per cent of its total financial assets. In terms of gross domestic product (GDP), Japan's positive NIIP stood at 69 per cent of GDP, and the negative NIIP of the United States stood at 74 per cent of GDP. Theoretically, it is more appropriate to evaluate the size of the NIIP with a country's total financial assets. However, since such data are available only in the developed countries in a timely manner in their flow of funds tables (also known as financial accounts), GDP is widely used as a scaling variable for international comparisons of NIIPs.[1]

At the end of the second quarter of 2021, 30 countries held positive NIIP. In terms of GDP, Timor-Leste registered the highest NIIP-to-GDP ratio with 960 per cent, followed by Hong Kong with 670 per cent, Norway with 310 per cent, Singapore with 294 per cent. The high NIIP for Timor-Leste and Norway is attributed to considerable oil wealth relative to the GDP. In contrast, Hong Kong and Singapore attributed to the long tradition of being international hubs of trade and finance. During the same period, 77 countries held net negative NIIP. Mozambique registered the lowest NIIP-to-GDP ratio with -360 per cent, followed by Mongolia with -267 per cent, Ireland with -182 per cent, Greece with -180 per cent. The considerably high negative NIIP is attributed to significant liabilities to past foreign direct investment inflows in both Mozambique and Mongolia. Multilateral corporations' investments influenced the negative NIIP of Ireland, while the legacy of financial adjustments to the past crisis influenced the NIIP of Greece.

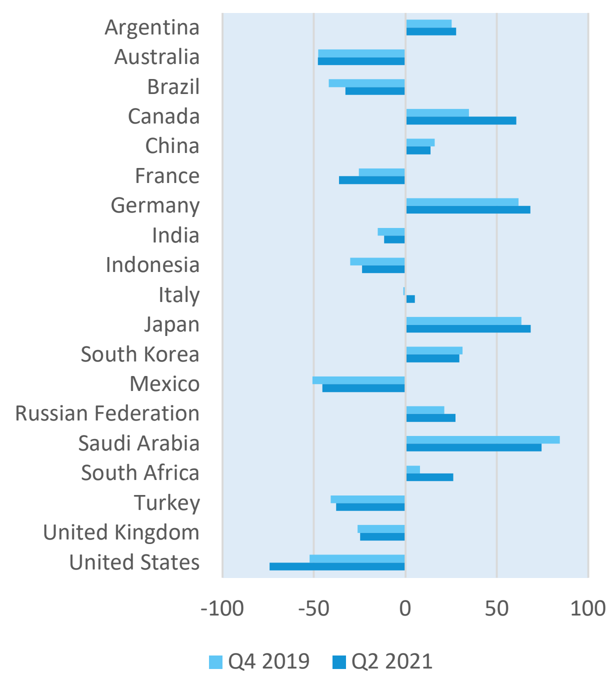
At the end of the second quarter of 2021, the average NIIP-to-GDP ratio was -17 per cent, the median was -33 per cent, and the standard deviation stood at 1.42. Before the pandemic, at the end of 2019, the average NIIP-to-GDP ratio was -20 per cent, the median was -33 per cent, and the standard deviation stood at 1.25. As a recent general trend over one and half years during the pandemic, the data show that the average NIIP improved, the median NIIP did not change, and the standard deviation increased. These data imply that external assets accumulated more than external liabilities on average, but with more variance than in 2019.[2] The NIIP deteriorated in 49 countries during this period and improved in 58 countries.

Italy, Malaysia, and Thailand became net creditors in 2020. Thailand reached this status due to its export-led industrial development over decades, having accumulated external assets on successive current account surpluses. Before Thailand, South Korea had turned a net creditor in 2014.

Trends in G20 countries

Among G20 countries, ten countries (Argentina, Canada, China, Germany, Italy, Japan, South Korea, Russian Federation, Saudi Arabia, South Africa) were net creditors. Nine countries (Australia, Brazil, France, India, Indonesia, Mexico, Turkey, the United Kingdom, the United States) were net debtors in the second quarter of 2021 (figure 1). Since 2019, the NIIP has improved in 13 countries, and it has deteriorated in 6 countries. The improvement pushed Italy to be a net creditor.

Figure 1
NIIP-to-GDP ratio: G20 countries
Percentage



Source: UN DESA calculation, based on IMF "Balance of Payments and International Investment Position Statistics".

Only France and the United States ran current account deficits during this period among the six countries where the NIIP deteriorated (Australia, China, France, South Korea, Saudi Arabia, and the United States). On the other hand, and despite the current account deficits, the NIIP improved for Canada, India, Turkey, and the United Kingdom. This implies that the NIIP dynamics in G20 countries were largely influenced by valuation change of assets and liabilities.

Looking at the growth of assets and liabilities separately, the growth of external assets outpaced the growth of liabilities in 12 countries, and the growth of external liabilities outpaced the growth of external assets in 7 countries in the group (figure 2).

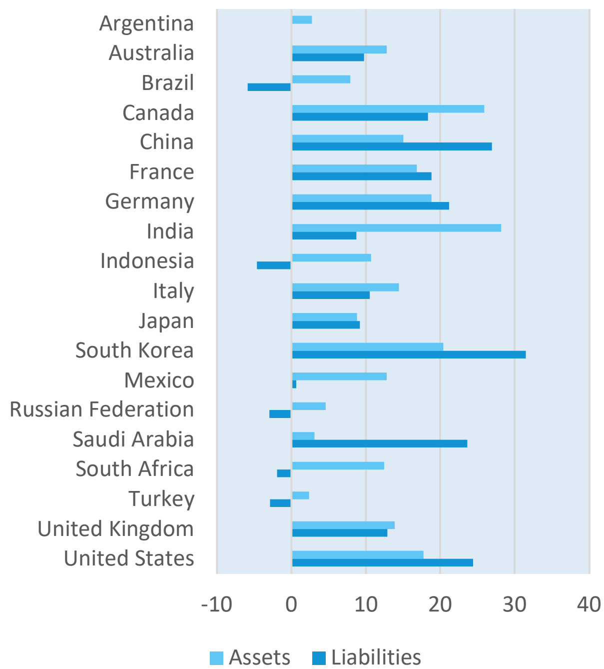
[1] In this section and the following sections, nominal GDP in the US dollar for 2019 is used to calculate NIIP-to-GDP ratio for both 2019 and 2021.

[2] Theoretically, the average should be zero as one country's external assets equal other countries' external liabilities. In practice, however, the average does not converge to zero because of the insufficient country coverage and differences in valuations of the assets/liabilities across countries.

Figure 2

Change in external assets and external liabilities: G20 countries

Percentage



Source: UN DESA calculation, based on IMF "Balance of Payments and International Investment Position Statistics".

As a general trend, the main driver of the rapid growth of external assets in G20 countries during this period is external portfolio investments, particularly in equities. It can be a combination of additional equity purchases and the valuation change as several stock markets, particularly the United States, had recovered quickly by the second quarter of 2020. The clear exception to this trend was India, where the growth of external assets was attributed to the increased reserve assets. The market valuation of equities also was a crucial factor in the growth of external liabilities. In South Korea and the United States, the growth in external liabilities is attributed to the rapid growth in the value of domestic equities owned by non-residents. In South Korea and the United States, the stock markets recovered promptly due to the solid economic recovery and highly accommodative monetary policies.

During this period, Argentina and Turkey experienced a tight balance of payments conditions and substantial depreciation of respective national currencies. However, no significant deterioration in the NIIPs was observed. Argentina remained as a net creditor, and Turkey's NIIP improved. For Argentina, its balance-of-payments problem can be characterized as a liquidity issue with its declining reserve assets. Also, Argentina's relatively large external assets result from capital flights, which may be challenging to convert into reserve assets to stabilize the balance-of-payments condition. The improvement of Turkey's NIIP is attributed to the overall decline in external liabilities, including direct investments. The decline is partly attributed to the valuation change due to the depreciation of the national currency. It may also imply a general slowdown of foreign investment activities in Turkey during this period.

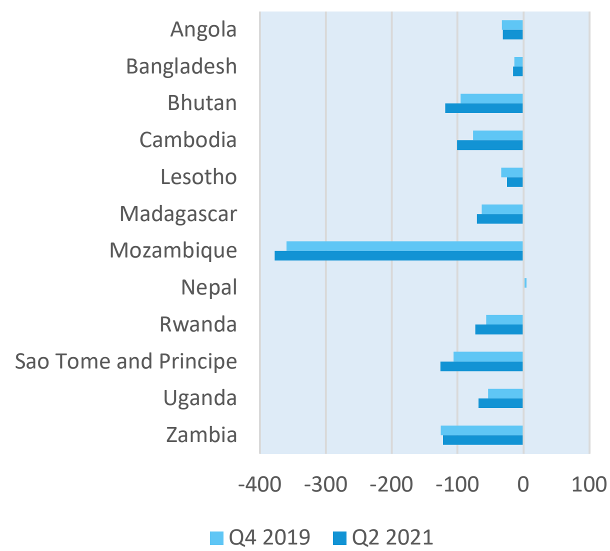
Trends in the least developed countries

The international investment position data are available for 13 least developed countries for the second quarter of 2021 (Angola, Bangladesh, Bhutan, Cambodia, Lesotho, Madagascar, Mozambique, Nepal, Rwanda, Sao Tome and Principe, Timor-Leste, Uganda, Zambia). Among them, 11 countries were net debtors, and two countries were net creditors (figure 3). Between the end of 2019 and the second quarter of 2021, the NIIP deteriorated in 9 countries and improved in 4 countries.

Figure 3

NIIP-to-GDP ratio: Least Developed Countries

Percentage



Source: UN DESA calculation, based on IMF "Balance of Payments and International Investment Position Statistics".
Note: NIIP-to-GDP ratio for Timor-Leste stood at 915 per cent in Q4 2019 and 960 per cent in Q2 2021.

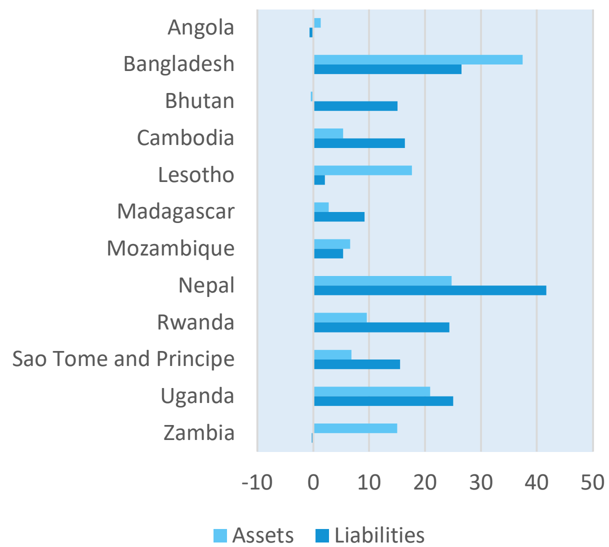
In LDCs, the NIIP dynamics reflect current account balances more directly than in the G20 countries due to minimal portfolio investment flows. Both external assets and liabilities are less prone to changes in market valuation. All nine countries where the NIIPs deteriorated ran current account deficits during this period. The countries where the NIIPs improved, Angola and Zambia, ran current account surpluses. The deviations are found in Lesotho and Timor-Leste, where the NIIPs improved despite successive current account deficits.

In LDCs, the reserve assets are the primary driver of external assets growth. External liabilities primarily consist of government debt and foreign direct investments inflows. For the G20 countries, the investor base is more diversified, both residents and non-residents, but in LDCs, the investor base is more concentrated in the public sector and foreign direct investments.

Figure 4

Change in external assets and external liabilities: Least Developed Countries

Percentage



Source: UN DESA calculation, based on IMF "Balance of Payments and International Investment Position Statistics".

Note: In Timor-Leste, the change in external assets stood at 7.9 per cent and the change in external liabilities stood at 87.4 per cent.

The growth of external assets outpaced the growth of external liabilities in 4 countries (figure 4), reflecting active foreign reserves accumulation in those countries. However, the growth of external liabilities outpaced the growth of external assets in 9 other LDCs with insufficient reserves asset growth, and the situation may exacerbate their already-vulnerable balance-of-payments conditions.

Conclusion

The change in market valuation of external assets and liabilities played a significant role in the NIIPs of the G20 countries. Consequently, the forthcoming US monetary policy will likely impact the NIIPs of the G20 countries through this valuation channel. Given those countries' significant exposure to US financial assets, the monetary tightening and associate asset price adjustments may improve the NIIP of the United States while deteriorating other G20 countries' NIIP. The likely depreciation of national currencies – against the backdrop of the hikes in the policy rate in the United States – may further exacerbate the NIIPs of a number of G20 countries. The spillover through markets is unlikely to influence the NIIP of the LDCs directly. However, the LDCs are already highly indebted with fewer prospects of improving their current account balances, and the repercussion may further deteriorate the NIIPs of the LDCs.

In addition to the anticipated monetary policy shock, geopolitical shocks can significantly impact the NIIPs. As the crisis in Ukraine unfolded on 24 February, the oil price reached the highest level since 2014. Wheat prices surged to the highest level in 10 years amid supply concerns because Ukraine is one of the largest wheat exporters in the world. Equity prices have already been volatile in major stock markets. The unfolding geopolitical crisis will likely further worsen the terms-of-trade for countries with high import-dependency of wheat and fuels. The terms of trade deterioration will also adversely impact their NIIPs, especially if they are already net debtor countries.