

**METHODOLOGICAL CHANGES IN THE COMPILATION OF THE EURO AREA BALANCE
OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION
(AS OF NOVEMBER 2009)**

2 November 2009

The compilation method for the euro area balance of payments (b.o.p.) *financial account* under *other sectors* (namely households and corporations that are not monetary financial institutions) has been modified as from the press release published on 2 November 2009. In particular, the results show a very sizeable diminution of the statistical discrepancies (“*net errors and omissions*”) within the euro area balance of payments from 2004 onwards.

Background

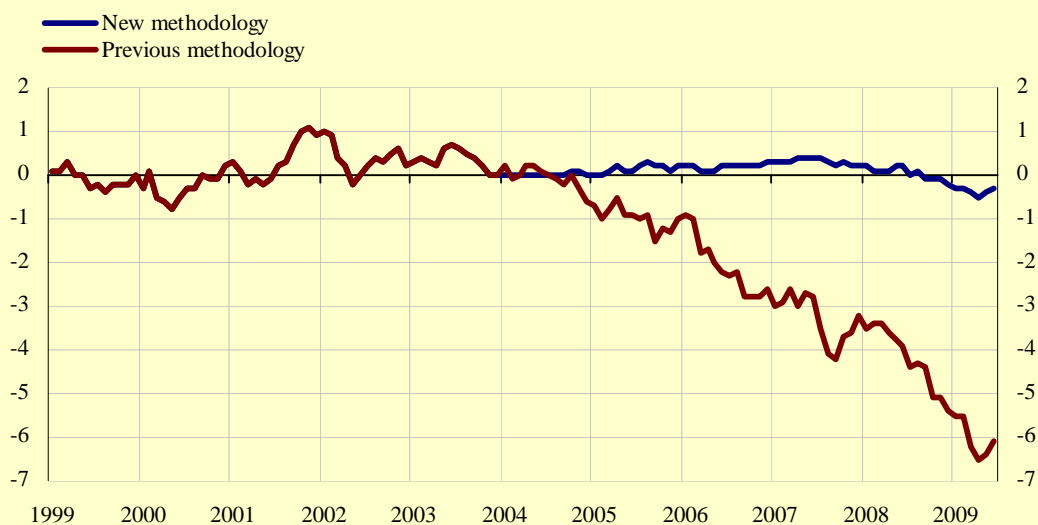
The “*net errors and omissions*” (n.e.o.) represent the statistical discrepancy in the b.o.p. statistics, i.e. the difference between the balance on the *current* and *capital accounts* and the balance on the *financial account*. Conceptually, these balances should be identical.

Historically, the b.o.p. was compiled from reports serving foreign exchange controls. When the foreign exchange controls were abolished, the b.o.p. began to rely on information from bank settlements, whereby the two entries in the b.o.p. – credits and debits – were captured at the same time, ensuring that the b.o.p. presented no n.e.o. However, driven by developments in the markets and information technology, data reported through financial settlements started to diverge from the underlying transactions (especially due to differences in timing, classification of b.o.p. items and geographical allocation). Currently, only a few euro area countries still rely on settlement data for their b.o.p. compilation. Instead, the data collection now in particular utilises stratified surveys.

The euro area b.o.p. had shown persistent negative n.e.o., especially since 2004 (see Chart 1), which had been significantly higher than in the b.o.p. of other major economies. During 2008, the ECB and euro area National Central Banks initiated a collaborative effort to understand and reduce the n.e.o. in the euro area b.o.p.

Chart I Net errors and omissions of the euro area balance of payments

(cumulated sums; Q1 1999 – Q2 2009; as a percentage of euro area GDP)



Source: ECB and ECB calculations.

Rationale of the new methodology

The methodology for three *financial account* items was reviewed taking into account information that was previously not used in the compilation of the euro area b.o.p. and international investment position (i.i.p.), such as the intra-euro area transactions and positions. The main pieces of evidence supporting a review were the following:

- A comparison between *portfolio investment liabilities* of each euro area country and the assets held by residents in other countries of the world was conducted using data from the IMF Coordinated Portfolio Investment Survey. That comparison revealed that euro area resident holdings of *equity securities* issued in Luxembourg and Ireland (by investment funds) were underestimated. This seemed to be associated with an under-reporting of households' holdings of *investment fund shares*.
- An asymmetrical geographical recording of transactions between euro area countries has been observed for *loans* between non-MFIs. The observed excess of assets, compared with liabilities, in intra-euro area *loans* is mostly due to difficulties in the statistical coverage and the residency classification of special financial vehicle corporations. Some of these transactions have been reclassified to counterparts located outside the euro area, thus increasing the euro area asset position in *loans* vis-à-vis the rest of the world.
- Finally, evidence from the BIS banking statistics suggested an underestimation of non-MFIs' *deposits* held abroad. Many of those *deposits* may be held by euro area households.

The new euro area b.o.p. compilation method for these items preserves, to the extent possible, the patterns and properties of the previous extra-euro area time series, while adjusting them for the above-mentioned intra-euro area asymmetrical recordings. The adjustment is only performed for the euro area b.o.p. and i.i.p.

The new methodology has been consistently applied to the b.o.p. and i.i.p.:

1. Changes have been made to the transactions in the above-mentioned three items.
2. End-period positions (i.i.p.) have been adjusted to reflect the changes in transactions.
3. The income account in the b.o.p. has also been adapted to preserve the relationship with the adjusted end-period positions.
4. The changes mainly consisted in the reallocation of certain transactions and positions from intra euro area to offshore financial centres as counterparts.
5. Consistency across all frequencies (monthly, quarterly and annual) in the b.o.p. and i.i.p. has been maintained.

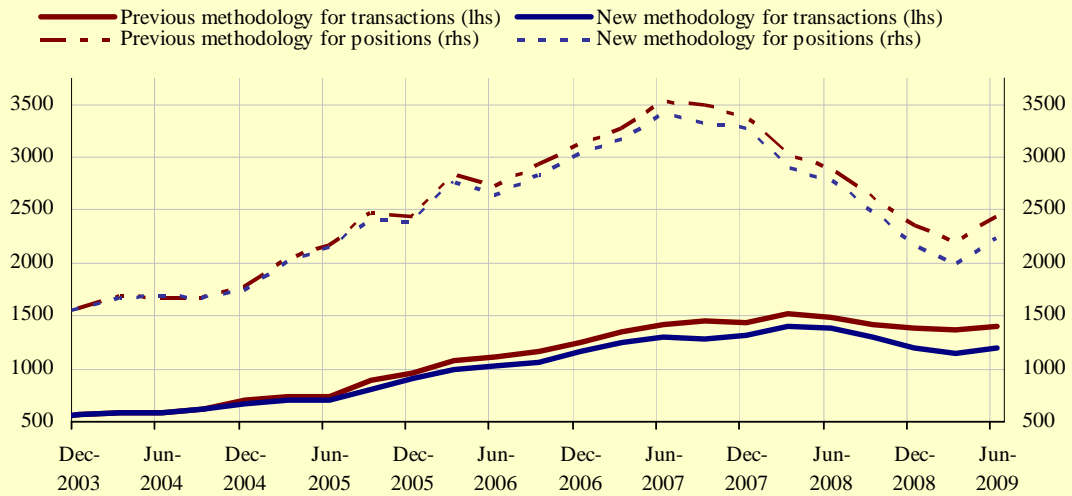
Results

The application of the new methodology for these three items has led to a very sizeable diminution of the statistical discrepancy in the euro area b.o.p., with only a very limited impact on the time-series patterns of the adjusted items. For the period from Q1 1999 to Q2 2009 the new data resulted in a reduction in the cumulated n.e.o. from about -6.1% of euro area GDP to -0.3% (from EUR -555 billion to EUR -30 billion). The impact on the *current account* balance through the second-order effect in the income account was not significant.

Cumulated over the period Q1 2004-Q2 2009, the transactions in *portfolio investment equity liabilities* have been reduced by EUR 217 billion (see Chart 2). This reduction represents an 8.8% decrease in the outstanding amounts at the end of Q2 2009. In the *other investment account*, the assets of *other sectors* recorded as *loans (deposits)* vis-à-vis residents outside the euro area have been increased by EUR 204 billion (EUR 42 billion), which represents an increase by 21.9% (10.7%) of the corresponding position at the end of Q2 2009 (see Charts 3 and 4).

Chart 2 Equity securities recorded in portfolio investment liabilities

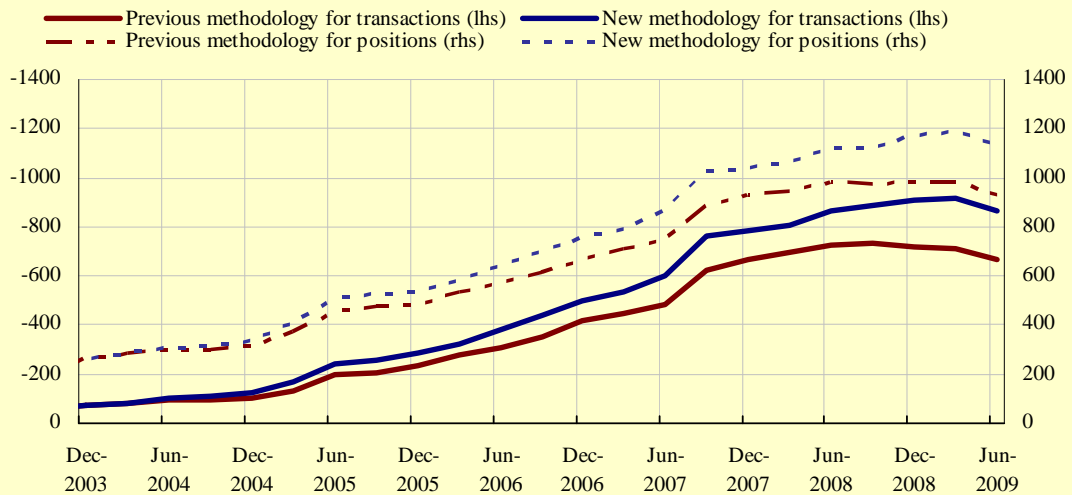
(cumulated sums for transactions; end-period outstanding amounts; Q1 1999 – Q2 2009; EUR billions)



Source: ECB and ECB calculations.

Chart 3 Other sectors' loans recorded in other investment assets

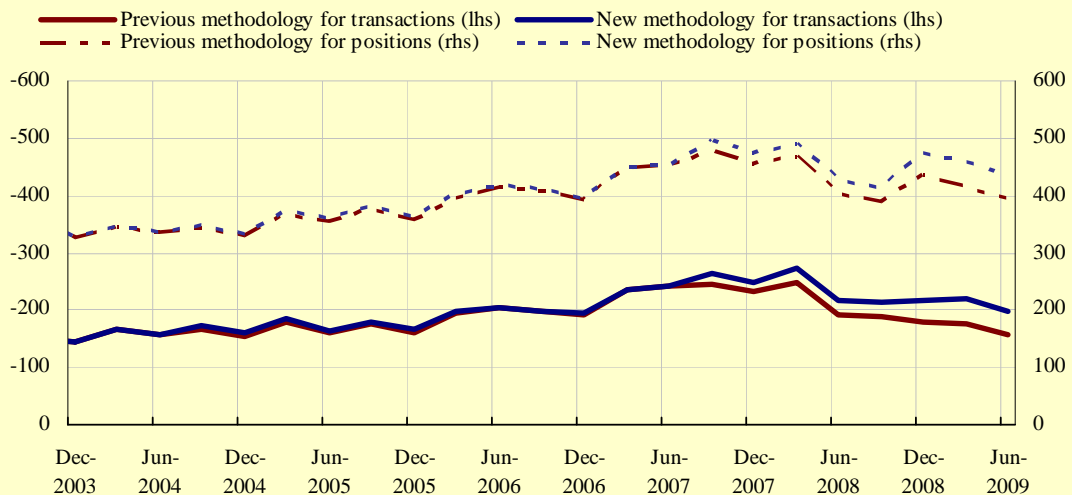
(cumulated sums for transactions (reversed); end-period outstanding amounts; Q1 1999 – Q2 2009; EUR billions)



Source: ECB and ECB calculations.

Chart 4 Other sectors' deposits recorded in other investment assets

(cumulated sums for transactions (reversed); end-period outstanding amounts; Q1 1999 – Q2 2009; EUR billions)



Source: ECB and ECB calculations.