THE IMPROVEMENT IN THE NET INTERNATIONAL INVESTMENT POSITION

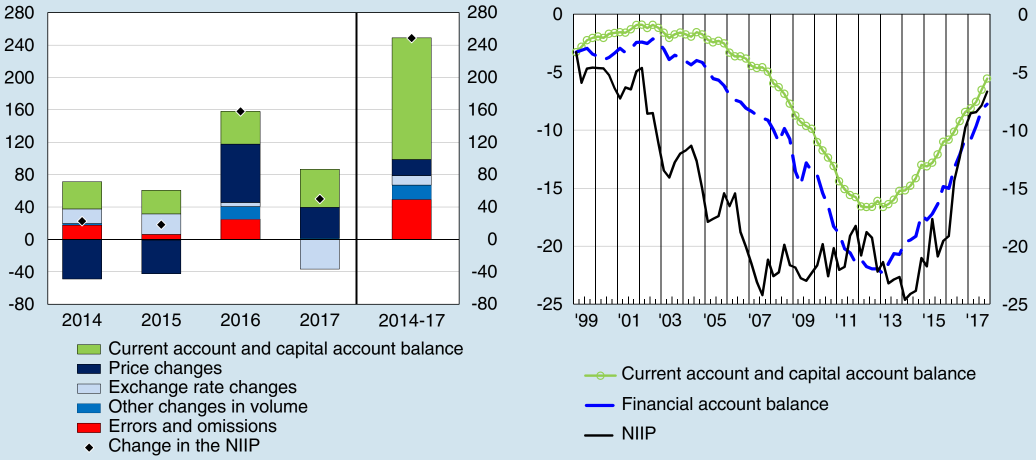
Italy's net international investment position (NIIP) has recorded a very significant improvement over the last four years: its debtor balance went from -€364 billion at the end of 2013 to -€115 billion at the end of 2017 (from 22.7 to 6.7 per cent of GDP). This reduction was caused above all by the current account and capital account surplus, with a cumulative effect over the four years that reduced net foreign liabilities by 60 per cent, i.e. by €150 billion (see panel (a) of Figure A).[1]

Figure A

Italy's net international investment position (NIIP)

(a) Changes in the NIIP and its decomposition (2014-17)
(annual data, billions of euros)

(b) NIIP and cumulative balances of the current and capital account and of the financial account (1)
(quarterly data, percentage of GDP)



Source: Istat (for GDP).
(1) The cumulative balances of the current account and the capital account and of the financial account starting from the first quarter of 1999, with an initial value equal to the corresponding NIIP value.

Given a large amount of foreign assets and liabilities, valuation adjustments due to movements in prices and exchange rates, together with errors and omissions, may create a significant gap between the change in the NIIP and the cumulative current and capital account balance (see panel (b) of Figure A): from 1999 to 2007 the decline in the NIIP was greater than could be explained by the current account deficit, while in the following period up to 2013, it was not affected by the widening of the deficit. Between 2014 and 2017, the valuation adjustments contributed around 20 per cent as a whole to the improvement in the NIIP, despite causing significant annual fluctuations: in 2016 the adjustments reduced the debtor position

[1] The recent revisions made to the estimates for some components of foreign financial assets did not influence the extent of the improvement. Instead, these revisions affected the levels, improving the NIIP balance over the entire time series for: (a) the issuance and import/export of euro banknotes; (b) the emergence, under the first voluntary disclosure procedure, of capital that had previously been held abroad illegally by Italian residents; and (c) the revision of the estimate of foreign mutual funds held by residents and directly deposited abroad. For further details, see 'International investment position and external debt' on the Bank of Italy's website.

by €93 billion, thanks above all to the fall in the prices of Italian shares and bonds held by foreign investors.

Based on the IMF's forecasts for the current account balance and nominal GDP growth, it can be estimated that Italy's NIIP will reach zero in 2020 and achieve a positive balance of around 4 per cent of GDP in 2023. Similar projections seem to indicate a further growth in Germany's net creditor position (over 90 per cent of GDP in 2023), a reduction in Spain's negative position, although it would still remain high, at -55 per cent, while France's net position would remain essentially stable, at around -20 per cent.

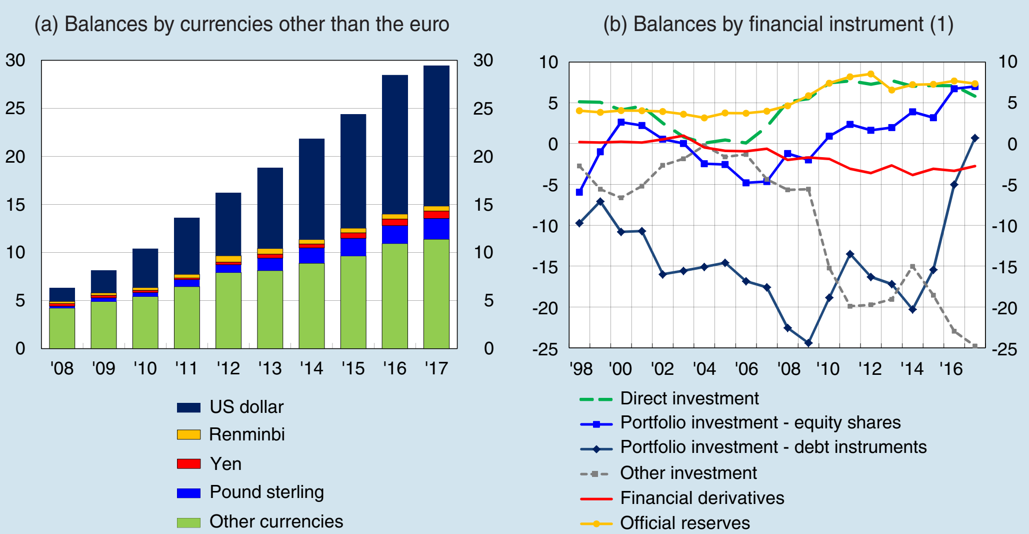
These projections assume that the valuation adjustments will have no impact. Three different scenarios were considered in a stress test, which includes possible adverse effects on Italy's NIIP, for example those resulting from unexpected shocks involving exchange rates, share prices and interest rates.[2]

In the first scenario, which assumes that the euro appreciates against all the other currencies by around 20 per cent, the valuation adjustments would cause the NIIP to worsen by nearly 6 percentage points of GDP; this reflects the currency exposure on the asset side which has grown considerably over the last few years, especially against the US dollar (panel (a) of Figure B). In the second scenario, if international equity

Figure B

Italy's net external debtor position

(end-of-year values as a percentage of GDP)



Source: Istat (for GDP).
(1) Assets held through foreign mutual funds were divided into equity shares (one third) and debt securities (two thirds); see the box 'Investments in foreign mutual fund shares and the asset composition of residents' portfolios'.

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[2] V. Della Corte, S. Federico and E. Tosti, 'Unwinding external stock imbalances? The case of Italy's net international investment position', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), forthcoming.

prices fall by 30 per cent, the NIIP worsens by about 2 percentage points of GDP;[3] Italy actually has a net creditor position in equity, direct and portfolio instruments (also including those held through foreign-based funds; panel (b) of Figure B). Finally, if a global interest rate hike of 100 basis points along the entire yield curve is assumed, the effect on the NIIP is practically nil, since the net position in debt securities (including those held by foreign-based funds) is essentially balanced, also in terms of duration.[4]

This analysis only considers the direct effects on the valuation of assets and liabilities and excludes any possible retroactive effects on the balance of payments. However, the limited size of these effects in the various scenarios (even when combined) means they do not seem able to substantially modify the situation delineated by the current macroeconomic projections; specifically, Italy's NIIP is likely to remain a long way from the threshold alert of -35 per cent envisaged by the European Commission's macroeconomic imbalance procedure.

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[3] In contrast, if the shock only affected Italian securities, the NIIP would improve by almost 5 percentage points of GDP, thanks to the reduction in the value of foreign liabilities.

[4] However, if the increase in interest rates only concerned securities issued by euro-area residents or only Italian securities, it would have a positive effect on the NIIP of around 1 and 3 percentage points of GDP respectively.