



EUROPEAN CENTRAL BANK

BALANCE OF PAYMENTS STATISTICS

AND EXTERNAL RESERVES DIVISION

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USE OF BALANCE OF PAYMENTS STATISTICS

For information of the IMF BOP Committee

1. The European Central Bank (ECB) compiles monthly and quarterly balance of payments (b.o.p.) and annual international investment position (i.i.p.) data for the euro area, in order to provide timely and regular information on the monetary conditions within the euro area and the factors which may have played a role in recent developments (assessed via the external counterpart of monetary aggregates) or which affect foreign exchange markets. This paper mainly addresses the methodological framework under which b.o.p. and i.i.p. data can be of use for macro-economic analysis, thereby supporting the conduct of monetary policy.

Brief overview of the monetary policy of the ECB

2. In 1998 the Governing Council of the ECB announced its monetary policy strategy, designed to achieve the mandate assigned by the Treaty establishing the European Community, as amended by the Treaty on European Union. The framework for assessing risks to price stability rests on two pillars. The first pillar assigns a prominent role to money, including the announcement of a reference value for monetary growth. This reflects the monetary origins of inflation over the medium to long term. Under the second pillar of the monetary strategy, the ECB Governing Council regularly monitors and analyses a wide range of other economic and financial indicators which affect price developments over the short to medium term.

3. Further information on the monetary policy strategy is given in the document “The Monetary Policy of the ECB”, August 2001, available on the ECB web site.

What are the policy applications of b.o.p. statistics in the euro area?

4. Euro area b.o.p. statistics are relevant for both pillars.

5. Monthly b.o.p. figures are used for the analysis of economic and financial developments in the euro area. They support analysis of the size and composition of inflows and outflows in response to financial market conditions and economic developments deepening the understanding of the link between a change in interest rate conditions and the amount, direction and structure of external financial flows.

6. After a brief review of the use of b.o.p. statistics under the second pillar, the present note will dwell more in detail on their use under the first pillar to set out the so-called monetary presentation of the b.o.p..

Use of b.o.p. statistics under the second pillar

7. *B.o.p. statistics* (compiled by the ECB), along with external trade statistics supplied by Eurostat, provide important information on developments in exports and imports which may affect inflationary pressures via their impact on demand conditions. These data also allow external trade prices – currently proxied by export and import unit value indices – to be closely monitored. These indices contribute to the assessment of, in particular, the potential impact on import prices of movements in the exchange rate and changes in commodity prices (such as oil). Although the euro area is a relatively closed economy compared with the individual countries that have adopted the euro, changes in import prices do affect domestic producer and consumer prices, as well as market expectations.

Use of b.o.p. statistics under the first pillar

8. However, the experience since the launch of the euro has shown that a main objective of the euro area b.o.p. is to contribute to the analysis of the monthly changes in the external counterpart to M3. As both b.o.p. and money and banking statistics are derived from a consistent methodological framework, the change in the net external position of the Monetary Financial Institutions (MFI) sector, as shown in the MFI consolidated balance sheet (including the Eurosystem), can be presented as the mirror image of the external transactions of other residents of the euro area. This breakdown of the b.o.p. into transactions by the MFIs and transactions by other residents – the so-called “monetary presentation” of the b.o.p. – relates the change in net external assets of MFIs (including the monetary authorities) to the b.o.p. transactions by other euro area resident sectors, i.e. the general government and, grouped under “other sectors” in the BOP Manual 5th edition, other financial intermediaries (non-MFIs), non-financial companies, and households. Investment and borrowing decisions of these non-MFI sectors are of high analytical value while difficult to predict as they tend to be volatile. A better understanding of developments behind changes in the net external position of MFIs in turn contributes to the analysis of developments in M3 and the impact on M3 of changes in interest rates and other financial conditions.

Monetary presentation of the euro area b.o.p.: analysis of the external counterpart to M3

9. According to Article 1 of the Guideline of the European Central Bank No. ECB/2000/4, the *b.o.p.* of the euro area is the statistical statement that reports with the appropriate instrument and sector breakdown cross-border transactions between residents and non-residents of the euro area during the month, quarter or year. In particular, cross-border transactions of four institutional resident sectors are separately identified within the euro area b.o.p.: monetary authorities (Eurosystem), general government, monetary financial institutions except the Eurosystem (MFIs), and other resident sectors.

10. In the field of the euro area money and banking (m&b) statistics, the *consolidated balance sheet* of the euro area MFIs (table 1), which provides the main source for a detailed analysis of the stock of money, its components and its counterparts, presents, among other things, the stock of euro area MFIs' financial claims on and financial liabilities to non-euro area residents, the so-called external assets and external liabilities of the euro area MFI sector.

11. Thus, since the two sets of statistics present conceptual consistency (derived from a coherent methodological framework) and under the assumption that the compilation procedures are also fully consistent, *changes in the external assets and liabilities of the consolidated balance sheet of the MFIs adjusted for valuation and other changes should, in principle, be consistent with the external flows of the MFIs sector in the b.o.p. financial account.*

IDENTITY I-Balance of payments of the MFI sector =Change in the net external assets of the MFI sector

12. Moreover, when payments are channelled through the domestic banking system, the offsetting entry of a transaction performed by a non-MFI appears in the MFI sector within the b.o.p. As a result, b.o.p. transactions of the euro area MFI sector are to a large extent the balancing record of cross-border transactions of euro area non-MFI residents. These transactions are reflected in the current and capital account and the non-MFI sector financial account of the euro area b.o.p.

IDENTITY II Balance of payments of the non-MFI sector = -Balance of payments of the MFI sector
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13. Taking into account these identities, the change in the net external position of the MFI sector (m&b) could be presented as the mirror image of the transactions of non-MFIs with non-euro area residents (b.o.p.). This is illustrated in the so-called monetary presentation of the euro area b.o.p. (table 2).

IDENTITY III
Balance of payments of the non-MFI sector
= - Balance of payments of the MFI sector
= Change in the net external assets of the MFI sector

14. Finally, as the monetary aggregate M3 can be presented as the arithmetic result of its counterparts using the consolidated balance sheet identity (table 1), the monetary presentation of the b.o.p. contributes to analysing the external counterpart to M3 (table 2).

M3 =	(i) Credit to euro area residents
	+ (ii) net external assets of euro area MFIs [= Balance of payments of the non-MFI sector]
	+ (iii) other counterparts
	- (iv) long-term financial liabilities.

Table 1: Schematic consolidated balance sheet of the euro area MFIs

Assets	Liabilities
	M3 ¹
Credit to euro area residents	Longer-term financial liabilities
External assets	External liabilities
Other assets (including fixed assets)	Other liabilities (including deposits held by the central government)

Table 2: Monetary presentation of the euro area b.o.p.

External transactions of the non-MFI sector:

	Current account
+	Capital account
+	Balance of financial transactions by the non-MFI sector
+	Errors and omissions
=	Balance of payments of the non-MFI sector

External transactions of the MFI sector: ²

	Balance of financial transactions of the Eurosystem
+	Balance of financial transactions by other MFIs
=	Balance of payments of the MFI sector

The overall balance of payments identity implies that:

	Balance of payments of the non-MFI sector
=	- Balance of payments of the MFI sector
=	Change in the net external assets of the MFI sector

15. B.o.p. statistics are also naturally used for the compilation of national accounts of which they constitute the rest-of-the-world sector. In this respect, the ECB has started the publication of a new set of statistics, the Monetary Union Financial Accounts (MUFA) to contribute to the monitoring and analysis of “flow of funds”.

¹ Including central government deposit liabilities of a monetary nature.

² This simplified presentation does not include external transactions of the MFI sector classified in the current account or in the capital account or errors and omissions corresponding to the external transactions of this sector.

16. Together with i.i.p. statistics, b.o.p. statistics also provide information useful in its own right (i.e. independently from monetary analysis) e.g. on the activity of non-residents in the field of direct investment or on euro area securities.