13TH IMF STATISTICAL FORUM

MEASURING
CROSS-BORDER ECONOMIC and FINANCIAL LINKAGES
in a Dynamic World

#StatsForum

Retained Earnings and the Current Account

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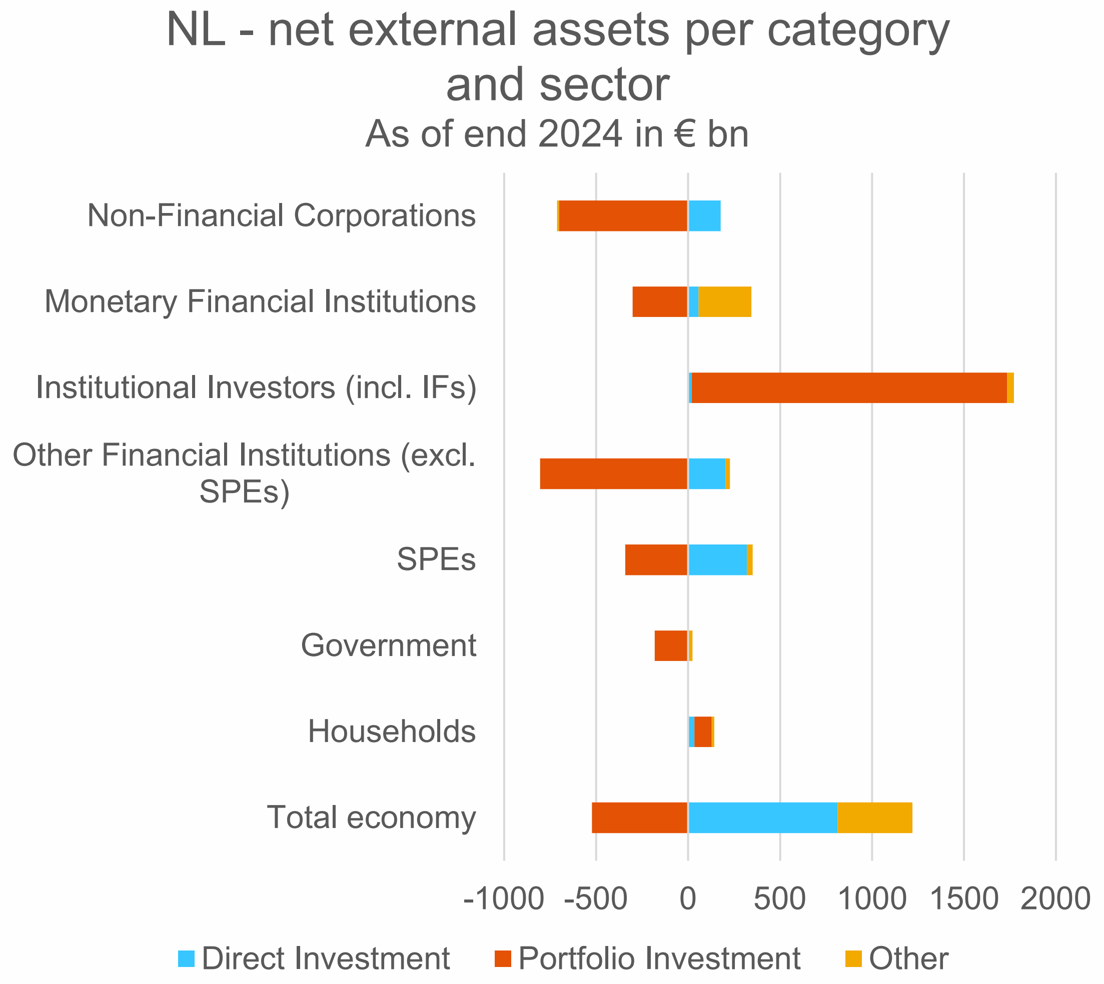
Melle Bijlsma
De Nederlandsche Bank

Introduction – on the Netherlands

The international economic relations of the Netherlands in a nutshell:

- Large, structural current account surplus mostly due to net exports of goods and services
- Large international assets and liabilities, with assets > liabilities; positive net IIP
- Liabilities: mostly listed multinationals with foreign portfolio shareholders (PI)
- Assets: mostly direct Investment (DI) positions by multinationals and portfolio investment (PI) assets held by pension and investment funds and insurers
- Large amounts of DI ‘pass-through’ capital – with roughly balancing assets and liabilities
- Looking at net positions, The Netherlands are ‘short’ PI and ‘long’ DI



Introduction – on PI and DI income measurement

Primary income in the current account: retained earnings are included in DI but not in PI.

Potential resulting biases and movements with little economic substance: Case of financial sector countries (such as NL) where ‘income’ does not lead to ‘wealth’, corporate relocations, profit distribution extent and method (share buy-backs vs. dividends).

Recording retained earnings in PI can have substantial impact on the current account; Di Nino, Habib and Schmitz (2020), Fisher et al. (2019).

“While reinvested earnings on portfolio investment are not recorded in the external accounts, supplementary information on this item is encouraged. It is also noted that the current treatment of retained earnings for direct investment may be expanded to portfolio investment in future versions of the Manual (paragraph 12.49)”

– BPM7 (pre-edited version), page 889.

Introduction – research question

Q: how does the current account balance of the Dutch economy change under an alternative measure, which includes retained earnings on PI?

Motivation:

Provide policymakers with a quantitative estimate of the effect, for use in discussions on the current account. Also given that its impact on NL as a financial center country is likely substantial.

Provide a more detailed and periodically produceable estimate compared to earlier macro data estimates, using available granular data sources

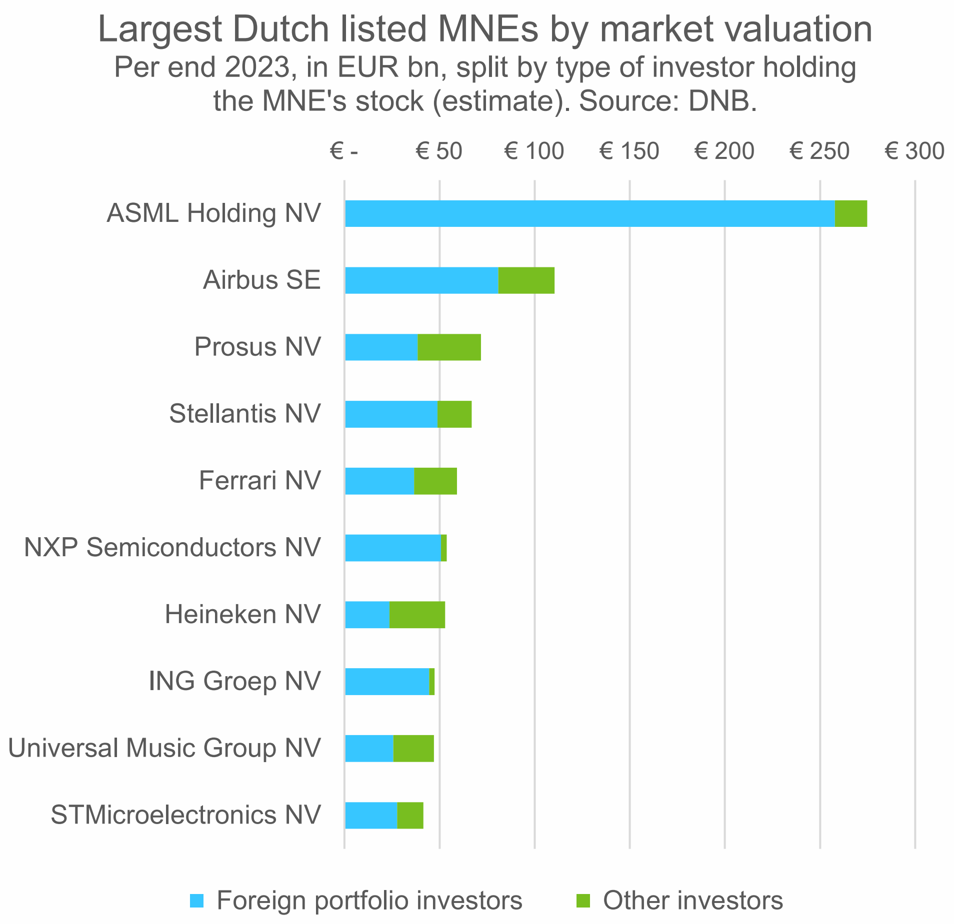
Follow up on the BPM7 recommendation to provide supplementary information

Introduction – what effect would we expect?

Given the large portfolio assets and liabilities of the Netherlands, we would expect to find substantial additional gross income flows

Debits (outflows): additional income attributed to foreign PI investors in Dutch multinationals – who often hold a large part of shares (graph)

Credits (inflows): additional income attributed to Dutch investors holding foreign equity



Methodology and data sources

Methodology

Roughly similar methodological approach as Fischer et al. (2019), but using far more detailed data

We combine granular securities data on cross border holdings – assets and liabilities – with commercial data on the earnings of institutions

We calculate a profit ratio based on granular data, project it onto the macro totals, and deduct dividends to arrive at a measure for Retained Earnings (RE)

Note that we also include indirect equity investments through foreign investment funds

Data sources

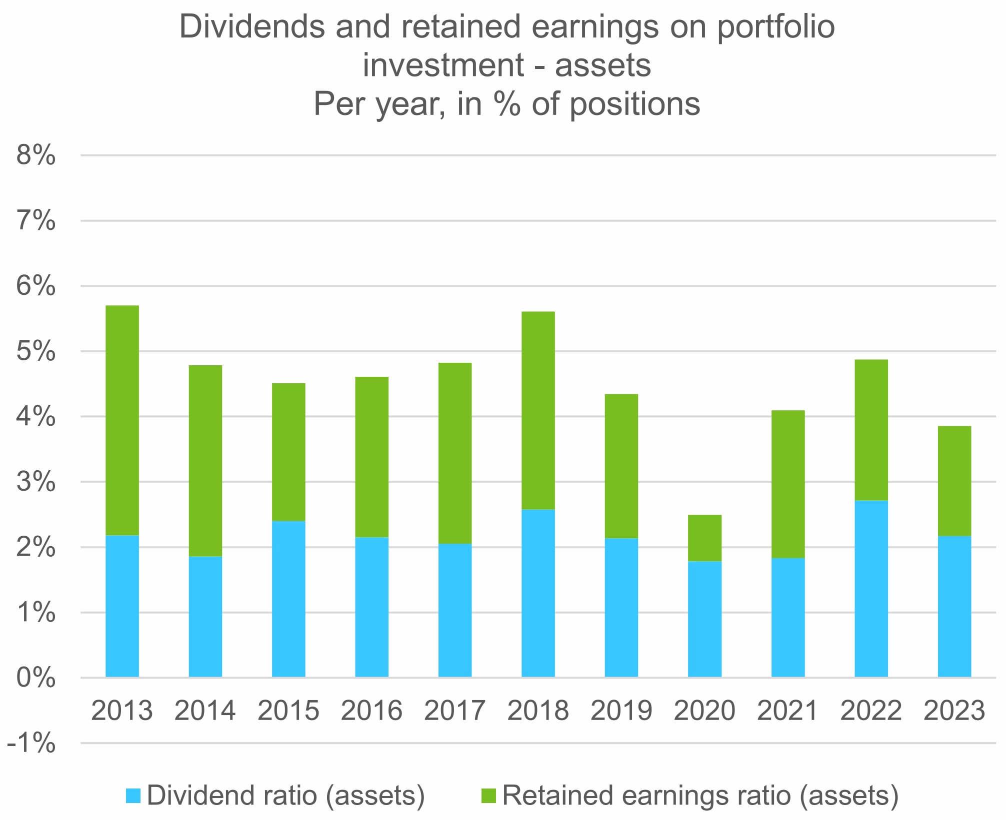
Liabilities: Centralized Securities Data Base (CSDB), originated by Dutch residents, residual approach, excluding DI positions

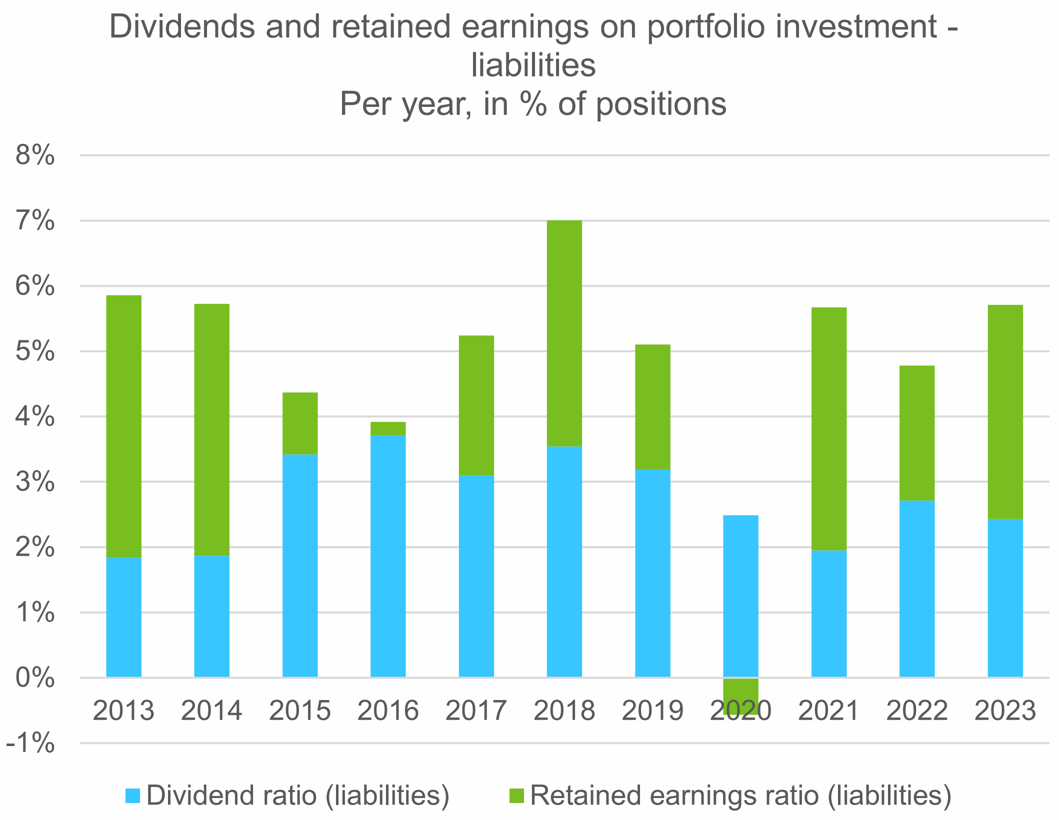
Assets: DNB Monthly Security Reporting, Dutch held, foreign securities, excluding DI positions

Earnings data for both assets and liabilities: commercial data provider (Refinitiv), basic Earnings Per Share (EPS) excluding extraordinary items

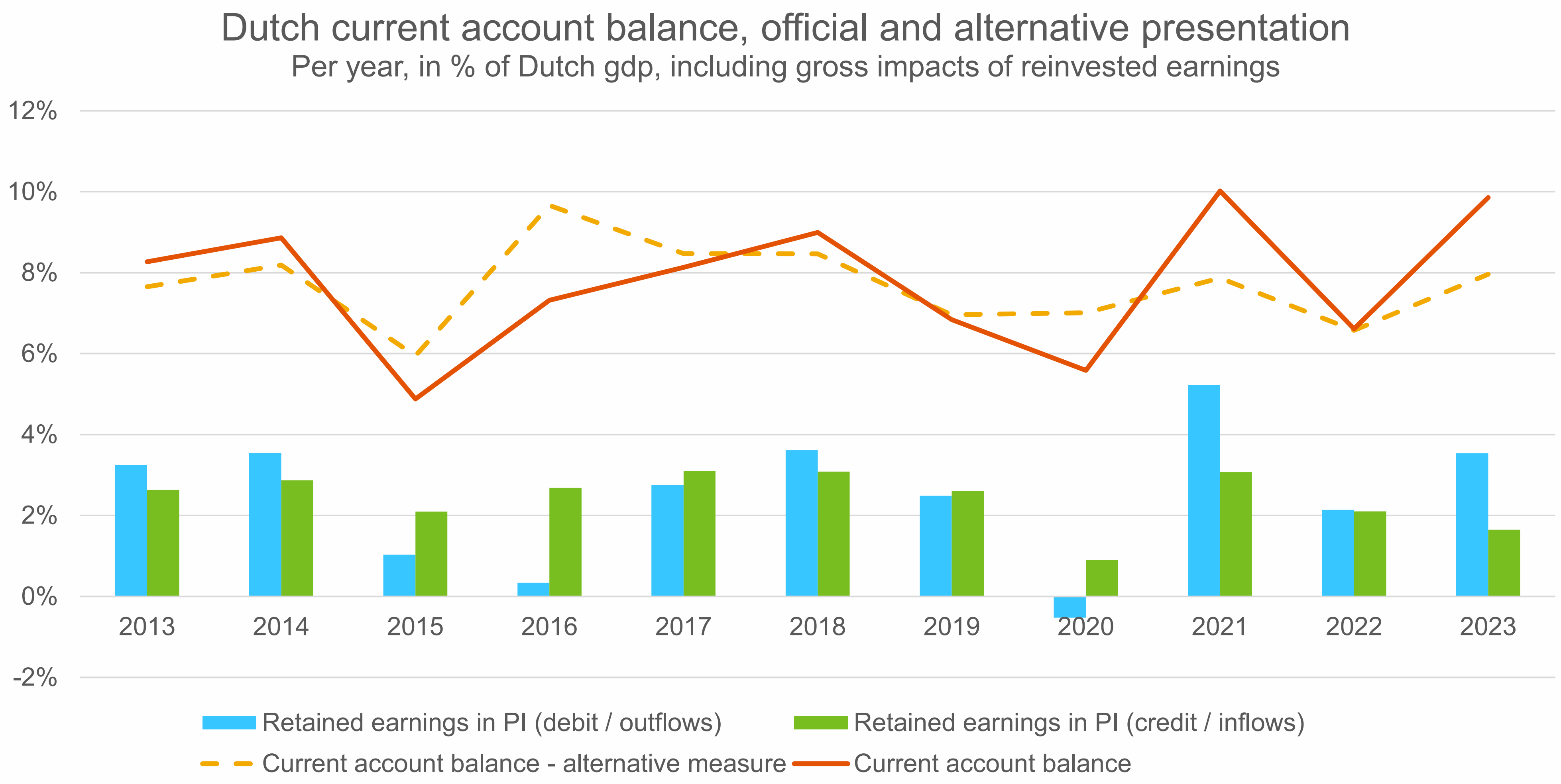
We use end of year positions as proxy for average year positions

Results – estimated retained earnings on PI





Results – official and alternative current account measure



Results - summarized

Average estimated effects for debits and credits are similar on average, in line with the large gross positions on both sides; foreign held shares in Dutch multinationals (outflows) and portfolio investment by Dutch insurers and pension funds (inflows).

The variance on the debit (outflows) side is substantially larger than on the credit (inflows) side, reflecting the diversified asset / inflows side and the relatively smaller / more concentrated population of entities on the liabilities / outflows side

The results show that the outgoing and incoming retained earnings roughly balanced each other until 2021 for the Dutch economy as a whole (but not for individual sectors of the economy!).

From 2021 onwards, the alternative measure for the current account balance is on average lower than the calculation according to official balance of payments regulations.

The change through time may be due to composition effects; Dutch entities paying relatively high dividends push down the debit RE estimate in earlier years, but corporate relocations diminished their impact on the current account

Conclusions

Definition of income used can have a substantial effect on the balance of the Dutch current account

The presented alternative measure filters out biases and developments with little no economic substance; this is advantageous for policymakers

For statisticians this analysis offers an initial, further refinable methodology for compiling supplementary information according to a broader income concept.

Also, the alternative measure also provides insights on why NL builds up less external assets than the official current account measure suggests

Finally – on the coding fun

```
# relating to the holdings of NL sectors, that we are interested in.

# first set a flag that we will use in the 'for' loop later.
initiate_id = 0
selected_rows = 0
chunk_size = 100000

# then we import and parse the relevant results into our dataset.
for ShsInputFile in InputShsFiles:

    # ShsInputFileLocation = ShsInputFile[1]
    ShsInputFilePeriod = ShsInputFile[0]

    print("\nProcessing SHS file for period " + ShsInputFilePeriod + ".\n")

    ShsInputFileLocation = direct_client_delivery.download_file(ShsInputFile[1], file_system

    for chunk in pd.read_csv(BytesIO(ShsInputFileLocation), sep=';', decimal='.', chunksize=

        # note our filters for including in our analysis:
        # HOLDER_AREA = NL (as we are interested in NL holdings)
        # VALUATION = M (market value)
        # TPH = R of Y (either direct reporting, of country flags that TPH should be used)
        # AMOUNT_TYPE = LE (end of period positions)
        # FUNCTIONAL_CATEGORY = not D (no direct investment positions, just portfolio invest

        RelevantRows = chunk[(chunk['HOLDER_AREA']=="NL") & (chunk['FUNCTIONAL_CATEGORY']!="

        # insert a marker for the period of the observation, taken from the input file array
        RelevantRows.insert(len(RelevantRows.columns), "PERIOD_END_DT", ShsInputFilePeriod)

        if initiate_id == 0:
```

If you're interested in undertaking a similar analysis, we're happy to share more information and the Python code we use

To work through a similar process, you'll need granular data on the holdings of securities, outstanding domestic securities, and some form of profit data

Part of the process is run using the Securities Holding Statistics by Sector (SHS-S) which makes it relatively easily portable to other Eurozone countries

More information?

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Rini Hillebrand, Melle Bijlsma & Luuk Verstraaten

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DeNederlandscheBank

EUROSYSTEEM

You can find the full study here, including a detailed description of the methodology:

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E-mail: betalingsbalans@dnb.nl