Reducing large net foreign liabilities

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Abstract

In light of persistently large net foreign liability (NFL) positions in several euro area countries, we analyse past episodes of successful reductions of NFLs for a broad sample of advanced and emerging economies. We provide stylised facts on the channels through which countries reduced net foreign liabilities and estimate factors which make episodes 'stable', i.e. sustained over the medium term. Our findings show that growth and valuation effects contributed most to reductions of NFLs, while stable episodes also required positive transaction effects (i.e. current account surpluses). In emerging economies, reduction episodes were almost exclusively driven by a decline in gross liabilities, while in advanced economies also gross asset accumulation contributed significantly, in particular for stable episodes. Formal regression analysis shows that NFL reductions are more likely to be sustained over the medium term for episodes with stronger real GDP growth, larger current account surpluses, IMF programmes and fixed exchange rate regimes.