International investment position: we're still a net-debtor nation

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A country's international investment position is like an external balance sheet, which represents the total holdings of foreign financial assets by domestic investors and domestic financial assets by foreign investors, usually at year-end.

Net IIP is the difference between the country's external financial assets and liabilities.

The latest figures at year-end 2010 indicate that Thailand retains its external "net debtor" status with a net IIP deficit of US$36.3 billion, up markedly from the deficit of $1.9 billion at end-2009.

The record-low 2009 deficit was due primarily to strengthening external assets, especially the build-up in international reserves, and foreign investors' fund withdrawals from the Thai capital market on account of liquidity needs during the sub-prime crisis.

In 2010, foreign assets owned by Thai investors increased markedly, which reflected the accumulation of gross reserves. However, external liabilities were built up faster than the asset side. On the liability side, the significant increase in foreign holdings of financial assets in Thailand was mainly caused by foreign direct investment (FDI) and foreign portfolio investment (FPI) in equities.

This was in line with growth differentials between the major industrialised countries and the emerging market economies, which resulted in more capital flows into Asia, including Thailand.

Capital inflows also reflected increased short-term external borrowings in the banking sector, that were primarily associated with operations to accommodate rising demand for foreign exchange hedging by Thai exporters.

Looking more closely at Thailand's IIP, there are asset-liability mismatches, both in the form of institutional sectors and types of financial instruments.

Most of Thailand's external assets are in the public sector - predominantly in terms of gross reserves, which were registered at $188.3 billion at end-August 2011.

By contrast, most of Thailand's external liabilities are FDI and FPI in equity securities in the private sector. At end-2010, FDI and FPI in equities were registered at 46 per cent and 23 per cent of total external liabilities, respectively. FDI is primarily clustered in private enterprises in industries such as autos, electric appliances and chemicals.

Indeed, like many other emerging market economies, Thailand has largely relied on capital, know-how and technology from outside the country over the past decades.

Taken together with the recent high global liquidity, which supports inflows to such countries with favourable rates of return as Thailand, external liabilities have been accumulated faster than external assets, inevitably resulting in a deficit of net IIP over time.

Going forward, increased ownership of external assets by Thai investors is necessary for Thailand to become a net creditor nation with capital flows that are more balanced and a net external position that is driven more by the private sector.

To this end, Thailand should further liberalise constraints on capital outflows. Given the time lag involved in policy implementation, this should be done as soon as possible.

In fact, the Bank of Thailand is in the process of drafting the Capital Account Liberalisation Master Plan to promote more outward investment. All relevant economic environments are supportive of accelerating this master plan.

Effective promotion of overseas investment requires Thailand's stakeholders, both public and private sectors, to be better coordinated.

It is important to note that an assessment of the country's overall external stability must go beyond IIP analysis.

For example, a wealthy country with strong growth prospects, developed financial markets, high savings and plenty of natural resources could either rely on domestic sources of funding and resources, and have low external liabilities, or be an attractive country for foreign investors, and end up with high external liabilities.

One also needs to review the fundamentals of the economy and other basic external vulnerability indicators such as the current level of external debt, the reserves to short-term debt ratio and external debt to GDP ratio in order to achieve a more comprehensive picture.

The views expressed are the author's own.

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