I. Recent developments in cross-border capital flows in the euro area[1]

Between 2008 and 2012, a substantial proportion of cross border financial flows in the euro area was taken over by official financing provided by central banks, as shown by the emergence of the so-called TARGET2 balances, or by governments in the context of financial assistance programmes. They were an important avenue through which debtor countries with balance of payments in distress managed the 'sudden stop' in private capital inflows that they were experiencing at the time. This section uses balance of payment data to look in depth at developments in financial flows since the European Central Bank (ECB) announced its Outright Monetary Transactions (OMT) programme in the summer of 2012. The data show that, since then, net private financial flows have resumed while official flows have in general come down. Private capital outflows have once again been the main counterpart to the current account surplus in Germany. After having experienced massive private capital flights during the peak of the crisis, debtor countries have seen either a return of net private inflows (Spain) or at least, a marked slowdown in net private outflows (Greece, Portugal). To a lesser extent, private capital net inflows have also returned to Italy. Overall, the partial replacement of official funding by private capital can be interpreted as a sign of regained confidence in the euro area. When looking at gross inflows and outflows, however, the picture is less benign and there are still signs of financial fragmentation despite the overall narrowing of the sovereign bond spreads. The strong dynamics of cross-border financial asset acquisition observed in pre-crisis years has not returned yet and both debtor and creditor countries seem to remain in "deleveraging" mode. In Germany, private net outflows appear to mainly reflect a marked decrease in debt inflows rather than an actual accumulation of foreign assets. In Spain, Italy, Portugal and Greece, the strong decline in foreigners' purchases of their debt, which was a main feature of the crisis period, has mostly come to an end but the trend has not reversed. ([1])

Introduction

Over the past few years, the current accounts of a number of countries including Greece, Spain and Portugal have reversed form very high deficits to balanced or even small surplus positions. By contrast, high surpluses in creditor countries such as Germany and the Netherlands have persisted and are forecast to remain high. As a result, the euro area as a whole is now posting a current account surplus. In a past issue of the *Quarterly Report on the Euro Area*, the nature of this rebalancing has been analysed through the lens of current account. ([2]) The aim of this section is to look more in depth at how this recent rebalancing has been reflected in the financial accounts of selected euro area economies.

The starting point is to update previous analyses which assessed how the rebalancing had taken place in the financial accounts up to 2012, taking into account the role played by TARGET2 balances. ([3]) It has been shown that the external adjustment during 2011 and 2012 coincided with lower net inflows of debt for the countries in distress. In addition, significant changes in the debt flows composition in both creditor and debtor countries took place due to an increased resort to official flows, in the form of either TARGET2 obligations boosted by refinancing operations carried out by the Eurosystem, or money directly coming from official financial assistance (EFSF, ESM, bilateral loans). These official flows, most of which peaked in 2012, compensated for the drying up of private in-(out) flows. By contrast, net equity flows did not experience significant changes.

The objective of this section is to revisit this work, focusing on developments that have taken place since the summer of 2012 when the ECB announced the introduction of a new conditional asset purchase programme for undertaking outright monetary transactions in secondary market for

(1) Section prepared by Alexis Loublier.

(2) Demertzis, M. and A. Hobza (2014), 'External rebalancing in the euro area: progress made and what remains to be', *Quarterly Report on the Euro Area*, Vol. 13 No 4.

(3) Merler, S. and J. Pisani-Ferry (2012), 'Sudden stops in the euro area', *Bruegel Policy Contribution*, Issue 2012/06 and Jevcak, A. and R. Kuenzel (2013), 'Recent capital flow developments in the euro area', *Quarterly Report on the Euro Area*, Vol. 12 No 2.

sovereign bonds (OMT). ([4]) This period is marked by the overall narrowing of the sovereign bond spreads and is widely seen as corresponding to a change in investors' appraisal of risks in the euro area. It is therefore important to see how this change has affected private capital flows in the euro area and if it has led to reduction in financial fragmentation. The analysis covers the period until Q1-2014.

The value added of the section is threefold. *First*, it examines not only net flows but also the gross components of the financial account (gross inflows and outflows). The distinction between net and gross flows is essential, as changes in net flows may be related to different underlying investor behaviours and the signals sent by financial markets (selloff of a certain type of assets, increased purchases of others), are not captured by net flows. For example, surpluses may result either from a reduction in liabilities towards the rest of the world, or from actual purchases of assets abroad. These two distinct features do not have the same implications in terms of rebalancing and risk exposure. A progressive reduction in liabilities may reflect the reduction of a country's dependence vis-à-vis foreign investors and this retrenchment may be a sign of persistent fragmentation forces which reduce the scope for cross-border risk sharing. A continuous accumulation of foreign assets may imply growing exposure to exchange rate risk and reduced room for national authorities to reduce risk (e.g., via prudential or regulatory measures), as the share of assets in domestic portfolios originating in foreign countries becomes larger. *Second*, this section provides a clear breakdown of the financial flows by instrument: a distinction is systematically made between TARGET2 balances and programme disbursements on the one hand, and private transactions involving debt instruments and equity flows, on the other. *Third*, a tentative interpretation of the factors underlying recent developments is provided, in particular as regards the evolution of TARGET2 balances.

The analysis is developed in three successive steps. *First*, a distinction between private and official flows is made. *Second*, net flows are looked at across instruments, in particular focusing on the trends in debt and equity. *Third*, changes on the asset and liability sides are analysed.

Attention is paid to financial flows involving creditor countries with persistently high surpluses (Germany), debtor countries (Spain, Greece, Portugal and Italy) and intermediary countries (France). The choice of these countries is partly a reflection of data availability.

Methodology: assumptions and limitations

Following the approach used by Merler and Pisani-Ferry (2012) to illustrate the 'sudden stop' of private funds into distressed countries, this section investigates how much of the total flows for the selected countries are accounted for by the private sector and how much are in the form of official flows. Using the balance of payments classification, the distinction is obtained, by approximation, by subtracting the *other investment* balance of general government (essentially programme assistance) and central bank (essentially TARGET2 flows) from the total net inflows. Stock values are computed by cumulating flows of the financial accounts starting from 2002. ([5]) Consequently, the slope of the curves shown in the various graphs provides information on the flows. A downward-sloping line indicates net outflows (e.g. in Germany) while an upward-sloping line indicates net inflows.

For consistency purposes, funds provided by the European Investment Bank (EIB) ought to be removed in the computation of private flows. However, due to data issues, this could not be done. Conversely, structural funds provided by the EU are not removed because they constitute official aid, not official financing. In the balance of payments decomposition, structural funds are classified either in the current account balance as income from the rest of the world, or in the capital account as transfers. Thus, they lower borrowing needs.

On the rise and fall of TARGET2 balances

It is essential to bear in mind that the TARGET2 system is firstly an interbank payment system and that it processes the majority of cross-border transactions between euro area countries. A

([4]) More precisely, the section focuses on the period following the so-called 'whatever it takes' speech: Speech by Mario Draghi, President of the European Central Bank, at the Global Investment Conference in London, 26 July 2012.

([5]) This section specifically focuses on the flows rather than the changes in the NIIP, taking away valuation effects and any other changes in the NIIP that do not come from flows.

transaction can be a real economy transaction, corresponding, for example, to an export/import of goods, which is recorded in the current account (CA). It can also be a purely financial transaction, like an interbank cross country loan, which is recorded in the financial account (FA). Whenever a transaction occurs, an opposite flow is recorded as a TARGET2 flow (T2), so that at any time the accounts of the balance of payments add up to zero, with the resulting TARGET2 net flow being recorded as a central bank inflow or outflow vis-à-vis the rest of the Eurosystem. (6) If financial surpluses in some Member States were entirely used to finance external deficits in others through private capital flows intermediated in the interbank market, TARGET2 balances would be zero everywhere. This was roughly the pre-crisis mechanism. (7) It then follows that non-zero TARGET2 balances may emerge for different reasons:

- The interbank market freezes, which means that banks need to refinance their liabilities to foreign banks with liabilities to the central bank. Given the financing needs and the liquidity provided by the Eurosystem, banks in distressed economies borrow directly from their national central banks instead of from foreign banks. As this constitutes a transaction between residents, it is not recorded as a balance of payments transaction. Therefore the change in the current account due to the real economy transaction is not offset by a change in the financial account and TARGET2 is the adjustment variable. This mechanism explains part of the increase in TARGET2 balances that was observed between 2008 and 2012.

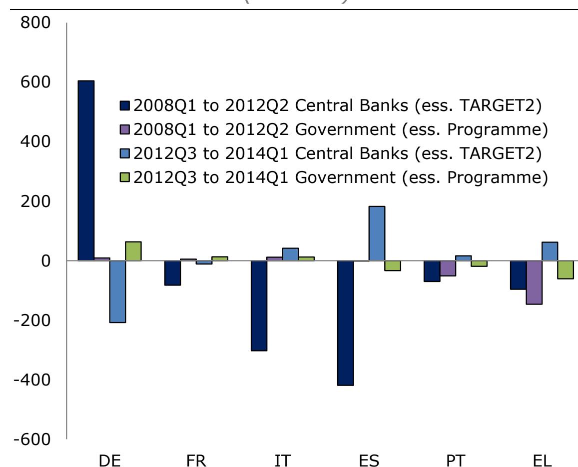
- Purely financial operations, such as foreign investors buying German debt, but also sovereign debt repayment or deposit outflows, may have no connection to the current account balance. In that case, provided that foreign investors have the liquidity to invest in Germany, the increase in the German liabilities mechanically leads to an increase in the TARGET2 claims of the same amount, *ceteris paribus*, i.e. if these inflows have no counterpart in the current account. This could partly explain the rise in German TARGET2 claims in the first half of 2012 which was marked by capital flight from periphery to core countries.

- An analogy can be made with the role of the central bank reserves in a fixed exchange rate regime. If private capital flows have no counterpart in the current account i.e., if, in aggregate terms, private inflows are not used to finance imports, then the central bank has to adjust its reserves in order to maintain the exchange rate. A similar mechanism is at play for euro area transactions, with TARGET2 balances being the equivalent of foreign currency reserves. However, unlike reserves, and although TARGET2 flows are recorded as central bank transactions with the rest of the Eurosystem, they do not involve concrete transactions between the national central bank and a foreign central bank since the liquidity is provided at the national level.

Separating private and official flows

As is known, until 2008, net flows were almost entirely private in all countries. In particular, TARGET2 balances were roughly zero, as TARGET2 flows corresponding to current account transactions were offset by TARGET2 flows corresponding to private foreign financing (see previous section). From 2008 onwards, however, private net flows started to depart from total flows in all countries as official flows gradually replaced private ones (see Graph I.1). This

Graph I.1: **Cumulated official flows**
(bn EURs)

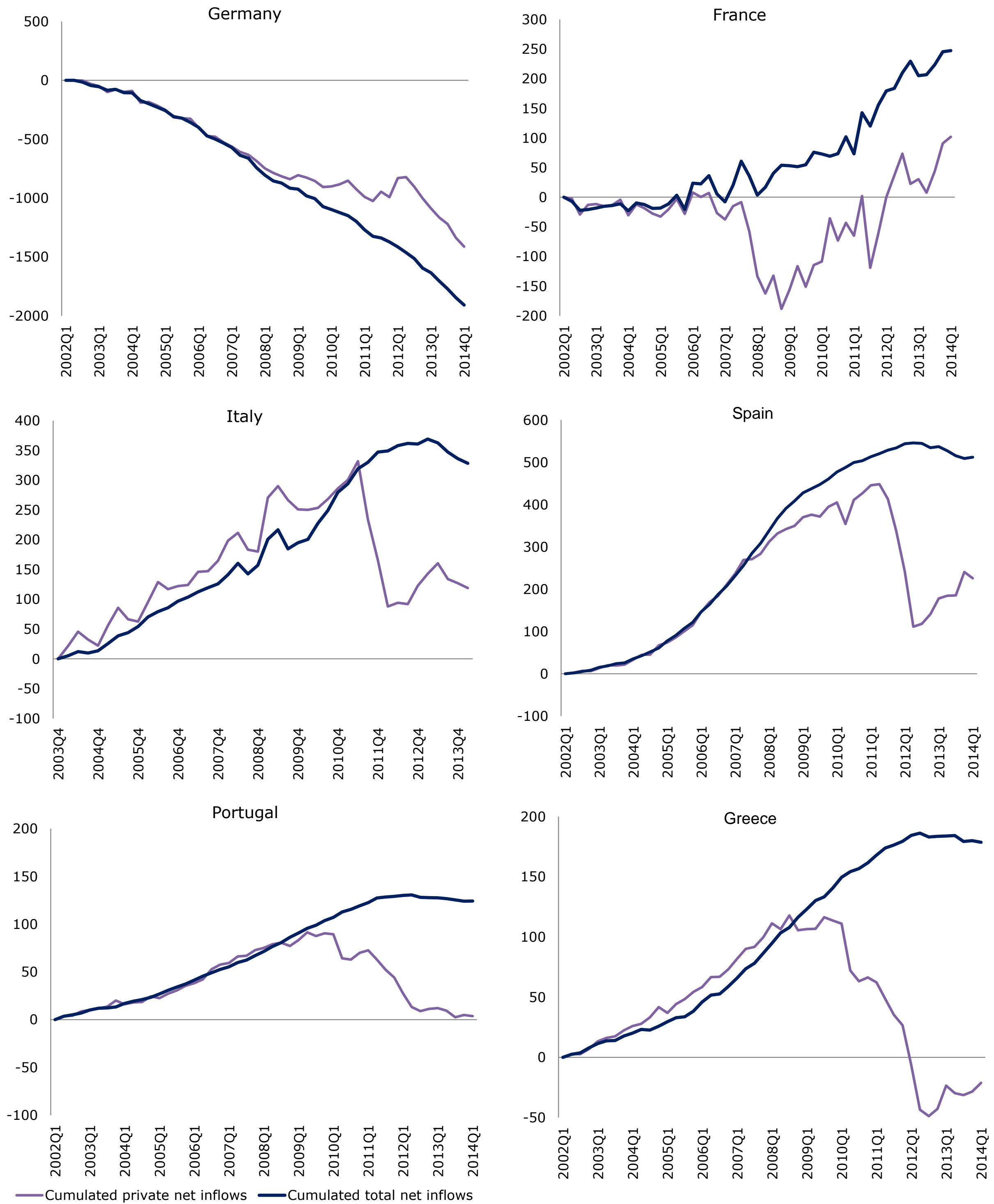


Source: Eurostat, BPM5: net other investment balance of central banks and general government.

(6) Taking capital account and error and omissions out of the picture for the sake of simplicity, the following identity holds at all times: CA+FA+T2=0.

(7) See Cecchetti, S., R. McCauley and P. McGuire (2012), 'Interpreting TARGET2 balances', *BIS Working Papers*, No 393.

Graph I.2: **Cumulated total and private net flows (1)**
(2012Q1-2014Q1, bn EURs)



(1) An upward-sloping line represents net inflows.
Source: Eurostat (BPM5), DG ECFIN calculations. Private net inflows are computed by subtracting the other investment balance of general government (essentially programme assistance) and central bank (essentially TARGET2 flows) from the total net inflows.

reflected a serious deterioration in confidence and an increased risk aversion in the private sector, especially among banks, which required the Eurosystem to step in and provide liquidity. In most cases, official flows rose in cumulated terms until the first half of 2012.

Since 2012, creditor countries have remained net exporters of financing/funding while debtor countries have started to post positive or near-balanced net outflows. This can be seen in Graph I.2. [8] The dark blue line, which represents cumulated total inflows, has been decreasing for Germany, while in the case of Italy, Spain, Portugal, and Greece, it has been increasing then stabilising or even slightly decreasing. For France, total net inflows have been on an overall positive trend.

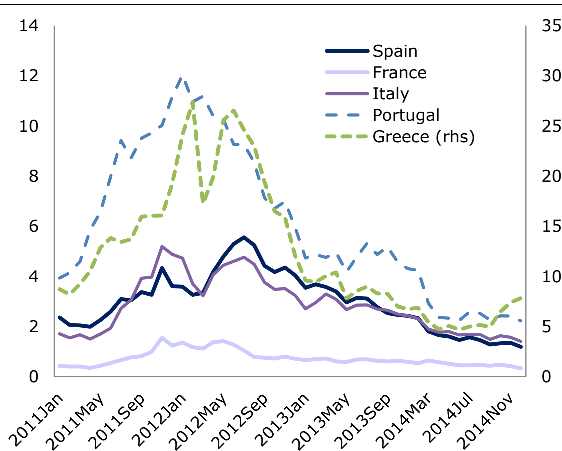
Since the summer of 2012, in Germany, private outflows, as defined in the section on methodology, have resumed in net terms, driving the dynamics of the financial account. This can be seen in Graph I.2, which shows that the gap between private and total net outflows has broadly stabilised, indicating that total net outflows are once again mainly explained by private flows.

In debtor countries, private inflows, in net terms, have been either roughly negligible (Portugal, Greece) or have resumed (Spain). For the latter country, this shows that the recent adjustment of the financial accounts has taken place through a reduction in the reliance on official flows.

In the case of Italy, private flows started to flock again into Italy right after the announcement of the ECB's OMT programme in the summer of 2012. They then turned into net outflows in 2013 when, by coincidence, Italy's overall financial account turned into a net financial surplus.

In the case of France, the decoupling between total net inflows and private net inflows seems to have started earlier than in the other countries analysed here. Since 2008, private net inflows and total net inflows have been on an overall positive trend but private flows have been quite volatile, marked by an alternation of net outflows (second half of 2011, end-2012 and first half of 2013) and net inflows (first three quarters of 2012 and since the second half of 2013).

Graph I.3: **Sovereign bond spreads vis-à-vis the German bund**
(2011-2014, %)



Source: Eurostat (in %)

The overall conclusion one can draw from this first step is that, since end-2012, private net flows have been once again explaining most of the dynamics in the financial accounts of Germany, France, Italy, Greece and Portugal. By contrast, Spain has been registering net private inflows on average while overall positive net outflows have been observed, signalling that the reduction in official flows has played a predominant role.

Decomposing the evolution of net financial flows by instruments

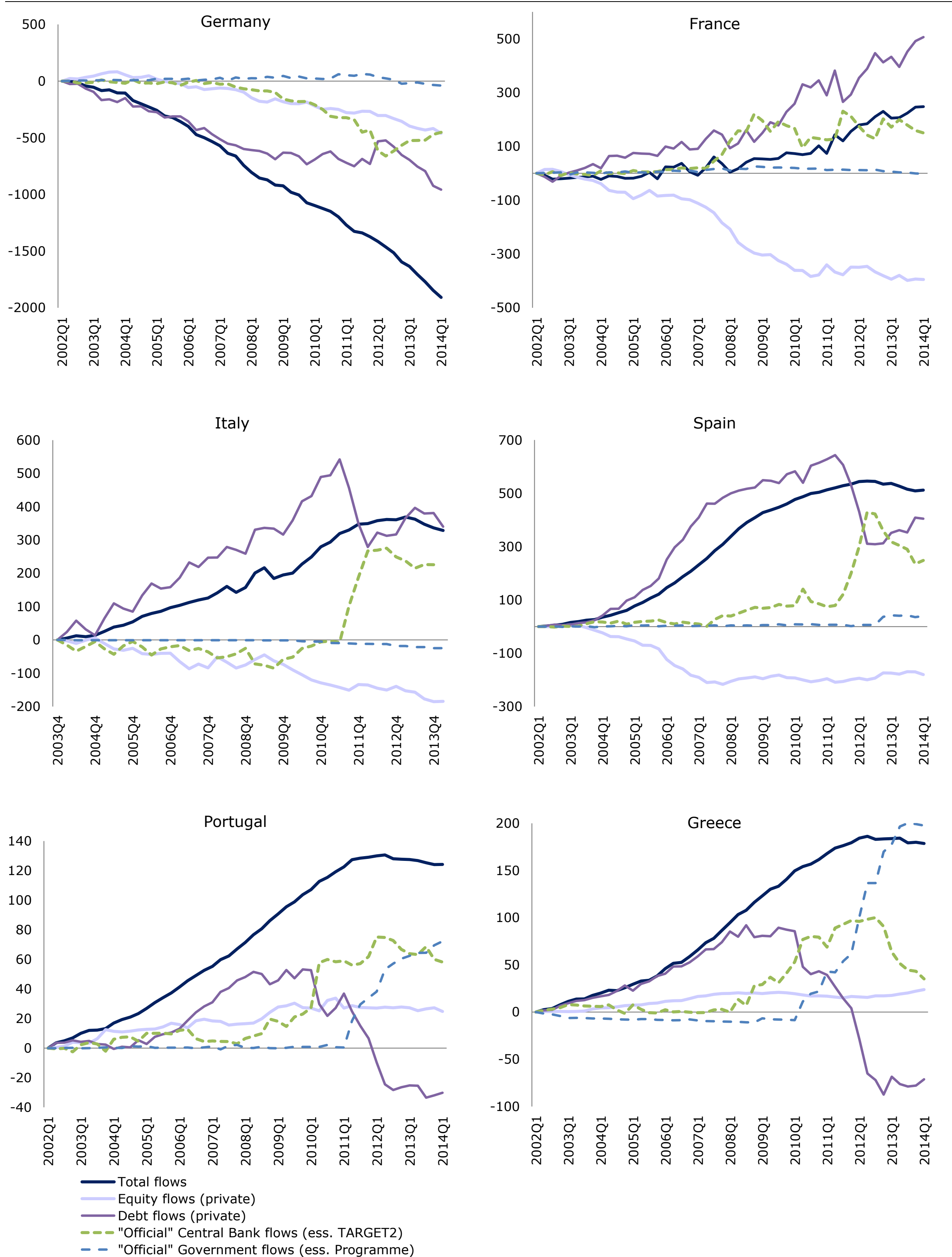
Net flows can be broken down further, focusing on whether they are of debt or equity type, as illustrated in Graph I.4. Using the same convention as in Graph I.2, Graph I.4 shows cumulated net inflows by distinguishing between the different components of the financial account.

It appears that the resurgence of private net outflows from Germany since 2012 (around 450bn EURs) mainly reflects net debt outflows (430bn EURs). At the same time, TARGET2 claims have started to decline, but the reduction has been of a lower magnitude (roughly –200bn EURs). Net equity outflows have also been registered at roughly the same pace as in the pre-2012 period: the slope of the equity flows line has not changed significantly since 2008.

[8] Unless otherwise mentioned, the data presented in this section are data following the BPM5 manual. The last observation compiled by Eurostat in this statistical standard is 2014Q1. More recent observations in BPM6 will be used when the full set of components of the financial account is complete.

Graph I.4: **Cumulated private net flows by instruments**

(2002Q1–2014Q1, bn EURs)



(1) An upward-sloping line represents net inflows.
Source: Eurostat (BPM5), DG ECFIN calculations. The category 'debt' contains portfolio debt, other investment (apart from central bank's and general government's) and financial derivatives. The category 'equity' contains FDI and portfolio equity. The category 'official central bank' contains other investment of central bank and official reserves. The category 'official government' contains other investment of general government.

In the case of Spain, Portugal and Greece, a common feature is the reduction in their TARGET2 liabilities, which occurred in parallel with the financial assistance they received. (9) For Spain, the resurgence of private inflows discussed earlier mainly comes from positive net debt inflows (+90bn EURs and around +20bn EURs respectively) while net debt flows have been almost negligible for Portugal and Greece. In the case of Spain, the reduction in TARGET2 liabilities seems to be driven, to some extent, by the resurgence of net debt inflows whereas in the other debtor countries the fall in TARGET2 liabilities mostly mirrors the fall in the current account deficit. The dynamics in net equity flows in all of these countries, by contrast, have been relatively stable.

As mentioned in the previous section, since 2012, Italy has been through two distinct periods. Right after the ECB announced its OMT programme, when confidence was quickly restored (as shown by the rapid narrowing of the sovereign spread), TARGET2 liabilities started to decline and private debt inflows resumed. However, this trend stopped in the first half of 2013 when the country's position turned into a financial surplus. Since then, the decrease in TARGET2 liabilities has slowed and debt flows have turned into net outflows, which may reflect a persistent reluctance of private investors to invest in Italian debt despite the narrowing of the spread. In parallel, Italy has been registering positive net equity outflows.

In the case of France, the dynamics of private flows since mid-2012 can be better understood by starting in the second half of 2011. Graph I.4 shows that the dynamics of private flows described in the previous section is mainly driven by capital flows involving debt assets. Tensions in the French banking sector started to rise in the second half of 2011 with the sovereign spread increasing by 1.2 pp between April and November 2011. This translated into an increase in TARGET2 liabilities with a concomitant reduction in the net debt inflows. The tensions in France then cooled off to some extent and the widening of the spread came to a halt. The first three quarters of 2012 were marked by positive net debt inflows and a decrease in TARGET2 liabilities. Following the announcement of the OMT programme, the spread narrowed quickly and debt flows turned into net outflows until the first half of 2013. Since then, net debt inflows have been on a positive trend again, with a concomitant decrease in TARGET2 liabilities. By contrast, net equity flows have shown little volatility and have been almost negligible since mid-2012.

The overall conclusion from this second step is that the recent developments in private flows described in the previous section mainly reflect debt instruments rather equity and, in most cases, they have coincided with smaller reductions in TARGET2 claims or liabilities.

Distinguishing between gross outflows and gross inflows

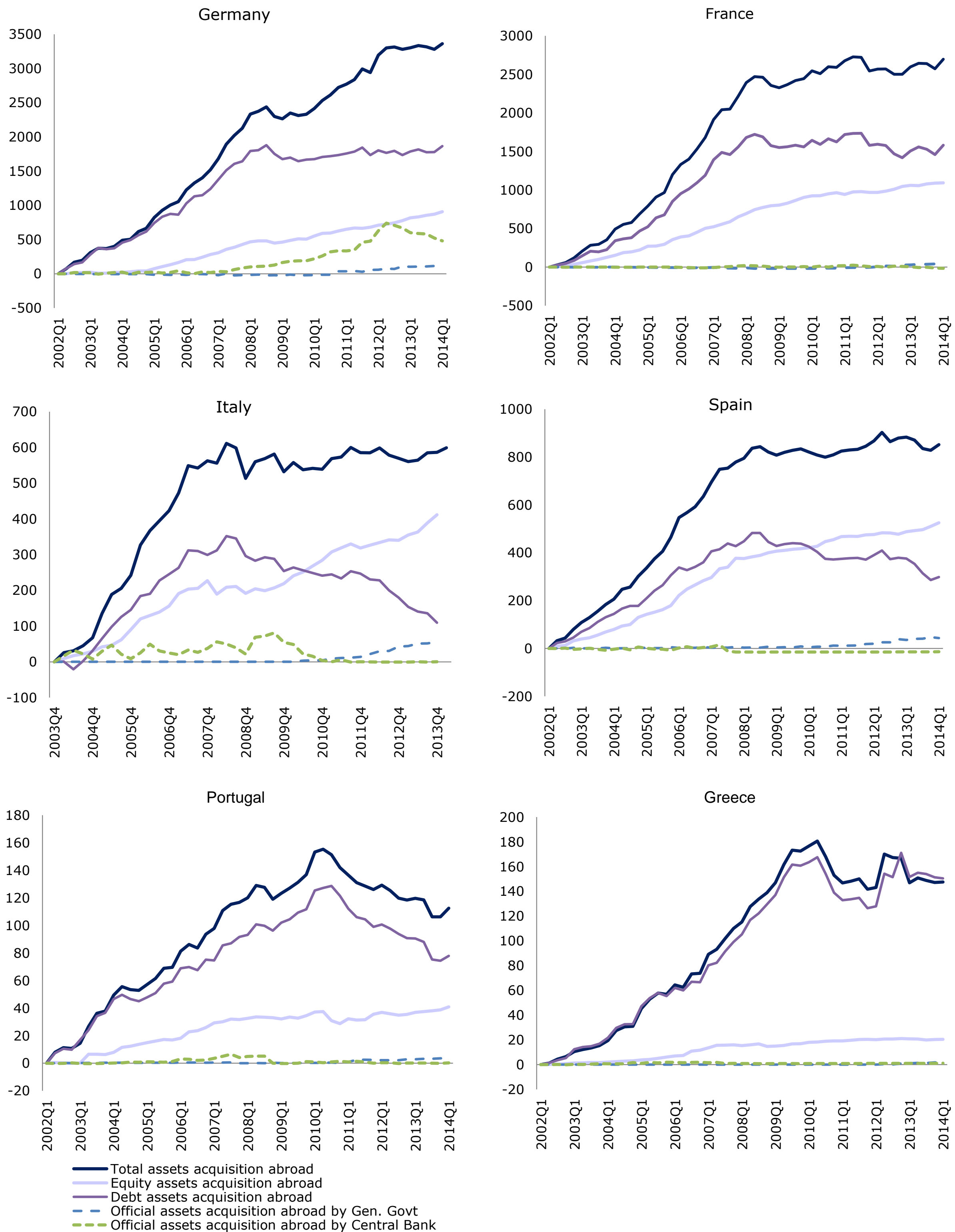
The analysis conducted in the previous sections describes developments of cross border financial flows in net terms i.e resulting from the combination of two distinct types of financial transactions: the acquisition or selloff of foreign assets by domestic investors minus the acquisition or selloff of domestic assets by foreign investors. This section examines the underlying gross inflows and outflows of the data commented on earlier. In particular, this allows to shed more light on the origins of TARGET2 flows.

Looking at Graph I.5 which shows cumulated assets acquisition abroad, it appears that since 2012, Germany has considerably reduced its pace of foreign asset accumulation (roughly 60bn EURs compared to 1tn EURs between Q4-2008 and Q2-2012). Looking more in depth into the type of instruments being acquired, it appears that German purchases of debt instruments have amounted to 100bn EURs since 2012, far lower than the net figures (400bn EURs) and equity holdings have increased by 180bn EURs. The increase in debt assets mainly reflects acquisition by the non-financial sector, while cross-border loans by German banks have decreased. (10) These moves have been more than compensated for by the decrease in the TARGET2 claims. Looking at the liabilities components in Graph I.6, an important feature is the strong reduction in the total liabilities of 350bn EURs. This reduction has primarily been driven by Germans buying back their own debts or not refinancing them (-310bn EURs, mainly explained by interbank loans). Combining the

(9) As data presented here are up to 2014Q1, they do not cover the period following the programme exit for Portugal and Spain.

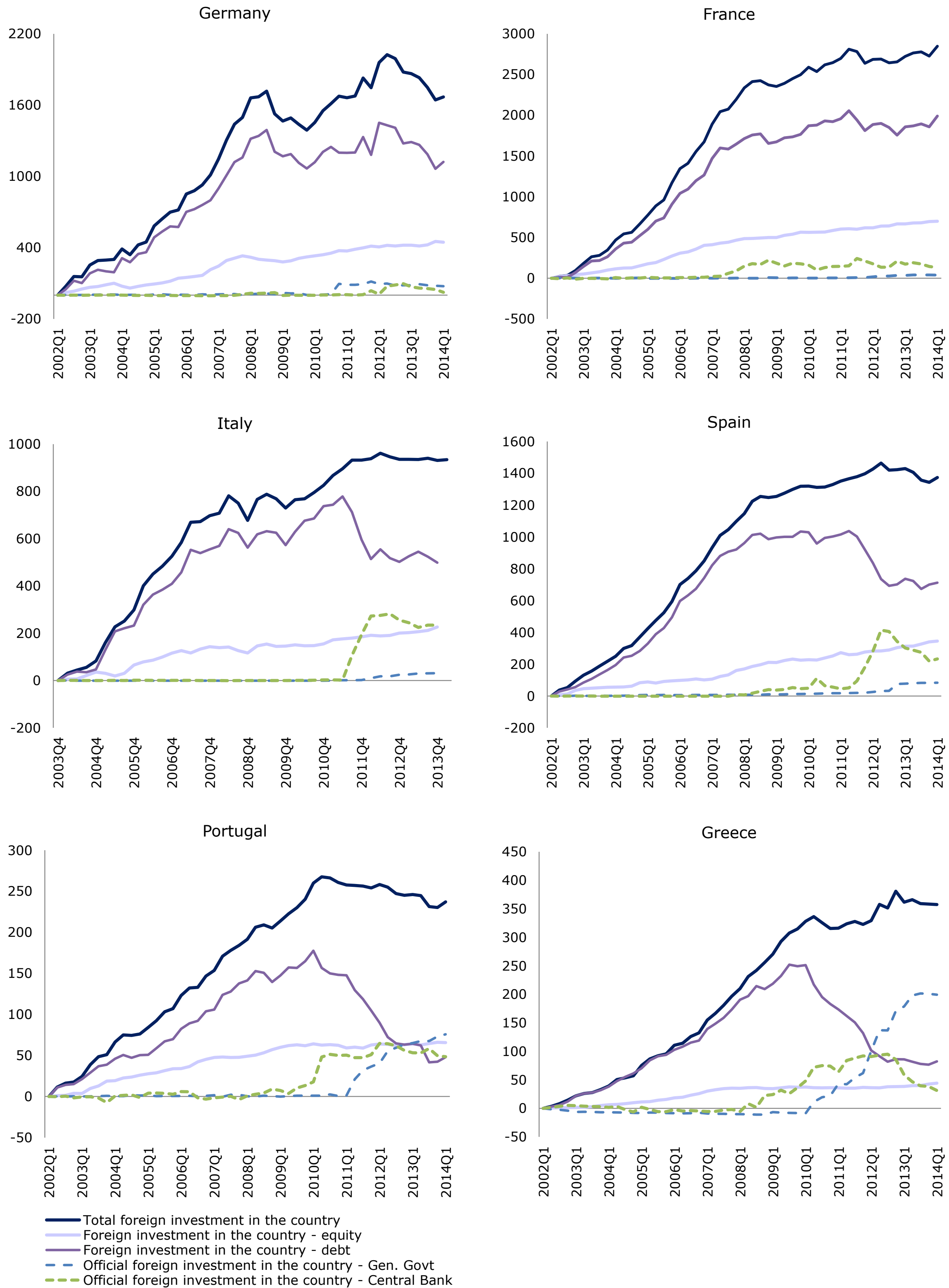
(10) The analysis uses also the decomposition of the debt flows by sectors and by instruments provided by Eurostat.

Graph I.5: **Cumulated assets acquisition by instruments, excluding financial derivatives**
(2002Q1–2014Q1, bn EURs)



Source: Eurostat (BPM5), DG ECFIN calculations. The category 'debt' contains portfolio debt and other investment (apart from central bank's and general government's). The category 'equity' contains FDI and portfolio equity. The category 'official central bank' contains other investment of central bank. The category 'official government' contains other investment of general government.

Graph I.6: **Cumulated liabilities flows by instruments, excluding financial derivatives**
(2002Q1-2014Q1, bn EURs)



Source: Eurostat (BPM5), DG ECFIN calculations. The category 'debt' contains portfolio debt and other investment (apart from central bank's and general government's). The category 'equity' contains FDI and portfolio equity. The category 'official central bank' contains other investment of central bank. The category 'official government' contains other investment of general government.

developments in gross components, the picture that emerges for Germany is that, in aggregate terms, the recent positive net outflows are mostly due to a reduction in liabilities rather than an increase in foreign asset acquisitions. German banks' debt liabilities, which peaked in 2012 (a reflection of Germany being seen as a safe haven), have since then been on a decreasing path, which seems, to some extent, to mechanically explain the decrease in TARGET2 claims. The latter would thus not reflect a normalisation of the interbank market, with German banks willing to lend again, but would rather reflect a mechanical reshuffling of the financial accounts coming from the reduction in debt liabilities, with probably no direct connection to the overall surplus position. In other words, the reduction in debt liabilities does not seem to be matched by another flow in the current account or the financial account, and TARGET2 flows seem to be the adjustment variable.

For Spain, Italy, Portugal and Greece, a common feature emerges in relation to the dynamics of debt flows. Since 2012, each of these countries has been selling foreign debt assets, while on the liability side, debt inflows have stabilised or have been barely decreasing. A mechanical consequence is the decrease in their TARGET2 liabilities. It then appears that the recent decline in TARGET2 liabilities does not have the same origin as in the pre-2012 period when the surge in TARGET2 liabilities was mainly associated with a drop in debt liabilities. Overall, following the ECB's OMT announcement, the strong reduction in private debt inflows has come to a halt but the trend has not reversed.

In France, during the tensions in the second half of 2011, the reduction in net debt inflows came from a reduction in the gross inflows (mainly interbank loans) but also from a selloff of foreign portfolio debt. Until the third quarter of 2012, the net debt inflows mainly reflected a selloff of loans by banks while gross debt inflows were almost negligible. Since end-2012, the liability side of the French financial account has been characterised by a significant increase in debt instruments (+235bn EURs). However, this increase does not reflect an expansion of the bank liabilities as it mainly stems from debt issued by French companies, probably seeking an alternative to bank lending. In parallel, on average since end-2012, France has increased its foreign debt holdings by about 160bn EURs.

Financial flows involving equity have in general not shown significant changes, except in Italy which has seen a significant increase in equity outflows since mid-2013 is worth noting. Also, in Germany, the only type of assets that has been actually purchased in recent years is equity.

A step further: geographical breakdown of German assets acquisitions

In this final section, data provided by the Deutsche Bundesbank are used in order to get a sense of the geographical destination of German investments. The section focuses on the asset side of the German financial accounts since, in general, statistics related to bilateral financial flows provided by national institutions tend to be more reliable for asset holdings than for liabilities. One reason explaining the difficulty to obtain directly reliable statistics for the liabilities side can be linked to the presence of major clearing houses in Belgium and Luxembourg which makes it less straightforward to track the ultimate holder of liabilities. (11)

Graph I.7 presents the cumulated assets acquired by Germany, distinguishing between the euro area and the rest of the world. The lower part of the graph focuses on several countries of the euro area and TARGET2 claims. It appears that, since 2012, the slowdown in the German assets acquisitions presented in the previous section has mainly concerned the euro area.

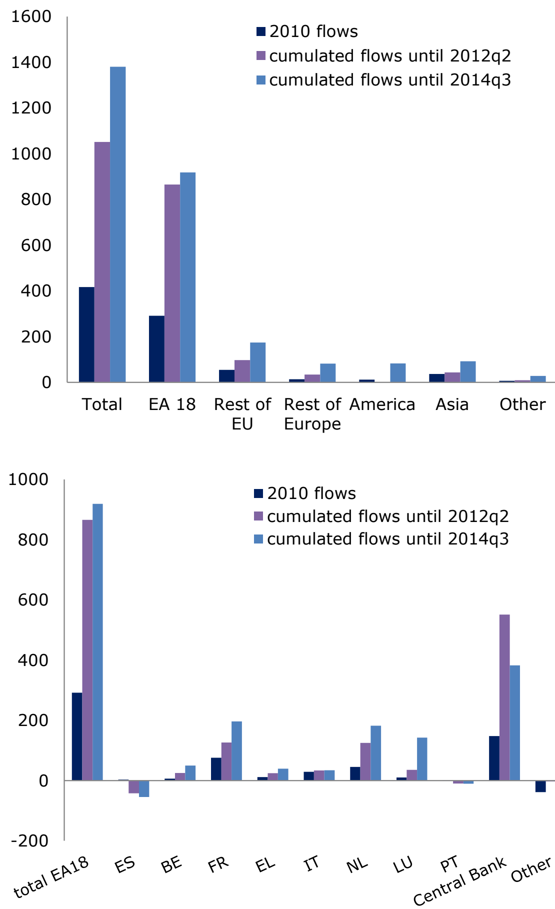
Looking more in-depth, it appears that the slower accumulation has been mainly driven by the decline in TARGET2 claims and that it also concerns vulnerable countries such as Spain, Portugal, or Italy. Conversely, Germany has actually kept on investing in core countries such as France, the Netherlands, Luxembourg and Belgium.

In terms of rebalancing, this analysis is a first step of an attempt to complement the diagnosis that is made when looking at bilateral trade linkages, where Germany appears to have reduced its current account surplus vis-à-vis the euro area and increased its current account surplus vis-à-vis the rest of the world. Although the analysis remains somewhat partial here and needs further

(11) For an in-depth discussion of bilateral financial flows, see Hobza, A. and S. Zeugner (2014), 'Current Accounts and Financial Flows in the Euro Area', *Journal of International Money and Finance* Vol. 48, Part B, pp. 291-313.

investigation, since only the asset side is considered with no breakdown by instruments, a qualitatively similar pattern seems to emerge from a financial account perspective.

Graph I.7: **Geographical breakdown of foreign assets acquisitions by Germany**
(bn EURs)



Source: Bundesbank

Conclusion and way forward

The main conclusions that emerge from the three-step analysis presented in this section are the following:

Since the summer of 2012, private capital flows have resumed in net terms, partly replacing official funding which has in general come down, mainly as the result of the overall reduction in TARGET2 balances. This can be interpreted as a sign of regained confidence in the euro area, as also suggested by the progressive narrowing of the sovereign bond spreads.

The re-emergence of private flows concerns both creditor and debtor countries but the situation in the latter group varies depending on the countries: Spain, and to a lesser extent Italy, have been once again experiencing net private inflows, while in the case of Portugal and Greece, the data suggest that net private outflows which had peaked in 2012, have only roughly stabilised.

When looking at gross outflows and inflows, however, the picture is less benign. The strong dynamics of cross-border asset acquisition of pre-crisis years has clearly not returned. Both debtor and creditor countries seem to remain in a "deleveraging" mode: debtor countries have been selling their foreign assets (mainly debt instruments) rather than accumulating new liabilities while creditor countries have been reducing their liabilities rather than acquiring new foreign assets.

All in all, the analysis suggests that, although the private sector has largely regained importance as a driver of net financial flows in a context of accommodative monetary policy and narrowed sovereign bond spreads, there are still signs of fragmentation in the euro area and the interbank market has yet to fully return to normal:

- Compared with the pre-2012 period, Germany has considerably reduced the pace at which it accumulates foreign assets, particularly those from Spain, Portugal and Italy. At the same time, it has been reducing its liabilities towards the rest of the world. The reduction in Germany's TARGET2 claims seems to some extent the mechanical result of foreign investors reducing their exposure to Germany, reversing the flight-to-safety flows seen before mid-2012.

- In Spain, Italy, Greece and Portugal, the ECB's OMT announcement and the reappraisal of risks that followed, have led to the stabilisation of the debt inflows in these countries, although the trend has not been reversed. At the same time, these countries have been selling some of their foreign debt assets. The combination of these moves, along with other financial flows like official assistance or equity flows, is reflected in the decline in their TARGET2 liabilities.

- Since end-2012, unlike other countries analysed here, France has actually been purchasing foreign debt while French debt has also attracted debt inflows.

The analysis in this section only covers the period between mid-2012 until the first quarter of 2014. Although the data since then is still incomplete, it seems likely that some of the trends described here may have come to an end over the summer of 2014. According to more recent data, the overall reduction in TARGET2 balances seems to have come to halt or even started to reverse since summer 2014, particularly for Germany, Italy and Greece. [12] This re-widening of TARGET2 balances could be a reflection of renewed tensions in financial markets stemming from a re-appraisal of sovereign risk and the reorientation of portfolios towards safer assets. However, a complete set of balance of payments data covering the most recent period would be needed to better understand these more recent TARGET2 movements.

Finally, the analysis presented in this section is a first attempt to design a framework in which financial accounts could be examined in a systematic manner. It calls for regular updates and further investigation, with a view to providing a proper assessment of external imbalances and their implications for the euro area's rebalancing from a financial flows perspective. In particular, the framework presented here could be enriched to address questions to be explored in a future work: what can explain the move by German investors away from the euro area and the only limited return of inflows into debtor countries? Is this a sign of persistent financial fragmentation forces? What can explain the persistence of fragmentation despite very low interest rates? How solid is the return of confidence and how vulnerable are capital flows to sentiment reversals?

[12] See monthly statistics of national central banks' balance-sheets.