



3% of GDP in the long-term, but as a cumulative stock measure, the NIIP is slow to reflect structural breaks in an economy's flow of funds.

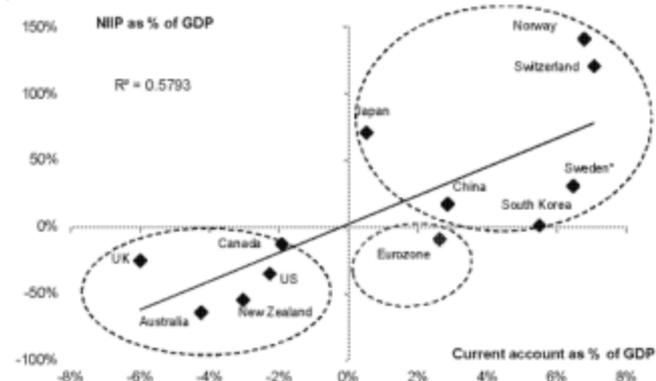
The Eurozone's incomplete transition is palpable when plotting average G10 current accounts against the latest NIIPs for Q3 2014 (Figure 7). All countries except the euro-area are in balance, with their structural surpluses (deficits) reflected in positive (negative) NIIPs. The EMU cuts a lonely figure in the bottom-right quadrant.³ We also include South Korea, which scraped into the first quadrant only last autumn following a twenty-year adjustment process. Korea is further advanced than Europe on a similar path towards economic Japanization, and we therefore study its case in more detail below.

The external accounts of individual member states vary significantly.⁴ Germany and the Netherlands are long-standing creditor nations. Germany's NIIP remained positive even as it borrowed heavily during the 1990s to finance reunification. Yet while Germany and the Netherlands account for much of Europe's surpluses, others are behind the structural shift: the GIIPS. Those states whose governments were on the verge of default in 2012 had also accumulated vast external debt ratios. Post-2012 austerity extends to their external accounts, but despite painfully sustained current account surpluses, it will take a generation for Greece and Spain in particular to align their NIIPs with their newly found prudence.

Transition to mature creditor economy requires massive outflows or depreciation. While it is evident that the euro area's external account is still in transition, it is difficult to determine the precise level at which the NIIP will settle. Modeling stationary conditions for NIIPs is one of the most central and contentious exercises in modern macroeconomics. We use a few simple frameworks to estimate the Eurozone's 'equilibrium NIIP'. Although these estimates vary, they all yield the fundamental conclusion that the structural adjustment is far from over.

Theoretical debt sustainability models essentially ask what current account level is consistent with a country's steady-state growth rates and stationary external debt levels. We flip these models around: given current account surpluses are here to stay, as argued above, what is the implied stationary NIIP level? In a simple stock-flow model, akin to Domar's classic public debt model, the stationary condition for

Figure 7: Only Eurozone has stock-flow mismatch in G10



Source: Deutsche Bank, Haver. Note: Sweden's NIIP adjusted for hidden capital outflows, see footnote 3.

Figure 8: Transition driven by austerity in near-defaulters



Source: Deutsche Bank, Haver

³ We adjusted the official Swedish NIIP of -10% for the fact that about half of Swedish capital outflows in the past two decades have not been recorded in the balance of payments. We demonstrate this in detail in our recent report "Dark matter: the hidden capital flows that drive G10 exchange rates", 6 March 2015.

⁴ Note that the sums of the parts are different from the EMU aggregates due to intra-EMU exposures which cannot be stripped out cleanly. We also exclude recently joined member states as their NIIPs were affected by revaluation.