



the NIIP is given by the ratio between the persistent current account level and the steady-state growth rate.⁵ Biasing the exercise against our argument by setting both variables to 2%, the NIIP would become stationary at around 100% of GDP.

Comparative benchmarking yields somewhat lower estimates. The vast foreign asset stocks accumulated by Switzerland or oil-rich Norway, both well over 100% of GDP, reflect greater saving rates and degrees of openness than the Eurozone will ever attain. Japan's NIIP of around 70% is in a more realistic ballpark. Ultimately, no single G10 country serves as a perfect benchmark, and the most plausible assumption is that the Eurozone as a whole will converge to a NIIP of around 50%, the level currently seen in its core group of creditor nations—Belgium, Germany and the Netherlands.

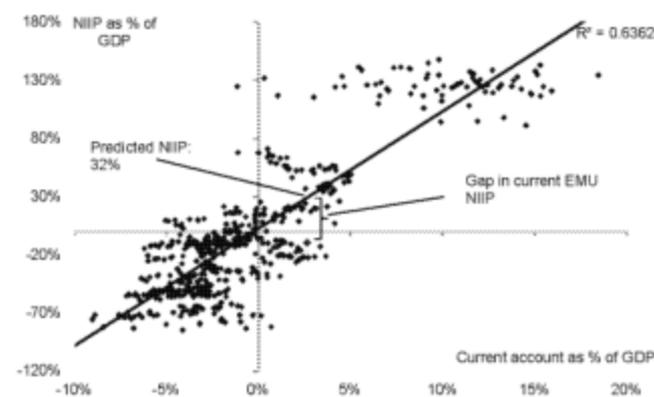
The most data-driven approach is to pool all stock-flow observations for the G10 space ex-Sweden over the past twenty years. A simple regression suggests that the current external surplus of the euro area would be consistent with a NIIP of roughly 30%. This estimate varies by a few percentage points as one includes time and/or country effects, effectively running a panel regression.⁶ Yet while this exercise necessarily remains indicative, it does yield a strong sense that the stock-flow adjustment will not be complete at any NIIP levels below 30% of GDP.

On this baseline estimate of a terminal NIIP of 30%, the Eurozone would need to invest 40% of its current GDP abroad in net terms, at least in the absence of valuation and growth effects. This amounts to a staggering €4 trillion. Assuming net financial outflows of €150bn a quarter, this process will take the rest of the decade.

With the exchange rate being endogenous to this process, the depreciation of the Euro caused by large outflows will both speed up the process and reduce the outflows required for adjustment. A weaker Euro raises the value of European assets abroad, mechanically raising the NIIP. A sensitivity analysis indicates that further Euro depreciation by 20% would shave only around 10% off the outflows implied by a 30% NIIP.

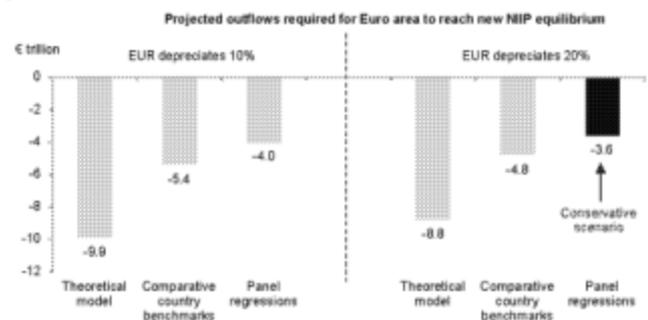
From an FX perspective, it is irrelevant whether adjustment is driven by capital outflows or exchange rate valuation: the Euro will continue to depreciate through either channel. Importantly, the fall in the Euro since Q3 cannot have fully priced

Figure 9: Illustrative regression analysis



Source: Deutsche Bank, Haver

Figure 10: €4 trillion of capital outflows required even with 20% depreciation



Source: Deutsche Bank

⁵ Papadimitriou et al (2011), Contributions to Stock-Flow Modelling, Palgrave Macmillan, chapter 10.

⁶ In practice, the NIIP is of course endogenous to the current account, but we only use the regression to explore the stock-flow relationship in the data, rather than to identify causal mechanisms. This caveat equally applies to non-stationarity.