



current account shows that despite two decades of large surpluses, Finland never turned into a mature credit economy. The peak NIIP of 15% in 2010 failed to generate considerable investment income to stabilize the current account against trade deficits. If Europe is to live off its foreign assets one day, it will probably need to accumulate a much larger NIIP, similar to Japan, Norway, or Switzerland.

Conclusion

Since we first introduced our Euroglut thesis last September the European current account surplus has reached a new record high, while EUR/USD has had its biggest yearly drop since 1985. We view the two developments as entirely consistent: the Eurozone's current account surplus is a symptom of a large pool of excess savings looking for investable assets abroad. Negative rates and quantitative easing from the ECB have engineered an acute problem of asset shortage in Europe, in turn initiating a process of large-scale capital flight. Over the last few months, more than €300bn worth of capital has left Europe.

In this paper we take our analysis a step further, and attempt to estimate the scale of likely future outflows. We argue that, like Japan, Europeans will need to turn into net creditors to the rest of the world to mirror structurally higher saving preferences. In turn this means that Europe's negative net international investment position needs to turn positive. Europeans will need to own more foreign assets than foreigners do in Europe. We estimate that this new equilibrium will require at least 4 trillion EUR of additional outflows from Europe over the next few years.

The investment implications of our Euroglut thesis therefore remain intact.

First, we continue to expect broad-based euro weakness. European outflows have been even bigger than our initial (high) expectations over the last six months, so we are revising our EUR/USD forecasts lower. We now foresee a move down to 1.00 by the end of the year and a new cycle low of 85cents by 2017.

Second, we expect continued European inflows into foreign assets, particularly fixed income. Our earlier work demonstrated that the primary destination of European outflows will be core fixed income markets in the rest of the world, and evidence over the last few months supports these trends: most European outflows have gone to the US, UK and Canada.

Finally, we see Euroglut as continuing to constrain monetary policy across the European continent for the foreseeable future. Since our paper in September central banks in Switzerland, Norway, Sweden, Denmark, the Czech Republic and Poland have all cut rates (most to negative), intervened in FX markets or started QE. All these countries run large current account surpluses. Through a unique mix of large excess savings and structurally low yields, the entire European continent will continue to be a major source of global imbalances for the rest of this decade.

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