The International Investment Position of Suriname

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Abstract

This paper discusses the current stance of the international investment position (IIP) as a tool for detecting possible vulnerabilities in the financial structure of the Surinamese economy. The macroeconomic indicators by themselves indeed suggest a flourishing economy. But macroeconomic statistics do not provide sufficient signals of vulnerabilities underlying the economy. Capital account liberalization stimulates capital flows, but also poses challenges to government policy with respect to the prevention of sudden capital reversals. The composition and size of the assets and liabilities for 2010 and 2011 on an aggregated and a disaggregated level suggest that there are no clear maturity or currency mismatches so that the IIP of the last two years confirms the validity of the existing macroeconomic conditions.

Contents

1. Introduction

The Surinamese economy is flourishing. The economy is on a path of continued positive real growth, accompanied by prudent fiscal and monetary policy stances, moderate inflation, and domestic and external debt ratios, well below sustainable legal limits. The International Monetary Fund (2012) underscored the positive macroeconomic developments in its recent Article IV report. It concluded that "economic activity in Suriname remains strong, and inflation pressures have abated considerably". Recently, Fitch Ratings (2012) upgraded Suriname's credit ratings.

The liberalization process of financial systems globally has increased the flow of capital, which partly reflects the ease of accessing credit on the international money and capital markets. Easy credit access enabled countries to borrow from these markets to finance investments, thereby contributing to periods of higher growth. However, the increased inflow of capital also posed new challenges to financial and macroeconomic policies. For one thing, private capital flows have been more volatile than expected. The sudden outflow of capital as a consequence of confidence loss in government policies can have detrimental effects on an economy. Policymakers clearly underestimated the sensitivity of capital flows to market conditions and its contagion effects. They were thus unprepared to deal with these new challenges.

Vulnerabilities in financial systems were at the centre of the financial crises in the 1990s and in 2007/08. Maturity and currency mismatches in the composition and size of assets and liabilities were prevalent and, as such, made the economy extremely vulnerable to sudden reversals of capital (Allen et al., 2002). In response to these problems, the so-called balance sheet approach was developed to examine the composition and size of liabilities and assets of financial institutions thoroughly (Toporowski & Cozzi, 2006). Mismatches in the composition and size of the assets and liabilities of companies and financial institutions were evident during the financial crisis in the Southeast Asian countries in 1997. The macroeconomic conditions of the Asian countries were relatively sound and there was no need for a devaluation for competitiveness or other macroeconomic reasons (Krugman, 1999). This balance-sheet approach considers the micro foundations of the economy in explaining the macroeconomic fragility (Prasetyantoko, 2006).

Given the importance of the micro-macro link, multilateral supervisory bodies and regulators developed new methods and procedures to assist examiners in identifying vulnerabilities in banks' and other financial institutions' assets and liabilities in an early stage. This resulted in the strengthening of risk assessment and the design of early warning systems that aim to detect risks in a timely manner.

Even though Suriname weathered the international 2007/08 financial crisis fairly well, the monetary authorities emphasized the importance of monitoring the underlying risks in the financial system. Therefore, the Central Bank of Suriname devotes considerable efforts to, among other things, strengthen the compilation of its database, in particular the balance of payments statistics. A new dataset that emerged is the compilation of the international investment position (IIP) for 2010 and 2011. The IIP is the balance sheet of a country and reflects a country's stock of external financial assets and liabilities at a given point in time.

The purpose of this paper is to discuss the IIP as a tool for detecting underlying risk exposures in the Surinamese economy. The focus is on the analysis of the composition and size of external assets and liabilities, as macroeconomic statistics do not provide sufficient signals of vulnerabilities in the economy. The central question is whether the IIP confirms the positive macro-economic conditions or whether the IIP signals risks emanating from the financial balance sheet structure.

The second section deals with the emergence and set up of the IIP. The third section is dedicated to the sources of the IIP and discusses the current stance of the IIP through some indicators to assess the vulnerability of the domestic financial system. Finally, the last section presents to a short conclusion.

2. International Investment position

2.1 Emergence of the IIP

Rapid communication and technology development enhanced the process of financial globalization and capital account liberalization in the last decades. This led to a massive enormous increase in international capital flows during the 1980s and 1990s, resulting in significant stocks of foreign assets and foreign liabilities for individual countries. Global capital flows and their impact has therefore been a subject of increased interest during the last two decades.

Capital account liberalization was supposed to stimulate growth in the developing world by channeling scarce capital to deserving economies and facilitating international risk sharing (Eichengreen & Hausmann, 2003**)**. Capital account liberalization may also be interpreted as signaling a country's commitment to good economic policies as capital could be suddenly taken out of the country (Kose & Prasad, 2004). These assumptions, however, did not bear fruit as it happened that private financial markets rather acted as an engine of instability. The increased incidence of financial collapse throughout the 1990s, for example Mexico in 1994, Southeast Asia in 1997, Russia in 1998 and in the USA and Europe more recently, serve as evidence. It would seem that the international financial integration has not worked as expected.

Research on the causes of the financial crises produces a range of explanations. Allen et al. (2002) mention three generations of models in explaining financial crises. The first generation pointed to macroeconomic fundamentals, such as the government deficit and current account imbalances. The second generation of models resulted from the Mexican crisis in 1994-1995 and pointed to the liquidity mismatches, besides improper government policy responses and the case of self-fulfilling panic under investors. This notion of liquidity mismatches can be seen in the context of the balance sheet approach, through the assets and liabilities approach. The Asian crisis confirmed the balance sheet approach as it points to vulnerabilities in the balance sheet of financial institutions, which were evident after sudden outflows of capital. The third generation of models further elaborated on this approach and explained the relation between sudden capital outflows and financial crises.

The balance sheet approach focuses on the examination of the stock variables in a country's sectoral balance sheet and aggregate balance sheet. Four types of risks can be detected, namely maturity, currency, capital structure and solvency risks (Allen et al, 2002). *Maturity mismatch* arise when assets are long term and liabilities are short term. The risk is when maturing debt cannot be refinance and the debtor is obliged to pay in cash. *Currency mismatch* arise when the liabilities and assets are not denominated in the same currency. This is when assets are denominated in domestic currencies and liabilities in foreign currencies and there is depreciation. *Capital structure risk* points to cases where the debt financing is so much more than financing through equity. Payments to equity holders depend on the profitability, whereas debt payments remain unchanged in bad times. Solvency risk is prevalent when a company's asset no longer covers its liabilities. A country is solvent as long as the present discounted value of all future fiscal primary balances is greater than the current stock of net external debt (Allen et al, 2002). The international investment position deals with the risks emanating from external assets and liabilities.

The IMF defined the IIP in the fourth edition of the *Balance of Payments Manual (BPM4)*, published in 1977. The fifth edition of the Fund's *Balance of Payments Manual* (*BPM5*), which was published in 1993, addressed the IIP statistics comprehensively and introduced a chapter on the IIP. It laid down the framework and a set of standard components for reporting and valuation of financial claims and liabilities vis-a-vis foreign countries. Twenty-five countries reported IIP data to the IMF in 1993 and the IMF began the publication of balance of payments and IIP data on the *BPM5* basis in 1995. In 2008 the IIP served a central role in the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6) Heath (2008). By end-2000, the number of reporting countries had risen to 63 countries.

2.2 The IIP and the Balance of payments

The IIP is a statistical statement that shows at a given point in time the value and composition of:

a) financial assets of residents of an economy that are claims on nonresidents and gold bullion held as reserve assets;
b) liabilities of residents of an economy to non-residents.

The IIP is thus a balance sheet that reflects the stock of a country's foreign assets and liabilities. The balance of payments (BOP) of a country reflects the flow of trade and financial transactions between the country and the rest of the world during a certain period. The link between the IIP and the balance of payments therefore follows naturally.

The direct link between the current account balance and the IIP arises from the financial account and the international reserves. In case of a surplus on the current account, excess foreign reserves are either added to the official reserves (part of external assets) or to the net foreign assets of its banking system. This means that residents acquire foreign assets in the form of direct investment or portfolio investment, which is recorded as gross outflows on the financial account. At the same time, foreign investors will also acquire assets in the country which will add to the country's liabilities, which is recorded as gross inflow on the financial account. The net acquisition of foreign assets, measured as the net outflow on the financial account plus the changes in net reserves, is the direct link between the BOP and the IIP (Boonstra, 2008).

In formula: $NIIP_t = \sum CA_t$ (1)

Where:

$NIIP_t$ = Net International Investment Position

CA = Current account balance of the BOP.

As such: $NIIP_t = NIIP_{t-1} + CA_t$, → $NIIP_t - NIIP_{t-1} = CA_t$,

This is the first channel, financial flows, through which the IIP changes.

Besides the transactions in the BOP, there are other factors influencing the IIP. Those are revaluation changes which are further split into price and exchange rate effects. Price variations of financial assets and liabilities arise from changes in stock market prices. The currency composition of assets and liabilities determines again the losses or gains resulting from a deprecation or appreciation. Other adjustments are other changes in volume and include debt cancellation, write-offs, reclassifications, entities changing residence, and changes in actuarial assumption. Intangible assets such as specialized knowledge, management expertise, and brand names are also considered as other adjustments.

Adding the other changes in the first equation makes

the ultimate net IIP

$$NIIP_t = NIIP_{t-1} + CA_t + (K_{At} * A_{t-1}) - (K_{Lt} * L_{t-1}) \quad \textbf{(2)}$$

Where :

A = Gross external assets

L = Gross external liabilities

K_A = Value change of external assets

K_L = Value change of external liabilities

Changes in the international investments position of countries that are fully integrated in the world economy and have well-developed financial sectors cannot be explained solely by their current account balances (Boonstra, 2006). Most industrial countries have built huge foreign assets and external liabilities resulting from globalization. Companies have invested oversees in new factories or by acquiring foreign companies, while investors have diversified their portfolios over currencies and countries (Boonstra, 2008).

3. Analysis of the IIP of Suriname

The sources consist of stock data of commercial banks, Central Bank and the State Debt Management Office (SDMO) as well as surveys. The surveys of the companies that were used represent 90 % of total export value. SDMO produces official external debt. Private debt is compiled on the basis of direct reporting from the firms and crosschecked with official statistics. The current legislation dictates that all residents are required to seek permission from the Foreign Exchange Authority when engaging in capital account transactions.

The current account surpluses in the last six years accumulated to US$ 1.733 million at the end of 2011. This development is largely attributable to the mining sector, which comprises alumina, oil and gold production and exports. The increased globally for mineral products in the last years propelled export prices and increased the total export value. A surplus means that Suriname's domestic savings are higher than its investments. In essence, Suriname acquired foreign assets, or in other words, the country increased its claims on the rest of the world. The analysis will focus on the composition and size of the external assets and liabilities to determine underlying vulnerabilities, as macroeconomic indicators do not measure weaknesses in the financial structure.

Net international investment position

The stock of net foreign claims of Suriname on the rest of the world amounted to US$ 559 million at the end of 2011. As already mentioned, the net international investment position can be divided into four different channels, but in the case of Suriname the fourth channel, asset price changes, is not available. The breakdown of overall NIIP is as follows:

- financial flows of US$ 207 million;
- exchange rate changes of US$ 2 million;
- other changes of US$ - 175 million[1].

[1] Due to statistical adjustments.

The stock of external assets at the end of 2010 and 2011 was US$ 1,681 million and US$ 2,118 million respectively, whereas the stock of external liabilities for the same years was US$ 1,156 million and US$ 1,559 million respectively (see table 1).

Table 1. International Investment Position		
(in million US$)	**2010**	**2011**
Total external assets	**1,681**	**2,118**
Total external liabilities	**1,156**	**1,559**
Net investment position	**526**	**559**

Source: Central Bank of Suriname

On average, external assets amounted to 42% of GDP, while external liabilities were 30% of GDP. In 2011 external liabilities grew at a faster pace (27%) than external assets (19%), indicating the need for continuous monitoring. The aggregate external balance for Suriname led to an increase in net external assets, primarily reflecting favorable export prices.

Vulnerabilities in the stocks of assets and liabilities

Allen et al. (2002) mentioned four types of risks, namely maturity and currency mismatches, capital structure imbalances and solvency risks. On an aggregate basis, the net external position is positive. Disaggregation into different institutional sectors points to different net external positions (see table 2).

Table 2. Net International Investment Position by Sectors		
1. Institutional sectors (in million US$)	**2010**	**2011**
Net investment position	**526**	**559**
Monetary Authorities	329	351
Banks	479	553
Other Sectors	-282	-345

Source: Central Bank of Suriname

The monetary authorities and banks realized a comfortable net external position. Other sector, which consists of firms and households, proved to have a net liability external position (see table 3).

An assessment of the composition of Other sectors' liabilities reveals that nearly 80% are attributable to direct investments in the mining sector. Direct investments are considered to have a long lasting relationship in the country and are not subject to sudden reversals. Moreover, payments from equity are state contingent, with profits and dividends plunging in bad times (Allen et al, 2002). As such, these liabilities will not create immediate risks. In addition, subtracting FDI investment from total liabilities, results in comfortable net external assets of US$ 215 million.

Table 3. External Assets and Liabilities of Other Sectors

	2010	**2011**
External Assets (in million US$)	**348**	**567**
- Currency and deposits	348	567
External Liabilities (in million US$)	**630**	**912**
- Short-term Credit	16	22
- Long-term Loans	118	317
- Direct investment in reporting economy	497	573
- Equity capital and reinvested earnings	560	674
- Other capital	-63	-100
- Claims on direct investors (-)	-271	-346
- Liabilities to direct investors	208	246
Net investment position	**-282**	**-345**

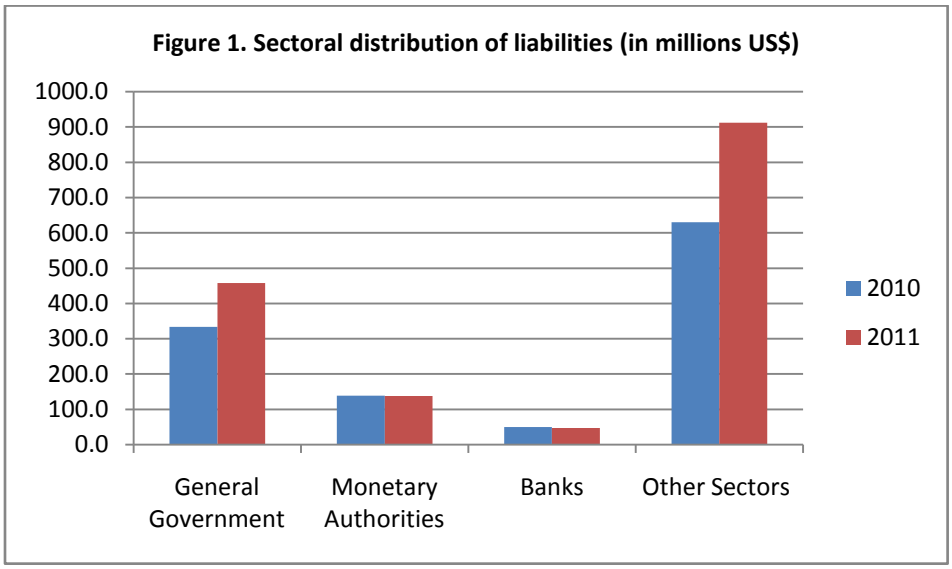
Source: Central Bank of Suriname

Foreign long-term loans increased significantly from US$ 118 million to US$ 317 million in 2011. This increase was, however, almost entirely attributable to the mining sector, specifically the oil and gold sectors. The loans were used to finance capital investments with the aim to increase oil and gold production. Capital investments were carried out following positive international prospects. Liabilities in the form of short-term debt, which are trade credits,

accounted for less than 1% of total liabilities. This is negligible in terms of maturity mismatch risks. It follows that the net investment position of firms and households, although a net liability position, is considered stable and has no apparent underlying maturity risk. The assets and liabilities are both mostly denominated in US-dollar and, as such, changes in the exchange rate will have no effect, as there is no currency mismatch.

Sectoral distribution and composition of total external liabilities

Figure 1 displays total external liabilities by sector. Other sectors held on average 60% of total external liabilities over the last two years. As explained earlier, this is not of great concern as the bulk of these liabilities consist of foreign direct investment. In the same period, the government held on average 30% of total external liabilities, followed by the commercial banks which accounted for less than 1% of total external liabilities. The government loans are exclusively long-term bilateral and multilateral loans with average interest rates of less than 1%. These loans are primarily used to upgrade the infrastructure and to strengthen the institutional capacities of the economy, thereby enhancing the competitiveness of the economy. Government external debt expressed as a percentage of GDP amounted 15% in 2010 and increased to 20% in 2011. These ratios are well below the legally permitted level of 35% of GDP.



Source: Central Bank of Suriname

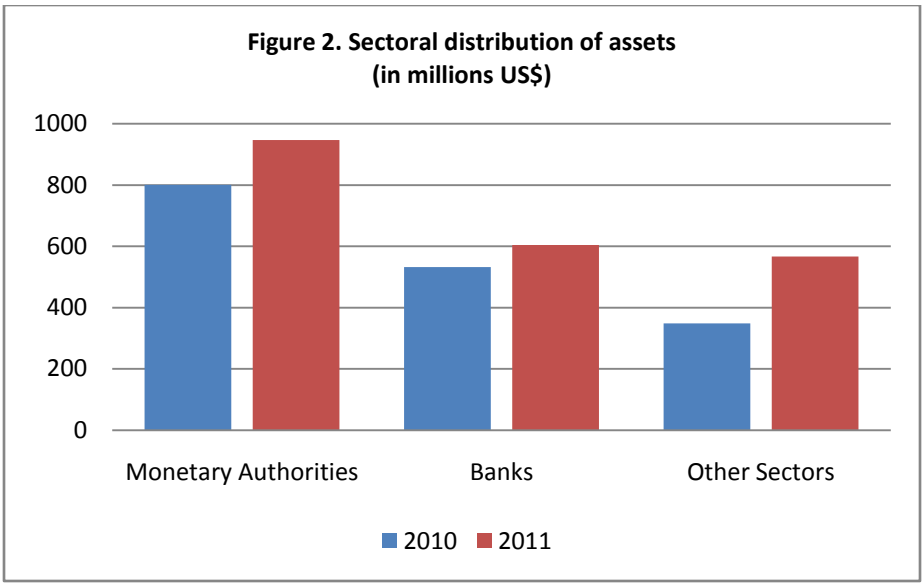
The expected future stream of receipts of the government from the mining sector and the rest of the economy are projected to increase and, as such, they are considered sufficient to service its external debt. The current external debt principal repayments are about US$ 20 million annually. The composition of assets and liabilities of the government do not pose maturity mismatch risks. Approximately 75% of government external debt is denominated in US-dollars. Since the assets of the government, which are included in the assets of monetary authorities, are also denominated in US-dollars, the existence of currency risks is negligible. The average share of commercial banks in total external liabilities is 1% and consists solely of short-term deposits loans (see table 4). Their external assets are far above their external liabilities.

Table 4. External liabilities by sector	**2010**	**2011**
External liabilities (in million US$)	**1,153**	**1,555**
- General Government/long-term	334	458
- Monetary Authorities/ SDR related liabilities	139	138
- Banks / Short-term	50	47
- Other Sectors	630	912

Source: Central Bank of Suriname

Sectoral distribution and composition of assets

In terms of external asset holdings, the monetary authorities held about the largest portion of total external assets, on average about 50% during 2010-2011. They are followed by banks with 30% and other sectors with 20%. Figure 2 presents the sectoral distribution of external assets by sector. The monetary authorities, including the government, built up their external assets from the revenues of the strongly performing mining sector, especially the gold sector. The increase of external assets of other sectors reflects the increased profitability in the gold and oil sectors and, to lesser extent, the agricultural sector.



Source: Central Bank of Suriname

The composition of external assets is presented in table 5. Total external assets, including securities of monetary authorities and commercial banks, are almost entirely liquid and readily available to meet foreign currency demand.

Table 5. Composition of External Assets	**2010**	**2011**
External Assets (in million US$)	**1,681**	**2,118**
- Monetary Authorities	801	947
International reserves	691	817
Other foreign assets	110	130
- Banks	532	604
Currency and deposits	491	569
Securities	41	35
- Other Sectors	348	567
Currency and deposits	348	567

Source: Central Bank of Suriname

The functional category of the liabilities is presented in table 6. As mentioned before, the loans are all long-term and attributable to the government and the mining sector.

Table 6. Functional Categories of External Liabilities	**2010**	**2011**
Total external liabilities (in millions US$)	**1,156**	**1,559**
- Direct investment	497	573
Equity capital and reinvested earnings	560	674
Other capital	-63	-100
- Portfolio investment	3	4
Debt securities	3	4
- Other investment	656	981
Trade credits	16	22
Loans	451	775
Currency and deposits	50	47
Other	139	138

Source: Central Bank of Suriname

For the sake of completeness, table 7 presents the external debt by sector. As indicated before, not all external liabilities are debt-related, in particular that of Other sectors.

Table 7. External Debt	**2010**	**2011**
(in million US$)		
General Government	334	458
Monetary Authorities	139	138
Banks	53	51
Other Sectors	341	584
Total external debt	866	1,231

Source: Central Bank of Suriname

Overall, the institutional sectors, whether on a disaggregated or an aggregated level, are currently not exposed to maturity or currency mismatch risks. The current stance of the composition and size of the external assets and liabilities partly reflects government policies towards financial transactions with non-residents. All financial transactions with regard to foreign direct investments, portfolio investments, and loans with non-residents are still subject to approval of

the Foreign Exchange Commission. Capital account liberalization as a part of financial liberalization is not yet introduced in Suriname. This policy stance probably prevented contagion effects from the global financial crisis.

4. Conclusion

This paper investigates the composition and size of external assets and liabilities through the IIP to detect possible risks emanating from the composition and size of external assets and liabilities. Globally, capital account liberalization as part of financial liberalization resulted in enormous capital flows, but posed new challenges to authorities, especially in the area of managing financial risks. The international financial crises have stressed the importance for monetary authorities to monitor risks emanating from their external balance sheets. The external balance sheet analysis for Suriname indicates that the composition of external assets and liabilities is very robust and poses no threat to the real economy at this stage. The external balance sheet analysis therefore substantiates the positive macroeconomic performance of Suriname.

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