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Canada's Net Foreign Debt at Market Value

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The following symbols are used in Statistics Canada publications:

.	not available for any reference period
..	not available for a specific reference period
...	not applicable
0	true zero or a value rounded to zero
0^s	value rounded to 0 (zero) where there is a meaningful distinction between true zero and the value that was rounded
^{p}	preliminary
^{r}	revised
x	suppressed to meet the confidentiality requirements of the *Statistics Act*
^{E}	use with caution
F	too unreliable to be published
*	significantly different from reference category ($p < 0.05$)

Canada's Net Foreign Debt at Market Value

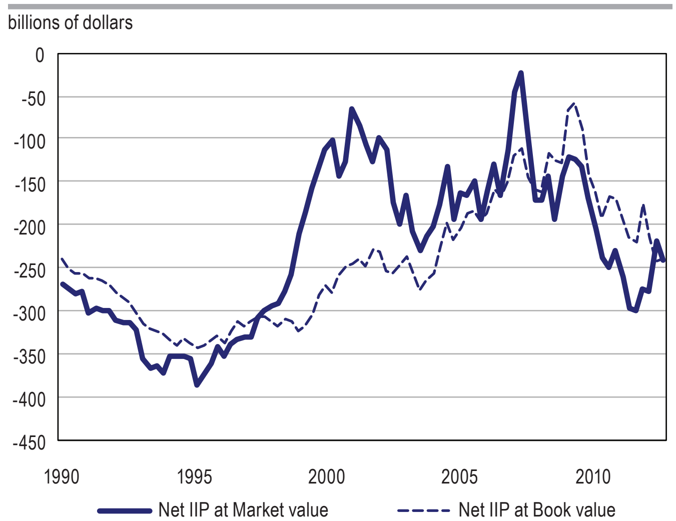
By Komal Bobal, Lydia Couture, and Ryan Macdonald

This article in the *Economic Insights* series highlights the new set of estimates for **Canadian direct investment abroad** and **Foreign direct investment in Canada** that present Canada's international investment position on a market value basis. It is one of a series of *Economic Insights* articles designed to emphasize key aspects of the new national accounts data and their utility for analyses of the Canadian economy. Several of these articles highlight changes to the organization of the national accounts data or draw attention to improvements in measurement.

Canada's balance sheet with non-residents is reported in the quarterly release, *Canada's International Investment Position (IIP)*, which covers four major investment categories: direct investment, portfolio investment, other investment, and official reserves. With the release of the 2012 revision to the Canadian System of National Accounts, a full set of market value international investment position estimates is now available for the first time. The market values of Canada's direct investment asset and liability positions were calculated and combined with existing market value estimates of portfolio positions. The effects of unrealized capital gains or losses have now been combined with foreign currency revaluations and other changes in the volume of assets such as write downs/ups in Canada's external investment position.

The net international investment position is the difference between Canada's international assets and liabilities. Because the balance is negative net international investment position is often referred to as net foreign debt where the negative sign is not required. In 2012 Q2, Canada's net foreign debt at market value was $241.6 billion or 13.5% of national income (Chart 1). This is an improvement from the early-1990s, when net foreign debt was around $297 billion, but, represented 43.9% of national income.[1]

Chart 1
Net IIP measures: Book versus market value



Source: Statistics Canada, Cansim Table 376-0142.

Net International Investment Position

The market value estimates for the net international investment position display more volatility than book value estimates, and can have different turning points. Between 1990 Q1 and 1997 Q4, trends in the market and book value estimates of the net position were similar. The book value estimates reached a trough in 1995 Q1 at -$343.5 billion; the market value estimates also reached a trough in 1995 Q1 at -$386.6 billion. From the mid-1990s to the peak of the high-tech boom, the market and book value estimates rose, reflecting larger increases in Canada's

1. Average 1990 Q1 to 1992 Q4.

international assets than liabilities. Led by relatively stronger capital gains on international assets, the market value estimate of the net position peaked at -$64.2 billion in 2000 Q4. The book value estimates continued rising until 2001 Q3, and reached a peak of -$228.9 billion. Between their respective troughs and peaks, the market value estimates increased by $322.4 billion, compared with a $114.6 billion rise in the book value estimates.

After the end of the high-tech boom, the market value net international investment position estimate fell by $165.0 billion between 2000 Q4 and 2003 Q2, reflecting downward stock market revaluation effects on international assets as well as the rise in the value of domestic currency. Between 2003 Q2 and 2006 Q3, the market and book value estimates rose at about the same rate, but between 2006 Q2 and 2007 Q1, the market value estimate increased relative to the book value estimate. With the onset of the global financial crisis, the market value estimates began declining while the book value estimates continued rising until 2009 Q1. The market value estimates started recovering after 2011 Q2 despite a continued decline in book value estimates. By 2012 Q2, the market value and book value estimates were almost the same.

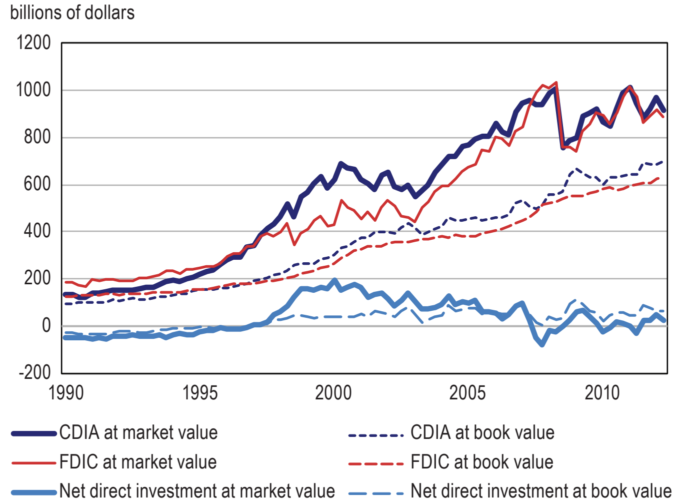
Direct investment positions

The largest change in the 2012 revision of the international accounts is attributable to the addition of direct investment at market value. Direct investment refers to cross-border inter-company investment. Direct investment includes both an investor's equity and inter-company debt, and occurs when holdings constitute at least 10% of a corporation's voting equity.[2] The difference between Canadian direct investment abroad (CDIA) and foreign direct investment in Canada (FDIC) is net foreign direct investment. This represents the portion of Canada's net foreign debt due to direct investment.

The book and market value estimates of net foreign direct investment offer similar perspectives, but the stock of Canadian direct investment abroad and foreign direct investment in Canada show quite different values reflecting the importance of the unrealized gains/losses included in the market value estimates (Chart 2). The book value measures were led by strong outward investment, so that by the mid-1990s, Canadian direct investment abroad exceeded foreign direct investment in Canada. Book value estimates of net foreign direct investment exhibited little annual variation, with some of this related to the effect of foreign currency revaluation.

By contrast, the market value estimates of net foreign direct investment rose rapidly in the mid-1990s to peak in 2000, led by relatively stronger revaluations on Canadian direct investment abroad than on foreign direct investment in Canada. This partly reflected a larger concentration of tech investment for outward than inward investment. The end of the high-tech boom did not lead to as rapid a decline in the market value of net foreign

Chart 2
Direct investment estimates: Book versus market value



Source: Statistics Canada, Cansim Table 376-0142.

direct investment as that shown by the total net international investment position. This reflected continued Canadian direct investment abroad and the simultaneous loss of value in foreign direct investment in Canada, as well as the fact that the total net international investment position is strongly influenced by portfolio investments.

Since 2000, the market value of net foreign direct investment declined for a number of reasons: revaluations of foreign direct investment in Canada that largely matched those of Canadian investment abroad; an upturn in resource-centered inward direct investment during the commodity boom; and the impact of the appreciation of Canadian currency on Canadian investment abroad. This decline was exacerbated by a large negative shock during the 2008-2009 global financial crisis.

The new market value estimates also illustrate the extent to which revaluations raise or lower the value of foreign direct investment across economic cycles. Book value estimates tend to be relatively more stable, despite financial market and economic shocks. Market value estimates, however, can change rapidly and significantly as financial market conditions change.

Just as no two economic cycles are exactly the same, the response of market value estimates to economic and financial events also varies. The end of the high-tech boom did not lead to as sharp a decline in the value of Canadian investments abroad or foreign investments in Canada as did the global financial crisis and its related recession, which affected a broader range of industries. The value of direct investment assets and liabilities declined rapidly in 2008, losing close to a quarter of their market value between 2008 Q2 and 2008 Q3. In 2001, the decline was more gradual, and continued for a longer period of time.

2. For Canada, most foreign direct investment occurs in situations in which the direct investor has majority ownership of the enterprise receiving the investment.

Portfolio investment positions

Portfolio investment consists of debt or share holdings where the investor accounts for less than 10% of the voting equity in corporations. Direct investment and portfolio investment constitute all of the equity and most of the debt in cross-border holdings, and they account for a majority of the difference between the market and book value estimates for the total net international investment position. On portfolio investment, Canada is a net debtor nation.

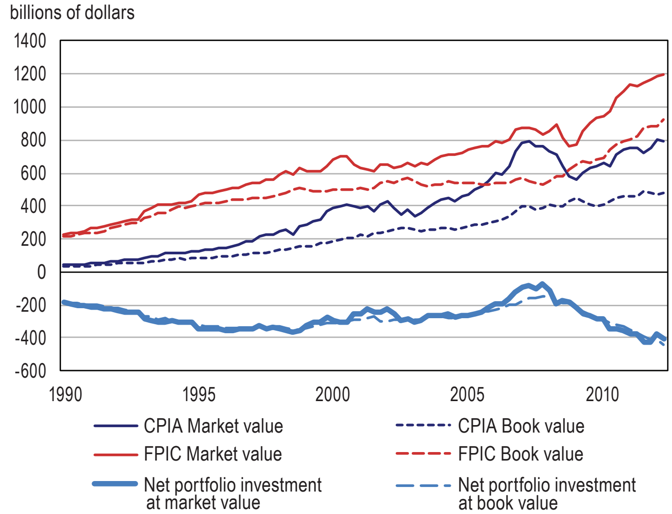
Aside from the years with substantial stock market fluctuations, the market and book value estimates for net portfolio investment are nearly identical. The deviations between the two net portfolio investment series, when they do arise, are largely a function of valuation changes on Canadian portfolio investment abroad (Chart 3).

Market value Canadian portfolio investment abroad is more responsive to stock market fluctuations than is market value foreign portfolio investment in Canada. This is because of the different composition of inward and outward investment in securities: Canadian portfolio investment abroad (CPIA) is comprised of proportionally more equity holdings than foreign portfolio investment in Canada (FPIC), which has proportionally more debt holdings.

Nevertheless, foreign portfolio investment in Canada over the period reflects the high-tech boom and the rapid stock market gains before the global financial crisis. Post-crisis, both the book and market value estimates reflect strong inward investment in Canada; and for the market value series, price gains from stock markets added to the value of the position in recent years.

From the mid-1990s to 2007, Canadian portfolio investment abroad generally rose more rapidly than foreign portfolio investment in Canada largely because of strong outward investment, which is reflected in both the book and market value estimate of Canadian portfolio investment abroad. Capital restrictions on foreign investments were loosened during the 1990s and early 2000s, and eliminated in 2005. Capital gains provided further support to the increases in the market value estimate of Canadian portfolio investment abroad until 2007.

Chart 3
Portfolio investment estimates: Book versus market value



Source: Statistics Canada, Cansim Table 376-0142.

Growth in outward investment resumed after the end of the high-tech boom. Canadian portfolio investment abroad rose in the 2005-to-2007 period, coinciding with the emergence of the maple bond market, until the financial crisis and global stock market declines began in the second half of 2008.

Thereafter, outward portfolio investment slowed, and most of the growth was confined to the market value estimates as stock markets improved. At the same time, there has been strong investment by non-residents in Canadian debt securities since 2009.

A new source of information

The new market value information about Canada's international investment position can be used to assess cross-border economic investment behaviour. For the first time, it is possible to examine the effects of revaluations on Canada's external assets and liabilities in their entirety. These data provide additional insight on the evolution of Canada's net foreign debt, as well as on the impact of international financial events. ■