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The Implications of the Structural Surplus in Korea's Net International Investment Position on Financial Stability and Financial Internationalization

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The Implications of the Structural Surplus in Korea's Net International Investment Position on Financial Stability and Financial Internationalization[1]

Young Sik Jeong (Korea Institute for International Economic Policy)

I. Introduction

Since 2014, South Korea's external financial sector has undergone a significant structural shift, particularly regarding its Net International Investment Position (Net IIP).[2] The Net IIP is defined as the difference between external financial assets held by residents and external financial liabilities held by non-residents. South Korea transitioned to a Net IIP surplus in the third quarter of 2014, and this surplus has steadily expanded since. This shift indicates that the external financial assets held by Korean residents now exceed the liabilities held by foreigners in Korea. As of the first quarter of 2025, the net IIP reached $1.084 trillion.

Historically, following the 1997 Asian Financial Crisis, Korea's external financial policies faced a persistent trade-off between ensuring financial stability and promoting financial internationalization. Financial stability entails stabilizing the foreign exchange market and mitigating capital flow volatility, whereas financial internationalization involves developing an international financial center, globalizing the financial industry, and internationalizing the Korean Won. Due to the legacy of the 1997 and 2008 currency crises, these two objectives were often viewed as incompatible, with policy heavily skewed toward stability. Consequently, despite various discussions on globalizing the financial sector and currency whenever the financial market stabilized or when the need to induce large-scale outflows of foreign currency arose, progress remained limited due to fears that such measures might compromise market stability.

This study aims to analyze whether the structural shift in Korea's Net IIP from deficit to surplus offers a pathway to resolve this policy dilemma. The paper proceeds as follows:

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[1] This study updated, cited, and referenced the study of KIEP which is Jeong, Young Sik et al. (2023). "Effect of Net International Investment Position on Economic Stability and Financial Internationalization." *Policy Analysis* 23-13. Korea Institute for International Economic Policy (KIEP).

[2] The international investment position (IIP) is the balance sheet of the stock of external financial assets and liabilities as of at a point in time, providing information to evaluate a country's external payment burden, ability to respond to it, and foreign currency liquidity risk.

Chapter 2 examines the trends in Korea's IIP and provides an international comparison; Chapter 3 analyzes the relationship between the Net IIP surplus and financial stability; Chapter 4 investigates the link between the Net IIP surplus and financial internationalization; and Chapter 5 offers conclusions and policy implications.

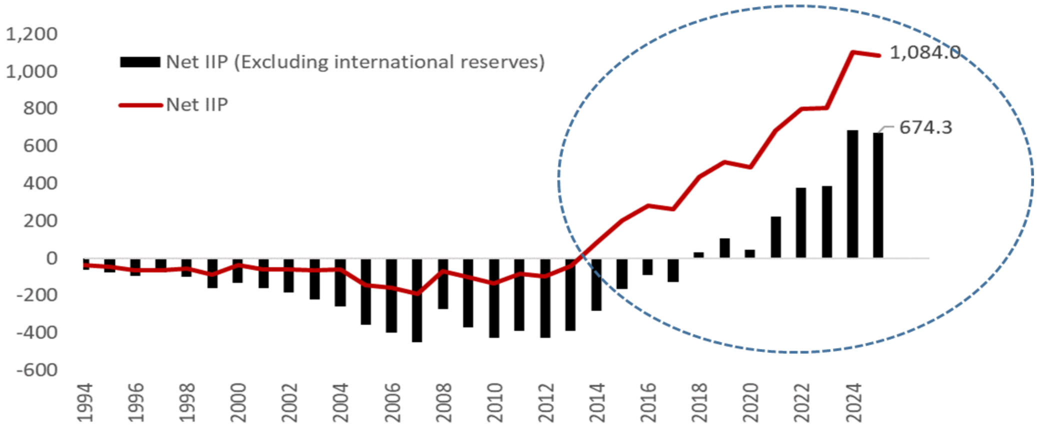
II. Development of Korea's International Investment Position and International Comparison

1. Development of Korea's International Investment Position

Korea's Net IIP shifted to a surplus in 3Q 2014 for the first time since statistics began. Furthermore, Net IIP excluding international reserves achieved a surplus in 4Q 2018. Both metrics have since shown a steady upward trajectory. As of 1Q 2025, the Net IIP stood at $1.08 trillion, while Net IIP excluding international reserves amounted to $674.3 billion (see Figure 1). This indicates a substantial improvement in the private sector's external payment capability, independent of public reserves held for emergency exchange rate stabilization.

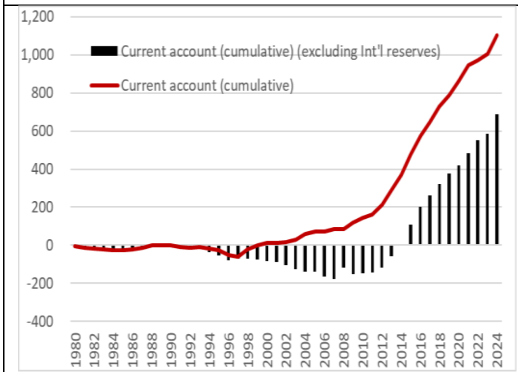
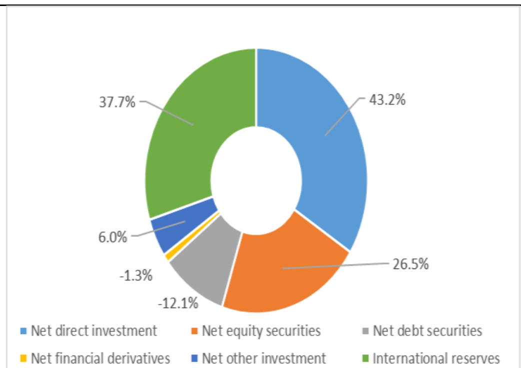
<Figure 1> Trends in Korea's Net International Investment Position (IIP)

(Unit: USD Billions)



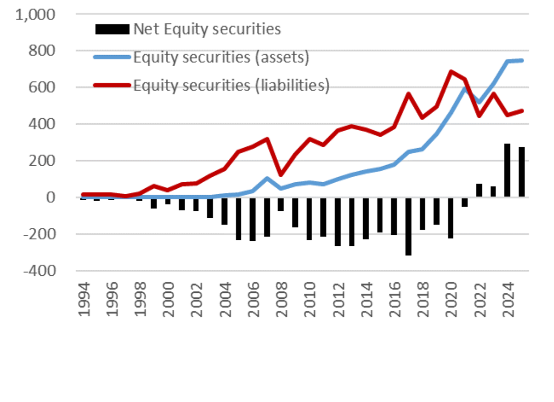
Source: Bank of Korea

The transition to a surplus in the Net IIP is primarily driven by a significant increase in actual external financial assets (transaction effects) rather than valuation effects arising from exchange rate fluctuations or changes in asset values. A similar pattern is observed in the cumulative balance of payments, which reflects these transaction effects. Notably, the cumulative balance of payments reached a surplus earlier than the Net IIP. This discrepancy prior to the mid-2000s can be attributed to external financial liabilities increasing faster than external financial assets, higher returns on external financial liabilities (held by non-residents) compared to external financial assets, and a strong Korean Won inflating the dollar value of external financial liabilities (see Figure 2).

<Figure 2> Cumulative Trends of Korea’s Current Account (Unit: USD Billions)	<Figure 3> Sectoral Composition of Korea’s Net IIP (Unit: %)
	
Source: Bank of Korea	Note: Net IIP is based on 2024 with a total value of $1,102 billion. Source: Bank of Korea

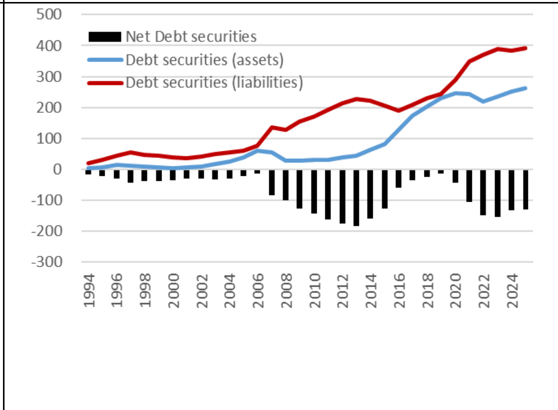
By sub-sector, Net Direct Investment accounts for the largest share of the surplus (43.2%), followed by International Reserves (37.7%), Net Equity Securities (26.5%), and Net Other Investments (6.0%) (see Figure 3). Conversely, Net Debt Securities remain in deficit (-12.1%). The timing of the transition to surplus varies by sector: Net Direct and Other Investments turned positive in the early 2010s, while Net Equity Securities followed in 2022. Net Debt Securities, however, continue to record a significant deficit (see Figures 4-7).

<Figure 4> IIP: Equity Securities
(Unit: USD Billions)



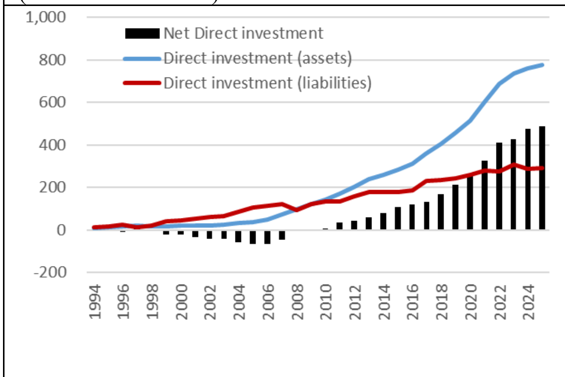
Source: Bank of Korea

<Figure 5> IIP: Debt Securities
(Unit: USD Billions)



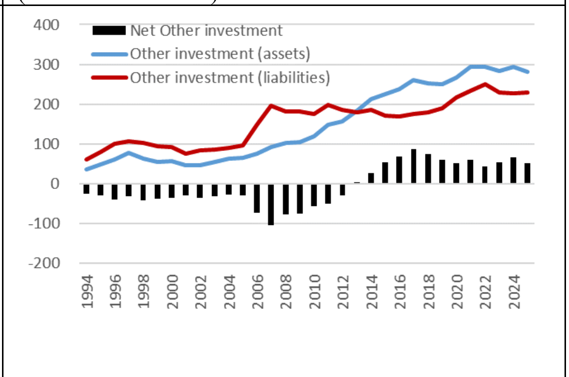
Source: Bank of Korea

<Figure 6> IIP: Direct Investment
(Unit: USD Billions)



Source: Bank of Korea

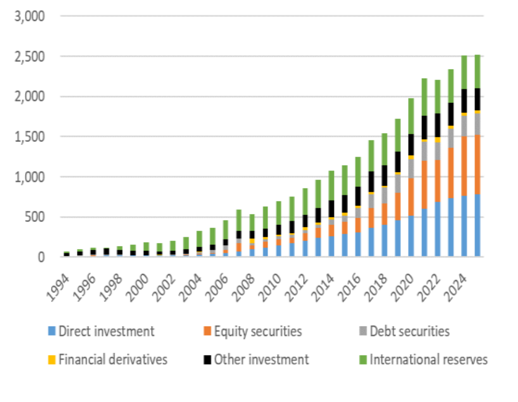
<Figure 7> IIP: Other Investment
(Unit: USD Billions)



Source: Bank of Korea

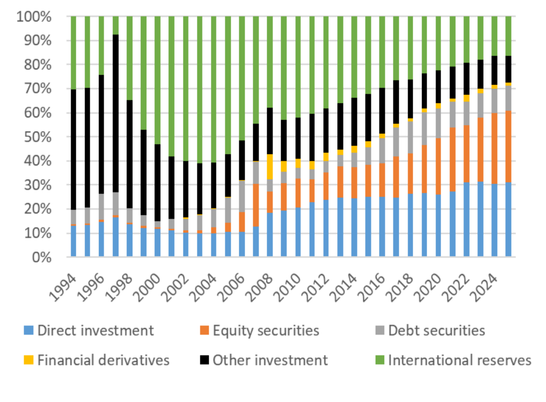
Key drivers behind this structural surplus include a sustained current account surplus since the 1998 crisis and the expansion of outward direct and indirect investment. Since the mid-2000s, Korea's outbound foreign direct investment (FDI) has grown, increasing loans by domestic financial firms to overseas Korean corporations. Additionally, following the 2008 Global Financial Crisis, a rapid rise in domestic savings led to expanded overseas equity securities investments by the National Pension Service, securities firms, insurance companies, and individual investors (see Figures 8 - 9).

<Figure 8> Growth of Korea's External Financial Assets by Sector (Volume)
(Unit: USD Billions)



Source: Bank of Korea

<Figure 9> Changes in Korea's External Financial Assets by Sector (Share)
(Unit: USD Billions)



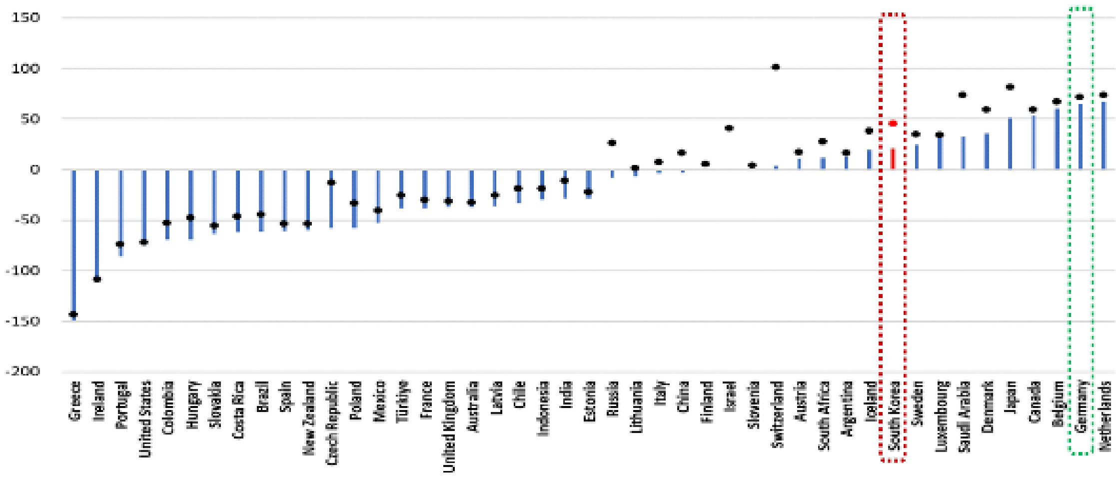
Source: Bank of Korea

2. International Comparison of Net International Investment Position

The international comparison of international investment positions reveals several noteworthy characteristics. First, maintaining a Net IIP surplus (excluding international reserves) is rare. As of 2023, only 15 out of 46 major economies recorded such a surplus. These 46 major economies include 38 OECD nations and eight major emerging economies, such as China, India, Brazil, Argentina, South Africa, Indonesia, Saudi Arabia, and Russia. In this context, Korea's shift is significant. Korea's Net IIP (excluding international reserves) to GDP ratio ranks 11th globally at 21.0%, trailing countries such as Norway, the Netherlands, Germany, Belgium, Japan, Denmark, Sweden, Luxembourg, Canada, and Saudi Arabia (see Figure 10). When including international reserves, Korea ranks 10th with a ratio of 45.5%.

<Figure 10> International Comparison of Net IIP-to-GDP Ratios

(Unit: %)



Notes: 1) All figures as of end of 2023 (except for Russia, for which figures are from end of 2021).
2) Norway is outlier with values of 293.0 and 309.5, respectively, and is excluded from the graph 3) The bars indicate the net IIP (excluding international reserves) to GDP ratio, while the dots indicate the net IIP to GDP ratio.
Source: International Financial Statistics, IMF.

Second, most countries with a net IIP surplus (excluding international reserves) are European and achieved this status around 2010. Korea joined this group later, in 2018 (see Table 1).

<Table 1> Timing of Transition to Net IIP Surplus in Major Economies

Region	Country	Net IIP surplus conversion year (Excluding international reserves)	Net IIP surplus conversion year
Europe	Netherlands	2010	2009
	Norway	2000	1998
	Denmark	2011	2009
	Germany	2004	Maintained net IIP surplus
	Luxembourg	2011	2010
	Belgium	1992	Maintained net IIP surplus
	Sweden	2019	2018
	Iceland	2020	2016

	Austria	2018	2013
Asia / Oceania	South Korea	2018	2014
North America	Canada	2015	2014
Latin America	Argentina	2019	2004
Africa	South Africa	2020	2015

Source : IMF

Finally, historical trends suggest that once a country transitions from deficit to surplus in a net IIP (excluding international reserves), the surplus tends to persist. This indicates that Korea's current position represents a structural rather than a temporary change.

III. The Net IIP Surplus and Financial Stability

This section investigates whether a net International Investment Position (IIP) surplus enhances financial stability, specifically by mitigating capital flow volatility. The analysis focuses on the channels through which increased Net IIP contributes to external sector stability.

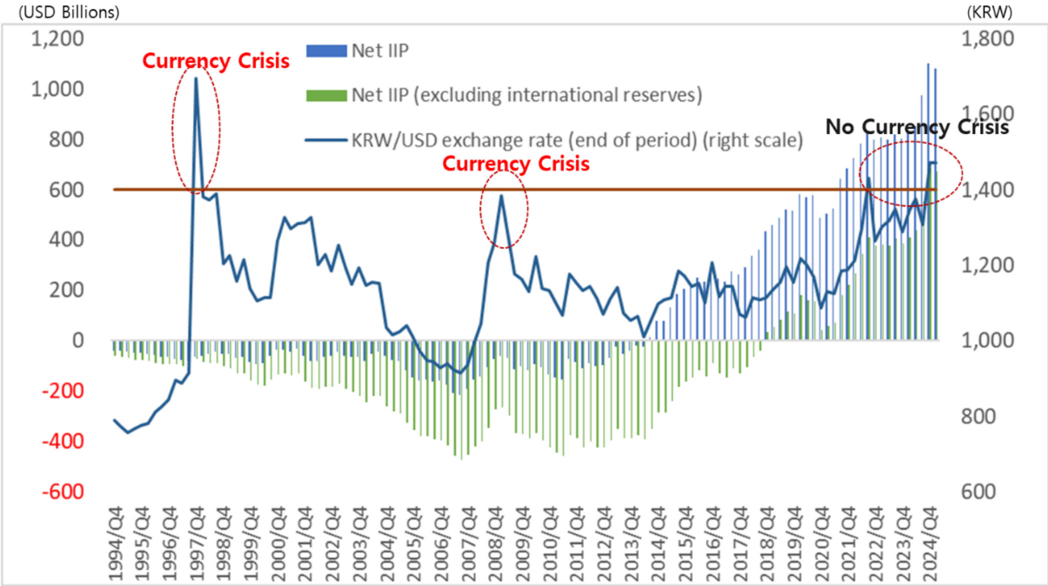
Using the framework of Forbes and Warnock (2012), capital flow volatility is categorized into four episodes: Surge (sharp increase in liabilities), Stop (sharp decrease in liabilities), Flight (sharp increase in assets), and Retrenchment (sharp decrease in assets). This Chapter employs a complementary log-log model to analyze the association between a country's Net IIP status and these episodes, controlling for global factors, transmission variables, and country-specific variables. Control variables used in the analysis include: global factors: CBOE Volatility Index (VIX), aggregate liquidity for major countries, average long-term government bond yields, and average economic growth rate; transmission variables: geographic proximity, trade linkages, financial linkages); country-specific variables: market capitalization, capital control index, economic growth rate, government debt, and GDP per capita

The empirical results indicate that a country's Net IIP status is closely related to "Retrenchment" episodes. Specifically, for Net IIP surplus countries, a "Stop" episode (sharp decrease in liabilities) increases the probability of a subsequent "Retrenchment". This implies a stabilizing mechanism: unlike in deficit countries, when foreign capital withdraws from a surplus country, the repatriation of overseas assets by domestic residents acts as a countercyclical buffer, mitigating volatility.[3]

This suggests that a market-friendly financial stabilization mechanism has been established in South Korea, alleviating the risk of future currency crises. This structural shift is significant because it reduces reliance on foreign exchange market intervention via international reserves, which carries high opportunity costs and increases the risk of being designated as a currency manipulator by the United States.

Historically, Korea faced currency crises when the KRW/USD exchange rate approached 1,400, such as during the 1997 Asian Financial Crisis and the 2008 Global Financial Crisis. However, despite the rate surpassing 1,400 since 2022, no crisis has occurred (see Figure 11). As illustrated in Figure 11, the stark difference between the two previous foreign exchange crises and the recent period lies in the Net IIP: it recorded a large deficit in the past, whereas it has recently recorded a large surplus.

<Figure 11> The Relationship Between the KRW/USD Exchange Rate and Net IIP



Source: Bank of Korea

[3] Jeong, Young Sik et al. (2023). pp. 87-97.

IV. The Net IIP Surplus and Financial Internationalization

This chapter examines the correlation between a net International Investment Position (IIP) surplus and financial internationalization. Specifically, it analyzes whether the impact of external financial assets on financial internationalization during periods of a Net IIP surplus differs significantly from its impact during periods of deficit.

Financial internationalization is a term used in various contexts, including an international financial center, currency internationalization, and the internationalization of the financial industry and services.[4] This study focuses on the internationalization of the financial industry and services, which refers to the expansion of financial institutions' overseas business. This research utilizes two measures:

Trans-nationality Index (TNI)[5]: A quantitative measure of internationalization, calculated as the average of the ratios of assets, profits, and personnel of overseas branches to the total assets, profits, and personnel of the financial institution.

Revealed Comparative Advantage (RCA) Index: A qualitative indicator of competitiveness in financial services exports. The RCA index, introduced by Balassa (1965), calculates the ratio of a product's share in a country's total exports to that product's share in world exports. An index value greater than 1 indicates a comparative advantage in that specific product, while a value less than 1 suggests a comparative disadvantage.

Analysis shows that the TNI for major Korean banks is correlated with the expansion of external financial assets. An increase in these assets signifies growing overseas investment by domestic entities, offering potential for qualitative improvements in external financial services. The transition to a Net IIP surplus likely incentivizes policy authorities to relax external risk management, thereby facilitating overseas expansion. Indeed, the number of overseas branches of Korean financial institutions surged from 322 in 2009 to 472 by March 2025, and the TNI

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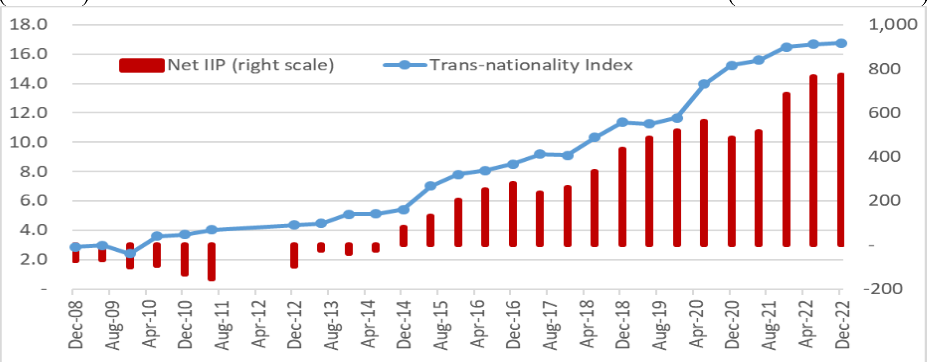
[4] An international financial center refers to a hub for domestic and international financial transactions, including fundraising, trading, management, and other financial dealings. This concept is more closely aligned with inbound financial internationalization and is therefore more closely related to external financial liabilities rather than external financial assets. Furthermore, currency internationalization signifies the widespread use of a nation's currency internationally for trade settlement, financial asset transactions and investment, and as an international reserve asset. The direct relevance of (Net) International Investment Position (NIIP) to currency internationalization is not substantial. While the expansion of (Net) external financial assets may indirectly increase the international transaction and use of the corresponding currency, the primary determinants are generally understood to be economic scale, stability of currency value, development of financial markets, network externalities, and global leadership.

[5] Trans-nationality Index = 1/3[(Overseas Branch Assets÷Total Assets) + (Overseas Branch Profits÷Total Profits) + (Overseas Branch Personnel÷Total Personnel)]

for commercial banks rose significantly after the 2014 surplus transition (see Figure 12).

<Figure 12> Correlation Between the Trans-nationality Index (TNI) of Korean Banks and Net IIP

(Unit: %) (Unit: USD Billions)



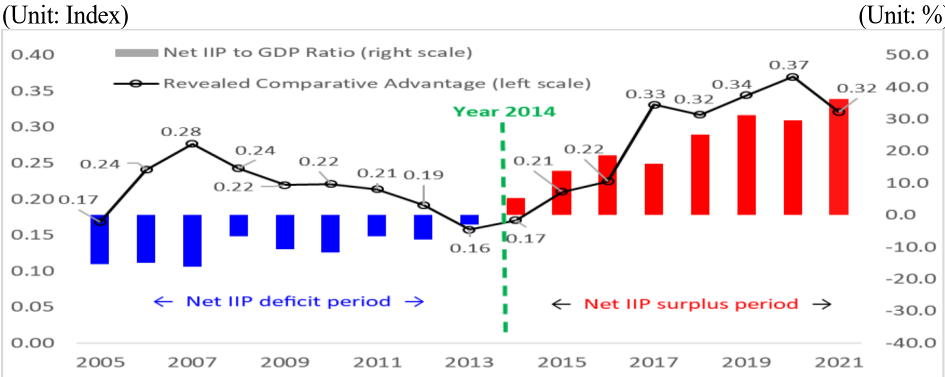
Note:

1) Commercial banks are Kookmin, Shinhan, Woori, Hana Bank
2) Excluded from the graph due to missing data on total personnel and overseas personnel at the end of December 2011 and June 2012
Source: Korea Financial Supervisory Service; Bank of Korea

Similarly, the RCA index for Korean financial services, while low by international standards, has risen rapidly from 0.16 in 2013 to 0.32 in 2021. This upward trend coincides with the 2014 Net IIP surplus conversion, suggesting a strong linkage (see Figure 13). The econometric analysis using panel data also confirms that external financial assets positively impact the RCA index, an effect that is amplified during periods of Net IIP surplus.[6]

<Figure 13> Trends in the RCA Index of Korean Financial Services and Net IIP

(Unit: Index) (Unit: %)



Source: IMF, IFS; WTO Stat

[6] Jeong, Young Sik et al. (2023). pp. 154-159.

V. Conclusions and Implications

The structural shift of South Korea's Net IIP into surplus has created a unique environment where financial stability and financial internationalization can be pursued simultaneously. The historical perception that these goals are incompatible—stemming from the trauma of past crises—is no longer valid. Instead, a virtuous cycle has emerged: enhanced internationalization leads to a larger primary income surplus, which further bolsters the Net IIP surplus and reinforces financial stability.

However, this "window of opportunity" for financial internationalization is finite. Due to population aging, the National Pension Fund is projected to shift to a decline around 2040,[7] and the current account may turn to deficit in the 2030s.[8] Therefore, Korea has an estimated 10-15 year period to leverage domestic capital for financial internationalization.

To capitalize on this, the government needs to reform regulations on overseas expansion that were established during the Net IIP deficit era. Renewed focus is needed on the internationalization of the Korean Won with little progress and the stalled International Financial Center policy. Finally, Korea should strengthen external financial cooperation, prioritizing areas where it holds comparative advantages to create mutually beneficial outcomes with emerging economies. Major areas with comparative advantages include: finance related to industrial support and development (e.g., development finance, SME finance), IT-based finance (e.g., FinTech), advanced financial infrastructure and systems (e.g., payment and settlement, open banking, deposit insurance, credit information, and evaluation), and the successful resolution of financial crises (e.g., evaluation and disposal of non-performing assets, crisis management systems). To facilitate this, financial sector development cooperation should be expanded within the priority areas of Official Development Assistance (ODA).

[7] The National Assembly Budget Office (2025), pp. 66-67.
[8] Yoon, Deok Ryong et al. (2017). p. 16.

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