In the years preceding the 2007/2008 global financial crisis, the Spanish economy posted persistent and growing current account deficits which reached 9.6% of GDP in 2007 and were barely offset by the modest capital account surplus (see Chart A). This continued recourse to external finance drove the net debtor position of the Spanish economy up from 34.7% of GDP in 1999 to 80.2% of GDP in 2008,[1] a record high at that time and well above the levels of other large European economies (see Chart B).

As a result of the crisis the Spanish economy underwent an internal process of adjustment of its current account balance which has taken it into surplus since 2013. This net lending to the rest of the world and the GDP growth reduced (in absolute terms) the negative net international investment position (IIP) of the Spanish economy by around 21 pp from the high in 2014 to 77.1% of GDP in 2018. This level, however, continues to be high and constitutes a source of vulnerability for the Spanish economy in the event of sudden changes in financing conditions on the global financial markets. In this respect, some studies have attempted to identify risk thresholds in external liabilities which, if exceeded, would be indicators of an appreciable increase in the vulnerability of the economy to international market turbulence. The Banco de España's analysis puts this threshold for the Spanish economy at 70% of GDP, a figure which, however, must be interpreted with caution given the methodological difficulties entailed in the construction of indicators of this type.[2] Moreover, the towering external debt of the Spanish economy is not amenable to correction in the short term, especially if it is taken into account that in the last few quarters the current and capital account surpluses have decreased and will for the next few years foreseeably hold at more moderate levels than those seen between 2014 and 2017.

To better understand the risks derived from the high debtor position of the Spanish economy, it is useful to analyse also which financial products are used to incur these debts and which resident institutional sectors are responsible for them. Chart C shows that the increase in the negative net IIP of Spain from 1999-2009 was due mainly to increased net liabilities in the portfolio investment and other investment categories. More specifically, in this period the Spanish economy financed its growing external imbalances mainly through portfolio investment in the form of debt instruments. As became clear upon the outbreak of the global financial crisis and the European sovereign debt crisis, the finance obtained through these instruments is particularly volatile (for example, in comparison with that raised in the form of direct investment) and liable to undergo sharp adjustments in response to changes in market sentiment. In this respect, it should be noted that the weight of these instruments in liabilities to the rest of the world has decreased in recent years from a high of 37% in 2006 to 28% in 2018.

Turning to the institutional sector, the breakdown in Chart D shows a marked change in the composition of the Spanish IIP. Thus, while in 2008 the resident private sector (i.e. other resident sectors and other monetary financial institutions) was responsible for 83% of Spain's negative net IIP, at present it only accounts for 19% of the total. By contrast, the weight of the public sector has increased notably from 22% in 2008 to 58% in 2018. Meanwhile, the Banco de España has gone from a creditor position in 2008 to being responsible for 23% of the current debtor position. Since most of the net external liabilities of the economy fall on the public sector, it is vital to underpin the sustainability of the public finances in order to forestall sharp changes in market sentiment and the reversal of external financing flows.

1 Changes in the IIP, in addition to being determined by the behaviour of the current account, also depend on valuation effects and other adjustments. In the period 1999-2008, these items made a negative contribution to IIP equivalent to 21 pp.

2 For more details, see Chapter 3 of the 2016 Annual Report of the Banco de España.

Chart A
CURRENT AND CAPITAL ACCOUNT BALANCES

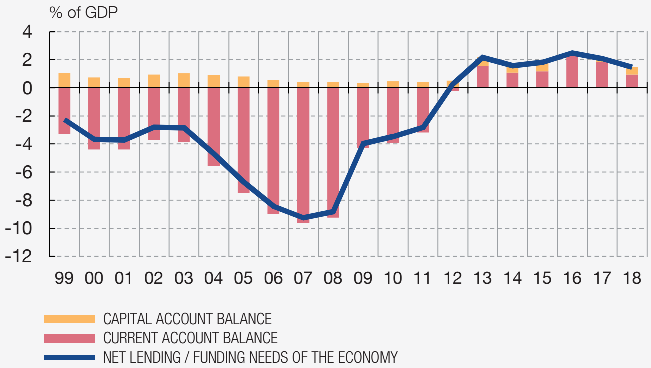
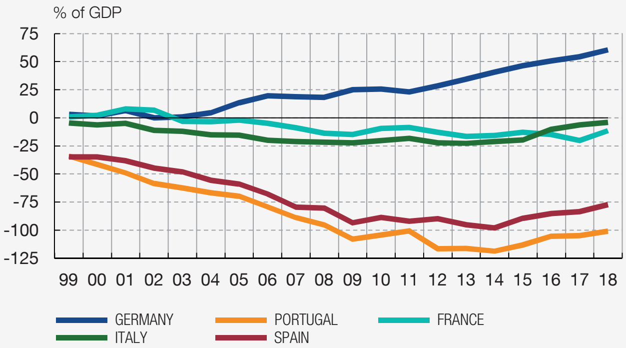


Chart B
NET IIP. INTERNACIONAL COMPARISON (a)



SOURCE: Banco de España.

a The net IIP is the difference between the value of the external assets and liabilities of resident sectors vis-à-vis the rest of the world.

INTERNATIONAL INVESTMENT POSITION OF SPAIN (con'd) BOX 1.3

Chart C
NET IIP. BREAKDOWN BY FUNCTIONAL CATEGORY (a)

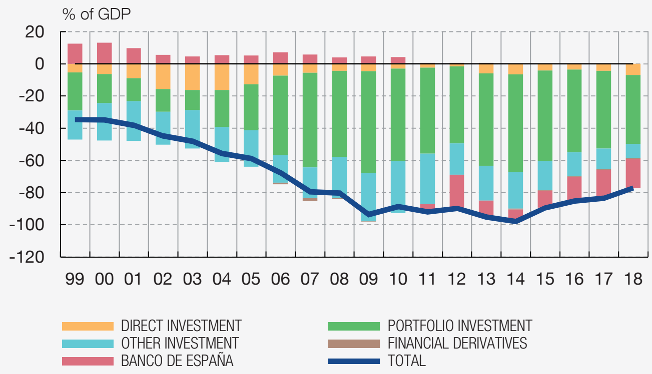


Chart D
NET IIP. BREAKDOWN BY INSTITUTIONAL SECTOR (a)

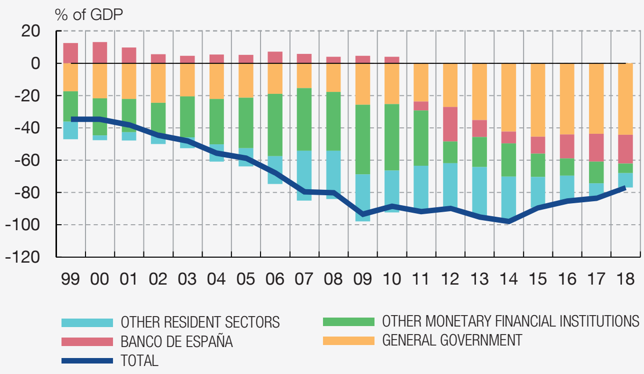


Chart E
EXTERNAL DEBT. INTERNACIONAL COMPARISON (b)

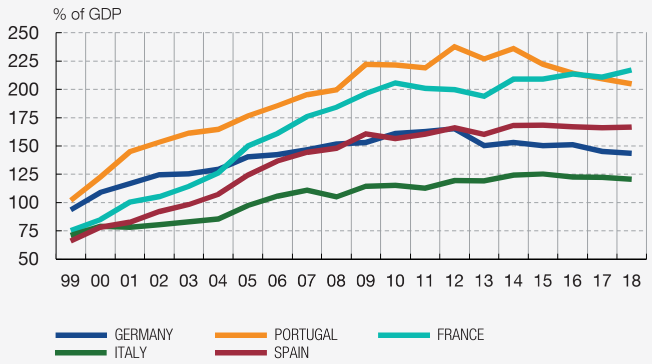
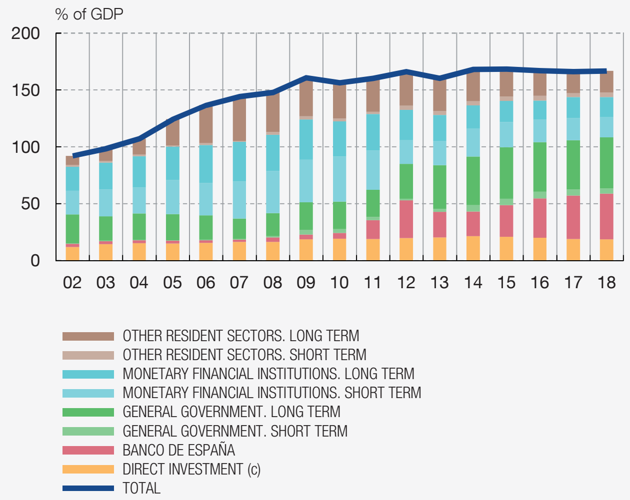


Chart F
GROSS EXTERNAL DEBT STRUCTURE BY INSTITUTIONAL SECTOR AND MATURITY (b)



SOURCE: Banco de España.

a The net IIP is the difference between the value of the external assets and liabilities of resident sectors vis-à-vis the rest of the world.
b The external debt comprises the balance of all liabilities giving rise to future payments of principal, interest or both (i.e. all financial instruments, except own funds, financial derivatives and monetary gold ingots).
c Including only direct investment in the form of debt.

Lastly, it is useful to supplement the information furnished by the IIP with that provided by gross external debt, an indicator which includes only the liabilities to the rest of the world that carry payment obligations.[3] In particular, this measure excludes all external liabilities in the form of holdings in capital, since these do not carry any future payment obligation and therefore do not pose the same risks to the sustainability and/or refinancing of external debt as other financing vehicles such as bonds or loans. Chart E shows that the gross external debt of the Spanish economy has barely shown signs of improvement in recent years, although it is in line with the euro area average. Since its peak in 2015, this indicator has only decreased by 2 pp to 166.7% of GDP in 2018. However, as regards its composition, there have been some changes in recent years which have helped to reduce its vulnerability. In particular, as shown by Chart F, the securities issued by the public sector, which generally carry lower refinancing and liquidity risk than those issued by the private sector, have increased their weight in the total gross external debt from 14% in 2008 to 30% in 2018. The same goes for the external liabilities of the Banco de España, closely linked to monetary policy implementation, and for certain associated risks even more limited than those of the public sector, whose weight in the gross external debt increased by 22 pp in the same period. The weight of long-term instruments, which likewise usually carry lower refinancing risk, has also increased.

3 External debt comprises all liabilities to non-residents that entail future repayment of principal, payment of interest or both. In practice, this includes all financial instruments except equity (shares and other equity, and investment fund units), financial derivatives and monetary gold ingots.