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The balance of payments and international investment position of Spain in 2018

Pana Alves, César Martín and Irene Roibás

Abstract

According to the balance of payments (BoP) statistics, in an environment of ongoing economic upturn, Spain was once again a net lender in 2018, albeit to a lesser extent than in preceding years. The decline in net lending is explained by the decrease in the goods and services surplus, which largely reflected the slowdown in external markets, the negative impact on exports of the cumulative euro appreciation since 2017 and the rise in oil prices. The nation's net lending, the positive amount of other flows and GDP growth were conducive to a decline in the Spanish economy's negative net international investment position (IIP), as a percentage of GDP, for the fourth year in succession. In terms of financial flows, international investors made net purchases under the portfolio investment (mainly, long-term bonds issued by general government) and direct investment headings in 2018, a sign of their continuing confidence in the Spanish economy, despite the deterioration in the global macro-financial scenario in the second half of the year. However, the fact that the Spanish economy's negative net IIP remains high (77.1% of GDP), both historically and by international standards, makes it vulnerable to shocks in the international capital markets.

Keywords: net lending, current account, financial transactions, international investment position, external indebtedness.

JEL codes: F10, F30, F32 and F34.

THE BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION OF SPAIN IN 2018

The authors of this article are Pana Alves, César Martín and Irene Roibás of the Directorate General Economics, Statistics and Research.

Introduction

In 2018, the Spanish economy posted an external surplus for the seventh consecutive year. On balance of payments (BoP) data, the nation's net lending amounted to 1.5% of GDP, down 0.6 percentage points (pp) from 2017.[1] The decline in the goods and services surplus offset the improvement in other items. In terms of cross-border financial flows, the Spanish economy once again posted a credit balance, equivalent to 1.9% of GDP, as a consequence of the net lending of resident agents, excluding the Banco de España (3.1% of GDP), which was only partly offset by a further increase in the Banco de España's debtor balance (1.2% of GDP). This increase was basically due to the implementation of the European Central Bank's (ECB) asset purchase programme, but it was smaller than in previous years, since the volume of acquisitions in 2018 was the lowest since the programme's launch in 2015. The Spanish economy's net lending and GDP growth, together with valuation effects, led to a further reduction in the nation's negative net IIP in 2018, to 77.1% of GDP, down 6.4 pp from 2017. Even so, this indicator remains high, both from a historical perspective and in comparison with other European economies, and amounts to a source of vulnerability. Reducing this vulnerability will continue to require the accumulation of current account surpluses for a prolonged period. In this respect, the Spanish economy's ability to achieve relatively large external surpluses, along with a significant growth rate, during the present economic expansion is a notable difference with respect to previous business cycles.

This article first reviews the performance of the current and capital accounts and their main components during 2018. Second, it describes Spain's financial transactions with the rest of the world, by functional category and institutional sector. Finally, the economy's financial position vis-à-vis the rest of the world is analysed.[2]

Current and capital account balances

On BoP data, the Spanish economy once again recorded net lending in 2018, of 1.5% of GDP, 0.6 pp less than in the previous year (see Chart 1). This reduction in net lending reflects a combination of temporary and persistent factors. Notable among the former are the rise in oil prices, the slowdown in export markets, the impact of the new emission standards on car exports and the cumulative euro appreciation since 2017. The latter include signs that the adjustment of relative prices and costs is coming to an end, and of a slowdown in the substitution of imported productive factors by domestic inputs in recent years.[3]

According to National Accounts information, this decrease in the Spanish economy's external balance is explained by the reduction in the net lending of non-financial corporations and, primarily by the expansion of the net borrowing recorded by households

1 On Quarterly National Accounts (QNA) data, the Spanish economy's net lending amounted to 1.5% of GDP in 2018, 0.7 pp less than in 2017.

2 The time series data on the various components of the BoP, the IIP and external debt are available on the external sector statistics page of the Banco de España's website. On that page the note entitled "Balance of payments and international investment position of Spain. Methodological note", which is kept up-to-date at all times, provides a detailed explanation of the methodology and data sources used in preparing these statistics.

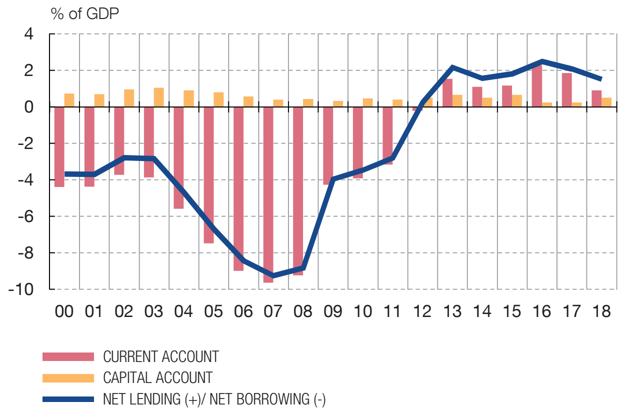
3 See "Recent developments and outlook for the Spanish economy's rest of the world account", Box 5 of the "Quarterly report on the Spanish economy", *Economic Bulletin,* 4/2018, Banco de España.

THE SPANISH ECONOMY POSTED NET LENDING IN 2018 FOR THE SEVENTH CONSECUTIVE YEAR

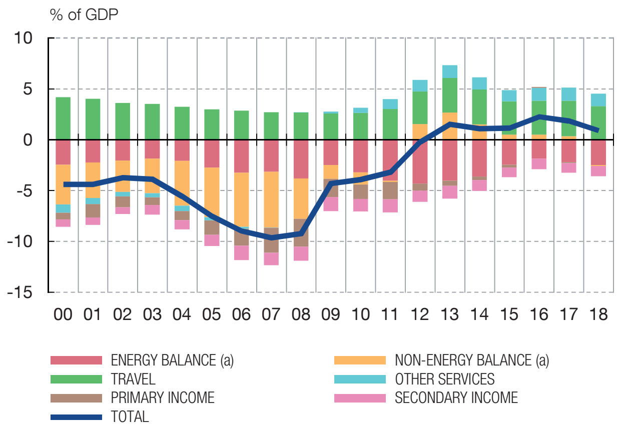
CHART 1

Net lending decreased in 2018, primarily as a result of the reduction in the goods and services surplus, which was only partly offset by the improvement in the capital account.

1 BALANCES



2 CURRENT ACCOUNT BALANCE



SOURCES: Banco de España and Departamento de Aduanas e Impuestos Especiales de la Agencia Estatal de la Administración Tributaria.

a The energy and non-energy balances are a Banco de España estimate based on Customs data.

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and non-profit institutions serving households (NPISHs) for the second year running. This development offset the reduction in the general government deficit and the increase in the net lending of financial corporations.

The decline in net lending in 2018 was caused, first, by the widening of the goods deficit (by 0.7 pp, to 2.6% of GDP). According to customs data, this widening was the result of an increase in the energy bill (0.3 pp of GDP) and a deterioration in the non-energy balance (0.4 pp of GDP), which moved into deficit for the first time since 2011. The decline in net lending was also caused by the decrease in the services surplus (of 0.2 pp of GDP, to 4.5%), which stemmed from both travel and other services. Meanwhile, the overall primary and secondary income balance remained practically unchanged at around 1% of GDP. The widening of the capital account surplus (the behaviour of which is basically determined by the capital transfers from the EU), by 0.3 pp, to 0.5% of GDP, only partially offset these developments.

The deterioration in the goods balance in 2018 took place against a backdrop in which exports slowed more sharply than imports. On BoP data, exports increased by 3.1% and imports by 6%, in nominal terms, as against 8.2% and 10.2% in 2017.[4]

The decline in the services surplus referred to above, was due to the decrease in net exports of travel and other services (of around 0.1 pp in both cases), to 3.3% and 1.2% of GDP, respectively. Services receipts slowed in 2018 (3.9%), especially travel receipts, and were less buoyant than payments, which accelerated to 8%. The slowdown in travel receipts was driven by the significant deceleration in tourist inflows in 2018, the impact of which was softened by the favourable behaviour of average spending per tourist (see Banco de España (2019)). Travel payments remained vigorous, buoyed by the favourable performance of employment and household income.

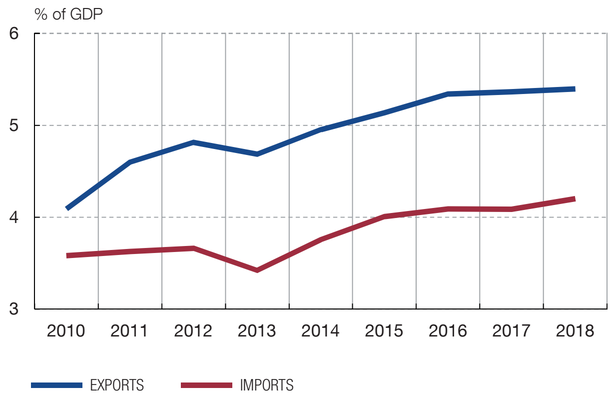
4 For a more detailed analysis of the behaviour of the determinants of goods and services transactions with the rest of the world, see Banco de España (2019), *Annual Report 2018*.

THE NON-TRAVEL SERVICES SURPLUS FELL SLIGHTLY IN 2018

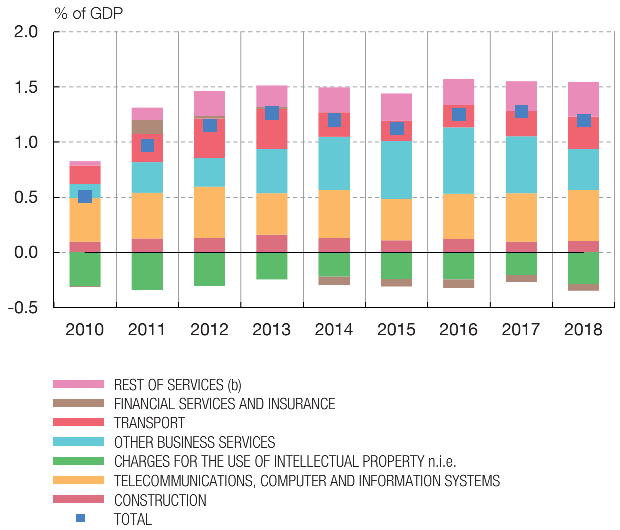
CHART 2

Imports of non-travel services grew at a faster rate than exports. By type of service, the slight decline in the surplus reflected the behaviour of other business services and charges for the use of intellectual property.

1 EXPORTS AND IMPORTS OF NON-TRAVEL SERVICES (a)



2 BALANCE OF NON-TRAVEL SERVICES (a)
By type of service



SOURCE: Banco de España.

a A change in the overall structure of other services gave rise to a statistical break in 2013 as a result of changes in the Encuesta de Comercio Internacional de Servicios (Survey on International Trade in Services).
b Includes processing, repair, government, personal, cultural and leisure services.

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The growth rate of non-travel service receipts moderated slightly in 2018 (4.2%). This increase was based mainly on professional and management consultancy services (which were notably buoyant) and on telecommunications, computer and information systems. The contribution of transport services, albeit significant, was smaller. Exports of other business services increased moderately. By geographical area, this growth was due, primarily, to the increase in sales to the euro area and the United Kingdom, and, to a lesser extent, to North America. Imports of non-travel services accelerated in 2018 to 6.5%. The items that contributed most to this increase where other business services and charges for the use of intellectual property (see Chart 2).

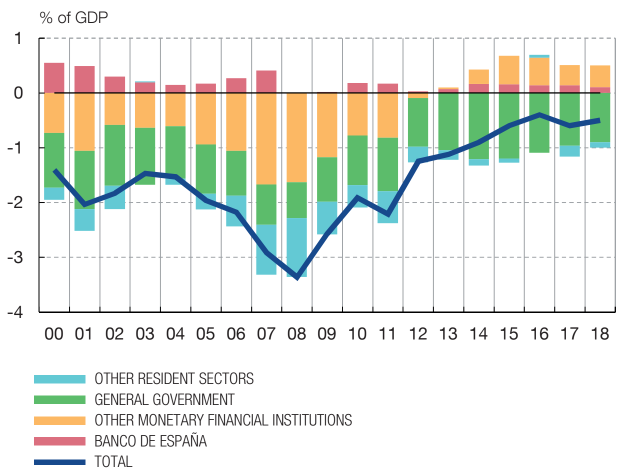
The primary income balance[5] stood in 2018 at around 0% of GDP, as against a deficit of 0.1% in 2017. This improvement reflected the partial correction of the investment income deficit, which fell to 0.5% of GDP, 0.1 pp less than in 2017. The breakdown of the investment income balance by functional category continued to show a deficit in other investment and, above all, in portfolio investment (mainly debt securities), partially offset by net receipts arising from foreign direct investment (see Chart 3).

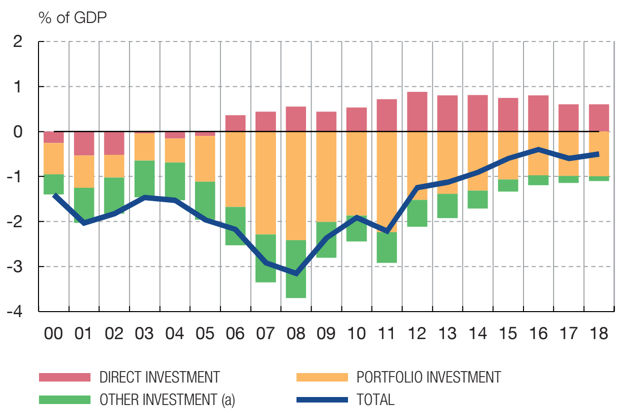
The deficit on the secondary income account, which covers the bulk of current transfers, increased by 0.1 pp in 2018, to 1% of GDP. This primarily reflected the increase in the net payments to the EU that are included in secondary income (see Table 1).

5 Primary income includes employment income, investment income, taxes on production and imports, and subsidies. Secondary income includes personal transfers, current taxes, social contributions and benefits, transfers relating to insurance transactions, current international cooperation and other miscellaneous items.

THE INVESTMENT INCOME DEFICIT REMAINED SMALL IN 2018 CHART 3

The investment income deficit corresponds, by institutional sector, to general government and other resident sectors. By functional category, the net income from direct investment partly offsets the deficit arising from portfolio and other investment.





SOURCE: Banco de España.

a Includes income arising from reserves.

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CURRENT AND CAPITAL TRANSFERS VIS-À-VIS THE EUROPEAN UNION TABLE 1
% of GDP

The net balance with the EU improved in 2018, mainly due to the increase in receipts in the form of capital transfers.

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Receipts	**1.1**	**1.2**	**1.3**	**1.2**	**1.1**	**1.1**	**0.8**	**0.8**	**1.1**
Primary income (a)	0.6	0.6	0.6	0.5	0.5	0.4	0.5	0.5	0.5
Secondary income. Transfers (b)	0.1	0.2	0.2	0.1	0.1	0.0	0.1	0.1	0.1
Capital transfers (c)	0.5	0.5	0.6	0.6	0.5	0.7	0.2	0.2	0.5
Payments	**1.0**	**1.1**	**1.1**	**1.2**	**1.1**	**1.1**	**1.2**	**1.0**	**1.1**
Primary income (d)	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2
Secondary income. Transfers	0.8	1.0	1.0	1.0	1.0	0.9	0.9	0.7	0.9
Balance	**0.2**	**0.1**	**0.2**	**0.0**	**0.0**	**0.0**	**-0.3**	**-0.2**	**0.0**

SOURCES: Ministerio de Economía, Industria y Competitividad, Ministerio de Hacienda y Función Pública, Ministerio de Agricultura, Pesca y Alimentación y Medio Ambiente, Ministerio de Asuntos Exteriores y Cooperación and Banco de España.

a In BoP terminology, the related heading is Other primary income, which includes taxes on production and imports, and subsidies (FEAGA and others).
b Includes current international cooperation (the European Social Fund and others) and VAT-and GNI-based resources.
c Comprises the European Regional Development Fund (ERDF), the European Agricultural Fund for Rural Development (EAFRD) and the Cohesion Funds. Cohesion Funds are not included in the 2014-2020 multiannual financial framework.
d Contributions to the Single Resolution Fund by financial institutions are included from 2015.

Financial transactions with the rest of the world

In 2018, the financial account of the balance of payments, excluding the Banco de España,[6] showed a credit balance equivalent to 3.1% of GDP, 1.5 pp less than in 2017 (see Table 2). This was a result of the fact that net purchases of assets by Spanish residents (€121 billion, 10% of GDP) exceeded net acquisitions by international investors of liabilities issued by resident agents (€84.7 billion, 7% of GDP), and that there was a marginally positive net flow of transactions linked to financial derivatives[7] (0.1% of GDP).

Net purchases of assets from the rest of the world by Spanish residents were positive under all headings (direct investment, portfolio investment and other investment) (see Chart 4). The largest volume of funds was channelled in the form of portfolio investment (4.1% of GDP), although this heading showed a notable decline with respect to 2017 (6.7% of GDP). This fall was largely a consequence of a significant reduction in net acquisitions of investment fund shares by other resident sectors (3.1 pp of GDP less than in 2017), which may be related to the poor performance of equities in 2018.

On the liabilities side, net acquisitions by foreign investors were positive under the portfolio and direct investment headings, and marginally negative under other investment. In the case of portfolio investment, the bulk of the net purchases by the rest of the world were concentrated in long-term bonds issued by general government (4.2% of GDP), a sign that international investors maintained their confidence in the Spanish economy despite the increase in macroeconomic and geopolitical uncertainty in the second half of 2018.

For its part, net foreign direct investment increased with respect to 2017 (by 2.5 pp of GDP), this increase basically being concentrated in equity holdings in non-financial corporations. These developments were also seen in the case of net foreign direct investment prepared in accordance with the directional principle,[8] which was twice that in 2017.

By institutional sector, only general government attracted funds from abroad in net terms (2.5% of GDP), while the private sector lent funds to the rest of the world (5.6% of GDP). This was consistent with the net borrowing of the former and the net lending of the latter.

Lastly, the Eurosystem's asset purchase programme (APP) seems to have driven the financial account of the Banco de España again.[9] The lower volume of net purchases carried out within the framework of the APP in 2018 resulted in a smaller increase in the Banco de España's debtor balance than in previous years (1.2% of GDP, against 2.7% in

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6 Since the start of Economic and Monetary Union in 1999, the financial account of the Banco de España should be considered to be largely an accommodating item since, besides the reserves, it records the net position of the Banco de España vis-à-vis the Eurosystem. Accordingly, to facilitate economic analysis, it is excluded. For a more detailed explanation see "Banco de España claims on the Eurosystem and the treatment of euro banknotes in the Balance of Payments and the International Investment Position", a Statistics Department note, of 30 September 2015, Banco de España.

7 Following international methodological recommendations, and in view of the difficulty of correctly allocating these transactions to assets and liabilities, the figures are given in net terms only.

8 This approach organises foreign direct investment flows and positions according to the direction of the investment from the viewpoint of the economy concerned, distinguishing between *outward direct investment*, which reflects the net assets between firms of the same group when the parent company is resident, and *inward direct investment*, which reflects the net liabilities between firms of a group when the parent company is non-resident. For further details, see Box 1, "Analytical approaches to foreign direct investment and recent developments", of "The balance of payments and international investment position of Spain in 2017", Analytical Articles, *Economic Bulletin,* 2/2018, Banco de España.

9 See J. Martínez Pagés (2016), "The Eurosystem quantitative easing measures and the financial account", *Economic Bulletin,* April, Banco de España.

BREAKDOWN OF THE FINANCIAL ACCOUNT OF THE BALANCE OF PAYMENTS TABLE 2

% of GDP	2011	2012	2013	2014	2015	2016	2017	2018
Financial account balance (NCA - NCL) (a)	**7.4**	**16.4**	**-8.3**	**-1.5**	**5.7**	**6.9**	**4.6**	**3.1**
Net change in external assets (NCA) (a) (b)	**2.3**	**4.0**	**-2.2**	**7.3**	**11.2**	**7.3**	**10.7**	**10.0**
Direct investment	3.0	-0.2	2.0	3.0	4.5	4.5	2.0	2.3
Monetary financial institutions	1.6	0.0	0.0	0.8	1.1	0.6	0.5	0.5
Other resident sectors	1.4	-0.2	2.0	2.2	3.4	3.9	1.6	1.7
Portfolio investment	-3.9	0.4	-0.4	5.0	6.0	2.3	6.7	4.1
General government	-0.1	-0.5	-0.3	-0.4	-0.3	0.0	0.0	0.1
Monetary financial institutions	-0.7	2.1	-0.7	0.6	-0.1	-0.2	0.6	1.2
Other resident sectors	-3.1	-1.3	0.5	4.8	6.4	2.5	6.1	2.8
Other investment (c)	3.2	3.8	-3.8	-0.8	0.8	0.5	2.0	3.7
General government	0.6	1.9	0.9	0.5	-0.1	-0.1	0.0	0.1
Monetary financial institutions	1.6	1.5	-5.1	-0.8	0.9	0.5	1.3	2.9
Other resident sectors	0.9	0.5	0.4	-0.4	0.0	0.1	0.6	0.7
Net change in external liabilities (NCL) (a) (b)	**-4.9**	**-13.2**	**6.2**	**8.9**	**5.4**	**0.1**	**5.9**	**7.0**
Direct investment	2.2	1.8	3.8	2.4	2.1	3.2	0.6	3.1
Monetary financial institutions	0.2	0.3	0.1	0.1	-0.1	0.2	-0.1	0.3
Other resident sectors	2.0	1.6	3.7	2.3	2.2	3.0	0.7	2.8
Portfolio investment	-6.4	-5.0	4.7	5.5	6.5	-1.2	5.2	3.9
General government	-1.0	0.3	6.6	4.7	5.9	0.0	2.5	3.4
Monetary financial institutions	-3.1	-3.9	0.0	1.2	0.9	-0.8	3.0	0.4
Other resident sectors	-2.3	-1.3	-1.8	-0.4	-0.3	-0.4	-0.3	0.1
Other investment (c)	-0.8	-10.1	-2.4	0.9	-3.2	-1.9	0.2	0.0
General government	0.2	5.3	0.7	0.5	-0.8	-0.2	-0.4	-0.8
Monetary financial institutions	-1.8	-14.5	-3.0	0.6	-2.4	-1.7	0.2	-1.3
Other resident sectors	0.8	-0.9	-0.1	-0.1	0.0	-0.1	0.4	2.0
Financial derivatives (d)	0.2	-0.8	0.1	0.1	-0.1	-0.3	-0.2	0.1
Change in net external position of the Banco de España (e)	**-10.2**	**-16.2**	**11.5**	**2.6**	**-3.7**	**-4.7**	**-2.7**	**-1.2**
Reserve assets	0.9	0.2	0.1	0.4	0.5	0.7	0.3	0.2
Net position vis-à-vis the Eurosystem	-11.6	-14.9	13.3	4.5	-4.7	-5.3	-2.7	-0.8
Other net assets	0.4	-1.6	-1.9	-2.3	0.5	-0.1	-0.4	-0.6
Errors and omissions (f)	**0.0**	**-0.1**	**1.1**	**-0.4**	**0.2**	**-0.3**	**-0.2**	**0.4**
Memorandum item								
Balance of the financial account, including the Banco de España	**-2.8**	**0.2**	**3.2**	**1.2**	**2.0**	**2.2**	**1.8**	**1.9**

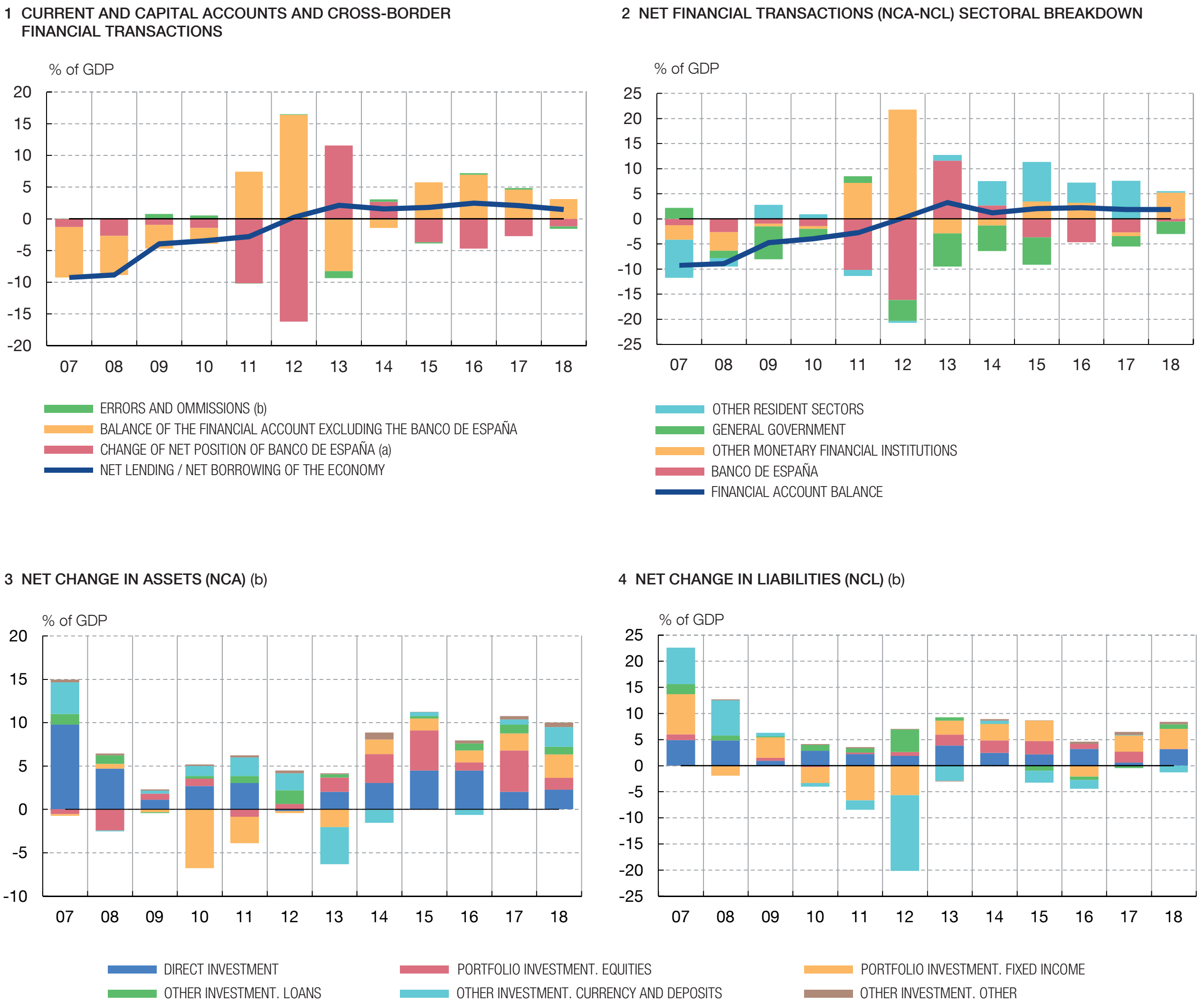
SOURCE: Banco de España.

a Excluding the Banco de España.
b Excluding financial derivatives.
c Mainly including loans, deposits and repos.
d Recorded as net of assets and liabilities.
e Change in assets less change in liabilities. A positive (negative) sign denotes a decrease (increase) in the net foreign liabilities of the Banco de España.
f A positive sign indicates that receipts are being understated and/or payments are being overstated, which in the financial accounts is the same as understating liabilities and/or overstating assets. A negative sign denotes the opposite.

IN 2018, THE FINANCIAL ACCOUNT OF THE BALANCE OF PAYMENTS, EXCLUDING THE BANCO DE ESPAÑA, AGAIN SHOWED A CREDIT BALANCE

CHART 4

The credit balance on the financial account, excluding the Banco de España, reached 3.1% of GDP in 2018, as a result of a larger increase in foreign assets held by residents than in national liabilities held by international investors. This outcome was driven by the net lending of the Spanish economy and was only partly offset by a new increase in the Banco de España's debtor position vis-à-vis the rest of the world. The deterioration in the central bank's external position was essentially due to the implementation of the European Central Bank's asset purchase programme, but was less than in previous years, since the volume of purchases in 2018 was the lowest since the start of the programme in 2015.



SOURCE: Banco de España.

a Change in assets less change in liabilities. A positive (negative) sign denotes a decrease (increase) in net external liabilities of the Banco de España.
b Excluding the Banco de España and financial derivatives.

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2017). These lower net acquisitions appear to have limited the increase in the Banco de España's TARGET liability[10] in 2018.

The international investment position and gross external debt

In 2018, the negative net IIP of the Spanish economy decreased by €42.2 billion, with respect to the end of the previous year, to €931.8 billion (see Table 3 and Chart 5.1). In terms of GDP, the reduction was 6.4 pp, to 77.1%, a cumulative fall of some 21 pp from its peak level in 2014.

10 For a detailed explanation of why the Eurosystem's asset purchase programme increases the TARGET liability of the Spanish economy, see P. Alves, A. Millaruelo and A. del Río (2018), "The increase in TARGET balances in the euro area since 2015", Analytical Articles, *Economic Bulletin,* 4/2018, Banco de España.

INTERNATIONAL INVESTMENT POSITION. BREAKDOWN OF FINANCIAL TRANSACTIONS AND OTHER FLOWS TABLE 3

€ bn	2017	2018							
	Position at period-end	Change in balance	Transactions in the period	Other flows in the period (a) (I + II)	Revaluations (I)	*Arising from changes in prices*	*Arising from exchange rate movements*	Other changes in volume (II)	Position at period-end
Total net position (assets – liabilities)	**-974.0**	**42.2**	**22.3**	**19.9**	**26.3**	**33.9**	**-7.6**	**-6.5**	**-931.8**
In terms of GDP (%)	*-83.5*	*6.4*							*-77.1*
Excluding the Banco de España	**-772.5**	**56.2**	**37.2**	**19.0**	**25.4**	**34.4**	**-9.0**	**-6.5**	**-716.3**
Direct investment	-51.7	-32.2	-10.1	-22.1	-15.2	-3.8	-11.4	-6.8	-83.9
Portfolio investment	-563.5	44.1	1.5	42.5	42.5	40.5	1.9	0.1	-519.5
Other investment (b)	-150.9	45.7	44.9	0.8	0.5	0.0	0.5	0.3	-105.2
Financial derivatives	-6.3	-1.4	0.9	-2.3	-2.3	-2.3	0.0	0.0	-7.7
Banco de España	**-201.5**	**-13.9**	**-14.8**	**0.9**	**0.9**	**-0.5**	**1.4**	**0.0**	**-215.4**
Reserves	57.9	3.8	2.1	1.7	1.7	0.3	1.4	0.0	61.7
Net position of the Banco de España vis-à-vis the Eurosystem	-256.2	-9.5	-9.5	0.0	0.0	0.0	0.0	0.0	-265.7
Other	-3.1	-8.3	-4.3	-4.0	-0.8	-0.8	0.0	0.0	-11.4
IIP. Assets	**1,866.0**	**94.9**							**1,960.9**
In terms of GDP (%)	*160.0*	*2.3*							*162.3*
Assets, excluding the Banco de España (c)	**1,535.6**	**68.3**	**121.0**	**-52.7**	**-44.3**	**-40.4**	**-3.9**	**-8.5**	**1,603.9**
Direct investment	639.8	6.1	27.4	-21.3	-12.8	-2.4	-10.4	-8.5	645.9
Portfolio investment	545.8	15.2	49.1	-34.0	-34.3	-37.9	3.6	0.3	561.0
Other investment	350.0	47.0	44.5	2.5	2.8	0.0	2.8	-0.3	397.0
IIP. Liabilities	**2,840.0**	**52.7**							**2,892.7**
In terms of GDP (%)	*243.5*	*-4.1*							*239.4*
Liabilities, excluding the Banco de España (c)	**2,301.8**	**10.7**	**84.7**	**-74.0**	**-72.0**	**-77.0**	**5.0**	**-2.0**	**2,312.6**
Direct investment	691.5	38.4	37.6	0.8	2.4	1.4	1.0	-1.6	729.9
Portfolio investment	1,109.3	-28.9	47.6	-76.5	-76.7	-78.5	1.7	0.2	1,080.4
Other investment	501.0	1.3	-0.4	1.7	2.3	0.0	2.3	-0.6	502.2
Memorandum item									
Gross external debt	1,938.5	75.9							2,014.4
In terms of GDP (%)	*166.2*	*0.5*							*166.7*

SOURCE: Banco de España.

a Other flows include revaluations (either due to changes in exchange rates or to changes in prices), other changes in volume (including, inter alia, forgiveness, unilateral loan write-offs or reclassifications) and statistical discrepancies between the IIP and the financial account of the BoP.
b Mainly includes loans, repos and deposits.
c Excluding financial derivatives. Following international methodological recommendations and in view of the difficulty of correctly allocating this component, especially its transactions, to assets or liabilities, it is only shown in net terms in the upper part of the table.

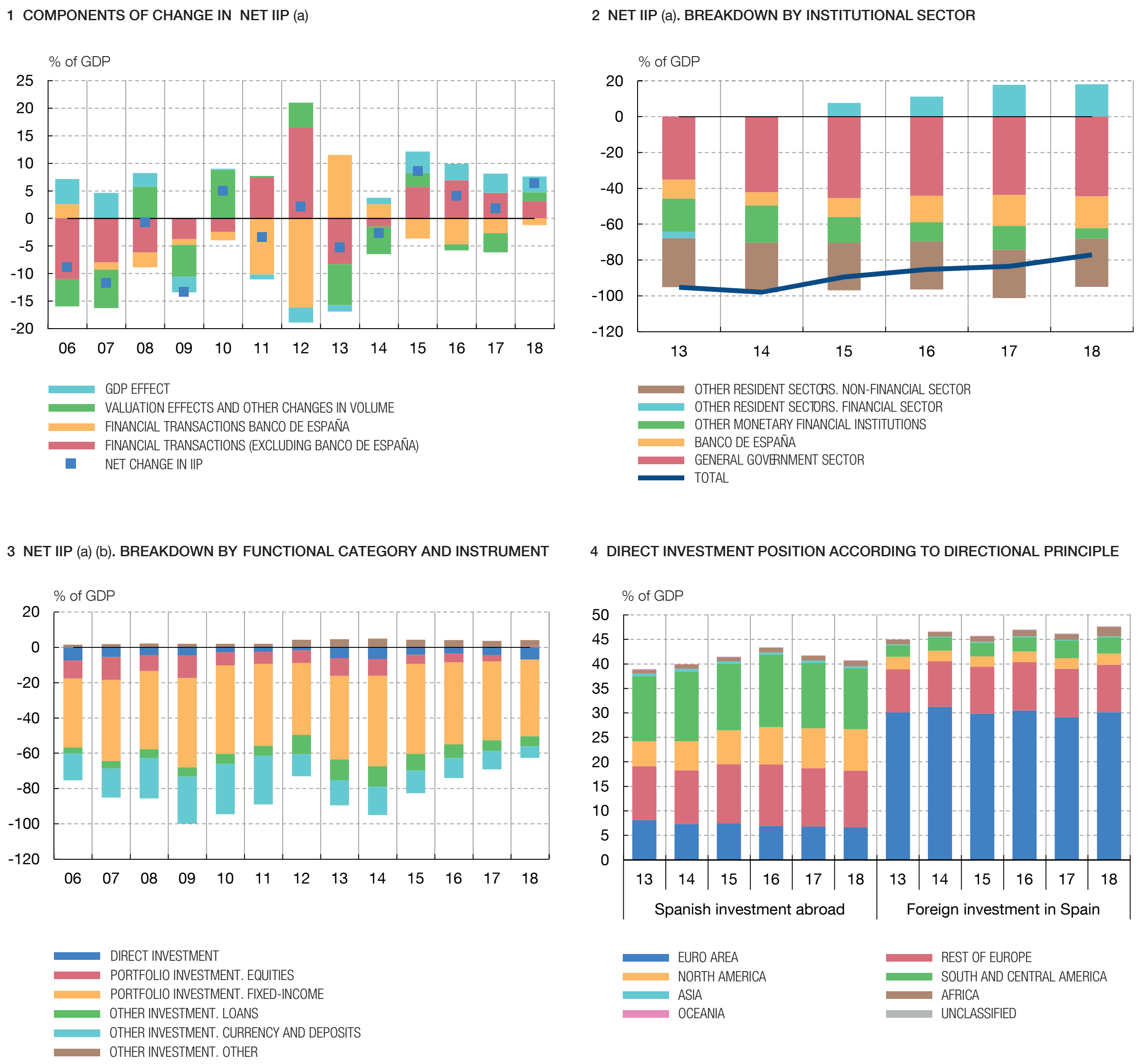
The change in the net IIP was the result of the positive amount of both net financial transactions (€22.3 billion), described in the previous section, and other flows (€19.9 billion), which include valuation effects and other changes in volume (see Box 1 for a detailed analysis of the nature and behaviour of other flows). As seen in Table 3, the behaviour of other flows in 2018 was a consequence of the fall in the value of liabilities (€72 billion) which exceeded the fall in the value of assets (€44 billion).[11] Both falls were fundamentally a result

11 The figures relating to changes in the value of assets and liabilities do not include the changes in value associated with financial derivatives or positions of the Banco de España.

THE NEGATIVE NET INTERNATIONAL INVESTMENT POSITION OF THE SPANISH ECONOMY CONTINUED TO DECLINE IN 2018

CHART 5

The negative net IIP of the Spanish economy declined by 6.4 pp, to 77.1% of GDP. This was the result of the positive amount of net transactions and other flows and of GDP growth. By institutional sector, the net external liabilities of other monetary financial institutions decreased. By functional category, excluding the Banco de España, the net external liabilities under the other investment and portfolio investment headings declined, while under the direct investment heading they increased.



SOURCE: Banco de España.

a The net IIP is the difference between the value of the external assets of the resident sectors and that of the liabilities to the rest of the world.
b Excluding the Banco de España and the net derivatives position.

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of the decline in the price of financial instruments, which was particularly sharp in the case of equity securities issued by resident other monetary financial institutions.

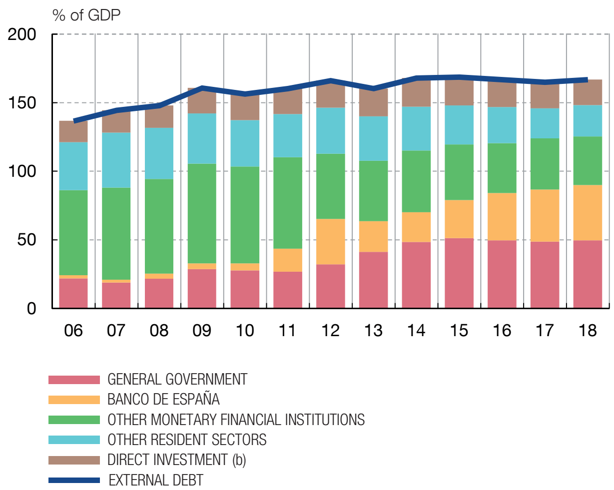
By institutional sector, the net debit position vis-à-vis the rest of the world of other monetary financial institutions decreased in 2018 (by 7 pp of GDP, to 6% of GDP), while that of other sectors hardly changed (see Chart 5.2). Thus, general government continued to have the largest net debit position, equivalent to 44% of GDP.

THE GROSS EXTERNAL DEBT OF THE SPANISH ECONOMY INCREASED IN 2018 AND CONTINUED TO BE DOMINATED BY PUBLIC-SECTOR LIABILITIES

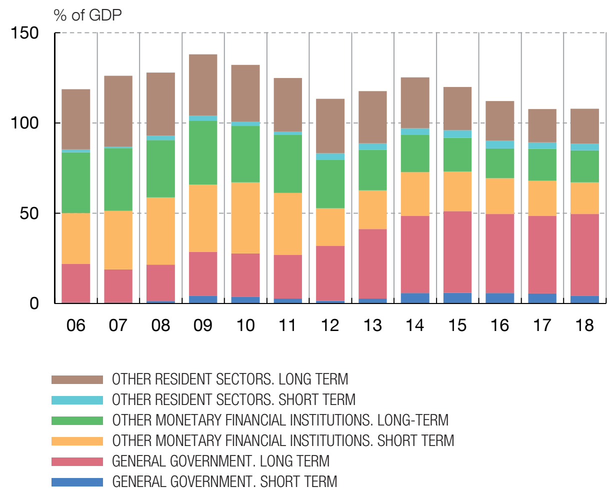
CHART 6

The gross external debt increased by 0.5 pp in 2018, to stand at 166.7% of GDP. In terms of its composition, long-term instruments issued by general government, which usually involve less refinancing risk than most of the debt liabilities issued by the private sector, continue to predominate.

1 GROSS EXTERNAL DEBT (a). SECTORAL BREAKDOWN



2 GROSS EXTERNAL DEBT STRUCTURE BY INSTITUTIONAL SECTOR AND ISSUE TERM (a) (c)



SOURCE: Banco de España.

a External debt comprises the balance of all liabilities that entail future repayment of principal, payment of interest or both. In practice, this includes all financial instruments, except equity securities (shares – including investment fund shares – and other equity securities), financial derivatives and monetary gold bullion.
b Includes only direct investment in the form of debt.
c Excluding the Banco de España and direct investment in the form of debt.

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By functional category, excluding the Banco de España, the debit position in respect of the other investment and portfolio investment headings decreased, although in the case of the latter, the debit position in debt securities continued to be the largest, amounting to 43% of GDP (see Chart 5.3). For its part, the net debit position associated with direct investment increased. According to the directional principle the stock of Spain's outward direct investment (i.e. the net assets among firms of the same group whose parent company is resident) fell, while the stock of inward direct investment of the rest of the world in Spain increased (comprising the net liabilities between firms of a group whose parent company is non-resident) (see Chart 5.4). By geographic area, Spanish direct investment continued to be highest in Latin America (12.4% of GDP), while the bulk of foreign direct investment in Spain[12] continues to originate from the euro area (30.1% of GDP).

The gross external debt of the Spanish economy, comprising all liabilities to non-residents that involve future payments in respect of repayment of principal, interest or both,[13] increased in 2018 by €75.9 billion, to stand at 166.7% of GDP, 1.7 pp below the peak reached in 2015 (see Chart 6.1). By original maturity, long-term liabilities predominate (76% of total), while, by institutional sector, general government continues to have the highest gross external debt (46% of the total) (see Chart 6.2)[14]. In so far as most of the

12 This geographical detail is based on the immediate and not the ultimate country.
13 In practice, this includes all financial instruments, except equity securities (shares – including shares in investment funds – and other equity securities), financial derivatives and monetary gold bullion.
14 These ratios are calculated with respect to gross external debt, having excluded the liabilities of the Banco de España and those associated with direct investment.

external liabilities of the Spanish economy correspond to the public sector, bolstering the sustainability of public finances is essential to reduce the economy's vulnerability to possible shocks in international capital markets.

23.5.2019.

Changes in the net IIP over time are determined by the balance of payments' financial account transactions and also by the performance of the account reflecting other flows. These other flows relate to valuation effects and other changes in volume. The former reflect changes in the value of the financial securities composing the economy's stock of foreign assets and liabilities arising from price and/or exchange rate movements. The latter comprise, inter alia, forgiveness, unilateral loan write-offs or reclassifications and may also include statistical discrepancies between the IIP and the financial account of the BoP.

This box shows the role played by the financial account and other flows in the changes in the Spanish economy's net IIP over the course of recent years. The breakdown of the changes in the IIP into these two factors, which may display very different dynamics, is highly significant. For instance, an increase in the economy's negative net IIP may have different implications in terms of external vulnerability depending on which factor is the main driver of the change.

As Chart 1 shows, in the years prior to the global financial crisis, both the financial account and the other flows contributed to an increase in the Spanish economy's negative net IIP. Thus, between 1999 and 2008 resident agents' persistent net borrowing was responsible for approximately 65% of the deterioration observed in the net IIP. The rest was due to other flows and, in particular, to the much greater decline in the value of foreign assets held by resident agents than in that experienced by their liabilities held by international investors (see Charts 2 and 3).

Chart 1
COMPONENTS OF CHANGES IN THE NET IIP (a)

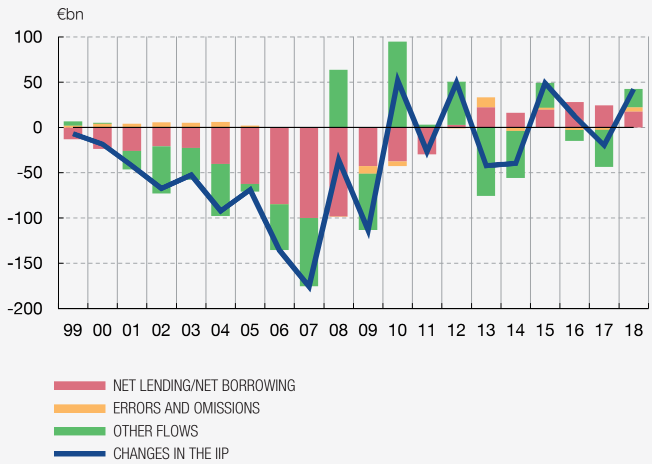


Chart 2
CHANGES IN ASSETS (b)

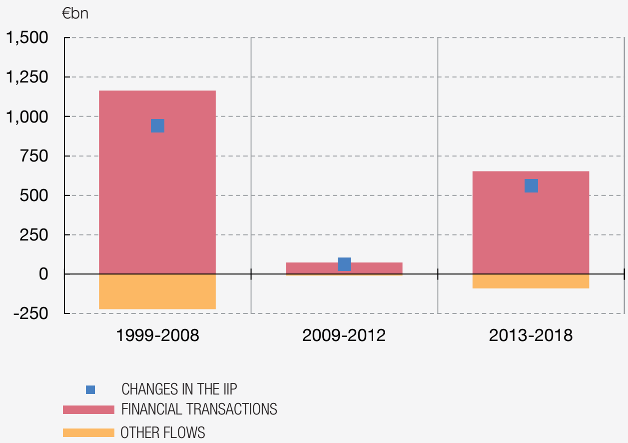


Chart 3
CHANGES IN LIABILITIES (b)

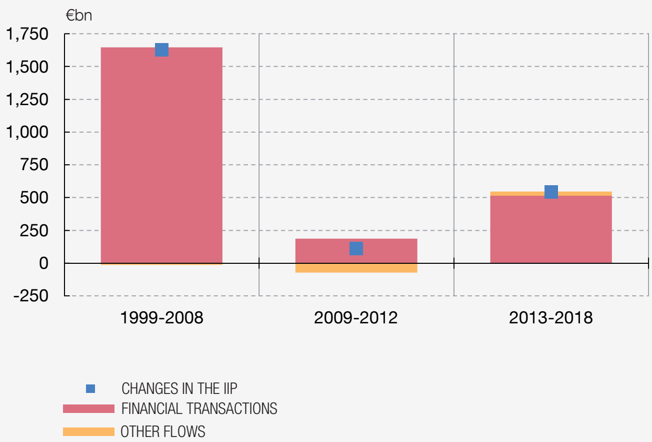
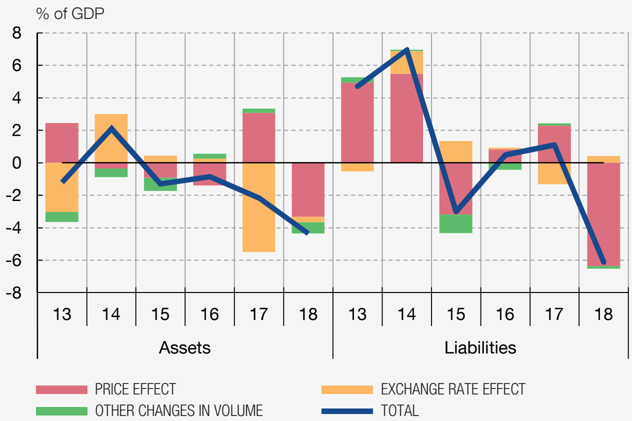


Chart 4
COMPONENTS OF CHANGES IN OTHER FLOWS (c)



SOURCE: Banco de España.

a The net IIP is the difference between the value of resident sectors' foreign assets and that of liabilities vis-à-vis the rest of the world.
b Excluding financial derivatives.
c Excluding the Banco de España and the net position in derivatives.

Since 2009 the performance of the financial account and other flows has been mixed, almost opposite, and especially volatile in the case of other flows. Two periods can be distinguished. From 2009 to 2012 the Spanish economy continued to be a net borrower vis-à-vis the rest of the world, although less than previously, contributing once again to an expansion of the net debit position. The effect of other flows on the IIP was the opposite, but this did not translate into the Spanish economy being less externally vulnerable. In particular, there was a substantial loss of international investor confidence in the Spanish economy during this period. This was reflected in the valuations of financial instruments issued by resident agents, which dropped much more sharply than did the value of foreign assets. The result was a positive contribution of other flows to changes in the IIP which, however, was linked to an increase in the Spanish economy's vulnerability.

In the period 2013-2018, the financial account and other flows switched roles in terms of their contribution to changes in the IIP. Thus, the current account surpluses recorded by the Spanish economy since 2013 have given rise to a reduction of the net debit position, while other flows have tended to increase it. Nevertheless, these negative valuation effects have reflected greater international investor confidence in the Spanish economy, resulting in a larger increase in the price of resident agent liabilities vis-à-vis the rest of the world than that observed for external assets. Notably, valuation effects in 2017 were more linked to exchange rates than to price effects. Specifically, the appreciation of the euro in 2017 led to a decline in the value of financial securities denominated in foreign currency. The decline was sharper for external assets held by residents than for domestic liabilities held by non-residents (since the proportion of instruments denominated in foreign currency is substantially higher in asset positions).