OVERVIEW

In recent months the rate of expansion of the global economy has been firming, essentially owing to the improvement in the advanced economies. In any event, the medium-term outlook continues to point to relatively modest rates. In the advanced economies the ability of the expansionary monetary policy stance to alone sustain a more pronounced expansionary path for economic activity is showing certain limitations, given the scant contribution of other economic policies. Among the emerging economies, recent developments show some divergences across the different countries, reflecting factors such as dependence on external financing, the economic policy headroom available or the status of each economy as a commodities producer or consumer, against the background of the rise in commodities prices.

Probably, the highlight on global financial markets in recent months has been the rise since October in sovereign bond yields from historically low levels, a trend that has stepped up notably following the US presidential election result. This has been accompanied by an increase, on a lesser scale, in expected inflation according to financial markets, against the backdrop of stronger expectations as to US policy interest rate rises. Confirmation of these expectations has begun to materialise with the Federal Reserve's first decision along these lines on 14 December. The upward movement in long-term rates has been accompanied by other developments that include a strengthening of the dollar and, generally, increases in stock market prices in the advanced economies, especially in the financial sector. More recently, oil prices have been significantly boosted following the agreement reached on 30 November by the OPEC countries to restrict global crude oil production, with the producer countries that are not OPEC members subsequently following suit. This decision might have contributed, by boosting expected inflation, to bolstering the upward movement in sovereign debt yields.

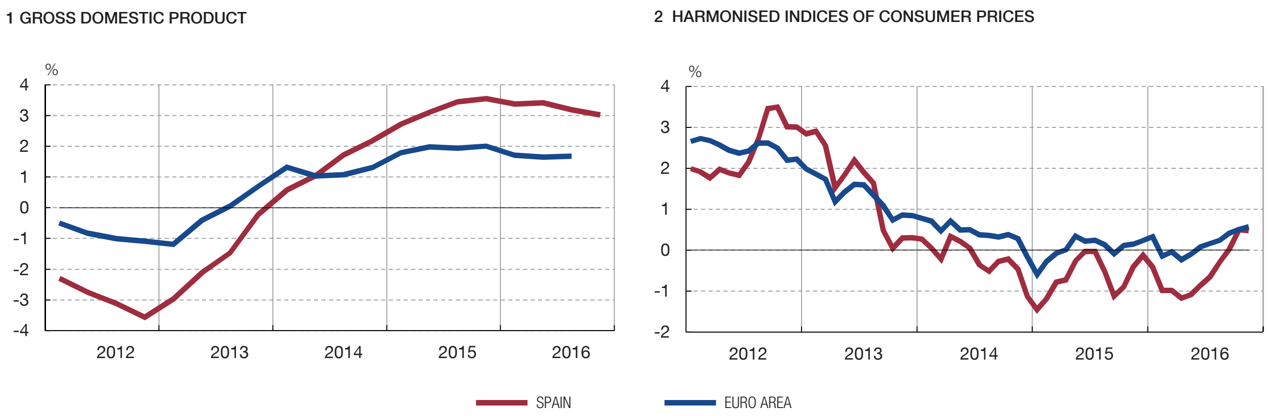
Despite the degree of improvement in worldwide economic developments and in the global short-term outlook, the most recent phase has been marked by the persistence of various risk factors. In particular, the uncertainty over the future course of global economic policies has increased notably, especially as regards the US economy, both in respect of trade and fiscal policy. Moreover, a potential steepening of the above-mentioned upward trajectory of long-term interest rates, along with their impact on prices in other financial markets, might jeopardise macrofinancial stability, in particular in the emerging economies with high dollar-denominated debt.

In the euro area, the quarter-on-quarter growth rate of GDP climbed in Q3 to 0.3%, in line with expectations. The latest Eurosystem projections for December broadly paint a similar picture to those disclosed by the ECB in September.[1] Specifically, the latest forecasts point to a continuation of the expansion in economic activity in the 2017-19 period at a similar pace to that observed this year. With respect to inflation, the latest figures have been in line with expectations, although this has been the outcome of negative surprises in the underlying component and of positive ones in the energy component, which have tended to cancel one another out and which have fed into the Eurosystem projections for

1 The projections for the euro area as a whole are available in December 2016: Eurosystem staff macroeconomic projections for the euro area. Those relating to the Spanish economy, which are part of the foregoing ones and have been prepared by Banco de España experts, can be viewed in Macroeconomic projections for the Spanish economy 2016-2018.

GROSS DOMESTIC PRODUCT AND CONSUMER PRICES (a)

CHART 1



SOURCES: Eurostat, INE and Banco de España.

a Year-on-year rates of change based on seasonally adjusted series in the case of GDP and on original series in that of the consumer price indices.

the coming years. These projections, which envisage HICP inflation standing at 1.7% on average in 2019, were one of the factors taken into consideration by the ECB Governing Council in deciding, on 8 December, to extend its asset purchase programme to December next year, at least, with the announcement being accompanied by certain technical adjustments so as to smooth the programme's application.

In Spain, economic activity has continued to post a high rate of increase in recent months. Specifically, in Q4, GDP is expected to have grown by 0.7%, unchanged on the rate observed in Q3 (see Chart 1) and underpinned by the strength of domestic spending. In particular, the continuation of the intense process of employment generation and the persistence of favourable financial conditions are estimated to have continued sustaining household spending on consumer goods and services, at a similar pace to that of the recent past. Investment by non-financial corporations is expected to have gained in strength, following its somewhat subdued moderate path in Q3. In a similar fashion, the coincident indicators of investment in construction suggest this demand component has picked up, following the easing in growth observed in Q3 according to QNA figures.

The as yet very limited information available points to a potential increase in trade in goods with the rest of the world in Q4, following the notable slowdown in the summer. That would reflect, in particular, greater firmness in export and import flows vis-à-vis the emerging economies as a whole. Should the scant information available be confirmed, there would be some easing in the net contribution of the external balance, which was marginally positive in the preceding quarter.

The uncertainty over the course of economic policies in Spain has tended to abate with the formation of a Government, following the lengthy spell covering most of the year in which a caretaker government was in office. In particular, in the fiscal policy realm, Parliament has approved the Royal Decree Law dated 2 December which defines a package of budgetary consolidation measures. While these measures may entail some short-term cost in terms of activity, it is a priority to redress the budgetary imbalance and lessen the Spanish economy's vulnerability, given its dependence on foreign financing. However, some uncertainty persists over the definition of the structural reforms agenda, such reforms being needed to durably raise the rate of expansion of activity and of employment creation.

MAIN MACROECONOMIC AGGREGATES OF THE SPANISH ECONOMY (a) — TABLE 1

	2015	2016	2015 I TR	2015 II TR	2015 III TR	2015 IV TR	2016 I TR	2016 II TR	2016 III TR	2016 IV TR
National Accounts										
Quarter-on-quarter rates of change, unless otherwise indicated										
Gross domestic product	3.2	3.2	1.0	0.8	0.9	0.8	0.8	0.8	0.7	0.7
Contribution of national demand (b)	3.3	2.8	0.9	1.0	0.9	0.8	0.7	0.4	0.6	0.7
Contribution of net external demand (b)	-0.1	0.4	0.0	-0.3	0.0	0.0	0.1	0.4	0.1	0.0
Year-on-year rates of change										
Employment	3.0	3.0	2.8	3.0	3.0	3.0	3.1	2.8	2.9	3.1
Price indicators (year-on-year change in end-of-period data) (c)										
CPI	-0.5	-0.2	-0.7	0.1	-0.9	0.0	-0.8	-0.8	0.2	0.7
CPI excl. energy and unprocessed food prices	0.6	0.8	0.2	0.6	0.8	0.9	1.1	0.6	0.8	0.8

SOURCES: INE and Banco de España.

a Information available to 16 December 2016.
b Contribution to the quarter-on-quarter rate of change of GDP (pp).
c Latest available figure for consumer price indices: November 2016.

Consumer prices have risen significantly in recent months, posting positive rates as from September. In November, the year-on-year rate of change of the CPI stood at 0.7%. That reflected the impact of the trajectory of oil prices on the energy component, while core inflation has in recent months held on the approximately stable path characterising it since mid-2015. The negative gap between Spanish inflation and that of the euro area, which before the summer stood at around 1 pp, has narrowed significantly in recent months and stood at -0.1 pp in November. This is the outcome of the path followed by the inflation differential of the energy component, which from being negative by more than 5 pp at the start of the summer turned slightly positive in November, while in terms of core inflation, a small negative gap has been maintained. If the latest path of oil prices holds, inflation might stand comfortably above 2% in the opening months of 2017. In any event, insofar as this rise in inflation is prompted by changes in oil prices, it is foreseen that the increase will essentially be temporary.

The Report includes six boxes devoted, respectively, to analysing the potential policies the new US Administration may implement from next year, along with the implications for the world economy (Box 1); the room for manoeuvre available for introducing a more expansionary fiscal policy stance in the euro area (Box 2); the impact of the base effects derived from the path of the oil price on the recent trajectory of the inflation rate (Box 3); new fiscal policy developments in Spain (Box 4); the recent trend of the Spanish economy's financial account and international investment position (Box 5); and the results of the latest ECB half-yearly survey on the access of Spanish SMEs to external financing (Box 6).

16.12.2016.

THE FINANCIAL MARKETS AFTER THE UNITED STATES PRESIDENTIAL AND LEGISLATIVE ELECTIONS AND THE IMPACT OF POTENTIAL ECONOMIC POLICY CHANGES

BOX 1

The United States presidential and legislative elections held on 8 November 2016 gave an unexpected triumph to Donald Trump and a Republican majority both in the House of Representatives and the Senate. Although the initial reaction of the financial markets was adverse, in a few hours the trend reversed in the main advanced economies. In fact, all of their stock exchanges recorded rises, although of differing magnitude (see accompanying Chart). The main US stock market indices reached all-time highs, most notably in those industries where firms would benefit more from the policies announced by Trump during the election campaign (banking, construction, health care and those more exposed to the domestic market), while sectors more sensitive to interest rate increases and/or non-cyclical in nature did not perform so well (utilities or shares of technology companies).

However, the main effects are being seen in the government bond markets of developed countries, where yields have risen, particularly in the United States, and the slope of the yield curve is now steeper. These increases in yields were principally due to a higher term premium which, as the accompanying Chart shows, in the United States accounts for around 75% of the increase in ten-year bond yields, while inflation expectations have increased by approximately 0.25 pp. The expected path of future official interest rates was also revised upward.

In the foreign exchange markets, the sustained trend of the dollar to appreciate has gained strength, especially against the yen, among developed countries' currencies, and against the Mexican peso, among emerging economies (see attached Chart). In fact, the reaction of emerging markets was unfavourable, particularly in those countries that might be more affected by the new US policies, such as Mexico, or that are more dependent on external financing, such as Turkey. In this group of countries, in addition to adverse movements in sovereign spreads and in equity market prices, there have been strong capital outflows since the election result was announced.

Developments in financial markets appear to factor in the materialisation of certain proposals made by president-elect Trump during the election campaign. Although many of these are vague, the changes announced in fiscal, trade and migration policy are noteworthy. Trump's proposals in fiscal policy would entail a decline of approximately $5.3 billion over ten years (CRFB calculations[1]) in tax income mainly from higher-income taxpayers and from corporate income tax.[2] As regards government expenditure, the aim would be to maintain it overall, but giving more weight to investment in infrastructure (partially private, but introducing tax incentives) and to military expenditure (see accompanying Chart). Trade policy proposals are protectionist: rejection of the Trans-Pacific Partnership Agreement (TPPA), renegotiation of the North American Free Trade Agreement (NAFTA) and higher tariffs (especially on China and México, to reduce the trade deficit with these countries). In migration policy, candidate Trump was very belligerent towards undocumented immigrants (there are an estimated 11 million in the United States) and announced that the legal entry of immigrants would become harder in the future.

Significant effects on the US economy may be expected if the proposals in these three fields are fully implemented. In the short term, the impact of the fiscal expansion, with a positive effect on GDP and inflation, would predominate. However, at medium and long term, the adverse effects on economic activity of a decline in trade and in the labour force, which has a strong immigrant component, would gain weight. Inflation would continue to rise, since domestic productive capacity would be lower and imported goods would be more expensive. The new economic policy stance in the United States would have significant cross-border effects, mainly as a result of curtailing trade, especially if other countries were to retaliate. Additionally, the impact abroad of the fiscal stimulus and the appreciation of the dollar would be partially offset by the induced increase in interest rates.

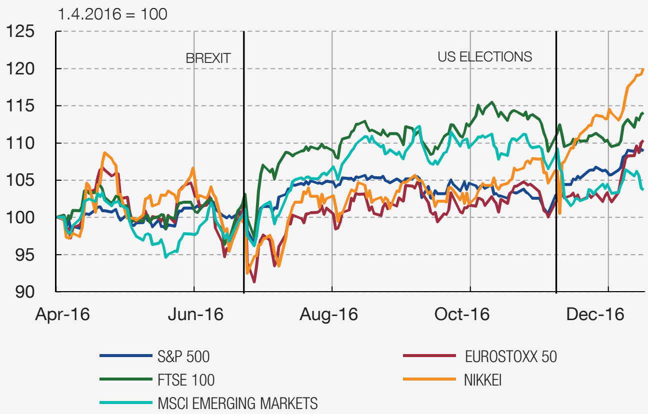
Donald Trump's far-reaching economic policy proposals, many of which depart markedly from those traditionally embraced by the Republican Party (e.g. trade and immigration policies), have sparked much uncertainty about their effective implementation. This is why his tax proposals are considered more likely to materialise, albeit on a smaller scale than that announced during the campaign.

1 The CRFB (Committee for a Responsible Federal Budget) is an independent non-profit, bi-partisan organisation that analyses federal fiscal issues.

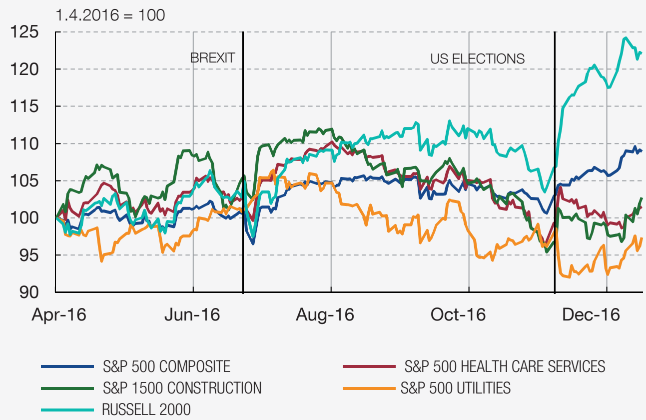
2 Income tax brackets would be reduced from seven to three (with a maximum tax rate of 33% against the current 39.6%); the maximum tax rate for capital gains and dividends would be 20%; federal estate and gift taxes would be eliminated, as would the tax on high-income earners that was approved to help pay for the Affordable Care Act. The corporate income tax rate would be lowered from 35% to 15% and firms would be allowed to repatriate earnings at a single rate of 10%.

THE FINANCIAL MARKETS AFTER THE UNITED STATES PRESIDENTIAL AND LEGISLATIVE ELECTIONS AND THE IMPACT OF POTENTIAL ECONOMIC POLICY CHANGES (cont'd)

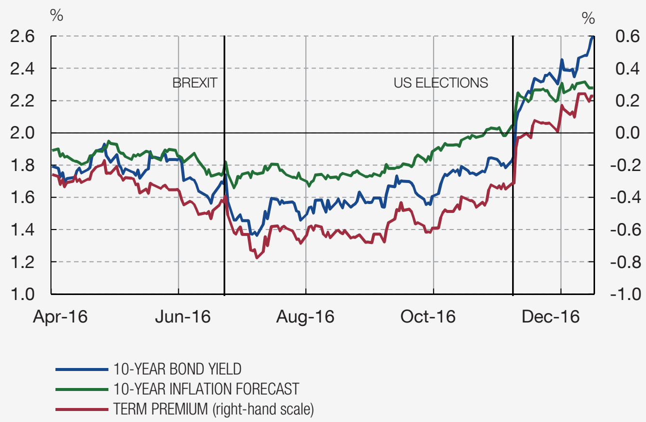
Panel 1
STOCK EXCHANGE INDICES IN DEVELOPED ECONOMIES



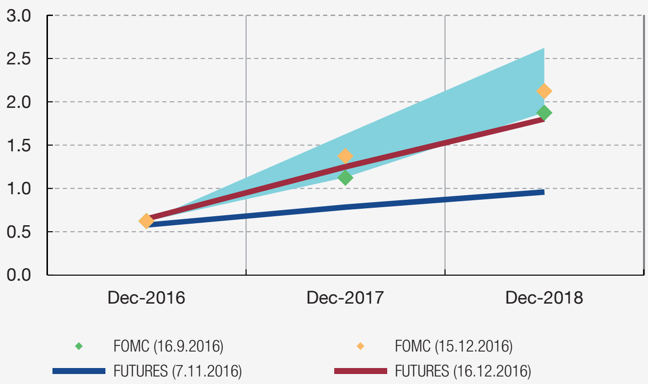
Panel 2
UNITED STATES STOCK EXCHANGE INDICES



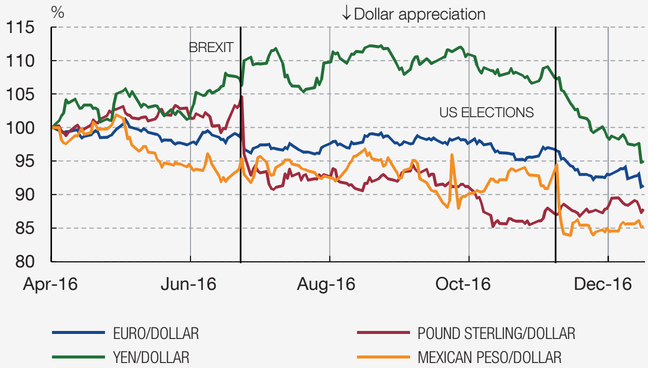
Panel 3
UNITED STATES: 10-YEAR TREASURY BOND



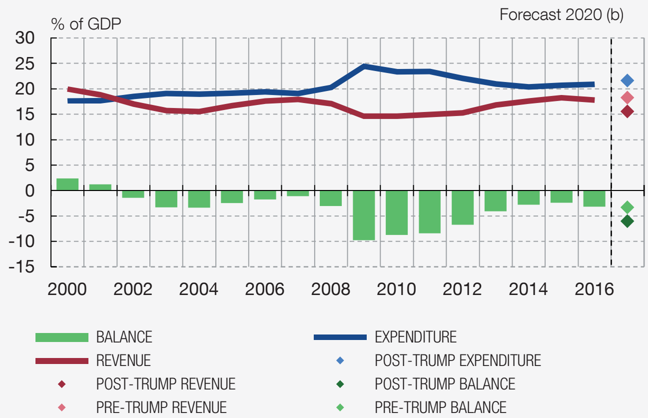
Panel 4
EXPECTED RATES (FUTURES) VS. MEDIAN AND FOMC RANGE (a)



Panel 5
EXCHANGE RATES AGAINST THE DOLLAR



Panel 6
GOVERNMENT EXPENDITURE AND REVENUE



SOURCES: Datastream, Federal Reserve System, Federal Reserve Bank of New York, Bloomberg inflation swaps, Congressional Budget Office (CBO), Committee for a Responsible Federal Budget, Bureau of Economic Analysis (BEA), in-house estimates.

a Excludes the three highest and three lowest projections.
b CBO's GDP projections (August 2016) for both scenarios.

On 16 November, in the framework of the European semester, the European Commission published a communication recommending the adoption of a more expansionary fiscal policy across the euro area in order to support the ECB's monetary policy and address the risks posed by the persistence of a scenario of low growth and inflation. In this context the Commission points out that the EMU's current governance framework lacks instruments with which to manage the euro area's overall fiscal policy directly, as it is the aggregate of the fiscal policies of its 19 member countries.

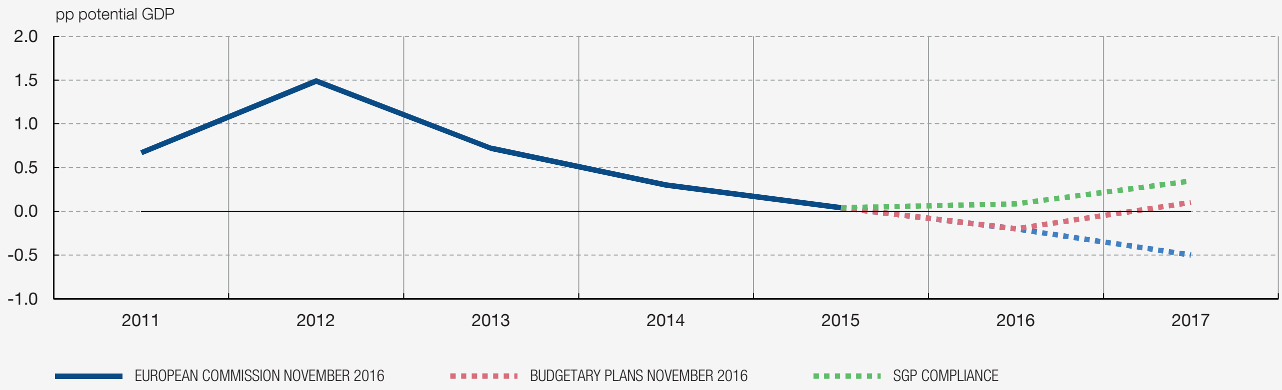
The draft budgetary plans member countries presented in mid-October suggest an aggregate neutral fiscal policy stance in 2017, which could turn restrictive, at around 0.3% of GDP, if countries comply strictly with the requirements of the Stability and Growth Pact (SGP) (see Chart 1). In the Commission's opinion, the fragility of the economic recovery, the persistence of a substantial volume of idle resources, and the high level of uncertainty, make a more expansionary fiscal policy stance appropriate. Specifically, the Commission proposes a fiscal expansion of 0.5 pp of GDP in the euro area, which would allow 75% of the current output gap (which is still negative) to be closed. This stimulus should aim to boost public investment in those countries with fiscal space available thanks to the relatively healthy state of their public finances. In this regard, some recent analyses suggest that in the EMU's current environment of low inflation and highly expansionary monetary policy, a fiscal expansion in part of the monetary union could have significant positive effects in the rest of the area.[1]

1 See Arce, O., Hurtado, S., and C. Thomas (2016), Policy Spillovers and Synergies in a Monetary Union, International Journal of Central Banking, vol. 12, n.º 3, pp. 219-277.

However, the Commission's proposal is difficult to implement in the current framework defined by the SGP's rules. The Commission's own diagnosis of the budgets submitted for 2017 points out that many of the area's countries are at risk of breaching the SGP's requirements, making any easing of their structural fiscal balances inappropriate. Consequently, a fiscal impulse on this scale would require a substantial expansion in just a few countries, such as Germany and the Netherlands, whose public finances are in good health and whose levels of public debt are low. These countries, which are in a more favourable cyclical position than the EMU average, may not consider it expedient to carry out such a large stimulus, however. Moreover, the SGP does not have any instruments with which to induce Member States with fiscal space to use it.

In short, the merit of the Commission's proposal is that it stimulates the debate on the optimal fiscal policy stance for the euro area as a whole. This is a debate to which the European Fiscal Board, which will soon be fully operational, has a mandate to contribute. But the proposal also highlights the difficulties of implementing a fiscal policy stance that, while compatible with the SGP's rules, is considered optimal for the area as a whole, in the absence of a central budget or supra-national fiscal capacity. In this connection, it should be recalled that the Commission has undertaken to set out concrete guidelines for the design of this common fiscal capacity in the white paper it is due to publish in the spring of 2017, as agreed in the Five Presidents' Report.

Chart 1
CHANGE IN STRUCTURAL BALANCE



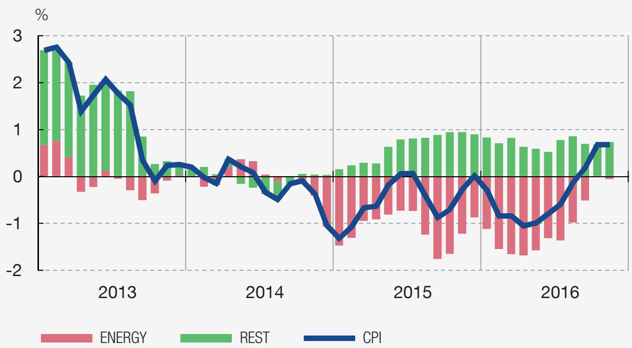
SOURCES: European Commission and national budgetary plans.

In the last two years, inflation in Spain, proxied by the growth rate of the consumer price index (CPI), has posted negative values of -0.5% on average in 2015 and of -0.8% in the first half of 2016. This took place against a background of oil price collapse in the international markets, which had a direct impact on energy prices and, through these, also on consumer prices. In fact, Chart 1 shows that the negative rate of change of the overall index from mid-2014 to August of this year is explained by the behaviour of the energy component, while the contribution from other goods and services is positive. The overall index excluding energy increased by 0.7% on average in 2015 and by 0.9% in the first half of 2016.

In September 2016 the year-on-year rate of change of the CPI became positive as a result of the energy component, and will foreseeably become more so in the coming months. This behaviour of inflation is partly a mechanical reflection of what is known in the literature as the base effect. Since the year-on-year rate of change of the CPI shows how this changes in a month with respect to the same month a year earlier, this rate is affected by what happened in the year-ago month, but also by what happened in the preceding 11 months. At the current point in time, this means that the inflation rate in the coming months will include the increase in oil prices from the low in January this year. Additionally, following the agreement to reduce supply by the OPEC and other producers, oil prices have risen on the international markets. This rise has fed through practically in full to the futures markets, which have maintained a certain positive slope (see Chart 2), thereby adding further momentum to the expected inflation rate.

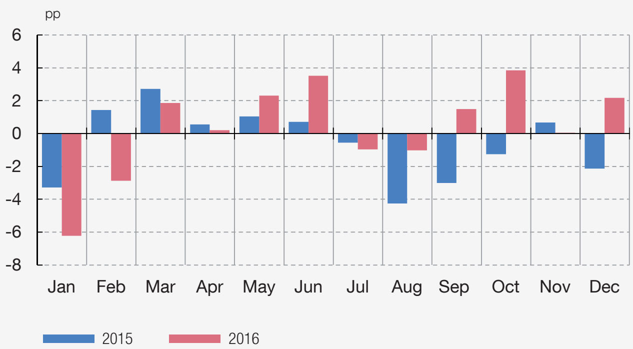
Chart 3, which plots the month-on-month change in the energy CPI, shows that in late 2015 and early 2016 there were very negative month-on-month rates linked to the behaviour of fuel prices, but also to those of electricity. Those price falls would explain, as a reflection of the aforementioned base effects, the rise in inflation observed in the latter months of this year. In a similar vein, Chart 4 breaks down the change in the year-on-year rate with respect to the previous month into the so-called current effect, which captures the price variation due to contemporaneous factors (e.g. the recent announcement of the reduction in the world oil supply), and the base effect, which is due to

Panel 1
CONTRIBUTIONS TO THE YEAR-ON-YEAR RATE OF THE CPI

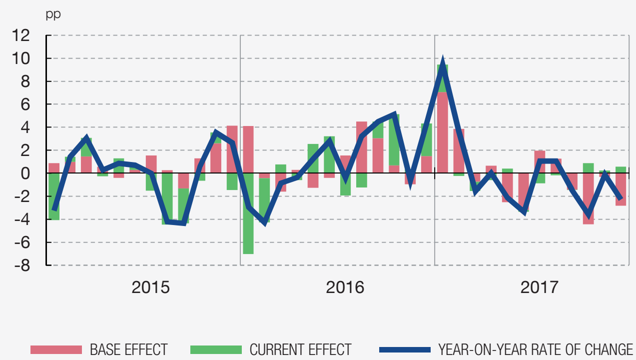


Panel 2
OIL PRICE
€/barrel

Panel 3
MONTH-ON-MONTH RATE OF CHANGE OF THE ENERGY CPI



Panel 4
YEAR-ON-YEAR RATE OF CHANGE OF THE ENERGY CPI WITH RESPECT TO THE PREVIOUS MONTH



SOURCES: INE, Reuters and Banco de España.

the behaviour in the same month a year earlier. It can be seen that the base effects were large between August and October of this year, and will again be large between December 2016 and February 2017. For its part, the recent rise in oil prices will also entail an upward revision of projections, albeit smaller than the previous one.

Against this background, the information received up to 14 December indicates that in the coming months the year-on-year rate of change of the CPI will reach a high in February 2017, foreseeably above 2.5%. Also, the average inflation rate for 2017 as a whole may exceed 2%, which will represent a considerable upward revision of the Banco de España's latest projections based on the information available up to mid-November.[1]

1 Macroeconomic projections for the Spanish economy (2016-2019).

This rise in inflation in the next few months will, in principle, be transitory, and the impact of the base effect on the year-on-year rate of change of the CPI will peter out over the course of the year, as indicated by the negative contribution of the base effect from March (see Chart 4). For this reason, the envisaged upward trend in inflation in the short term should not, by itself, have an impact on the monetary policy stance if the medium-term inflation projections do not change. Indeed, for the increase in the rate of change of the energy component to have a more lasting impact, it would have to feed through to the prices of other goods and services and to wages. In this respect, it should be taken into account that a priority consideration in determining labour costs must be the need to persevere with the competitive advantages obtained in recent years in order to boost job creation.

The latest figures released on the general government sector in National Accounts terms refer to September 2016 and cover the central government, the regional governments and the Social Security system.[1] According to that information, those sub-sectors combined posted a deficit of 3.3% of GDP in January-September, 0.1 pp less than a year earlier (see Panel 1). The most recent data refer to the central government, showing that to October it had a deficit of 1.9% of GDP, which is an improvement of 0.1 pp on a year earlier. In turn, the data on revenue from taxes shared by central government and the regional and local governments, in budgetary accounting terms, show a sharp increase in October, owing to the impact on the second prepayment of corporate income tax of the regulatory changes introduced in late September (Royal Decree-Law 2/2016). The latest projections prepared by the Directorate General Economics, Statistics and Research (DGEE, by its Spanish abbreviation),[2] which take into account the latest available data[3] and the annual impact of those regulatory changes, point to a combined general government deficit of 4.4% of GDP in 2016.

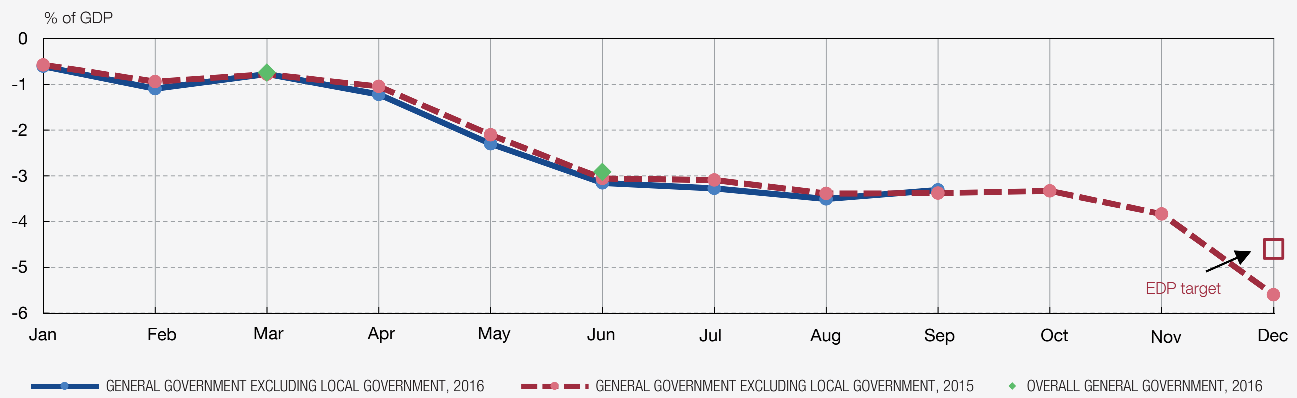
General government debt as a proportion of GDP fell by 0.7 pp in 2016 Q3 to 100.3%, as the rate of growth of GDP outpaced the small increase in liabilities (see Panels 2 and 3). This, together with the decrease in average financing costs, permitted a further moderate decline in the interest burden, to 2.9% as a proportion of GDP. The breakdown by instrument shows that the issuance of medium- and long-term securities continued to be the main financing channel for general government in Q3. By holder, the main net purchasers of securities issued by central government in the period were Spanish financial institutions other than credit

1 Monthly National Accounts figures released by the National Audit Office (IGAE).

2 To access the projections, click on this link.

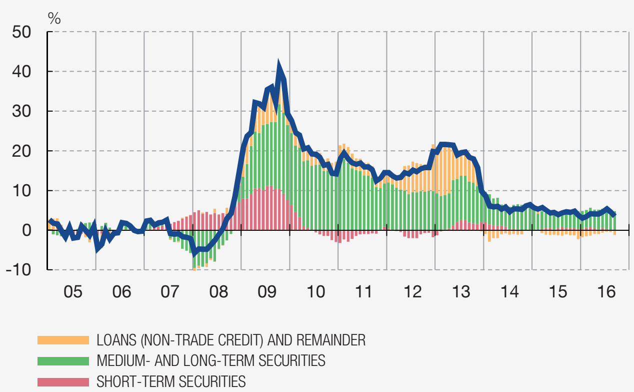
3 At the date of close of this report, 16 December 2016.

Panel 1
GENERAL GOVERNMENT BUDGET BALANCE IN NATIONAL ACCOUNTS
Cumulative data since January



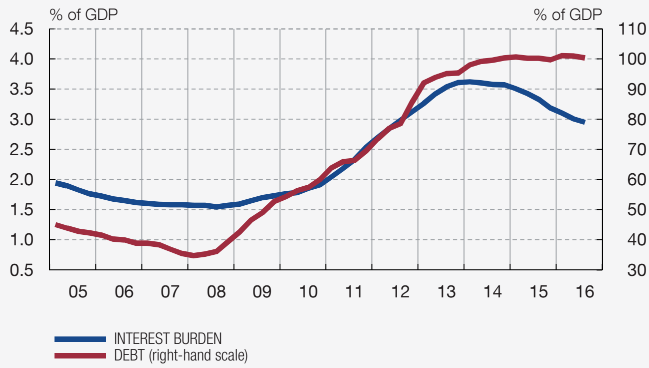
SOURCES: IGAE and the Council of the European Union.

Panel 2
GROSS FINANCING
Y-o-y rate and contribution by instrument



SOURCE: Banco de España.

Panel 3
INTEREST BURDEN AND DEBT RATIO
Cumulative four-quarter data



SOURCES: Banco de España and INE.

institutions. In this respect, both the Banco de España and (to a lesser extent) non-residents made notable purchases, the former continuing to make large acquisitions of government debt in the secondary market as part of the Eurosystem asset purchase programme. Conversely, credit institutions, households and non-financial corporations reduced their holdings of these instruments.

On 2 December the government set in train the preparatory cycle for the General State Budget for 2017, presenting to Parliament the budgetary stability targets for 2017-2019, the macroeconomic projections for that period and the approval of the central government expenditure ceiling for 2017. The targets for general government and its sub-sectors are 4.6%, 3.1%, 2.2% and 1.3% of GDP for the period 2016-2019, consistent with the deficit reduction path set by the Council of the European Union on 8 August. The ceiling on central government non-financial expenditure for 2017 has been set at €118,337 million.

Against this backdrop, the Council of Ministers also approved a package of extraordinary tax measures (Royal Decree-Law 3/2016 of 2 December 2016), validated by Parliament on 15 December, aiming to ensure that the official revenue forecast for 2017 is compatible with the budget deficit targets and the expenditure ceiling. These measures notably include the change to corporate income tax, broadening the tax base, which the government expects will have an impact of €4.65 billion on revenue. In particular, the offset of prior years' losses has been confined to firms with turnover of more than €20 million and limits have been placed on their use of double taxation tax credits, and the deduction of losses on holdings in resident and non-resident entities has been eliminated. Second, in the case of excise duties, the tax rate on alcoholic beverages has been raised by 5%, in the tax on tobacco products, the weight of the specific component with respect to the *ad valorem* component has been increased, taking it closer to the European average, and a tax on sugary soft drinks has been announced, to be introduced in the course of 2017. Third, as regards the social security system, the maximum limit and the maximum contribution bases have been raised by 3%. Lastly, various measures have been adopted to boost the fight against fraud and improve tax management.

To conclude, on 9 December the government submitted an update of the General Government Budget Plan for 2017 to the European Commission. This includes a full projection of public revenue and expenditure for 2017, consistent with the general lines of the draft budgets of the various tiers of government and with the new macroeconomic projections. In particular, the Budget Plan contains the corrective tax measures described above. These measures, which were not included in the Banco de España's latest projections report,[4] as they were approved subsequently, should help to significantly curb the budget deficit, with a target of 3.1% of GDP, in 2017.

4 To access the projections, click on this link.

In the first half of 2016, the Spanish economy's negative net international investment position (IIP) increased slightly (by €2.4 billion), although relative to GDP it fell by 1.4 percentage points, to 88.5%, thanks to the growth in GDP (see Panel 1 of this box and Chart 16 in the main text of the Spanish version of this report). The slight increase in the negative net IIP was the result of an increase linked to valuation changes of external assets and liabilities with non-residents (arising from movements in their prices and in exchange rates)[1] and to other adjustments,[2] which more than offset a decline in the positive balance, in line with the nation's financing capacity, in net financial transactions (€2.8 billion).

The breakdown into assets and liabilities shows that, excluding financial derivatives, between January and June 2016, residents again acquired, in net terms, a large volume of foreign assets. When combined with the valuation changes and the (small) negative other changes in volume, this led to an increase in the amount of assets vis-à-vis the rest of the world equivalent to 9.1% of GDP in the first half (see Panel 2). The net investment of non-residents in the Spanish economy (excluding the Banco de España) was also positive, albeit smaller, so that the positive balance in the financial account of the balance of payments, excluding the central bank, easily exceeded the current and capital account surplus, which was reflected in a very negative amount of net financial transactions of the Banco de España with the rest of the world (–7.7% of GDP in the first half of the year, see Panels 2 and 3). These developments continued to be influenced by the ECB's quantitative easing policy, which has generated excess liquidity within the euro area, prompting financial flows between the countries of the area.[3] In line with developments on the asset side, the movements in the prices of financial instruments and in exchange rates had overall a negative (although minor) impact on the valuation of liabilities with non-residents. In net terms, financial derivatives also contributed to an increase in the IIP, basically due to valuation effects.

The institutional sector breakdown shows that the decline in the negative net IIP relative to GDP resulted from the reduction in the net debtor positions of monetary financial institutions other than the Banco de España and of other resident sectors, in line with the financing capacity of the resident private sector as a whole, which more than offset the increase (of 3.4 pp) in the net debtor position of the Banco de España, while there was barely any change in that of general government (see Chart 16 in the main text of the Spanish version of this report). Excluding the Banco de España, these liabilities declined more sharply (by 4.8 pp, to 74.5% of GDP).

The functional category breakdown shows that, excluding the Banco de España, all the categories contributed to a reduction in the net debtor position of the Spanish economy in the first half (see Panel 4). Thus, the net debtor position in direct investment fell by 0.4 pp, to 4.4% of GDP, in portfolio investment by 3.9 pp, to 52.3% of GDP, and in other investment by 1 pp, to 17% of GDP.[4] Within direct investment, there was a notable increase in the amount of external assets of residents (specifically, of non-financial sectors) in the form of shares and other equity and debt securities, which was somewhat higher than that in liabilities vis-à-vis non-residents. With regard to portfolio investment, the fall in the amount of external assets of resident agents was more than offset by the reduction in their liabilities vis-à-vis the rest of the world. The sector breakdown shows mixed behaviour. Specifically, on one hand, the non-residents' holdings of assets issued by monetary financial institutions and, to a lesser extent, by other resident sectors declined again, in line with their current deleveraging process. In contrast, non-residents' public debt holdings increased, although more moderately than in previous years, against a background in which the Eurosystem, under its asset purchase programme, continued to acquire this type of securities. Finally, the decline in the net debtor position in other investment was a result of the increase in the amount of residents' external assets and the decline in their external liabilities.

To improve the assessment of the degree of vulnerability associated with the Spanish economy's international position it is worth supplementing the IIP information with other indicators such as the volume of gross external debt (which only includes liabilities that generate payment obligations; in Spain around 75% of the total).[5] Gross external debt increased by 3 pp to 171.4% of GDP between December 2015 and June 2016, as the increase in the external debt of the Banco de España (by 4.9 pp, to 32.8% GDP) was greater than the decline in that of the rest of the other sectors (see Panel 5). The external debt of other financial institutions, excluding the Banco de España, and of other resident sectors declined, over the same period, by 1.3 pp and by 0.7 pp of GDP, to 39.6% and 27.4%, respectively.[6] In contrast, the external debt of general government increased by somewhat less than 2%, in line with GDP growth, so that its weight relative to GDP barely changed, remaining close to 51%. At the same time, the breakdown by original maturity continues to show a high weight for long-term

1 Specifically, as mentioned in the next paragraph, there was a reduction in the value of the assets and liabilities vis-à-vis the rest of the world (and also an increase in the negative net position in derivatives largely linked to valuation effects). These falls stemmed both from changes in the prices of the various financial instruments and, to a larger extent in the case of assets, from movements in the euro exchange rate against other currencies.

2 Other changes in volume are included here.

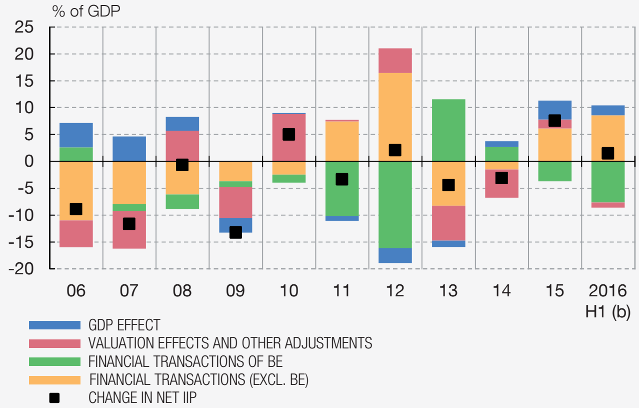
3 In particular, the liquidity generated in Spain by the ECB's quantitative easing measures has largely been channelled abroad. Thus, since the end of 2014, the net acquisition of external assets by resident agents has increased, while the flows of net liabilities vis-à-vis the rest of the world, excluding the Banco de España, have decreased. For further details, see the article "The Eurosystem quantitative easing measures and the financial account", Banco de España, Economic Bulletin, April 2016.

4 The net debtor position in financial derivatives increased slightly in that period, from 0.2% to 0.8% of GDP.

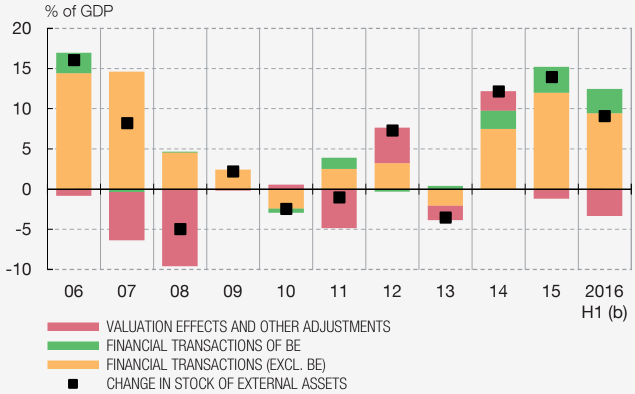
5 The external debt of a country comprises the amounts of all liabilities vis-à-vis non-residents that involve the future payments of principal, interest or both (all financial instruments, except equity holdings and financial derivatives).

6 Excluding direct investment in the form of debt instruments.

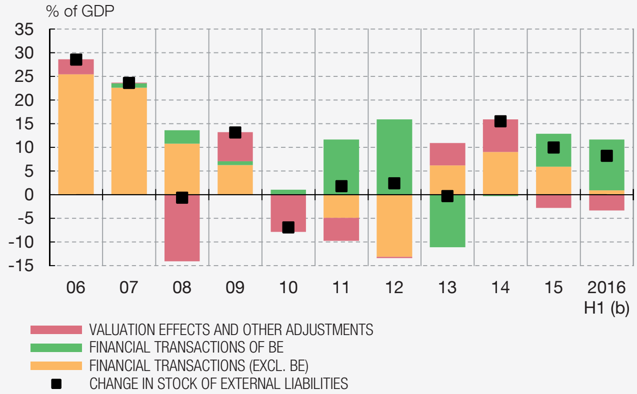
Panel 1
DETERMINANTS OF CHANGE IN NET IIP (a)



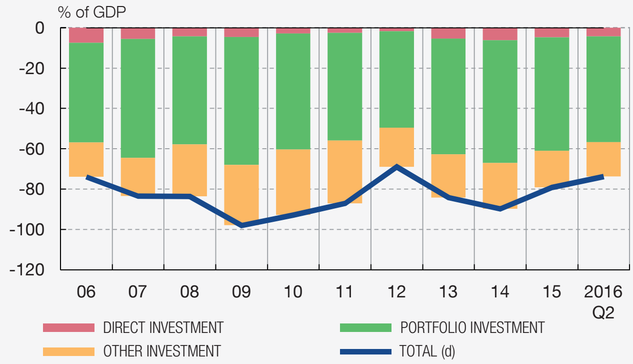
Panel 2
BREAKDOWN OF THE CHANGE IN EXTERNAL ASSETS (c)



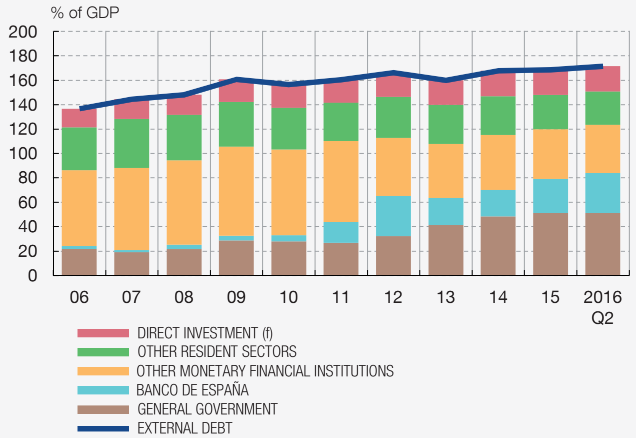
Panel 3
BREAKDOWN OF THE CHANGE IN EXTERNAL LIABILITIES (c)



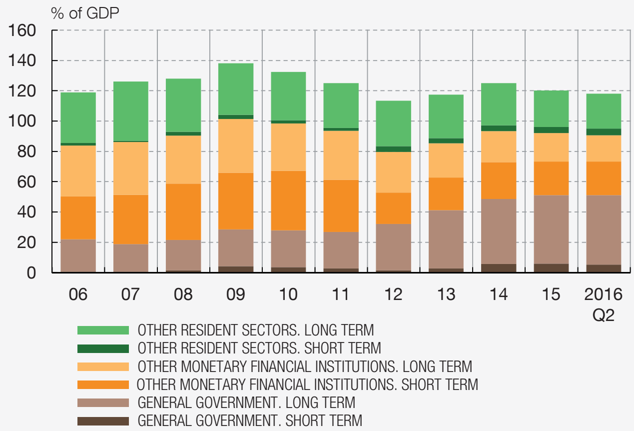
Panel 4
NET IIP (a). BREAKDOWN BY FUNCTIONAL CATEGORY



Panel 5
GROSS EXTERNAL DEBT (e). SECTORAL BREAKDOWN



Panel 6
STRUCTURE OF GROSS EXTERNAL DEBT. BREAKDOWN BY INSTITUTIONAL SECTOR AND ORIGINAL MATURITY (e) (g)



SOURCES: Banco de España.

a The net IIP is the difference betwen the value of the external assets of resident sectors and the value of liabilities with the rest of the world.
b Total change between January and June 2016. In Panels 2 and 3, GDP is that of the first half of 2016.
c Excluding financial derivatives.
d Excluiding Banco de España and the net position in derivatives.
e External debt comprises the stock of all liabilties that give rise to future payments of principal, interest or both (i.e. all financial instruments other than own funds and financial derivatives).
f Includes only direct investment in the form of debt.
g Excluding the Banco de España and direct investment in the form of debt.

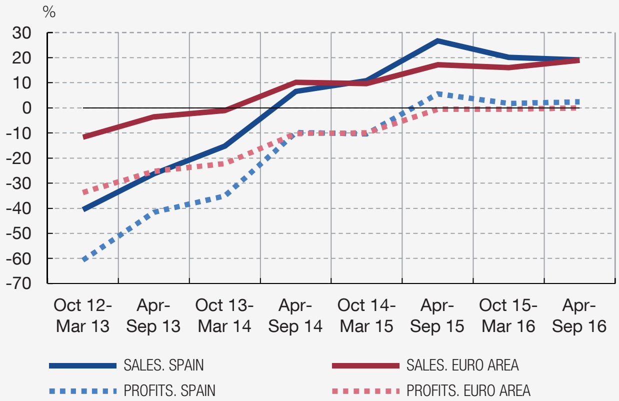
liabilities (almost 75% of the total, excluding those of the Banco de España, see Panel 6), which normally involve a lower refinancing risk.

In the future, the still high net debtor position of the Spanish economy vis-à-vis the rest of the world entails a significant element of vulnerability, insofar as the substantial net borrowing needs generated by this position exposes the economy to possible turbulence in the financial markets. This underlines the importance of extending the current path of decline in the international debtor position, for which purpose it is necessary to obtain recurrent external surpluses and to persevere with the competitiveness gains that make them possible.

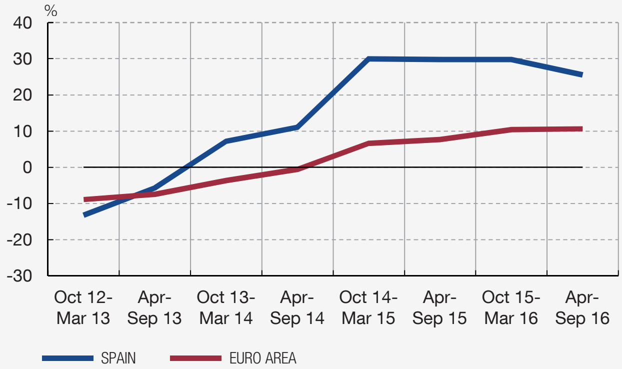
On 30 November 2016 the ECB released the results of the 15th edition of its survey on the access to finance of SMEs in the euro area (SAFE) covering the period between April 2016 and September 2016. The firms surveyed, essentially SMEs, are asked how their economic and financial situation, their external financing needs, the availability of financing and the conditions of the financing received or rejected have changed over the past six months.

The latest survey data show that, overall, the economic situation of Spanish SMEs has continued to improve. Thus, the number of firms reporting an increase in sales was once again much higher than the number of firms reporting a drop in sales, with a relative difference between the two groups (net percentage) of 19%, similar to that observed in the euro area and 1 pp lower than the figure for the previous six months (see Panel 1). The profit performance was somewhat less favourable, owing to the increase both in labour and other costs, a circumstance that was reported by a high net proportion of the sample (37% and 36%, respectively, compared with 44% and 37% in the euro area). Thus, the proportion of firms that reported an increase in profits was barely 2 pp higher than that which reported a drop in profits, similar to the figure recorded six months earlier. In the euro area, the percentage of SMEs reporting an increase in profits was the same as that of SMEs reporting a fall in profits. In addition, according to the survey results, the deleveraging process of Spanish SMEs continued in the most recent period. Thus, the net proportion of SMEs that

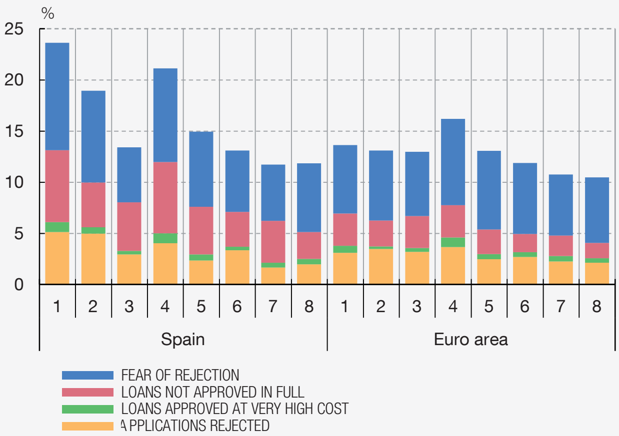
Panel 1
SALES AND PROFITS (a)



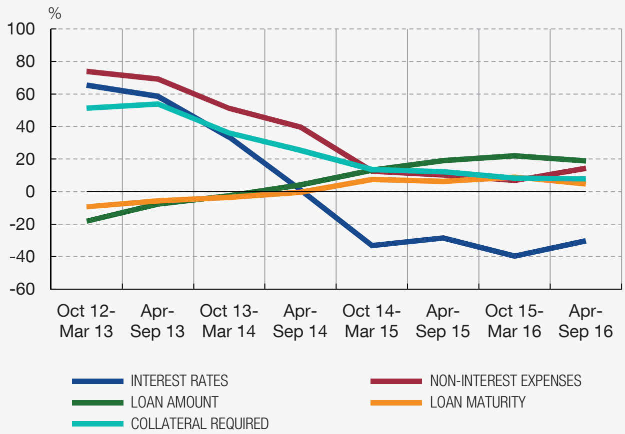
Panel 2
AVAILABILITY OF BANK LOANS (b)



Panel 3
SMEs FACING DIFFICULTIES OBTAINING BANK LOANS (c)



Panel 4
BANK FINANCING CONDITIONS. SPAIN (a)



SOURCE: ECB.

a The proportion of firms reporting an increase minus the proportion reporting a decrease.
b The proportion of firms reporting an improvement minus the proportion reporting a deterioration.
c The numbers on the horizontal axis indicate the rounds of the survey: 1 is the period October 2012 - March 2013 and 8 is the period April 2016 - September 2016. The indicator reflects the proportion of firms that are in any of the following situations: firms whose applications for financing were rejected; firms that did not receive all the funding they had requested; firms that received bank loans but at what they considered to be a very high cost; and firms that did not request financing because they believed it would probably not be approved (fear of rejection).

reported a decrease in their debt ratio (measured as the ratio of total debt to assets) was 8%, 1 pp less than in the previous survey and in line with that observed for the euro area.

The percentage of Spanish SMEs that classed access to external financing as the most pressing problem for their business fell again, continuing to be the factor, among all those included in the question, cited by the lowest number of firms (9% of the total, a proportion similar to that of the euro area and the lowest figure recorded since the survey was launched in 2009). The lack of customers was the predominant concern (selected by 31% of firms), followed by competition (18%).

In this setting, the bank financing needs of Spanish SMEs fell in net terms for 3% of these firms, compared with the increase of 2% recorded six months earlier and the 1% rise observed in the euro area as a whole for this segment. In line with these results, the proportion of Spanish SMEs that requested bank loans fell by some 2 pp, down to 30%, similar to the figure reported for the euro area (29%).

In turn, the availability of bank financing continued to improve (see Panel 2).Thus, in net terms, 26% of firms reported an increase in this respect, 4 pp less than in the previous survey and 15 pp above the figure for their euro area peers. In addition, SMEs perceived positive developments in most factors affecting the supply of credit. Specifically, in net terms, 32% of firms reported greater willingness of banks to provide credit (7 pp less than in the previous survey) and 16% signalled an improvement in the overall economic outlook (similar to that reported six months earlier).

The proportion of Spanish SMEs whose requests for bank financing were rejected rose by 2 pp compared with the previous six months, standing at 7%, identical to the figure for the euro area as a whole. When a broader indicator of obstacles in obtaining bank loans is considered[1], those difficulties affected 12% of Spanish SMEs, which is slightly more than for the euro area (11%) and similar to the figure reported in the previous survey (see Panel 3).

Regarding financing conditions, the net percentage of Spanish SMEs that reported a drop in interest rates was positive for the fourth consecutive six-month period, standing at a high 30%, 10 pp less than in the previous period (see Panel 4). Thus, the average interest rate applied to these firms on credit lines or bank overdrafts fell by 50 bp to 3.5%. In addition, the net proportion of firms that reported an increase in loan amount and loan maturity remained positive (19% and 5%, respectively). In contrast, these firms continued to perceive a tightening of collateral requirements (8%) and of other terms and conditions of financing such as commissions (14%).

To conclude, the latest SAFE shows that, between April 2016 and September 2016, access of Spanish SMEs to external financing continued to improve, and only a small number of firms reported this as their most pressing problem, while finding customers continued to be the predominant concern for the majority. As their financial position became progressively sounder and their bank financing needs declined somewhat, these firms reported, overall, that in the aforementioned period they identified an increase in the availability of credit and perceived a greater willingness of banks to grant loans on more favourable conditions and an improvement in the overall economic outlook. Lastly, the survey results also show that Spanish SMEs expected the availability of bank credit to improve in the period October 2016 to March 2017.

1 This indicator reflects the proportion of firms in any of the following situations: firms whose applications for financing were rejected; firms that did not receive all the funding they had requested; firms that received bank loans but at what they considered to be a very high cost; and firms that did not request financing because they believed it would probably not be approved (fear of rejection).