

ANNUAL REPORT 2016

CHAPTER 3

THE CURRENT ACCOUNT ADJUSTMENT IN SPAIN

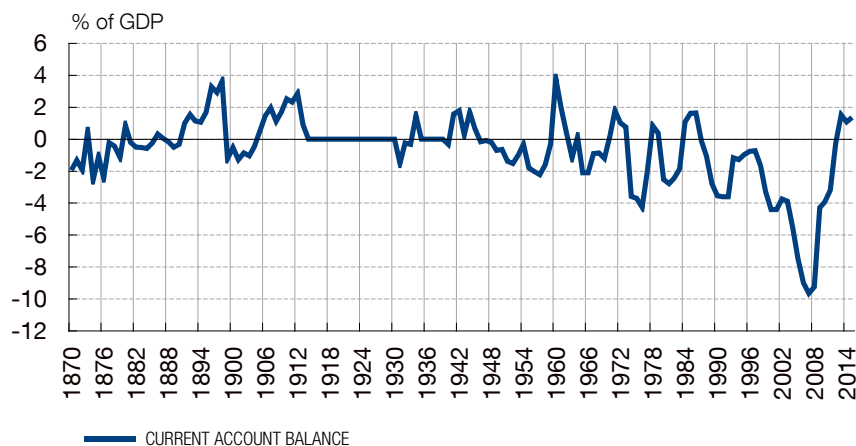
CHAPTER AIMS

Since the start of the EMU until the onset of the economic crisis, the Spanish economy posted record high current account deficits. These deficits raised Spain's external debt to a very high level.

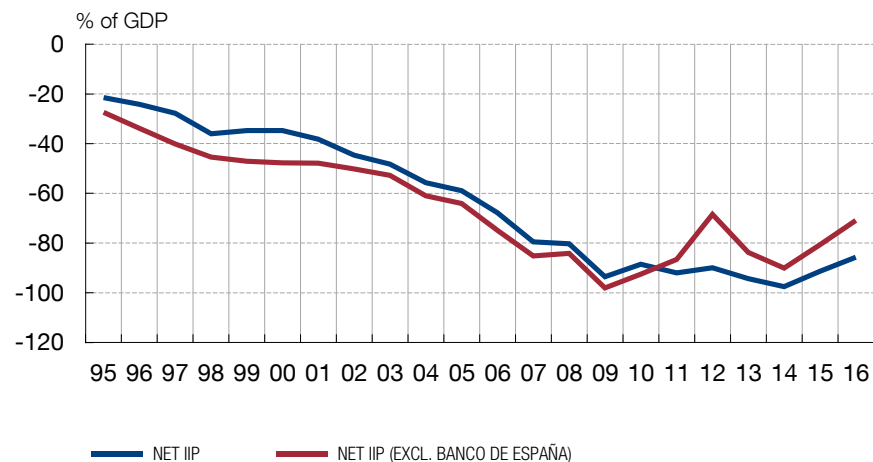
In recent years, Spain's current account balance has undergone a sharp adjustment.

Against this background, Chapter 3 analyses the nature (structural/temporary) of the current account adjustment in the recent period and its implications for the net international investment position.

CURRENT ACCOUNT BALANCE



NET INTERNATIONAL INVESTMENT POSITION (IIP)



CHANGES IN THE COMPOSITION OF THE CURRENT ACCOUNT BALANCE

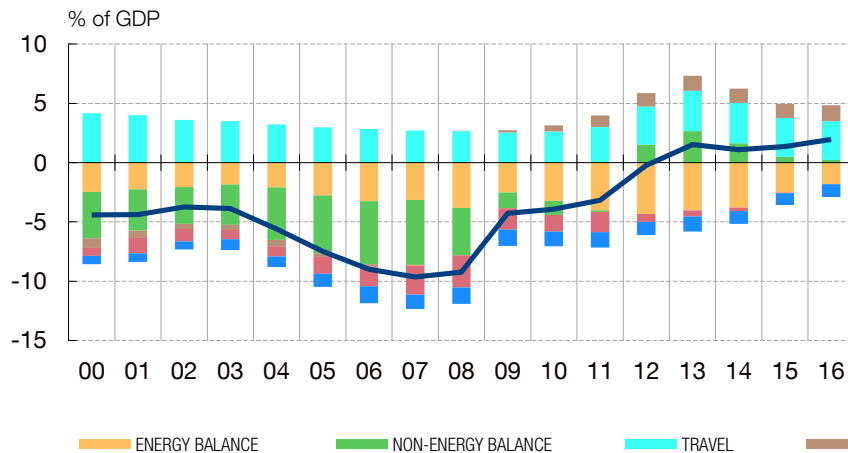


The current account balance of the Spanish economy deteriorated by 6 pp of GDP between 2000 and 2008, but has since improved by 12 pp, due to the behaviour of all its headings, particularly purchases of non-energy goods (5.7 pp of GDP) and the income balance (2.5 pp of GDP).

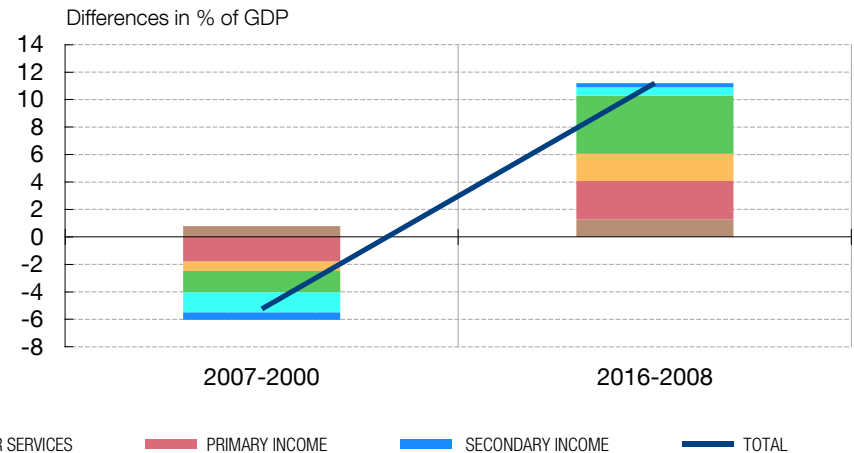
As a result of the gains in energy efficiency and the recent fall in oil prices, the energy balance has also contributed to the adjustment (1.3 pp of GDP).

The travel services balance rose by 0.6 pp of GDP.

CURRENT ACCOUNT BALANCE COMPONENTS



CHANGE IN CURRENT ACCOUNT BALANCE



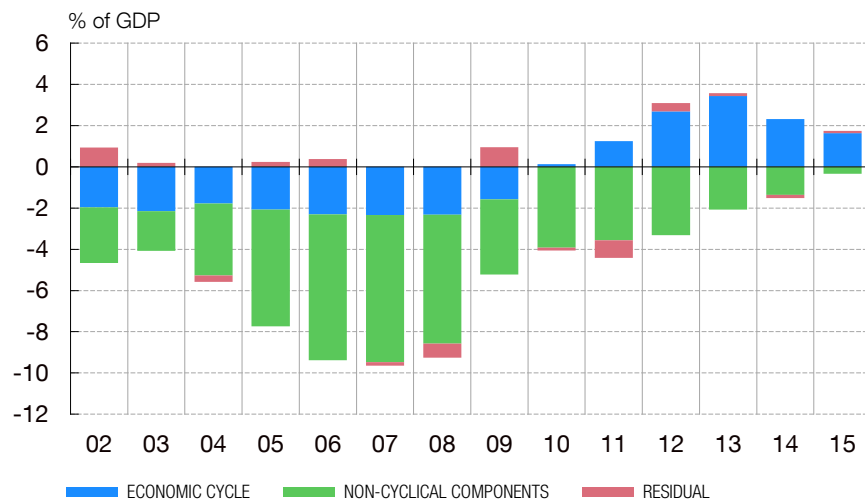
CONTRIBUTION OF THE CYCLE TO THE CURRENT ACCOUNT ADJUSTMENT



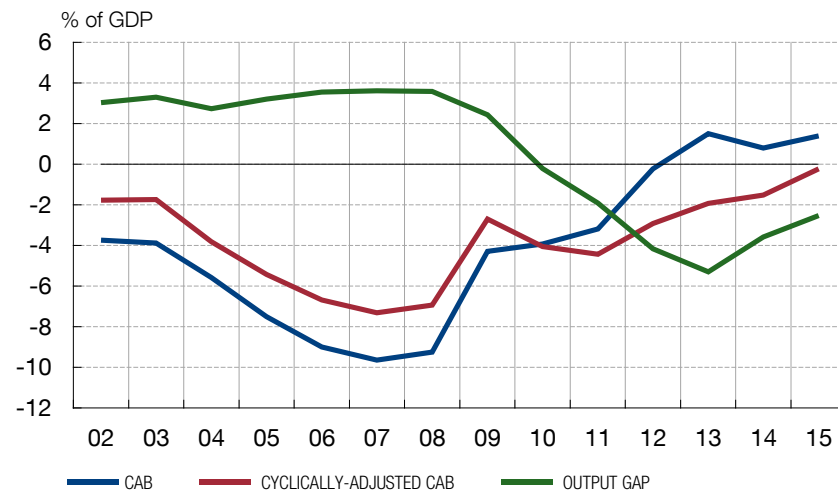
It is estimated that around one-third of the adjustment in the external balance between 2008 and 2015 was due to the cyclical downturn in economic activity.

Thus, the cyclically adjusted current account balance posted a deficit of 0.2% of GDP in 2015, compared with the deficit of 6.9% in 2008.

BREAKDOWN OF CURRENT ACCOUNT BALANCE



CYCLICALLY-ADJUSTED CURRENT ACCOUNT BALANCE



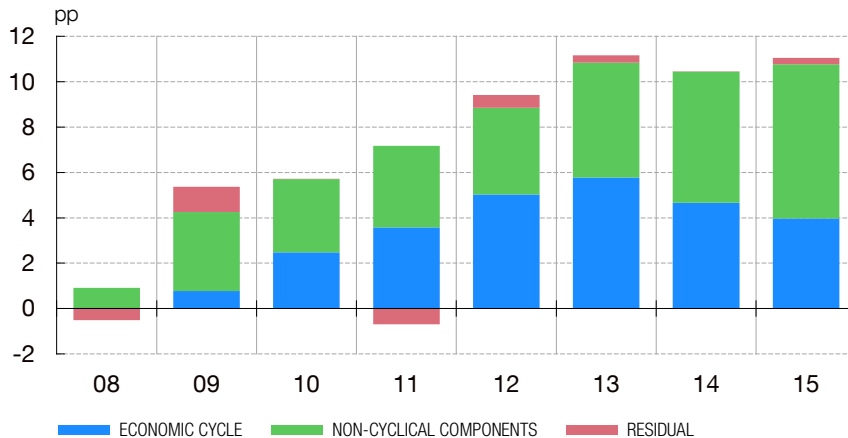
CONTRIBUTION OF OTHER FACTORS TO THE CURRENT ACCOUNT ADJUSTMENT

Euro-denominated oil prices decreased by 73% between 2012 and 2015, which explains around one-fifth of the correction in the current account balance.

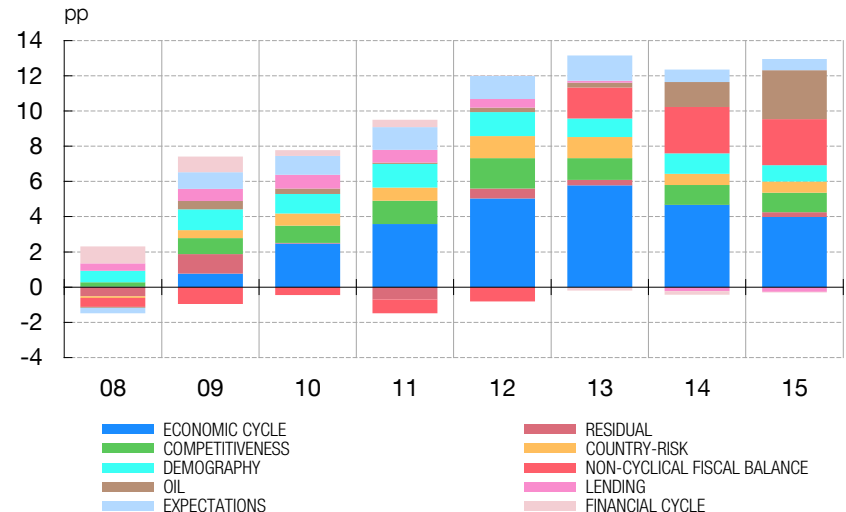
The improvement in the public finances (the structural component of the budget deficit has decreased by 5.3 pp of GDP since 2010) contributed around 20% to this adjustment.

The gains in competitiveness explain around 9% of the adjustment observed. Population ageing (7%) and lower future growth expectations (5%) have also helped to correct the external deficit.

CUMULATIVE ADJUSTMENT IN CURRENT ACCOUNT BALANCE 2008-2015



BREAKDOWN OF CUMULATIVE ADJUSTMENT IN CURRENT ACCOUNT BALANCE 2008-2015



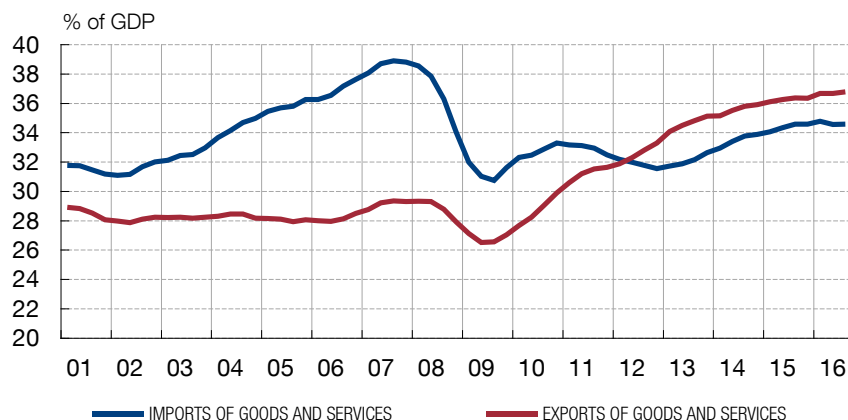
STRUCTURAL ADJUSTMENT OF THE TRADE BALANCE



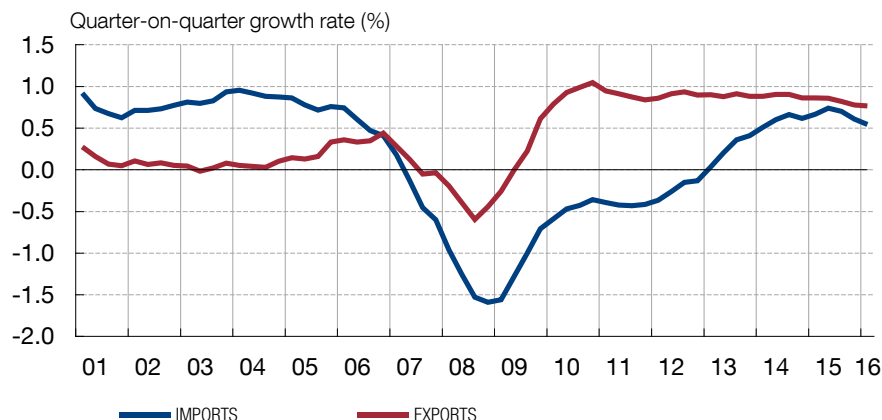
Once the cyclical component of trade transactions with other countries has been stripped out, the results suggest the presence of an increase in the structural growth rate of exports since the onset of the global financial crisis.

Although the change in the structural component of imports is of a smaller size, its growth rates in the more recent period are slightly below the pre-2009 levels, once the effect of domestic demand and import prices is stripped out.

EXPORTS AND IMPORTS AS % OF GDP
(in real terms)



STRUCTURAL GROWTH OF EXPORTS AND IMPORTS OF GOODS AND SERVICES AS % OF GDP (a)



a The structural growth rates are based on an estimate in which the cyclical component depending on competitiveness and demand is deducted from the observed growth.

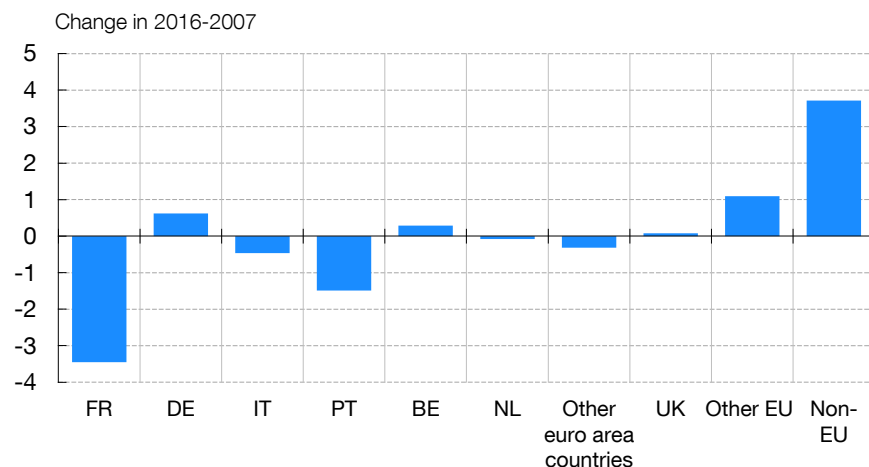
STRUCTURAL CHANGE IN EXPORTS



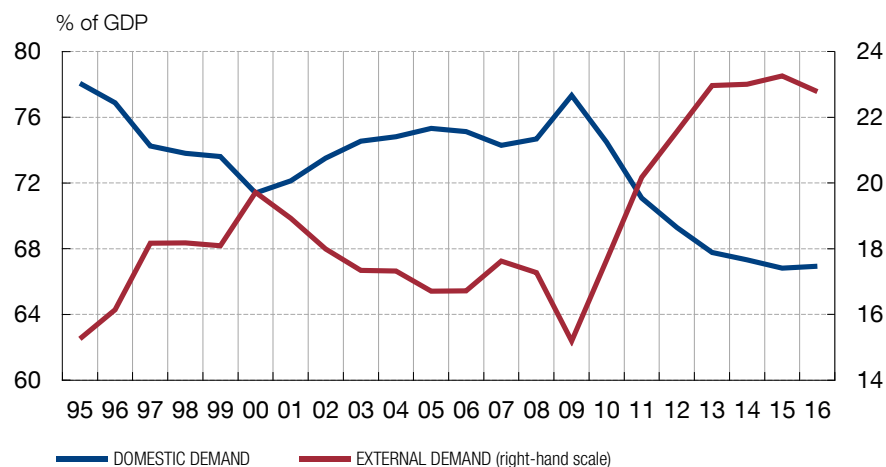
External demand benefited from a shift towards non-EU markets which, in general, were more buoyant in the past recession.

The improved competitiveness of the Spanish economy favoured the strong performance of exports, to which the weakness of domestic demand also contributed during the crisis.

CHANGE IN THE DISTRIBUTION OF EXPORTS, BY COUNTRY



DOMESTIC DEMAND VS. EXTERNAL DEMAND



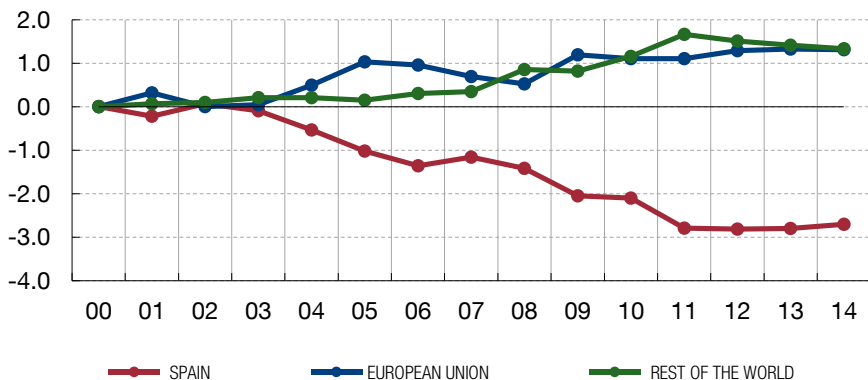
RECENT DEVELOPMENTS IN IMPORTS

The strong performance of exports, particularly in sectors with a higher import dependence, has led to a rise in imports.

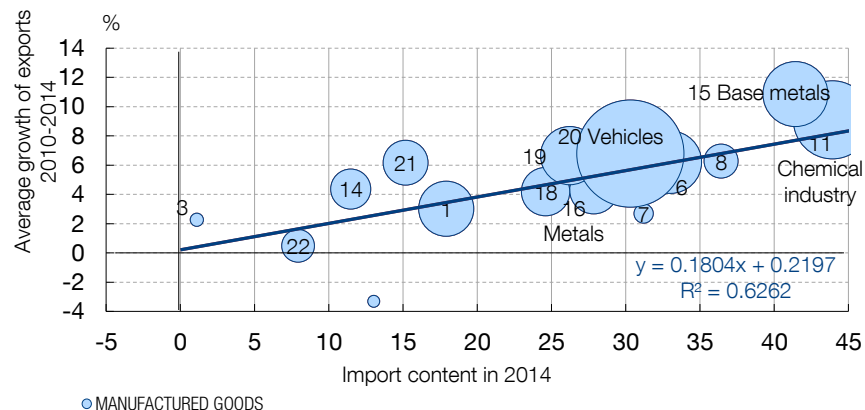
The import content of other GDP components (private consumption), whose relative weight fell during the crisis, has decreased.

Firm-level evidence suggests that imports have to a certain extent been replaced with domestic products in the most recent period. At aggregate level, this has been masked by the reallocation of resources to larger and more productive firms, which are higher importers.

DISTRIBUTION OF INPUTS USED BY SPANISH FIRMS, BY GEOGRAPHICAL ORIGIN (a)



IMPORT CONTENT AND CHANGES IN EXPORTS, BY BRANCH OF ACTIVITY (b)



a Change in the weight of inputs from each source in total inputs with respect to the level recorded in 2000.

b The size of the circle represents the weight of the branch of activity in total exports. The import content is defined as the percentage of a given product that was imported.

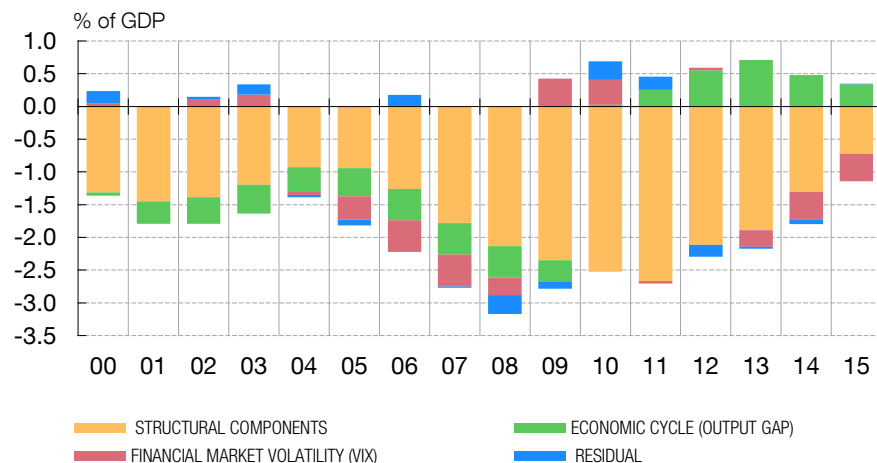
STRUCTURAL ADJUSTMENT OF THE INCOME BALANCE



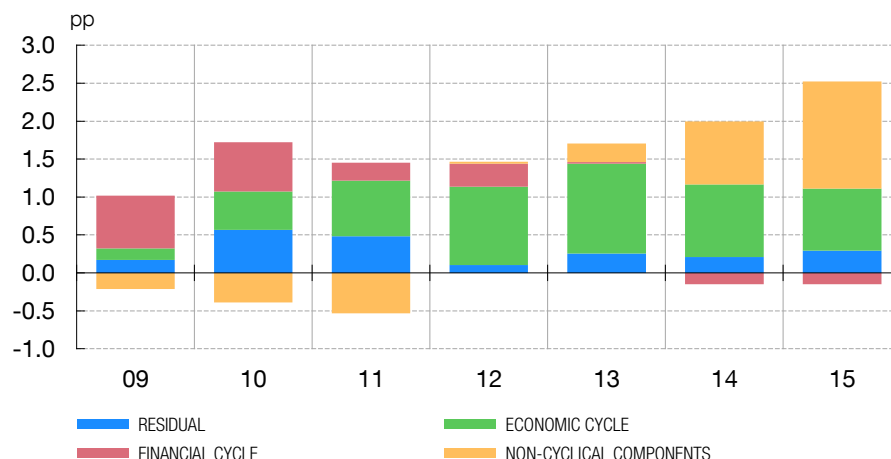
Both the economic cycle and the normalisation of financial conditions during the crisis have contributed significantly to the adjustment of investment income in recent years.

However, 60% of the cumulative correction in the income balance is due to other factors, notably the increased weight of government debt held by residents and the contraction in lending.

BREAKDOWN OF INVESTMENT INCOME BALANCE



CUMULATIVE ADJUSTMENT OF INVESTMENT INCOME BALANCE

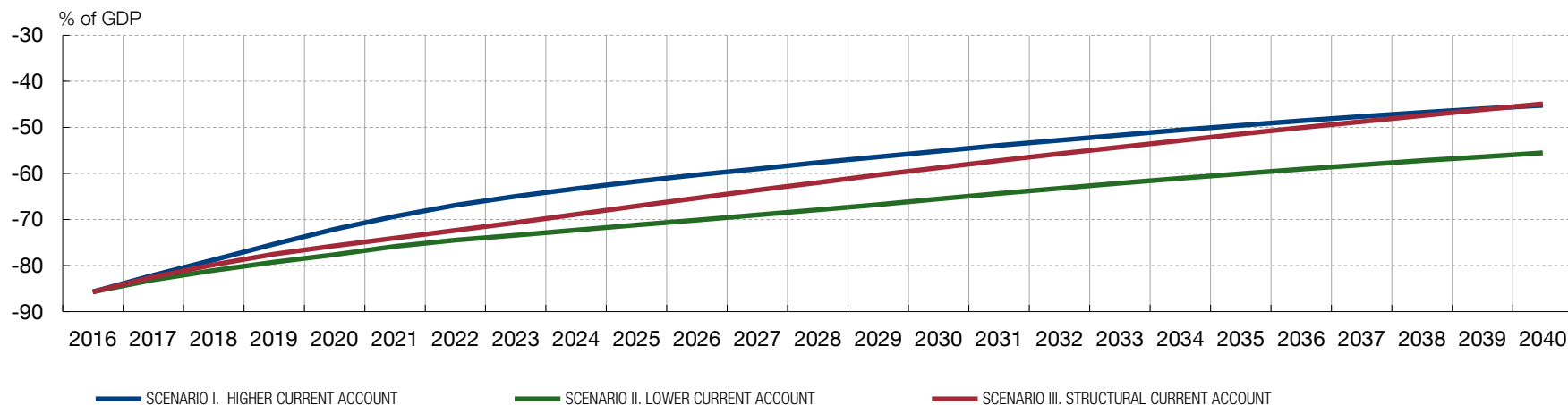


CHANGES IN THE INTERNATIONAL INVESTMENT POSITION



Reducing the net international investment position (IIP) to 60% of GDP by the end of the next decade (a value which is indicative of risk) would require current account surpluses to be run on a sustained basis throughout that period.

LONG-TERM PATHS OF NET IIP (a)



a The three scenarios are based on the same real GDP growth, deflator and nominal interest rate assumptions (1.3%, 1.8% and 3.1%, respectively), although they differ in the path for the current account balance.

CONCLUSIONS



Around half of the improvement in the current account balance can be explained by cyclical economic developments and the fall in oil prices. Other factors include most notably the adjustment in public finances, population ageing, lower growth expectations and the gains in competitiveness.

Despite the sharp adjustment in the current account balance, the still-high net external debt represents one of the vulnerabilities of the Spanish economy.

The risks associated with the high external debt highlight the need to run current account surpluses on a sustained basis. Achieving this will require contributions from:

- The structural consolidation of public finances.
- The reform of factor and product markets to encourage productivity growth and to put the gains in external competitiveness on a firmer footing.