

1 OVERVIEW

1 Overview

This chapter summarises the most salient developments in the balance of payments and in the international investment position in 2008, along with the main changes introduced in connection with the production and dissemination of these statistics since this report was last published.

In 2008, the worsening of the international financial crisis and the generalisation of the contractionary trends marked the developments in the actual and financial transactions of the Spanish economy with the rest of the world. The financial market tensions, present since summer 2007, intensified following the collapse of Lehman Brothers in mid-September, giving rise to a severe global financial crisis. The subsequent robust response from central banks and governments has corrected some of the instability in the international financial markets, most notably since spring 2009, although the situation is still far from normal and credit conditions remain tight worldwide. The effect of the financial crisis on real activity was felt most intensely in 2008 Q4, with a severe impact on global trade flows, which recorded an unprecedented decline in the closing months of 2008 and in early 2009. The difficulties in securing lending worldwide, and the growing interdependence between economies as a result of the globalisation of production chains, exacerbated the slump in trade flows worldwide and possibly played a part in propagating the recession.

The Spanish economy underwent a brusque adjustment in the second half of 2008, similarly to that seen in other developed countries, closing the year in recession, with GDP falling at a rate of 0.7% year-on-year, although for the year as a whole, the rate of growth of GDP was positive at 1.2%. The decline in GDP was due to the severe contraction in domestic spending, while the contribution of the external sector to GDP growth was positive for the first time in the past decade, albeit due primarily to the decrease in imports. The quarterly national accounts (QNA) for 2009 Q1 reflect a heightening of the recession, with a sharp fall in the rate of growth of GDP (to -3% year-on-year) and a significant positive contribution to growth from net external demand, against the backdrop of a slump in both exports and imports of goods and services.

As the rate of growth of the Spanish economy decelerated, net foreign borrowing moderated. According to balance of payments data, in 2008 Spain's net borrowing fell for the first time since 2002, to 9% of GDP, 0.6 pp below the 2007 figure. The correction of the deficit accentuated in the closing months of 2008 and in 2009 Q1, as net borrowing fell in year-on-year terms by 1.5 pp and 2.6 pp, respectively, due to the severity of the contraction in domestic demand, which is depressing purchases abroad, and to the lower price of energy which has led to a substantial cut in the energy deficit.

The decline in net borrowing in 2008 was primarily a reflection of the decrease in the current account deficit (0.5 pp of GDP, to 9.5% of GDP), while the contribution of the capital account surplus was just 0.1 pp (see Table 1.1 and Chart 1.1). The progressive improvement in the current account balance was fundamentally due to the notable correction, since the summer, in the trade imbalance and, to a lesser extent, to the widening of the services surplus, as both the income and the current transfers deficits increased moderately.

The improvement in the trade balance was a result of the decline in the non-energy imbalance, which decreased by 25% in 2008 as a whole. Conversely, the energy deficit grew by almost

% of GDP	2000	2001	2002	2003	2004	2005	2006	2007	2008
NET LENDING (+) / NET BORROWING (-)	-3.1	-3.1	-2.2	-2.5	-4.2	-6.5	-8.4	-9.6	-9.0
Current account	-4.0	-3.9	-3.3	-3.5	-5.3	-7.4	-9.0	-10.0	-9.5
Goods	-6.4	-5.7	-5.0	-5.1	-6.4	-7.5	-8.5	-8.7	-8.0
Services	3.3	3.4	3.1	3.0	2.6	2.4	2.3	2.2	2.4
— Travel	4.1	4.0	3.5	3.5	3.2	2.9	2.8	2.6	2.6
— Other services	-0.8	-0.6	-0.4	-0.5	-0.6	-0.5	-0.5	-0.4	-0.1
Income	-1.2	-1.8	-1.7	-1.3	-1.4	-1.9	-2.1	-2.9	-3.1
— Of which: reinvested earnings	0.3	-0.2	-0.2	0.0	0.0	0.2	0.5	0.5	0.4
Current transfers	0.3	0.2	0.3	-0.1	0.0	-0.4	-0.7	-0.7	-0.8
Capital account	0.8	0.8	1.1	1.0	1.0	0.9	0.6	0.4	0.5
FINANCIAL ACCOUNT (a)	3.1	3.2	2.1	2.3	4.1	6.7	8.7	9.6	8.7
Excluding Banco de España	4.1	0.6	1.6	2.1	5.8	6.9	11.3	8.3	5.9
Foreign direct investment	-3.2	-0.8	0.9	-0.3	-3.4	-1.5	-6.0	-4.8	-0.7
Portfolio investment	-0.2	-2.8	0.6	-3.4	10.2	6.5	20.3	10.0	0.4
Other investment	7.2	4.2	0.7	6.2	-1.0	1.9	-3.2	3.5	7.0
Financial derivatives	0.3	-0.1	-0.7	-0.4	0.0	0.0	0.2	-0.4	-0.7
Banco de España (b)	-1.0	2.6	0.5	0.2	-1.7	-0.2	-2.6	1.4	2.8
ERRORS AND OMISSIONS	0.0	0.0	0.1	0.2	0.1	-0.2	-0.4	0.0	0.4

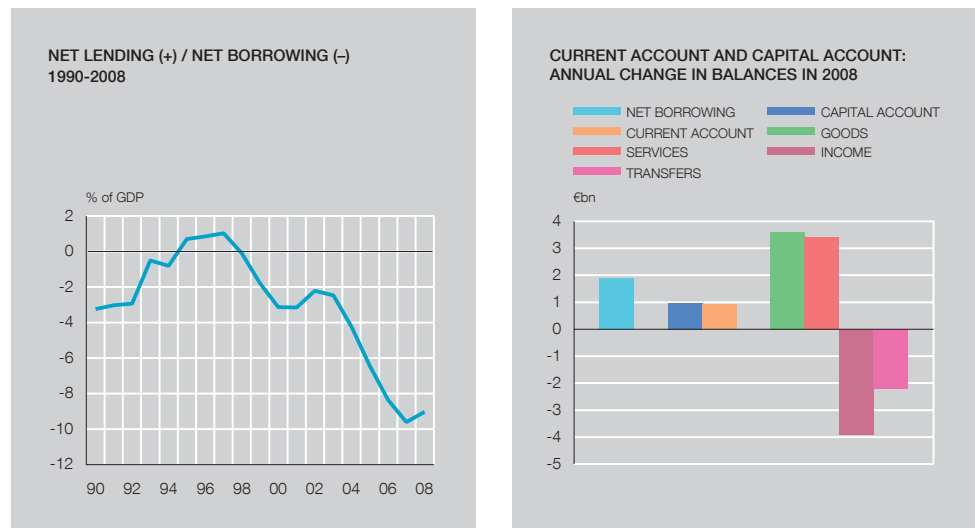
SOURCE: Banco de España.

a. Change in liabilities minus change in assets.

b. A negative (positive) sign denotes an increase (decrease) in the Banco de España's net foreign assets.

34%, due to the high price of oil in the year as a whole, despite the sharp decline recorded after the summer (see Box 2.1). Thereafter, the energy balance also helped reduce the trade deficit, which in 2008 Q4 was 30% lower than a year earlier. As a result of the sharp deceleration in final demand and of the decline in industrial activity in Spain, the demand for inputs from abroad and for high-technology content consumer durables and capital goods decreased progressively throughout the year, but most especially in 2008 Q4. Thus, on QNA data, goods imports fell by 2.7% in real terms, as opposed to an increase of 4.8% in 2007. In turn, real exports, which had maintained some degree of dynamism for most of the year, fell sharply in 2008 Q4, against the backdrop of a collapse in world trade, growing by just 0.9% in the year as a whole (in comparison with 4.3% in 2007). This fundamentally reflects the growing weakness of Spain's main export markets, as in general price-competitiveness indicators fell only moderately. However, export shares in real terms were practically stable in 2008, for the third consecutive year, reflecting the efforts made by Spanish firms to maintain their presence in foreign markets, despite growing competition from the new emerging economies (see Box 2.2 for an analysis of the characteristics of Spanish export firms). For 2009 Q1, when the contraction in world trade heightened, the available QNA data showed a marked drop in real terms in goods exports (-20.5%) and in good imports (-23.9%); as a result, the nominal trade deficit narrowed by almost 50% year-on-year in the period.

The increase in the services surplus in 2008 was due to the decline in the non-tourism services deficit, since the surplus on the tourism balance decreased, as a result of the highly adverse impact of the crisis of confidence on international tourism flows. In consequence, not only nominal tourism receipts, but also and especially tourism expenditure, fell in 2008 as a whole (at a rate of -0.4% and -3.7%, respectively), falling further in the opening months of the year as the economic recession heightened. In the case of non-tourism services, receipts



SOURCE: Banco de España.

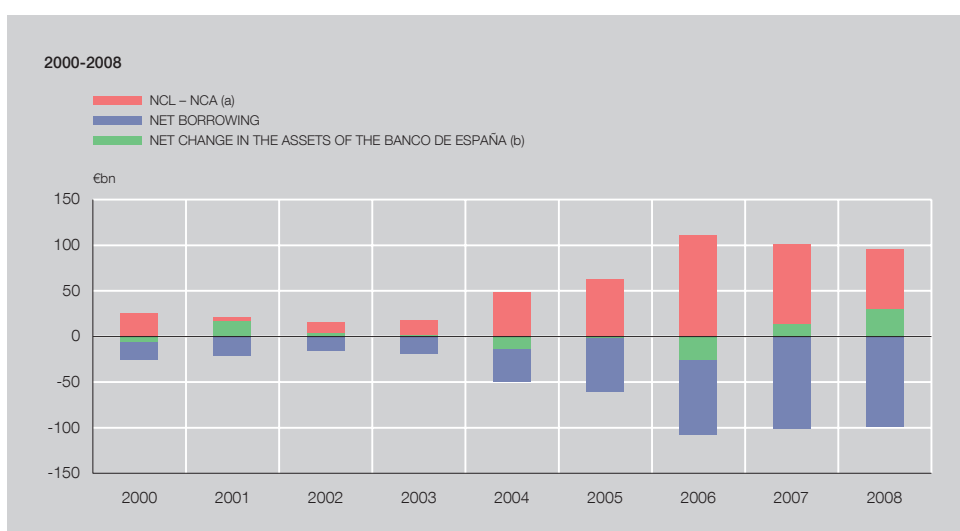
posted a higher rate of growth than payments (8.7% and 2.5%, respectively), leading to a substantial decrease in the non-tourism services deficit, a pattern that has continued in 2009 to date. Of particular note was the narrowing of the business services and royalties deficit and, to a lesser extent, the widening of the construction services surplus, and conversely, the deterioration in the transport and financial services deficits.

In 2008 the income balance deficit widened, although more slowly than in 2007. This moderation was due, not only to the deceleration in the rate of growth of indebtedness of the Spanish economy to the rest of the world, but also to the changes in the returns on these debt instruments and in the returns on foreign assets held by Spanish residents. By type of instrument, the deficits generated by “Other investment” (fundamentally, loans, deposits and repos) and “Portfolio investment” widened, offsetting the considerable improvement in the direct investment income surplus.

Lastly, the current transfers deficit widened, as the balance of transfers with the EU worsened and general government expenditure rose, the latter over and above the decrease in the workers’ remittances deficit. The capital account, which fundamentally depends on capital transfers with the EU, saw its surplus grow by 0.1 pp of GDP, having narrowed in the last three years.

The financial transactions between Spain and the rest of the world were also affected by the financial crisis, resulting, in 2008, in net inflows of funds from abroad that were not only lower than in 2007 but also insufficient to meet the net borrowing in the year as a whole (see Chart 1.2). As a result, the Banco de España’s net assets vis-à-vis the rest of the world fell more sharply than a year earlier (specifically by 2.8 pp of GDP). This decrease was concentrated on the Bank’s net assets vis-à-vis the Eurosystem, reflecting the change in the way in which monetary financial institutions (MFIs) covered their liquidity requirements, as discussed below.

The growing instability in the international financial markets in 2008 meant that the uncertainties surrounding financial institutions’ balance sheet positions persisted; this was reflected in the virtual seize-up in the wholesale financing markets, especially the asset securitisation markets in which Spanish financial institutions had been very active prior to the onset of the finan-



SOURCE: Banco de España.

a. Excluding the Banco de España.

b. A negative (positive) sign denotes an increase (decrease) in the Banco de España's net foreign assets.

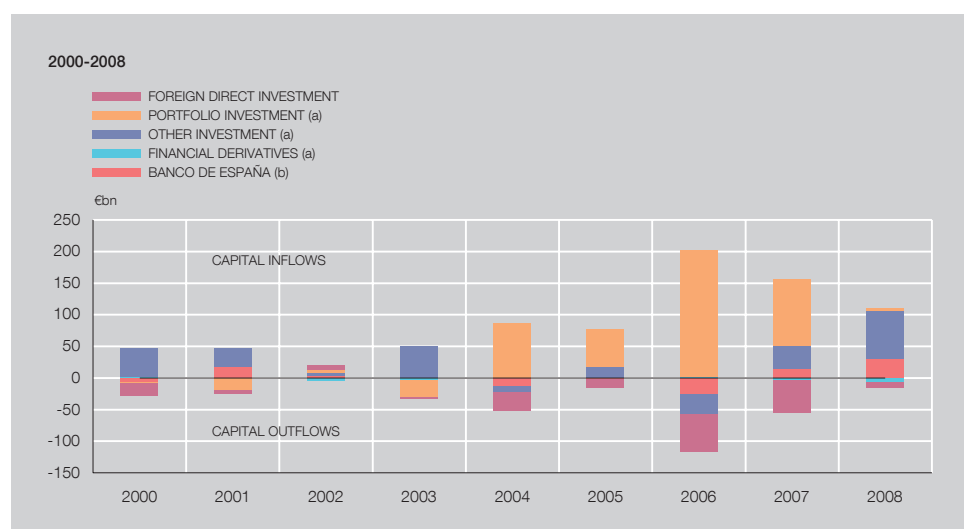
cial crisis in August 2007. Against this backdrop, the volume of international capital flows declined and investor preference shifted to safer and more liquid assets, with home bias (see Box 3.1). In this setting, Spanish MFIs adjusted the relative weight of the different financial instruments used to raise funds from abroad, in a context in which fewer new funds were needed to fill the gap between credit and deposits, raising a greater proportion through short-term instruments, such as loans and deposits, money market instruments and recourse to the Eurosystem. In turn, institutional investors channelled their funds from abroad through sales of shares and holdings in mutual funds issued by non-residents. In consequence, in 2008 net capital inflows were represented primarily by “Other investment” (fundamentally, loans, deposits and repos), while “Portfolio investment” accounted for a much smaller proportion than in previous years (see Chart 1.3). Direct investment transactions and financial derivatives gave rise to capital outflows.

The change in the type of instruments used to raise funds abroad signified a shift towards more short-term financing, reflecting the greater preference for more liquid assets and the collapse in the securitisation and corporate bond markets, trends that were first seen in the closing months of 2007. In the case of portfolio investment, the funds raised abroad were mainly in the form of equities, while fixed-income transactions generated a net outflow, due to the reduction in the balance of medium- and long-term bonds issued by residents held by non-residents, which exceeded the net inflows channelled through short-term fixed-income instruments (see Chart 1.4). There was also a very marked decrease in asset-backed securities in portfolios held by non-residents, in sharp contrast to the pattern seen to August 2007. However, this decrease was concentrated on asset-backed bonds, as institutions continued to issue covered bonds to be used, as by other countries, as collateral at ECB auctions.

The Spanish economy's net debit international investment position (IIP) widened further, although much more slowly than in previous years (in an amount equivalent to 1.2 pp of GDP), standing at 80% of GDP at end-2008. Excluding the Banco de España, this would be 84.6% of GDP, 1.7 pp below the 2007 figure. In a year marked by the financial and eco-

NET CROSS-BORDER FINANCIAL TRANSACTIONS, BY INSTRUMENT (NCL - NCA)

CHART 1.3



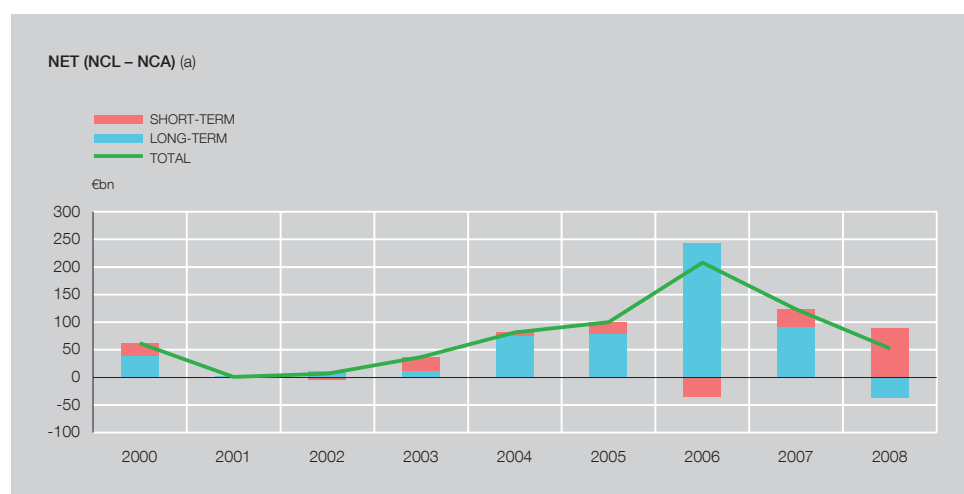
SOURCE: Banco de España.

a. Excluding the Banco de España.

b. A negative (positive) sign denotes an increase (decrease) in the Banco de España's net foreign assets.

FINANCIAL ACCOUNT: FIXED INCOME BY MATURITY

CHART 1.4



SOURCE: Banco de España.

a. The short-term fixed-income consists of money market instruments and other short-term investment; the long-term fixed-income consists of medium- and long-term bonds and other long-term investment. In all cases, excluding the Banco de España.

During the economic crisis, the prices of financial assets and liabilities (especially equities) fell sharply. This reduced the value of the external liabilities that make up Spain's IIP more than that of the external assets, helping improve the net debit position vis-à-vis the rest of the world in 2008 and, therefore, helping offset part of the increase stemming from the net capital inflows recorded in the year (see Box 4.1 for an international comparison). The fact that financial institutions had greater recourse to short-term external financing and to the Eurosystem, to the detriment of asset-backed securities, was reflected in an increase in the debit balance on "Other investment".

Turning to the new features described in this edition of the report, in the case of the information system used to compile the balance of payments and the IIP, it should be noted, first, that the amount below which residents are exempt from the obligation to report the type of foreign transaction has been raised from €12,500 to €50,000. As indicated in previous editions of this report, this change required a search for alternative sources to estimate the amount of certain headings under which a large number of transactions of an amount below the above-mentioned threshold were concentrated, a task on which progress continued to be made throughout 2008. It also prompted a change, as from the data disseminated in April 2008, in the calendar of publication and revision of the balance of payments. Lastly, September 2008 saw the publication for the first time, and for data as from December 2004, of stock data on shares and other direct investment capital holdings of “Other resident sectors”, calculated using the data contained in the annual reports on Spanish investment abroad and foreign investment in Spain of the Investment Register of the Ministry of Industry, Tourism and Trade. The use of this data source, which brings the valuation of capital holdings more in line with established standards, required revision of the time series of Spanish investment abroad (see Box 5.1 for a detailed description of the new procedure).