FOCUS · The economy's external position: how can it be corrected?

In the last few years the Spanish economy has made some crucial advances in correcting its external imbalance. Indeed, the balance of the current account has gone from a deficit of 9.6% of GDP in 2007 to a surplus of 1.3% of GDP on average in the years 2013-2015. But in spite of these achievements it is worrying to note that part of this correction could reverse when the temporary elements that have been supporting this improvement in the current account disappear.

Firstly, the slump in oil prices contributed significantly to reducing the energy deficit: while in 2012, at a price of 87 euros per barrel, the energy balance accounted for –4.5% of GDP, in 2015, with a barrel costing 48 euros, this fell to –2.5%. With a view to the future, we expect oil prices to rise steadily to 70 euros per barrel by 2020, pushing up the energy deficit to slightly above 3% of GDP.

A second element that has helped to improve the current account surplus has been the reduction in interest rates. Given the large volume of external debt, interest rate changes have considerable impact on external interest payments. External assets, on the other hand, are composed mostly of foreign direct investment and not so much of debt instruments, so that income from Spanish investment abroad has been less affected by low interest rates than payments associated with liabilities. Consequently, the primary income deficit has fallen dramatically from –2.7% of GDP in 2008 to –0.1% in 2015, an improvement that could well continue for several years to come. Once interest rates start to rise again, the volume of external debt will be smaller thanks to the deleveraging of the Spanish economy and this will help to contain external payments although it will not stop the primary income account from deteriorating slightly.

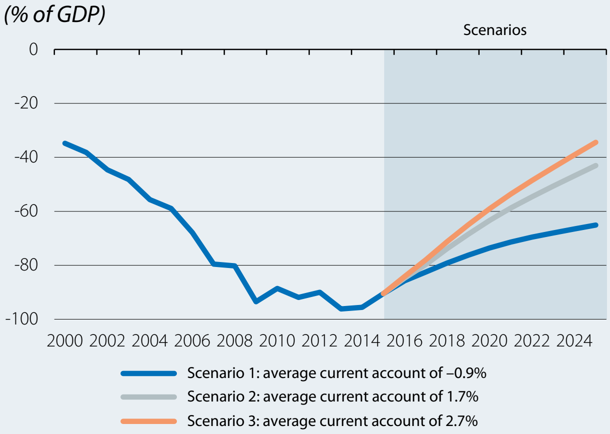
But in addition to the two aforementioned temporary supports, it should also be noted that the current account balance has been corrected largely due to factors of a structural nature that are boosting exports, such as the gains achieved in competitiveness over the last few years and the considerable internationalisation efforts made by Spanish firms. Such dynamic exports have helped to redirect external flows (current account) but the Spanish economy is still highly in debt with the rest of world in terms of stock, with its net international investment position (NIIP) amounting to –90.8% of GDP in 2016 Q1, one of the largest debt positions in the world. To highlight the need to maintain a sustained current account surplus that results in a gradual reduction of the NIIP to levels considered to be more sustainable (–35% according to the European Commission), we have constructed different scenarios for the trend in such variables.[1]

In the first and most conservative scenario we assume the current account will once again be slightly in deficit. Here the NIIP falls very gradually thanks to growth in nominal GDP but still stands at –65% of GDP in 2025. In the second scenario we assume the current account remains at similar levels to the present, so the NIIP falls gradually to –43% of GDP in 2025. Lastly, in the third scenario, we assume an average current account surplus of 2.7% of GDP, the figure required to reduce the NIIP to –35% of GDP in 10 years.

The correction of the current balance over the last few years has been a first step in stabilising the Spanish economy's external position but the country will have to persevere to reduce its external debt.

Net international investment position (NIIP)

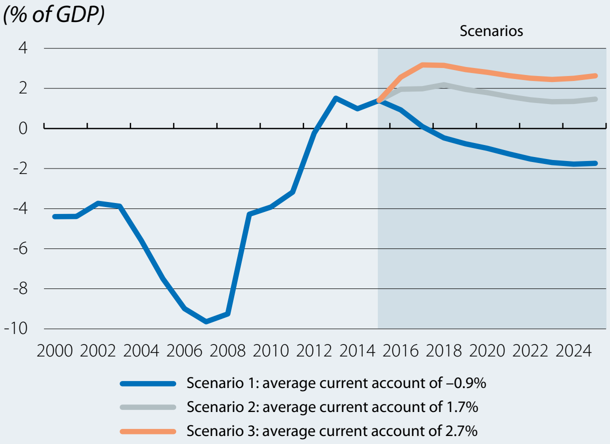
(% of GDP)



Source: *CaixaBank Research, based on data from the Bank of Spain.*

Current account

(% of GDP)



Source: *CaixaBank Research, based on data from the Bank of Spain.*

1. All the scenarios assume 4% growth in nominal GDP, an average income balance of –1.1% of GDP, a capital account of 0.6% of GDP and neutral valuation effects. See the Working Paper Series 02/16 «La posición externa de la economía española: claves para reducirla» for the return sensitivity of assets and liabilities regarding the trend in the NIIP.