THE ADJUSTMENT OF THE EXTERNAL IMBALANCE IN THE SPANISH ECONOMY

The author of this article is Juan Peñalosa, of the Directorate General Economics, Statistics and Research.

Introduction

There are several facets to the highly complex economic crisis that Spain has been undergoing in recent years. And it is in the external sector that many of the features characterising this crisis and the requirements for overcoming it can be found. Many reports have analysed how the long expansionary phase from the mid-1990s until 2007 led to a growing loss of competitiveness of Spanish production, a high external deficit and high indebtedness vis-à-vis the rest of the world. Although some of these developments have begun to be corrected, the deterioration of expectations triggered by the crisis has affected perceptions about the sustainability of the external position, acting as a drag on the adjustment phase and increasing the Spanish economy's vulnerability.

In particular, the deepening of the sovereign debt crisis has made external financing one of the crucial problems of the Spanish economy in the current situation. The deterioration of confidence – possibly both in the economic outlook for Spain and in the current institutional framework of the euro area – has stemmed the flows of external refinancing of the economy, resulting in high net outflows in recent months that have had to be covered by credit institutions increasingly resorting to the Eurosystem for financing.

In the European arena, from 2012 the framework for coordination of the EU's economic policies has been strengthened considerably through the *macroeconomic imbalance procedure,* whereby not only fiscal policy is subject to close surveillance by the European authorities, but also national macroeconomic policy as a whole, in order to detect the existence of imbalances in areas such as private debt or the external sector, to propose solutions and monitor that they are implemented [see Matea (2012)]. Thus, on 14 February the European Commission published the first *Alert Mechanism Report,* in which Spain was included among the countries in which, due to the severity of the imbalances that had built up, a subsequent in-depth analysis should be performed. On 30 May, the European Commission published this exhaustive examination of Spain (an *In-Depth Review)* which concludes that the imbalances of the Spanish economy are very serious and need to be addressed urgently. The imbalances were not described as *excessive* in any country – which would have meant that the corrective part of the procedure would have started – however, Spain and Cyprus were assessed to have the most severe macroeconomic imbalances.

This means that Spain's economic imbalances will continue to be closely monitored by the European authorities. The external imbalance will occupy a key place in this procedure and, consequently, changes in the current account balance, the performance of exports, the competitiveness trajectory of national production and the correction of high indebtedness vis-à-vis the rest of the world will be meticulously examined. The crucial role that improved competitiveness should play in Spain's economic policy strategy has been analysed in depth in Chapter 2 of the Banco de España's *Annual Report, 2011,* whereas developments in the current, capital and financial account balances have been described in detail in the Balances of Payments report which is published annually.

This article reviews progress in the correction of the external imbalances throughout the adjustment phase which began in 2008. Firstly, the decline in the external deficit since

2008 is analysed, seeking to identify the determinants of that improvement and the products and areas in which Spanish production has been more competitive. Secondly, the external financing of the Spanish economy during that period is examined and, finally, to conclude, the ways of pressing ahead with the correction of the external imbalances and consolidating the sustainability of Spain's external position are discussed.

The adjustment of the external deficit in the period 2007-2011

Spain's external deficit declined rapidly between 2007 and 2011. In terms of the nation's net borrowing requirement the deficit fell by more than 6 pp (percentage points) of GDP to 3.4% in 2011 (see Chart 1). The trade balance in goods and services improved by a similar amount (see Table 1). This correction was shared almost equally between the increase in exports and the decrease in imports, which indicates that Spanish firms took advantage of the continuing slight buoyancy in world trade in this period to increase their exports. However, part of the correction was in response to the effect of the decline in national demand – which has been especially significant in Spain – on the demand for imports.[1] If recent trends continue, the external deficit could be in balance in the near future.

In real terms, these changes in exports and imports of goods and services represented a sizable positive contribution to activity. Specifically, from 2007 to 2011 net external demand contributed almost 8 pp to GDP growth in cumulated terms compared with national demand's negative contribution to GDP of almost 10 pp, with the result that the external sector cushioned a very large part of that effect on final GDP figures. Furthermore, the correction of the deficit was hindered by the deterioration in the terms of trade, which decreased by 5%, owing to the cumulative increase of import prices which exceeded the deflator of exports of goods and services and was partly due to higher energy prices.

If the goods balance is analysed in more detail, it can be seen that the improvement in this period was quite widespread both in terms of geographical areas and products (see Table 2[2]). By country, most of that correction occurred in trade with the euro area against which, furthermore, Spain recorded a surplus in 2011 for the first time in several decades. Additionally, in 2011, it achieved a surplus vis-à-vis the rest of the EU. The improvement in the case of the rest of the world was smaller, partly due to higher energy prices. The largest deficits were seen vis-à-vis the OPEC countries and China, whereas the balance against other developed countries, such as the US or Japan, was close to equilibrium in 2011. By component, the foreign trade balance for consumer and capital goods recorded a surplus in 2011, but maintained a substantial deficit in intermediate goods.[3] In any event, there was an improvement in the three categories in the trade balance in recent years.

Changes in the energy deficit warrant slightly more attention, given their volume and persistency, since the Spanish economy is highly reliant on net energy imports. In this adjustment phase the energy deficit has shown various fluctuations in response to volatile oil prices, but an upward trend has predominated, prompting an imbalance of 3.8% of GDP in 2011, compared with 3.2% in 2007. The magnitude of this deficit is higher than that of other European countries and shows substantially larger oil consumption per unit of GDP than in the euro area [see Banco de España (2011)]. In this period the price of oil denominated

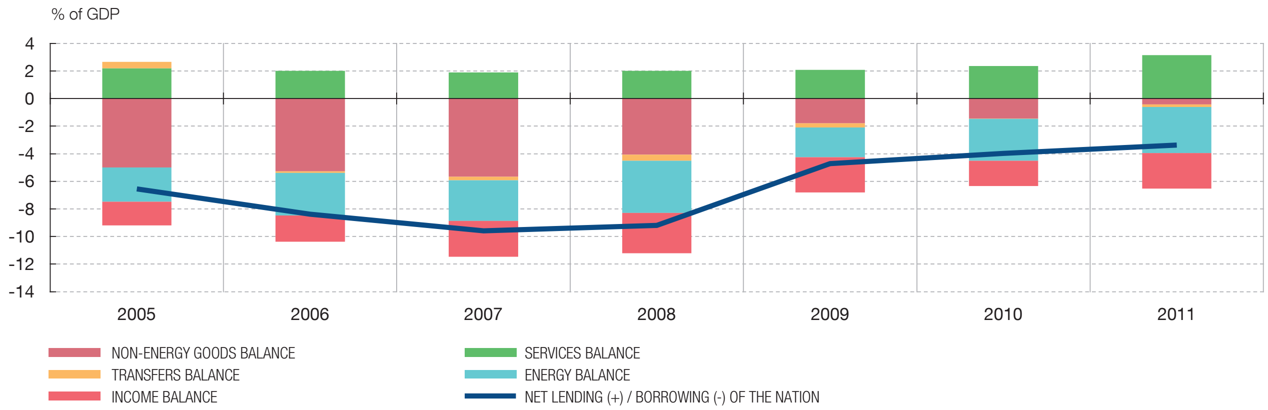
1 The first variable would have a more defined structural component, whereas the second would be more cyclical.

2 Tables 2 and 3 present information on trade in goods based on Customs data which may differ slightly from the information on these items provided by National Accounts that is used in other parts of the article (such as in Table 1).

3 If valued together, the improvement in the balance in terms of consumer and capital goods accounted for almost two-thirds of the reduction in the trade deficit, which is approximately double the weight of these items in goods trade in Spain.

THE NATION'S NET BORROWING

CHART 1



SOURCES: INE, Departamento de Aduanas and Banco de España.

FOREIGN TRADE IN GOODS AND SERVICES IN SPAIN
% of nominal GDP

TABLE 1

	2007	2011	Change	Percentage of total adjustment
Exports	26.9	30.1	3.2	52
Goods	18.3	20.7	2.4	40
Services	8.6	9.4	0.8	13
Tourism	4.0	4.0	0.0	0
Other	4.6	5.4	0.8	13
Imports	33.6	30.7	-2.9	48
Goods	26.9	24.5	-2.4	40
Services	6.7	6.2	-0.5	8
Tourism	1.1	1.0	-0.2	3
Other	5.6	5.3	-0.3	5
Balance	-6.7	-0.6	6.1	100
Goods	-8.6	-3.7	4.9	79
Services	1.9	3.2	1.3	21
Tourism	2.9	3.1	0.2	3
Other	-1.0	0.1	1.1	17

SOURCE: INE.

in euro increased by 52% and that of gas by 32%. This has influenced the decline in net energy imports in real terms – estimated at 8% in cumulated terms – which is higher than the cumulative decline in real GDP in the period 2007-2011 (see Chart 2).

The improvement in the trade balance, as discussed above, was shared quite similarly between the increase in exports and the decrease in imports, but it is worth analysing whether or not that equal distribution is maintained in terms of areas and products. Firstly, it should be underlined that exports have responded favourably during the crisis period. Between 2007 and 2011 international goods trade in nominal terms grew more than Spanish exports, however, that result is influenced by the rise in energy prices. For instance, in real terms, Spanish exports grew in that period at a considerably higher pace than world trade (17% and 8%, respectively, in cumulative terms) and, consequently, the share of Spain's production increased its weight in the world total (see Chart 3). In any event, it should be recalled that Spain's share of the international goods

TRADE BALANCE BY COUNTRY AND PRODUCT
% of nominal GDP

TABLE 2

	2007	2011	Change	Total percentage of adjustment
Trade balance	-9.4	-4.3	5.1	100
Euro area	-3.5	0.2	3.7	72
Of which:				
France	*0.0*	*0.9*	*1.0*	
Germany	*-2.2*	*-0.8*	*1.3*	
Italy	*-0.8*	*0.0*	*0.8*	
Portugal	*0.6*	*0.6*	*0.0*	
Other	*-1.1*	*-0.6*	*0.5*	
Rest of the EU	-0.2	0.2	0.4	7
United Kingdom	0.0	0.3	0.3	
Other	-0.2	-0.1	0.1	
Rest of the world	-5.7	-4.7	1.0	20
Of which:				
United States	*-0.2*	*-0.2*	*0.0*	
Japan	*-0.4*	*-0.1*	*0.3*	
China	*-1.6*	*-1.4*	*0.2*	
Latin America	*-0.4*	*-0.6*	*-0.2*	
OPEC	*-1.5*	*-1.8*	*-0.2*	
Other	*-1.6*	*-0.6*	*1.0*	
Consumer goods	-1.0	0.9	1.9	38
Food	0.5	0.9	0.4	
Cars	0.0	1.1	1.2	
Other	-1.5	-1.1	0.4	
Capital goods	-1.2	0.1	1.3	26
Intermediate goods	-7.1	-5.3	1.8	36
Energy	-3.3	-4.0	-0.7	
Mineral	-0.7	0.2	1.0	
Chemical	-0.6	-0.8	-0.2	
Metal and electrical	-1.3	-0.3	1.0	
Transport equipment	-0.6	-0.4	0.3	
Other	-0.6	0.0	0.5	

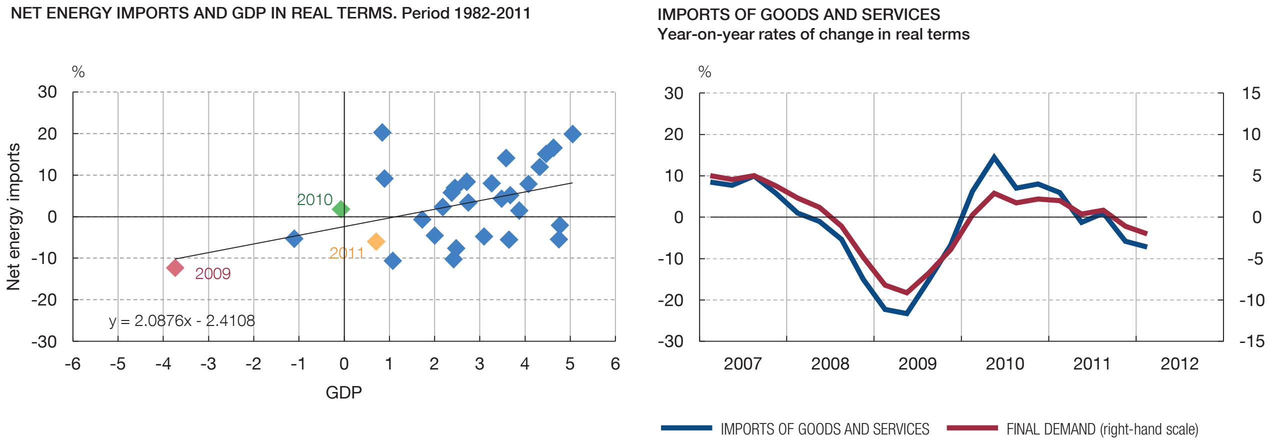
SOURCE: Departamento de Aduanas.

trade is slightly lower than the weight, for example, of its GDP in world GDP [see García and Gordo (2006)].

By country, the increase in sales has been based proportionately more on non-EU countries, which indicates their relatively more buoyant trade and the gradual diversification of Spanish foreign trade (see Table 3). In 2011, 53% of goods were exported to the euro area, but that was 4 pp lower than four years earlier (and 9 pp lower than in 1999, at the inception of EMU). In EU countries that do not belong to the euro area, the percentage held hardly unchanged at 13%, whereas the weight of sales outside the EU as a percentage of the total increased by 1 pp each year to 34%. The concentration of exports on certain euro area economies continues to be very high (France, Germany, Italy and Portugal represent 44% of total goods sales abroad) and exports to emerging economies account for a small share of the total. Noteworthy is the low relative weight of exports to Latin America: in

IMPORTS

CHART 2



SOURCES: INE and Ministerio de Economía y Competitividad.

SPAIN'S EXPORT SHARES

CHART 3

SOURCES: Ministerio de Economía y Competitividad and CPB (Netherlands Bureau for Economic Policy Analysis).

a Seasonally adjusted series.

2011 they amounted to 1% of GDP which represents, for example, only 60% of exports to Portugal in that year. Admittedly, in recent years these relative shares have gradually changed and many Spanish firms have expanded into new markets; however, it seems necessary to strengthen that trend so as to increase export momentum [see González *et al.* (2012)]. By type of goods, the increase in exports in this adjustment stage has centred significantly on intermediate goods and on numerous items within this category.

Goods imports decreased 7% between 2007 and 2011 in nominal terms (almost 15% in real terms), in a setting of a sharp weakness in demand, which resulted in a decline in imports of 2.4 pp as a percentage of GDP (see Table 3). By country, the lower import dependence was centred on the euro area. Conversely, imports from outside the EU rose, although higher energy prices were a decisive influence in this connection; if they are stripped out, it is estimated that purchases from this region stabilised between 2007 and 2011. This distribution can be explained by changes in imports by product, where it can

EXPORTS AND IMPORTS OF GOODS BY COUNTRY AND PRODUCT
% of nominal GDP

TABLE 3

	Exports				Imports			
	2007	2011	Change	Total percentage of adjustment	2007	2011	Change	Total percentage of adjustment
TOTAL	**17.2**	**20.0**	**2.8**	**100**	**26.6**	**24.3**	**-2.3**	**100**
Euro area	9.7	10.5	0.8	29	13.3	10.4	-2.9	123
Of which:								
France	*3.2*	*3.6*	*0.4*		*3.3*	*2.6*	*-0.6*	
Germany	*1.9*	*2.0*	*0.2*		*4.0*	*2.9*	*-1.2*	
Italy	*1.5*	*1.6*	*0.1*		*2.3*	*1.6*	*-0.7*	
Portugal	*1.5*	*1.6*	*0.1*		*0.9*	*1.0*	*0.1*	
Other	*1.7*	*1.7*	*0.0*		*2.8*	*2.3*	*-0.5*	
Rest of the EU	2.3	2.6	0.3	12	2.5	2.4	-0.1	2
United Kingdom	1.3	1.3	0.0		1.3	1.0	-0.3	
Other	1.0	1.4	0.3		1.2	1.4	0.2	
Rest of the world	5.2	6.8	1.6	59	10.9	11.5	0.6	-25
Of which:								
United States	*0.7*	*0.7*	*0.0*		*0.9*	*1.0*	*0.0*	
Japan	*0.1*	*0.2*	*0.0*		*0.6*	*0.3*	*-0.3*	
China	*0.2*	*0.3*	*0.1*		*1.8*	*1.7*	*0.0*	
Latin America	*0.9*	*1.0*	*0.1*		*1.3*	*1.6*	*0.3*	
OPEC	*0.5*	*0.8*	*0.3*		*2.1*	*2.6*	*0.5*	
Other	*2.7*	*3.7*	*1.1*		*4.3*	*4.3*	*0.0*	
Consumer goods	6.3	6.6	0.3	11	7.3	5.7	-1.6	70
Food	2.0	2.4	0.4		1.5	1.5	0.0	
Cars	1.9	2.0	0.1		2.0	0.9	-1.1	
Other	2.3	2.2	-0.2		3.8	3.3	-0.6	
Capital goods	1.6	1.7	0.1	5	2.8	1.6	-1.2	51
Intermediate goods	9.3	11.7	2.3	84	16.5	17.0	0.5	-21
Energy	0.6	1.2	0.6		3.9	5.2	1.3	
Mineral	1.8	2.3	0.4		2.6	2.0	-0.5	
Chemical	1.5	2.2	0.7		2.0	3.0	0.9	
Metal and electrical	1.8	2.0	0.2		3.1	2.3	-0.8	
Transport equipment	1.5	1.4	-0.1		2.1	1.7	-0.4	
Other	2.2	2.6	0.5		2.7	2.7	0.0	

SOURCE: Departamento de Aduanas.

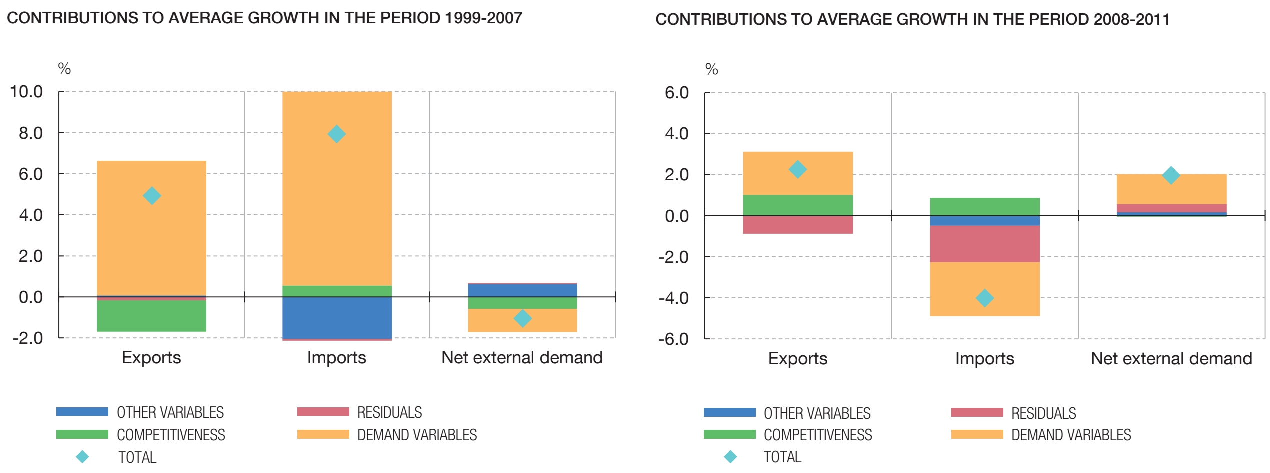
be seen that imports of consumer and capital goods fell, a sign of the weak spending of Spanish households and firms.[4] Purchases of intermediate goods remained slightly buoyant which is related to the fact that Spanish exports were relatively dynamic and have a high import content [see Cabrero and Tiana (2012)].

Turning to services, in the period 2008-2011 as a whole, there were hardly any increases in the tourism surplus which held at around 3% of GDP, partly due to the general cyclical weakness of many countries that provide the majority of tourists to Spain. This surplus is

4 Note in the case of consumer goods that car imports fell in 2011 to less than half of their level recorded four years earlier.

MAIN DETERMINANTS OF FOREIGN TRADE IN GOODS AND SERVICES

CHART 4



SOURCES: INE and Banco de España.

a structural feature of the Spanish economy which must be preserved and built on, paying attention to maintaining suitable quality and price-competitiveness levels. Under the "other services" item, the deficit of 1% of GDP seen in 2007 changed to a slight surplus in 2011, with more vigorous exports, particularly of business services [see Banco de España (2012b)]. Noteworthy is the growing importance of services exports, both in Spain and in international trade, as well as the role that large Spanish services exporting firms can play in promoting the opening up of new markets abroad for smaller companies.[5]

The performance of exports and imports in this period seems to be reasonably explained by changes in its usual determinants, such as those considered in traditional functions of foreign trade [see García *et al.* (2009)]. In the case of exports, the main explanatory factor is the increase in export markets, although, as discussed above, Spanish firms have diversified their sales abroad to take advantage of the higher buoyancy of markets outside the euro area (see Chart 4). Furthermore, the price competitiveness indicators and relative costs have performed favourably in this adjustment phase, compared with their contribution in the previous boom period, with the result that the differential which built up in the expansionary phase has narrowed, especially significantly in the case of unit labour costs. Both factors – market diversification and the improvement in competitiveness – are linked to sluggish internal markets which have compelled firms to make further efforts to open up new markets and compete internationally.[6]

The elasticity of imports to changes in final demand is very high when compared to other countries, since it is close to a value of two (see Chart 2). Obviously, this leads to a rapid increase in the external deficit during boom periods but also helps to correct that deficit in adjustment phases as is currently happening. It is difficult to determine whether that elasticity has varied in recent years.[7] In any event, it should be recalled that the strong penetration

5 The characteristics of Spanish firms exporting non-tourism services are examined in González Sanz and Rodríguez Caloca (2010).

6 Certain estimates from an export equation show that in Spain national demand has a negative influence on the volume of exports [see Martínez-Mongay and Maza (2009)].

7 The European Commission (2012) shows that countries affected by banking crises display a persistent weakness in imports, insofar as these crises are usually linked to credit restrictions and the need for the private sector to deleverage.

INTERNATIONAL INVESTMENT POSITION (IIP) AND INVESTMENT INCOME CHART 5

SOURCE: Banco de España.

a Excluding reserves and financial derivatives.

in world markets of very cheap products from countries such as China, which are difficult to compete with on price, coupled with the Spanish economy's reliance on high-technology goods, which cannot be replaced in the short term by Spanish products, are keeping the weight of imports in Spain persistently high.

Together with the balance of goods and services, there are two main items which determine the nation's net borrowing requirement: the transfers balance and the income balance. The former is dominated by migrants' remittances and current and capital transfers vis-à-vis the EU. This balance is close to equilibrium. In recent years there has been a slight decrease in migrants' remittances as a result of the economic crisis, which has triggered an increase in unemployment in this group and even prompted some migrants to return to their country of origin.

Conversely, the deficit on the income balance is very significant and the result of the build up of high external deficits in the boom phase which have led to a highly negative net international investment position. This balance has fluctuated in recent years insofar as it depends on the level of interest rates, in addition to other decisions by firms such as the extent to which their profits are repatriated. Firstly, it should be noted that the investment income deficit is a result of significant flows of receipts and payments: receipts represented almost 4% of GDP in 2011, whereas payments were slightly higher than 6% of GDP (see Chart 5). Secondly, by instrument, the breakdown is different between receipts and payments: 60% of receipts come from Spain's foreign direct investment,[8] whereas payments centre on the Spanish economy's debt in the form of fixed-income securities and loans. Finally, it should be pointed out that the implicit returns of receipts and payments are similar and in 2011 they stood at around 3%, compared with 4.5% in 2007. Within receipts, the most profitable item was FDI with an implicit return of close to 5%,[9] whereas on the payments side the fixed-income securities incurred a cost of 3.5% and short-term loans (which include interbank deposits and repos) incurred a cost of 1.5%, due to the low level of short-term interest rates.

External financing during the adjustment phase

As a result of the significant correction of the external deficit in recent years, the expansionary dynamic of the net debtor position vis-à-vis the rest of the world was halted, but not sufficiently so as to reverse it. The burgeoning external deficits of the boom phase led to a swollen debt position, which reached a weight in GDP of around 90% in recent years, one of the highest among euro area countries.

In this boom phase, the external deficit was financed without difficulty thanks to strong capital inflows, largely intermediated by the banking system which raised abundant funds through the issuance of securities and the securitisation of loans. Following the financial crisis of 2007, the availability of financing began to dry up. As shown in Chart 6, between 2007 and 2009 the net inflows of funds were not sufficient to finance the external deficit, since in many economies a greater "home bias" began to be seen, namely the purchase of national assets and the sale of foreign ones. The tone was similar in 2010 as a whole, although the considerable impact that uncertainty about the future of the euro area could have on those flows was seen as early as in Q2 when there was a sharp outflow of financing, coinciding with the worsening of the sovereign debt crisis in Greece and its reflection in the financial markets of other countries considered vulnerable, such as Spain. In 2011 this phenomenon became more acute, especially after Q3: in the year as a whole, net outflows of financing represented almost 7% of GDP, which, together with the external deficit that had to be financed, led to an increase in the Banco de España's net liabilities amounting to 10% of GDP. In the first four months of 2012 the situation has got worse with €122 billion of net outflows of financing (11% of GDP).[10]

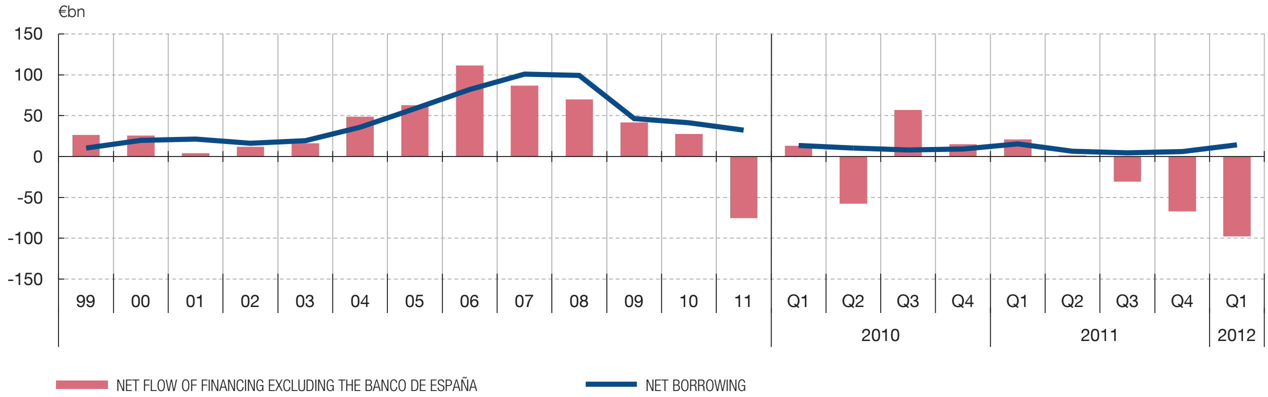
These net outflows of financing from Spain occurred through various channels: in some cases, the outflows represent an active decision of foreign investors such as the sale on the secondary market of Spanish government debt holdings; in others, the decision is passive, such as non-residents simply not renewing securities on maturity. The delocalisation of deposits from Spanish banks to non-resident banks has been less significant, in particular certain foreign firms with operations in Spain have played a substantial role in this process [see Banco de España (2012c)]. Finally, these outflows have at some point been partially offset by divestment abroad by residents, too. As a result of this, Spaniards' portfolio investments held in foreign assets decreased from 42% of GDP in 2007 to 24% in 2011. In any event, total external assets still represented 120% of GDP in 2011.

These sharp fluctuations in cross-border financing flows create a severe balance of payments crisis which reflects the financial markets' negative assessment both of the imbalances of the Spanish economy and the possibilities of them being absorbed within the institutional

8 Most of these receipts come from Latin American with the result that the low level of goods exports to this area is offset by the higher funds provided from the return on these investments.
9 The calculation of these implicit receipts should be assessed cautiously since the way the FDI balance is valued (i.e. the denominator of that ratio) may substantially affect the estimate.
10 In the first few months of the year part of the outflows of financing were related to an increase in the foreign assets of resident agents, especially credit institutions.

FINANCING OF THE SPANISH ECONOMY

CHART 6



SOURCE: Banco de España.

framework that has prevailed to date in the euro area. Since they are taking place within a monetary union, the typical instruments to combat a crisis of these characteristics (such as currency devaluation or the introduction of exchange control measures) are not available to the authorities.[11] In a fixed exchange rate system, these pressures would compel central banks to intervene in the markets by selling reserves to offset the depreciating momentum of financial outflows.

However, EMU is not a fixed exchange rate system because national currencies no longer exist and, consequently, outflows of financing from an economy in the euro area do not put pressure on the exchange rate. However, the strains can be reflected in the Eurosystem's balance sheet, given the central role played by the banking system in the intermediation of cross-border financial flows and its access to central bank liquidity injecting operations.[12] Thus, Spanish credit institutions, faced with the difficulties of renewing external financing or raising new funds, have resorted to a greater extent to these Eurosystem tenders, especially the two three-year liquidity tenders conducted at end-2011 and at the beginning of 2012.[13] With these funds, institutions have been able to meet net payments which they owed to the rest of the world, either through current account operations – in which Spain has continued to post a deficit – or through financial accounts operations – due to net outflows of financing.[14]

The full allotment of the liquidity demanded in the Eurosystem's tenders – which has been maintained since 2008 – and the recent three-year LTROs, have made it easier for Spanish

11 The possibility of generating inflation as a form of reducing indebtedness is not available either, given the absence of monetary sovereignty.

12 In the case of the euro area, banks regularly tap the tenders conducted by the Eurosystem, but they do so through their national central bank. Thus, it is the Banco de España which lends to Spanish banks and holds that asset on its balance sheet vis-à-vis the banks.

13 The outflows of financing may also be partly endogenous in nature, since they respond to the desire of Spanish banks to replace external funding by Eurosystem funds, possibly at a lower cost.

14 Insofar as those payments abroad are channelled through the banks' accounts at the Banco de España, the latter will order a national central bank of another country in the area to credit the current account of a credit institution with a certain amount. That payment order does not entail a material transfer of funds, it is recorded for accounting purposes as a liability of the Banco de España and an asset of the other central bank. These operations, which are called intra-system accounts, disappear in the Eurosystem's consolidated balance sheet since the asset and liability positions are fully netted off. That is to say, if the liquidity-injecting operations were performed directly by the European Central Bank instead of by national central banks, those intra-system accounts would not exist. These intra-system balances – which are also called "TARGET balances" because this is the payment system for channelling operations between central banks only reflect the form of conducting monetary policy in the euro area and cannot be limited ex ante, since, ultimately, they are the logical consequence of the euro being the currency in various countries with the same intrinsic and indistinguishable value [see Merler and Pisani-Ferry (2012)].

banks to substantially increase their borrowing from the Eurosystem in recent months. Access to that funding has maintained a regular flow of funds to finance the external deficit, with the result that the latter has been corrected gradually. However, resorting to that funding cannot permanently cover the outflows of financing from the economy, if the latter continue to occur at the speed seen recently. Consequently, that funding from the Eurosystem should be considered as a mechanism for temporarily resolving a situation of high uncertainty and lack of confidence. Accordingly, the request for financial assistance from the EU to recapitalise the Spanish banking system intends to end one of those sources of uncertainty, since it guarantees the solvency of Spanish credit institutions even in the hypothetical case that the economic outlook should deteriorate significantly.[15]

Conclusions

From 2007 until 2011 there has been quite a sharp adjustment of the Spanish external deficit, based partly on weak internal demand but also on the momentum of Spanish firms' exports. This adjustment should continue. However, in order to achieve a lasting external equilibrium, it is necessary to offset the high, persistent weight represented by two items: the energy and income deficits (see Table 4). The balances of these two items can only be corrected gradually as greater energy efficiency measures are introduced, in the case of the former, and a reduction is achieved in the Spanish economy's net debtor position, in the case of the latter, or, at least, that the external funding costs for general government and credit institutions can be reduced. Therefore, in the short term the correction of the deficit should lie, in particular, in widening the surplus of non-energy goods and of services.

The short-term outlook for the external deficit is shrouded in uncertainty, especially due to the greater weakness shown recently by international markets, particularly in the euro area. Thus, in the early months of 2012 exports were less buoyant, although, once again, weak national demand has resulted in a lower level of imports. As a result, the nation's net borrowing requirement has dropped 16% year-on-year in the period January-April 2012.

From a financial standpoint, the Spanish economy is in a vulnerable situation since its heavy net debtor position requires sizable refinancing, which, furthermore, has been compounded by financing outflows triggered by the early redemption of securities held by non-residents vis-à-vis Spanish issuers. Compared with the volume of the financial flows, the external deficit is in itself of secondary importance: for example in the period January-April 2012, net financing outflows rose to €122 billion, whereas the external deficit in that period increased to €15 billion. Nevertheless, the importance of a swifter correction of the external deficit should not be underestimated: firstly, because it would represent, in principle a greater positive contribution of external demand to growth and, secondly, due to the improvement that it would make to external debt since it would favourably impact the external balance and the pace of GDP growth.[16]

In short, the external imbalances of the Spanish economy are one of the keys to the current crisis and, consequently, correcting them is essential in order to restore the confidence of the financial markets and to improve the outlook for growth. From the standpoint of the external deficit, the adjustment to date has been significant but possibly, part of it can be explained by weak national demand, i.e. it is seemingly very cyclical. This could mean that the external

---

15 Furthermore, the financial assistance programme for the recapitalisation of certain Spanish credit institutions will bring temporary relief to the external financing problems since it represents a capital inflow.

16 The debtor position vis-à-vis the rest of the world moves according to similar determinants to those analysed in the case of the public debt dynamic. In order to reduce the debtor position it is therefore necessary to achieve a primary surplus (i.e. net of the income balance) or for the pace of nominal growth to exceed the cost of the debt. Movements in both directions would obviously bolster the correction of that position.

THE NATION'S NET BORROWING
% of nominal GDP

TABLE 4

	2007	2011	Change
Balance of goods and services	-6.7	-0.6	6.1
Energy goods (Customs data)	-3.2	-3.8	-0.6
Other	-3.5	3.2	6.7
Balance of transfers	-0.3	-0.2	0.1
Current transfers	-0.7	-0.7	0.0
Capital transfers	0.4	0.5	0.1
Balance of income	-2.6	-2.6	0.0
Nation's net borrowing (-)	-9.6	-3.4	6.2

SOURCES: INE, Departamento de Aduanas and Banco de España.

deficit may rise again faced with an incipient recovery in activity. Consequently, all the necessary competitiveness-enhancing policies must be implemented so that the external balance rapidly moves into surplus and the recovery in activity is essentially external demand-led,[17] so that the aforementioned surplus and the decrease in the net international debtor position can be maintained in a phase of higher growth. From the standpoint of financing, it is essential to redress the situation and improve the outlook of the two agents most heavily indebted abroad (credit institutions and general government), so that they might once again regularly tap the international markets for funds. Uncertainties about the solvency of some institutions have received a suitable response in the form of the request for financial assistance from the EU and in the clean-up and recapitalisation plans which will be drawn up immediately. It is also necessary to stem the growth of public debt through stringent compliance with the fiscal consolidation process in place to put public finances back on a stable trajectory.

13.7.2012.

REFERENCES

BANCO DE ESPAÑA (2011). "Channels for correcting the Spanish external deficit" *Annual Report, 2010,* Box 5.2.
— (2012a). "The competitiveness of the Spanish economy", *Annual Report, 2011,* Chapter 2.
— (2012b). "El comercio internacional de servicios en la última década", *Balanza de Pagos y Posición de Inversión Internacional de España, 2011,* recuadro 1.2.
— (2012c). "Changes in the deposits of households and non-financial corporations", "Quarterly report on the Spanish economy", *Economic Bulletin,* April, Box 5.
CABRERO, A., and M. TIANA (2012). "The import content of the industrial sectors in Spain", *Economic Bulletin,* April, Banco de España.
EUROPEAN COMMISSION (2012). "Quarterly report on the euro area", *Economic and Financial Affairs,* Volume 11, no. 2.
GARCÍA, C., and E. GORDO (2006). "La cuota de los productos españoles en los mercados internacionales", *Boletín Económico,* October, Banco de España.
GARCÍA, C., E. GORDO, J. MARTÍNEZ-MARTÍN and P. TELLO (2009). *Una actualización de las funciones de exportación e importación de la economía española,* Documentos Ocasionales, no. 0905, Banco de España.
GONZÁLEZ SANZ, M. J., and A. RODRÍGUEZ CALOCA (2010). "Las características de las empresas españolas exportadoras de servicios no turísticos", *Boletín Económico,* November, Banco de España.
GONZÁLEZ SANZ, M. J., A. RODRÍGUEZ CALOCA and P. TELLO (2012). "La respuesta de las empresas exportadoras españolas a los cambios del comercio mundial (2008-2010)", *Boletín Económico,* January, Banco de España.
LA CAIXA (2012). "El sector exterior español", *Informe mensual,* July-August.
MARTÍNEZ-MONGAY, C., and L. Á. MAZA (2009). "Competitiveness and growth in EMU: The role of the external sector in the adjustment of the Spanish economy", *Economic Papers,* no. 355, European Economy.
MATEA, M. LL. (2012). "Nuevo marco de vigilancia de los desequilibrios macroeconómicos de la UE", *Boletín Económico,* March, Banco de España.
MERLER, S., and J. PISANI-FERRY (2012). *Sudden stops in the euro area,* Bruegel Policy Contribution, 2012/06.

17 La Caixa (2012) estimates the growth that would have to be achieved by exports to maintain a certain pace of expansion without any contribution from internal demand.