One feature that marks out the current upturn favourably is that the Spanish economy's high GDP growth has been compatible with maintaining relatively high external surpluses (averaging 2% of GDP, in terms of net lending over the period 2013-2017). However, more recently, the Spanish economy's lending capacity has decreased somewhat, dropping to 1.4% of GDP in cumulative twelve-month terms in September 2018, compared with 2.1% over 2017 as a whole (see Chart 1). It is therefore worth analysing the factors underlying these developments and, in particular, whether they are predominantly transitory or permanent, particularly given that, despite the recent correction, the Spanish economy still has a high net debtor position against the rest of the world. To bring down this debt it will be necessary to run an external surplus for an extended period. This box examines these factors and how they affect likely future developments in the external balance.

From the viewpoint of the various items of the rest of the world account, the recent decrease in the economy's lending capacity has been concentrated in the balance of goods and services. By components, the reduction in the surplus in non-energy goods and non-tourism services, the widening deficit in energy goods, and the falling surplus in tourism services account for around 65%, 20% and 15% of the total reduction in the external surplus since the start of 2017. Unlike the situation observed in the case of the goods and services balance, the changes during the period in the balance of primary and secondary income and the balance of the capital account were insignificant.[1]

There were a number of factors underlying the deterioration in the various components of the balance of goods and services in recent quarters. Some of the most significant of these are intrinsically transitory, and some, such as the oil price, are difficult to predict. In particular, as regards the energy balance, the net bill has risen by 0.2 pp of GDP since the start of 2018 (and 0.5 pp since end-2016), as a consequence of rising oil prices, with the price of a barrel climbing from €28 in January 2016 to €57 in January 2018 and €71 in October 2018 before subsequently declining somewhat to €56 in November (see Chart 2). The role of dearer oil is also reflected in the breakdown of the trade balance by counterparties' geographical area, with the deterioration in the trade balance with countries outside the euro area being more pronounced than that with euro area countries, given that oil is mainly bought outside the euro area (see Chart 3). Nevertheless, the deficit under this heading has tended to remain below that observed in previous periods in which oil price levels were similar to those today, probably as a result of improvements in the Spanish economy's energy efficiency (see Chart 4).[2]

For its part, the recent reduction in the balance of non-energy goods and non-tourism services was partly a response to losses in competitiveness induced by the rise in the value of the euro since early 2015 (see Chart 2). On the sales side, the slowdown in Spanish export market growth since early 2017 – slowing more than growth in global trade flows – has also had a negative impact on this sub-balance (see Chart 5).[3] Lastly, in the case of tourism, the recent deceleration is largely a response to the progressive normalisation of the geopolitical situation in competing destinations around the Mediterranean, such as Turkey or North Africa.[4]

In the specific case of real terms export flows, a simple econometric model proxying how this variable behaves based on its key determinants helps quantify the relative importance of each determinant in explaining the recent slowdown in this demand component. As can be seen in Chart 6, the slowdown in external demand and loss of competitiveness[5] together account for the majority of Spanish exports' loss of vigour so far in 2018.

Nevertheless, other more persistent factors in the domestic sector have also played a significant role in explaining the recent moderation of the foreign surplus. In particular, the process of substituting certain imported factors with domestic inputs observed in recent years[6] could have begun to reverse in 2017 (see Chart 7). This process, in conjunction with an ongoing increase in the share of exports, which have a high import content, in final demand, would have been reflected in rising elasticity of imports to final demand. In any event, the import content of exports and of final demand as a whole remains significantly smaller than that observed in the pre-crisis period, such that the improvement in the trade balance appears to include a structural component (see Chart 8).[7]

The Banco de España's latest projections suggest that, as a result of the factors just discussed, the economy's lending capacity could decrease in 2018 as a whole to around 1% of GDP.[8] Over the period from 2019 to 2021, the Spanish economy's external balance

1 Among other items, the primary income balance includes interest payments and collections for liabilities and assets vis-à-vis the rest of the world. Secondary income includes, among other items, payments and collections of migrants' remittances, and the capital account balance includes capital transfers with the rest of the world.

2 See Box 3 of the Banco de España's September 2018 Quarterly Report.

3 The possible role of adaptation to the new emissions standards for the type-approval of new vehicles in the European Union, which came into effect on 1 September, is less clear-cut, given that as has happened in neighbouring countries, it has affected both sales and foreign purchases.

4 See Box 6 of the Banco de España's September 2018 Quarterly Report.

5 For more details on the estimation of these contributions, see E. Prades and C. García (2015), Actualización de la función de las exportaciones españolas de bienes, Economic Bulletin, April, Banco de España

6 See Chapter 3 of the Banco de España's September 2016 Annual Report. In order to distinguish to what extent these developments are due to companies importing more inputs from abroad or companies with a larger import content have gained market share in 2017 and 2018 a company-level granular analysis is needed, for which up-to-date data are not available.

7 See Chapter 3 of the Banco de España's September 2016 Annual Report.

8 See Macroeconomic projections for the Spanish economy (2018-2021): the Banco de España's contribution to the Eurosystem's December 2018 joint forecasting exercise.

will also be shaped by the various assumptions on which the projections are based. These include interest rates following an upward path – steeper in the case of longer maturities – in line with market expectations, the oil price following a slightly downward path (indicated by futures markets), exchange rates remaining at current levels, and the Spanish economy's external markets growing at an annual average of 3.5%.

Meanwhile, the projections anticipate the values of elasticity of imports to final demand to be similar to those observed in the last two years, in turn somewhat higher than in the early years of the recovery, and that exports will make further gains in external market share, although smaller than those in the period 2014-2016. This somewhat less favourable behaviour by external trade flows may reflect the fact that competitiveness gains relative to the rest of the world have tended to slow and that stronger domestic demand means Spanish companies are facing less pressure to find new markets.[9]

With these ingredients, the Spanish economy's lending capacity is expected to further moderate somewhat over the three year period from 2019 to 2021 (by around 0.4 pp of GDP), which would be explained in equal parts by a modest additional reduction in the balance of goods and services and a certain expansion in the income deficit (driven by the rising cost of the economy's external debt).

In short, the reduction in net lending observed over the course of 2018 is due to a convergence of a variety of different factors, such

9 See Almunia, M., P. Antràs, D. Lopez-Rodriguez, E. Morales (2018) "Venting Out: Exports during a Domestic Slump," Working Papers, No. 1844, Banco de España.

Chart 1
NET LENDING (+)/NET BORROWING (-). BALANCES

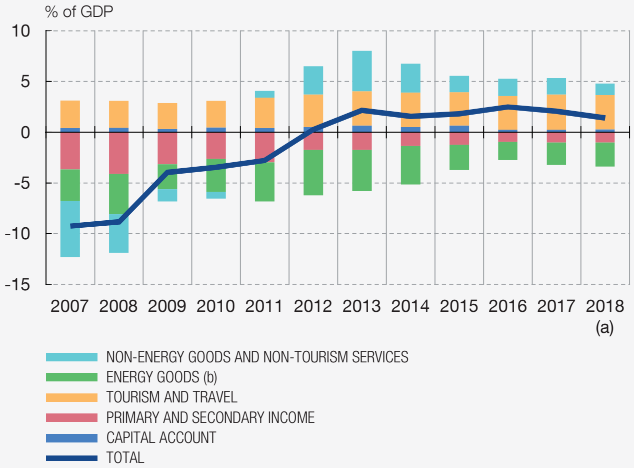


Chart 2
OIL PRICE AND NOMINAL EFFECTIVE EXCHANGE RATE

Chart 3
GOODS TRADE BALANCE

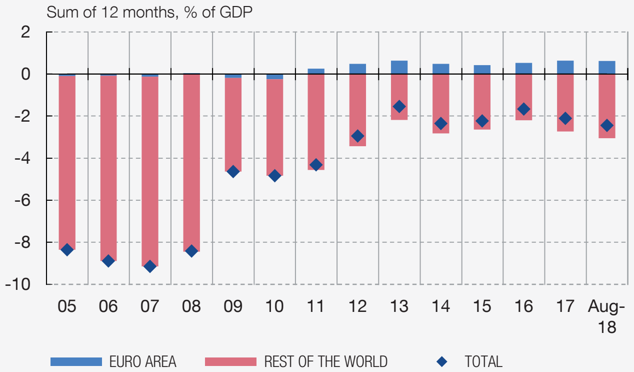
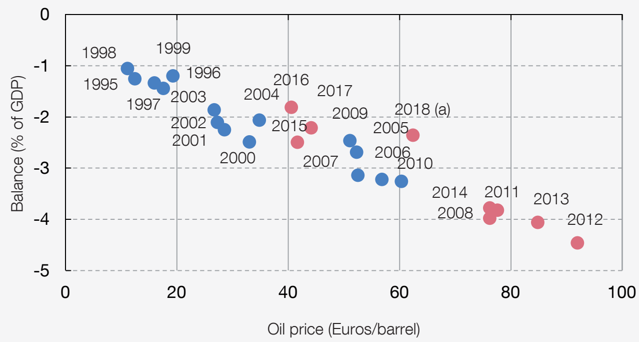


Chart 4
ENERGY GOODS BALANCE AND OIL PRICE



SOURCES: Banco de España and INE.

a 2018 data calculated as the sum of the data for the 12 months to September.
b The energy and non-energy balances are Banco de España estimates based on customs data.

as the appreciation of the euro, rising oil prices, the slowdown in world trade flows, and a degree of recovery of import penetration in final demand. Some of these factors may have only a passing impact, such that if the variables concerned (such as the oil price or exchange rate) remain close to their current values, no further deterioration is to be expected. However, the existence of signs of a partial reversal in 2017 and 2018 of the more (less) expansionary behaviour shown by exports (imports) in relation to their determinants between the start of the recovery and 2016 may perhaps indicate that the process of competitiveness gains under way since the start of the recovery has lost momentum, in a context in which the Spanish economy needs to run broad external surpluses to reduce its external debt from its current high levels.

Chart 5
SPAIN'S EXPORT MARKETS AND WORLD TRADE IN GOODS AND SERVICES

Chart 6
GOODS AND SERVICES EXPORTS AND THEIR DETERMINANTS: CONTRIBUTION TO ANNUAL GROWTH

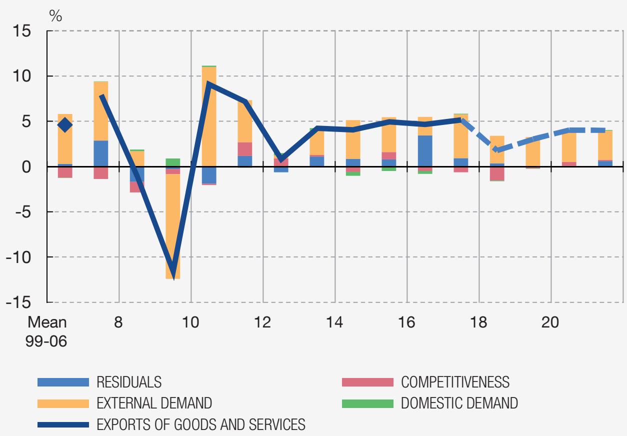


Chart 7
RATIO OF IMPORTS BY GOODS TYPE TO FINAL DEMAND COMPONENT

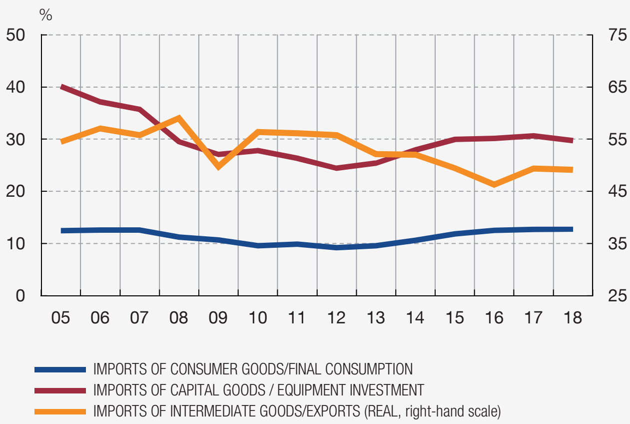
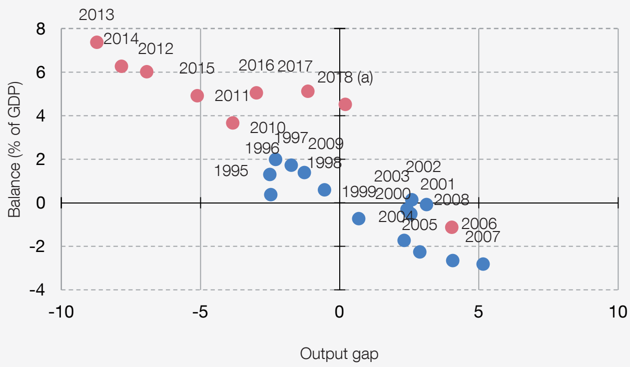


Chart 8
NON-ENERGY GOODS AND SERVICES BALANCE AND THE OUTPUT GAP



SOURCES: Banco de España and INE.

a 2018 data calculated as the sum of the data for the 12 months to September.
b The energy and non-energy balances are Banco de España estimates based on customs data.