

## Box 3

**HOW INCOME PAYMENTS, CURRENT TRANSFERS AND THE OIL BALANCE HAMPER CURRENT ACCOUNT ADJUSTMENT**

Since the outbreak of the economic and financial crisis in the euro area, there has been a reversal in the trend of the current account balances of those euro area countries that ran sizeable deficits at the height of the boom (i.e. Estonia, Ireland, Greece, Spain, Cyprus, Malta, Portugal, Slovenia and Slovakia). The current account balances of these countries have improved markedly and, in some of them (Estonia, Ireland and Slovenia), deficit has even turned into surplus. However, the current account deficits of Greece, Spain, Cyprus and Portugal still stood at high levels in 2011. In the same year Belgium, France and Finland experienced a deterioration in their current account balances and recorded deficits, while the current account deficit remained high in Italy. At the same time, only three euro area countries (Greece, France and Portugal) posted a negative balance for non-oil goods and services in 2011. This box assesses the extent to which other items of the current account, such as the income balance, current transfers and the oil balance, impede current account adjustment and require an even stronger improvement of the balance for non-oil goods and services.

Current account adjustment in euro area countries is hampered by the slow reaction of a number of items which have a significant weight in the current account and do not easily adjust in the short run. The most relevant of these items are, first, net exports of oil, which – given the low price elasticity of demand – may force countries to absorb adverse price fluctuations; second, net income payments, as they depend on the past accumulation of liabilities which cannot be quickly reversed; and third, current transfers, which are largely exogenous to the country's economy and depend on political and demographic factors. All euro area countries recorded a deficit in 2011 in the combined balance for the less-adjustable current account components (oil, income and current transfers), but many of them were able to offset it with sufficiently high net exports of non-oil goods and services (see Chart A).<sup>1</sup>

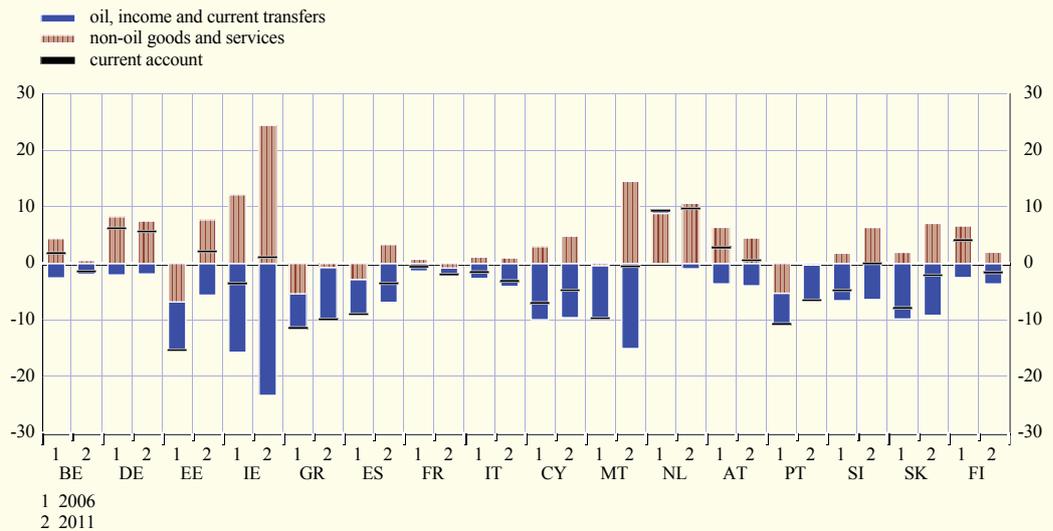
Although those countries that recorded sizeable current account deficits in the run-up to the financial and economic crisis have, since 2006, improved their non-oil goods and services balances (with Estonia, Spain and Malta switching from a deficit to a surplus), Greece and Portugal remain net importers of non-oil goods and services. These two countries, together with France, are the only countries in the euro area recording a deficit for this balance. Nevertheless, over the same horizon, the deficit for the less-adjustable current account components actually increased in the majority of euro area countries, implying a necessity to even further improve the balance for non-oil goods and services.

The worsening of the deficit for the less-adjustable current account components reflected a combination of: (i) rising income payments in all euro area countries, except Belgium,

<sup>1</sup> Luxembourg has been excluded from Charts A, B and C for the sake of readability as the magnitude of the income deficit and concomitant surplus for non-oil goods and services of Luxembourg is substantial.

### Chart A Current account balance: non-oil goods and services versus less-adjustable components

(as a percentage of GDP)



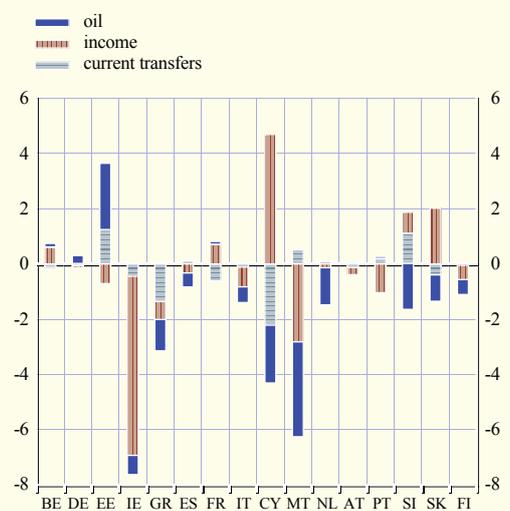
Source: ECB.

France, Cyprus, Slovenia and Slovakia (see Chart B), largely on account of a substantial increase in the net debtor position of the countries; (ii) an increase in the oil deficit in Ireland, Greece, Spain, Italy, Cyprus, Malta, the Netherlands, Slovenia, Slovakia and Finland; and (iii) a worsening of the current transfers balance in the case of Belgium, Germany, Ireland, Greece, France, Italy, Cyprus, Austria, Slovakia and Finland. This latter worsening of the current transfers balance is mainly attributable, in the case of Greece and Cyprus, to a decline in EU structural funding, as the ability of these two countries to absorb funding by generating and co-financing projects was limited.

In 2011 both the income balance and the oil balance accounted for a sizeable part of the overall current account deficits and surpluses in several euro area countries. In that year net income payments to the rest of the world by Estonia, Greece, Spain, Malta, Portugal and Slovakia stood between 2% and 7% of GDP (see Chart C). These were mostly dividends and interest payments on debt securities held by foreigners, as well as payments of income on foreign direct investment in these economies. Income deficits were even more sizeable in Ireland

### Chart B Change in the less-adjustable current account components

(2006-11; as a percentage of GDP)

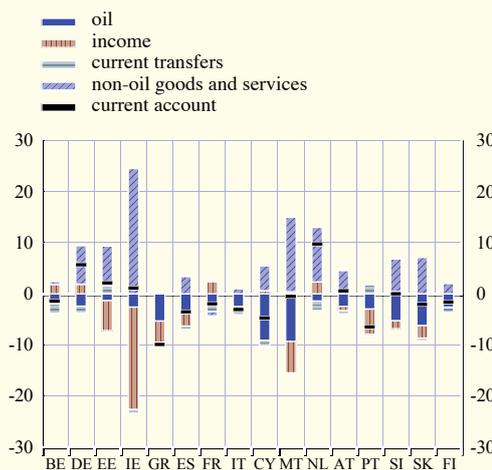


Source: ECB.

and Luxembourg, where they were closely related to the operations of multinational companies (in financial and other services). These firms generated profits by exporting services and these profits were channelled to parent companies in the form of payments of income on foreign direct investment. Therefore, in these cases a significant part of the income deficit was “automatically” covered by a surplus in services trade. Sizeable deficits in the oil balance in 2011 were recorded in Greece, Cyprus, Luxembourg, Malta, Slovenia and Slovakia, ranging between 5% and 9½% of GDP. Current transfers, comprising both private transfers (such as migrants’ remittances) and public transfers (such as general government transfers with European institutions), played a relatively minor role.

Chart C Current account balance of euro area countries

(2011; as a percentage of GDP)



Source: ECB.