

3 The Financial Account and International Investment Position in 2009

3.1 Overview

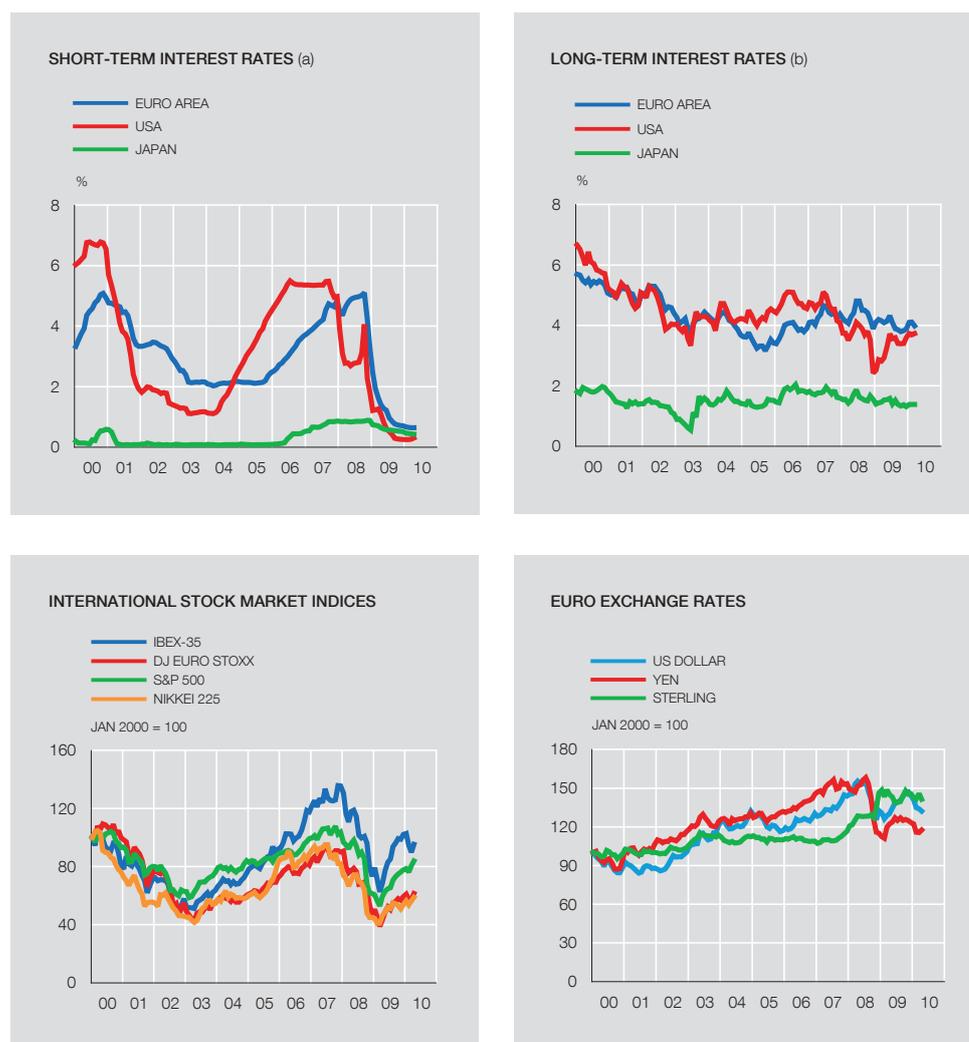
The Spanish economy's net borrowing fell considerably in 2009, to 5.1% of GDP (€53,086 million), 4.1 pp down on 2008, owing to the sharp drop in investment and the increase in private sector saving. As a result, the Spanish economy had to raise far fewer funds abroad than in the previous year.

The international financial markets normalised as the year progressed, assisted by the robustness and speed of the global economic policy response,¹ permitting reopening of the wholesale funding markets (with the exception of the securitisation markets). Inter-bank rates and long-term government debt yields were all low (see Chart 3.1). In this setting, the cost of funding for Spanish firms via fixed-income issues declined and corporate bond spreads narrowed. Spanish government debt yields also fell (especially at the short end of the yield curve) and the spread between Spanish and German 10-year bonds narrowed. In keeping with the widespread improvement on the markets, stock prices in Spain, the United States and the euro area recovered as the year progressed. For its part, the euro maintained its strength against sterling, but it depreciated against the US dollar in 2009 on average, despite recovering in the second half of the year. In the opening months of 2010, the financial markets bore the brunt of the heightening public finance crisis in Greece, prompting high volatility on the European stock markets, significant depreciation of the euro against the dollar and high volatility also on the bond markets, as several European countries' long-term government debt yield spreads over German bonds widened.

There was a considerable increase in net fixed-income issues by Spanish residents in 2009 (47%), particularly in general government issues and, to a much lesser extent, in issues by monetary financial institutions (MFIs) and non-financial corporations. Conversely, net issues by securitisation special-purpose entities (SPEs) declined significantly.² Net issues of equity securities also continued to head down in 2009, though at a considerably slower pace than in 2008; in fact, issuance picked up in the second half of the year.³

Against this backdrop, financial transactions between Spain and the rest of the world, excluding the Banco de España, generated net inflows of €47,149 million in 2009 (4.5% of GDP, 2.1 pp down on 2008). As these inflows were insufficient to meet the nation's net borrowing requirements, the Banco de España's net assets vis-à-vis the rest of the world fell by €10,464 million (see Table 3.1 and Chart 3.2). Despite growing market normalisation, in 2009 both net capital inflows and outflows continued to decline considerably, albeit at a more moderate pace than in 2008. Thus, non-residents' investment in financial assets in Spain fell by 41% in the year to €70,705 million, while Spanish investment abroad fell by 51% to €19,237 million. In keeping with the higher public sector borrowing requirement, government debt purchases by non-residents and, to a lesser extent, bonds issued by non-financial corporations and covered bonds accounted for most funds raised abroad (see Box 3.1). By contrast, non-residents continued to pare down their holdings of asset-backed securities and securities issued by non-monetary subsidiaries of MFIs.

1. In the case of monetary policy, the response consisted of non-conventional measures. For more information, see Chapters 1 and 4 of the Banco de España's *Annual Report, 2009*. 2. Since the onset of the crisis, issuance of these instruments had continued, but with the peculiarity that the originating institutions were acquiring the asset-backed securities, since they were used, as in other countries, as collateral in the ECB's liquidity auctions. 3. For a more detailed description of issuance by Spanish residents, see Chapter 6 of the Banco de España's *Annual Report, 2009*.



SOURCES: ECB and Banco de España.

- a. Three-month interbank rates.
b. Ten-year government bond yields.

The Spanish economy's net liabilities vis-à-vis the rest of the world, measured via the International Investment Position (IIP), continued to grow in 2009, rising by 12% to €983 billion, representing 93.6% of GDP (12.6 pp higher than in 2008) (see Chart 3.3 and Table 3.2). This increase was due to the net borrowing from abroad mentioned in the previous paragraph, and to the effect of changes in the prices of financial instruments (the "valuation effect") which also played a significant part.⁴ The valuation effect mainly reflected the positive impact of the stock market recovery on Spain's net debit position in equities, an impact that was greater on the liabilities than on the assets side, while the impact of exchange rate fluctuations was marginal (see Table 3.3).

4. In accordance with international statistical standards, the IIP values financial assets and external liabilities at the market prices and exchange rates prevailing at the end of the reference period. Therefore, any changes in the prices, expressed in national currency, of the assets that make up the IIP have a direct impact on the external credit or debit balance. It follows that the change in the IIP between two points in time is determined not only by the financial transactions between the residents of an economy and the rest of the world, which reflect the nation's net borrowing or lending in that period, but also by the changes in value of the financial instruments that make up the stock of financial assets and liabilities (the *valuation effect*). In addition to these two factors, there is a third, *other adjustments*, which occasionally affects the IIP.

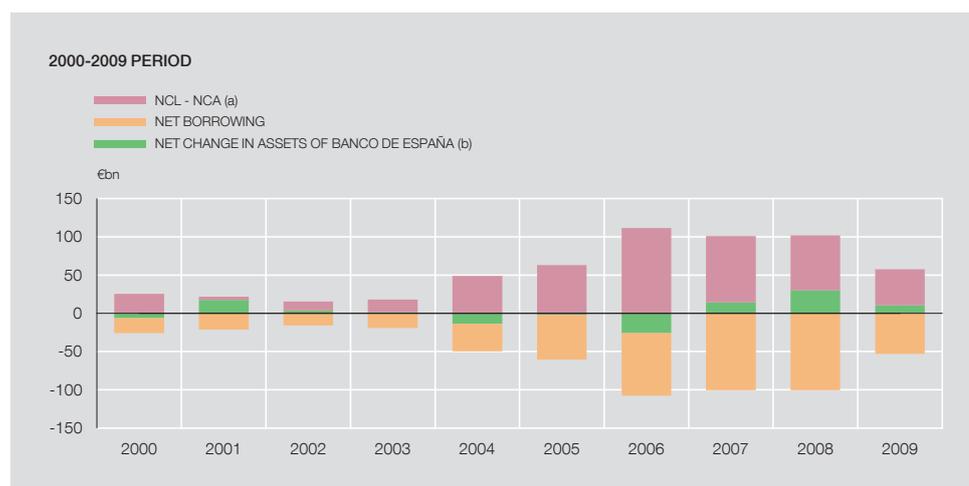
% of GDP	2003	2004	2005	2006	2007	2008	2009
CURRENT ACCOUNT PLUS CAPITAL ACCOUNT BALANCE	-2.5	-4.2	-6.5	-8.3	-9.6	-9.2	-5.1
FINANCIAL ACCOUNT BALANCE (a)	2.1	5.8	6.9	11.3	8.2	6.6	4.5
CHANGE IN EXTERNAL LIABILITIES (b)	16.2	18.2	24.6	25.9	22.6	11.0	6.7
<i>Foreign direct investment</i>	2.9	2.4	2.2	2.5	4.5	4.6	1.0
— Monetary financial institutions	-0.1	-0.1	0.0	0.0	0.1	0.1	0.1
— Other resident sectors	3.0	2.5	2.2	2.5	4.4	4.5	0.9
<i>Portfolio investment</i>	5.0	13.4	15.2	19.9	9.1	-2.0	4.7
— General government	-1.0	2.7	0.3	1.4	-1.6	1.6	5.4
— Monetary financial institutions	3.4	5.9	6.2	8.3	3.6	-1.3	1.5
— Other resident sectors	2.5	4.8	8.8	10.2	7.0	-2.3	-2.2
<i>Other investment</i>	8.3	2.4	7.1	3.5	9.1	8.4	1.0
— General government	-0.1	0.6	0.0	0.1	0.0	0.3	0.2
— Monetary financial institutions	7.1	1.8	5.6	0.4	7.2	6.9	0.8
— Other resident sectors	1.3	0.0	1.5	3.0	1.9	1.2	0.0
CHANGE IN EXTERNAL ASSETS (c)	14.1	12.4	17.6	14.6	14.4	4.4	2.2
<i>Foreign direct investment</i>	3.2	5.8	3.7	8.4	9.5	4.7	1.1
— Monetary financial institutions	-0.9	1.6	0.1	0.6	2.9	0.6	0.5
— Other resident sectors	4.1	4.2	3.6	7.8	6.6	4.1	0.6
<i>Portfolio investment</i>	8.4	3.2	8.8	-0.4	-0.8	-2.0	0.5
— General government	0.0	0.1	0.5	1.1	0.6	0.2	-1.2
— Monetary financial institutions	4.2	0.6	4.5	-3.1	0.3	0.7	0.9
— Other resident sectors	4.2	2.5	3.7	1.6	-1.7	-2.9	0.8
<i>Other investment</i>	2.0	3.4	5.2	6.7	5.3	1.2	0.1
— General government	0.0	0.2	0.1	0.0	0.1	0.1	0.1
— Monetary financial institutions	1.1	2.0	4.4	6.0	4.8	0.7	0.1
— Other resident sectors	0.9	1.2	0.8	0.7	0.4	0.4	-0.1
<i>Financial derivatives</i> (d)	0.4	0.0	0.0	-0.2	0.4	0.6	0.5
NET CHANGE IN EXTERNAL ASSETS OF BANCO DE ESPAÑA (e)	0.2	-1.7	-0.2	-2.6	1.4	2.8	1.0
Of which:							
<i>Reserve assets</i>	1.7	0.6	0.2	0.0	0.0	-0.1	-0.1
<i>Net assets vis-à-vis the Eurosystem</i>	0.6	-1.6	1.6	-1.3	2.7	2.9	0.6
<i>Other net assets</i>	-2.1	-0.6	-2.0	-1.3	-1.3	-0.1	0.6
MEMORANDUM ITEMS:							
FINANCIAL ACCOUNT BALANCE INCLUDING BANCO DE ESPAÑA	2.3	4.1	6.7	8.7	9.6	9.4	5.5
Errors and omissions (f)	0.2	0.1	-0.2	-0.4	0.0	-0.1	-0.4

SOURCE: Banco de España.

- a. Excluding the Banco de España.
b. A positive sign denotes an increase in liabilities, i.e. a capital inflow.
c. A positive sign denotes an increase in assets, i.e. a capital outflow.
d. Recorded net of netted out amounts and allocated, by convention, to the net change in assets.
e. A positive (negative) sign denotes a decrease (increase) in the external assets of the Banco de España.
f. A positive (negative) sign denotes a receipt (payment) not recorded in any other Balance of Payments caption.

The international comparison shows that, in general, international capital movements also reflected the gradual improvement in financial markets, as portfolio investment flows recovered (or declined more moderately, as appropriate) (see Chart 3.4).⁵ In 2008, these capital transac-

5. The external assets of the euro area and US monetary authorities were conditioned, in 2009, by the non-conventional measures approved by the ECB and the Federal Reserve and which were wound down in February 2010 (there were also similar agreements with monetary authorities in other countries, especially the United Kingdom, Switzerland and Japan). Among these measures was a temporary reciprocal currency arrangement (swap line) established, in April 2009, between the ECB and the Federal Reserve, to supply the latter with sufficient funds to provide euro liquidity to US financial institutions, initially in an amount up to €80 billion. This swap line was also extended on numerous occasions.



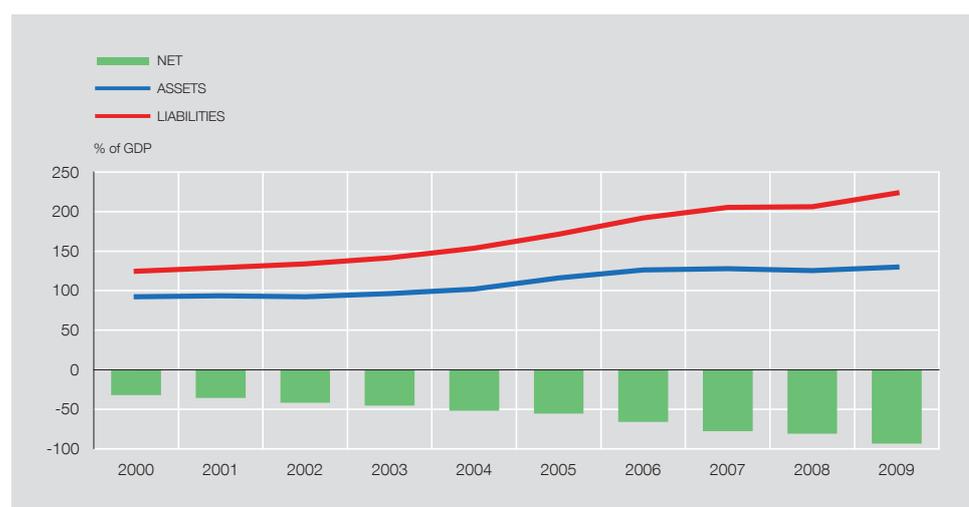
SOURCE: Banco de España.

a. Excluding the Banco de España.

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

INTERNATIONAL INVESTMENT POSITION

CHART 3.3



SOURCE: Banco de España.

INTERNATIONAL INVESTMENT POSITION. RECENT DEVELOPMENTS

TABLE 3.2

	VALUE OF STOCK (€bn)		PERCENTAGE OF GDP (%)	
	NET IIP	NET IIP EXCLUDING MONETARY AUTHORITY	NET IIP	NET IIP EXCLUDING MONETARY AUTHORITY
2007	-817	-896	-77.6	-85.1
2008	-881	-932	-81.0	-85.6
2009	-983	-1,028	-93.6	-97.8

SOURCE: Banco de España.

The Spanish economy's net borrowing fell significantly in 2009 (by 4.4 pp to 4.7% of GDP on the rest of the world account data), quickening the decline that began in 2008. This correction conceals a very different performance at different institutional sectors. Thus, while the private sector, as a result of the sharp contraction in spending, recorded a net lending position of 6.5% of GDP in 2009 (in comparison with net borrowing of 5% of GDP only a year earlier), general government net borrowing rose to 11.2% of GDP, an increase of 7.1 pp on the previous year (see Panel 1).

The impact of the crisis on public sector receipts and expenditure, and the effect of the discretionary measures adopted to mitigate the severe adjustment in demand, prompted a rapid deterioration of public finances in 2009. This contrasts with the lower financing needs in the private sector, among firms (-0.6% of GDP in 2009, in comparison with -5.6% in 2008) and, in particular, among households (7.1% of GDP in 2009, in comparison with 0.6% in 2008). Since the onset of the crisis, private saving has risen (to historically high rates in the case of households) and investment has declined; together, these factors explain the sharp correction in the Spanish economy's net borrowing in 2009. The shift in financing needs from the private to the public sector conditioned

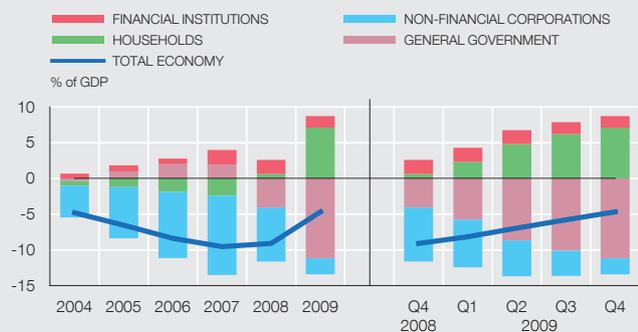
the way in which the Spanish economy raised funds abroad in the year, creating a pattern that was very different from that seen in 2008. Thus, there was a substantial increase (148% in annual terms) in general government's net issues of fixed-income instruments in 2009, in contrast to the decline (-17%) in private sector issues.¹

According to the Balance of Payments Financial Account data, the Spanish economy registered net capital inflows in 2009 of €57,614 million (43% down from the previous year). Unlike 2008, when most funds from abroad were raised by the private sector, in 2009 general government raised most of the Spanish economy's net borrowing, while the private sector recorded net lending with the rest of the world (see Panel 2).²

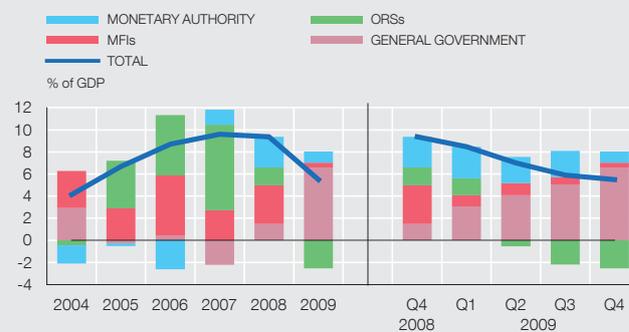
1. At end-2009, the outstanding balance of securities other than shares (except financial derivatives) of general government as a whole totalled €517,650 million (83% long-term and 17% short-term), against €390,102 million at end-2008 (86% and 14%, respectively). 2. In the analysis of the financial account, the private sector covers monetary financial institutions (MFIs) and other resident sectors (ORSs), which also include non-financial public corporations, not included in the general government sector.

RECENT DEVELOPMENTS IN THE FINANCING OF THE SPANISH ECONOMY (a)

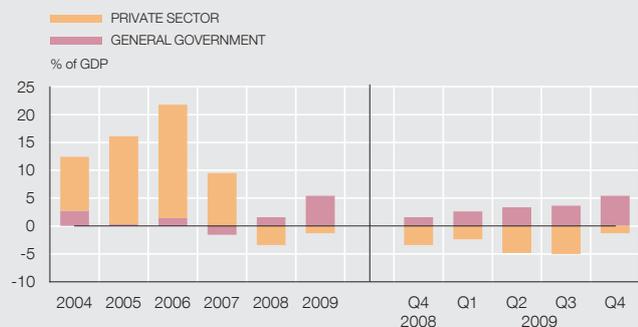
1 SPANISH ECONOMY NET LENDING (+)/ BORROWING (-)



2 FINANCIAL TRANSACTIONS WITH THE REST OF THE WORLD (NCL - NCA)



3 FIXED-INCOME PORTFOLIO INVESTMENT (NCL)



4 FIXED-INCOME PORTFOLIO INVESTMENT. GENERAL GOVERNMENT (NCL)



SOURCES: INE and Banco de España.

a. Quarterly data refer to the sum of four quarters.

PRIVATE DEBT (cont'd)

The main channel used by general government to raise funds from abroad was public debt placement among non-residents. Public debt securities were in strong supply on the international markets, as a result of the widespread deterioration of public finances in the main developed economies. But foreign investors preferred them to private debt securities in 2009, in light of their higher liquidity and lower credit risk, both characteristics that are highly valued at times of uncertainty.³ Thus, in 2009, non-residents raised their holdings of Spanish government debt as the year progressed, to the detriment of private debt securities (see Panel 3). Specifically, non-residents made net purchases of fixed-income securities issued by the Spanish general government

3. Despite the increased supply of public debt on the international markets, the marginal rate at the Spanish Treasury's bond auctions, especially at the short end of the yield curve, declined almost continuously throughout the year.

sector⁴ totalling €56,774 million (45% long-term and 55% short-term).⁵ At the same time, they made significant divestments (€13,924 million) of private debt securities.⁶ Despite the extensive purchases by non-residents, their share of total general government debt slipped, to approximately 44%. In 2010, Spanish government debt became less attractive, in light of the heightening of the Greek crisis and the contagion effect on other countries, such as Spain, with high budget deficits.

4. Part of this total corresponds to issues made by the FROB. 5. If net sales of foreign public debt by the Social Security Reserve Fund are considered, the net funds raised by general government via long-term portfolio investment securities exceeded those raised via short-term instruments in 2009. 6. That said, note should be taken of non-residents' renewed interest in covered bonds, following the launch of the ECB's buyback programme, and in issues made with State guarantee. In both cases, non-residents made net purchases.

tions had borne the brunt of the high prevailing uncertainty, steering investors towards safer and more liquid assets, and national assets. Unlike portfolio investment, direct investment flows showed no sign of recovery in 2009, severely affected by the global crisis. As international capital flows rebounded, the gap between economies with net debit and net credit positions widened; thus, existing net debit balances rose in 2009, as did existing net credit balances. The net debit IIP of the euro area narrowed slightly.

3.2 Breakdown by investment instrument

In 2009, the Spanish economy's net capital inflows consisted mainly of portfolio investment, and to a much lesser extent of other investment (fundamentally, loans, deposits and repos), in contrast to the previous year when other investment accounted for most external financing (see Chart 3.5).⁶ By contrast, transactions in all other instruments generated net outflows of funds. Portfolio investment inflows centred on fixed income, especially government debt, while equity transactions generated net outflows. Funds obtained in the form of other investment were long-term instruments, countering the net outflows in short-term instruments. Thus the Spanish economy once again had greater recourse to long-term debt instruments, i.e. portfolio and other investment, to meet its net borrowing (see Chart 3.6).

In keeping with developments in financial transactions with the rest of the world, the net debit IIP widened, essentially reflecting the higher debit balance on portfolio investment and, to a lesser extent, on other investment (see Table 3.4). These two headings more than offset the decline in the debit balances on direct investment and financial derivatives. In this setting, portfolio investment grew as a share both of total external assets and liabilities, to the detriment of the other investment heading (see Table 3.5).

Despite the increase in the net debit IIP in recent years, a correct assessment of the risks and vulnerabilities this growth entails requires deeper analysis of the nature of the

6. Unless expressly indicated, Banco de España operations and positions are excluded.

RECONCILIATION OF CHANGE IN STOCK WITH BALANCE OF PAYMENTS TRANSACTIONS

TABLE 3.3

	€bn													
	NET (a)				ASSETS					LIABILITIES				
	VALUE OF STOCK	CHANGE IN STOCK	TRANSACTION	VALUATION EFFECT AND OTHER ADJUSTMENTS	VALUE OF STOCK	CHANGE IN STOCK	TRANSACTION	VALUATION EFFECT AND OTHER ADJUSTMENTS		VALUE OF STOCK	CHANGE IN STOCK	TRANSACTION	VALUATION EFFECT AND OTHER ADJUSTMENTS	
								LEVELS	% (b)				LEVELS	% (b)
2007	-816.8	-168.6	-101.0	-67.6	1,345.7	105.1	147.4	-42.3	-3.4	2,162.5	273.7	248.4	25.3	1.3
2008	-881.3	-64.5	-102.0	37.5	1,364.3	18.6	49.8	-31.2	-2.3	2,245.6	83.1	151.8	-68.7	-3.2
2009	-983.4	-102.0	-57.6	-44.4	1,366.7	2.4	19.2	-16.9	-1.2	2,350.1	104.4	76.9	27.6	1.2

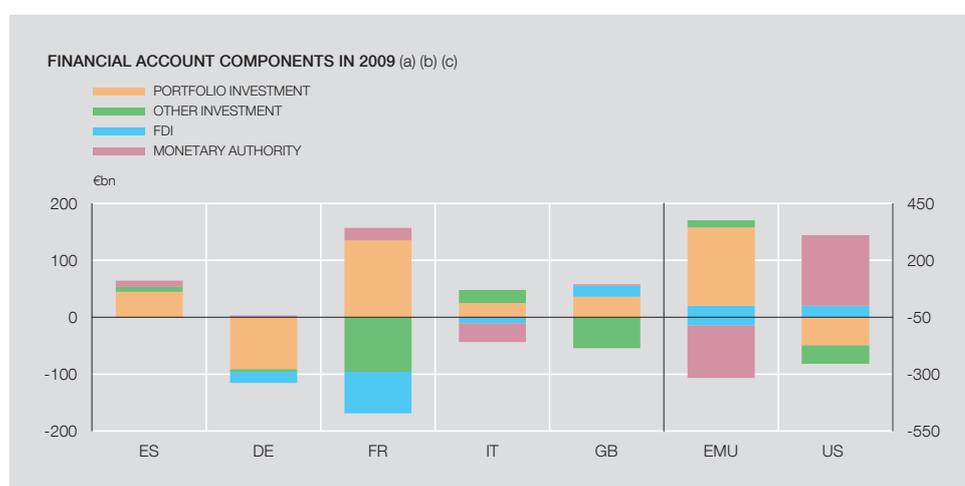
SOURCE: Banco de España.

a. A (-) sign denotes a larger change in liabilities than in assets.

b. Difference between the change in stock and the balance of payments transactions, in terms of the stock at the start of the period.

INTERNATIONAL COMPARISON OF FINANCIAL ACCOUNT

CHART 3.4



SOURCES: International Financial Statistics and national sources.

a. ISO country codes (ES: Spain; DE: Germany; FR: France; IT: Italy; GB: United Kingdom; EMU: euro area; US: United States).

b. Other investment excludes the monetary authority, save in Germany and the United Kingdom. The monetary authority series includes other investment transactions and reserves (save in Germany and the UK where it includes only reserves).

c. The right-hand scale corresponds to the euro area and the United States.

instruments that make up the external assets and liabilities. It should be noted that a significant portion of external liabilities, such as shares and other equity, is not claimable per se, signifying that the Spanish economy's claimable liabilities are lower than may appear from the debit balance. Specifically, at end-2009, around 75% of total liabilities were claimable, while around 70% consisted primarily of long-term instruments that do not require immediate refinancing. In turn, the debit balance in the form of claimable instruments represented some 87% of GDP, and long-term instruments some 60% of GDP.

FOREIGN DIRECT INVESTMENT

In 2009 the Spanish economy recorded net outflows of foreign direct investment (FDI) totalling €939 million, representing 0.1% of GDP and a decrease of 12% in comparison with 2008.



SOURCE: Banco de España.

a. Excluding the Banco de España.

b. Financial derivatives are recorded net of netted out amounts and allocated, by convention, to the net change in assets.

INTERNATIONAL INVESTMENT POSITION. SUMMARY

TABLE 3.4

€bn	2007	2008	2009			
			Q1	Q2	Q3	Q4
NET INTERNATIONAL INVESTMENT POSITION (A - L)	-817	-881	-880	-927	-972	-983
Excluding the Banco de España	-896	-932	-932	-973	-1,009	-1,028
Foreign direct investment	2	-19	-9	-20	-25	-17
Portfolio investment	-647	-603	-588	-605	-653	-684
Other investment (a)	-232	-303	-336	-340	-326	-326
Financial derivatives	-19	-6	0	-7	-5	-1
Banco de España	79	51	52	45	37	44

SOURCE: Banco de España.

a. Includes primarily loans, deposits and repos.



SOURCE: Banco de España.

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

INTERNATIONAL INVESTMENT POSITION Breakdown by instrument (a)

TABLE 3.5

	FOREIGN DIRECT INVESTMENT		PORTFOLIO INVESTMENT		OTHER INVESTMENT		FINANCIAL DERIVATIVES	
	ASSETS	LIABILITIES	ASSETS	LIABILITIES	ASSETS	LIABILITIES	ASSETS	LIABILITIES
% OF TOTAL								
Average 2004-2006	26.7	20.2	42.6	46.7	27.3	30.4	3.3	2.6
2007	31.6	18.4	34.8	50.3	30.0	28.3	3.5	2.9
2008	33.5	20.3	27.8	43.4	30.2	31.2	8.4	5.2
2009	35.0	20.2	30.1	46.3	28.9	30.1	6.0	3.4
VALUE OF STOCK (€bn)								
Average 2004-2006	266	325	423	752	272	489	33	43
2007	399	397	440	1,087	379	611	45	63
2008	428	448	356	959	387	690	108	114
2009	448	465	385	1,069	370	696	77	78

SOURCE: Banco de España.

a. Excluding the Banco de España.

Nevertheless, there was a marked decline in both Spanish direct investment abroad and foreign direct investment in Spain (see Chart 3.7).⁷

This pattern is similar to that seen around the world. Global FDI flows fell notably in 2009 (by 39%, on preliminary UNCTAD estimates), with a similar decline in FDI flows to developed and

7. Note that Spanish balance of payments FDI data include transactions by foreign-equity holding companies (ETVEs by their Spanish name), which generally give rise to neither capital inflows nor outflows, but chiefly represent accounting entries. These companies have frequently been set up in recent years by non-resident multinational groups to centralise their FDI holdings in third countries. The heading includes other holding companies which, although not strictly ETVEs, have been set up in Spain for the main purpose of channelling direct investment. Excluding the ETVEs' transactions, FDI remains virtually unchanged in 2009.

FOREIGN DIRECT INVESTMENT (a)
Financial transactions with the rest of the world and International Investment Position

CHART 3.7



SOURCE: Banco de España.

a. Excluding the Banco de España.

emerging economies (-41% and -35%, respectively). Investment in the OECD countries fell by almost 70% in 2008 and 2009, and by around 55% in the rest of the world.⁸ Lower profits at multinational corporations, financing constraints and the uncertainty regarding the severity and duration of the global crisis meant that investment plans that had already been approved were delayed and reviewed. As a result, there were far fewer cross-border mergers and acquisitions, though the decline was less marked in greenfield investment projects.

In keeping with developments in direct investment transactions, Spain's net debit position in FDI narrowed slightly in 2009, by 0.2 pp of GDP to 1.6%.⁹

⁸. See: "Invest in Spain: Tendencias actuales en los flujos globales de IED y el impacto de la crisis", *Boletín Económico del ICE*, No. 2986 (2010); and OECD, "Global Investment Activity Stagnates into 2010", *OECD Investment News*, March 2010, No. 12. ⁹. The investment register of the Ministry of Industry, Tourism and Trade was first used to calculate the "Shares and other equity" heading of direct investment by other resident sectors in the IIP in September 2008, giving rise to an extraordinary review of the time series. For a more detailed description of the changes in the calculation procedure entailed by the use of this data source, see Banco de España (2009), *The Spanish Balance of Payments and International Investment Position, 2008*, Box 5.1.

€m	SPANISH DIRECT INVESTMENT ABROAD		FOREIGN DIRECT INVESTMENT IN SPAIN	
	2008	2009	2008	2009
	TOTAL	51,102	11,758	50,036	10,820
Agriculture, hunting, forestry and fishing	51	5	11	30
Mining and quarrying	2,286	917	-873	724
Manufacturing	14,359	-261	27,095	4,548
Electricity, gas and water supply	6,806	-174	11,366	7,770
Construction	-696	-1,674	449	-903
Wholesale and retail trade and repairs	4,202	2,415	-1,425	-7,334
Hotels and restaurants	1,240	178	1,239	221
Transport, storage and communication	-1,549	-1,155	-1,232	-608
Financial intermediation	15,295	6,877	-845	-461
Real estate activities and business services	4,982	2,206	5,426	428
<i>Of which: ETVEs (a)</i>	<i>-157</i>	<i>-66</i>	<i>347</i>	<i>56</i>
<i>Other services (b)</i>	<i>968</i>	<i>606</i>	<i>1,031</i>	<i>272</i>
Unclassified	3,159	1,816	7,795	6,133
<i>Real estate</i>	<i>1,726</i>	<i>956</i>	<i>5,392</i>	<i>3,659</i>
<i>Other</i>	<i>1,433</i>	<i>861</i>	<i>2,404</i>	<i>2,474</i>

SOURCE: Banco de España.

a. Estimate based on CNAE classification. Includes transactions of ETVEs and other holding companies that are not strictly ETVEs but which, like them, have been established in Spain for the main purpose of channelling direct investment flows.

b. "Other services" include "General government, defence and compulsory Social Security", "Education", "Health and veterinary activities and social services", "Other community service and social activities and personal services", "Private households employing domestic staff" and "Extra-territorial organisations".

Spanish direct investment abroad amounted to €11,758 million in 2009, a decrease of 77% in comparison with 2008. This represented 1.1% of GDP (3.6 pp down on 2008 and clearly below the average for the period 2000-2009). This, together with the positive revaluation impact, meant that Spain's stock of outward FDI amounted to 42.7% of GDP in 2009, almost 3.4 pp more than at end-2008. By instrument, other capital holdings and inter-company debt transactions stood out, together representing 72% of the total.

Most of Spain's direct investment abroad – specifically 58%, a sharp increase in comparison with 2008 – centred on "Financial intermediation" (see Table 3.6). By contrast "Manufacturing", which had in recent years accounted for much of Spanish direct investment abroad, recorded moderate net divestment. Similarly, the construction sector continued to record net divestment abroad, in keeping with the decline in profits at construction companies and the sector-wide adjustment.

Regarding the geographical breakdown of Spanish FDI outflows (excluding ETVEs), the decline in investment in the euro area (to 2% of the total) is particularly noteworthy, as it goes against the usual trend (see Table 3.7). By contrast, the new EU Member States' share of FDI rose, as did that of the United Kingdom, the United States and Latin America (in each of these, by some 20%). These developments signified very little change in the geographical breakdown of the stock of FDI external assets; thus, the euro area and Latin America continued to be the leading recipients of Spanish FDI, while the United Kingdom and the United States maintained a significant share (see Table 3.8).

FOREIGN DIRECT INVESTMENT TRANSACTIONS IN 2008 AND 2009 (a)
Breakdown by geographical area

TABLE 3.7

€m	SPANISH DIRECT INVESTMENT ABROAD				FOREIGN DIRECT INVESTMENT IN SPAIN			
	2008		2009		2008		2009	
	TOTAL	ETVEs (d)	TOTAL	ETVEs (d)	TOTAL	ETVEs (d)	TOTAL	ETVEs (d)
WORLD TOTAL	51,102	-157	11,758	-66	50,036	347	10,820	56
EUROPEAN UNION 27 (b)	20,137	-422	4,121	614	45,449	241	5,561	1,739
Euro area	9,341	-573	811	574	26,697	433	8,818	1,275
Germany	1,702	.	792	.	13,193	.	1,027	97
France	-252	.	-1,278	.	4,299	.	-2,883	.
Netherlands	1,232	-128	-187	.	15,792	63	6,857	406
Italy	1,351	51	.	.	653	.	7,077	.
Luxembourg	-119	-320	112	534	-9,735	-216	-54	763
Portugal	2,049	.	873	.	1,133	.	-782	.
United Kingdom	6,395	122	2,665	.	18,069	-245	-1,345	501
New EU members (c)	4,000	.	737	.	152	.	158	.
Switzerland	3,686	-273	1,096	-99	185	-306	1,711	.
United States	8,945	80	1,234	-1,347	-903	-513	-1,676	-1,419
LATIN AMERICA	13,578	293	3,169	718	2,195	.	771	.
Argentina	2,758	123	200	90	.	.	101	.
Brazil	2,850	88	1,240	.	.	.	.	.
Chile	1,048	.	-471	.	50	.	.	.
Mexico	4,018	63	3,853	62	176	.	461	.
Morocco	718	.	69	.	.	.	.	.
Japan	130	.	.	.	.	.	.	.
Australia	85	.	-268	.	112	.	.	.
MEMORANDUM ITEM: OECD	37,805	-513	10,705	-760	44,743	-560	6,381	.

SOURCE: Banco de España.

a. "." Amount below €50 million in absolute terms.

b. European Union: International institutions of the European Union, ECB, France, Belgium, Netherlands, Germany, Italy, United Kingdom, Ireland, Denmark, Greece, Portugal, Luxembourg, Austria, Finland, Sweden, Cyprus, Czech Republic, Estonia, Hungary, Lithuania, Latvia, Malta, Poland, Slovenia, Slovakia, Romania and Bulgaria and their dependencies.

c. New member countries: Czech Republic, Estonia, Hungary, Lithuania, Latvia, Poland, Bulgaria and Romania.

d. Estimate based on CNAE classification. It includes the transactions of ETVEs and other holding companies which are not strictly ETVEs but which, like them, have been established in Spain for the main purpose of channelling direct investment flows.

Foreign direct investment in Spain fell by 78%¹⁰ in 2009 to €10,820 million (1% of GDP, 3.6 pp down on 2008 and in this case also below the average for the period 2000-2009). This, together with the revaluation effect, explains the increase (3.2 pp of GDP to 44.3%) in the value of FDI liabilities in the Spanish IIP in 2009.

The breakdown by instrument shows that inter-company debt transactions accounted for most of the FDI received by the Spanish economy (some 52% of the total), followed by real estate (34%), though in this latter case with interruption of the moderate growth seen in both 2007 and 2008. There were big differences in FDI in Spain by branch of activity, with high investment and divestment. Thus, in-bound investment was particularly high, as has become usual in recent years, in "Manufacturing" and "Electricity, gas and water supply", as was divestment in "Wholesale and retail trade and repairs".

¹⁰. This comparison is affected by the high volume of FDI made in Spain in 2008; specifically, by the purchase, by a German electric utility, of a subsidiary of a Spanish electric utility with interests throughout Europe, and by the takeover bid launched by a British tobacco company on a Spanish tobacco company.

	SPANISH FOREIGN DIRECT INVESTMENT				FOREIGN DIRECT INVESTMENT IN SPAIN			
	2008		2009		2008		2009	
	€bn	% OF TOTAL	€bn	% OF TOTAL	€bn	% OF TOTAL	€bn	% OF TOTAL
WORLD TOTAL	428	100.0	448	100.0	448	100.0	465	100.0
EU27 (b)	244	56.8	251	55.9	365	81.6	378	81.2
Euro area	161	37.6	162	36.1	297	66.4	313	67.2
<i>Germany</i>	14	3.2	15	3.2	34	7.6	35	7.6
<i>France</i>	22	5.1	21	4.6	48	10.6	46	9.8
<i>Netherlands</i>	43	10.0	42	9.4	94	20.9	100	21.5
<i>Luxembourg</i>	30	7.1	30	6.7	47	10.4	46	10.0
<i>Portugal</i>	25	5.7	25	5.7	11	2.5	10	2.2
United Kingdom	51	11.9	57	12.7	61	13.6	59	12.7
New EU members (c)	28	6.6	29	6.4	1	0.2	1	0.2
Switzerland	13	3.0	14	3.1	11	2.4	13	2.7
United States	37	8.6	35	7.9	45	10.0	43	9.2
LATIN AMERICA	116	27.1	126	28.0	10	2.3	11	2.3
<i>Argentina</i>	30	6.9	27	6.0	0	0.1	1	0.1
<i>Brazil</i>	40	9.2	49	10.8	3	0.6	3	0.6
<i>Chile</i>	9	2.1	10	2.2	.	.	.	.
<i>Mexico</i>	23	5.3	26	5.8	2	0.4	2	0.5
Morocco	3	0.7	3	0.7	.	.	.	.
Japan	1	0.2	1	0.1	2	0.5	2	0.4
Australia	2	0.5	2	0.5	.	.	.	.
MEMORANDUM ITEM: OECD	321	74.9	332	74.1	430	96.0	443	95.2

SOURCE: Banco de España.

a. "." Amount below €0.3 billion.

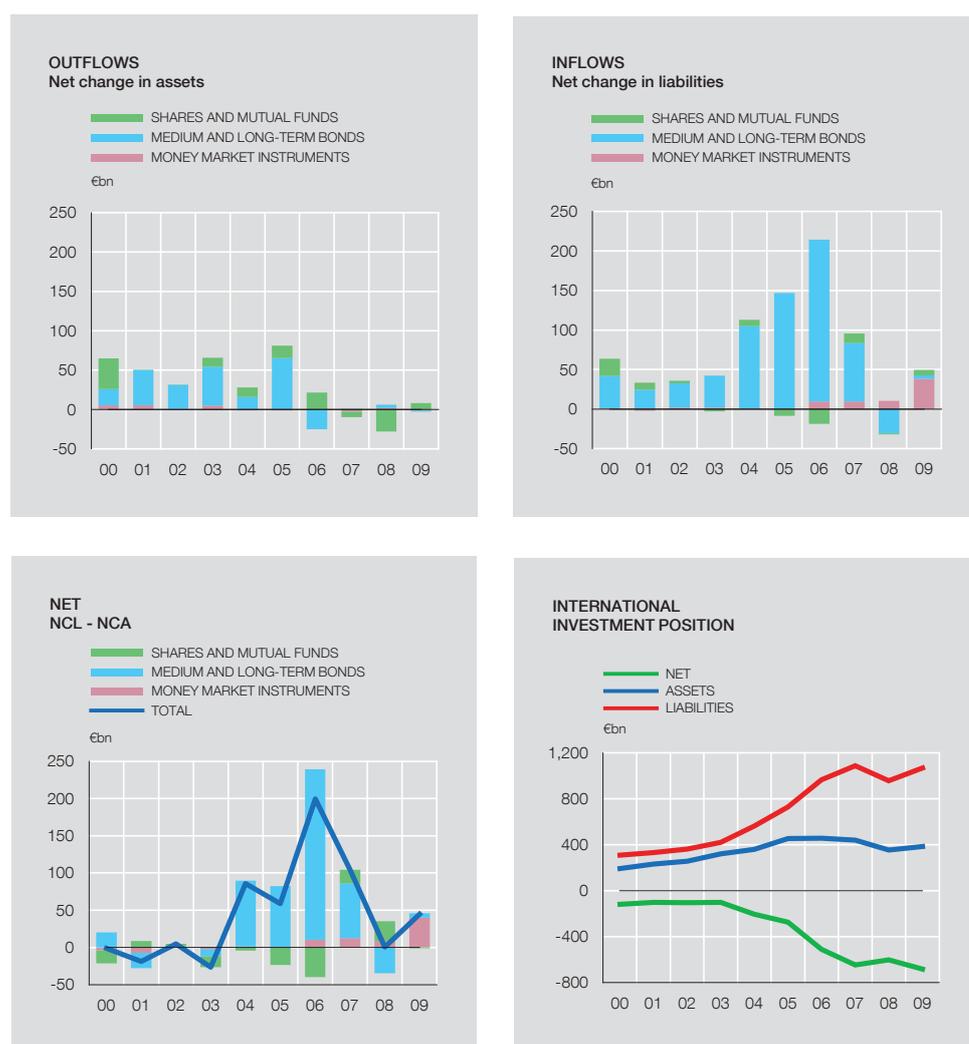
b. EU27: International institutions of the European Union, ECB, France, Belgium, Netherlands, Germany, Italy, United Kingdom, Ireland, Denmark, Greece, Portugal, Luxembourg, Austria, Finland, Sweden, Cyprus, Czech Republic, Estonia, Hungary, Lithuania, Latvia, Malta, Poland, Slovenia, Slovakia, Bulgaria and Romania and their dependencies.

c. New EU members: Bulgaria, Czech Republic, Estonia, Hungary, Lithuania, Latvia, Poland and Romania.

The euro area was the leading source of direct investment in Spain (excluding ETVEs) in 2009, accounting for 70% of the total and with a notable contribution from the Netherlands. Conversely, UK residents made significant divestments, in contrast to the high investments recorded in 2008. Beyond the EU, the leading source of direct investment was Switzerland with 16% of the total. As is customary, most of the stock of direct investment by non-residents in Spain comes from the euro area, while the United Kingdom and the United States represent a more modest, but not insignificant, share.

PORTFOLIO INVESTMENT

In 2009, portfolio investment was once again the leading channel for funds raised from abroad, with net inflows of €44,507 million, in comparison with just €378 million in 2008 (see Chart 3.8). This investment was primarily focused on the general government sector, in keeping with the increase in its financing needs, followed at a considerable distance by MFIs. The improvement on the financial markets, the granting of State guarantees for issues by credit institutions and the ECB's covered bond buyback programme all drove up MFIs' fixed-income issues. Conversely, the portfolio investment transactions of the ORSs generated net outflows, as non-residents continued to reduce their holdings in



SOURCE: Banco de España.

a. Excluding the Banco de España.

securitisation SPEs and securities issued by the subsidiaries of Spanish MFIs. The net inflows generated by portfolio investment were essentially channelled through money market instruments (€40,103 million) and, to a much lesser extent, through medium and long-term bonds (€5,735 million). In contrast, equities generated net outflows of €1,331 million.

Financial transactions, along with the valuation effect primarily connected with the recovery in stock market prices in the year, were responsible for the increase (9.6 pp of GDP to 65.1%) in the net debit position in *portfolio investment* in 2009.¹¹ This growth was largely due to the higher debit balance on fixed income (which rose by 6.3 pp of GDP to 51.9%), and especially to net purchases of government debt by non-residents. The net debit position in equities also widened (by 3.3 pp to 13.2% of GDP), but this was due to valuation effects which drove up the value of liabilities more than that of assets.

¹¹ The value of the stock of liabilities rose by more than that of external assets.

IIP: FOREIGN PORTFOLIO INVESTMENT BY SPAIN
Breakdown by geographical area and by instrument. 2008 (a)

TABLE 3.9

€bn	EQUITY SECURITIES	DEBT SECURITIES	TOTAL	SHARE OF TOTAL (%)
France	12.0	45.0	56.9	15.7
Germany	4.9	34.6	39.5	10.9
Italy	2.2	43.9	46.1	12.8
United Kingdom	2.5	31.1	33.6	9.3
Netherlands	1.5	39.5	41.0	11.3
Luxembourg	19.6	5.0	24.6	6.8
United States	4.9	26.0	30.9	8.5
Cayman Islands	1.1	13.2	14.3	3.9
Ireland	3.6	14.9	18.5	5.1
Belgium	0.3	5.2	5.5	1.5
Portugal	1.5	7.3	8.8	2.4
Other	10.9	31.0	41.9	11.6
Total assets	64.9	296.7	361.6	100.0

SOURCES: Banco de España and IMF.

a. Excluding the Banco de España.

Spanish portfolio investment abroad generated net outflows of €4,946 million (0.5% of GDP) in 2009, in comparison with net inflows (i.e. divestments) of €21,928 million in 2008. Residents increased their foreign equity holdings (€7,934 million) and reduced their fixed-income holdings. The Social Security Reserve Fund made net sales of foreign public debt (€12,200 million), while the resident private sector made net purchases of €9,200 million. Renewed interest in investment abroad, especially in equities, is consistent with the recovery in investor confidence internationally. This led to greater geographical diversification of investor portfolios, correcting the trend observed since the onset of the crisis.

External assets in the form of portfolio investment securities rose by 4 pp of GDP to 36.7% in 2009, owing to the increase both in equity (2.3 pp of GDP to 8.1%) and fixed-income (1.7 pp of GDP to 28.5%) positions. The geographical breakdown of the stock of portfolio investment abroad saw no major changes in 2009, the most noteworthy feature being the high EU share (see Table 3.9).

Turning to *foreign portfolio investment in Spain*, in 2009 non-residents again increased their holdings in portfolio investment securities issued by residents; these holdings rose by €49,453 million (4.7% of GDP), after declining by €21,550 million in 2008. The preference expressed by investors for short-term securities in that year moderated as the financial markets normalised. Thus, in 2009, non-residents' raised their holdings of medium and long-term bonds by €4,416 million, in comparison with divestments of €30,664 million in 2008. As in the case of short-term securities, non-residents favoured government debt (€25,445 million) and, to a lesser extent, fixed-income securities issued by MFIs (€4,712 million, mostly in covered bonds), while they continued to reduce their holdings of long-term fixed-income securities issued by ORSs (which fell by €25,741 million). There was renewed interest in paper issued by large non-financial corporations (€13,262 million, against net purchases of €1,332 million in 2008), but this was insufficient to offset the sales of asset-backed bonds (€23,188 million) and of securities issued by subsidiaries of resident financial institutions (€15,971 million). Lastly, non-residents' holdings of Spanish equities increased again, as investor confidence was restored internationally.

€bn	EQUITY SECURITIES		DEBT SECURITIES		TOTAL		SHARE OF TOTAL (%)	
	FKC	EI	FKC	EI	FKC	EI	FKC	EI
	France	16.1	16.4	79.8	147.5	96.0	163.9	10.1	17.2
Germany	6.1	10.1	82.6	149.4	88.7	159.5	9.3	16.7
Luxembourg	15.2	10.5	163.5	48.6	178.8	59.1	18.7	6.2
United Kingdom	51.0	14.0	8.1	47.4	59.1	61.4	6.2	6.4
United States	50.9	45.5	27.4	21.5	78.2	67.0	8.2	7.0
Netherlands	5.3	4.5	22.6	41.5	27.9	46.0	2.9	4.8
Ireland	1.2	6.9	10.2	44.0	11.4	50.9	1.2	5.3
Japan	.	4.3	.	13.5	.	17.8	0.0	1.9
Belgium	9.7	2.1	224.4	27.5	234.0	29.6	24.5	3.1
Italy	1.9	2.5	5.2	20.9	7.1	23.5	0.7	2.5
Unassigned	-0.5	.	149.1	.	148.5	.	15.6	0.0
Other	15.6	21.5	9.1	56.5	24.7	78.0	2.6	8.2
TOTAL LIABILITIES	172.7	138.2	782.0	618.5	954.7	756.6	100.0	100.0

SOURCES: Banco de España and IMF.

a. "." Amount below €0.3 billion.

b. FKC: geographical assignment of liabilities under the first-known counterparty principle. EI: geographical assignment by end-investor, based on the stock of assets of creditor countries.

External portfolio investment liabilities rose at a considerably faster pace than assets, growing by 13.7 pp of GDP to 101.7%. This increase extended both to equity holdings, which rose by 5.7 pp of GDP to 21.3%, boosted, in addition, by the above-mentioned valuation effects, and to fixed-income holdings, which rose by 8 pp of GDP to 80.4%. The geographical breakdown of portfolio investment liabilities depicted in the IMF's latest Coordinated Portfolio Investment Survey (CPIS),¹² with data as at end-2008, reflects the predominance of investment from the euro area, with a significant share also for the United Kingdom and the United States (see Table 3.10).

OTHER INVESTMENT (LOANS, DEPOSITS AND REPOS)

Other investment transactions (essentially loans, deposits and repos) resulted in net inflows of €9,269 million in 2009 (see Chart 3.9), down significantly on 2008 (€78,903 million). By maturity, the net capital inflows centred on long-term instruments (€26,273 million), which offset the net outflows from short-term instruments (€17,004 million). This contrasts with the breakdown in 2008, when short-term financing predominated in light of the uncertainty on the international markets. In 2009, the gradual normalisation of the international financial markets, the granting of State guarantees and the lower demand for financing due to the fallback in activity tempered the pressure on financial institutions to secure funding via short-term instruments. In this setting, MFIs reduced their short-term external loans and deposits and their recourse to Eurosystem liquidity auctions. As has become customary, most funds raised through other investment corresponded to MFIs (almost 71% of the total), followed by ORSs (almost 22%).

The net debit position in *other investment* widened in 2009 by 3.1 pp of GDP to 31%, as the value of external assets fell slightly (by 0.3 pp of GDP to 35.2%) and the value of external lia-

¹² The IIP does not give an adequate geographical breakdown, as it provides information only on the first known non-resident counterparty, which in many cases is not the ultimate holder of the securities, the latter being the relevant party for the purposes of economic analysis. The analysis under the end-investor criterion is based on the geographical breakdown of the portfolio assets of other countries vis-à-vis Spain contained in the CPIS. For the CPIS data, see the IMF website: <http://www.imf.org/external/np/sta/pi/cpis.htm>.

Financial transactions with the rest of the world and International Investment Position



SOURCE: Banco de España.

a. Excluding the Banco de España.

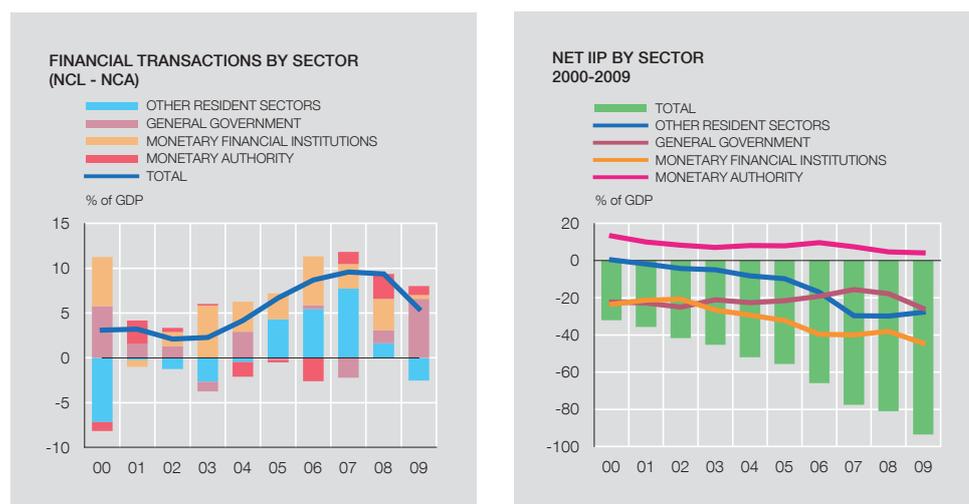
bilities rose (by 2.8 pp of GDP to 66.2%). In 2009 there were no significant changes in the geographical breakdown of other Spanish investment, which is highly concentrated on the EU, especially on the euro area. The United Kingdom also represents a substantial portion, reflecting its position as an international financial centre.

Other Spanish investment abroad recorded net outflows of just €1,163 million in 2009, against €12,781 million in 2008. Net investments in long-term instruments (€11,890 million) offset divestments (i.e. repatriation of capital) of short-term assets (€10,727 million). Most net transactions under this heading corresponded to MFIs.

In turn, *other foreign investment in Spain* gave rise to inflows of €10,432 million in 2009, in marked contrast to the inflows of €91,684 million in 2008. This is due to non-residents reducing their holdings of short-term instruments (by €27,731 million), essentially by cancelling deposits placed with resident MFIs (€16,571 million) and short-term loans granted to resident ORSs (€8,851 million). Conversely, long-term instruments generated large net inflows (€38,163 million), mainly channelled through deposits placed with MFIs (€24,530 million) and loans to resident ORSs (€9,928 million).

FINANCIAL TRANSACTIONS WITH THE REST OF THE WORLD AND INTERNATIONAL INVESTMENT POSITION, BY SECTOR

CHART 3.10



SOURCE: Banco de España.

BREAKDOWN BY INSTRUMENT OF THE OTHER RESIDENT SECTORS (ORSs) SECTOR

TABLE 3.11

€m	2008			2009		
	TOTAL ORSs	NON-MONETARY FINANCIAL INSTITUTIONS	NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS AND NPISHs	TOTAL ORSs	NON-MONETARY FINANCIAL INSTITUTIONS	NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS AND NPISHs
NCA TOTAL	16,920	-26,821	43,741	12,636	-1,931	14,568
FOREIGN DIRECT INVESTMENT	44,480	1,155	43,324	6,298	116	6,181
SHARES AND MUTUAL FUNDS	-25,210	-21,349	-3,861	9,625	3,544	6,080
PORTFOLIO INVESTMENT						
MEDIUM AND LONG-TERM BONDS	-9,556	-10,246	690	3,379	1,501	1,877
MONEY MARKET INSTRUMENTS	2,779	2,574	205	-5,113	-4,807	-306
OTHER INVESTMENT	4,428	1,044	3,384	-1,552	-2,287	735
NCL TOTAL	37,841	-22,485	60,326	-13,274	-34,740	21,466
FOREIGN DIRECT INVESTMENT	49,007	-1,810	50,817	9,615	-39	9,654
SHARES AND MUTUAL FUNDS	-6,049	-36	-6,013	-2,544	65	-2,610
PORTFOLIO INVESTMENT						
MEDIUM AND LONG-TERM BONDS	-29,793	-31,125	1,332	-25,741	-39,002	13,262
MONEY MARKET INSTRUMENTS	11,251	11,130	121	4,929	4,892	37
OTHER INVESTMENT	13,425	-643	14,068	467	-657	1,123

SOURCE: Banco de España.

DERIVATIVE FINANCIAL INSTRUMENTS

Transactions involving derivative financial instruments gave rise to net outflows of €5,688 million in 2009, 12% down on 2008. In keeping with this pattern, the Spanish economy's modest debit position in these instruments narrowed by 0.5 pp of GDP to 0.1%. It should be borne in mind that these transactions are not due to the need to cover a financing gap in the economy, but rather to agents' strategic and hedging decisions, which explains why these transactions are generally highly volatile and why they grow at times of uncertainty.

	MONETARY AUTHORITY			MFIs			GENERAL GOVERNMENT			ORSs		
	NET	ASSETS	LIABILITIES	NET	ASSETS	LIABILITIES	NET	ASSETS	LIABILITIES	NET	ASSETS	LIABILITIES
VALUE OF STOCK (€bn)												
Average 2004-2006	78.5	78.6	0.1	-309.7	325.7	635.4	-191.0	19.6	210.6	-107.8	626.5	734.3
2007	78.9	82.5	3.6	-419.9	472.5	892.4	-163.7	34.8	198.6	-312.1	755.9	1,068.0
2008	50.9	86.1	35.2	-413.9	531.6	945.5	-193.2	40.6	233.8	-325.1	706.0	1,031.1
2009	44.1	85.6	41.5	-466.8	501.8	968.6	-269.5	29.5	298.9	-291.3	749.8	1,041.1
PERCENTAGE OF GDP (%)												
Average 2004-2006	9.3	9.3	0.0	-36.8	38.7	75.5	-22.7	2.3	25.0	-12.8	74.5	87.3
2007	7.5	7.8	0.3	-39.9	44.9	84.8	-15.6	3.3	18.9	-29.7	71.8	101.4
2008	4.7	7.9	3.2	-38.0	48.8	86.9	-17.8	3.7	21.5	-29.9	64.9	94.7
2009	4.2	8.1	3.9	-44.4	47.7	92.1	-25.6	2.8	28.4	-27.7	71.3	99.0

SOURCE: Banco de España.

3.3 Breakdown by institutional sector

In 2009, all institutional sectors raised funds abroad, except for ORSs¹³ (see Chart 3.10). The general government sector led the field, raising €69,372 million (6.6% of GDP), followed at a considerable distance by MFIs with €4,516 million (0.4% of GDP). Conversely, and in contrast to the previous year, ORSs' financial transactions generated net capital outflows of €26,738 million (2.5% of GDP).

As regards the general government sector, non-residents increased their holdings of government debt (both money market instruments and medium and long-term bonds). The Social Security Reserve Fund made net sales of foreign public debt. For a more detailed analysis of how the development of public finances affected the way in which the Spanish economy met its financing needs in 2009, see Box 3.1.

Net funds raised abroad by MFIs were in the form of equities and long-term loans and deposits. In the case of portfolio investment in fixed income, non-residents increased their holdings of securities issued by Spanish MFIs (especially covered bonds included in the ECB buyback programme), in contrast to net divestment in 2008. Nevertheless, the capital outflows generated by net purchases of foreign securities by Spanish MFIs offset the capital inflows generated by the above-mentioned purchases.

Lastly, ORSs' financial transactions with the rest of the world generated net capital outflows, essentially owing to portfolio investment, in the form of equities and, especially, medium and long-term bonds. Funds raised via long-term loans, bonds issued by large non-financial corporations (some immersed in international expansion processes) and money market instruments issued by non-monetary subsidiaries of MFIs were lower than net sales by non-residents of securitisation SPEs and bonds issued by the above-mentioned subsidiaries (see Table 3.11). Moreover, Spanish firms repaid short-term loans obtained abroad in previous years.

As a result of these developments in financial transactions, the general government's net debit IIP widened by 7.9 pp of GDP to 25.6% (see Table 3.12); this increase was concentrated,

¹³ It is important to note here that ORSs include not only households and non-financial corporations, but also non-monetary financial institutions (e.g. securitisation SPEs and the subsidiaries of MFIs specialising in the issuance of securities).

almost entirely, on portfolio investment in fixed income. The net debit position of MFIs also widened notably (by 6.4 pp of GDP to 44.4%), in this case largely due to portfolio investment in equities (4.1 pp of GDP), followed by other investment (2.6 pp of GDP) and, at a distance, by portfolio investment in fixed income (0.5 pp of GDP). Conversely, the ORSs' debit balance narrowed by 2.2 pp of GDP to 27.7%, thanks to the decline in the debit positions in portfolio investment both in fixed income (2 pp of GDP) and equities (0.8 pp of GDP), which offset the deterioration in the balances on all other instruments.

To conclude, in 2009 the net assets of the Banco de España fell by €10,464 million (against €30,218 million in 2008), representing a significant slowdown in the rate of decline, in keeping with the gradual recovery on the financial markets. In the year as a whole, net assets vis-à-vis the Eurosystem fell by €6,146 million (€31,713 million in 2008). The Banco de España's other net assets fell by €5,882 million,¹⁴ while reserves rose by €1,563 million. Accordingly, the Banco de España's net credit position declined in 2009, though at a much more moderate pace than in 2008 (0.5 pp), to 4.2% of GDP.

¹⁴ Investment in securities that do not form part of reserves. For a description of these assets, see Chapter 4 of this report.