

3 The financial account in 2007

3.1 Introduction

During 2007 the Spanish economy's foreign financial transactions were affected by the episode of financial instability that arose in the United States further to the increase in defaults on subprime mortgage loans, and which rapidly spread to international financial markets. Tensions were particularly significant on the money markets, reflecting in part the greater demand for funds on the interbank market and, in part, the crisis of confidence that emerged among financial institutions. The outcome saw the significant widening of spreads between central bank intervention rates and interbank rates. The heightened uncertainty that these spreads reveal also affected the capital markets, prompting a generalised re-pricing of risk and a rise in private debt yield differentials, which was more marked in the case of financial sector issues (particularly those relating to securitisation instruments). Against this background, private sector financing conditions in the medium and long-term wholesale debt markets tightened considerably, restricting the possibility of raising funds through these markets. Consequently, from August Spanish financial institutions used alternative channels to meet their liquidity requirements. These included specifically the issuance of short-term securities, such as notes, the cost of which had been less affected by the financial turmoil than that of mortgage-backed securities, and the greater resort to interbank financing. Nonetheless, the bulk of the Spanish economy's financing needs was covered over the year as a whole, as in previous years, by foreign funds raised through portfolio investment securities, which was possible thanks to net placements in the first seven months of the year.

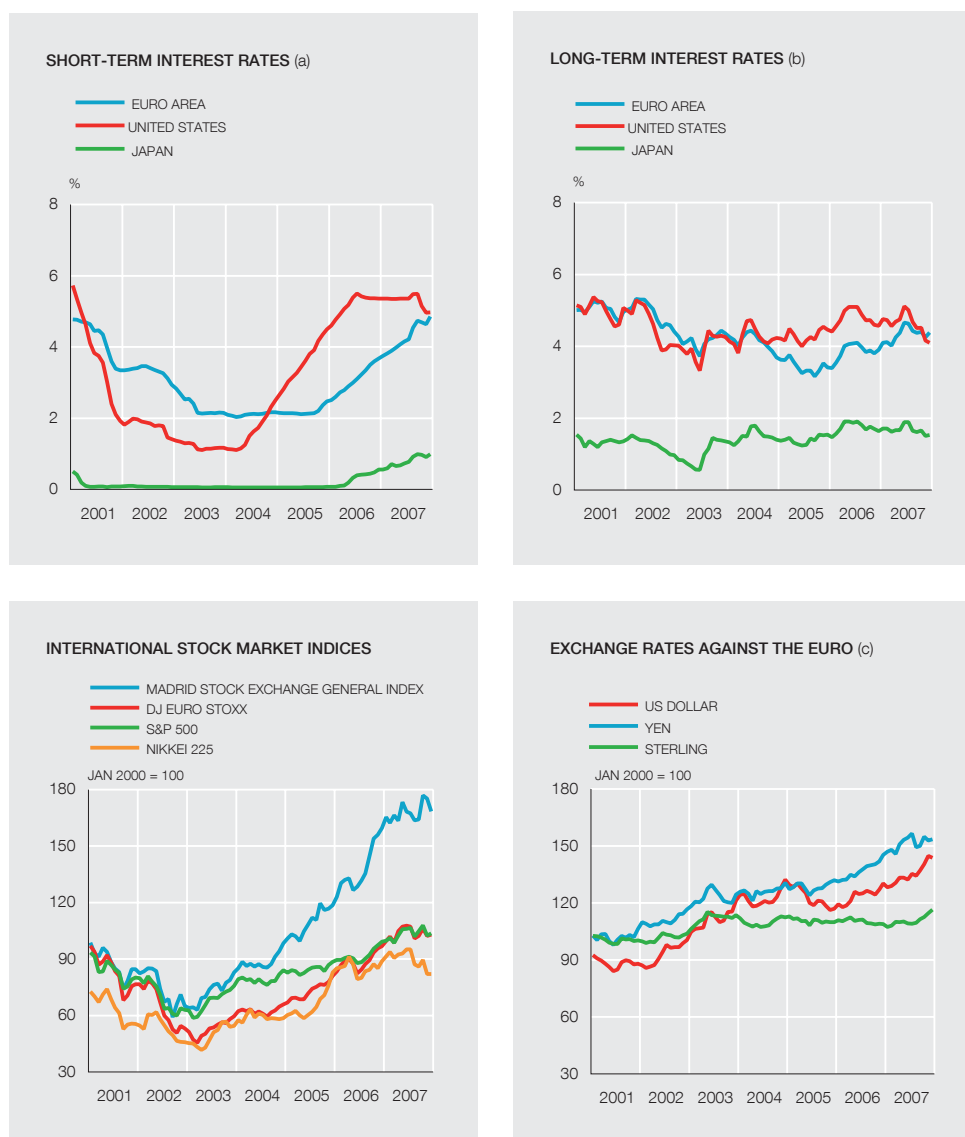
Stock market prices were relatively resilient in the closing months of 2007, posting gains for the year as a whole, although their volatility increased significantly (see Chart 3.1). In the case of the IBEX 35, these gains amounted to 7.3%, similar to those of the EURO STOXX-50 and above those of the S&P-500 (3.5%). However, stock market prices fell across the board in the opening months of 2008, affected by the worsening macroeconomic outlook (especially in the United States) and by the continuation of the financial turmoil. This, along with the reduction and subsequent reversal of interest rate spreads between the US economy and the euro area, contributed to the significant depreciation of the dollar against the euro during 2007 (by 9.5% in relation to December 2006).

On balance of payments figures, the Spanish economy's net borrowing for its overall non-financial transactions continued to widen in 2007 to €101,346 million (9.7% of GDP), 24% up on the previous year. Funds raised abroad by the resident sectors (€83,769 million, excluding the Banco de España) did not suffice to cover the financing needs generated during the year, whereby the Banco de España's net foreign assets fell by €14,322 million.¹

According to the institutional sectors' non-financial accounts, the increase in the economy's overall financing needs reflects, above all, the widening of the gap between non-financial corporations' saving and investment (to 10.6% of GDP, up from 8.5% in 2006), since household net borrowing rose by 0.8 pp in 2007 to 2.8% of GDP. The general government budget surplus continued to increase, amounting to 2.2% of GDP (1.8% in 2006).

In 2007 this demand for funds from abroad was met (see Table 3.1) firstly by net capital inflows in the form of portfolio investment (€104,360 million was received in the period) and, secondly, by other investment (€34,624 million). Conversely, both foreign direct investment (FDI) and fi-

1. Hereafter the Banco de España is excluded from the analysis, unless otherwise indicated.



SOURCES: ECB and Bank of Japan.

- a. Three-month interbank market interest rates.
 b. Ten-year government bond yields.
 c. An increase in the value of the index denotes an appreciation of the euro against the currency in question.

financial derivatives generated net outflows totalling €48,383 million and €6,832 million, respectively. As earlier discussed (see Chart 3.2), further to the financial turmoil during the summer the possibilities of raising resources on long-term international fixed-income markets were considerably curtailed, meaning that from August Spanish financial institutions met their liquidity needs differently. Between January and July, net capital inflows in the form of fixed-income portfolio investment were recorded for the increase in the outstanding balance of asset-backed securities and of securities issued by non-monetary subsidiaries of resident monetary financial institutions (MFIs) held by non-residents, which remained the primary source of financing for the Spanish economy, while net outflows were recorded in other investment and FDI. Subsequently, from August, and as a result of the financial turmoil and of the ensuing decline in activity on long-term fixed income wholesale markets, resident financial institutions raised financing through the issuance of short-term instruments (notes) and greater resort to interbank financing. This change in the type of instruments with which the Spanish economy has ultimately covered its financing needs has also been seen in other countries. Specifically, in the United

% of GDP	2003	2004	2005	2006	2007
CURRENT ACCOUNT PLUS CAPITAL ACCOUNT BALANCE	-2.5	-4.2	-6.5	-8.3	-9.7
FINANCIAL ACCOUNT BALANCE (a)	2.1	5.8	6.9	11.1	8.0
Change in external liabilities (b)	16.2	18.2	24.6	25.6	21.7
<i>Foreign direct investment</i>	2.9	2.4	2.2	2.2	3.7
— Monetary financial institutions	-0.1	-0.1	0.0	0.0	0.1
— Other resident sectors	3.0	2.5	2.2	2.2	3.6
<i>Portfolio investment</i>	5.0	13.4	15.2	20.0	9.1
— General government	-1.0	2.7	0.3	1.4	-1.5
— Monetary financial institutions	3.4	5.9	6.2	8.3	3.6
— Other resident sectors	2.5	4.8	8.8	10.2	7.1
<i>Other investment</i>	8.3	2.4	7.1	3.5	8.9
— General government	-0.1	0.6	0.0	0.1	0.0
— Monetary financial institutions	7.1	1.8	5.6	0.4	7.1
— Other resident sectors	1.3	0.0	1.5	3.0	1.7
Change in foreign assets (c)	14.1	12.4	17.6	14.5	13.8
<i>Foreign direct investment</i>	3.2	5.8	3.7	8.1	8.3
— Monetary financial institutions	-0.9	1.6	0.1	0.5	2.9
— Other resident sectors	4.1	4.2	3.6	7.6	5.5
<i>Portfolio investment</i>	8.4	3.2	8.8	-0.4	-0.8
— General government	0.0	0.1	0.5	1.1	0.6
— Monetary financial institutions	4.2	0.6	4.5	-3.1	0.3
— Other resident sectors	4.2	2.5	3.7	1.6	-1.7
<i>Other investment</i>	2.0	3.4	5.2	7.0	5.6
— General government	0.0	0.2	0.1	0.0	0.1
— Monetary financial institutions	1.1	2.0	4.4	6.0	4.9
— Other resident sectors	0.9	1.2	0.8	1.0	0.6
<i>Financial derivatives (d)</i>	0.4	0.0	0.0	-0.2	0.7
NET CHANGE IN FOREIGN ASSETS OF BANCO DE ESPAÑA (e)	0.2	-1.7	-0.2	-2.6	1.4
Of which:					
<i>Reserve assets</i>	1.7	0.6	0.2	0.0	0.0
<i>Net assets vis-à-vis the Eurosystem</i>	0.6	-1.6	1.6	-1.3	2.7
<i>Other net assets</i>	-2.1	-0.6	-2.0	-1.3	-1.3
MEMORANDUM ITEMS:					
FINANCIAL ACCOUNT BALANCE INCLUDING BANCO DE ESPAÑA	2.3	4.1	6.7	8.5	9.3
Errors and omissions (f)	0.2	0.1	-0.2	-0.2	0.3

SOURCE: Balance of Payments, Banco de España.

a. Excluding Banco de España.

b. A positive sign denotes an increase in liabilities, i.e. an inflow of capital.

c. A positive sign denotes an increase in assets, i.e. an outflow of capital.

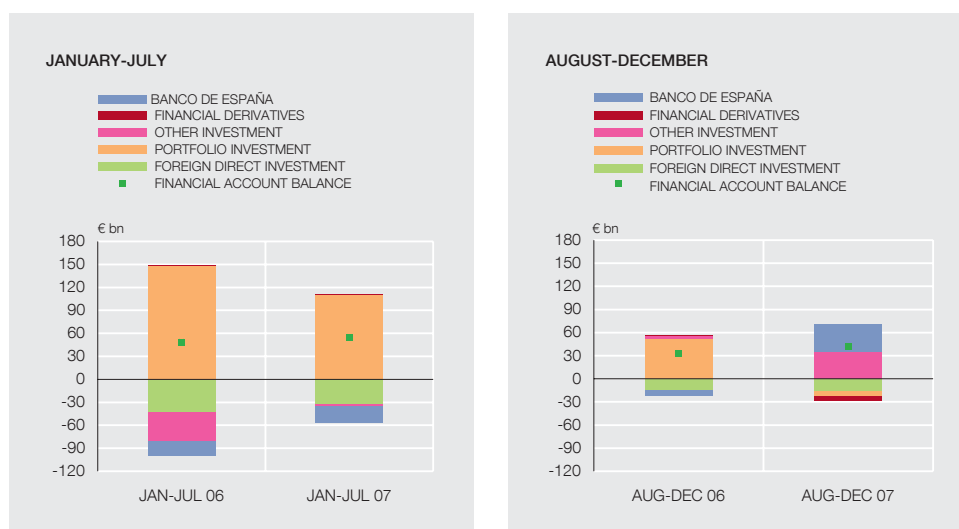
d. They are recorded net of netted out amounts and have been allocated, by convention, to the net change in assets.

e. A positive (negative) sign denotes a decrease (increase) in Banco de España foreign assets.

f. A positive (negative) sign denotes a receipt (payment) not recorded in another balance of payments caption.

States net capital inflows of portfolio investment fell in the second half of 2007, without this having hampered the coverage of US financing needs. Similarly, the euro area has been the recipient of less foreign financing in the form of portfolio investment, while in the United Kingdom no significant changes are discernible.

The breakdown by *institutional sector* (see Charts 3.3 and 3.4) shows that Other resident sectors (ORSs) raised most of the funds that the Spanish economy received from abroad (€82,492 million), followed by MFIs (€24,817 million). It should be recalled that this sector includes not only non-financial corporations but also non-monetary financial institutions [e.g. securitisation special-purpose entities (SPEs) and the subsidiaries of MFIs specialising in the issuance of securities], the weight of which in foreign portfolio investment transactions has been significant



SOURCE: Banco de España.

(see Table 3.2). Conversely, non-residents' holdings of public debt fell, coinciding with sizeable redemptions over the course of 2007.

3.2 Foreign direct investment

In 2007 the Spanish economy recorded net outflows in the form of FDI for an amount of €48,383 million (4.6% of GDP), compared with €58,479 million in 2006 (6% of GDP), against the background of a rise both in Spanish direct investment abroad (at an annual rate of 9%) and, above all, in foreign direct investment in Spain (an annual rate of 82%). It should be noted here that the Spanish FDI figures recorded in the balance of payments include, on both the assets and liabilities sides, the transactions of the so-called foreign-equity holding companies (ETVEs by their Spanish name), which generally do not give rise to either capital inflows or outflows, but which chiefly represent accounting entries.² Stripping out these transactions, whose actual influence on the economy is very limited, the behaviour of FDI does not change significantly, posting net outflows of €49,269, compared with outflows of €56,461 million in 2006. It would be premature to assess the impact of the financial turmoil on FDI transactions, but the tightening of financing conditions and the worsening of the growth outlook in the main developed economies might delay further direct investment projects, both outward and inward.

These developments occurred in an environment in which world FDI transactions remained relatively dynamic over the course of the year,³ growing by 8% valued in euro (in dollars, this increase amounted to 17.8%).⁴ Direct investment in the developed economies was slightly more expansionary than that in developing countries (respective growth stood at 7% and 6%), while the funds received by the European economies in transition, which are not included in the foregoing groupings, were 29% higher than in 2006. Over the year as a whole, multinational companies continued to expand their international activity, driven by mergers

2. These companies have frequently been set up in recent years by non-resident multinational groups to centralise the holding of their foreign direct investments in third countries. See Law 43/1995 on corporate income tax and Title IV of Law 6/2000 on measures to support the internationalisation of firms (BOE of 14 December 2000). To ensure that these transactions, which are difficult to identify using the ordinary reporting system, are included in the balance of payments, information has begun to be used from the Investments Register of the Spanish Ministry of Industry, Tourism and Trade. Other holding companies are included in this heading, which although not strictly ETVEs, have been set up in Spain for the main purpose of channelling direct investment. 3. See the UNCTAD press release, "Foreign Direct Investment reached new record in 2007", of 8.1.2008. 4. These preliminary estimates should be viewed with caution, since the figure for 2007 as a whole relates, in most countries, to the annualised figures of the first three quarters of that year.

NET CROSS-BORDER FINANCIAL FLOWS BY SECTOR.
NCL – NCA (a)

CHART 3.3

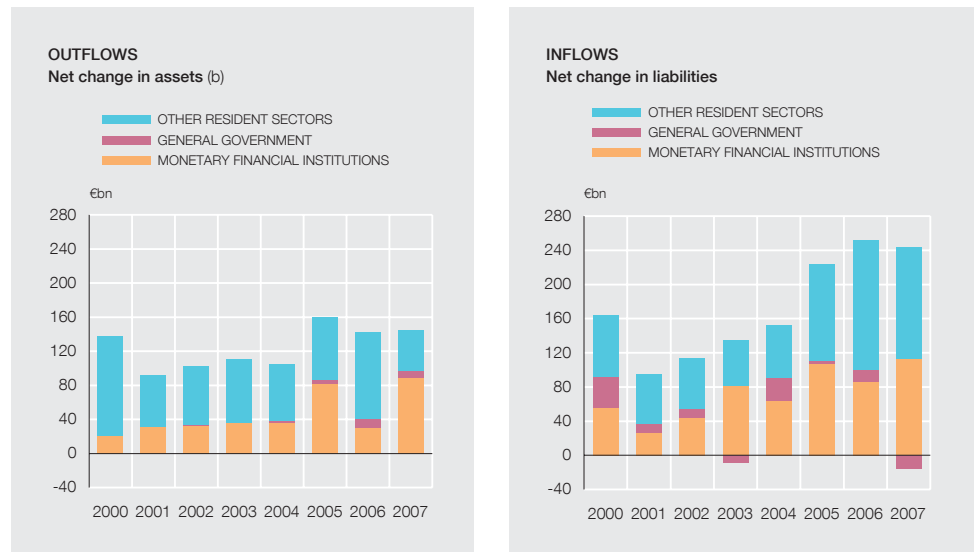


SOURCE: Banco de España.

a. Net change in liabilities minus net change in assets. Monetary financial institutions excluding the Banco de España.

and acquisitions. These, however, diminished in the second half of 2007, in line with the heightened uncertainty on the financial markets and with the deterioration in growth prospects in the main industrialised countries. Among the developed economies, there was prominent growth in FDI into the United Kingdom (12%) and France (39%). The United States remained the biggest global recipient of FDI, despite the flows received by this economy flattening out in 2007. FDI received by the EU as a whole continues to be higher (42% of global FDI).⁵ Investment routed towards the developing economies reached an all-time high in 2007, underpinned by the favourable growth outlook and by the rise in commodities prices. Thus, both in Latin America and in the European economies in transition (the CIS and the south-east European countries), FDI rose most significantly (by 37.6% and 29.1%, respectively), with notable growth in investment in Russia. Investment in Africa reached an unprecedented scale.

5. Bulgaria and Romania are not included in the UNCTAD figures.



SOURCE: Banco de España.

a. Excluding the Banco de España.

b. Including financial derivatives, which are recorded net of netted out amounts and have been allocated, by convention, to the net change in assets.

Spanish direct investment abroad amounted to €87,388 million in 2007 (see Chart 3.5), up 9% on the previous year and marking a new high in terms of level. Nonetheless, as a percentage of GDP it remains below the high reached in 2000 (8.3% and 10%, respectively). The favourable result for 2007 essentially reflects three major operations during the year. Firstly, the purchase of a British electric utility by a Spanish company in the same sector; and, secondly, the respective acquisitions of a Dutch bank and a US bank by two Spanish MFIs. The favourable performance of this type of investment comes following a year in which FDI abroad also increased notably, owing to the purchase of a telecommunications operator in the United Kingdom by a Spanish company belonging to this sector. This increase in foreign investment, which entails the ongoing internationalisation of Spanish firms begun some years back, has tended to become generalised across sectors and regions. Box 3.1 analyses in depth the microeconomic determinants of Spanish corporate FDI decisions in recent years. As a result of the two above-mentioned operations, MFIs' FDI in 2007 accounted for 34% of the total, as opposed to only 6% in 2006.

In terms of instruments, direct investment abroad in 2007 was essentially in equities, which accounted for 83% of the total, increasing by 37%, and, to a lesser extent, through reinvested earnings, which represented 10% of invested funds and which increased by 8%.⁶ The remaining items represented a much smaller magnitude, although there was notable growth (47%) in investment in real estate. Finally, inter-company debt transactions accounted for 1% of foreign direct investment.

Analysis by branch of activity, excluding ETVEs,⁷ shows an increase in the degree of concentration in Spanish FDI in 2007 (see Table 3.3), brought about by the three above-mentioned

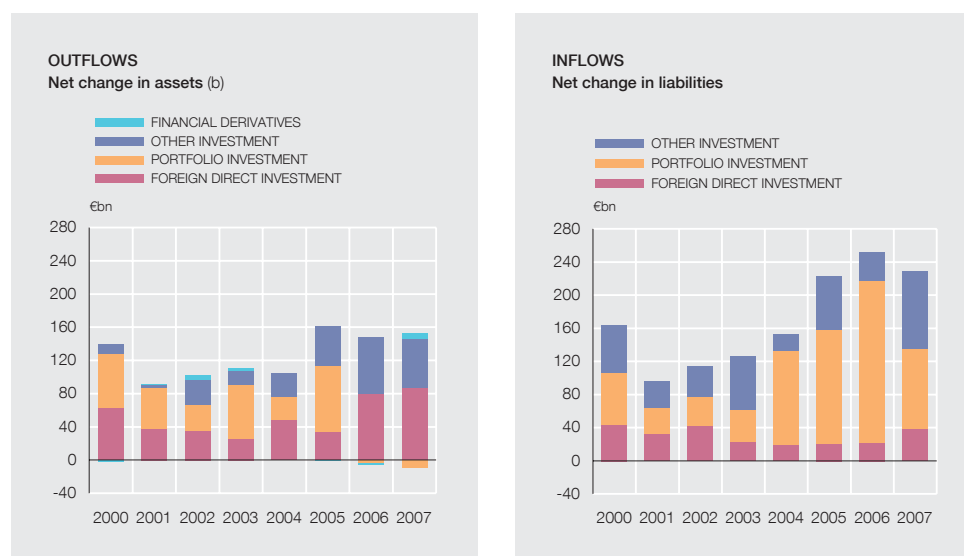
6. Reinvested earnings include the share of the direct investor (in proportion to its share in the capital stock) in the earnings that the subsidiaries or affiliate companies have not distributed as dividends, or in the earnings that branches have not remitted to the direct investor. Improvements to the calculation of this heading were made in 2007. See Chapter 5 of this Report. 7. ETVEs are included in the sector "Real estate, renting and business activities".

INSTRUMENT		BREAKDOWN OF ORSs	ASSETS		LIABILITIES	
			2006	2007	2006	2007
FOREIGN DIRECT INVESTMENT			75034.2	57314.3	21788.6	38060.9
		Non-monetary financial corporations	774.7	1150.5	1531.7	2107.5
		Non-financial corporations and households and non-profit institutions serving households	74259.5	56163.7	20256.8	35953.4
PORTFOLIO INVESTMENT	EQUITY		16562.1	-10149.9	-22123.7	15192.3
		Non-monetary financial corporations	9447.1	-14371.1	522.1	-395.9
		Non-financial corporations and households and non-profit institutions serving households	7115.0	4221.2	-22645.8	15588.2
	BONDS AND NOTES		1763.7	-5066.1	120867.7	63316.7
		Non-monetary financial corporations	-1120.2	-8346.8	112344.7	48343.7
		Non-financial corporations and households and non-profit institutions serving households	2883.9	3280.7	8523.0	14973.0
	MONEY MARKET INSTRUMENTS		-2582.6	-2303.5	1676.6	-4301.9
		Non-monetary financial corporations	-2720.4	-2403.9	1597.8	-4297.4
		Non-financial corporations and households and non-profit institutions serving households	137.8	100.4	78.7	-4.6
OTHER INVESTMENT			9906.3	6320.1	29136.8	18303.1
		Non-monetary financial corporations	445.7	-290.1	1933.0	-1458.3
		Non-financial corporations and households and non-profit institutions serving households	9460.6	6610.2	27203.7	19761.4

SOURCE: Banco de España.

operations. The three most active resident sectors were responsible for 74% of Spanish FDI. First ranked was the “Financial intermediation” branch, with 40% of the total (10% in 2006), followed by “Electricity, gas and water supply”, which accounted for 24% of direct investment transactions abroad. Third placed were investments in “Manufacturing”, representing 10% of the total. Running counter to this was the decline in the relative significance of “Transport, storage and communication”, which accounted for only 1% of total foreign direct investment in 2007, although this comparison is affected by the operation in the telecommunications sector in 2006.

As regards the geographical breakdown of Spanish FDI outflows (excluding ETVEs, see Table 3.4), the EU was, as has been habitual in recent years, the recipient of a large portion (69% of the total). The euro area accounted for a moderate proportion (34% of the total), with investment in the Netherlands to the fore, owing chiefly to the acquisition of a Dutch financial institution. The United Kingdom accounted for a significant proportion (23% of the total) of Spanish FDI, owing to the purchase of an electric utility. Outside the EU, the United States represented



SOURCE: Banco de España.

a. Excluding Banco de España.

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

15% of total direct investment abroad, mainly as a result of the acquisition of a bank resident in this country. Finally, Latin America accounted for 10% of the total, a very moderate proportion compared with those achieved in the second half of the 1990s.

Foreign direct investment in Spain increased significantly (82%) to €39,005 million (3.7% of GDP, against 2.2% in 2006). Affecting this increase is the purchase of a Spanish electric utility by an Italian company belonging to the same sector, which explains why most FDI transactions in 2007 were made by the non-financial private sector.

The breakdown by instrument shows the significance of investment operations involving equities, which accounted for 39% of total FDI in Spain, while both inter-company debt transactions and FDI in the form of other equity holdings represented, in each case, around 18% of total FDI. The most significant change is that in FDI in real estate, which accounted for 14% of the total, thanks to the appreciable increase in this item in 2007 (14%), in contrast to the declining trend on which it had generally moved in the three previous years, after peaking in 2003. Finally, undistributed profits, which were 8% up on 2006, represented 11% of foreign direct investment in Spain.

The breakdown by branch of activity (excluding ETVEs) shows a higher concentration in 2007 in inward FDI than in outward FDI. The three most significant branches accounted for 82% of the total. In first position was the “Electricity, gas and water supply” branch, which received 55% of the total. Second ranked was real estate investment, which amounted to 15% of the total. Further behind were “Transport, storage and communications” and “Financial intermediation”, with each accounting for more than 12% of foreign direct investment abroad. Though on a lesser scale, net investment in “Wholesale and retail trade and repairs” was buoyant, standing at 5% of the total.

The geographical breakdown of FDI inflows to Spain (excluding ETVEs) shows that, as usual, the EU continued to be the main source of direct investment in Spain (89% of the total), with

The internationalisation of Spanish firms through foreign investment abroad has gathered renewed momentum in recent years, following the widespread easing off of this type of operation globally at the start of the current decade. On UNTACD figures, Spanish foreign direct investment (FDI) in 2006 accounted for 41.5% of GDP, exceeding Germany and Italy. Moreover, in contrast to what was seen in the second half of the 1980s, when investment was led by major corporations in the energy, financial and telecommunications sectors, the current expansion abroad is being characterised by the participation of a growing number of firms, with SMEs playing a greater role. At the same time, greater diversification can be seen both in the geographical destination of investment and in the sectors making such investment.

The decision by a firm to internationalise itself by making a direct investment abroad, bearing the greater costs and risks that this entails compared with exporting or establishing franchises, is essentially determined by a set of advantages that grant the firm a degree of market power and, above all, an edge over its competitors. These advantages, according to Dunning's so-called "eclectic theory" or "OLI paradigm" can be grouped under three headings: ownership, location and internalisation. The ownership advantages are those firm-specific characteristics arising both from the ownership of tangible assets (a patent or project) and of intangible assets (organisational and management capacity, technological drive, staff skills and previous experience). Location advantages are those that govern the choice of destination for the investment, and are thus related to host country-specific features (size, endowment of productive resources,

cultural proximity and transport costs). Finally, internalisation advantages group those factors that encourage the firm to maintain direct control over the production process, instead of outsourcing it. These incentives may arise from the presence of market failings that generate problems of asymmetric information, moral hazard and difficulties in entering into agreements with a foreign partner.

The shortage of disaggregated FDI figures at firm level has restricted work on testing the consequences suggested by the theory. In Spain's specific case, most papers addressing this matter use disaggregated information at sectoral level or information relating to a small number of companies that does not necessarily represent the population adequately. With the aim of circumventing these limitations, a recent paper has combined the balance of payments database, which contains information on all firms engaging in FDI operations abroad, with that of the Central Balance Sheet Data Office, which provides information on the characteristics of a high number of non-financial corporations. The period of analysis is confined to the most recent years (2003-2006), for which information common to both databases is available.¹ Table 1 offers some indicators of the representativeness of the sample of firms carrying out FDI operations abroad and that report to the Central Balance Sheet Data Office, in relation to the total population of non-financial corporations investing abroad. A high degree of coverage

1. Regard has been had only to FDI in the form of equity and capital holdings. Likewise, ETVEs and financial corporations have been eliminated from the analysis, as there is no information at the Central Balance Sheet Data Office on them.

1 REPRESENTATIVENESS OF THE SAMPLE IN RELATION TO BALANCE OF PAYMENTS STATISTICS

	REPRESENTATIVENESS PERCENTAGE	DISTRIBUTION OF VALUE OF FDI BY BRANCH OF ACTIVITY		DISTRIBUTION BY SIZE OF COMPANIES IN THE SAMPLE ENGAGING IN FDI	
	VALUE OF SAMPLE FDI RELATIVE TO THE BALANCE OF PAYMENTS	BALANCE OF PAYMENTS	SAMPLE	FEWER THAN 200 EMPLOYEES	MORE THAN 200 EMPLOYEES
Agriculture, livestock breeding and fisheries	14.9	0.1	0.0	93.0	7.0
Mining and quarrying	74.2	3.4	3.3	50.0	50.0
Manufacturing	74.9	26.9	26.8	29.8	70.2
Construction	56.9	4.3	3.2	32.0	68.0
Production and distribution of electricity, gas and water	84.5	7.1	8.0	24.2	75.8
Wholesale and retail trade and repairs	59.6	6.2	4.9	42.9	57.1
Restaurants and hotels	60.6	1.0	0.8	16.7	83.3
Transport, storage and communications	98.8	30.2	39.8	38.8	61.2
Real estate activities and business services	52.0	18.0	12.5	43.6	56.4
Other	13.9	3.0	0.6	44.0	56.0
TOTAL	75.0	100.0	100.0	35.7	64.3

SOURCE: Banco de España.

can be seen, since the sample of 868 companies accounts for 75% of total FDI, as can too a high representativeness by type of sector.² Mention should also be made of the weight in the sample of corporations with fewer than 200 employees, 36% of the total.

With the aim of exploring the characteristics of companies investing directly abroad, a Probit model has been estimated where the dependent variable takes the value 1 if the company invests abroad in the period 2003-2006 and 0 otherwise. According to the theory of internalisation of the firm, the selection of variables that influence the likelihood of a company undertaking FDI projects abroad has been conditioned by the information available at the Central Balance Sheet Data Office. These variables are: i) size, proxied by the number of employees, insofar as a minimum size is needed to undertake investment; ii) organisational capacity, which is often proxied by the number of years the company has been up and running; iii) international experience, measured by a dichotomic variable that takes the value 1 if the company invests and 0 otherwise, although a measure of exporting intensity was also considered, taking exports relative to total sales; iv) the physical capital/employee ratio; v) technological capacity, measured as R+D expenditure and tech-

nology transfer payments as a proportion of total company sales, as a proxy of innovative intensity; vi) human capital skills, proxied by the proportion of matches to total employees. However, these last two variables are only available for companies with more than 100 employees. Accordingly, so as to be able to use all the companies in the sample, two alternative variables were defined which proxy more indirectly the company's intangible assets, i.e. net intangible fixed assets per employee and the percentage of temporary employment; vii) the presence of foreign capital in the company, since it acts as a transmission channel of experience in foreign markets and of technological know-how; viii) ease of access to external financing, proxied by a dichotomic variable that takes the value 1 if the company is stock exchange-listed and 0 otherwise; and, finally, ix) degree of concentration or competition, measured by the market share of the five biggest companies in each sector.

The results of the estimate are given in Table 2. The exercise has been conducted for a broad sample, for which direct information is not available on the variables that proxy the company's intangible assets (4,747 companies, of which 792 carry out FDI), and for a small sample for which such information is actually available (1,598 companies, of which 574 carry out FDI). For each of these samples, the first column presents the marginal impact of an increase of one marginal unit in the related independent variable on the decision to invest abroad, and the second column the degree of significance of each variable.

According to the results obtained for the sectors as a whole, size, exporting experience, the presence of foreign capital in the company's

2. The best represented sectors are Production and distribution of electricity, gas and water, and Transport, storage and communications, as what are involved are large corporations that report to the Central Balance Sheet Data Office, and also Manufacturing. Conversely, Real estate activities and Business services, owing to ETVEs being excluded from the sample, and Agricultural activities and Other activities, which are of less relative significance in the total, are relatively poorly represented in the sample.

2 RESULTS OF THE ESTIMATE FOR ALL SECTORS (PROBIT MODEL) (a)

DETERMINANTS	TOTAL SAMPLE		REDUCED SAMPLE	
	EFFECT	T-RATIO	EFFECT	T-RATIO
Size	0,1	20,6	0,1	11,2
Experience	0,0	-0,8	0,0	-0,2
International experience	0,1	8,0	0,2	6,3
Exporting intensity	—	—	—	—
Physical capital/worker ratio	0,0	2,8	0,0	2,7
Intangible asset/worker ratio	0,0	6,4	—	—
Innovative intensity	—	—	0,0	1,8
Temporary employment ratio	0,0	-2,6	—	—
Skills	—	—	0,0	2,4
Stock market listing	0,4	8,8	0,3	5,5
Share of foreign capital	0,1	5,6	0,1	3,1
Import penetration in the sector	—	—	—	—
Degree of concentration of the sector	-0,2	-1,5	-0,7	-1,8
MEMORANDUM ITEMS				
Success rate	86,2%		72,3%	
LR chi2	1.142,0		349,1	
Pseudo R squared	0,3		0,2	
NUMBER OF ACTUAL OBSERVATIONS				
Investment	792,0		574,0	
Total	4.747,0		1.598,0	

SOURCE: Banco de España.

a. All the regressions include a constant and sectoral dummies. To make interpretation of the ratios easier, the influence of each variable on the probability of investing abroad is given, i.e. the marginal effects evaluated at the mean.

ownership structure and the fact it is stock market-listed are the variables that most influence the likelihood of investing abroad. In contrast, the age of the company does not have a significant impact, which might be related to the fact that, in the 2003-2006 period, FDI was characterised by its geographical and sectoral diversification, and, therefore, experience in the local market was of lesser importance. As might be expected, the capital-labour relationship and the indicators of human capital skills also have a positive influence on the likelihood of investing abroad. On the other hand, the somewhat sur-

prising result from the estimates is that technological effort is not significant when proxied by the company's R+D expenditure and technology transfer payments. However, the fact that the intangible fixed assets/employee ratio is significant and the difficulties of ascertaining technological effort at some of the companies in the sample suggest that this result should be interpreted with caution. Finally, the degree of sectoral concentration has a negative but not significant impact on the probability of investing abroad, which might be linked, as in the case of size, to the degree of diversification of FDI in recent years.

investment from the euro area proving particularly prominent (63% of the total). Within the euro area the biggest investor was Italy (56% of the total), owing essentially to the aforementioned operation involving an electric utility. The United Kingdom also accounted for a relevant proportion (23% of the total received). Finally, among investment from countries outside the EU, that by companies resident in the United States accounted for 4% of the total.

3.3 Portfolio investment

During 2007, portfolio investment continued to be the main instrument through which the Spanish economy raised funds from abroad. Net capital inflows valued at €104,360 million (€200,000 million in 2006) and representing 9.9% of GDP were recorded in this connection. These were concentrated essentially in medium and long-term bonds (74% of the total). Nonetheless, there were two clearly differentiated periods to developments in portfolio investment operations during the year. In the first, between January and July, before the onset of the financial turmoil on international markets, the Spanish economy received net funds from abroad in the form of portfolio investment for a value of €110,443 million (€147,806 million in the same period in 2006). In the second period running to the end of the year, net capital outflows amounting to €6,083 million were recorded (compared with net inflows of €52,224 million in the same period the previous year). This change reflects the impact on capital flows of the decision by both Spanish and foreign investors to increase the national bias in their portfolios, coinciding with greater uncertainty over the future course of financial markets and of the different economies. Thus, between August and December 2007, and at the same time as non-residents reduced their holdings of portfolio investment securities issued by Spaniards (by €29,089 million), residents in Spain repatriated capital from abroad for the reduction in the outstanding balance they held of portfolio investment securities issued by non-residents (€23,006 million). The net outcome of these operations led to net capital outflows in the form of portfolio investment being recorded in the second half of 2007.

The foregoing transactions came about in a setting in which total net issues of both public and private fixed income by residents in Spain fell by 2% in relation to 2006. These issues essentially comprised long-term securities issued by financial institutions and, in particular, by non-monetary institutions, since the issues by non-financial corporations were for a very small amount and redemptions of public debt were made. The behaviour over 2007 as a whole was affected by events from August, since net total issues by the resident sectors declined considerably, standing at €51,756 million, against issues totalling €149,099 million in the same period in 2006, reflecting once again the major impact of the bout of financial turmoil on the international markets.

Spanish portfolio investment abroad showed disinvestment totalling €8,586 million in 2007, up on the disinvestment the previous year (€4,092 million). This result basically reflects the reduc-

FOREIGN DIRECT INVESTMENT TRANSACTIONS IN 2006 AND 2007
Breakdown by economic sector

TABLE 3.3

€ m	SPANISH DIRECT INVESTMENT OUTFLOWS		SPANISH DIRECT INVESTMENT INFLOWS	
	2006	2007	2006	2007
	TOTAL	79,913.0	87,388.2	21,433.8
Agriculture, hunting, forestry and fishing	44.8	35.0	-28.0	54.0
Mining and quarrying	2,573.5	1,472.7	156.4	205.2
Manufacturing	7,758.3	8,126.6	289.7	1,117.5
Electricity, gas and water supply	2,433.3	20,287.6	-277.0	19,222.5
Construction	6,769.5	-652.1	6.8	262.6
Wholesale and retail trade and repairs	2,384.4	2,395.2	97.6	1,637.0
Hotels and restaurants	874.1	935.0	372.8	399.1
Transport, storage and communication	26,674.5	893.4	4,575.6	4,303.1
Financial intermediation	7,225.9	33,481.6	3,065.3	4,259.0
Real estate and business activities	18,113.1	10,186.6	10,971.2	5,141.4
<i>Of which: ETVEs (a)</i>	<i>8,700.1</i>	<i>3,041.9</i>	<i>6,682.5</i>	<i>3,928.0</i>
Other services (b)	4,107.4	627.0	982.2	-462.0
Unclassified	954.2	9,599.6	1,221.3	2,865.9
<i>Real estate</i>	<i>2,257.9</i>	<i>3,318.3</i>	<i>4,703.3</i>	<i>5,378.8</i>
<i>Other</i>	<i>-1,303.8</i>	<i>6,281.3</i>	<i>-3,482.0</i>	<i>-2,512.9</i>

SOURCE: Banco de España.

a. 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.

b. Other services include "Public administration, defence and compulsory social security", "Education", "Health and social work", "Other community, social and personal service activities", "Private households and employed persons" and "Extra-territorial organisations".

tion in residents' holdings of shares and investment fund participations, for a value of €6,767 million, since the outstanding balance in fixed-income securities, although it also fell, did so much more moderately (€1,819 million, accounted for in full by money market instruments). In this latter case net inflows are very moderate compared with those recorded in 2006 owing to the significant reduction in the outstanding balance of residents' medium and long-term bonds (€24,629 million), in contrast to the slight increase in 2007 (€844 million).

An analysis of Spanish portfolio investment transactions abroad by institutional sector shows that there were significant changes in 2007 compared with the previous year. ORSs' operations were the only ones to generate net inflows, for €17,519 million (in contrast to net outflows of €15,743 million in 2006), approximately half of which related to investment fund participations (€8,409 million) and somewhat more than one-third to medium and long-term bonds (€5,066 million). Some of these operations were transacted with the aim of obtaining funds to finance a direct investment operation abroad in 2007. Conversely, MFIs' transactions prompted net capital outflows amounting to €2,841 million in 2007 (compared with disinvestment of €30,435 million in 2006). General government holdings in portfolio investment securities issued by non-residents also declined considerably (influenced by the investment strategy pursued by the Social Security Reserve Fund), and stood at €6,093 million (€10,600 million in 2006).

As to *foreign portfolio investment in Spain*, non-residents' holdings of these types of securities issued by residents continued to increase over the course of 2007. However, this increase was far lower than that the previous year: €95,774 million and €195,938 million, respectively. This reduction shows how the effects of the financial turmoil bear on the raising of foreign capital

FOREIGN DIRECT INVESTMENT TRANSACTIONS IN 2006 AND 2007
Breakdown by geographical area

TABLE 3.4

€m	SPANISH DIRECT INVESTMENT ABROAD				FOREIGN DIRECT INVESTMENT IN SPAIN			
	2006		2007		2006		2007	
	TOTAL	ETVEs (c)	TOTAL	ETVEs (c)	TOTAL	ETVEs (c)	TOTAL	ETVEs (c)
WORLD TOTAL	79,913.0	8,700.1	87,388.2	3,041.9	21,433.8	6,682.5	39,005.3	3,928.0
EUROPEAN UNION 27 (a)	61,259.5	7,285.1	62,199.6	4,029.0	15,077.9	4,729.2	36,051.1	4,960.8
Euro area	23,405.0	6,886.2	32,457.6	3,701.1	10,302.6	5,598.3	27,493.0	5,333.7
Germany	1,196.8	97.0	3,730.4	43.0	-602.8	72.5	-2,337.8	574.6
France	5,457.5	649.8	4,132.6	181.4	758.1	59.2	730.9	206.4
Netherlands	6,967.5	4,053.5	13,454.6	2,334.9	6,741.2	5,378.4	2,909.9	1,698.0
Italy	676.8	177.5	6,149.4	23.7	0.2	35.1	19,822.0	-9.5
Luxembourg	2,171.7	1,603.4	2,521.3	1,001.6	1,936.1	-49.1	5,377.5	2,554.8
Portugal	3,264.5	84.8	1,047.9	62.3	813.6	209.8	100.2	247.3
United Kingdom	33,380.3	-35.0	19,565.6	91.8	2,282.9	-989.9	7,514.0	-499.6
New EU members (b)	3,801.9	413.4	9,397.1	177.8	971.4	97.5	486.5	37.8
Switzerland	-228.6	-492.7	-369.3	-993.0	-1,872.1	-157.8	505.9	375.4
United States	8,768.5	477.2	11,138.0	-1,189.9	5,524.8	1,232.1	1,875.4	527.6
CENTRAL AND SOUTH AMERICA	7,483.1	762.7	9,776.1	1,067.9	699.0	324.6	979.5	-780.3
Argentina	1,357.6	463.1	815.2	97.3	-64.6	-62.4	9.8	3.3
Brazil	2,308.3	209.4	2,466.8	155.0	-94.6	-203.0	700.9	2.7
Chile	810.4	314.1	503.3	303.8	38.2	12.5	-25.8	12.0
Mexico	712.7	-657.7	3,944.6	178.6	152.3	12.1	-37.0	9.0
Morocco	875.3	14.4	317.4	13.5	-12.4	13.0	-1.9	2.8
Japan	108.7	9.2	78.9	8.5	100.4	0.9	-288.3	0.8
Australia	-58.7	40.7	526.5	9.1	2.2	1.1	35.3	1.1
MEMORANDUM ITEM: OECD	70,991.5	7,051.7	78,285.5	2,104.9	19,671.7	6,257.2	37,164.0	4,678.6

SOURCE: Banco de España.

- a. European Union: International institutions of the European Union, European Central Bank, 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, Bulgaria and their dependencies.
- b. New member countries: Cyprus, Czech Republic, Estonia, Hungary, Lithuania, Latvia, Malta, Poland, Slovakia, Romania and Bulgaria.
- c. 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.

via portfolio investment, with asset-backed securities particularly penalised by the crisis. From January to July, net inflows amounted to €124,863 million (14% less than in the same period in 2006) as the outstanding balance of these types of securities held by non-residents increased, while over the rest of the year there were net outflows of funds abroad since there was a decline in this balance of €29,089 million declined (compared with net inflows totalling €50,708 million in the same period in 2006).

The raising of financing abroad in the form of portfolio investment was primarily via medium and long-term bonds, which accounted for approximately 81.5% of the total (€78,028 million, 62% lower than in 2006). As in previous years, these inflows were in the form of fixed-income instruments issued by ORSs, especially in asset-backed bonds and in securities issued by the subsidiaries of MFIs,⁸ and in medium and long-term bonds issued by MFIs, including most notably covered bonds. In all cases, non-residents' interest in these types of securities declined in the wake of the instability that emerged on international financial markets, reflecting

8. Law 19/2003 of 4 July 2003 refers to these issues. See Banco de España (2006), Annual Report, 2005, Box 5.2.

in part the increase in the national bias in investors' portfolios at times of uncertainty. Hence, the outstanding balance of asset-backed bonds issued by Spaniards in non-residents' hands declined significantly in the second half of the year, which generated net outflows totalling €962 million in the August-December period (compared with inflows amounting to €26,439 million recorded in the same period in 2006). All told, over the year as a whole funds raised abroad via these types of securities amounted to €46,448 million, 33% down on the net funds channelled from abroad the previous year. This reduction came about despite the fact that net issues of these types of securities remained significant not only in 2007 as a whole (€111,460 million, 62% more than in 2006), but also as from August (21.6% up on the same period in 2006), inferring that a large portion of these issues was acquired by residents. Funds raised abroad by the subsidiaries of MFIs specialising in the issuance of securities fell at an annual rate of 42% in 2007, standing at €19,246 million, following a period from August to December in which non-residents reduced their holdings of these types of securities. These developments came about against the background of a reduction in the volume of securities issued in 2007 as a whole (36%), placing net issues for the year at €35,882 million. Finally, non-residents increased their holdings of Spanish covered bonds (issued by MFIs) by 48% less than in 2006, giving rise to inflows of €14,755 million, and recording disinvestment in the August-December period. Net issues of these products eased in 2007 (€19,723 million, against €43,149 million in the same period in 2006).

Turning to non-residents' investments in equity holdings, these generated net inflows amounting to €11,976 million (12.5% of total net portfolio investment in Spain), compared with net outflows of €18,399 million the previous year. Under this heading, non-residents' outstanding balance of equities increased, while that in the form of investment funds declined. This behaviour came about in a setting in which residents' net share issues and public offerings far exceeded those of the previous year (€47,861 million and €10,214 million, respectively). Net inflows invested in money market instruments accounted for 6% of the total foreign capital raised through portfolio investment, standing at €5,771 million, little more than half that in 2006.

Lastly, the outstanding balance of Spanish public debt held by non-residents declined in 2007, posting net capital outflows amounting to €16,052 million, in contrast to the net inflows totalling €13,641 million in 2006. These developments, which affected both medium and long-term bonds and money market instruments, came about at a time of sizeable net redemptions of public debt (€4,361 million, compared with redemptions of €2,733 million in 2006). In this respect, the relative weight of non-residents in holdings of Treasury securities fell in 2007, significantly so in the case of medium and long-term bonds (45.4% of the held-to-maturity portfolio at end-2007 was held by non-residents, compared with 48.5% at end-2006). Partly contributing to this reduction was the aforementioned increase of the national bias in agents' portfolios.

3.4 Other investment (loans, deposits and repos)

In 2007, residents' other investment transactions (essentially loans, deposits and repos) resulted in net inflows of €34,624 million (3.3% of GDP), in contrast to the net outflows of €34,393 million recorded in 2006 (equivalent to 3.5% of GDP that year). These net inflows were the outcome of the fact that foreign investment in Spain amounted to €93,535 million, compared with more moderate Spanish investment abroad, amounting to €58,911 million. The behaviour of this type of transaction was also influenced by the impact of the financial turmoil on international markets. Thus, between January and July 2007, net capital inflows relating to non-residents' investment in Spain were only slightly higher than the outflows generated by Spanish investment abroad, with net inflows of funds posting €163 million (in contrast to the high net outflows in the same period of the previous year, which amounted to

€37,408 million). This figure is in contrast to the sizeable net inflows in the form of other investment recorded from August, which amounted to €34,461 million, against only €3,015 million in the same period in 2006, and reflects the above-mentioned change in the way in which Spanish financial institutions have covered their liquidity requirements since the summer.

The breakdown by institutional sector shows that MFIs were responsible for the bulk of net inflows in the form of other investment (€23,750 million, accounting for close to 69% of the total), in contrast to the net outflows arising in 2006 (equivalent to €54,695 million). This change of sign was concentrated in other short-term investment, with net inflows of €31,283 million (compared with outflows of €45,157 million the previous year), and was extensive both to repos and to other instruments. Conversely, transactions in long-term instruments gave rise to net outflows valued at €7,533 million (€9,538 million in 2006). Unlike MFIs, ORSs' transactions in financial instruments classified as other investment gave rise to net capital inflows totalling €11,983 million (34.6% of total inflows in the form of other investment), far below the related figure the previous year (37.7%). This decline reflects developments both in net funds raised through long-term instruments, which fell by 9% (to €21,958 million), and in net outflows through short-term instruments (€9,975 million), which were double those recorded in 2006. General government transactions in other investment resulted in net outflows of €1,109 million, in contrast to net inflows of €1,071 million in 2006. This change in sign reflected the behaviour of transactions in short-term instruments which, having generated net inflows of €1,758 million, gave rise to outflows amounting to €1,050 million.

As to the breakdown by instrument, net inflows of funds from abroad were extensive to all maturities, corresponding in the main to short-term maturities, which were responsible for 58.5% of total funds received from abroad (€20,258 million, against outflows of €48,309 million the previous year). Somewhat lower were the net capital inflows attributable to long-term instruments, which amounted to €14,366 million (€13,915 million in 2006), and which were concentrated in ORSs. The increase in short-term financing reflects the scant activity and tightening of financing conditions for institutions on international wholesale markets, especially the long-term debt markets.

Other Spanish investment abroad recorded net outflows of €58,911 million in 2007, 14% down on the previous year (see Chart 3.6). Much of this decline related to MFIs, since their transactions gave rise to net outflows totalling €51,107 million, 13% down on the previous year, as a result of the reduction in funds placed in short-term instruments (by 20%, to stand at €39,604 million). Along the same lines, ORSs considerably reduced their net investment abroad (by 36%), which stood at €6,320 million. Influencing this reduction was the high level attained in 2006, which evidenced how a sizeable foreign direct investment transaction conducted in the United Kingdom was financed.⁹

As usual, general government activity was modest, giving rise to net inflows amounting to €1,484 million, in contrast to the disinvestment (i.e. net inflows) of €31 million in 2006.

As regards instrument maturity, the decline in other investment abroad recorded in 2007 was due to short-term transactions, as these gave rise to net outflows of 46,529 million, 19.8% down on those of the previous year. This decline reflected the behaviour of the transactions of ORSs and, to a greater extent, of MFIs, whose net investment fell by 31.7% and 20.5% to €6,190 million and €39,604 million, respectively. Conversely, investment in the form of long-term instruments gave rise to far higher net capital outflows than those recorded in 2006 (17%

9. See the 2006 edition of this Report.

CAPITAL OUTFLOWS (a)
Net change in foreign assets

CHART 3.6



SOURCE: Banco de España.

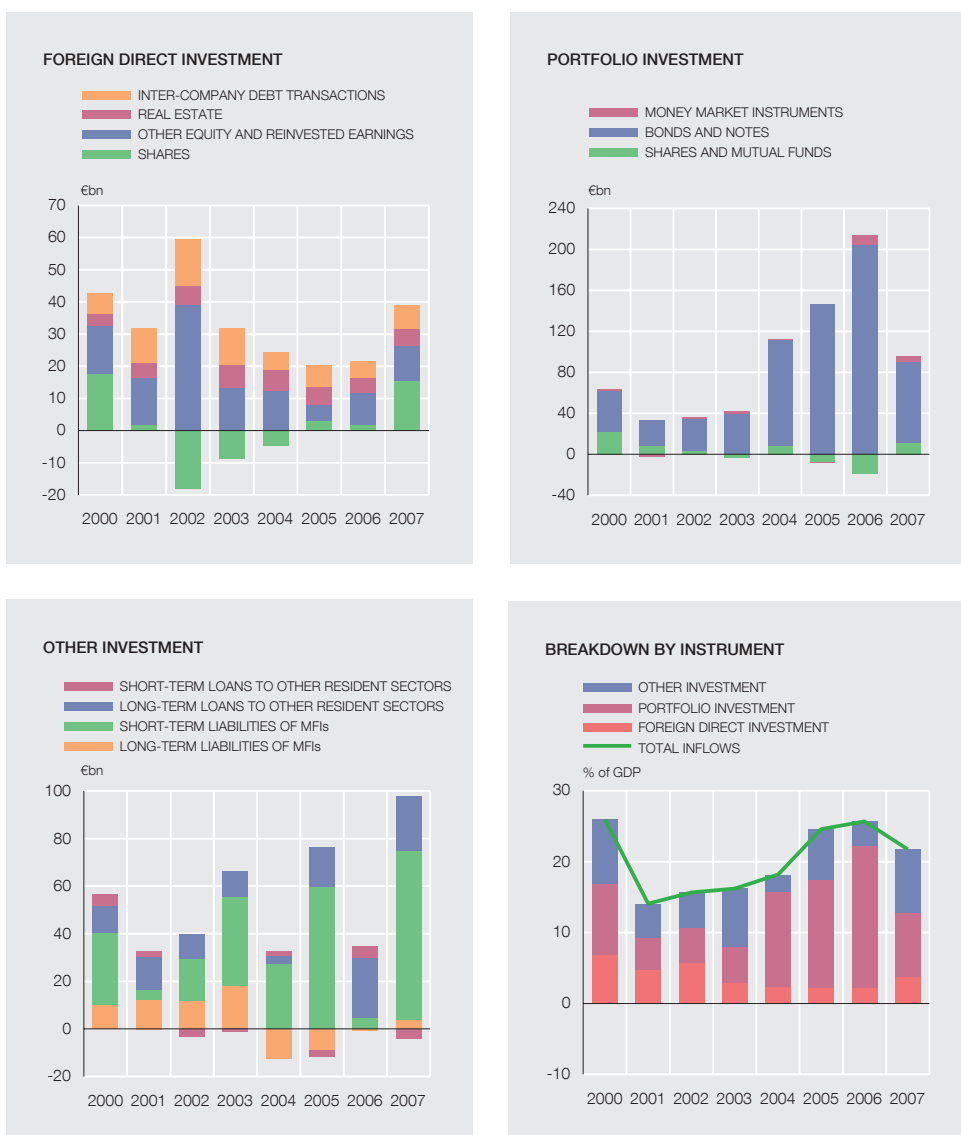
a. Excluding Banco de España.

up, amounting to €12,382 million). Contributing to this was the 28.7% increase (to €11,503 million) in MFIs' investment, which offset the decline to which the transactions by the other sectors gave rise.

There was a net inflow of *other foreign investment in Spain* of €93,535 million in 2007, far higher than the figure of €34,208 million recorded in 2006 (see Chart 3.7). Underlying this increase were the net funds routed from abroad through MFIs, totalling €74,857 million, against only €4,302 million in 2006. Most of these funds related to short-term instruments, amounting to €70,887 million (i.e. 94.7% of the total), against only €4,634 million in 2006. Of particular note was the considerable change in the behaviour of MFIs' repo transactions which, having given rise to disinvestment of €28,744 million in 2006, resulted in an inflow of €13,115 million in 2007. MFIs also raised funds from abroad in the form of other long-term investment for an amount of €3,970 million, which is in contrast to the disinvestment recorded the previous year (€603 million). Influencing the net flows raised by MFIs abroad through these types of financial

CAPITAL INFLOWS (a)
Net change in foreign liabilities

CHART 3.7



SOURCE: Banco de España.

a. Excluding Banco de España.

instrument was the impact of the financial turmoil, which prompted a change in the foreign financing strategy of Spanish MFIs. The remaining sectors contributed negatively to the raising of foreign capital in the form of other investment. Specifically, the net inflow received by ORSs fell by 37% in 2007 to €18,303 million. This decline affected both long-term and, especially, short-term instruments. General government received net funds from abroad amounting to €375 million (€1,040 million in 2006), with the disinvestment by non-residents in short-term instruments influencing this figure.

Overall, other foreign investment transactions in Spain generated a net inflow in short-term instruments valued at €66,787 million in 2007, far higher than the previous year (€9,713 million), driven by MFIs. The inflow of funds in the form of long-term instruments, which increased by 9% to €26,748 million, was much more moderate. MFIs contributed fundamentally to this increase, although ORSs continue to account for the bulk of total inflows in long-term instruments (82.6%).

3.5 Derivative financial instruments

Transactions involving derivative financial instruments in 2007 gave rise to net outflows totalling €6,832 million, marking a contrast with the net inflows the previous year (€1,919 million). It should be borne in mind that these types of transactions are not in response to the need to cover a financing gap in the economy, but to strategic and agents' hedging decisions, which is why they usually show some volatility. Most of these net outflows related to transactions with tailor-made instruments, i.e. those not negotiated on organised markets, for 89% of the total.

By institutional sector, MFIs gave rise to net outflows amounting to €4,582 million (compared with net inflows a year earlier of €2,429 million), followed by ORSs and, to a lesser extent, by general government, which posted net outflows of €1,964 million and €286 million, respectively.

3.6 Net assets of the Banco de España

In 2007 the net assets of the Banco de España fell by €14,322 million (in contrast to the €25,800 million increase in 2006). This change in the course of net external assets indirectly reflects the effect that the financial turmoil has had on the way in which the Spanish economy met its financing needs during 2007. Thus, while in the January-July period the net external assets of the Banco de España increased by €21,503 million (€18,407 million in the same period in 2006), from August to December they declined by €35,825 million (compared with the €7,393 million increase in the same period in 2006). This decline reflects exclusively the reduction in the net assets of the Banco de España vis-à-vis the Eurosystem, as a result of the change in the coverage of MFIs' financing needs, in particular the greater resort to Eurosystem liquidity auctions.

Over the year as a whole, net assets vis-à-vis the Eurosystem declined by €28,329 million (against an increase of €12,327 million in 2006), while other net assets of the Banco de España (basically debt securities, which are classified under the heading of portfolio investment) increased by €13,843 million (€12,993 million in 2006). Finally, the increase in reserves was on a much lesser scale (€164 million in 2007, against €480 million in 2006).