

#### 4 SPAIN'S INTERNATIONAL INVESTMENT POSITION IN 2007

## 4 Spain's international investment position in 2007

### 4.1 Introduction

Spain's net debit international investment position (IIP)<sup>1</sup> widened further in 2007, although slightly more slowly than in the previous year (28%, compared with 31%) to stand at €727,826 million in December (see Table 4.1). As a percentage of GDP, it increased by 11.2 pp to 69.3% (see Chart 4.1). Excluding the Banco de España, Spain's debit IIP increased by 21% to €806,747 million (76.8% of GDP, against 67.9% in 2006). The financial transactions included in the balance of payments<sup>2</sup> represented 62.2% of the change in the stock, a similar percentage to that of the previous year. If the monetary authority is excluded, the corresponding financial transactions amounted to 59.4% of the change in the net debit IIP excluding the Banco de España, a lower percentage than in the previous year. The wider debit balance vis-à-vis the external sector mainly reflects the Spanish economy's recourse to foreign savings to finance expansion of private investment and generates increased net payments of investment income to the rest of the world (Box 4.1 analyses in more detail the relationship between the change in Spain's debit IIP and the stock of investment income).

The aforementioned changes in the IIP were set against a backdrop of growing worldwide financial integration evidenced by the high level of external financial assets and liabilities outstanding between countries. In the case of Spain, the stocks of external liabilities and of external assets both continued to grow at high rates (by 14% and 8%, respectively), amounting to €2,143,125 million and €1,415,299 million, respectively.<sup>3</sup> As a result, the degree of financial integration (approximated by the sum of external financial assets and liabilities as a percentage of GDP) stood at nearly 339% of GDP at the end of 2007, nearly 15 pp more than in the previous year (despite the increased national bias in agents' investment decisions) and above that of the euro area and the United States.<sup>4</sup>

The widening of Spain's net debit IIP in recent years has been less vigorous than in other economies which have notably higher net debit positions, such as Greece and Portugal (94% and 89.9% of GDP in 2007, respectively) (see Chart 4.2). In the United States, the net debit IIP (19.2% of GDP in 2006) is relatively steady, against a background of significant current account deficits, while Japan's credit position widened appreciably to more than 52% of GDP. The euro area has a relatively small net debit balance (14.8% of GDP), although it is growing. Among the European countries, apart from those already mentioned, the United Kingdom is noteworthy for its deteriorating debit position in recent years, which contrasts with the net credit position of Germany. Although the process of international financial integration has meant that the dispersion of the IIPs of the main developed economies has increased,<sup>5</sup> these larger divergences mainly reflect their different cyclical position and the increasingly marked global imbalances of recent years.

As a result of Spain's larger debit position vis-à-vis the external sector, payments of income to the rest of the world have increased considerably. The contribution of this increase and that of the implicit return on the instruments comprising the financial assets and liabilities portfolio to the widening of the income deficit is analysed in detail in Box 4.1.

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1. The term "credit (debit) position" is used in this chapter to refer to the difference between external financial assets and external financial liabilities, i.e. the net credit (debit) position. 2. The net financial transactions of an economy do not coincide with its net lending/borrowing: the difference represents errors and omissions. However, over long periods of time these errors and omissions tend to cancel out. 3. From end-2006 the stock of financial derivatives is included (information available only since December 2006). 4. Contributing to this result is the fact that Spain is a smaller economy. 5. The cross-country comparison of IIP balances includes data relating to the monetary authority.

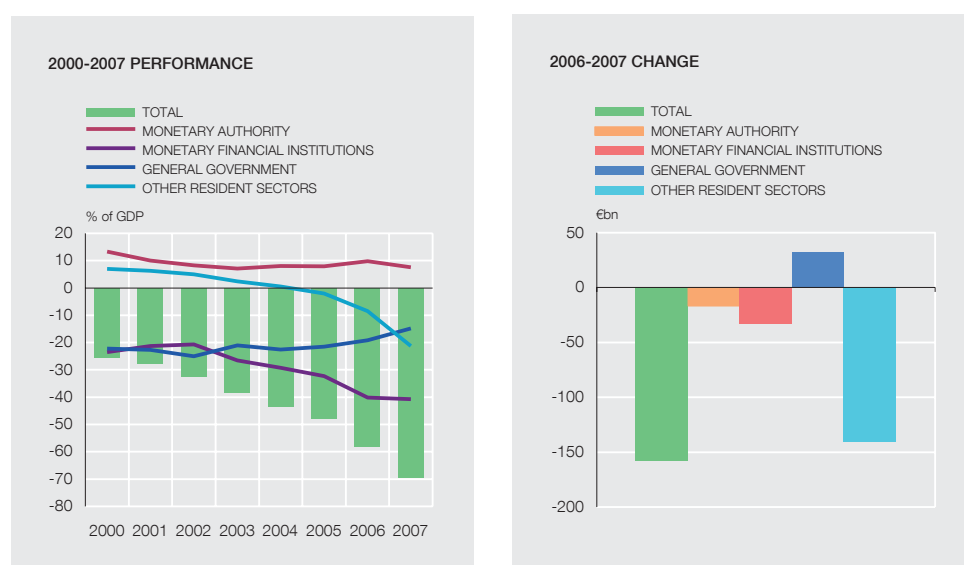
€m	2005	2006	2007			
			Q1	Q2	Q3	Q4
NET INTERNATIONAL INVESTMENT POSITION (A-L)	-434,999	-570,119	-612,766	-646,209	-683,977	-727,826
Excluding Banco de España	-506,718	-665,797	-713,153	-758,355	-773,626	-806,747
Foreign direct investment	3,434	56,423	62,988	68,599	76,926	76,697
Portfolio investment	-273,648	-508,895	-579,890	-612,874	-635,543	-638,141
Other investment (a)	-236,504	-203,730	-184,961	-198,145	-197,122	-226,454
Financial derivatives	...	-9,595	-11,290	-15,935	-17,887	-18,849
Banco de España	71,719	95,678	100,387	112,146	89,649	78,922

SOURCE: Banco de España.

a. Principally, loans, deposits and repos.

### NET IIP BY SECTOR 2000-2007 PERFORMANCE AND 2006-2007 CHANGE

CHART 4.1



SOURCE: Banco de España.

The change in an economy's IIP between two points in time basically depends on three factors: (i) the financial transactions that have taken place in the period, which reflect the economy's net borrowing; (ii) valuation effects, consisting of changes in the exchange rates of the currencies in which the external financial assets and liabilities are denominated and of changes in their prices (of which stock market prices or bond prices are a reasonable indicator); and, finally, (iii) other adjustments,<sup>6</sup> which are sporadic and include reclassifications of positions between headings. At this point it should be noted that changes in the exchange rate and in external financial asset and liability prices directly affect the value of the stock, but that they also affect it indirectly through their influence on the investment decisions of economic agents. For a detailed analysis of changes in the balance of payments financial transactions and of the setting in which they took place, see Chapter 3 of this report.

6. Including the gold sales by the Banco de España in 2007 for an amount equal to 0.2% of GDP

The significant increase in net payments of investment income to the rest of the world has been a major factor in the rise in borrowing by the Spanish economy in recent years. As evidence of this, in 2007 the investment income deficit amounted to 3% of GDP, substantially higher than in 2000 (1.2%) and accounting for nearly 30% of the increase in borrowing by Spain in that period.<sup>1</sup> These developments in the income balance reflect both the deterioration in the international investment position (IIP) of the economy and the changes in the returns on the financial instruments comprising it.

As regards the IIP, the debit balance of the Spanish economy vis-à-vis the external sector has widened uninterruptedly since 2000 to 69% of GDP at the end of 2007 (44 pp more than in 2000). The main reason for this deterioration has been the increase in the net debit position in portfolio investment, which reflects how the Spanish economy has met its net borrowing needs in recent years.

Unlike the IIP, the return on asset- and liabilities-side financial instruments vis-à-vis the external sector has not followed a clear trend, showing rises

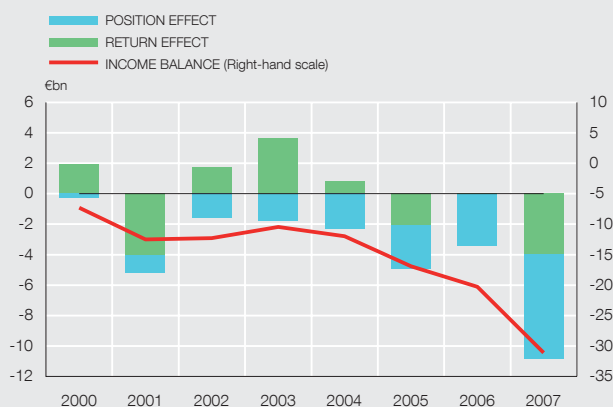
1. For convenience, the terms "investment income" and "income" will be used interchangeably.

and falls throughout the period, albeit of moderate size compared with past episodes. Short and long-term interest rates fell significantly from 2000 to 2003, holding relatively steady at those levels until end-2005, when they resumed an upward path which became steeper in the wake of the subprime crisis.<sup>2</sup> Finally, the stock markets (in Spain and in the main developed countries alike), after falling significantly in 2001 and 2002, subsequently initiated an upward trend which ran into 2007.<sup>3</sup>

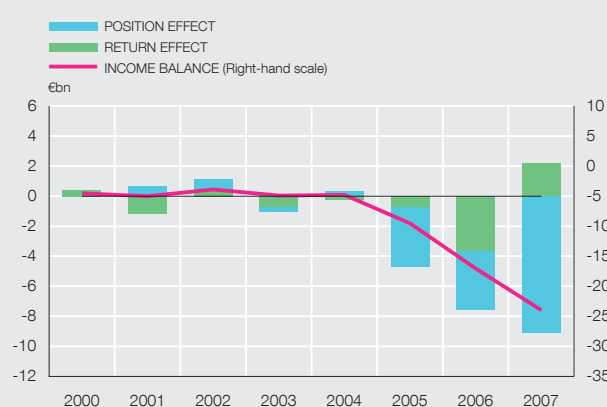
The contribution of these two factors – changes in return and in stock – to the investment income balance has varied over time. Expression [1] represents the variation in the income received (paid) for holding a financial asset (liability) vis-à-vis the rest of the world as the sum of two components. The first approximates the changes associated

2. The three-month Euribor declined from around 4.2% to close to 2% in 2003, rising subsequently as from end-2005 to stand at 4.6% in 2007. Along these same lines, the interest rate on three-year German bonds fell from nearly 4% to somewhat less than 3% in 2003, rising subsequently to 4% at end-2007. 3. The performance of stock market indices over an extensive period is considered a good indicator of corporate dividends to be paid, although year-to-year the relationship is not direct. Moreover, in this case dividend payment decisions are affected by other factors not always related to stock market prices.

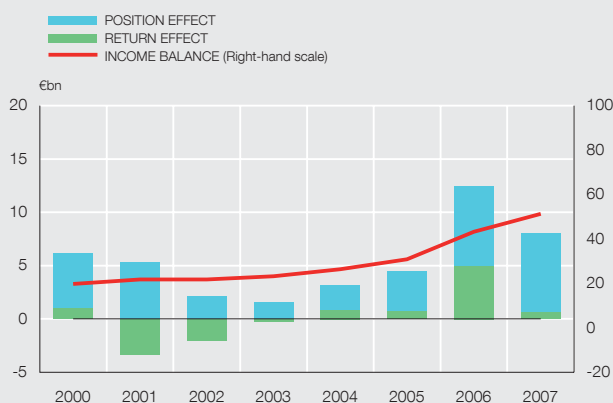
1 INVESTMENT INCOME BALANCE



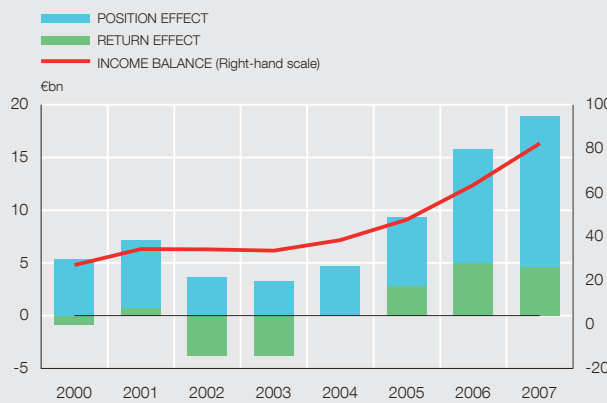
2 PORTFOLIO INVESTMENT BALANCE



3 INVESTMENT INCOME RECEIPTS



4 INVESTMENT INCOME PAYMENTS



SOURCE: Banco de España

with the variation in the implied return of the asset (return effect),<sup>4</sup> and the second the variation in the level of net debt (position effect).<sup>5</sup>

$$\Delta R_t = R_t - R_{t-1} \approx \Delta i_t \text{PII}_{t-2} + i_{t-1} \Delta \text{PII}_{t-1} \quad [1]$$

This expression can be used to obtain the contribution of each of those components to the change in investment income receipts and payments and, therefore, the deterioration in the income balance in recent years. The accompanying panels show the position and return effects estimated from equation [1] for the change in the total balance of investment income, in the balance of portfolio investment (the most important component in the behaviour of the total balance), and for the change in investment income receipts and payments.

Panel 1 shows that, after an initial period in which the return effect determined the behaviour of the total income balance, from 2004 the position effect took on a dominant role. This result is consistent with the increase in the IIP debit balance since then, which has been particularly significant in the last two years. The contribution of the return effect to the deterioration in the income balance, which has shown fluctuations generally consistent with the aforementioned behaviour of the financial markets, was also positive on average between 2005 and 2007, in line with the rise in interest rates. These results are similar to those obtained separately for the case of investment income receipts and payments (see accompanying panels). As regards the position effect, this has dominated the behaviour of receipts and payments throughout the whole of the period, reflecting the increase in the level of financial assets and liabilities vis-à-vis the external sector, against the background of financial integration and globalisation. Also, since 2004 this effect has been particularly important in payments, coinciding with an increase in borrowing by the Spanish economy. By contrast, the return effect, partly because of the moderate fluctuations in the prices of financial instru-

4. Implied returns (which exclude capital gains) are obtained by dividing the income flow generated by an instrument at  $t$  by the external asset or liability stock at  $t-1$ . This means that the changes in the position between  $t$  and  $t-1$  are not taken into account. A description of the behaviour of these returns is given in Box 4.2 of last year's report. 5. The approximation would be exact if the term  $\Delta i_t \text{PII}_{t-1}$  were included. This term has generally taken small values in all the headings and instruments discussed in the period 2000-2007.

ments, has, except on limited occasions, made a fluctuating and smaller contribution to income receipts and payments. Of note is the positive contribution of the return effect to the behaviour of income receipts and payments in response to the increase in interest rates.

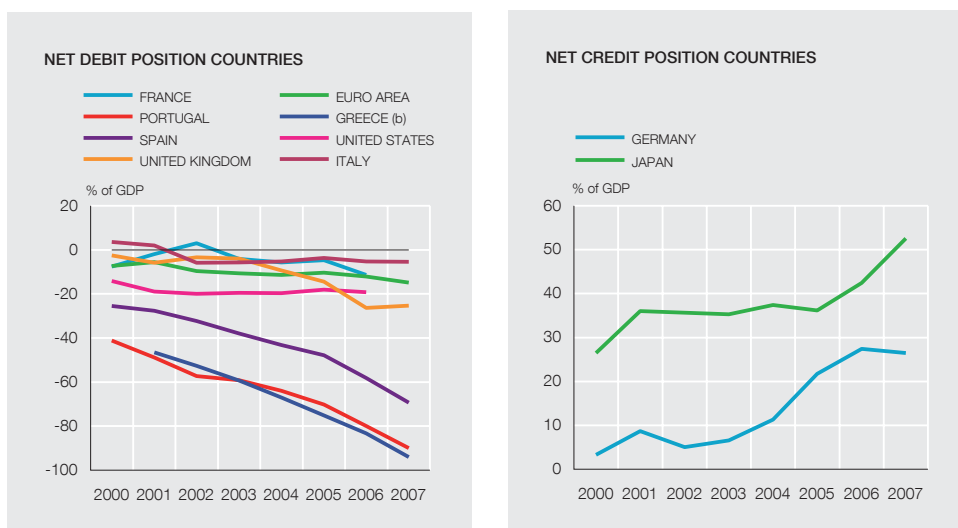
As noted above, portfolio investment is the item which has most contributed to the recent change in the income balance, owing basically to the position effect (see panel 2). This reflects the fact that a portion of the funds raised abroad took the form of purchases of bonds issued by (monetary and non-monetary) financial institutions, particularly asset-backed securities<sup>6</sup>, which prompted a deterioration in the portfolio investment debit balance. The position effect has not only been very significant in the deterioration in the income balance, but also accounts for most of the increase in stocks of foreign financial claims on and liabilities to the rest of the world. Unlike the position effect, governed by portfolio investment, changes in the return effect cannot be associated with a specific item. Thus, for instance, the positive contribution of the return effect to the deterioration in the income deficit is mainly due to other investment<sup>7</sup> and direct investment<sup>8</sup>, which offset the mitigating effect on the portfolio investment income balance.<sup>9</sup>

The return and position effects were of similar significance in the dynamic of receipts, payments and income balance between 2000 and 2003; yet in the period 2004-2007, changes in investment income balances were mainly due to the effects of the increase in the net external debt position (75% of the total), while the return effects, which were generally consistent with developments on markets, had a significantly smaller weight (25% of the total) and showed greater fluctuations.

6. A significant fraction of these asset-backed securities were variable-rate instruments, generally indexed to a money market interest rate. See Chapter 2 of this Report. 7. During the period 2000-2006, the changes in the net balance of other investment income were minor, and, generally, the position and return effects were moderate and of the opposite sign. 8. In the case of FDI, the position and return effects in the net balance of income have behaved erratically throughout the period according to the results obtained in this exercise. This highlights, first, the greater volatility of dividends, and, further, the practical problems of valuing FDI shares and other equity at market prices (see Chapter 5 of this Report). 9. In the case of portfolio investment, the positive return effect chiefly reflects the significant increase in income associated with assets of these types of securities owing to the rise in interest rates.

In 2007 the direct impact of valuation effects<sup>7</sup> and other adjustment effects was not very significant in total (see Table 4.2). The euro's appreciation in 2007, both against the dollar and

7. The impact of valuation effects may differ considerably from one type of investment to another. It depends on the size of the external assets and liabilities in each type of investment, on the characteristics of the instruments in which it is made, on the currencies used and, finally, on the characteristics of the information sources and calculation methods used to estimate the stocks of its type of investment. Thus, in the case of Spain, most foreign direct investment (FDI) in the form of shares and other equity is not valued at market prices, since in this case the stock is compiled as the accumulation of balance of payments financial transactions, adjusted by exchange rate changes. For this reason, the price changes reflected by the IIP do not move fully in parallel with stock market price movements. In other financial instruments, the IIP adequately reflects price variations, either because the information sources used enable the stocks to be measured at market prices in each period (this is so in portfolio investment) or because the instruments are not negotiable and, under the applicable methodology, their price changes must not be recorded (this is the case of loans and deposits).



SOURCE: National sources and ECB.

- a. Monetary authority data are included. The latest available information is given.  
 b. Data available from 2001.

against sterling (see Table 4.3), reduced the equivalent euro value of assets and liabilities denominated in other currencies.<sup>8</sup> In line with the mix of currencies in the IIP, the exchange rate developments are having a particular influence on the foreign direct investment assets and on the assets and liabilities of other investments.<sup>9</sup> Meanwhile, the stock markets ended 2007 with moderate gains, which in Spain were larger than in the United States but similar to those in the rest of Europe.<sup>10</sup> Lastly, the prices of European fixed-income securities fell, in line with the rise in their interest rates, while in the United States the year ended with slightly higher prices (see Table 4.3). The overall impact of the aforementioned developments in financial variables on Spain's IIP was small, since the negative effect of the euro's appreciation was practically offset by the positive price effect. Specifically, in the case of the widening of the net debit IIP, excluding the Banco de España and financial derivatives,<sup>11</sup> which was 8.2 pp of GDP, financial account transactions represented 6.1 pp of GDP, with the rest relating mainly to other adjustments. According to the estimates made (which require assumptions, so the results should be interpreted with caution), the behaviour of external financial asset and liability prices contributed, in overall terms, to reducing the net debit IIP of the Spanish economy by approximately 0.9 pp of GDP, which contrasts with the contribution of opposite sign estimated for previous years. Most of this reduction was due to investment in fixed-income instruments (0.6 pp of GDP), and the remainder to capital holdings. This was largely offset by the valuation effect as-

**8.** An appreciation of the euro of 10% against the dollar means that Spain's debit balance vis-à-vis the rest of the world widens by slightly less than 0.5 pp of GDP. **9.** At end-2007 more than 69% of external assets and nearly 85% of external liabilities were denominated in euro. Currencies other than the euro accounted for nearly 46% of total FDI assets and somewhat more than 35% and 22% of the assets held in the form of portfolio investment securities under the capital holdings and other investment headings, respectively. Notable in FDI abroad were the dollar, with 23%, and sterling, with more than 14%, while in the balance of capital holdings issued by non-residents, the dollar exceeded 15%, accounting for nearly 12% of other investment assets (sterling exceeded 4%). As for foreign liabilities, only in other investment did the currencies other than the euro account for a truly significant proportion (nearly 26%), with the dollar making up nearly 16% and sterling more than 8%. **10.** It should be taken into account that non-residents' investments in the capital issued by residents in Spain are concentrated in a small number of companies, which means that the change in the IBEX 35 does not always properly reflect the impact of the valuation effect on the stock of IIP. The same can be said of assets taking the form of capital holdings, which are concentrated in European firms. **11.** Financial derivatives are excluded because of the difficulty in finding representative price indices which enable the valuation effects of this heading to be estimated satisfactorily.

€m	NET (b)			ASSETS			LIABILITIES		
	CHANGE IN STOCK	TRANSACTION	% VALUATION EFFECT AND OTHER ADJUSTMENTS (c)	CHANGE IN STOCK	TRANSACTION	% VALUATION EFFECT AND OTHER ADJUSTMENTS (c)	CHANGE IN STOCK	TRANSACTION	% VALUATION EFFECT AND OTHER ADJUSTMENTS (c)
	2005	-75,718	-62,932	3.0	187,013	160,263	3.1	262,731	223,196
2006	-159,079	-109,076	9.9	167,344	142,503	2.4	326,423	251,579	4.8
2007	-140,950	-83,769	8.7	124,631	144,545	-1.7	265,581	228,314	2.0

SOURCE: Banco de España.

a. Excluding Banco de España.

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

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

## FINANCIAL MARKET DEVELOPMENTS

### Prices, interest rates and exchange rates

TABLE 4.:

	STOCK EXCHANGE INDICES (a)			EXCHANGE RATE (b)		LONG-TERM INTEREST RATE (c)		
	IBEX 35	EUROSTOXX 50	S&P 500	DOLLAR	STERLING	EURO AREA	US	UK
2005	18.2	21.3	3.0	-11.6	-2.3	3.41	4.46	4.27
2006	31.8	15.1	13.6	9.1	-1.0	3.90	4.57	4.54
2007	7.3	6.8	3.5	10.2	7.2	4.38	4.10	4.68

SOURCES: ECB and Banco de España.

a. Cumulative rate of change. End-period data.

b. Cumulative rate of change, calculated with respect to the mean of the final month of the same period of the previous year. National currency per euro.

c. Mean of the final month of the period.

sociated with the exchange rate in 2007, which acted to widen the debit position by around 0.8 pp of GDP. Finally, in 2007 other adjustments widened the debit balance by 2.2 pp of GDP, an appreciably higher percentage than in previous years.

A basic factor to be taken into account in assessing Spain's net debit position vis-à-vis the external sector is the fact that part of this increase stemmed from financial instruments which, by their very nature, are not claimable, such as shares and other corporate capital holdings,<sup>12</sup> so the actual indebtedness of the Spanish economy is lower than that suggested by the total figures. Lastly, the size of valuation effects in the behaviour of the net external financial wealth of the various institutional sectors depends on the composition of their portfolios, as described in Box 4.2, which analyses the sensitivity of the private and public sectors' net external financial wealth to changes in asset prices and exchange rates.

#### 4.2 Composition of the IIP by institutional sector

The sectoral disaggregation shows that the widening of the net debit IIP (by 11.2 pp of GDP) was mainly due to other resident sectors (ORSs), the debit balance of which increased by 12.8 pp (see Chart 4.1). Also contributing to this widening were the decrease

<sup>12</sup> In the period 2003-2007, the net price effect of capital holdings was, in annual average terms, around 25% of the growth of the net debit IIP (excluding the Banco de España).

The increase in the Spanish economy's net debit position vis-à-vis the rest of the world reflects a recurring gap in recent years between Spanish saving and investment. It also shows that foreign financial assets held by Spaniards have appreciated to a lesser degree than their liabilities vis-à-vis the rest of the world. The impact of changes in foreign asset and liabilities prices on the various institutional sectors' foreign financial wealth is not uniform, since it depends on whether or not these sectors have a credit or debit position vis-à-vis the rest of the world and on the breakdown by instrument of their position. At times of uncertainty and volatility on financial markets, when changes in prices and the exchange rate bear increasingly on the international investment position (IIP), it is worth identifying the extent to which the various sectors' net financial wealth vis-à-vis the rest of the world responds to these changes.

The change in the whole economy's IIP from one year to the next can be broken down into: the sum of financial transactions made throughout the year; the impact of changes in prices (the price effect)<sup>1</sup> and in the exchange rate (the exchange rate effect) on the value of financial assets and liabilities held at the beginning of the period; and the other adjustments which, by definition, cannot be classified in the above categories.<sup>2</sup> In order to estimate these effects, indices were constructed representing changes in prices and in the exchange rate of the euro against the currencies in which the

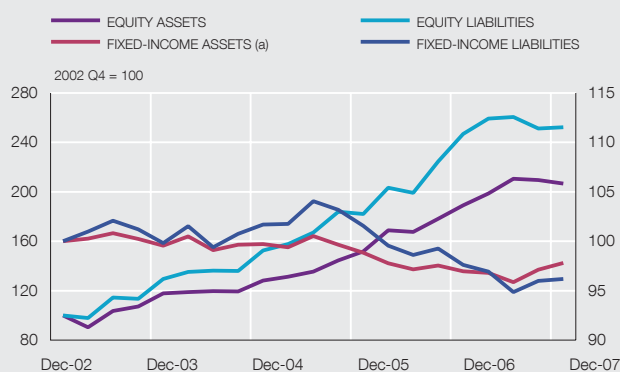
1. The market prices of financial instruments which, due to their characteristics, can undergo changes are: shares and other equity (direct investment and portfolio investment) and bonds and notes (portfolio investment). However, due to practical problems, a substantial part of the IIP's direct investment in shares and other equity does not reflect price changes from one period to the next. Chapter 5 of this report includes a detailed description of the calculation procedure used to measure the various IIP components. 2. According to the fifth edition of the *Balance of Payments Manual*, the other adjustments include, for example, reclassifications between portfolio investment and direct investment, the monetisation and demonetisation of gold, changes in sectoral structure and classification, and changes in the residence of the economic units.

various financial instruments comprising the IIP<sup>3</sup> are issued. Furthermore, these indices are built for each institutional sector in order to take into account the different composition of their portfolios.<sup>4</sup> To estimate the various effects, however, it is necessary to make certain simplifying assumptions and, consequently, the results obtained must be interpreted with caution.<sup>5</sup>

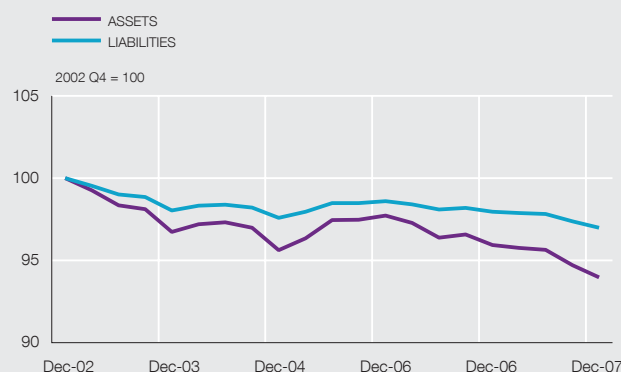
At end-2007, the Spanish economy, excluding the monetary authority, recorded a debit position<sup>6</sup> of 75% of GDP, 34.4 pp up on the end-2002 figure. Of this rise, 66.9% is explained by financial transactions with non-residents during the 2003-2007 period (23.0 pp of GDP), and the remainder by valuation effects (price and exchange rate effects) and other adjustments (11.4 pp of GDP). The fact that Spain has a credit position in foreign currency, i.e. that foreign assets denominated in a currency other than the euro exceed the corre-

3. All the currencies which have a weight in each sector's asset or liability instrument of 3% or more were included in the construction of the exchange rate index. In many cases, the number of currencies which meet this requirement is small and confined to the main currencies (euro, dollar, sterling, Swiss franc and yen), which, nevertheless, represent a very large amount of the total. It is more complicated to construct a price index, and simplifying assumptions were introduced which could bias the results. This applies to portfolio investment in fixed-income securities, in which the reference price used for all institutional sectors and all instruments is the price of public debt securities issued by non-residents and held by Spaniards (on the assets side) and Spanish public debt held by non-residents (on the liabilities side). In the case of portfolio investment in other equity, on the asset side changes in the principal stock markets on which ORSs and MFIs purchase securities are considered, and on the liabilities side changes in the IBEX 35 are taken, which has proved to be a good proxy of the price effect of this IIP heading, distinguishing, in turn, between a specific stock market index for MFIs and another for ORSs. 4. Once these indices have been prepared, the price and exchange rate effects implicit in the total IIP and by sector are estimated following the procedure used by the ECB, which employs the Kalman filter to optimise the estimate on the basis of information about its determinants. See *Main changes in the components of the International Investment Position of the Euro Area*, European Central Bank, 2006. 5. See Note 3. 6. Financial derivatives and transactions of the monetary authority are excluded from the analysis throughout the Box.

1 PRICE INDICES



2 EXCHANGE RATE INDICES (a) (b)



SOURCE: Banco de España

a. Excluding the Banco de España.  
b. Of the euro versus other currencies.

## ON THE IIP (cont'd)

sponding liabilities, means that an appreciation in effective terms of the euro has a negative impact on the IIP, which is calculated in euro. For this reason, the euro's appreciation since 2002 (see Chart 3) explains around 2.5 pp of GDP of the increase in the Spanish economy's debit position. The price effect was much more significant since it contributed to the IIP increasing by 7.4 pp. This result is the sum of two contributions of opposite signs: that of other equity, which had a negative impact, and that of fixed income, which had a positive impact. In the first case, the result reflects the higher average appreciation of non-residents' holdings in the equity of Spanish firms in comparison with that of residents' holdings in foreign firms, while in the second case it is due to the higher drop recorded, since the second half of 2005, by Spanish fixed-income securities prices in relation to those issued by non-residents (see Chart 3).<sup>7</sup> Lastly,

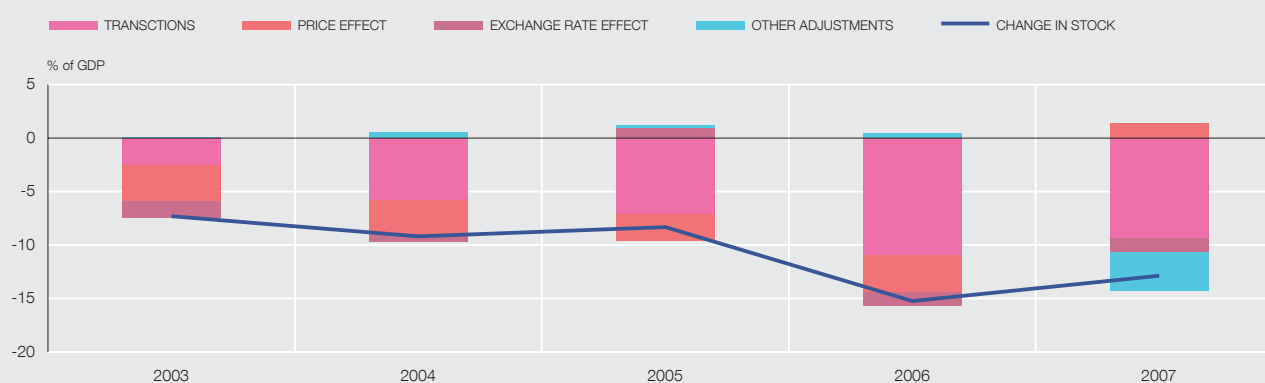
7. A higher debit or credit position in portfolio investment in equities or fixed income will sharpen the impact of price changes on the position in the following period, with the result that the position will widen or narrow depending on the direction and intensity of movements in the prices of securities which make up its foreign assets and liabilities. In the case of Spain's IIP, the only financial instruments with a price effect, in practice, are portfolio investment in bonds and notes, and in shares and other equity (see Note 2), which are characterised over the period analysed by their debit positions (averaging 33.3% and 20.9%, respectively, of the economy's debit position).

other adjustments account for the remaining 1.5 pp of GDP change in the IIP.<sup>8</sup>

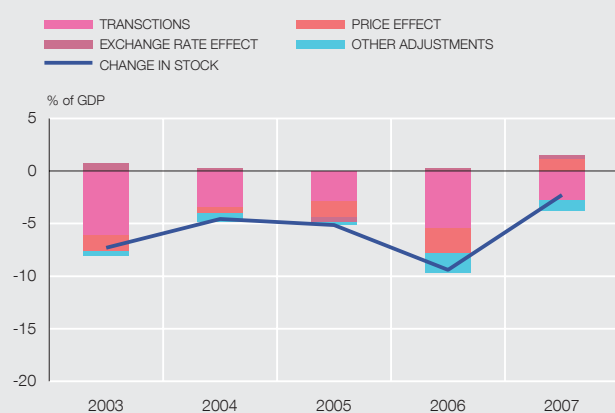
The impact of price and exchange rate changes on the net foreign financial wealth of monetary financial institutions (MFIs) and other resident sectors (ORSs) is very different. For MFIs, which had a debit IIP at the end of 2007 totalling 39% of GDP (18.3 pp up on 2002), a substantial amount of the widening of their debit position is accounted for by financial transactions undertaken throughout the period amounting to 13.1 pp of GDP (see Chart 4). The price effect (3.1 pp) also contributed to this rise on account of the higher relative appreciation of liabilities in the form of other equity in relation to assets, since the net impact of changes in fixed-income security prices was very modest. However, the latter effect has become increasingly important in recent years because a substantial amount of net borrowing in the period was financed with bonds and notes. In 2007, unlike what happened previously over the 2003-2007 period as a whole, the price effect was positive, contributing

8. The most important other adjustments were in the FDI shares and other equity heading and affected the liabilities side more than the assets side. That said, their impact on the IIP throughout the 2003-2007 period was very small (0.8% and -0.1% on the assets and liabilities sides, respectively).

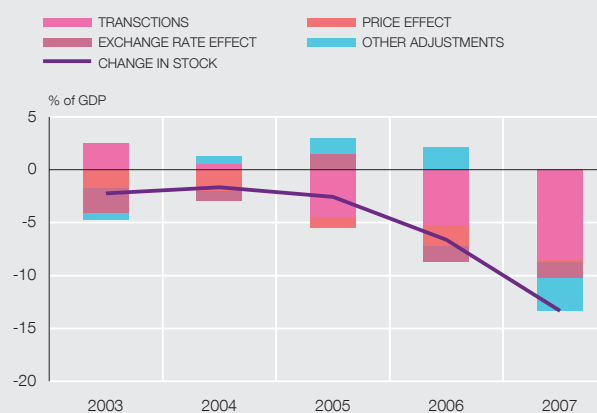
## 3 TOTAL (a)



## 4 MONETARY FINANCIAL INSTITUTIONS (b)



## 5 OTHER RESIDENT SECTORS (c)



SOURCE: Banco de España.

- a. Not including the monetary authority or financial derivatives.  
 b. Not including non-monetary financial institutions or financial derivatives.  
 c. Including non-monetary financial institutions.

## ON THE IIP (cont'd)

to reducing the MFIs' foreign debit balance due to the poorer performance of share prices in the resident financial sector relative to those which made up its foreign assets. The exchange rate effect, unlike events in the economy as a whole, contributed to reducing the sector's debit position by 0.6 pp of GDP. This result is explained by the fact that there are more foreign-currency-denominated securities on the liabilities side than on the assets side and, consequently, MFIs have a foreign currency net external debit position.<sup>9</sup> Finally, other adjustments explained 2.8 pp of GDP of the widening in the period analysed.

The external debit position of ORSs, which include non-monetary financial institutions, stood at 21.3% of GDP in 2007, in contrast with the credit position of 5% of GDP in 2002. Chart 5 shows that, like MFIs, financial transactions in the period account for most of the widening of the ORSs' external debit position (14.2 pp of GDP). Additionally, in this case, unlike MFIs and general government, transactions have played a larger and growing role since 2005. This shows that the Spanish economy has covered its borrowing needs in recent years to a greater degree with securitised assets (against a backdrop of significant growth in mortgage credit) and with issues by subsidiaries of MFIs classified under ORSs.<sup>10</sup> As at MFIs, the

9. This fact mainly reflects the high weight of liabilities denominated in currency other than the euro under Other investment. The positive impact on changes in the MFIs' net IIP between 2007 and 2002 of the exchange rate effect associated with MFIs' Other investment is estimated to be around 0.9 pp of GDP. Conversely, the exchange rate effect on MFIs' portfolio investment in fixed income was negative and stood at 0.4 pp of GDP, since foreign-currency-denominated assets exceeded liabilities. 10. See Box 3.2 of the report *The Spanish Balance of Payments and International Investment Position, 2005*: "The securitisation process and its impact on the balance of payments".

price effect contributed to raising the external debt position (7.1 pp of GDP) due to the negative effect of other equity (7.7 pp of GDP), since fixed income had a positive effect (0.6 pp of GDP). However, unlike MFIs, changes in the prices of liabilities classified as other equity were relatively more favourable in 2007 than those in the corresponding assets and, consequently, the total price effect continued to be negative that year. Similarly, the exchange rate effect pushed the external debit balance 5.7 pp of GDP higher during the period, in this case due to the larger volume of assets denominated in foreign currency than liabilities.<sup>11</sup> Other adjustments contributed to reducing the ORSs' debit position vis-à-vis the rest of the world by 0.7 pp of GDP.

In short, the respective impact of price and exchange rate changes on MFIs' and ORSs' net external wealth has been different. These divergences are mainly explained by the different composition of their financial assets and external liabilities. In the two major sectors analysed, financial transactions carried out in the period explain most of the changes in their net external investment positions. This has been so because these sectors have attracted the foreign saving required to cover the Spanish economy's net borrowing. However, the exchange rate effect has had a negative impact on the ORSs' net debit IIP and a positive effect on that of MFIs. Conversely, the price effect has, on average, had a negative impact on both sectors, although this was sharper in the case of ORSs.

11. Unlike MFIs, the sign of the exchange rate effect stems from the equity of direct investment issued by non-residents (5.2 pp of GDP), in which the weight of foreign currency is significant. On average in the period, 40.4% of ORSs' total assets took the form of FDI shares and other equity, 42.7% of which is denominated in foreign currency. Conversely, in the corresponding liabilities, scarcely 2% is denominated in foreign currency.

in the Banco de España's credit position and the increase in the net debit balance of monetary financial institutions (MFIs) (by 2.2 pp and 0.5 pp, respectively). By contrast, the debit position of general government decreased by 4.3 pp.

In 2007 the rate of expansion of the debit position of MFIs moderated appreciably (8%, against 35% in 2006), taking it to €427,140 million in December (see Chart 4.3). This widening took place against a background in which financial assets showed greater dynamism than financial liabilities (24% and 16%, respectively). Thus the balance as a percentage of GDP increased slightly to 40.7%. MFIs have played a significant role in channelling from abroad the funds needed to finance the gap between credit and deposits in Spain, primarily through the issuance of debt securities.

In 2007 the net debit position of the ORSs increased further to €223,698 million, against €83,475 million at end-2006. This amounted to 21.3% of GDP, against 8.5% in 2006 (see Chart 4.3). Liabilities grew more strongly than assets (19% and 3%, respectively). According to the financial transactions data of the balance of payments, ORSs channelled more than 84% of the net inflows recorded by the Spanish economy in 2007, through asset-backed se-



SOURCE: Banco de España.

curities and fixed income issues by MFI subsidiaries. Despite this, from summer the stock of this type of securities held by non-residents declined.

By contrast, the debit position of general government decreased more sharply in 2007, with a fall of 17%. As a result, this balance stood at €155,909 million (14.9% of GDP). This correction of the net debit position was in line with the net outflows of funds resulting from financial transactions with the rest of the world, in a year in which the share of non-residents in the holdings of securities issued by the Treasury decreased, against a background of net redemptions of debt by general government. Additionally, the Social Security Reserve Fund continued its portfolio investments abroad.

In 2007 the net credit position of the monetary authority decreased by 17% to €78,922 million, representing 7.5% of GDP. This change reflected primarily that of net assets vis-à-vis the Eurosystem and, to a much lesser extent, that of reserves. The increase in other net assets could not offset the changes in those items.

The developments described above affected the sectoral structure of the external financial assets and liabilities of the Spanish economy (see Table 4.4). On the assets side, increases were seen in the relative weight of MFIs and, to a lesser extent, of general government, while the share of the monetary authority and of ORSs decreased.<sup>13</sup> Notable on the liabilities side was the decrease in those to general government, while the weight of the rest of the sectors, particularly the ORSs, increased.

### 4.3 Composition of the IIP by type of investment

In 2007 the net debit position of the Spanish IIP excluding the monetary authority<sup>14</sup> increased by 21% to €806,747 million (76.8% of GDP, against 67.9% in 2006). The breakdown by instrument reveals that the increase is explained mainly by portfolio investments (see Chart 4.4), the debit balance of which increased by 8.9 pp of GDP. Much less sizeable were the contributions of other investment and of financial derivatives, the debit balances of which

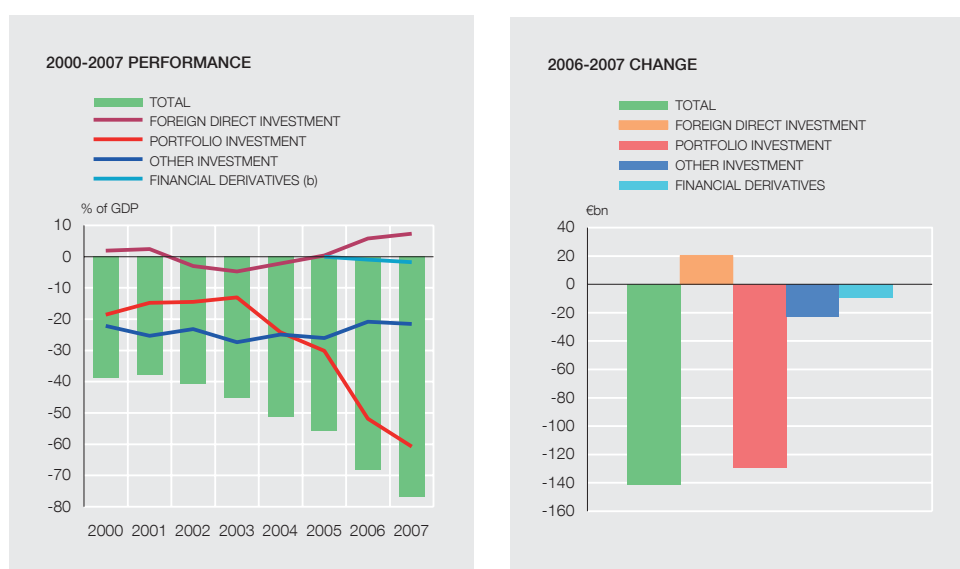
<sup>13</sup> When analysing the sectoral composition of the assets it is important to take into account that it is affected by the fact that a large proportion of the investments of Spanish MFIs in the capital of non-resident companies is routed through holding companies, which are included in the sector ORSs. <sup>14</sup> Unless otherwise indicated, the analysis in this chapter does not include the Banco de España.

% of total	MONETARY AUTHORITY		MFIs		GENERAL GOVERNMENT		ORSs	
	ASSETS	LIABILITIES	ASSETS	LIABILITIES	ASSETS	LIABILITIES	ASSETS	LIABILITIES
	Average 2002-2004	7.6	0.1	28.3	38.6	1.4	17.1	62.8
2005	6.5	0.0	30.5	40.9	1.6	13.8	61.4	45.3
2006	7.4	0.0	28.8	41.1	2.1	11.5	61.7	47.4
2007	5.8	0.2	32.9	41.7	2.5	8.9	58.8	49.3

SOURCE: Banco de España.

NET IIP BY INSTRUMENT  
2000-2007 PERFORMANCE AND 2006-2007 CHANGE (a)

CHART 4.4



SOURCE: Banco de España.

a. Excluding Banco de España.

b. In 2006 Q4 the Banco de España began to publish data on the financial derivatives position.

increased by 0.8 pp of GDP in both cases. By contrast, the credit position of FDI widened by 1.6 pp of GDP.

Meanwhile, during 2007 the relative weight of portfolio investment in total assets decreased, while that of the other instruments rose, particularly that of FDI and other investment. On the liabilities side, the changes were less significant, with a decrease in the share represented by portfolio investment and an increase in the weight of financial derivatives (see Table 4.5).

#### 4.3.1 FOREIGN DIRECT INVESTMENT

The net credit balance of foreign direct investment (FDI) increased appreciably (see Chart 4.5) to €79,697 million, representing 7.3% of GDP. This was mainly due to the large amount of Spain's direct investment abroad, which reached a new all-time high in terms of levels. Foreign direct investment transactions in Spain rose appreciably.

The performance of the stock of direct investment abroad was shaped mostly by the behaviour of the related balance of payments financial transactions (see Table 4.6). A significant ef-

**INTERNATIONAL INVESTMENT POSITION**  
Breakdown by instrument (a)

TABLE 4.5

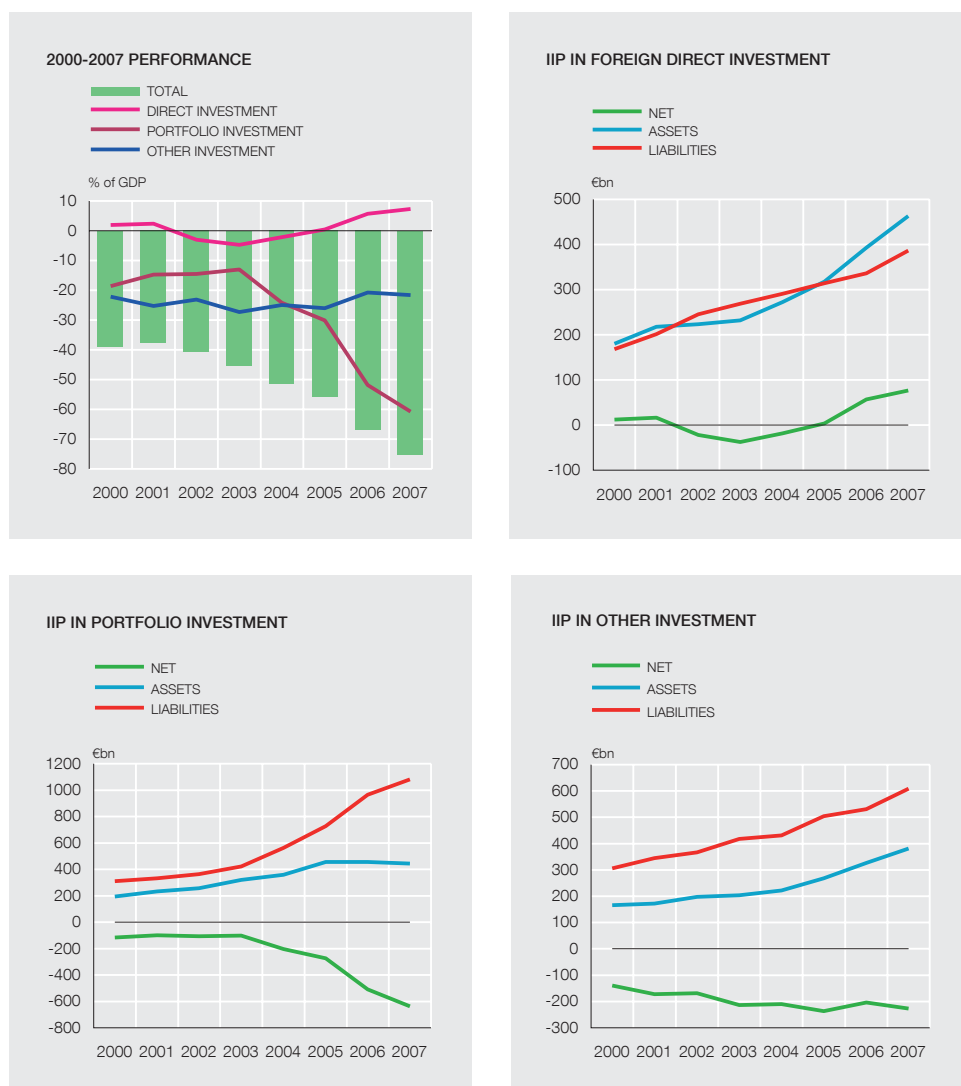
% of total	FOREIGN DIRECT INVESTMENT		PORTFOLIO INVESTMENT		OTHER INVESTMENT		FINANCIAL DERIVATIVES	
	ASSETS	LIABILITIES	ASSETS	LIABILITIES	ASSETS	LIABILITIES	ASSETS	LIABILITIES
	Average 2002-2004	31.8	24.0	40.8	39.7	27.4	36.3	...
2005	30.5	20.3	43.7	47.1	25.8	32.6	...	...
2006	32.5	17.9	37.7	51.5	27.1	28.3	2.7	2.3
2007	34.7	18.1	33.3	50.5	28.6	28.4	3.3	3.0

SOURCE: Banco de España.

a. Excluding Banco de España.

**INTERNATIONAL INVESTMENT POSITION, BY INSTRUMENT (a)**

CHART 4.5



SOURCE: Banco de España

a. Excluding Banco de España.

## Reconciliation of the change in the IIP stock with the balance of payments transactions (a)

	NET (b)			ASSETS			LIABILITIES		
	CHANGE IN STOCK	TRANSACTION	% VALUATION EFFECT AND OTHER ADJUSTMENTS (c)	CHANGE IN STOCK	TRANSACTION	% VALUATION EFFECT AND OTHER ADJUSTMENTS (c)	CHANGE IN STOCK	TRANSACTION	% VALUATION EFFECT AND OTHER ADJUSTMENTS (c)
2005	21,825	13,517	45.2	45,593	33,636	4.4	23,769	20,119	1.3
2006	52,989	58,479	159.9	74,714	79,913	-1.6	21,725	21,434	0.1
2007	20,274	48,383	49.8	70,449	87,388	-4.3	50,175	39,005	3.3

SOURCE: Banco de España.

a. Excluding Banco de España.

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

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

fect was also exerted by the appreciation of the euro against the main currencies, particularly the dollar,<sup>15</sup> which generated a negative valuation effect on the equivalent euro value of external financial assets. All this meant that the stock of Spanish direct investment abroad rose by 18% in 2007 (23% in 2006) to €463,081 million (44.1% of GDP, up 4.1 pp on 2006).

The breakdown by instrument of the stock of Spain's foreign direct investment abroad showed a high degree of concentration in shares and other equity, while the rest was concentrated in inter-company debt transactions. Within equity, shares are the preferred form of residents' holdings of FDI (76.3% of the total), while other direct holdings amounted to 16.8%.<sup>16</sup> The relative weight of shares increased by nearly 4 pp at the expense of other direct holdings. Lastly, real estate continues to account for a minority, albeit growing, share (2.2%).

Geographical analysis confirms the predominance of the EU, with nearly 63% of Spanish FDI abroad (see Table 4.7), including most notably the euro area (39.6% of total FDI assets). The United Kingdom accounted for a significant share of the stock (17.1%), reflecting the significant FDI transactions by Spanish firms in this country in recent years. The new members of the EU accounted for 5.3% of total. As regards the rest of the world, Latin America was again the leading area (20.7% of total), followed at a distance by the United States (7.8%). Comparison with end-2006 shows a moderate increase in the relative importance of the EU, mainly due to the euro area. In the rest of the world, the share of Latin America decreased and that of the United States increased. These changes generally reflected the course of Spanish FDI transactions abroad in 2007, with a significant increase in those with the euro area, and the impact of the euro's appreciation, which lowered the equivalent euro value of investments outside the euro area.

The stock of FDI in Spain grew by 15% in 2007 to €386,384 million, which in terms of GDP was an increase of 2.5 pp to 36.8%. The balance of payments financial transactions were responsible for a large part of the increase in this stock (see Table 4.6).<sup>17</sup>

Disaggregation by instrument of the stock of FDI in Spain in 2007 showed, as usual, a lower concentration than that of FDI assets, basically due to the importance of non-residents' invest-

15. See Notes 8 and 9. 16. Other equity includes principally capital contributions to branches, acquisitions of firms without PLC status and reinvested profits. 17. See Notes 8 and 9.

	SPANISH FOREIGN DIRECT INVESTMENT				FOREIGN DIRECT INVESTMENT IN SPAIN			
	2006		2007		2006		2007	
	€m	% OF TOTAL	€m	% OF TOTAL	€m	% OF TOTAL	€m	% OF TOTAL
WORLD TOTAL	392,631.7	100.0	463,080.5	100.0	336,208.8	100.0	386,383.5	100.0
EU 27 (a)	236,443.4	60.2	290,875.6	62.8	248,599.2	73.9	296,240.9	76.7
Euro area	151,749.0	38.6	183,514.2	39.6	178,094.7	53.0	217,563.5	56.3
Germany	14,922.3	3.8	18,513.9	4.0	20,487.4	6.1	18,161.1	4.7
France	24,624.2	6.3	28,611.1	6.2	21,154.2	6.3	23,212.9	6.0
Netherlands	26,711.9	6.8	40,309.2	8.7	50,021.2	14.9	52,349.1	13.5
Luxembourg	38,585.0	9.8	40,559.6	8.8	37,893.5	11.3	42,957.2	11.1
Portugal	21,302.0	5.4	22,462.6	4.9	14,132.9	4.2	14,472.4	3.7
United Kingdom	65,569.3	16.7	79,021.5	17.1	61,704.5	18.4	68,661.2	17.8
New EU members (b)	15,910.6	4.1	24,397.4	5.3	1,488.7	0.4	1,785.1	0.5
Switzerland	12,928.1	3.3	12,307.8	2.7	8,977.8	2.7	9,447.7	2.4
United States	27,485.0	7.0	36,255.0	7.8	56,453.7	16.8	57,891.3	15.0
LATIN AMERICA	93,582.7	23.8	96,055.4	20.7	5,518.3	1.6	7,449.3	1.9
Argentina	20,686.4	5.3	18,496.2	4.0	279.7	0.1	272.4	0.1
Brazil	28,309.7	7.2	29,798.4	6.4	729.8	0.2	1,394.9	0.4
Chile	9,360.4	2.4	9,323.3	2.0	999.7	0.3	1,018.2	0.3
Mexico	20,367.3	5.2	23,249.1	5.0	1,150.0	0.3	1,117.8	0.3
Morocco	2,965.4	0.8	3,264.9	0.7	107.7	0.0	109.8	0.0
Japan	1,780.9	0.5	1,781.8	0.4	2,411.7	0.7	2,118.3	0.5
Australia	800.6	0.2	2,066.7	0.4	177.0	0.1	209.9	0.1
MEMORANDUM ITEM: OECD	301,122.2	76.7	368,657.8	79.6	323,584.6	96.2	371,910.8	96.3

SOURCE: Banco de España.

a. EU 27: 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 the corresponding dependencies of their economic territory.

b. New members: Cyprus, Czech Republic, Estonia, Hungary, Lithuania, Latvia, Malta, Poland, Slovakia, Romania and Bulgaria.

ments in real estate. Thus shares and other equity accounted for 77.8% of total. The relative weight of shares slightly exceeded that of other direct holdings (31.2% and 28.9% of the total, respectively), unlike the situation in FDI abroad. Another notable feature is the importance of the balance of non-residents' real estate, which amounted to 17.7% of the total. Meanwhile, inter-company debt transactions represented 22.2% of the total, a higher percentage than in the case of FDI assets.

Turning to the geographical composition of FDI in Spain, as usual the EU was the main investor, since it accounts for most of the stock (76.7% of the total of 2007) (see Table 4.7). The euro area accounted for a significant fraction, with more than 56% of the total liabilities, this share being appreciably higher than in assets. Also notable was the relative importance of the United Kingdom (17.8% of total). In the rest of the world, the main investor country was the United States, with 15%. Unlike in Spanish FDI abroad, the role of Latin America was, as might be expected, minor. The behaviour of FDI financial transactions in Spain augmented the concentration of FDI from the euro area, such that its share in the stock increased by 3.3 pp in that year.

## Reconciliation of the change in the IIP stock with balance of payments transactions (a)

€m	NET (b)			ASSETS			LIABILITIES		
	CHANGE IN STOCK	TRANSACTION	% VALUATION EFFECT AND OTHER ADJUSTMENTS (c)	CHANGE IN STOCK	TRANSACTION	% VALUATION EFFECT AND OTHER ADJUSTMENTS (c)	CHANGE IN STOCK	TRANSACTION	% VALUATION EFFECT AND OTHER ADJUST- MENTS(c)
<b>TOTAL</b>									
2005	-70,464	-58,734	5.8	95,429	79,741	4.4	165,892	138,475	4.9
2006	-235,247	-200,030	12.9	951	-4,092	1.1	236,198	195,938	5.5
2007	-129,246	-104,360	4.9	-12,396	-8,586	-0.8	116,850	95,774	2.2
<b>EQUITIES AND SHARES IN MUTUAL FUNDS</b>									
2005	11,967	23,667	11.1	26,104	15,757	13.3	14,137	-7,910	12.0
2006	-19,299	39,513	63.1	29,037	21,114	7.6	48,336	-18,399	33.8
2007	-38,053	-18,742	17.2	1,603	-6,767	6.3	39,656	11,976	11.3
<b>BONDS AND NOTES AND MONEY MARKET INSTRUMENTS</b>									
2005	-82,431	-82,401	0.0	69,325	63,984	1.9	151,756	146,385	1.4
2006	-215,948	-239,543	-13.1	-28,086	-25,206	-0.8	187,862	214,337	-5.0
2007	-91,193	-85,618	1.4	-13,999	-1,819	-3.8	77,194	83,799	-0.9

SOURCE: Banco de España.

a. Excluding Banco de España.

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

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

## 4.3.2 PORTFOLIO INVESTMENT

In 2007 the debit position in portfolio investment widened by 25%, following a strong rise (of 86%) in the previous year. This took the position to €638,141 million (see Chart 4.5), equal to 60.8% of GDP. Unlike in the 1990s, when the net debit balance of portfolio investment rose due to the acquisition of Spanish public debt by non-residents, in the last few years this increase has come from securities issued by the private sector (MFIs and ORSs), in keeping with the pattern of net borrowing by the various institutional sectors.

The widening of the net debit position in portfolio investment was generally consistent with the behaviour of the balance of payments financial transactions (see Table 4.8). The appreciation of the euro also contributed to the increase in this debit position, since it reduced the equivalent euro value of assets denominated in other currencies, whereas the price effect acted in the opposite direction, mainly due to the positive net effect of debt security price changes on financial assets and liabilities held in the form of bonds.

Analysis by institutional sector of the portfolio investment balance shows that MFIs accounted for 43.6% of the resulting net debit balance, followed by ORSs with 33.2% and, to a lesser extent, by general government with 23.2%. The relative weight of ORSs increased significantly in line with the increase in their borrowing needs, while the improvement in the public accounts acted in the opposite direction. The private sector's debit position (the result of aggregating the positions of MFIs and ORSs) amounted to 46.7% of GDP, up 13.2 pp on 2006. Mention should be made of the high volume of both liabilities and, in particular, portfolio assets of ORSs (49.3% and 72.6% of the total, respectively).

The stock of Spain's portfolio investment abroad stood at €443,290 million in 2007, a decrease of nearly 3% with respect to end-2006. Consequently, its share of GDP decreased by

4.2 pp to 42.2%. This decline, which was concentrated in the second half of the year, coincided with a sharper appreciation of the euro against the dollar and with the financial turmoil in the international markets, which has affected the manner in which the Spanish economy finances its external imbalance. The prices of financial instruments moved unevenly. The stock markets ended 2007 with moderate gains, somewhat more significant in Europe than in the United States,<sup>18</sup> while the prices of European debt securities fell and those of US debt rose slightly (see Table 4.3).

By instrument, the most important heading continued to be bonds, which represented 70.6% of the total, followed by shares and mutual funds, which amounted to 26.6%, with a significant proportion being accounted for by ORSs in both cases. Lastly, the stock of money market instruments continued to be very low (2.9%). This pattern scarcely underwent changes worthy of mention with respect to that at end-2006. Comparison between the financial account transactions and the stocks reveals that most of the change in the asset-side portfolio investment position relates to transactions.

The breakdown by geographical area confirms that the stock of portfolio investment is highly concentrated in the EU (80.9% of total), with the euro area having a particularly significant role (69.3% of total). The United Kingdom accounted for 10.2%. Most notable in the rest of the world were the United States and the tax havens (8.4% and 4.2% of the total, respectively). In comparison with 2006, there was a slight decrease in the relative weight of the EU (by 0.6 pp), due to the United Kingdom and to the United States and tax havens (down by 0.2 pp in both cases).

The stock of foreign portfolio investment in Spain grew more moderately in 2007, rising by 12% to €1,081,431 million, which represented 103% of GDP, nearly 5 pp more than at end-2006. This performance reflects the role of this type of instruments in raising foreign funds to cover the net borrowing requirements of Spanish non-financial corporations and households in recent years. However, the last part of the year saw a decrease in this stock (down by 1% with respect to the close of 2007 Q3), under the impact of the financial turmoil.

Financial account transactions accounted for 82% of the change in the total stock of foreign portfolio investment in Spain (see Table 4.8). The valuation effects were particularly significant in the case of capital holdings, against a background of moderate gains in stock market indices. By contrast, in fixed income the cumulative transactions in 2007 as a whole amounted to 109% of the change in the stock, countering the negative impact of the price falls in these instruments.

The breakdown by instrument is similar to that of assets. The most important heading continued to be bonds, which represented 71.6% of the total, followed by shares and mutual funds, with 26.4%. ORSs and MFIs accounted for most of the stock of bonds, with more than 72% of the total. The weight of these sectors is growing, while that of general government has been declining continuously since 2003. As for capital holdings, ORSs have the largest proportion of the stock. Finally, the stock of money market instruments accounted for a very small share (2%). This pattern underwent modest changes with respect to that at end-2006, with the share of bonds decreasing at the expense of the other items.

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**18.** It should be taken into account that non-residents' investments in the capital issued by residents in Spain are concentrated in a small number of companies, which means that the change in the IBEX 35 does not always properly reflect the impact of the valuation effect on the stock of IIP. The same can be said of assets taking the form of capital holdings, which are concentrated in European firms.

**STOCK OF FOREIGN PORTFOLIO INVESTMENT BY SPAIN**  
**Breakdown by geographical area and by instrument. CPIS data. 2006**

TABLE 4.9

€m				
	EQUITY SECURITIES	DEBT SECURITIES	TOTAL	WEIGHT IN TOTAL (%)
France	24,208	42,919	67,127	14.7
Germany	9,830	43,137	52,966	11.6
Italy	5,907	49,939	55,846	12.3
United Kingdom	6,952	43,088	50,040	11.0
Netherlands	6,120	38,139	44,258	9.7
Luxembourg	44,447	4,762	49,209	10.8
United States	9,360	30,248	39,608	8.7
Cayman Islands	843	14,263	15,106	3.3
Ireland	6,546	14,705	21,251	4.7
Belgium	1,000	7,277	8,278	1.8
Portugal	2,725	3,382	6,107	1.3
Other	15,255	30,634	45,889	10.1
<b>TOTAL ASSETS</b>	<b>133,193</b>	<b>322,492</b>	<b>455,685</b>	<b>100.0</b>

SOURCES: Banco de España and IMF.

Turning to the geographical distribution of portfolio investment liabilities, the IIP does not give an adequate breakdown, since it only provides information on the first known non-resident counterparty. In many cases this refers to the country of residence of a financial intermediary which does not generally coincide with that of the ultimate holder of the securities, the latter being the relevant party for the purpose of economic analysis. Analysis based on the end-investor principle can be performed using information from the geographical breakdown of portfolio assets of other countries in Spain, contained in the latest Coordinated Portfolio Investment Survey (CPIS),<sup>19</sup> which is for 2006. According to CPIS data, the most notable feature of the stock of foreign portfolio investment in Spain is its high degree of concentration, since, as at end-2006, 10 countries accounted for 91% of the total. The main investors continued to be the euro area countries, which in 2006 slightly increased their securities holdings to 71% of the total. France and Germany stood out within the area, together accounting for more than 40% of the total. In the case of fixed-income securities, the weight of the euro area is even higher, since at end-2006 they represented 79.5% of total portfolio investment issued by residents in Spain. As for non-euro area countries, the liabilities were concentrated to the United States, the United Kingdom and Japan (together accounting for 22.5% of the total). The relative weight of the United States in equities stands out, the heading in which it is by far the largest investor, accounting for 35% of total. When the end-country principle is considered, the geographical distribution of the portfolio investment liabilities is relatively similar to that of portfolio investment assets, the most significant difference being the considerably lower weight of France and, in particular, of Germany among the latter countries, ceding ground to Italy and, above all, Luxembourg (see Tables 4.9 and 4.10). The relatively high share of Luxembourg in assets is due to the significance of the investment by residents in equities.

#### 4.3.3 OTHER INVESTMENT

The net debit position of other investment (basically loans, deposits and repos) increased by 11% in 2007, in contrast to the decrease in 2006 (see Chart 4.5). This lowered the debit balance to €226,454 million (21.6% of GDP, 0.8 pp more than in 2006). This increase was achieved

<sup>19</sup> The CPIS data are available at the IMF website: <http://www.imf.org/external/np/sta/pi/cpis.htm>. For further information, see "El stock de la inversión de cartera de España y la Encuesta Coordinada del Fondo Monetario Internacional", Boletín Económico, Banco de España (June 2006). The geographical breakdown of the portfolio assets abroad is similar to that contained in the IIP.

**STOCKS OF FOREIGN PORTFOLIO INVESTMENT**

TABLE 4.10

**Breakdown by geographical area and by instrument, and comparison with CPIS data (a). 2006**

€m	EQUITY SECURITIES		DEBT SECURITIES		TOTAL (b)		WEIGHT IN TOTAL (%)	
	FKC	EI	FKC	EI	FKC	EI	FKC	EI
	France	22,272	18,587	72,481	150,555	94,753	169,142	9.8
Germany	10,067	11,988	69,635	151,664	79,701	163,652	8.3	19.8
Luxembourg	23,356	19,604	169,487	54,694	192,843	74,298	20.0	9.0
United Kingdom	74,874	23,833	20,554	52,558	95,428	76,392	9.9	9.3
United States	69,475	64,996	27,755	19,253	97,229	84,249	10.1	10.2
Netherlands	10,028	4,103	13,415	43,451	23,443	47,554	2.4	5.8
Ireland	1,192	8,456	5,703	48,977	6,895	57,433	0.7	7.0
Japan	322	5,697	2	19,685	324	25,383	0.0	3.1
Belgium	3,778	3,657	5,780	21,634	9,559	25,291	1.0	3.1
Italy	11,077	3,956	219,667	21,211	230,744	25,167	23.9	3.0
Unassigned	-1,510	0	107,265	0	105,755	0	11.0	0.0
Other	20,753	21,591	7,153	53,065	27,906	76,825	2.9	9.3
<b>TOTAL LIABILITIES</b>	<b>245,682</b>	<b>186,468</b>	<b>718,897</b>	<b>636,748</b>	<b>964,579</b>	<b>825,385</b>	<b>100.0</b>	<b>100.0</b>

SOURCE: Banco de España and IMF.

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

b. The value of the total stock of foreign portfolio investment in Spain differs from the sum of the stock of equity securities and debt securities because certain countries which participate in the CPIS, for reasons of confidentiality, provide the geographical breakdown of their total portfolio investment assets but not the breakdown of the various instruments in which they are invested.

**OTHER INVESTMENT**

TABLE 4.11

**Reconciliation of the change in the IIP stock with the balance of payments transactions (a)**

€m	NET (b)			ASSETS			LIABILITIES		
	CHANGE IN STOCK	TRANSACTION	% VALUATION EFFECT AND OTHER ADJUSTMENTS (c)	CHANGE IN STOCK	TRANSACTION	% VALUATION EFFECT AND OTHER ADJUSTMENTS (c)	CHANGE IN STOCK	TRANSACTION	% VALUATION EFFECT AND OTHER ADJUSTMENTS (c)
	2005	-27,079	-17,349	4.6	45,991	47,253	-0.6	73,070	64,601
2006	32,774	34,393	0.7	58,706	68,601	-3.7	25,931	34,208	-1.6
2007	-22,724	-34,624	-5.8	54,907	58,911	-1.2	77,631	93,535	-3.0

SOURCE: Banco de España.

a. Excluding Banco de España.

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

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

despite the fact that assets grew more quickly than liabilities (17% and 15%, respectively) and stemmed from the behaviour of the corresponding financial transactions (see Table 4.11).

The stock of Spain's other investment abroad rose by nearly 17% in 2007 to €381,813 million, a more moderate growth rate than in 2006 (21.9%). In any event, the growth path of recent years continued. As a percentage of GDP, other investment assets increased by 3 pp to 36.4%. The trend in Spain's other investment abroad is related basically to the behaviour of balance of payments transactions, counterbalancing the direct negative impact of the appreciation of the euro against the dollar and sterling<sup>20</sup> (see Table 4.11).

By instrument, the most notable feature is that Spain's other investment abroad is concentrated in deposits, which account for nearly 82% of the total. Most of these deposits were short term (83.4%). MFIs accounted for most of the deposits (65.2% of the total), increasing their share by 4.1 pp, mainly at the expense of ORSs. This pattern extended to the whole of other investment assets and, as a result, MFIs accounted for most of the stock.

By geographical area, other investment abroad was concentrated in the EU, which accounted for more than 83% of the total at end-2007. The euro area's share exceeded 54% and that of the United Kingdom, at more than 26%, represented a significant fraction of the total. As for the rest of the world, Latin America, tax havens and the United States had relatively similar weights, ranging from 3% to 4% of the total.<sup>21</sup> With respect to 2006, there was a modest increase in the share of the United States at the expense of Latin America and tax havens.

In 2007 the stock of other investment in Spain increased by around 15%, a smaller rise than that recorded by assets. This rate was, however, significantly higher than that posted in 2006 (5.1%). As a result, external liabilities in the form of other investment stood at €608,267 million at end-2007, equivalent to 57.9% of GDP (3.8 pp more than at end-2006). The main factor responsible for these developments was balance of payments financial transactions (see Table 4.11). In the period analysed, these transactions rose sharply, driven by those carried out by MFIs in short-term instruments, against the background of financial turmoil mentioned throughout this chapter.

The breakdown by instrument shows that 72.7% of the liabilities were deposits. As also occurs in the case of Spain's other investment abroad, most of the deposits were short term (more than 74% of the total). Analysis by institutional sector shows that MFIs accounted for the largest share of the stock, followed by ORSs.

Finally, the breakdown by geographical area shows a similar composition to that for assets. The EU accounts for around 86% of the total, with 52% of the total stock corresponding to the euro area. The United Kingdom, at 25%, also accounts for a significant fraction. As for the rest

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20. As mentioned in the introduction, in this case the changes in the other investment position from one period to another are basically explained by balance of payments transactions and by exchange rate movements. 21. Financing granted to Latin America represents a small portion of the total but, according to BIS data, Spanish banks lead the field in international bank financing in the region, accounting for more than 35% of the total. 22. The data on the stock of financial derivatives were disseminated for the first time with the publication of the IIP data relating to end-2006. These data on the stock of derivatives relate to MFIs (the most important sector) and to general government. The data on MFIs' stocks are taken from a new accounting statement established in Banco de España Circular 4/2004 which includes financial derivatives and credit derivatives at market prices. The general government stocks relate to the Treasury and were obtained from information provided by the Treasury. These were the sources of information used to collect data on the stocks of financial derivative assets and liabilities separately, although, because of the characteristics of certain instruments, the data in net terms are more reliable. At present, preliminary work in co-ordination with the Banco de España's Central Balance Sheet Data Office is under way to enable the future incorporation of data on the stock of financial derivatives of ORSs.

of the world, the United States represented 4.6% of the total, followed by tax havens with nearly 3%. Comparison with 2006 shows a moderate increase in the relative importance of the EU, which reflects the higher weight of both the euro area and of the United Kingdom.

#### 4.3.4 FINANCIAL DERIVATIVES<sup>22</sup>

The net debit position of financial derivatives practically doubled in 2007, rising to €18,849 million. This figure amounts to 1.8% of GDP, compared with 1% at the end of the previous year. This increase came about because external liabilities grew faster than external assets (49.2% and 35.4%, respectively). As a percentage of GDP, liabilities rose to 6% (1.7 pp more than at end-2006), while assets amounted to 4.3% (0.9 pp more than in 2006). The breakdown by institutional sector shows, on the information available so far, that MFIs accounted for practically all the stock, both assets and liabilities.