
Results of non-financial firms in the second quarter of 1999 (1)

1. INTRODUCTION

The Central Balance Sheet Office Quarterly Survey (CBQ) data for the first half of 1999 show a slowdown in productive activity with respect to the same period a year earlier. However, in the second quarter of 1999 activity stabilised and indeed picked up with respect to the slowdown discerned in the second half of 1998. The further reduction in the cost of debt enabled profits to grow again in the second quarter of 1999, with the spread over financial costs (leverage) reaching an historic high.

Comparison of the first halves of 1999 and 1998 reveals a slowdown in productive activity [as measured by the rate of change of gross value added (GVA)]. However, examination of the quarterly series shows that moderate growth in domestic consumption and investment, and the slow recovery in exports, kept GVA growth at the same level as at the start of the year. To the extent that the signs of recovery detected in foreign markets strengthen, business activity can be expected to recover, particularly in manufacturing, the sector hardest hit by the foreign trade situation and the rise in international oil prices.

Against this backdrop, the rate of growth of personnel costs fell further in the first half of 1999 (to 1 %). As explained in the article on the data for the first quarter of 1999, this was due to a fall in employment and moderate growth in average compensation. Employment in the sample firms fell even though in the first half of 1999 most of the reporting firms continued to record significant rises in both permanent and temporary employment as in preceding periods. However, a small number of very important firms continued to make significant adjustments to their workforces, and this explains why the net change in the total number of workers was negative in the first half of 1999. The restrained growth of average compensation, which at 1.6% was below the rate of inflation of the period, is explained basically by the existence of newly hired workers, who normally start work on lower rates of compensation. As explained in section 3, the phenomenon is not equally apparent in all the productive sectors.

The overall effect of the paths of these variables was nominal growth of 4.8 % in the gross operating result. The latter thus sustained a no-

(1) The information in this article relates to the 737 firms that have reported their quarterly data to the Central Balance Sheet Office (the CBQ survey) to September 16th 1999. These firms account for 16.1 % of the total activity – as measured by gross value added at factor cost (GVA) – of the sector of non-financial firms.

TABLE 1

Profit and loss account. Year-on-year performance
**(Growth rates of the same firms on the same period a year earlier/
 % of GVA at factor cost in the case of the net result)**

Data bases	CBA		CBQ		
	1996	1997	98 Q1-Q4/ 97 Q1-Q4 (a)	98 Q1-Q2 (a)	99 Q1-Q2
Number of firms / Total national coverage	7951/37.8 %	7445/36.6 %	821/18.8 %	851/19.5 %	737/16.1 %
1. VALUE OF OUTPUT (including subsidies)	5.6	10.0	2.8	4.7	4.8
Of which:					
1. Net amount of turnover and other operating income	6.6	9.7	3.2	5.4	6.2
2. INPUTS (including taxes)	7.2	11.5	2.0	3.3	5.9
Of which:					
1. Net purchases	6.1	11.6	0.3	3.2	4.4
2. Other operating costs	8.8	10.7	6.8	5.8	11.0
S.1. GROSS VALUE ADDED AT FACTOR COST	<u>2.5</u>	<u>7.1</u>	<u>4.2</u>	<u>6.9</u>	<u>3.1</u>
3. Personnel costs	<u>3.9</u>	<u>3.7</u>	<u>3.3</u>	<u>3.9</u>	<u>1.0</u>
S.2. GROSS OPERATING RESULT	<u>0.9</u>	<u>11.4</u>	<u>5.1</u>	<u>9.6</u>	<u>4.8</u>
4. Financial revenue	4.8	15.5	14.9	-1.1	49.7
5. Financial costs	-13.0	-13.7	-8.4	-10.1	-5.7
6. Corporate income tax	9.7	22.7	16.6	34.2	32.4
S.3. FUNDS GENERATED FROM OPERATIONS	5.1	17.7	8.1	9.7	9.3
7. Depreciation and provisions (b)	-3.5	24.1	-3.9	-1.7	10.3
S.4. TOTAL NET RESULT (% of GVA at factor cost)	11.0	15.7	22.4	23.2	30.1
PROFITABILITY RATIOS					
R.1. Return on net assets (before taxes) (b)	8.6	10.6	11.8	12.1	12.8
R.2. Interest on borrowed funds/ interest-bearing borrowing	8.1	6.8	6.2	6.2	4.9
R.3. Return on equity (before taxes) (b)	8.9	13.2	15.3	15.9	17.8
R.4. Debt ratio	42.4	40.7	38.5	38.7	38.9
R.5. Financial leverage (before taxes) (R.1 - R.2) (b)	0.5	3.8	5.6	6.0	7.9

Source: Banco de España.

(a) All the data in this column have been calculated as the arithmetic mean of the quarterly data.

(b) When calculating these items the effect of balance-sheet restatement under Royal Legislative Decree 7/1996 has been removed in order to homogenise the series.

CHART 1

Non-financial firms reporting to the Central Balance Sheet Office (a)



Source: Banco de España.

- (a) Information available to September 16th 1999 (CBA and CBQ).
- (b) The 1994, 1995, 1996 and 1997 data are based on information from the firms included in the annual survey (CBA) and the average of the four quarters of each year in relation to the previous year (CBQ).
- (c) Average of the four quarters of 1998 in relation to the same period in 1997.
- (d) Average of the first two quarters of 1999 on the same period of 1998.

table rate of expansion, albeit significantly below that of the first half of the previous year (when an extraordinary increase of close to 10 % was recorded). Financial costs, following the trend of previous quarters, fell further and continued to decline in importance in the profit and loss account, both in absolute and relative terms. This reduction in financial costs is explained by the fact that the reduction in interest rates was passed through to firms' cost of debt, at the same time as non-financial firms, capitalising on the favourable market conditions, were resorting to external sources of finance for their investment projects. The cost of debt ratio (interest on borrowed funds/interest-bearing borrowing) fell again to all-time lows (4.9 %, 1.3 points below the same period in 1998). Finally, the positive contribution from other costs and revenues produced a sharp rise in funds generated from operations in the first six months of 1999. This gave rise to a scenario in which the sample firms sustained high levels of profitability (in terms of both the return on net assets and the return on equity), that even somewhat exceeded those recorded in the first half of 1998. The decline in the cost of debt caused financial leverage to reach a new high. If the excellent performance of this indicator is accompanied over the coming months by control of the inflationary processes detected (this control being necessary to avoid the gradual erosion of the competitiveness of Spanish firms), then solid foundations will be laid for growth and to enable the large firms to contribute to the generation of employment currently occurring in the Spanish economy.

2. ACTIVITY

In the first six months of 1999 the activity (GVA) of the non-financial firms in the CBQ sample grew at a nominal rate of 3.1 % (see Table 1 and Chart 1), which represents a slowdown on the rate a year earlier (6.9 %). However, it should be borne in mind that the rate of growth of output in the first half of 1998 was exceptionally high and also that the figure for the second quarter of 1999 indicates a certain stabilisation, confirmed by the strong growth of turnover in the same quarter. Business activity continued to be sustained by those branches whose products are sold for private consumption and investment (certain sectoral details are given in Table 2.a, although comparing the first halves of 1998 and 1999 also reveals the slowdown described, due to the effects of the international financial crisis on exports and the effect of the rise in oil prices on value added. Table 3 shows that the activity of the firms as a whole continued to be buoyed by domestic sales, the reduction in exports hitting certain

manufacturing industries (those most affected by the aforementioned problems) particularly hard. The signs of recovery in the European, Japanese and Russian markets, the continuing favourable situation in the United States, and the impression of gradual stabilisation in South American markets, give cause for optimism regarding the outlook for foreign trade.

As regards sectors (see Table 2.a), the distributive trade, driven by the continuing strength of private consumption, is still the fastest growing sector. In the first half of 1999 its GVA grew by 15.2 %, which was well above the rate a year earlier (10 %). The electricity, gas and water production and distribution sector also posted significant GVA growth (5 %) in the first half of the year, basically due to the increase in the demand for electricity, which outweighed the effects of the price falls in the sector and the lower output of hydro-electricity. By contrast, the GVA of manufacturing fell by -2.7 % in the same period, although this contraction did not extend to all its subsectors. As mentioned above, the fact that exports had still not recovered their previous buoyancy (despite signs of improvement) and the impact of the increase in international oil prices on the refining industries explain a fall in activity, which was confined to certain sectors (activity rose, in fact, in the transport equipment and food, drink and tobacco industries). Lastly, the transport, storage and communications sector grew, although at a much more modest rate than in 1998: whereas its GVA grew by 6.7 % in the first half of 1998, in the same period of 1999 it only grew by 1.9 %. This moderation was basically due to the effect on prices of the introduction of competition into the sector, although the negative impact on turnover of certain labour disputes during the period also had an effect.

Finally, it can be seen in Chart 2 (which shows the distribution of firms according to the rate of change in their GVA, without any account being taken of their size) that the percentage of firms in which value-added grew continues to rise, although there was a slight shift towards the category of firms recording increases of less than 20 %. In short, the slowdown stemmed from a fall in the rate of growth, rather than from a reduction in the number of firms showing positive growth.

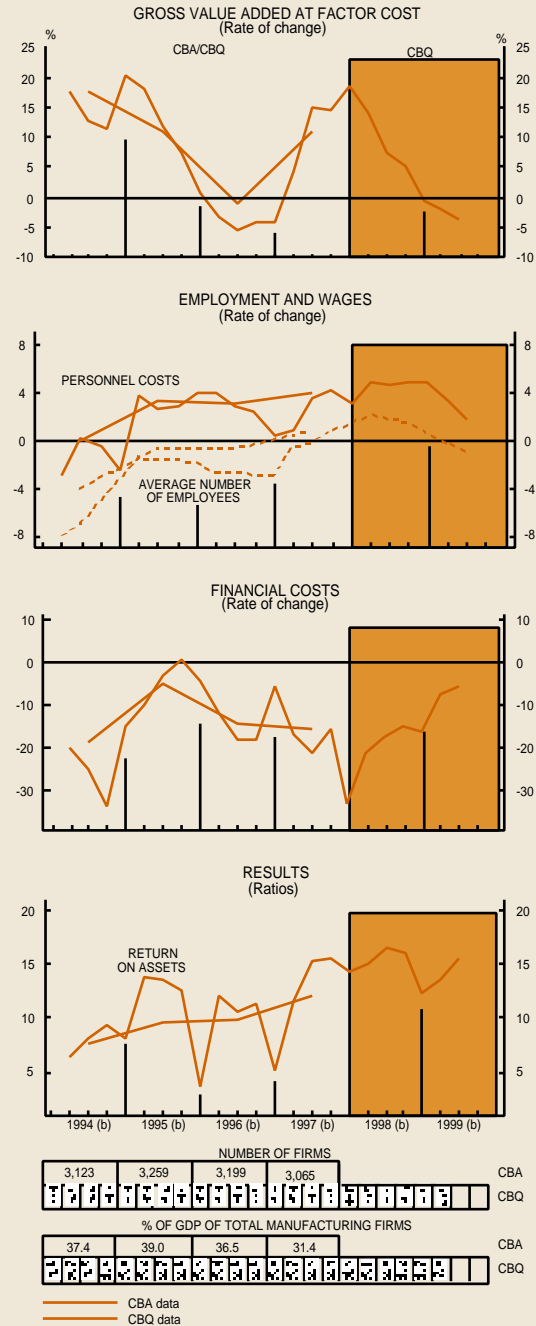
3. EMPLOYMENT AND PERSONNEL COSTS

The personnel costs of the CBQ firms grew by 1 % in the first half of 1999, a significantly lower rate than in the same period a year earlier (3.9 %). To understand the factors behind this

Analysis of the manufacturing sector

As usual in the CBQ articles, developments in manufacturing are analysed separately, owing to the importance of this sector, its representativeness in the sample and its usefulness for analysing the current economic situation. In the first half of 1999, activity in the sector was in recession, falling by -2.7% in terms of nominal GVA. This performance, which was not common to all the sub-sectors, was a result of two factors: first, the crisis afflicting certain international economies, which have had a particular impact on the external activity of the sector; and second, the increase in the prices of oil inputs, which reduced the value added of the oil refining sector in particular and, indirectly, that of the other sectors. By contrast, certain sub-sectors, such as food, drink and tobacco, chemicals and transport equipment (the latter strongly boosted by the unstoppable growth in new registrations) have made positive contributions to the growth of activity, albeit failing to offset fully the negative effects mentioned above. In line with the slackness of the sector, the employment generation process which had commenced in 1998 came to a halt in the first half of 1999, with rates close to zero (-0.6%). Average compensation grew by 3.2% , significantly above the general growth of prices. By sub-sector, the increases were above average in firms engaged in the manufacture of transport equipment, and in the food, drink and tobacco industries, a sector in which the existence of adjustment processes and the severance pay entailed thereby meant that compensation grew more strongly. As a consequence of the recession in the sector's activity, the gross operating result declined (-8.6%) and, despite the further reduction in financial costs, funds generated also grew at a negative rate (-4.6%). That said, the final net result did not deteriorate to the same extent, thanks to a significant reduction in provisions, which enabled profitability to remain high. The return on net assets was 14.6% , only one percentage point lower than in the first half of 1998. This, together with the further reduction in the cost of debt, gave rise to a high value for leverage (10). In accordance with what has been said throughout this report, the slowdown in activity in the first half of 1999, especially in the manufacturing sector, may begin to be reversed from the third quarter, to the extent that the signs of recovery seen in foreign economies are confirmed and consolidated.

Performance of the manufacturing firms which report to the Central Balance Sheet Office (a)



Source: Banco de España.

(a) Information available to September 16th 1999 (CBA and CBQ).

(b) The CBQ data are growth rates on the same quarter of the previous year.

TABLE 2.a

**Value added, employees, personnel costs and compensation per employee
Breakdown by size, ownership status and main activity of firms
(Growth rates of the same firms on the same period a year earlier)**

	Gross value added at factor cost				Employees (average for period)				Personnel costs				Compensation per employee			
	CBA		CBQ		CBA		CBQ		CBA		CBQ		CBA		CBQ	
	1997	98 Q1-Q4 (a)	98 Q1-Q2 (a)	99 Q1-Q2 (a)	1997	98 Q1-Q4 (a)	98 Q1-Q2 (a)	99 Q1-Q2 (a)	1997	98 Q1-Q4 (a)	98 Q1-Q2 (a)	99 Q1-Q2 (a)	1997	98 Q1-Q4 (a)	98 Q1-Q2 (a)	99 Q1-Q2 (a)
Total	7.1	4.2	6.9	3.1	1.6	0.7	0.9	-0.6	3.7	3.3	3.9	1.0	2.0	2.5	3.0	1.6
Total, except electricity sector	9.3	6.3	8.7	2.7	1.8	1.3	1.4	0.1	4.0	4.3	1.9	1.9	2.1	2.6	2.9	1.7
SIZE:																
Small	8.4	—	—	—	3.9	—	—	—	6.6	—	—	—	2.6	—	—	—
Medium	10.5	8.3	10.3	8.8	3.9	3.7	3.4	5.3	6.8	6.8	6.8	7.6	2.8	3.1	3.4	2.2
Large	6.6	4.0	6.7	2.7	1.1	0.5	0.7	-1.3	3.0	3.0	3.6	0.4	1.9	2.5	2.9	1.7
STATUS:																
Public-sector	9.0	4.5	6.7	2.5	3.0	1.0	-0.1	2.8	4.9	3.3	3.9	5.7	1.9	2.3	3.9	2.7
Private-sector	0.6	4.2	6.9	3.3	-2.9	0.7	1.2	-1.7	-0.3	3.2	3.8	-0.5	2.6	2.6	2.6	1.3
BREAKDOWN OF ACTIVITIES BEST REPRESENTED IN THE SAMPLE:																
Manufacturing industries	10.9	6.5	10.7	-2.7	0.7	1.5	2.0	-0.6	3.9	4.9	4.8	2.5	3.1	3.4	2.8	3.2
Production and distribution of electricity, gas and water	-4.5	-3.1	0.3	5.0	-1.7	-5.5	-3.9	-8.4	-0.6	-1.9	0.5	-5.8	1.1	3.8	4.5	2.9
Distributive trade	9.4	11.8	10.0	15.2	2.7	3.7	2.7	5.5	4.6	6.1	5.0	6.5	1.9	2.3	2.3	1.0
Transport, storage and communications	8.7	4.1	6.7	1.9	-1.1	-1.6	-1.6	-5.4	2.0	1.1	2.4	-2.8	3.1	2.7	4.1	2.7

Source: Banco de España.

(a) All the data in these columns have been calculated as the arithmetic mean of the quarterly data.

TABLE 2.b

**Employment and personnel costs
Detail according to changes in staff levels**

	Total CBQ firms 1999 Q1-Q2	Firms increasing (or not changing) staff levels	Firms reducing staff levels
Number of firms	737	425	312
Personnel costs			
Situation 1998 Q1-Q2 (EUR millions)	8,633.7	3,888.7	4,745.0
Rate 99 Q1-Q2/98 Q1-Q2	1.0	9.7	-6.1
Average compensation			
Situation 1998 Q1-Q2 (EUR)	17,585.0	15,839.4	19,300.1
Rate 99 Q1-Q2/98 Q1-Q2	1.6	1.6	3.3
Number of employees			
Situation 1998 Q1-Q2 (thousands)	491	245	246
Rate 99 Q1-Q2/98 Q1-Q2	-0.6	8.0	-9.2
Permanent			
Situation 1998 Q1-Q2 (thousands)	429	198	231
Rate 99 Q1-Q2/98 Q1-Q2	-1.3	6.8	-8.1
Non-permanent			
Situation 1998 Q1-Q2 (thousands)	62	48	14
Rate 99 Q1-Q2/98 Q1-Q2	3.9	12.6	-25.3

Source: Banco de España.

outcome it is necessary to analyse the changes in employment and in average compensation separately. Employment in the first half of 1999, as in the first quarter, did not follow the trend established in 1998 of generation of employment by the firms studied. Thus, the rate of change of average employment in the first two quarters of 1999 was -0.6 %, with permanent employment particularly hard hit (down 1.3 %). However, this trend does not apply to all or even most of the firms in the sample since the aggregate figure is distorted by the existence of staff adjustment processes in a small number of large firms in certain sectors. Due to their quantitative importance the latter make the overall rate of growth of employment negative and prevent it from reflecting the trend common to most firms. The effects of this phenomenon, already analysed in detail in the report on the first quarter of the year, will be felt in this and subsequent quarters. The aforementioned restructuring is in fact concentrated in the electricity, gas and water production and distribution and transport and communications sectors (both in the process of reorganisation and liberalisation). If

TABLE 3

**Purchases and turnover of firms reporting data on purchasing sources
and sales destinations**
Structure

	CBA	CBQ	
	1997	98 Q1-Q4/97 Q1-Q4 (a)	99 Q1-Q2/98 Q1-Q2 (a)
Total firms	7,445	821	737
Firms reporting source/destination	7,445	768	690
	%	%	%
Net purchases	100.0	100.0	100.0
SOURCE OF PURCHASES:			
Spain	65.7	68.7	70.6
Total abroad	34.3	31.3	29.4
<i>EU countries</i>	22.5	23.1	18.5
<i>Third countries</i>	11.8	8.3	11.0
Net turnover	100.0	100.0	100.0
SALES DESTINATIONS:			
Spain	80.5	85.9	87.5
Total abroad	19.5	14.1	12.5
<i>EU countries</i>	14.6	10.4	8.6
<i>Third countries</i>	4.9	3.8	3.9

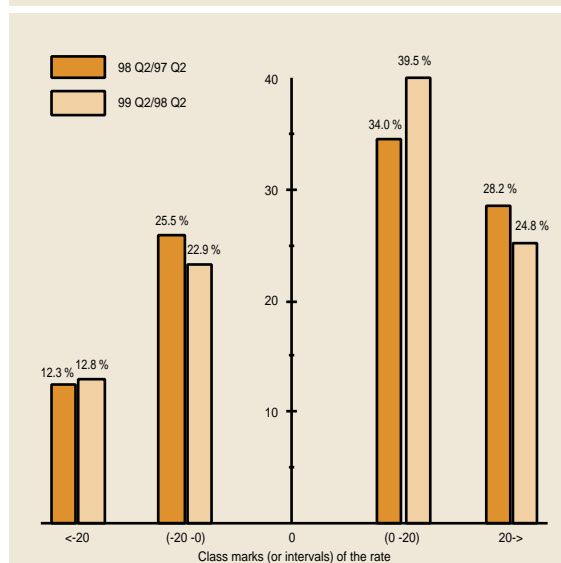
Source: Banco de España.

(a) All the data in this column have been calculated as the arithmetic mean of the relevant quarters, including the figure for the total number of firms.

we ignore these firms the employment figures show clear growth, both as regards total and permanent employment (temporary employment grew, even in the sample as a whole, by 3.9 %). Table 2.a shows that when the electricity, gas and water production and distribution sector is excluded, employment in the rest of the sample grew by 0.1 %. The most positive performance was again in the distributive trade, which stood out as the most dynamic as regards employment creation. Its staffing levels rose by 5.5 % in the first half of 1999, in line with the expansion of its productive activity. The performance of manufacturing, in step with its activity, has deteriorated in recent quarters. In the first half of 1999 its employment was virtually stagnant (-0.6 %), compared with a 2 % rise in the first half of 1998. As regards average compensation (approximated in the CBQ by calculating personnel costs per worker), it rose by 1.6 % in the first two quarters of 1999. A sectoral analysis shows that the aggregate which contributed most to this moderation was that of the distributive trade, due to the effect of new hiring. The significant incorporation of new workers, at lower starting salaries, is the reason

CHART 2

**Distribution of firms by rate of change
in GVA at factor cost (99 Q2/98 Q2, 98 Q2/97 Q2)
(CBQ)**



Source: Banco de España.

TABLE 4

**Personnel costs, employees and average compensation
% of firms in specific situations**

	CBA		CBQ			
	1996	1997	97 Q1-Q4 (a)	98 Q1-Q4 (a)	98 Q2	99 Q2
Number of firms	7,951	7,445	725	821	839	639
Personnel costs	100.0	100.0	100.0	100.0	100.0	100.0
Falling	26.3	24.0	31.8	31.4	27.7	30.3
Constant or rising	73.7	76.0	68.2	72.3	72.3	69.7
Average number of employees	100.0	100.0	100.0	100.0	100.0	100.0
Falling	32.8	28.0	50.3	39.9	39.9	43.3
Constant or rising	67.2	72.0	49.7	60.1	60.1	56.7
Average compensation (relative to inflation) (b)	100.0	100.0	100.0	100.0	100.0	100.0
Lower growth	48.3	43.9	41.1	42.2	45.8	47.2
Higher or same growth	51.7	56.1	58.9	57.8	54.2	52.8

Source: Banco de España.

(a) Arithmetic mean of the four quarters.

(b) Twelve-month percentage change in the CPI.

why average compensation in the sector grew by only 1 %. The rates of around 3 % in the rest of the sectors reflect wage-cost rigidity and a differential with respect to inflation of around one or one-and-a-half percentage points. Meanwhile, although average compensation in these sectors has also been pushed up by the costs associated with staff restructuring, the latter have not been fully passed through, due to the way in which certain severance payments arising from the major adjustment processes mentioned above have been recorded (2).

Table 2.b permits a more detailed analysis of the consequences of the dichotomy in the aggregate of reporting firms between those increasing and reducing their staff levels. Those which created employment (58 % of the total) in-

creased their workforces by 8 % between the first half of 1998 and the first half of 1999, with their permanent employment rising by 6.8 % and their temporary employment by 12.6 %. This creation of new jobs involved an increase in average compensation of 1.6 % and led to an increase of 9.7 % in the personnel costs of these firms during the period considered. Meanwhile, the firms which reduced their workforces recorded a fall of 6.1 % in their personnel costs as a consequence of the heavy shedding of labour during the period (-9.2 %). Average compensation in this group of firms grew by 3.3 %. Although this rate is higher than that of the aggregate of firms which created employment, for the reasons explained above it only reflects part of the costs associated with dismissals.

Finally, in Table 4 it can be seen that the firms have been gradually adjusting their average compensation to contemporaneous levels of inflation. In the second quarter of 1999 average compensation grew at rates above inflation in 53 % of firms, as against 59 % in 1997. Once more, it is clearly imperative that inflationary pressures should not be passed automatically through to wages irrespective of productivity growth. In the medium term this can only damage the competitiveness of firms, their productive activity and, eventually, their expansion and ability to create employment. This premise is especially applicable to the sectors most exposed

(2) Some non-financial firms pay severance payments with a balancing entry in the balance sheet, by means of one of the following alternatives: a) out of provisions, previously set aside via the profit and loss account, which is a normal entry envisaged by the chart of accounts, and b) out of a generic reserve, a kind of entry which has begun to be used very recently by certain large firms. Given that severance payments which do not appear as such in the profit and loss account cannot be included in the compensation of the period, from an analytical viewpoint wage income data are distorted, and this affects analyses of household disposable income based on these sources. Severance pay recorded as in b) also affects the comparative analysis of the profitability ratios.

TABLE 5

**Gross operating result, funds generated, return on assets and leverage
Breakdown by size, ownership status and main activity of firms
(Growth rates of the same firms on the same period a year earlier)**

	Gross operating result				Funds generated				Return on assets (R.1) (a)				Leverage (a)			
	CBA	CBQ			CBA	CBQ			CBA	CBQ			CBA	CBQ		
	1997	98 Q1- Q4 (b)	98 Q1- Q2 (b)	99 Q1- Q2 (b)	1997	98 Q1- Q4 (b)	98 Q1- Q2 (b)	99 Q1- Q2 (b)	1997	98 Q1- Q4 (b)	98 Q1- Q2 (b)	99 Q1- Q2 (b)	1997	98 Q1- Q4 (b)	98 Q1- Q2 (b)	99 Q1- Q2 (b)
Total	11.4	5.1	9.6	4.8	17.7	8.1	9.7	9.3	10.6	11.8	12.1	12.8	3.8	5.6	6.0	7.9
Total, except electricity sector	17.6	9.0	13.9	3.4	23.5	11.7	14.1	8.3	10.7	11.6	11.5	13.4	3.7	5.3	5.3	8.4
SIZE:																
Small	11.6	—	—	—	19.0	—	—	—	13.3	—	—	—	4.5	—	—	—
Medium	16.3	10.4	15.5	10.4	18.0	11.5	17.2	12.6	13.4	13.1	14.5	14.8	6.1	7.1	8.6	10.2
Large	10.9	4.9	9.3	4.5	17.6	7.9	9.3	9.1	10.2	11.7	12.0	12.7	3.5	5.5	5.8	7.8
STATUS:																
Public-sector	1.9	8.0	16.4	-4.4	12.2	31.1	19.7	19.3	5.4	5.0	4.2	8.2	-0.9	-0.3	-0.9	3.7
Private-sector	13.6	4.9	9.1	5.7	18.8	6.9	9.0	7.5	13.0	13.1	13.6	13.9	5.9	6.8	7.3	9.0
BREAKDOWN OF ACTIVITIES BEST REPRESENTED IN THE SAMPLE:																
Manufacturing industries	22.0	9.2	19.2	-8.6	27.3	8.3	19.4	-4.6	12.2	15.0	15.8	14.6	5.4	9.5	10.3	10.0
Production and distribution of electricity, gas and water	-5.7	-3.6	0.1	8.8	0.2	-0.5	-0.8	16.0	10.1	12.1	13.5	11.4	4.0	6.2	7.4	6.7
Distributive trade	17.2	20.1	17.6	29.8	17.4	21.2	20.1	30.0	14.4	13.9	12.4	15.7	7.6	7.8	6.1	11.4
Transport, storage and communications	15.2	6.2	9.9	5.1	22.0	13.6	11.3	0.7	8.3	10.0	9.1	12.0	0.4	2.9	2.2	6.7

Source: Banco de España.

(a) When calculating the data in these columns the effect of the balance-sheet restatement under Royal Legislative Decree 7/1996 has been removed in order to homogenise the series.

(b) The data in these columns have been calculated as the arithmetic mean of the quarterly data.

to foreign competition, as the current situation in Spanish manufacturing may be indicating. Lastly, other factors, such as the promotion of research and investment in basic technology and in high-value-added activities, the constant improvement of productivity and quality, and the implementation and completion of structural reforms aiming to liberalise certain sectors, must stem from a suitable combination of private and public initiative. These factors must be harnessed to increase business efficiency.

4. RESULTS, MARGINS AND PROFITABILITY

As a consequence of the developments in activity and personnel costs, the gross operating result (see Table 5) grew by 4.8 %. This

rate reflects the healthy situation of the firms although, when compared with the first half of 1998 (9.6 %), it again reveals the slowdown referred to above. Comparison of the first and second quarter data, in contrast, shows a stabilisation if not an improvement. By sector, manufacturing stands out as the worst performing sector, with a rate of -8.6 %, a consequence of the decline in productive activity in the period in question (Box 1 analyses the results of this sector in greater detail). In the rest of the sample there were increases across the board, although once again the distributive trade must be mentioned due to the extraordinary growth in the generation of this surplus, at a rate of close to 30 %. This high rate was primarily based on strong growth in the sector's turnover, although the business margin, which has historically always been lowest in this sector, also grew in

TABLE 6

**Structure of reporting firms' returns on net assets
and on equity**

	CBQ			
	Return on net assets (R.1)		Return on equity (R.3)	
	98 Q1-Q2 (a)	99 Q1-Q2 (a)	98 Q1-Q2 (a)	99 Q1-Q2 (a)
Total firms	100.0	100.0	100.0	100.0
R 0 %	16.1	13.3	18.5	15.8
0 % < R 5 %	10.8	12.7	8.5	8.8
5 % < R 10 %	14.3	14.4	8.7	8.6
10 % < R 15 %	13.5	13.5	10.5	10.2
15 % < R	45.3	46.1	53.9	56.6
Number of firms	839	638	839	638
MEMORANDUM ITEM:				
Average return	12.6	14.2	16.9	20.2

Source: Banco de España.
(a) The data in these columns have been calculated as the arithmetic mean of the quarterly data.

the period considered. The electricity sector also saw an improvement in the growth of the gross operating result in the first half of 1999, due to the strong increase in the demand for electricity, and the fact that the outcome in the same period a year earlier was poor. In terms of size, the slowdown was most apparent in the case of large firms. The gross operating result of the latter firms grew by 4.5 %, as against 9.3 % in the first half of 1998.

Financial costs continued to fall in the first half of 1999, at a rate of 5.7 %, to represent 3 % of the total output of the firms analysed, exactly half the 1995 level. The effects of the changes in the cost and in the amount of debt on the fall in financial costs are shown separately below:

	99 Q1-2/98 Q1-2
Change in financial costs	-5.7 %
A. <i>Interest on borrowed funds (1+2)</i>	-7.7 %
1. Due to the cost (interest rate)	-24.4 %
2. Due to the amount of interest-bearing debt	16.7 %
B. <i>Commissions and cash discounts</i>	2.0 %

Table 1 confirms that interest rate reductions continued to be passed through to the firms' profit and loss accounts. Yet, although the percentage change was significant, in absolute terms the level of financial costs was relatively low at the beginning of the period, so that the impact on the firms' results was much smaller

than in previous periods. At the same time there was significant growth in the amount of debt, entailing an increase in financial costs, which shows that firms are attempting to capitalise on the improved terms offered by the market to finance new investment projects.

The favourable behaviour of financial costs and revenue made a greater contribution to the generation of funds. In the first half of 1999, funds generated by the firms analysed grew by 9.3%, slightly below the rate recorded in the first half of 1998 (9.7 %). As regards sectors, the rate of growth of this variable in manufacturing reflected the fall in activity (-4.6 %) in that sector, while the distributive trade posted the highest rate of growth of funds generated.

Levels of profitability (both in terms of the return on net assets and on equity) were higher than in 1998. In the case of manufacturing firms, the reduction in their depreciation and provisions meant that, in spite of the developments described above in the other variables, profitability was only slightly below the 1998 levels. The rest of the sectors also sustained high levels of profitability. These, in conjunction with the cost of debt (down by more than one percentage point for the sample as a whole), led to a new high for leverage. Finally, Table 6 enables conclusions to be drawn regarding the distribution of firms according to their profitability, irrespective of their size and ownership status. The most important effect observed is that

the improvement in the levels of profitability was across the board, as the percentage of firms posting losses fell by over two percentage points to 16 %.

In short, the activity of the CBQ firms, which commenced the year against a background of

some uncertainty and more moderate rates of growth, appears to have resumed and consolidated the expansionary path, which may be underpinned in the coming months by the recovery in foreign trade.

24.9.1999.