6 FINANCIAL DEVELOPMENTS IN SPAIN

1 Introduction

Euro area financial market tensions shaped financial developments in Spain

Financial developments in Spain in 2010 were strongly influenced by the tension in the euro area financial markets. The most difficult moments stemmed from the debt crises of Greece (between May and June) and Ireland (between November and December), which prompted requests for financial assistance by these two economies. For the reasons explained in detail in Chapter 1 of this Annual Report, Spain was among the countries most affected by the ensuing crisis of confidence: the imbalances accumulated during the phase of expansion and some areas of vulnerability aggravated by the crisis (such as labour market rigidities or certain structural aspects of the functioning of savings banks) fuelled investors' misgivings. These tensions led to significant tightening of financing conditions in wholesale markets, where risk premia rose and funds became less readily available. The most strongly affected sectors were general government and credit institutions, which are the ones that raise most funds in these markets (see Box 6.1).

Given this situation, numerous measures were taken in the financial area

To address the crisis, European and national authorities took measures in various areas.[1] In the national financial area, which is the subject of this chapter, it should be remembered, first, that in 2009 the FROB had already been set up for the dual purpose of providing a solution for the institutions that had ceased to be viable and of promoting the integration of viable institutions by expediting their restructuring.

Action was taken in 2010 to increase financial transparency and so restore the confidence of investors in the Spanish financial system. Noteworthy here was the performance and publication, in coordination with the other EU authorities, of banking system stress tests in July 2010, which in Spain were conducted on a large number of institutions (well above the 50% required), including all savings banks. Moreover, the results were published in greater detail. Subsequently, first savings banks, and subsequently all other banks, had to make public their level of exposure to the real estate sector (at end-2009) and disclose expressly and in detail each type of transaction and the collateral taken, as well as the amount, broken down by category, of potentially troubled loans to the sector (non-performing, doubtful, standard under special surveillance and foreclosed).

In the regulatory field, summer 2010 saw a tightening of provisioning rules, which were already comparatively more stringent in Spain than in other countries. The new legislation hastened the requirement to provision all past-due loans, albeit recognising explicitly the value of collateral (after severe haircuts). Also, the requirements regarding foreclosed assets and assets given in satisfaction of debt were tightened to encourage their prompt sale. At that time savings bank law was reformed to remedy the main structural weaknesses of this sub-sector. More specifically, the professional standards required of savings bank managers and directors were tightened and new channels established for raising high quality funds, through, among other options, the indirect exercise of financial activity via a public limited company having the nature of a commercial bank and able to issue ordinary shares.

The resurgence of tensions at the end of the year was conducive to the approval of Royal Decree-Law 2/2011, which raised the minimum required core capital to 8% or 10% of risk-weighted assets, depending on certain characteristics of the institution (percentage of

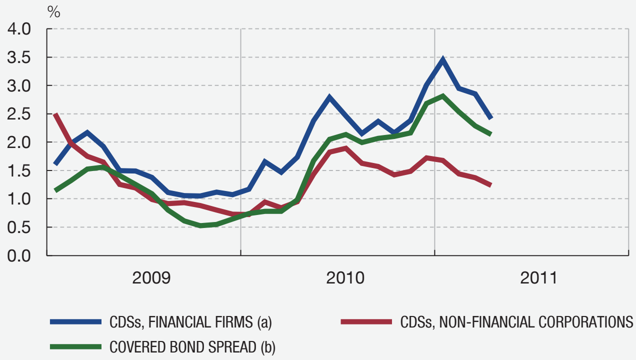
1 For more details, see also Box 1.2 of this Annual Report.

The public debt crisis caused problems of market confidence in various euro area are economies, with Spain among the countries most strongly affected. This meant that, in the two main waves of the crisis (in spring, centred on Greece, and in autumn 2010, in Ireland), risk premia rose on the securities issued by resident sectors and fundraising became more difficult, especially for credit institutions. In the two bouts of the crisis, the measures taken by Spanish and European authorities finally contributed to the easing of tensions.

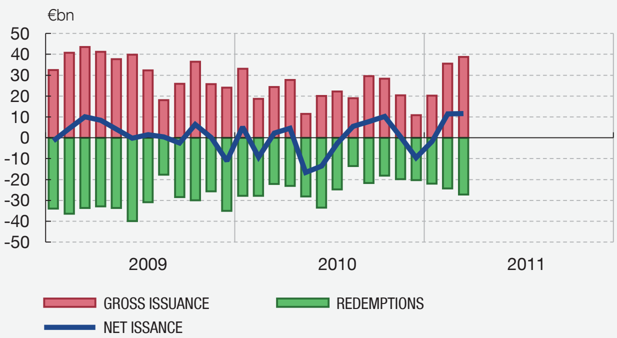
In the case of general government, the misgivings of the markets were accompanied by the downgrading of Spanish sovereign debt

1 TEN-YEAR SPANISH GOVERNMENT BONDS

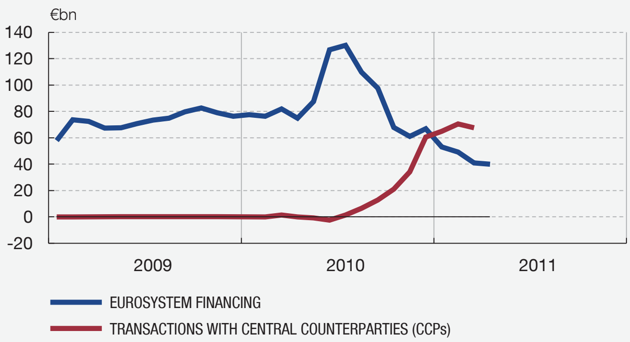
2 FIVE-YEAR CDSs AND SPANISH PRIVATE FIXED INCOME SPREADS



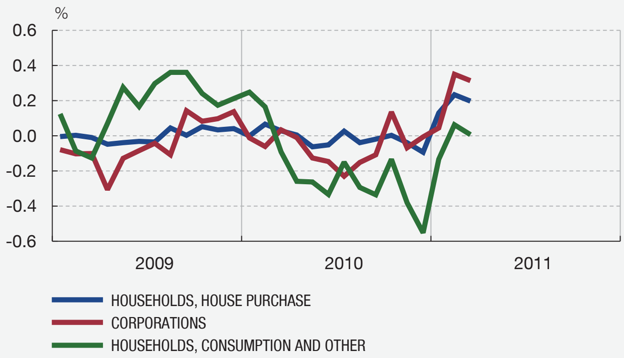
3 FIXED INCOME SECURITIES OF CREDIT INSTITUTIONS (c)



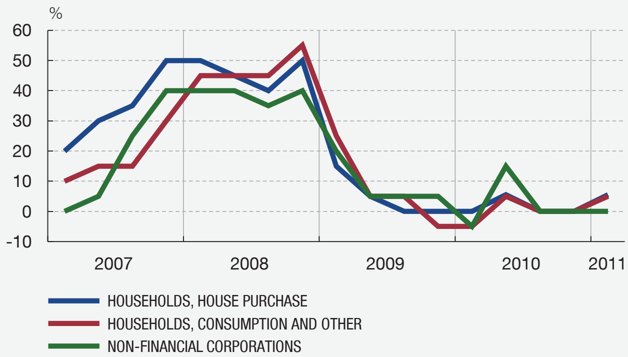
4 EUROSYSTEM AND CENTRAL COUNTERPARTIES (CCPs) FINANCING



5 SURPRISES IN LOAN INTEREST RATES (d)



6 CHANGES IN CONDITIONS OFFERED IN BANK LOANS (e)



SOURCES: BCE, JP Morgan and Banco de España.

a Arithmetic mean of eight institutions.
b Three-five year asset swap spread.
c Including financing through resident, but not non-resident, subsidiaries.
d Differences between the interest rates applied in new loans with the projections derived from a an interbank rate transmission model and the cyclical position of the economy (projections made with origin in January 2009).
e Indicator = % of institutions perceiving considerable tightening x 1 + % of institutions perceiving a certain tightening x 1/2 – % of institutions perceiving a certain relaxation x 1/2 – % of institutions perceiving considerable relaxation x 1.

(S&P downgraded it from AA+ to AA in April 2010, Fitch downgraded from AAA to AA+ in May, Moody's from Aaa to Aa1 in September 2010 and then to Aa2 in March 2011). As a result of the deterioration of investor confidence, the cost of issuance rose from below 3.9% for 10-year bonds in December 2009 to more than 5.4% a year later, while the spread with respect to the German bund, which was barely 60 bp in December 2009, rose to 200 bp in June and 290 bp in late November 2010 (see Chart 1). Subsequently, this risk premium tended downward amidst high volatility, although it continues to be high and subject to significant fluctuations.

Financial institutions, some of whose credit ratings were downgraded, were also affected by problems of investor confidence. Thus, the cost of issuing mortgage covered bonds (these assets, since they are secured by the best collateral, are those that have been most readily accepted by investors since the beginning of the economic and financial crisis) has increased considerably and, as result, the spread over the swap interest rate has risen from around 60 bp in 2009 to more than 290 bp on average in the closing months of 2010 (see Chart 2). Credit default swap (CDS) premia also increased. As with general government securities, in the opening months of 2011 the risk premia on securities issued by financial institutions decreased, although they remain well above their levels of 2009.

The crisis not only increased market financing costs, but also, when tensions were at a peak, affected the amount of funds raised by credit institutions. Thus, at the most critical time of the first wave of tension (in May and June), gross issuance by these institutions was insufficient to cover the maturities of outstanding debt (see Chart 3). Hence, like the banks of other European countries, they had to resort to the liquidity provided by the Eurosystem, a peak of €130 bn being reached in July (see Chart 4). At end-2010 net issuance again turned negative amidst the tensions accompanying the Irish crisis, but on this occasion banks were able to cover their funding needs through repos traded in international central counterparty clearing houses (such as LCH, Clearnet or Eurex Clearing), once some of them had become members of these systems which diversify the risks assumed by providers of funds. In this way, recourse to the Eurosystem was reduced.

The tighter fundraising conditions in the wholesale markets also lead to an increase in competition for deposits, which caused the interest rates on these transactions to rise during the year from 1.3% in February 2010 to 1.6% in March 2011. The increase in costs was not passed through immediately to household and corporate loans, since these had some leeway to absorb the shock. However, the increase in the margins applied to these transactions from the beginning of 2011 cannot be explained by their ordinary behaviour, indicating that a gradual pass-through seems to have commenced (see Chart 5. Hence, if the interest rates on new loans are compared with the projections derived from an interbank rate transmission model and the cyclical position of the Spanish economy, it can be seen that, both for house purchase loans to households and for loans to non-financial corporations, the rates remained in line with expectations for most of the year, but from early 2011 there was an increase in financial costs not explained by the model.[1] Also, according to the bank lending survey, credit institutions slightly tightened credit standards in 2010 Q2, mainly as a result of the effect of market tensions, although subsequently they seem to have held them unchanged until the opening months of 2011, when they again tightened them in the household financing segment (see Chart 6).

Turning to non-financial corporations, there was also an increase in the cost of raising funds in the markets, the channel used by the largest firms, although less so than by financial firms and general government (see Chart 2). Unquestionably, the high international diversification of non-financial corporations contributed to them being less affected by the financial tensions.

Although tensions eased in the opening months of 2011, spreads and risk premia continue to be high. The persistence or worsening of this situation would entail some risks for the Spanish economy. Thus, in the case of general government, the higher interest rates demanded by the market, although they slowly pass through to the debt burden (at the pace that maturing debt is rolled over), exert continuous pressure on public finances. This weakens the net interest income of banks because the higher cost of liabilities cannot be passed through to loans that have already been granted. Lastly, both non-financial corporations and households may have to face additional tightening of the credit standards for new loans, since financial institutions will have to pass through to their customers the higher cost of funding. Furthermore, if in extreme situations the difficulties of some institutions in refinancing their debt on the markets become more serious, the need to make a more thorough adjustment to their balance sheets may lead to stricter credit standards.

1 For more detailed information on the equations used in this projection exercise, see Nieto and Nieto (2011), *La transmisión de los tipos de interés de mercado a los tipos de interés bancarios en España.*

capital stock or voting rights held by third parties and relative weight of wholesale funding) and empowered the FROB to recapitalise those institutions failing to comply with these new requirements on their own.

In addition, the process of restructuring of the Spanish financial system initiated in the previous year was speeded up, so that by the cut-off date of this Annual Report the number of savings banks had been reduced from 45 to 18 institutions or groups. This process of integration has been accompanied by the restructuring of the institutions involved. The consolidation of the financial system, once it is operationally complete, will entail a significant decrease in capacity, which will help to reduce the excess size accumulated during the long expansionary stage. The implications of these changes are discussed in Section 4 of this chapter, although other regular publications of the Banco de España, such as the *Financial Stability Report* and the *Report on Banking Supervision in Spain*, discuss in greater detail the situation of the financial system and the restructuring and recapitalisation strategy.

… which contributed, along with others adopted at national and European level, to easing the tension, although risk premia remain at high levels and subject to high volatility

Since end-2010, Spain has tended to decouple from the countries most seriously affected by the market tension. The request for financial assistance by the Portuguese authorities in April 2011, and the deterioration in Portugal's sovereign spread which preceded it, did not, in fact, have an impact on Spanish financial variables comparable to that caused by the Greek and Irish crises. In any event, risk premia remain at high levels and subject to fluctuations linked to the varying market perception of the various events relating to the development and management of the sovereign debt crisis in the various countries.

Credit institutions have come under significant pressure…

Against this background, the activity of credit institutions has been subject to significant pressure. First, the sovereign debt crisis led to a significant rise in their funding costs, both on the wholesale markets and, indirectly, in funds obtained through deposits, because of the heightened competition for alternative sources of funds. Second, they have continued absorbing the losses derived from the impairment of assets relating to construction and real estate development, a segment in which doubtless asset ratios have continued to grow rapidly (see Chart 6.1).

… and, since early 2011, they have begun to pass through the higher cost of liabilities to loans

The cost of bank financing to households and firms has remained low. Since mid-2010, however, it has tended to increase as a result of progressive pass-through of the higher cost of financial institutions' liabilities to loan interest rates. This pass-through is not yet complete, so further increases will probably be seen.

Meanwhile, credit standards remained stringent and, according to the bank lending survey (BLS), tightened further during the past year, albeit moderately, and also during the first three months of this year in the household lending segment.

The debt of households and non-financial corporations continued to show little dynamism…

Against this background, household debt remained practically stagnant in 2010 and has contracted slightly since the beginning of 2011. In firms, bank credit decreased in real estate-related activities, and in other areas showed practically zero or slightly positive growth.

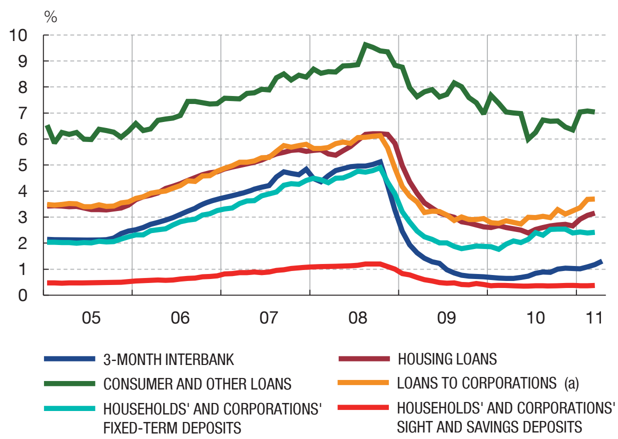
… although debt ratios scarcely changed due to the behaviour of income

Despite the stagnation of household liabilities in recent years, the debt ratio scarcely decreased from the high levels of mid-2008 due to income sluggishness (see Box 6.2). The notable weight of debt for house purchase and its long repayment period also help to explain the slowness with which household leverage is being corrected. Meanwhile, wealth again decreased in 2010, basically due to the loss in value of the real estate com-

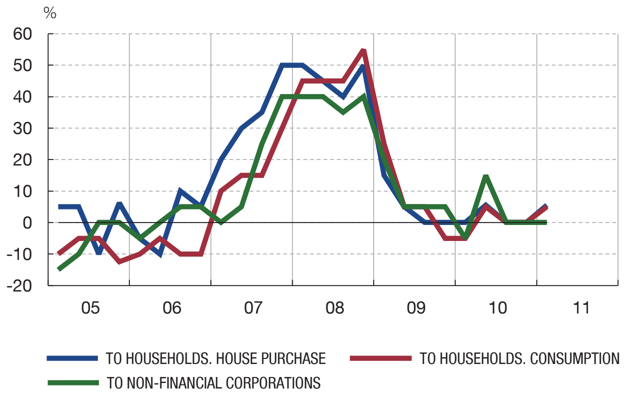
INTEREST RATES, LOAN CONDITIONS, CREDIT, HOUSE PRICES AND DOUBTFUL ASSETS RATIOS

CHART 6.1

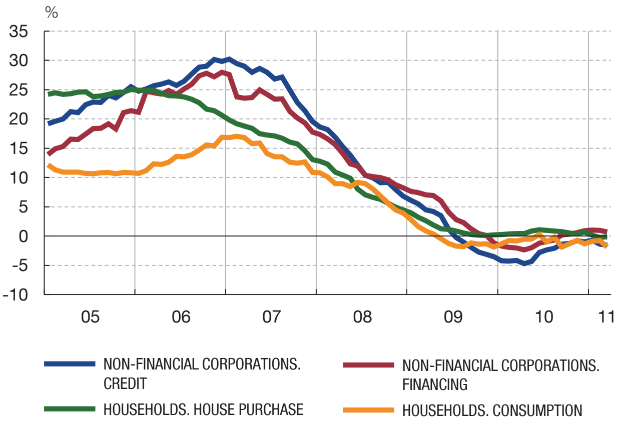
INTEREST RATES



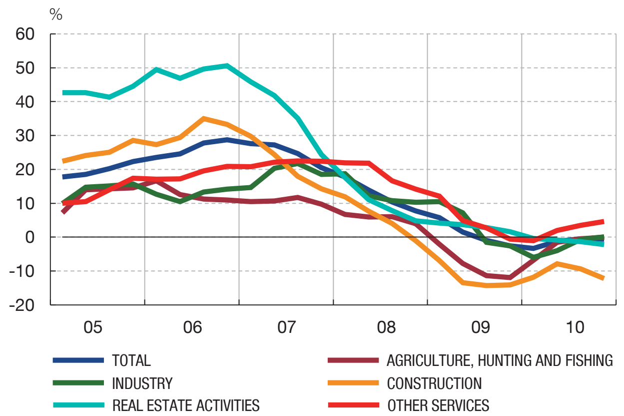
LOAN CONDITIONS OFFERED BY BANKS (b)



CREDIT EVOLUTION (c)

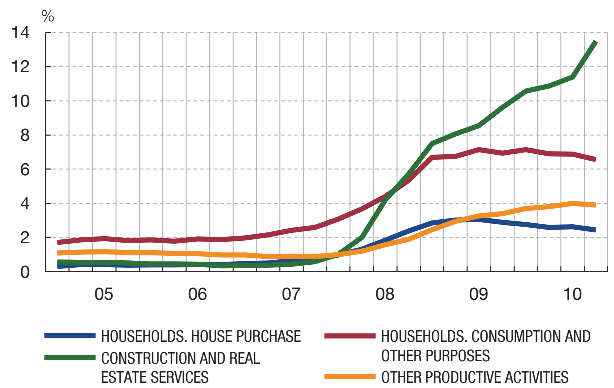


LENDING TO PRODUCTIVE ACTIVITIES
(Annual growth)



PRICE PER SQUARE METRE
OF APPRAISED HOUSING

DOUBTFUL ASSETS RATIOS (d)



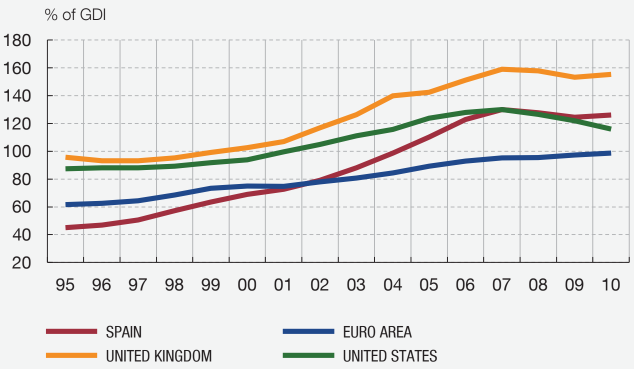
SOURCES: ECB and Banco de España.

a Calculated as a weighted average of the interest rates of various operations grouped according to their volume. For loans over €1 million, the interest rate is obtained by addding to the NDER (narrowly defined effective rate), which does not include commission and other expenses, a moving average of these expenses.
b Cumulative changes in the diffusion index so a positive sign denotes tightening.
c Year-on-year rates.
d Calculated as doubtful credit/total credit.

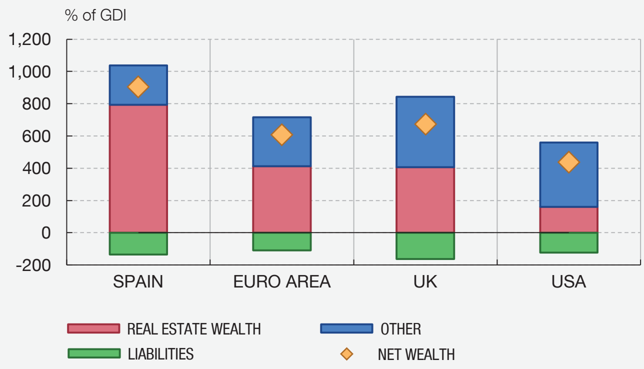
The notable increase in household and non-financial corporation liabilities between the mid-1990s and the outbreak of the crisis took the debt of both these sectors to historically high levels, above those in the rest of the euro area. Household debt currently stands at nearly 125% of gross disposable income, above the euro area average (98%) and similar to the ratio in the United States (one of the 19%), although below that in the United Kingdom (151%) (see Chart 1). Since the highs of mid-2008, which practically tripled those of the mid-1990s, the decrease in this indicator has been very slight (scarcely 5 pp). Two factors explain the slowness of this process: first, the weakness of household income in this period (denominator of the ratio), and, second, the long debt repayment periods of house purchase loans.[1] These loans constitute the bulk of the financing of this sector in Spain, and this, even in the current situation of little new lending, makes

1 On average, in Spain the residual maturity of collateralised loans is 14 years.

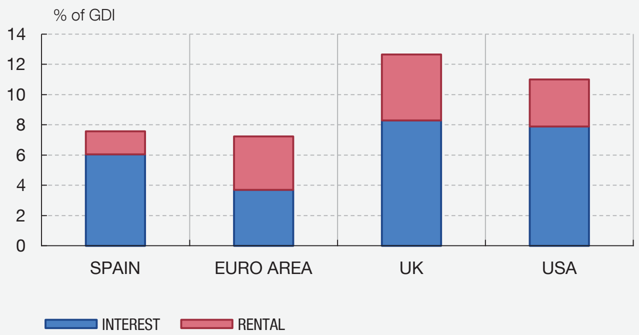
1 HOUSEHOLD DEBT RATIO



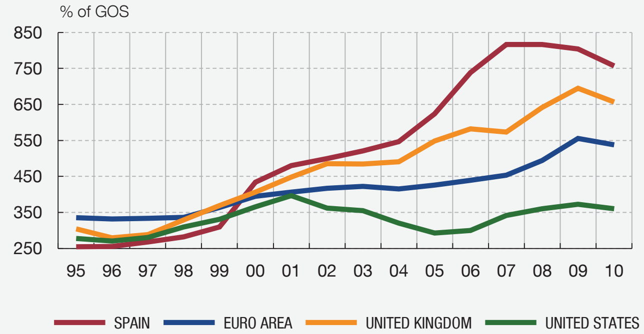
2 HOUSEHOLD GROSS WEALTH. 2010 (a)



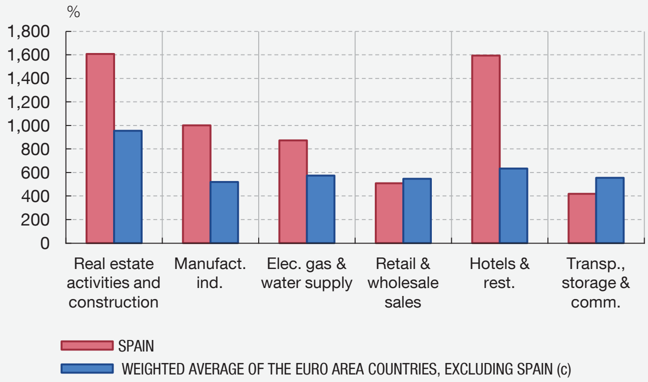
3 INTEREST AND HOUSE RENTAL PAYMENTS OF HOUSEHOLDS. 2009



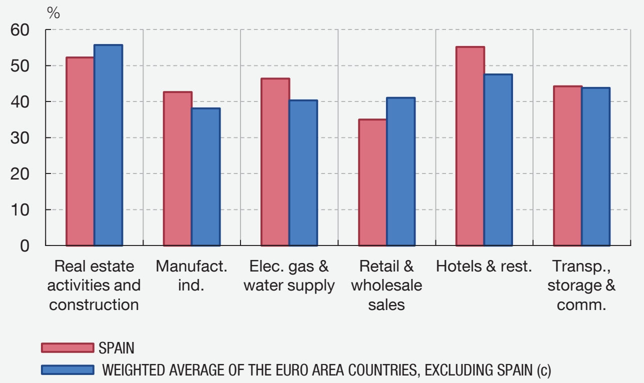
4 DEBT RATIO OF NON-FINANCIAL CORPORATIONS



5 DEBT (b) / GROSS OPERATING PROFIT OF NON-FINANCIAL CORPORATIONS. SECTORAL BREAKDOWN. 2009



6 DEBT (b) / TOTAL ASSETS OF NON-FINANCIAL CORPORATIONS. SECTORAL BREAKDOWN. 2009



SOURCES: Banco de España, INE, ECB, BACH, Eurostat, Federal Reserve, Bureau of Economic Analysis, UK Office for National Statistics and Bank of England.

a UK figures relate to 2009.
b Debt does not include short-term trade credit.
c GDP-weighted average of the ratios in Germany, France, Italy, Portugal and Belgium.

it difficult to reduce liabilities quickly. Deleveraging must thus be a process sustained over time, the duration of which will depend, among other things, on the economy's capacity to recover.

To assess the implications of the level of leverage, it is important to analyse the final purpose of the liabilities. In this respect, in Spain the higher household debt compared with other euro area countries can be traced to the residential mortgage component, since the ratio consumer credit is much the same fraction of gross disposable income as in other euro area economies. This, in turn, is related to the greater propensity to invest in housing in Spain (which reflects the greater preference for ownership and the popularity of second homes), with the consequent higher levels of wealth, even after deducting debt (see Chart 2). Unquestionably, the fact that a large part of these liabilities is secured by assets tends to mitigate some sources of vulnerability associated with such debt. The greater wealth of households would, in principle, allow them to save a smaller proportion of their income and to spend less on rental than the households of other economies with a lower percentage of owner occupancy (see Chart 3). However, this situation is not exempt from significant risks, for the following reasons. First, although there are no homogeneous statistics to allow a comparison of the total debt burden of households, all the evidence indicates that, as a proportion of disposable income, the debt burden in Spain is higher than the euro area average, even if rental expense is added in, which reduces the funds available for consumption. Second, since wealth is more concentrated in property ownership than in other countries, it tends to be less liquid, and thus less available for use in coping with unforeseen situations, and, in addition, it is more sensitive to changes in house prices, thus showing sharper negative wealth effects in situations like the present one of declining values. Lastly, a high level of debt increases vulnerability to interest rate rises (given the marked predominance of floating rate loans in Spain) or to adverse shocks in income (such as, for example, job loss). In this respect, the recent crisis has increased the percentage of households with debts which, as a result of the rise in unemployment, are in a more fragile position, which has naturally obliged them to cut spending more than if they did not have those financial obligations.

In the case of firms, corporate indebtedness in Spain, measured in terms of gross operating surplus, is higher than in the euro area as a whole and than in the United States and in the United Kingdom (see Chart 4). As with households, the scant dynamism of business profits has constrained the correction of the debt to income ratio in the last few years (since 2008 it has decreased by 12 pp, scarcely 1% of its value).

The aggregate corporate debt indicator conceals, however, a high sectoral dispersion. Thus, Chart 5 shows that in most areas of activity the debt to income ratio is higher than in the rest of the euro area, the difference being extremely marked in some of them. In the case of real estate activities and construction, which account for a significant part of corporate debt in Spain (practically half of bank loans, the main financing instrument used by firms). The high volume of debt in these cases basically reflects the ample stock of unsold real estate assets. As this stock is progressively absorbed, these liabilities will tend to be transferred to the agents which acquired the real estate (mainly households), although maybe some of these outstanding loans will end up being written off. All this will tend to reduce the debt ratio. Indeed, it is in firms of this type where debt adjustments have been sharpest in the last two years.

Also in manufacturing and in hotels and restaurants, the levels of debt are very high in comparison with those in other euro area countries, although, in these cases, the divergences have increased particularly sharply since the outbreak of the crisis due to the unfavourable trend in income. It can therefore be expected that a portion of the deleveraging will take place through the recovery of business surpluses. In fact, in terms of balance sheet size, the differences from other euro area economies are not so marked (see Chart 6). By contrast, in other sectors (wholesale and retail trade and transport, storage and communication), the leverage ratio is similar to or lower than in the rest of the euro area. In any event, the high corporate indebtedness detracts from the dynamism of investment because it makes it harder for firms to expand activity with debt financing, while the financial obligation to pay interest and repay principal reduce the funds available for expenses.

The deleveraging of the private sector initiated in the last few years is far from having concluded. The most important contribution to this process will come from the recovery of income. Therefore, actions taken to boost economic growth are the best way to quickly complete the process which will prevent the high debt from weakening spending, especially in a setting in which interest rates will tend to increase.

ponent as house prices fell by 3.5% in the year as a whole. With the 2011 Q1 figure, which showed an increased rate of contraction, the cumulative fall is 15% (20% in real terms) from the high at the beginning of 2008. It should also be kept in mind that there is a notable dispersion in wealth across the sector, so the aggregate indicators fail to capture the deterioration that may have taken place in the groups in a more fragile position, such as, for example, unemployed debtors. Also, the prolongation of the crisis and the pattern of slow recovery are eroding the resources that households can deploy to deal with the deterioration of their situation.

In the case of non-financial corporations, the recovery of business profits, the scant dynamism of borrowing and the lower average cost of outstanding debt gave rise to a slight decrease in the debt ratio and the associated debt burden. In any event, the leverage of the business sector as a whole remains high, although the dispersion within the sector is high.

The debt and debt burden of general government continued to rise

The fiscal consolidation programme implemented by general government was instrumental in slowing the sector's liabilities following the marked deterioration in public finances in 2009, although they continued to grow rapidly. This, together with the scant economic dynamism, led to an increase in the public debt ratio and in the debt burden to GDP ratio.

If the recent economic policy actions continue in the same vein as in the past, the recovery of investor confidence will firm, although risks persist…

Although financial market tensions have eased in the early months of 2011, the continuing high risk premia mean that the possibility of a worsening cannot be ruled out. This would be particularly injurious for an economy which continues to depend on the savings of the rest of the world. The higher cost of funding for institutions, the economic situation of some borrowers and financial institutions' exposure to the real estate sector continue to pose significant challenges. Therefore, the actions aimed at strengthening the economy's ability to grow and those designed to underpin the soundness of the financial system continue to be essential not only to restore the GDP growth rates needed to complete the convergence of the Spanish economy with the standards of the more developed European countries, but also to complete the process of recovery of investor confidence initiated at the beginning of the year.

… and the high private sector indebtedness continues to hinder the recovery of spending

The recovery of growth, moreover, is essential also for correcting the high leverage of the non-financial private sector, which has barely been corrected since the peaks recorded at the beginning of the crisis, and which continues to hinder the expansion of demand, since it reduces the scope for financing consumption and investment through borrowing and consumes a large part of the disposable income of the sector.

2 The Spanish financial markets

2.1 MARKET PRICES

The sovereign debt crisis has raised the financing costs of resident issuers in the fixed income markets…

Spanish financial market prices were strongly affected by the tensions arising from the sovereign debt crisis. The yields on general government securities rose and the spreads over the German bund widened (see Box 6.1). The rise affected all terms, although it was somewhat sharper in the short- and medium-term tranches of the yield curve (up to three years), where yields increased by nearly two percentage points (pp) in 2010 (see Chart 6.2). Also, funding costs of financial institutions increased as a reflection of investors' doubts regarding the situation of some savings banks. By contrast, the interest rates on securities issued by non-financial corporations increased more moderately, benefiting from the broad international diversification of the firms which use this type of instruments for financing.

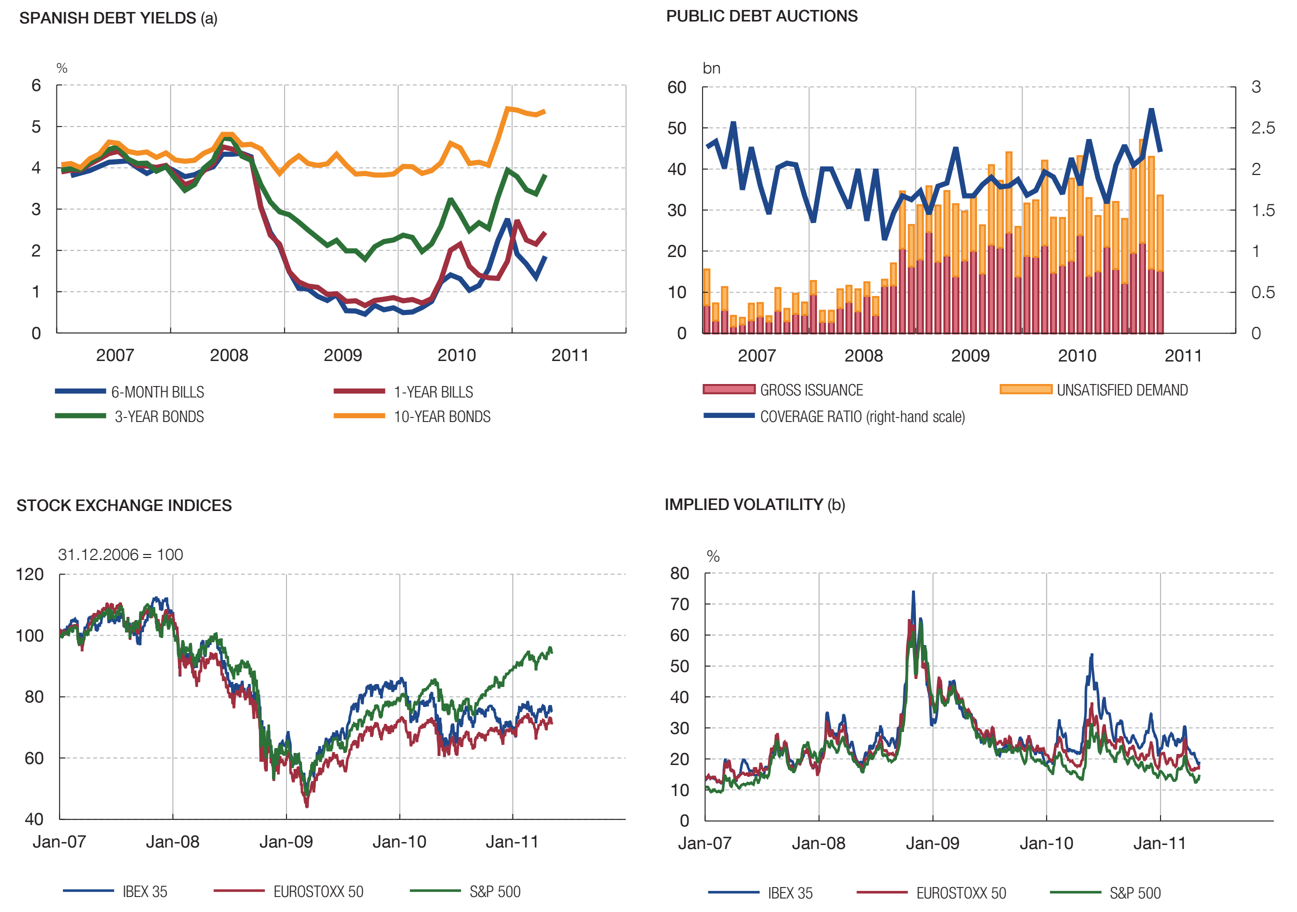
The period of highest tension came at the end of November. Subsequently, the risk premia of resident issuers tended to decrease. The behaviour of volatility was not unrelated to the measures taken by Spanish and European authorities. In any event, these premia remain high and subject to major fluctuations.

… and has caused stock market prices to fall and volatility to rise

The turmoil also spread to the stock markets, where prices fell and volatility rose, ending the favourable trend seen since March 2009. At the time of greatest debt market tension (at the end of November), the IBEX 35 was down by 22.4% on its end-2009 level. This performance was worse than those of the EUROSTOXX 50, the EU stock exchange index, which at that date was down by 10.6%, and the US S&P 500, which was up by 5.9%. Among the sectors showing the sharpest falls were real estate (55%) and finance (33.6%). Subsequently, this trend reversed, and stock markets rose in most sectors, although volatility continued to be high.

FINANCIAL MARKETS

CHART 6.2



SOURCES: ECB and Banco de España.

a Monthly averages.
b Five-day moving average.

2.2 THE PRIMARY MARKETS

Net issuance of marketable debt securities decreased appreciably…

Net issuance of bonds by resident sectors fell sharply to €74 bn, compared with €190 bn in the previous year (see Table 6.1). This was explained basically by the decrease in net borrowing by general government and credit institutions, although it was also true that the tighter financing conditions in these markets did not favour the use of this means of financing.

The bulk of net bond issuance was by general government (€76 bn). This amount, which represented a decrease of €51 bn with respect to 2009, resulted from an increase in the volume issued by regional governments and a decrease in issuance by State government, these variations being in line with the changes in the borrowing needs of these two subsectors. Despite the tensions prevailing on financial markets and the downgrades in Spanish debt ratings by rating agencies, the Spanish bond auctions achieved ample coverage (demand to allotted funds) ratios, albeit at a progressively higher cost. Of the €63 bn issued by the State, more than 93% was medium and long term, meaning that the average life of outstanding debt was lengthened from 6.4 to 6.6 years, thus contributing to reduce the refinancing risk.

As a result of credit institutions' lower funding needs and of the wholesale market tensions, monetary financial institutions and their resident and non-resident subsidiaries made net redemptions of bonds amounting to €15 bn. There was a shift towards instruments involving lower risk. Thus, issues of paper guaranteed by the State and of covered

ISSUANCE AND PUBLIC OFFERINGS OF MARKETABLE SECURITIES — TABLE 6.1

€bn

	2007	2008	2009	2010
NET ISSUANCE BY RESIDENTS	268.3	145.9	199.7	89.5
FIXED INCOME	222.4	131.1	189.5	74.7
Monetary financial institutions	78.2	-26.9	39.6	7.8
Other financial intermediaries	146.5	104.6	21.5	-10.9
Of which:				
Financial vehicle corporations	*106.9*	*95.0*	*14.9*	*-5.9*
Subsidiaries of monetary financial institutions	*34.5*	*7.4*	*-8.8*	*-12.2*
Subsidiaries of non-financial corporations	*4.5*	*3.0*	*14.5*	*7.4*
Non-financial corporations	2.0	1.9	0.7	1.3
Central government	-4.7	50.2	119.4	63.2
Regional and local government	0.4	1.4	8.4	13.2
EQUITIES	46.0	14.8	10.2	14.8
Monetary financial institutions	12.0	10.0	3.0	6.6
Other financial intermediaries	3.5	1.4	0.4	0.1
Non-financial corporations	30.5	3.4	6.8	8.1
PUBLIC OFFERINGS	2.1	0.0	0.0	0.5
MEMORANDUM ITEM:				
Net issuance by foreign subsidiaries	9.5	12.9	-2.0	-8.9
Financial institutions	8.2	14.3	-3.4	-10.6
Non-financial corporations	1.3	-1.4	1.4	1.7

SOURCE: Banco de España.

bonds amounted, in net terms, to €12 bn and €13 bn, respectively, while gross placements of other instruments were less than maturities. Against a background in which the securitisation market continues to be inactive and in which institutions hold an ample volume of collateral, the balance of the securities issued by financial vehicle corporations (asset-backed bonds) fell for the first time in many years. By contrast, net issuance by non-financial corporations turned positive again (€10 bn, including that by resident and non-resident subsidiaries). The higher net borrowing by firms of this type (basically large multinationals), whose business is highly diversified internationally, and the fact that these have been less affected by the financial turmoil explain the greater dynamism of this primary market segment compared with that of financial firms.

… but, by contrast, issuance of equity securities increased

Equity issuance by both credit institutions and non-financial corporations increased, amounting in total to €15 bn, up 45% on 2009. However, it should be noted that this growth was heavily influenced by two specific transactions (one in each sector).

2.3 SECONDARY MARKET ACTIVITY

Secondary market trading varied depending on the segment

Secondary market activity varied across segments (see Table 6.2). In public debt, the volume traded remained somewhat below €19,000 bn, combining an increase in spot transactions, which grew by nearly 90% despite momentary liquidity problems following the outbreaks of tension in May and November, and a decrease in repo and sell/buy-back transactions. The fall in the latter is partly associated with problems of investor confidence since, when tensions peaked, investors perceived a high risk in bilateral repo transactions with Spanish institutions, believing there was a high negative correlation between the risk of default by financial institutions and the value of the asset used as collateral in these transactions (Spanish Treasury debt). In the second half of the year some institutions begin to oper-

TURNOVER ON SECONDARY AND DERIVATIVES MARKETS — TABLE 6.2

€bn

	2007	2008	2009	2010
PUBLIC-DEBT BOOK-ENTRY MARKET (a)	22,664	19,944	18,522	18,552
Spot	3,177	2,202	2,470	4,635
Repos and sell/buy-back agreements	19,193	17,477	15,903	13,761
Forward	294	265	150	156
AIAF FIXED-INCOME MARKET	900	2,401	3,692	3,658
Commercial paper	482	577	529	383
Covered bonds and asset-backed securities	329	1,740	2,849	2,413
Other	90	83	314	862
STOCK EXCHANGE: FIXED INCOME	90	80	75	67
STOCK EXCHANGE: EQUITIES	1,670	1,245	898	1,038
MEFF DERIVATIVES MARKETS	1,451	1,073	710	1,263
IBEX 35	1,384	989	622	1,158
Equity derivatives	68	84	88	105

SOURCES: Bolsas y Mercados Españoles, Federation of European Stock Exchanges and Banco de España.

a Only includes transactions in State securities.

ate in repo markets with central counterparties clearing houses, in which the supposed link is substantially diluted. In this way, trading was channelled partly through foreign trading platforms (such as BrokerTec or Eurex Repo), instead of through the Spanish debt market.

The volumes traded on the AIAF bond market remained around the levels of 2009. The decrease in spot transactions was offset by the increase in repo and sell/buy-back transactions. A major feature was the fall in covered bond and asset-backed bond transactions, which had grown notably in the previous two years. By contrast, the downward trend in equity market trading volumes since the outbreak of the financial crisis in 2007 was interrupted. The volumes of spot and derivatives transactions moved up above €1,000 bn and €1,200 bn, respectively. However, this increase also reflected, at least in part, the climb in average prices, which raised the unit value of transactions.

3 External investment in and financing of the Spanish economy

The financial tensions made it more difficult to raise funds abroad

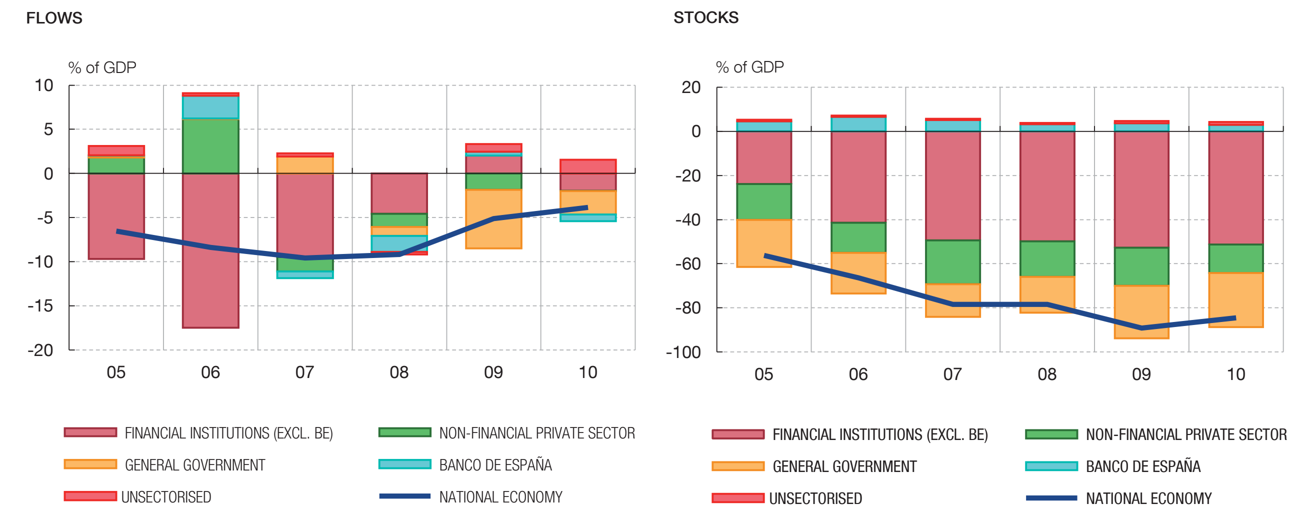
The nation's net borrowing decreased again last year, falling, in 12-month cumulated terms, to a figure equivalent to 3.9% of GDP (compared with 5.1% at end-2009, as shown by Chart 6.3). The behaviour of financial flows vis-à-vis the rest of the world evidences the considerable difficulties that the Spanish economy has had in raising funds abroad as a result of the euro area sovereign debt crisis.

Borrowing requirements were met through capital inflows channelled mainly in the form of instruments issued by general government and non-financial corporations…

In line with the lower borrowing requirements and the greater difficulty in raising funds as a result of the sovereign debt crisis, the funds received from abroad decreased again in 2010, being limited to a figure equivalent to 0.6% of GDP, down from the 4.9% recorded in the previous year and well below the 23.7% reached in 2007 (see Table 6.3). Capital inflows were channelled mainly through instruments issued by non-financial corporations and general government, specifically loans from the rest of the world and shares, in the first case, and fixed income securities, in the second case. The funds raised by the latter instrument by general government amounted to 2% of GDP. By contrast, the volume of securities issued by financial institutions held by the rest of the world decreased (by 1.1% of GDP in the case of credit institutions, and by 2.4% of GDP for other financial institutions including fi-

NET FINANCIAL ASSETS VIS-À-VIS THE REST OF THE WORLD
(Changes in and contributions of components)

CHART 6.3



SOURCE: Banco de España.

nancial vehicle corporations). There was also a slight decrease in the net debit position in the interbank market, along with an accompanying change in its composition. In particular, flows in the form of collateralised transactions increased considerably, being favoured by the trading in central counterparty clearing houses, and uncollateralised net transactions fell.

… and also through the reduction of external assets held by residents

The nation's net borrowing was covered, lastly, by the reduction of external assets held by residents (3.3% of GDP). Noteworthy was the contraction in holdings of securities other than shares by an amount equivalent to 7% of GDP, in net terms, effected mainly by institutional investors and credit institutions. By contrast, there was an increase in acquisitions of shares and other equity securities (2.3% of GDP). In this line, the downward path followed over the past two years by Spanish foreign direct investment was interrupted and this item increased by 0.9 pp to 1.6% of GDP, an amount similar to that represented by the direct investment of non-residents in Spain, which also increased by nearly 1 pp.

The balance of the nation's net liabilities decreased slightly

Despite the net negative sign of the nation's financial transactions, the movements in prices (upwards in assets and downwards in liabilities) meant that the balance of the nation's net liabilities to the rest of the world decreased by nearly 4 pp to around 85% of GDP, according to the Financial Accounts of the Spanish Economy (see Chart 6.3). External assets amounted to 130% of GDP, while gross liabilities were 215% (165% relating to gross debt and 50% to equity). Sectoral analysis shows that financial institutions had the largest net debit position vis-à-vis the rest of the world, followed by general government (amounting in the first case to 52% of GDP and in the second to 25.4%). The net debit position of the non-financial private sector is close to 13% of GDP, down 4 pp on the previous year.

4 Spanish financial intermediaries

4.1 CREDIT INSTITUTIONS[2]

The effects of the crisis in Spain and the tensions in financial markets set in motion a merger and restructuring process in financial institutions which particularly affected savings banks. The objectives of this process, furthered by the creation of the FROB in

2 For more details of the situation of Spanish credit institutions, see the *Report on Banking Supervision in Spain* and the *Financial Stability Report* of the Banco de España, the specialised publications of the Banco de España which discuss these subjects in greatest depth.

FINANCIAL TRANSACTIONS OF THE NATION
Cumulative four-quarter data

TABLE 6.3

% of GDP

	2007	2008	2009	2010
NET FINANCIAL TRANSACTIONS	-9.6	-9.2	-5.1	-3.9
FINANCIAL TRANSACTIONS (ASSETS)	14.1	0.7	-0.2	-3.3
Gold and SDRs	0.0	0.0	0.0	0.0
Cash and deposits	1.4	-1.3	-3.2	-1.4
Of which:				
Interbank, credit institutions (a)	*4.2*	*-0.5*	*-1.7*	*-1.3*
Securities other than shares	1.6	1.3	0.0	-6.9
Of which:				
Credit institutions	*1.8*	*1.5*	*1.2*	*-3.0*
Institutional investors	*0.0*	*-1.3*	*-0.5*	*-3.3*
Shares and other equity	8.8	1.7	1.6	2.4
Of which:				
Non-financial corporations	*6.6*	*3.0*	*0.1*	*2.4*
Institutional investors	*-1.1*	*-1.6*	*0.3*	*0.8*
Loans	1.2	0.8	0.2	0.4
FINANCIAL TRANSACTIONS (LIABILITIES)	23.7	9.9	4.9	0.6
Deposits	6.7	8.0	-0.5	-0.5
Of which:				
Interbank, credit institutions (a)	*6.7*	*6.2*	*0.7*	*-7.3*
Repos, credit institutions (b)	*0.1*	*0.2*	*0.1*	*5.7*
Interbank, BE (intra-system position)	*-0.3*	*1.9*	*-0.8*	*0.2*
Securities other than shares	8.1	-2.7	3.8	-1.5
Of which:				
General government	*-1.3*	*1.1*	*5.4*	*2.0*
Credit institutions	*3.6*	*-1.9*	*1.1*	*-1.1*
Other non-monetary financial institutions	*5.8*	*-1.9*	*-2.6*	*-2.4*
Shares and other equity	4.6	3.2	1.1	0.8
Of which:				
Non-financial corporations	*4.7*	*2.4*	*0.3*	*1.1*
Loans	3.1	2.9	0.3	1.2
Other, net (c)	0.2	0.2	-1.1	-1.7
MEMORANDUM ITEMS:				
Spanish direct investment abroad	9.5	4.7	0.7	1.6
Foreign direct investment in Spain	4.5	4.8	0.6	1.5

SOURCE: Banco de España.

a Excluding repos.
b Including transactions with central counterparty clearing houses.
c Includes, along with other items, the asset-side caption showing insurance technical reserves and the net flow of trade credit.

2010 saw a significant concentration in Spanish savings banks

2009, are various. First, after a period of vigorous growth in banking activity, the system as a whole had reached a size which, although commensurate with the relative weight reached in other developed economies, was excessive in a scenario characterised by a moderating trend in the growth rate of financial activity and by the need for deleveraging of a significant portion of Spanish households and firms. The concentration of financial institutions also aims to achieve synergies and economies of scale to make for more efficient financial intermediation. A larger size of the resulting groups should make it easier to achieve additional increases in efficiency and to access the capital markets. Along these same lines, the exercise of savings bank financial activity by limited liability companies licensed as banks broadens the range of instruments accessible to the latter, enabling them to issue ordinary shares. Finally, the process under way contributes to strengthening the solvency of the sub-sector and to improving its management capacity, since some of the more vulnerable institutions are now being absorbed by others in a stronger position.

Although the process of concentration is not limited only to savings banks, most of the concentration transactions are taking place in this sub-sector. This is basically because of the more pronounced imbalances accumulated in the phase preceding the crisis: faster balance sheet growth and excess capacity, greater need to raise funds through the issuance of securities on wholesale markets instead of traditional instruments and a higher exposure to the real estate development sector. Nor should it be overlooked that these institutions were characterised by a singular corporate structure which hindered the issuance of high-quality capital instruments (voting shares) in a crisis situation, when the volume of internally generated funds decreases considerably. Recent events have also demonstrated the need for substantial improvements in the governance of these institutions.

The process has been supported only partially by government aid and accompanied by the recapitalisation of institutions

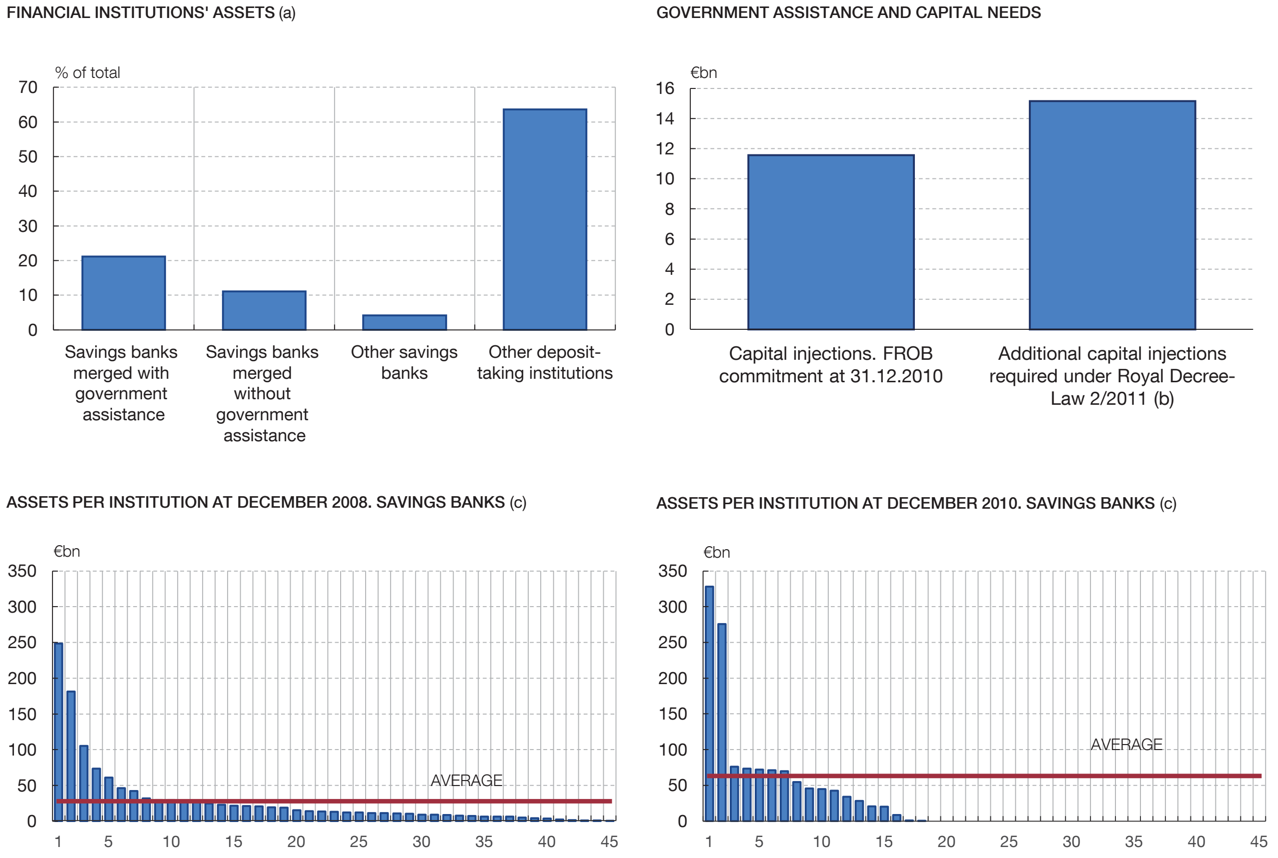
As shown in the top left panel of Chart 6.4, the processes of concentration under way have involved most of the savings bank sector, although not all savings banks have made use of government funds. In terms of the credit system as a whole, the savings banks involved in mergers with assistance from the FROB represent somewhat more than 20% of total assets, while those that have undertaken processes of this type without the use of government funds represent 11% of the total.

In this process up to December 2010, the FROB had committed a total of €11,559 million (see top right panel of Chart 6.4). On 10 March 2011, the Banco de España made public the additional amounts to be raised by the various Spanish credit institutions to comply with the new capital requirements approved at the beginning of 2011 on the basis of their situation at 31 December 2010. In all, they amount to a €15,152 million, of which €14,077 million related to savings banks. Subsequently, the initial project of the Banco Base institutional protection scheme (IPS), for which assistance of €1,493 million had been earmarked (this amount was included in the aforementioned €11,559 million), was aborted and the two institutions or groups resulting from that rupture designed their recapitalisation strategies to meet the new needs derived from the provisions of Royal Decree-Law 2/2011. This entailed some changes with respect to the situation in March. In any event, the amount of the sector's recapitalisation needs finally covered by the FROB will depend on the private funds raised by institutions and on their possible strategic decisions on asset sales or concentration transactions. However, in any event, the final outcome will be that Spanish intermediaries will find themselves, in September of this year (or March 2012 at the latest) with a minimum core capital[3] ratio of 8% or 10%, depending on the characteristics of the institution.

3 Defined in Royal Decree-Law 2/2011 of 4 March 2011. For more details, see Box 1.2 of this Annual Report.

FINANCIAL SYSTEM RESTRUCTURING

CHART 6.4



SOURCE: Banco de España.

a Data drawn from consolidated balance sheets as at 31.12.2010. Situation at the beginning of May 2011.
b Estimated amounts, based on data at 31.12.2010, required to comply with Royal Decree-Law, according to the BE publication of 10 March 2011.
c Consolidated data. Those relating to December 2010 take into account the group structure at the beginning of May 2011.

All this has brought a substantial change in the structure of the savings bank sector

Although the process is still under way, the changes in 2010 entailed a significant transformation of the Spanish savings bank sector. In terms of the size of institutions and of their degree of concentration (see the bottom panels of Chart 6.4), it brought an increase in average size from €28 bn at end-2008 to €70 bn two years later. The number of savings banks decreased from 45 to 18 savings bank institutions or groups.

Institutionally, the process took the form of both mergers (seven operations) and the formation of IPSs (five operations). The latter necessarily involve the formation of a commercial bank which acts as the central institution of the IPS, carrying out its financial activity and to which the bulk of the group's assets have been or will shortly be transferred. In this way, practically all financial activity is transferred to institutions which are limited liability companies, thereby altering the previous corporate structure. This movement was strengthened by the reform of the savings bank law and by the capital reinforcement requirements laid down by Royal Decree-Law 2/2011.

The savings bank law reform included in Royal Decree-Law 11/2010 of 9 July 2010 made it possible for all savings banks to indirectly exercise their financial activity through a commercial bank. Subsequently, Royal Decree-Law 2/2011 accentuated this trend by encouraging the entry of private investors in the capital of institutions. The intention here is to foster more professional management, increase the role of market discipline and, at the same time, make it easier to raise additional top-quality capital where necessary. The Royal Decree-Law also increases the minimum level of core capital (10%, as against 8%) for those institutions that have not distributed to third parties equity securities representing 20% or more of their capital and raise a significant portion of their funds in the wholesale financial markets. Compliance with the first part of these requirements requires the existence of an institution legally organised as a limited liability company which can issue these securities, leaving to one side the possibility of issuing non-voting equity units ("cuotas participativas") of savings banks. In addition, it is made compulsory to choose the option of indirect exercise of financial activity in order to be eligible for the new assistance from the FROB, which in all cases will take the form of acquisition of ordinary shares of the group. These acquisitions will necessarily be temporary and the related securities will be resold to private investors and within a maximum of five years, whereupon the final result will be the same.

On 14 April of this year the Banco de España approved the various strategies which the institutions involved had drawn up to meet the new capital requirements. Two weeks later, on 28 April and within the legally stipulated time period, those savings banks or groups of savings banks which have chosen the FROB as the primary source of capital funding to meet these new requirements submitted their plans.

Total assets in Spain remained stagnant and the number of branches and staff decreased

Against this background, the consolidated total assets of Spanish institutions as a whole increased slightly as a result of the growth of business abroad, since that in Spain remained practically stagnant, for the second year running (see Table 6.4).[4] Moreover, in December the number of branches and staff in Spain had decreased by 6% and 5%, respectively, from their peaks in 2008, and the institutions involved in merger processes with FROB support recorded the provisions needed to cover the cost of the agreed headcount and branch network reductions over the next few years.

There was a decrease in the volume of credit granted

The credit granted to the resident private sector also shrank slightly. According to the bank lending survey, this seems to be due to sluggish demand and shrinking supply. Demand remained basically stagnant in the case of non-financial corporations, fluctuated throughout the year with no clear trend in respect of household residential mortgages and performed somewhat more negatively in consumer credit and other lending to households. The credit standards for the approval of new loans continued to be strict and generally tightened slightly in 2010 Q2, mainly as a result of wholesale financial market tensions, although subsequently they remained steady. In the early months of 2011 they tightened further in the household credit segment.

… and the cost rose moderately

The interest rates applied in new loans to households and non-financial corporations remained low. However, from the beginning of this year institutions have begun to pass through more actively the higher cost of their liabilities to their lending rates. This has resulted in a rise of between 55 basis points (bp) and 115 bp in the cost of bank financing to households and firms between June 2010 and March 2011.

...partly influenced by the financial market tensions

The difficulty in raising funds on the wholesale markets and their higher cost meant that the institutions temporarily had to resort more to the Eurosystem in spring and summer. Subsequently, such recourse to the Eurosystem decreased to account for only 1.4% of the consolidated total balance sheet at December 2010 (against 2% a year earlier) and have continued to decrease during this year. Their place has basically been taken by funds from

4 Owing to the restructuring carried out in the last few days of the year, the figures for 2010 had to be adjusted to make them comparable with those for 2009. This comparison must therefore be interpreted with caution.

CREDIT INSTITUTIONS
BALANCE SHEET AND INCOME STATEMENT (a)

TABLE 6.4

	CONSOLIDATED			INDIVIDUAL		
	Dec-09	Dec-10	Y-o-y rate (%)	Dec-09	Dec-10	Y-o-y rate (%)
MAIN BALANCE SHEET ITEMS (% of TA)						
TOTAL ASSETS (€bn)	3,739.9	3,816.5	2.0	3,142.4	3,122.0	-0.6
Credit	64.1	63.4	0.8	61.5	61.2	-1.2
Of which: resident private sector in Spain				56.1	55.4	-1.8
Debt securities	13.5	12.8	-3.4	13.2	12.7	-4.6
Other assets	22.4	23.8	8.8	25.3	26.1	2.6
LIABILITIES						
Banco de España and other central banks	3.3	2.5	-23.2	3.6	2.4	-33.7
Interbank deposits (b)	14.2	15.6	12.0	17.6	19.6	10.5
Customer deposits (c)	49.6	50.6	4.1	50.5	49.9	-1.7
Of which: households and non-fin.corps. res. in Spain				29.3	30.4	3.1
Marketable securities	17.0	14.6	-12.2	12.5	11.4	-9.6
Other liabilities	9.8	10.9	13.2	9.8	11.0	12.1
Equity	6.1	5.8	-2.4	6.0	5.6	-6.9
INCOME STATEMENT (% of ATA)						
(+) Interest income	4.10	3.35	-15.7	3.42	2.54	-25.0
(–) Interest expense	2.12	1.57	-23.7	1.97	1.39	-28.8
Net interest income	1.98	1.78	-7.1	1.45	1.15	-19.9
Gross margin	3.01	2.78	-5.1	2.26	2.10	-6.3
(–) Operating expenses	1.30	1.32	4.1	0.98	0.97	0.0
(–) Write-downs of and provisions for financial assets	1.05	0.85	-14.9	0.77	0.72	-4.3
Operating profit	0.67	0.61	-7.6	0.53	0.42	-21.1
After-tax profit	0.54	0.47	-10.0	0.42	0.32	-23.7
RATIOS (%)						
Solvency	12.2	11.9				
Doubtful assets/TA	3.1	3.5		3.1	3.5	
Foreign operations/TA	23.3	26.3				
Efficiency (OE/GI)	43.1	47.2		43.2	45.1	
ROE (d)	9.3	7.5		7.1	5.7	

SOURCE: Banco de España.

a Owing to the restructuring processes carried out in the closing days of the year, the 2010 figures have had to be adjusted to make them comparable with those of 2009. This comparison therefore had to be regarded with some caution.
b Including money market transactions with central counterparties.
c Including liabilities to securitisation financial vehicle corporations.
d Although stated at both consolidated and individual level, it should be noted that this item is more representative in the former case, since the individual figure does not include all group operations.

repo transactions carried out through foreign central counterparties. The net funds raised in this way amounted to around €60 bn at end-2010, against a value of practically zero at the beginning of that year. Nevertheless, the market tensions also prompted fiercer competition for deposits from the public, the cost of which increased significantly (54 bp between December 2009 and March 2011, in time deposits).

Cumulative provisions and write-downs are high

Credit institutions also recorded significant write-downs. Thus, while the growth rate of doubtful assets moderated (from year-on-year growth of 48% in 2009 to 15% in 2010), provisions continued to increase at a rate of more than 25%. In 2010 additional provisions were charged to cover losses on foreclosed real estate and other commitments relating to planned staff reductions. In all, from January 2008 the sector has recognised and borne €96 bn of losses on its assets, representing approximately 5% of total credit to the private sector at December 2007 and 9% of GDP.

Write-downs and the contraction of net interest income resulted in a fresh decline in profits in 2010

Provisioning charges, along with the contraction in net interest income, resulted in a further decrease in net profits, which, however, remained positive (see Table 6.4).

The new capital requirements and the increased transparency should help to normalise access to market funding, although significant challenges persist

Despite the lower profits earned, Spanish credit institutions continued to increase their top-quality capital (core capital) until it accounted for 9.5% of total risk-weighted assets at end-2010 (including contributions from the FROB). At the same time, the overall solvency ratio decreased slightly from 12.2% in December 2009 to 11.9% twelve months later. During 2011, as a result of the new requirements approved by the government in February, the less well capitalised institutions are making additional advances in this respect.

In any event, institutions still face significant challenges relating to the still-fragile economic situation of some of their borrowers, the higher cost of their funding sources and their exposure to the real estate sector, so they will have to continue making efforts to strengthen their financial position and reduce their cost structure.

4.2 INSTITUTIONAL INVESTORS

The competition from bank deposits and the high perception of risk by savers continued to affect the sector negatively

The activity of institutional investors continued to be affected by the competition for funds in the form of bank deposits and by the still high perception of risk by savers. This led, yet another year, to a decline in the net assets of collective investment companies and funds and to a modest increase in the case of insurance companies and pension funds (see Chart 6.5).

Holders of investment funds made net redemptions during the year, these withdrawals being most notable in those institutions with a more conservative investment policy (money market funds and short-term bond funds), which are the ones that compete most directly with credit institutions. Meanwhile, the renewed financial market tensions led to lower yields than in the previous year, practically across the board. Against this background, management entities continued to market mainly instruments of the conservative nature. The high debt issuance by Spanish general government and the greater preference for instruments issued by residents favoured a further increase in the holdings of securities of this type, while external assets decreased.

Investment by private equity institutions showed a notable recovery in comparison with the previous year, albeit based mainly on the activity of foreign operators. By contrast, the funds raised by Spanish private equity institutions decreased slightly with respect to 2009, as did those raised by real estate funds and hedge funds.

The process of savings bank concentration may affect the structure of the sector in the coming quarters, given the significant weight of savings bank subsidiaries in collective investment.

5 The financial flows and balance sheet position of the non-financial sector

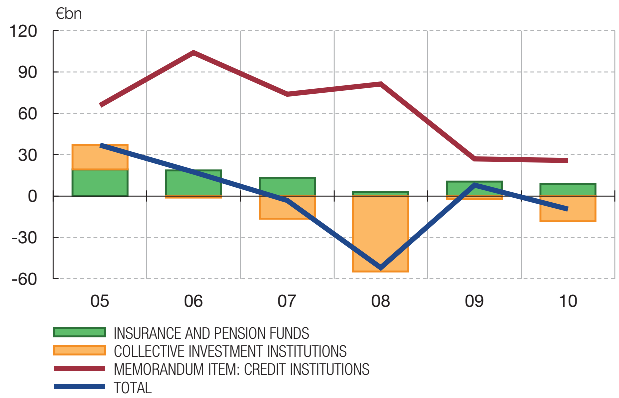
5.1 HOUSEHOLDS

Following its significant deceleration between mid-2006 and end-2009, household debt remained practically flat in 2010 as a result of a slight increase in that incurred for real estate purchases and a moderate decrease in consumer credit and other lending. Since the beginning of the current year, it has contracted slightly as a result of a decrease in both these components.

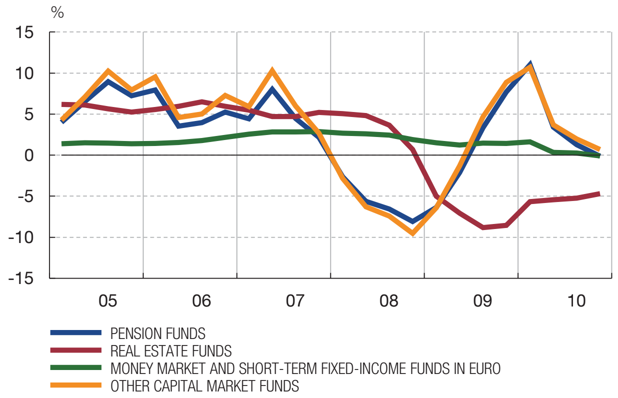
INSTITUTIONAL INVESTORS

CHART 6.5

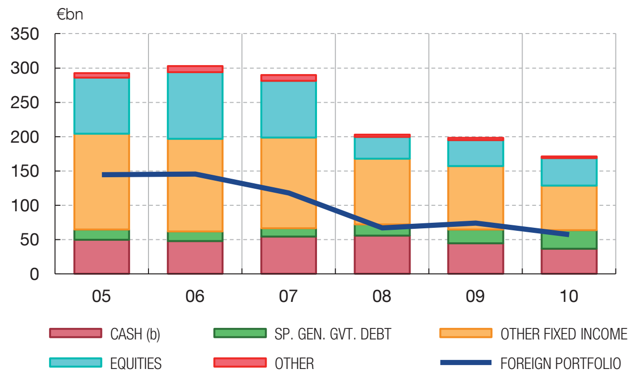
FUNDS RAISED BY OTHER FINANCIAL INTERMEDIARIES (a)



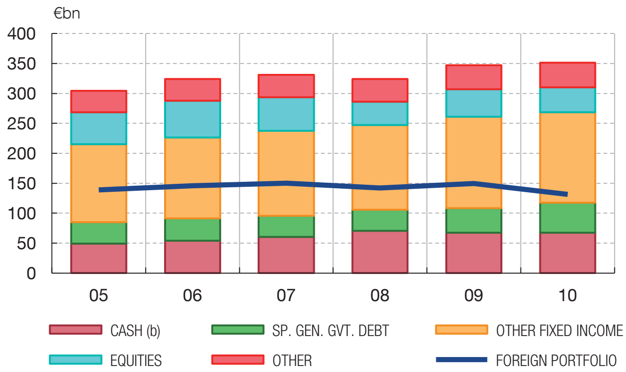
ANNUAL RETURN



COLLECTIVE INVESTMENT INSTITUTIONS: FINANCIAL ASSETS



INSURANCE COMPANIES AND PENSION FUNDS: FINANCIAL ASSETS



SOURCES: Comisión Nacional del Mercado de Valores, Banco de España and Dirección General de Seguros y Fondos de Pensiones.

a Shares and other equity in CIIs and reserves of insuranece companies and pension funds. In the case of credit institutions, deposits and repos of households and non-financial corporations.
b Includes cash, deposits and repos.

Household debt remained practically stagnant but the scan dynamism of income prevented the debt ratio from decreasing, while wealth and the debt burden continued to fall

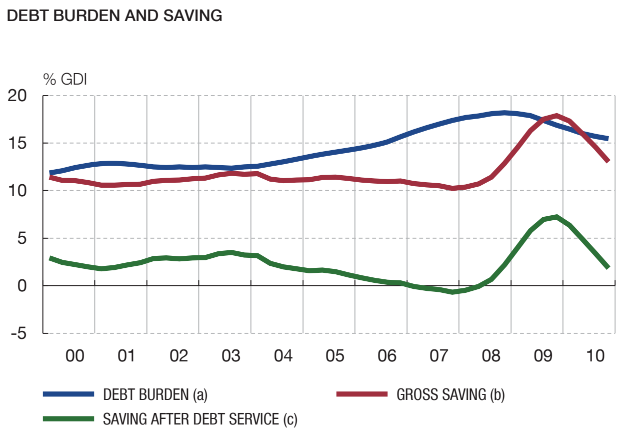
Despite the scat momentum of household debt, the debt ratio of the sector remained steady due to the stagnation of income and to the high relative weight of debt for house purchases and the long mortgage loan maturities, which also influence the dynamics of household deleveraging (see Box 6.2). This indicator thus continues at high levels (at end-2010 it was around 125% of GDI, some 5 pp below the peak at mid-2008; see Chart 1 of Box 6.2). Meanwhile, net wealth continued to fall, basically as a result of the declining value of the real estate component, and, to a lesser extent, of the financial component. The debt burden also decreased again because of the fall in the average cost of financing (see Chart 6.6). However, this indicator captures movements in interbank interest rates with a certain lag, so foreseeably the rise in these rates since mid-2010 will gradually pass through to debt service in the next few quarters.

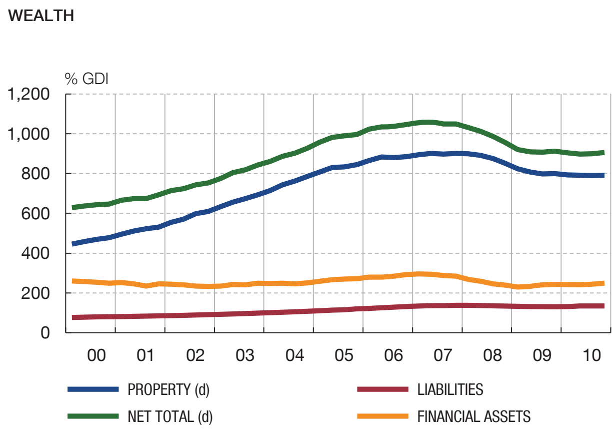
The doubtful loans ratio decreased

The lower debt burden contributed to a slight fall in the doubtful asset ratios of the sector in 2010 (in the previous three years they had trended upwards), both for house purchase loans and for consumer credit and other lending (down by 0.4 pp in both cases to stand at 2.4% and 6.6%, respectively).

INDICATORS OF THE FINANCIAL POSITION OF HOUSEHOLDS AND NPISHs

CHART 6.6





SOURCES: Ministerio de Fomento, INE and Banco de España.

a Estimated interest payments plus debt repayments.
b Balance of use of disposable income account.
c Gross saving less estimated debt repayments.
d Calculated on the basis of the estimated changes in the stock of housing, in the average area per house and in the price per square metre.

This aggregate situation is compatible with a more vulnerable financial position of some segments of the population

The latest available information from the survey of household finances shows that between 2005 and early 2009 the level of financial pressure increased more markedly in some segments which are comparatively more vulnerable. In households in which no member works, the proportion of those with some type of loan increased by more than 6 pp (the equivalent of somewhat less than 2% of total households) during this period to 21%, while for the sector as a whole the rise was practically zero. This change, however, basically reflects the fact that a significant number of the members of indebted households moved from employed to unemployed status. In the households in which no member works, the percentage of those with a debt burden exceeding 40% of their income stood at nearly 25% at the beginning of 2009 (as against 16.6% for indebted households as a whole). By age group, younger households showed the largest increases in the proportion exceeding this threshold. Thus, for example, in households headed by a person below age 35 (10% of household units), it rose to 24% (9.2 pp more than in 2005).

5.2 FIRMS

Corporate financing showed greater dynamism from mid-2010 onwards, although it varied significantly across sectors

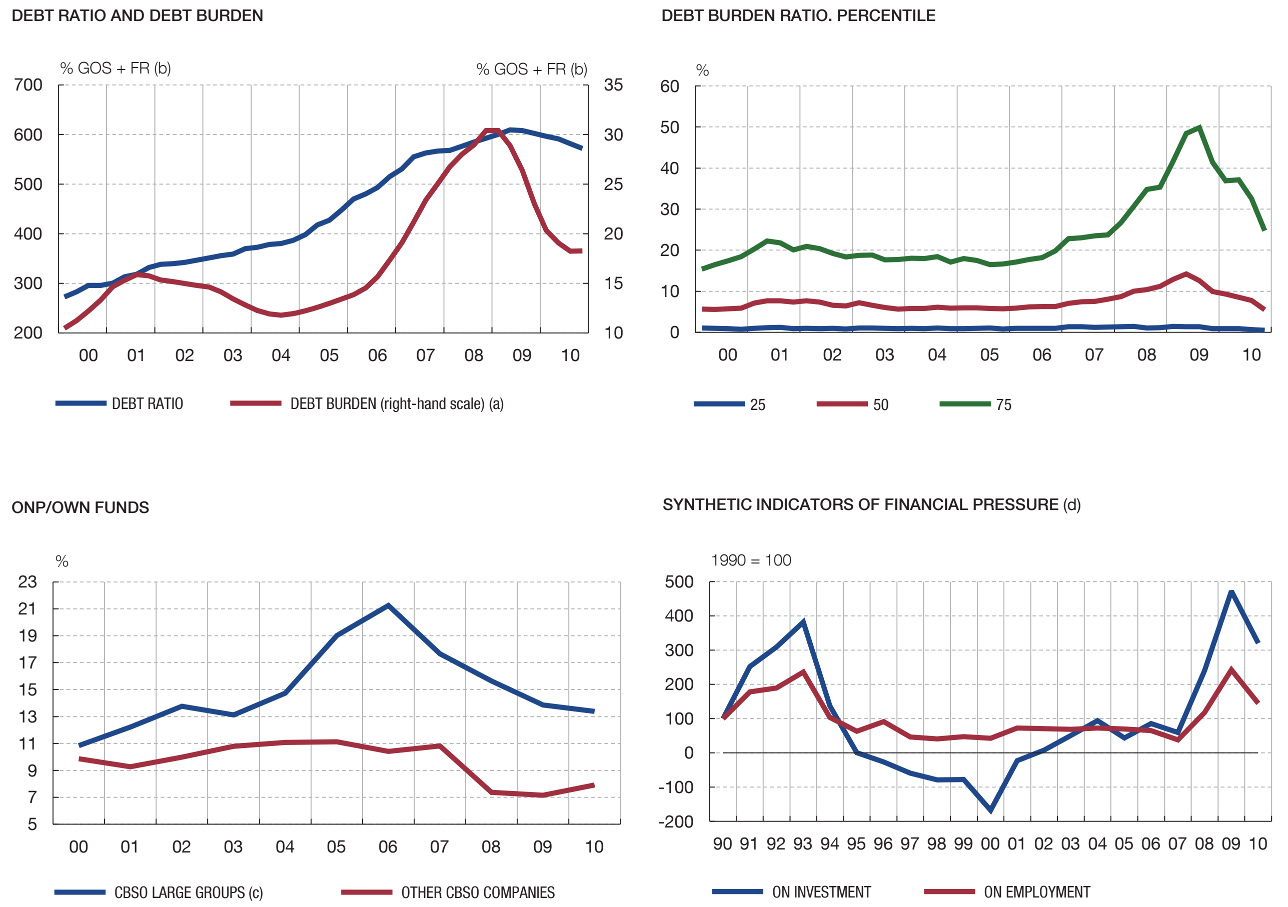
From mid-2010, the debt of non-financial corporations has followed a path of recovery and from 2010 Q3 its growth rate has been slightly positive. By instrument, this came about because lending by resident credit institutions contracted more slowly and lending by non-residents picked up, while financing obtained via fixed income securities continued to grow quickly. Behind this recovery are a number of differing sectoral patterns, consistent with a process of selective deleveraging across the various areas of activity. Thus those linked to the housing market continued to show negative growth rates of bank credit, while the others posted year-end growth rates that were positive or around zero (see Chart 6.1). The available information indicates that the differences between larger firms and SMEs (in areas unrelated to the real estate sector) seem to be less marked than those observed in the more acute phases of the crisis.

The sector became a net lender for the first time since 1998

Net borrowing by firms showed a credit balance for the first time since 1998, for an amount equivalent to 1.3% of GDP, according to the Financial Accounts. However, the financing gap, which approximates the funds required to bridge the difference between gross corporate saving and gross capital formation plus permanent foreign investment, was positive and stood at 0.8% of GDP, 0.5 pp less than a year earlier.

INDICATORS OF THE FINANCIAL POSITION OF NON-FINANCIAL CORPORATIONS

CHART 6.7



SOURCE: Banco de España.

- **a** Estimated interest payments.
- **b** Gross operating surplus plus financial revenue.
- **c** Aggregate of all the firms reporting to the CBSO belonging to the groups Endesa, Iberdrola, Repsol and Telefónica. Adjusted for intra-group financing to avoid double counting.
- **d** Indicators based on debt, debt burden and profit ratios of the firms reporting to the CBSO annual and quarterly surveys, appying coefficients to take into account the impact of these variables on investment and employment and to reflect the importance of each firm in the total in terms of the stock of capital and of employment. A value of more (less) than 100 indicates higher (lower) financial pressure than in the base year. For more datails, see Hernando and Martínez-Carrascal (2003), *El impacto de la posición financiera de las empresas sobre la inversión y el empleo, Boletín Económico,* November, Banco de España.

The financial position indicators of firms showed a certain improvement

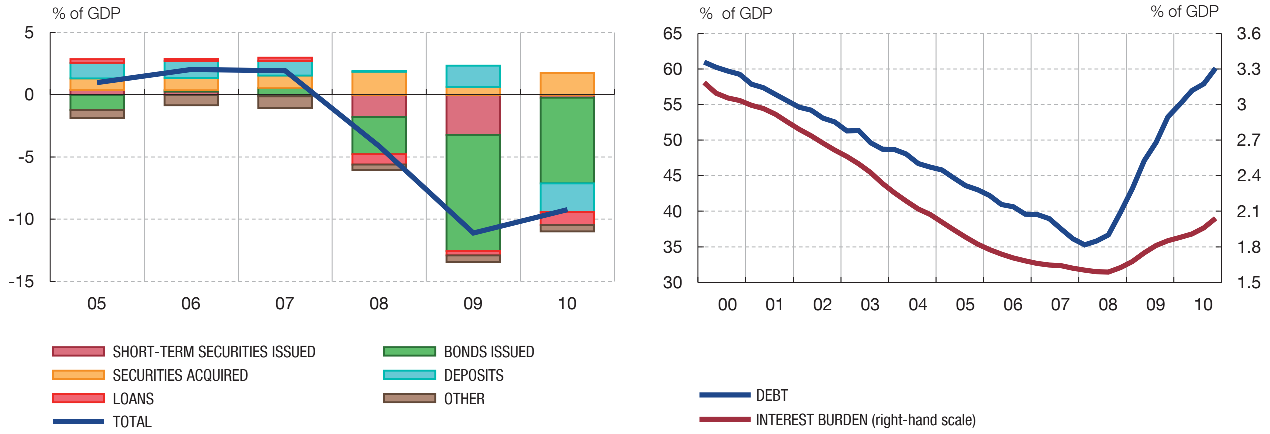
The aggregate financial position of the sector showed a certain improvement. The recovery of economic results and the scan dynamism of liabilities meant that the debt ratio decreased slightly and profitability increased. This performance, along with the decline in the average cost of outstanding debt, allowed the debt burden to drop (see Chart 6.7). Moreover, in the sample of firms reporting to the Central Balance Sheet Data Office Quarterly Survey (CBQ), the dispersion of the distribution of these ratios decreased, since the improvement was more marked in those firms in a more unfavourable financial position. The overall effect of this was a reduction in the synthetic indicators of financial pressure on investment and employment, from the peaks reached between the end of 2009 and the beginning of 2010 (see Chart 6.7). These developments at aggregate level were compatible with uneven behaviour across sectors. Thus, according to the CBQ, the improvement in these indicators was most apparent in industry, a sector which had recorded a particularly marked deterioration in 2009. Further, analysts revised upward the profit expectations of listed companies in 2010, both for the long-term and for the short-term, and the growth rate for the latter turned positive.

GENERAL GOVERNMENT

CHART 6.8

NET FINANCIAL TRANSACTIONS
BREAKDOWN BY INSTRUMENT (a)

DEBT RATIO AND INTEREST BURDEN



SOURCE: Banco de España.

a A positive (negative) sign denotes an increase (decrease) in assets or a decrease (increase) in liabilities.ation x 1.

Despite decreasing slightly, corporate debt continues to be high (around 800% of gross operating surplus), with no significant reduction since 2008. This ratio is particularly high in some sectors, such as construction and real estate services (see Box 6.2), where the doubtful assets ratio increased most sharply and reached 13.5% at end-2010 (against 3.9% in other sectors).

5.3 GENERAL GOVERNMENT

Public sector net borrowing decreased, although it continues to be high…

The fiscal consolidation efforts made enabled the budget deficit to be reduced to 9.2% of GDP, 1.9 pp less than in 2009. The breakdown by instrument shows that the budget deficit was basically covered by long-term securities issuance for a net amount equivalent to 6.9% of GDP (see Chart 6.8). Moreover, general government acquired securities amounting to 1.7% of GDP, these investments being partly linked to the measures to support the financial system.

… which gave rise to a significant rise in the sector’s liabilities and, as a result, in the debt and debt burden ratios

Despite slowing, the sector’s liabilities rose notably (their growth rate was 13.8%). This, along with the scant dynamism of GDP, resulted in an increase in indebtedness, which reached 60% of GDP at end-2010, nearly 7 pp more than in the previous year, and in the associated debt burden, albeit moderate taking it to 2% of GDP. Despite the rise in market interest rates, the average cost of liabilities scarcely changed, due to the slowness with which these movements pass through to interest payments.