RESULTS OF NON-FINANCIAL CORPORATIONS TO 2006 Q4 AND SUMMARY YEAR-END DATA

Overview[1]

The results obtained by the Central Balance Sheet Data Office Quarterly Survey (CBQ) for 2006 Q4, along with those already discussed in previous articles on the first three quarters, provide preliminary results for the year, which will be finalised when the results of the Central Balance Sheet Data Office Annual Survey (CBA) are disseminated in November. There is evidence (see Chart 1) to show that the CBQ anticipates the trends later reflected in the CBA, but equally the approximately 800 large firms of the CBQ are clearly less representative than the some 9,000 firms that make up the CBA (the main CBQ biases being the over-representation of large firms and certain sectors). The information available for 2006 shows that the productive activity of the firms continued to grow at a high rate, with the result that GVA rose by 6.3%, a significantly larger increase than in 2005 (3.5%), confirming what was anticipated in previous articles. This greater buoyancy is consistent with the trend in alternative indicators. All the sample sectors grew by more than in the same period of the previous year, except energy, although this sector still grew by 8.1%. The dynamism of industrial firms was notable; during 2006 they had the benefit of both the positive trend in investment in capital goods and of the pick-up in external activity, principally the recovery in the main euro area economies, although the growth in industrial firms' exports was accompanied by even higher growth in their imports. Firms also performed very positively in wholesale and retail trade and in transport and communications, in line with private consumption.

The personnel costs of the firms in the quarterly sample increased by 4.6% in 2006, as against 3.9% in 2005, basically owing to the growth of employment against a background of wage moderation. Thus, during 2006, the average number of employees grew by 1.8%, over one percentage point more than in 2005, the highest growth being recorded by the firms in the wholesale and retail trade sector, in line with the buoyancy of their productive activity. In other sectors employment continues to grow at negative rates, largely due to the one-off regularisation operations mentioned below, which especially affect transport and communications and industrial firms. If these regularisations are excluded, both these sectors would have recorded net increases in employment more in line with the positive performance of their activity. Average compensation followed a smooth growth path (2.8%) throughout 2006, slightly below the rate recorded in the two previous years in the quarterly database but in line with the trend in this variable in the most recent period.

As a result of the behaviour of GVA and personnel costs, gross operating profit grew by 7.5% in 2006, as against 3.3% in 2005. Financial revenue also increased in 2006 (10.7%), although by less than a year earlier (34.2%), the latter rate being affected by the exceptional growth in dividends from foreign subsidiaries in 2005. Financial costs increased by 34.5% in 2006, mainly on account of the rise in levels of indebtedness due to a greater recourse to additional funds to finance investment operations (specifically for the acquisition of capital goods and other tangible fixed assets, which grew at a rate of 12.6%) and the acquisition of subsidiaries owing to the share purchases undertaken in 2006 by large energy, telecommunications and construction firms, basically in Spain, but also in the rest of the world. This increase in the level of debt is reflected in the ratios both of the level of debt and of the ability to repay (principal and interest). The combined effect of the growth

1. This article is based on the information obtained by the Central Balance Sheet Data Office from the 741 corporations that, on average, reported their data to 15 March 2007. The GVA of this aggregate accounts for 13% of the total GVA of the sector non-financial corporations (according to CNE data).

NON-FINANCIAL CORPORATIONS REPORTING TO THE CENTRAL BALANCE SHEET DATA OFFICE

CHART 1

REPORTING NON-FINANCIAL CORPORATIONS		2001	2002	2003	2004	2005	2006
Number of corporations	CBA	8,414	8,418	8,834	8,984	7,877	—
	CBQ	853	842	825	810	793	741
% of GDP of the sector non-financial corporations	CBA	29.6	29.5	30.4	32.4	28.7	—
	CBQ	15.4	15.4	14.9	14.8	14.3	13.0

SOURCE: Banco de España.

a. The 2001, 2002, 2003, 2004 and 2005 data are the average data of the four quarters of each year (CBQ) in relation to the previous year for the corporations reporting to the annual survey (CBA).
b. Average of the four quarters of 2006 relative to the same period in 2005.

in financial revenues and financial costs enabled ordinary net profit (ONP) to grow by 5.1% in 2006, as against 14.1% the year before. The growth of ONP and financial costs (the two addends in the numerator of the return on investment ratio), enabled the firms to maintain high levels of profitability in 2006, which actually slightly exceeded those in previous periods. Meanwhile, the ratio that approximates the cost of external financing still did not reflect in 2006 the transmission of the rate rises to business costs (owing to the low relative weight of loans taken out following the latest rises), and these continued to remain at low levels (3.8%, as against 3.7% in 2005). This scenario meant that in 2006 the spread between the ROI and the cost of debt remained clearly positive (5.5), even exceeding the

NON-FINANCIAL CORPORATIONS REPORTING TO THE CENTRAL BALANCE SHEET DATA OFFICE (cont'd)

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2005 level (5.1), from which it may be concluded that the firms continued to generate surpluses and high returns.

Finally, an analysis of the items that make up the extraordinary results in 2006 reveals increases in revenues and reductions in expenses that explain why final net profit grew by more than ONP. On the revenue side, significant capital gains were obtained during the year on various share disposals. At the same time, on the expenses side, extraordinary expenses fell significantly, after the large negative exchange differences recorded by certain firms in 2005. Also, during 2006, certain Spanish holding companies made significant extraordinary provisions on their share portfolios, in order to reflect the lower market value of their foreign subsidiaries. As anticipated, the growth in these revenues and expenses meant that final net profit grew by 31.7% in 2006, which was well above the growth rate of ONP (5.1%) and even exceeded the high rate recorded in 2005 (29.7%)[2]. With the increase recorded in this period, the level of profits attained by the CBQ firms, expressed as a percentage of GVA, stood at 31.7%, a new all-time high for the quarterly series.

In short, the productive activity of the non-financial firms that report to the CBQ was highly buoyant in 2006, helped by the growth of investment in capital goods and by foreign activity. Both these factors were behind the positive performance of industrial firms, which have seen their imported inputs increase notably as well. The strength of private consumption also contributed positively to these general developments, which were likewise accompanied by an acceleration in employment creation, against a background of continued moderate wage growth and falling inflation rates, the latter being partly due to the positive oil price developments in the final quarter of the year. At the same time, firms invested heavily, especially in acquisitions, leading to an increase in their average levels of debt and, consequently, in the weight of financial costs in their income statements. However, continued low interest rates and the solidity of corporate surpluses enabled Spanish firms to confront this new situation without any decline in their profitability which, for a further quarter, remained high and well above the costs associated with external financing, a fact that sums up their favourable current situation. Thus, the outlook for business activity is encouraging, the main uncertainties being the continuity of industrial growth, the path of debt and continuation of the recent oil price moderation.

Activity

The CBQ data available for 2006 show that the GVA of non-financial firms grew by 6.3% in 2006, as against 3.5% the previous year (see Table 1 and Chart 1). This greater buoyancy of activity was based on the performance of industrial firms, on the one hand, and on that of firms in the wholesale and retail trade and transport and communications, on the other.

The expansion of productive activity recorded in 2006 was reflected in all the sample sectors (see Table 2.A). Among them, the performance of industry should be noted: its GVA grew by 7.1% last year, significantly above the 1.5% rate recorded in 2005. The reason for this recovery in industrial activity is to be found in the growth recorded in 2006 in investment in capital goods and also in the sector's exports, which were highly buoyant throughout the year. Table 3 shows the increase in industrial exports in 2006 (14.6%), but this was well below that of the imports which appear among this sector's inputs (24.6%), so that the sector's net external demand can be assumed to have deteriorated. Meanwhile, the GVA of energy and water firms increased by 8.1%, with mixed behaviour across their component aggregates. On one hand, the GVA of the firms in the "oil refining" sub-sector (see Chart 2) fell by 15.3% in 2006, owing to the narrowing of margins following their sharp widening in previous years (in 2004 and 2005 the GVA of these firms grew by 55.6% and 34.4% respectively). On the other hand, "electricity, gas and water" utilities recorded GVA growth in 2006 of 14.6%, as a result of lower production costs for electricity utilities (in 2006 hydroelectric power plants, which have the lowest production costs, produced 34% more electricity than in 2005) and the rise in electricity charges (5.9%). The expansion in the productive activity of gas utilities was in line with the behaviour described. Finally, the "wholesale and retail trade" and "transport and communications" firms,

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2. The growth in the final net profit obtained by the CBQ firms tallies with the rate obtained from alternative sources (such as that published by the CNMV for listed companies), when the comparison is on a homogeneous basis. In this respect, it should be taken into account that the CNMV publishes information on consolidated groups of financial and non-financial listed corporations (including non-resident firms that form part of groups), while the analysis of the Central Balance Sheet Data Office refers to an aggregate made up of individual listed and unlisted non-financial corporations resident in the Spanish economic territory.

PROFIT AND LOSS ACCOUNT. YEAR-ON-YEAR CHANGES AND PROFIT RATIOS TABLE 1
Growth rates of the same corporations on the same period a year earlier

	CBA STRUCTURE	CBA		CBQ (a)		
DATABASES	2005	2004	2005	04 Q1-Q4/ 03 Q1-Q4	05 Q1-Q4/ 04 Q1-Q4	06 Q1-Q4/ 05 Q1-Q4
Number of corporations		8.984	7.877	810	793	741
Total national coverage		32,4%	28,7%	14,8%	14,3%	13,0%
PROFIT AND LOSS ACCOUNT						
1. VALUE OF OUTPUT (including subsidies)	100.0	8.3	10.7	8.0	13.1	11.0
Of which:						
— Net amount of turnover and other operating income	*137.2*	*8.8*	*12.0*	*8.1*	*16.1*	*9.9*
2. INPUTS (including taxes)	68.4	8.6	13.7	9.3	18.5	13.3
Of which:						
— Net purchases	*40.8*	*11.9*	*15.4*	*10.5*	*21.3*	*13.5*
— Other operating costs	*27.6*	*4.9*	*12.3*	*7.1*	*12.6*	*7.0*
S.1. GROSS VALUE ADDED AT FACTOR COST [1 – 2]	31.6	7.5	4.7	5.7	3.5	6.3
3. Personnel costs	16.5	4.7	5.7	3.0	3.9	4.6
S.2. GROSS OPERATING PROFIT [S.1 – 3]	15.1	10.8	3.6	7.9	3.3	7.5
4. Financial revenue	3.4	14.5	26.4	0.1	34.2	10.7
5. Financial costs	2.6	-3.7	9.4	-7.5	4.9	34.5
6. Depreciation and operating provisions	6.0	2.7	-0.1	-0.8	-0.1	1.2
S.3. ORDINARY NET PROFIT [S.2 + 4 – 5 – 6]	9.9	23.0	11.2	16.5	14.1	5.1
7. Capital gains and extraordinary revenue	4.4	-31.1	32.7	-39.4	32.2	36.4
8. Capital losses and extraordinary expenses	3.9	-2.3	32.9	-27.3	71.4	-25.2
9. Other (provisions and taxes)	3.1	-16.3	-6.9	-5.9	-24.1	57.7
S.4. NET PROFIT [S.3 + 7 – 8 – 9]	7.3	18.9	22.8	6.5	27.6	13.4
NET PROFIT/GVA (S.4/S.1)		19.8	23.0	24.1	29.7	31.7
PROFIT RATIOS	Formulas (b)					
R.1 Return on investment (before taxes)	(S.3 + 5.1)/AN	8.2	8.7	8.3	8.8	9.3
R.2 Interest on borrowed funds/ interest-bearing borrowing	5.1/RAC	3.6	3.7	3.9	3.7	3.8
R.3 Ordinary return on equity (before taxes)	S.3/RP	11.9	12.7	12.0	13.3	14.8
R.4 ROI – cost of debt (R.1 – R.2)	R.1 – R.2	4.5	4.9	4.4	5.1	5.5

SOURCE: Banco de España.

a. All the data in these columns have been calculated as the weighted average of the quarterly data.
b. The variables in the formulas are expressed as absolute values. NA = net assets (net of non-interest-bearing borrowing); E = equity; IBB = interest-bearing borrowing; NA = E + IBB. The financial costs in the numerators of ratios R.1 and R.2 only include that portion of financial costs which is interest on borrowed funds (5.1) and not commissions or cash discounts (5.2).
Note: In calculating rates, internal accounting movements have been edited out of items 4, 5 and 9.

assisted by the strength of private consumption, also recorded positive GVA growth in 2006, of 6% and 4.2% respectively, exceeding their rates in 2005. As regards the transport and communications sector, activity expanded in both sub-sectors in the period considered, especially in transport. The favourable performance of transport in 2006 (the reporting firms in the sector recording GVA growth of 6.3%) enabled the impact of the rise in fuel prices during 2005 (when GVA fell by 2.7%) to be reversed. In the case of communications firms, their performance was boosted by the strategy of fixed telephony firms, which expanded the additional services offered to their customers, and by the growth in the use of ADSL lines.

Finally, Chart 3 shows the distribution of firms according to the rate of change in their GVA, irrespective of their size and the sector of activity in which they operate. It can be seen that the percentage of firms that obtained increases in GVA of more than 20% in 2006 rose to 28.1%, almost four percentage points higher than in 2005. These data confirm the generalised nature of the growth in business activity in 2006.

VALUE ADDED, EMPLOYEES, PERSONNEL COSTS AND COMPENSATION PER EMPLOYEE. BREAKDOWN BY SIZE AND MAIN ACTIVITY OF CORPORATIONS

Growth rate of the same corporations on the same period a year earlier

TABLE 2.A

	GROSS VALUE ADDED AT FACTOR COST				EMPLOYEES (AVERAGE FOR PERIOD)				PERSONNEL COSTS				COMPENSATION PER EMPLOYEE			
	CBA		CBQ (a)		CBA		CBQ (a)		CBA		CBQ (a)		CBA		CBQ (a)	
	2004	2005	05 Q1-Q4	06 Q1-Q4	2004	2005	05 Q1-Q4	06 Q1-Q4	2004	2005	05 Q1-Q4	06 Q1-Q4	2004	2005	05 Q1-Q4	06 Q1-Q4
Total	7.5	4.7	3.5	6.3	2.7	3.2	0.7	1.8	4.7	5.7	3.9	4.6	2.0	2.4	3.2	2.8
SIZE																
Small	8.4	4.3	—	—	0.8	-0.6	—	—	4.4	4.1	—	—	3.5	4.7	—	—
Medium	7.6	4.5	3.5	7.4	2.0	2.2	0.5	1.5	5.2	6.1	4.3	5.5	3.1	3.8	3.8	3.9
Large	7.5	4.7	3.5	6.3	2.9	3.5	0.7	1.8	4.7	5.7	3.8	4.6	1.7	2.1	3.1	2.8
BREAKDOWN OF ACTIVITIES BEST REPRESENTED IN THE SAMPLE																
Energy	6.5	13.0	10.5	8.1	-1.2	-0.7	-0.7	-0.8	2.2	4.5	3.5	3.4	3.4	5.2	4.2	4.2
Industry	5.8	0.6	1.5	7.1	-0.6	-0.6	-0.3	-0.9	2.9	2.7	3.4	2.0	3.5	3.3	3.7	2.9
Wholesale and retail trade	10.0	5.3	3.3	6.0	5.5	5.4	2.7	3.7	7.7	7.0	4.3	7.0	2.0	1.5	1.6	3.2
Transport and communications	5.8	0.7	0.4	4.2	-0.8	0.5	-0.6	-0.4	1.9	4.0	2.8	3.0	2.7	3.5	3.4	3.4

SOURCE: Banco de España.

a. All the data in these columns have been calculated as the weighted average of the quarterly data.

EMPLOYMENT AND PERSONNEL COSTS

Details based on changes in staff levels

TABLE 2.B

		TOTAL CBQ CORPORATIONS 2006 Q1 - Q4	CORPORATIONS INCREASING (OR NOT CHANGING) STAFF LEVELS	CORPORATIONS REDUCING STAFF LEVELS
Number of corporations		741	451	290
PERSONNEL COSTS				
Initial situation 05 Q1-Q4 (€m)		23,455.9	13,248.3	10,207.6
Rate 06 Q1-Q4/ 05 Q1-Q4		4.6	9.2	-1.2
AVERAGE COMPENSATION				
Initial situation 05 Q1-Q4 (€m)		41,404.6	37,273.0	48,362.3
Rate 06 Q1-Q4/ 05 Q1-Q4		2.8	3.1	4.0
NUMBER OF EMPLOYEES				
Initial situation 05 Q1-Q4 (000s)		567	355	212
Rate 06 Q1-Q4/ 05 Q1-Q4		1.8	5.9	-5.0
Permanent	Initial situation 05 Q1-Q4 (000s)	478	286	192
	Rate 06 Q1-Q4/ 05 Q1-Q4	0.4	3.3	-3.9
Non-permanent	Initial situation 05 Q1-Q4 (000s)	89	69	20
	Rate 06 Q1-Q4/ 05 Q1-Q4	9.2	16.3	-16.3

SOURCE: Banco de España.

Employment and personnel costs

Personnel costs rose by 4.6% in 2006, 0.7 percentage points more than a year earlier. This growth was a consequence of the increase in employment, which grew more strongly than in 2005, while the rate of change of average compensation remained moderate, actually falling slightly from the previous year.

In 2006, the average number of persons employed by the CBQ firms increased by 1.8%. This was a significant acceleration in job creation from the 0.7% growth recorded by this group of

NET EXTERNAL DEMAND OF THE INDUSTRIAL FIRMS THAT REPORT TO THE CENTRAL BALANCE SHEET DATA OFFICE

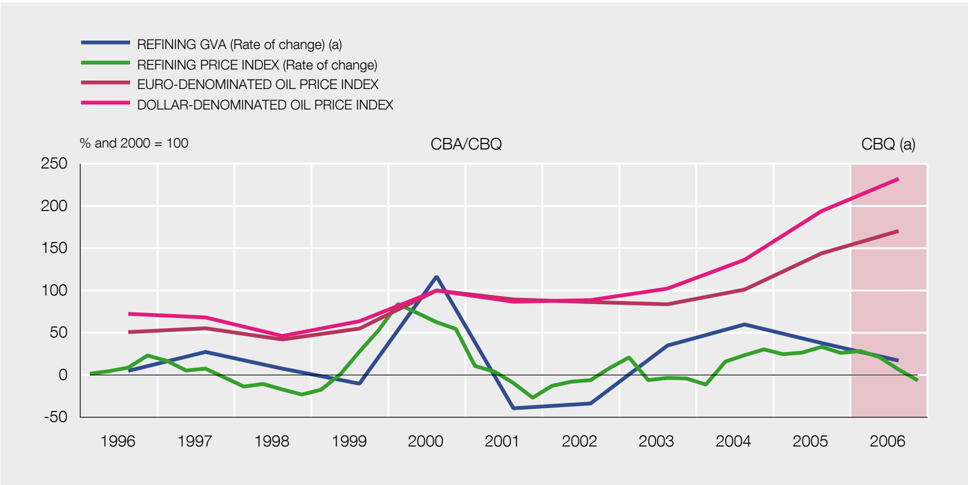
TABLE 3

		2006 Q1 - Q4		Rates of change
		2005 Q1 - Q4	2006 Q1 -Q4	2006 Q1 - Q4 / 2005 Q1 - Q4
Number of industrial firms		272	272	272
1. Sales		43,934	48,563	10.5
	1. Exports	13,257	15,196	14.6
	2. In Spain	30,677	33,367	8.8
2. Purchases		27,247	30,859	13.3
	1. Imports	10,069	12,547	24.6
	2. In Spain	17,178	18,312	6.6
3. Other net costs		6,847	7,163	4.6
Gross value added (1 – 2 – 3)		9,841	10,540	7.1
Net external demand (1.1 – 2.1)		3,188	2,649	-16.9
MEMO ITEM: All firms				
	1. Exports	19,907	24,036	20.7
	2. Imports	24,856	28,335	14.0
	Net external demand (1 – 2)	-4,950	-4,299	13.1

SOURCE: Banco de España.

IMPACT OF OIL PRICES ON THE REFINING SECTOR

CHART 2



SOURCES: Banco de España and Ministerio de Industria, Turismo y Comercio (Informe mensual de precios).

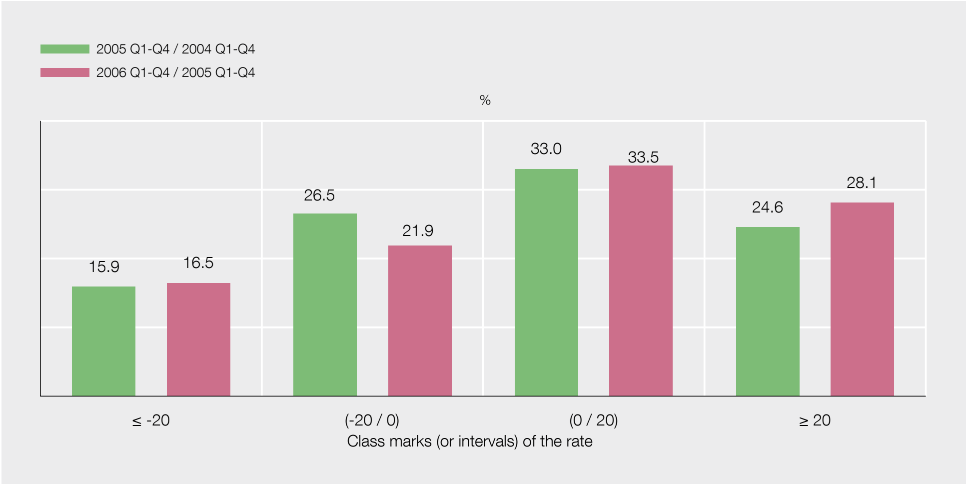
a. The 2006 data relate to the CBQ.

firms in 2005. However, the firms in question are not representative in relation to this variable, owing to the high concentration of large firms and sectors affected by staff restructuring. In terms of the type of employment, non-permanent was more dynamic than permanent (with a rate of change of 9.2%, as against 0.4% in the case of permanent), although it should be pointed out that, as the year elapsed, the rate of growth of non-permanent employment fell, a development that must have been influenced by the provisions of Royal Decree-Law 5/2006[3].

3. Royal Decree-Law 5/2006 of 9 June 2006 to improve growth and employment was designed to reduce Social Security contributions for contracts converted from temporary to permanent by 31.12.2006.

DISTRIBUTION OF CORPORATIONS BY RATE OF CHANGE IN GVA AT FACTOR COST

CHART 3



SOURCE: Banco de España.

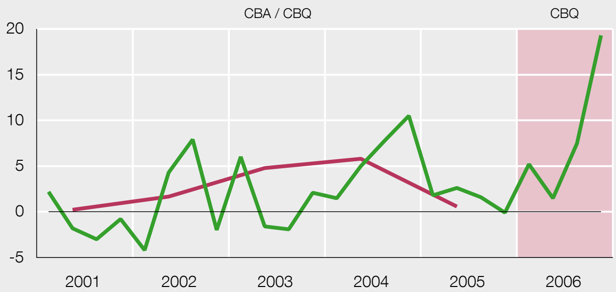
Turning to a sectoral analysis, a trend of no change or slight improvement can be discerned in the main sectors of the sample, with the exception of industry, which recorded a larger fall in average employment than in 2005. This was a consequence of restructuring and temporary adjustment in the sub-sectors “food products, beverages and tobacco”, and “manufacture of transport equipment”, which prevented the total employment figure for this aggregate from reflecting the positive behaviour among the rest of the firms that make it up. If the firms affected by the processes referred to are excluded, industry would have recorded growth in average workforces of 0.7%, an improvement on the rate of –0.1% obtained by the same firms in 2005. For its part, the “wholesale and retail trade” was, once again, the sector to record the strongest growth in average staff levels, recording a rate of change of 3.7% in 2006, one percentage point more than in 2005. Transport and communications firms reduced their workforces slightly, both in 2005 and in 2006, although this trend continues to be affected by the staff reductions being made at a large communications concern to which reference has been made in recent editions of this article (affecting 15,000 staff between 2003 and 2007). Excluding this effect, employment in this sector would have grown by 0.8% in 2006 and 0.3% in 2005, rates that better reflect the actual trend experienced by most of the firms in this sector. For their part, energy and water utilities continued to record slight staff reductions, similar to those recorded in previous periods, which are closely linked to the restructuring and reorganisation being carried out by the electricity utilities as part of their progressive adaptation to the workings of a deregulated market. Finally, the data in Table 4 confirm that the positive trend in employment extends to most of the firms of the sample since, in 2006, 61.3% of them increased their staff levels or held them unchanged, two percentage points more than in the same period of the previous year.

The data for the average compensation of all the reporting firms show a slight reduction in 2006 in the rate of change of average personnel costs, which fell from 3.2% in 2005 to 2.8%, appearing to extend its recent trend. Behaviour across sectors was very uniform, with only the energy utilities standing out, having increased their average compensation by more than in the other sectors. Table 2.B, which distinguishes between those firms creating employment and those destroying it, shows that, as usual, the firms that destroyed jobs were also those that increased the average compensation of their employees most (by 4% in 2006), as against those that increased their staff levels or left them unchanged, whose average wage costs increased by 3.1%.

According to the available CBSO data on the industrial sector, the productive activity of the firms of the sector expanded strongly in 2006, their GVA increasing by 7.1% in this period, as against 1.5% in 2005. This growth was underpinned by the recovery in exports and by buoyant investment in capital goods throughout the year. However, the improvement did not affect all industrial sub-sectors equally. Some, such as manufacture of electrical and optical equipment and glass, ceramics and metals, recorded significant rises in GVA (22.8% and 23.6%, respectively), while others, such as food products, beverages and tobacco, affected by the impact on demand of the entry into force of the law restricting tobacco consumption, and manufacture of chemicals, which saw a significant contraction in its margins, suffered falls in GVA (of 10.5% and 3.1%, respectively). Manufacture of transport equipment, which had recorded negative GVA rates in Q2 and Q3, recovered notably in Q4, although that did not avoid a negative rate of change for the year as a whole (–1.4%), similar to that in 2005 (–1.5%). As for employment in industrial firms, the 2006 data show that there was still no return to net increases, with a negative rate of –0.9%, which was worse than a year earlier (–0.3%). However, as in the case of activity, this figure is strongly affected by the growth of certain sub-sectors in which there have been heavy workforce reductions, these being some of those that recorded falls in their gross value added (food products, beverages and tobacco and manufacture of transport equipment). In the rest of the sub-sectors employment displayed a favourable trend on balance. Electrical and optical equipment stood out, with growth of 4.9% in the average number of jobs in 2006, this being the sub-sector that made the largest contribution to GVA growth in the period considered. Moreover, the quarterly profile shows a more positive trend in employment in the second half of the year, with a positive rate of change of 0.5% in the final quarter, as against –1.2%, –2.1% and –0.4% in Q1, Q2 and Q3. Average compensation in industry grew by 2.9% in 2006, displaying the same moderation already mentioned for the sample as a whole. The combined performance of compensation and employment resulted in a 2% increase in personnel costs, enabling ONP to grow by 13.8%. Meanwhile, the large inflow of dividends recorded by this aggregate in 2006 caused the growth of ONP to rise to 35.6%, which explains why the profitability

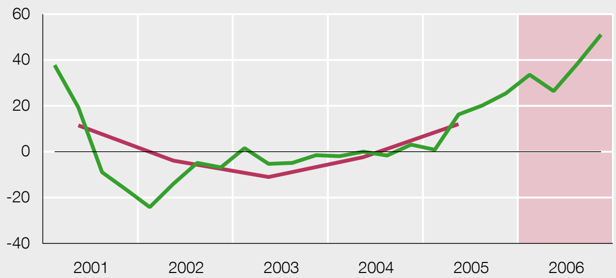
PERFORMANCE OF THE INDUSTRIAL CORPORATIONS REPORTING TO THE CBSO

GROSS VALUE ADDED AT FACTOR COST
Rate of change

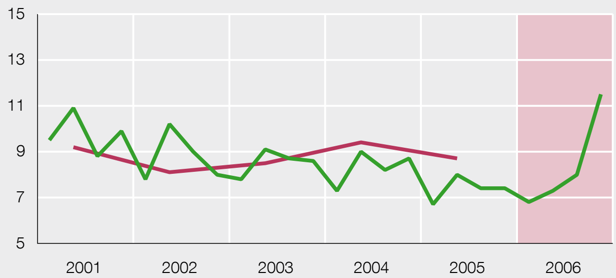


EMPLOYMENT AND WAGES
Rate of change

FINANCIAL COSTS
Rate of change



RETURN ON INVESTMENT
Ratios



REPORTING INDUSTRIAL CORPORATIONS		2001				2002				2003				2004				2005				2006			
Number of corporations	CBA	2,814				2,715				2,624				2,517				2,153				—			
	CBQ	400	390	378	361	388	375	365	353	364	359	350	342	348	338	331	329	319	307	299	290	322	305	280	179
% of GDP of the sub-sector industrial corporations	CBA	28.2				27.9				28.5				28.6				24.5							
	CBQ	21.5	21.2	18.7	20.1	19.6	20.6	18.7	18.5	18.8	19.0	17.1	17.7	19.4	19.7	17.7	19.1	18.9	19.5	16.7	17.6	18.7	18.0	15.9	12.2

SOURCE: Banco de España.

ratios recovered an upward trend in 2006, following the fall of the previous year. Thus, the return on investment stood at 9% in 2006, up 0.7 percentage points from the same period a year earlier, while the return on equity rose to 12.6%, exceeding the level reached in 2004. As the ratio that approximates the cost of debt remained at low levels (3.9%), similar to those of the previous year (3.8%), the spread between ROI and the cost of debt was, for another year, positive, displaying an upward trend with respect to the preceding year. In short, Spanish industry picked up notably in 2006, driven by investment in capital goods and the improvement in exports (14.6%), although the imports of products included among its inputs increased by even more (24.6%), leading to a fall in the sector's net external demand. This positive performance has still not resulted in net increases in employment, but the progressive improvement in this aspect as the year elapsed means that the expansionary trend displayed by Spanish industry in 2006 can be expected to continue in 2007.

Profits, rates of return and debt

The growth of productive activity in 2006, having deducted personnel costs, generated a gross operating profit which grew by 7.5% in 2006, as against 3.3% in 2005. Both financial revenue and financial costs increased in 2006, with rates of change of 10.7% and 34.5%, respectively. In the case of financial costs this is the highest rate of growth since 2000, so it is worth noting the reasons for this change, which are set out in the following table:

	06 Q1-Q4/05 Q1-Q4
Change in financial costs	**34.5%**
A. Interest on borrowed funds (1+2)	*36.2%*
1. Due to the cost (interest rate)	2.7%
2. Due to the amount of interest-bearing debt	33.5%
B. Commissions and cash discounts	*–1.7%*

It is clear that the increase in financial costs in 2006 is almost entirely explained by the flow of new financing, against a background in which the rises in benchmark interest rates have had a very limited impact on non-financial firms, given the low weight of loans taken out under the new conditions, as reflected in the ratio R.2 (interest on borrowed funds / interest-bearing borrowing). The notable growth in indebtedness recorded in 2006 is explained by the existence of some important acquisitions, both in Spain and abroad, by certain large firms (basically holding companies in the telecommunications and construction sectors). The ultimate aim of these operations was to take control of other companies, as part of a strategy of seeking extra returns and diversifying risk. The ratio E1 (see Chart 4) of interest-bearing borrowing to net assets, confirms the upward trend in debt relative to net assets, rising sharply in 2006, reflecting the operations mentioned above. On the other hand, the ratio E2, which can be used to analyse the ability to repay the principal of the debt contracted, shows (consolidated) debt relative to value added generated. It can be seen that the acceleration in this ratio in 2006, owing to the growth of debt, affected both firms belonging to what are referred to as multinational groups (MGs), which include only those in the energy and telecommunications sectors (not construction groups), and other large firms of the sample[4]. Chart 4 also depicts the interest burden, showing interest on borrowed funds relative to the firm's income. It can be seen that, although there has been notable growth in this

4. It has been decided, for the time being, not to include construction firms in the group of MGs, in order to facilitate the separate monitoring of these groups. That said, if construction firms continue their new strategy of acquiring firms to diversify their risks, they will be included in MGs.

PERSONNEL COSTS, EMPLOYEES AND AVERAGE COMPENSATION TABLE 4
Percentage of corporations in specific situations

	CBA			CBQ (a)		
	2003	2004	2005	03 Q1-Q4	05 Q1-Q4	06 Q1-Q4
Number of corporations	8,834	8,984	7,877	810	793	741
PERSONNEL COSTS	100	100	100	100	100	100
Falling	25.5	28.0	26.4	32.5	28.8	27.3
Constant or rising	74.5	72.0	73.6	67.5	71.2	72.7
AVERAGE NUMBER OF EMPLOYEES	100	100	100	100	100	100
Falling	31.7	31.5	30.5	44.8	40.7	38.7
Constant or rising	68.3	68.5	69.5	55.2	59.3	61.3
AVERAGE COMPENSATION RELATIVE TO INFLATION	100	100	100	100	100	100
Lower growth (b)	38.9	44.1	43.0	46.3	49.7	48.9
Higher or same growth (b)	61.1	55.9	57.0	53.7	50.3	51.1

SOURCE: Banco de España.

a. Weighted average of the relevant quarters for each column.
b. Twelve-month percentage change in the CPI for the CBA and quarter-on-quarter percentage change in the CPI for the CBQ.

ratio since 2005, which has taken it close to the levels reached in 2001, such levels were not exceeded in 2006.

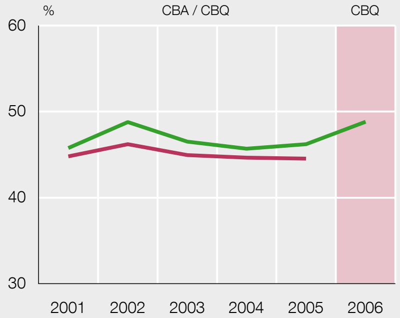
The growth in financial revenue in 2006 (10.7%), albeit very positive, was significantly lower than in 2005 (34.2%), when there was an exceptional inflow of dividends from foreign subsidiaries. This growth (see Table 5) was still sufficient to enable ONP to grow by 5.1%, and although this was a smaller increase than in 2005 (14.1%), it shows a notable rate of profit generation. This performance of ONP, together with the funds assigned to financial costs (the numerator used to calculate the return on investment), enabled the firms to continue to earn high returns, which even exceeded those of the immediately preceding periods. Specifically, the return on investment (R1) was 9.3% in 2006 (8.8% in 2005), while that on equity reached 14.8% (13.3% in 2005). Finally, in Table 6, which shows the distribution of firms according to their returns (on both investment and equity), a slight shift can be seen towards the higher return segments. At the same time, the ratio that approximates the cost of borrowing (R.2) remained at low levels (3.8%) in 2006 (although it rose by 0.1 percentage points during the year), as the transmission of rate rises to business costs only affects new loans and the weight of loans taken out under the new conditions is still low. The combined performance of the profit ratios and the cost of debt explains why the spread between them remains positive and large, standing at 5.5 in 2006, higher even than in the previous year (5.1).

Extraordinary results had a positive impact on final net profit, primarily because, compared to the previous year when large negative exchange differences were recorded, there were significant capital gains generated by share sales and significant reductions in the extraordinary expenses of reporting firms. There was also a sharp increase in extraordinary provisioning of the share portfolio, in this case by certain holding companies to compensate for the lower market value of some of their foreign investments. All this led to an increase in final net profit of 13.4%, smaller than that recorded a year earlier (27.6%), but involving a notable increase in the level of corporate profits; expressed as a percentage of GVA, they were 31.7% in 2006, a new historic high in the CBQ series. Finally, for the sample as a whole, the rate of change of investment in tangible fixed assets reached 12.6% in 2006, up slightly from 9.9% in 2005. The

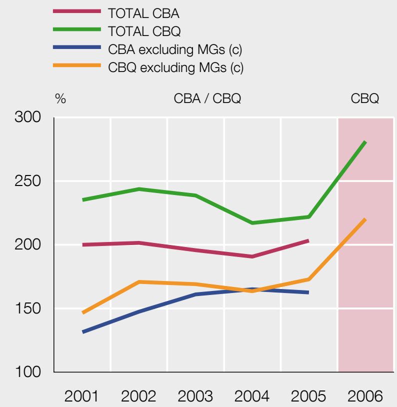
DEBT RATIOS

CHART 4

E1. INTEREST-BEARING BORROWING/NET ASSETS (a)
Ratios



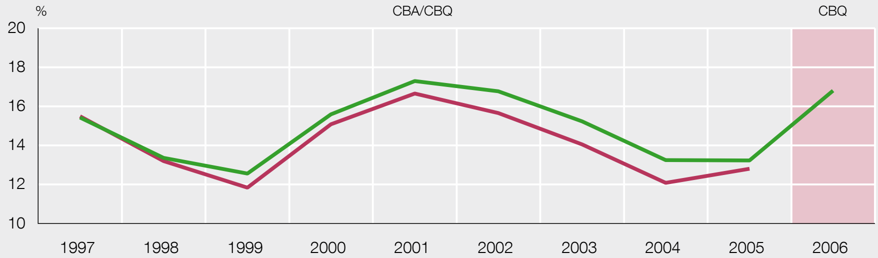
E2. INTEREST-BEARING BORROWING/GVA (b)
Ratios



	2001	2002	2003	2004	2005	2006
CBA	44.8	46.2	44.9	44.6	44.5	
CBQ	45.8	48.8	46.5	45.7	46.2	48.8

	2001	2002	2003	2004	2005	2006
CBA	200.1	201.5	195.8	190.8	203.1	
CBQ	235.2	243.8	238.7	217.2	221.8	281.2
CBA excl. MGs	131.5	147.6	161.1	165.0	162.5	
CBQ excl. MGs	146.5	171.0	169.0	163.7	172.9	220.3

INTEREST BURDEN
(Interest on borrowed funds / GOP + financial revenue)



	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
CBA	15.5	13.2	11.8	15.1	16.7	15.6	14.0	12.1	12.8	
CBQ	15.4	13.4	12.6	15.6	17.3	16.8	15.2	13.3	13.2	16.8

SOURCE: Banco de España.

a. Ratio calculated from final balance sheet figures. Own funds include an adjustment to current prices.
b. Ratio calculated from final balance sheet figures. Interest-bearing borrowing includes an adjustment to eliminate intragroup debt (approximation of consolidated debt).
c. MGs: sample corporations belonging to the main reporting multinational groups. Large construction sector corporations are not included.

GROSS OPERATING PROFIT, ORDINARY NET PROFIT, RETURN ON INVESTMENT AND ROI-COST OF DEBT (R.1 – R.2). BREAKDOWN BY SIZE AND MAIN ACTIVITY OF CORPORATIONS

Ratios and growth rates of the same corporations on the same period a year earlier

TABLE 5

	GROSS OPERATING PROFIT				ORDINARY NET PROFIT				RETURN ON INVESTMENT (R.1)				ROI-COST OF DEBT (R.1-R.2)			
	CBA		CBQ (a)		CBA		CBQ (a)		CBA		CBQ (a)		CBA		CBQ (a)	
	2004	2005	05 Q1-Q4	06 Q1-Q4	2004	2005	05 Q1-Q4	06 Q1-Q4	2004	2005	05 Q1-Q4	06 Q1-Q4	2004	2005	05 Q1-Q4	06 Q1-Q4
Total	10.8	3.6	3.3	7.5	23.0	11.2	14.1	5.1	8.2	8.7	8.8	9.3	4.5	4.9	5.1	5.5
SIZE																
Small	15.2	4.6	—	—	23.2	9.1	—	—	7.1	6.9	—	—	3.3	3.2	—	—
Medium	11.1	2.4	2.4	10.0	13.2	1.0	-0.4	20.3	8.3	7.5	7.6	7.7	4.9	4.0	4.5	4.3
Large	10.7	3.6	3.3	7.5	24.2	12.3	14.6	4.7	8.2	8.8	8.9	9.3	4.5	5.1	5.2	5.5
BREAKDOWN OF ACTIVITIES BEST REPRESENTED IN THE SAMPLE																
Energy	8.1	15.8	12.5	9.4	11.3	41.6	33.7	6.0	8.1	9.8	10.3	10.7	4.8	6.4	6.9	7.0
Industry	10.0	-2.1	-0.7	13.8	16.5	2.4	-3.5	35.6	9.4	8.7	8.3	9.0	5.9	5.1	4.5	5.1
Wholesale and retail trade	13.3	2.9	1.9	4.6	23.3	4.1	2.5	8.4	12.1	10.8	8.7	7.6	8.6	7.4	5.1	3.9
Transport and communications	8.5	-1.6	-1.0	5.0	23.9	0.0	0.3	8.2	10.0	8.5	10.6	12.9	5.8	4.5	7.0	8.8

SOURCE: Banco de España.

a. All the data in these columns have been calculated as the weighted average of the quarterly data.

STRUCTURE OF REPORTING CORPORATIONS' RETURN ON INVESTMENT AND ORDINARY RETURN ON EQUITY

TABLE 6

		CBQ (a)			
		RETURN ON INVESTMENT (R.1)		ORDINARY RETURN ON EQUITY (R.3)	
		05 Q1-Q4	06 Q1-Q4	05 Q1-Q4	06 Q1-Q4
Number of corporations		793	741	793	741
Percentage of corporations by profitability bracket	R ≤ 0%	24.0	23.3	26.8	27.0
	0% < R ≤ 5%	21.3	21.8	16.5	16.1
	5% < R ≤ 10%	17.6	15.8	12.8	11.8
	10% < R ≤ 15%	10.2	11.4	10.1	8.8
	15% < R	26.8	27.8	33.7	36.3
MEMORANDUM ITEM: Average return		8.8	9.3	13.3	14.8

SOURCE: Banco de España.

a. All the data in these columns have been calculated as the weighted average of the quarterly data.

investment efforts of CBQ firms were concentrated in the energy sector and, especially, in transport and communications, in the latter case almost exclusively on account of the plans being executed by land, and water and air, transport firms.

In conclusion, Spanish firms saw their productive activity expand significantly in 2006, with strong broad-based growth in practically all sectors of activity. The performance of the industrial sector merits special mention, assisted by the greater dynamism of investment in capital goods and by the pick-up in external activity, although industry’s net external demand (exports less imports) actually grew at negative rates. At the same time, an ever larger number of firms has been creating jobs, encouraged by the climate of prosperity and wage moderation. This favourable scenario, and the need to diversify risks, encouraged some large firms to undertake significant investment, financed by borrowing, capitalising on the fact that the cost of debt, albeit rising slightly during the year, remained at low levels. This caused an increase in debt levels, although, on the information currently available, there is no sign of any risk factors that might endanger the financial position of the aggregate of firms. In fact, profitability levels remained high, actually exceeding those of previous years, and corporate profits (final net profit), relative to added value, were again at all time highs.

19.3.2007.