

Results of non-financial corporations in the first half of 2018

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20 September 2018

According to data from the Central Balance Sheet Data Office Quarterly Survey, non-financial corporations continued to see an increase in activity, employment and ordinary profits in the first half of 2018, supporting a continued recovery in aggregate profitability levels. There was no significant change in debt ratios, while the debt burden continued to fall, reaching historic lows, indicating that financial pressure on the corporate sector is currently low. Nevertheless, the simulations included with this article reveal that certain segments of the corporate sector would be particularly vulnerable to rising borrowing costs.

RESULTS OF NON-FINANCIAL CORPORATIONS IN THE FIRST HALF OF 2018

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Overview¹

The Central Balance Sheet Data Office Quarterly Survey (CBQ) data shows that the productive activity of the firms in the sample remained expansionary in the first half of 2018. Gross value added (GVA) increased, in nominal terms, by 3.9% compared with the same period in 2017, as against an increase of 0.8% the previous year. However, on applying a structural weighting closer to that of the national accounts (reweighted data) to GVA, the acceleration of this surplus is more moderate, as whereas for 2018 a similar value would be maintained (3.9%) up until June 2017, by contrast, the reweighted rate would be substantially higher, at 3.3%. Moreover, the GVA growth seen in 2018 took place in a context in which domestic trade gained in importance relative to both imports and exports.

Employment increased by 1.7% year-on-year, a similar growth rate to that in the first half of the previous year. Employment growth in 2018 was mainly driven by increased hiring of permanent staff (2%), with temporary contracts increasing only slightly (0.1%), thus continuing the trend observed in the previous quarters.

The increase in productive activity, along with the growth of financial revenue (owing to higher dividend income) and the decline in expenses linked to borrowing (associated with lower borrowing costs), was conducive to an expansion in ordinary net profit (ONP), which increased at a year-on-year rate of 11% to June, compared with growth of 7.1% a year earlier.

The growth in ordinary profits translated into somewhat higher levels of business profitability than in the previous year, such that return on assets came to 4.2%, compared with 4% the previous year, and return on equity rose by 0.3 pp to 5.6%. The smaller share of firms with negative profitability also stood out, highlighting the improved economic circumstances of the most vulnerable firms. The increase in the aggregate return on assets, together with a further fall in the average cost of borrowing, widened the gap between the two ratios to 1.9 pp, 0.2 pp larger than the previous year.

The reporting firms' borrowed funds rose in the first six months of the year, compared with end-2017, although their weight relative to assets remained virtually unchanged. The debt-to-operating profit ratio, on the other hand, grew slightly, since the growth in borrowed funds, the numerator of the ratio, was somewhat more pronounced than the growth in the ordinary surplus. Conversely, the debt burden ratio (calculated as the ratio of financial costs to profit) continued to decline, on the back of lower interest expenses, although at a slower pace than in previous periods, and is currently at a historical low. Therefore, the current level of financial pressure on Spanish non-financial corporations is very low, partly thanks to deleveraging and the recovery in profits in recent years, as well as lower borrowing costs. However, the simulation exercise shown in Box 1 reveals that a future

¹ This article draws on the information on the 921 firms which had reported their data to the CBQ by 12 September. According to National Accounts data, this sample represents 12.8 % of the GVA generated by the entire non-financial corporate sector.

scenario of rising borrowing costs would increase the level of financial pressure on the corporate sector. This would be felt most in the SME segment and certain sectors such as construction and real-estate, basically reflecting the low profitability of firms of this kind, whose profits have yet to return to pre-crisis levels. The implications of these developments are potentially more significant in terms of financial vulnerability, as a result of the debt accumulated in firms under high financial pressure, than for the economy as a whole, through the risk of job losses among these firms.

Activity

The information compiled by the CBQ shows that business activity remained expansionary in the first half of 2018, such that the GVA of the firms in the sample grew by 3.9% in nominal terms (see Table 1 and Chart 1), comfortably exceeding the increase in the same period of the previous year (0.8%). However, the reweighted rate of change of GVA based on the weight of the different sectors of the economy shows somewhat more moderate acceleration, given that applying this methodology resulted in the surplus reflecting stronger growth in the first half of 2017 (3.3%), 0.6 pp less than the 3.9% obtained for 2018 (see memorandum item in Table 1). In a similar vein, the information in Chart 2, which shows the distribution of the firms into quartiles according to the rate of change in GVA, gives a median value of 4% for 2018 compared with 3.1% the previous year.

Productive activity developed in a context in which domestic trade gained in importance relative to both imports and exports. Imports accounted for 29.3% of total purchases by the reporting firms, 2 pp less than the figure for the previous year (see Table 2). Exports as a share of total net turnover decreased by 0.8 pp to 20.4%.

By sector, increases in GVA were observed across the board in all industries (see Table 3). In the energy sector it increased by 2.3%, in contrast with the decreases seen in the first half of 2017. In manufacturing industry, GVA grew by 5%, exceeding last year's growth by just over 1 pp, although the headline figure masks a mixed picture. Thus, while on this indicator some subsectors, such as oil refining (23.8%) or other manufacturing (8.9%) underwent strong growth, in other subsectors such as food products, beverages and tobacco (5.9%) or the manufacture of mineral and metallic products (4%), the increases were more moderate, and in some subsectors, such as chemicals, there was even a decline (-6%). Meanwhile, in the wholesale and retail trade and hospitality sector, GVA growth rose to 7.3% from 0.9% the previous year, and in the information and communications sector, the surplus grew at a similar rate to the previous year (1.2%). Lastly, in the "other activities" group there was an increase of 3.8% (5.8% the previous year), driven in particular by the strong performance of the transport sector.

Employment and personnel costs

Personnel costs increased by 3% in 2018 Q1, twice as fast as in the year earlier period (see Table 3). This item's buoyancy reflected both employment growth and, to a lesser extent, increasing average compensation.

Employment in the CBQ sample grew by 1.7% between January and June of this year, a rate virtually identical to last year's. This growth was mainly driven by increased hiring of permanent staff (2%), with temporary contracts only increasingly slightly (0.1%) (see Table 4). This represents a continuation of the trend observed in the previous quarters, in which growth in permanent employment progressively gained momentum, while temporary employment growth slowed. The information in Table 5 reveals that the percentage of firms that increased their staff numbers grew slightly, to 51.2% (compared with 50.4% a year earlier). This percentage of firms also again exceeded that at which there were net job losses (34.7%).

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

TABLE 1

Databases	CBI structure	CBI		CBQ (a)		
	2016	2015	2016	2017 Q1-Q4 / 2016 Q1-Q4	2017 Q1-Q2 / 2016 Q1-Q2	2018 Q1-Q2 / 2017 Q1-Q2
Number of corporations		660,336	600,680	988	1,012	921
Total national coverage (% of GVA)		49.7	46.1	13.3	13.4	12.8
PROFIT AND LOSS ACCOUNT						
1 VALUE OF OUTPUT (including subsidiaries)	100.0	2.8	2.0	6.0	7.4	5.6
<i>Of which:</i>						
<i>Net amount of turnover and other operating income</i>	146.7	1.7	0.8	7.3	9.4	5.6
2 INPUTS (including taxes)	63.0	0.6	0.1	8.5	10.8	6.4
<i>Of which:</i>						
<i>Net purchases</i>	39.9	-1.3	-0.3	11.3	14.8	9.1
<i>Other operating costs</i>	23.4	4.0	0.9	0.8	0.5	5.7
S.1 GROSS VALUE ADDED AT FACTOR COST [1 – 2]	37.0	6.9	5.3	1.1	0.8	3.9
3 Personnel costs	23.6	3.7	4.5	2.5	1.5	3.0
S.2 GROSS OPERATING PROFIT [S.1 – 3]	13.4	13.7	6.8	-0.3	0.0	4.9
4 Financial revenue	3.6	-9.9	3.2	12.7	8.4	2.9
5 Financial costs	2.9	-10.0	-8.4	-11.4	-11.5	-7.2
6 Depreciation, impairment and operating provisions	5.8	1.9	1.3	0.6	0.6	0.0
S.3 ORDINARY NET PROFIT [S.2 + 4 – 5 – 6]	8.2	25.6	16.3	8.4	7.1	11.0
7 Gains (losses) from disposals and impairment	0.4	–	–	–	-99.9	–
7' As a percentage of GVA (7 / S.1)		-5.5	1.2	-4.9	0.0	16.8
8 Changes in fair value and other gains (losses)	-0.3	–	45.7	47.5	21.3	–
8' As a percentage of GVA (8 / S.1)		-1.0	-0.8	-1.7	-1.4	-4.0
9 Corporate income tax	2.3	19.4	–	-51.4	-30.2	10.9
S.4 NET PROFIT [S.3 + 7 + 8 – 9]	6.1	-14.1	46.8	-29.5	-24.9	77.0
S.4' As a percentage of GVA (S.4 / S.1)		10.0	16.5	24.3	26.6	42.3
PROFIT RATIOS						
R.1 Return on investment (before taxes)	(S.3 + 5.1) / NA	4.6	5.0	6.0	4.0	4.2
R.2 Interest on borrowed funds/interest-bearing debt	5.1 / IBD	3.2	2.8	2.4	2.4	2.2
R.3 Ordinary return on equity (before taxes)	S.3 / E	5.7	6.4	8.7	5.3	5.6
R.4 ROI – cost of debt (R.1 – R.2)	R.1 – R.2	1.5	2.1	3.6	1.7	1.9
MEMORANDUM ITEM: TOTAL SAMPLE WITHOUT ENERGY SECTOR						
S.1 GROSS VALUE ADDED AT FACTOR COST [1 – 2]		6.7	5.4	3.2	3.3	3.9
S.2 GROSS OPERATING PROFIT [S.1 – 3]		12.3	7.0	4.0	6.4	4.1

SOURCE: Banco de España.

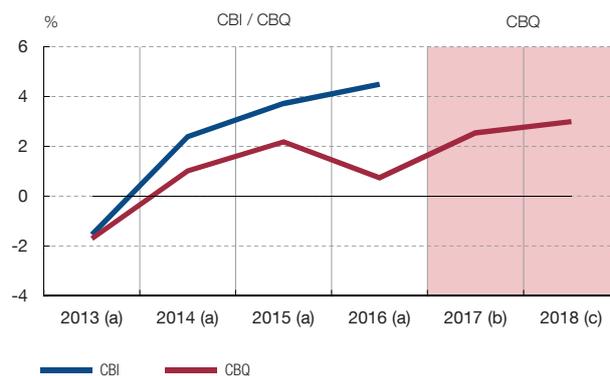
NOTE: In calculating rates, internal accounting movements have been edited out of items 4, 5, 7 and 8.

- a All the data in these columns have been calculated as the weighted average of the quarterly data.
b NA = Net assets (net of non-interest-bearing borrowing); E = Equity; IBD = Interest-bearing debt; NA = E + IBD. The financial costs in the numerators of ratio only include the portion of financial costs that is interest on borrowed funds (5.1).

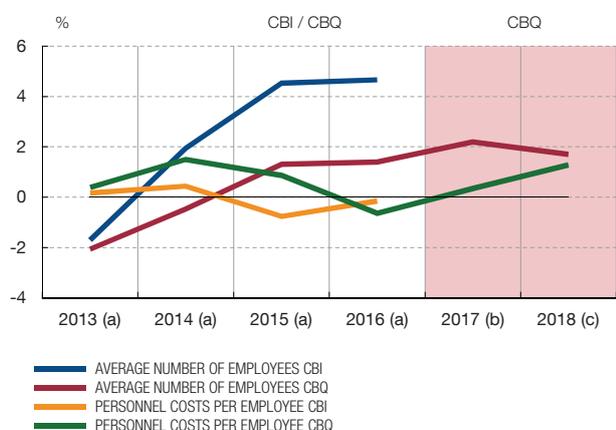
1 GROSS VALUE ADDED AT FACTOR COST
Rate of change



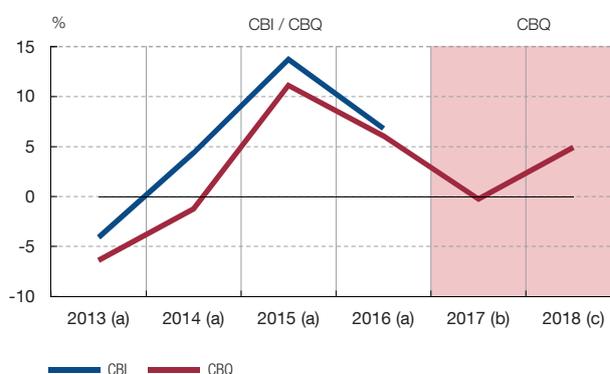
2 PERSONNEL COSTS
Rate of change



3 EMPLOYMENT AND WAGES
Rate of change



4 GROSS OPERATING PROFIT
Rate of change



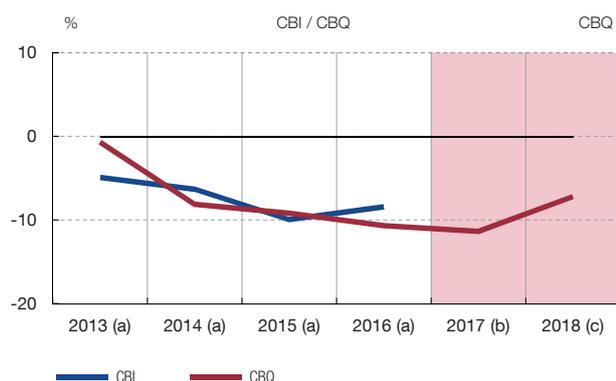
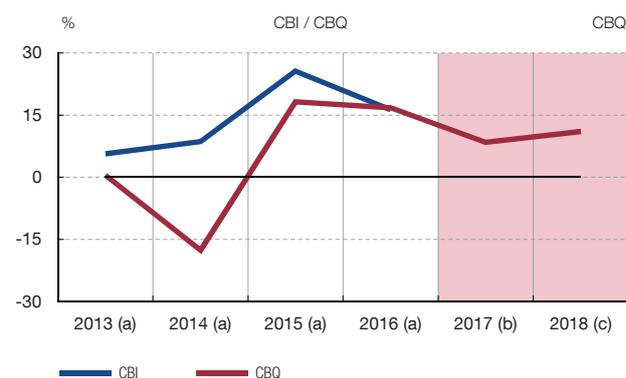
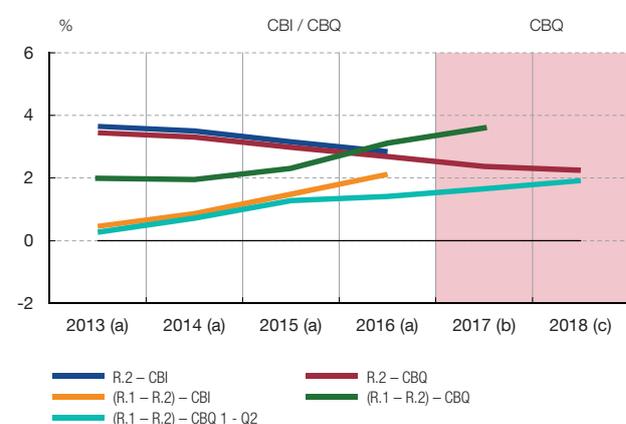
Reporting non-financial corporations		2013	2014	2015	2016	2017	2018
Number of corporations	CBI	627,102	688,853	660,336	600,680	—	—
	CBQ	842	888	986	983	988	921
% of GVA of the non-financial corporations sector	CBI	48.0	49.9	49.7	46.1	—	—
	CBQ	11.9	13.4	14.1	13.9	13.3	12.8

SOURCE: Banco de España.

- a The 2013, 2014, 2015 and 2016 data, for the corporations reporting to the CBI, and the average data of the four quarters of each year in relation to the previous year (CBQ).
- b Average of the four quarters of 2017 relative to the same period in 2016.
- c 2018 Q2 data relative to the same period in 2017.

By sector, employment gains were widespread, although the strength varied. The biggest increases were in the information and communications sector and the other activities category, with growth rates of 2.4% and 2.6%, respectively (see Table 3). Increases were somewhat more moderate in the energy sector (1.8%), while the smallest gains were in manufacturing (0.8%) and in wholesale and retail trade and hospitality (0.9%).

The average compensation for the overall CBQ sample rose by 1.3 % in the first half of 2018, compared with a drop of 0.2% one year earlier. However, within this overall performance individual sectors evolved differently. Thus in manufacturing industry and the wholesale and

5 FINANCIAL COSTS
Rate of change6 ORDINARY NET PROFIT
Rate of change7 RETURN ON INVESTMENT (R.1)
Ratios8 COST OF DEBT (R.2) AND ROI - COST OF DEBT (R.1-R.2)
Ratios

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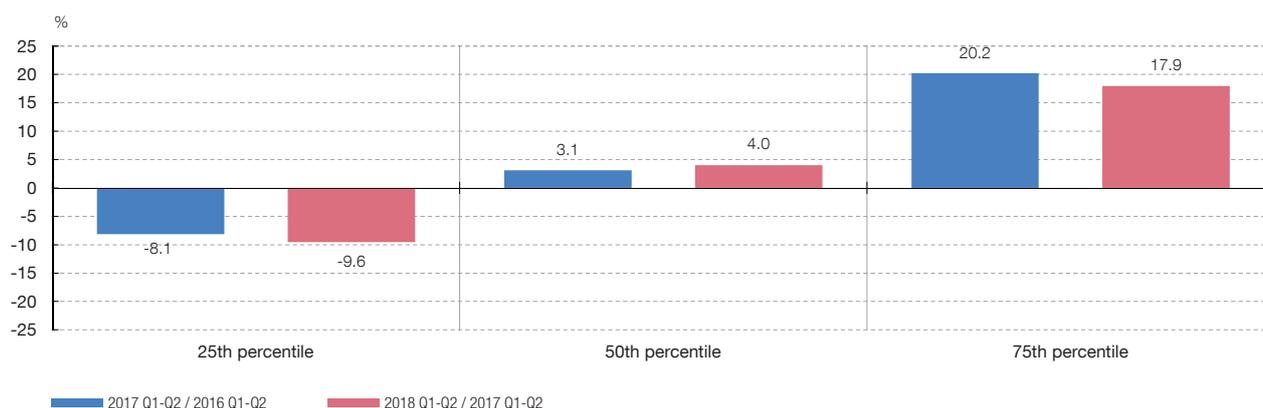
SOURCE: Banco de España.

- a The 2013, 2014, 2015 and 2016 data for the corporations reporting to the CBI and the average data of the four quarters of each year (CBQ). The rates are calculated relative to the previous year.
b Average of the four quarters of 2017. The rates are calculated relative to the same period in 2016.
c Data up to 2018 Q2. The rates are calculated relative to the same period in 2017.

retail trade and hospitality sector average personnel costs rose at above average rates (2.8% and 3.5%, respectively), in other activities they did so more moderately (0.9%) and in energy and information and communication they decreased (by 1.8% and 1.4%, respectively).

Profit, rates of return
and debt

The gross operating profit (GOP) of the aggregate of the CBQ sample increased by 4.9% in the first six months of 2018, compared with almost no change the previous year. By contrast, similar to the case when analysing GVA, this progress is qualified by the results obtained re-weighting the sample with the weights of the various sectors in the economy. The reweighted GOP would reflect a slowdown by significantly raising the growth of this



SOURCE: Banco de España.

ANALYSIS OF PURCHASES AND TURNOVER OF CORPORATIONS REPORTING DATA ON PURCHASING SOURCES AND SALES DESTINATIONS

TABLE 2

Structure and rate of change, percentages

		CBA		CBQ (a)	
		2016	2017 Q1-Q4 (a)	2017 Q1-Q2	2018 Q1-Q2
Total corporations		9,497	988	921	921
Corporations reporting source/destination		9,497	911	862	862
Percentage of net purchases according to source	Spain	65.6	70.3	68.7	70.7
	Total abroad	34.4	29.7	31.3	29.3
	EU countries	19.3	20.2	20.8	20.3
	Third countries	15.1	9.6	10.5	9.0
Percentage of net turnover according to destination	Spain	76.5	79.5	78.8	79.6
	Total abroad	23.5	20.5	21.2	20.4
	EU countries	15.3	14.1	14.6	14.2
	Third countries	8.2	6.4	6.6	6.2
Change in net external demand (exports less imports), rate of change	Industry	8.9	3.3	3.5	3.9
	Other corporations	14.5	-70.5	-91.9	12.8

SOURCE: Banco de España.

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

surplus in the first half of 2017 (to 6.4%) and so reducing the increase in the first six months of 2018 to 4.1%.

Financial revenue of the sample as a whole increased by 2.9% in the first half of 2018, which was less than the 8.4% increase in the year-earlier period. This performance was the result of increasing dividend payments (up 7.5%), which was partly offset by falling interest income (-13%).

Financial costs decreased by 7.2%, essentially owing to lower borrowing costs, as interest-bearing debt had a minor impact in the period analysed (see Table 6).

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

TABLE 3

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

	Gross value added at factor cost				Employees (average for period)				Personnel costs				Compensation per employee			
	CBI		CBQ		CBI		CBQ		CBI		CBQ		CBI		CBQ	
	2016	2017 Q1-Q4	2017 Q1-Q2	2018 Q1-Q2	2016	2017 Q1-Q4	2017 Q1-Q2	2018 Q1-Q2	2016	2017 Q1-Q4	2017 Q1-Q2	2018 Q1-Q2	2016	2017 Q1-Q4	2017 Q1-Q2	2018 Q1-Q2
Total	5.3	1.1	0.8	3.9	4.7	2.2	1.7	1.7	4.5	2.5	1.5	3.0	-0.2	0.3	-0.2	1.3
SIZE																
Small	8.2	—	—	—	6.7	—	—	—	7.5	—	—	—	0.7	—	—	—
Medium	6.5	6.0	5.2	8.9	4.4	5.2	4.4	5.1	5.3	6.0	5.7	6.0	0.9	0.7	1.2	0.9
Large	4.0	1.1	0.7	3.9	3.3	2.1	1.7	1.6	2.9	2.5	1.4	3.0	-0.4	0.4	-0.2	1.3
BREAKDOWN BY ACTIVITY																
Energy	-0.9	-9.7	-8.9	2.3	2.0	2.1	1.7	1.8	0.0	2.4	1.5	-0.1	-1.9	0.3	-0.2	-1.8
Industry	5.2	4.9	3.9	5.0	3.5	1.5	1.9	0.8	4.3	3.3	2.1	3.6	0.8	1.8	0.2	2.8
Wholesale and retail trade and hospitality	7.1	1.7	0.9	7.3	5.2	2.4	2.4	0.9	5.6	3.3	2.2	4.4	0.3	0.8	-0.2	3.5
Information and communications	4.6	3.6	1.2	1.2	2.5	0.2	-1.9	2.4	1.7	-0.4	-1.7	0.9	-0.7	-0.6	0.1	-1.4
Other activities	5.9	4.8	5.8	3.8	5.2	2.8	1.8	2.6	4.9	2.6	1.8	3.5	-0.3	-0.2	0.0	0.9

SOURCE: Banco de España.

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

EMPLOYMENT

TABLE 4

	Total CBQ corporations 2018 Q1-Q2	Corporations increasing (or not changing) staff levels	Corporations reducing staff levels
Number of corporations	921	601	320
NUMBER OF EMPLOYEES			
Initial situation 2017 Q1-Q2 (000s)	917	616	301
Rate 2018 Q1-Q2/ 2017 Q1-Q2	1.7	4.9	-4.9
Permanent	Initial situation 2017 Q1-Q2 (000s)	512	242
	Rate 2018 Q1-Q2/ 2017 Q1-Q2	4.3	-2.7
Non-permanent	Initial situation 2017 Q1-Q2 (000s)	104	59
	Rate 2018 Q1-Q2/ 2017 Q1-Q2	8.1	-14.1

SOURCE: Banco de España.

The favourable course of financial revenue and costs led to ONP growth outpacing GOP in the first half of 2018 at 11%, somewhat stronger growth than one year earlier (7.1%). The performance of extraordinary gains had a positive impact on the final surplus, mainly owing to capital gains on the sales of shares recorded this year. This pushed up the results for the year by 77%, contrasting with the 24.9% decline in the same period in 2017. As a

PERSONNEL COSTS AND EMPLOYEES
Percentage of corporations in specific situations

TABLE 5

	CBI (a)		CBQ (b)			
	2015	2016	2016 Q1 - Q4	2017 Q1 - Q4	2017 Q1-Q2	2018 Q1-Q2
Number of corporations	480,109	440,999	983	988	1,012	921
PERSONNEL COSTS	100	100	100	100	100	100
Falling	39.6	34.5	38.2	32.7	33.6	30.3
Constant or rising	60.4	65.5	61.8	67.3	66.4	69.7
AVERAGE NUMBER OF EMPLOYEES	100	100	100	100	100	100
Falling	30.9	28.6	37.6	34.1	34.1	34.7
Constant	26.1	27.8	15.5	15.1	15.4	14.1
Rising	43.0	43.6	46.9	50.8	50.4	51.2

SOURCE: Banco de España.

- a To calculate these percentages, corporations that did not have any staff in 2014 and in 2015 were excluded.
b Weighted average of the relevant quarters for each column.

FINANCIAL COSTS
Percentages

TABLE 6

	CBI	CBQ	
	2015 / 2016	2017 Q1-Q4 / 2016 Q1-Q4	2018 Q1-Q2 / 2017 Q1-Q2
CHANGE IN FINANCIAL COSTS	-8.4	-11.4	-7.2
A Interest on borrowed funds	-10.2	-11.0	-6.4
1 Due to the cost (interest rate)	-10.0	-11.1	-5.9
2 Due to the amount of interest-bearing debt	-0.2	0.1	-0.5
B Other financial costs	1.7	-0.3	-0.8

SOURCE: Banco de España.

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

TABLE 7

		CBQ			
		Return on investment (R.1)		Ordinary return on equity (R.3)	
		2017 Q1-Q2	2018 Q1-Q2	2017 Q1-Q2	2018 Q1-Q2
Number of corporations		1012	921	1012	921
Percentage of corporations by profitability bracket	R ≤ 0%	23.0	21.6	25.8	24.6
	0% < R ≤ 5%	24.2	25.5	16.8	17.9
	5% < R ≤ 10%	17.2	15.8	12.3	11.9
	10% < R ≤ 15%	9.7	10.6	8.5	9.7
	15% < R	25.8	26.6	36.5	35.9
MEMORANDUM ITEM: Median return (%)		5.9	5.8	8.2	8.2

SOURCE: Banco de España.

GROSS OPERATING PROFIT, ORDINARY NET PROFIT, RETURN ON INVESTMENT AND
ROI-COST OF DEBT (R.1 – R.2).

TABLE 8

BREAKDOWN BY SIZE AND MAIN ACTIVITY OF CORPORATIONS

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

	Gross operating profit				Ordinary net profit				Return on investment (R.1)				ROI-cost of debt (R.1 – R.2)			
	2016	2017 Q1-Q4	2017 Q1-Q2	2018 Q1-Q2	2016	2017 Q1-Q4	2017 Q1-Q2	2018 Q1-Q2	2016	2017 Q1-Q4	2017 Q1-Q2	2018 Q1-Q2	2016	2017 Q1-Q4	2017 Q1-Q2	2018 Q1-Q2
Total	6.8	-0.3	0.0	4.9	16.3	8.4	7.1	11.0	5.0	6.0	4.0	4.2	2.1	3.6	1.7	1.9
SIZE																
Small	10.6	—	—	—	19.7	—	—	—	3.0	—	—	—	0.4	—	—	—
Medium	9.3	6.2	4.1	15.0	14.5	18.1	14.1	12.3	6.9	7.3	7.0	8.0	4.2	5.1	4.6	5.8
Large	5.7	-0.3	0.0	4.9	15.8	8.4	7.0	11.0	5.4	6.0	4.0	4.1	2.6	3.6	1.6	1.9
BREAKDOWN BY ACTIVITY																
Energy	-1.2	-14.2	-12.7	3.4	15.3	-13.4	-12.9	5.2	5.5	5.2	3.8	3.7	2.3	2.6	1.2	1.3
Industry	6.7	6.6	6.2	6.7	13.3	9.6	-3.8	8.6	8.3	10.5	8.0	8.7	5.5	7.7	5.6	6.4
Wholesale & retail trade and hospitality	10.8	-0.6	-1.1	12.1	24.0	0.3	6.2	14.6	8.1	12.7	8.2	9.1	5.2	10.8	6.3	7.7
Information and communications	7.9	6.0	3.1	1.4	27.0	6.9	8.3	4.9	11.7	17.5	16.2	15.8	9.6	15.9	14.8	14.3
Other activities	8.7	8.6	13.2	4.3	12.3	28.7	4.8	3.8	3.2	4.2	2.3	2.5	0.4	1.9	0.0	0.3

SOURCE: Banco de España.

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

result of the impact of extraordinary gains, net profit as a proportion of GVA reached a historical high of 42.3%, well above the figure for the previous year (26.7%).

The rise in ordinary profits allowed profit ratios to grow relative to the levels reached in the first half of 2017. Specifically, return on assets was 4.2%, 0.2 pp higher than one year earlier (4%), while return on equity rose by 0.3 pp to 5.6%. By contrast, the information in Table 7 shows that the median of the two indicators analysed (return on assets and return on equity) remained at levels similar to those of the previous year in 2018, suggesting that the growth reflected by the levels of aggregate profitability might have been influenced by the strong performance of certain large corporations with bigger weights in the sample. However, it is worth noting the decrease observed in the share of firms with negative profitabilities, suggesting an improvement in the economic situation of the most vulnerable firms.

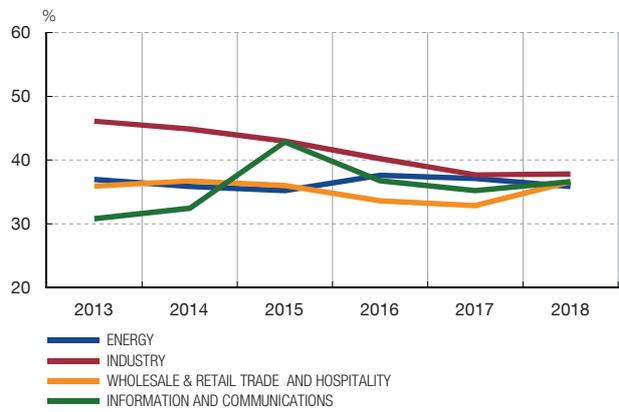
The sector breakdown reveals a degree of dispersal in the performance of aggregate profit (see Table 8). In particular, the rising return on investment in the wholesale and retail trade and hospitality sectors and manufacturing industry, of 9.1% and 8.7%, respectively, exceed last year's figures by slightly less than 1 pp. In the energy sector and other activities, levels of return on ordinary activities were similar to those the previous year, at 3.7% and 2.5%, respectively. Lastly, a clearer drop was observed in the information and communications sector, with the indicator falling almost 0.5 pp to 15.8%, although this sector remains the most profitable.

The average cost of borrowing continued to decline, decreasing by 0.2 pp over the period to 2.2% compared with the same period in 2017. The unbroken downward trend that this ratio has been following for the past seven years has taken it to historical lows, after accumulating a drop of almost 3 pp since 2008. The downward trend in borrowing costs,

1 E1. INTEREST-BEARING DEBT / NET ASSETS (a)
TOTAL CORPORATIONS
Ratios



2 E1. INTEREST-BEARING DEBT / NET ASSETS (a)
BREAKDOWN BY SECTOR. CBQ
Ratios



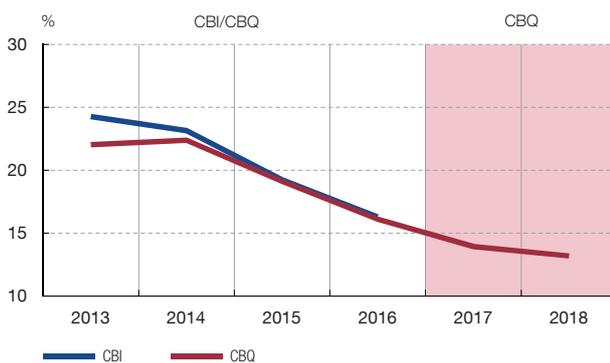
3 E2. INTEREST-BEARING DEBT (b) / (GOP + FR) (c)
TOTAL CORPORATIONS
Ratios



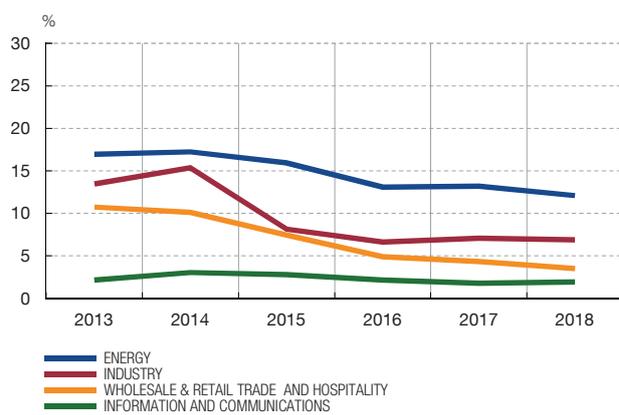
4 E2. INTEREST-BEARING DEBT (b) / (GOP + FR) (c)
BREAKDOWN BY SECTOR. CBQ



5 INTEREST BURDEN
TOTAL CORPORATIONS
(Interest on borrowed funds) / (GOP + FR) (c)



6 INTEREST BURDEN
BREAKDOWN BY SECTOR. CBQ
(Interest on borrowed funds) / (GOP + FR) (c)



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 intra-group debt (approximation of consolidated debt).
- c The expenditure and revenue included in these ratios are calculated on the basis of cumulated four-quarter amounts.

linked to the slight rise in the return on assets, widened the gap between the two ratios to 1.9 pp, 0.2 pp larger than the previous year.

Lastly, across the sample as a whole, interest-bearing debt increased from the levels attained at the close of the previous year, despite which the E1 debt ratio (which is calculated as the ratio of interest-bearing debt to net assets) remained virtually unchanged at 42.6% (see Chart 3). Across the various sectors, increases in this ratio were observed in the information and communications sector, wholesale and retail trade and hospitality, while it declined somewhat in energy and remained stable in industry. The E2 ratio (defined as the ratio of interest-bearing debt to the sum of GOP and financial revenue) also increased slightly, standing at 537% (compared with 526% at end-2017) owing to the fact that the increase in debt slightly exceeded that in ordinary profits. Conversely, the interest burden continued to decline, driven by lower financial costs, although at a more moderate pace than in the previous year, falling to a historical low of 13.2%.

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As a result of the high level of indebtedness accumulated by non-financial corporations in the expansionary phase that preceded the start of the last crisis, interest expenses payable also rose significantly, amounting in 2008 to 11% of the gross value added (GVA) generated by the sector, more than double their level just five years earlier (4.9%). With the start of the downturn, a growing number of firms began to experience difficulties meeting their financial obligations with the income from their ordinary activity, forcing many of them to embark on deleveraging processes, allowing them to clean up their balance sheets and ease the excessive financial burden. In this setting, the decline in interest rates that began in 2009 considerably eased the financial pressure on the corporate sector. The Central Balance Sheet Data Office data confirm this pattern, showing how, for the Integrated Central Balance Sheet Data Office Survey (CBI, by its Spanish abbreviation) overall, the ratio that proxies the average cost of financial debt fell by more than 54% between 2008 and 2016 (the last year available in the database), taking its median value down from 5.9% at the start of 2008 to 2.7% in 2016. However, the disaggregated data reveal significant differences in the change in the average cost of financial debt in the period analysed. Thus, although this indicator fell at the vast majority of firms (around 80%, see Chart 1), the scale of the decline was very unequal, most commonly amounting to up to 2 pp (23% of firms), followed by between 2 pp and 4 pp (21%) and by between 4 pp and 6 pp (17%). For most firms, the savings generated by the cumulative reduction in the cost of borrowing had a positive impact on return on equity. Specifically, ROE rose by up to 2 pp at almost 60% of firms, and by more than 2 pp at 27% (see Chart 2).

Given the current level of the cost of borrowing, which is at an all-time low, and the possible normalisation of monetary conditions in the medium term, any further decline in this cost is now very limited and an increase in coming years cannot be ruled out. It is therefore timely to analyse the effects that such moves could have on the financial situation of Spanish non-financial corporations. To this end, a simulation exercise has been performed, considering, for purposes of illustration, two hypothetical scenarios of an increase in the cost of borrowing (by 100 bp and 200 bp, respectively) applied to the 2016 CBI figures (the last year available in the sample).¹ Specifically, the exercise leaves unchanged all balance sheet items and income statements, with the only changes made being in the cost of borrowing, in the amounts indicated. This approach tends to exaggerate the effects of an interest rate rise, since this would be expected to be accompanied, for example, by higher levels of activity and ordinary profit at firms that could moderate the impact. In addition, it is important to note that firms' current economic and financial situation is somewhat

more favourable now than it was in 2016, which is the base year used, because there has been a gradual improvement since then and the cost of borrowing has continued to decline, albeit moderately. Accordingly, the findings should be taken as an upper bound of the expected effect. It should also be noted that, in practice, increases in market interest rates would not be passed through immediately but gradually (as outstanding debt matures or interest rates on variable rate loans are reset), although it is estimated that the time lag would be relatively short, given the predominance of short-term variable-rate borrowing among Spanish firms.²

Chart 3 shows that the impact of these increases on ROE³ would be relatively moderate for the whole of the CBI sample, with a drop of 0.8 pp in the case of an increase in the cost of borrowing of 100 bp, and a drop of approximately 1.5 pp in the worst-case scenario considered. The breakdown by firm size shows that the decline in ROE would be rather more severe among large corporations, where it could fall by almost 2 pp if borrowing costs were to rise by 200 bp. This finding is linked to the higher level of indebtedness of these corporations. By sector of activity, the decline in ROE would be somewhat less than 1 pp in all sectors in the event of a 100 bp rise, and would range between 1.4 pp and 1.9 pp in the worst-case scenario, with the energy sector, the information and communications sector and the construction and real estate sector posting a rather more pronounced decline (see Chart 4).

It is also important to analyse the effects of an increase in the cost of borrowing on the proportion of firms bearing high financial pressure.⁴ Chart 5 illustrates, first, that the proportion of debt in these firms, which in 2016 accounted for 14.7% of total sector indebtedness, would gradually rise as the cost of borrowing increased, to reach almost 20% in the worst-case scenario (a 200 bp increase).⁵ In this case, the increase would be most marked in the SME segment, as the debt of financially vulnerable SMEs could amount to 24.4% of total SME indebtedness, while in the case of financially vulnerable large corporations, in the worst-case scenario, their debt would amount to 18.2% of total large corporation indebtedness. The reason for this is that, although the decline in ROE at SMEs would be less marked, as

1 The Central Balance Sheet Data Office Quarterly Survey (CBQ) has more recent data, but it was considered more appropriate to use the CBI for this purpose as it permits analysis of the impact of increases in the cost of borrowing on a broader corporate base, with a high number of SMEs.

2 See Box 7, "Sensitivity of the income of Spanish general government, non-financial corporations and households to interest rate rises", in the *Quarterly report on the Spanish economy*, June 2018.

3 ROE would be affected by an increase in the cost of borrowing through its numerator (ordinary net profit), the calculation of which includes financial costs.

4 Firms are understood to bear high financial pressure or to be financially vulnerable when, for two consecutive years, their income from ordinary activities (gross operating profit plus financial revenue) is lower than their financial costs.

5 For purposes of reference, during the crisis this indicator peaked, in 2013, at 22.8%.

EFFECT OF CHANGE IN COST OF BORROWING ON FIRMS' RATE OF RETURN AND FINANCIAL PRESSURE (a)

Chart 1
DISTRIBUTION OF CHANGE IN AVERAGE COST OF BORROWING, 2008 TO 2016

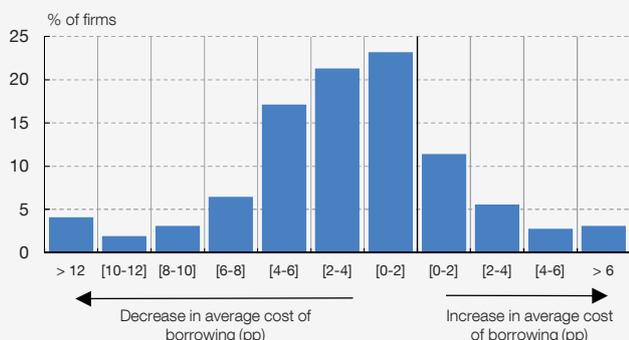


Chart 2
DISTRIBUTION OF IMPACT ON ROE OF CHANGE IN AVERAGE COST OF BORROWING, 2008 TO 2016 (b)

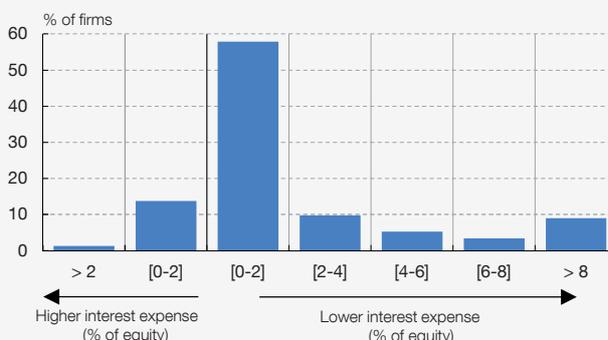


Chart 3
IMPACT ON ROE OF INCREASES IN COST OF BORROWING. BREAKDOWN BY FIRM SIZE (c)

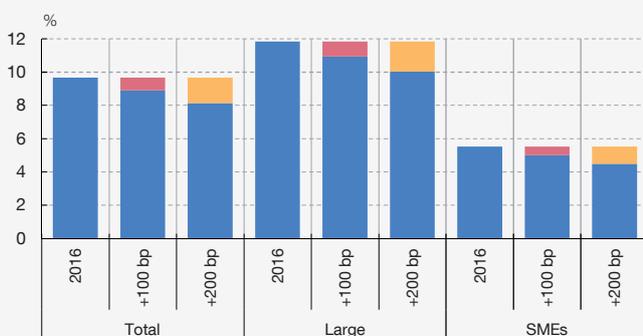
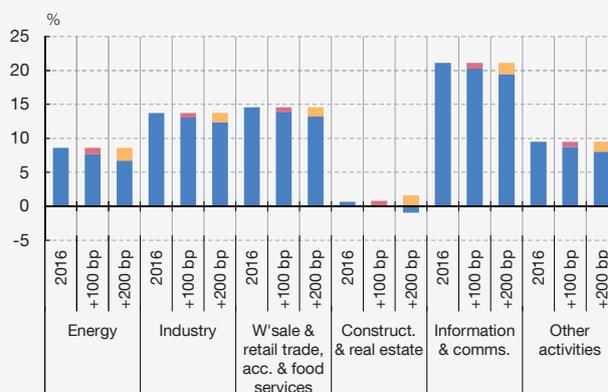


Chart 4
IMPACT ON ROE OF INCREASES IN COST OF BORROWING. BREAKDOWN BY SECTOR



Legend: Decline in ROE owing to 200 bp interest rate rise (orange), Decline in ROE owing to 100 bp interest rate rise (red), ROE (at book value) (blue) (b)

Chart 5
IMPACT OF INCREASE IN COST OF BORROWING ON PROPORTION OF FIRMS BEARING HIGH FINANCIAL PRESSURE. BREAKDOWN BY FIRM SIZE (c) (d)

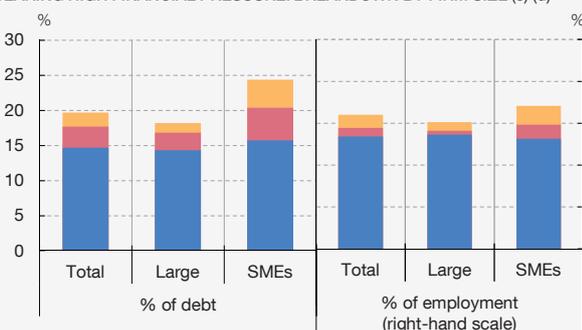
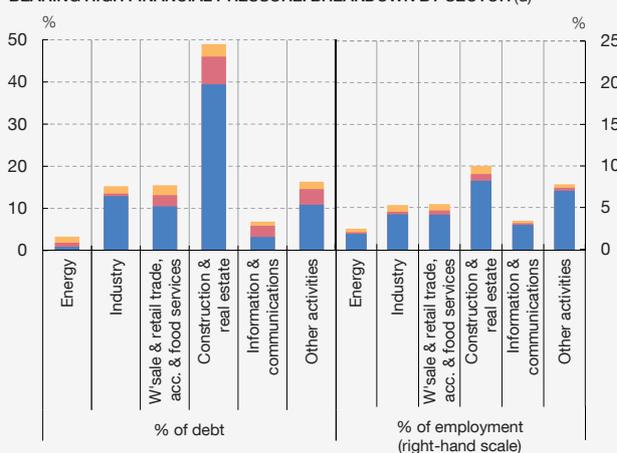


Chart 6
IMPACT OF INCREASE IN COST OF BORROWING ON PROPORTION OF FIRMS BEARING HIGH FINANCIAL PRESSURE. BREAKDOWN BY SECTOR (d)



Legend: +200 bp (orange), +100 bp (red), LEVEL IN 2016 (blue)

SOURCE: Banco de España.

- a For the purposes of this analysis the CBI sample was used, excluding holding companies, newly created firms and construction and real estate sector firms with zero employment and zero turnover in two consecutive years (inactive).
- b Return on equity (ROE), calculated as the ratio between ordinary net profit (ONP) and equity at book value.
- c Definition of firm size in accordance with Commission Recommendation 2003/361/EC.
- d Firms bearing high financial pressure are those where the ratio (Gross operating profit + Financial revenue) / Financial costs is less than 1 in the previous two years. The charts depict the debt (or employment) of firms bearing high financial pressure as a proportion of the total debt (or employment) of each group analysed.

noted above, their rate of return before interest is lower and, therefore, they would have less leeway to withstand higher financial costs. In terms of numbers of workers, the impact would be less severe: thus, as the result of an increase in the cost of borrowing, the proportion of employment concentrated at vulnerable firms could increase, from just over 5% in 2016 to a maximum of 6.4% in the worst-case scenario, with no significant differences perceived by firm size (see Chart 6). The analysis by sector of activity shows that construction would be one of the sectors most affected, both in terms of debt (with a maximum increase of 10 pp) and employment (which would rise by almost

2 pp). Accordingly, in general, these findings point to a larger impact in terms of debt than in terms of employment, which suggests that the weaknesses detected would have more significant implications in terms of financial vulnerability, owing to potential debt servicing problems, than in economic terms, owing to the risk of job losses. In this respect, although it is true that the deleveraging processes undertaken by many firms in the past decade have made them less vulnerable to a rise in their financial costs, the fact that profitability still remains below pre-crisis levels means that some firms have less leeway to absorb shocks of this kind.
