

Spanish Chamber
of Commerce in
the United Kingdom

I Barometer on the Climate and Outlook for Spanish Investment in the UK

—
26th February 2019

 Sabadell

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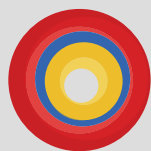
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We live in times of uncertainty, political transformation and social unrest. Indeed, we live in times of change. 2019 has so far been and will continue to be a landmark year in the history of Europe and more specifically, regarding the bilateral relations between Spain and the UK.

Since Spain's incorporation into the European Community in 1986, the Spanish-British relationship has developed profoundly under the EU framework and arguably can be described as having been a categorical success. Never before has the relationship between the two countries been as prosperous.

These are the two principal ideas that are incorporated into **the I Barometer on the Climate and Outlook for Spanish Investment in the UK**: to contribute towards an important debate which helps to provide some certainty in areas in which it is currently lacking, while also ensuring the required understanding and strengthening of the bilateral relations between both countries.

The **Spanish Chamber of Commerce in the United Kingdom** is where it needs to be: working with its members and patrons and alongside British institutions; as much parliamentary as the governmental. Well aware of the critical moment we currently find ourselves in, the Chamber seeks to provide an essential space for the discussion of politics and business ideas between the two countries. This is our calling and the Barometer is a product of this.

Throughout the pages of this Barometer the intensity and great importance of Spanish investment in the United Kingdom is well documented, alongside the invaluable contribution of Spanish talent to this country and its economy.

The United Kingdom is one of the most important markets for Spain and its companies. Despite the aforementioned uncertainty, the Chamber has strategically chosen to launch its very first Barometer in the weeks leading up to the due date of Brexit. It is a document comprising detailed information while at the same time including a highly useful testimony for gaining a deeper understanding the opinions of Spanish companies on the matter.

The dialogue between both Spanish and British companies and institutions has never been so necessary, and this with in mind I hope that this study will be of great use to you.

With my very best wishes,

Eduardo Barrachina

President of the Spanish Chamber of Commerce in the United Kingdom

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Note: the results and opinions in this Barometer are not necessarily the opinions of the sponsoring companies, the Spanish Chamber of Commerce in the United Kingdom or its members.

Executive Summary

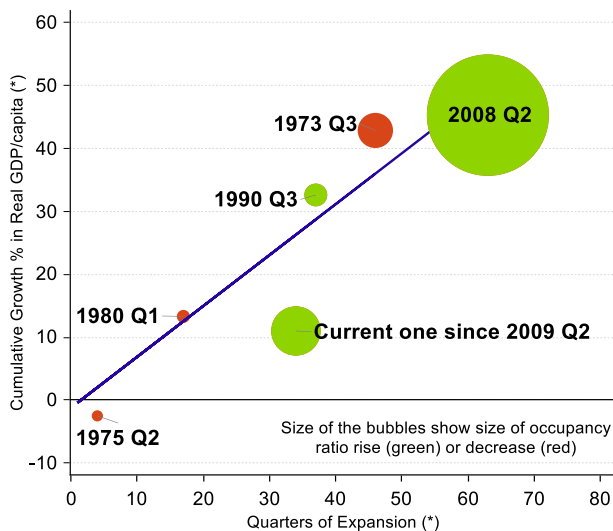
- ▶ The United Kingdom has consistently been a major destination for Spanish Foreign Direct Investment (FDI). The investment position (*stock*) of Spanish companies almost doubled between 2007 and 2016, reaching 77,077 million euros, 16.8% of total Spanish investment abroad. In terms of Spanish FDI flows (a different and non-additive measure with respect to the position), the UK has received the largest sum of cumulative flows since the beginning of the historical series.
- ▶ The stock of Spanish FDI in the United Kingdom is concentrated in the financial services, telecommunications, electricity trading, insurance, infrastructure concessions and business consultancy sectors.
- ▶ To date, Brexit has had no significant adverse impact on Spanish investment in the UK. The volume of Spanish investment in the United Kingdom rebounded in the expansive phase of the Spanish economy and, up to the third quarter of 2018 does not appear to have suffered any sharp deterioration attributable to Brexit. Flows to the United Kingdom were the largest of all Spanish FDI in 2016 and 2017 and the second largest in the first three quarters of 2018. However, uncertainty, the anticipation of direct investment decisions and the perception of the deterioration of the business climate by Spanish companies would counsel caution with respect to future developments.
- ▶ It is estimated that Spanish FDI in the UK contributed to the generation of at least 126,260 jobs in 2016, representing 0.4% of total national employment.
- ▶ Nearly three out of four Spanish companies established in the UK responding to the survey consider that the British business climate has deteriorated in the last year. Political risk related to institutional stability and territorial cohesion is the most worst rated aspect, while digitisation, both of the economy and of enterprises, is best rated.
- ▶ More than half of the companies expect their revenue to increase in the UK in 2019. In general, their outlook on business is better than that on developments in the UK economy.
- ▶ One in four Spanish companies plans to increase its investment in the UK in 2019. Among the activities to which they will allocate resources are marketing actions and the development of new products.
- ▶ Half of companies say they have changed their investment policy in the British market since 2016. In addition, 58% of companies do not expect Brexit to affect their UK investment plans for 2019. Although another 43% say that it will have an impact and for many the impact can be significant.
- ▶ Free trade in goods and services is considered by Spanish companies to be of the utmost importance in the Brexit negotiations, with a view to mitigating the impact on economic relations between Spain and the United Kingdom.
- ▶ In short, taking into account the strong performance of investment so far and enterprises' perception of Brexit-related risks, future perspectives will be highly conditioned by the type of exit and how ambitious the country's future relationship with the EU will be.

1. Macroeconomic context in the United Kingdom and Spain

Although they have followed different trajectories, the macroeconomic situation in both Britain and Spain is relatively favourable in the run-up to the UK's planned exit from the EU (henceforth "Brexit"). Both economies saw a slowdown in growth in 2018, but for the time being they are reasonably resilient, albeit with the differences inherent in their respective moments of the cycle and to the deterioration in the global growth outlook.

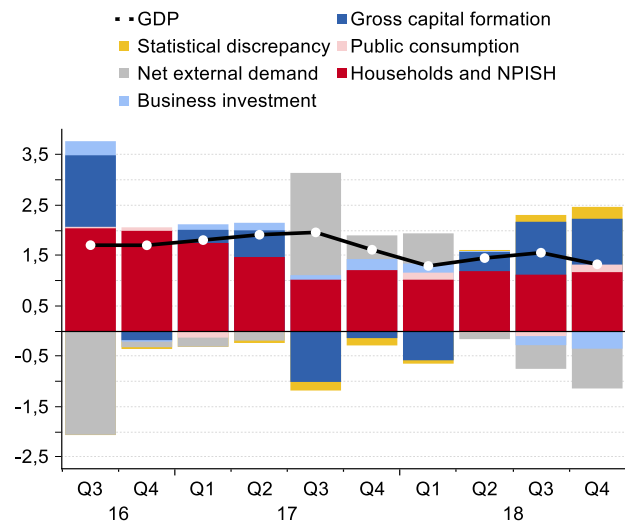
British economic growth following the referendum of 23 June 2016 has shifted into a lower gear and slowed down. But it has managed to avoid a recession and boasts an economic expansion of almost 10 years which, moreover, is accompanied by sustained growth in employment. The labour market is operating at full capacity and the British economy reached an unemployment rate at the end of 2018 that is among the lowest of the major developed economies (3.9% in 4Q18).

Duration of British economic growth phases since 1962



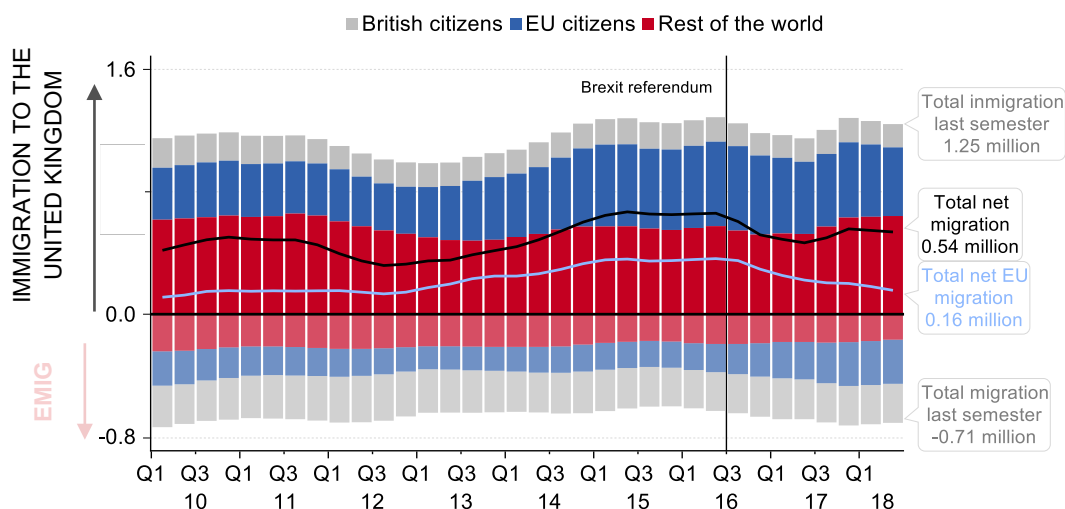
Source: Afi, Macrobond

GDP growth (% year-on-year) and contributions



Source: Afi, Macrobond

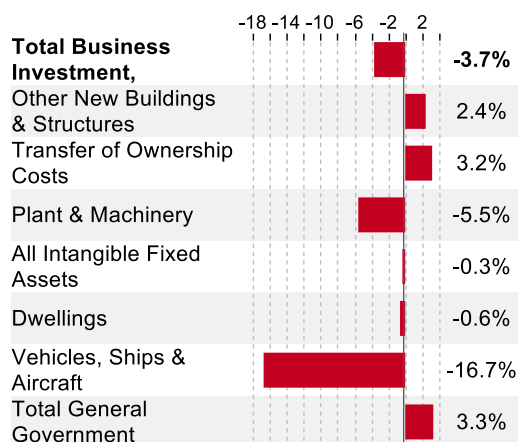
Migration flows of the United Kingdom



Source: Afi, Macrobond

The first challenge for the British economy in this environment (apart from adjusting to Brexit) is how to manage labour market stress, especially in terms of productivity growth, which remains very modest. In addition, to achieve this, the UK faces a second major challenge: how to continue to stimulate business investment, which is beginning to show signs of weakness in an environment of high political uncertainty. Business investment contracted in the second half of 2018, and has been one of the factors responsible for the slowdown in GDP growth in 4Q18, when the economy grew by 1.3% year-on-year.

Year-on-year growth of business investment, by asset, in 4Q18

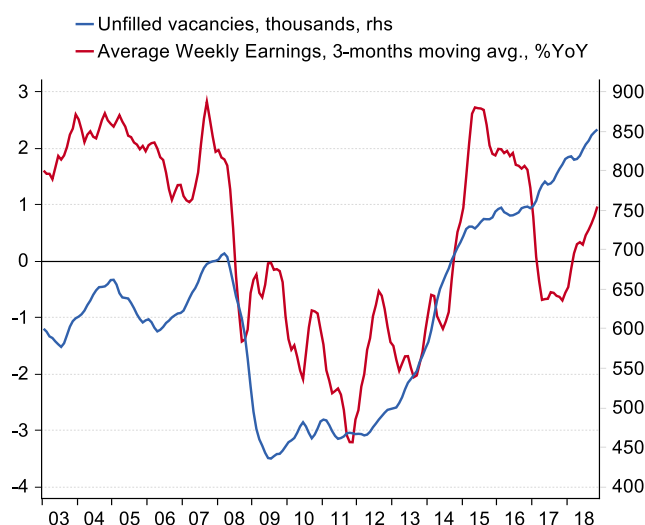


Source: Afi, Macrobond

As for the labour market, any possible increase in employment in an already populated market will have to come from an improvement in the quality of employment, since not only is there room for improvement (as the rate of British underemployment is still relatively high), but also the net entry of workers into the country has fallen sharply following the Brexit referendum (and will cease to be a favourable supply factor if the United Kingdom finally leaves the EU, limiting the entry of workers). This reduction in migratory flows and the gradual fall in unemployment are in turn already reflected in wages which, owing to the low inflation of recent months **and the nominal acceleration (3.4% year-on-year in November, the fastest pace in a decade) have grown again in real terms in 2018.**

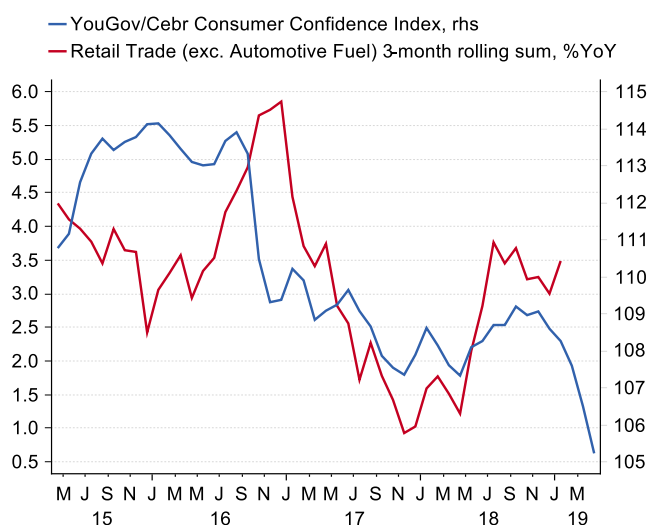
On the other hand, the dynamism of the labour market contrasts with recent confidence data suggesting that political uncertainty is affecting businesses and consumers. **The recent slowdown in retail sales is a cause for concern in an economy where private consumption accounted for more than 65% of GDP in 2017.** The deterioration in consumer confidence also suggests that this weakness could continue into 1Q19. If it does, the increase in households' purchasing power would result in greater precautionary savings, although no increase in the rate of household savings has been observed so far (4.2% in Q318).

Wage growth and vacancies



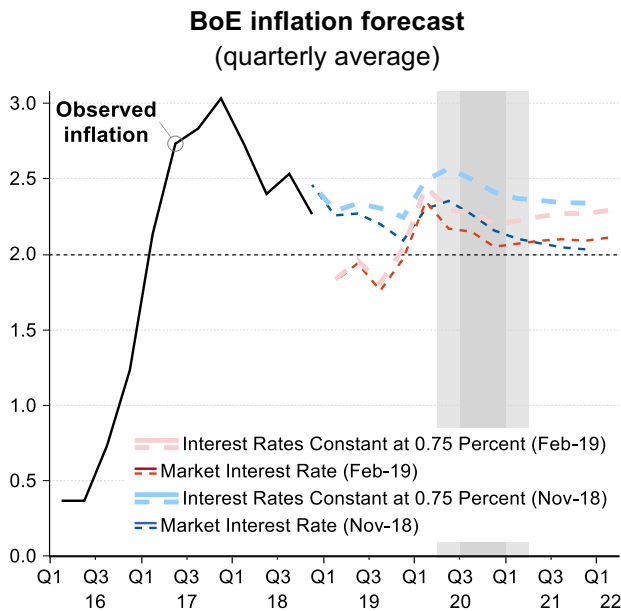
Source: Afi, Macrobond

Retail sales and consumer confidence

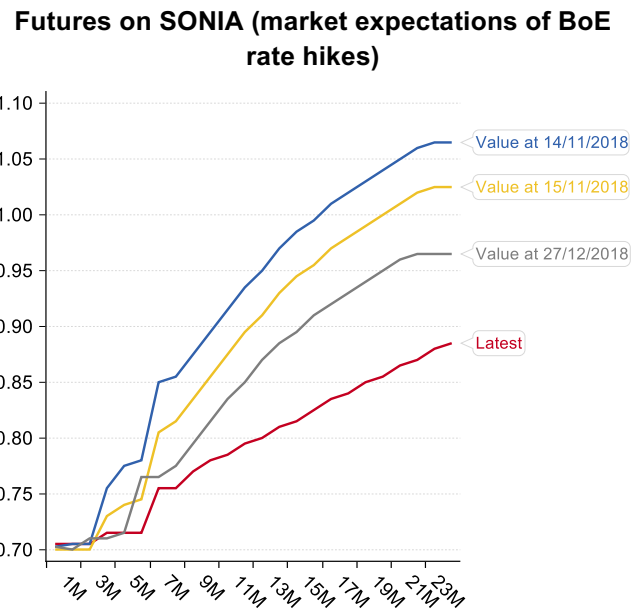


Source: Afi, Macrobond

The persistent increase in unfilled vacancies and the need to improve the quality of employment suggest that wage growth could continue in the coming months. In a context of economic slowdown, this would give rise to inflationary pressures rather than productivity gains. Nevertheless, the Bank of England's *Monetary Policy Committee* (MPC) has been much more optimistic in recent weeks that price tensions will divert it from its 2% inflation target in the medium term (assuming a scenario in which Brexit takes place in an orderly manner with an agreement). These forecasts have allowed the BoE to moderate its tone with respect to future interest rate hikes as well as to widen its scope of action in the event of an abrupt no-deal Brexit, and the need arises to implement an accommodative monetary policy to backstop the economy.



Source: Afi, Macrobond

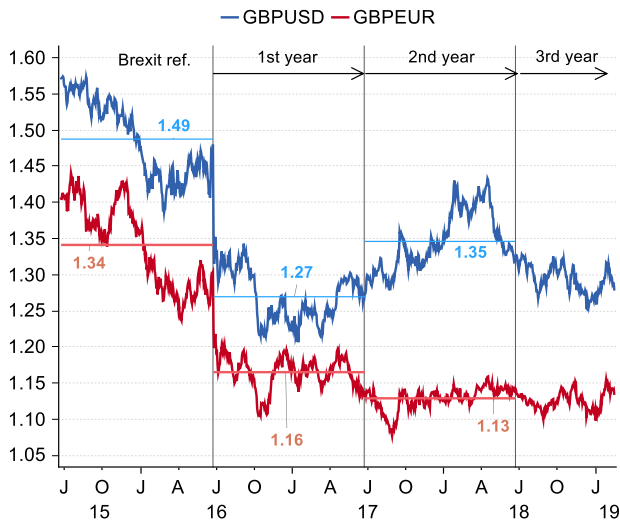


Source: Afi, Macrobond

The financial variable that has been sharply affected by the Brexit effect so far is the currency: the pound depreciated by 13% against the euro in the first year after the referendum and its exchange rate has since been largely determined by expectations about the mode of the UK's exit from the EU. This has become particularly clear in recent weeks: until the recent adoption of the so-called "Brady amendment" (which forced Theresa May to attempt to renegotiate the Irish border backstop with the European Commission) the pound had built up since late last year an appreciation of close to 3.5% against the EUR and the USD, and slightly more than 4% against the Swiss franc. The parliamentary majority against an abrupt, no-deal exit that has come into view since the end of December has given a strong boost to the currency. In any case, trends in trade flows in value and volume indicate that British exporters have not taken advantage of the depreciating pound sterling to export more, but to adjust in price, so that external demand has not been a source of support for growth, in contrast to in previous depreciations of the pound.

Evolution of the GBP against EUR and USD in recent years

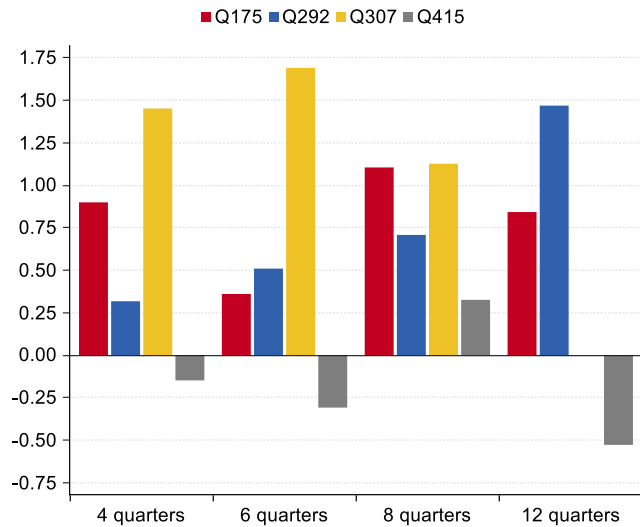
(an increase indicates a depreciation of the pound)



Source: Afi, Macrobond

Contribution of external demand to cumulative GDP growth in periods of GBP depreciation

(percentage points)

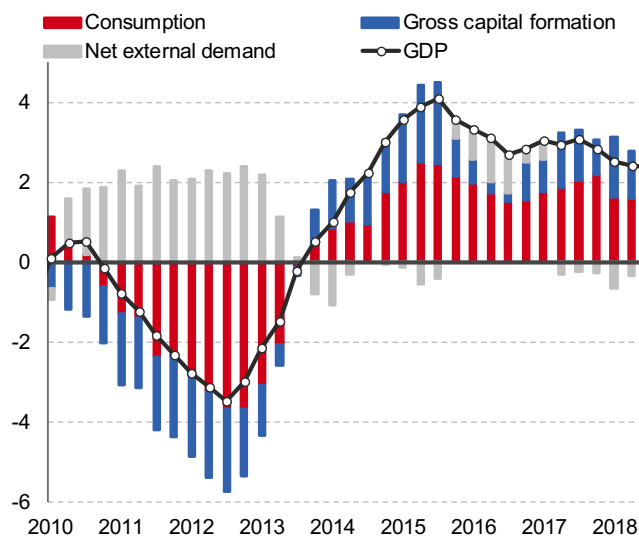


Source: Afi, Macrobond

For its part, in 2018 the Spanish economy has undergone its sixth year of expansion at a healthy pace, based on strong job creation, steady domestic demand and a more sustainable growth pattern thanks to the reduction of imbalances. The unemployment rate has fallen by more than ten points from its peak level, but remains among the highest in the European Union. The dynamism of growth has so far been compatible with the maintenance of a current account surplus, which allows for gradually reducing the country's debtor position vis-à-vis the rest of the world. This improvement in the performance of the external sector is reflected in the increase in the share of exports and imports in GDP, which reached 34.3% in 2017, nearly twelve percentage points higher than in 2009. Reducing the indebtedness of non-financial enterprises and households bolsters their financial position and enhances the sustainability of their spending on consumption and investment.

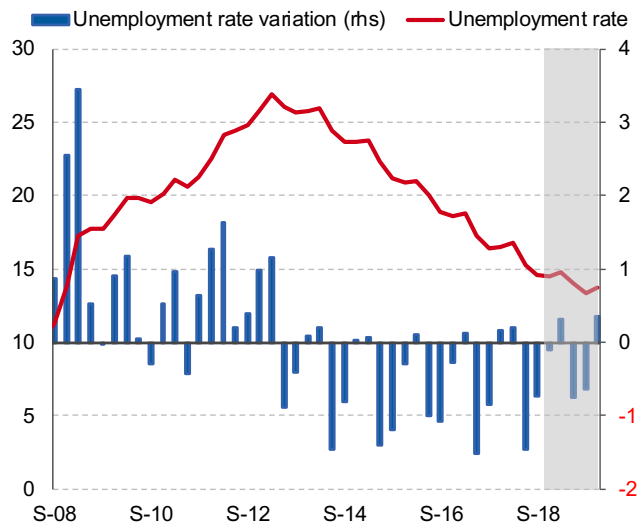
The steadiness of domestic demand has allowed the Spanish economy to end 2018 with an annual growth rate of 2.5%, which is 0.7% higher than the euro area as a whole, despite the abrupt turnaround of activity in the core economies of the area in the latter part of the year. However, this resilience has coexisted with a certain loss in the quality of growth, which is reflected in the negative contribution of external demand and in the negative trend in productivity. Lesser dependence on external demand can be a symptom of strength in a difficult external environment. However, for growth to be sustainable and unemployment to be brought down to levels closer to the European average, productivity gains and the contribution of external demand must be reactivated in the course of 2019.

GDP growth of Spain
(year-on-year change and contributions)



Source: Afi, INE

Unemployment rate in Spain (percentage of the active population and change in percentage points)



Source: Afi, INE

2. Stock of Spanish FDI in the United Kingdom

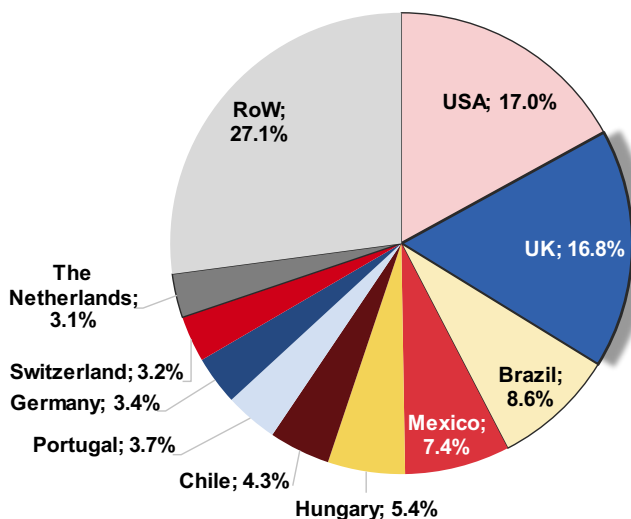
The UK is the second largest destination for Spanish Foreign Direct Investment (FDI), with a position that has almost doubled since 2007.

According to data from the Investment Register of the Secretary of State for Trade of Spain¹, the United Kingdom represents 16.8% of the total stock of Spanish FDI in 2016 (77,077 million euros²). This figure is slightly lower (less than 4,100 million euros) than the historic peak of 81,156 million euros of 2015, in which the United Kingdom was the number one destination of Spanish investment abroad.

Despite this small decrease, **Spain's investment activity in the British market has remained solid to date**. Despite the fact that stock data only reach 2016, our analysis of Spanish investment flows to the United Kingdom below covers up to the third quarter of 2018 and reveals that the volume of investment to date has proved resistant to political uncertainty. Given the early timing of investment decisions, this development does not guarantee that a negative effect of Brexit will not materialise in the future.

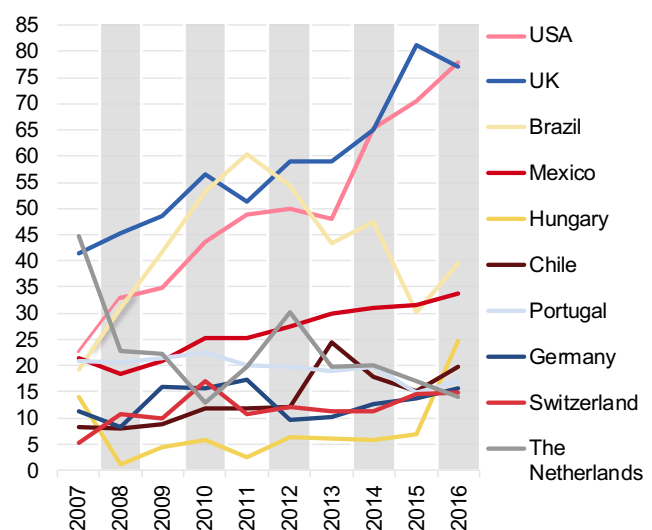
The forward-looking analysis of our survey of Spanish enterprises with an investment presence in the UK reveals greater investor caution, at least until the manner in which the UK will leave the European Union is finally defined, so the historical trend may vary. In one way or another, what is already a reality is that so far no country has managed over the years to attract a larger amount of Spanish investment than the United Kingdom. Since the start of the series in 2007, the British market has been the main repository of Spanish FDI in seven of the ten years compiled by the Secretary of State for Trade.

Stock of Spanish FDI abroad in 2016, by country
(percentage distribution)



Source: Afi, Secretary of State for Trade

Historical evolution of stock of Spanish FDI, by country (€ bn of euros)



Source: Afi, Secretary of State for Trade

¹ The Investment Register produces statistics on the position (stock) and gross and net investment flows from the declarations of enterprises resident in Spain with foreign shareholdings or with stakes in companies abroad. The statistics comply with the *OECD Benchmark Definition of Foreign Direct Investment* in order to obtain data broken down by countries and sectors according to directional criteria (perspective of the enterprise making the investment).

² According to data from the *British Office for National Statistics*, in 2017 the stock of Spanish investment in the United Kingdom amounted to 50,216 million pounds (57,324 million euros at the exchange rate of 1 February), representing 3.8% of the total foreign investment position in the United Kingdom.

3. Stock of Spanish FDI in the United Kingdom by sector

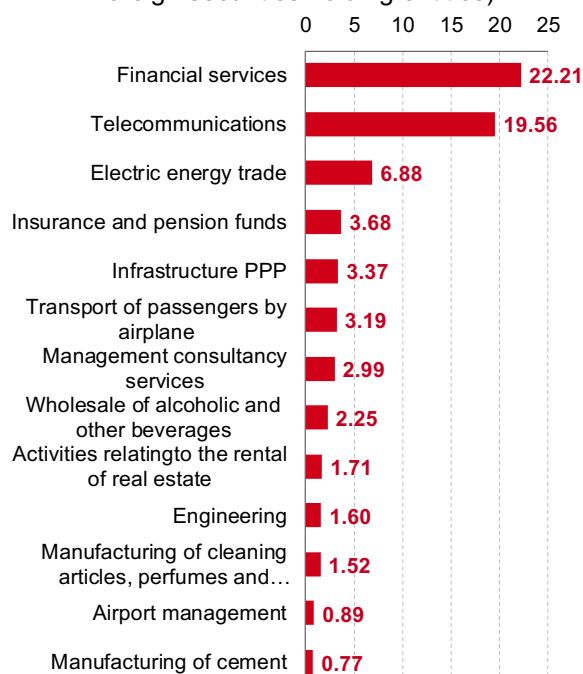
The stock of Spanish FDI accumulated in the United Kingdom is concentrated in the financial services, telecommunications, electricity trading, insurance, infrastructure concessions and business consultancy sectors.

The stock of Spanish FDI accumulated in the United Kingdom is mainly focused on the financial services (22,211 million euros), telecommunications (19,559 million euros) and electricity trading (6,876 million euros) sectors.

Furthermore, as a percentage of the overall stock of Spanish investment abroad, investment in the United Kingdom is particularly significant in the passenger transport sector (in both air and bus, sectors with a combined investment of more than 3,300 million euros of FDI, representing 99% of the stock of foreign investment by Spanish companies in the sector). Also noteworthy are engineering services and the wholesale trade in beverages, where the United Kingdom holds more than 80% of Spain's foreign investment stock, in both cases worth more than 1,500 million euros.

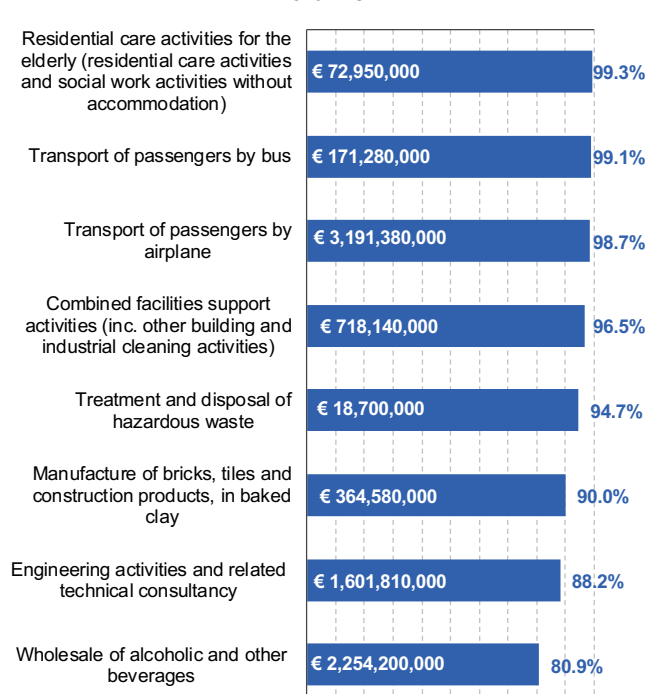
In addition, other sectors where commitment to the UK is also particularly strong, despite smaller stocks, are the elderly care sectors (with or without residential accommodation, where the UK accounts for 99.3% of what the sector has invested abroad), comprehensive building services (cleaning and other activities, 96.5%) and hazardous waste treatment (94.7%). In short, the UK is a particularly attractive market to invest in for many of Spain's most productive and value-added industries, many of which have so far barely considered investing outside the UK market.

Stock of Spanish investment by sector in 2016 (€ bn of euros, excluding investment made through foreign securities holding entities)



Source: Afi, Secretary of State for Trade

Percentage of stock of Spanish FDI in the United Kingdom out of sector's total FDI and final volume.

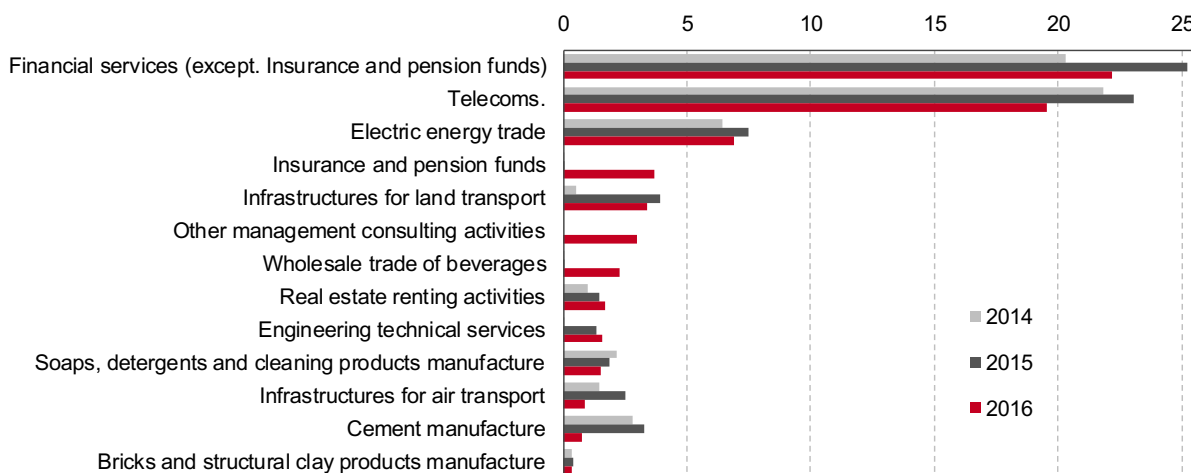


Source: Afi, Secretary of State for Trade

In financial services, the stock of Spanish FDI exceeded 20,000 million euros in the last three years for which data are available. Also significant is the upturn in business management consultancy activities, the beverage wholesale trade and the insurance sector.

Cumulative stock of Spanish FDI in UK by sector in 2014, 2015 and 2016

(excludes investment through foreign securities holding entities ("ETVE" in Spanish) in € bn of euros)



Source: Afi, Secretary of State for Trade

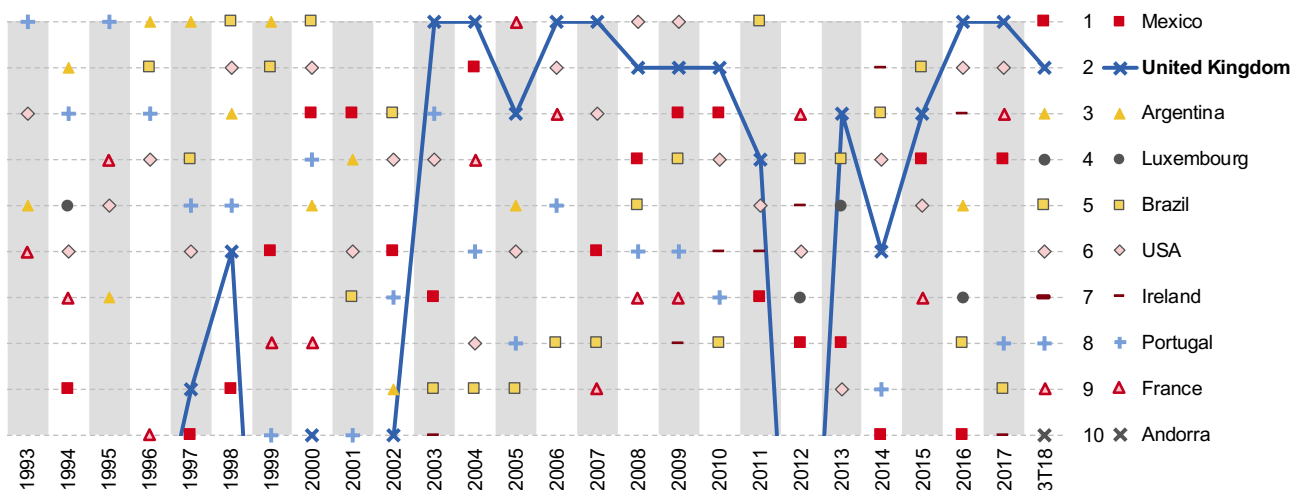
4. Total cumulative cash flows through the first half of 2018

The United Kingdom accounts for the largest volume of Spanish FDI flows since the beginning of the historical series (1993). In addition, the flow of Spanish investment in the United Kingdom rebounded in the expansive phase of the Spanish economy and, up to the third quarter of 2018, does not appear to have suffered any sharp downturn attributable to Brexit. In effect, flows to the United Kingdom were the largest of all Spanish FDI in 2016 and 2017 and the second largest in the first three quarters of 2018.

In cumulative terms, the United Kingdom has received more than 141,000 million euros of Spanish FDI (Gross Investment excluding operations carried out by foreign securities holding entities), or 18.6% of total Spanish FDI flows in the period from 1993 to the third quarter of 2018. In the nine quarters since the Brexit referendum (from the third quarter of 2016 to the third quarter of 2018) Spanish investment flows to the UK totalled more than 36,000 million euros, more than 25% of Spanish FDI flows worldwide in that period.

Year after year, the UK has consistently ranked among the top investment destinations for Spain (in gross terms) and since the start of the historical series in 1993 it has ranked first in six of the last 24 years (2003, 2004, 2006, 2007, 2016 and 2017) and second in four other years. The volume of Spanish FDI flows to the UK has been increasing steadily since 2014 and, despite the obvious concern about Brexit, the slowdown in 2018 seems more closely related to an overall decline in global FDI - and Spanish FDI in particular - than to a waning in Spanish investors' interest in the British market. According to the United Nations Conference on Trade and Development (UNCTAD), global gross FDI flows fell by 19% in 2018 compared to 2017 and by up to 40% in the case of flows received by Europe. However, both the UK and Spain managed to buck this trend, with growth rates of 20% and 269% on the previous year, respectively.

Ranking of Spanish FDI flows by country and year
(excludes investment made through a foreign securities holding entity)

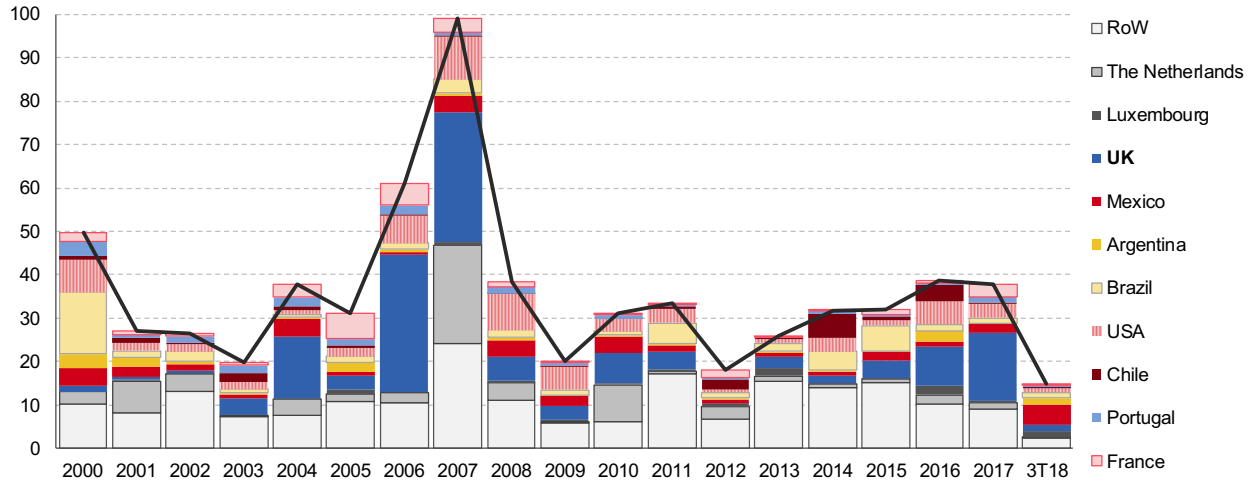


Source: Afi, Secretary of State for Trade

The United Kingdom has managed to accumulate the largest volume of Spanish investment flows by a wide margin (141,000 million euros compared to the 73,938 million euros of Spanish investment accumulated by the Netherlands and 70,765 million by the United States), demonstrating the interest of Spanish companies in staying in the British market with the perspective of generating business at least in the medium term, depending on the type of Brexit undertaken and any regulatory divergence occurring between the two countries. The years in which Spanish investment reached its highest levels in global terms, 2006 and 2007, were characterised by a strong volume of investment towards

the UK (31,487 million in 2006 - greater than the combined investment to the rest of the world in the year - and 30,043 million euros in 2007, the largest Spanish investments that any country has ever received in a single year).

Gross Spanish FDI flows by country through to the third quarter of 2018
(€ bn of euros, last country criterion, excluding foreign security holding entities)



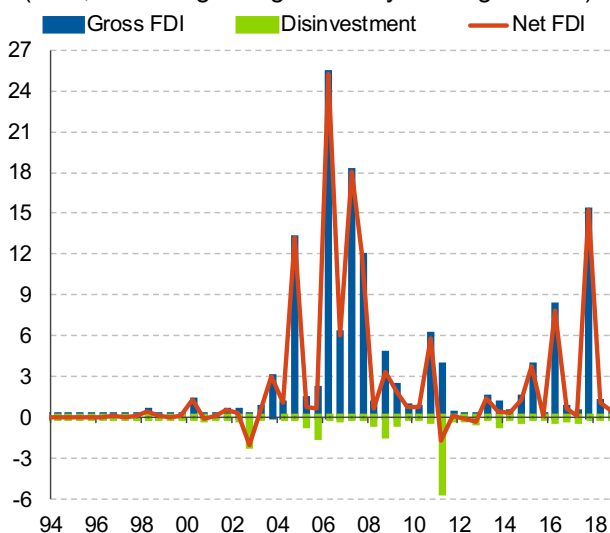
Source: Afi, Secretary of State for Trade

Moreover, the nature of Spanish investment in the UK is predominantly productive, as shown by the fact that most of it is not made through a foreign security holding entity (that is, it is not carried out through an entity holding foreign securities, companies that benefit from a special tax regime that exempts from tax dividends or capital gains obtained by holding shares or holdings in foreign companies).

Another feature of Spanish investment in the United Kingdom is the scant disinvestment flows in the historical series, which has made net investment flows positive and explains the systematic increase in the stock of Spanish FDI in the country. The available data (up to 3Q18 inc.) shows no significant disinvestment in the United Kingdom. Nevertheless, it is true that some disinvestments undertaken in the last two years have been related to political uncertainty, and our survey reveals that concern about this is elevated, and the trend may continue in the coming quarters depending on the type of Brexit that ultimately takes place.

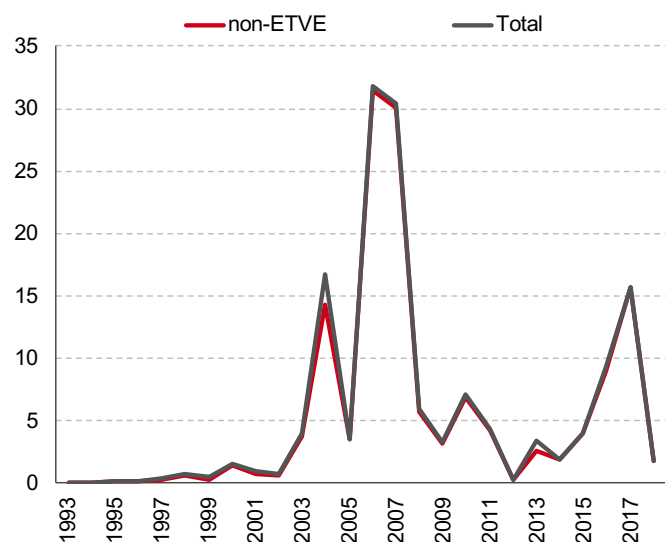
Spanish FDI flows to the United Kingdom up to 3Q18

(€ bn, excluding foreign security holding entities)



Source: Afi, Secretary of State for Trade

Spanish FDI flows to the UK by type of entity up to 3Q18 (€ bn)



Source: Afi, Secretary of State for Trade

5. Spanish FDI flows by sector

Spanish investment in the United Kingdom is especially focused on the services sector, where it is also highly diversified (financial sector, retail, technical advisory and support activities and so on). Although there are industrial sectors that are also attractive for Spanish investors, such as the manufacture of beverages, cement or the chemical industry, the British financial sector has been the main pole of attraction for Spanish investment in the country, both in volume (more than 29,000 million euros) and for its regularity and consistency over the years.

Spanish investment in the UK has been particularly attracted by the strength of the British financial sector and monetary and credit intermediation banking activities have had Spanish investment flows in every year since 1993. In addition, the three economic categories (CNAE in Spanish) related to financial services (the financial services category, which includes monetary and credit intermediation banking activities, the ancillary activities category, which mainly comprises fund management; and the insurance, reinsurance and pension fund sector category) accumulated 29,675 million euros in the whole of the historical series. If the City of London were to see an erosion of its position as an international financial centre due to Brexit, one would expect this investment dynamism to diminish in future quarters. However, since 2016, as we will discuss below, the volume of FDI flows received by the financial sector has not decreased. One of the explanations is that part of the activity of Spanish enterprises in the financial sector is centred on the retail business, which in principle is not so affected by Brexit, insofar as it is a business that is more dependent on the strength of the British domestic market and less focused on an international provision of services (as is the case of the majority of the wholesale or investment banking in the City, whose trading or settlement services denominated in euros, for example, are at risk of moving to another geography under the protection of the ECB). Further, the degree of regulatory and supervisory cooperation that is attained following the UK's departure from the EU will also determine the volume of investment in such a heavily regulated sector.

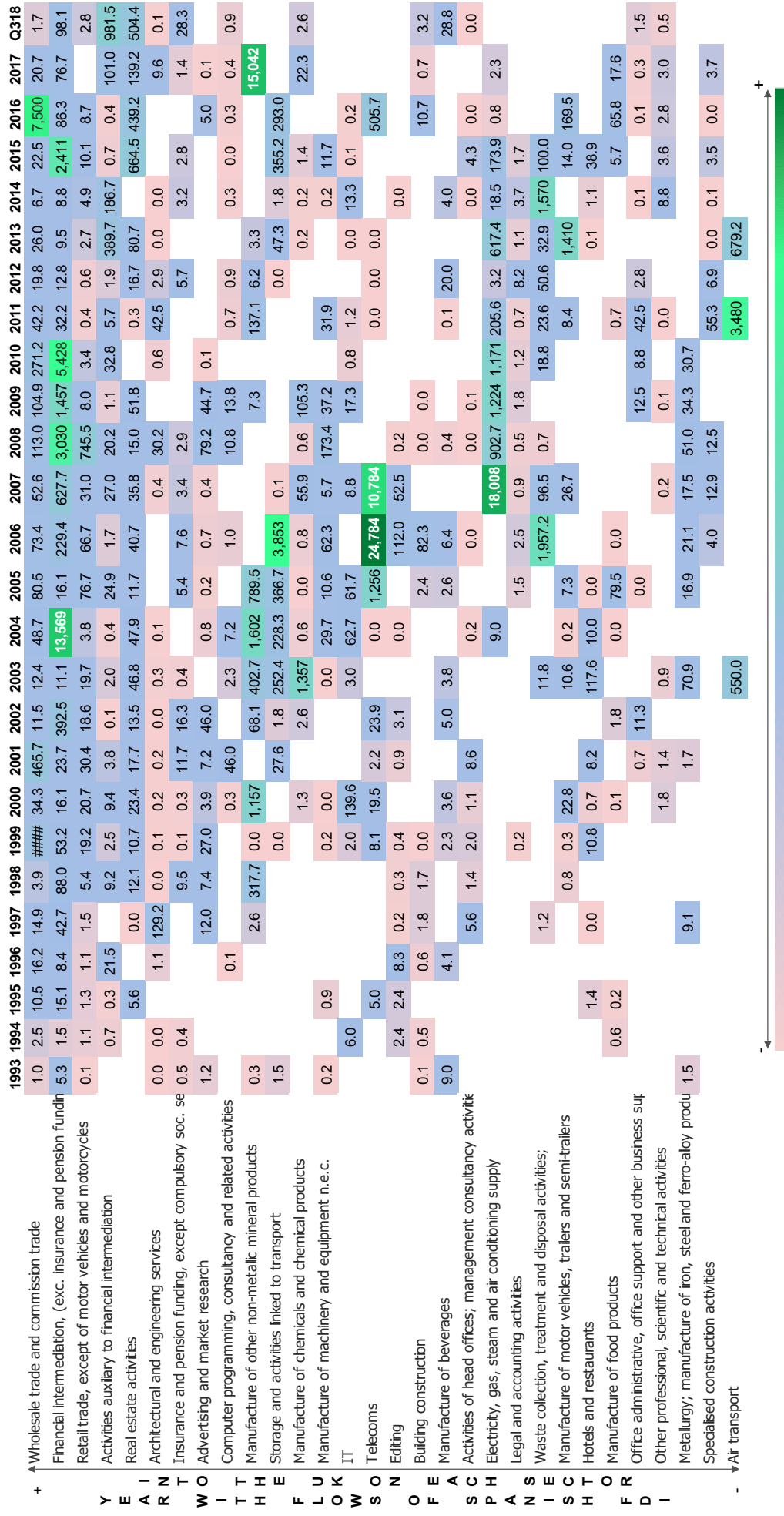
In addition to the financial sector, other sectors stand out, either because of the consistency with which they have received Spanish investment over time or because they have received a high volume of investment. As for the former, the sectors in which Spanish investment has shown the most sustained commitment over the years have been commerce, both wholesale and retail (with 10,253 million euros of accumulated investment between them and a presence, in the case of wholesale commerce, in the 26 years of the historical series), real estate activities (2,177 million euros) or technical services of architecture and engineering (with a lower volume, 217 million euros, but which have had a constant flow in 21 of the 26 years of the historical series). By sub-sectors, within wholesale trade, the sub-sectors of household items, construction materials, clothing and footwear or machinery and equipment are significant. Again, a sharp deterioration in the UK economy in the event of an abrupt Brexit may eventually lead to disinvestment on the part of Spanish retail companies, but this is still uncertain and, as with financial services, the flow of FDI received by the trade sector has not diminished.

The British sectors that have accumulated the highest flows of Spanish investment, apart from financial services, include the telecommunications sector (37,387 million), the supply of electricity, gas, steam and air (22,336 million, mostly trade in the marketing of electrical energy), the manufacture of other non-metallic mineral products (mainly cement, with an accumulated investment of 19,534 million), storage and activities ancillary to transport (5,429 million euros) and air transport (4,708 million, mostly in passenger air transport).

The following double-entry table provides a breakdown of annual Spanish FDI flows by sector since the beginning of the historical series.

Gross Spanish FDI flows to the United Kingdom by sector since the beginning of the historical series

(millions of euros, intermediate country criterion, excl. foreign security holding entities, vertical arrangement corresponds to the number of years with investment flow, colour scale to the amount of annual FDI flow)



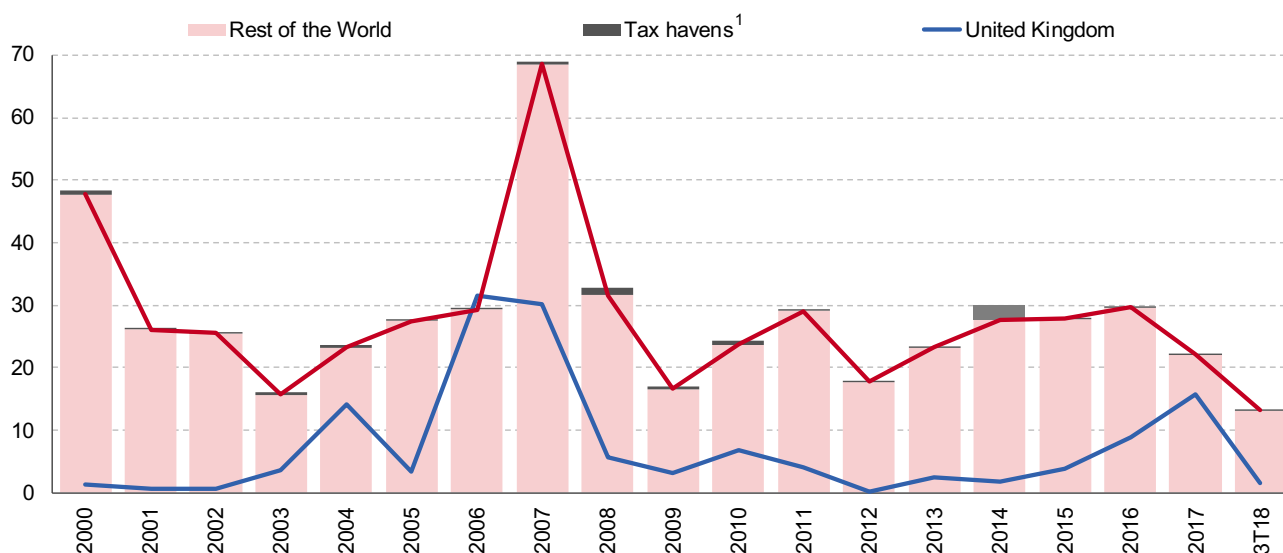
Source: Afi, Secretary of State for Trade

6. Spanish FDI flows since Brexit

Despite uncertainty about the terms on which the UK's exit from the EU will take place, Spanish investor interest in the UK has not so far declined significantly. In 2016 and 2017, the investment trend continued on an upward path, and was focused on the usual sectors. Its decline in 2018 occurred in a manner that was both simultaneous with and parallel to that of the rest of Spanish investment abroad.

Spanish investment in the United Kingdom has, for the time being, been resistant to uncertainty and, since the Brexit referendum, the investment activity of Spanish companies in the British market has not shown any particular clear signs of deterioration. Total Spanish investment abroad rebounded in 2013, after the euro crisis, then stagnated in 2015 and 2016, and declined in 2017 and 2018. Investment flows to the United Kingdom grew uninterruptedly between 2013 and 2017, and it was only in the first three quarters of 2018 that the trend of FDI towards the UK appears to converge with the overall trend of Spanish FDI, and decreased both simultaneously with and in parallel with the latter.

Gross Spanish FDI flows to the United Kingdom and the rest of the world
(running total of 4 quarters, excl. foreign security holding entities, quarterly, € bn of euros)



Source: Afi, Secretary of State for Trade

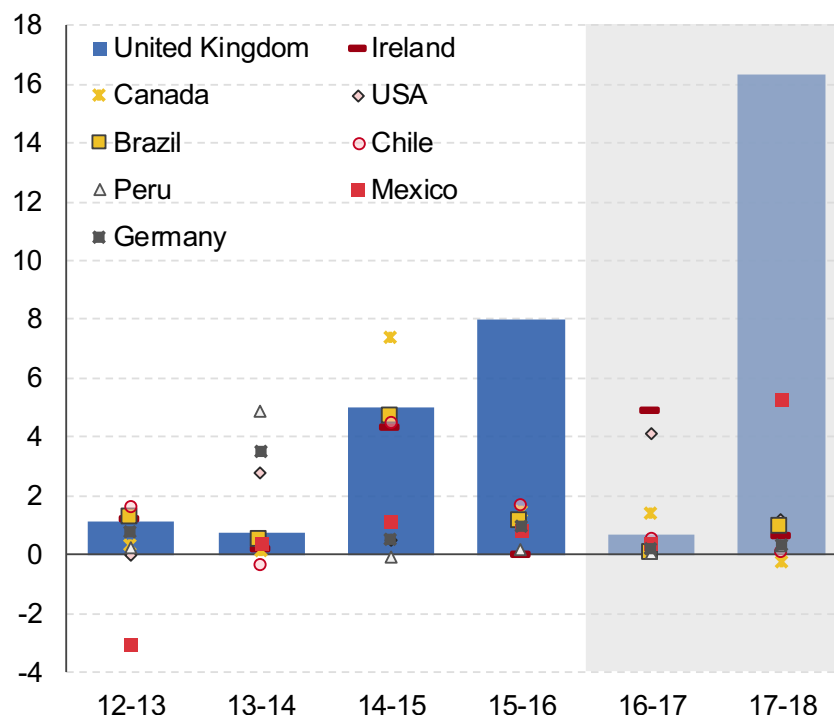
¹Tax havens according to Spanish legislation: Anguilla, Antigua and Barbuda, Bahrain, Bermuda, Brunei, Dominica, Fiji, Gibraltar, Grenada, Guernsey, Isle of Man, Cayman Islands, Cook Islands, Falkland Islands, Northern Mariana Islands, Solomon Islands, Turks and Caicos Islands, British Virgin Islands, United States Virgin Islands, Jersey, Jordan, Lebanon, Liberia, Liechtenstein, Macau, Mauritius, Monaco, Montserrat, Nauru, Saint Vincent and the Grenadines, Saint Lucia, Seychelles, Vanuatu

The performance in the two years since the referendum (from the third quarter of 2016 to the third quarter of 2018, both inclusive) does reveal a decrease in the first year after the referendum, although the strong upturn in flows in that second year would suggest that this trend was not entirely attributable to political uncertainty or, at least, that this uncertainty has not diminished, for now, Spain's investment interest in the United Kingdom.

In any case, although the UK remains above other countries, the decline in 2017 was noteworthy. If we compare the first three quarters of each year (since, at the moment, only the first three quarters of 2018 are available), Spanish investment in the United Kingdom went from 8,303 million euros in 2016 to 534 million euros in 2015; a fall of -93.6% compared to the -46.7% in total Spanish FDI in the period. However, in the first three quarters of 2018 investment increased to 1,657 million euros, a high figure that makes the United Kingdom the second largest recipient of Spanish FDI in the year, but far from the figures that the British market was able to attract in previous years.

Main recipients of net Spanish FDI flows since 2012

(excl. foreign security holding entities, € bn of euros, running total four quarters 3Q-2Q)

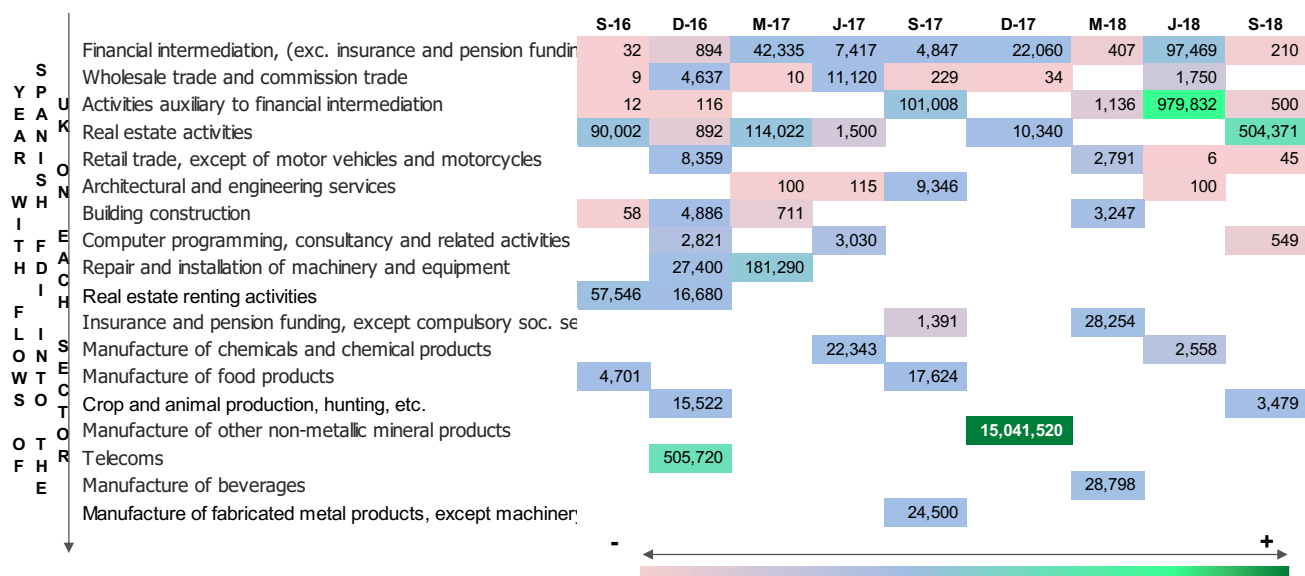


Source: Afi, Secretary of State for Trade

Further, a examination of the sectoral behaviour will reveal no differential pattern since the Brexit referendum suggesting that Spanish investor interest in the United Kingdom has weakened owing to the UK's future exit from the European Union. The financial, wholesale and real estate sectors have continued to receive a constant and substantial flow of Spanish investment, as have technical services in architecture and engineering. Investment in the cement manufacturing sector is also significant.

Gross Spanish FDI flows to the United Kingdom by sector since the Brexit referendum

(thousands of euros, intermediate country criterion, excludes foreign security holding entities, vertical arrangement corresponds to the number of quarters with investment flow, colour scale to the amount of quarterly FDI flow)



Source: Afi, Secretary of State for Trade

7. Effects on employment of Spanish FDI in the United Kingdom

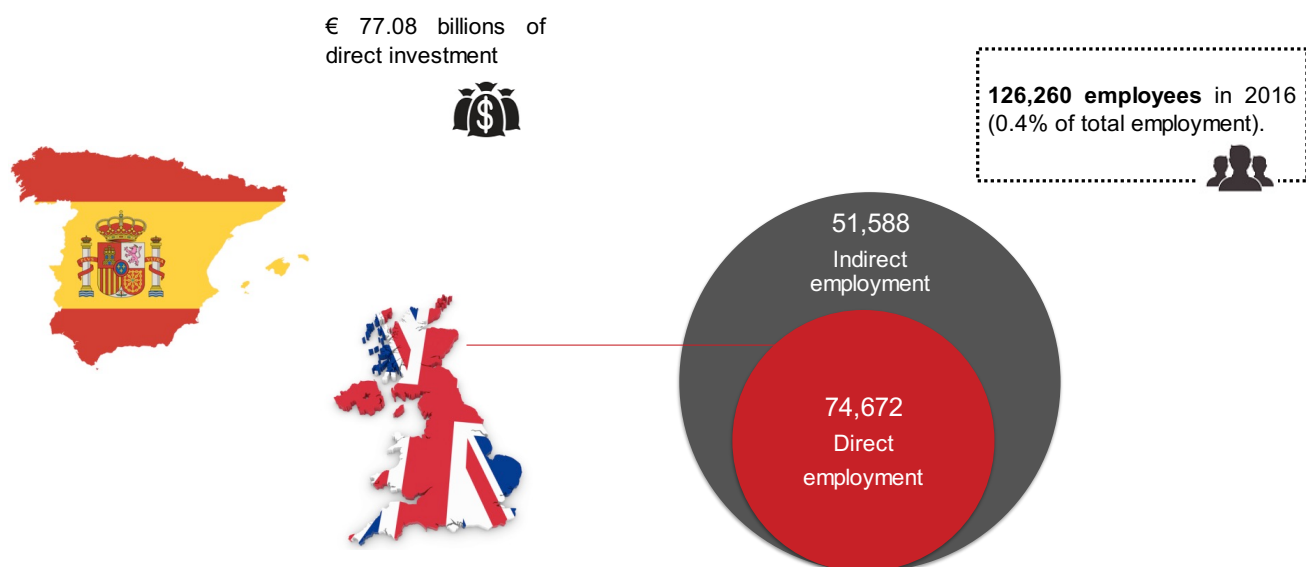
It is estimated that Spanish FDI in the UK contributed to the generation of at least 126,260 jobs in 2016, representing 0.4% of total national employment.

It is estimated that Spanish FDI in the UK contributed to generating a total of at least 126,260 jobs in 2016, representing 0.4% of total employment in the UK.

Of the total employment generated by Spanish investment in 2016, 74,672 jobs are direct employment, while the remaining 51,588 jobs are indirect jobs generated as a result of the knock-on effect in the supply chain.³

The figures for direct employment provided by the Foreign Investment Register show a decrease from 102,354 in 2015 to 74,672 in 2016. Part of this decrease is due to a rules change in the declaration that companies must make for their investment abroad, which eliminated the option of including the employment of the entire consolidated group abroad, in this case of all group companies within the United Kingdom. Direct employment in 2016 only includes that of the Spanish enterprise's own subsidiary and that of the next level of control. Foreign investment in Spain includes one more level in the chain of control, so that the employment figures generated, for example, by British investment in Spain would not be strictly comparable to those of Spanish investment abroad.

Employment generated by Spanish FDI in the United Kingdom



Source: Afi, Secretary of State for Trade

³ Indirect employment has been estimated on the basis of Leontief type I multiplier effects for the different productive branches of the British economy (2014 *Input-Output* Tables).

8. Assessment by Spanish companies in the United Kingdom of the British business climate

This and subsequent sections of the report provide an overview of a sample of Spanish companies with investments in the United Kingdom (more information on the sample is included in the methodological annex). This overview has been obtained through an online survey to ascertain the climate and perspectives of Spanish investment in the British market.

Below is the assessment made by Spanish companies of the business climate in the United Kingdom. First, an overall assessment and perception of change over the past year is provided, and then nine descriptive or defining categories of the business climate are analysed in detail.

8.1. Overall assessment and recent developments

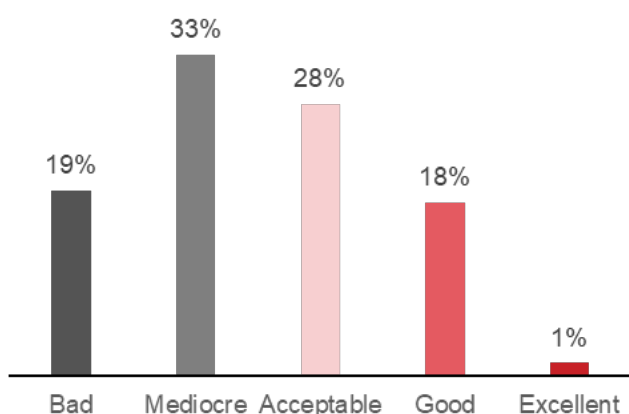
Spanish companies in the United Kingdom give the current British business climate a rating of 2.5 out of 5.

Nearly three out of four companies believe that it has deteriorated in the past year.

The overall assessment by Spanish companies in the United Kingdom of the British business climate is 2.5 out of 5. One in three companies considers it to be mediocre and only 19% rate it as good or excellent.

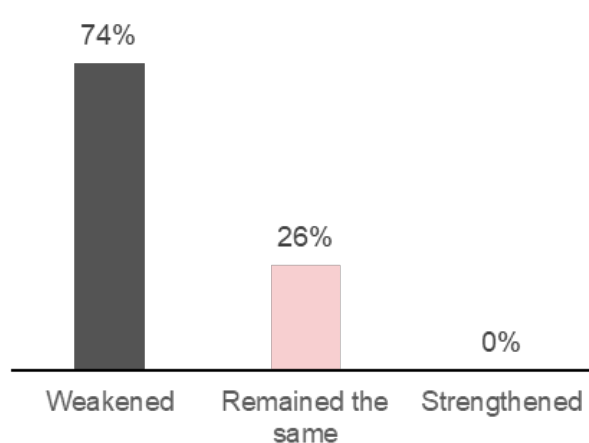
In addition, 74% of Spanish companies perceive that the business climate has deteriorated in the past year. While the other 26% consider that it has not changed. A perception that would be aligned with the climate of uncertainty related to the process of the UK's exit from the European Union.

Overall assessment by Spanish companies of the British business climate
(% responses)



Source: Afi, "Survey of Spanish investment in the UK"

Perceived change in UK business climate over the last 12 months
(% responses)



Source: Afi, "Survey of Spanish investment in the UK"

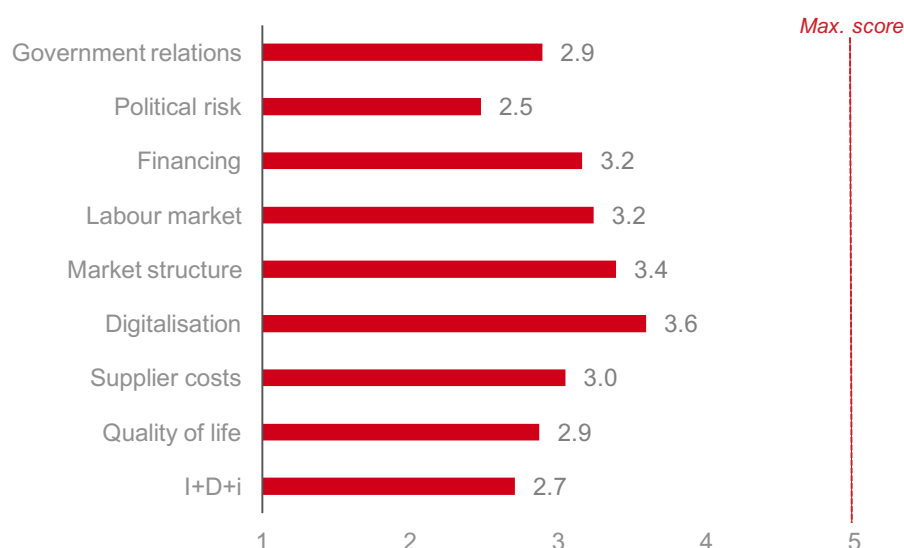
8.2. Assessment of the main aspects of the business climate

Political risk related to institutional stability and territorial cohesion (between different regions of the country) is the worst rated aspect (2.5 points out of 5), while digitisation is best rated (3.6) by Spanish companies in the UK.

The assessment of the business climate in the United Kingdom is conditioned by companies' perception in nine thematic areas: relations with the Public Administration, political risk, financing, labour market, market structure, digitisation, supplier costs, quality of life and R&D&i.

All areas receive a score of at least 2.5 out of 5, although none exceeds 3.6. The worst rated area is that of political risk, in line with what might be expected in view of the future of the Brexit negotiations, to which Spanish companies in British territory are particularly sensitive. On the opposite side is the area of digitisation or digital transformation, where the UK also performs well on other European indicators. It ranks seventh in the European Commission's 2018 Digital Economy and Social Index (DESI) (Spain ranks tenth).

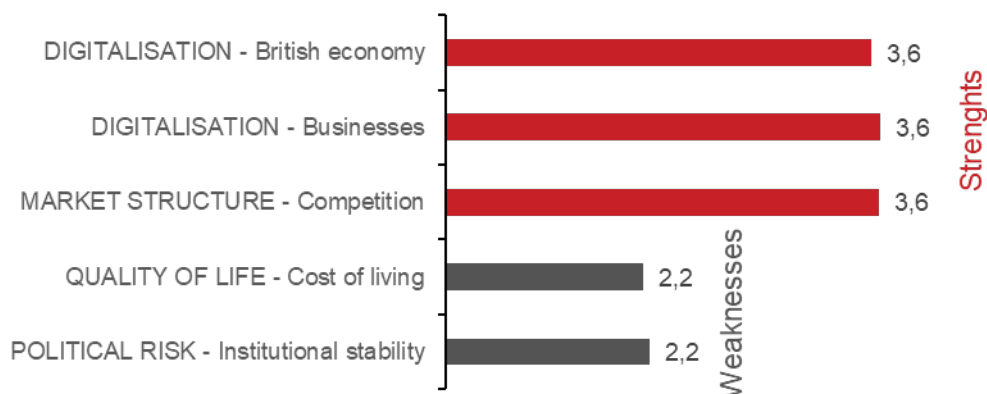
Assessment of the business climate in the UK by thematic area (score based on % of responses, where 1 is bad and 5 is excellent)



Source: Afi, "Survey of Spanish investment in the UK"

Digitisation, both for the UK economy as a whole and for businesses, can be seen as a strength or an attractive aspect of the UK market. Also, the lack of perceived unfair competition associated with the black economy is another strong point. On the other hand, the aspects rated worst by Spanish companies with investments in the United Kingdom relate to institutional stability (within the area of political risk) and cost of living (quality of life).

Main strengths and weaknesses of the British business climate (score based on % of responses)



Source: Afi, "Survey of Spanish investment in the UK"

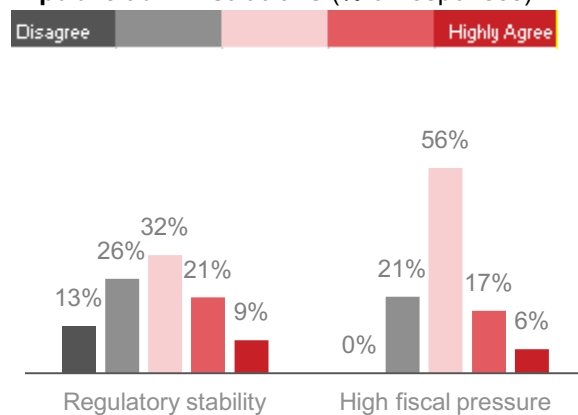
Dealings with Public Administrations

As regards relations with Public Administrations, both the regulatory stability aspect and the high tax burden aspect received a score of 2.9.

The framework for relations with the public administration is defined by the level of regulatory stability existing in the United Kingdom, as well as by the tax burden to which companies are subject.

Both aspects receive a score of 2.9. Some 38.5% of Spanish companies that have responded to the survey say they do not agree or disagree little on the existence of regulatory stability, while another 23% point to a high tax burden.

Assessment of framework for dealings with the public administrations (% of responses)



Source: Afi, "Survey of Spanish investment in the UK"

Political risk

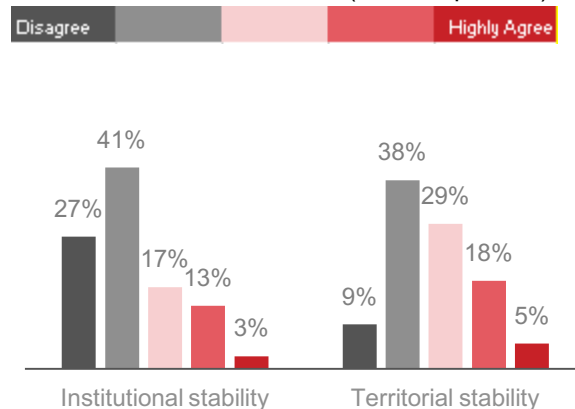
The political risk assessment is negative, given the perception of territorial stability in the United Kingdom (2.7 points) and, to a greater extent, shortcomings in institutional stability (2.2).

Political risk is addressed from the perspective of stability in both institutional and territorial terms.

As has already been mentioned, institutional stability is one of the aspects least valued by Spanish companies (2.2 points). Sixty-eight per cent of those surveyed do not consider that there is currently sufficient institutional stability.

Although high, the percentage of companies that perceive a lack of territorial stability is lower: 47%, resulting in a score of 2.7.

Political risk assessment (% of responses)



Source: Afi, "Survey of Spanish investment in the UK"

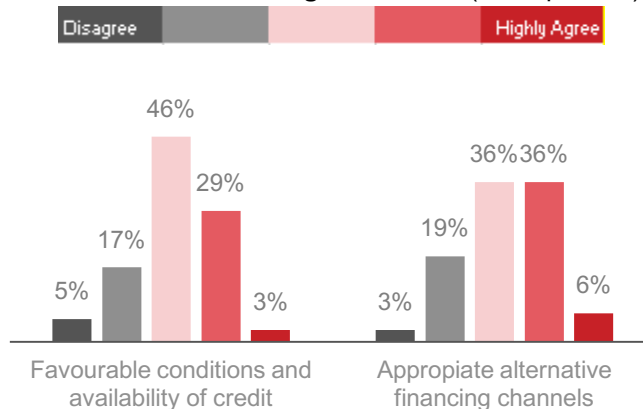
Funding

The assessment of the UK funding framework is positive: in terms of access to bank finance (3.1 points) and the development of alternative funding channels (3.2).

The two aspects that make up the area relating to funding are: the conditions for access to and obtaining of bank loans, with a score of 3.1; and the degree of development of alternative funding channels, which receives a score of 3.2.

Thirty-two per cent of Spanish companies consider accessibility to bank financing to be favourable. At the same time, 42% believe that the current level of development of other funding channels is adequate.

Assessment of funding conditions (% responses)



Source: Afi, "Survey of Spanish investment in the UK"

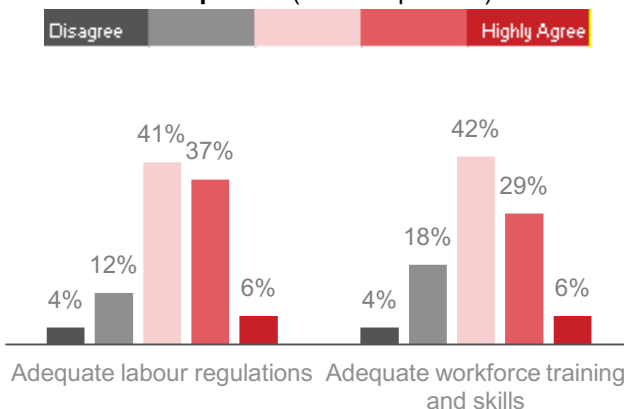
Labour market

The assessment of the British labour market is also favourable. Companies gave a score of 3.3 for labour regulation and 3.2 for how well workers meet business needs.

Spanish companies gave a score of 3.3 to British labour regulations (hiring subsidies, flexibility, labour costs, redundancy costs, etc.), this being one of the most highly valued aspects. Thus, 44% of the companies that responded to the survey consider that the regulation is adequate.

Another aspect that rounds out their view of the labour market is how well adapted workers' skills are to the needs of the company (availability of specialists and qualified workers, level of language proficiency and so on). The score in this area is 3.2, with 35% of companies rating it as adequate.

Assessment of the UK labour market by Spanish companies (% of responses)



Source: Afi, "Survey of Spanish investment in the UK"

Market structure

The lack of perception of unfair competition, or of significant entry barriers scored positively (3.6 and 3.2, respectively).

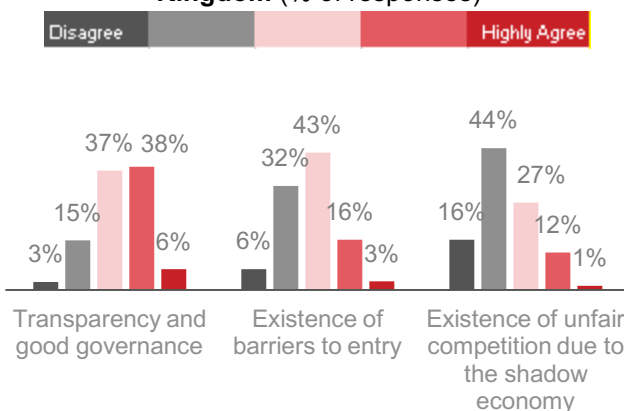
So does the existence of a framework of transparency and good governance in companies' dealings with the British administrations (3.3).

Forty-five per cent of Spanish companies responding to the survey consider that there is a framework of transparency and good governance in their dealings with the British administrations, giving it a score of 3.3.

In addition, 39% of companies do not consider the barriers to entry to the British market (regulatory, derived from the organisation of the market, etc.) to be significant, so the score is also favourable (3.2).

The majority (60%) of companies do not consider that there is unfair competition either (3.6).

Assessment of the market structure in the United Kingdom (% of responses)



Source: Afi, "Survey of Spanish investment in the UK"

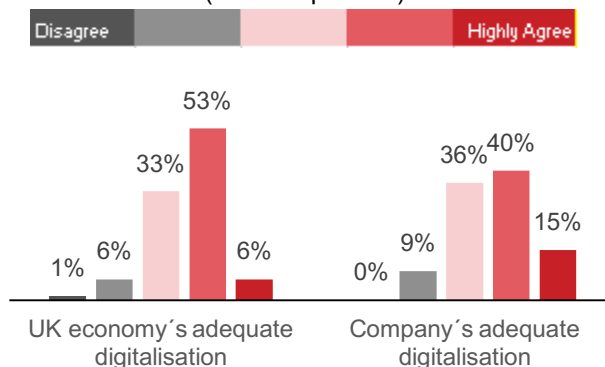
Digitisation

The high level of digitisation perceived with respect to both the British economy and to business itself were given a score of 3.6.

More than half of the Spanish companies operating in the United Kingdom consider that a high degree of progress has been achieved in the process of digital transformation of the British economy (59%) and of business itself (55%).

Both aspects receive a score of 3.6.

Assessment of digitisation in the United Kingdom (% of responses)



Source: Afi, "Survey of Spanish investment in the UK"

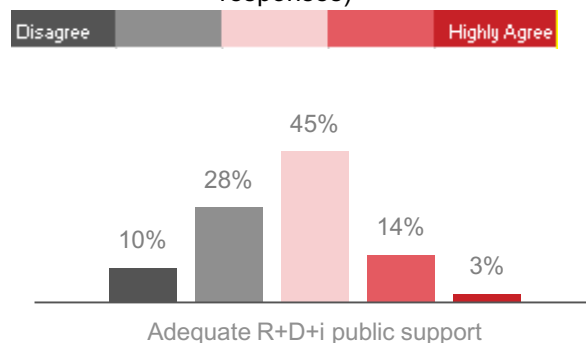
R&D&I

British public support for boosting spending on business R&D&i is considered insufficient, so this area receives a rating of 2.7.

Only 17% of the companies surveyed consider that public support (subsidies, tax incentives) aimed at encouraging R&D&i spending by companies in the United Kingdom are sufficient.

The score received in this area is 2.7. It is granted in a context of declining public expenditure on R&D&i. According to the latest data published by the ONS, government spending on R&D (GERD) fell by 11.2% between 2013 and 2016, although business spending increased by 19.4% in this period.

Assessment of public support for R&D&i expenditure in the United Kingdom (% of responses)



Source: Afi, "Survey of Spanish investment in the UK"

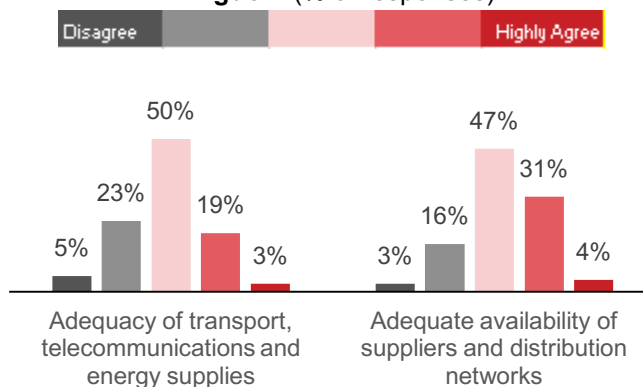
Supplier costs

The availability of supplier and distribution networks in the British market is rated at 3.2. Meanwhile, the degree of adequacy of the main supplies (transport, telecommunications and energy) received 2.9.

The availability, quality and costs of suppliers (mainly of transport, telecommunications and energy services) in the United Kingdom are not perceived as adequate by 28% of Spanish companies responding to the survey, so the survey yielded a score of only 2.9.

More favourable is the opinion on the existence of sufficient supplier and distribution networks for business activity. The score it receives is 3.2, with support from 35% of respondents.

Assessment of the supplier costs in the United Kingdom (% of responses)



Source: Afi, "Survey of Spanish investment in the UK"

Quality of life in the UK

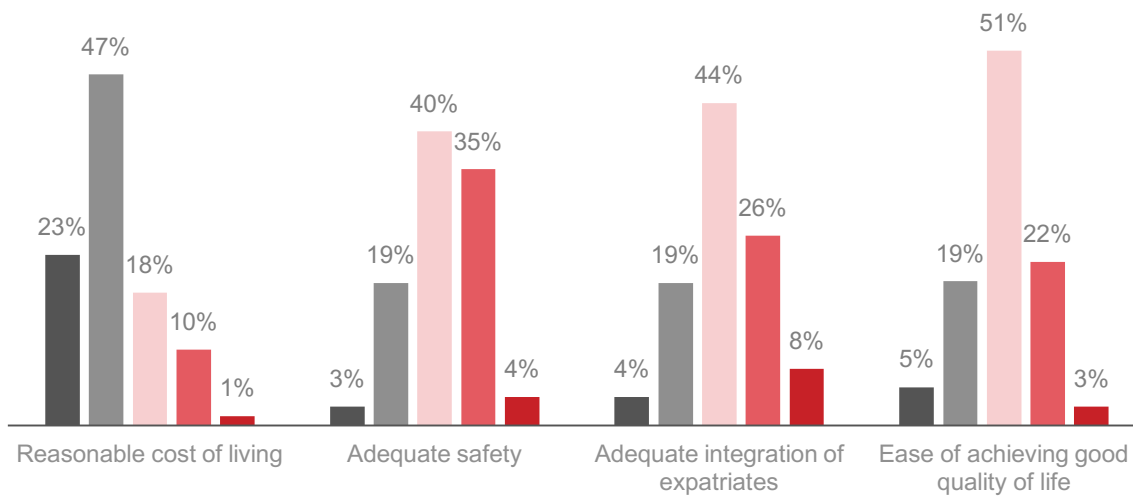
The safety and proper integration of expatriates, with scores of 3.2 and 3.1, respectively, are the best-rated factors related to quality of life in the United Kingdom.

The aspects considered for rating the quality of life in the United Kingdom are as follows: the cost of living, safety, conditions for the integration of expatriates and ease for attaining a good quality of life.

Only the first, the cost of living, receives a score below 3 from Spanish companies doing business in the United Kingdom (score of 2.2). Seventy-one per cent of companies do not consider it to be reasonable. And, as noted above, this is a weakness in the British business climate.

On the contrary, at least one in three companies considers that there is sufficient safety and adequate integration of expatriates. These aspects receive a score of 3.2 and 3.1 respectively. Lastly, the ease of attaining a good quality of life is given a rating of 3.

Assessment of quality of life in the United Kingdom (% of responses)



Source: Afi, "Survey of Spanish investment in the UK"

9. Perspectives of activity in the UK in 2019

This section contains the assessment of Spanish companies with investments in the United Kingdom on the expected performance of the British economy and of the company's own activity (in terms of revenue, employment and investments) for 2019.

The investments that Spanish companies are planning to implement in the British market this year are also the object of a detailed analysis to determine their sectoral, geographical and temporal profile.

9.1. British economy and business performance

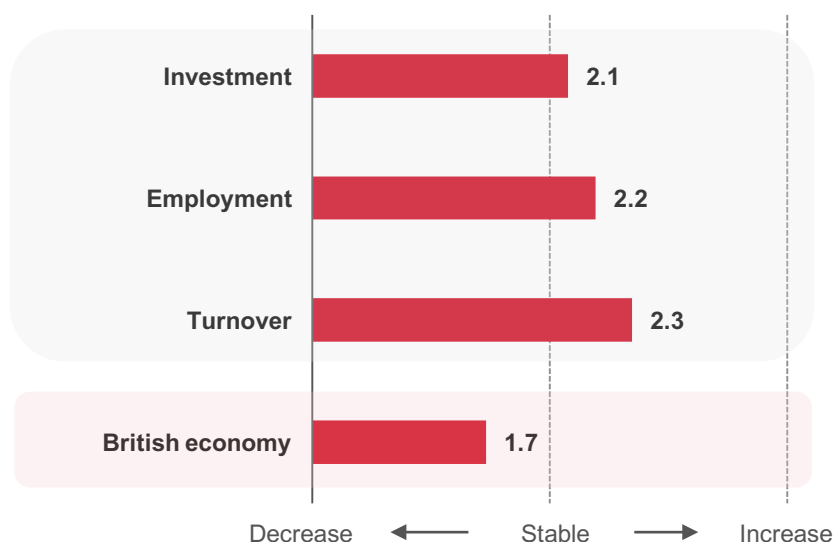
Spanish companies established in the United Kingdom have a favourable perspective for business activity in 2019. In addition, their expectations for the growth of the British economy are better.

More than half of the companies expect their turnover in the British economy to increase this year.

The perspectives of Spanish companies on their activity for the whole of 2019 are positive, showing a rating higher than 2 points out of 3. Specifically, business turnover shows the best expected performance.

For their part, companies' expectations of the growth of the British economy are more modest, in the current context of Brexit, standing at 1.7 out of 3. Nearly half of the companies responding to the survey (47%) expect lower economic growth.

Perspectives on the growth of the British economy and the business activity of Spanish companies in the United Kingdom (score based on % of responses, where 1 is decrease and 3 is increase)



Source: Afi, "Survey of Spanish investment in the UK"

However, more than half of the companies (53%) expect an increase in their turnover in the UK this year. At least 55% also expect their employment levels and investments in the British market to remain stable.

Only 18% of companies expect to reduce their turnover in the UK in 2019. This is the same percentage as those who expect a fall in investments. And with respect to employment, only 13% of companies have short-term plans to reduce their workforce.

9.2. Business investments planned for 2019

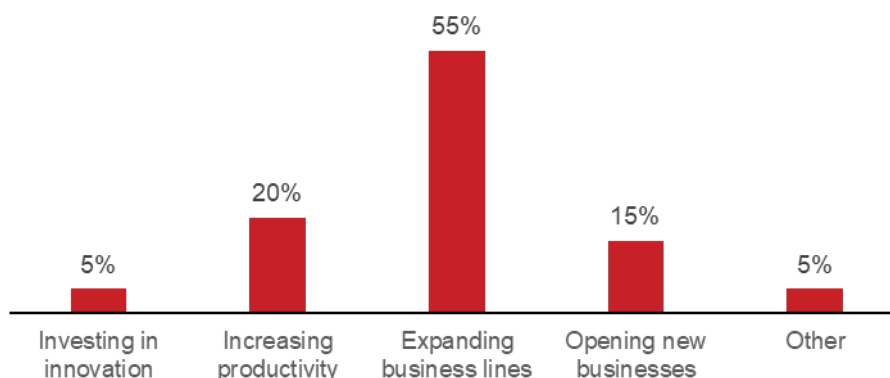
One in four Spanish companies plans to increase its investment in the UK in 2019.

Most of them have as their main objective the expansion of their lines of business, and "other services" is the most significant target sector. Among the activities to which they will allocate resources are marketing actions and the development of new products.

All the regions of the United Kingdom will receive Spanish investment, although the most significant are England and Greater London.

Twenty-six per cent of Spanish enterprises responding to the survey expect to increase their investments in the British market in 2019. The expansion of the business line is the most frequent investment objective, found in 55% of respondents. Albeit to a lesser extent, the increase in productivity (20% of responses) and the opening of new business (15%) are also cited as motivations to invest.

Main objectives for expanding Spanish investments in the United Kingdom (% responses)

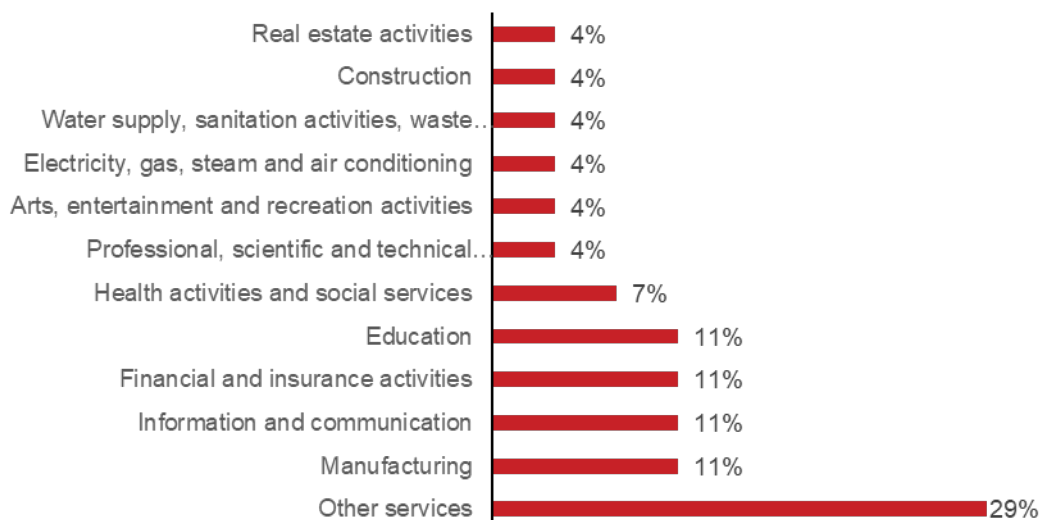


Source: Afi, "Survey of Spanish investment in the UK"

As for the sectoral profile, "other services"⁴ is named as the recipient of investments by Spanish companies in the United Kingdom for 2019 in 29% of responses (a single company may invest in different sectors). Other main sectors chosen are education, finance and insurance, information and communications, and manufacturing (11% of responses each).

⁴ The heading "other services" includes: "activities of membership organisations", "repair of computers and personal and household goods"; and "other personal service activities".

Sectoral distribution of Spanish investments planned in the United Kingdom (% responses)



Note: sectors according to Spain's National Classification of Economic Activities (CNAE-2009) at single-digit level.

Source: Afi, "Survey of Spanish investment in the UK"

Specific activities towards which investments in the British market will be targeted include new marketing actions (34% of responses) and the development of new products (25%), which would reinforce the competitive capacity and the will of Spanish companies to stay in this market, in spite of the perspectives of lower economic growth mentioned for this year.

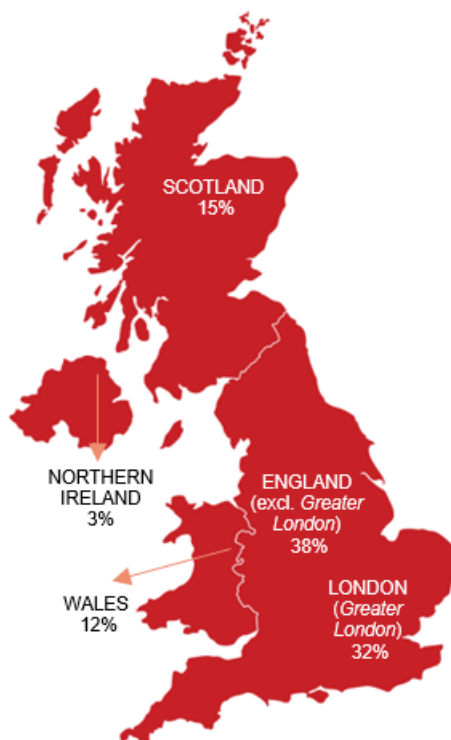
Destination activities of Spanish investments planned in the United Kingdom (% responses)



Source: Afi, "Survey of Spanish investment in the UK"

Geographically, many of the planned investments relate to locations other than the Spanish company's headquarters in the United Kingdom, with reasonable territorial diversification. Although all the British regions are on the investment radar, England (excluding Greater London) is mentioned in 38% of cases as an investment destination and Greater London in another 35% (bearing in mind that a single company may have more than one investment destination).

Territorial distribution of Spanish investments planned in the United Kingdom (% responses)

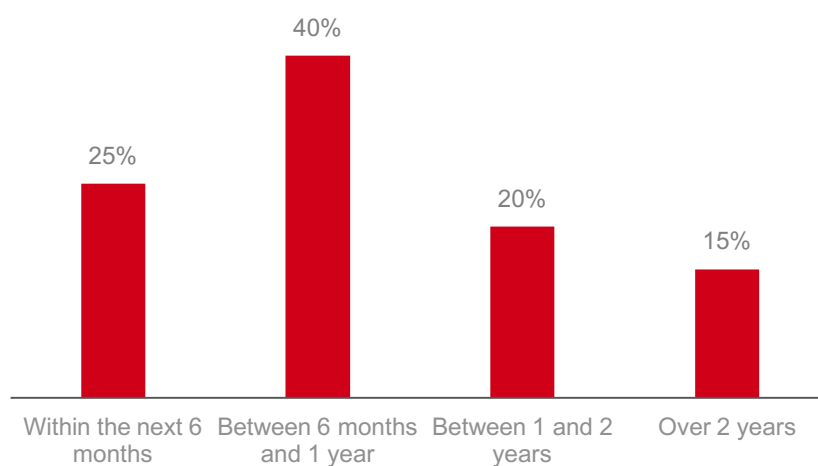


(*) A single company may offer several answers when it plans to invest in more than one country/region or the whole of the United Kingdom.

Source: Afi, "Survey of Spanish investment in the UK"

With respect to the estimated time frame for the investments planned in the United Kingdom, 65% of companies will have a time horizon of up to one year, clustered mainly between 6 months and 1 year.

Planned time frame for increasing investment in the United Kingdom (% responses)



Source: Afi, "Survey of Spanish investment in the UK"

10. Perception of the impact of Brexit

The exit of the United Kingdom from the European Union is of vital importance for Hispano-British economic and trade relations and, in particular, for the interests of Spanish companies with investments in the British market. Hence the opportunity to report in this section companies' perceptions of the impact of Brexit on their business and investment plans in the United Kingdom.

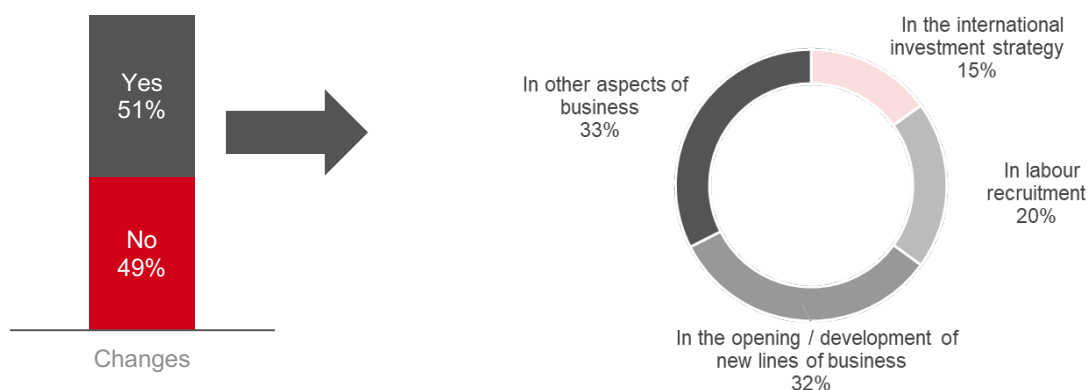
10.1. Impact on business investment plans in the United Kingdom

Half of Spanish companies have changed their policy for investing in the United Kingdom since 2016.

Fifty-eight per cent of companies do not expect Brexit to affect their UK investment plans for 2019. Although for many among the 43% that say that it will have an influence, the impact may be significant.

Two and a half years after the referendum on whether the United Kingdom should remain in the European Union, half (51%) of the Spanish companies established in the British market claim to have made significant changes in their investment policy in that market. These are mainly changes in the opening or development of new business lines (32% of responses), as well as in other business aspects (33%).

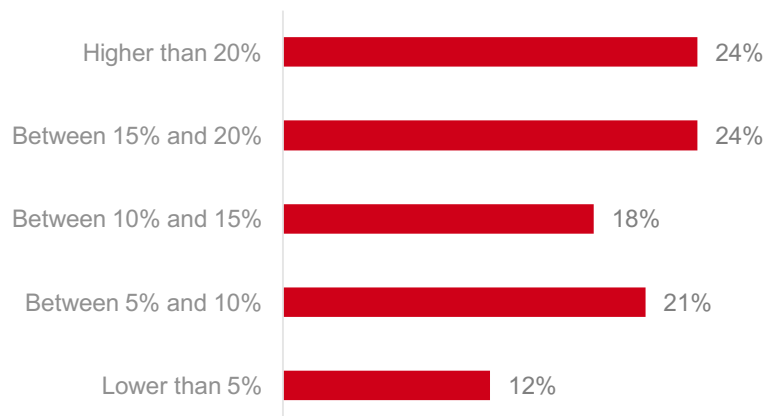
Existence of significant changes in the company's policy regarding its investment in the United Kingdom since the beginning of the Brexit negotiation (% responses)



Source: Afi, "Survey of Spanish investment in the UK"

The majority of Spanish enterprises do not expect Brexit to affect their UK investment plans for 2019. However, some 40% believe they might scale back their investments.

Intensity of impact expected by Spanish companies that consider that Brexit will affect their investment in the United Kingdom in 2019 (% responses)



Source: Afi, "Survey of Spanish investment in the UK"

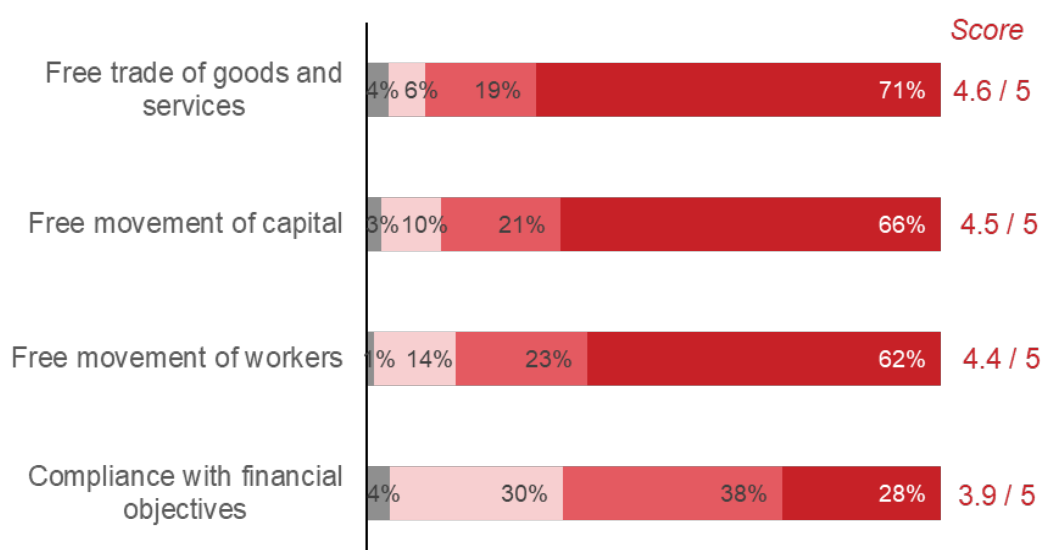
10.2. Issues viewed as critical in the Brexit negotiations

Free trade in goods and services is considered by Spanish companies to be of the utmost importance in the Brexit negotiations, with a view to mitigating the impact on economic relations between Spain and the United Kingdom.

Among the key aspects of the Brexit negotiation, 71% of Spanish companies attach the utmost importance to free trade in goods and services. This aspect receives an overall score of 4.6 points out of 5.

The free movement of capital and the free geographical mobility of workers are also given the highest score by more than 60% of companies. Their overall rating is 4.5 and 4.4, respectively.

Assessment of the importance that should be given to different aspects of the Brexit negotiation to mitigate the impact on economic relations between Spain and the United Kingdom (score based on % of responses)



Source: Afi, "Survey of Spanish investment in the UK"

10.3. Opinion of government actions

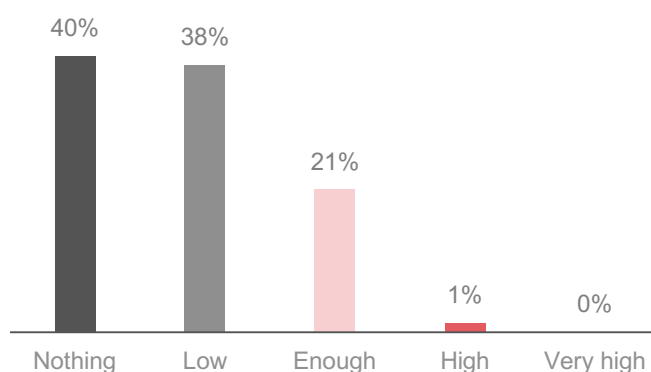
There is a low rate of perception as to whether the British government is taking into account the views of Spanish companies in the UK in the Brexit negotiations.

One area in which Spanish companies would like more government support is the development of contingency plans.

The degree to which the British Government's policy takes account of the views of Spanish companies established in the UK in the Brexit negotiations is rated only 1.7 out of 5.

Seventy-eight per cent of Spanish companies that responded to the survey do not perceive that the British government is taking their opinion sufficiently into account.

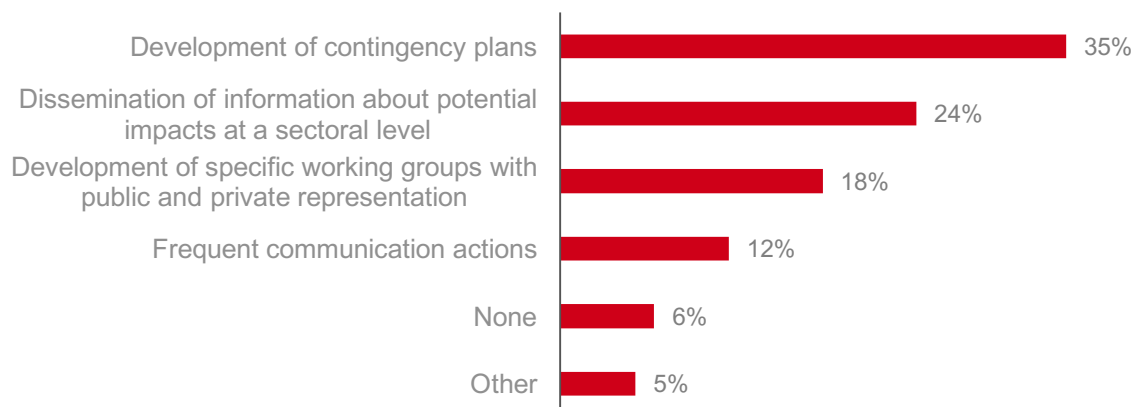
Perception as to whether the British government is taking into account the views of Spanish companies in the UK in the Brexit negotiations (% responses).



Source: Afi, "Survey of Spanish investment in the UK"

Further, with respect to the support that Spanish companies demand from the British government, 35% of companies consider assistance for the development of contingency plans to be a priority area. And another 24% prioritise the dissemination of information on possible impacts of Brexit at sectoral level.

Principal areas where Spanish companies consider that more support from the British government is needed (% of responses)



Source: Afi, "Survey of Spanish investment in the UK"

Methodological annex: characteristics of the sample of companies

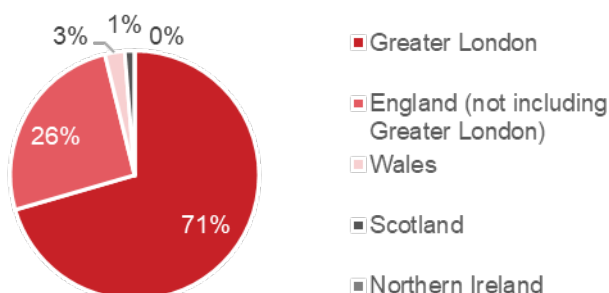
The results of this Barometer of Spanish investment in the United Kingdom are based on the opinion of a total of 78 Spanish companies established in the British market.

An online questionnaire was distributed to 344 Spanish companies established in the United Kingdom. The questionnaire includes questions relating to the company's profile, its assessment of the UK business climate, its prospects linked to UK activity and investment, as well as additional questions on the potential impact of Brexit.

The survey was conducted over approximately one month, between mid-December 2018 and mid-January 2019.

The profile of the companies that responded to the survey is detailed below.

Regional distribution (% total)



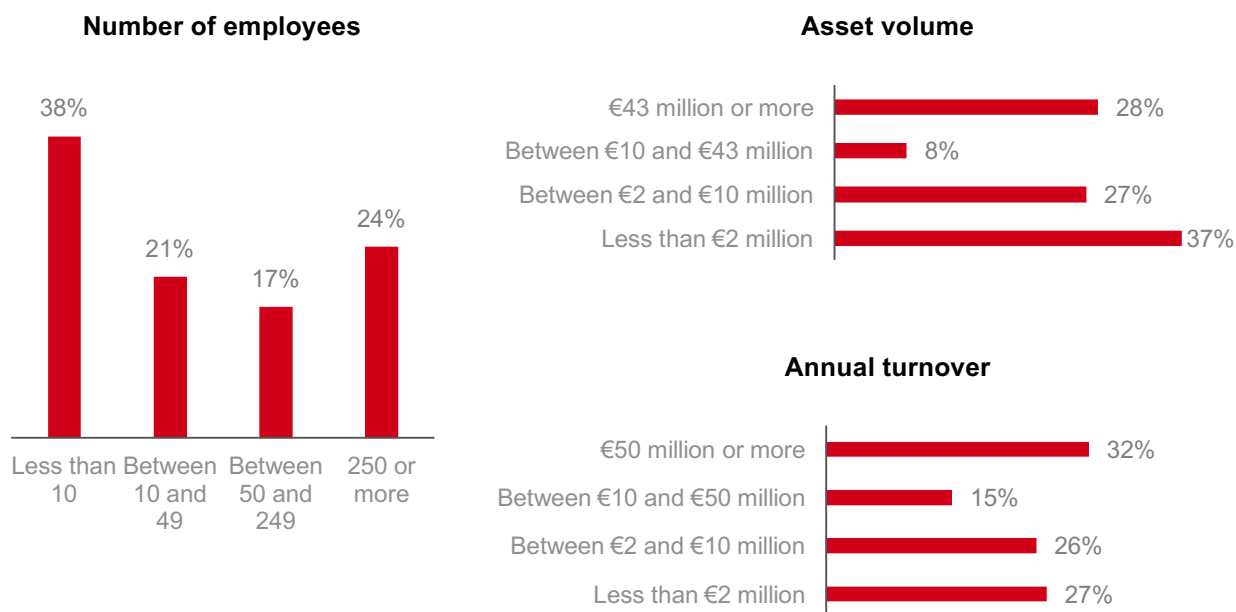
Source: Afi, "Survey of Spanish investment in the UK"

Sectoral profile (% of total)



Source: Afi, "Survey of Spanish investment in the UK"

Distribution by company size (% total)



Source: Afi, "Survey of Spanish investment in the UK"

Notes

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