Quarterly report on the Spanish economy

1. Overview

The behavioural patterns marking recent developments in the Spanish economy have not changed significantly in the period to date in 2000. The growth rates of output and job creation continue to be notable, national demand remains resilient and goods exports are, against a favourable international background, showing considerable strength, improving their position on foreign markets. Notwithstanding, the trade deficit is widening owing to the real growth of imports and the deterioration in the terms of trade. The latter is essentially due to the impact on import prices of dearer energy products and the depreciation of the euro.

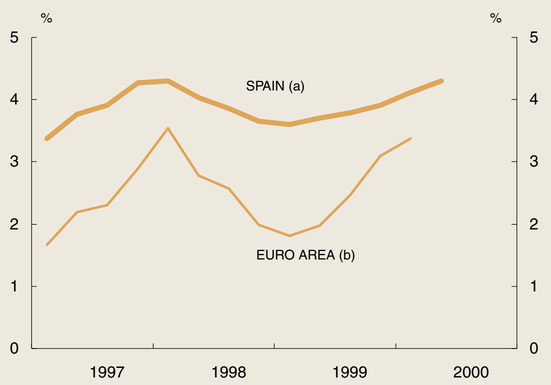
Given the usual caveats, the estimated real growth of Spanish GDP ran at around 4.2 % in 2000 Q2 compared with the same period a year earlier. This figure, irrespective of its quantification (INE has announced the revision of the QNA series over the coming months), accentuates, albeit only slightly, the buoyancy with which the year began. The growth rate of national demand also increased in relation to the preceding period, drawing close to 4.5 %, while no relevant changes are expected in the negative contribution of net external demand to GDP growth, which stands once again at around 0.3 percentage points. Comparing these figures with those – for Q1 – recently released for the euro area countries as a whole (3.4 % for real GDP growth, 2.7 % for domestic demand [with no change in stocks] and 0.7 percentage points for the positive contribution of the external balance), the gap between GDP growth rates can be seen to be continuing to narrow (see Chart 1).

Price trends remain marked by notably dearer energy products. The 12-month growth rate of the consumer price index (CPI) stood at 3.4 % in June, with the related rate of the harmonised index one-tenth of a point higher at 3.5 %, and the rate for the euro area as a whole at 2.4 %. Consequently, the inflation gap has held virtually stable (see Chart 2).

Against this background, economic policies have progressively been adapted to the targets set. The monetary policy defined for the euro area countries continued gradually to accommodate the conditions prevailing in the area, namely sustained growth and greater inflationary risks. But the somewhat tighter monetary policy stance is still relatively generous for those economies, such as Spain, which are ahead in the cycle. The Spanish fiscal authorities, for their part, have considered more demanding targets to correct the budget deficit, since tax revenue is increasing at a greater rate

CHART 1

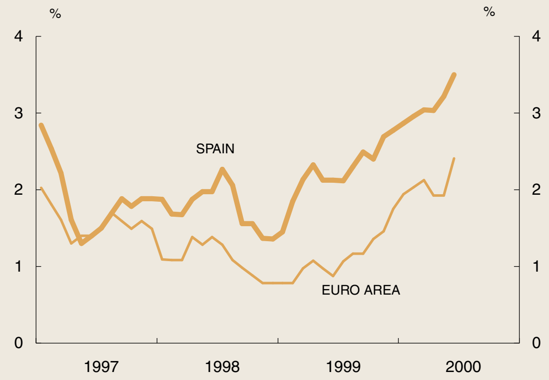
Gross domestic product



Sources: ECB, Instituto Nacional de Estadística and Banco de España.
(a) Non-centred annual rate of change calculated on the basis of the trend-cycle series.
(b) Non-centred annual rate of change calculated on the basis of the seasonally adjusted series.

CHART 2

Harmonised indices of consumer prices



Sources: Eurostat and European Central Bank.

than expected in line with the more expansionary macroeconomic scenario. Lastly, the government agreed recently to further boost liberalising measures by means of a series of actions aimed at improving the workings of and increasing competition in the various markets for goods and services. The effects of these measures will be felt, above all, in the medium term (see Boxes 1 and 2).

As in Spain, the international economic environment has not undergone significant changes during the first half of the year, and most organisations have retained highly optimistic forecasts for world growth this year and next. The United States economy remains remarkably buoyant, although signs of a slight slowdown in private consumption are perceptible. The improvements discernible in those areas lagging most behind in terms of recovery (Japan, Russia and certain Latin American countries) must generally be assessed with caution. The main inflationary risks continue to be associated with crude oil prices which, on international markets, are above the level that had been forecast for the second half of this year. Nonetheless, in recent days, and given expectations of future increases in production, oil prices have edged down to stand at around $26 per barrel.

Oil prices also pose the biggest risk for continuing stability within the euro area, now that virtually all EMU members are running at a sustained rate of expansion increasingly underpinned by the confidence of agents and the firmness of domestic expenditure (see Chart 3). Despite the fact there is a significant temporary component to the rise in consumer prices witnessed in recent months, derived from the trend in energy prices, if their impact on other sectors is to slacken, then the increase in unit labour costs must be contained by means of a combination of productivity gains, wage restraint and an ambitious policy of fiscal consolidation.

Given this situation, the European Central Bank (ECB) decided on June 8th to raise the interest rate on its main refinancing operations by 50 basis points to 4.25 %. As a result of this rise, the euro area benchmark interest rate has, in approximately one year, increased by almost two percentage points. And despite the fact the feed-through to the rates on banking transactions has been fairly swift, it is still too early to determine what the impact will be on the monetary and credit aggregates, whose rates of increase, though still generally high, have slowed over the past month.

The change in monetary policy stance, to which the stability of the price of the euro (which is still at a considerably weak level) has also contributed, can also be seen in the Spanish economy's interest rates (see top panel of Chart 4). The growth of financing received by households and firms is high, although incipient signs of a slowdown are apparent in the latest figures. Monetary conditions remain excessively generous for an economy in which agents' spending decisions have taken the nation's net financial saving to increasingly more negative levels, with household net financial saving at an historical low. The contribution of public finances to restoring more balanced financial conditions is undoubtedly proving significant. And this has again been manifest following the

BOX 1

Measures approved in June 2000 to liberalise and step up competition in the network industries

As part of a broader set of measures, two royal decrees were approved in late June which significantly amended the regulatory framework for the network industries, namely liquid hydrocarbons, electricity, natural gas and telephony. The aim was to step up competition in the related markets. The most significant changes are summarised below.

In the liquid hydrocarbons industry (fuel and other energy products), the measures adopted are aimed, first, at providing readier access for all operators to the wholesale distribution network on an equal footing; and further, at promoting greater competition in retail distribution via service stations. To achieve the first objective, limits have been set on shareholdings in the Compañía Logística de Hidrocarburos (Hydrocarbons Logistics Company) both for individuals or corporations (25 %) and for all refining companies existing in Spain (45 %). In this way it is sought to provide for the separation of logistic and transport activities from distribution and supply, which had hitherto evidenced a high degree of vertical integration. Likewise, to make the working of the network more transparent, the conditions entered into in all the contracts governing network access shall be publicly disclosed. As to the distribution of oil products in the retail segment, various measures have been taken to reduce the high concentration prevailing. First, operators have been prohibited from increasing the number of service stations over the next three or five years if their market share stands at between 15 %-30 % or exceeds 30 %, respectively. Further, it has been established that large retail outlets shall incorporate at least one service station which shall be supplied by at least two wholesale oil-product operators. Completing the measures shall be the obligation to provide information on the prices charged by service stations, which have begun to be published.

In the electricity industry two types of measures have been approved. Whereas some are aimed at increasing competition in the industry, others modify prices and rates. Regarding the first group, it should be recalled that that the strong vertical integration in the industry and the high degree of concentration in electricity generation inhibit, in practice, competition in retail distribution. In this setting, the possibilities of the retailing companies (which group together the demand by big consumers, i.e. those that can choose a supplier) acquiring electricity are broader; they can enter into electricity purchase contracts with foreign suppliers and with domestic «special-regime» (i.e. when electricity is produced in association with other unrelated activities or when waste or non-hydraulic renewable energies are used in its production) producers, and, from 2003 onwards, with «ordinary-regime» domestic producers. Accompanying these measures, electricity producers whose generation share exceeds 40 % are prohibited from increasing this share over the following five years. This prohibition will apply for only three years for those producers with a share of over 20 %. Further, the date from which all consumers may freely elect suppliers and, therefore, negotiate purchase prices has been brought forward to 1st January 2003 (four years ahead of schedule). In the period to that date, the steps required to acquire big-consumer status have, moreover, been simplified. Regarding the second types of measures, the tariffs for access to transport and distribution networks for big consumers have been reduced, so as to encourage resort to the market. Likewise, capacity payments have been reduced and a commitment has been made to restructure network access tariffs before 1st January 2001. Lastly, domestic consumer tariffs will be lowered by a maximum of 9 % during the period 2001-2003.

In the natural gas industry, the measures introduced are aimed, on one hand, at increasing competition in the various stages of the productive process and, on the other, at reducing charges and access payments in the industry. In the first group, mention should be made of those measures designed to rationalise the industry and to facilitate third-party access to the network for outsiders and the emergence of new operators. The measures include most notably the following: the creation of a «technical management» organisation for the gas system; the diversification of shareholdings in ENAGAS, via the setting of a limit of 35 % on the capital or the voting rights that any group of companies may hold; the transfer of 25 % of the rights on gas imported from Algeria to retailing companies other than ENAGAS; a limit on market share of 70 % for each gas supplier as from January 2003; and the bringing forward of the date from which new operators may construct their own distribution networks to 2005. Secondly, the timetables for the free selection of supplier by end-consumers are brought forward: liberalisation shall be applicable forthwith for those consuming more than three million standardised cubic metres and for all co-generation plants, and brought forward to 2003 for the rest. Further, all third-party access payments for reception, re-gasification, storage and transport facilities have been reduced by 8 %. Moreover, in early 2001 a new cost-based system of natural gas charges and payments applicable to the use of infrastructure by new operators shall come into effect.

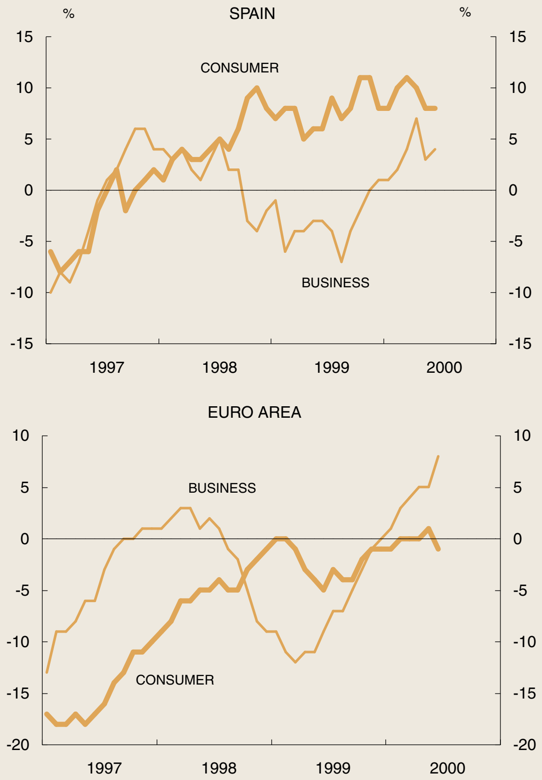
In telecommunications, the main measures affect local calls, a segment of fixed telephony which had, to date, remained outside the liberalisation process. It has been stipulated that, as from January 2001, the incumbent operators of fixed telephone public networks shall allow the exclusive lease to another operator of the final section of the fixed network arriving at users' homes (the subscriber's loop), or shall lease out on an exclusive basis at least high speed data (Internet) services. Further, by 15th November this year the pre-selection of local calls must have been made available. As concerns prices, the incumbent operator shall have provided flat rates, on one hand, for Internet in a limited time band, and, on the other, for Internet and local calls at different time bands. Before 15th September, reference interconnection tariffs for use of the fixed network of the former monopoly shall have been modified. However, the introduction of additional competition in mobile telephony has been left for a later date.

Lastly, for all four sectors (liquid hydrocarbons, electricity, natural gas and telecommunications), holdings by individuals or corporations in more than one company with the consideration of main operator are limited.

In sum, the measures introduced may have beneficial effects on competition in the network industries, as a result of the introduction of specific limits on concentration; the unbundling -in certain cases- of varied activities; the restrictions on shareholdings in more than one main operator; and the new arrangements for authorising mergers, which are discussed in Box 2. Significant steps have also been taken to increase transparency in the setting of prices, charges and access payments, and important segments of these markets have been opened up to real competition, especially that for fixed telephony. Though these measures are positive, some time may have to pass before they are fully effective. And it should further be stressed that, in some of these sectors, considerable concentration and obstacles to entry remain in place.

CHART 3

Confidence indicators



Source: European Commission.

economic authorities' revision of the budget deficit target for the current year, which has been altered from 0.8 % of GDP, as established in the Updated Stability Programme, to 0.4 % of GDP. The latest data on the State budget outturn in the first half of the year, or their expression in National Accounts terms, are in this respect highly favourable: tax revenue is proving considerably higher than forecast, both as regards indirect tax and, in recent months, direct tax, and the growth of spending is, overall, fairly moderate.

Against this backdrop, the Spanish economy is, for the fourth consecutive year, running a high real growth rate underpinned by the buoyancy of national demand and exports. As a result, the rate of increase of final demand has stabilised at a level of over 6 %; the growth of imports deducts approximately two percentage points from the expansion of output. With the exception of government consumption, which is growing at a much more moderate rate, the other components of domestic demand continue to show signs of considerable strength. Nonetheless, in some of the latest indicators of household consumption, there are signs of a slowdown, chiefly in the consumer durables segment. The rises in interest rates, the increase in energy products prices and the possible petering out of demand, after a lengthy period of growth (as may be the case of the automobile industry), might account for these results. In any event, the real rate of change of household consumption remains high, driven by the growth of disposable income and accumulated gains in wealth, and consumer confidence continues to stand at historically high levels; that said, the year-on-year growth rate in Q2 may be slightly lower than the figure of 4.5 % advanced by INE for the first three months of the year.

Investment in capital goods might, for its part, exceed in Q2 the figure it posted the previous quarter, which had checked the slowdown that took place throughout 1999. Although some of the latest indicators show a tendency towards stabilisation, corporate investment decisions are expected to gather greater steam insofar as final demand in the economy (both domestic and external) retains its current pattern of expansion and business results remain favourable, as reflected in the Central Balance Sheet Office data released last month and presented in this Bulletin. Business expectations and order books appear to attest to this estimate. Turning to investment in construction, the latest figures show signs of a slowdown in the demand for housing, whereas public works appear to be resuming a more sustained pace. The rate finally estimated does not differ substantially from the INE figure for Q1, which was 5.5 %.

The Q2 data on the external demand components are incomplete and the estimates offered are based on the results of the forecasting models habitually used and on the assessment of the trends discernible in the latest figures. These trends confirm the notable buoyancy of goods exports, which are gaining market share both in the EU and in other regions, with the odd exception such as China. The gains in competitiveness arising from the depreciation of the euro – which offsets the acceleration in export prices – and the strong growth of world trade are the factors traditionally behind this positive trend, to be confirmed by the figures in the coming months. These highly favourable trade results also extend to the tourist sector, despite the fact the latest indicators released were somewhat less buoyant. Lastly, the real growth forecast for imports is consistent – despite the erraticism seen in the previous months' data – with the expansionary behaviour

BOX 2

Liberalisation measures and stepping up of competition in other sectors

In addition to the measures affecting the network industries (see Box 1), many other varied measures were adopted bearing on a very wide and heterogeneous set of sectors. Notable among these are those that strengthen competition by means of amendments to the Competition Act (via the new merger authorisation system), those smoothing the ongoing internationalisation of Spanish companies, and those aimed at removing obstacles to various professional activities. Outlined below in a non-exhaustive fashion are the most important measures.

Regarding the promotion of competition, notification to the Competition Service of mergers and takeovers (a requirement which, under current legislation, affects all operations above a certain threshold) has been stipulated. Such notification shall be before the operations begin, and they may not be carried out before the appropriate authorisation has been granted (previously, the notification could be obtained up to three months after having commenced the operation). Further, the procedures for the resolution of these cases have been made more flexible, and no more than three months (previously six) may elapse from the time of notification to the Competition and Fair Trading Board until the time the government makes a decision.

As to pharmaceutical products, the margins on drugs have once more been modified as from 1st August (the previous change in May 1999 involved a cut in the distributor's margin). Chemists' margins on advertised drugs (those sold without a prescription and which are not publicly funded) have been made more flexible, as discounts of up to 10 % may be applied. Further, both chemists' and distributors' margins on the most expensive products have been reduced, having been set at a fixed amount for all drugs exceeding ESP 20,000. To offer incentives on the sale of generic drugs, a margin of 33 % has been set for chemists for this type of product, which is higher than that applied to other drugs (where the maximum margin is 27.9 %). Elsewhere, the Social Security pharmaceutical bill has been reduced by means of deductions based on volume purchases.

As concerns opening hours, the weekly total has been notably extended in all regions from the 72 hours currently in effect to 90. In addition, Sunday and holiday opening has been liberalised for retail establishments of less than 300 square metres which do not belong to distribution chains. For other establishments, Sunday and holiday opening is gradually being extended from 8 days at present to 12 in 2004, at the rate of one additional day per year. However, the second-licence requirement for the opening of large retail outlets has not been changed.

Notaries public shall be allowed to apply discounts to fees of up to 10 %, while it is established that for documents exceeding a specific amount, the fee shall be freely applicable. The fees of property and mercantile registrars shall generally be reduced by 5 %, and by higher percentages if the registration of urban property documents (15 %) or the subrogation of mortgage loans for protected housing (50 %) is involved. Moreover, in the case of documents for amounts exceeding ESP 1 billion, the fee is limited to a fixed amount. Consequently, the regulated fees of these professionals have been lowered. In connection with mortgage loans, greater transparency is stipulated for the related information brochures as regards the borrower's right to select an appraiser, agent, insurer and notary public. These measures are reinforced by others aimed at the land-use and housing sector. Specifically, private enterprise shall be allowed to promote the transformation of buildable land, and the administrative procedures for approving development and town planning instruments shall be simplified. Further, property intermediation is liberalised and, under property tax, taxation of the habitual dwelling is exempt up to a maximum amount of ESP 25 million.

To increase competition in road passenger transport, the duration of exclusive concessions of regular services have been reduced from a range of 8-20 years to 5-10 years. Moreover, the technical inspection of vehicles has been liberalised, with the current fixed-rate concessionary system being replaced by a maximum-rate authorisation system.

Certain obstacles hindering professionals from engaging in their activity in regions other than that where they are officially registered have been eliminated. It is now forbidden to demand payments relating to professional eligibility, and that are not included in membership quotas, other than those required of regional registrants with such professional bodies.

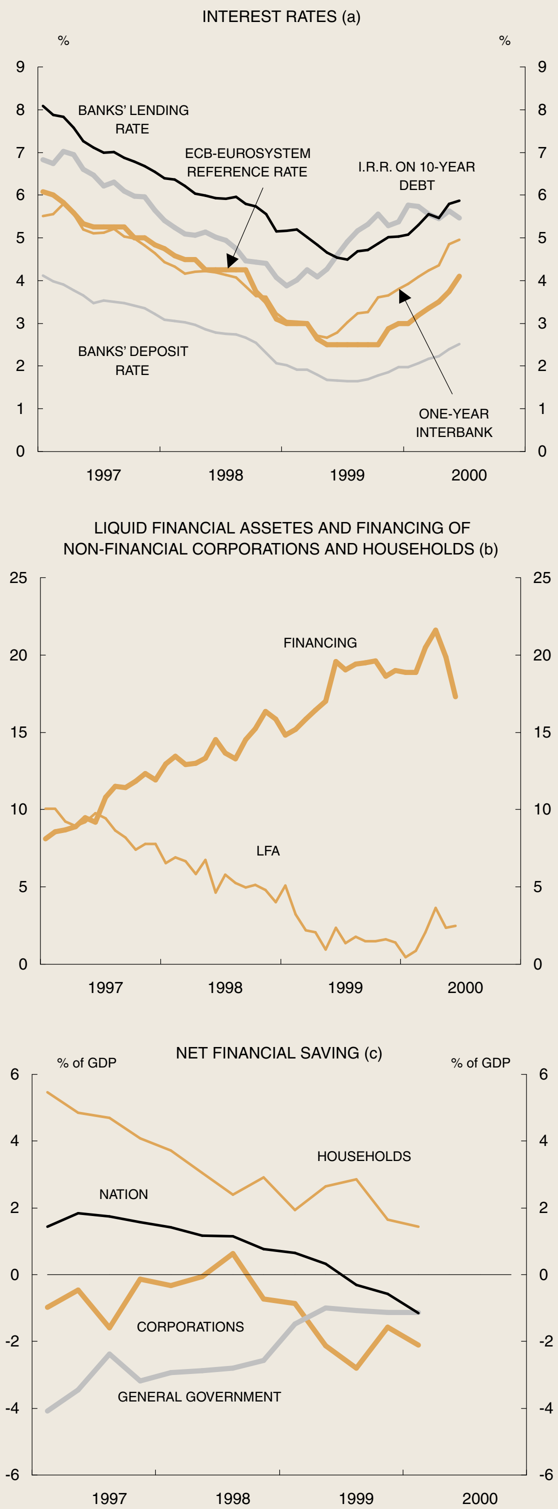
In the tobacco products sector, current restrictions on wholesale tobacco distributors have been eased insofar as they are not required to cover all the national territory and are allowed to distribute various other products at the same time. In exchange, manufacturers and importers are obliged to ensure their products can be obtained throughout the territory provided there is a demand for them.

Discounts on text books have been liberalised and the medical services of the mutual insurance companies covering temporary disability have been authorised to issue and cancel sick notes in this connection. Further, the formal obstacles to the establishment of new sales outlets for bunker fuel have been lifted.

In relation to foreign investment, the related regime has been altered to avoid double taxation on business activities engaged in abroad (by means of subsidiaries) and, to encourage internationalisation, payment of corporate income tax may be deferred when shareholdings are taken up in non-resident companies. In line with the recommendations of the Lisbon Summit, tax deductions for investment in new technologies, for staff training in such technologies and for SMEs' investment in R+D are appropriate steps for fostering the Information Society. Lastly, a further group of tax measures aimed at promoting saving was introduced (see the article on «Financial regulation: 2000 Q2» in this Bulletin).

CHART 4

Financial indicators of Spanish economy



Source: Banco de España.

(a) The series are averages of daily data.

(b) Financing includes bank loans extended by resident and non-resident credit institutions and fixed-income securities.

(c) Cumulative four-quarter data.

of their main determinant: final demand in the economy.

Turning to the productive branches, the indicators available for 2000 Q2 confirm the estimate of output growth discussed previously from the standpoint of demand. The main expansionary boost has stemmed from industrial activities, although it should be pointed out that the agriculture and fisheries branch has ceased to post negative rates of change. Meanwhile, the growth of market services has been more stable.

In this clearly expansionary setting, employment growth continues to be notable, as does the decline in the unemployment rate. Most of the latest indicators appear to show a modest loss of momentum in job creation, as a result of which apparent labour productivity is picking up, from very low levels. The increase in productivity has been greater in industry. And this, combined with the acceleration in industrial prices on both domestic and foreign markets, is driving the increase in corporate margins in the sector.

The wage rises being negotiated in collective bargaining agreements and the effect of the inflation-adjustment clauses that have been activated in the opening months of the year have accentuated the growth of compensation per employee. This is why, despite the moderate recovery in productivity, the growth of unit labour costs is holding at around 2 % (with significant differences across the various branches and industries), somewhat over one percentage point higher than the related euro area rate.

Most price indicators have worsened during Q2, with their growth rates rising. The gap between the growth rate of the Spanish HICP and that of the euro area as a whole has stabilised at around one percentage point since the beginning of 1999, after having been virtually zero in 1997 when the Spanish economy completed its process of nominal convergence with the countries in the area. The differences are wider and more persistent in the services sector, and fluctuate in the case of goods depending, basically, on the trend of food prices. In any event, it is in the non-energy industrial goods index where the differences between growth rates are tending to widen; indeed, there is already a gap of 1.5 percentage points.

The main challenge currently facing the Spanish economy is to prolong its expansionary phase, which is in its fourth consecutive year, so that real convergence with the EU countries may continue. For this to come about, the macroeconomic stability achieved must be maintained and competitiveness improved. In this respect, the firming of the differences between the rates of change of prices and production costs relative to the euro area countries, and the low growth observed in factor productivity, may pose an obstacle that should be obviated. To this end, and so that the persistence of a high growth rate of demand should not ultimately generate excessive imbalances, the potential for economic growth – preferentially investment- and export-led growth– should be increased, and the workings of markets made more efficient. In this respect, the recent government measures aimed at heightening competition in numerous markets for goods and services will contribute to increasing the capacity of aggregate supply to react and improving the economy's efficiency. This course of action, ini-

2. The external environment of the euro area

In 2000 Q2, the external environment of the euro area continued to move on an expansionary path. The United States economy remained very buoyant, although there has been a significant slowdown in private consumption. In Japan, the slow recovery that began a year back appears to be continuing, after having put behind the slowdown in the second half of 1999. Meanwhile, in the emerging south-east Asian and Latin American economies, economic growth continues to gather momentum. Against this background, prices have worsened in the industrialised economies, this having been largely brought about by the additional increase in oil prices in Q2, set against the greater uncertainty surrounding supply developments on the international markets for crude.

In the United States, the final National Accounts data for Q1 confirmed the economy's vigorous growth (5.3 % year-on-year) over this period (see Chart 5), driven by the expansion of private demand and exports. The information for Q2 points to the continuing buoyancy of the economy in this period, with GDP running at an annualised quarter-on-quarter growth rate of 5.2 % (6 % compared with the same period a year earlier). As in previous quarters, economic activity was based on the strong increase in domestic demand and in exports, although imports rose by a greater extent than exports. Nonetheless, private consumption slowed appreciably, posting in 2000 Q2 the lowest quarter-on-quarter growth rate since 1997 (3 % in annualised terms), thereby confirming the signals that the economic indicators had been providing. Fixed capital investment was as expansionary as in the preceding quarters, with the strong increase in inventories and in public spending (traditionally volatile components), which had run at negative quarter-on-quarter growth rates in the previous period, the main determinants of the acceleration in GDP in Q2.

During the period under review, no significant deterioration in the imbalances characterising this high-growth phase of the US economy was observed, but nor were there clear signs of any correction. In particular, after the current-account balance reached a new peak in Q1 (see Chart 7), the rate of deterioration of the trade deficit abated. On the Stock Exchange, there was a partial correction of the price rises seen in the opening months of the year.

Turning to prices and costs, and drawing on hourly earnings figures, the relative stability of wages throughout Q2 was notable, despite the tightening labour market. The unemployment rate has duly held at close to 4 %. Moreover, insofar as productivity growth is running at around 3 % year-on-year, unit labour costs are continuing to rise at very moderate rates. Consumer prices, however, worsened during Q2. They climbed to 3.7 % in June, essentially as a result of the impact of the hike in oil prices on world markets, although underlying inflation (excluding energy and fresh food prices) held at 2.4 % in May and June.

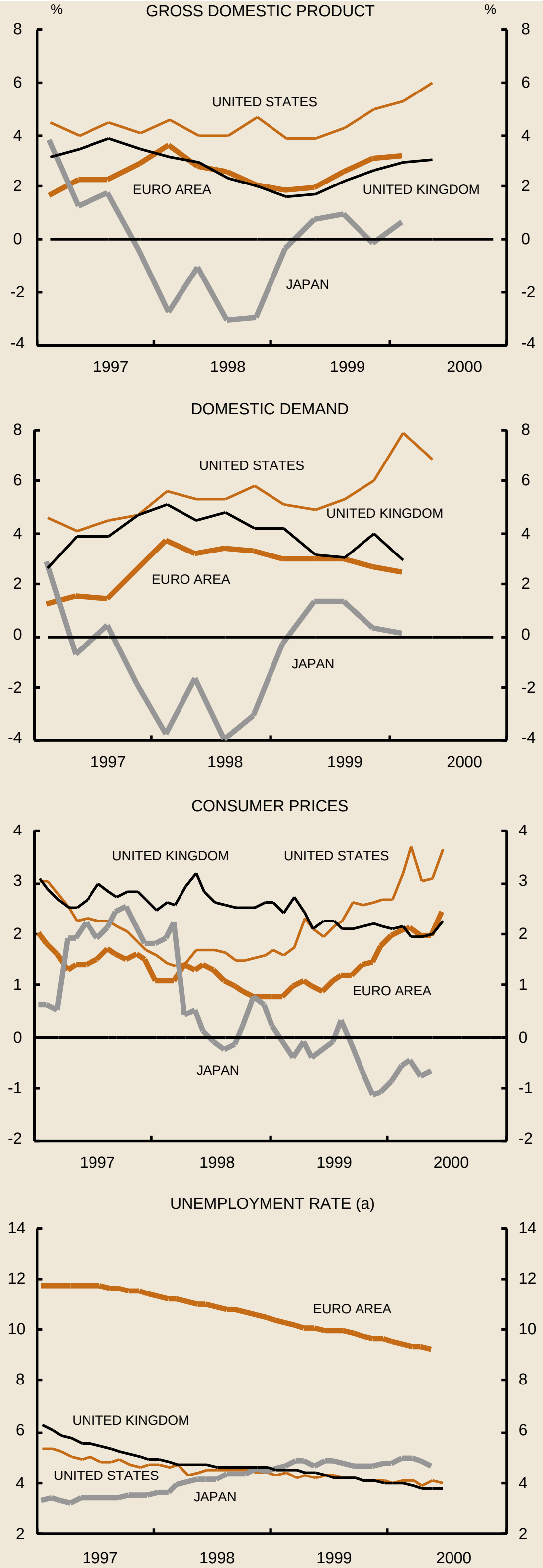
Against a backdrop of latent inflationary pressures, the Federal Reserve decided on May 16th on a further 50 basis points rise in its federal funds rate. This was the third such rise since January and the first on such a scale since the progressive tightening of monetary policy began in late June 1999. Subsequently, the incipient signs of a moderation in the growth rate of consumption, together with the ongoing rise in productivity, which prevented inflationary pressures from the labour market from materialising, led the Federal Reserve to keep its target interest rate unchanged at 6.5 % at the Open Market Committee meeting held at the end of June. Nonetheless, the US central bank continued to warn public opinion about the persistence of significant inflationary risks.

Japanese GDP grew by 2.4 % in 2000 Q1 compared with the preceding quarter and by 0.7 % compared with the same period a year earlier. This saw the economy emerge from the «technical recession» experienced in the second half of 1999. The favourable GDP performance was underpinned by the expansion of private demand and of exports; the boost to activity from the extraordinary fiscal package approved in late 1999 has yet to become manifest. Indeed, public investment fell heavily, and government consumption posted zero growth. As regards the components of private demand, both gross fixed capital formation (for the second quarter running) and consumption (which picked up substantially, running counter to the information provided by economic indicators throughout the period in question) trended favourably. Although imports were also very buoyant, the contribution of external demand to GDP growth was 0.6 percentage points, far above the figure of -0.2 points for the previous quarter.

The indicators available for 2000 Q2 point to no substantial change in the patterns hitherto witnessed. They reflect the sound performance of industry and the persistence of slack private consumption demand (although this is abating). The foreseeable increase in public investment, following the application of the latest fiscal package, and the continuing expansion of exports, in line with the economic recovery in Japan's main trading partners, may result in an additional boost to GDP growth during the period, despite the appreciation of the yen in effec-

CHART 5

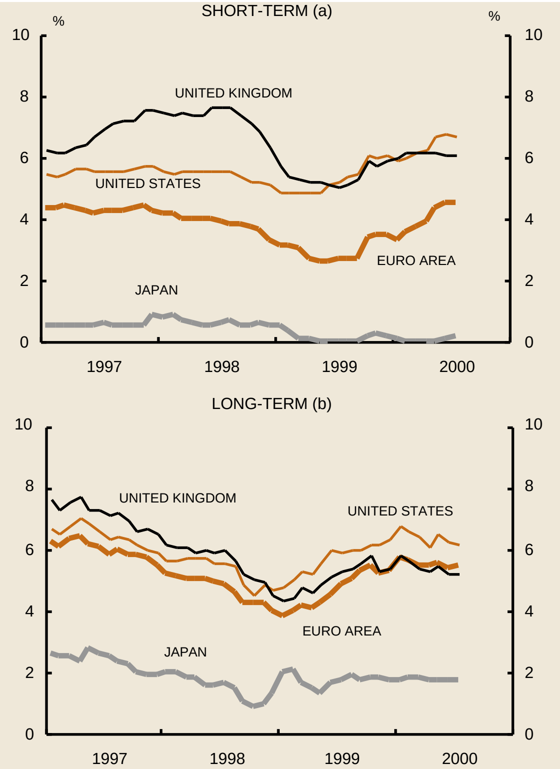
**Main macroeconomic indicators.
Percentage change on previous year**



Sources: Banco de España, national statistics and Eurostat.
(a) As a percentage of the labour force.

CHART 6

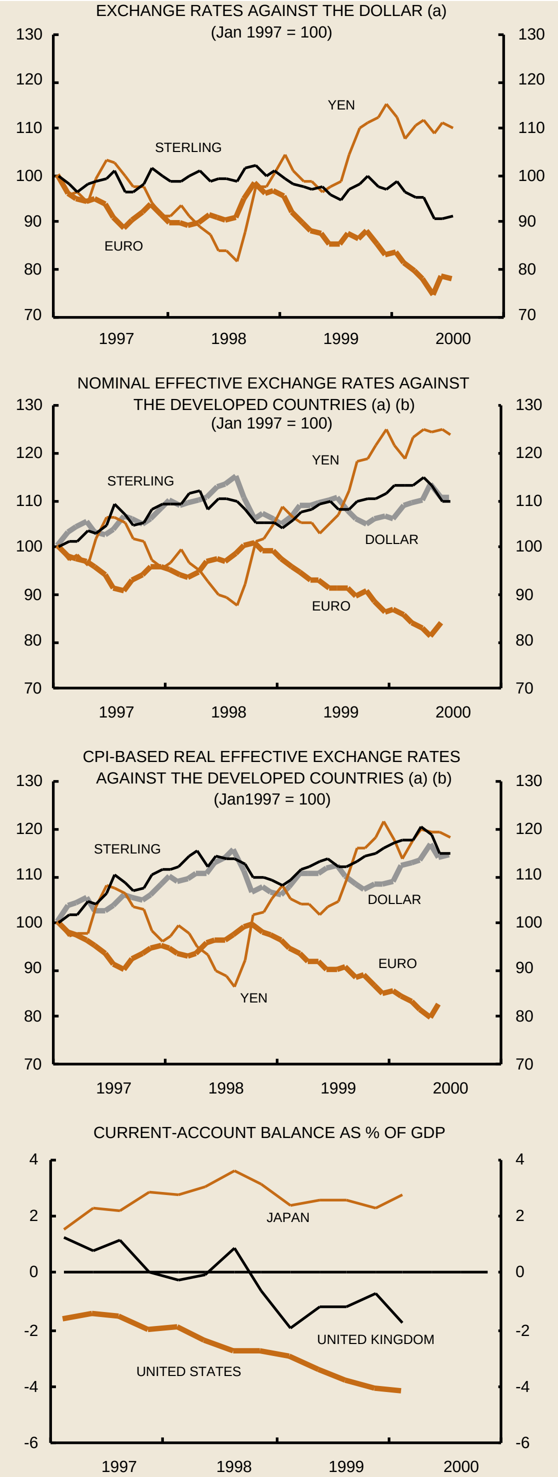
Interest rates



Source: Banco de España.
(a) Three-month interbank market interest rate. Euro area: until 1999 and 2000, three-month EURIBOR
(b) Ten-year government bond yields. Euro area: until December 1998, weighted average of the eleven euro-area countries.

CHART 7

Exchange rates and current-account balances



Sources: Banco de España, BIS and national statistics.
(a) A fall in the index denotes a depreciation of the currency against the dollar or the rest of the currencies making up the grouping and vice-versa.
(b) Before 1999 the euro is represented by an approximate indicator devised by the BIS on the basis of the effective exchange rates of the euro-area countries.

tive terms during 2000 Q2. Finally, prices remain subject to deflationary pressures, as the 12-month growth rate of consumer-price inflation was -0.7 % in May, compared with -0.5 % in March. Given this setting, the Bank of Japan is considering a possible interest rate rise if economic recovery takes hold.

The United Kingdom posted GDP growth of 3 % year-on-year in 2000 Q1. Underpinning this growth was the expansion of private consumption and exports, since private investment slowed considerably. The indicators of economic activity available for Q2 do not generally point to any significant increase on the previous quarter, and this is reflected in the preliminary estimate of GDP growth in Q2 which, in year-on-year terms, has risen to 3.1 %. However, the recent depreciation of sterling against the euro (partly offsetting its strong appreciation in the previous months), the growing strength of euro-area demand and the recent announcement of a less restrictive fiscal policy for the coming years might provide a boost to economic growth. The inflation rate, measured by the retail price index excluding mortgage interest payments, rose to 2.2 % in June, two-tenths of a point above the March figure. The unemployment rate held stable throughout Q2, standing at 4.1 % in June. These signs of macroeconomic stability, and the possibility that further interest-rate rises might strengthen the exchange rate of sterling, once more dampening exports and industrial activity, have been influential in the Bank of England holding its main intervention rate at 6 % since mid-February.

Most of the south-east Asian countries recorded very high GDP growth in 2000 Q1, led by both the buoyancy of exports and of domestic demand. Notably, year-on-year increases in GDP of over 10 % were achieved in several economies in this area, namely Hong Kong, South Korea and Malaysia, while growth was close to this level in Singapore, Taiwan and China. In all these countries, the recent economic performance has been accompanied by a reduction in inflation rates and stable exchange rates.

The main central and south American economies have, in the opening months of 2000, furthered the process of improvement begun in late 1999. Their inflation rates have also been significantly corrected. World economic recovery and the climate of financial stability, assisted by the firm commitment of most of these countries' authorities to further fiscal consolidation and structural reform, have been the factors contributing most to overcoming the crisis. Nonetheless, the increase in US interest rates, with the subsequent rise in the cost of external borrowing, might weaken somewhat the expectations of economic expansion in the area. Country by country, Brazil has exhibited notable growth, essentially as a result of the robust recovery in external demand, with an increase in GDP of 3.1 % in 2000 Q1 over the same period a year earlier, accompanied by a decline in inflation to 6.5 % in May. In Mexico, greater financial stability and the strong knock-on effect from the US economy were conducive to year-on-year GDP growth in Q1 climbing to 7.9 %, the highest rate obtained since 1997 Q2, while 12-month inflation continued falling, reaching 9.5 % in May. In Argentina, the economy continued to show signs of weakness, with a high liability position vis-à-vis the rest of the world. That said, it ran a positive GDP growth rate of 0.9 % in Q1, over one point more than the related rate in 1999 Q4, and the scant indicators available for Q2 offer signs pointing to the continuity of the recovery. Finally, the inflation rate remains subject to deflationary pressures.

Developments on financial markets have been marked, in 2000 Q2, by the gradual rise in short-term rates (see Chart 6). This has arisen from the tightness of monetary policies on both sides of the Atlantic and from the reduction in long-term interest rates, especially in the United States, which reflect the downward revision of expectations about growth and inflation in the US economy. Yields on ten-year Federal Government bonds declined by an average of 32 basis points from Q1 to Q2, standing at 6.11 % in the closing week of July. The average three-month interest rate rose to 6.56 % in Q2, standing at over 6.6 % at end-July. This has led to the yield curve being inverted, and it is now negative. In Japan, short rates remained at minimum levels, while ten-year yields declined slightly during Q2, although both rose slightly once more as from mid-June, in line with the improved expectations about the pace of recovery of the Japanese economy. The decline on equity markets in the main economies which began between late March and early April continued until May. They picked up thereafter, but insufficiently so to offset the loss in value incurred in the first two months of Q2. The downturn in prices was particularly sharp in the New York NASDAQ index, and in the Tokyo NIKKEI index. Lastly, on the foreign exchange markets (see Chart 7), the US dollar held stable in Q2 in relation to the yen, appreciating against the euro by 5.73 %, in daily average terms, between Q1 and Q2. Nonetheless, there was a turnaround in this trend in June, with the dollar/euro exchange rate standing at end-July at similar levels to those seen in April.

3. The euro area and the monetary policy of the European Central Bank

3.1. Economic developments

The latest information on economic developments in the euro area depicts an outlook propitious to the expansion of activity, driven by highly buoyant net external demand fuelled, in turn, by sound world growth and by the euro exchange rate. The determinants of domestic demand are also trending favourably, and an increase in the contribution of this aggregate to GDP growth is foreseeable in Q2 2000. Prices have risen at growing rates in recent months as a result of a fresh rise in oil prices and the upward trend in certain foodstuffs. Nonetheless, even if the trend of these components should turn around, the lagging effect of the depreciation of the euro in the opening months of the year, against a background of growing strength in activity, might continue influencing the behaviour of prices over the coming months.

On Eurostat estimates, GDP in the euro area grew by 3.4 % in 2000 Q1 compared with the same period in 1999 (see Chart 8), three-tenths of a point higher than the related rate in 1999 Q4. The continuation of the path of acceleration of GDP was based on the favourable performance of the external sector, as the growth of domestic demand held stable. The fact that exports outpaced imports led the positive contribution of net external demand to be three-tenths of a point higher than the related contribution in 1999 Q4, rising to 0.7 percentage points. The contribution of domestic demand held at 2.7 points, with all of its components behaving similarly to the preceding quarter.

Looking at the various member states, there was a surge in the growth rate in Italy, brought about by the notable pick-up in private consumption and, above all, in exports. Admittedly, the vigorous expansion of exports since 1999 Q4 has been a common feature of other euro-area members. But it has been more intense in Germany and Italy, which have possibly benefited to a greater extent from the recovery of the south-east Asian and eastern European economies, given their greater trade exposure to these regions.

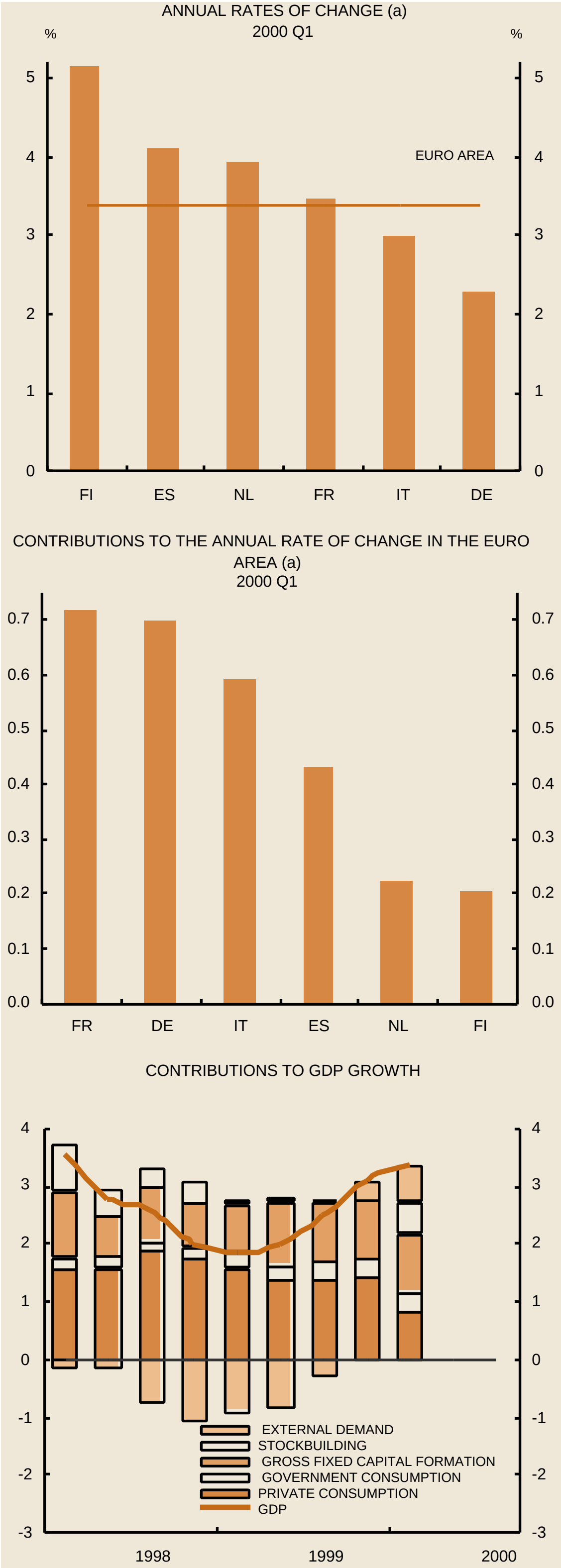
An assessment of the set of economic indicators relating to 2000 Q2 (see Chart 9) reveals that the accelerating profile of GDP has been maintained. The industrial production index for the area increased significantly to May, with a fairly generalised expansion being the case for the various countries and categories of goods, in keeping with the improvement in the business confidence indicator over the period under review. Furthermore, the private consumption indicators (retail sales, consumer and retail trade confidence, and, less clearly, new car registrations) have remained during the opening months of the year at the high level attained at end-1999. Hence, the favourable effect on household disposable income of the growth in employment and of the tax cuts announced or already implemented in numerous countries in the area have, along with the accumulated increases in financial wealth, shaped a setting conducive to the expansion of private consumption. Moreover, the economic vitality in the world's main geographical areas -though it might moderate if the signs of a slowdown in US activity were to be confirmed- and the lagged effects of the effective exchange rate of the euro should continue to boost exports. The resilience of the main components of private final demand should, for their part, help maintain the momentum of gross capital formation. Indeed, the results of the spring half-yearly investment survey recently released by Eurostat appear to testify to this, as they have signified an upward revision of the forecast for investment in manufacturing industry for the year 2000.

On provisional ECB estimates, employment increased by 1.3 % in 2000 Q1, one-tenth of a point up on the previous quarter. This moderate rise in employment, linked to the expansion of output, enabled apparent labour productivity to continue recovering to a year-on-year rate close to 2 %. In 2000 Q2, the sole employment indicator available, namely the unemployment rate, has continued on a downward course, falling to 9.2 % of the labour force in May (compared with 9.6 % at end-1999). The favourable performance of employment in the euro area countries is partly attributable to relative wage restraint and to the implementation in a large number of countries, albeit to differing degrees, of labour market structural reform. Hourly labour costs rose in Q1 to 3.6 % year-on-year (up from 2.4 % the previous quarter). However, given that wage settlements in collective bargaining agreements have been relatively moderate and that the acceleration does not appear due to non-wage labour cost trends, it might be ventured that the strong increase was partly reflecting temporary factors, such as the application of inflation-adjustment clauses and extraordinary payments related to the new millennium.

Euro-area inflation, measured by the 12-month rate of change of the HICP, stood in June at 2.4 % (see Chart 10), three-tenths of a point above the March figure. The significant increase in inflation during Q2 has been essentially due to unprocessed food prices, as the other components have remained relatively stable. The index excluding industrial energy

CHART 8

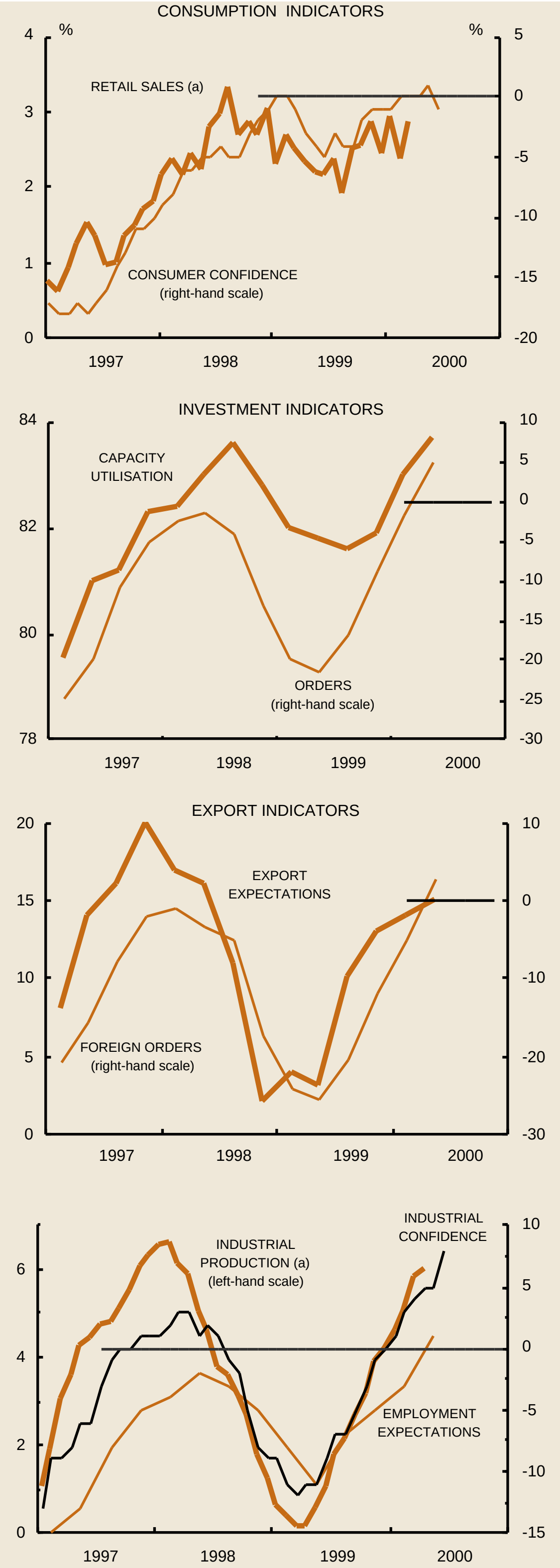
GDP in the euro area



Sources: Eurostat and national statistics.

CHART 9

Euro area. Real indicators



Sources: Eurostat and European Commission.

of the quarterly moving average of the seasonally adjusted series.

goods and unprocessed foods increased by one-tenth of a point from March to 1.2 % in June. The increase was due to the acceleration in service prices, as the growth rate of both non-energy industrial goods and processed food was unchanged during the period. Lastly, the growth rate of the energy component moderated slightly in June, compared with March, although it moved on to a pronounced upward path as from April. Country by country, the range in which the different countries' inflation rates stand in relation to March has not changed, although this has been the result of a widening of the range for services, offset by the opposite effect in the range for goods. Industrial prices have been on an accelerating course so far in 2000. In May they posted a 12-month growth rate of 6.5 %, i.e. 1.4 percentage points above the December 1999 figure, an increase linked predominantly to the impact of oil prices on intermediate goods. However, it should be pointed out that, although prices in the remaining sub-groups are continuing to grow moderately, they are clearly trending upwards, as rising intermediate goods prices are still feeding through to subsequent stages of the productive process.

Oil prices have continued to be the main conditioning factor of inflationary prospects for the area in recent months. After peaking in early March at around $32 per barrel, the oil price moved onto a declining path. It turned around as from mid-April (at which point it stood at $21), resuming levels exceeding $30 per barrel in the period from the second fortnight of June to mid-July, slipping back subsequently by almost $5 at the end of July. Paradoxically, it would seem, the increase in production quotas agreed on by the OPEC countries at their meeting on 21st June had a slightly upward influence on market prices, revealing itself insufficient to correct the imbalance between supply and demand. The firming of current crude price levels and the lagged effects of the effective depreciation of the euro are the main inflationary risks to the area. Such risks are further exacerbated by the progressive narrowing of the output gap. To date, the impact of the rise in foreign prices on euro-area inflation has been relatively limited. It is not yet possible to determine whether this is due to the offsetting effect of productivity gains on costs, or to a temporary squeeze on margins that might disappear, exerting pressure on consumer prices, in the near future.

On ECB estimates, the current-account balance of the area ran a deficit of EUR 4.4 billion in the four months to end-April. This was a notable deterioration on the 11.1 billion surplus recorded in the same period in 1999. Approximately half of the change was attributable to the decline in the merchandise balance surplus. The marked growth of imports, which was higher than that of exports, largely reflects the worsening of the terms of trade, owing to the combined effect of the rise in oil prices and the depreciation of the euro.

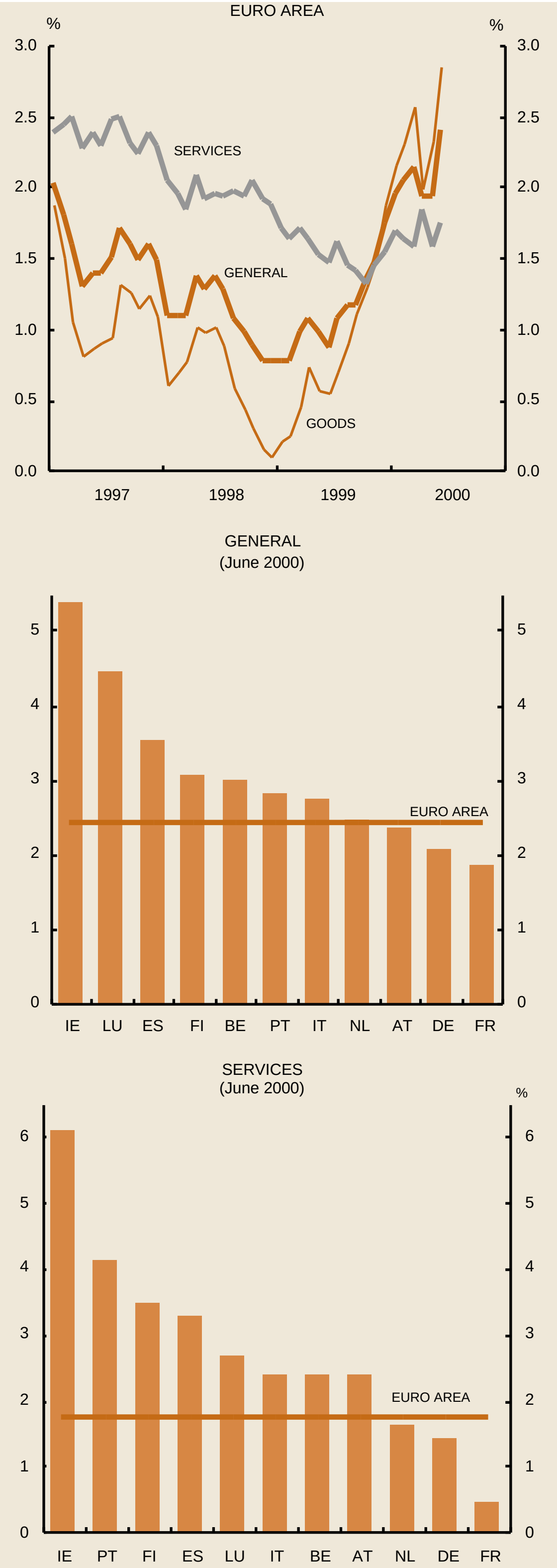
Regarding general government finances in the area, the budgetary outturn data for the period to date in 2000 mean that better-than-expected results for the year as a whole may be projected (see Table 1). Sound economic growth is driving direct tax revenue, while the relative strength of consumption and the increase in the prices of oil-related products is providing for buoyant indirect tax revenue. In addition, the rise in the numbers registered with the social security system is boosting the growth of social security contributions receipts, while the fall in unemployment is helping control spending. Nonetheless, in most member countries discretionary measures entailing improvements in structural balances have not been adopted, and the European Commission forecasts something of a deterioration in cyclically-adjusted primary balances in relation to 1999 in a large number of countries. This easing of fiscal policy is particularly inappropriate in those cases where the economy is ahead in the cycle, where the budgetary position is still far from balance or where the level of debt is high.

In step with the favourable trend of the cyclical component of budgetary balances, the authorities of certain euro area countries have revised their fiscal forecasts for 2000. In France and Italy, the new projections for the overall general government deficit are 1.5 % and 1.3 % of GDP, respectively, i.e. two-tenths of a point below the targets set in their stability programmes. In Germany, the government has approved the draft federal budget for next year, which foresees the nominal spending level being maintained and a fall in revenue as a result of the tax reform recently approved by Parliament. At the same time, discussions about reforming the State pensions system are under way.

The procedures for granting third-generation mobile telephony licences currently in train in most countries in the area have given rise to debate about how the sizeable revenue it is expected to obtain will be used. Generally, national authorities have announced their intention to employ at least most of the resulting resources to set aside reserve funds for State pensions systems or to reduce outstanding public debt.

CHART 10

Harmonised indices of consumer prices
Twelve-month percentage change



Source: Eurostat.

TABLE 1

General government financial balance of euro-area countries (as % of GDP)

	1996	1997	1998	1999	2000 (a) European Commission (b)	2000 (a) Latest official forecast (c)
Belgium	–3.7	–2.0	–1.0	–0.9	–0.5	
Germany	–3.4	–2.6	–1.7	–1.1	–1.0	–1.0
Spain	–5.0	–3.2	–2.6	–1.1	–0.7	–0.4
France	–4.2	–3.0	–2.7	–1.8	–1.5	–1.5
Ireland	–0.6	0.8	2.1	2.0	1.7	
Italy	–7.1	–2.7	–2.8	–1.9	–1.5	–1.3
Luxembourg	2.7	3.6	3.2	2.4	2.6	
Netherlands	–1.8	–1.2	–0.8	0.5	1.0	1.1
Austria	–3.8	–1.9	–2.5	–2.0	–1.7	
Portugal	–3.8	–2.6	–2.1	–2.0	–1.5	
Finland	–3.2	–1.5	1.3	2.3	4.1	4.8
MEMORANDUM ITEM:						
Euro area						
Primary balance (b)	1.4	2.5	2.7	3.1	3.1	
Total balance	–4.2	–2.6	–2.0	–1.2	–0.9	
Public debt	74.7	74.5	73.0	72.1	70.3	

Source: European Commission

(a) Déficit (–) / surplus(+).
(b) Spring forecast.
(c) Includes data only for countries authorities have published official forecasts after the release of the European Commission's spring forecasts.

3.2. Monetary and financial developments

The monetary policy stance in 2000 Q2 has continued to adapt to the improved economic outlook in the euro area. After raising the Eurosystem's interest rates by 50 basis points in Q1, the ECB Governing Council again raised rates on 27th April and 8th June by 25 and 50 basis points, respectively (see Chart 11). At the cut-off date for this quarterly report, the interest rate on the main refinancing operations stood at 4.25 %, 175 basis points higher than a year earlier.

With the delay typical to the process of transmission of the monetary authorities' signals on economic variables, the rise in official interest rates has led to progressively dearer bank credit and to an increase in the return on saving. It is more difficult to detect the effects of interest-rate rises on the euro-area monetary and credit aggregates, since in recent months they have continued to exhibit growth rates that may be considered high. Although the depreciating trend of the euro was curtailed in the second quarter, with the currency even appreciating moderately, its effective exchange rate against the developed countries remains at a very favourable level for the expansion of economic activity across the area.

As in previous months, monetary and financial conditions in Spain remained more generous than in the euro area as a whole. This was essentially due to the greater intensity of demand and price pressures in the Spanish economy which, among other things, have been reflected in the form of very high growth rates of cash and cash equivalents, and of financing raised by the private sector.

The EONIA rate held at levels very close to the rates on the main refinancing operations during Q2, except, as usual, during the final days of the reserve requirement maintenance periods. In the maintenance period ending 23rd June, temporary liquidity pressures led the EONIA to rise significantly above the interest rate on the main refinancing operations, prompting the Eurosystem to conduct a liquidity injection through a fine-tuning operation on 21st June. Under the current Eurosystem operational framework these operations are exceptional and, indeed, since the outset of Monetary Union only one such operation -in January this year- had been undertaken in order to absorb the surplus liquidity provided during the Y2K transition. Despite the increase in official interest rates, the financial markets continue to forecast a degree of monetary policy tightening in the future (see Chart 12).

During Q2 longer-dated interest rates were somewhat volatile. This was seemingly due more to external factors (such as developments on US financial markets) than to movements on euro area money markets. After varying fluctuations, long-term interest rates stood as from end-June at levels similar to, or even below, those prevailing at the end of Q1. In the case of Spain, these rates trended, as was to be expected, similarly to those in the other countries of the area, although the long-term interest rate spread over Germany increased slightly (see Table 2). Previous movements had brought about a levelling of the yield curve for the area as a whole. As a result, while expectations of further increases in short-term interest rates remained in place, the expected levels for these rates at horizons of over one year held fairly stable.

In April and May, the euro remained on a fairly sharp depreciating trend, taking its value on certain days to below $0.90 per euro. Subsequently, it began to pick up and, on the cut-off date for this report, it stood at $ 0.94, a similar level to that observed in April this year.

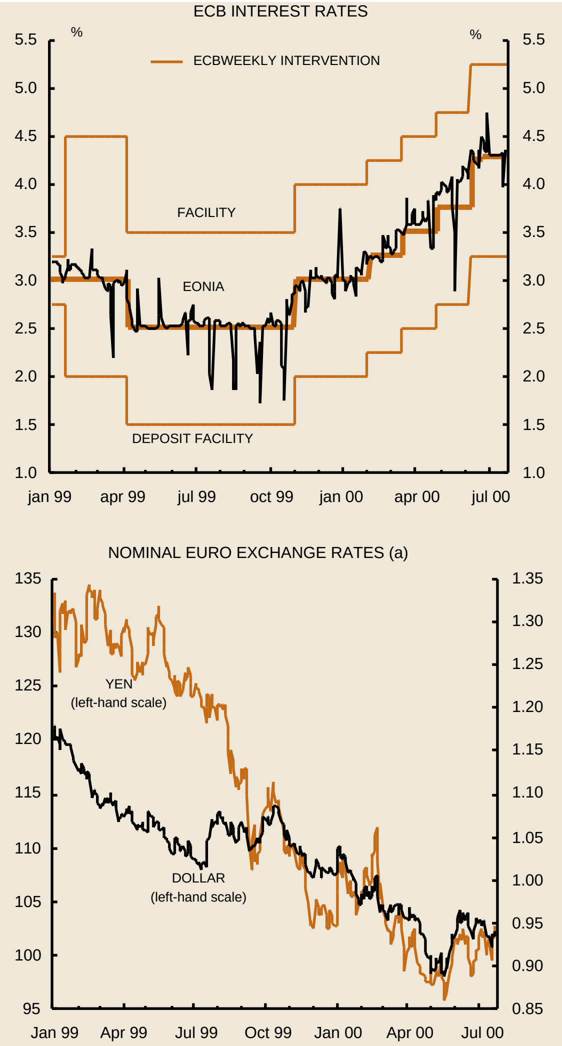
As earlier discussed, bank lending rates in the euro area (which are, perhaps, of most importance for determining agents' spending decisions) progressively reflected increases in money market interest rates. However, the feed-through has, as usual, been partial: whereas the three-month EURIBOR rate rose by 175 basis points between June 1999 and May 2000, the interest rates on credit to households and firms increased very unevenly over the same period, from 40 basis points in the case of consumer credit, to 135 basis points in the case of housing loans and loans to companies at over one year (see Chart 13). In Spain, the interest rates applied by resident Monetary Financial Institutions (MFIs) in their private-sector lending operations have also risen across the board: again for the June 1999-May 2000 period, the synthetic interest rate on credit to the private sector in Spain rose by 125 basis points, in line with the euro area as a whole.

Turning to the stock markets, the volatility of euro-area equity markets heightened during April and until early June. Thereafter, however, these markets were more stable, with rises on the Dow Jones Euro Stoxx index that took its cumulative percentage change during the year to almost 5 % as of the time of this report going to press. These movements were very similar to those on the main international bourses (generally led by developments on the US market) and came about against a backdrop of interest rate rises in the area and the high volatility of technology stock prices. In Spain, equity price volatility remained more marked. Although the Madrid Stock Exchange General Index has rallied somewhat in July, the change in the year to date remains negative.

Although the May and June figures on the growth of the monetary and credit aggregates in the euro area appear to show a slowdown in their hitherto buoyant trend, the rates of increase remain high, in line with continuing optimistic growth expectations, with the as yet relatively low interest rate levels and with the lack of a full transmission of past monetary policy measures to financial conditions in the economy and to agents' spending decisions. Until May, the three-month moving average of the year-on-year growth of the benchmark mone-

CHART 11

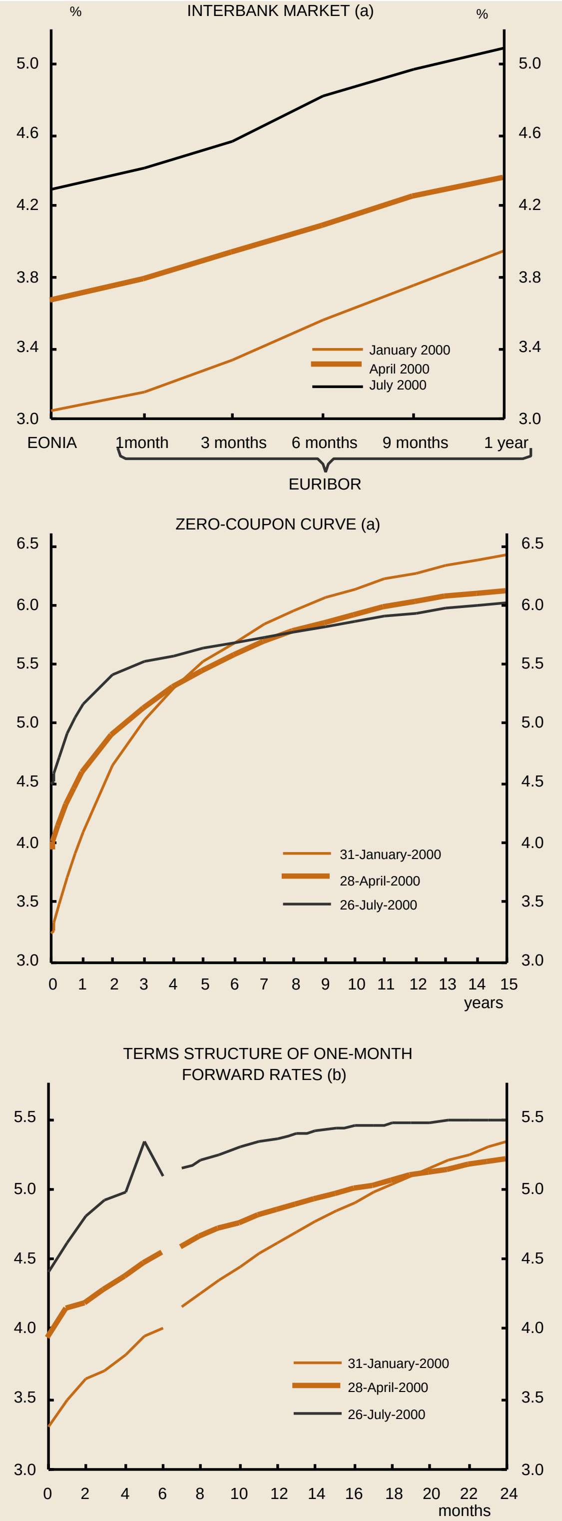
ECB interest rates and euro exchange rates



Sources: Banco de España and ECB.
(a) Dollar/euro and yen/euro exchange rate.

CHART 12

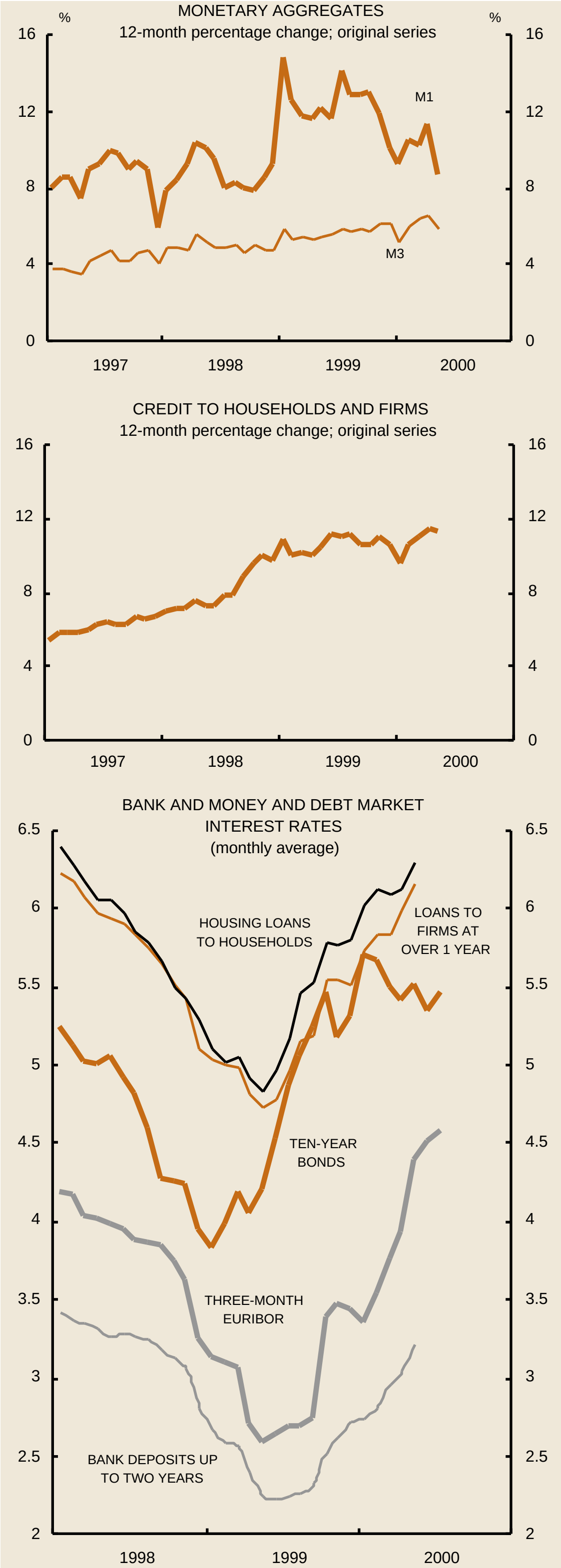
Euro area yield curves



Sources: Banco de España and ECB.
(a) Estimation based on money and swap markets data.
(b) Implied rates up to 6 months for EUROIBOR and estimated rates with zero-coupon curve for longer horizons.

CHART 13

Monetary and credit aggregates and interest rates in the euro area



Sources: Banco de España and ECB.

TABLE 2

Monetary and financial conditions in the euro area and Spain

	1999	2000						
	DEC	JAN	FEB	MAR	APR	MAY	JUN	JUL (c)
MONETARY VARIABLES (a):								
EURO AREA								
M3	6.1	5.2	6.0	6.4	6.5	5.9		
M1	10.0	9.2	10.5	10.2	11.3	8.6		
Loans to private sector	10.5	9.5	10.5	10.9	11.4	11.3		
FINANCIAL MARKETS (b):								
EONIA	3.04	3.05	3.28	3.51	3.67	3.92	4.29	4.30
Three-month EURIBOR	3.44	3.34	3.54	3.75	3.93	4.38	4.50	4.57
Public debt								
Euro area ten-year bond yields	*5.31*	*5.70*	*5.66*	*5.49*	*5.41*	*5.52*	*5.35*	*5.46*
USA – Euro area ten-year bond spread	*1.06*	*1.08*	*0.97*	*0.88*	*0.63*	*1.03*	*0.85*	*0.68*
Germany-Spain ten-year bond spread	*0.22*	*0.22*	*0.22*	*0.22*	*0.23*	*0.25*	*0.26*	*0.27*
Spanish bank interest rates								
Synthetic deposit rate	*1.98*	*1.97*	*2.06*	*2.17*	*2.23*	*2.40*	*2.52*	
Synthetic lending rate	*5.03*	*5.08*	*5.30*	*5.55*	*5.47*	*5.79*	*5.87*	
USD/EUR exchange rate	1.011	1.014	0.983	0.964	0.947	0.906	0.949	0.941
Equities (d)								
Dow Jones EURO STOXX Broad index	*39.5*	*–4.1*	*6.8*	*6.0*	*2.9*	*2.5*	*2.0*	*4.6*
Madrid Stock Exchange Broad Index	*16.2*	*–3.4*	*11.4*	*7.5*	*3.8*	*–2.5*	*–3.4*	*–1.7*

Sources: ECB and Banco de España.

(a) Annual percentage change.
(b) Monthly averages.
(c) Monthly average up to latest available data.
(d) Cumulative percentage change over the year. End-of-month data. Latest available day for the latest month.

tary aggregate, M3, stood at 6.3 %, with the 12-month growth rate for this month at 5.9 % (see Table 2). The increase in interest rates has translated into a change in the composition of M3 growth, showing a slowdown in the pace of the most liquid assets making up this aggregate (insofar as the opportunity cost of holding these liquid positions is increasing) and a higher rate of expansion of the negotiable instruments included in M3. In the recently released data for June, this changing composition continues to be seen, along with a slowdown in the growth rate of M3, which stands at 5.4 % year-on-year.

A lower growth rate of cash and cash equivalents held by households and non-financial corporations was also seen in Spain in 2000 Q2. The non-financial private sector's overall liquid assets continued to run at very moderate growth rates as a result of the ongoing disposal of shares in money market and fixed-income mutual funds, intense purchases of real assets and the greater diversification of financial saving, which has largely been channelled to liquid assets such as insurance products and international assets.

In the euro area as a whole, financing extended by MFIs to euro zone residents has been expanding at a rate of around 8 %, although this growth rate has been the outcome of highly differing behaviour across the economic sectors. Financing to the private sector has run at rates above 11 % in recent months, while credit extended to general government has continued to exhibit a negative growth rate. As in the case of M3, credit to resident sectors also decelerated in June, whereby the associated year-on-year rate of expansion of financing extended by MFIs to the private sector stood below 10 %. The continuing difference between the rate of expansion of credit and of M3 has been financed, among other channels, via an increase in MFIs' foreign debt.

In Spain, the rate of expansion of financing extended to the non-financial private sector has slowed in recent months. Compared with growth rates of close to 20 % at the start of the year, the year-on-year rate dipped to around 17 % in June. In any event, this trajectory is still a very expansionary one, especially when compared with the euro area as a whole. The sharp growth of financing led the Spanish authorities to alert institutions about the potentially adverse affects of a possible easing of their lending policies. Moreover, the progressive feed-through of the increase in monetary policy interest rates to bank lending rates should contribute to moderating the rate of expansion of loans extended by banks to the private sector.

With regard to monetary policy implementation by the Eurosystem, the ECB Governing Council decided on June 8th, in response to the excessive level of overbidding at the tenders for the main refinancing operations, that, starting from the operation to be settled on 27th June, such operations would be conducted as variable rate tenders, applying the multiple rate auction procedure. It further set a minimum bid rate of 4.25 % for the tender. The initial tenders conducted using the system have unfolded very satisfactorily. As a result, marginal rates very close to the minimum rate set have been established and, on the money markets, the rates negotiated following the tenders have held close to the marginal rate.

4. The Spanish economy

Against the background of the expansion of the world economy in the first half of the year (in both the euro area and other regions) and under financial conditions which remain generous, the Spanish GDP growth rate has posted further increases in the first two quarters of the year 2000. At the same time, the economy has shown high job creation capacity. The progressive improvement in international markets and the depreciated level of the euro have translated into a strong expansion of exports, which has given an additional boost to corporate investment plans. Further, household spending has grown at a higher rate over this period, fuelled by the notable growth of real disposable income and by a higher level of confidence about the economic situation. Consequently, on provisional Quarterly National Accounts figures for Q1, the year-on-year growth of GDP is running at 4.1 % (1) in real terms, compared with 3.9 % the previous quarter. And according to Banco de España estimates, GDP growth may have risen to 4.2 % in Q2 (see Chart 14).

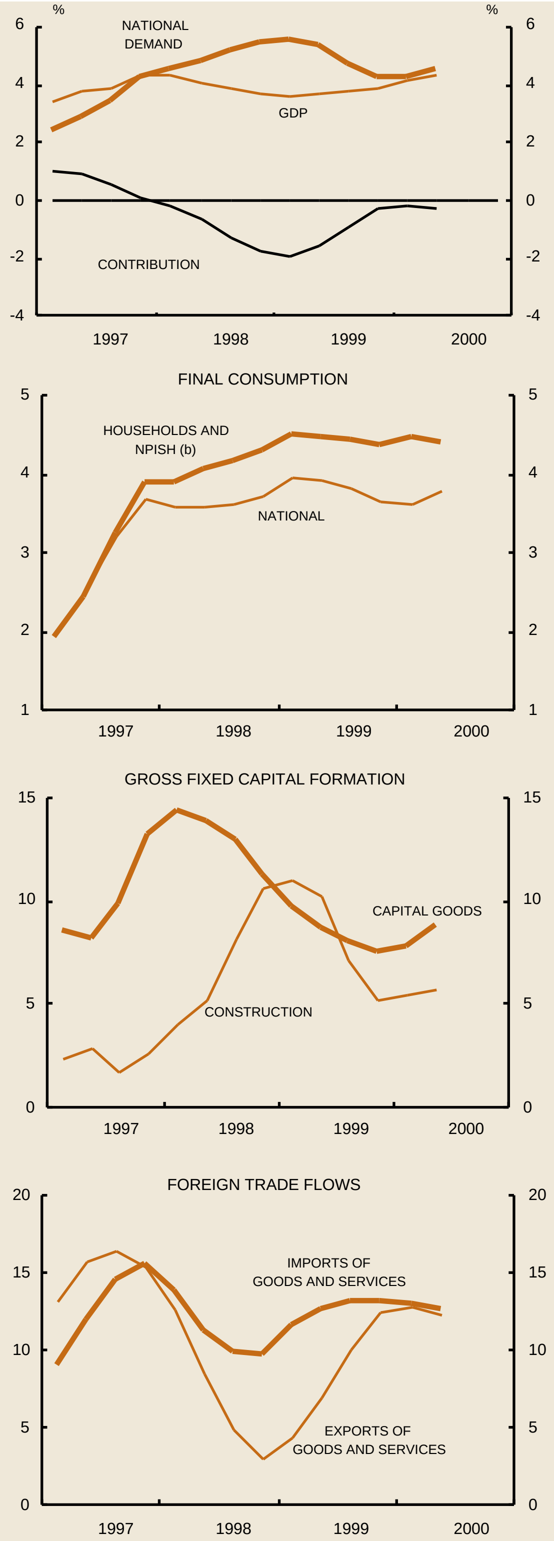
The acceleration in GDP in the first half of 2000 largely reflects the course of national demand, the ongoing deceleration in which throughout 1999 was halted. Domestic expenditure increased at a rate of 4.2 % in Q1 and at an estimated rate of close to 4.5 % in Q2, as a result of the recovery of gross capital formation. Meanwhile, private consumption grew at a stable and high rate, and general government demand held on a moderate path. The contribution of net external demand to GDP growth stabilised at negative levels close to those recorded at end-1999, following the substantial improvement in the first three quarters of last year. Specifically, on QNA figures, the negative contribution of the external balance in 2000 Q1 was 0.2 percentage points (-0.3 the previous quarter), and the scant data available for Q2 point to a similar or slightly more negative contribution.

The strong job creation (3.4 % year-on-year in Q1) accompanying the acceleration in output has only permitted a muted recovery in apparent labour productivity, which has continued growing at very low rates. This recovery has essentially been in industry, where employment has slowed despite this being the sector that has recorded the most forceful recovery, inducing marked moderation in unit labour costs. In other productive activities, such as construction and market services, the rate of job creation has remained very high or has even increased.

(1) Unless otherwise indicated, the rates of change of the Quarterly National Accounts series in this section relate to trend-cycle series.

CHART 14

Main macroeconomic aggregates (a)



Sources: Instituto Nacional de Estadística and Banco de España.
(a) Non-centred annual percentage change, based on the trend-cycle component.
(b) Non-profit institutions serving households.

In recent months, the upward course of final prices witnessed in Q1 has continued, owing mainly to dearer energy products. Nonetheless, signs that higher costs (associated with oil and other commodity price rises) are feeding through to the final prices of other goods and services are becoming discernible. And this feed-through is being assisted by the buoyancy of expenditure. The rate of increase of wages has also been trending upwards, leading to an acceleration in unit labour costs in certain activities, such as services. These upward pressures on prices have contributed to the inflation differential with the euro area remaining at more than one percentage point, despite the fact that final prices have also quickened in other European economies.

4.1. Demand

Within the national demand aggregates, household final consumption spending in real terms has posted a high and stable growth rate since the start of 1999, and the information available suggests it may have run in 2000 Q2 at a similar – or slightly lower – rate than the INE estimate of 4.5 % for the preceding quarter (see Chart 15). Of note in respect of the consumption components is the slowdown in durable goods purchases, especially cars, while there appears to have been a sustained increase in the consumption of services. There are also signs of a pick-up in spending on food, which had been very depressed the previous year.

Most consumption indicators tend to confirm the stability of, or something of a downturn in, the growth rate of this aggregate, which would be consistent with the profile of the consumer confidence index. In Q2 this indicator fell slightly from the levels attained in Q1, and a somewhat less optimistic assessment of the overall economic situation and a lesser inclination to purchase durable goods could be perceived. Among the indicators best approximating spending, the rate of increase of the aggregate index of apparent consumption of goods and services tended to ease in 2000 Q2 (for which period only partial information on this indicator is available). Notable here was the lesser buoyancy of the goods component, the growth rate of which stabilised at substantially lower levels than those observed during 1999. New car registrations slowed significantly to June, following the burgeoning increases they had shown in the first two months of the year. Lastly, the retail sales index was on a rising course in April and May, though a tendency for it to stabilise at high rates is discernible.

In any event, private consumer spending has remained notably strong in the first half of 2000, above the growth estimated for real disposable income. It continues to be boosted by the increases in financial wealth recorded in previous years, to which the recent rise in property-related wealth should be added. Household disposable income has continued to grow significantly, against a backdrop of accelerating wages and a sustained rate of high job creation. The personal income tax reform implemented early last year has also exerted an expansionary effect on household income, albeit on a much lesser scale than that seen in 1999. However, the absence of additional improvements to Spanish household confidence levels, the recent tightening of financial and monetary conditions and the petering out of the effects arising from the tax reform might temper spending increases in the coming months.

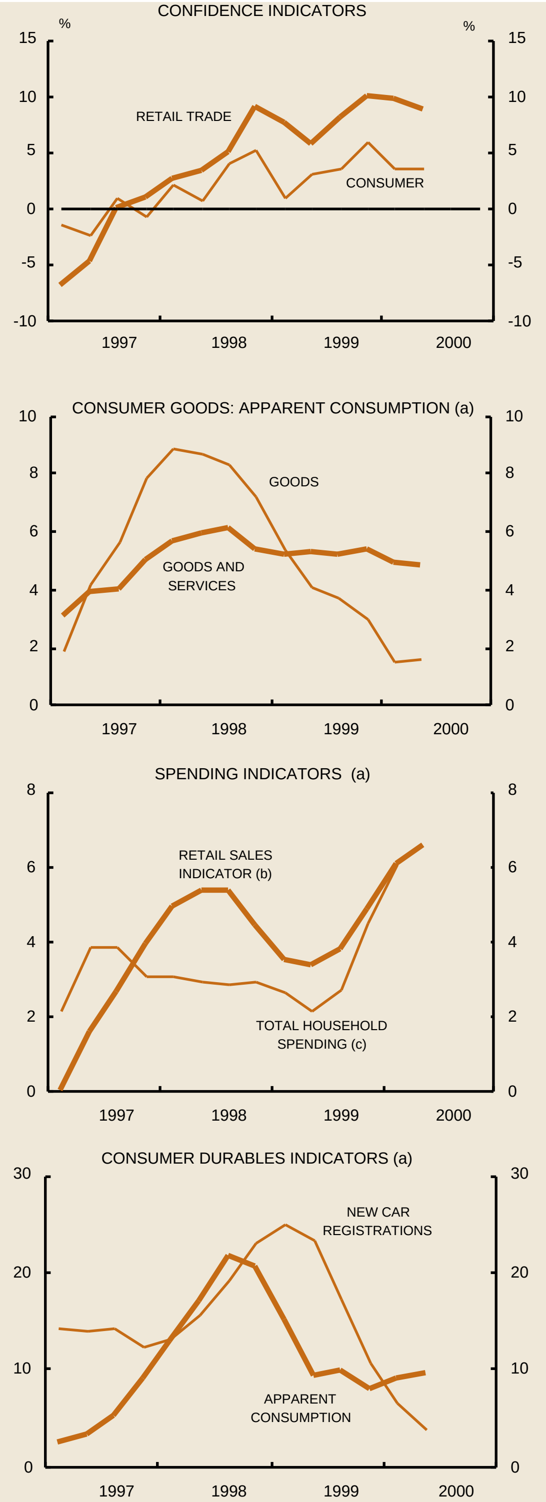
On provisional QNA estimates, general government final consumption spending grew by 0.7 % in real terms in 2000 Q1 compared with the same period a year earlier. The information on State receipts and expenditure available for Q2 and the budgetary plans drawn up for the year as a whole confirm the moderate trend of this expenditure item, although the associated rates of change are closer to those recorded on average last year, when government consumption increased by 1.8 %.

Gross fixed capital formation in Q1 ceased to move on the downtrend it had followed during 1999, growing at a rate of 6.3 % year-on-year, three-tenths of a point up on the previous quarter. The greater buoyancy of investment was a result of the strength of its two components: investment in construction, up four-tenths of a point to a growth rate of 5.5 %, and capital investment, which accelerated by two-tenths of a point to 7.7 %. In general, these trends have firmed in Q2, and it is estimated that both components of gross fixed capital formation have gained further momentum.

As can be seen in Chart 16, the growth rate of the index of apparent investment in capital goods (compiled using domestic production data to May and foreign trade data to April) was on a mildly declining trend until 2000 Q1, owing to the loss of steam of capital goods purchases abroad. However, there has been an ongoing recovery in the domestic production of investment goods, which has notably stepped up according to the May figure and which has translated into a strong improvement in the index under review here. The recent trend of this index appears to be more in step with the acceleration of capital investment suggested by the QNA data and with business optimism about

CHART 15

Private consumption indicators



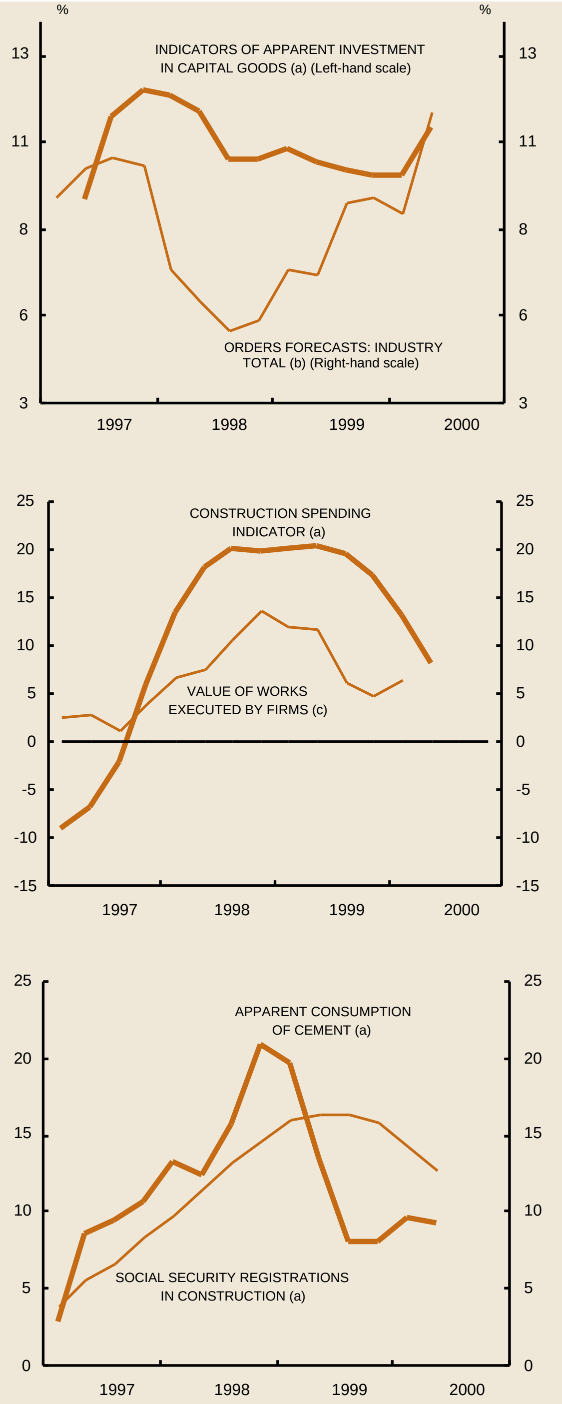
Sources: Instituto Nacional de Estadística, European Commission, Dirección General de Tráfico and Banco de España.

(a) Non-centred annual percentage change, based on the trend of the indicator.

(b) Deflated by the CPI.

CHART 16

Gross fixed capital formation indicators



Sources: Instituto Nacional de Estadística, Ministerio de Industria y Energía, Ministerio de Fomento, OFICEMEN, Instituto Nacional de Empleo and Banco de España.

(a) Non-centred percentage change on same quarter a year earlier, based on the trend of the indicator.

(b) Trend level.

(c) Obtained from the quarterly construction industry survey and deflated by the construction costs indicator. Four-quarter rate of change based on original series.

the course of demand. In this respect, the results of the monthly business survey highlight a notable rise in orders forecasts in industry.

The main determinants of capital investment reveal the continuing presence of an environment propitious to the pursuit of investment plans. Final demand has gained fresh momentum, driven by the buoyancy of exports and the resilience of domestic demand (the increase in turnover reported in the Central Balance Sheet Office CBQ survey in Q1 illustrates this strength). As a result, the degree of capacity utilisation has remained high, heightening the need to add to productive equipment. Moreover, according to the aforementioned CBQ figures, corporate profitability levels have continued to improve, despite the fact that financial costs embarked on a rising course in Q1 against a background of higher interest rates and higher corporate debt. In fact, the financial leverage ratio, which measures the difference between the return on assets and the cost of borrowed funds, increased once more in Q1, and the results of the half-yearly investment survey in industry, relating to spring 2000, continue to highlight the financial situation as one of the main factors behind investment, along with demand.

Investment in construction grew by 5.5 % year-on-year in 2000 Q1, interrupting the gradual slowdown it had shown during 1999. According to the results of the related survey for the sector, the greater buoyancy of construction spending in Q1 was underpinned by the building component, as civil engineering works slipped back to a sharper degree than in previous quarters. Given the inertia habitually characterising this spending component and the short-term information available, it is estimated that investment in construction continued its recovery in Q2 on the basis of the strength of residential building (as the conditions of access to housing remain favourable, despite the recent increases in house prices and in interest rates) and the more favourable trend of civil engineering works. Non-residential building, for its part, has also continued growing at a sustained rate, in line with the other components of corporate investment.

The coincident indicators of construction in Q2 have, overall, trended very favourably. However, some moderation in comparison with Q1 is generally discernible, probably as a result of the heavy rainfall during the spring, which may have hampered construction activity. The rates of increase of the indicators of inputs (apparent consumption of cement and the production of construction materials) tended to ease in April and May after having clearly picked up in Q1.

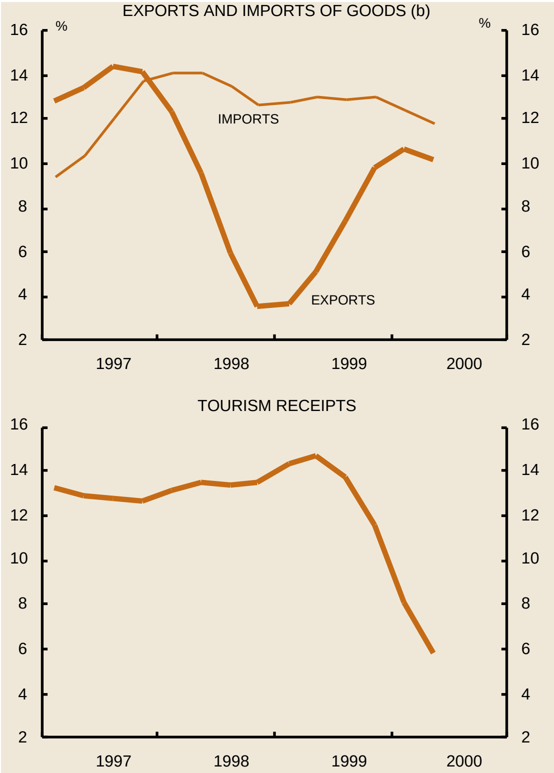
The latest employment indicators for the sector (registered unemployment and social security registrations) continued to slow in Q2, albeit retaining considerable vigour. As to the indicators relating to works started, general government procurement tenders increased by 12.8 % in Q1 compared with the same period a year earlier, after undergoing a very significant cut in 1999. This, combined with the Spanish Development Ministry's investment plans, which envisage a notable increase in infrastructure (especially concerning railways and airports), means greater civil works expenditure may be projected for the rest of the year 2000. With regard to building, the number of square metres to be built, according to project-approval statistics, accelerated in the opening months of the year. That said, these figures should be interpreted with caution, as they might reflect the bringing forward by builders of project-approval applications, so as to avoid the increase in costs entailed by the obligatory insurance aimed at covering structural flaws in housing, which came into force on 6th May.

The contribution of stockbuilding to the year-on-year growth of GDP in 2000 Q1 was zero, as in the two previous quarters. Information from the monthly business survey points to a slight increase in the involuntary component of stocks in Q2, as the proportion of entrepreneurs reporting higher-than-desirable stock levels has increased.

On QNA data, the negative contribution of net external demand in real terms to year-on-year GDP growth declined by one-tenth of a point to –0.2 percentage points in 2000 Q1, continuing the improvement witnessed since 1999 Q2. This result reflects the strength of goods exports during this period, which offset the slowdown in tourism receipts. Imports, for their part, held at a sustained growth rate. The information available for Q2, relating exclusively to balance of payments and foreign merchandise trade figures for April, shows a moderate slowdown in trade flows in respect of both exports and imports, which may have been influenced by the fact that the Easter holiday period fell that month (see Chart 17). In any event, the main exports determinants attest to the highly expansionary behaviour of this aggregate in Q2, against a backdrop marked by the progressive improvement in world economic growth (with the euro area economies furthest behind in the cycle, and which are Spain's main export markets, picking up notably) and the weakness of the euro. The growth rate of imports may have slackened somewhat as a result of strong increases in their prices, although they will have continued to run strongly, underpinned by the

CHART 17

Foreign trade (a)



Sources: Ministerio de Economía y Hacienda and Banco de España.

(a) Non-centred percentage change on same quarter a year earlier, based on the trend of the indicator.

(b) Series deflated by the corresponding unit value indices.

strength of final demand and the recovery in industrial production.

According to official customs figures, goods exports grew by 12.8 % in real terms in the first four months of the year compared with the same period in 1999, building on their buoyancy in the closing months of last year. This expansionary behaviour was due both to the bigger increase in sales to the EU and to the sharp acceleration in exports to third countries' markets, once the effects of the international financial crisis were behind. By type of good, all components exhibited high growth rates; there was a notable acceleration in sales of non-food consumer goods, and in particular of cars, boosted by the improvement in demand and heightened consumer confidence in EU. As to exports of services, tourism receipts were very moderate in the first four months of the year 2000, in sharp contrast to their strength during 1999. Both nominal tourism receipts and the real indicators for the sector (foreign visitors lodged in hotels and tourists entering Spain at borders) slowed in the opening months of the present year. Nonetheless, given the volatility habitually characterising these indicators and the limited representativeness of these results, given that they refer to an off-season period, it will be necessary to wait for the coming months to determine whether the moderation perceived holds firm. Lastly, exports of other services remained buoyant in 2000 Q1, with a strong recovery in transport revenue (linked to the vigour of merchandise exports) and resilient financial services, insurance and IT services.

The pace of goods imports slowed slightly in the first four months of the year, according to customs figures, posting real growth of 11.1 % compared with 13.9 % in 1999 Q4. The slowdown is attributable, at least in part, to the notable increase in import prices, influenced by the depreciation of the euro and the upward course of international prices. Although the biggest price rises have been in energy products, manufacturing import prices have also quickened notably in recent months. In terms of the composition of imports, the marked buoyancy of capital-goods and non-food-consumer-goods imports seen in 1999 moderated. Notable among the latter was the slowdown in car purchases, in step with the ongoing deceleration of consumer durables. Conversely, purchases of non-energy intermediate goods retained the strength they had shown in the final months of 1999, driven by the progressive recovery in industrial production and the thrust of exports (the production of which involves a very high proportion of imported inputs). Finally, purchases of energy intermediate goods were very depressed following the stock replenishment process undertaken by Spanish refineries in the opening months of the year. Moreover, imports of services lost steam during 2000 Q1, although they remained at a high rate: the pace of tourism payments eased slightly, probably influenced by the rise in the cost of foreign travel resulting from the depreciation of the euro, and other non-tourist services slowed across the board, significantly so in the case of payments linked to merchandise and passenger transport.

4.2. Output and employment

The renewed momentum of national demand and the strength of exports were conducive to a growing expansion of GDP in 2000 Q1. From the standpoint of the various productive activities, this took the form of an accelerating profile for industrial activity and a resumed expansionary path for construction. By contrast, there was a notable decline in agriculture, while services held at a sustained rate of increase. The economic information available for Q2 indicates that, in general, these trends tended to extend into this quarter, further accelerating GDP. As earlier discussed, the expansion of economic activity continues to be accompanied by a high rate of job creation, which has provided for a mild though continuous recovery in apparent labour productivity (see Chart 18).

During the opening months of 2000, unfavourable weather continued to exert a highly adverse influence on activity in the primary sector. On QNA estimates, the contraction in the gross value-added of this sector witnessed throughout 1999 intensified, slipping back to a year-on-year rate of –2.4 % in Q1 compared with –2 % in 1999 Q4. This was the result of the sharp contraction in agricultural output during the quarter owing to the heavy fall in winter cereal and olive yields induced by scant rainfall. In addition, livestock production decelerated, with its main components – meat, milk and eggs – losing momentum. As regards Q2, the abundant rainfall in April and May may have provided for a recovery in agricultural output, having occurred at a most propitious time for vegetable produce. In this respect, although the information is as yet very scant, the projected figures for arable land-use and agricultural output furnished by the Ministry of Agriculture, Fisheries and Food show an improvement in the expected output of certain fruit and vegetable products.

The current expansion in industrial activity is a result of the progressive improvement in the international economic environment which, given the weakness of the euro, has entailed a notable increase in exports. Likewise, the buoyancy of certain domestic demand components in the first half of the year has also exerted a positive influence on industrial activity, where gross value-added (including energy) trended strongly, furthering the recovery on which it had embarked in the second half of 1999 and increasing by 3.9 % in real terms in 2000 Q1 compared with the same period a year earlier. The economic information available for Q2 points to an additional strengthening of this branch: the industrial production index grew by 7 % year-on-year in the first five months of the year, up on the level observed at end-1999, while the business confidence indicator held at a very positive level in Q2, incorporating clearly upward output prospects for the coming months. The number of Social Security registrations accelerated again in the period from April to June, thereby entrenching the rising course of employment in industry in the preceding quarters. Generally, the expansion in industry is firmly underpinned, and has extended to most of the associated branches with odd exceptions such as the chemical industry and certain traditional manufacturing industries.

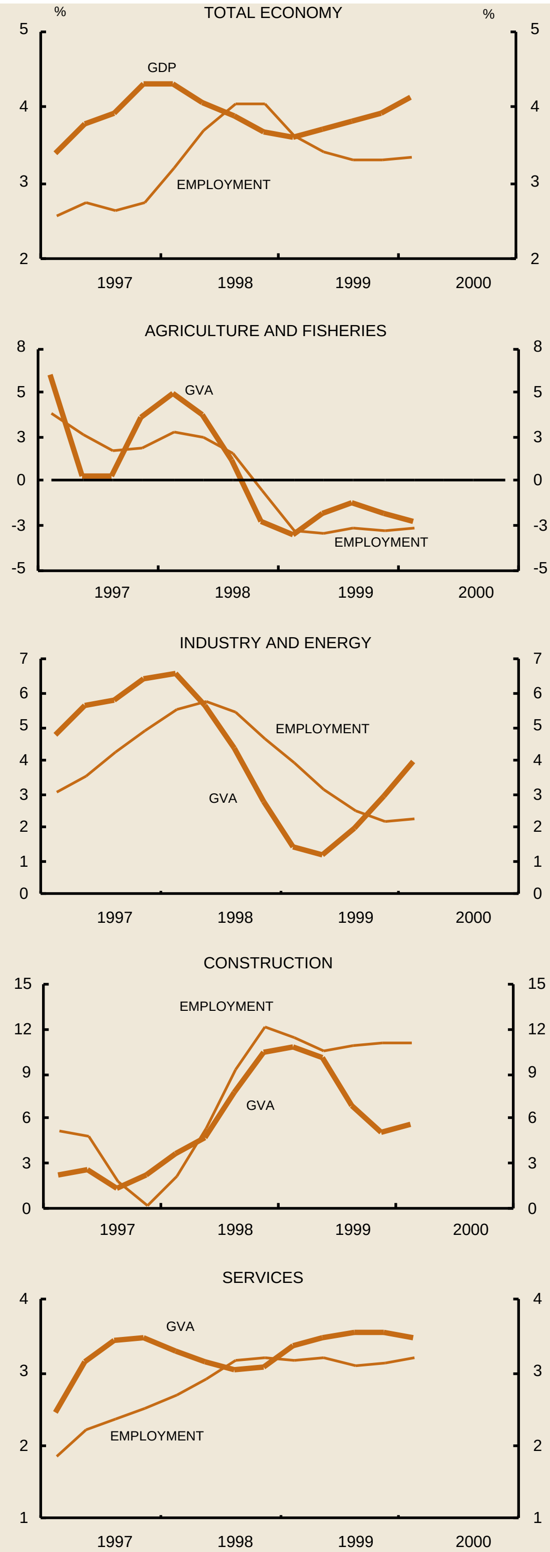
Value-added in construction rose by 5.6 % in 2000 Q1 on the same period a year earlier, turning upwards in a similar fashion to that estimated for investment in construction. As earlier discussed in connection with the behaviour of investment, the renewed momentum of construction in this period was based on the vigour of the building component, since civil engineering works continued to run at negative rates. Nonetheless, this latter component has foreseeably begun a recovery in Q2, to judge by the rising trajectory of the leading indicators of government procurement tenders in the opening months of the year. This development, coupled with the continuing thrust of building, should have further increased the pace of construction in Q2. Indeed, the substantial improvement in construction industry surveys in this period would testify to this fact.

Services activity in 2000 Q1 held on the sustained growth path characterising it in 1999, running at a rate of 3.5 % year-on-year, a very similar figure to the preceding quarters. As was the case in 1999, the buoyancy of this activity was based fully on the vigour of market services, as there was a fresh cut in the growth rate of non-market services. The economic information available for Q2 points to the continuing momentum of market services, with some changes in the activity of the various branches they comprise. Specifically, the hotel and restaurant trade appears to have regained the strength of previous quarters, after slowing in the opening months of 2000 owing to fewer foreign tourists, while the growth rate of retailing and repair activities has tended to stabilise. Lastly, transport, storage and communications services, along with financial intermediation services, have remained buoyant.

As earlier indicated, the Spanish economy continued forcefully generating employment in 2000 Q1, against a more dynamic economic background. On QNA figures, the number of full-time equivalent jobs posted an increase of 3.4 % year-on-year, one-tenth of a point up on the previous quarter, and apparent labour productivity accelerated by the same amount, prolonging the mild course of recovery it had initiated in 1999 Q1. By branch of activity, the pattern of employment was generally in step with that of output, as discussed above (see Chart 18). A key feature was the slight pick-up in industrial employment in Q1, interrupting the declining course it had shown in 1999. Moreover, the greater buoyancy of employment in this branch was compatible with a notable increase in apparent productivity, which resumed growth rates

CHART 18

Gross value added and employment by branch of activity (a)



Sources: Instituto Nacional de Estadística and Banco de España.
(a) Non-centred percentage change on same quarter a year earlier, based on the trend-cycles series published by INE. Employment refers to

more in line with those recorded in the past. In any event, the branches where the biggest growth in employment was seen were market services and, above all, construction, while the process of job destruction continued in agriculture and in non-market services. Job creation continue to be centred on dependent employees, while there was a further decline among the self-employed.

The employment indicators available for 2000 Q2 were very expansionary, although their growth rate tended to ease slightly. Social security registrations slowed during the spring months, running at 5.1 % compared with the increase of 5.4 % recorded in Q1. This moderation was the outcome of the slowdown in the number of employees is registered in construction, while in industry, by contrast, numbers increased with greater vigour, and held virtually stable in services. The mild slowdown in employment, set against the acceleration in activity, should have made for a further increase in apparent labour productivity in Q2.

As usual, the detailed analysis of employment developments is made using EPA (Labour Force Survey) figures. However, regard should be had, when interpreting the results to the successive changes and improvements in this Survey, which have temporarily affected the growth rates of the main variables on which it focuses. The EPA results for Q1 differ from QNA estimates in that they indicate a significant cut in the rate of increase of employment in this period, which stood at 4.7 % [when adjusted for the censual update made in that quarter (2)], five-tenths of a point down on the previous quarter. This deceleration might be partly related to the Easter holiday period falling in 2000 Q2, although it should also be recalled that the year-on-year employment growth rates in the EPA in 1999 might be affected by the changes introduced into the Survey at the beginning of that year. Leaving aside these changes and turning to contract duration, the EPA figures indicate that the various measures to promote stable employment have continued exerting a favourable influence in early 2000, since all the dependent jobs created in Q1 were under the fixed-employment contract category, while numbers of dependent employees with temporary contracts moderated notably. Consequently, the proportion of temporary to total employees was 31.7 %, over one percentage point below the figure for the previous quarter, although two-tenths of this decline would be attributable to the impact arising from the renewal of the sample. As regards the duration of the working day, although part-time employment decelerated markedly in Q1, the associated rate of increase exceeded that for full-time workers, taking the proportion of part-time to total employees to 8.2 % (8.4 % in homogenous terms).

Finally, according to EPA results the labour force followed an expansionary course in 2000 Q1. This is in line with the economy’s current cyclical phase, which is encouraging greater labour market participation, and with the gradual increase in the proportion of women in employment. Specifically, the labour force grew by 2.3 %, according to the homogenous sample (2.8 % if the new sections are used), compared with 1.8 % in 1999 Q4, and the participation rate for the over-16s rose to 51 %. By sex, the participation rate remained higher among males (63.5 %) than females (39.5 %), although the gap between both groups has narrowed, partly because the updating of the sample had a more marked effect among women. Despite the acceleration in the labour force, the ongoing strength of job creation led to a further fall in the unemployment rate, which stood at 15 % of the labour force, four-tenths of a point less than the previous quarter. Nonetheless, the rate of decline in the number of unemployed was considerably cut, in keeping with the trend reflected in the registered unemployment figures in the opening months of the year.

4.3. Prices and costs

In the early months of 2000, the pace of the main price indicators intensified, against a backdrop of dearer energy product prices on international markets and the depreciation of the euro. On QNA figures for the first three months of the year, both domestic produce prices and import prices rose significantly, markedly so in the case of the latter.

The year-on-year growth of the GDP deflator rose to 3.8 %, one-tenth of a point more than the previous quarter. This slight acceleration was the result of the greater expansion by unit labour costs and net taxes per unit of output, while the unit surplus continued to grow significantly, prompting a fresh increase in operating margins. In turn, the acceleration in unit labour costs reflected sharper growth in compensation per employee (2.8 % against 2.5 % the previous quarter), which was only partly offset by the greater buoyancy of productivity. The raw-data QNA series reveal that the acceleration in compensation per employee in Q1 is some eight-

(2) In 2000 Q1, INE updated the censual sections considered in the Survey. To avoid the problems that may arise on calculating rates of change using different samples, INE conducted a parallel survey based on the old sample, thus allowing uniform rates of change to be obtained for 2000 Q1.

tenths of a point greater, largely reflecting the impact arising from the application of inflation-adjustment clauses under 1999 collective bargaining agreements, which were activated in the opening months of 2000 owing to the deviation by inflation during 1999 from the official forecast.

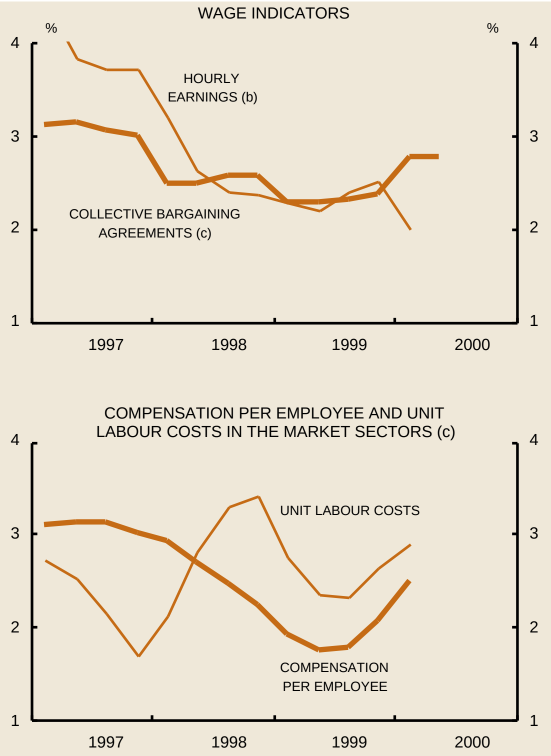
The QNA estimates of compensation per employee contrast with the results of the Wage Survey for Q1, which showed an increase of 2.4 % in total average hourly earnings, signifying a slowdown of two-tenths of a point compared with the increase observed in 1999 Q4. The increase in average hourly earnings in terms of basic pay was even lower (2.1 %), due partly to the fact that these figures exclude the impact derived from the inflation-adjustment clauses (see Chart 19). The wage increases reflected in the Survey in Q1 may be affected to some extent by the sample renewal undertaken at the beginning of each year, and which in the current year has entailed an upward revision of the relative weight of those branches, such as construction, where wage levels are lower. In fact, an analysis of figures by branch of activity shows, in general, an acceleration in wage growth. The biggest increase in average hourly earnings in Q1 was in construction (4.4 %), where there are signs of labour shortages. Wage increases were more moderate in industry and in services (3 % and 2.8 %, respectively).

Set against the aggregate results of the Wage Survey, the increase in wage rates under collective bargaining agreements entered into in the period to 30th June stood at 2.8 %, three-tenths of a point above the related rise in 1999. Most collective agreements registered to date this year have been revised agreements, incorporating a wage settlement of 2.7 %. In newly signed agreements, the average settlement has been 3 %; but this is hardly indicative of how wage negotiations are unfolding this year, since the number of newly signed agreements registered to date has been very limited. By branch of activity, the average settlement in agriculture has been 3.4 %, higher than that in services (2.8 %), industry (2.7 %) and construction (2.5 %).

As regards the value-added deflators and unit labour costs in the main market economy branches, the performance of prices and margins in industry and in market services can be seen to have differed appreciably (see Chart 20). In industry, the value added deflator accelerated significantly in Q1, while unit labour costs tended to moderate as a result of the recovery in productivity in this branch. The depreciation of the euro and the current acceleration,

CHART 19

Wages and labour costs (a)



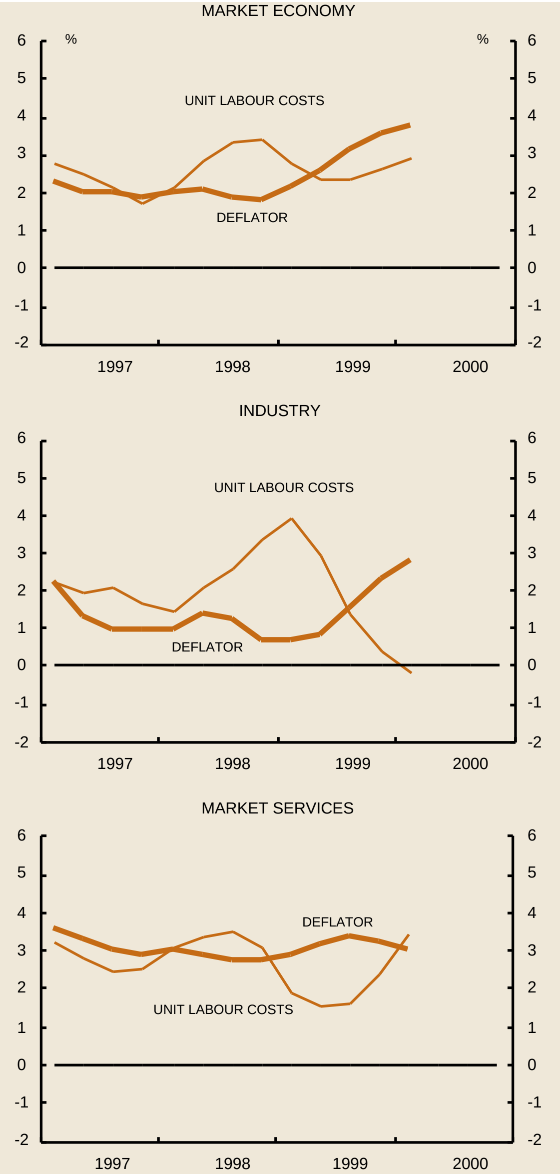
Sources: Instituto Nacional de Estadística and Ministerio de Trabajo y Asuntos Sociales.
(a) Percentage change on same quarter a year earlier.
(b) Basic pay.
(c) Average wage increase for the current year, up to the reference month. Without inflation-adjustment clause.
(d) Rates based on QNA trend-cycle series.

in general, in the prices of imported products that are competing with domestic produce have enabled industrial entrepreneurs to continue pursuing a less moderate price-setting strategy, providing for a pick-up in their operating margins, which had dwindled during 1999. The market services deflator eased slightly, while unit labour costs, reflecting a fresh slowdown in apparent labour productivity, increased by one point more than in 1999 Q4. The growth gap between the deflator and costs closed, giving rise to a minor squeeze on margins. In any event, these trends should be judged in qualitative terms, in view of the difficulties and uncertainty involved in measuring and interpreting apparent productivity and, consequently, the behaviour of unit labour costs.

As in the second half of 1999, the acceleration of the GDP deflator in 2000 Q1 was accompanied by a notable expansion of import prices (6.5 %), such that the year-on-year rate of the

CHART 20

Prices and costs by branch of activity (a)



Source: Instituto Nacional de Estadística.
(a) Non-centred annual percentage changes based on the QNA trend-cycle series.

final demand deflator rose to 4.3 %, three percentage points above the related rate in the same period a year earlier. The performance of the import unit value indices (UVIs), which grew by 12.2 % in the first four months of the year, would indicate that the upward course of import prices may have steepened in Q2. The high growth of this index mainly reflects dearer oil prices on international markets. Nonetheless, driven by the depreciation of the euro and the rise in international prices, the UVIs of non-energy products also accelerated significantly in the first four months of the year to 3.5 % year-on-year, compared with 0.9 % in 1999 Q4.

In this setting, the rising trend marking the course of the main price indicators in the Spanish economy over the preceding quarters has recently been accentuated. The 12-month growth rate of the consumer price index (CPI) stood at 3.4 % in June, half a point above the March level (see Chart 21). This increase was mainly due to the rise in the energy and unprocessed food components. Underlying inflation – for which the index of services and non-energy processed goods prices (IPSEBENE by its Spanish name) provides an approximation – edged up slightly in Q2 to 2.3 % in June. Foreseeably, the measures recently adopted by the government (see Boxes 1 and 2) will contribute to tempering the prices of certain specific products (such as text books or pharmaceuticals). That said, the short-term impact on overall inflation will be scant judging by the limited relative significance of these products in the consumer basket. In any event, the measures planned for key sectors such as gas and electricity production and the distribution of hydrocarbons will no doubt have a beneficial effect over a lengthier horizon.

All the basic components of the CPI accelerated in Q2, with the exception of processed food prices. Assisting the moderation of this item was the fact that the notable price rises posted by specific products (olive oil and wine) in the opening months of 1999 were stripped out of the index. The 12-month growth rate of the energy component climbed to 16.5 % in June following a transitory cut in April which placed it at 13.9 %. The increases in oil production agreed upon by the OPEC countries in the spring have proven clearly insufficient to ease the imbalances in this market, against a background of expanding international economic activity. Nevertheless, expectations of production increases in the coming months have led the price of crude to fall, prior to the cut-off date for this bulletin, to around $26 per barrel. The year-on-year rate of non-energy industrial goods prices increased once more in Q2 to 2.1 % in June, compared with 1.3 % in December 1999. This behaviour suggests that the increases in production costs in Spanish companies, resulting from the rise in the oil and other imported input prices and which have caused a gradual deterioration in wholesale prices, are beginning to feed through also to consumer prices. Services prices quickened in Q2, largely due to the rise in hotel and restaurant prices. Finally, the inflation rate of unprocessed food ran at 3.9 % in June, influenced by meat prices and, over the last month, by potato prices.

The comparison between the Spanish inflation rate and that of the euro area as a whole using the harmonised indices of consumer prices (HICP) shows that the inflation spread with the euro area has held (with fluctuations from one month to another) at slightly over one percentage point since the start of 1999 (see Chart 22). Specifically, it stood at 1.1 percentage points in June. Component by component, there was a gradual increase in the differential for non-energy industrial goods, and the services differential remained in place. In the case of energy product prices, the growth differential has held at high levels, despite having narrowed, owing possibly to the Spanish economy's greater dependence on imports of this type of good.

As regards the other price indicators, the 12-month growth rate of the producer price index remained on a rising trend until June, when it stood at 5.8 %, in tow to the notable increases posted by energy products and, to a lesser extent, to the persistent acceleration in non-energy intermediate goods. The remaining components generally held at more moderate growth rates. Lastly, farm-gate prices, which are a leading indicator of unprocessed food prices, are running at negative rates.

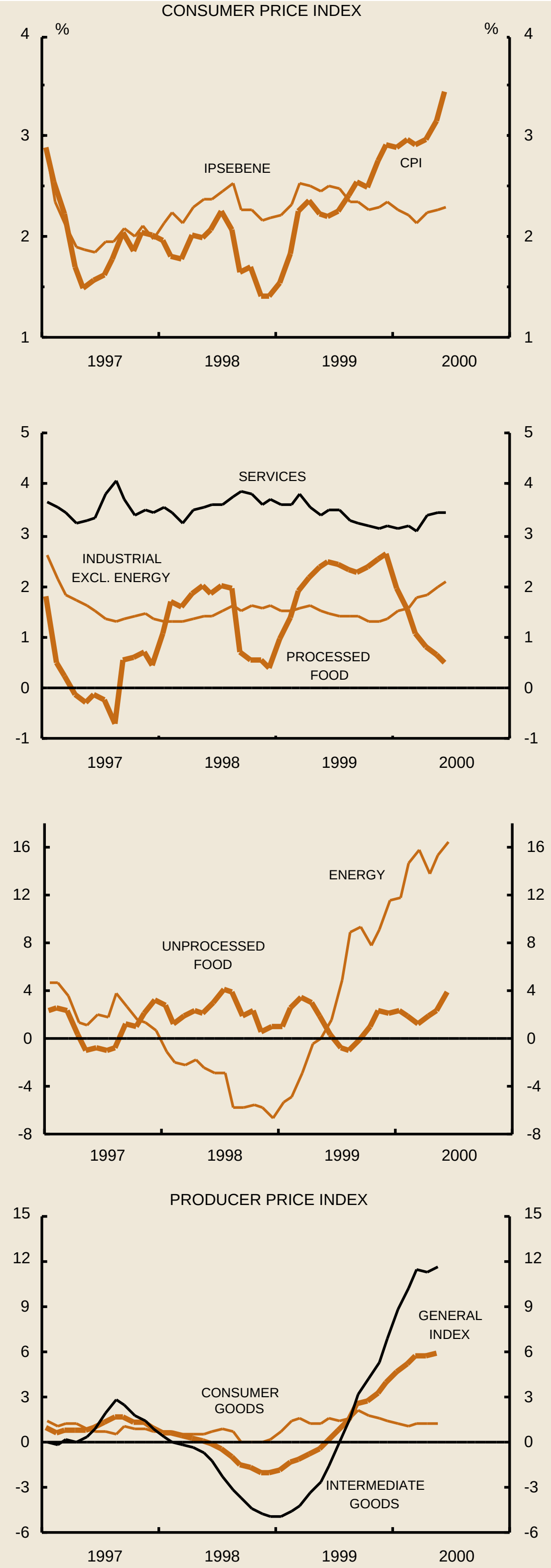
4.4. State budget

Public finances performed very favourably in 2000 Q2, in line with the budget deficit target for this year which has been revised downwards by the government from 0.8 % of GDP, for the overall general government financial balance established in the Updated Stability Programme, to 0.4 %.

Under National Accounts methodology, the State budget outturn to June resulted in a deficit of ESP 129 billion (0.1 % of GDP), a significant improvement on the deficit of ESP 548 billion (0.6 % of GDP) recorded in the same period a year earlier (see Table 3). During Q2, the growth rate of revenue increased while expenditure slowed notably. Revenue rose by 9.2 % (against 8 % in Q1), owing essentially to the strength of taxes on consumption, production and imports, and in particular to value-added tax (VAT), which grew by 17.7 %. Nonetheless, the marked buoyancy of these taxes has moderated in recent months, lowering their growth rate to around four points below that recorded in Q1. Conversely, direct taxes accelerated substantially to 7.7 % (3.4 % to March). As in the previous quarter, other current revenue was considerably cut, mainly as a result of lesser revenue in respect of Banco de España ordi-

CHART 21

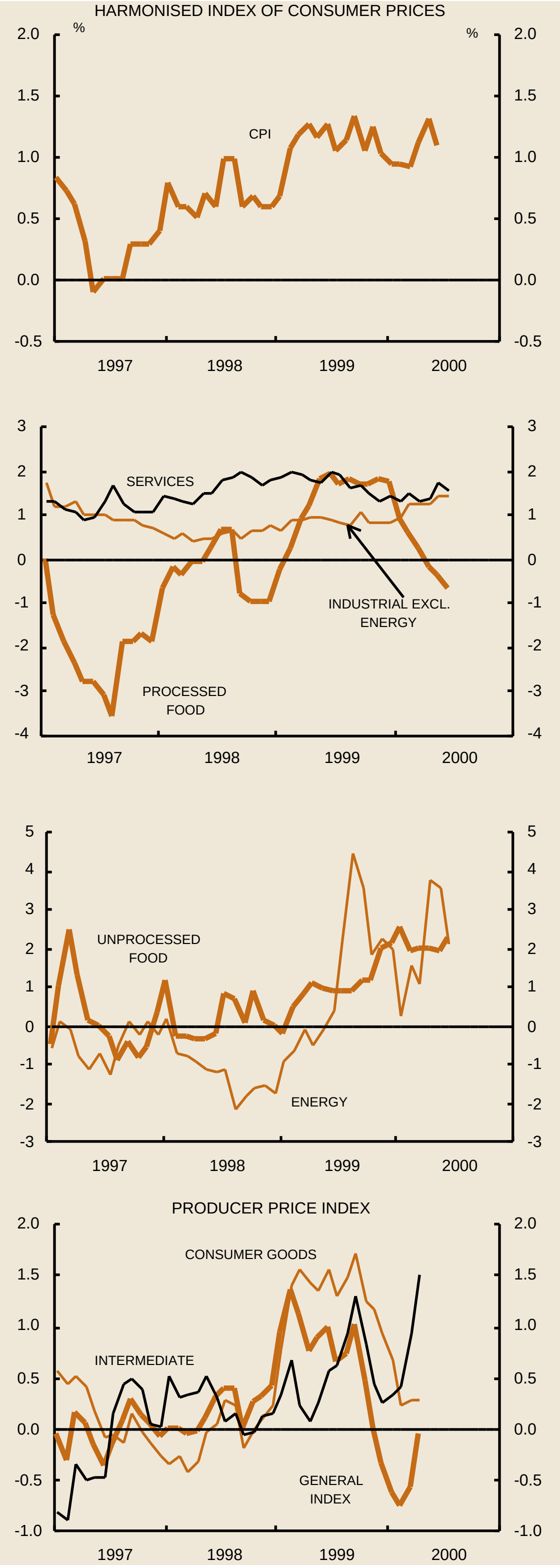
Price indicators (a)
Spain



Source: Instituto Nacional de Estadísitica.
(a) Twelve-month percentage change based on the original series.

CHART 22

Price indicators
Differential vis-à-vis the euro area (a)



Sources: Eurostat and Banco de España.
(a) Twelve-month percentage change based on the original series.

nary profits, while capital revenue, principally from the EU, increased notably.

The growth rate of expenditure stood at 4.3 % (8 % in Q1). The slowdown was attributable above all to the trend of final consumption expenditure, which fell by 12.2 % to June, as a result of the transfer of responsibility for non-university education to the regional (autonomous) governments. For this same reason, current transfers to other general government units increased by 14.7 % in the first half of the year. Finally, mention should be made of the reduction in accrued interest.

In cash-basis terms, the State deficit to June 2000 was ESP 989 billion, down 1.7 % on the same period a year earlier. The improvement in the cash-basis balance, which is in line with the budgeted figure, began in April, once an adjustment had been made for the calendar effects falling in the first three months of the year. The main factor behind the improvement has been the buoyancy of tax receipts. Overall revenue posted growth of 4.4 % in the first half of the year (against a decline of 2.7 % to March), exceeding the initially projected figure for the year as a whole (2.1 %) and also outpacing the increase in expenditure (3.8 % to June, a similar rate to Q1). The breakdown of revenue and expenditure in cash-basis terms is discussed below.

Under revenue, the growth rate of tax receipts intensified in Q2, outpacing the budgetary forecast. However, this overall behaviour masks uneven developments across the various components. Direct taxes increased moderately in the period to June, although they accelerated notably in Q2, while indirect taxes remained very buoyant. Personal income tax receipts, having decreased by 5.3 % to March, picked up to 3.7 % in the period to June. The improved performance of personal income tax was due above all to the trend of withholdings on earned income, which incorporated additional income from the regional governments in Q2. Moreover, receipts relating to withholdings on moveable capital income, though affected by the reduction in the withholding percentage applied to dividends, also quickened in Q2. The rate of decline of corporate income tax slackened substantially as a result of the favourable course of the first pre-payment of this tax in April. The cumulative decline in revenue in respect of this tax was 2.8 % to June (compared with a fall of 66.9 % to March), chiefly as a consequence of the strong increase in tax refunds.

The growth rates to June of all the indirect tax components far outstripped those initially budgeted. As earlier stated, VAT was notably strong, partly because of dearer fuel prices

BOX 3

Social security budget outturn

On budget outturn data to April 2000, the Social Security system ran a surplus of ESP 800 billion, ESP 160 billion (25 %) higher than in the same period of 1999. This performance is the result of growth in revenue of 10.6 % to April, well above the budget forecast (7.9 %), and an increase in expenditure of 8.4 %.

Receipts from social security contributions rose by 9.7 % (6.6 % in the whole of 1999), far above the budget forecast of 6.2 %. This was attributable, above all, to the notable buoyancy of registrations, which grew by 5.2 % year-on-year in the period to June (against 5.5 % throughout 1999). This figure compares with a budget forecast of only 3 % for the increase in the level of contributions by employed workers. The other major source of revenue, current transfers from the State, also increased by 11.3 %, in line with budget forecasts.

The growth of expenditure during the first four months of 2000 stood above the budget forecast for the year as a whole, owing basically to the payment of ESP 66 billion in February as compensation for excess inflation in 1999. Spending on contributory pensions rose by 8.6 % to April; however, this increase is expected to revert somewhat over the next few months. Accounting for the effect of the above-mentioned one-off payment, the increase in contributory pensions amounts to 5.6 %, a figure fairly consistent with the budget forecast. The number of contributory pensions grew by 1.2 % to April, in line with forecast and with the increase observed in 1999. By contrast, sick pay benefits showed a percentage change well above the budget forecast.

As regards INEM (the National Employment Office) expenditure, spending on unemployment contributions grew by 1.3 % to June, compared with a decrease of 2.9 % for 1999 as a whole. This development was attributable to changes in the number of beneficiaries, which fell to 4.4 % in the period to May, in comparison with an average decrease of 9.5 % for 1999. This latter figure captures the slower decline in registered unemployment (6 % to June, compared to 11.7 % in the whole of 1999). In step with the trends observed in 1999, the fall in the number of unemployed entitled to unemployment benefits ran, to May, below the reduction in the number of registered unemployed. The replacement ratio duly rose to 64 % (62.9 % in the first five months of 1999).

Social security system (a)
(Transfers to Regional Governments allocated) (b)
(Current and capital transactions, in terms of recognised entitlements and obligations)

ESP bn and %

	Budgeted			Outturn JAN-APR		
	1999 (c) 1	2000 2	% change 3=2/1	1999 4	2000 5	% change 6=5/4
1. Revenue	**13,519**	**14,583**	**7.9**	**4,801**	**5,309**	**10.6**
Social security contributions (d)	9,032	9,589	6.2	2,987	3,277	9.7
Current transfers	4,326	4,825	11.5	1,766	1,966	11.3
Other (e)	160	169	5.8	47	66	39.0
2. Expenditure	**13,589**	**14,432**	**6.2**	**4,161**	**4,509**	**8.4**
Wages and salaries	2,144	2,267	5.7	761	809	6.3
Goods and services	1,281	1,381	7.9	433	459	6.1
Current transfers	9,959	10,567	6.1	2,926	3,196	9.2
Benefits	9,896	10,499	6.1	2,900	3,168	9.3
Contributory pensions	*7,892*	*8,342*	*5.7*	*2,221*	*2,412*	*8.6*
Sick pay	*505*	*528*	*4.7*	*143*	*162*	*12.8*
Other (f)	*1,499*	*1,628*	*8.6*	*535*	*594*	*11.1*
Other current transfers	64	68	6.9	26	28	6.3
Other (g)	205	217	5.7	41	45	9.4
3. Balance	**–71**	**151**	**—**	**640**	**800**	**25.0**

Sources: Ministerios de Hacienda y de Trabajo y Asuntos Sociales, and Banco de España.

(a) Only data relating to the System, not to the entire Social Security Funds sector, are given. This is because the figures for other Social Security Funds for the year 2000 are not available.
(b) Transfers to Regional Governments to finance the health-care and social services responsabilities they have assumed have been distributed among the various expenditure captions on the basis of the percentages resulting from the General Government accounts for 1995.
(c) For comparative purposes, the budgeted figures are based on the 1999 budget. This is because no data are available yet for that year's overall outturn.
(d) Including surcharges and fines.
(e) Excluding surcharges and fines, and the contribution from the pharmaceutical industry.
(f) Reduced by the contribution from the pharmaceutical industry.
(g) Reduced by the disposal of investments.

TABLE 3

State Budget outturn

ESP bn and %

	Outturn 1999	Percentage change 1999/1998	Budget 2000	Percentage change	Outturn JAN-MAR Percentage change 2000/1999	Outturn 1999 JAN-JUN	Outturn 2000 JAN-JUN	Outturn Percentage change
	1	2	3	4=3/1	5	6	7	8=7/6
1. Revenue	**18,364**	**4.8**	**18,742**	**2.1**	**–2.7**	**9,158**	**9,561**	**4.4**
Direct taxes	7,817	4.8	8,008	2.4	–6.6	3,839	3,984	3.8
Personal income tax	*5,098*	*2.1*	*5,149*	*1.0*	*–5.3*	*3,059*	*3,172*	*3.7*
Corporate income tax	*2,436*	*10.0*	*2,563*	*5.2*	*–66.9*	*624*	*606*	*–2.8*
Other (a)	*283*	*14.9*	*296*	*4.5*	*100.9*	*156*	*205*	*31.8*
Indirect taxes	7,951	13.3	8,558	7.6	15.9	3,954	4,480	13.3
VAT	*5,114*	*17.0*	*5,655*	*10.6*	*19.0*	*2,591*	*3,026*	*16.8*
Excise duties	*2,567*	*7.4*	*2,630*	*2.5*	*9.0*	*1,233*	*1,306*	*5.9*
Tariffs	*144*	*9.2*	*143*	*–0.9*	*12.9*	*67*	*77*	*14.7*
Other	*126*	*5.3*	*130*	*3.3*	*7.6*	*63*	*71*	*12.3*
Other net revenue	2,597	–14.8	2,176	–16.2	–36.4	1,366	1,097	–19.7
2. Expenditure (b)	**19.421**	**4.2**	**19,769**	**1.8**	**3.4**	**10,164**	**10,550**	**3.8**
Wages and salaries	2,979	–2.4	2,888	–3.0	–4.3	1,525	1,369	–10.2
Goods and services	436	12.3	340	–22.0	0.2	227	202	–10.9
Interest payments	3,178	–4.7	2,806	–11.7	–1.8	2,183	2,035	–6.8
Current transfers	10,809	9.1	11,664	7.9	9.9	5,203	5,962	14.6
Investment	957	2.6	1,012	5.8	–8.8	582	531	–8.7
Capital transfers	1,063	6.6	1,059	–0.3	9.2	445	450	1.1
3. Cash-basis deficit (3 = 1 – 2)	**–1,057**	**–5.1**	**–1,028**	**–2.8**	**48.6**	**–1,006**	**–989**	**–1.7**
MEMORADUM ITEM: NATIONAL ACCOUNTS:								
Revenue	18,796	8.7	—	—	8.0	8,999	9,826	9.2
Expenditure	19,882	3.5	—	—	8.0	9,547	9,955	4.3
Net borrowing (–) or lending (+) (c)	**–1,087**	**–43.4**	**–788**	**–27.5**	**12.1**	**–548**	**–129**	**–76.5**

Source: Ministerio de Hacienda.

(a) Includes all revenue from the tax on the income of non-residents.
(b) Includes unclassified expenditure.
(c) The annual figures (columns 1 and 3) are drawn from the Spanish Finance Ministry's response to the Excessive Deficit Procedure questionnaire (ESA 95 methodology).

since the beginning of the year (3). Nonetheless, VAT revenue slowed in Q2, increasing by 16.8 % to June (compared with 19 % in Q1). The growth rate of excise duties also declined (from 9 % to March to 5.9 % in the first half of the year), although the duties on tobacco and car registration remain very buoyant.

The rate of decline of other revenue items eased notably in Q2. This was due above all to the extraordinary revenue arising on the concession of four mobile telephony licences, for an amount close to ESP 86 billion (4), and to the acceleration in capital transfers from the European Union. However, revenue relating to profits and dividends diminished by 33.3 % to June owing to a reduction in revenue from the Banco de España, both that derived from capital gains (5) and that relating to ordinary profits. Further, lower positive debt issuance premia had a bearing on the reduction in the aggregate of other revenue.

As regards expenditure, the slight acceleration seen in Q2 was due to the performance of current transfers, whose growth rate rose from 9.9 % in March to 14.6 % in June. This acceleration was due in particular to the behaviour of transfers to the Community budget, which increased by 11.8 % (after having declined by 9.9 % in Q1), while transfers to regional govern-

(3) Dearer fuel prices do not affect takings relating to the excise duties on hydrocarbons, since a fixed amount is involved. In contrast, VAT (with a rate of 16 % in this case) is applied to the price.

(4) According to a recent decision by Eurostat, this revenue is, under National Accounts methodology (ESA 95), computed as disposals of non-financial assets, i.e. as a deduction from capital expenditure, which reduces the budget deficit.

(5) This extraordinary revenue is not computed on obtaining the balance in National Accounts terms.

ments in respect of their share in State revenue posted the same growth rate as in Q1 (this was a very high rate as a result of the transfer of responsibility for education). The growth rate of the contribution to the Social Security system to finance INSALUD (Spanish Health Service) current transactions also held stable at 6.4 % (as budgeted). Conversely, the rate of decline of interest charges intensified on adjustment of the calendar effect observed in the period to March. Operating expenses (wages and salaries, and goods and services) fell at a sharper rate in Q2, running at close to 11 %. In the case of wages and salaries, this reduction is far higher than budgeted. As for capital transactions, the reduction in real investment was similar to that observed in Q1, in contrast to the budgeted increase, while the growth of capital transfers decelerated substantially to 1.1 %. This increase was due to the absence of payments to RENFE (the State-owned railway company) for most of 1999 owing to the delay in the approval of its Contract-Programme.

4.5. The Spanish balance of payments and capital account

In the first four months of 2000 the current and capital accounts ran an overall deficit of EUR 3,126 million, marking a significant deterioration on the EUR 142 million surplus recorded in the same period a year earlier (see Table 4). This result largely reflects the sharp increase in the trade deficit during this period, essentially due to dearer energy imports, as exports and imports of non-energy goods showed very similar rates of change, in both nominal and real terms. The rate of improvement of the tourism surplus was checked owing to the moderate pace of receipts during this period, and the deficit relating to other services widened as a result of strong growth in payments, especially under communications.

The investment income balance also worsened slightly, reflecting the notable fallback in credit-system income. This was linked to the decline in short-term investment abroad and portfolio investment. Meanwhile, the income of other resident sectors held at a strong pace, in step with the forceful foreign investment of recent years. In addition, payments by general government also increased, owing to the increase in the purchase of government debt purchases by non-residents. The surplus on current transfers held virtually stable, since the increase in flows from the EU in connection with the EAGGF-Guarantee and the European Social Fund was offset by the rise in payments under the Additional Resource (GNP). Finally, the surplus on capital account widened notably in the period under review further to the increase in EU structural funds, specifically the ERDF.

TABLE 4

Balance of payments: summary table (a)

EUR m

	JAN-APR 1999	JAN-APR 2000
	Receipts	Receipts
Current account	**56.361**	**64.115**
Goods	32.514	38.576
Services	14.051	15.199
Tourism	*7.968*	*8.346*
Other services	*6.083*	*6.854*
Income	4.488	4.569
Current transfers	5.308	5.771
Capital account	**1.960**	**2.614**
	Payments	Payments
Current account	**57.828**	**69.586**
Goods	39.439	48.997
Services	8.582	10.108
Tourism	*1.424*	*1.585*
Other services	*7.158*	*8.523*
Income	6.567	6.784
Current transfers	3.240	3.696
Capital account	**351**	**269**
	Balance	Balance
Current account	**–1.466**	**–5.471**
Goods	–6.925	–10.421
Services	5.470	5.091
Tourism	*6.544*	*6.761*
Other services	*–1.075*	*–1.669*
Income	–2.079	–2.215
Current transfers	2.068	2.074
Capital account	**1.609**	**2.345**

Source: Banco de España.
(a) First provisional results.

The increase in the nation's net borrowing reflected in these data denote a weakening of the sectoral balances of households and corporations, against the backdrop of the lower household saving ratio and the marked buoyancy of residential investment and private productive investment. Conversely, the figures available for the first two quarters of the year indicate that the headway in reducing the budget deficit continues apace.

5. Financial flows in the Spanish economy (6)

5.1. Financial flows in the economy as a whole

The information for 2000 Q1 from the financial accounts of the Spanish economy confirms the deterioration in the nation's net financial saving (7) that was apparent in the 1999 figures. Thus, taking cumulative data over four quarters, the stock of the Spanish economy's financial transactions with the rest of the world was –1.1 % of GDP at the end of 2000 Q1 (see Table 5). This was essentially the result of the decline in the saving of households and non-financial corporations, since the contribution of general government was similar to that in 1999 and the credit balance of financial institutions' financial transactions with other sectors rose marginally. The performance of the nation's saving is in step with the Spanish economy's cyclical position, which continues to be one of strong growth largely sustained by the vigour of domestic demand. The Spanish economy's financial position, i.e. the difference between the stock of financial assets and liabilities vis-à-vis the rest of the world (which includes, along with net financial transactions, valuation changes), likewise highlights an increase in the debit balance vis-à-vis the external sector at the end of 2000 Q1.

A more detailed breakdown of the items at the root of this net indebtedness can be obtained drawing on the information from the balance of payments financial account for the period January-March 2000. According to this information, the Spanish economy's net external liabilities increased by 0.7 % in 2000 Q1, in terms of annual GDP, substantially up on the figure for the same period in 1999 (see Table 6). This net indebtedness, which reflects the widening of the gap between non-resident investment in Spain and Spanish investment abroad, is in line with the significant increase in the current- and capital-account deficit, which is analysed in section 4 of this quarterly report.

(6) The information from the financial accounts acting as a basis for this report incorporates ESA 95 methodological criteria. The article «Presentation of the Financial Accounts of the Spanish Economy. ESA 95. 1995-1999» in this Economic Bulletin and Box IV.3 of the Banco de España Annual Report examine the changes introduced into the analysis of the Spanish economy's financial flows by the new criteria. However, economic indicators 8.3 to 8.8 published at the end of this Bulletin do not yet include these new methodological criteria.

(7) In ESA 79 terminology, the balance of the financial transactions account was called net financial saving. In the financial accounts according to ESA 95 methodology, this balance is now called net financial transactions. Likewise, the difference between the stock of financial assets and liabilities of a sector, which was previously called net financial wealth, is now called net financial assets. No distinction is made between both terms as used throughout this report.

TABLE 5

Saving and financial position

	FINANCIAL SAVING AS A % OF GDP (Cumulative data over four quarters)								
	1995	1996	1997	1998	1999				2000
					Q 1	Q 2	Q 3	Q 4	Q 1
Financial saving of the nation	1.0	1.2	1.6	0.8	0.6	0.3	–0.3	–0.6	–1.1
Non-financial corporations and households	6.6	5.0	3.9	2.2	1.1	0.5	0.1	0.1	–0.7
Non-financial corporations	*0.3*	*0.2*	*–0.1*	*–0.7*	*–0.9*	*–2.1*	*–2.8*	*–1.6*	*–2.1*
Households	*6.3*	*4.8*	*4.1*	*2.9*	*1.9*	*2.6*	*2.8*	*1.6*	*1.4*
Financial corporations	1.0	1.2	0.8	1.2	1.0	0.8	0.7	0.5	0.7
Credit institutions (a)	0.8	0.7	0.6	0.9	0.8	0.6	0.6	0.3	0.5
Institutional investors (b)	*0.0*	*0.3*	*0.0*	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*
Other financial institutions	*0.2*	*0.2*	*0.2*	*0.2*	*0.2*	*0.1*	*0.1*	*0.1*	*0.1*
General government	–6.6	–5.0	–3.2	–2.6	–1.5	–1.0	–1.1	–1.1	–1.1

	FINANCIAL POSITION AS A % OF GDP (c) (Fourth-quarter data)					
	1995	1996	1997	1998	1999	2000 (e)
Financial position of the nation	–19.6	–19.8	–20.9	–22.0	–24.9	–25.7
Non-financial corporations and households (d)	82.3	99.6	114.8	148.0	162.1	165.6
Non-financial corporations (d)	*–13.6*	*–6.4*	*–0.8*	*14.6*	*20.0*	*21.7*
Households	*95.9*	*105.9*	*115.7*	*133.5*	*142.1*	*143.9*
Financial corporations (d)	13.6	19.8	24.0	33.6	37.1	38.1
Credit institutions (a) (d)	*12.8*	*17.4*	*20.9*	*28.6*	*32.2*	*33.1*
Institutional investors (b) (d)	*1.1*	*2.7*	*3.6*	*5.3*	*5.5*	*6.0*
Other financial corporations (d)	–0.2	–0.4	–0.5	–0.3	–0.5	–1.0
General government	–49.2	–53.4	–52.5	–52.4	–46.5	–45.1

Source: Banco de España.

(a) Defined according to the 1st Banking Directive.
(b) Insurance corporations and portfolio investment institutions.
(c) Calculated as the difference between outstanding financial assets and liabilities.
(d) Liabilities do not include shares.
(e) First-quarter data.

The main trends observed over the past two years as regards capital inflows and outflows continued during 2000 Q1, albeit, in general, with lesser intensity (see Table 6). Regarding Spanish investment abroad, the most sizeable item was portfolio investment, with net purchases by the non-credit private sector equivalent to 2.4 % of GDP (compared with 1.8 % of GDP in the same period a year earlier). Overall, direct investment abroad was along the lines of the volume recorded in 1999 Q1, although the relative weight of credit institutions increased and that of non-financial corporations diminished. Also, unlike in 1999, the non-credit private sector increased its deposits abroad. Finally, the cumulative change in reserve assets in the period January-March 2000 was a minor one. Broadly, the balance of payments information for April is confirming the aforementioned trends.

As to inward investment in Spain, the pace of direct and portfolio investment inflows was sustained, while indebtedness via credit and deposits fell in comparison with 1999 Q1. Specifically, the ongoing moderation of the credit system's debt continued (assisted by the notable growth of residents' bank deposits), as did the diversification of its sources of financing, with a greater relative resort to long-term deposits and fixed-income securities as opposed to loans and short-term deposits, which accounted in the past for most of credit institutions' external debt.

The sectoral structure of cross-border financial flows retains similar characteristics to those of previous years, albeit now with a net debit balance for the Spanish economy as a whole. In aggregate terms, non-credit private-sector purchases of net assets vis-à-vis the rest of the world has continued to be financed by the in-

TABLE 6

Balance of payments on financial account

% of GDP

	1997	1998	1999	1999 JAN-MAR	2000 JAN-MAR
BALANCE ON FINANCIAL ACCOUNT	**–0.6**	**0.0**	**2.0**	**0.1**	**0.7**
CHANGE IN FOREIGN LIABILITIES	**7.0**	**12.8**	**16.3**	**5.6**	**3.7**
Direct investment (a)	**1.1**	**2.0**	**1.6**	**0.3**	**0.4**
Portfolio investment (b)	2.3	2.9	7.8	2.1	1.6
General government	2.0	0.8	4.5	1.5	0.8
Other resident sectors	0.2	1.6	1.8	0.3	0.4
Credit system	0.0	0.5	1.4	0.3	0.5
Other investment	**3.6**	**7.9**	**6.9**	**3.2**	**1.6**
General government	0.0	0.2	0.0	–0.1	–0.1
Other resident sectors	0.1	0.8	2.7	0.6	0.1
Credit system	3.5	6.8	4.3	2.7	1.5
CHANGE IN FOREIGN ASSETS	**7.6**	**12.8**	**14.3**	**5.5**	**2.9**
Direct investment	**2.2**	**3.3**	**5.9**	**0.7**	**0.7**
Other resident sectors	2.0	2.9	6.0	0.7	0.4
Credit system	0.2	0.3	–0.1	0.0	0.4
Portfolio investment	**2.9**	**7.9**	**7.8**	**2.6**	**2.2**
Other resident sectors	2.0	6.0	5.4	1.8	2.4
Credit system	0.9	2.0	2.4	0.8	–0.2
Other investment	**0.3**	**4.0**	**4.2**	**4.0**	**0.0**
General government	0.1	0.1	0.0	0.0	0.0
Other resident sectors	2.5	3.3	–1.6	0.3	0.8
Credit system	–2.3	0.6	5.8	3.7	–0.8
Reserve assets	**2.1**	**–2.3**	**–3.7**	**–1.8**	**0.0**
MEMORANDUM ITEM: DISTRIBUTION OF FLOWS BY SECTOR (CHANGE IN LIABILITIES – CHANGE IN ASSETS):					
Credit system (excluding Banco de España)	4.7	4.5	4.1	2.2	1.8
Banco de España (c)	–2.1	2.3	–2.7	–1.9	0.8
General government	2.0	0.9	4.4	1.4	0.7
Other resident sectors	–5.1	–7.8	–3.8	–1.6	–2.6

Source: Balance of Payments, Banco de España.
(a) Includes portfolio investment in unlisted shares.
(b) Includes direct investment in listed shares.
(c) Includes reserve assets and intra-system assets.

debtedness of the public sector and of the credit system (see lower part of Table 6).

5.2. Financial flows of households and non-financial corporations

The decline in the saving of households and non-financial corporations referred to above was due to a minor fall in the volume of household saving and to a somewhat more marked reduction in that of non-financial corporations (see Table 5). As a result, household net financial transactions in 2000 Q1, taking cumulative data over four quarters, stood at 1.4 % of GDP, while those relating to non-financial corporations amounted to –2.1 % of GDP. Further, purchases of assets and liabilities in 2000 Q1 ran at a brisk pace, with flows clearly outpacing the seasonal pattern of previous years. Compared with its expansionary behaviour in recent years, private-sector net financial wealth, measured as the difference between the stock of financial assets and liabilities (excluding the stock of shares and other equity), increased only slightly in 2000 Q1 (see the lower part of Table 5).

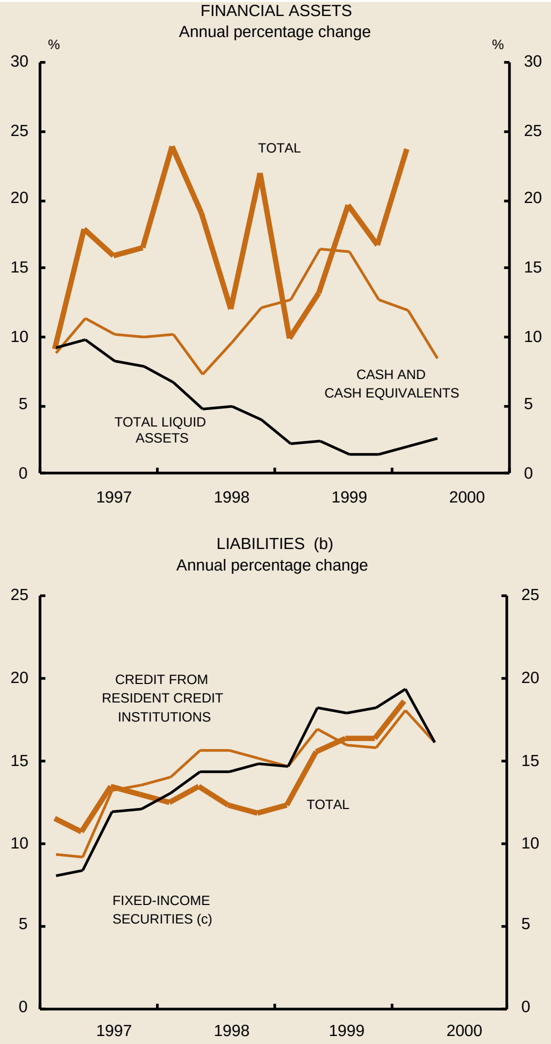
The sizeable volume of financial assets acquired by households and non-financial corporations during the first three months of the year gave rise to notable growth in the stock of assets, the annual rate of which stood at close to 25 % at the end of Q1 (see Chart 23). During this period, cash and cash equivalents continued on the decelerating course they had initiated in mid-1999. Conversely, the growth rate of time deposits increased to an annual rate of 20 %. However, other liquid financial assets taken as a whole (including, in addition to time deposits, repos and shares in money-market and fixed-income mutual funds) continued to run at negative growth rates owing to sales of shares in these collective investment schemes and to the decline in their realisable value. The pace of other financial assets was very intense during Q1, owing first, to the rise in the value of the equity portfolio that has built up in recent quarters and, further, to purchases of foreign assets and to the growth of trade credit.

The expectations of interest rate rises that have firmed since mid-1999 and the greater volatility apparent on equity markets have detracted from the attractiveness of investing in products whose realisable value fluctuates with the price of financial assets (equity and mutual funds). At the same time, they have also raised the opportunity cost of holding very liquid assets, giving rise to a shift in saving from highly liquid assets and high-risk products towards fixed-income investments. Despite the lower growth of cash and cash equivalents, the information available for Q2 indicates a progressive acceleration in liquid financial assets, as a result of the high rate of expansion of time deposits (see Chart 23). The rate of decline of mutual funds, for their part, appears to have moderated.

The year-on-year growth of the liabilities of households and non-financial corporations increased once more in 2000 Q1. This was principally due to the brisker pace of credit from resident banks, the annual rate of which stood at 18 % at the end of Q1. The surge in the growth rate of bank financing in this period, above the habitual seasonal pattern, could denote a bringing forward of the demand for financing given the expectations of interest rate rises that have prevailed during this quarter. Increases in other sources of financing, such as bond and equity issues, were relatively insignificant, although foreign financing continued to provide a constant flow of funds to Spanish companies. The information for Q2 suggests something of a slowdown in financing to households and corporations; having grown at a rate of close to 20 % in recent quarters, it might now be at a level of 16 %-17 %.

CHART 23

Non-financial corporations and households (a)



Source: Banco de España.
(a) The data for 2000 Q2 are provisional estimates.
(b) Excluding shares.
(c) Excluding trade credit.

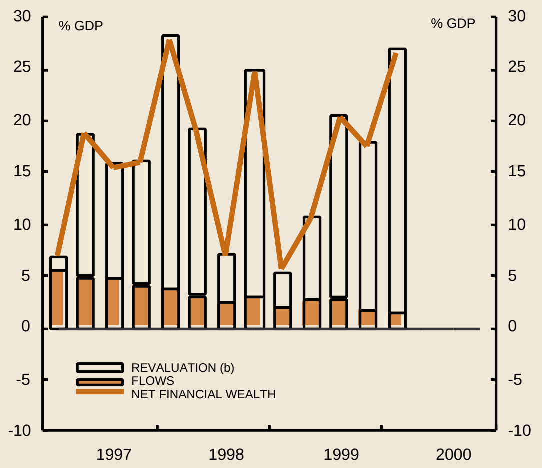
5.3. Financial flows of households

Household financial saving fell moderately in 2000 Q1 following the notable decline in 1999. In any event, the average trend in recent quarters is that of a reduction in the volume of this sector's saving, driven by consumption growth outpacing that of disposable income, and by sustained investment in real assets. Moreover, despite recent interest rate rises, financing conditions remained conducive to households sustaining a high rate of acquisitions of liabilities. Insofar as bank financing progressively incorporates the latest interest-rate rises (in terms both of extending new financing and of revising lending extended at a floating rate), moderation in household private spending and in the associated demand for financing is likely to be detected.

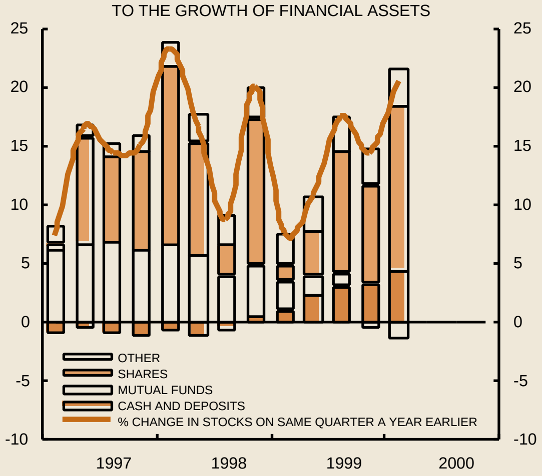
CHART 24

Households (a)

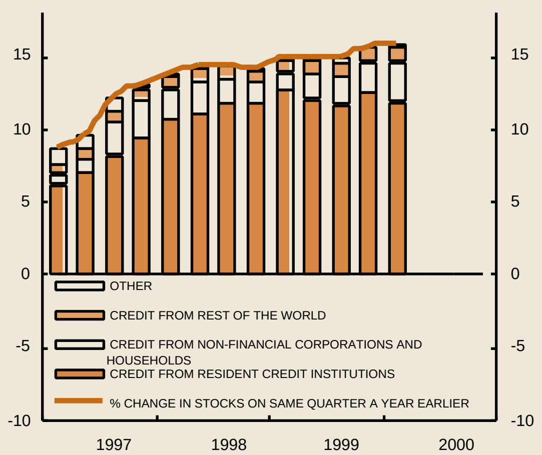
ANNUAL PERCENTAGE CHANGE IN NET



CONTRIBUTION OF THE VARIOUS INSTRUMENTS
TO THE GROWTH OF FINANCIAL ASSETS



CONTRIBUTION OF THE VARIOUS INSTRUMENTS
TO THE GROWTH OF LIABILITIES



Source: Banco de España.
(a) The flows and revaluation data are cumulative data for the latest four quarters.
(b) Change in the stock - flow - changes in volume.

These developments in households' net financial transactions, along with a limited contribution by the revaluation of financial assets, restrained the growth rate of their financial wealth in the first three months of the year. Bearing in mind equity market prices, a fresh slowdown in the growth of households' net financial assets may be expected in 2000 Q2.

As a result of the expansion of domestic demand and favourable finance conditions, the growth of financial resources obtained by households remained at high levels of around 16 % (see Chart 24) in 2000 Q1. The latest information on bank credit to households indicates that this rate of expansion is holding in 2000 Q2. The main end-use of this finance continued to be housing and staple consumer goods purchases. Credit for the purchase of consumer durables, which is one of the uses most sensitive to interest rate changes, continued on the slowing trend initiated in late 1999.

The growth rate of the stock of financial assets held by households increased in 2000 Q1 (see Chart 24), placing the year-on-year rate at 20 %. Contributing significantly to this growth was the rise in equity prices during 1999. The flow of asset purchases was in step with seasonal patterns, following the limited volume observed in 1999 Q4. The value of shares in mutual funds contributed negatively to the growth of household financial assets, although disinvestment from this type of instrument moderated in relation to the preceding quarter. In 2000 Q1, asset purchases continued to be centred on time deposits and, to a lesser extent, on contributions to pension and insurance schemes, although the information on the latter instruments is still provisional. Cash and cash equivalents continued decelerating in the first half of 2000 in the face of the rise in their opportunity cost. The information for 2000 Q2 suggests the continuation of the above-mentioned trends, with high growth in time deposits, slowing cash and cash equivalents and the disposal of shares in mutual funds. Likewise, the sizeable volume of public share offerings with retail-investor tranches in Q2 augurs an increase in household holdings of these securities.

5.4. Financial flows of non-financial corporations

The net saving of non-financial corporations declined in 2000 Q1 to –2.1 % of GDP, in cumulative terms over four quarters (see Table 5). This deterioration reflects the widening of the gap between gross capital formation and gross saving, as a result of the notable rate of advance of the former. If, moreover, regard is had to the acquisition of foreign companies by Spanish corporations (and which constitute installed plant which is not computed in the capital account of non-financial corporations), the financing gap between gross saving and gross capital formation, in Spain and abroad, would have increased by somewhat more than two percentage points of GDP in annual average terms over the past two years.

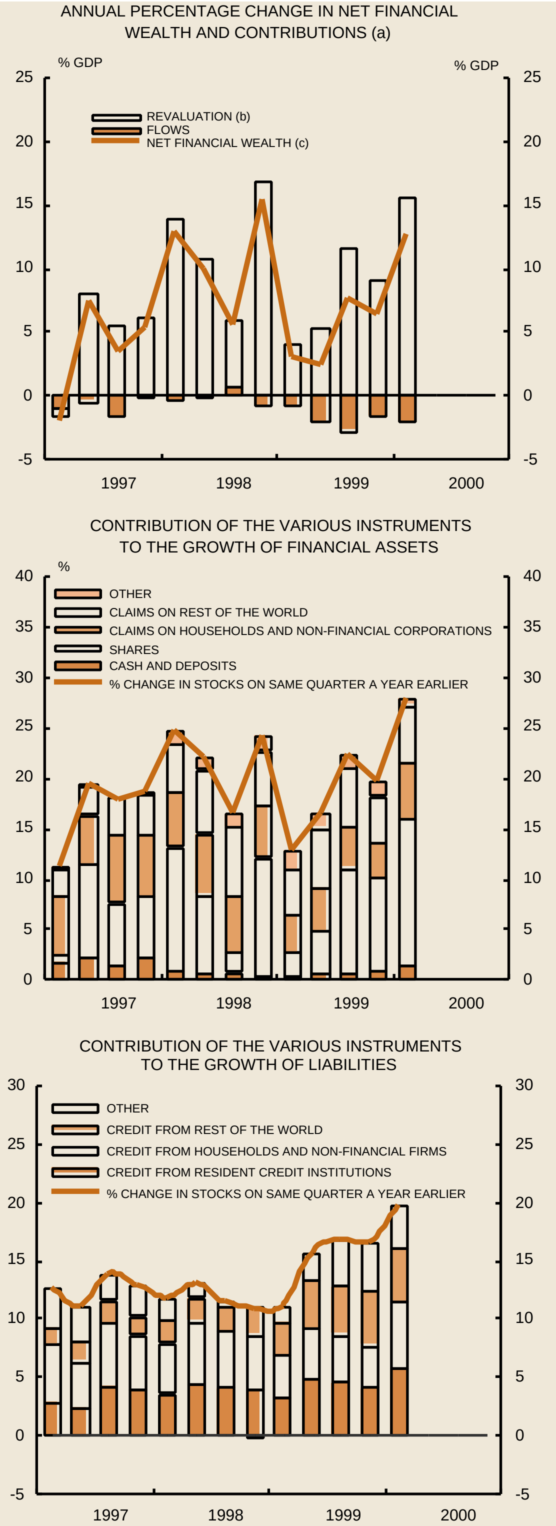
The financing of gross capital formation, enlarged with investment in foreign corporations, means that the equity and borrowed funds of Spanish corporations are having to grow sizably. This process has gathered steam in 2000 Q1, in which the flow of liabilities has increased by a far greater amount than would correspond to the seasonal pattern at this time of year. As earlier discussed, this behaviour may be in response to an attempt to bring forward the raising of resources in view of expectations that financing conditions may tighten in the future. In this way, the aggregate comprising the financing of resident credit institutions, fixed-income securities issues and foreign loans grew by almost 24 % in 2000 Q1, after having held at around 21 % in the second half of 1999. Nonetheless, the growth of this aggregate dipped at the end of Q2, due largely to the mechanical effect on its annual rate of the purchase by Repsol of YPF, which gave rise to a change in the level of the stock of credit in June 1999. Further, non-financial corporations have raised funds of considerable significance in the capital increases that took place during Q2.

Information on the destination of bank finance for 2000 Q1 indicates something of an acceleration in lending extended to productive activities, the year-on-year growth rate of which stood two percentage points above that for 1999 Q4. All sectors contributed to this acceleration, except agriculture, where growth moderated. Financing to construction showed the most expansionary behaviour, running at 24 % year-on-year. However, it was once again the services sector and industry, excluding construction, which most contributed to the growth of the total stock of bank credit, posting annual growth rates of 13 % and 16 %, respectively.

Non-financial corporations purchased a high volume of financial assets during 2000 Q1, essentially in the form of foreign assets and trade credit. Investment in foreign assets accounted for approximately 40 % of total asset purchases in this quarter, and was the outcome of various placements, such as equity purchases, loans to affiliated companies and deposits. In terms of stocks, it was foreign assets and the national equity portfolio which most contributed to the annual growth of corporate assets (see Chart 25).

CHART 25

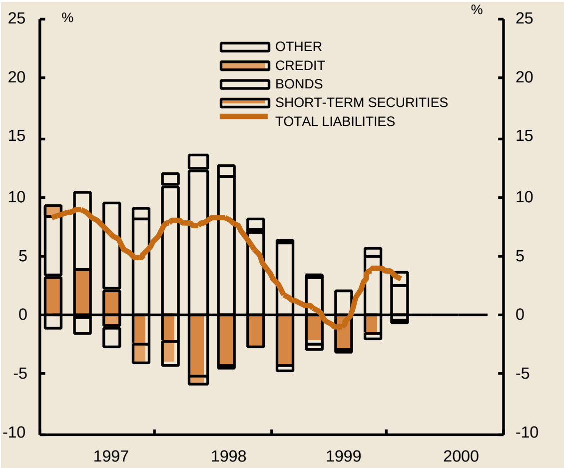
Non-financial corporations (a)



Source: Banco de España.
(a) The flows and revaluation data are cumulative data for the latest four quarters.
(b) Change in the stock - flow - changes in volume.
(c) Shares are not included in liabilities.

CHART 26

Growth of general government liabilities



Source: Banco de España.

The pace of cash and cash equivalents and other liquid financial assets increased somewhat in relation to the previous quarter, although their contribution to the growth of the stock of assets is very small.

5.5. General government financial flows

Over the four quarters to 2000 Q1, general government financial saving stood at –1.1 % of GDP, at a similar level to that seen in 1999 (see Table 5). During the first three months of 2000, the growth of general government liabilities slowed, largely due to interest payments in respect of medium- and long-term government bonds. These payments were concentrated in the opening months of the year (8), offsetting net issues of these securities (see Chart 26). The net volume of such issues amounted to EUR 3.5 billion, despite the fact that there were redemptions for a sizeable amount in March. Once again, there was a negative net issue of short-term securities in 2000 Q1, following positive net issues in the second half of 1999. The data on gross issues indicate an increase in the average amount thereof since end-1999, apparently in response to the greater attractiveness of these securities for investors, in a setting in which expectations of interest rate rises have prevailed. These developments have meant that the average life of peseta-denominated government debt was 5.3 years at the end of 2000 Q1, a similar figure to end-1999. Finally, a large portion of financial requirements during Q1 were met by drawing down transferable deposits, fundamentally the deposit at the Banco de España, the outstanding balance of which declined by almost EUR 6 billion.

The partial information available on the volume of funds raised by general government in Q2 indicates there was a negative net issue of Treasury bills, but only for a minor amount (EUR –339 million). By contrast, there was a net issue of long-term securities totalling EUR 1.5 billion, after redemptions amounting to over EUR 7 billion. Overall, the financing raised by the State via securities issues in Q2, which was EUR 594 million down on that for Q1, is in line with the progressive decline in its borrowing requirements.

31.7.2000.

(8) In accordance with ESA 95 methodological criteria, net financial transactions (flows) and the stock of debt incorporate the net amount of interest accrued and unpaid and, therefore, are reduced when the interest is paid. See the article in this Bulletin referred to in footnote 6.