
Quarterly report on the Spanish economy

1. Overview

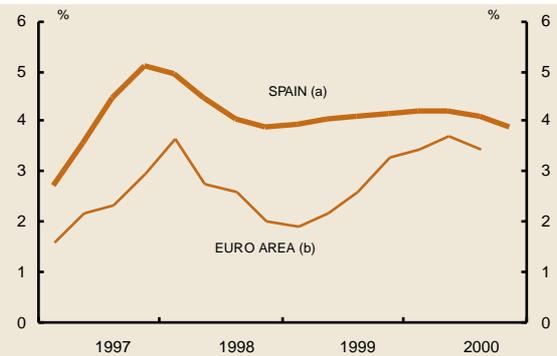
The information available on the performance of the Spanish economy in 2000 Q4 confirms the continuation of the slowdown which began the previous quarter. Preliminary estimates indicate that real GDP growth may have dipped slightly to a rate of 3.9 % year-on-year, compared with 4.1 % in Q3. For the year as a whole, therefore, GDP will have shown a high increase of 4.1 %, albeit moving on a moderately decelerating path in the second half of the year (see Chart 1). This loss of momentum was common to the euro area countries taken as a whole. They posted year-on-year growth of 3.4 % in Q3, a rate likewise below that for the first six months. And, on all signs, this trend extended into the closing months of the year. In both Spain and the euro area the progressive deceleration in activity has originated in the course of domestic demand, and particularly of private consumption. This is the result – among other factors – of the loss of real income inherent to the upsurge in energy prices, the slide in consumer confidence levels and the poor performance of the securities markets. Outside the euro area, the pace of economic growth has also weakened. The main factor here is the greater-than-expected slowdown in the US economy, which is adversely affecting the growth outlook for the world economy in 2001.

The Spanish economy's inflation rate, measured by the consumer price index, climbed above that of Q3 to 4 % on average in the final three months of the year. This result was essentially due to the effects – both direct and those arising from the pass-through via productive processes – of dearer imports, especially of energy products. Food prices also contributed to raising the inflation rate in this period. Only in December could something of a downward correction in the growth rate of consumer prices be discerned, following the movements in the exchange rate of the euro, which began to appreciate significantly as from end-November, and in oil prices, which trended down from the same date. Prices in the euro area showed a similar pattern to that of the Spanish HICP, although the inflation differential between Spain and the area widened marginally in the final quarter, denoting the presence of certain factors of greater inflationary inertia in Spain (see Chart 2).

As indicated, these results have arisen against a backdrop of an external environment marked by growing evidence of a sharper-than-forecast slowdown in the US economy, by the turnaround in the euro and by the downturn in oil prices. These signs of deceleration have affected both investment and consumer spending in the US economy; that said, both the personal saving ratio and the economy's net borrowing requirement have continued to worsen. As a re-

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.

sult, the Federal Reserve, faced with clear indications of an economic slowdown and with prices under control, opted to cut its federal funds target interest rate by half a percentage point on 3rd January. Activity in other economic regions, such as the emerging Asian countries and the Latin American economies, remained most buoyant in the second half of 2000, though this could be affected by expectations of lower US growth, curtailing the expansion of world markets.

In the euro area, where activity and spending have also shown signs of slowing (taking the form of a lower increase in GDP in 2000 Q3), the outlook is for activity being sustained to a greater extent than in the case of the United States. Fiscal policies are exerting a neutral effect on developments in these economies, ensuring compliance with the targets set in the stability programmes for 2000, albeit in a more dynamic environment than initially envisaged. For the year 2001, marginal headway in budgetary consolidation is expected, which in some cases will actually mean an easing of the fiscal impulse. Nonetheless, inflation began to turn in December, prompted by the above-mentioned course of the exchange rate of the euro and of oil prices, and there are prospects of a significant downward correction during the current year. Wage bargaining across the euro area countries generally points, at least in the short run, to moderate wage behaviour, even though there are still risks of upward drift.

In addition to the foregoing the money supply has been slowing, thereby responding to the successive increases in the Eurosystem's offi-

cial rates, which have risen by 225 basis points in the period from November 1999 to October 2000. Conversely, credit extended to the private sector has proven more resilient to the slowdown, although credit developments have been affected by specific operations, which hamper their interpretation. Against this background, the Eurosystem has opted to hold its official interest rates unchanged since 5th October (the date of the last rise), acknowledging the alignment of monetary conditions with the current cyclical position of the euro area economy. The maintenance of the Eurosystem's interest rates has been compatible with a slight downturn in long-term interest rates.

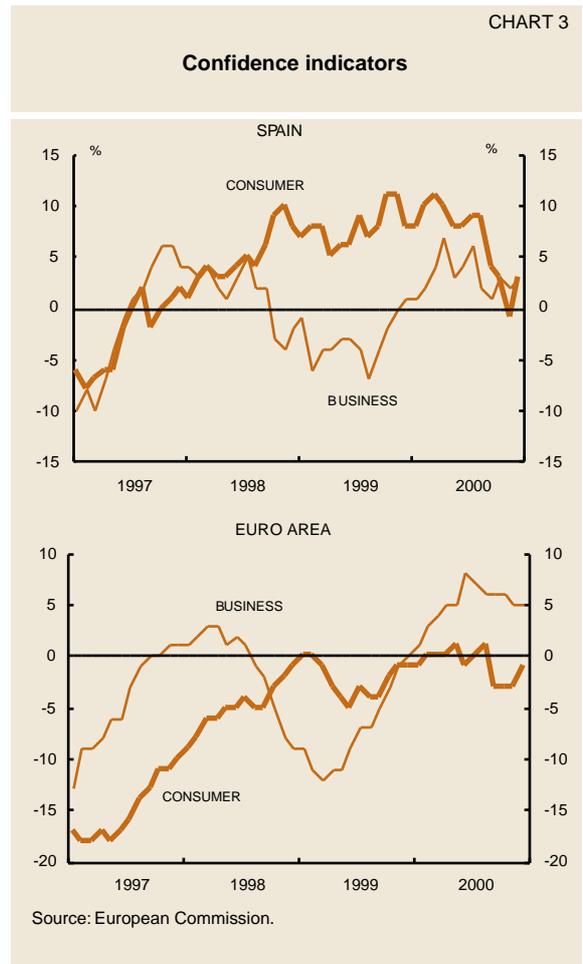
Monetary and financial conditions in Spain reflect a slowdown in corporate and household liquidity similar to that of the euro area as a whole, while credit growth has held at very high rates. Money and debt market interest rates have turned down recently, although bank rates (lending rates in particular), which move with a greater lag, were stable during Q4.

General government conduct in the closing months of the year followed a similar pattern to that of the first three quarters. Although the final data on the State budget outcome are not available yet, the information to November augurs comfortable compliance with the budget deficit target for the year 2000, set at 0.3 % of GDP. As in 1999, this result has been achieved against a background of higher growth than initially envisaged, which has translated in turn into a higher-than-expected increase in revenue, allowing an above-budget increase in expenditure to be financed. However, final general government demand (government consumption and public investment) is estimated to have remained moderate throughout the year.

As earlier indicated, the Spanish economy continued to slow in 2000 Q4, the estimated GDP increase in this period having been 3.9 % year-on-year. Domestic demand determined this performance, its year-on-year rate of change dipping to 3.9 % from 4.1 % the previous quarter, while the contribution of net external demand, according to the information available to date, continued to improve and ceased to be negative. The year 2000 thus closed with annual average growth of 4.1 %, very close to that of 1999 (4 %), though with a different composition: national demand slowed by eight-tenths of a point as a result of the lower growth rates of both private consumption and investment, while the contribution of net external demand to growth was negative of the order of -0.2 percentage points, compared with -1.5 points in 1999.

Combining to detract from the buoyancy of household expenditure during 2000 was the worsening of household expectations (see Chart 3) and the loss of value of financial assets (stock market asserts in particular), against a backdrop of tighter monetary conditions. Notwithstanding, consumer spending growth is estimated to have continued outpacing that of disposable income, giving rise to a fresh fall in the saving ratio. If it is further taken into account that house purchases, despite decelerating, retained a high growth rate throughout the year, the outcome is a notable squeeze on households' lending capacity. As can be seen in Chart 4, which plots sectoral financial saving (the net lending or borrowing of sectors, estimated using financial flows), the stock of household saving reached a trough as a percentage GDP in 2000 Q2. This is a further factor that could be behind the slowing trend of consumption (the need for households to rebuild their saving levels) and one that foreshadows the moderate behaviour of this type of spending in the near future.

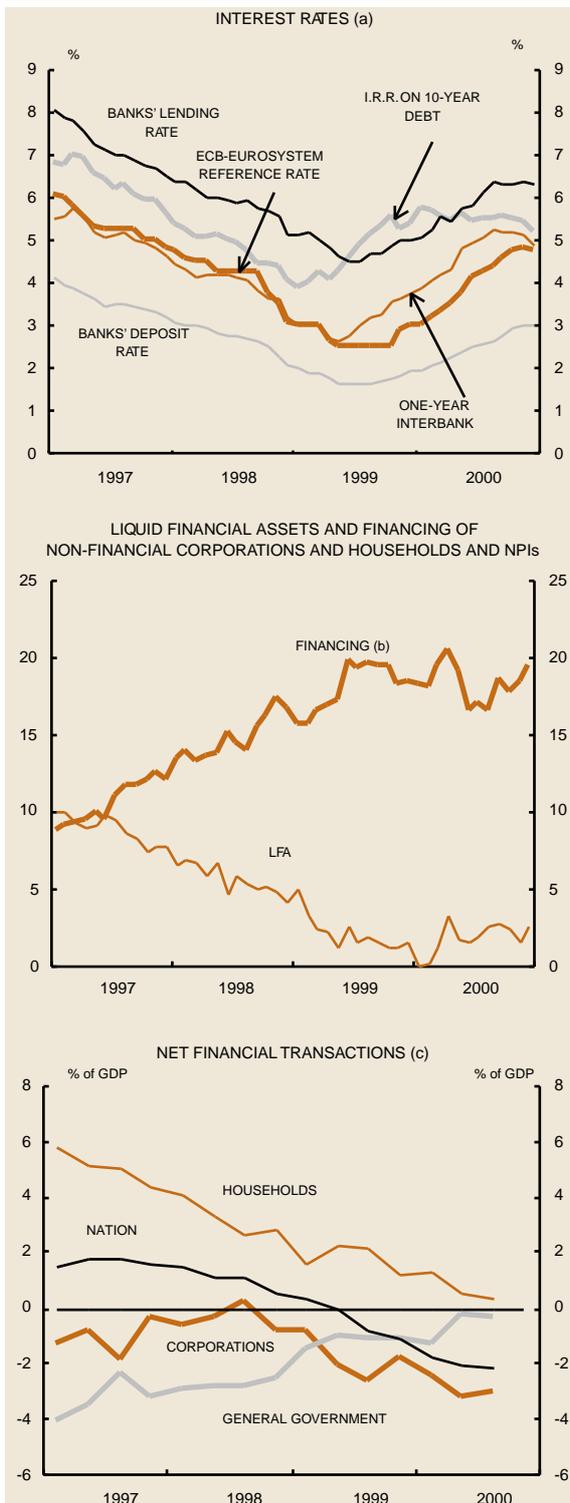
The growth rate of investment in capital goods was progressively cut during the year 2000. It likewise remained moderate in Q4. As elsewhere indicated, this is in contrast to the healthy position companies continue to show and the high return on assets they have achieved. However, the falling profile of corporate expenditure is consistent with the interest rate rises since late 1999 and with demand prospects which may have been revised, to some extent, owing to developments in the US economy (with the ensuing global consequences) and to the positive price and cost differentials building up in certain industries. In any event, the financing of investment both inside and outside Spain has led to a significant increase in companies' borrowing requirements, as reflected in their net financial saving.



The contribution of the external sector to GDP growth turned progressively less negative as the year 2000 unfolded, reaching an equilibrium position in the closing months. Exports benefited from the pick-up in the world economy, which prevailed for most of the year, and from the depreciation of the euro. Exports to non-EU regions were particularly expansionary, while within the EU (and the euro area in particular) they displayed lower growth rates due partly to the lack of exchange rate-induced gains in competitiveness in this market. Indeed, the growth of unit labour costs in Spain is running higher than in the European countries as a whole, eroding the competitive edge of Spanish products over these countries' goods. Imports were influenced by the declining profile of domestic demand, in the second half of the year, and by the effect of the euro's cumulative depreciation, despite its recent recovery. As a result, imports continued to lose steam in Q4. Nonetheless, dearer import prices meant that, despite the trend of real flows, the trade balance deteriorated significantly over the course of the year, contributing to the increase in the nation's net borrowing.

CHART 4

Financial indicators of the Spanish economy



Source: Banco de España.

- (a) The series are averages of daily data.
- (b) Includes bank loans extended by resident and non-resident credit institutions, fixed-income securities and financing through securitisation funds.
- (c) Cumulative four-quarter data.

The slowdown in GDP in the second half of 2000 was accompanied by a similar performance in employment which, it is estimated, ended the year with an increase of 3.3 %, three-tenths of a point down on 1999. As to price formation, there was an upsurge in costs arising both from dearer imports and from the behaviour of labour costs. And this against a background of high demand growth which has, overall, allowed corporate margins to be sustained. Price indicators have reflected these developments in costs. The CPI quickened progressively during the year up to a 12-month growth rate of 4 % in December, after peaking in November at 4.1 %. Although the acceleration was sharper in the energy component, it was also observable in the prices of non-energy industrial goods and of services, owing to the feed-through of greater costs to the final prices of these products. This has distanced Spain somewhat from the results posted in other euro area countries, giving rise to a widening of inflation differentials in most of the HICP components, probably as a consequence of a parallel widening in cost differentials and of a fuller pass-through of such costs to final prices.

In sum, the year 2000 has ended with very favourable results in terms of growth and job creation; but it evidences, in turn, a degree of divergence from the euro area regarding the behaviour of prices and costs. This poses a risk of a loss of competitiveness, a risk that might heighten during the coming year against the background of an appreciating euro. The inflation-adjustment clauses built into wage agreements entered into in 2000 already mean that part of the temporary acceleration in prices, derived from dearer energy, is feeding through to wages, unlike what is happening in other euro area countries. If collective bargaining in the year 2001 is not approached seeking to resume an inflation rate at levels compatible with price stability but rather taking as a basis the current growth rate of the CPI, there will be a greater risk of a further acceleration in costs and of setting even greater distance between Spain and its fellow EU members. The economy is now at a junction. Either it can confront the challenge of returning to the path of income moderation that enabled it to lock into an area of nominal stability and move towards real convergence with the most advanced EMU members. Or it can lapse into behaviour more in keeping with an indexed economy which, given the lack of alternative adjustment mechanisms, would sap the economic and job creation growth potential shown in recent years.

2. The external environment of the euro area

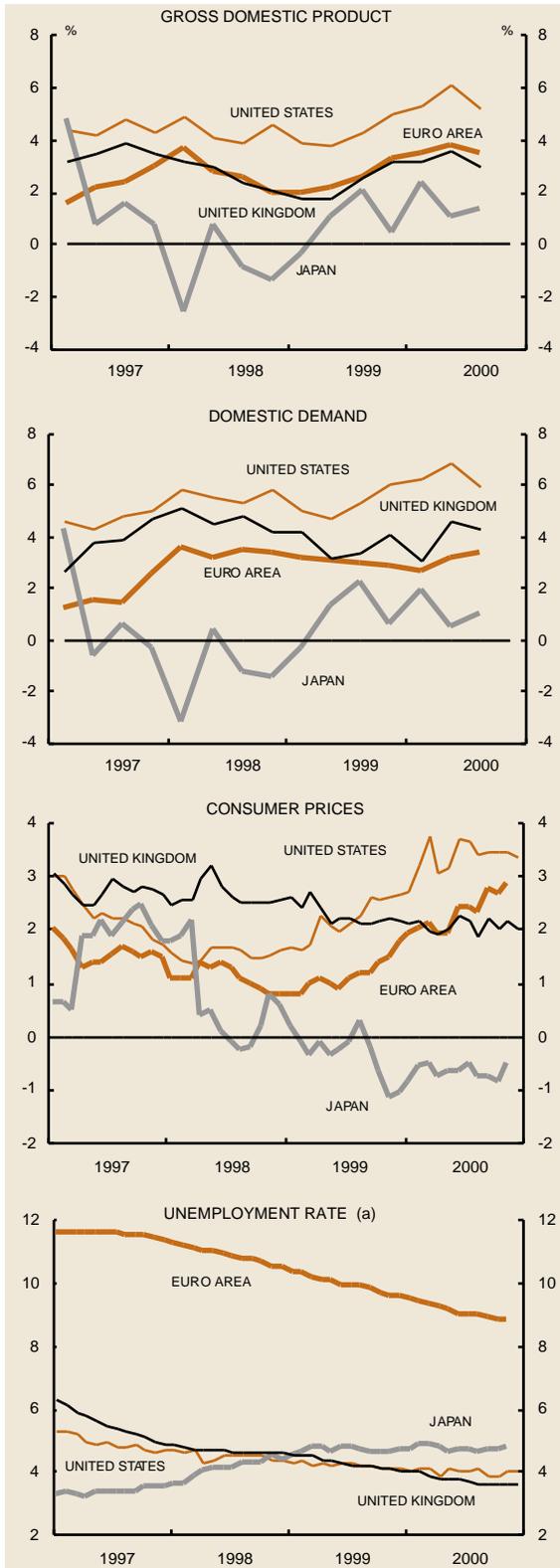
The latest information on economic developments in the external environment of the euro area points to a reduction in the pace of growth during the final months of the year 2000. The basic causes here lie in the signs of a greater than initially envisaged slowdown in economic activity in the United States, in the persisting weakness of the Japanese economy and in the indications of a loss of steam in certain emerging economies. Against this background of economic deceleration, the fall in oil prices on international markets since November has eased somewhat the inflationary pressures prevailing in most industrialised economies. Economic developments in the United States and Japan have determined the recent trajectory of the foreign exchange markets. In particular, the dollar has gradually depreciated against the euro since late November, this being associated with the perceived deterioration in the outlook for the US economy. At the same time, the yen has weakened against the dollar and the euro, largely as a result of the growing fragility of the process of recovery in the Japanese economy. Nonetheless, in effective terms, the final quarter of 2000 has been marked by the notable appreciation of the dollar, the yen and sterling, by 10.5 %, 3.4 % and 1.7 %, respectively. In the closing weeks of the year, as the signs of world growth moderating became progressively clearer, the ongoing reduction of short and medium-term interest rates in the United States and Europe intensified. Lastly, the widespread downward trend of stock market prices continued in 2000 Q4, affecting new technology stocks particularly sharply. Taking average levels, the Nasdaq index fell by 30 % between September and December, while the Dow Jones index slipped back 2.4 % over the same period. In the opening weeks of January, however, there has been something of a rally on most international stock markets.

On the latest revised US National Accounts data for 2000 Q3 (see Chart 5), the annualised quarter-on-quarter growth rate of GDP stood at 2.2 %, far below the figure of 5.6 % posted in Q2. This deceleration in activity reflected, above all, the lesser increase in private fixed investment and in public spending, since private consumption held at a high growth rate and the contribution of external demand to GDP remained relatively stable.

The indicators available for Q4 show economic activity to have lost further momentum, consistent with a quarter-on-quarter rate of change in GDP closer to zero. Of particular note are the rapid slowdown in industrial output, the successive falls in the NAPM index of manufacturing activity, and the diminished buoyancy of the job creation indicators. On the demand

CHART 5

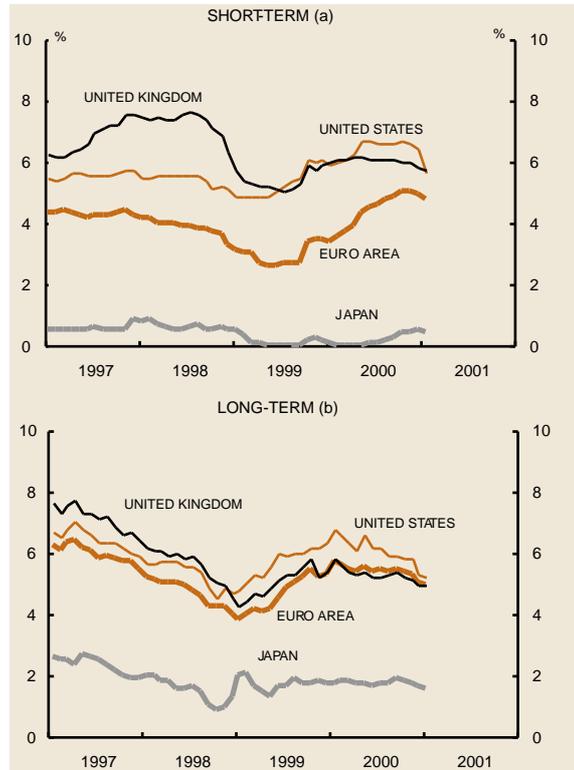
**Main macroeconomic indicators.
Annual rates of change**



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 December 1998, weighted average of the eleven euro-area countries; thereafter, three-month EURIBOR.

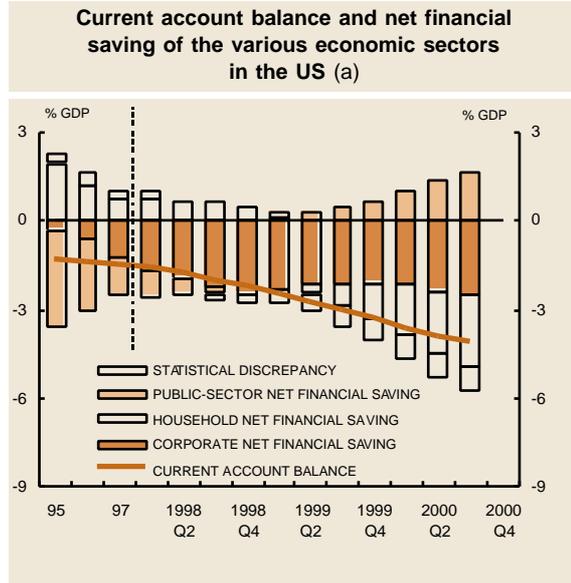
(b) Ten-year government bond yields. Euro area: until December 1998, weighted average of the eleven euro-area countries.

side, virtually all the private consumption indicators worsened in the final months of the year. Nonetheless, despite signs of household spending decelerating, the personal savings ratio reached a new low in November of -0.8 %, a reflection of the moderate growth of personal income.

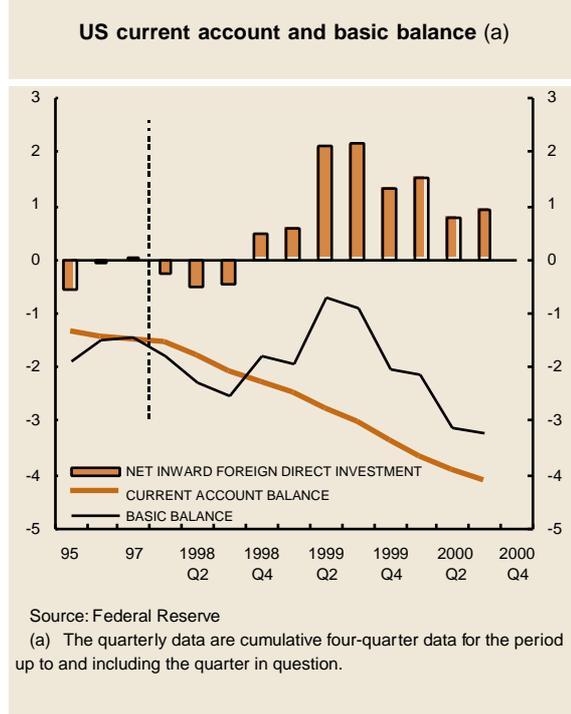
As regards macroeconomic disequilibria, the balance of payments on current account worsened further in Q3, running a deficit of 4.5 % of GDP (see Chart 7). This was due almost in its entirety to the increase in the trade deficit. As Box 1 explains, the progressive deterioration in the current-account balance in recent quarters reflects the need for the US economy to attract foreign saving to finance its strong investment process. If the reduction in oil prices and the improvements in competitiveness arising from the recent depreciation of the dollar take hold and if, as is foreseeable, the growth differential between the US economy and the other industrialised countries narrows, the external imbalance might be corrected in the coming months.

Deceleration of the US economy and adjustment of sectoral financial balances

The sharp growth of the US economy in recent years has been accompanied by significant sectoral restructuring in its financial accounts. As can be seen in the upper panel of the accompanying chart, the financial position of the household sector has moved out of surplus to show negative net financial saving which has reached historically low levels in 2000 Q3, accounting for -2.4 % of GDP. This singular household financial position has come about against the background of the prolonged US economic expansion which, on one hand, has enabled levels close to full employment to be attained and, on the other, has been conducive to an extraordinary rise in stock market prices, raising household financial wealth most substantially. Similarly, as regards companies, the financing of the intense investment process (with an annual average growth rate close to 10 % in the last five years) that has accompanied the upturn has led to a progressive increase in this sector's borrowing needs, which exceeded 2.5 % of GDP in 2000 Q3. Overall, net private sector saving has turned around from a positive balance in 1996 to account for close to -5 % of GDP.



The sound performance of public finances, which have run a surplus during the past two years and stood indeed at 2 % of GDP in 2000 Q4, has acted as a counterweight, though one insufficient to prevent a progressive increase in the current-account deficit to 4.5 % of GDP. This deficit largely reflects the ability shown by the US economy to capture foreign capital lured by expectations of growing corporate profits in a highly dynamic economic setting. Foreign capital has thus been channelled in a non-speculative fashion and, particularly, in the form of direct investment in the most promising sectors (see bottom panel). The stability inherent in a large portion of capital inflows has meant that the degree of vulnerability of the US external financial position is much lower than the high current-account deficit would at first sight suggest.



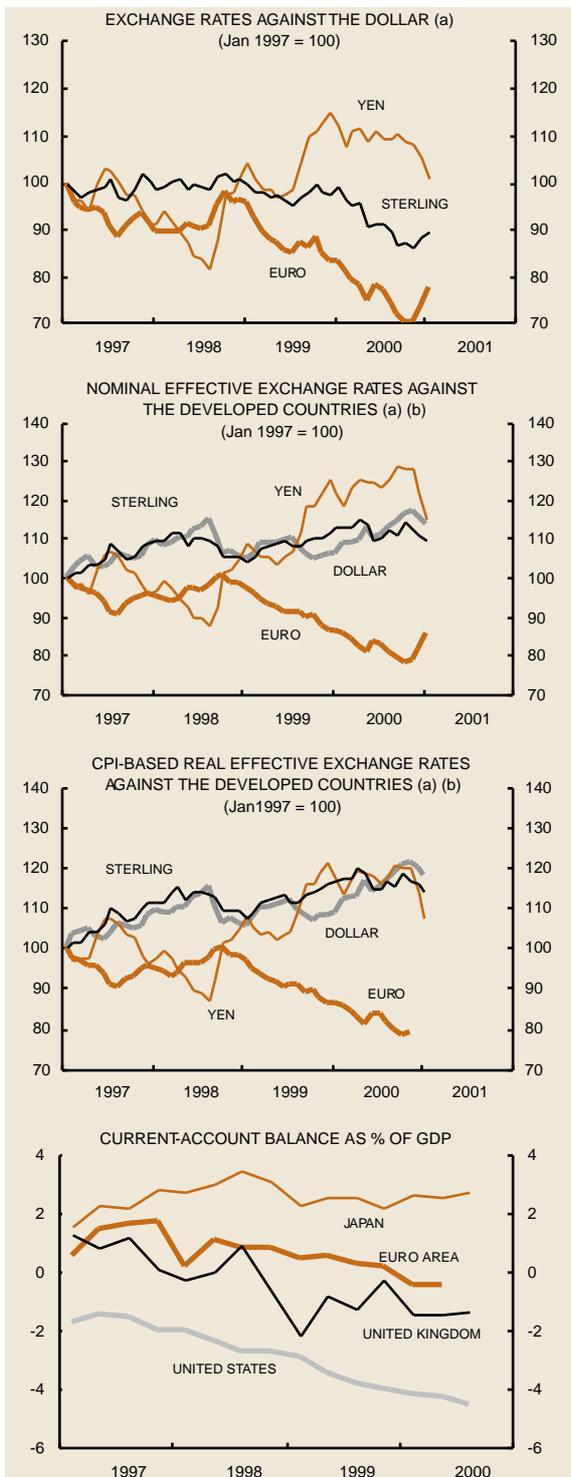
Source: Federal Reserve
 (a) The quarterly data are cumulative four-quarter data for the period up to and including the quarter in question.

Nonetheless, since mid-2000, the economy has moved into a decelerating phase which appears to have taken root in the final quarter in the light of the latest indicators available. This moderation in the growth rate of economic activity has been accompanied by a significant correction of stock market prices (leading household financial wealth to slip) and by less buoyant corporate profits and diminished expectations as to their future course, thereby prompting a contraction in private consumption and business investment. These adjustments might be propitious to a restructuring of inter-sectoral financial flows: a higher household and corporate saving ratio would enable the economy's financing needs to be lessened, despite the likely reduction in the public-sector surplus. Moreover, the moderation of capital inflows in the wake of the temporary worsening of expectations would also provide for a depreciation of the dollar which would contribute to easing further the current-account deficit position.

Evidently, however, a sudden revision of profit expectations by international investors would lead to far-reaching portfolio shifts that might require more drastic adjustments than expected in US agents' spending decisions so that such agents might respond to the tightening of financing conditions.

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.

Turning to price and cost developments, the rise in wages during Q4 and an inflation rate holding at marginally over 3 % were both worthy of mention. According to the hourly earnings figures, wages rose by 4 % on the same period a year earlier, three-tenths of a point up on the related figure in the previous quarter. This increase in wages has been prompted by the tightness still present in the labour market, since the unemployment rate stood at 4 % in November, despite the lesser pace of growth of employment. Likewise, the year-on-year rate of change of productivity appears likely to have moderated in the closing months of the year, whereby the course of unit labour costs will contribute, to a lesser extent than in the past, to restraining inflationary pressures. The 12-month growth rate of the CPI stood at 3.4 % in December, one-tenth of a point below the September figure. This marked stability of the general index during Q4 has been the case for most of its components. As a result, the index that strips out fresh food and energy stood at 2.4 % in December, unchanged on September. Against this backdrop, the Federal Reserve decided at its informal meeting on 3rd January unexpectedly to alter the monetary policy stance, agreeing to a cut of 50 basis points in the federal funds target rate to 6 %. The decision was motivated by the weakness of sales, output and confidence indicators, by the pressures in certain financial market segments and by the deterioration in household and corporate purchasing power arising from the increase in oil prices. The measure brought about a substantial and immediate downward revision of short and long-term interest rates both in the United States and in other industrialised countries. However, in the days following the Federal Reserve's decision, long-term interest rates on the US debt market moved progressively upwards and even exceeded their end-December level in mid-January.

The budgetary policy stance has remained moderately restrictive. Despite the slowdown in revenue foreseen for the final quarter, as a result of sluggish economic activity, this stance might provide for a public finances surplus of around 1.5 % of GDP for the year 2000 as a whole.

Japanese GDP in 2000 Q3 grew at a weak rate of 1.4 % on a year earlier (1 % in annualised quarter-on-quarter terms), three-tenths of a point above the rate for the previous quarter. This slight acceleration was the result of the greater buoyancy of domestic demand linked with the strong increase in gross private fixed capital formation. Conversely, private consumption remained as slack as in previous quarters. The contribution of external demand to annual

Argentina's financial arrangement with the International Monetary Fund

In the final months of 2000 the Argentine economy was beset by a delicate financial situation, the outcome of a sizeable increase in its public-sector borrowing requirements combined with high interest rates on international markets.

The deterioration in public finances arose mainly from the difficulties in increasing government revenue, given the sluggishness of economic activity, and prompted a failure to meet the budgetary targets agreed upon with the IMF for the first half of the year 2000. This non-compliance, along with the lack of strength shown by the economy, resulted in an investor confidence crisis as to the ability of the Argentine economy to pay. The interest rates on Argentine debt issues on international markets duly rose significantly. Faced with this situation, the government approved a series of ambitious measures in late October aimed at reinforcing investment and economic growth. Then, in early November, it entered into negotiations with the IMF to reach a new agreement.

After more than two months of negotiations, the IMF approved the financial aid package for Argentina on 12th January. The arrangement was very favourably received by the market. And once certain aspects of its content became known, the high interest rates on Argentine debt on international markets declined. The main elements of this agreement are set out below, addressing both the financing conditions and the economic policy commitments entered into by the Argentine authorities.

Financial package negotiated with the IMF

USD bn

	Total	2001
International Monetary Fund	13.7	8.8
IDB and World Bank	5.0	2.0
Spanish government	1.0	1.0
Market-makers	10.0	10.0
Argentine institutional investors	3.0	3.0
Administration of liabilities		0.6
Euro	1.0	
Dollars and pesos	3.0	
Coupon reinvestment	3.0	
Total	39.7	25.4

Source: Argentine Ministry of Economy.
(a) Includes \$2.1 billion paid out in December 2000.

1. Financing envisaged

- The IMF raised the financing ceiling to USD 13.7 billion, equivalent to 500 % of Argentina's quota with the IMF. Of this amount, 2.74 billion will be drawn down under the Supplemental Reserve Facility (SRF), while the rest will be under the Stand-By Arrangement (SBA).
- In the year 2001, Argentina may apply for a maximum disbursement of USD 6.7 billion, of which 2.9 billion may be drawn down in the first quarter. In each of the following quarters, disbursements will have a ceiling of USD 1.26 billion.
- The remaining multilateral contributions total USD 5 billion, the World Bank and the Inter-American Development Bank each accounting for 2.5 billion. Of these USD 5 billion, 2 billion would be disbursed in the current year, with a maturity of two years.
- The Spanish government has provided USD 1 billion of bilateral financing. The disbursement and reimbursement terms are identical to those in the IMF SBA programme.
- Argentine banks with market-maker capacity agreed to maintain their bond positions during the year 2001, this entailing an amount of USD 10 billion.
- Argentine pension fund managers have arranged the purchase of new government debt for an amount of USD 3 billion in the year 2001.
- According to official sources, the government has received proposals from some investment banks to: a) exchange euro-denominated bonds maturing before the year 2005 for an amount of USD 1 billion; b) to exchange short and medium-term bonds denominated in pesos and dollars for an amount of USD 3 billion; and c) to reinvest as from the year 2002 the coupon interest held by local institutional investors, which would signify an extra USD 3 billion.

As a result of the foregoing points (see table), in the year 2001 Argentina may draw down USD 25.4 billion of the USD 39.7 billion made available. Included in the amount of 25.4 billion is the figure of 2.1 billion received by the Argentine government at the end of last year.

2. Economic conditions required of and assumed by the Argentine government

In its letter of intent to the IMF, the Argentine government presented a macroeconomic scenario involving GDP growth of 2.5 % for the year 2001, an inflation rate of virtually 0 % and a balance of payments deficit on current account standing at close to 3.5 % of GDP. The government has also entered into the following commitments in 2001:

- The federal government fiscal deficit shall not exceed USD 6.5 billion in the year 2001 (2.2 % of GDP). This fiscal deficit target envisages only a modest reduction in the deficit in 2001 compared with the previous year (200 million), so as to avoid a fiscal contraction in the early stages of economic recovery.
- Federal government primary expenditure for the year 2001 shall not exceed USD 53.21 billion, entailing a decline of 0.5 % in terms of GDP compared with the year 2000. As a result, the primary surplus would account for 1.7 % of GDP compared with 1 % in the year 2000.
- Federal government debt shall not increase by more than USD 6.7 billion in the current year (5.7 billion in 2000).
- The targets for provincial deficits continue to be a guide and are non-binding, as they were in previous arrangements with the IMF. The consolidated provincial deficit shall not exceed USD 2.76 billion in the year 2001. It is estimated to have totalled 3.4 billion in the year 2000.
- Regarding structural reform, the government undertakes, among other aspects, to move ahead with the controversial Social Security reforms; to expand domestic tax coverage to 100,000 taxpayers; to publish a quarterly report detailing the provinces' public finances; to table a draft law to improve the process of bank intervention and liquidation; to establish a new regulatory framework for the telecommunications industry; and to enact a Competition Protection Act.
- The government shall likewise guarantee that it shall not promulgate a tax amnesty during the time the arrangement runs. As is known, given the persistent tax difficulties last year, the government repeatedly used tax amnesties as an instrument for increasing tax revenue in the short run.

GDP growth lessened, as there was a sharper slowdown in exports than in imports.

The indicators for 2000 Q4 broadly offer a slightly more unfavourable picture than that for the previous quarter. In fact, the main indicators of activity reflect a loss of momentum in the closing months of the year. This had been largely anticipated by the «Tankan» business survey, whose business confidence indicator in Q4 last year showed a virtual zero increase, breaking the appreciable upward trend witnessed since 1999. On the demand side, the consumption indicators continued in the final months of 2000 to display declines on a year earlier that were similar, on average, to those in the previous quarter. The only positive figure was for employment, which showed a slight increase in the period October-November compared with a year earlier, although the unemployment rate climbed once more up to 4.8 % in the latter month. Deflationary pressures remained patent in consumer prices, the general index for which posted a fall of 0.5 % in November, less than the related figure for September (-0.8 %). The current-account surplus (measured in yen) fell again in 2000 Q3, as it had in the preceding quarter, as a result of the gradual reduction in the trade balance surplus.

Against this background of lacklustre economic activity and deflation, the weakness shown since December by the yen might contribute to bolstering recovery if it manages to offset the adverse effects on spending arising from the poor stock market performance, which has worsened since November. The decline in share prices reflects, in addition to wavering economic activity, the heavy disposals of non-financial corporations' securities by banks during the second half of 2000 in order to restore health to their balance sheets and upgrade their asset portfolios before the start of the coming fiscal year in March 2001.

In south-east Asia, the latest economic data point to the continuation of the phase of buoyant economic growth seen in most economies in the region up to 2000 Q3, despite the contractionary effects of the rapid rise in oil prices. However, as from 2000 Q4, the consequences of the slowdown in the US economy have begun to make themselves felt, especially in those countries (such as Malaysia, South Korea and Thailand) whose export industries are more geared to the US market.

In the closing months of 2000, the economic recovery under way in a good number of South American countries continued. And, at the same time, there has been considerable headway in redressing the main macroeconomic imbalances and in adopting structural reforms in the markets for goods and productive factors, against a backdrop of relative financial stability. For the area as a whole, and on current forecasts, economic growth for the year 2000 will be close to 4 %. Particularly worthy of mention is the dynamism of the Mexican economy, which is forecast to grow by around 7 % in 2000, and the forceful pace of expansion in Brazil and Chile, where average growth rates close to 4 % and 5.5 %, respectively, may be attained. In Argentina, where economic activity remains sluggish, the outlook for the near future has nevertheless improved appreciably following the implementation of the IMF aid package in the second half of 2000 (see Box 2). The package has eased pressures on the public debt market. Into the year 2001, these economies will have to withstand a possible slowdown in external demand as a result of the foreseeable reduction in the US growth rate. But the region as a whole might benefit from more favourable financing conditions, insofar as US monetary policy maintains a less restrictive stance than last year.

Finally, turning to the non-euro area European economies, UK GDP rose by 3 % in 2000 Q3 compared with the same period a year earlier (0.7 % in quarter-on-quarter terms). During Q4, the available indicators pointed to a moderation in the pace of activity, and the preliminary release of the GDP growth figure for Q4 duly reflected this (2.4 % on the same period a year earlier, and 0.3 % on the previous quarter). Although the breakdown of GDP growth by component in 2000 Q4 is not known, the buoyancy of the consumption indicators extended into the closing months of the year, in step with the strong momentum of job creation, as reflected by the stabilisation of the unemployment rate at 3.6 % in December. Consumer prices exhibited moderate increases, since the index excluding mortgage interest payments posted 12-month growth of 2 % in December (0.9 % in harmonised terms with the rest of the EU), two-tenths of a point lower than the September figure. Given the lack of significant inflationary pressures, the Bank of England has kept its official interest rate unchanged at 6 %.

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

3.1. Economic developments

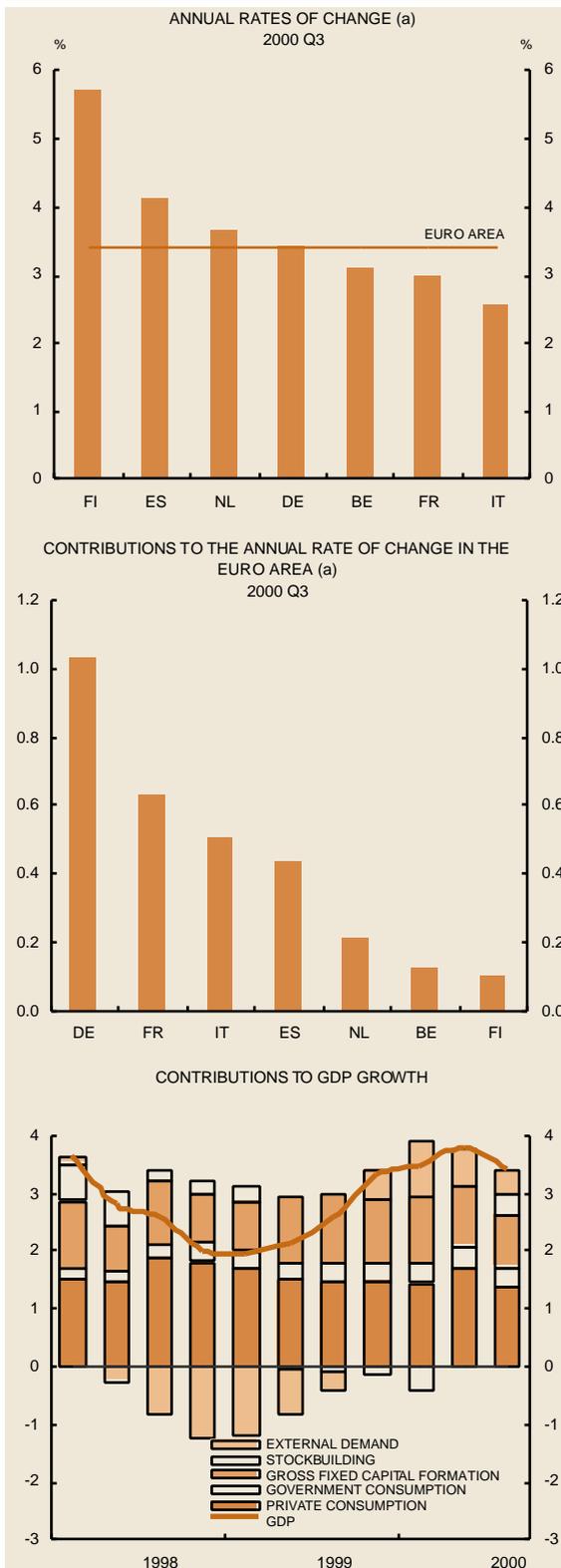
The latest data on economic developments in the euro area point to a slight reduction in the growth rate of productive activity in 2000 Q4, thereby extending the trend signalled in the summer months. The inflationary situation has improved somewhat following the recent fall in oil prices and the appreciation of the euro, against the background of a less buoyant world economy. However, although the inflation outlook has improved, risks associated with the behaviour of wages and public finances remain in place.

According to the second Eurostat euro-area national accounts estimate for 2000 Q3, GDP increased by 0.7 % on the previous quarter, two-tenths of a point below the rate successively recorded since 1999 Q4. In relation to the same period a year earlier, GDP rose by 3.4 %, four-tenths of a point less than in Q2 (see Chart 8). The slowdown in GDP largely reflects the course of domestic demand (excluding changes in stockbuilding), the contribution of which to annual GDP growth has dipped from 3.1 % in Q2 to 2.6 % in Q3. The contribution of net external demand to annual GDP growth fell from 0.7 percentage points in Q2 to 0.5 points in Q3, the outcome of the bigger increase in imports than in exports. Lastly, the contribution of stockbuilding to GDP amounted to 0.3 percentage points, thereby offsetting in part the unfavourable performance of the other components. By sector, the biggest growth in value added in Q3 was in industry and in market services, where annual rates were close to 5 %, while in the primary sector and in construction the associated rates were below 1 %. This deceleration of the growth rate of GDP in Q3 was common to virtually all the Member States. In relation to the same period a year earlier, the slowdown was most pronounced in Belgium and in the Netherlands, while the bigger countries (Germany, France, Italy) saw their growth rates decline by between three and four-tenths of a point.

Most of the as yet substantially incomplete economic indicators for the euro area for Q4 (see Chart 9) tend generally to coincide on the extension of the mildly decelerating profile. Indeed, the main indicators of activity, such as the industrial production index, the European Commission's business confidence indicator and the manufacturing industry purchasing managers' index all advanced to a lesser extent than in the summer months. On the demand side, retail sales in October (which grew at half the rate of the average for Q3), new car registrations in October and November (down 5 % on average in relation to the same period in

CHART 8

GDP in the euro area



Sources: Eurostat and national statistics.
 (a) Excluding Ireland, Luxembourg, Austria and Portugal, for which no information is available on the quarter concerned

1999), and the lower level of the consumer and retail confidence indices in the closing months of the year compared with the previous quarter point to weaker consumption in Q4. Nonetheless, the December figure for the consumer confidence indicator was more favourable than in the previous months, due possibly to lower oil prices and the appreciation of the euro.

The easing of the growth rate of private consumption would be largely motivated by the deterioration of real disposable income as a result of the impact of dearer oil prices. Likewise, the slowdown in stock market prices during the year and the delayed effects of the tightening of monetary policy may have contributed to a lesser expansion of household spending. It is likely in the coming months that the reduction in oil prices and in the tax burden will lead to real income gains for households, which might be propitious to consumption. Moreover, the recent easing of long-term interest rates, against a background of relatively resilient demand, could have a favourable bearing on corporate investment activity. Conversely, the appreciation of the euro and the lower growth rate of export markets may entail a reduction in the contribution of external demand to GDP in the coming months.

Turning to the labour market, the pace of job creation during the first half of the year in the euro area was stable at around 2 %. Given GDP developments, this meant an increase in the rate of job creation per unit of output of close to 1.5 percentage points, approximately double that in 1999. Although the figures on the change in employment in Q3 are not available, this variable is likely to have sustained its growth rate and thereby provided for the reduction seen in the unemployment rate in this period from 9.1 % in May to 8.9 % in September. In 2000 Q4 there has been an additional improvement in unemployment, which edged down to 8.8 % in November. Notable in the composition of unemployment is the high proportion of the youth (up to 25 years old) cohort, which was 16.9 % in November, compared with a figure of 7.7 % for adults, although the slowdown in the unemployment rate during the year 2000 has been more marked for the former than for the latter.

The recent course of the main price indicators in the euro area signals a slight easing of the upward trend seen in previous quarters. The essentially imported nature of inflation has been reflected in 2000 Q3 in the GDP deflator, which stood at 1.1 % (see Chart 10), far below the related figure for the final demand deflator, which was 2.9 % in this same period. Although full information on the breakdown of the GDP

deflator is not available, it is estimated that the moderation of the growth rate of unit labour costs seen until Q2 (see Chart 10) may have continued or advanced slightly in Q3.

As regards consumer prices, the HICP for the area stood in December at 2.6 %, two-tenths of a point below the September figure. Nonetheless, underlying inflation – proxied by the index of non-energy processed goods and services prices – slipped slightly in 2000 Q4, rising to 1.5 % in December, one-tenth of a point up on September. This was due to the extension of the upward trend in processed food and non-energy industrial goods prices, since services held unchanged at a rate of 1.8 %. Country by country, the spread between the maximum and minimum inflation rates has narrowed by three-tenths of a point between September and December. The key development here was the notable slowdown in the maximum rate, that of Ireland, induced by a stripping out of the effect of the tax measures adopted one year earlier. The 12-month growth rate of the producer price index moderated in November to 6.3 %, one-tenth of a point above the September rate. The relative stability of this price indicator during Q4 is the outcome of the favourable performance of the intermediate goods component, which has partly offset the deterioration in consumer goods.

For inflationary pressures to remain in check during 2001 will largely depend on the behaviour of crude oil prices and on the euro. The expected slowdown in the world economy and the onset of spring in the northern hemisphere may mean that oil prices will firm at around the levels reached during December. That said, a conditioning factor here will be the production decisions adopted by the OPEC countries in the course of the year. The narrowing of the growth differential between the United States and the euro area should be conducive to a sustained recovery of the euro. Nonetheless, continuing wage restraint will prove essential in helping gradually lower the growth rate of prices in the near future.

According to ECB data, the euro area current-account balance ran a deficit of EUR 20.5 billion in the first 10 months of the year 2000, notably wider than in the same period in 1999 when the balance was virtually zero. This was due almost in its entirety to the decline in the surplus on the goods balance, since the services balance deficit held unchanged and the income balance improved almost to the same degree as the current transfers deficit widened. The significant worsening in the goods balance is the outcome of the deterioration in the terms

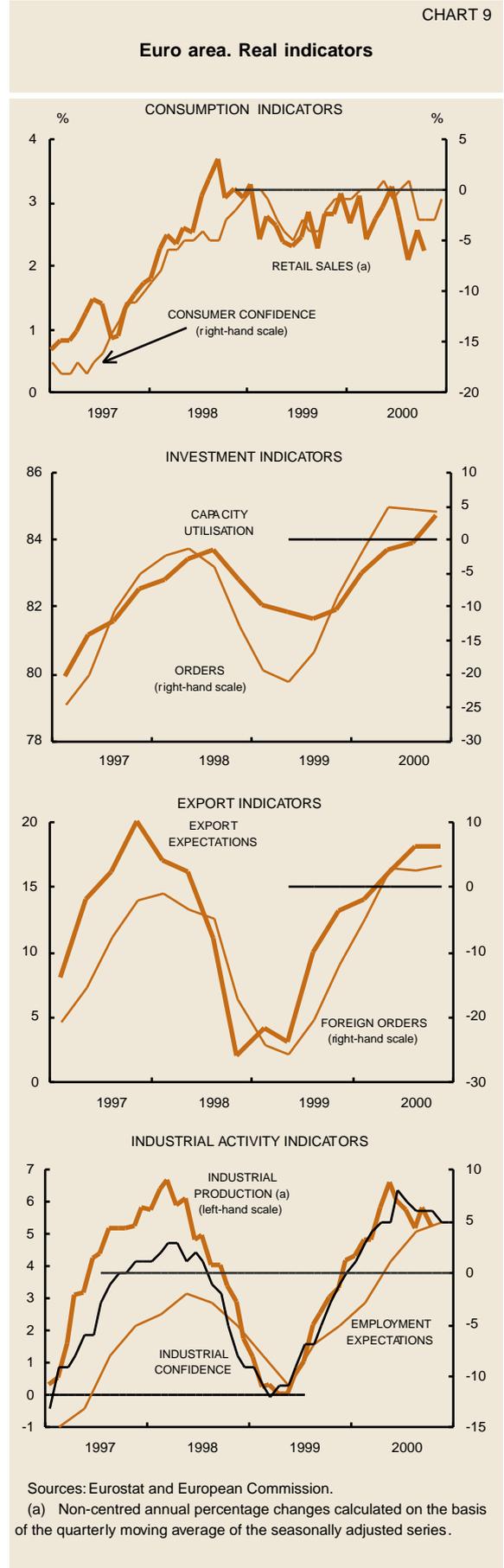
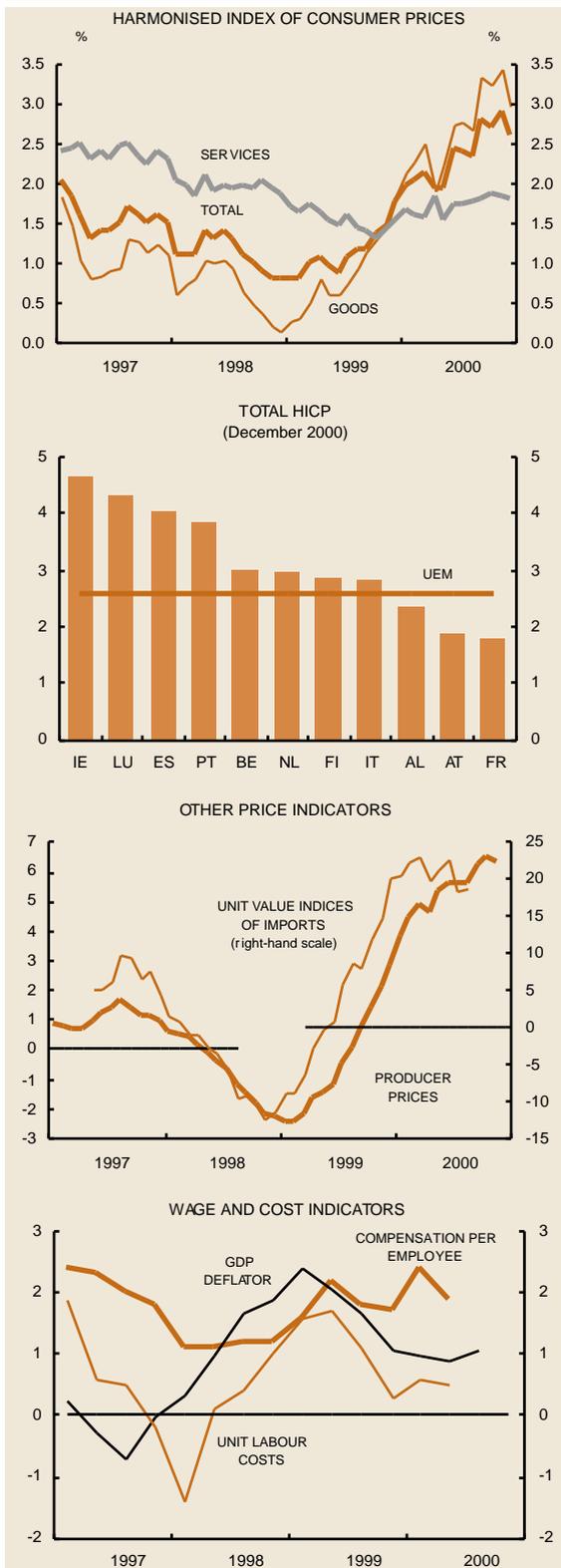


CHART 10

**Euro area. Price, wage and cost indicators
Twelve-month percentage change**



Sources: Eurostat and ECB.

of trade as a result of dearer oil prices and the depreciation of the euro.

In the fiscal policy realm, most of the Member States will record budgetary balances in 2000 meeting or improving on the targets set before the start of the fiscal year. Generally, these results have come about thanks to the favourable course of government revenue, largely attributable to the vigour of economic growth and to the persistence of high oil prices, which have boosted indirect tax takings. Conversely, the results on the spending side have been more heterogeneous, and in some cases there has been significant upward slippage in relation to forecasts. For the area as a whole, the year 2000 should close (excluding revenue arising on the sale of third-generation mobile telephony licences) with a deficit close to 0.9 % of GDP which, if confirmed, would be an improvement of four-tenths of a point compared to 1999.

All the euro area countries have already submitted the revised versions of their respective stability programmes (see Table 1). Broadly, the documents disclosed confirm the Member States' commitment to arrive at budgetary positions consistent with the attainment of a balance in equilibrium, on average, during the course of the economic cycle. Nonetheless, the rate at which this target is being approached could slow in certain cases as a consequence of programmed reductions in the tax burden, since the resulting loss of revenue may only be partly countered through offsetting measures on the expenditure side. Accordingly, only a marginal reduction in the overall deficit for the area is expected in the year 2001, while for the current year the European Commission forecasts a deterioration in the cyclically adjusted primary balance for the area as a whole of the order of 0.3 % of GDP. That may pose difficulties for the progressive moderation of inflation rates in the near future.

3.2. Monetary and financial developments

The recent symptoms of a slowdown in world economic activity and the easing seen in the main short-term inflation determinants (mentioned in the preceding section) have influenced the Eurosystem's monetary policy stance in recent months. The latest rise in ECB intervention rates was on 5th October and placed the marginal rate on the main refinancing operations at 4.75 % (see Chart 11). The progressive tightening of monetary policy (interest rates have risen by 225 basis points since end-1999) and the significant recovery of the euro have helped bring monetary and financial conditions

TABLE 1

General government financial balances: stability programme targets

	1999	2000	2001	2002	2003	2004
Belgium	-0.7	-0.1	0.2	0.3	0.5	0.6
Germany	-1.4	-1.0	-1.5	-1.0	-0.5	0.0
Greece	-1.8	-0.8	0.5	1.5	2.0	2.0
Spain	-1.1	-0.3	0.0	0.2	0.3	0.3
France	-1.8	-1.4	-1.0	-0.6	-0.4	0.2
Ireland	3.9	4.7	4.3	3.8	4.6	...
Italy	-1.9	-1.3	-0.8	-0.5	0.0	0.3
Luxembourg	4.4	3.0	2.6	2.5	2.5	...
Netherlands	1.0	1.0	0.7	0.3 (a)	0.3 (a)	0.3 / 0.6 (a)
Austria	-2.1	-1.4	-0.75	0.0	0.0	0.0
Portugal	-2.0	-1.5	-1.1	-0.7	-0.3	0.0
Finland	1.9	4.5	4.7	4.4	4.5	4.9

Source: National Stability Programmes.

(a) Lower growth scenario.

in the euro zone into line with the area's current cyclical position. At its meeting on 14th December, the Governing Council decided to confirm the medium-term reference value for the growth of the M3 monetary aggregate at 4.5 % for the year 2001.

As in previous months, monetary and financial conditions in Spain remained more generous than in the euro area as a whole, due basically to the greater strength of demand and the greater intensity of inflationary pressures. Reflecting these conditions were the very low level of real interest rates and the high growth of lending to the private sector. Nonetheless, as indicated in the October «Economic Bulletin», the greater inflationary pressures in the Spanish economy arise largely from supply-side factors associated with continuing rigidity in price determination in certain markets, especially in the labour market. The ability of monetary policy to correct such pressures is duly limited.

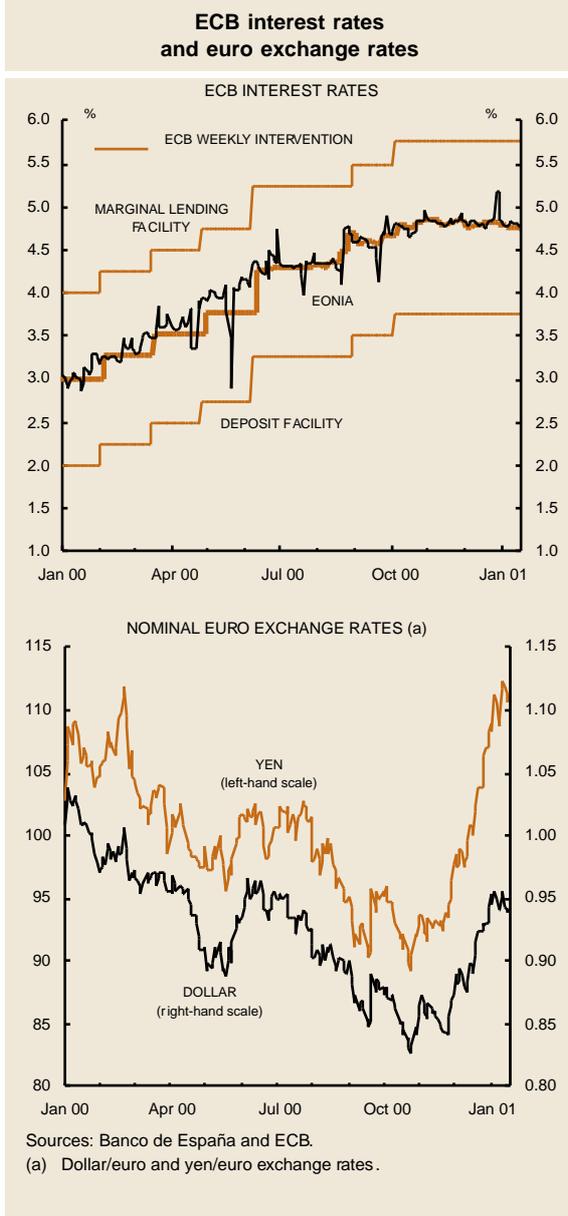
Throughout October and November, the expectations of interest rate rises previously prevailing in the euro area abated, giving way to a change in sign in December when reductions in official interest rates began to be discounted. As can be seen in Chart 12, the term structure of one-month implicit forward rates presupposes a foreseeable scenario of relative stability of ECB intervention rates over the next two years, after a slight decline in the first half of the current year.

Long-term interest rates have also trended downwards since the second half of November. The trend became more marked as from mid-

December, placing 10-year government bond yields in the euro area at around 5 % in the third week of January, a decline of almost 50 basis points on the September level. Initially, this reduction might have been related to the end of the euro's downtrend and to the uncertainty surrounding the future growth of the world economy. Subsequently, a series of factors contributed to this trend taking root. These included most notably the improved inflationary outlook for the euro area (influenced by the fall in oil prices and by the appreciation of the euro); the firming of a more moderate growth outlook following the publication in most euro area countries of lower-than-expected GDP growth rates in Q3; and the loss of momentum in the US economy which, finally, led to a change in monetary policy stance by the Federal Reserve. Nonetheless, the correction on US bond markets was sharper as a result of the increasingly more pronounced expectations of a slowdown in the economy. And this meant that the spread between European interest rates and those on US assets narrowed considerably at all terms.

The cut in interest rates by the Federal Reserve on 3rd January brought about a reduction in European interest rates at all maturities on the yield curve. Nonetheless, this movement was temporary, since in mid-January interest rates had risen to resume similar levels to those prevailing prior to the cut in interest rates in the United States. This points to a possible initial over-reaction by the markets to the US monetary policy measure, caused by something of a knock-on effect spurred by the depth of the cut and the special circumstances in which it was

CHART 11



adopted. Likewise, the subsequent correction may be related to the widespread perception that the cut in US rates was largely in response to financial constraints in the US economy that can not be extrapolated to the euro area.

The lesser pace of US economic growth in Q3 and its foreseeable extension into the following quarter had a bearing on the upward trajectory of the euro against the dollar in mid-November. The euro reached a level close to 0.95 dollars per euro in the second week of January, dipping somewhat in the following days (see Chart 11). The foreseeable narrowing of the growth differential between each side of the Atlantic and a rapid reduction in the short-term interest rate spread should be pro-

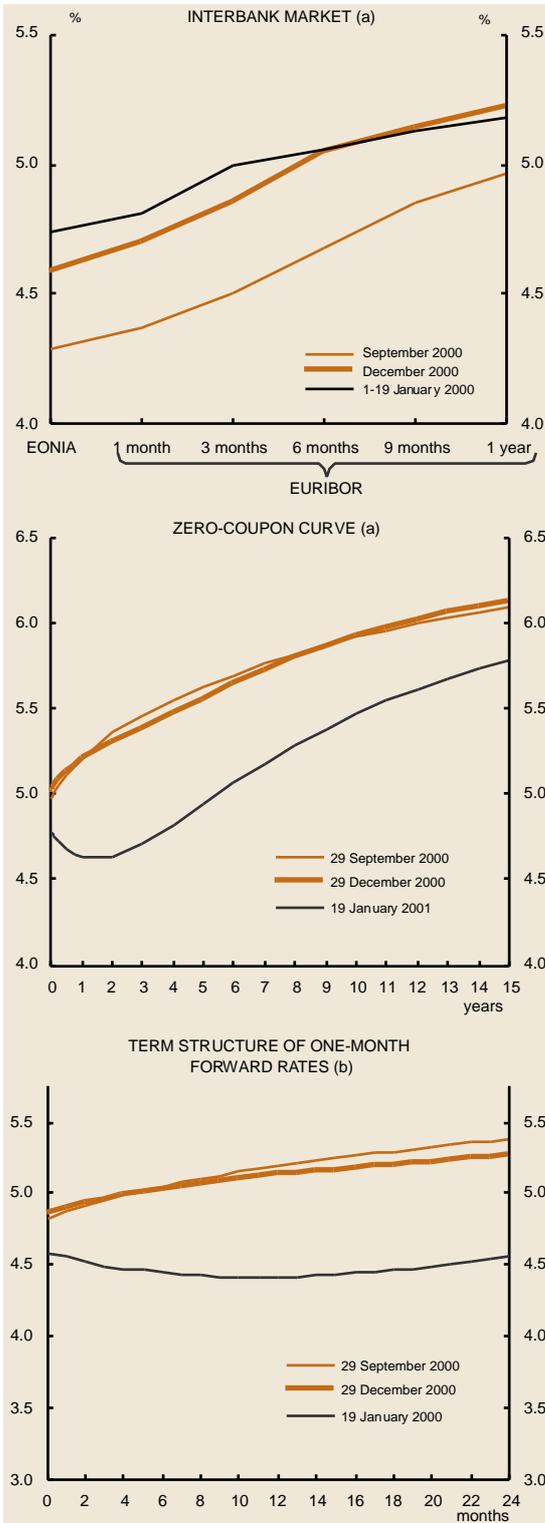
pitious to the consolidation of this rising trend of the euro.

The progressive pass-through of the past rises in official interest rates to the rates charged by credit institutions in the euro area has meant that, despite the cut in the three-month EURIBOR during Q4, bank lending interest rates have not fallen during this period. Thus, both the interest rates on lending intended for house purchases and those on loans to companies at over one year stood at close to 6.6 % in November, a level similar to and somewhat above the related rates in September (see lower panel of Chart 13). The easing of market interest rates was likewise reflected in the prices of bank liabilities, although to highly differing degrees according to the maturity involved. While rates on deposits with an agreed maturity of less than two years rose by 20 basis points between September and November, the rates on euro area bank deposits with an agreed maturity of more than two years remained virtually unchanged over the same period. In Spain, given the importance of floating-rate credit, the reduction in money market interest rates has significantly moderated the upward trend of the synthetic lending rate, to the extent that it stood in December at a level very close to that in September (see Table 2). The greater lag with which credit institutions pass through interest-rate movements to their liabilities has meant that the synthetic interest rates on deposits, for Spain, has continued on an upward course in 2000 Q4, despite the aforementioned behaviour of bank lending rates.

Developments on stock markets in the final months of 2000 reflected the greater pessimism prevailing internationally, accentuating the bearish and volatile trend evident for most of the past year. The broad Euro Stoxx index closed the year 2000 with a cumulative annual return close to -6 %, while the Madrid Stock Exchange General Index was down 13 % in the same period (see Table 2). Across the various sectors, telecommunications companies posted the biggest losses, thereby offsetting in part the strong rises they had shown in past years and reflecting the uncertainty surrounding the viability of projects initiated by these companies under a more favourable economic setting. The Federal Reserve's decision on 3rd January contributed to reducing the volatility marking stock markets, prompting a rally in the shares of certain US companies and in European indices. In this respect, the broad Euro Stoxx index rose by 0.4 % in mid-January on its end-2000 level, while the Madrid Stock Exchange General Index (which, as earlier indicated, had fallen more markedly in 2000) rose by 7.6 % in the same period.

CHART 12

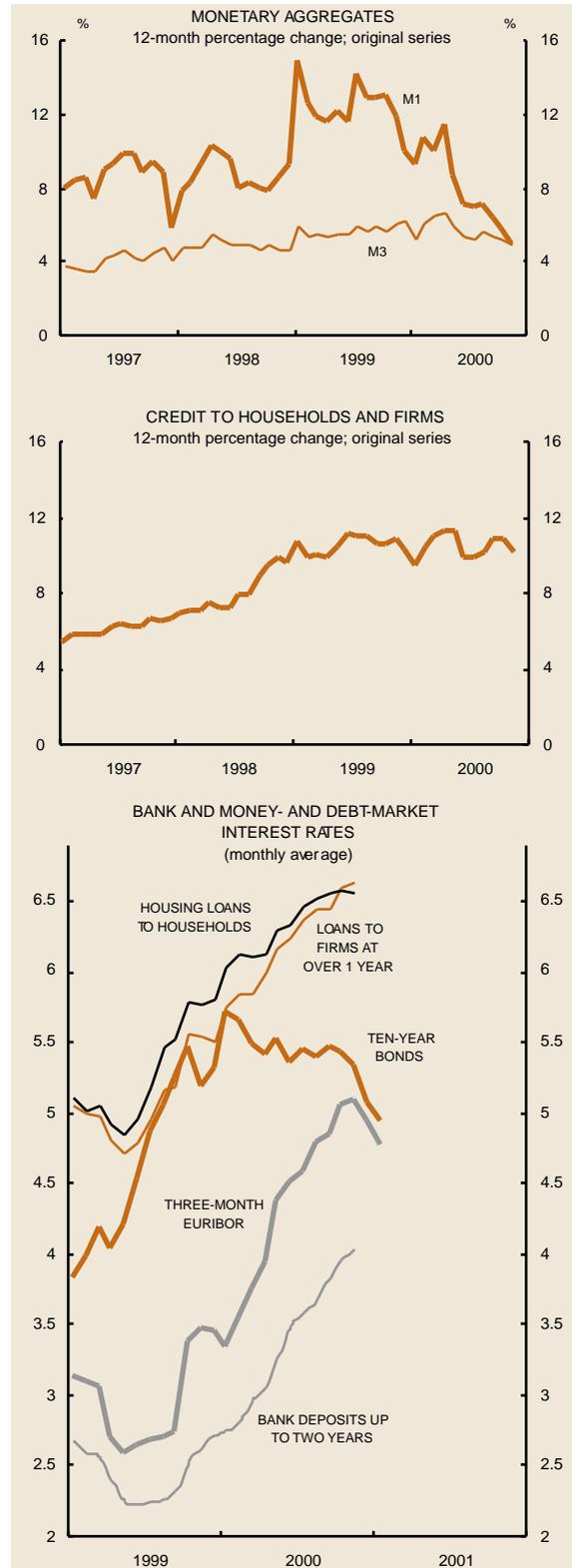
Euro-area yield curves



Sources: Banco de España and ECB.
 (a) Estimation based on swap market data.
 (b) Estimated using the zero-coupon curve.

CHART 13

Monetary and credit aggregates and interest rates in the euro area



Sources: Banco de España and ECB.

TABLE 2

Monetary and financial situation in the euro area and Spain

	1998	1999	2000				2001	
	DEC	DEC	AUG	SEP	OCT	NOV	DEC	JAN (c)
MONETARY VARIABLES (a):								
EURO AREA								
M3	4.8	6.2	5.7	5.3	5.2	5.0	4.9	
M1	9.2	10.1	7.1	6.2	5.8	5.0	5.5	
Loans to private sector	9.8	10.4	10.1	10.9	10.9	10.3	10.3	
SPAIN								
Liquid financial assets	4.0	1.4	1.8	2.8	2.3	1.5	2.6	
Cash and cash equivalents	12.1	12.7	7.0	7.9	5.8	4.4	4.6	
Financing to the private sector	16.8	18.5	16.9	18.6	17.6	18.3	19.5	
FINANCIAL MARKETS (b):								
EONIA	3.25	3.04	4.42	4.59	4.76	4.83	4.83	4.79
Three-month EURIBOR	3.25	3.44	4.78	4.85	5.04	5.09	4.94	4.77
Public debt								
Euro area ten-year bond yields	3.95	5.31	5.40	5.47	5.42	5.34	5.07	4.94
US-euro area ten-year bond spread	0.74	1.06	0.52	0.41	0.41	0.46	0.25	0.23
Spain-Germany ten-year bond spread	0.21	0.22	0.29	0.30	0.28	0.30	0.31	0.27
Spanish bank interest rates								
Synthetic deposit rate	2.06	1.98	2.66	2.77	2.93	3.02	3.04	
Synthetic lending rate	5.15	5.03	6.43	6.33	6.35	6.39	6.35	
US/EUR exchange rate	1.172	1.011	0.904	0.872	0.855	0.856	0.897	0.946
Equities (d)								
Dow Jones EURO STOXX Broad Index	29.8	39.5	4.4	-1.2	-0.6	-2.9	-5.9	0.4
Madrid Stock Exchange General Index	37.2	16.2	0.5	1.0	-3.6	-12.0	-12.7	7.6

Source: European Central Bank and Banco de España.

(a) Annual percentage change.

(b) Monthly averages.

(c) Monthly average to 19 January 2001.

(d) Cumulative percentage change during the year. End-of-month data. Latest month: to 18th January 2001.

The pace of the monetary aggregates in the euro area eased during the final quarter of 2000 as a result of the lesser buoyancy of the economy and of the official interest-rate rises applied to the zone as from November 1999. The growth of M3 in the area continued to slow, standing in December below 5 % for the first time since the creation of Monetary Union (see Chart 13) and drawing closer to the benchmark value of 4.5 % set by the ECB. It is the most liquid components included in the aggregate M1 whose growth rate has most declined, this being the result of their greater sensitivity to interest rates and to the cyclical position of the economy.

In Spain, liquid financial assets held at a very moderate growth rate (2.1 %) in Q4. This moderation is the outcome of a combination of high growth rates of term deposits and repos (27 % and 19 %, respectively) and of heavy cuts in short-term bank securities and in shares in the most liquid mutual funds (-18 % and

-32 %). As in the case of the euro area, the most liquid component of liquid financial assets (the aggregate «cash and cash equivalents») also slowed substantially in 2000 Q4.

As regards the counterpart of the monetary aggregate, the reduction in budgetary imbalances has enabled the rate of change of lending to general government in the euro area to continue to ease. The resulting growth rate in December was -5.8 % year-on-year.

Credit extended to the private sector in the euro area, standing in as it did in December 2000 at a very similar level to that observed at the start of the year (10 %), did not reflect the slowdown in the monetary aggregates or the correction in stock market prices. The resilience of private-sector lending masks the uneven distribution of financing to corporations and that extended to households. Indeed, while the latter variable showed a relatively stable rate of change throughout the first three quarters of

2000, reaching 8 % in Q3, one percentage point down on its end-1999 rate, credit to corporations has grown significantly in the first nine months of 2000, increasing at a year-on-year rate of 12 % in 2000 Q3 compared with an end-1999 rate of 6 %. Nonetheless, this notable acceleration partly reflects one-off operations relating to the financing of the companies awarded the UMTS telephony licences.

In Spain, private-sector financing continues to grow at markedly high levels (19.5 % in December) and shows no signs, for the moment,

of moderating. Certain factors, such as the continuing buoyancy of residential investment spending in Spain or the financing required for the purchase of the UMTS licences, may explain, at least in part, this development. In any event, as a result of its resilience and the prolongation of its recent growth, credit in Spain stands above the levels which, in terms of GDP, were attained during the last cyclical upturn. Moreover, as is discussed in greater detail in section 5, credit developments are proving significant in explaining the deterioration in the nation's net financial saving.

4. The Spanish economy

On Quarterly National Accounts (QNA) data, the real GDP of the Spanish economy grew at a year-on-year rate of 4.1 % (1) in 2000 Q3. This was only one percentage point down on the previous quarter, since the slowdown in national demand was largely offset by the diminishing negative contribution to output growth from net external demand. Growth in the Spanish economy is consequently running at a high rate, which exceeds the 3.4 % rate attained by the euro area as a whole in the same period (see Chart 1).

The information available on 2000 Q4 is consistent with a further slowdown in national demand - to a year-on-year growth rate of less than 4 % (and a virtually zero net contribution from the external sector, which is an improvement on the previous quarter. The rate of growth of real GDP is, accordingly, estimated at around 3.9 %. The slowdown in national demand in the last three months of 2000 appears basically to have stemmed from private consumption, since gross fixed capital formation held at a more steady rate of growth (see Chart 14). Exports showed increasing strength, whereas the increase in imports moderated considerably. From the viewpoint of productive activity, the profile of GDP largely reflects the slowdown in market services. The short-term indicators available for this sector, and for industry as a whole, show signs of a loss of momentum in Q4, which has been passed through - despite its notable strength during the year - to employment creation, against a background of higher growth in wage compensation and unit labour costs than in the euro area as a whole. The main price indicators maintained their upward trend, and the inflation differential with respect to the euro area also widened. The HICP ended the year at an annual rate of growth of 4.0 % (the same rate as the national index), as compared to the 2.6 % rate recorded in the euro area as a whole.

If these estimates are confirmed, the real GDP of the Spanish economy will have grown by 4.1 % on average during 2000, a slightly higher rate than in 1999. A significant slowdown in national demand (to around 4.3 %, 1.2 percentage points less than in 1999), would have been accompanied by a negative contribution from real net external demand of some 0.2 percentage points (as against the one-and-a-half percentage point deduction this aggregate made from output growth in 1999). The growth

(1) Unless otherwise indicated, the rates of change of the QNA series mentioned in this section refer to the trend-cycle series.

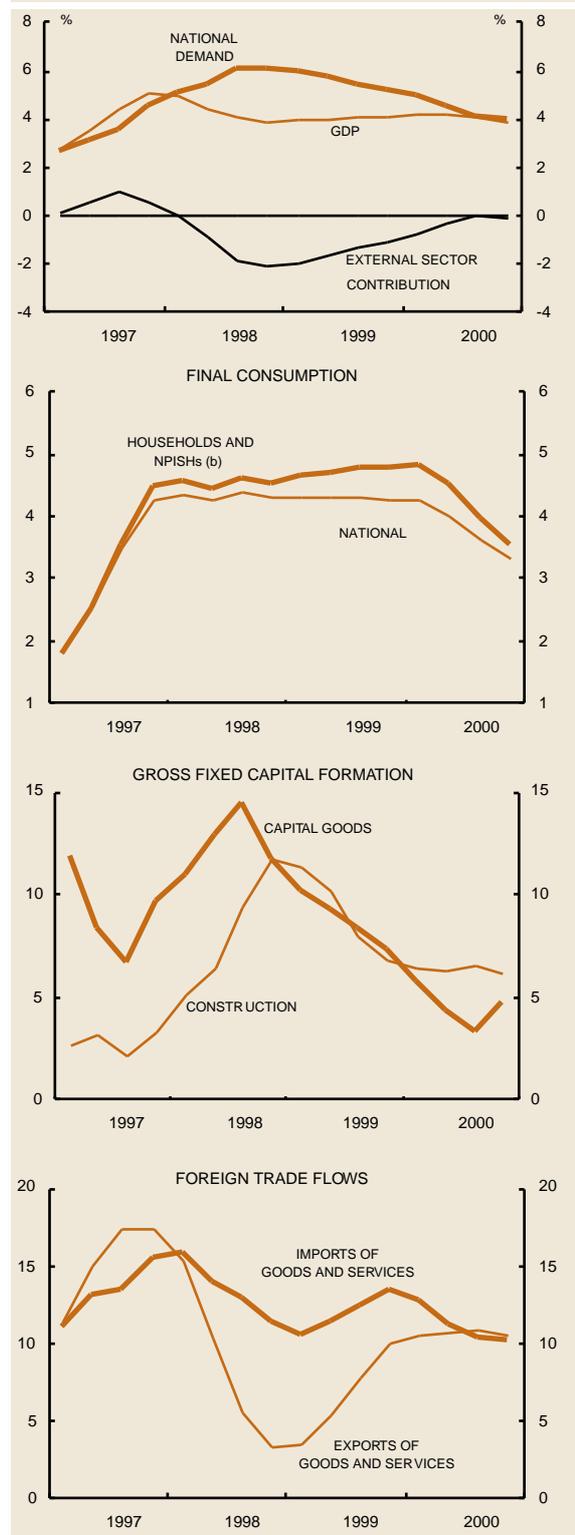
rates of all the components of demand were lower last year, while exports were again notably buoyant. Against this macroeconomic background, the strength of employment growth was one of the more positive notes during the year, which also saw an upsurge in wage growth. If the latter is not offset by higher productivity growth, it will put pressure on unit labour costs. The acceleration in consumer prices, following the rise in the prices of energy products on world markets, led to an average annual increase of 3.4 % (3.5 % in the case of the harmonised index) in this aggregate, as opposed to 2.3 % (2.2 % in the case of the harmonised index) in 1999 and 2.3 % in the euro area as a whole.

4.1. Demand

The slowdown in national demand in the Spanish economy in 2000 broadly matches that recorded by private consumption. On QNA figures, the growth in household spending in Q3 was 4 % in real terms, and most of the available indicators seem to point to a further reduction in the rate of growth of this aggregate in Q4, to around 3.5 %. Almost all its components behaved similarly, with the exception of spending on food, which tended to recover. The moderation in household spending was greater in the case of goods than in that of services and, among the former, the steepening of the deceleration in purchases of durable goods, and especially of cars, was notable.

As stated above, all the available indicators confirm the slowdown in consumption growth. There was a significant decline in the consumer confidence index in the final months of last year, with respect to the levels of previous quarters. A deterioration can be discerned in the assessment of the general economic situation and, to a lesser extent, in that of the situation of households themselves (see Chart 15). Likewise, apparent consumption of goods and services – for which only partial information is available – was on a downward trend in Q4. This deceleration varied from component to component, with only food goods rising slightly and consumer durables slowing sharply. The weakness displayed by consumer durables last year is also apparent in other indicators, such as new car registrations (which fell further in Q4) and in opinion surveys, which show a sharp reduction in the likelihood of making purchases of such goods. The retail sales index, meanwhile, indicates a reduction in buoyancy and the indicator of retail sector confidence held, on average, at around the levels of the previous quarter.

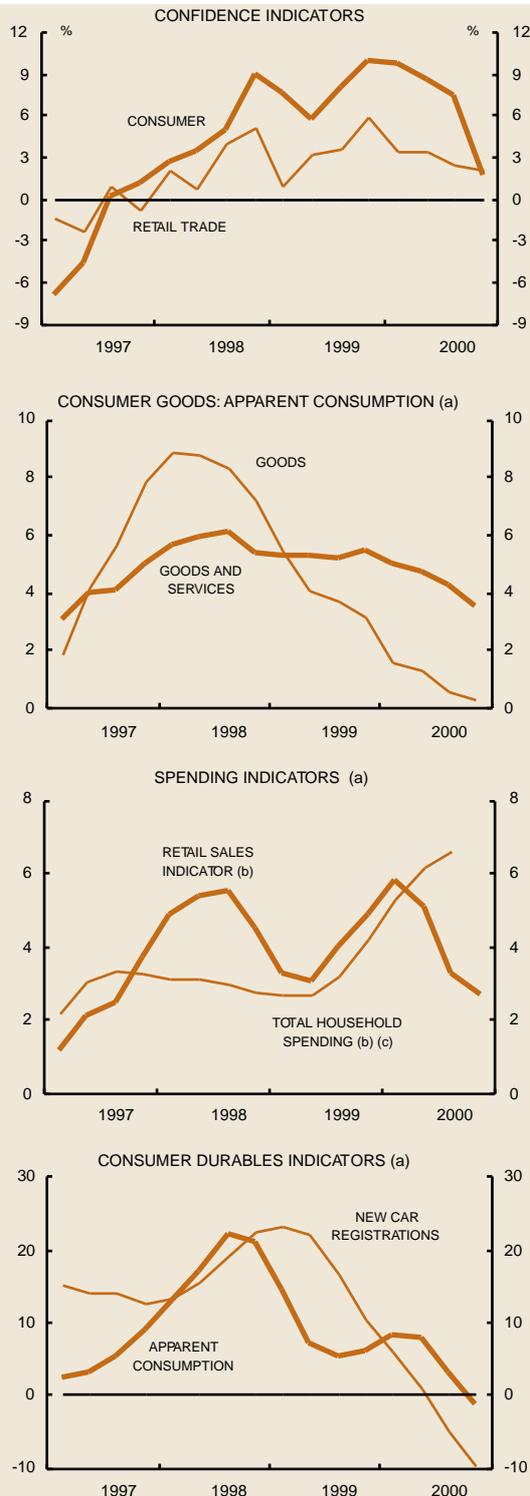
CHART 14
Main macroeconomic aggregates (a)



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.

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.
- (c) Household expenditure survey.

The trend of many of the determinants of consumption is consistent with the lower rate of growth in this aggregate. The disappearance of the expansionary effect of the revaluation of financial wealth on some household spending decisions, against a background of higher interest rates and less favourable consumer expectations, is notable. As regards employee compensation, the slower growth of employment was offset by the rise in wages, although household purchasing power was reduced, in turn, by the rise in consumer prices. The estimated real growth rate of private consumption on average in the year 2000 (4.2 % and half a percentage point down on 1999) entails a further decline in household saving as a proportion of disposable income. If the notable increase in house purchases is added to this, the result is that households ended the year with their financing capacity at historically low levels (see the fifth section of this report).

On QNA estimates, general government final consumption spending grew at a real year-on-year rate of 2.4 % in 2000 Q3, slightly up on the 2.2 % rate recorded in the preceding quarter. The information available on Q4, solely relating to State spending developments, and the budgetary plans of the whole of general government for 2000 are consistent with the moderate behaviour displayed by this aggregate. In particular, the growth in State consumer spending is consistent with an estimated average real increase for the year of 2.4 %.

In 2000 Q3, there was a reduction in the rate of deceleration of gross fixed capital formation from that of previous quarters, with a year-on-year increase of 5.3 %. Investment in capital goods was less forceful, its growth declining to 3.3 %, which extended the downturn that commenced in the second half of 1998. Construction spending, meanwhile, posted a slight rise in momentum of two percentage points, to a rate of 6.5 %. The year-on-year growth rate of gross fixed capital formation is estimated to have tended to stabilise during Q4, with construction investment sustaining a growth rate of over 6 %, while spending on capital goods appears to have been less vigorous.

Among the main short-term indicators of investment in capital goods, the apparent investment indicator, on data to October, continued to slow with respect to previous periods, due to a loss of momentum, which affected both the domestic output and imports of such goods (see Chart 16). Survey data for the industry, provided by the European Commission, also show a certain slowdown in Q4, although some components, such as forecast output, are at very high levels.

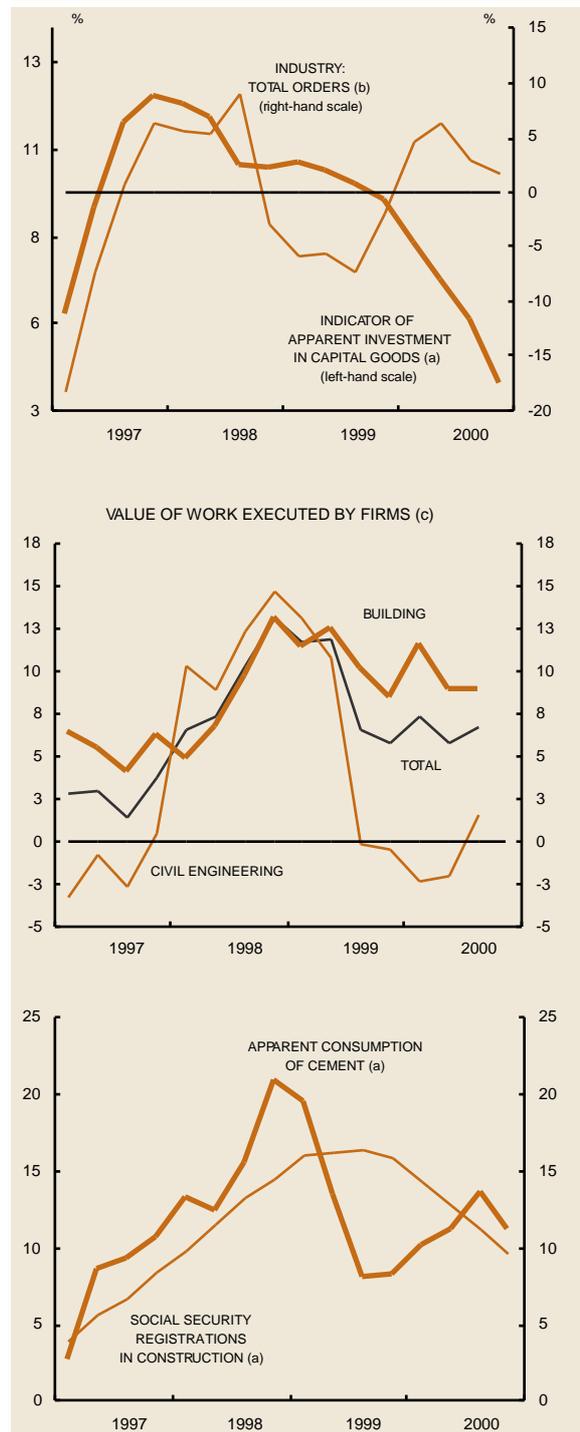
The trends of the main determinants of investment in capital goods are favourable for future investment. Domestic demand and exports are displaying high growth rates, and capacity utilisation is high. Also, as the Central Balance Sheet Office Quarterly Survey (CBQ) data show, firms are reporting high rates of profitability and, despite the rises in interest rates, financial leverage (which measures the difference between the return on assets and the cost of borrowing) continues to widen.

The latest information on construction investment indicates sustained growth, although at a rate that may be lower than in Q3. The construction confidence indicator, which held at very high levels until August, has sharply deteriorated since then. As regards the trends in the contemporaneous indicators, those for intermediate consumption have behaved unevenly: apparent consumption of cement rose at a slower rate than in Q3, while the IPI for construction materials has been more buoyant. Indicators of employment in the sector are holding up, although they continue to lose momentum. Social security registrations in construction grew at a slightly lower rate than in Q3, while the rate of decline of registered unemployment in this sector also appears to have moderated. As for the indicators related to building starts, they seem to project a slowdown in spending in the coming quarters, with a slight recovery in spending on civil engineering projects, and a certain slowdown in spending on building. Government civil engineering tenders have declined by less than in 1999, but the leading indicators of private-sector building (permits granted by local councils and approvals by architects' associations) display a profile of marked deceleration from 1999.

The analysis of the available indicators would be consistent with growth of gross fixed capital formation in the Spanish economy during 2000 as a whole of 5.7 %, somewhat more than three percentage points down on the preceding year. The slowdown in Spanish investment last year (which affected all its main components) has, nonetheless, been accompanied by a fresh increase in corporate net borrowing, as analysed in Section 5.

The contribution of stockbuilding to GDP growth in 2000 Q3 was one percentage point, according to QNA estimates, the same as in Q2. The Business Survey information for the final quarter shows an increase in the level of stocks in industry as a whole compared to preceding months. The increases in levels of stocks have taken place in all industries, and especially in the intermediate goods industry.

CHART 16
Gross fixed capital formation indicators



Sources: Instituto Nacional de Estadística, European Commission, Ministerio de Fomento, OFICEMEN, Instituto Nacional de Empleo and Banco de España.

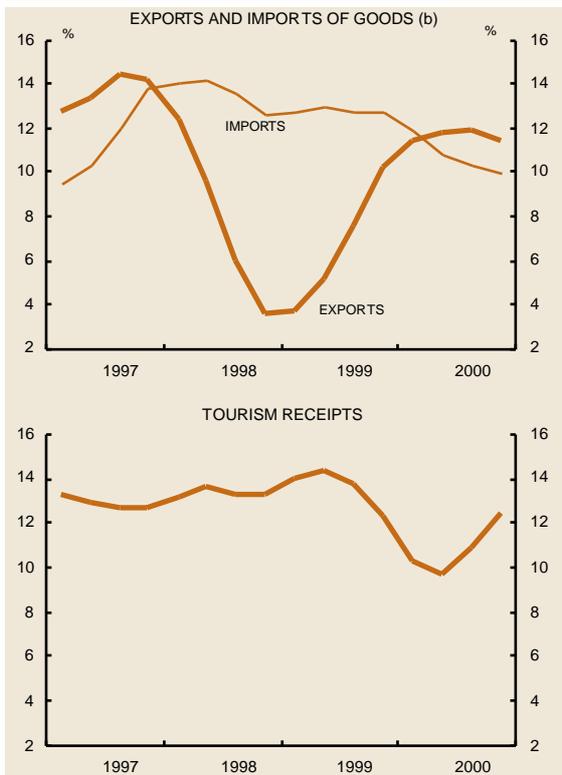
(a) Non-centred percentage change on same quarter a year earlier, based on the trend of the indicator.

(b) Level of original series.

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

CHART 17

Foreign trade (a)



Sources: Ministerio de Economía, Ministerio de 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.

As commented at the beginning of this section, the contribution of real net external demand to GDP growth in the Spanish economy continued to increase during 2000 Q3, since exports maintained the vigour recorded in the first half of the year and imports slowed slightly (see Chart 17). The still incomplete information on Q4 appears to confirm this pattern. Specifically, it is estimated that goods exports continued to post high real rates of growth, which exceeded those of the preceding quarter, driven by the determinants already mentioned: buoyant world markets and the level of the euro, which remained weak until well into December. The slowdown characterising purchases from abroad during the year appears to have become more pronounced as the slowdown in domestic demand firmed. When the figures for services trade are included, the final result for the quarter, as already indicated, would be a nil contribution from net external demand to real GDP growth.

Customs data for the first eleven months of the year show that the growth in goods exports was shared by all groups of goods, although perhaps somewhat less in the case of food goods. As for geographical areas, sales in practically all areas outside the EU were notable. Indeed, results were also positive inside the euro area, especially as growth in these economies has firmed.

On QNA figures, the increase in services exports stabilised in 2000 Q3. The real indicators of foreigners' hotel stays and tourist frontier entries continued to display the reduced vigour that has characterised them since the beginning of the year. However, the latest data of these indicators and the figures for the services balance generally show a certain pick-up, which would contribute to faster growth in goods and services exports in Q4. The relative slowing of tourism growth that has occurred, in any event, in 2000 may indicate a certain waning of comparative advantages. Other factors of a more short-term kind would also have worked in the same direction, such as the strong increase in fuel prices (which has been reflected in the price of transport), and also the notable rise in hotel and domestic tourism service prices, which would be generating competitiveness losses vis-à-vis other destinations. Finally, non-tourism services have displayed notable vigour since the beginning of the year, which should be sustained during the last few months of the year.

Customs data for external trade in the period January-November confirm the slowdown in imports reflected in the QNA figures. According to the estimates mentioned above, this slowdown became sharper in Q4. Almost all groups of goods have been affected by this slowdown but, including in the latest figures, it has been most strongly apparent in consumer goods and in non-energy intermediate goods. Finally, imports of energy intermediate goods, despite the strong increase in their peseta prices (98.5 % in the first ten months of the year), posted a strong real increase (14.9 %), possibly as a consequence of restocking by Spanish refineries.

Services imports continued to slacken during 2000 Q3, albeit from a high rate of growth. The growth of tourism payments moderated slightly, probably influenced by the sustained depreciation of the euro, and non-tourism services decelerated, especially those linked to the transport of merchandise and passengers, although the expansionary behaviour of payments for communication and IT services should be noted. It does not appear that these trends will change significantly in Q4.

Should the final Q4 data confirm the forecasts made in this section, there would have been a marked change last year in the pattern of growth in the Spanish economy. Specifically, less buoyant national demand would have been accompanied by an increasingly favourable contribution to output growth from external demand. This significant improvement in net trade flows has been based, as seen above, on the renewed vigour of goods exports, underpinned in turn by the notable expansion of external markets and the depreciation of the euro. These factors have enabled the competitiveness losses resulting from the differentials between Spanish and foreign, especially euro-area, price and cost growth to be offset in certain areas. The loss of momentum of imports also contributed to this change in the behaviour of the external accounts, even though the latter deteriorated significantly, in nominal terms. As will be seen below, this was a consequence of the strong rise in the prices of goods imports, and in particular of imported oil products.

4.2. Output and employment

As mentioned above, real GDP grew at a rate of 4.1 % year-on-year in 2000 Q3, slightly down on the Q2 rate. From the viewpoint of value-added this performance involved a range of behaviour across industries. Specifically, while energy and construction gained momentum, manufacturing and services lost a little. The further decline in the rate of growth of GDP in Q4 (to around 3.9 % year-on-year) appears to have stemmed from the continued tendency for activity to slow in manufacturing and services. In any event, the relatively high growth meant that job creation continued at a high rate. The number of full-time equivalent jobs rose by 3.3 % during this period, 0.1 percentage points less than in the previous quarter. Apparent labour productivity, meanwhile, held steady (see Chart 18).

Growth in value added was rather subdued in the primary sector in Q3, but less so than in the previous period. Agricultural output was primarily responsible for this relative improvement, although the irregular rainfall prevented all crops from showing improvements. In particular, tubers, fruit and vegetables suffered setbacks, while the output of cereals and pulses rose significantly. Farming of animals was in the midst of a slowdown, which was especially severe in the case of the milk and eggs. Output improvements can be expected to be posted for recent months, on the basis of Ministry of Agriculture, Fishing and Food indicators and considering the abundant rainfall this winter. However, the appearance of the first cases of BSE

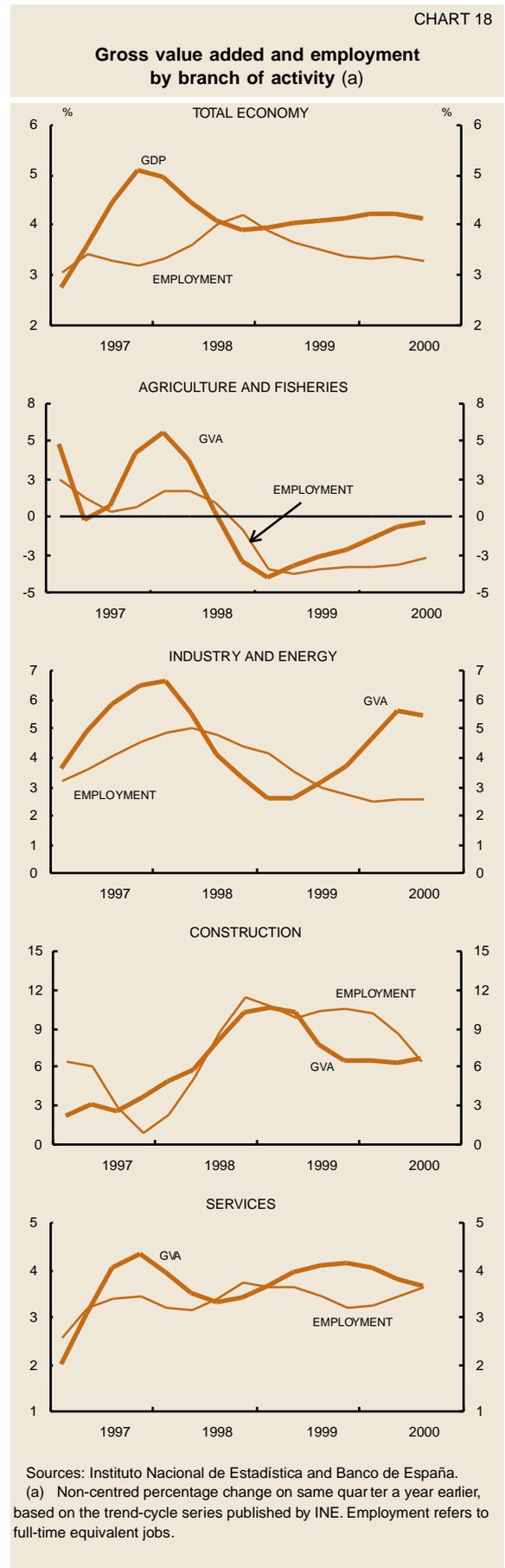
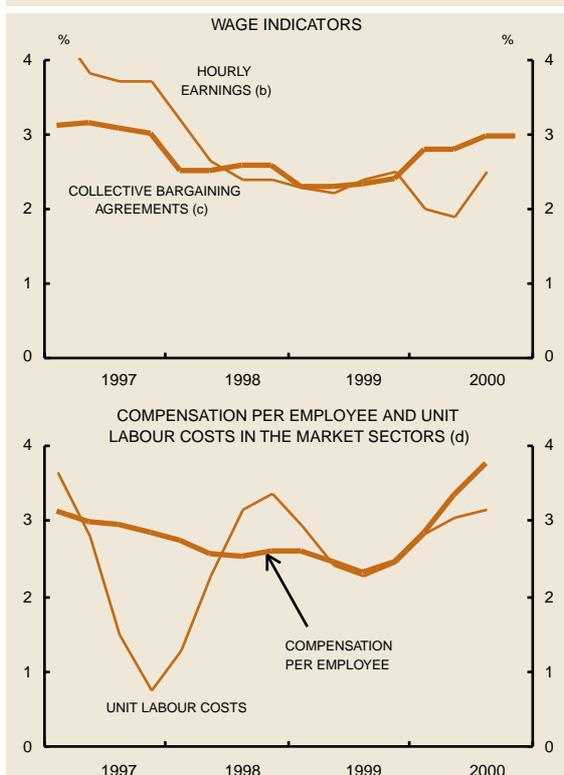


CHART 19

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 (excluding the effects of inflation-adjustment clauses).
- (d) Rates based on QNA trend-cycle series.

in Spain will probably have an adverse impact on the output of this industry, of a magnitude that is hard to estimate.

Industrial activity began to show signs of a slowdown in Q3, although its rate of growth remained high, at 5.5 % year-on-year. An economic environment characterised by less vigorous domestic demand and more uncertain expectations over future international developments help to explain this outcome. The slowdown was centred on the non-energy component, while growth in the energy industries (particularly in the hydroelectric and gas industries) accelerated from last spring. According to industrial production index (IPI) data, growth in the metal processing industries and other manufacturing industries declined, whereas the mining and quarrying and chemical industries were somewhat more expansionary. Q4 data confirm the slowdown in industrial activity, within the general scenario of moderation indicated. The

IPI showed a further loss of momentum in October and November, which affected its main components. During the same period Social Security registrations displayed a similar trend. As for the industrial confidence indicator, it held steady in Q4, with a higher level of expected output offsetting the decline in orders. Finally, the level of capacity utilisation in industry rose slightly.

On QNA estimates, construction activity grew slightly in 2000 Q3, to take its year-on-year growth rate to 6.6 %. As mentioned when discussing investment in construction, the pick-up, albeit a weak one, in civil engineering, and the buoyancy of residential building should be highlighted. Q4 data show that this pattern of behaviour continued and project a slight slowdown in the high rate of growth in this industry. Indeed, the confidence of construction employers appears to have diminished significantly, both as regards work contracted and the trend in employment. Social Security registrations seem to show the same trend.

Lastly, on QNA estimates, the year-on-year growth rate in the services sector in 2000 Q3 stood at 3.6 %, 0.2 percentage points less than in Q2. The slowdown basically affected market services (being reflected in almost all its components), with the rise in services provided by general government holding virtually steady. The available indicators for Q4 are tending to indicate an extension of this gradual deceleration to most of the industries that make up the market services sector. The retail sales index, the indicator of the business climate in the retail trade and Social Security registrations would indicate a loss of momentum in the distributive trade. Hotels and restaurants also appear to be growing at a more subdued rate, according to hotel occupancy statistics. Social Security registrations in the transport and communication industries would be consistent with a further slowdown in these activities. Finally, growth in financial intermediation appears to have held at a similar level to the preceding period.

Employment, on QNA estimates, grew by 3.3 % in 2000 Q3, in terms of full-time equivalent jobs, 0.1 percentage points down on Q2, in line with the more subdued performance of the productive activity. There were no gains in apparent labour productivity in the economy as a whole, since the moderation of employment and the weakening of activity were of a similar degree. Events in the final quarter of the year might be expected to have been similar, since the slowdown in activity should have prompted a further modest slowdown in the rate of growth of employment. And this would appear to be the case, at least according to Social Security reg-

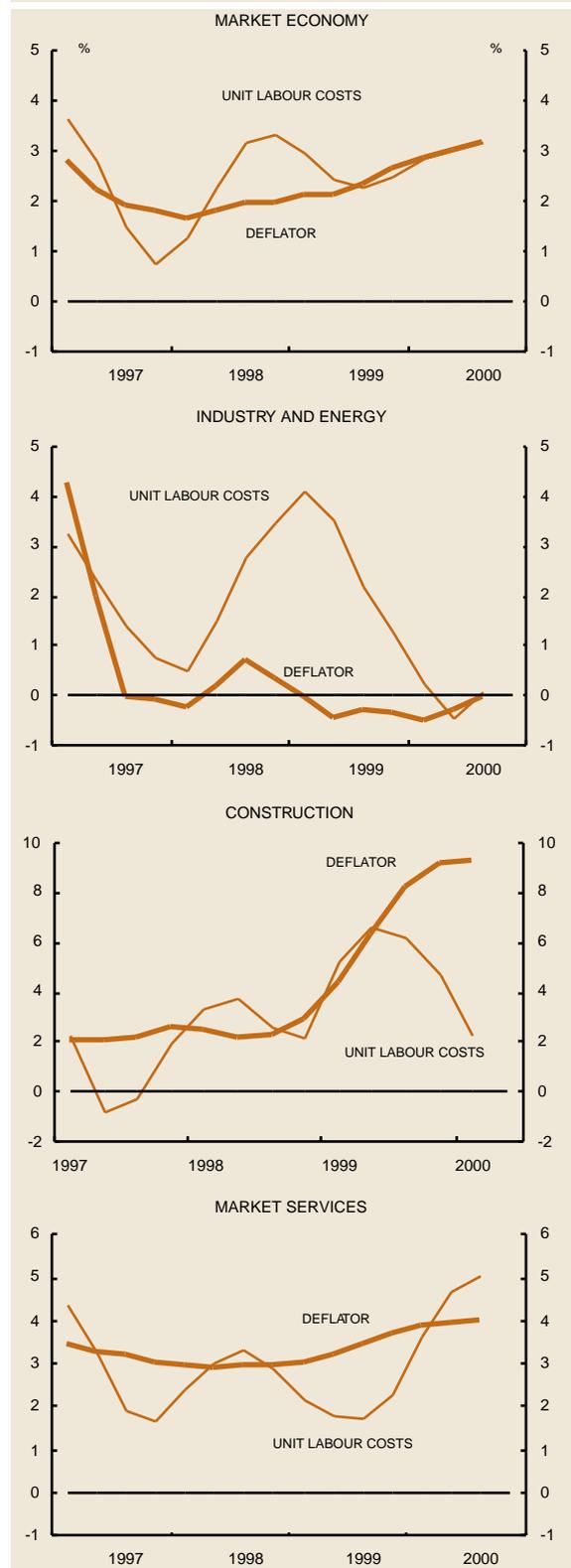
istrations, which although significantly higher in Q4, did not rise by as much as they did during the summer. A similar decline was seen in the rate of reduction of registered unemployment; the year-on-year fall of 3.8 % in Q4 was less than in the preceding quarters.

At the industry level, QNA data show notably buoyant employment creation in construction and market services in Q3, with growth of 6.5 % and 4.9 %, respectively. In both cases, however, these figures implied a moderation of the rate of increase of employment in the previous quarter, which was accompanied by a recovery in productivity. Net job creation in industry as a whole held at the same rate as in the previous quarter (2.6 %), although it continued to slow in energy. Consequently, apparent productivity fell further. In agriculture, there continued to be a net shedding of jobs, but this phenomenon was slowing, as in the case of the contraction of GVA. Lastly, employment in non-market services increased by 1 % year-on-year, after nine months of continuous decline, and the pattern in this industry is being passed through to services as a whole, as can be seen in Chart 18. It should be pointed out that during Q3 job creation was concentrated among wage-earners, while the numbers of self-employed declined further.

The foregoing analysis can be completed using the information furnished by the Labour Force Survey (EPA). It should be recalled, as mentioned in previous reports, that the updating of the sample carried out in 2000 Q1 distorts comparisons between 2000 and the previous year. Bearing this in mind, the situation described by this survey may be considered to coincide broadly with that implied by the QNA. The most important difference relates to the trend of industrial employment. According to the EPA, it gradually accelerated throughout 2000, whereas the QNA trend-cycle data shows steady growth. Permanent employment continued to grow at a high rate in Q3 (7.7 % year-on-year), while the growth of temporary employment dropped significantly, to 3 %. Accordingly, the proportion of temporary employment fell considerably, to 32.3 %, one percentage point down on the same quarter of 1999. The growth in permanent employment in the first nine months of 2000 remains significant even when adjusted for the updating of the sample. By contrast, there was a reduction in the number of permanent contracts registered at the National Employment Office (INEM). Meanwhile, part-time employment was more buoyant than full-time employment.

As in previous quarters, the supply of labour continued to be characterised by the buoyancy

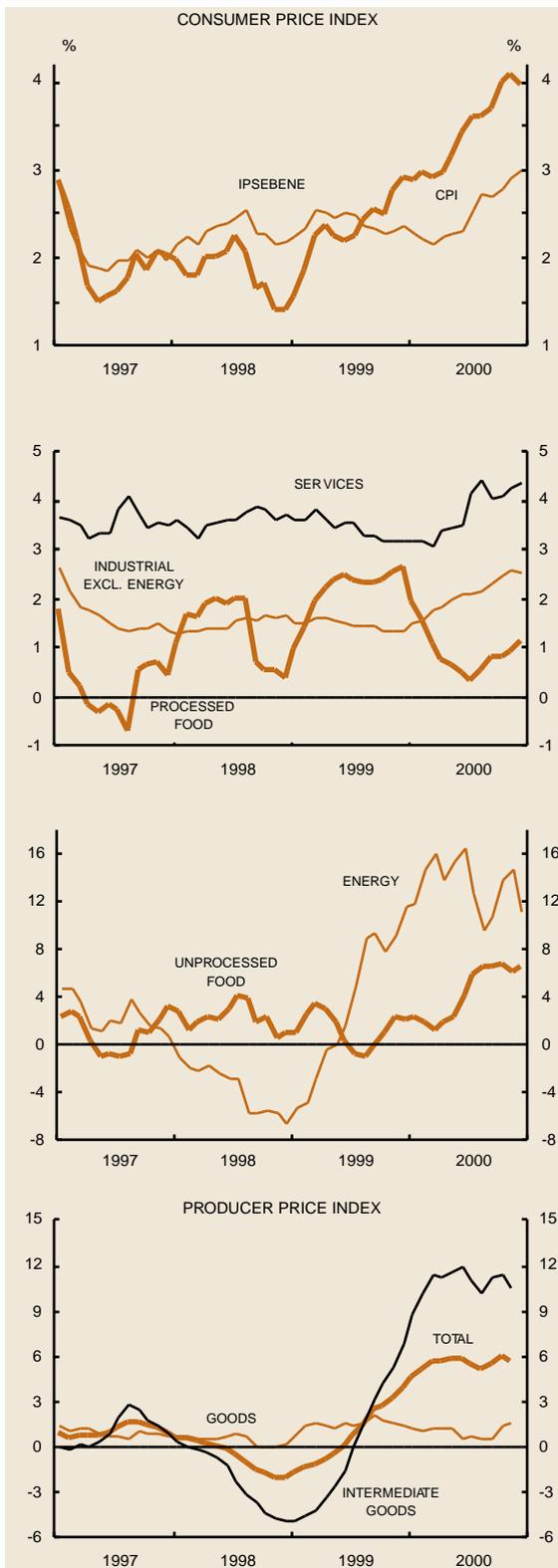
CHART 20
Prices and costs by branch of activity (a)



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

CHART 21

**Price indicators (a)
Spain**



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

of the labour force, which increased in Q3 by 2.7 %, albeit slightly down on the rate in the first half of the year. The participation rate rose to 51.6 % of the population aged over 16 years (65.3 % if the over-65s are excluded), although it was offset by the ongoing deceleration in the growth of the population of working age. The rate at which women were entering the labour market fell by more than half a percentage point, to stand at 4 %. As the increase in the labour force was accompanied by a larger increase in employment, the rate of unemployment fell again, to stand at 13.7 % of the labour force. Male unemployment fell more sharply than female, which caused the difference between these two groups to widen: the rate of female unemployment (20.3 %) was twice the male rate (9.3 %). The decline in unemployment was apparent across practically all age groups, and the proportion of long-term unemployment (defined as being without a job for more than one year) fell again.

4.3. Prices and costs

The main indicators of prices in the Spanish economy displayed an upward trend during 2000, primarily as a consequence of inflationary pressures originating externally. The indicators which approximate the domestic component of inflation also deteriorated, although much less sharply. The GDP deflator, on provisional QNA estimates, grew by 3.2 % year-on-year in Q3, the same rate as in Q2. Among the components of the deflator, the growth of unit labour costs held steady at 2.9 %. The contribution to the GDP deflator of net taxes per unit of output decelerated, so that the deflator of the economy's gross value added which excludes such taxes rose by 3.1 %, 0.1 percentage point more than in the preceding quarter. As a result, the operating surplus per unit of output, estimated as the difference between the deflator of value added and unit labour costs accelerated slightly, causing the gross operating margin to widen.

According to the Wages Survey (see Chart 19), the increase in average hourly earnings, in terms of total pay, was 2.5 % in Q3, 0.3 percentage points higher than in Q2. The increase in average monthly earnings was lower (2.4 %). As on previous occasions, it should be noted that wage increases in all industries were higher than on aggregate. This is because the partial renewal of the sample at the beginning of the year involved an increase in the weight of industries, such as construction, in which wage levels are lower. In any event, according to the survey, the industries recording the fastest acceleration in wage growth are construction (4 %, in terms of average hourly earnings), fol-

lowed by industry (3.3 %) and lastly, services (2.7 %).

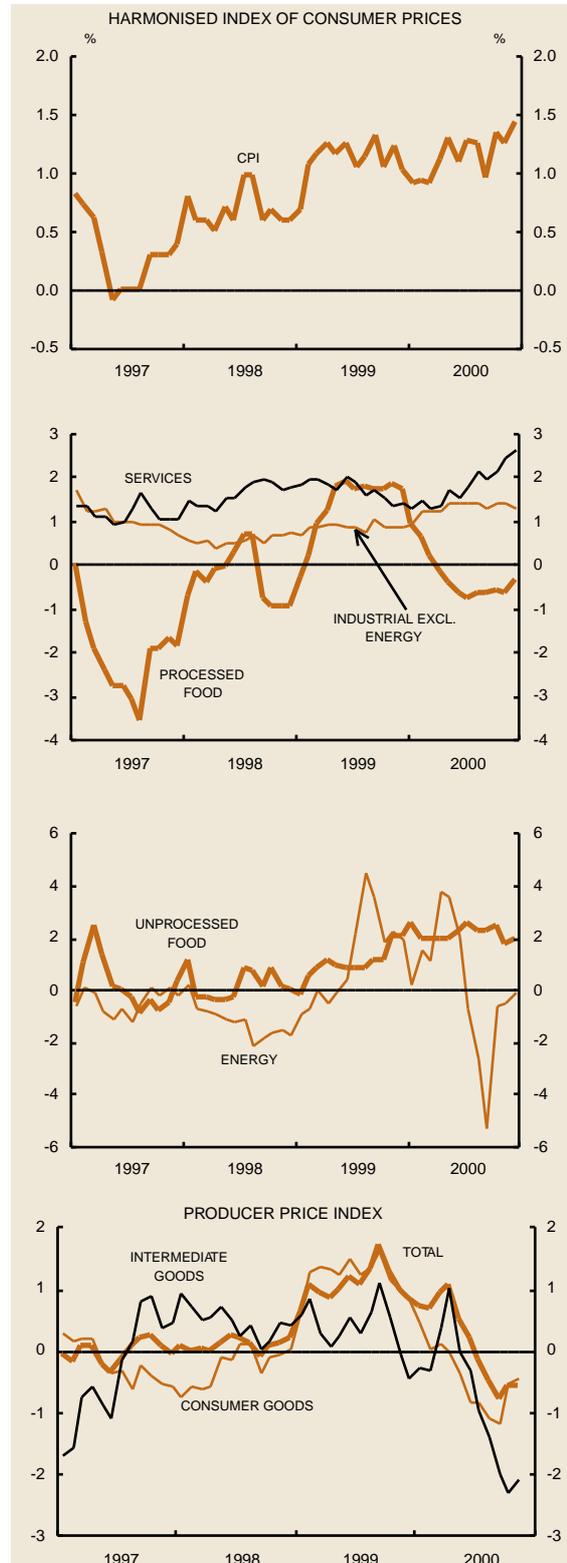
Compared to these results, the wage settlements negotiated in collective bargaining agreements recorded up to 31 December was 3.0 %, 0.5 percentage points higher than in 1999, before taking into account the effect of inflation-adjustment clauses. The settlements in revised agreements were 2.9 %, while in newly signed agreements they were 3.1 %. By industry, the largest settlements were agreed in agriculture and construction (3.4 %), while in industry and services the settlement was 2.9 %.

Analysis of the latest available data for the deflator of value added in the sectors which make up the market economy (see Chart 20) yields similar results to those mentioned for the economy as a whole: a slight acceleration in the growth of the deflator, a steady rate of increase of unit labour costs and, consequently, a slight widening of unit margins. However, a wide range of behaviour is seen across the various industries, the disparities between industry and market services being particularly marked. The deflator of industrial value added continued to fall at high rates (-3.3 %), while industrial unit labour costs accelerated sharply, as a consequence of the combined effect of higher average compensation and lower productivity growth. The result, naturally, was that the industrial gross unit operating margin deteriorated significantly. In any event, these trends should be interpreted with caution, since the available indicators for industrial prices do not display such negative growth rates as the provisional QNA estimates, so that it is possible that the trend for industrial margins to narrow has been much more gentle. As for market services, the widening of margins has been much more sustained, since throughout 2000 the growth of the deflator approximately offset the growth in unit labour costs, which stemmed from the increase in average compensation. Lastly, in the construction industry operating margins widened further, owing to the large increase in the deflator and the significant moderation in unit labour costs associated, in this case, with productivity gains.

The stability of the GDP deflator in 2000 Q3 was accompanied by notable growth in import prices and some moderation in export prices, so that the final demand deflator held steady at 4.8 %. The deflator of goods and services imports rose at a year-on-year rate of 10.1 % in this period, so that the acceleration recorded in previous quarters did not continue. These figures are significantly affected by the trend in the prices of energy imports, driven by the upward path of crude oil prices on interna-

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.

tional markets. In any case, the unit value indices show that the prices of non-energy imported products were also affected, with a total rise of 6.2 % over the first ten months of the year. These trends will persist for some months to come and should then moderate, when the changes in energy prices, set against a stronger euro, are felt.

The main indicators of final prices in the Spanish economy continued throughout 2000 along the upward path that they had set out on at the beginning of 1999. The CPI rose at a 12-month rate of 4 % in December, the average rate for the year being 3.4 %, which was one percentage point higher than in 1999 (see Chart 21). Underlying inflation, approximated by the IPSEBENE index, which includes the prices of services and non-energy processed goods, accelerated in Q4, to end the year at a 12-month rate of 3 % (2.5 % on average during the year).

Despite recording the highest rate of growth (11.2 % in December), the energy component of the CPI moderated in 2000 Q4, especially in December, with the sharp fall in crude oil prices that month. The rate of growth of unprocessed food prices stabilised during Q4 at above 6 %. The initial price increases following the discovery of the first cases of BSE, which is having repercussions on the market for meat products, had a significant impact during this quarter. Supply problems affecting certain products, caused by the protests of road hauliers and fishermen against diesel price increases, also had an upward impact on prices.

There was a tendency, in 2000 Q4, for the consumer prices that are normally most stable to rise, with the behaviour of service prices being particularly notable. After recording a rate of 4 % in September, these prices accelerated to 4.3 % in the final month of the year. This outcome is basically explained by the notable growth in the prices of tourism and transport services. The other components of the IPSEBENE also accelerated, albeit less sharply. In December, processed food posted growth of 1.1 %, as against 0.8 % in September, as a consequence of increases in the prices of tobacco and meat products. Non-energy industrial goods, meanwhile, recorded 12-month growth of 2.5 % in December, up from 2.3 % in September. Periodicals stand out among the products that have most contributed to the increase in the 12-month rate.

Differentials in consumer price inflation between Spain and the euro area, as measured by the harmonised indices (see Chart 22) widened during 2000. In December, the differ-

ential in terms of the total HICP was 1.4 percentage points, a rise of 0.4 percentage points on the end-1999 differential. The widening was particularly notable in services and non-energy industrial goods. In the case of services, inflation differentials widened by more than one percentage point to stand at 2.6 percentage points in December, while in the case of non-energy industrial goods they widened by almost 0.5 percentage points, to 1.3 percentage points in December. Inflation differentials in the case of energy and food products are less significant, although in the case of food a large positive differential for unprocessed food is offset by a negative one for processed food.

As in the case of consumer prices, the producer price index has deteriorated somewhat in recent months, with the 12-month growth rate rising from 5.1 % in August to 5.7 % in November. This acceleration affected all components of the index although it was particularly strong in the case of food consumer goods. Wholesale agricultural prices also rose, posting a 12-month growth rate of 4.9 % in October.

4.4. State budget

On the basis of National Accounting methodology, the State ran a surplus of ESP 570 billion (0.5 % of GDP) during the period January-November, as compared with a deficit of ESP 145 billion (0.2 % of GDP) during the same period of 1999 (see Table 3). Since the State deficit tends, for seasonal reasons, to rise during December, this significant improvement is in line with the official estimates of the budget deficit for the year, which have been revised successively downwards by the government to 0.3 % of GDP for general government as a whole. This target has recently been confirmed in the Updated Stability Programme 2000-2004. Total revenue was 8.1 % higher in the period January-November 2000 than a year earlier (8 % higher to the end of Q3), slightly above the initial projection in the State budget. The strength of direct taxes was notable, with an increase of 12.3 % (10.1 % to September), to stand well above the official estimate for the year as a whole. By contrast, VAT receipts continued to decelerate and grew by 10 % (11.5 % to September), below the official estimate for the year as a whole. As for expenditure, there was a significant slowdown, to a rate of 4.2 % in November (as against 5.2 % to the end of Q3), slightly below the official rate estimated for the year as a whole, basically due to the significant contraction in capital expenditure. Within current expenditure, the high growth rate of intra-general-government transfers continued to stand out, being well above the forecast in the

TABLE 3

State Budget outturn

ESP bn and %

	Outturn	Percentage	Initial	Percentage	Outturn	Outturn		
	1999	change	projection	change	JAN-SEP	1999	2000	Percentage
	1	1999/1998	2000	2000/1999	Percentage	JAN-NOV	JAN-NOV	change
				4=3/1	change	6	7	8=7/6
					2000/1999			
1. Revenue	18,364	4.8	19,507	6.2	4.5	17,213	18,272	6.2
Direct taxes	7,817	4.7	8,438	7.9	6.9	7,406	8,078	9.1
<i>Personal income tax</i>	5,098	2.0	5,361	5.2	3.8	4,786	5,088	6.3
<i>Corporate income tax</i>	2,436	9.9	2,772	13.8	10.1	2,358	2,646	12.2
<i>Other (a)</i>	283	15.2	304	7.5	38.2	262	344	31.3
Indirect taxes	7,951	13.4	8,593	8.1	9.4	7,495	8,094	8.0
VAT	5,114	17.1	5,600	9.5	11.3	4,898	5,359	9.4
<i>Excise duties</i>	2,567	7.3	2,689	4.8	5.3	2,352	2,460	4.6
<i>Other (b)</i>	270	5.9	304	12.6	12.5	244	275	12.8
Other net revenue	2,597	-14.6	2,476	-4.6	-19.1	2,313	2,100	-9.2
2. Expenditure	19,421	4.2	20,149	3.7	5.3	17,526	18,150	3.6
Wages and salaries	2,979	-2.4	2,765	-7.2	-8.8	2,620	2,376	-9.3
Goods and services	436	12.3	379	-13.1	-8.5	371	348	-6.0
Interest payments	3,178	-4.7	2,947	-7.3	-0.8	3,107	2,834	-8.8
Current transfers	10,809	9.1	12,126	12.2	12.8	9,682	10,941	13.0
Investment	957	6.6	950	-0.7	2.3	822	873	6.1
Capital transfers	1,063	-0.8	982	-7.6	-3.3	924	779	-15.7
3. Cash-basis balance (3=1-2)	-1,057	-5.1	-642	-39.3	14.4	-313	122	—
MEMORANDUM ITEM: NATIONAL ACCOUNTS:								
Revenue	18,804	8.8	20,160	7.2	8.0	17,226	18,626	8.1
Expenditure	19,901	3.6	20,785	4.4	5.2	17,371	18,108	4.2
Net borrowing (-) or lending (+)	-1,097	-42.9	-625	-43.0	-42.2	-145	517	—

Source: Ministerio de Hacienda.

(a) Includes the revenue from the tax on the income of non-residents.

(b) Includes taxes on insurance premiums and tariffs.

initial projection, while the rate of decline of interest payments has fallen during recent months.

In cash terms, the State recorded a surplus of ESP 122 billion in the period January-November 2000, as against a deficit of ESP 313 billion in the same period of the previous year. This improvement in the cash-basis balance contrasts with the increase of 14.4 % in the deficit to September and is in line with the cut forecast in the initial projection. The favourable trend in the balance of non-financial

transactions to November was attributable both to the acceleration in revenue, which grew by 6.2 % (4.5 % to September), and to the deceleration of expenditure, to a rate of growth of 3.6 % (5.3 % to September). In both cases the growth rates to November practically coincide with those forecast in the initial projection for the whole year. The breakdown of revenue and expenditure is discussed below using cash-basis information.

The acceleration in revenue was mainly attributable to the trend in non-tax revenue,

TABLE 4
Balance of payments: summary table (a)
EUR m

	JAN-OCT	
	1999	2000
	Receipts	Receipts
Current account	147,583	172,515
Goods	84,966	101,395
Services	41,951	47,620
<i>Tourism</i>	25,907	28,723
<i>Other services</i>	16,044	18,897
Income	9,680	12,645
Current transfers	10,985	10,856
Capital account	5,536	5,125
	Payments	Payments
Current account	154,210	187,249
Goods	106,830	131,097
Services	23,282	27,222
<i>Tourism</i>	4,294	4,948
<i>Other services</i>	18,988	22,274
Income	16,523	20,197
Current transfers	7,575	8,733
Capital account	819	755
	Balance	Balance
Current account	-6,627	-14,734
Goods	-21,864	-29,703
Services	18,669	20,398
<i>Tourism</i>	21,613	23,775
<i>Other services</i>	-2,943	-3,377
Income	-6,843	-7,552
Current transfers	3,411	2,123
Capital account	4,717	4,370

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

whose annual rate of decline fell substantially (down from 19.1 % in the period January to September to 9.2 % to November), drawing close to the forecast in the initial projection. This trend is basically explained by profit and dividend income from the Banco de España. In particular, the income on account of current year profits was, unlike in previous months, much higher in November than in the same month of 1999. In addition, the strong increase in capital transfers from the European Union and the decline in fees and charges and other revenue due to lower debt issuance premia continued to be notable.

Tax receipts grew at a similar rate to that during the period January to September and to

that forecast in the initial projection, although the behaviour of their main components differed. Direct taxes continued to accelerate, to a rate of growth above that forecast for the year as a whole and above that recorded by indirect taxes, whose growth rate fell to coincide almost exactly with the initial projection. The acceleration in direct taxes was primarily due to personal income tax. Mainly as a consequence of the different schedule for rebates of negative amounts of net tax payable, its growth rate rose from 3.8 % at the end of Q3 to 6.3 % to November, which exceeded the projection. Corporate income tax receipts also accelerated, with the inclusion of receipts from the October payment on account, although less sharply.

The rate of growth of all the main indirect taxes fell from September (in line with the loss of vigour in consumption and imports), to coincide almost exactly with the forecasts in the initial projection. The slowdown in VAT was notable: receipts rose at an annual rate of 9.4 % in the period January to November, as against 11.3 % to the end of Q3. This rate of growth was affected by the rise in fuel prices since the beginning of the year (2). The rate of growth of excise duties fell to 4.6 % in November, with the slowdown in the duty on new car registrations standing out, in accordance with the trend in this consumption indicator.

As for expenditure, its deceleration from September was primarily due to the trend in interest payments: their decline accelerated notably (8.8 % to November, as against 0.8 % to September), so that by end-November they had fallen by more than forecast in the initial projection for the whole year. The rate of decline of wages and salaries for the period to November also increased, to exceed that in the initial projection. By contrast, the rate of decline of goods and services slowed, drawing away from the forecast for the year as a whole. The trade-off seen in recent years between the trend in State wages and salaries and State current transfers, as a consequence of the transfer of educational powers to the regional (autonomous) governments, meant that, as the counterpart of the deceleration in the former, transfers accelerated slightly. Their growth rate rose from 12.8 % for the period to September to 13 % to November, which is somewhat higher than the forecast for the year. As regards capital transactions, their two components also displayed opposite behaviour during the months of the final quarter of 2000 for which information is available: invest-

(2) The rise in the price of fuel does not affect the hydrocarbon duty, since it is levied at a flat rate. By contrast, VAT (charged at a rate of 16% in this case) is applied to the price.

Social security budget outturn

The Social Security System ran a surplus of ESP 1,316 billion to October 2000, ESP 437 billion (49.7 %) higher than in the same period of the preceding year (see table below). This improvement in the balance, larger in absolute terms than that recorded to July, was the result of growth in revenue of 10.5 %, which accelerated slightly, and of the moderate increase in expenditure (7.3 %, against 7.7 % to July).

Receipts from social security contributions rose by 9.9 % to October, a similar rate to that recorded to July and higher than the 6.8 % recorded in the whole of 1999 and the budget forecast of 3 %. The strength of revenue from contributions was attributable, above all, to the buoyancy of registrations, which grew by 5 % during the whole of 2000 (5.5 % during 1999). This compares with a budget forecast of only 3 % for the increase in the number of contributing employees. The other major source of revenue, current transfers from the State, increased by 11.2 % (11.6 % to July), in line with the budget.

As for expenditure, spending on contributory pensions increased by 7.2 % to October (7.4 % to July), a similar rate to the budget forecast (7 %). The number of contributory pensions grew by 1.2 % to November, in line with the budget and with the growth recorded in 1999. Sick pay benefits also slowed somewhat, although their rate of change (13.1 % growth to October) was still well above the budget forecast (4.7 % cut).

As regards INEM (the National Employment Office) expenditure, spending on unemployment benefits slowed during 2000 Q4, rising by 0.8 % to November (5 % to August), compared with a decline of 2.9 % in 1999 as a whole. This outcome was the result of the behaviour of the number of beneficiaries, which fell by 3 % to November, compared with an average decrease of 9.5 % in 1999, reflecting the slower decline in registered unemployment (4.5 % during the whole of 2000, as against 11.7 % in 1999). In line with the trends observed in 1999, the fall in the number of unemployed persons entitled to unemployment benefits to November was smaller than the reduction in registered unemployment. As a result, the replacement rate rose to 64.5 % (63.3 % to November 1999).

Contributions received by INEM rose by 8.9 % in the period to September, despite the 0.25 percentage points cut in the unemployment contribution rate, while concessions on employers' contributions for employment-promoting contracts increased by 10.1 % to August, compared with the 1.9 % reduction forecast in the budget.

(3) However, the draft Social Security System budget for 2001 includes an estimate of 10.2% for the increase in regular contributions to the general regime for the whole of 2000.

**Social Security System (a)
(Transfers to regional governments allocated) (b)
(Current and capital transactions, in terms of recognised entitlements and obligations)**

ESP bn and %

	Outturn	Budgeted		Outturn	Outturn JAN-OCT		
	1999 1	2000 2	% change 3=2/1	JAN-JUL % change 4	1999 5	2000 6	% change 7=6/5
1. Revenue	13,832	14,583	5.4	10.4	11,785	13,023	10.5
Social security contributions (c)	9,310	9,589	3.0	9.7	7,722	8,488	9.9
Current transfers	4,349	4,825	10.9	11.6	3,931	4,372	11.2
Other (d)	173	169	-2.3	17.8	132	163	23.2
2. Expenditure	13,582	14,432	6.3	7.7	10,905	11,706	7.3
Wages and salaries	2,129	2,245	5.4	6.6	1,820	1,931	6.1
Goods and services	1,341	1,397	4.2	6.5	1,083	1,152	6.4
Current transfers	9,916	10,570	6.6	8.1	7,892	8,501	7.7
Benefits	9,851	10,502	6.6	8.1	7,831	8,436	7.7
<i>Contributory pensions</i>	<i>7,796</i>	<i>8,342</i>	<i>7.0</i>	<i>7.4</i>	<i>6,122</i>	<i>6,563</i>	<i>7.2</i>
<i>Sickness</i>	<i>555</i>	<i>528</i>	<i>-4.7</i>	<i>15.1</i>	<i>414</i>	<i>468</i>	<i>13.1</i>
<i>Other (e)</i>	<i>1,501</i>	<i>1,631</i>	<i>8.7</i>	<i>9.5</i>	<i>1,295</i>	<i>1,406</i>	<i>8.6</i>
Other current transfers	65	68	4.4	6.1	61	65	6.0
Other (f)	195	220	13.0	9.2	111	122	10.1
3. Balance	250	151	-39.6	54.6	879	1,316	49.7

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 only available to June 2000.

(b) Transfers to regional (autonomous) governments to finance the health-care and social-services responsibilities they have assumed have been distributed among the various expenditure captions on the basis of the percentages resulting from the general government accounts for 1997.

(c) Including surcharges and fines.

(d) Excluding surcharges and fines, and the contribution from the pharmaceutical industry.

(e) Reduced by the contribution from the pharmaceutical industry.

(f) Reduced by the disposal of investments.

ment accelerated to 6.1 % (2.3 % to September), as compared with the slight fall forecast in the initial projection, while the rate of growth of capital transfers fell to a decline of 15.7 % to November, which was greater than forecast for the whole of the year. In any event, both items are normally strongly influenced by transactions in December.

4.5. The Spanish balance of payments and capital account

During the first ten months of 2000, the current and capital accounts ran a deficit of EUR 10,363 million, an increase of EUR 8,452 million on the same period a year earlier (see Table 4). This outcome basically reflects the large increase in this period in the trade deficit. Other current transactions, with the exception of tourism, also deteriorated, with the result that the current account deficit widened to EUR 14,734 million, an increase of EUR 8,106 million on the same period a year earlier. The surplus on capital account also deteriorated slightly, to stand at EUR 4,370 million during the period January-October, which amounts to a reduction of EUR 346 million on the same period of 1999.

The notable worsening of the trade deficit, which increased by 35.9 % during the first ten months of the year, was primarily attributable to the high cost of purchases of energy products, against a background of significant growth in their prices in pesetas. The slowdown in non-energy imports and the firming of strong exports helped to reduce the deterioration in the trade deficit. The tourism services surplus rose by 10 % during the period January-October, although the fast rate of improvement of the pre-

vious year moderated, as a consequence of more subdued tourism receipts in the first half of the year and of more buoyant payments. As for other services, there was a slight widening in the deficit, with communications and IT services transactions displaying great vigour.

The income balance deteriorated by EUR 709 million during the first ten months of 2000. On the receipts side, direct and portfolio investment receipts remained highly buoyant, in step with the intense foreign investment that has been taking place in recent years, while receipts from other short-term investments rose more moderately. As for payments, all the captions were expansionary, especially those linked to portfolio investment, in line with the forceful growth of foreign investment in mutual funds and bonds. The current transfers surplus fell by EUR 1,287 million during the period analysed, as a consequence of the notable decline in flows from the EU under the European Social Fund, while transfers to the private sector under EAGGF-Guarantee rose slightly. Finally, the surplus on capital account deteriorated by EUR 346 million in relation to the same period a year earlier, as a result of the sharp decline in structural funds received from the EU under EAGGF-Guidance, since the flows corresponding to the Cohesion Fund improved.

The net borrowing of the nation reflected by these data would indicate a weakening of the sectoral balances of households and corporations, during a period in which the household saving ratio continued to decline, while residential investment and, to a lesser extent, private productive investment sustained notable increases. By contrast, the rise in general government saving and the consequent reduction in the budget deficit have been consolidated.

5. Financial flows in the Spanish economy

5.1. Financial flows in the economy as a whole

The latest National Accounts and financial accounts figures indicate that the deterioration in the net financial saving of the nation (4) continued during 2000 Q3. The net balance of the financial transactions between the Spanish economy and the rest of the world was -2.2% of GDP at the end of 2000 Q3, in cumulative four quarter terms, having been -1.1% of GDP in 1999 (see Table 5). This decline reflects, above all, a reduction in the net financial saving of households and non-financial corporations, which is at historically low levels. By contrast, the low level of net general government borrowing in the first three quarters of 2000 helped to moderate the deterioration in the net balance of the nation's financial transactions. Likewise, the increase in the credit balance of the financial transactions of financial institutions with other sectors worked in the same direction.

The trends in inter-sectoral flows broadly reflect some of the most significant processes that have been taking place since late 1999. In the case of households, along with the trend decline in their net financial saving, a process of reintermediation of their financial flows by credit institutions is discerned in recent quarters. This follows a period in which households preferred to channel their savings through institutional investors (see the lower part of Table 5). That said, certain instruments issued by the latter continued to attract a high volume of household saving during 2000, such as shares in international mutual funds and unit-linked life assurance.

Another significant trend apparent in recent information on inter-sectoral financial flows is their increasing internationalisation. On one hand, the increase in the net borrowing of non-financial corporations in recent quarters has been covered, as seen in Table 5, with funds from resident credit institutions and the rest of the world. However, these figures do not adequately reflect the magnitude of the gross borrowing of non-financial corporations from non-residents, because, as discussed below, the net balance was the result of large inflows and outflows of funds. General government has also

(4) 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. In this report both terms are used without distinction. Likewise, the names non-financial corporations and households (used in previous reports) and non-financial corporations and households and non-profit institutions (the name of the same sectors in ESA 95) are also used without distinction.

TABLE 5

**Net financial transactions and inter-sectoral flows
(Cumulative data for the last four quarters)**

% of GDP

	NET FINANCIAL TRANSACTIONS							
	1995	1996	1997	1998	1999	2000		
						Q1	Q2	Q3
Total economy	1.0	1.2	1.6	0.5	-1.1	-1.6	-1.9	-2.2
Non-financial corporations and households and NPIs	6.7	5.1	4.0	2.0	-0.6	-1.0	-2.3	-2.6
Non-financial corporations	0.2	0.0	-0.3	-0.7	-1.7	-2.2	-2.6	-3.0
Households and NPIs	6.5	5.1	4.4	2.7	1.1	1.1	0.3	0.3
Financial institutions	1.0	1.0	0.7	1.1	0.5	0.8	0.8	0.9
General government	-6.6	-4.9	-3.2	-2.6	-1.1	-1.4	-0.4	-0.4
	INTER-SECTORAL FLOWS (a)							
	1995	1996	1997	1998	1999	2000		
						Q1	Q2	Q3
Households and NPIs	6.5	5.1	4.4	2.7	1.1	1.1	0.3	0.3
Vis-à-vis:								
Credit institutions (b)	2.2	-2.8	-6.6	-4.6	-0.2	1.7	1.3	1.8
Institutional investors (c)	3.0	8.7	10.8	7.8	0.8	-1.0	-1.8	-1.8
Non-financial corporations	0.2	0.0	-0.3	-0.7	-1.7	-2.2	-2.6	-3.0
Vis-à-vis:								
Credit institutions (b)	-1.6	-0.4	-3.3	-4.1	-3.6	-5.1	-4.5	-5.5
Rest of the world	-0.3	0.3	1.7	0.9	-0.2	0.5	-0.3	-0.6
General government	-6.6	-4.9	-3.2	-2.6	-1.1	-1.4	-0.4	-0.4
Vis-à-vis:								
Credit institutions (b)	-3.1	-0.4	1.4	1.4	1.4	1.3	1.2	1.2
Institutional investors (c)	0.6	-6.0	-3.9	-2.6	1.7	1.7	3.3	3.5
Rest of the world	-3.4	-0.2	-2.0	-1.1	-4.3	-3.8	-3.8	-4.5
Rest of the world	-1.0	-1.2	-1.6	-0.5	1.1	1.6	1.9	2.2
Vis-à-vis:								
Credit institutions (b)	-2.9	0.9	2.8	7.1	2.0	3.6	3.7	3.2
Institutional investors (c)	-0.5	-0.9	-2.6	-6.1	-3.5	-3.6	-3.9	-4.2
Non-financial corporations	0.3	-0.3	-1.7	-0.9	0.2	-0.5	0.3	0.6
General government	3.4	0.2	2.0	1.1	4.3	3.8	3.8	4.5

Source: Banco de España.

(a) A positive sign indicates the extension of financing to the counterpart sector. A negative sign denotes financing received by the counterpart sector.

(b) Defined in accordance with the First Banking Directive.

(c) Insurance corporations and collective investment undertakings.

been obtaining a large volume of financing from the rest of the world, replacing domestic funds with foreign financing. This substitution is evident in the maintenance of and, more recently, in the increase in the positive balance of their financial transactions with resident credit institutions and institutional investors, stemming from the sales of government securities which both sectors have been conducting for some time. Lastly, institutional investors have also been increasing their net credit position vis-à-vis the rest of the world, while credit institutions have been increasing their net debt position vis-à-vis

the external sector, partly in response to the larger gap between deposits received and financing extended to other resident sectors.

Overall, the net financial transactions with the rest of the world of all sectors of the Spanish economy have increased significantly in recent years. These data, which reflect the growing internationalisation of the Spanish economy, show the increase in net external borrowing as a consequence of the two-fold process of declining household saving and increasing foreign investment. These flows are being channelled

mainly through credit institutions and the purchase by non-residents of securities issued by general government.

5.2. Financial flows of households and NPIs

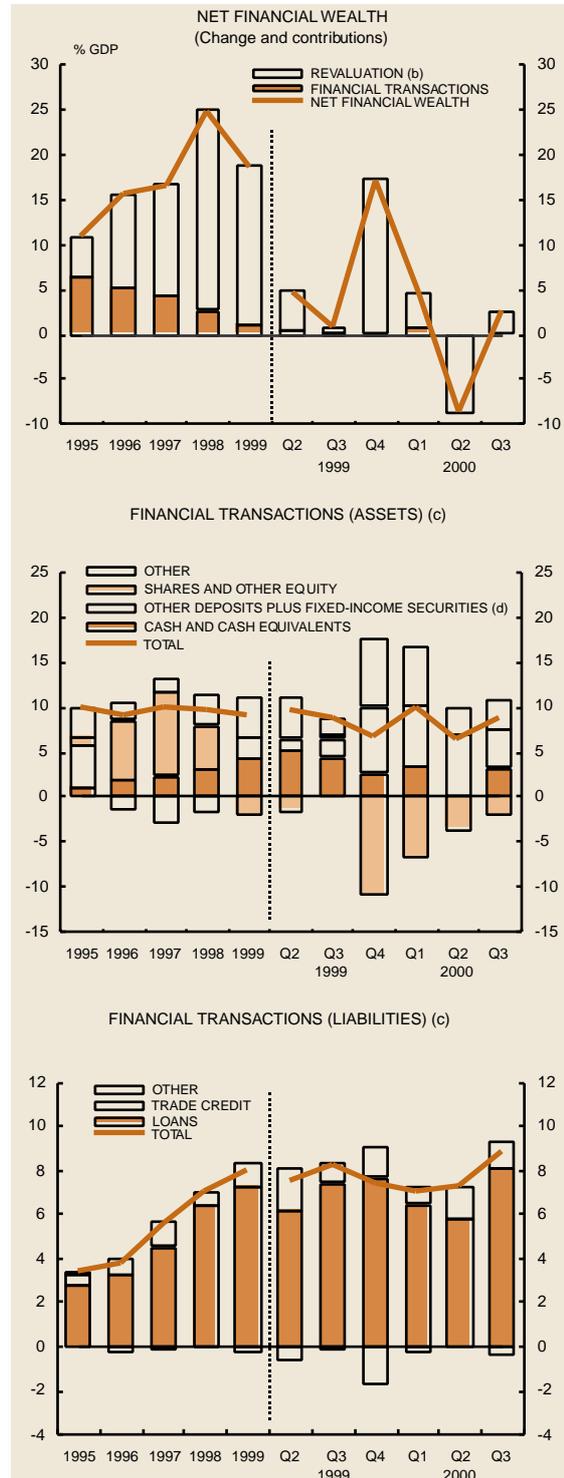
In 2000 Q3, household net financial saving stood at the same level as in the previous quarter, namely 0.3 % of GDP, in cumulative four quarter terms (see Table 5). The continued growth of financing to households and private non-profit institutions (NPIs) and the stability of acquisition of financial assets (and, more recently, their decline, probably in favour of real assets) would explain this sustained deterioration in the sector's saving since 1995. Besides the cyclical position of the Spanish economy and monetary and financial conditions conducive to the expansion of spending and borrowing, this behaviour was underpinned by an intense process of revaluation of financial assets, which led household net financial wealth to increase until 1999, despite the ongoing decline in financial saving (see upper part of Chart 23). The decline in the value of equities and shares in mutual funds that has taken place in 2000 could give rise to a turning point in the trend of the net financial saving of the sector, to enable the decline in non-financial wealth to be mitigated.

Q3 information indicates that the rate of acquisition of financial assets was higher than in the preceding quarter (see Chart 23 and Table 6), owing to the increase in cash and cash equivalents and the more moderate decline in shares and other equity (specifically, mutual funds). The effect of time deposits and repos, which decelerated in this quarter, was in the opposite direction. This trend in financial assets could be a response to the moderation of expectations of rising interest rates that occurred in Q3. Meanwhile payments to pension schemes and insurance policies (included in the item other in the above-mentioned table and chart), although very significant in 2000 as a whole, fell in value in Q2 and Q3 in relation to the previous two quarters, as a result of a certain tailing off of the reallocation of savings from other assets towards unit-linked insurance.

In 2000 Q3, the flow of financing obtained by households was, in seasonally adjusted terms, at one of the highest levels of the last two years (see lower part of Chart 23). As usual, the increase in the flow of financing was attributable to loans granted by resident credit institutions, which are the main source of financing for this sector. Over the last four quarters, however, financing to households

CHART 23

Households and NPIs (a)



Source: Banco de España.

- (a) Seasonally adjusted data
- (b) Changes in the balance that are not explained either by financial transactions or volume changes
- (c) The quarterly data are annualised.
- (d) Not including unpaid accrued interest, which is included under other.

TABLE 6

Financial assets and liabilities of households, NPIs and non-financial corporations (a)

% of GDP

	1998	1999	2000 (b)	2000		
				Q1	Q2	Q3
HOUSEHOLDS AND NPIs:						
Financial transactions (assets)	9.6	9.0	6.2	2.5	1.6	2.2
Cash and cash equivalents	3.0	4.2	1.6	0.8	0.0	0.8
Other deposits and fixed-income securities (c)	-1.6	2.4	4.5	1.7	1.7	1.1
Shares and other equity	4.9	-2.1	-3.1	-1.7	-0.9	-0.5
Other	3.3	4.5	3.2	1.6	0.8	0.8
Financial transactions (liabilities)	7.0	8.0	5.8	1.8	1.8	2.2
Credit from resident credit institutions	5.9	6.5	4.9	1.5	1.4	2.0
Other	1.1	1.5	0.9	0.2	0.4	0.2
NON-FINANCIAL CORPORATIONS						
Financial transactions (assets)	15.3	17.4	20.2	5.5	7.0	7.7
Cash and cash equivalents	1.6	0.8	1.3	0.7	0.5	0.2
Other deposits and fixed-income securities (c)	0.3	-0.1	1.8	0.5	0.4	0.9
Shares and other equity	3.6	7.7	6.2	1.0	2.9	2.4
Other	9.8	9.0	10.8	3.4	3.2	4.2
Financial transactions (liabilities)	16.1	19.3	22.9	6.2	7.6	9.1
Credit from resident credit institutions	4.8	5.0	5.5	2.0	1.5	2.0
Foreign loans, fixed-income securities and securitisation funds (c)	1.8	3.7	2.9	0.4	0.9	1.7
Other	9.4	10.6	14.4	3.8	5.1	5.5
MEMORANDUM ITEM: YEAR-ON-YEAR GROWTH RATES (%):						
Liquid financial assets	4.0	1.4		1.3	1.5	2.8
Households and NPIs	4.1	0.4		-0.2	-0.1	0.8
Non-financial corporations	3.8	7.2		9.7	9.8	13.1
Financing (d)	16.8	18.5		19.4	16.5	18.6
Households and NPIs	19.3	19.6		18.2	17.4	17.5
Non-financial corporations	15.0	17.6		20.5	15.9	19.4

Source: Banco de España.

(a) Seasonally adjusted data. Annual GDP has been used to obtain the figures as a % of GDP.

(b) Cumulative data to Q3.

(c) Not including unpaid accrued interest, which is included under "Other".

(d) Including bank credit extended by resident credit institutions, foreign loans, fixed-income securities and financing through securitisation funds.

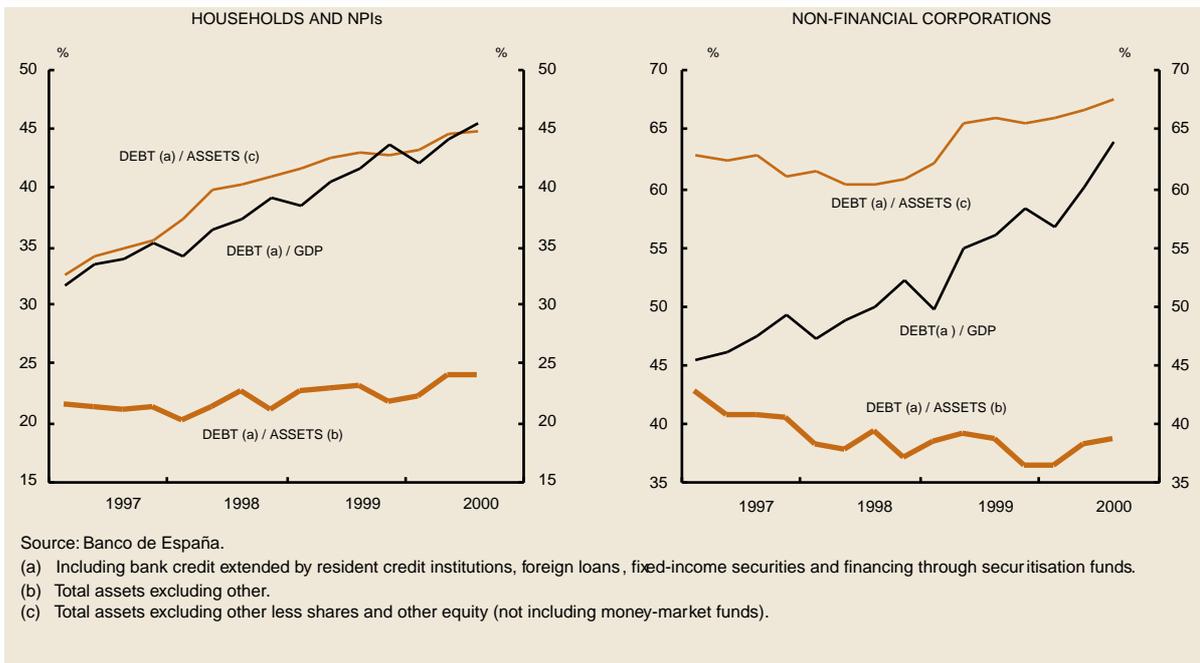
and NPIs has only accelerated slightly (see Table 6). According to the available information on credit by type, this financing continued to be used mainly for house purchases, so that the rate of growth of this component of lending increased in relation to previous quarters. Consumer credit, by contrast, continued to decelerate. The growth in financing for house purchases in 2000 and the parallel decline in the rate of acquisition of financial assets in this period may indicate a certain substitution of real investment for some financial investments. This process would have

been boosted by the rapid rise in the price of housing and the scant revaluation, or even loss of value, of certain financial assets held by households.

The higher volume of financing obtained in Q3 continued to increase household debt ratios (see Chart 24), both in terms of GDP and liquid assets. By contrast, it held steady in relation to the total value of financial assets or gross wealth, as a result of the revaluation in this quarter of equities and shares in capital-market mutual funds.

CHART 24

Debt ratios



5.3. Financial flows of non-financial corporations

In 2000 Q3, the net financial saving of non-financial corporations continued to decline, to stand at -3 % of GDP, in cumulative four quarter terms (see Table 5). This explains the deterioration in the nation's net financial transactions in that quarter, since other sectors either maintained the same level as in the previous quarter or else increased their credit balance. This deterioration indicates that the gap between gross capital formation and gross saving continued to widen in 2000, increasing the sector's indebtedness.

The net borrowing of non-financial corporations also rose as a consequence of acquisitions of foreign enterprises, which took the form of an increase in holdings of shares and other equity. If holdings of foreign equities are added to gross capital formation (considering them to be an approximation to the value of the enterprises acquired and, in most cases, equivalent to a permanent investment in installed capital equipment), then the gap between gross saving and real and permanent financial investment would rise to 9 % of GDP, in cumulative four quarter terms, almost one percentage point higher than in 1999 (see upper part of Chart 25).

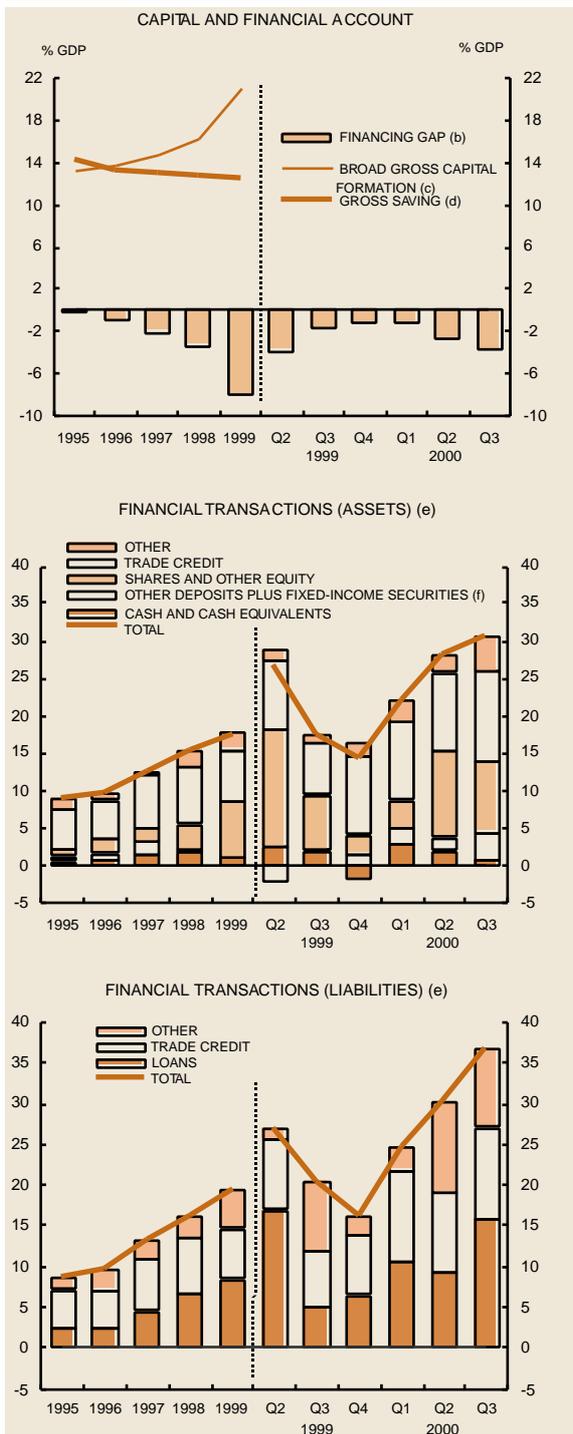
In 2000 Q3, non-financial corporations continued to increase their rate of acquisition of financial assets (see Table 6 and Chart 25), the value of which reached a historic high. A large part of this increase (55 %) is explained by the acquisition of enterprises and the extension of financing to subsidiaries. A small part (15 %) corresponds to cash and cash equivalents, other deposits and fixed-income securities, and the rest (35 %), to financing to customers.

The financing of acquisitions of enterprises by Spanish multinationals, gross capital formation and other financial investment continued to require strong growth in the own funds and borrowing of Spanish firms in 2000 Q3. As a result, there was an increase in both the flow of financing from resident credit institutions and external loans (see Table 6), the need to finance the acquisition of UMTS licenses in Europe having had an impact on both variables. This led to year-on-year growth of 19.4 %, as at end Q3, in funds obtained through bank loans, issuance of fixed-income securities and securitisation funds (Table 6). Also, a significant volume of funds was obtained through increases in capital (25 % of the change in liabilities) which, in the case of Q3, are directly related to the acquisition of enterprises in Latin America.

The available information on bank financing by productive sector in Q3 indicates that financ-

CHART 25

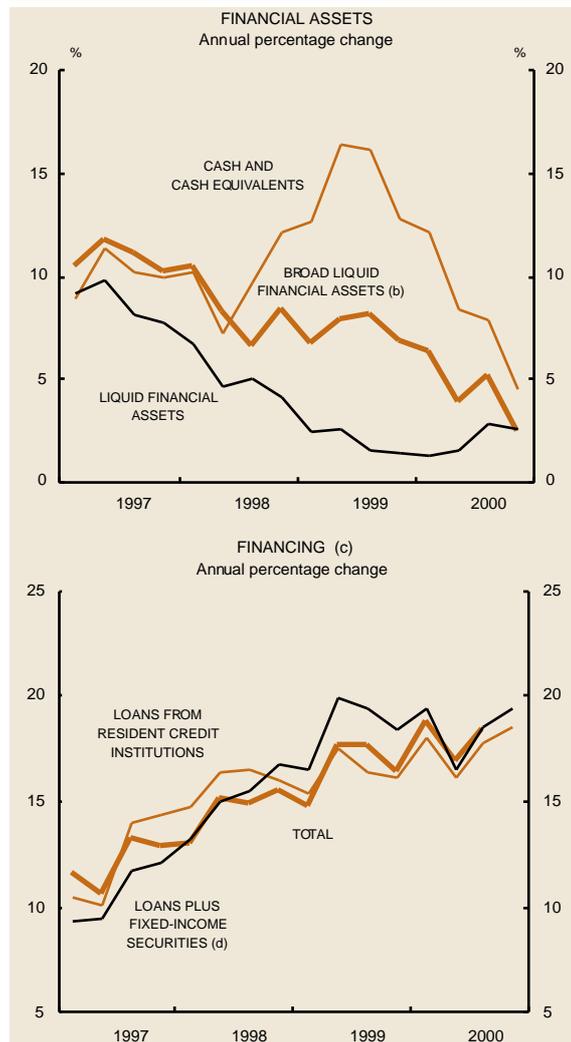
Non-financial corporations (a)



Source: Banco de España.
 (a) Seasonally adjusted data.
 (b) Financial resources that cover the gap between real and permanent financial investment and gross saving.
 (c) Including stockbuilding and foreign equities.
 (d) Including capital transfers.
 (e) The quarterly data are annualised.
 (f) Not including unpaid accrued interest, which is included under other.

CHART 26

Non-financial corporations, households and NPLs (a)



Source: Banco de España.
 (a) The data for 2000 Q4 are provisional estimates.
 (b) Defined as liquid financial assets plus mutual funds other than money-market and fixed-income securities funds.
 (c) Including credit, securities and other borrowed funds.
 (d) Including loans from resident and non-resident credit institutions, securities issuance and financing through securitisation funds.

ing to the services sector and construction held at a high rate of growth (17 % and 23 %, respectively). By contrast, loans to industry, excluding construction, tended to decelerate in the second and third quarters, affected by the cancellation of a loan obtained by a large corporation one year earlier.

The sustained growth in the financing of non-financial corporations, referred to above, led the debt ratios of the sector to continue to rise (see Chart 24), especially the ratio of debt to GDP, which has increased by 20 per-

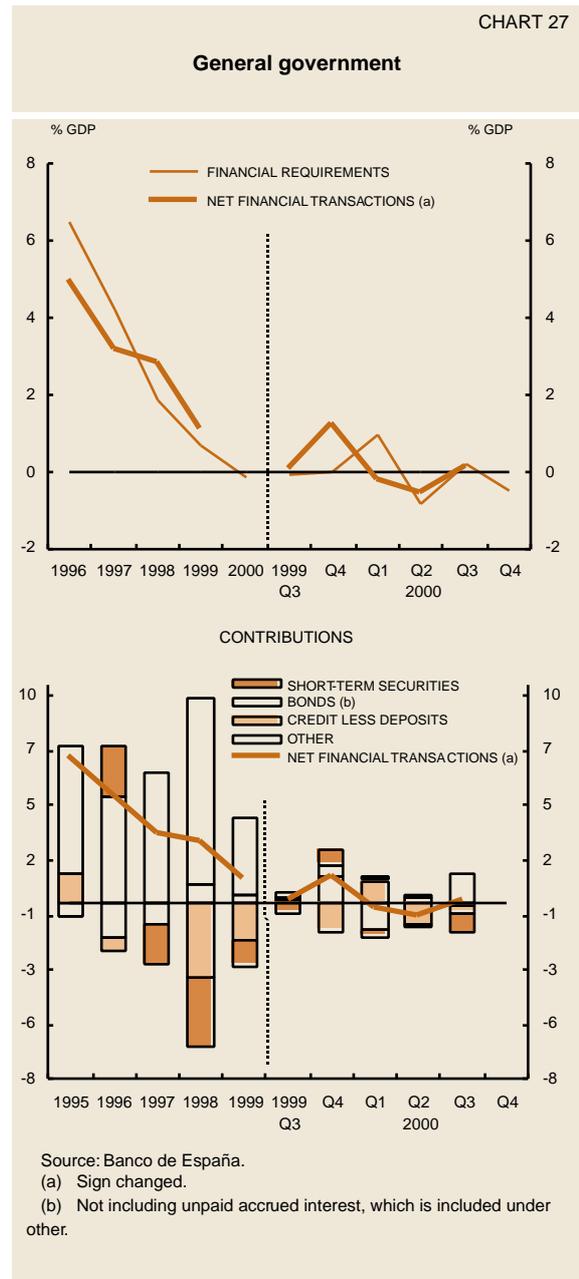
centage points over the last four years. The ratio of debt to the value of gross financial wealth (financial assets), has remained relatively stable over the last two years, as a consequence of the significant growth in the value of equities and the recent acquisitions of enterprises at market prices. It should not be forgotten that, although these acquisitions are stable investments with high expected returns, their level of risk has tended to increase in recent months. Accordingly, these investments need to be closely monitored by managers, supervisory authorities and the investors who have facilitated the international expansion of Spanish firms.

5.4. Financial assets and liabilities of households and non-financial corporations

Having examined the information on financial flows provided by the quarterly financial accounts for 2000 Q3, the developments in Q4 in various monthly indicators, providing partial information on investment in financial assets and the financing of non-financial corporations, households and NPIs, shall now be examined (5).

According to this information, which is still incomplete, the rate of growth of the financial assets of these sectors tended to decline in Q4. The deceleration in cash and cash equivalents that began in mid-1999 (see Chart 26) continued, while time deposits and repos continued to grow at high year-on-year rates. The value of shares in mutual funds that are considered to be liquid financial assets (FIAMMs and FIMs) continued to display negative growth rates, owing to the sale of shares and the decline in their net-asset value. As a result, liquid financial assets continued to sustain very moderate growth rates. During this quarter there was a significant slowdown in the net worth of international and equity funds as a result of the performance of stock markets worldwide. This has meant that the aggregate which includes these funds along with liquid financial assets, broad liquid financial assets, slowed notably in Q4.

(5) It should be noted that the growth rates of the indicators referring to financial assets capture the effects of both new transactions and any price changes. For a precise definition of these indicators, in accordance with ESA 95 methodology, see the box "Aplicación de la metodología SEC/95 a los indicadores monetarios y crediticios mensuales" in the September 2000 edition of the Boletín Económico (only available in Spanish)



The increase in the flows of financing obtained by households and non-financial corporations during 2000 Q3 was translated into the Q4 stocks, so that all the financing aggregates saw an increase in their annual growth rate (see Chart 26). The flow of financing obtained by non-financial corporations and households in the final quarter of the year was also high. The growth of bank lending by resident institutions, as at end-2000, stood at 18.5 %, and it is estimated that the aggregate made up of this lending, financing through securitisation funds, foreign loans and the issuance of fixed-income securities grew at a rate of 19.5 %, a rise of one percentage point on the previous quarter.

5.5. General government financial flows

General government net financial saving in 2000 Q3 was very close to zero (see Chart 27), with a cumulative four-quarter total of -0.4% of GDP. Recourse to the financial markets through the issuance of securities, the obtaining of credit and the use of balances held on deposit (known overall as *financial requirements*, and which is an indicator of the financial saving of the sector) was practically nil in Q3, turning negative in the final quarter of 2000. However, the Q4 data are still provisional since, unlike in previous reports, they do not include the last few days of the year.

During 2000 Q3 the net issuance of bonds rose in relation to the previous quarter, to reach a volume of almost EUR 10 billion. At the same time, there was an increase in the amount of redemptions of short-term securities that was not offset by gross issuance, so that the net issuance of these securities was EUR -5.2 billion. This outcome meant that the proportion of cumulative *financial requirements* covered by bonds continued to rise to stand at close to 85% at the end of Q3. Lastly, the net flow of loans and deposits was negative owing to the decline in the balance of outstanding loans and to the increase of EUR 2.4 billion in general government deposits at financial institutions.

The partial information available on the volume of funds raised by general government on the markets during the final quarter of the year indicates that the volume of net issuance of long-term securities by the State held at a high level (EUR 8.5 billion). The net issuance of short-term securities remained negative, albeit somewhat smaller than in Q3 (EUR -1.3 billion). Finally, the reduction in the balance of outstanding loans and the high amount of the deposit at the Banco de España in the last few days of the year 2000 would give rise to a reduction in the flow of financing obtained by these means, leading to negative *financial requirements* in Q4, and a value of close to zero for the year 2000 as a whole.

During the last two quarters of the year, to reduce the future cost of its debt, the State took advantage of the room for manoeuvre existing in its finances to make exchanges and early redemptions of securities totalling EUR 6.8 and 4.2 billion, respectively. This meant that liabilities issued in the past at higher interest rates were replaced or cancelled. The total financing obtained by the State through securities issuance during the year 2000 was EUR 20 billion, in the case of bonds, and a negative amount of EUR -8.9 billion, in that of Treasury bills.

5.6. Financial flows between the Spanish economy and the rest of the world

The balance of the financial transactions of the Spanish economy with the rest of the world remained negative in 2000 Q3. The cumulative value for the year was -1.9% of GDP (see Table 7) and the cumulative four-quarter figure -2.2% of GDP (see Table 5). As regards financial transactions, financial accounts information indicates that this negative balance was attributable to a significant increase in the accumulation of both external assets and external liabilities. This sustained growth in the accumulation of assets and liabilities was a consequence, on one hand, of the internationalisation of large Spanish firms, whose flows of financing and investment now take place in a global market and, on the other, of portfolio diversification by institutional investors, which has boosted purchases of external assets.

In relation to external financial assets, there has been a notable and sustained increase in purchases of shares and other equity over the last four years. In the first three quarters of 2000, these purchases (which include most direct investment and that part of portfolio investment in the form of shares and other equity) had already reached a higher volume than in 1999 (see Table 7). A final element that helps to explain the notable increase in external assets in 2000 Q3 was the significant amount of loans granted by the non-credit private sector to subsidiaries and related companies, the volume of which was similar to that of 1998 and slightly below that of 1999.

As already mentioned, during 2000 Q3 the Spanish economy accumulated a significant volume of liabilities vis-à-vis the rest of the world, which is reflected in various items. Credit institutions continued to borrow at a high rate from non-resident intermediaries, so that the cumulative flow during the first three quarters of 2000 was already higher than in 1999 as a whole (see Table 7). The term structure of these new liabilities was again dominated by short-term loans and deposits (70 % of the increase in liabilities in the first three quarters of the year was at a maturity of one year or less, while the equivalent figure in 1999 was 40 %). Purchases by non-residents of securities issued by general government also gained momentum during Q3, thus continuing the trend that began in 1999. There was also a significant inflow of capital into Spain in the form of purchases of shares in Spanish firms, partly related to swap transactions stemming from the acquisition of Latin American enterprises. Finally, the non-

TABLE 7

Financial transactions of the nation (a)

% of GDP

	1998	1999	2000 (b)	2000		
				Q1	Q2	Q3
Net financial transactions	0.5	-1.1	-1.9	-0.7	-0.5	-0.6
Financial transactions (assets)	12.8	15.3	17.1	3.8	4.4	9.0
Gold and SDRs	0.0	-0.2	0.0	0.0	0.0	0.0
Cash and deposits	3.2	1.8	2.3	0.8	-1.0	2.5
Credit system	0.0	3.7	1.7	0.1	-1.0	2.6
Other resident sectors	3.2	-2.0	0.6	0.7	0.0	-0.1
Securities other than shares	3.4	2.8	2.2	-0.4	1.3	1.3
Credit system	-1.4	-0.9	-0.2	-0.4	-0.2	0.4
Other resident sectors	4.8	3.7	2.4	0.0	1.5	0.9
Shares and other equity	4.4	8.8	9.2	2.5	3.3	3.4
Credit system	0.4	0.5	1.6	0.5	0.5	0.6
Other resident sectors	4.0	8.3	7.6	2.0	2.7	2.8
Of which:						
Non-financial corporations	2.5	6.0	4.8	0.5	2.1	2.2
Loans	1.9	2.1	3.4	0.9	0.8	1.7
Credit system	0.2	0.1	0.4	0.2	0.0	0.1
Other resident sectors	1.7	2.0	3.0	0.6	0.8	1.6
Financial transactions (liabilities)	12.3	16.5	18.9	4.5	4.9	9.6
Deposits	5.9	4.2	4.6	1.5	1.5	1.6
Of which:						
Credit system	5.9	4.1	4.6	1.5	1.5	1.6
Securities other than shares	1.0	5.5	4.7	1.4	1.0	2.3
Credit system	0.2	0.9	0.8	0.3	0.3	0.3
General government	1.0	4.3	3.5	0.9	0.6	2.0
Other resident sectors	-0.2	0.3	0.4	0.2	0.1	0.0
Shares and other equity	2.9	2.9	5.5	0.7	1.8	2.9
Credit system	0.1	0.3	1.5	0.3	0.5	0.7
Other resident sectors	2.8	2.7	4.0	0.4	1.4	2.2
Loans	3.1	4.8	4.3	0.7	1.2	2.4
General government	0.1	0.0	0.0	0.0	0.1	-0.1
Other resident sectors	2.9	4.8	4.3	0.8	1.1	2.5
Other, net (c)	-0.6	-1.0	-0.2	0.1	-0.6	0.3

Source: Banco de España.

(a) Annual GDP has been used to obtain the figures as a % of GDP.

(b) Cumulative data to Q3.

(c) Includes the asset-side caption reflecting insurance technical reserves.

financial private sector obtained a significant volume of financing in Q3, part of which enabled the acquisition of mobile telephone licences in Europe to be financed.

The only information available on Q4 is the October balance of payments data. These indicate that the flows of direct and portfolio investment in external assets held at high levels, as did non-residents' purchases of Spanish government debt. There were also capital inflows in the form of some significant stock market acqui-

sitions, as well as in the form of direct investment (other equity).

The negative balance of the financial transactions of the Spanish economy with the rest of the world in the first three quarters of 2000 helped to increase the net external debit position (see Table 8). The sectors that saw an increase in their net debit position in this period were general government (almost 3 GDP percentage points) and credit institutions (almost 4 GDP percentage points). By contrast, institu-

tional investors continued to increase their net holdings of foreign assets.

Some conclusions can be drawn regarding the nature of the process of internationalisation of Spanish financial flows on the basis of the trends in the positions of the various sectors vis-à-vis the rest of the world. Spanish households are channelling a progressively larger part of their savings abroad, through institutional investors. This is occurring while their sav-

ings are declining and the net borrowing of corporations increasing. In these circumstances, the Spanish economy clearly requires a significant flow of financing, which can only come from abroad. This external saving is mainly being channelled through credit institutions and purchases by non-residents of securities issued by general government.

26.1.2001.