
Quarterly report on the Spanish economy

1. Overview

The onset of 2002 has seen the culmination of the introduction of the euro as a common currency for the twelve euro area countries. The changeover of notes and coins has unfolded successfully thanks to the resolute collaboration of all the parties involved, namely the European monetary authorities, financial institutions and retailers, and companies and individuals. The pace of the rise in demand for the new currency has exceeded all earlier forecasts, reflecting the high degree of acceptance by the general public, and marks a great step forward in the project of European integration. The complex process witnessed in the opening days of the year is part of a far-reaching structural change which, by smoothing trade and improving market transparency, will boost competition in the euro area. Its concurrence with a weak world economy and sagging trade has posed no obstacle to the introduction of the new currency.

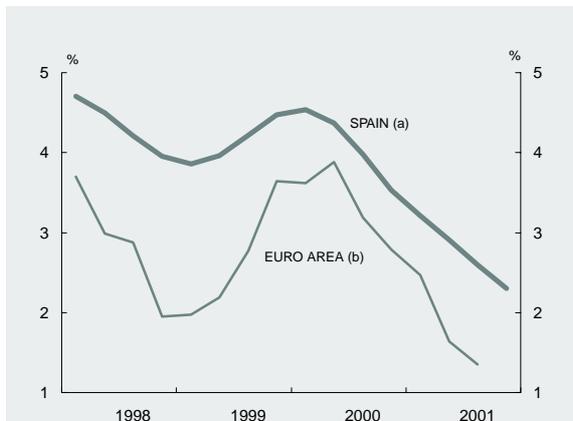
Against a far from propitious international background, the pace of growth of the Spanish economy fell during Q4 last year to an estimated real GDP rate of around 2.3%, three-tenths of a percentage point down on the INE figure released for Q3. This result places GDP growth for the year 2001 at 2.8% on average, 1.3 points down on 2000. These figures confirm that, despite the slowdown in its growth rate, the Spanish economy continued to move ahead last year in the process of real convergence with the euro area countries, whose estimated average growth for the year was 1.5%.

The main underpinnings of the Spanish economy's buoyancy in the final quarter were spending by households (on consumer goods and housing) and, to a lesser extent, by general government. Meanwhile, exports and investment in capital goods (and thus industrial activity) were affected by the deterioration in foreign markets and the associated uncertainty. This same pattern governed developments in the euro area economies and in the United States, although the declines in investment and, especially, in exports were sharper in the US economy, turning the real output rate negative. Recession continues to dog the Japanese economy, and the global downturn has spread to many emerging economies, with the notable exception of certain major countries such as Russia or China.

Despite this considerably depressed international picture, the latest figures released are, in general, relatively promising, as they would be consistent with expectations that the deceleration in the main economies in late 2001 is bottoming out. That would pave the way during the current year to a slow recovery which, however, is not free from uncertainty, particularly as regards its timing and intensity.

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.

In the United States the fall in real GNP has been sharper than expected. But the US economy's growth potential remains very high following the surge in productivity in the preceding years and given its capacity to incorporate and benefit from the latest technological innovations. This process has not yet run its course, as is demonstrated by the fact that, even in recession, the growth rate of productivity has been relatively high. The markedly expansionary macroeconomic policy stance adopted, which placed the federal funds interest rate at 1.75% on 11 December, and the end of the military conflict in Afghanistan are factors which should also contribute to putting the recession behind.

The cyclical change in the US economy is pivotal if markets are to recover and the uncertainty still besetting worldwide activity is to clear. That would particularly help the many south-east Asian and Latin American emerging economies that have been affected by the downturn in world trade. The deep-seated crisis in which Argentina is immersed is a case apart, with specific connotations clearly separating it from the other countries in the area, and whose effects are confined to developments within Argentina.

Turning to the euro area, the preliminary annual growth rate of real GDP for Q3 last year was 1.4%; in quarter-on-quarter terms, the rate was, for the second period running, 0.1%. The data available for Q4 indicate that the area may have ended last year in a stagnant position, albeit with appreciable differences between the economies in the zone. The most positive aspect of the latest data published is, perhaps, the fact that the slow-

CHART 2

Harmonised indices of consumer prices



Sources: Eurostat and European Central Bank.

down in gross fixed capital formation appears to have eased, a development in step with an incipient improvement in business expectations. The factor most blackening the picture would be the notable slide in exports, in response to the strong contraction of world markets. It is these two variables – investment and exports – which must trigger and drive a sustained pick-up in the European economies.

The macroeconomic policies pursued by the European authorities have continued along the lines set in previous quarters, as the changes in the economic outlook at home and abroad became apparent. The European Central Bank (ECB), given the improved inflationary expectations (partly associated with the fall in oil and other commodity prices on international markets), the decline in the pace of industrial activity and the scaling back of growth prospects for the area, cut its official interest rates once again on 8 November by half a percentage point to their current level of 3.25%. National fiscal authorities have not adopted significant specific measures of an expansionary hue beyond letting the automatic stabilisers operate freely. It should be noted, however, that the initial situation was one in which appreciable tax cuts had been agreed in certain countries and in which the budget deficits of certain members had reached a sizeable level. According to the forecasts accompanying the updated stability programmes, a worsening of structural balances is not generally expected in the coming year.

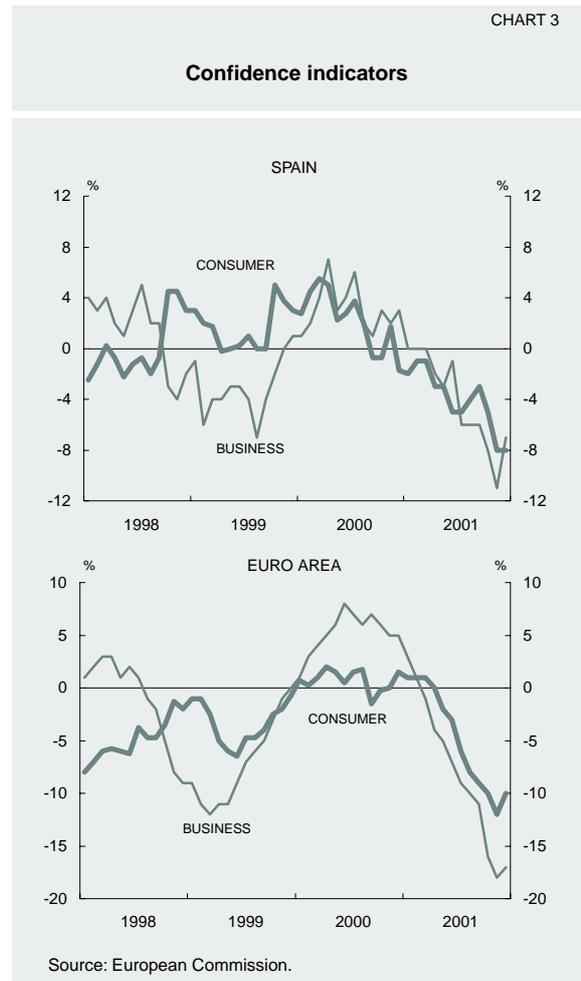
Monetary conditions across the euro area are tailored to the current economic situation and to how developments are most plausibly expected to unfold. Money market interest rates have responded to the fall in official rates and are holding stable. The growth of the aggregate

M3 is very high, but should be assessed with caution. This is because exceptional and temporary factors relating to the public's increased preference for liquidity in a context of heightened uncertainty have influenced its course. The growth rate of lending continues to decelerate, albeit more slowly. Forward rates have moved upwards, correcting the expectations which, to date, markets had held about further – and modest – cuts in rates in the coming months. These shifts, which have also occurred on other markets, may be due to a more favourable perception of future economic developments in Europe and, in general, internationally, following the release of certain relatively favourable data referred to above.

As regards prices, the euro area-wide inflation rate continued to slow in the closing months of the year. The twelve-month growth rate of the HICP stood at 2.1% at end-2001. Although the reduction in the rate of increase of consumer prices (from the high of 3.4% last May) is largely due to the trend of energy prices, it will foreseeably continue over the coming year as other sectors begin to benefit from the fall in energy and other commodity prices. Nonetheless, it would be unwise to rule out a scenario in which these favourable expectations might be dampened due to the ongoing demands for wage rises in the key industries of certain euro area economies being met.

The relative stability of national demand continues to be essentially determined, as in previous quarters, by consumer spending and private and public investment in construction, and by the positive contribution of stockbuilding, since investment in capital goods is showing no signs of picking up. Yet the keynote in the economy in the closing months of 2001 was, perhaps, the behaviour of external demand. Here, a fall in the real rate of change of exports of goods and services combined with a continuing modest but stable growth rate of imports, in step with the course of domestic demand. This marks a difference between the recent trend of the Spanish economy and that of the euro area as a whole, since the deterioration in exports in the latter has largely been offset by lower imports.

Goods exports are forecast to have posted negative year-on-year rates in Q4. This is duly anticipated by the latest figure available (for October), which denotes a continuation of the notable shrinkage in exports initiated last June, as the decline in world trade began to affect European markets. If, as is foreseeable, the fall in world markets should have bottomed out in the final months of 2001, a more adverse performance by goods exports (but not by tourism, according to the latest indicators) in that period



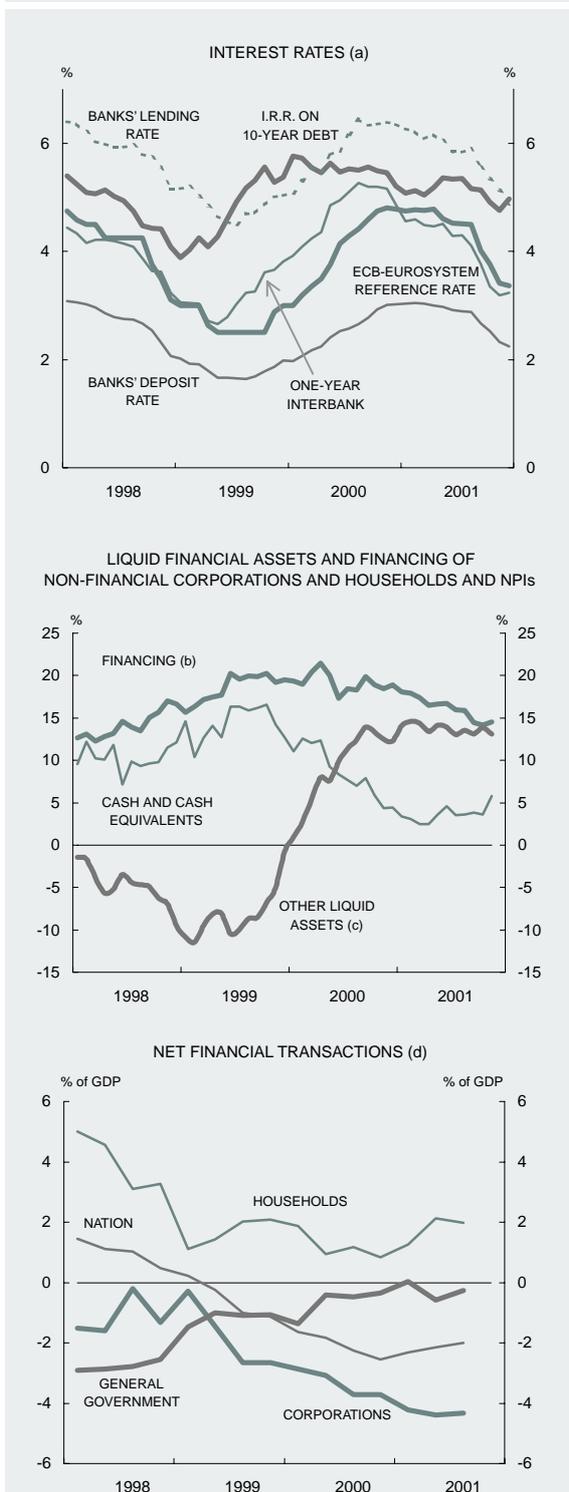
cannot be ruled out. That would further accentuate the negative contribution of net external demand to real GDP growth in Q4 and, as a result, the estimated growth rate for this variable would be reduced by one or more tenths of a percentage point.

During 2001 Q4 the Spanish economy followed the same patterns of behaviour that had characterised the rest of the year. Net jobs continued to be created, albeit at a lesser pace than previous quarters (especially in industry, where the deceleration in real value added was most marked). The inflation rate fell as the movements in oil and oil-related prices were stripped out, meaning the CPI at the end of the year was running at a twelve-month growth rate of 2.7% (2.9% in terms of the harmonised index, leaving the inflation differential with the euro area as a whole at seven-tenths of a point). And finally, the State budget deficit eased, whereby its December outturn will foreseeably prove compatible with the attainment of overall general government budgetary stability.

If confirmed, the results for Q4 would close a year in which the Spanish economy posted

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) Includes deposits with agreed maturity, repos, bank securities, residents' cross-border deposits and shares in money-market funds.

(d) Cumulative four-quarter data.

more modest growth than in previous years, but growth which was nevertheless still high compared with most of its trading partners. Specifically, real GDP growth is estimated at 2.8% on average in 2001, with an increase in national demand of slightly less than 3% (4.2% in 2000) and a negative contribution of net external demand of 0.2 percentage points, more or less unchanged on the previous year. Particularly notable in the productive branches was the slowdown in value added in industry, proving far greater than that in market services and, above all, construction.

It should be borne in mind, however, that annual average values may mask widely differing patterns of behaviour over the course of the year. Thus, the slowdown by national demand on average in 2001 was partly due to the spillover effect of the notable loss of buoyancy in 2000. Though this continued in 2001, it did so to a much lesser extent. Conversely, the apparent stability in the negative contribution of external demand in average terms in both years fails to disclose its notable tendency to improve during 2000 and a notable deterioration during 2001.

As has often been the case, it was consumption and investment in construction which most contributed to the growth of national demand in 2001. Notwithstanding, the annual average increases in these variables will be lower than in the previous year, especially that of household consumption, whose real growth rate may be almost one and a half percentage points below the figure of 4% recorded in the year 2000. The differences in government consumption will be much less, as they will in construction; indeed, they may not even amount to half a percentage point, since the modest slowdown in residential investment has been offset by the greater robustness of public works. Investment in equipment, on the other hand, has been very slack as it reacted promptly (before exports did) to the change in economic climate and worsening business expectations. The negative real rate of change of this variable for the year on average may be close to 2%.

The behaviour of household expenditure last year was in response to a wide range of factors. Although the losses in financial wealth and the context of uncertainty in which decisions were taken bore adversely on consumption, the real increase in disposable income was appreciable (provisionally estimated at around 3%), albeit approximately half a percentage point lower than the previous year. The growth of employee compensation, which was likewise lower than in 2000, was pivotal to the increase in disposable income since the contribution of general government was, although positive, fairly modest.

The saving ratio is estimated to have recovered slightly, as did household lending capacity, since the robustness of investment in housing – further boosted by the falling returns on alternative forms of financial investment – lost momentum as the year unfolded.

The provisional data available on the quarterly financial accounts of the Spanish economy confirm the recovery in household financial saving last year. The pick-up was essentially due to the fall in household debt, against a background of increasing uncertainty. Corporations, however, retained considerable debt ratios, despite the slowdown in investment. This was possibly attributable to their lesser resource-generating capacity and to the strong demand for funds, against a background of low interest rates, to finance the foreign investment flows of recent years.

In any event, the improvement in household and general government lending capacity has provided for an appreciable fall in the nation's financing requirements (amounting to perhaps one percentage point relative to GDP). This relates, in turn, to the decline in the deficit on goods and services transactions with the rest of the world (where the fall in oil prices was instrumental) and to bigger capital transfers being received.

As earlier discussed, the data available to date suggest the balanced budget programmed for the overall general government sector in 2001 will be attained. Stability in the ratio of total expenditure to GDP and an improvement of three-tenths of a point in the corresponding revenue/GDP ratio (chiefly due to capital revenue and social security contributions) are foreseen. In terms of agents, the bigger central government deficit is expected to be offset by the surplus on social security. The recent enactment of the legislation on the financing of the regional (autonomous) governments and the Law of Budgetary Stability have entailed significant headway in the co-ordination of, and co-responsibility between, different tiers of Spanish government. And that should result in greater transparency of public finances. The Updated Stability Programme, recently approved by the Commission, confirms the authorities' commitment to fiscal stability as established in the EU. That said, if the macroeconomic scenario were worse than programmed (depending on international economic developments), the Programme does not rule out the possibility of a modest fiscal imbalance, of a few tenths of a point of GDP, as a consequence of the operation of the automatic stabilisers and without any deterioration in the structural deficit.

One of the salient features of the Spanish economy in 2001 was its capacity to continue

generating jobs. Employment growth in terms of equivalent jobs is estimated to have been around 2.5%, six-tenths of a point down on the previous year, meaning apparent productivity growth was very low. This was not the case, however, in the market economy, where productivity actually picked up, especially in services and, to a lesser extent, in industry.

Wages tended to quicken in most branches, as did unit labour costs. Nonetheless, the market-economy unit output surplus widened in 2001, especially in the opening months of the year. The increase in margins was greater in services and in construction, although in this latter variable the widening was much less than in the previous year. In industry, although there was no recurrence of the shrinkage in unit margins seen the previous year (due partly to the recovery in the related value-added deflator, in the face of the fall in input prices, especially energy inputs), the pick-up was not significant.

The prevailing pattern is thus one which is harmful to the more competitive industries and one which, by allowing cost increases above those of our trading partners to become embedded, may ultimately erode the economy's competitiveness.

This fact can be deduced from an analysis of price behaviour. In 2001 the CPI posted an annual average growth rate of 3.6%, although it moved on a declining trend over the course of the year, resulting in a twelve-month increase of 2.7% at end-December. The correction came about basically because of the performance of energy prices, as other components evidenced greater downward stickiness. In any event, the gap with the euro area countries, which stood in early 2001 at around 1.4 percentage points (in HICP terms), has tended to narrow and, in Q4, it held at 0.7 percentage points.

The Spanish economy may be emerging from the slowdown running at a modest growth rate, but this rate has been consistently higher than that of the other euro area countries and has provided for continuing net job creation. The advantages of adopting a framework of macroeconomic stability are thus clear to see: there has been headway in real convergence during the weaker phases of the business cycle, and the sharp contractions formerly generated by the build-up of imbalances have been avoided. To sustain this new pattern in the long run, when the initial effects of the economy's change of regime have petered out, it is essential to preserve competitiveness and thus prevent price and cost differentials with our fellow euro area members being perpetuated.

2. The external environment

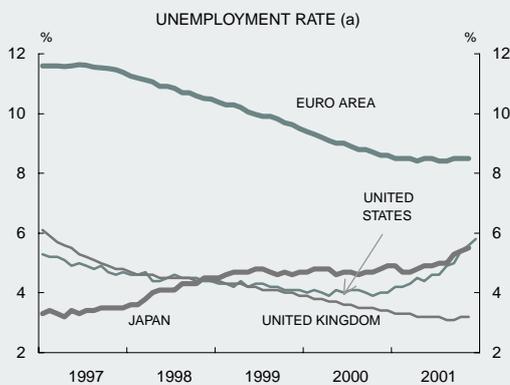
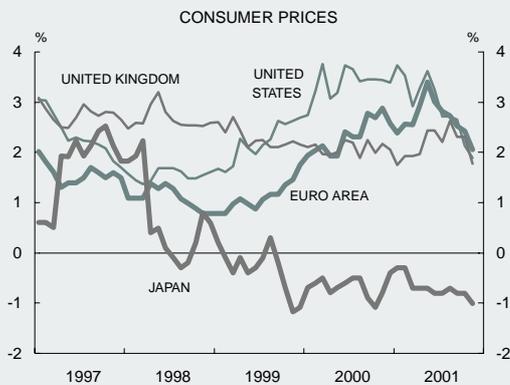
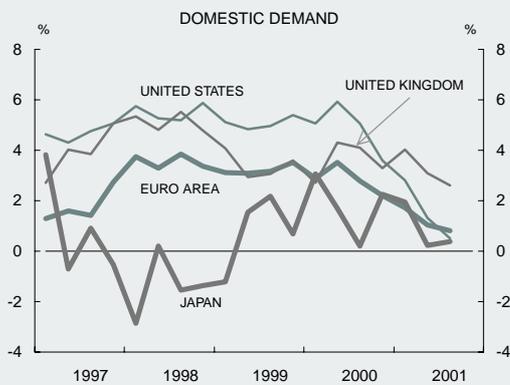
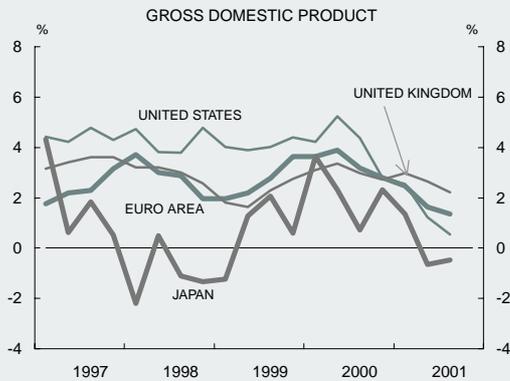
The information available for 2001 Q4 indicates that economic conditions in the external environment of the euro area have exacerbated the slowdown seen in Q3. Although certain signs of an improvement in the United States have emerged very recently, uncertainty as to how soon and strong the US recovery will be remain high. In addition, the Japanese economy is in recession and facing increasingly greater risks in respect of financial stability. Furthermore, the decline in world trade has checked the growth expectations of the emerging countries, which have also been affected by the Argentine crisis.

The final US Q3 data showed a decline of 1.3% in GDP (in annualised quarterly terms). The contraction was due to gross fixed capital formation falling, albeit at a lesser rate than in the previous quarter, to the continuing adjustment of inventories and to the slowdown in private consumption, although this variable continues to grow at relatively high levels given the country's current cyclical position. The slowing trend continued for most of Q4. Industrial output fell by 6% year-on-year and retail sales grew, though at a lower rate (shifting from a year-on-year rate of 7.1% in October to 3.8% in December). Corporations continued shedding jobs, especially in October and November, and the unemployment rate rose to 5.8% in December. However, some recently released indicators appear to signal that the worst of the recession may be behind in certain industries. The NAPM manufacturing and services indices have, like the leading indicators index, picked up more than expected in recent months, orders for capital goods (machinery) and electronic components have increased and inventories continue to be adjusted at a very high rate. Consequently, the decline in industrial output might shortly come to an end. As regards the factors underpinning consumption, consumer confidence has risen and the falls in employment appear to have moderated. But one of the key variables of this recession, namely corporate earnings, has yet to recover. That is needed, over and beyond the end of the adjustment of inventories, so that private investment may regain momentum, this being hampered by excess capacity. On the other hand, however, low interest rates may help lighten corporations' financing costs and thus increase their profits.

Turning to prices, the absence of inflationary pressures is increasingly patent. Testifying to this is the reduction in the private consumption deflator, which has dipped from 2.2% in Q2 to 1.6% in Q3, and – above all – the performance of producer prices (which declined by 1.8% year-on-year in December) and of import prices (down 8.9% year-on-year in the same month).

CHART 5

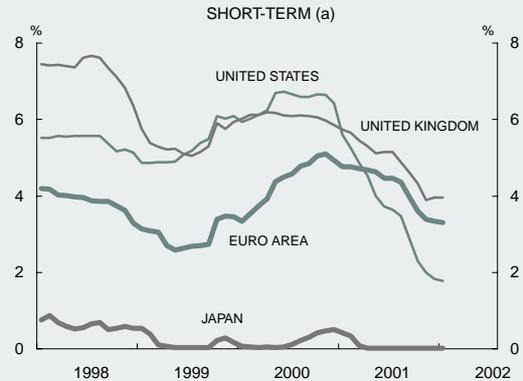
**Main macroeconomic indicators
Annual rates of change**



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.

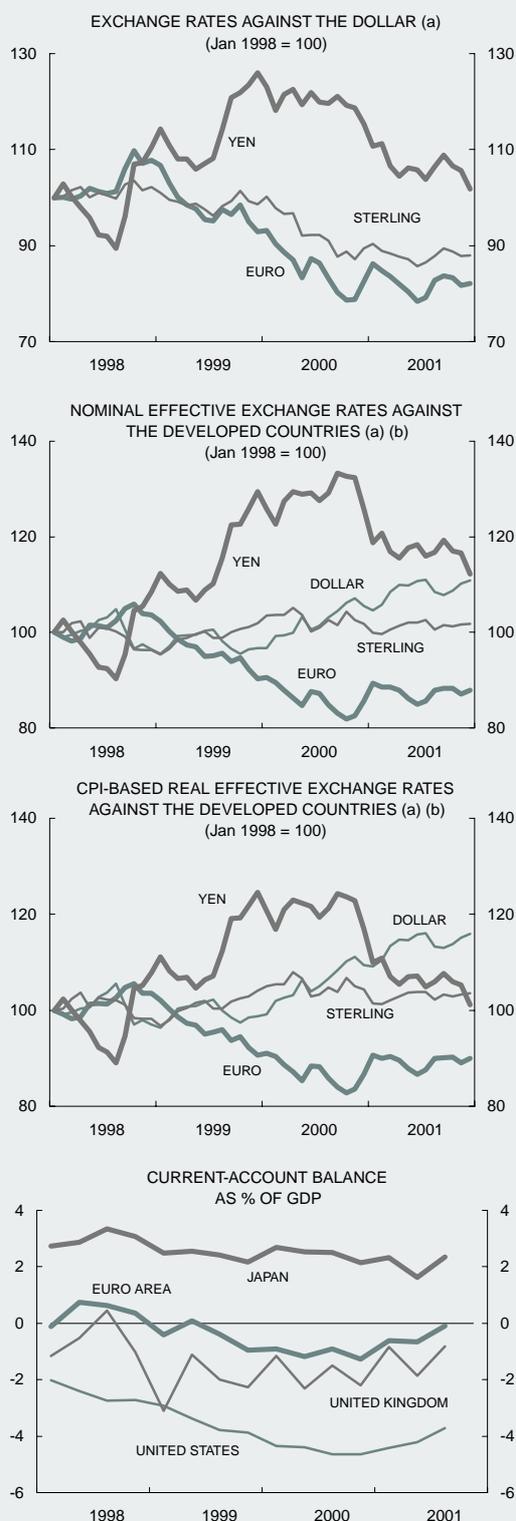
The CPI has also been more restrained, moving from 2.6% in September to 1.6% in December, although the underlying rate edged up from 2.6% to 2.7% in that same period.

During Q4, and judging by the favourable trend of securities markets and the trajectory of the yield curve, the financial markets appear to have discounted a speedier recovery in the US economy than most analysts appear to expect. Nonetheless, in the opening weeks of 2002, the lack of clear evidence of a pick-up, combined with the subsequent slowdown in prices, has bolstered expectations that the Federal Reserve may pursue lower interest rates for some time longer or that the turnaround in rates may be somewhat longer in coming.

In Japan, on preliminary figures, real GDP fell in 2001 Q3 at an annualised quarter-on-quarter rate of 2.2%. The main factors behind this were the falls in private consumption (6.6%) and in exports (12.4%), while private invest-

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.

ment grew by 4.4%, as a result of the headway in corporate restructuring. The main economic activity indicators for Q4 trended negatively, in line with expectations. That augurs a further decline in real GDP during 2002, pending the specific form of the Government's reform plans. Mention should be made of the prolonged decline in the composite coincident indicator of activity, the collapse in industrial production and the ongoing fall in plant capacity. Likewise, business confidence indices (Tankan survey) continued to decline. The only positive development concerns exports, the rate of decline of which has eased slightly since November, against the background of the depreciation of the yen. Unemployment climbed to 5.5% in November, an all-time high, heralding a very negative outlook for consumption. The deflationary trend of consumer prices was further accentuated, with year-on-year falls of 0.8% and 1% in October and November, respectively. The yen, for its part, depreciated against the dollar by around 10% in Q4, standing at over 130 yen per dollar. The Nikkei index regained its August level in November, but slipped back once more in December when the announcement of structural reforms was again deferred and the depth of the recession was confirmed.

In the United Kingdom, private consumption grew by more than 4%, driven by low interest rates, the rise in house prices and low unemployment. This has checked the slowdown in British GDP growth to 1.8% in annualised quarter-on-quarter terms (2.2% year-on-year) in Q3, despite the contraction of private investment and recession in industry. Industrial output continued to decline at an annual rate of close to 5% in Q4, while the growth of retail sales was above 6% and that of house prices above 15%. The registered unemployment rate held stable at 3.2%. Inflation slowed to below the Bank of England target: 1.9% in December on the RPIX (Retail Price Index, excluding mortgage interest payments) measure, and 1% in terms of the HICP. The Bank of England has measured out its interest rate cuts, reducing its base rate first in October and then in November to a level of 4% (against 6% at end-2000).

As regards the central and eastern European countries, the stagnant world economy coupled with the brisk real appreciation of some of the currencies in this area has notably harmed the region's exports. The latest data on economic activity show a widespread slowdown in the area, with heavy reductions in the growth rate of industrial output. However, moderate inflation has allowed monetary and fiscal policy to sustain internal demand in the region to some extent, albeit at the expense of bigger budget deficits. The fall in imports and oil prices has slightly improved their

current-account balances. Russia, by contrast, has been adversely affected by falling oil prices. But it is nevertheless exhibiting firm growth which might reach 5.5% by the end of the year, underpinned by sizeable budget and current-account surpluses and by high currency reserves.

During 2001 Q4, the falling trend of the south-east Asian economies' exports worsened, this decline having been the driving force of the slowdown in train since early last year. The available indicators of activity in 2001 Q4 point to further falls in the pace of output and in these countries' GDP growth rates. The exception is China, which continued to expand at a brisk pace thanks to the lesser influence of foreign disturbances on its economy and to massive foreign direct investment inflows. Against this backdrop, the low inflation rates of most countries eased further in October and November and some (China, Hong Kong, Singapore and Taiwan) continued to show deflationary pressures. The currency markets generally held stable. But there have been incipient signs of a possible change in the situation, especially for the Korean won, since the further weakening of the yen against the dollar in the closing weeks of 2001.

The situation in Latin America has been marked by events in Argentina. These gave rise to a burgeoning crisis further to the deterioration of the Argentine economic and political situation in Q4. Industrial output fell by 12.4% year-on-year, activity in the construction industry fell by 18.6%, unemployment climbed to 18.3% and inflation ended the year at a negative rate (-1.5%). Tax revenue in Q4 fell by 16.8% on the previous year, making compliance with the IMF-set deficit target impossible. Despite securing a pact with the provinces to reduce monthly State transfers to them and to see through the conversion of domestic debt, the imposition of

exchange controls and of a freeze on bank deposits, in the face of massive withdrawals thereof, resulted in social unrest and violent demonstrations. There was likewise marked political instability in late 2001 and early 2002. Various measures were decreed, including most notably: the suspension of payments to foreign creditors; the abandonment of the currency board and the devaluation of the peso, with a dual exchange rate arrangement; the partial and asymmetrical "peso-ification" of bank balance sheets and of other contracts in foreign currency; a freeze on dollar deposits, at least until 2003; and the possibility of introducing price controls on staple goods.

In Brazil there has been a recovery in the exchange rate and a narrowing of sovereign debt spreads thanks to the economic policies pursued and to the adjustment of domestic demand. That has improved the trade balance, bringing it into surplus. The indicators of demand and activity remain negative, but they are showing signs of an improvement. On the negative side is the December inflation rate. It rose to 7.7%, above the target set by the monetary authorities.

The Mexican economy evidences a contrast between its financial and productive variables: the former are favourable, while the latter reveal an economy still in recession. The outlook for the industrial sector worsened in Q4, the upshot of a heavy decline in exports (12.3% in October and November) and in revenue from the oil and in-bond industries. However, the exchange rate has been very strong, spreads have narrowed to 300 b.p. and the inflation rate stood at 4.4% in December, below the target of 6.5%. Economic policies have been prudent and the tax reform has finally been approved, though it is not as far-reaching as previously announced.

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

The information available on economic activity in the euro area in the final quarter of 2001 suggests that growth was again non-existent or slightly negative. The weakness that activity had shown throughout the year was reinforced by the negative effects arising from the September terrorist attacks, leading to a further deterioration in world trade and the postponement of spending decisions by economic agents, amid the prevailing climate of uncertainty. However, the stance of economic policy over the last few months (with interest rate reductions and the operation of budgetary automatic stabilisers), the gains in purchasing power associated with the slowdown in inflation and the absence of significant economic imbalances should be conducive to an early resumption of growth in the euro area. In fact, some confidence indicators for December have shown a slight improvement, but such trends must still be interpreted with great caution.

3.1. Economic developments

According to the second National Accounts estimate, euro area GDP grew by 0.1% in Q3 last year, in quarter-on-quarter terms, which was the same as the average rate in the previous three months. In year-on-year terms, the rise in GDP was 1.4%, 0.2 percentage points down on the rate in Q2 (see Chart 8). The weak expansion of output is explained by the slowdown in private and government consumption, by the slackness of gross fixed capital formation, which held steady at Q2 levels, and by the reduction in the contribution of inventories to output. Overall, domestic demand reduced the quarter-on-quarter growth of output by 0.1 percentage points. Meanwhile, although net external demand contributed 0.2 percentage points to the quarter-on-quarter growth of output, both exports and imports faltered considerably, with trade flows slowing sharply in the first nine months of the year. Box 1 analyses the euro area's external trade by area and product with the information available for 2001.

The National Accounts country breakdown shows diverse GDP growth rates across countries. In some countries, such as France and Italy, output growth was positive and higher than in the previous quarter. In Spain, although there was a slight slowdown, GDP grew at a seasonally adjusted quarter-on-quarter rate of 0.3%, which was well above the rate for the area as a whole. By contrast, in Germany and, especially, in the Netherlands, output fell in quarter-on-quarter terms. In the case of Germany, the estimate of the Institute of Statistics for average growth during 2001 is also known. This rate was 0.6%, implying a slight slowdown in activity in Q4. Diver-

gent behaviour is also seen among the main components of demand. While the growth rate of private consumption fell in Germany it rose in France and Spain. At the same time, the weakness of investment was not so apparent in other euro area countries as it was in Germany.

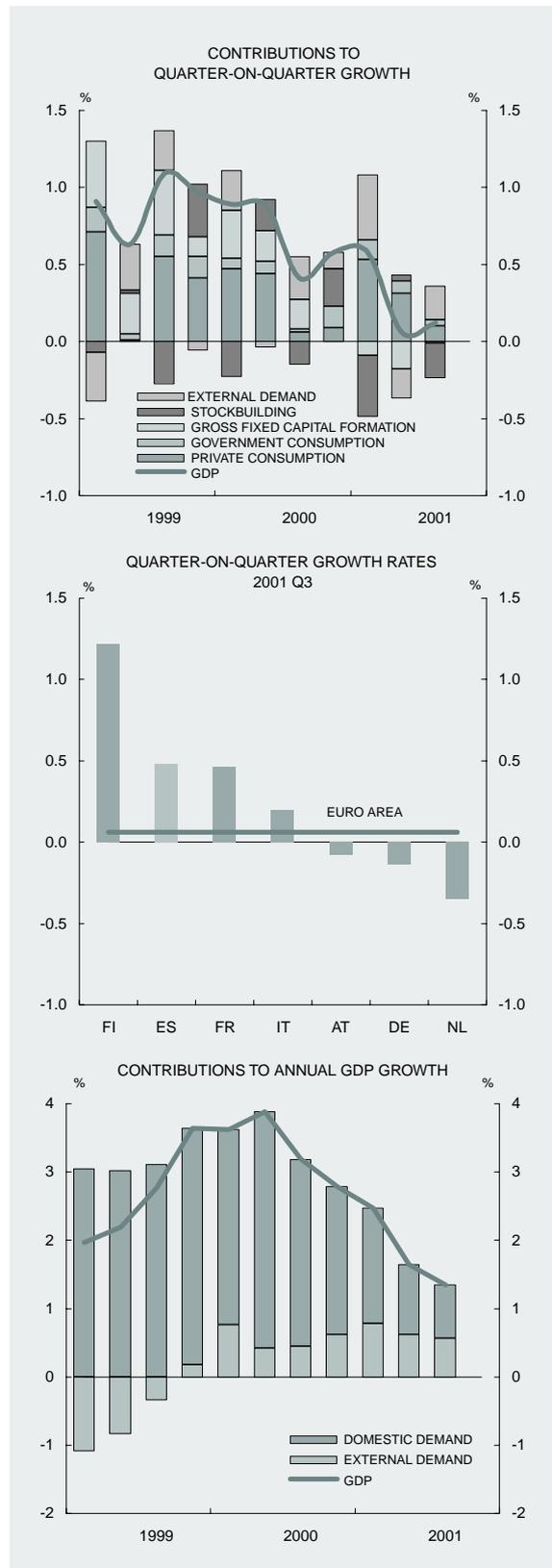
On the supply side, the slowdown in output in Q3 affected the industrial sector (including energy) more strongly than other sectors and its GVA fell by 0.4%, in quarter-on-quarter terms. Most of the other branches recorded quarter-on-quarter rates similar to those in the previous quarter, with the exception of construction, where the notable decline since mid-2000 came to a halt in the summer months.

The information available on Q4 signals a further deterioration in activity, which would make the growth rate for the year as a whole around 1.5%. In fact, relative to Q3, the industrial production index showed negative growth in October and November. For their part, the European Commission's industrial confidence indicator and the manufacturing purchasing managers' index stood at lower levels on average than in the previous quarter. However, sentiment indicators in December were more favourable than in previous months, although it is difficult to distinguish to what extent this signals the start of a sustained recovery or a simple correction, following the sharp slowdown in the previous months owing to the terrorist attacks of 11 September. On the demand side, private consumption indicators remained unfavourable in the final quarter of the year. The retail-sales indicator again recorded a negative quarter-on-quarter rate in October and the consumer and retail confidence indicators worsened on average in Q4 although, as in the case of the industrial sector, consumer confidence improved slightly in December. Investment and exports indicators meanwhile showed a further loss of momentum in Q4, extending the trend established at the beginning of the year. Likewise, industrial order books, capacity utilisation and, in particular, the indicators of expectations of exports and foreign orders deteriorated significantly in Q4. Finally, Confidence Survey information reflects a further increase in the level of inventories in Q4 above the desired level, which may indicate that inventory adjustment is still not complete.

The behaviour of the determinants of agents' spending was generally consistent with its weakness in the latter part of 2001. Notable, in particular, were the slower rate of growth of employment and the cumulative loss of value of financial wealth since the beginning of the year, despite the recovery in share prices in the final months. Also the climate of uncertainty, exacerbated by

CHART 8

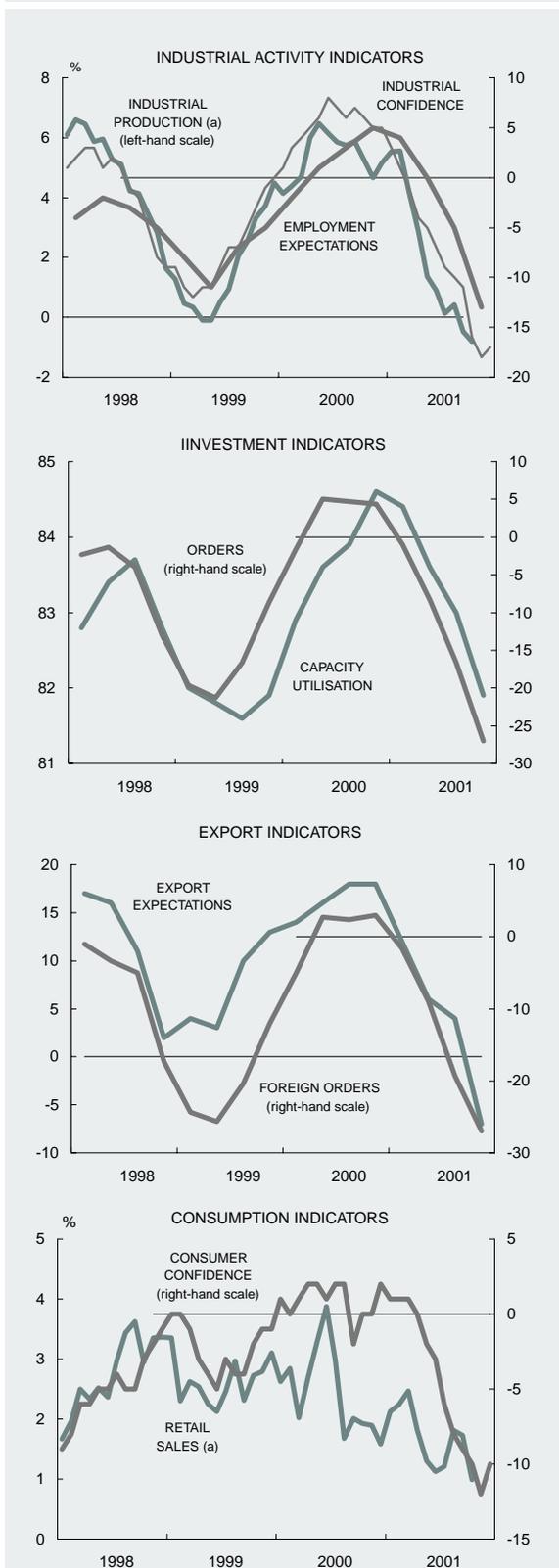
GDP in the euro area



Sources: Eurostat and national statistics.

CHART 9

Euro area. Real indicators



Sources: Eurostat and European Commission.

(a) Non-centred annual percentage changes calculated on the basis of the quarterly moving average of the seasonally adjusted series.

the terrorist attacks of 11 September, may have led to a postponement of corporate-investment and household-consumption decisions, and a further moderation in foreign trade. However, the decline in inflation, which translates into a higher purchasing power for labour incomes, and the favourable financing conditions may have partly offset the aforementioned negative effects.

Employment growth in Q3 ran at 0.2%, the same rate as in Q2, which would make the annual rate of change 1.3%, down 0.3 percentage points on the previous quarter. Accordingly, apparent labour productivity was again close to zero in that period. The slowdown in the rate of job creation has entailed a slight rise in the euro area unemployment rate in recent months, to 8.5% in November, 0.1 percentage points above the average Q3 rate. The employment indicators, obtained from opinion surveys, for the final quarter, signal a further decline. However in this case too, the most recent data, for December, show a certain halt in the deterioration seen previously.

The area price indicators continued to show a moderating of inflationary pressures in Q4, largely owing to the progressive disappearance of the effects of the rise in oil prices and the food crises in 2001. However, the indicators of core inflation show greater downward stickiness (see Chart 10). As for the determination of domestic prices, unit labour costs in Q3 increased at an annual rate of 2.5%, the same rate as in the previous quarter, which has narrowed margins slightly, since the GDP deflator rose by 2% in that period, 0.5 percentage points less than in the previous quarter (see Chart 10).

As measured by the HICP, the slowdown in prices in the final quarter of 2001 was significant, since the annual rate of change in December was 0.4 percentage points down on September at 2.1%. The average inflation rate in the euro area in 2001 thus stood at 2.7%, as against 2.4% in 2000. The reduction in the rate of inflation in the final quarter of the year was basically attributable to the fall in energy and unprocessed food prices, since the component that includes services and non-energy processed goods (the IPSEBENE) increased by 2.5% year-on-year in December, as against 2.4% in September. Most countries in the area recorded improvements in price behaviour during Q4 2001. The inflation differential between the countries with the highest and lowest rates (the Netherlands and France (1) respectively)

(1) The country with the lowest inflation rate in December was Luxembourg (0.9%). However, since its behaviour that month was not normal and, in consequence, distorts the trend in the inflation differential, this extreme value has been excluded from the comparison.

Developments in the volume of euro area foreign trade by geographical area and type of product

The slowdown in euro-area GDP during 2001 coincided with a sharp loss of momentum in foreign trade. Indeed, according to euro area national accounts data, average growth of goods and services exports fell from 11.9% in 2000 to 0.8% in 2001 Q3, compared with the same period a year earlier. Imports also slowed at a similar rate, with a year-on-year rate of change of -0.6% in Q3, which was far below the growth of the previous year (10.7%). The notable weakness of trade flows in the euro area is a phenomenon shared by the vast majority of other economic areas of the world. Thus, according to IMF estimates, there may have been an abrupt reduction in the rate of growth of world trade in 2001, as shown in the adjoining chart. Some contraction in world trade was foreseeable last year, following its heightened buoyancy in 2000, but the size of the deterioration was, nonetheless, greater than expected by the international agencies in the middle months of last year.

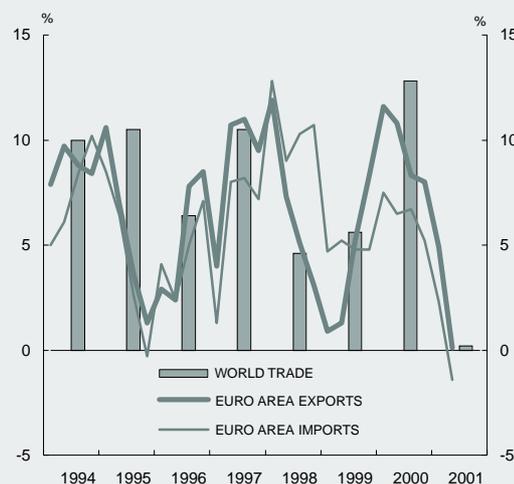
As seen in the adjoining chart, against a background of sharply slowing world trade and subdued economic activity in the euro area, the volume of euro-area goods exports and imports has been gradually worsening since mid-2000. In the first eight months of the year, real exports and imports of goods grew by only 2.7% and 0.5%, respectively, which amounted to the fastest slowdown in the volume of goods trade in the last eight years.

By geographical area, the slowdown in real exports has been across the board. In particular, the annual growth of real exports to other euro area countries fell from 7.5% in 2000 to only 1.8% in the period January-August of 2001. At the same time, the growth of exports to the rest of the world moderated from 12.1% in 2000 to 3.7% on average in the first eight months of 2001. Especially striking was the deceleration in euro-area exports to the twelve EU accession countries and Japan, followed by the slackness displayed by exports to the United Kingdom and the United States.

Although the table does not give a breakdown by product, during the first eight months of 2001 all the components of exports displayed a slowdown in their rate of change in relation to the same period a year earlier. This was particularly marked in the case of raw materials, oil, food and manufactures.

On the imports side, as shown in the lower part of the table, the notable moderation in real goods imports is reflected in all products, in line with the decline in domestic production and the weakening of final demand. In particular, the strong contraction in equipment investment (which, according to the national accounts information available for some countries, may have stood at -3% year-on-year in Q3, well below the average growth in 2000 (8.2%)) has been reflected in the imports of machinery and transport material, the grouping that has recorded the largest slowdown during the year. Somewhat more moderate was the loss of momentum in the components most directly related to private consumption, namely food, drink and tobacco, and other manufactures (including, inter alia, clothing, footwear, furniture and travel goods). This was in line with the trend in spending on this type of good, as indicated by euro area retail sales.

As regards the geographical origin of real imports, there was a notable reduction in the flow of imports from outside the euro area during the period January to August and, in particular, from Japan, the United States and the United Kingdom. This may be linked to the rise in the prices of their products relative to those of domestic euro area goods, owing to the depreciation of the euro exchange rate. Finally, imports from the EU accession countries, far from slowing down, have gained momentum.

**Real trade in goods
(Annual percentage change)**


	%		Annual percentage change	
	2000	2000	2001	
			JAN-AUG	Q1 Q2

EXPORTS - BREAKDOWN BY AREA

Total	9,6	2,7	4,9	0,1	
Intra-euro area	53,1	7,5	1,8	4,0	-1,6
Extra-euro area	46,9	12,1	3,7	6,0	2,1
United Kingdom	8,7	7,2	3,1	3,8	1,3
Accession countries	6,7	20,1	0,1	6,5	-3,2
United States	7,3	14,4	3,4	7,1	0,7
Latin America	2,2	11,7	8,4	12,2	11,1
Japan	1,5	18,1	-0,8	3,6	-1,0
China	0,8	17,6	27,7	27,3	24,0
South-east Asia	1,3	18,3	7,3	20,4	-1,3

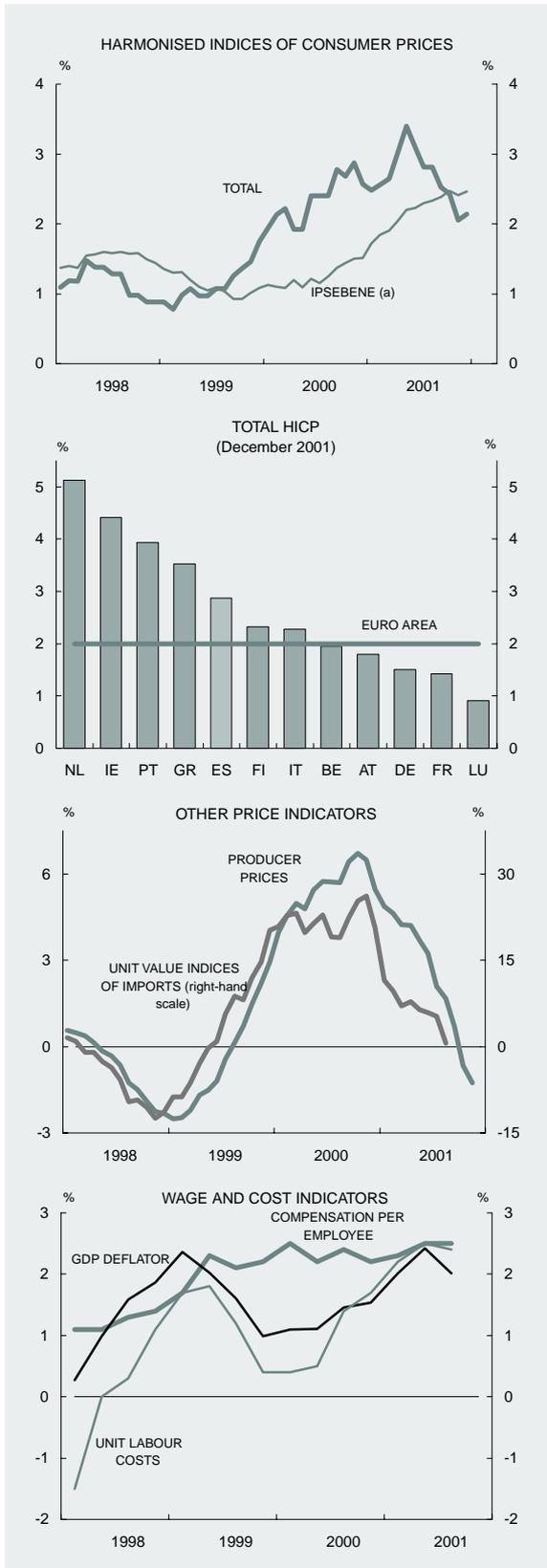
IMPORTS - BREAKDOWN BY PRODUCT

Total	6,5	0,5	2,3	-1,4	
Food, beverages and tob.	8,3	1,5	-2,0	-1,2	-3,6
Commodities	4,4	3,7	-2,3	-2,5	-2,4
Oil and oil derivatives	5,4	5,6	-1,8	-1,3	-0,9
Manufactures	79,8	8,4	-2,3	0,3	-3,5
Chemicals	11,3	5,9	1,0	1,1	0,5
Raw material derivatives	16,2	7,8	-3,4	-1,9	-3,7
Machinery and transport	40,5	10,1	-2,5	1,8	-4,5
Other	11,8	5,8	-3,3	-2,6	-3,8

Sources: Eurostat and IMF.

CHART 10

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



Sources: Eurostat and ECB.
(a) Index excluding energy and fresh food prices.

held unchanged from September at 3.7 percentage points. Meanwhile, industrial prices (excluding construction) fell by 1.3% in November, relative to the same month of 2000. Underlying this notable contraction was the decline in the prices of intermediate goods and energy, and the slowdown in the prices of industrial consumer goods, which will tend to moderate the future course of final consumer prices.

The inflationary outlook is shaped by factors with opposite signs. On the one hand, the foreseeable weakening in import prices, attributable mainly to the possible stabilisation of the price of crude oil at around current levels, will tend to mitigate inflationary pressures. However, despite the prevailing climate of economic weakness, preliminary data for wage demands in the collective bargaining that has already begun would entail, if such demands were accommodated, higher wage increases than in 2001. Thus, possible pressure from unit labour costs, increases in indirect taxes in certain countries and a still uncertain impact on prices of the introduction of the euro may reduce the strength of the current disinflationary trend. At the same time, it should be noted that, although oil prices have remained subdued in the wake of the two-million-barrels-per-day cut in production, implemented on 1 January, they may tend to recover as world economic activity picks up, possibly in the second half of 2002. Moreover, as the current year elapses the base effect arising from the sharp falls in oil prices in 2001 will disappear.

On ECB estimates, the current account deficit of the euro area was reduced in the first ten months of 2001 to EUR 23 billion, from EUR 55.4 billion in the same period of 2000. This reduction was mainly due to the significant improvement in the goods balance and, to a lesser extent, in the services balance, which outweighed the increase in the overall deficit on the income and current transfers accounts. Taking into account the slight decline in the capital account balance, net borrowing vis-à-vis the rest of the world fell in the first ten months of the year by EUR 31.8 billion.

Turning to fiscal policy, the overall budget deficit of the euro area, according to the EC's autumn estimates, stood at 1.1% of GDP in 2001. This would represent a deterioration of 0.3 percentage points with respect to the previous year (see Table 1). For its part, the primary surplus would have been reduced by 0.4 percentage points. Overall, the deterioration in the budget position stems from the decision of the authorities to permit automatic stabilisers to operate in response to the worsening of the macroeconomic environment and, to a lesser extent, from the application, in certain cases, of tax

General government financial balances of euro area countries (a)

TABLE 1

% of GDP

	1998	1999	2000	2001	2002 (b)	2002 (c)
Belgium	-0.9	-0.6	0.1	-0.2	0.0	-0.2
Germany	-2.2	-1.6	-1.3	-2.5	-2.0	-2.7
Greece	-2.5	-1.8	-1.1	-0.3	0.8	0.3
Spain	-2.6	-1.1	-0.4	0.0	0.0	-0.2
France	-2.6	-1.6	-1.4	-1.5	-1.4	-2.0
Ireland	2.1	2.3	4.5	1.4	0.7	1.8
Italy	-2.8	-1.8	-1.5	-1.1	-0.5	-1.2
Luxembourg	3.3	3.7	6.2	4.1	2.8	2.7
Netherlands	-0.8	0.4	1.5	1.0	1.0	0.5
Austria	-2.3	-2.2	-1.5	0.0	0.0	-0.4
Portugal	-1.9	-2.1	-1.8	-2.2	-1.8	-1.6
Finland	1.3	1.9	6.9	4.7	2.6	2.9
MEMORANDUM ITEM:						
Euro area						
Primary balance	2.6	3.0	3.2	2.8	2.7	2.4
Total balance	-2.2	-1.3	-0.8	-1.1	-0.9	-1.4
Public debt	73.1	72.7	70.5	68.7	67.2	68.4

Sources: European Commission and national stability programmes.
(a) As a percentage of GDP. Proceeds from the sale of UMTS licences not included. Deficit (-) / surplus (+).
(b) Stability programme targets unveiled between November and December 2001.
(c) European Commission projections (autumn 2001).

cuts. At the individual country level the position varied greatly. Two-thirds of the member states have achieved, according to the preliminary information available, positions close to budget balance or surplus. However, four countries (France, Italy, Germany and Portugal) recorded a deficit of more than 1% of GDP. In the latter two cases the deficit was close to or exceeded 2% of GDP.

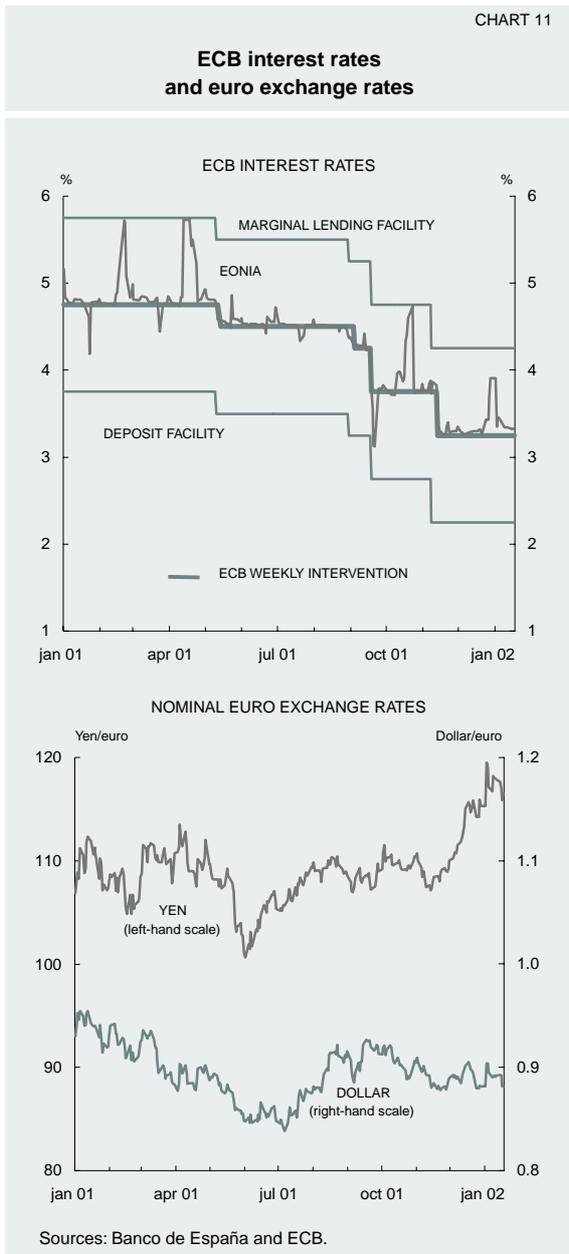
All the countries of the area unveiled their stability programmes at the end of last year. The economic growth hypotheses contained in these documents (which, for 2002, are generally more optimistic than the forecasts of international agencies) entail a slight improvement in the aggregate budgetary position this year with balance reached in 2004. In particular, the updated stability programmes of the countries with the largest deficits in 2001 have confirmed the target, already laid down in the programmes prepared a year earlier, of achieving a balanced budget in 2004 (2003 in the case of Italy). In order for fiscal policy to be able to make a proper contribution to the ultimate aim of securing sustained non-inflationary economic growth and, also, to preserve the credibility of the multilateral budget vigilance mechanisms existing in Europe, it is very important that this commitment is fulfilled. Attainment of these medium-term tar-

gets will require a considerable effort, since some countries are now in the difficult position of having to maintain a balance between, on the one hand, allowing automatic stabilisers to help sustain activity in the short run and, on the other, pressing ahead with budget consolidation. Those countries that have already balanced their budgets have sufficient leeway to allow automatic stabilisers to operate.

3.2. Monetary and financial developments

The Governing Council of the ECB, having assessed the signs of abatement in inflationary pressures that accumulated after the summer, the weakness of indicators of activity and the downward revision to the growth prospects for the area, partly as a result of the global climate of uncertainty emanating from the September terrorist attacks, decided to reduce official interest rates by 50 basis points on 8 November. Following this cut, which brought the cumulative reduction since May 2001 to 150 basis points, the minimum bid rate on the main refinancing operations of the Eurosystem stood at 3.25% (see Chart 11). At its two subsequent meetings, held at the beginning of December and January 2002, the Governing Council left official ECB interest rates unchanged.

CHART 11



During Q4, the cut in official ECB interest rates was passed rapidly through to money market rates. At the end of the year there was a temporary increase in EONIA, associated with disquiet among agents regarding the possibility of a liquidity shortage at the beginning of 2002, as a consequence of the introduction of euro notes and coins (Box 2 describes the main characteristics of this process). When the ECB had confirmed its intention of meeting any liquidity shortage, EONIA fell back to around 3.3%. As can be seen in Chart 12, expectations of reductions in official interest rates in the euro area moderated during Q4, especially following the last ECB rate cut in November. Markets are currently showing no expectations of a reduction in official rates in the coming months, but rather signalling a possible rise

from next summer, in line with the profile of recovery of the economy according to most existing forecasts. As regards long-term interest rates, the yield on 10-year government bonds in Germany rose by 60 basis points from mid-November to reach 4.9% at the beginning of January. During that same period, the yield on US government bonds rose by somewhat more, from around 4.3% to 5.1%, so that there was a widening of the spread over German debt.

The gradual decline in the lending and deposit interest rates of euro-area credit institutions that commenced in December 2000 continued in Q4. In November 2001, the interest rates on housing and corporate loans at more than one year stood 40 basis points below their September levels. Spanish banks' synthetic rates were reduced, between September and December, by 70 basis points in the case of lending instruments and 43 in the case of deposit instruments (see Table 2).

On the foreign exchange markets the euro depreciated against the US dollar by 0.5% in 2001 Q4. There was a slight appreciation of the euro in early January, attributable to the introduction of euro notes and coins, which turned out to be temporary. Against the yen, however, the euro appreciated significantly during Q4 (see Chart 11). As at the close of this bulletin, the nominal effective exchange rate of the euro vis-à-vis the developed countries stood at around the September level.

During Q4, euro area stock markets recovered appreciably from their late-September lows. Up to a point this was a return to normality following the severe impact of the September attacks. These developments were not unrelated to the economic policy decisions taken during the period and the course of the political and military conflict, which led to improvements in the confidence of agents regarding the situation and prospects for the international political environment and for economic developments in the main industrialised countries and in the euro area in particular. In any case, the year ended with the Dow Jones EURO STOXX index down almost 20% on its end-2000 level and with the Madrid Stock Exchange General Index down 6%. By 28 January the Dow Jones EURO STOXX Broad Index had fallen by 1.6%, which was similar to the decline in the Madrid Stock Exchange General Index, although in the latter case the events in Argentina have affected the prices of certain large corporations.

Euro area M3, having been adjusted for the holdings of liquid assets of non-residents, ac-

Key aspects of the introduction of euro notes and coins in the euro area and in Spain

The introduction of euro banknotes and coins from 1 January 2002 marked the culmination of the process of European monetary integration, in which the decisive step was taken three years ago with the creation of the euro and the establishment of a single monetary policy. After the first few weeks of circulation of the single currency, the operations to replace the national currencies have been, on balance, very satisfactory, both in terms of the rapidity of the exchange and the use of the new currency and, especially, of the favourable acceptance of the euro by Europe's citizens.

The success of the changeover to the euro is largely attributable to the large-scale frontloading of new banknotes and coins at the end of last year. This complex operation was executed in an orderly manner, with euro banknotes and coins first being frontloaded to credit institutions and, then, sub-frontloaded by the latter to businesses and shops. Finally, from mid-December, the public had access to the coins, through the acquisition of "starter kits". 150 million kits were sold, meaning that, on average, each citizen of the countries belonging to the monetary union acquired 14 of the new coins.

During the months leading up to the changeover, the demand for cash fell sharply in the euro area, owing to the desire of holders of European notes and coins to limit the balances that they would have to convert into euro. Consequently, compared with historic rates of growth of currency in circulation in the euro area as a whole (of around 4-5% per annum), there was a rapid slowdown during 2001 to an annual rate of -32% at the end of the year. A large part of the fall in the demand for cash was channelled towards other financial assets such as sight deposits and, to a lesser extent, deposits redeemable at notice of up to three months. Accordingly, the lower demand for cash does not appear to have affected the trends in the euro area monetary aggregates, as shown in the upper panel of the adjoining chart.

On 1 January 2002, all the frontloaded euro banknotes and coins became legal tender. For accounting purposes, therefore, EUR 133 billion of banknotes and EUR 12.4 billion of coins came into circulation that day. This represented approximately 44% of the national currency banknotes and coins in circulation at the end of December 2001.

During January to date, the stock of banknotes in circulation, calculated as the sum of the national currency and euro denominations, has recovered a profile of more moderate, although still slightly negative, growth. Thus, the total stock of banknotes in the euro area as a whole stood at EUR 326 billion on 25 January, with a growth rate in the month to date of -0.5% with respect to the same period a year earlier. In Spain, the growth in the stock of banknotes launched by the Banco de España in this same period was almost 8%. However, these data may not be representative of the growth of currency in circulation, since the cash held by credit institutions should be deducted. This cash traditionally represents a very low percentage of total cash in circulation, but it may be at relatively high levels during the early weeks of 2002 for logistical reasons associated with the changeover.

The degree to which the euro has supplanted the national currencies is clearly shown by the "euro progress ratio", which expresses the value of euro banknotes in circulation as a percentage of all banknotes (denominated in national currency and euro). Chart 2 shows the rapid introduction of the euro in the first few weeks of January: on 25 January, the ratio stood at 66% in the euro area as a whole and at a very similar level in Spain.

Some additional data complete the assessment of the degree of introduction of the euro in Spain. On 25 January 2002, the balance of euro banknotes launched by the Banco de España was 36.2 billion, of which 62% corresponded to low-denomination notes (5, 10, 20 and 50 euro) and 38% to high denomination notes (100, 200 and 500 euro). At that date, the stock of banknotes in pesetas had been reduced by 57% with respect to the level of 31 December 2001. The process of replacing the coins is proceeding somewhat more slowly, as is natural given that they are much more difficult to transport and handle. As at 25 January, the stock of coins in circulation in Spain was EUR 3.8 billion, of which EUR 1.6 billion corresponded to the new currency, i.e. the progress ratio for euro coins was 42%.

It may be concluded from these developments that the replacement of the national currency banknotes and coins held by the public by euro ones will have been almost fully completed before 28 February 2002. This is the last date set by most euro area countries for use of the national currencies as a means of payment. In any case, the latter may still be exchanged for euro at credit institutions several months thereafter (until 30 June in the case of Spain) and during a much longer period, which may even be unlimited (the case in Spain), at the central banks.

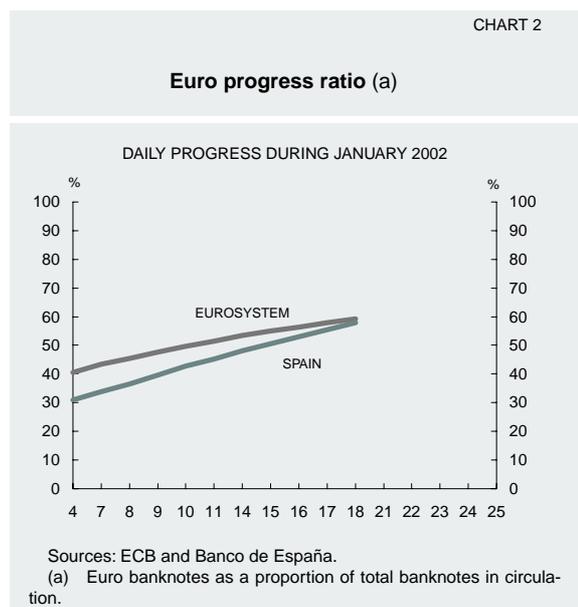
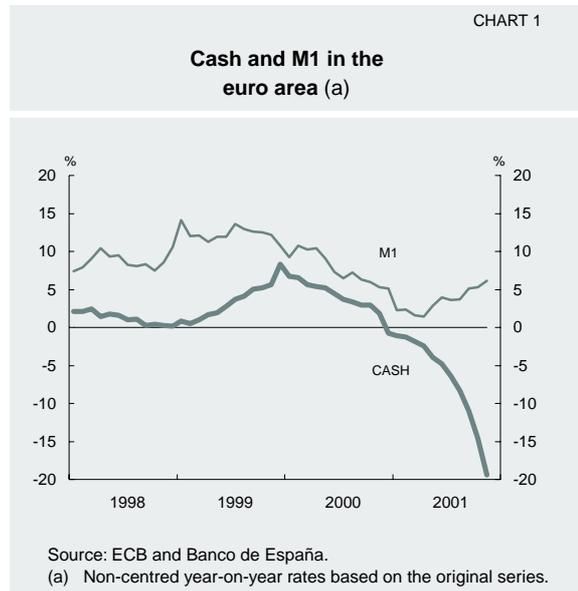


TABLE 2

Monetary and financial situation in the euro area and Spain

%

	1999	2000	2001				2002	
	DEC	DEC	AUG	SEP	OCT	NOV	DEC	JAN (c)
MONETARY VARIABLES (a):								
EURO AREA								
M3	5.7	4.0	5.9	6.8	7.4	8.0		
M1	10.7	5.1	3.7	5.1	5.3	6.1		
Credit to private sector	10.3	10.1	7.6	7.0	6.8	6.8		
SPAIN								
Cash and cash equivalents	12.7	4.4	3.6	3.8	3.6	5.8		
Other bank liabilities	3.9	19.7	14.1	12.5	12.4	10.7		
Mutual funds	-21.4	-27.3	6.5	12.2	18.7	23.5		
Financing to the private sector	19.5	18.9	15.9	14.5	14.1	14.5		
FINANCIAL MARKETS (b):								
EONIA	3.04	4.83	4.49	3.99	3.97	3.51	3.36	3.36
Three-month EURIBOR	3.44	4.94	4.35	3.98	3.60	3.39	3.35	3.32
Public debt								
Euro area ten-year bond yields	5.32	5.07	5.06	5.04	4.82	4.67	4.96	5.00
US-euro area ten-year bond spread	1.04	0.25	-0.03	-0.26	-0.20	-0.02	0.16	0.11
Spain-Germany ten-year bond spread	0.22	0.31	0.34	0.33	0.31	0.31	0.20	0.19
Spanish bank interest rates								
Synthetic deposit rate	1.98	3.02	2.88	2.67	2.53	2.32	2.24	
Synthetic lending rate	5.03	6.35	5.89	5.55	5.33	5.12	4.87	
USD/EUR exchange rate	1.011	0.897	0.900	0.911	0.906	0.888	0.892	0.892
Equities (d)								
Dow Jones EURO STOXX Broad Index	39.5	-5.9	-19.7	-30.5	-27.7	-22.3	-19.7	-4.4
Madrid Stock Exchange General Index	16.2	-12.7	-8.2	-18.0	-13.3	-6.4	-6.4	-3.9
Sources: European Central Bank and Banco de España.								
(a) Annual percentage change.								
(b) Monthly averages.								
(c) Monthly average to 17 January 2002.								
(d) Cumulative percentage change during the year. End-of-month data. Latest month: 16 January for the EURO STOXX and 17 January for the Madrid Stock Exchange.								

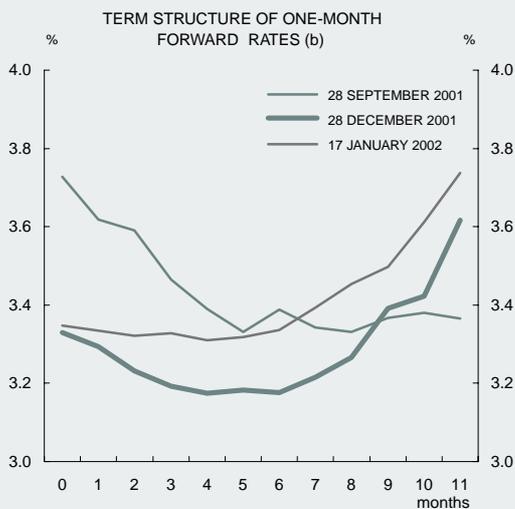
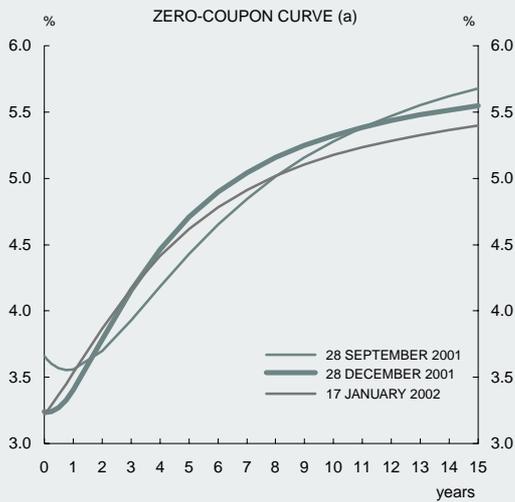
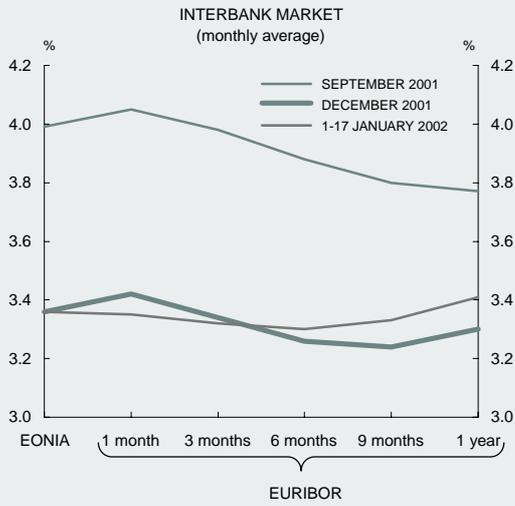
celerated significantly in Q4. In December, its year-on-year rate of change reached 8%, 0.5 percentage points up from October, so that its average year-on-year growth in the three-month period October-December rose to 7.8%, from 7.4% in the period September-November. However, this outcome does not appear to signal the existence of medium-term inflationary risks, since it is basically explained by a number of temporary factors, largely associated with an increase in the preference for liquidity amid the great uncertainty existing in financial markets. Meanwhile, the narrow aggregate M1 grew by 5% in December, as against 6% the preceding month. Within this aggregate, there was a significant reduction in cash and an increase in sight deposits. As explained in Box 2, this was related to the euro cash changeover. Finally, on 6 December 2001 the

Governing Council of the ECB decided to keep the reference value for annual M3 growth at 4.5%.

As for the counterparts of the monetary aggregates, in the final quarter of 2001 the gradual deceleration displayed by lending in the euro area to the resident private sector (the aggregate most closely linked to spending decisions) moderated, its annual rate of change in December (6.7%) being 0.4 percentage points down on September. The recent trend in lending has been outweighing the impact of the slowdown in output. According to the available data on lending by purpose and agent to Q3, the loss of momentum in lending during that period stemmed from both the behaviour of non-financial corporations and households and, among the latter, both from consumer credit

CHART 12

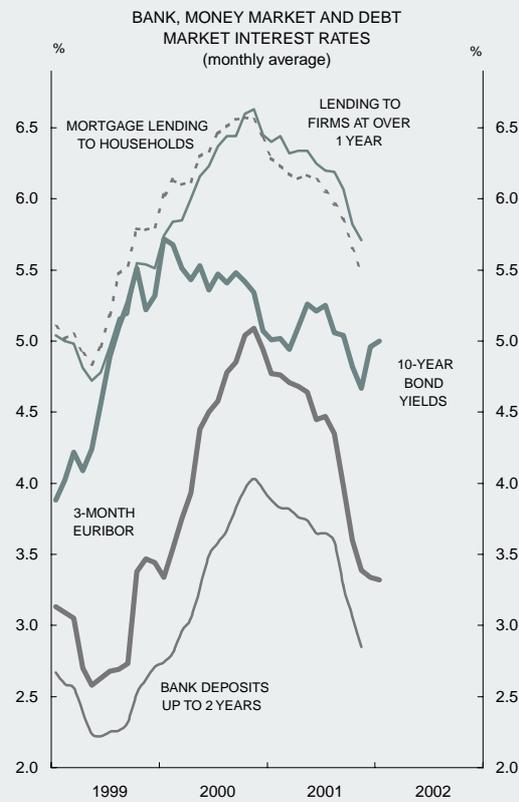
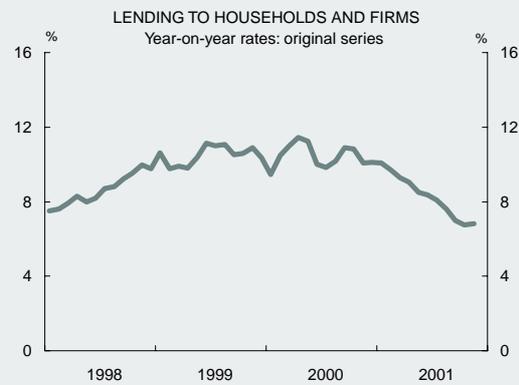
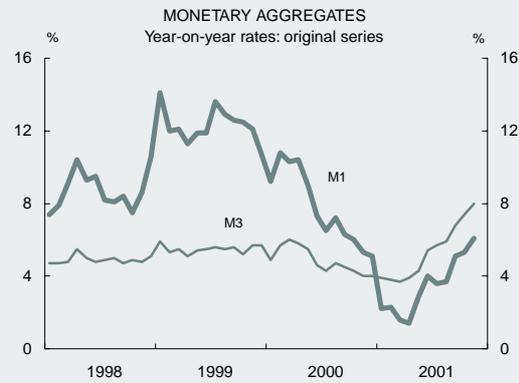
Euro area yield curves



Sources: Banco de España and ECB.
 (a) Estimation based on swap market data.
 (b) Estimated using Euribor data.

CHART 13

Monetary and credit aggregates and interest rates in the euro area



Sources: Banco de España and European Central Bank.

and lending for house purchases. In Spain, the slowdown in the financing granted to the non-financial private sector has been similar to that seen for the area as a whole, although such financing is still expanding at significantly higher rates. Indeed, the financing received by the

non-financial private sector increased at a year-on-year rate of 14.3% in December, as against 14.8% in September, while lending by resident institutions, which is its main component, slowed from 13.6% to 12.6% in the same period.

4. The Spanish economy

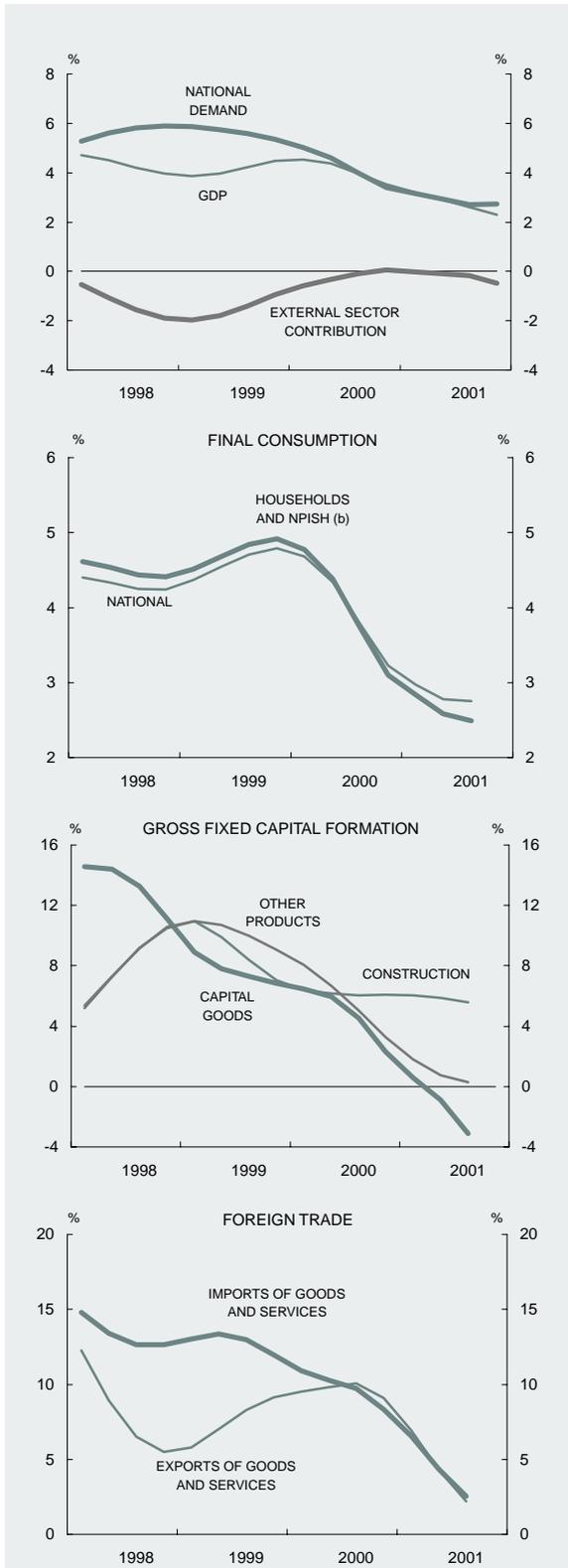
In the second half of 2001 the Spanish economy underwent the impact arising from the slowdown in the world economy. This had already been felt in the summer months and intensified in Q4, compounding the cyclical downturn in Spain. As a result, the contractionary nature of the contribution of external demand to GDP growth became progressively greater, owing to the loss of momentum of exports, while the slowing trend of domestic demand eased to some extent. The increase in domestic spending was sustained both by a favourable financial environment, to which the easing of monetary conditions was conducive, and by the economy's continuing capacity to generate employment. Nonetheless, productive investment, which had already been looking increasingly weak, turned clearly negative, having been particularly impacted by the downturn in export markets and the general deterioration in expectations. Overall, real GDP, after a rate of 2.6% in 2001 Q3 compared with a year earlier, would have posted an estimated rate of 2.3% in Q4 on the latest QNA figures, closing the year with an increase of 2.8%, more than one percentage point below that attained in 2000 (see Chart 14).

The growth of national demand in the second half of the year, when it ran at a rate of around 2.7% year-on-year, was relatively stable. This was due to the sustained course of private consumption and the continuing buoyancy of investment in construction, both of which factors helped offset the ongoing decline in capital investment. For the year as a whole, domestic spending is estimated to have increased by 2.9%, against 4.2% in 2000. The contribution of external demand to growth will have been of a similar magnitude in 2001 to that in 2000 (-0.2 percentage points), although with a very different profile. Whereas in the year 2000 it progressively improved, it followed the opposite pattern in 2001. It would have subtracted around half a point from GDP growth in Q4, amid a marked deterioration in exports and a sustained rate of increase in imports, against a backdrop of notably moderating import prices.

From the standpoint of activity, the loss of momentum in the final months of last year took the form of a fresh weakening in industrial activity which, at least in quarter-on-quarter terms, slipped back, and a sharper slowdown in market services. The moderation of productive activity translated into a further reduction in the growth rate of employment. After climbing 2.3% year-on-year in Q3, two-tenths of a point below the increase the previous quarter, the rate of change of employment would have drawn closer to 2% in the closing months of 2001, while unemployment was beginning to rise. These developments in output and employment meant

CHART 14

Main macroeconomic aggregates (a)



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

that productivity held at a low rate which would not have exceeded 0.3% over the year as a whole.

The information available shows that salaried income rose during last year. The increase was greater in the market economy, giving rise to quickening unit labour costs, although this acceleration was perhaps less forceful than that indicated by QNA figures up to Q3. Adding to this behaviour by costs, which reflected both the increase in collectively bargained wage settlements and the slowdown in productivity, was a widening of margins, giving rise to an increase in the economy's domestic deflators. Nonetheless, the sound performance of import prices in the second half of the year provided for an easing in the main final price indicators similar to that observed in the euro area as a whole. This meant that the inflation differential narrowed to 0.7 percentage points in the final month of the year.

4.1. Demand

During the first three quarters of 2001, the slowing path on which household final consumption spending had embarked at the beginning of the year 2000 continued, albeit somewhat more mildly, placing the year-on-year growth rate of this variable at 2.5% in Q3. The as yet partial information available on the behaviour of consumption in Q4 indicates that its rate of increase would have held at around this figure, giving rise to an increase of 2.6% in the year as a whole. This growth, which is down by more than one point in relation to 2000 (4%), allowed the household saving ratio to recover some ground.

The indicators most directly related to household spending point to a degree of stability in the rate of expansion of private consumption in the closing months of 2001. On as yet incomplete information, the indicator of apparent consumption of consumer goods grew in this period at a similar rate to that posted in the preceding quarters (see Chart 15). The stable growth profile last year was the result of differing behaviour by the components of the index. The apparent consumption of food goods was notably buoyant, offsetting the negative performance of the non-food component and, in particular, of durable goods. The rate of increase of the retail sales index eased in November, with greater sluggishness becoming widespread across all its components, although food sales continued to post high increases in step with the information reflected by the apparent consumption index. The growth rate of new car registrations, which had picked up signifi-

cantly in the first two quarters of the year, tended to stabilise in the closing months, recording an increase of 2.2% in 2001 as a whole, compared with the decline of 2.4% in 2000. The consumer confidence indicator was on a declining course in Q4, a trend already observed in the preceding quarters. This was due essentially to the deterioration in employment prospects and the worsening perception of the possibility of saving in the near future, against a background of rising price expectations.

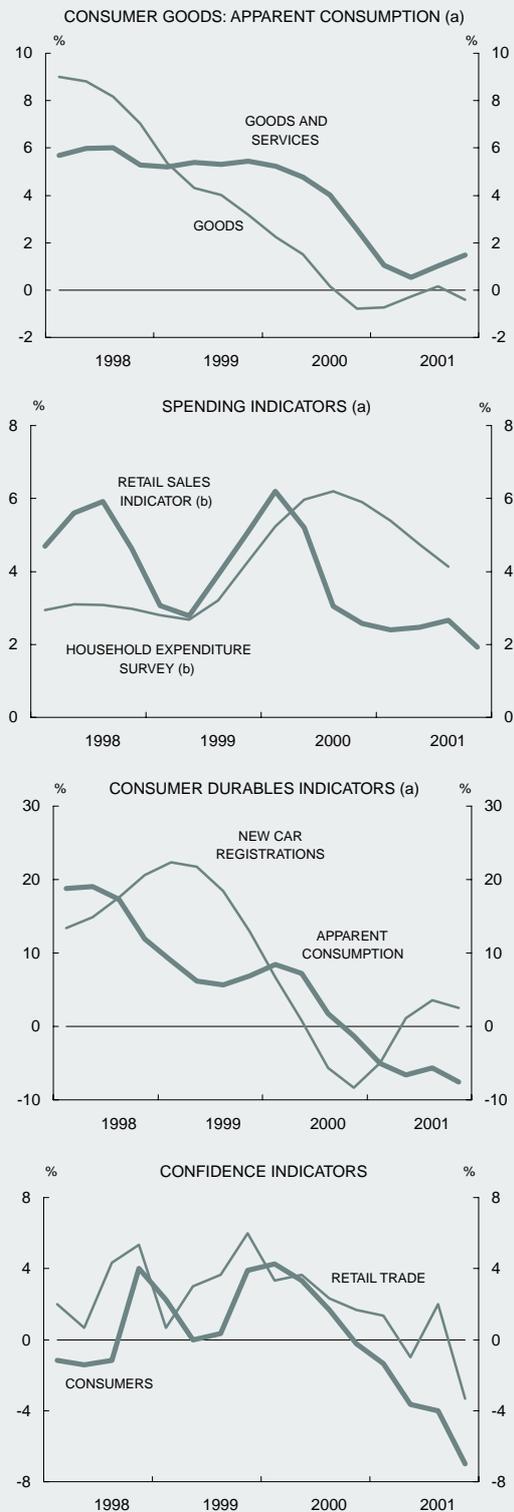
The slowdown in household consumption in the year 2001 as a whole is consistent with the estimated course of household real disposable income and with the loss of value seen in household financial wealth during the year, which was closely tied to stock market developments. The growth of salaried income was lower than in 2000, since the lower rate of job creation more than offset the bigger increase in compensation per employee. Moreover, the net contribution of general government to the growth of income was less expansionary than in previous years, partly because fiscal drag pushed direct tax payments up. The bigger increase in consumer prices in 2001 on average, compared with 2000, contributed to reducing purchasing power. Against this backdrop, the loss of value of net financial wealth helps explain both the lesser buoyancy of expenditure and the slight pick-up in the saving ratio during last year.

The latest QNA figures revised the year-on-year growth rate of government consumption appreciably upwards, in real terms, in the first half of the year 2001, placing the increase in this aggregate in Q3 at 3.6%. However, the information available means a slowdown in final general government consumption in Q4 may be estimated. And this would extend throughout 2002, in line with the balanced budget target for the overall general government sector for that year.

In 2001 Q3, the slowing trend that had characterised gross fixed capital formation since early 1999 continued, with a year-on-year growth rate of 2% being recorded, nine-tenths of a point down on the previous quarter. The reduction in the growth rate of investment in the summer months was mainly due to the significant contraction in investment in capital goods (-3.1% year-on-year), while the rate of increase of spending on construction and investment in other products eased only slightly. Gross fixed capital formation is estimated to have run in 2001 Q4 at a year-on-year growth rate close to that attained the previous quarter, owing to the continuing robustness of investment in construction, whereas investment in capital goods

CHART 15

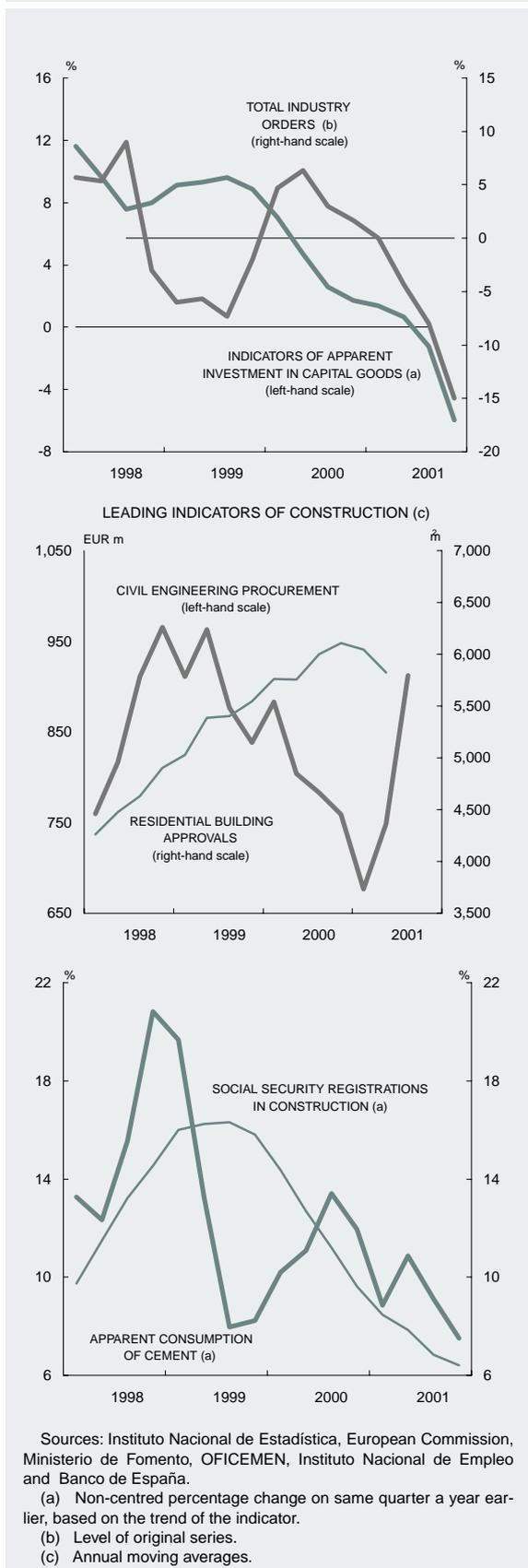
Private consumption indicators



Sources: Instituto Nacional de Estadística, European Commission, Dirección General de Tráfico and Banco de España.
 (a) Non-centred annual percentage change, based on the trend of the indicator.
 (b) Deflated by the CPI.

CHART 16

Gross fixed capital formation indicators



would have continued worsening. That would entail an increase in gross fixed capital formation of 2.7% for the year as a whole, almost three points less than in 2000.

As regards capital investment, the as yet incomplete information on the index of apparent investment in capital goods in Q4 saw its deteriorating profile steepen, as can be seen in the top panel of Chart 16. Along the same lines, expectations as to orders in industry, provided by the monthly Business Survey with information to December, worsened considerably from Q3 onwards owing to the decline in both national and foreign orders. The business climate indicator in the capital goods industry also fell back considerably in the final months of the year. The results of the half-yearly survey of investment in industry relating to last autumn, according to which entrepreneurs estimate a fall of 3% in investment in nominal terms in 2001, would warrant the contraction in capital investment reflected by QNA data to Q3. And bearing in mind the information available for Q4, this figure might stand at around -1.7% for the year as a whole.

Clearly, as earlier indicated, the slackness of export markets contributed to exacerbating, in the second half of last year, the progressive weakness that productive investment had previously been showing. The latest quarterly report of the Banco de España Central Balance Sheet Office reveals a slowdown in the results of non-financial corporations to Q3 last year, although the return on net assets and the leverage ratio (the differential between the aforementioned return and interest on financing received) remain high. That highlights the fact that their financial position remains sound and would not, in principle, pose an obstacle to a revival of investment plans, which might take place in the event of an improved economic outlook.

The economic information available indicates that investment in construction remained the most buoyant component of domestic demand in the second half of 2001, after increasing by 5.6% in Q3 on QNA figures. The coincident indicators provide evidence of a different sign on the profile of spending in the final quarter. Thus, the rate of increase of apparent consumption of cement continued to moderate until November and the employment indicators also point to a further mild easing in growth (see Chart 16). The production of construction materials held, to November, on the notably robust course initiated early last year.

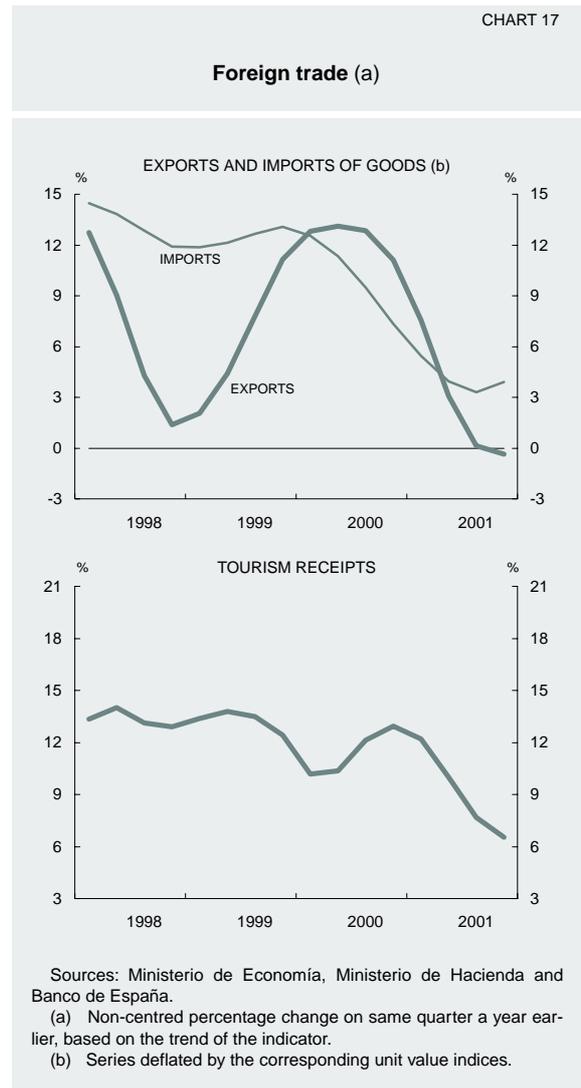
ECIC (Construction Industry Survey) data, which only cover the first half of 2001, reveal a rise in the value of works executed over this pe-

riod. This derives from a notable pick-up in civil engineering works and, to a lesser extent, in non-residential building, along with a slowdown in residential building, though this variable's growth is holding at a fairly positive rate. The data on government procurement (in respect both of civil engineering works and building) and building authorisations and architect associations' approvals would point to a prolongation of these trends in the second half of the year and in successive quarters (see Chart 16). In the case of residential building, this progressive moderation would be consistent with a slowdown in household disposable income and the marked increases in prices in the recent past.

On QNA results for 2001 Q3, stockbuilding contributed one-tenth of a point to GDP growth. The latest data, drawn from the monthly business survey to November, showed stocks were being maintained at notably higher levels than desired for the various types of goods, which would be consistent with a further positive contribution of stocks in Q4.

As indicated at the outset of this section, net external demand subtracted two-tenths of a point from GDP growth in Q3, confirming and adding to the change in sign seen the previous quarter. Moreover, the as yet incomplete information for 2001 Q4 would point to a further increase in the negative contribution for that period. Exports of goods and services, which had begun to slow slightly in the closing months of 2000, decelerated at a sharper pace last year as a result of sagging world trade and posted a year-on-year rate of 2.2% in the summer months. This rate fell once more in the final months of the year, in step with the heightened uncertainty and gloomier expectations prevailing after the terrorist attacks on 11 September. Furthermore, unlike in the year 2000, 2001 saw a loss in the competitiveness of exports derived from the trend of Spanish products' relative costs and prices, against the background of the euro's exchange rate stability. The growth rate of imports in Q3 on a year earlier also fell by two percentage points to 2.6%, in line with the moderation of final demand. That said, their rate of increase would have stabilised in Q4, underpinned by firm private consumption and the significant easing of their prices.

According to Customs figures, goods exports posted a real rate of change of -0.6% in October compared with the same month a year earlier, following zero growth on average in Q3. That accentuated the slowdown evident since last spring. Overall, the real growth rate of total exports eased during the first ten months of last year to 3.8%, against 12.5% twelve months



earlier, and the trend reflected in Chart 17 points to a further weakening of sales abroad in 2001 Q4.

In terms of geographical destination, sales to the European Union have been weak since mid-2000. In October nominal exports to the EU declined at a year-on-year rate of 0.9%, against a nominal increase of 7.8% in the first ten months of the year. Of particular significance was the loss of steam of exports to France and Germany, our main trading partners. The notably slowing profile of sales to non-Community markets that had begun in spring 2001 also steepened: in October exports to outside the Community posted a nominal decline of 1.6% year-on-year, and an increase of 5.9% overall in the first ten months of 2001 compared with 26.5% in the same period a year earlier. In respect of product groups, the growth rate of all components moderated notably between January and October, especially capital goods exports (-6.8% in real terms) and sales of con-

sumer goods, due partly to the lower demand for cars.

As to exports of services, the rate of nominal tourism receipts in 2001 Q3 moderated, in line with the trend initiated early last year (see Chart 17). This is in keeping with the behaviour of the real indicators – tourists entering Spain at borders and foreign visitors lodged in hotels – which, as from September, felt the impact on the industry of the terrorist attacks against the United States. Nonetheless, in the January-November period the number of tourists increased by 3.7%, up on the related figure of 2.3% in 2000. By country of origin, the worst results were for tourists from the United States and Latin America. The two biggest sources, namely the United Kingdom and Germany (which account for around 50% of total tourists), behaved in very different ways: whereas the growth rate of numbers of Britons remained positive, though more moderate than a year earlier, there was a strong contraction in the number of German tourists in the final months. Non-tourist services continued to moderate in Q3, in line with the greater sluggishness of goods exports and of foreign visitors entering the country. In addition, the loss of momentum of investment outflows during 2001 has interrupted the robustness of financial services seen in prior years.

On Customs data, the growth rate of real imports quickened to 5.5% in October on a year earlier, following a sharp reduction in Q3 as a whole. This result is partly influenced by the comparison with a period in which imports began to slow considerably. Indeed, over the first ten months of 2001 purchases abroad increased by 4.7% in real terms, half the growth recorded in the same period in 2000. Given the volatility characterising these flows, the assessment of a sole figure for Q4 necessarily requires caution, although the trend points to growth in real imports in this period of the order of that recorded in Q3 (see Chart 17). In respect of product groups, there was a notable slide (of 5.6% in real terms in the January-October period) in capital goods purchases, while consumer imports grew at a year-on-year rate of 10.5% over this same period, due mainly to the sizeable growth of purchases of food. Non-energy intermediate goods imports climbed by 5.7% in the first ten months of the year. Their rate of increase quickened in October against the background of a strong moderation of their prices and after slowing considerably in Q3. The decline in prices drove the growth of real energy imports, which rose by 5.8% between January and October.

Lastly, real service imports continued to slow in 2001 Q3, recording a growth rate of 3.4%

year-on-year on QNA figures. Nominal tourist expenditure decelerated mildly in this period, although over the first nine months of the year it increased by 13.4%, sustained by the greater stability of the euro throughout the period. As regards expenditure relating to non-tourist services, the Balance of Payments data moderated significantly in Q3, in line with the slowdown in goods exports and the loss of momentum of foreign investment.

4.2. Output and employment

From the standpoint of activity, all the productive branches in the economy contributed to the slowdown in GDP in 2001 Q3. In the primary branches this process was most marked in the summer, when the year-on-year rate of change of value added was virtually zero (0.1%) according to QNA estimates (see Chart 18). As in previous quarters, the loss of pace was caused by the fall in agricultural output, whereas livestock production held firm on an increasingly robust path. Paradoxically, the falls in agricultural output, which were extensive to a high number of crops, including most notably cereals, coincided with a very wet year overall, although the timing and geographical location of rainfall proved very harmful to yields.

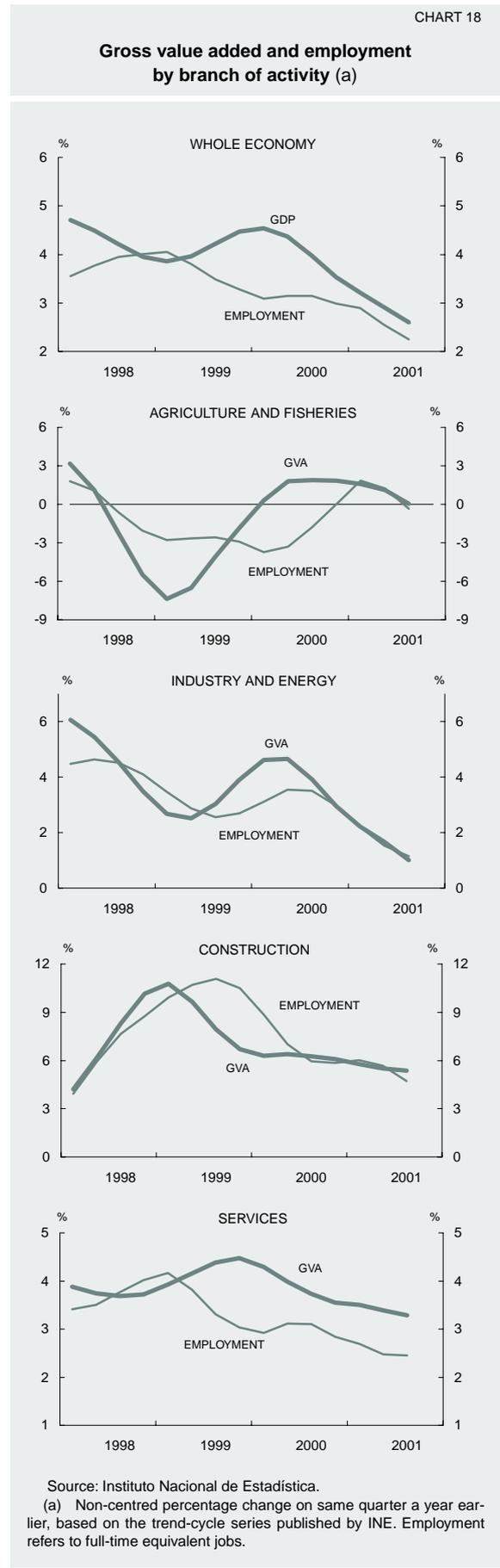
Industrial activity in the year 2001 was marked by the sluggishness of the international economy and the diminished vigour of national demand. On QNA estimates, the slowing trend of industrial activity in 2001 Q3 steepened, and the year-on-year rate of advance of value added dipped to 1%, seven-tenths of a point below the figure for the previous quarter. There were cuts in output in the metal transforming industry, and these were extensive to all its component activities, but the reduction was particularly notable in the manufacture of information and communication technology (ICT) goods, such as electronic equipment and office machinery. According to the latest updated economic information, the loss of vigour in industrial activity became worse in the closing months of last year. After several months during which no clear trend was apparent, the industrial production index fell back appreciably in November. Behind this was the markedly contractionary behaviour of capital goods production, which was in turn greatly affected by the worsening business outlook. Indeed, the business climate indicator fell in Q4 owing to the deterioration in the value of orders and the production trend, while there was also a high level of unwanted stocks. Other indicators add to the impression that the turning point in industry has not yet come about; thus, the number of social security registrations turned negative in terms of its rate

in November on a year earlier, following ten months of increasingly more modest year-on-year increases.

Construction continued to be the most buoyant activity in Q3 last year, despite the mild slowdown in value added. Its rate of change on a year earlier was 5.4% according to QNA estimates. In the year 2001, the buoyancy of construction was underpinned by civil engineering works (specifically infrastructure) and, to a lesser extent, by non-residential building. As discussed in the analysis of construction expenditure, the coincident indicators of this activity project a continuity of these trends for the final months of 2001.

The lesser thrust of activity in 2001 Q3 was also reflected in services, where slacker domestic consumption and the lesser pace of industrial production reduced the year-on-year growth rate of tertiary activities by one-tenth of a point to 3.3% on QNA figures. This was in line with the mildly slowing profile seen since the year 2000. The deterioration affected only market services, as the behaviour of services provided by general government was expansionary. The economic information relating to the final months of 2001 points to a further slowdown in most tertiary activities. In particular, both the retail trade business indicator for Q4 as a whole and the retail trade index in October and November were along these lines. However, social security registrations to November in retail and repair services point to their rate of advance having been maintained in the final quarter, in contrast to the declining profile observed over the year. The hotel and catering trade ultimately felt the impact of the terrorist attacks on 11 September, which accounts for the negative rates of change in both numbers of foreigners entering Spain at borders and overnight hotel stays, the information for which is to November. Activity in transport and communications also exhibited a slowing profile in the closing months of the year. This was due to the contraction in air transport in terms of both passengers and freight, and sluggishness in telecommunications, which the greater vigour of land transport could not offset. As to the remaining market service activities, diminished buoyancy is common to most, with the exception of real estate and rental services. The growth rate of the latter, according to the information on social security registrations to November, would have stabilised following the sharp deceleration during the first ten months of the year.

The easing of productive activity in 2001 Q3 was mirrored by employment. On QNA estimates, and measured in terms of equivalent full-time jobs, employment increased by 2.3%



year-on-year, two-tenths of a point down on the previous quarter. That made for a modest increase of 0.3% in apparent labour productivity, similar to that observed in the first half of the year. The slowdown in the generation of new jobs during the summer was reflected with greater intensity in social security registrations, which grew by 3.4% on a year earlier compared with 4.3% the previous quarter. The numbers of employed according to EPA (the labour force survey), for their part, held stable at a rate of 1.8% in the same period. The tendency towards more subdued employment growth might have continued in the final quarter of last year given the movements in social security registrations during that period (a year-on-year increase of 3.3%) and the increase in unemployment in the October-December period on a year earlier, compared with the decline seen up to Q3.

Drawing on QNA estimates, job creation lost momentum in all branches of activity between July and September except in non-market services. Construction continued to be the industry where job creation was most intense, although it was here that the year-on-year rate of increase in employment fell most (by 1 percentage point), to 4.7%. The slowdown in employment, which was much sharper than that in value added, provided for a recovery in apparent labour productivity following the falls in this variable over the past two years. The notable cut in the rate of increase in industrial activity in Q3 did not pass through in full to employment, the growth rate of which fell by only three-tenths of a point to 1.1% compared with the same period a year earlier. Productivity fell back by one-tenth of a point, it being estimated that it recorded zero growth over 2001 as a whole. In the primary sector, where employment had undergone an anomalous increase in the first half of the year, jobs declined slightly in the summer months, in line with the course of value added. Lastly, the rate of advance of employment in services held at 2.5%. Here, in the market services branches, employment continued on the sharply decelerating path seen since a year earlier. That placed its rate at 1.5% in Q3, after it had grown by 4.2% in the year 2000. By contrast, employment in non-market activities remained on a marked rising path.

The slowdown in employment in the first nine months of last year was sharper in the case of dependent employees, while growth was brisk in the case of the self-employed. This behaviour, which is to be expected in periods in which the economy is losing steam, took the form of a 0.4 percentage point reduction in the rate of change of dependent employment in Q3 to 2%, according to QNA figures. Conversely, the related rate for the self-employed was 3.6%,

three-tenths of a point up on the previous quarter. The more detailed information provided by the EPA shows that the main contribution to dependent employment continued to be provided by workers on permanent contracts. An increase of 2.8% was seen in this group in Q3 according to the EPA, outpacing the 1% year-on-year rise in employees on temporary contracts. The proportion of temporary to total employees stood at 31.9%, four-tenths of a point down on the same quarter a year earlier. Some of this reduction is due to the March 2001 reform measures, when allowances were re-introduced for the conversion of temporary contracts into permanent ones. It was, in fact, this type of permanent contract which most expanded over the course of the year according to the related INEM statistics. As regards part-time employment, the effects of the new regulations are not yet discernible, especially for permanent contracts under this heading. The numbers of wage-earners on a reduced working day rose by 1.3% in Q3, and part-time employees as a proportion of total employees fell to 7.9%. As to employees working part-time with a stable contract, numbers fell by 0.4%.

From the standpoint of labour supply, the EPA data revealed a marginal increase in the participation rate in Q3 to 51.8% (66.1% if the over-65s are excluded). The rise in the participation rate, which was less than in previous quarters, nonetheless entailed a further narrowing of the negative gap with the EU average. The increase made it possible to absorb in full the greater supply of labour, and unemployment fell once more, to a rate of 12.8%, two-tenths of a point down on Q2. This reduction principally affected the female unemployment rate and also resulted in a fresh decline in long-term unemployment, whose incidence stands at 42.2%. In year-on-year terms, the rate of decline of unemployment was 6.2%, having slackened slightly. In terms of numbers of INEM-registered unemployed, however, the fall was rather more modest (1.8%) in Q3 and, as earlier signalled, the resulting year-end increase compared with a year earlier was 1%, the first time there had been a rise since 1994.

4.3. Costs and prices

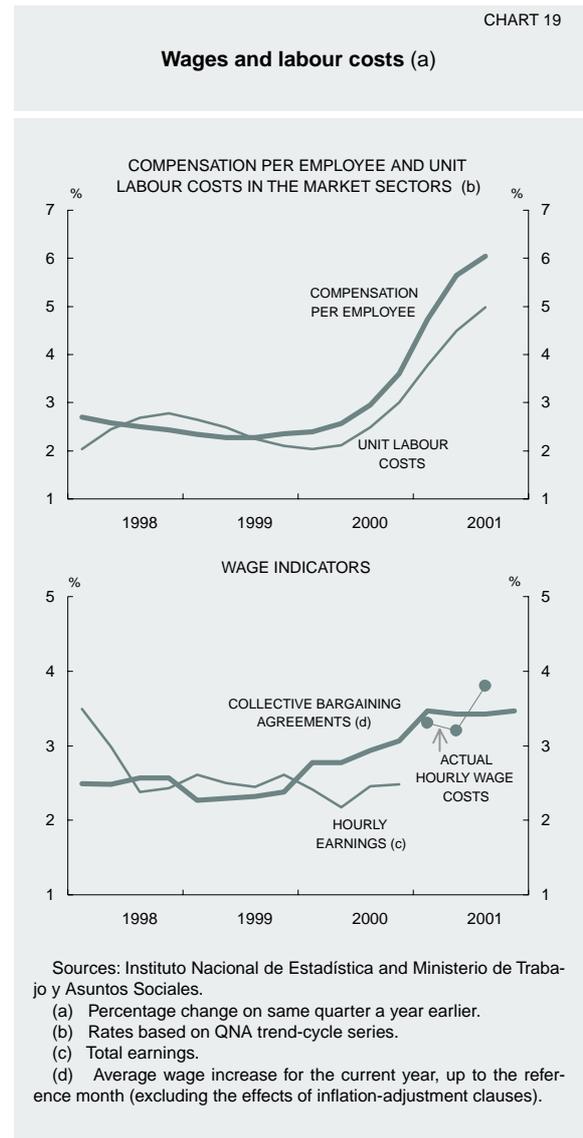
On QNA estimates, the GDP deflator increased by 3.9% in 2001 Q3 compared with the same period a year earlier. This figure was below the rate of 4% posted in the first half of the year, but substantially above the average for 2000 (3.4%). The rise in domestic inflationary pressures during 2001 was the outcome both of a widening of operating margins in the market economy and an increase in unit labour costs

which, according to QNA figures, intensified during the year to reach a rate of 4.3% in Q3. The acceleration was even sharper in the market economy, where labour costs would have increased by 6% in this period (see Chart 19). The bigger increase in unit labour costs in the market sector was the result of the acceleration of compensation per employee, while labour productivity, measured in terms of value added, climbed at a higher rate than in the year 2000.

The information provided by the short-term indicators available indicates that wages are trending more moderately than the QNA estimates would suggest. The labour costs index (LCI), based on actual hours worked, recorded an increase of 4.4% in Q3 on a year earlier owing to a rise of 3.8% in wage costs and of 6.1% in other costs. Across the branches of activity, the LCI increased by 3.9% in industry, 4.3% in construction and 4.9% in services. Per employee and month, the increases were somewhat lower: 4.1% for labour costs and 3.6% for wage costs. Although the wage increases reflected by the LCI are higher than those in earnings under the wage survey during the year 2000, the spliced series are not yet available. It is thus not possible to make a sufficiently grounded assessment of the scale of the acceleration in wages between the years 2000 and 2001 using both statistics.

Collectively bargained wage settlements recorded to 31st December 2001 stood at 3.5%, five-tenths of a point above the increase in 2000, before including inflation-adjustment clauses. Whereas revised collective bargaining agreements included a wage increase of 3.4%, in newly signed agreements the rise was 3.7%. Construction and agriculture are notable cases in point with respective increases of 4.1% and 4%, outpacing services (3.3%) and industry (4%). For the year 2002, wage settlements agreed in collective bargaining are expected to stand slightly above 2.5%, given the information available on pluriannual agreements in force in the year 2002 and in the light of the bargaining criteria adopted in the Interconfederal Agreement entered into by the most representative trade unions and employers' associations. The agreement stipulates that wage increases will be set with reference to the official inflation target (2%), with higher increases permitted if they are warranted by productivity gains, but without cancelling such gains out.

According to QNA estimates, the gross value added deflator of the branches making up the market economy grew at a rate of 4.5% in 2001 Q3, two-tenths of a point less than the previous quarter. As indicated, unit labour costs grew at a rate of 5% in Q3 compared with 4.5%

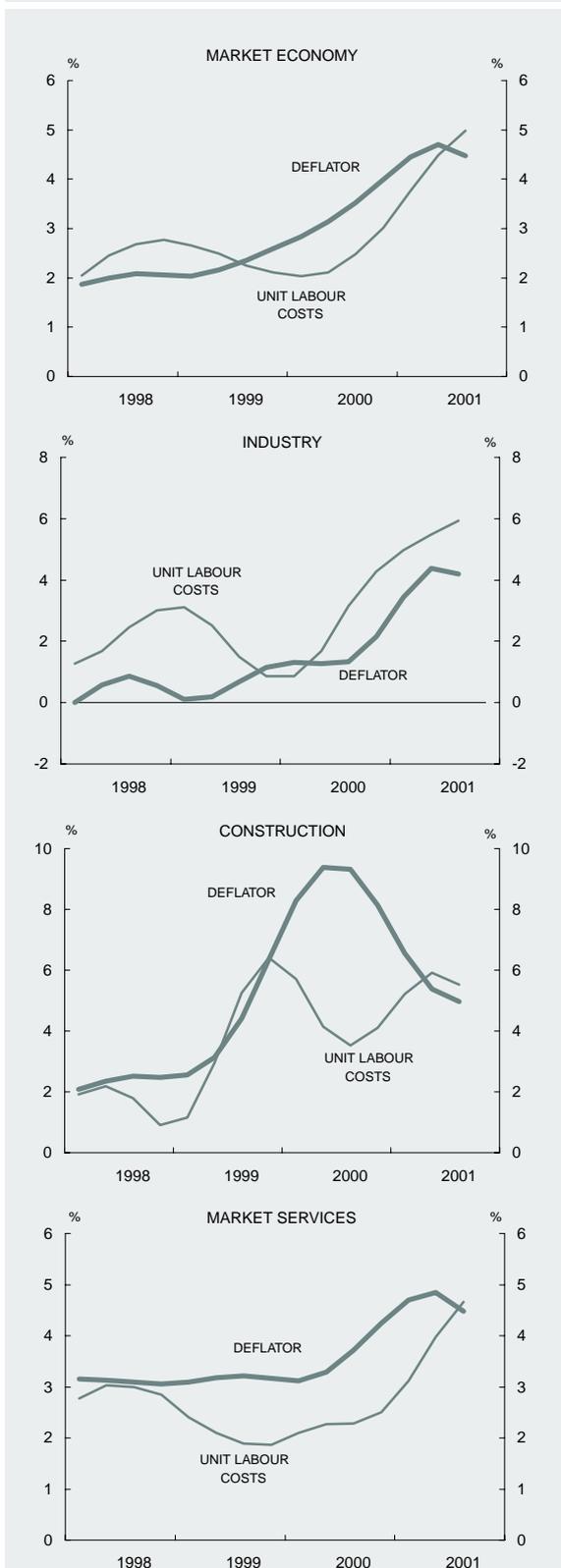


in the summer months. For the first three quarters as a whole, operating margins widened, although this increase was unevenly distributed both across branches and during the year. In industry, the rise in the value added deflator stabilised in Q3 at 4.2%, following the sharp acceleration the previous quarter, while unit labour costs quickened as a result of compensation per employee. Consequently, the gross unit operating margin narrowed anew (see Chart 20). The market services deflator also decelerated, despite the sharp rise in unit labour costs, with the unit margin narrowing slightly in relation to Q2 after having widened significantly in the first half of the year. Lastly, a slowdown similar to that in unit labour costs and in the value added deflator was discernible in construction. The unit operating margin held more or less stable after having increased strongly in Q1.

Final prices in the economy were favoured during 2001 by the sound performance of im-

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.

port prices, which helped soften the impact of domestic cost pressures. The deflator of goods and services imports, which had increased by 5% year-on-year in Q1, posted a negative rate of 0.4% in Q3, and the behaviour of the import unit value indices means a sharper reduction may be estimated in Q4. The final demand deflator took up this moderating effect and increased by 2.9% in Q3, against 4.2% in Q1.

Turning to the most updated final price indicators, the consumer price index (CPI) continued in Q4 on the decelerating path embarked on in June. That said, the December figures show this process to have been interrupted, as the 12-month growth rate stood at 2.7%, unchanged on November, and seven-tenths of a point below the September figure (see Chart 21). Conversely, the IPSEBENE index (one of the habitual measures of core inflation) ceased to reflect the stability of the previous months, and its 12-month growth rate increased by three-tenths of a point to 3.8% at the close of the year (see Chart 21).

In Q4 the CPI was greatly influenced by the sound performance of the prices of its most volatile components, most particularly energy prices, which continued on the falling trend marking their course since mid-year. The reductions in energy prices were sharper in the case of liquid and other fuels, to which the favourable performance of oil prices on international markets and the relative stability of the euro exchange rate contributed. The slowdown in unprocessed food prices, dating back to the summer months, stepped up in December, a base effect which was the outcome of the sizeable increases in the prices at the end of the previous year. The growth rate of processed food prices, however, continued to increase during the closing months of 2001. Their 12-month growth rate in December stood at 5.3%, one percentage point up on the September figure. Service prices also rose in the closing months of 2001, reaching an end-year rate of 4.2%. Service price increases were steepest in tourism and hotels and catering, and also in the leisure industry and in entertainment events, which might be related to upward adjustments ahead of the changeover to the euro. Finally, the prices of non-energy industrial goods continued on the stable growth path observed since the closing months of 2000, posting a 12-month rate of 2.6%.

Between September and December, the inflation spread between Spain and the euro area, measured in terms of the harmonised index of consumer prices (HICP), narrowed by three-tenths of a point, leaving the gap at the end of the year at 0.6 percentage points. This reduction in the inflation gap during Q3 was the

result of the falls in energy prices in Spain, relative to the euro area, which enabled the higher rates recorded by processed food prices to be more than offset. The service prices differential held virtually unchanged in relation to September, standing at 1.2 percentage points in December.

The decelerating path characterising the producer price index since the end of last year continued, leading to negative rates of change being recorded in October and November. Once again, the adjustment in intermediate goods prices – which recorded successive declines both in monthly and annual terms, and which were particularly marked in the case of energy – has prompted the slowdown in the overall index. Adding further to this has been the slowdown (albeit to a lesser extent) in the remaining components. Lastly, the rate of increase of prices received by farmers declined following the burgeoning growth at the end of the first half of the year; the resulting 12-month rate stood at 4.2% in September.

4.4. The State budget

Since the publication of the last quarterly report on the Spanish economy, two key pieces of legislation for general government conduct have been approved: the new financing arrangements for the ordinary-regime regional (autonomous) governments and the General Law on Budgetary Stability. The latter reinforces the procedures for further headway in the process of fiscal consolidation and the co-ordination mechanisms between the State and the regional governments. The new regional government financing arrangements provide a degree of financial autonomy that is consistent with the level of decentralisation of spending powers attained in recent years. December saw the approval of the State budget (Box 3 includes a list of the budgetary measures finally adopted) and the updating of the 2001-2005 Stability Programme for the Kingdom of Spain, which ratified the objective of an overall general government balanced budget in the year 2001 and its maintenance in 2002. Regarding the first of these objectives, the pick-up in tax receipts in the second half of last year and the sound performance of the social security budget outturn (see Box 4) indicate it will be met.

Turning to the State budget outturn, in the eleven months to November, and under National Accounts methodology, a surplus of EUR 4009 million (0.6% of GDP) was built up, compared with the surplus of EUR 2455 million (0.4% of GDP) recorded in the same period in 2000 (see Table 3). Receipts continued to re-

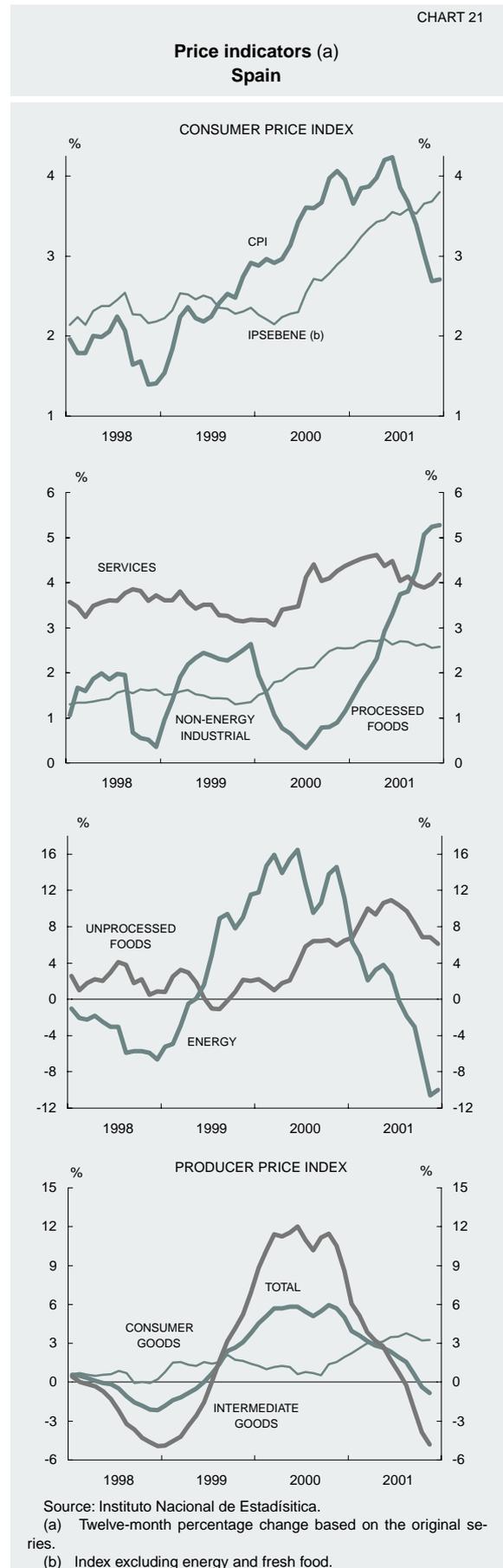
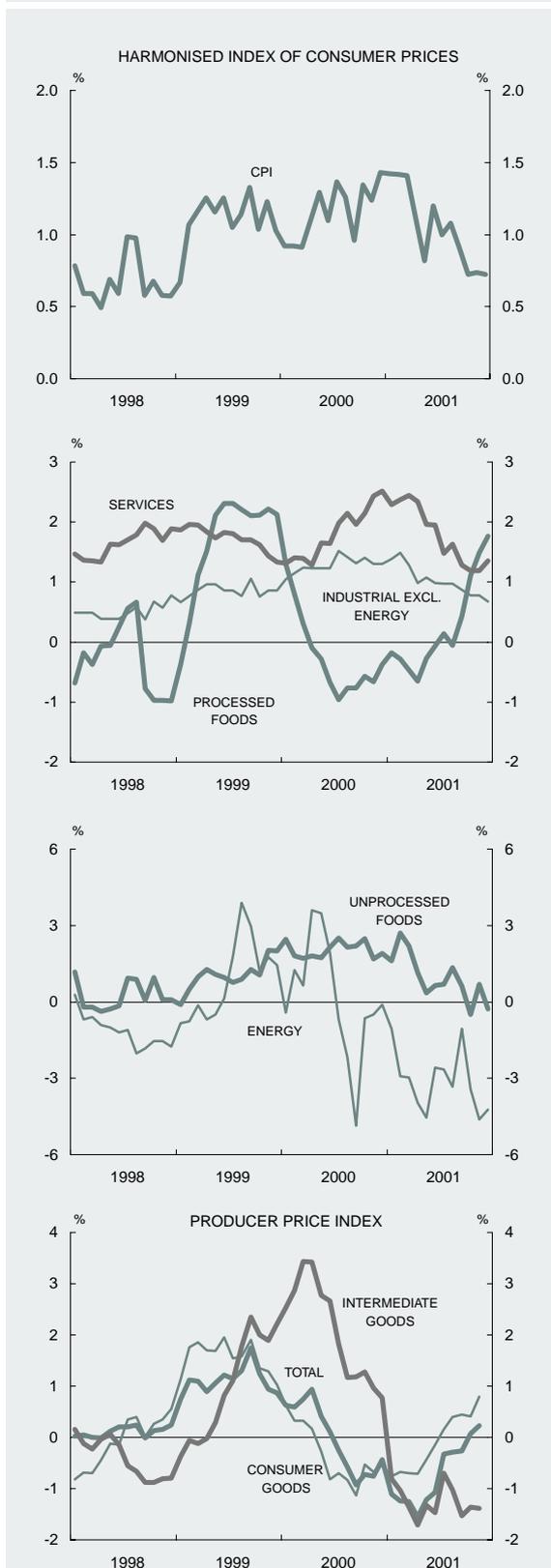


CHART 22

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.

cover in the final months, posting an increase of 6.7% to November 2001 (3.8% at the end of Q3), slightly above the forecast in the initial State budget projection. Bearing on this favourable result was the bringing forward of the transfer to the State from the Social Security system (in connection with the healthcare responsibilities transferred to the Basque country and Navarra), which took place in November for an amount of EUR 1833 million, and which the previous year had arisen in December. That said, tax receipts – in particular from income and wealth tax – remained relatively buoyant. As a result, direct taxes increased by 6.8%, slightly below the official estimate for the year as a whole, and indirect taxes rose by 3.3% to November, albeit appreciably below the growth forecast for the whole year (4.4%).

Expenditure also accelerated significantly to a rate of 5.4% in November (compared with 4.6% at the end of Q3), in line with the officially estimated rate for the year as a whole. This acceleration was largely due to capital expenditure, which grew by 15.7% to November, owing substantially to the recovery in the extent of the investment outturn. Notable under current expenditure was the acceleration in final consumption to a rate of 3.6%, while current transfers to other regional governments held at a growth rate of 6.5%, in line with the initial projection.

In cash-basis terms, the State ran a surplus of EUR 392 million to November 2001, compared with the surplus of EUR 731 million in the same period a year earlier. On this measure, therefore, the performance was worse than in the year 2000, in contrast to the reduction in the cash-basis deficit (40.4%) envisaged in the initial projection for the year as a whole. However, in relation to Q3, revenue has accelerated to a growth rate of 5.5% in the January-November period (3.4% to September), while expenditure has also accelerated, but at a more moderate rate (5.8% to November, compared with 5.1% to September).

The acceleration in revenue, which placed the related growth rate in line with what was initially projected, was mainly due to the performance of personal income tax and to non-tax revenue, although indirect tax also quickened slightly. The exception to these positive developments was corporate income tax, the growth rate of which turned negative (-0.6%) in November, compared with the increase of 0.3% to September, and the 5% increase forecast in the initial projection for the year as a whole. The growth rate of personal income tax quickened to 11.4%, in step with the official estimate for the whole year. That reflects the pick-up in this

Main budgetary measures for the year 2002

The State Budget and its complementary legislation, approved on 31 December last year, include an extensive range of measures bearing both on revenue and expenditure, and which have a differentiated impact on the net tax take. A brief review of the measures follows.

Among the measures involving a rise in revenue are, first, the increase in VAT on certain goods and services (motorcycles, propane and butane, and motorway tolls); the rise in duties on production (alcohol, beer and tobacco); and the creation of a new duty on retail sales of certain hydrocarbons. This latter tax is split into two portions: the first relates to the State, the revenue from which is transferred to the regional (autonomous) governments and assigned to fund healthcare spending; and the second to the regional government, the revenue from which may be earmarked, moreover, to finance environmental measures.

Other measures that will provide for increased revenue will be the non-adjustment for inflation of the personal income tax schedule and personal and family allowances (letting fiscal drag operate), and the raising of the maximum Social Security bases (one point above forecast inflation) and of the bases of the lowest contribution groups, as a result of the finalisation of the process whereby the specific ceilings on these latter bases are removed.

In parallel, the accompanying budgetary legislation includes a raft of fiscal measures that will entail reductions in revenue and affect corporate income tax, on one hand, and the set of tax incentives for contributions to employee and individual pension schemes, on the other. The changes to corporate income tax are seen as spearheading a more thoroughgoing reform over the course of 2002, against a background in which the slowdown in activity and heightened international economic uncertainty advised shoring up companies financially and promoting investment. As a result, the qualifying limit for incentives for small and medium-sized companies (SMEs) has been raised from EUR 3 million to EUR 5 million of annual turnover; the period in which negative taxable income may be offset has been extended; provisioning for possible bad debts qualifies for deductions; and tax on capital gains ploughed back into companies has been reduced. The corporate income tax reform is also aimed at boosting technological development in Spanish firms (in which connection the allowance for research, development and investment activities has been amended) and at providing for greater tax neutrality for mergers.

The improved treatment of supplementary social welfare is secured through changes to both personal and corporate income tax. The latter tax establishes in relation to tax payable a new allowance of 10% applicable to contributions made by the company to employee pension schemes, under certain conditions. The percentage ceilings on contributions to pension schemes are lifted and the overall annual quantitative limit of EUR 7,212 per year is raised for each year after taxpayers pass the age of 52 up to a maximum limit for fund participants of 65 years of age or over.

The accompanying budgetary legislation introduces a further two measures which will lower tax revenue in 2002: the reduction of the charge on the use of the electromagnetic spectrum and, for employers, the cuts in and exemption from social security contributions for employees over 60 and 65, respectively.

The Budget for 2002 also includes a series of measures that will have a bearing on expenditure. Among those that will increase spending are the continuing rebates applicable to employers' social security contributions in the case of their offering permanent contracts, and the improvement in widows' and orphans' pensions and in minimum pensions, further to the application of the measures under the agreement on pensions entered into in April. The application of the State Pact for the reform of Justice and the adoption of the new regulation on professional military compensation will raise spending. Set against this, the 25% replacement ceiling on public-sector hiring will – with the exception of the Justice Department, the Armed Forces and small municipal councils – remain in place, as in previous years, reducing the growth rate of expenditure.

Lastly, mention should be made of certain provisions that will not have any influence on the general government deficit. This is either because they are removed on the consolidation of the various agents' accounts (increase in the transfer from the State to the Social Security system relating to the supplement to minimum pensions or the application of the new financing arrangements for the regional governments), or because they are considered to be financial transactions [increases in the provision to the pension reserve fund and in the capital contribution to the GIF (Railway Infrastructure Managing Entity)].

TABLE 3

State Budget outturn

EUR millions and %

	Outturn	Percentage	Initial proj.	Percentage	Outturn	Outturn		
	2000	change	2001	change	JAN-SEP	2000	2001	Percentage
	1	2000/1999	3	2001/2000	change	JAN-NOV	JAN-NOV	change
					2001/2000	6	7	8=7/6
				4=3/1	5			
1. Revenue	118,693	7.5	125,063	5.4	3.4	109,818	115,848	5.5
Direct taxes	51,431	9.5	55,907	8.7	5.8	48,552	51,578	6.2
<i>Personal income tax</i>	32,152	4.9	35,935	11.8	8.6	30,581	34,063	11.4
<i>Corporate income tax</i>	17,207	17.5	18,072	5.0	0.3	15,902	15,799	-0.6
<i>Other (a)</i>	2,073	21.8	1,900	-8.3	2.8	2,069	1,715	-17.1
Indirect taxes	51,280	7.3	53,508	4.3	3.1	48,647	50,239	3.3
VAT	33,399	8.7	35,058	5.0	3.1	32,207	33,287	3.4
<i>Excise duties</i>	16,056	4.1	16,533	3.0	2.9	14,785	15,231	3.0
<i>Other (b)</i>	1,824	12.4	1,917	5.1	4.2	1,656	1,721	4.0
Other net revenue	15,982	2.4	15,648	-2.1	-4.6	12,620	14,031	11.2
2. Expenditure (c)	121,124	3.8	126,511	4.4	5.1	109,087	115,455	5.8
Wages and salaries	16,261	-9.2	16,789	3.2	2.6	14,279	14,710	3.0
Goods and services	2,372	-9.5	2,405	1.4	3.5	2,094	2,216	5.9
Interest payments	17,715	-7.3	18,011	1.7	4.0	17,030	17,696	3.9
Current transfers	72,826	12.1	77,514	6.4	6.7	65,758	69,924	6.3
Investment	6,033	4.9	5,750	-4.7	-7.1	5,245	5,368	2.3
Capital transfers	5,918	-7.4	6,042	2.1	9.0	4,682	5,541	18.4
3. Cash-basis balance (3=1-2)	-2,431	-61.7	-1,448	-40.4	22.2	731	392	-46.3
MEMORANDUM ITEM: NATIONAL ACCOUNTS (d):								
Revenue	119,208	7.6	126,447	6.1	3.8	109,985	117,306	6.7
Expenditure	122,971	4.7	129,716	5.5	4.6	107,531	113,296	5.4
Net lending (+) or borrowing (-)	-3,763	-43	-3,270	-13.1	24.1	2,455	4,009	63.3

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.
 (c) Includes unclassified expenditure.
 (d) The annual figures (columns 1 and 3) are from the Spanish Finance Ministry's reply to the Excessive Deficit Protocol, for 2000, and from the initial projection for 2001.

tax after having brought forward to mid-2001 the refunds for excess income tax paid the previous year. VAT quickened to a rate of 3.4%, albeit significantly below the official estimate for the whole of 2001, and excise duties posted a growth rate of 3%, coinciding with the official estimate. The favourable trend of non-tax revenue (11.2%) was mainly due, as mentioned, to the current transfer by the Social Security system to the State for the transfer of healthcare responsibilities to the Basque country and Navarra having been brought forward. Conversely,

revenue relating to profits obtained by the Banco de España (which have no bearing in National Accounts terms) diminished.

The acceleration in expenditure in relation to September has placed the related growth rate significantly above the initial projection for 2001 as a whole. This acceleration was essentially in capital expenditure, both on real investment and on transfers. Under current expenditure, purchases of goods and services quickened notably. Interest payments, though they have

Social Security budget outturn

On budgetary outturn data to October 2001, the Social Security System ran a surplus of EUR 9,738 million, 18.2% up on the same period a year earlier (see accompanying table). This improvement in the balance is in contrast to the reduction in the surplus initially projected for 2001 in relation to the 2000 outturn. Receipts held at a growth rate of 8.3% to October (far higher than budgeted), while expenditure slowed and increased by 7.1% (likewise outpacing the budgeted figure).

The high growth rate of receipts from social security contributions continued to slacken, standing at 9.2% in the period to October, far above the budgeted figure of 1.5% (a). This was partly due to the buoyancy of registrations, which grew by 3.9% on average over the course of 2001 (5% in 2000). The other major source of receipts – current transfers from the State – posted a higher-than-budgeted increase of 6.1% to October.

Expenditure on contributory pensions slowed and grew at a rate of 5.5% to October (6.9% to July), against initially projected growth of 3.9% for 2001. Nonetheless, it should be borne in mind that the comparison between the 2001 budget and the outturn for 2000 is distorted by the fact that the latter includes both the payment relating to the deviation by consumer-price inflation in 1999 and that corresponding to the year 2000. If the latter were excluded from the 2000 outturn, the budgetary forecast for 2000 would be growth of 6.1%, higher than the figure recorded to October. The number of contributory pensions increased by 1.1% to November 2001, in line with the figure budgeted and with the growth recorded in 2000. The growth rate of spending on temporary disability, for its part, stood at 14%, above budget.

With regard to INEM (National Employment Office) spending, expenditure on unemployment benefits increased by 10.4% to October 2001 against 3.1% in 2000. Behind this increase was the behaviour of the number of beneficiaries, which rose by 5.5% to October, compared with an average reduction of 2.7% in 2000. The rise in the number of beneficiaries and the slight growth in the number of registered unemployed (0.1% in 2001 as a whole compared with a 4.5% reduction in 2000) gave rise to a fresh increase in the eligibility ratio, which stood at 68.1% to October (64.7% in 2000).

Contributions received by INEM climbed by 9.1% to August, against a budgeted projection of 6.2%, while employment-promoting concessions on employers' contributions declined by 9.8% to August, in contrast to the budgeted increase of 3%.

(a) Nonetheless, the draft Social Security Budget for 2002 presents a forecast outturn entailing an increase of 6.5% in the System's social contributions for the year 2001 as a whole.

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

EUR millions and %

	Outturn	Budget		Outturn	Outturn JAN-OCT		
	2000	2001	% change	JAN-JUL	2000	2001	% change
	1	2	3=2/1	4	5	6	7=6/5
1. Revenue	92,339	94,576	2.4	8.4	78,268	84,772	8.3
Social security contributions (c)	61,674	62,618	1.5	9.5	51,012	55,689	9.2
Current transfers	29,247	30,796	5.3	5.5	26,278	27,880	6.1
Other (d)	1,418	1,162	-18.0	31.9	977	1,203	23.1
2. Expenditure	88,680	92,267	4.0	7.7	70,029	75,034	7.1
Wages and salaries	13,610	14,355	5.5	6.0	11,607	12,328	6.2
Goods and services	8,570	8,967	4.6	8.2	6,922	7,534	8.8
Current transfers	65,232	67,514	3.5	7.9	50,765	54,295	7.0
Benefits	64,805	67,063	3.5	7.2	50,703	53,882	6.3
Contributory pensions	51,078	53,047	3.9	6.9	6,563	6,926	5.5
Sickness	3,784	3,557	-6.0	14.5	2,811	3,206	14.0
Other	9,942	10,459	5.2	6.2	41,329	43,750	5.9
Other current transfers	427	451	5.7	—	62	412	—
Other (e)	1,269	1,432	12.8	18.5	735	876	19.3
3. Balance	3,659	2,309	-36.9	15.4	8,239	9,738	18.2

Sources: Ministerio de Hacienda, Ministerio 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 are only available to July.

(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.

(e) Reduced by the disposal of investments.

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

	JAN-OCT	
	2000	2001
	Receipts	Receipts
Current account	174,199	193,269
Goods	101,626	109,304
Services	48,729	54,240
<i>Tourism</i>	28,772	31,738
<i>Other services</i>	19,957	22,502
Income	13,055	17,693
Current transfers	10,790	12,031
Capital account	5,162	5,404
	Payments	Payments
Current account	188,601	206,081
Goods	131,033	138,040
Services	28,083	30,457
<i>Tourism</i>	4,954	5,636
<i>Other services</i>	23,129	24,821
Income	20,747	27,632
Current transfers	8,738	9,952
Capital account	886	734
	Balance	Balance
Current account	-14,402	-12,812
Goods	-29,408	-28,735
Services	20,646	23,783
<i>Tourism</i>	23,819	26,102
<i>Other services</i>	-3,172	-2,319
Income	-7,692	-9,939
Current transfers	2,052	2,079
Capital account	4,276	4,669

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

slowed slightly, are also higher than forecast for the whole year, while both spending on wages and salaries and current transfers are in line with the official estimate for 2001 as a whole.

4.5. The Spanish balance of payments and capital account

In the period from January to October 2001, the joint cumulative balance on current and capital account resulted in a deficit of EUR 8143 million, EUR 1983 million less than in the same period a year earlier. This improvement was due both to the favourable performance of the current-account balance, the deficit on which fell by EUR 1589 million in the first ten months of the year compared with the same period in the year 2000, and to the better result on

the capital account, the surplus on which was EUR 394 million up on that for the related period in 2000 (see Table 4).

In the period January-October 2001, the cumulative trade-balance deficit showed an improvement of EUR 672 million compared with the same period the previous year. Measured in year-on-year terms, the negative balance fell by 2.3%, which is in contrast to the burgeoning increase seen the previous year. Although real goods export flows have sagged greatly since Q2 last year, with growth rates systematically lower than import flows, the notable improvement in the terms of trade during the period – arising essentially from the decline in imported energy prices – has provided for the above-mentioned reduction in the trade deficit in nominal terms. In services, the positive cumulative balance for the period January-October totalled EUR 23,783 million, up 15.2% on the results for the related period in the year 2000. The increase is attributable to a 9.6% rise in the tourism and travel balance and to a 26.9% reduction in the deficit on other services. Nominal tourism receipts and expenditure grew by 10.3% and 13.8%, respectively, over the first ten months of the year. That said, both items have been on a moderating trend since Q2. The increasingly buoyant trend that had marked tourism revenue since the closing months of 2000 was interrupted, with numbers of German tourists slipping heavily and the growth of flows of British tourists declining, these countries being the two main providers of visitors to Spain. In addition, the negative impact of the terrorist attacks of 11 September has made itself felt, with a heavy decline in tourists from the United States and, in general, from other non-European markets. Payments have also moderated in recent months, in step with weaker consumer confidence.

In the January-October period, the deficit on the income balance was EUR 2246 million higher than the same period the previous year. Revenue continued to grow, as in the year 2000, at a most substantial rate (35.5%), reflecting the strong investment abroad in recent years, which was interrupted in the course of last year. Payments also grew at a high rate (33.2%), the result of the forceful momentum of foreign investment in Spain in 2000, and which also weakened during last year.

The positive balance on current transfers in the first ten months of 2001 stood at EUR 2079 million, a marginal increase of EUR 27 million in relation to the balance in the same period the previous year. Revenue grew at a rate of 11.5% in this period, with notable increases in flows from the EU relating to the EAGGF-Guarantee fund and the European Social Fund. Payments, for their part, grew at a higher rate (13.9%),

with a notable surge in emigrants' remittances abroad. Finally, the capital-account surplus climbed by EUR 394 million in relation to the figure for the January-October 2000 period. This growth of 9.2% year-on-year was due to the pick-up in most structural funds from the EU (with the exception of those intended for the Cohesion Fund), which would be incorporating arrears arising in the previous year.

The lower net borrowing these figures imply would be the reflection of the improvement in the balances of households and firms' accounts, derived in turn from the progressive slowdown in residential investment and from sluggish private productive investment. Such developments have become apparent in recent months against a backdrop of lower growth and worsening expectations.

5. Financial flows in the Spanish economy

5.1. Financial flows in the economy as a whole

According to the latest information available on the financial accounts, in Q3 the cumulative four-quarter debit balance of the net financial transactions of the nation fell slightly to -2% of GDP (1) (see Table 5). This improvement is basically attributable to the behaviour of general government, whose net saving was positive during Q3. In cumulative four-quarter terms, however, the balance of general government net financial transactions stood at -0.3% of GDP. No significant changes were seen in the other institutional sectors with respect to the previous quarter. Accordingly, the net borrowing of non-financial corporations continued to exceed 4% of GDP, while the surplus balance of the financial transactions of households continued to sustain the recovery seen since the beginning of the year, standing at 2% of GDP.

The financial flows between sectors (lower part of Table 5) show an increase in the household saving channelled towards institutional investors, which amounted to 3% of GDP, as against 1.8% in the previous quarter. This intensification of the institutionalisation of household saving, evident since the beginning of 2001, is largely explained by the pick-up of investment in mutual funds, in particular, in money market funds (FIAMM). Meanwhile, during Q3, general government again increased the net financing received from resident credit institutions, which amounted to 1% of GDP. Credit institutions continued to make net acquisitions of government securities, while the Treasury reduced the deposits that it holds with these institutions (and which it manages through liquidity tenders). Finally, the net financing received by non-financial corporations from resident credit institutions fell slightly to -4.4% of GDP.

During 2001 Q3, the financial decisions of economic agents were taken amid greater cyclical weakness and a high degree of uncertainty. These factors, which continued to exist during the final quarter of 2001, have contributed to the slowdown in the financing of the private sector. This slowdown has been gradual, however, partly due to the relative laxity of financing conditions in Spain. On provisional December information, annual growth of loans granted by resident credit institutions to the non-financial private sector stood at 12.6% , as against 13.6% three months earlier.

(2) Throughout this chapter, including in the tables and charts, the figures refer to cumulative four-quarter data, unless stated otherwise.

TABLE 5

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

% GDP

	NET FINANCIAL TRANSACTIONS								
	1996	1997	1998	1999	2000		2001		
					Q3	Q4	Q1	Q2	Q3
Total economy	1.2	1.6	0.5	-1.1	-2.3	-2.6	-2.3	-2.2	-2.0
Non-financial corporations and households and NPIs	5.1	4.0	1.9	-0.6	-2.5	-2.9	-3.0	-2.3	-2.4
Non-financial corporations	-0.1	-0.5	-1.3	-2.7	-3.7	-3.7	-4.2	-4.4	-4.3
Households and NPIs	5.2	4.5	3.3	2.1	1.2	0.8	1.3	2.1	2.0
Financial institutions	1.0	0.7	1.1	0.5	0.8	0.7	0.6	0.7	0.6
General government	-4.9	-3.2	-2.6	-1.1	-0.5	-0.3	0.0	-0.6	-0.3
	INTER-SECTORAL FLOWS (a)								
Households and NPIs	5.2	4.5	3.3	2.1	1.2	0.8	1.3	2.1	2.0
Vis-à-vis:									
Credit institutions (b)	-2.7	-6.7	-4.4	0.3	1.7	-0.2	-0.1	-0.2	-0.6
Institutional investors (c)	8.8	10.9	7.5	1.1	-0.7	0.4	1.0	1.8	3.0
Non-financial corporations	-0.1	-0.5	-1.3	-2.7	-3.7	-3.7	-4.2	-4.4	-4.3
Vis-à-vis:									
Credit institutions (b)	-0.3	-3.2	-4.3	-3.8	-5.6	-6.5	-5.8	-4.5	-4.4
Rest of the world	0.4	1.7	0.9	-0.7	-0.6	1.5	1.0	-0.3	0.0
General government	-4.9	-3.2	-2.6	-1.1	-0.5	-0.3	0.0	-0.6	-0.3
Vis-à-vis:									
Credit institutions (b)	-0.4	1.4	1.4	1.4	1.3	2.2	0.3	-0.5	-1.0
Institutional investors (c)	-5.9	-3.9	-2.6	1.7	3.5	3.5	3.8	3.6	2.8
Rest of the world	-0.2	-2.0	-1.1	-4.3	-4.7	-6.1	-4.9	-4.6	-3.3
Rest of the world	-1.2	-1.6	-0.5	1.1	2.3	2.6	2.3	2.2	2.0
Vis-à-vis:									
Credit institutions (b)	0.9	2.8	7.1	2.0	3.6	5.4	5.8	3.7	4.6
Institutional investors (c)	-0.9	-2.5	-6.3	-3.5	-4.4	-5.7	-5.5	-5.2	-5.0
Non-financial corporations	-0.4	-1.7	-0.9	0.7	0.6	-1.5	-1.0	0.3	0.0
General government	0.2	2.0	1.1	4.3	4.7	6.1	4.9	4.6	3.3

Source: Banco de España.

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

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

(c) Insurance corporations and collective investment undertakings.

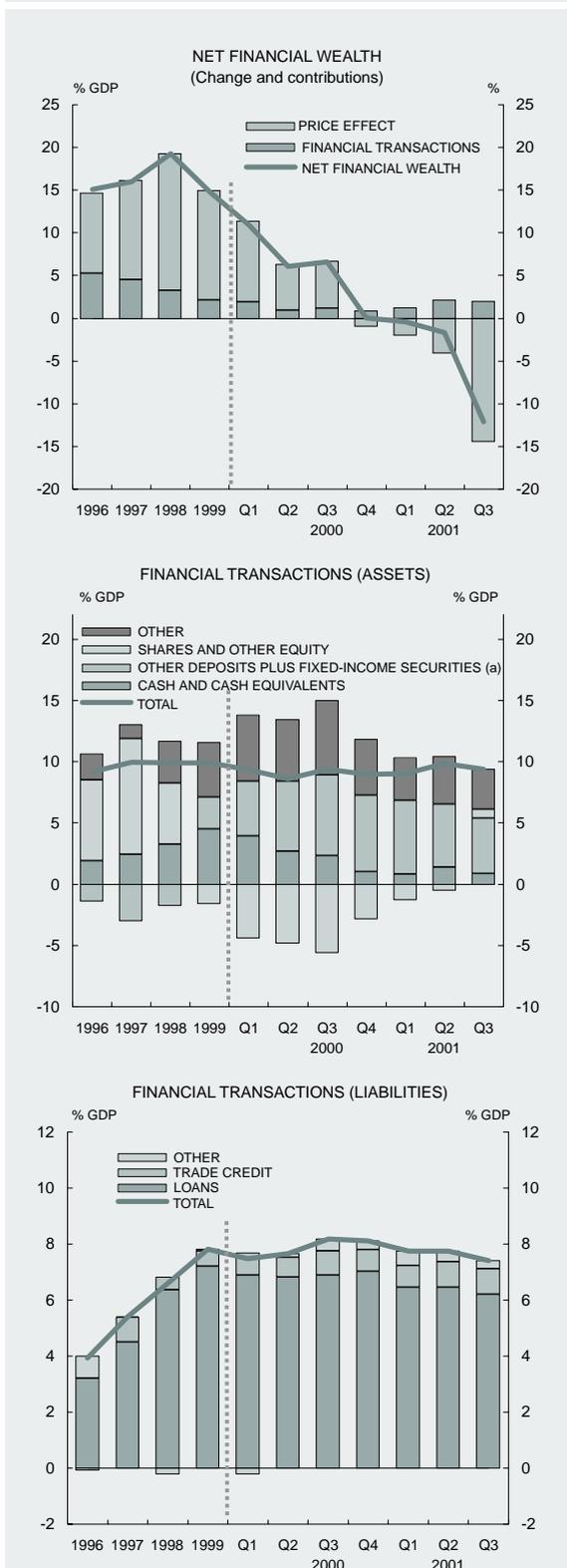
5.2. Financial flows of households

Between July and September 2001, the investment by households in financial assets exceeded the financing they received by 0.8% of GDP. Accordingly, the positive balance on their financial transactions remained on the path of recovery followed since the beginning of the year, to stand, in cumulative four-quarter terms, at 2% of GDP (see Table 5). However, a certain slowdown was discerned in the recovery of saving, which seems to have had its counterpart in relatively buoyant consumption, given the current cyclical position of the Spanish economy.

The recovery in household saving is occurring amid a decline in financial wealth that began in 2000 and that has been relatively steep, owing to the increasing exposure of households in recent years to changes in the prices of the most risky assets. Thus, the reduction in the value of the net financial assets of households (the so-called "price effect" in Chart 23) intensified after the terrorist attacks of 11 September, amounting to more than 14% of GDP over the last four available quarters. Although the immediate reaction of the prices of assets quoted on financial markets following the attacks has largely been corrected, the cumulative losses

CHART 23

**Households and NPIs
(Cumulative four-quarter data)**



Source: Banco de España.

(a) Not including unpaid accrued interest, which is included under "other".

are still significant, especially given the climate of greater economic weakness and uncertainty.

Household investment in financial assets fell slightly during Q3, to stand at 9.4% of GDP (see Table 6 and Chart 23), while saving in the form of cash and cash equivalents declined to 0.8% of GDP, as compared with 1.4% in the previous quarter. This lower investment in more liquid assets was due to the fall in the demand for cash, which was not offset by greater investment in sight and savings deposits, although it does seem to have resulted in an increase in time deposits and, especially, in shares in money market funds (FIAMM). Thus, time deposits continued to grow at rates of more than 20%, although within the trend slowdown that commenced in late 2000, while investment in FIAMM, which was negative between 1998 and 2000, represented 0.8% of GDP during the last four available quarters.

As regards borrowing transactions, the trend of previous quarters continued to hold in Q3. The financing received by households amounted to 7.4% of GDP (7.7% in the first two quarters of 2001, as seen in Table 6), its annual growth rate decelerating from 15% in the previous quarter to 14% (see the memorandum item of Table 6). Credit granted by resident institutions, the main source of household financing, amounted to 5.8% of GDP, compared with 6.3% in the previous quarter. This deceleration did not entirely translate into lower household debt, since some of the loans removed from bank balance sheets (mainly mortgage loans) were not repaid, but transferred to other agents through securitisation (see Box 5).

The information available on its distribution by purpose indicates that the deceleration in the financing granted by resident institutions was particularly marked in the case of loans for house purchase, although they continued to grow at high annual rates: 19.8%, as against 22.4% in the previous quarter. Meanwhile, consumer finance continued to accelerate, to reach an annual growth rate of more than 25%. This was consistent with the relative strength of consumption, especially of durable goods.

The provisional information on the financial flows of the Spanish economy during 2001 Q4 points to continuity in the previously identified trends (3) (see Chart 24). On the financing side, the slowdown in loans from resident institutions continued. As for investment in financial assets,

(3) Note that these indicators provide aggregate information on the sectors households and non-financial corporations, so that the conclusions on the trends in household transactions must be interpreted with due caution.

TABLE 6

**Financial assets and liabilities of households, NPIs and non-financial corporations
(Cumulative data for the last four quarters)**

% GDP

	1998	1999	2000	2001		
				Q1	Q2	Q3
HOUSEHOLDS AND NPIs:						
Financial transactions (assets)	9.9	9.9	9.0	9.0	9.9	9.4
Cash and cash equivalents	3.2	4.5	1.0	0.8	1.4	0.8
Other deposits and fixed-income securities (a)	-1.8	2.6	6.2	6.1	5.1	4.5
Shares and other equity (b)	0.0	0.2	0.7	0.9	0.6	0.8
Mutual funds	5.0	-1.8	-3.6	-2.3	-1.2	-0.1
<i>FIAMM</i>	-1.1	-1.4	-1.3	-0.5	0.1	0.8
<i>FIM</i>	6.2	-0.5	-2.3	-1.8	-1.3	-0.9
Insurance technical reserves	2.5	3.3	3.5	2.6	2.6	2.5
Of which:						
<i>Life assurance</i>	1.3	2.1	2.1	1.3	1.2	1.0
<i>Pension funds</i>	1.0	0.9	1.1	1.0	1.1	1.2
Other	0.9	1.2	1.1	0.8	1.4	0.8
Financial transactions (liabilities)	6.6	7.8	8.1	7.7	7.7	7.4
Credit from resident credit institutions	5.9	6.5	6.8	6.3	6.3	5.8
Securitisation funds	0.5	0.6	0.1	0.1	0.0	0.2
Other	0.3	0.7	1.1	1.4	1.4	1.4
NON-FINANCIAL CORPORATIONS:						
Financial transactions (assets)	14.1	18.0	27.5	25.8	25.0	19.1
Cash and cash equivalents	1.5	0.7	0.9	0.3	0.6	0.7
Other deposits and fixed-income securities (a)	0.2	-0.1	0.9	1.3	0.8	-0.2
Shares and other equity	3.1	8.3	13.9	13.7	11.9	8.2
Of which:						
<i>Vis-à-vis rest of the world</i>	2.2	6.4	10.8	10.3	9.4	7.6
Other	9.3	9.1	11.7	10.6	11.8	10.3
Financial transactions (liabilities)	15.4	20.7	31.2	30.0	29.4	23.4
Credit from resident credit institutions	4.7	4.9	6.7	5.4	5.5	5.3
Securitisation funds	0.2	0.4	1.0	0.9	0.6	0.7
Foreign loans	1.6	3.0	3.3	4.0	4.2	2.6
Debt securities (a)	0.0	0.5	-0.5	-0.1	-0.2	-0.1
Shares and other equity	2.7	5.3	12.3	12.5	11.6	7.5
Other	6.3	6.6	8.2	7.2	7.7	7.3
MEMORANDUM ITEM: YEAR-ON-YEAR GROWTH RATES (%):						
Financing (c)	16.7	19.5	18.9	17.4	16.7	14.5
Households and NPIs	19.3	19.6	17.3	15.5	15.0	14.0
Non-financial corporations	14.7	19.5	20.1	18.9	18.0	14.8

Source: Banco de España.

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

(b) Not including mutual funds.

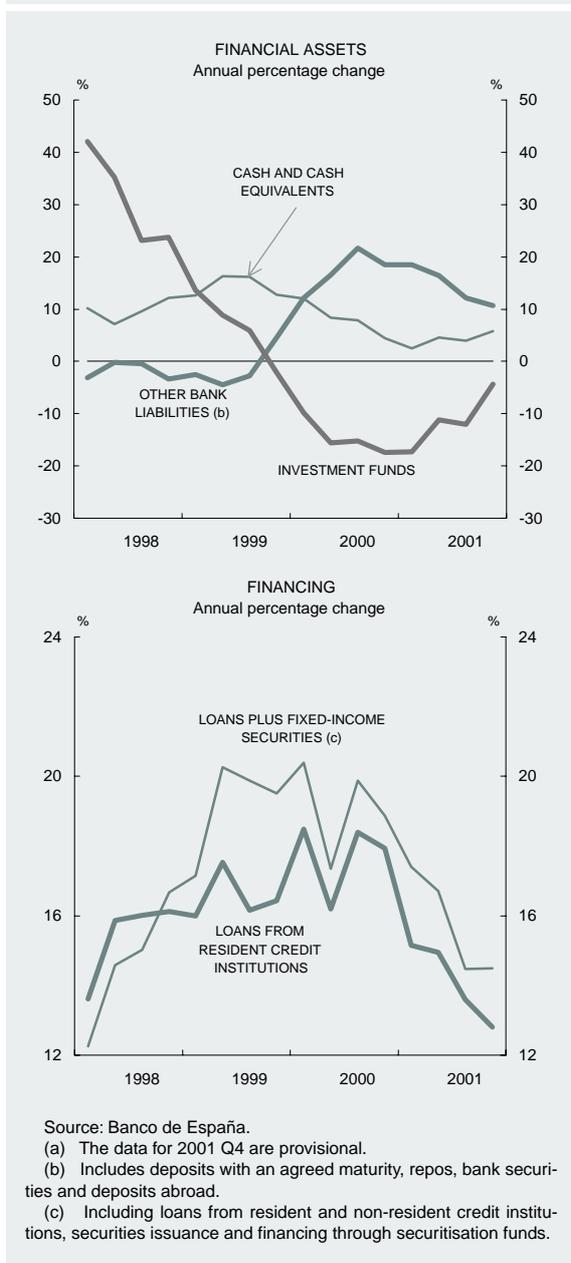
(c) Including bank credit extended by resident credit institutions, foreign loans, debt securities and financing through securitisation funds.

there was a recovery in cash and cash equivalents, since the intensification of the fall in cash seems to have been offset by a significant increase in investment in sight and saving deposits. The rate of growth of time deposits continued to slow, while investment in money market funds increased again.

It should be noted, finally, that the balance sheet position of households at the end of Q3 was adversely affected by the significant loss of financial wealth entailed by the decline in share prices. Thus, although the level of debt relative to GDP and relative to the value of their holdings of more liquid and less risky assets was stable,

CHART 24

**Non-financial corporations.
Households and NPIs (a)**



standing at 49% and 46% respectively (see Chart 25), household debt increased significantly when measured in terms of the total value of their financial assets. Specifically, the ratio of debt to total financial assets of households rose to 29.1%, up from 27.3% in the previous quarter.

5.3. Financial flows of non-financial corporations

In 2001 Q3, the balance of the financial transactions of non-financial corporations was -1.8% of GDP. In cumulative four-quarter terms,

their net financial requirements amounted to 4.3% of GDP, as against 4.4% in the previous quarter (see Table 5). Since the beginning of 2001 the financing gap of this sector, that is to say the financial resources needed to finance its domestic and foreign investment (see Chart 26), has been gradually narrowing. Accordingly, the worsening over the year of the balance of its financial transactions may be related to a reduced capacity to generate resources and to finance itself, against a background of less buoyant economic activity.

The acquisition of financial assets and liabilities was significantly lower in Q3 than in the same quarter of 2000. That year some large-scale financial transactions were executed, linked to the purchase of foreign companies and the financing of UMTS licences (see Chart 26 and Table 6).

Net corporate investment in financial assets amounted to 19.1% of GDP in 2001 Q3, down from 20% in the previous quarter. This reduction was particularly apparent in the acquisition of shares and other equity abroad (7.6% of GDP, as against 9.4% in the previous quarter). However, the volume of credit extended to the rest of the world held relatively steady as a consequence of the level reached by investment abroad. In comparison with other financial assets (see Table 6), the growing profile of investment in cash and cash equivalents should be noted, although their value is relatively small. This may partly reflect a higher preference for less risky financial assets against a background of growing uncertainty.

On the liabilities side, the reduction in flows was also notable, although somewhat smaller than in the case of assets. The accumulation of liabilities in 2001 Q3 represented 23.4% of GDP, down from 29.4% in the previous quarter. This reduction was particularly sharp in the case of share issuance, which fell from 11.6% of GDP in 2001 Q2 to 7.5%. Loans received from abroad also declined, although to a lesser extent (from 4.2% of GDP to 2.6%). It should be noted that in 2000 Q3 there was a large flow of foreign financing associated with the purchase of UMTS licences (4). In the year to date, the net financing raised through loans from abroad has been larger than that received through the issuance of shares, which may be explained at least partly by the adverse trend in share prices.

The volume of credit granted by resident institutions continued to slow, albeit gradually.

(4) The figures in the tables are cumulative data for the latest four quarters.

Recent developments in securitisation in Spain

Securitisation is a financial process that involves transforming any non-marketable asset capable of generating a stream of income into a marketable security. An independent institution (known as a securitisation fund) acquires the assets from the entity transferring them and issues securities (asset-backed bonds) against them. These bonds are normally standard debt securities and, most importantly, are marketable on organised markets. In the case of the "off-balance-sheet" variety of securitisation, the asset transferred is removed from the balance sheet of the transferring entity (a) and the credit risk is transferred to the bondholder. Securitisation incorporates in its design elements of credit improvement, which means that asset-backed bonds enjoy a higher credit rating than their underlying assets (b). Until 1998, securitisation regulations only provided for "mortgage securitisation", i.e. the securitisation of credit or loans secured by mortgage. That year, the securitisation of other non-mortgage assets was regulated, opening the way for financial and non-financial corporations to securitise all their assets, including future creditors' rights (c).

As seen in Chart 1, securitisation (in its off-balance-sheet form) has, in recent years, grown very considerably in Spain. In 2001, total outstanding asset-backed bonds exceeded EUR 21,000 million (excluding those arising from the nuclear moratorium). Similarly notable has been the growth of securitisation of non-mortgage assets. In 2000, 82% of securitisation involved the issuance of non-mortgage assets, while in 2001 the proportion was 70%. Also, new kinds of securitised credit have appeared, such as consumer credit and credit to small and medium-sized businesses, through a type of fund known as FTPyme (d), although the volume of these new forms is still negligible.

Outstanding securitisation is still small compared to government debt and other private fixed-income. However its recent development, as seen in Chart 2, has been very significant, relative to other alternative sources of financing for households and non-financial corporations. This expansion must be seen against a background characterised, on one hand, by an increase in net borrowing by banks, as a consequence of the strong demand for credit (mainly mortgage loans) and the more moderate growth in their deposits and, on the other, by increasing competition in banking, which has squeezed margins and made commission income relatively more important. In this setting, securitisation offers a new source of financing for banks, while enabling them to maintain their commission income and their relationship with customers, since very often the transferor entity remains responsible for the administration and management of the loans transferred until maturity (which in the case of mortgages is usually in the long term). Also, off-balance-sheet securitisation enables credit institutions to reduce their capital requirements.

Asset securitisation, especially in Spain, is conducive to the development of financial markets. It should be recalled that in recent years there has been high growth in the demand for securities, as a result of greater institutional investment, while the outstanding balance of public debt has been falling. Considering the traditional dependence of Spanish corporations on bank finance, securitisation offers possibly the most promising way of increasing, at least in the short term, the size and liquidity of the domestic private fixed-income markets. Thus, the potential for growth of securitisation in Spain is high, as is also clear from its current level relative to other European countries.

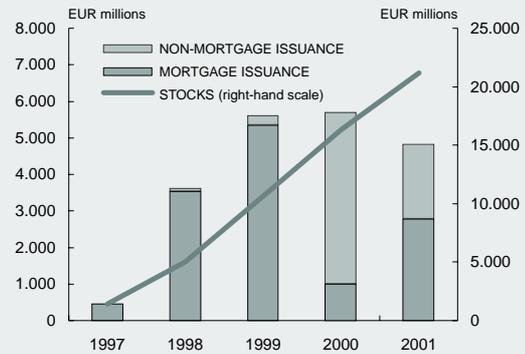
(a) There is also another form of securitisation known as "on-balance-sheet" securitisation. Here it is the entity holding the assets itself that issues securities backed by such assets (e.g. trade credit). The risk of non-payment on the underlying asset is not transferred to the holder of the security and the securitising entity keeps on its balance sheet both the asset and the liability issued. This form has also grown significantly in Spain in recent years. In particular, in 2001, a group of small and medium-sized savings banks issued a large volume of special mortgage-backed certificates (EUR 4,500 billion), which they then transferred to an asset securitisation fund.

(b) One of the most common elements of improvement is subordination, which involves delaying payment on one series (the subordinated series) or making it subject to payment on another series (the senior series). Subordination may be limited to the principal or may also include the interest.

(c) Royal Decree 926/1998 of 14 May 1998 regulating asset securitisation funds.

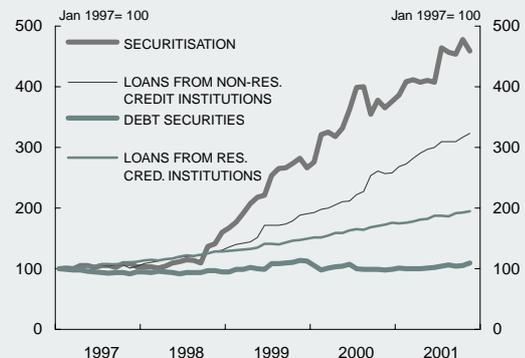
(d) A Ministerial Order of 28 May 1999 lays down the regime and content of the promotion agreements that the Ministry of Economy and Finance can sign with asset-securitisation-fund management companies for the promotion of an asset securitisation fund, under the trade name "FTPyme".

CHART 1
Asset-backed bonds:
Stocks and annual net issuance (a)



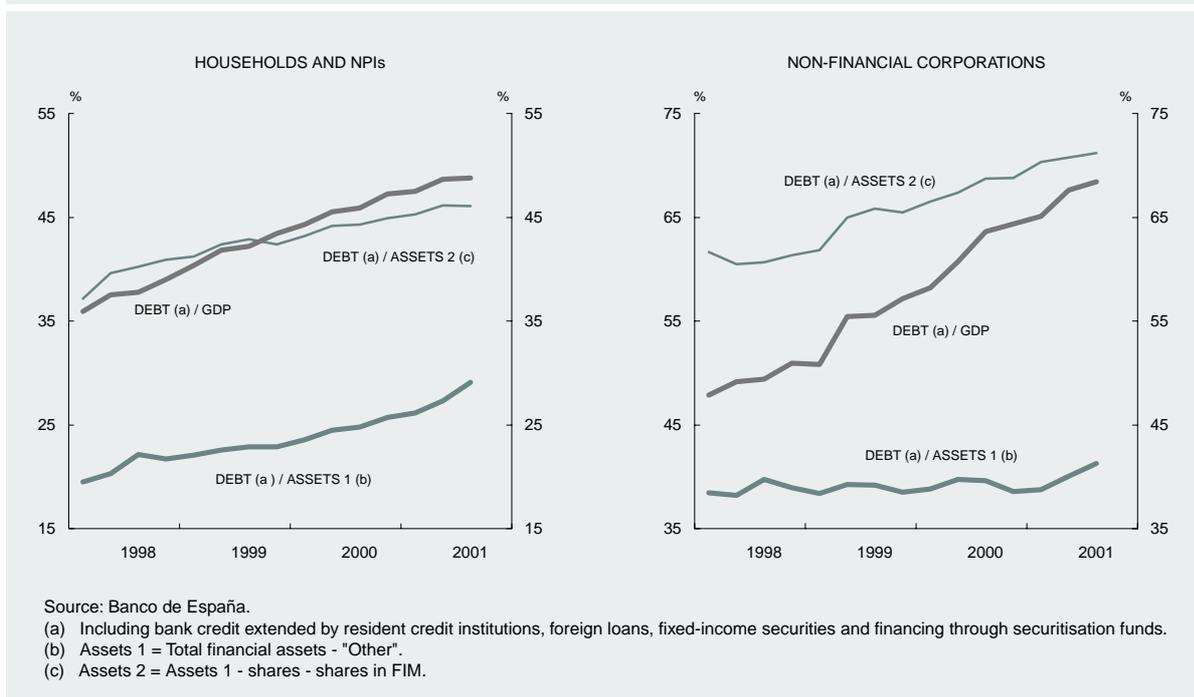
Source: Banco de España.
(a) Excluding nuclear moratorium stocks and the special mortgage certificates mentioned in note (a) to the text of this box.

CHART 2
Financing of households and non-financial corporations in Spain



Source: Banco de España.

Debt ratios



According to the information on the distribution of credit by type, the slowdown was concentrated, in-line with events during the year, in the services sector and construction. The rate of growth of credit to the services sector, which represents over 50% of all credit to productive activities, fell to 11.1% in 2001 Q3 (from rates of 20% in late 2000). Credit to construction, meanwhile, slowed to 9.1% in Q3 (from rates of more than 20% in 2000).

These developments in the liabilities of corporations entailed a further slowdown in total financing received, the year-on-year growth of which stood at 14.8%, as against 18% in the previous quarter (see the memorandum item of Table 6). The provisional information on 2001 Q4 points to continuity in the patterns observed in Q3, albeit with a certain recovery in the financing raised through the issuance of debt securities.

The volume of financing received by non-financial corporations translated into a further increase in their debt ratios, especially in relation to the value of more risky assets, whose prices fell significantly after the attacks of 11 September. The level of debt of non-financial corporations (in the form of credit from resident banks, foreign loans, debt securities and financing through securitisation funds) stood at 68.4% of GDP and 71.2% of their more risky financial assets.

5.4. General government financial flows

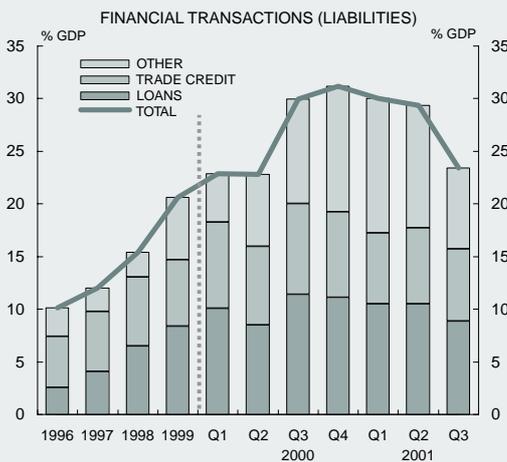
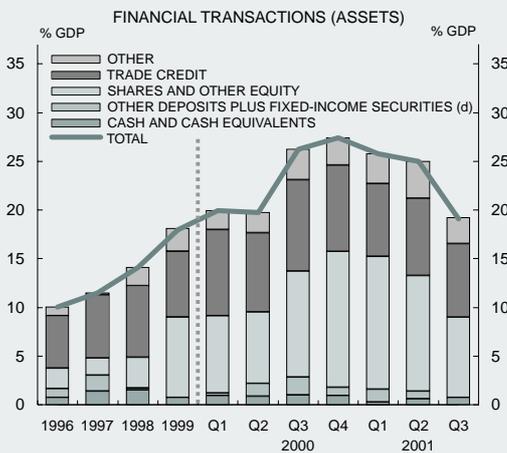
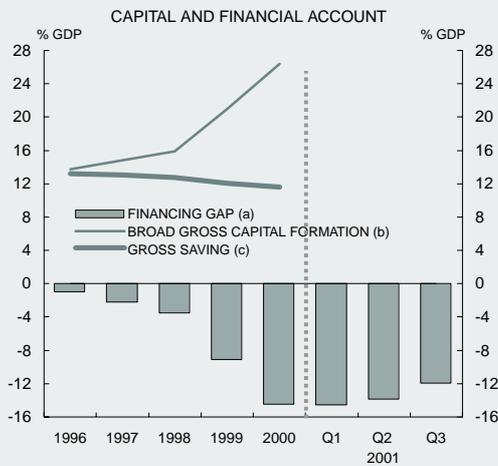
The balance of the financial transactions of general government was slightly positive during 2001 Q3 (see Chart 27). In cumulative four-quarter terms this entailed a reduction of 0.3 percentage points in its net borrowing, to -0.3% of GDP.

During Q3, general government net issuance of long-term securities amounted to EUR 5 billion, which was mostly acquired by non-residents, with the result that external financing increased by EUR 3.8 billion. Some of the funds raised through this issuance were used to reduce the net financing received through the issuance of short-term securities and loans by EUR 2.9 billion and EUR 0.8 billion respectively. At the same time, general government reduced the deposits held with credit institutions by EUR 3.9 billion, of which EUR 2.8 billion was associated with Treasury liquidity tenders.

Provisional Q4 data point to continuity in the net issuance of long-term securities and redemption of Treasury bills and loans. At the same time, some of the funds obtained were in the form of an increase in the deposits held with credit institutions, so that the *financial requirements*, an indicator of general government's recourse to the financial markets, which approximates the sector's saving, increased in the final quarter of the year (see Chart 27). Significantly,

CHART 26

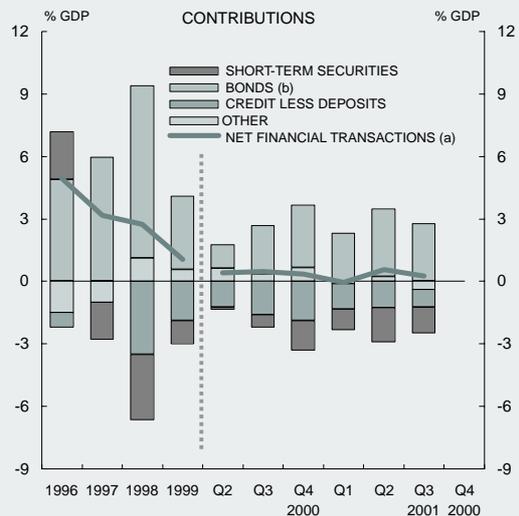
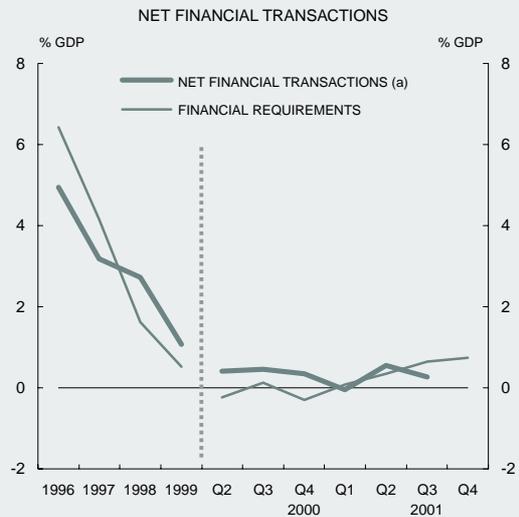
**Non-financial corporations
(Cumulative four-quarter data)**



Source: Banco de España.
 (a) Financial resources that cover the gap between real and permanent financial investment and gross saving.
 (b) Including gross capital formation, stockbuilding and foreign equities.
 (c) Including capital transfers.
 (d) Not including unpaid accrued interest, which is included under "other".

CHART 27

**General Government
(Cumulative four-quarter data)**



Source: Banco de España.
 (a) Sign changed.
 (b) Not including unpaid accrued interest, which is included under other.

in December, Moody's raised its credit rating for Spanish public debt to the top grade, which will entail a reduction in the cost of finance for general government (see Box 6).

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

The balance of the financial transactions of the nation during 2001 Q3 was somewhat less negative than in the same quarter a year earlier, standing at -2% of GDP (see Table 7). The rate of acquisition of external financial assets and liabilities had been falling over the year, owing firstly to the absence of extraordinary

TABLE 7

**Financial transactions of the nation
(Cumulative data for the last four quarters)**

% GDP

	1998	1999	2000	2001		
				Q1	Q2	Q3
Net financial transactions	0.5	-1.1	-2.6	-2.3	-2.2	-2.0
Financial transactions (assets)	12.3	15.0	24.3	25.2	23.2	16.2
Gold and SDRs	0.0	-0.2	0.0	0.0	0.0	0.0
Cash and deposits	3.2	1.8	2.8	3.7	2.7	-0.4
Credit system	0.0	3.7	2.6	3.0	2.0	-0.5
Other resident sectors	3.2	-1.9	0.2	0.7	0.6	0.1
Securities other than shares	3.4	2.8	3.8	5.3	6.6	5.7
Credit system	-1.4	-0.9	-0.3	0.4	1.8	1.0
Other resident sectors	4.7	3.7	4.1	4.8	4.9	4.8
Shares and other equity	4.3	9.8	15.1	13.2	10.9	8.1
Credit system	0.4	0.7	1.7	1.4	0.6	0.3
Other resident sectors	3.9	9.0	13.3	11.8	10.2	7.8
Of which:						
Non-financial corporations	2.2	6.4	10.8	10.3	9.4	7.6
Loans	1.4	0.8	2.6	3.0	3.1	2.7
Credit system	0.2	-0.2	0.5	0.6	0.6	0.7
Other resident sectors	1.2	0.9	2.1	2.3	2.4	2.0
Financial transactions (liabilities)	11.8	16.1	26.8	27.5	25.4	18.2
Deposits	5.9	4.2	7.3	8.7	6.7	5.0
Of which:						
Credit system	5.9	4.1	7.2	8.7	6.6	4.9
Debt securities issued	1.0	5.4	7.1	6.0	5.8	4.1
Credit system	0.2	0.9	0.8	0.7	0.8	0.7
General government	1.0	4.3	5.8	4.8	4.4	3.0
Other resident sectors	-0.2	0.2	0.5	0.4	0.5	0.4
Shares and other equity	2.9	3.9	8.9	8.9	8.6	6.1
Credit system	0.1	0.3	1.6	1.5	1.1	0.4
Other resident sectors	2.8	3.6	7.3	7.5	7.5	5.7
Loans	2.2	3.8	4.3	4.9	5.2	3.5
General government	0.1	0.0	0.1	0.1	0.0	0.1
Other resident sectors	2.1	3.7	4.2	4.9	5.2	3.4
Other, net (a)	-0.2	-1.2	-0.8	-1.0	-0.8	-0.5

Source: Banco de España.

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

transactions like those in 2000, linked to the strategic purchases of foreign businesses. Secondly, the reduction in the financial flows with the rest of the world also seems to have been related to the greater uncertainty and weakness of the world's main economies, to the military conflict engendered by the terrorist attacks and to the worsening of the economic and political crisis in Argentina.

Investment in financial instruments issued by non-residents fell gradually over the year. In Q3 the value of net investment abroad amounted to 16.2% of GDP, as against 25.2% and 23.2%, respectively, in Q1 and Q2. The largest flows of investment, 8.1% of GDP in net terms, were used to purchase *shares and other equity*, and continue to be primarily related to permanent investment by the non-financial private sector. As

The raising of the credit rating for Spanish sovereign debt

The yield spread of Spanish long-term sovereign debt over German debt has been falling in recent years (see Chart 1). Between early 1995 and end-2001 it fell from over 500 basis points (b.p.) to around 20 b.p. The two main factors explaining this change are, first, the reduction in exchange rate risk, and its subsequent elimination with the commencement of Stage Three of EMU, and second, the lower credit risk on Spanish debt associated with the improvement in macroeconomic conditions in the Spanish economy and fiscal consolidation.

Against this background, on 13 December 2001, Moody's decided to raise the credit rating assigned to the long-term debt issued by the Spanish Treasury to the highest score (a rise of two grades). This rating is awarded to a small number of sovereign issuers (14, in the case of long-term issues in foreign currency) (a). As is well known, the debt issued by sovereign states is, like certain private issues of debt securities, subject to rating by rating agencies, which assess the creditworthiness of the issuers and assigns them a score based on certain criteria.

To illustrate the importance of credit ratings in the determination of the interest rates issuers have to pay, Chart 2 shows the average yield, in November 2001, on the 10-year benchmark issues of euro-area sovereign states, according to categories based on the credit ratings of Moody's and Standard & Poor's (b). The first category includes the highest rated benchmarks, while the lowest rated issues are in the seventh category (c). This chart reveals a clear relationship between ratings and yields, which suggests that the former are an important determinant of interest rates. Specifically, it can be seen that a one-category improvement in credit rating entails, on average, a four-basis-point fall in the yield (straight line). Obviously this is not the only determinant of negotiated interest rates, as shown by the significant differences in the yields between debt issues with a similar rating, especially in the first category.

Although the information used by the agencies to assess issues is basically public, announcements of changes in ratings usually have an impact on negotiated interest rates, insofar as they reinforce the market's perceptions of issuers' creditworthiness. In the case of Spanish debt, in the days following the announcement by Moody's of its decision to raise its rating, there was a reduction in the long-term yield spreads over the other issues of euro-area sovereign states with a similar maturity. For example, the spreads on the Spanish 10-year benchmark fell by an average of four basis points. The largest declines were seen in the spreads over the issues with the lowest yields and highest ratings, such as German debt (7-10 b.p.). These movements are in line with the relationship between interest rates and credit rating seen in Chart 2. In fact, in terms of this chart, the Moody's decision meant that Spanish debt moved from category 4 to category 2, with a reduction in the expected yield of some 8 b.p.

The reduction in the rates negotiated for Spanish debt as a result of the improvement in its credit rating will mean reduced interest charges for the Treasury over the coming years assuming, as seems likely, that this effect proves to be lasting.

(a) Standard & Poor's has not, as yet, revised the rating of Spanish debt, which it is still rating at the second highest level.
 (b) Probably the two agencies with the highest reputation.
 (c) Specifically, categories 1, 3 and 5 include the issues that receive, respectively, the first, second and third best ratings from both agencies. The even categories include issues with different ratings from each agency. For example, those of category 2 are those that receive the highest rating from one agency and the second highest from the other. Finally, category 7 includes the debt with the lowest rating.

CHART 1
Yield spread between Spanish and German 10-year sovereign bonds

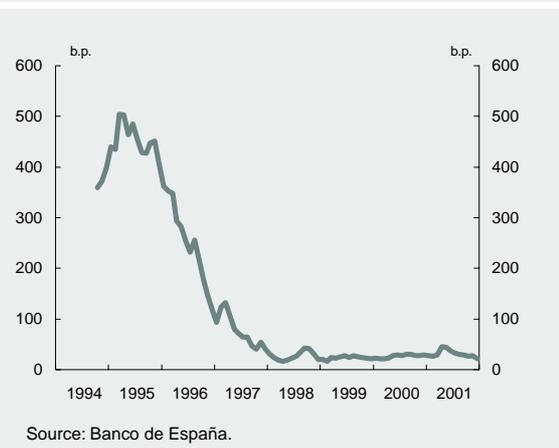


CHART 2
Yields on 10-year sovereign bonds and credit ratings

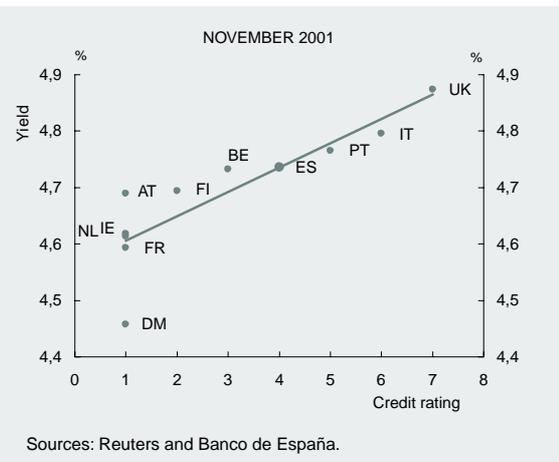


TABLE 8

**Net financial assets vis-à-vis the rest of the world (a)
(Q4 data)**

% GDP

	1996	1997	1998	1999	2000	2001 (b)
Total economy	-19.7	-20.6	-21.4	-22.8	-22.2	-21.4
Non-financial corporations and households and NPIs	-13.3	-10.8	-8.6	-9.3	-2.6	0.3
Non-financial corporations	-18.3	-17.1	-14.8	-16.9	-10.4	-7.6
Households and NPIs	5.0	6.3	6.2	7.7	7.9	7.9
Financial institutions	8.8	7.2	5.1	7.0	5.2	3.7
Credit institutions (c)	6.7	2.4	-5.4	-7.5	-12.5	-14.2
Institutional investors (d)	2.2	4.9	10.9	15.1	18.5	19.2
Other financial institutions	-0.1	-0.1	-0.4	-0.6	-0.8	-1.3
General government	-15.3	-17.0	-17.9	-20.5	-24.8	-25.4

Source: Banco de España.
(a) Calculated as the difference between the stock of financial assets and liabilities vis-à-vis the rest of the world according to quarterly financial accounts data.
(b) Q3 data.
(c) Defined according to the First Banking Directive.
(d) Insurance corporations and collective investment undertakings.

a consequence of this investment, the credit extended abroad by other resident sectors held at levels of around 2% of GDP.

The volume of liabilities accumulated vis-à-vis the rest of the world decelerated noticeably. In Q3, the net financing received from abroad represented 18.2% of GDP, as against 27.5% and 25.4% in Q1 and Q2 respectively. This reduction in funds raised was particularly notable in the case of non-financial corporations. General government, by contrast, obtained more financing through the placement of public debt abroad than in the first two quarters (although it was still less than in 1999 and 2000).

Provisional balance-of-payments information for October shows net capital inflows in all resident sectors. The flows of direct investment were very subdued and portfolio investment was concentrated in the acquisition of bonds, against a background of great uncertainty on

stock markets. Also, there was an especially large capital inflow in the form of long-term loans to the non-financial private sector.

As a result of these transactions and of the path of the exchange rate and of financial asset prices, the net external debit position of the national economy improved, to stand at -21.4% of GDP (see Table 8). The value of the net external financial assets of the non-financial private sector increased considerably and turned positive, owing to the improvement in the position of non-financial corporations. Institutional investors saw the value of their net external assets fall, although it remained higher than at the end of 2000. Finally, there was also an improvement in the position of credit institutions and general government, although these positions were still worse than in 2000.

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