

---

# Quarterly report on the Spanish economy

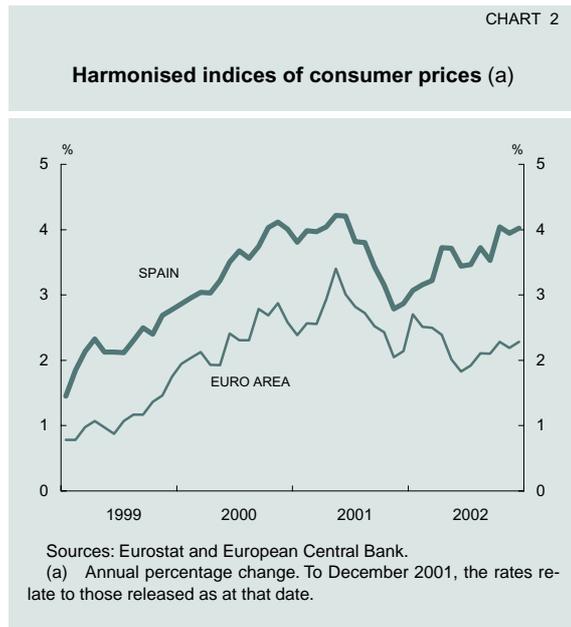
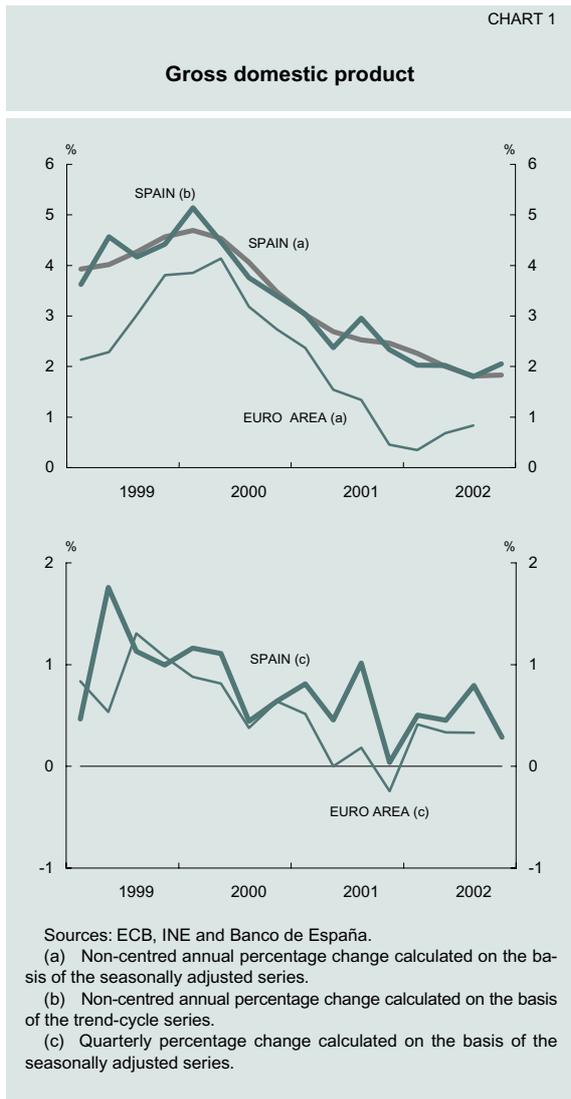
## 1. Overview

The year 2002 ended without the numerous sources of uncertainty influencing global economic developments having been dispelled. Geopolitical tension and the failure to correct some of the basic imbalances besetting certain economies mean that the conditions needed to set a sustained recovery in train are not yet in place. In these circumstances, the principal impulses have arisen from the implementation of clearly expansionary macroeconomic policies which, to date, have not fuelled relevant inflationary pressures in the main regions where, with very few exceptions, growth is running far below potential.

Against this international background, the Spanish economy performed comparatively favourably last year. On Banco de España forecasts, real GDP growth in 2002 on average was 2%, down on the previous year (2.7%) but far higher than the figure expected for the euro area as a whole (below 1%). As a result, Spain's real convergence towards the EU core has continued. The rise in employment for the year will be around 1.3%, although the unemployment rate has climbed to almost 11.5% and productivity in the economy will have picked up. The least favourable result has been on the prices front. The twelve-month growth rate of the harmonised index of consumer prices (HICP) was 4% in December, placing the differential with the euro area at 1.7 percentage points (1.4 points on average for the year). Finally, the general government accounts have closed the year with a modest deficit of only 0.2% of nominal GDP, and it is estimated that the fiscal policy stance has been virtually neutral.

Taking into account the preliminary INE data for the first three quarters of 2002, the above-mentioned estimated annual increase in GDP is the outcome of growth of 2.1% year-on-year in Q4, in terms of the seasonally adjusted series, compared with 1.8% in Q3. The quarter-on-quarter rate, influenced by the short-term volatility of the seasonally adjusted series, would have been around 0.3%, against 0.8% the previous quarter. In any event, moving beyond the fluctuations proper to quarter-on-quarter rates calculated using the seasonally adjusted series, Chart 1 shows that the Spanish economy held at a modest but sustained growth rate throughout 2002, moving on a mildly slowing trend that appears to have eased in the closing months of the year.

Although the events in recent months have not contributed to improving growth expectations for the world economy, most analysts hold by the central growth scenario outlined for the year 2003, albeit accentuating the downside risks. Expectations of recovery continue to



hinge largely on developments in the US economy, since the most buoyant regions (the emerging Asian and eastern European economies) are not of sufficient weight to significantly affect the growth of international markets. And neither Japan (which shows no firm expectations of emerging from the prevailing crisis) nor the European Union (greatly affected by the adverse results of certain countries) may be seen, for the time being, as sound alternatives to the US recovery. Finally, leaving aside the problems in Venezuela, and despite the fact growth expectations for the region as a whole in 2003 remain very moderate, recent events in certain Latin American countries pave the way for the onset of an improvement. This is particularly the case with the reduction of the spread on Brazilian debt, following the formation of a new government, and the greater stability the Argentine economy appears to be showing.

Recent data on the US economy are contradictory and the outlook remains overshadowed

by the depressive effects arising from uncertainty over how the situation in the Middle East will unfold. Further, the failure to correct some of the imbalances generated during the previous long upturn, especially the shortfall in private saving, might heighten the fragility of the incipient recovery, which is basically underpinned by the impact of monetary and fiscal expansion on consumption, with investment having remained lacklustre.

Economic activity in the euro area in recent months has been characterised by its slow and hesitant pace. Growth projections have been scaled back as a result of the risks associated with the international setting (the outbreak of war) and dearer oil prices. The latest figures reveal something of a change on the previous months, as consumer confidence has worsened while business confidence has improved, the latter owing perhaps to a slight pick-up in exports, the continuation of which has yet to be confirmed. A quarter-on-quarter increase in real GDP for the euro area as a whole similar to that in recent quarters is expected for 2002 Q4. And this, given the poor result in 2001 Q4, will raise the year-on-year rate to over 1% (owing to a simple statistical effect), although the annual average rate will be below this figure.

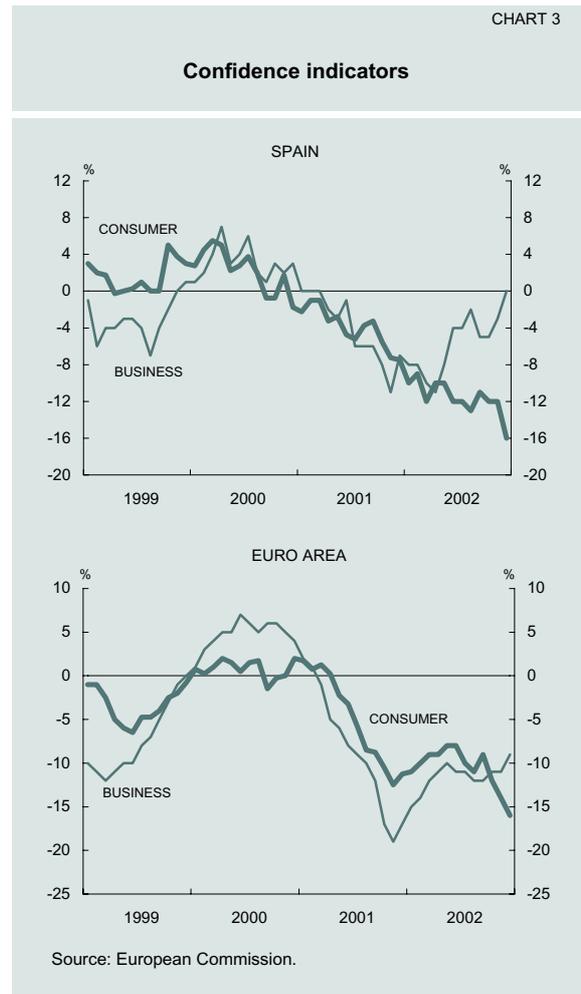
The sluggishness of demand and the appreciation of the euro contributed to easing inflationary pressures in the closing months of 2002, placing the rate of increase of the euro area HICP at 2.3% in December. These factors will continue to bear favourably on prices in the coming months, depending on the path of oil prices. Taking a medium-term view, the moderation of unit labour costs must continue, based

not only on higher productivity gains (as in recent months) but also on a greater containment of wage increases.

Monetary conditions in the euro area held relatively stable in the closing months of 2002 and early 2003, since the cut in official interest rates in December (the only decision to alter rates taken last year) has been more or less offset by the appreciation of the euro. While financial conditions have not worsened, the continuing relatively high risk premia on private debt and the past declines still weighing down stock prices have made financing for agents, especially corporations, difficult. Reflecting these factors has been the ongoing slowdown in credit to the private sector, the year-on-year growth rate of which stood at around 4.5% at the end of 2002. As will be seen, this is not the case of the Spanish economy where the growth of credit to the non-financial private sector has remained very high. Moreover, although uncertainty has also been the keynote of Spanish financial markets in recent months, developments have proven relatively more favourable than in the preceding quarters. Indeed, stock market prices in Spain have performed similarly to those in the United States, improving the results on European markets.

In the fiscal policy realm, the euro area budget deficit widened to 2.2% of GDP in 2002. The deterioration in the overall budgetary position has largely been due to the impact of the cyclical slowdown. But analysis of the positions in the various countries shows that the current results are the outcome of their different starting positions in 2000. In those countries where a balanced budget had been attained, the recent deterioration is indicative, above all, of the operation of the automatic stabilisers. In those other members where structural imbalances were not corrected at the top of the cycle, the current phase of low growth has seriously exacerbated their budgetary position, placing them in a very delicate situation in terms of compliance with the requirements laid down in the Treaty and in the Stability and Growth Pact. Indeed, two countries – Portugal and Germany – have seen the Excessive Deficit Procedure applied, and another Member State – France – has been warned not to let its budget deficit exceed 3% in 2003. Against this background, the European Commission has formulated various proposals to reinforce the Stability and Growth Pact and the co-ordination of fiscal policies in the EU, which will be discussed in the coming months by the Council.

The monetary conditions laid down for the euro area countries last year proved too generous for the Spanish economy, which was experi-

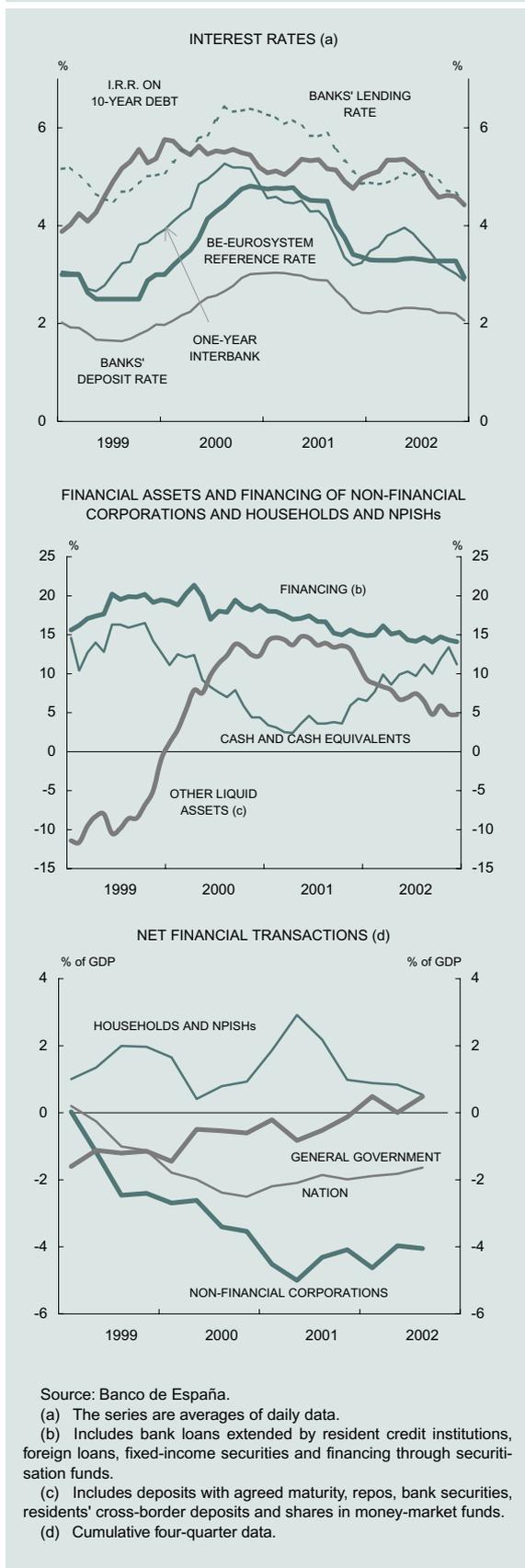


encing a much more moderate cyclical slowdown than the area as a whole and much sharper price pressures. As the year unfolded and the pace of activity slowed, monetary conditions became more suited to the Spanish situation, especially as the euro appreciated and hardened against the main currencies. The fiscal policy pursued contributed positively to sustaining household income; notwithstanding, and despite the increase in public investment, the overall fiscal policy stance was virtually neutral. The modest deficit recorded is therefore largely due to the operation of the automatic stabilisers, since the structural balance improved.

Given these constraints and the adverse international environment, which drastically restricted the growth of foreign markets, the Spanish economy posted an average real GDP growth rate of 2% in 2002, as earlier stated. National demand increased by a similar amount to output, whereby the negative contribution of net external demand stood at around one-tenth of a percentage point. All demand components, with the exception of government consumption and stockbuilding, contributed to the slowdown in GDP; yet while private consumption and invest-

CHART 4

**Financial indicators of the Spanish economy**



ment in construction posted appreciable rates of increase (that of construction was notable especially in the residential sector), the performance of capital investment was very negative. The slowdown in private consumption provided for a slight pick-up in the household saving ratio, but household lending capacity held at very low levels as a result of the exceptional robustness of investment in housing, fuelled by expectations of rising prices, which did not abate as expected, and this prompted an increase in household debt levels. The course of interest rates, however, meant that the burden associated with this indebtedness held stable.

Both exports and imports of goods and services posted positive but rather insignificant rates of increase. Of particular note were the poor results for tourism. The fall in the goods imports deflator made for a reduction in the trade deficit, with a subsequent improvement in the current-account deficit. The favourable performance of import prices over the year as a whole, despite the changes in the prices of imported energy products, which fed through to various sectors in the economy, means that the 4% increase in the value-added deflator is basically attributable, therefore, to domestic reasons. The pressure of unit labour costs, whose growth rate in the market economy was only slightly below the figure of 3.7% recorded the previous year, may have passed through to final prices in the economy, especially in those industries where the increase in demand was particularly high or where the lack of competition is more marked, with the corresponding widening of business margins. Wider margins were particularly notable in the construction industry, whereas it is in certain services branches that there is evidence that the currency changeover may have had greater influence on the rate of increase of prices.

Estimates on the growth of the Spanish economy in 2002 Q4, which were mentioned at the beginning of this section, show some differences from annual average results. This is quite significant as regards the assessment of trends at the onset of 2003. Firstly, the year-on-year growth rate of 2.1% estimated for 2002 Q4, calculated in terms of the seasonally adjusted series, confirms that the Spanish economy maintained a sustained growth rate throughout 2002, on a mildly slowing trend that does not appear to have extended into the closing months of the year. Growth has been fully underpinned by domestic demand, the rate of increase of which was somewhat over 2%, whereas net external demand will have subtracted at least two-tenths of a point from GDP growth. Although the increase in demand has continued to reside essentially on investment in construction and on

both private and government consumption, capital investment, while still sluggish, has shown signs of a pick-up which the data in the coming months will have to confirm. The growth rate of private consumption has stabilised at close to 1.5%, and that of investment in construction has been just marginally lower than in the previous quarter, moving on a decelerating trend.

Another characteristic feature of the Q4 data is that the performance of merchandise exports has remained more expansionary than in the first half of the year, although their rate of increase has tended to slacken compared with their notable buoyancy in the summer months. The rise in exports carried industrial activity in its wake, whereby its year-on-year rate of change, which had already ceased to be negative in Q3, steepened in the closing months of 2002. The foregoing factors ultimately boosted the growth of imports, to the point where they more than checked the positive impact of exports on the GDP growth rate. The performance in the tourism industry, though not as unfavourable as in previous quarters, has also contributed to the negative net result of external demand.

The notable buoyancy that financing to the private sector continues to show (with growth of around 14%) does not correspond to the cyclical position of the Spanish economy and can only be explained by the exceptional robustness of credit extended to construction-related activities. Of particular significance is the increase in credit intended to finance house purchases, with growth of 18.1% in 2002 Q3. For this reason, and despite the fact that the growth of consumer credit has slowed appreciably, the household debt ratio has continued increasing. The non-financial business sector has also seen its debt ratios increase, albeit on a lesser scale than in previous years.

Although the growth of the Spanish economy has continued to be underpinned by the buoyancy of public- and private-sector construction and, to a lesser extent, by consumption, the data for recent months show the first signs of a change in which exports and private-sector investment might play a more prominent

role. For a pattern of this type to firm will depend, to some extent, on a recovery in the world economy taking root, but the appropriate fundamentals must also be in place for this to occur. In this respect, it is encouraging that the Spanish economy should have sustained positive employment growth rates – of over 1% in Q4 – throughout 2002, and that the rate of increase of unit labour costs should have tended to slow (due largely to apparent productivity gains), even though it still remains high. Indeed, at the end of the year, the growth of this variable exceeded that of the euro area as a whole by approximately one percentage point, with increases in compensation per employee still considerably high in both cases.

The challenge facing the Spanish economy at the onset of 2003 is to attempt to narrow the differential between its consumer-price growth rate and that of the euro area countries. The persistence of such a gap may ultimately erode competitiveness and therefore restrict growth and employment generation potential. Forecasts point to a significant improvement on the end-2002 figures, as some of the factors contributing to the increase in the inflation rate during 2002 (4% in December in terms of consumer prices) were transitory and related to the prices of energy products and of certain foodstuffs, and the growth of the overall index should ease as such factors abate. That should not mask the risks underlying the behaviour of other components: thus, the growth rates of prices of non-energy manufactured goods and, above all, of services have stabilised at comparatively high levels, meaning that the related differential with the euro area has fluctuated at around one and one and a half percentage points, respectively, throughout the year.

Finally, the budget figures for the closing months of the year mean that the overall general government outturn for 2002 was virtually in line with the balanced budget scheduled (the preliminary deficit announced is two-tenths of a point of GDP). The growth of revenue has exceeded the forecasts made in the projected outturn accompanying the Budget for 2003, and the case of expenditure is the same.

## 2. The external environment of the euro area

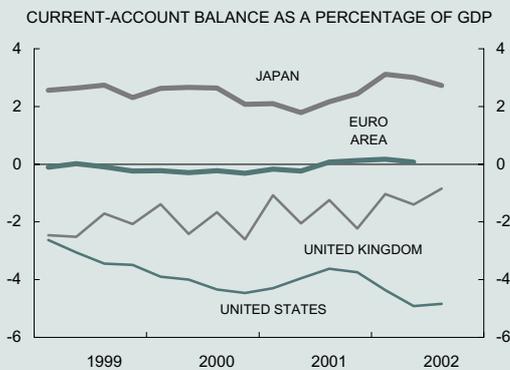
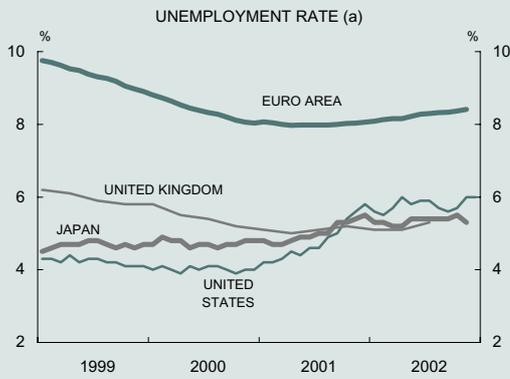
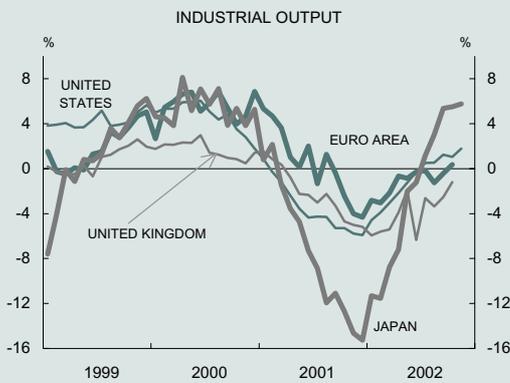
Economic developments in the external environment of the euro area in 2002 Q4, and the outlook for 2003, continued to depend heavily on developments in the United States. Published data confirm the central scenario of moderate recovery in the pace of global activity, led by the United States and the Asian countries, excluding Japan, although at a slower pace than was initially expected.

In the fourth quarter, international financial markets saw a significant improvement in the stock market, especially in October and November. Subsequently, these developments were reversed in January owing to geopolitical tensions. There was also a moderate narrowing of the spread between interest rates on corporate debt and government bonds, especially the lowest quality bonds. This improvement has been even more striking in the case of sovereign fixed-income spreads in the emerging economies, in particular in Latin America and in the EU candidate countries. For its part, the dollar resumed its downward course, partly associated with the increasing evidence of twin deficits (in the public sector and the external sector) in the United States. The price of oil rose above 30 dollars a barrel, for supply reasons relating to the uncertainties associated with conflict in the Persian Gulf and the negative social and political developments in Venezuela.

In the *United States* the indicators point to a significant reduction in growth in Q4, following a very positive performance in Q3 when GDP grew by 4% (in annualised quarterly terms). The main factor driving growth in Q3 was private consumption, especially spending on consumer durables, which grew by 22.8% (in annualised quarterly terms). Public spending and private capital formation also made positive contributions, while the contributions of exports and imports cancelled each other out. The indicators for Q4, especially the sharp declines in consumer confidence, but also the lower industrial production and manufacturing activity, point to a slowdown in private consumption growth. The employment data in November and December were also negative, with a cumulative loss of 190,000 jobs over this two-month period, which took the rate of unemployment up to 6%, from an average of 5.7% in Q3. As regards prices, inflationary pressures remained moderate, despite the rise in the price of oil. Thus, the rate of increase in the total consumer prices index stood at 2.4% in December, while underlying inflation dipped to 1.9%. In short, while developments in the US economy in Q4 are not going to dash the prospects for recovery, it may now take longer for the growth rate to reach a level close to its potential. Indeed, not only have the downside risks not dispelled, in some cases

CHART 5

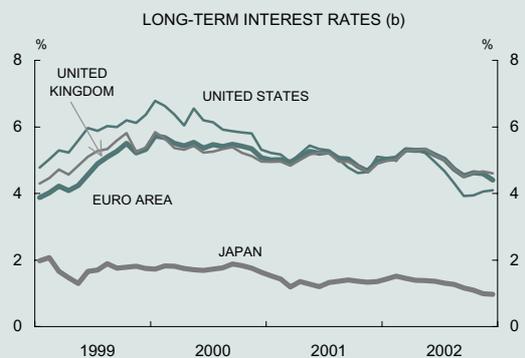
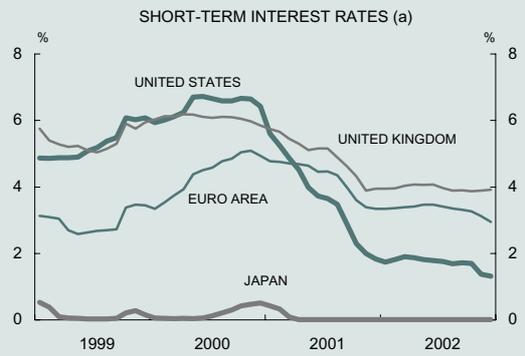
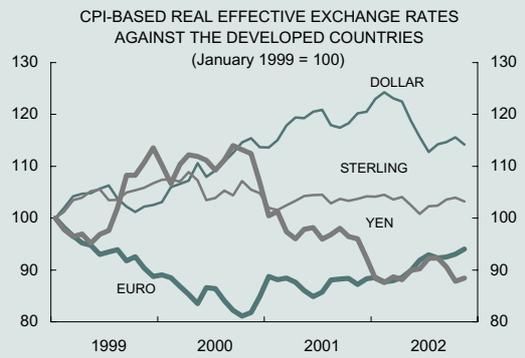
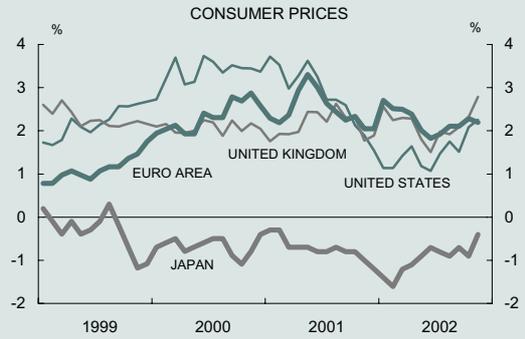
**Main macroeconomic indicators  
Annual rates of change**



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

CHART 6

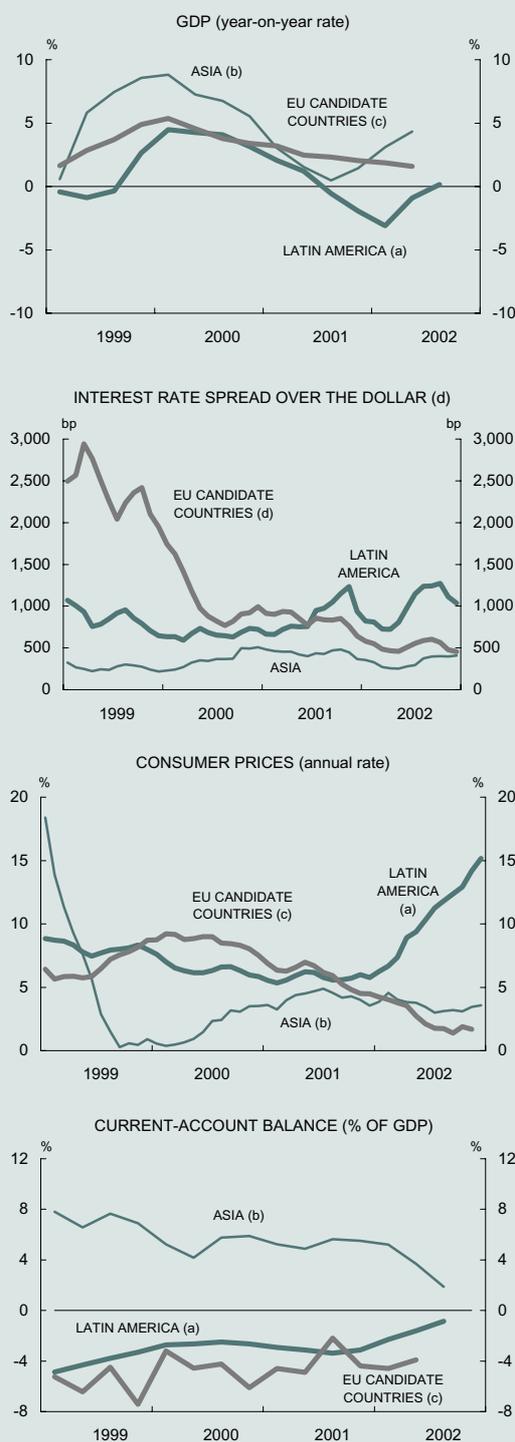
**Prices, real exchange rates and interest rates**



Source: Banco de España.  
(a) Three-month interest rates on the interbank market. Euro area: weighted average of the eleven countries to December 1998; three-month EURIBOR as from 1999.  
(b) Ten-year government bond yields. Euro area: weighted average of the eleven countries to December 1998.

CHART 7

**Emerging economies: main macroeconomic indicators**



Sources: National statistics and JP Morgan.  
 (a) Argentina, Brazil, Chile, Mexico, Colombia, Venezuela, and Peru.  
 (b) Malaysia, Korea, Indonesia, Thailand, Hong Kong, Singapore and Taiwan.  
 (c) Latvia, Lithuania, Estonia, Czech Republic, Hungary, Poland, Slovenia and Slovakia.  
 (d) Spreads according to JP Morgan's EMBI+ index. Russia is included with the EU candidate countries.

they have actually worsened. Notable among them are the geopolitical ones, and also those deriving from the fragility of the recovery, which is still based on private consumption and the expansionary economic policy measures, private investment having failed to take over. The US government announced a new fiscal package, the main objective of which is to stimulate investment, by eliminating the double taxation of dividends, and consumption, by reducing taxes on the lowest incomes. It is projected that these measures will increase the budget deficit by 1% of GDP in 2003.

In *Japan*, preliminary national accounts figures for 2002 Q3 show real GDP growth at a non-annualised quarterly rate of 0.7% (1.5% year-on-year). Also, quarterly GDP growth in Q2 was revised upwards to 1%, from the previous estimate of 0.6%. The contribution of domestic demand to quarterly GDP growth was positive (0.8%), while the contribution of external demand was negative (-0.1%), for the first time since 2001 Q3. The slowdown in goods and services exports, which grew at a quarterly rate of only 0.5%, as against 5.9% in Q2, shows that the main determinant of output growth in the first half of the year faded rapidly. The available indicators for Q4 seem to show a decline instead of the incipient recovery that seemed to be signalled in the first half of the year. Thus, industrial production fell by 2.2% in November, relative to the same month a year earlier, the third consecutive monthly decline, while sales data did not herald a recovery in private consumption either. As shown by the rate of underlying inflation, which held steady at around -0.8% in November 2002 (the latest figure available), deflationary pressures continue to hold sway.

The *UK* economy grew by 0.9% in 2002 Q3 (2.1% year-on-year), with private consumption and government consumption both growing by 0.8% during the quarter, while gross fixed capital formation fell by 0.9%, exports by 1.2% and imports by 0.5%. According to the economic indicators, the industrial sector again failed to recover in 2002 Q4, with industrial production declining by 1.2% year-on-year in November and falls in business sentiment. Private consumption indicators displayed notable strength, although they slowed with respect to previous quarters. Exports in October and November fell rather more than imports, so that the trade deficit widened significantly during these months. The rate of unemployment, meanwhile, held steady at 5.2% to November (registered unemployment was 3.1% in December), and wage growth year-on-year increased slightly to 3.8%. Inflation rose to 2.7% in December, owing to the sharp rises in the housing component and

the base effect arising from the fall in the oil price a year earlier.

The most important event for the *European Union candidate countries* in the last quarter was the agreement reached at the Copenhagen summit, held on 12 and 13 December 2002, for the entry of a first wave of countries. Ten countries and the current members can now ratify accession treaties in 2003 and, assuming they do so, all of them will participate in the European Parliament elections in 2004 as EU Member States. The most likely accession date for Bulgaria and Romania seems to be 2007, while December 2004 has been set as the date for assessing whether Turkey meets all the political and democratic criteria required by the EU so that accession talks can begin without delay.

As for economic developments in these countries, GDP growth in Q3 was generally higher than in the previous quarter, owing to the strength of domestic demand and in spite of the weakness of external demand. In addition, long-term interest rate spreads vis-à-vis the euro continued to narrow and in some cases, such as that of the Czech Republic, reached less than 50 basis points. As for exchange rates, the sharp appreciation of the Hungarian Forint was notable, forcing the central bank to lower interest rates by 200 basis points.

In *Latin America* economic and financial developments were relatively positive in the final quarter. Especially important among the domestic factors contributing to this improvement was reaffirmation by the new Brazilian government of policies of economic discipline. The worsening of the economic and social crisis in Venezuela, which appears increasingly complicated to resolve, does not seem to have affected the rest of the region, although it has affected the rise in the price of oil in recent weeks. Tension in the financial markets of the area eased from October, leading to a significant reduction in debt spreads, to around 1000 basis points at the end of January in the region as a whole. Exchange rates have also recovered

somewhat, albeit unevenly and with reversals. Despite the mild improvement in financial indicators in the last few months of 2002 economic growth in the region over the year as a whole will be much lower than initially expected.

It was confirmed in the final quarter that activity had stabilised in Argentina following the sharp fall in GDP in the first half. Inflationary pressures also moderated and the exchange rate, which recently embarked on an upward path, stabilised. This improvement, although precarious, facilitated the lifting of the freeze on bank accounts at the beginning of December and some of the exchange restrictions at the beginning of January. The transitional agreement with the IMF eases the financing of payment commitments to official agencies up to August 2003. Following the elections in Brazil, affirmation of the commitment to fiscal discipline and the formation of a moderate economic team led to a significant improvement in sentiment on financial markets. As a result, debt spreads were almost halved from their September highs (although they still stand close to 1,400 basis points) and the exchange rate appreciated, although it has fallen back in recent days. If the narrowing of spreads and the appreciation of the real prove lasting, the public-debt vicious circle can be broken and the external constraint, which led to a sharp external adjustment last year, can be relaxed. However, the situation has deteriorated significantly on the prices front, with inflation running at almost twice the target rate (12.4%, as against a 6.5% upper limit to the target). This substantial deviation led to a marked rise in interest rates from October, which rose from 18% to 25.5%, and an extension of the horizon for achieving the inflation targets previously established for 2003. In *Mexico* the recovery remains shaky with attention focused on events in the United States. Fiscal policy is still disciplined, with the help, on this occasion, of the approval of the 2003 budget. Another country in the area that has benefited from a positive change in sentiment in recent months is *Colombia*, owing to IMF support for the new government's reforms.

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

In 2002 Q4, economic growth in the euro area was subdued, so that the conditions of faltering recovery that had characterised the first three quarters continued to prevail. As for 2003, the prospects for growth have moderated over the last few months, owing to the uncertainty arising from the international setting, the rise in oil prices and the hardening of the euro. Even so, recovery is still expected to firm in the euro area in the first half of this year, which should enable the annual growth rate of the area to draw close to its potential by the summer although, given the international geopolitical uncertainty, this scenario is subject to significant downside risks. On the inflation front, the weakness of demand and the appreciation of the exchange rate helped to reduce inflationary pressures in the last quarter of the year and partly offset the upward impact on consumer prices of the rise in oil prices. In the short run, however, the pass-through of the recent rise in oil prices to domestic prices may mean that it will take longer for inflation to fall below 2%.

These conditions of uncertainty continued to govern monetary and financial variables in 2002 Q4 and in the first few weeks of 2003. Interest rates displayed a downward trend, stock markets were unable to sustain an upward course and risk premiums remained high. At the beginning of December, given the improvement in inflation prospects, which was largely a consequence of the fragility of the economic recovery, the ECB reduced its interest rate by 50 basis points. This cut took the minimum bid rate in the Eurosystem's main refinancing operations to 2.75%. In the area of fiscal policy, there was a further deterioration in the budget position in 2002, which was especially pronounced in certain countries that had failed to capitalise sufficiently on the previous upturn to consolidate their finances. In various cases this led to activation of the procedures provided for in the Treaty and in the Stability and Growth Pact to impose budgetary discipline.

#### 3.1. Economic developments

According to the second National Accounts estimate, GDP in the euro area grew at a quarter-on-quarter rate of 0.3% in 2002 Q3, similar to the rate recorded in the first half of the year. This took the year-on-year growth rate to 0.8%, up 0.1 percentage points on Q2. In terms of the composition of output, domestic demand was particularly important in 2002 Q3, contributing 0.3 percentage points to GDP growth, following a negative contribution in the first half of the year (see Chart 8). The recovery in domestic demand was a consequence of the higher growth rates of private consumption and of in-

vestment, the latter being positive for the first time since the beginning of 2001. Among the components of gross fixed capital formation, both investment in capital goods and investment in construction grew at higher rates than in the previous quarter, although the quarter-on-quarter growth rate of investment in construction was still negative. Meanwhile, net external demand contributed 0.2 percentage points to output growth, as exports were stronger than imports, while stockbuilding subtracted 0.2 percentage points from GDP growth, in contrast to its positive contributions in the previous two quarters.

At the country level, the National Accounts figures for Q3 show that most countries sustained or increased their quarter-on-quarter growth rates. Among the largest economies of the area, France was the only country to see a moderation in its growth rate, owing to the deterioration in investment, which the buoyancy of private consumption and the growing contribution from the external sector were unable to offset fully. GDP grew by 0.3% in Germany, thanks to a favourable foreign trade performance, while Italy and Spain benefited from more buoyant domestic demand. Recent developments in economic activity in the euro area countries are analysed in Box 1.

From the standpoint of supply, the growth rate of value added was the same in 2002 Q3 as in the previous quarter owing to a similar increase in industrial GVA, a milder slowdown in construction activity and a slight loss of buoyancy in the services sector. As for the labour market, employment fell by 0.1% in 2002 Q3 relative to Q2, so that the year-on-year rate of change was down 0.3 percentage points on the rate recorded in the previous quarter (0.3%). Apparent labour productivity rose year-on-year by half a percentage point as a result of this slowdown in employment and the higher growth of output.

The information available on indicators of activity in 2002 Q4 points to an unchanged or slightly poorer quarter-on-quarter GDP growth rate in the euro area, which would make the rate of change for the year as a whole less than 1%. Although most of the indicators of activity in industry improved in 2002 Q4, those for construction and services declined relative to the previous quarter. Specifically, the index of industrial production increased on average by 0.8% during October and November, with respect to Q3, and the industrial confidence indicator of the European Commission (EC) rose in Q4 (see Chart 9). By contrast, the purchasing managers' index for the manufacturing sector was down on Q3, as were the EC's confidence

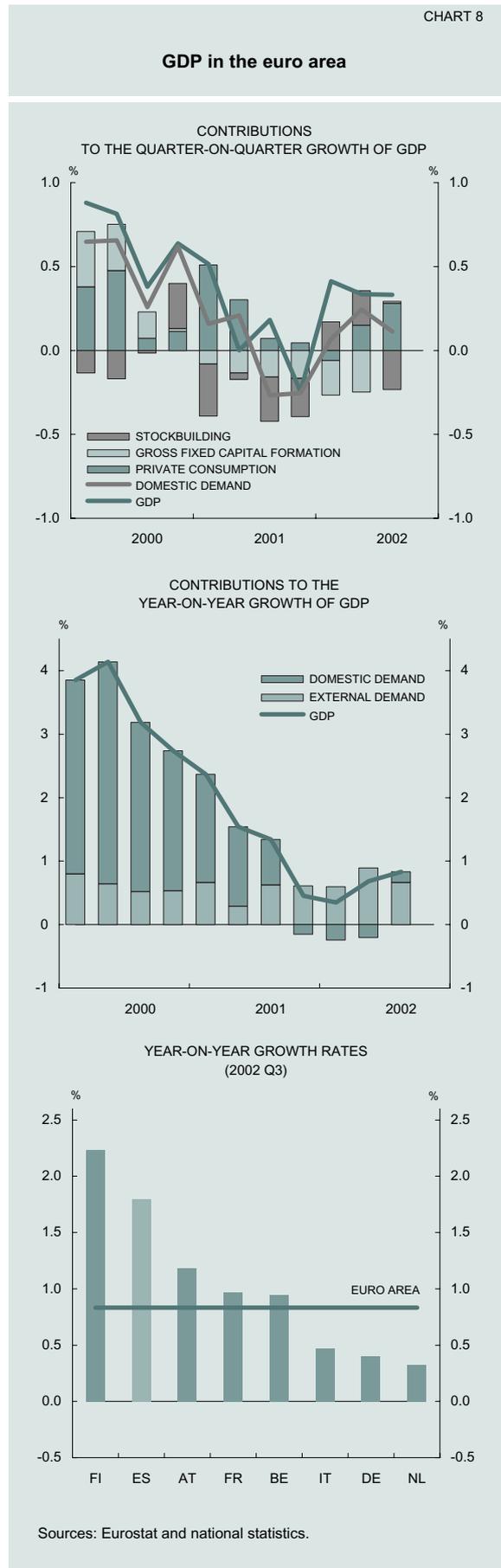
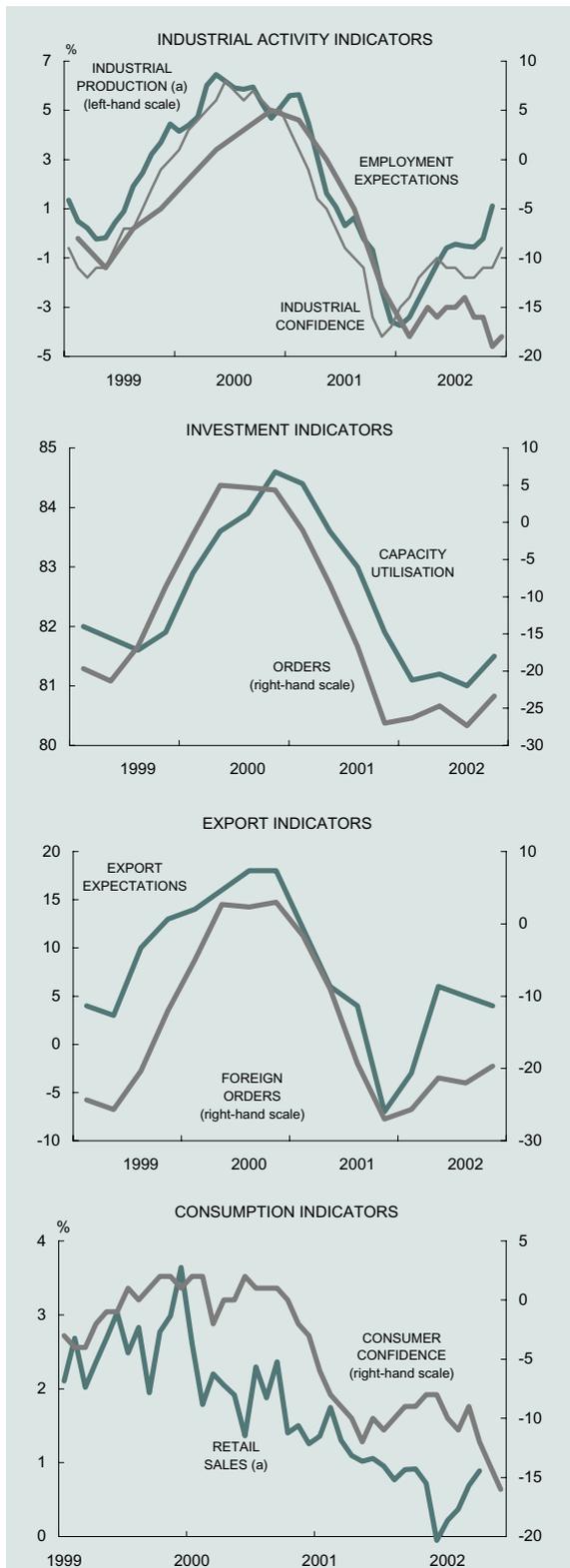


CHART 9

**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.

indicators for services and construction and the purchasing managers' index for services. At the same time, on provisional data of the German Statistics Institute, German GDP grew by 0.2% in 2002, 0.5 percentage points less than in 2001. This average annual growth rate implies a lower quarter-on-quarter rate of change in 2002 Q4 than in the previous quarter.

From the standpoint of demand, private consumption indicators point to slightly slower growth than in Q3. The consumer confidence indicator fell in Q4 and, in December, reached levels not seen since 1997, while retail sales only grew by 0.3 percentage points more in October than on average in the previous quarter. However, at the other extreme, the retail confidence indicator improved slightly on average in Q4, while new passenger car registrations displayed notable vigour in the same period (see Chart 9). Investment indicators, such as assessments of industrial order books and capacity utilisation, improved in 2002 Q4. Export expectations according to the quarterly business survey compiled by the EC, were also positive in Q4, although slightly down on the preceding quarter, and the assessment of export order books improved during the final quarter of 2002. The information from the business survey on the assessment of stocks suggests that levels were higher than desired. Finally, the employment indicators, also obtained from business surveys, show a further deterioration on average in the period October- December. In fact, the rate of unemployment of the euro area rose in October and November by 0.1 percentage points, to 8.4%.

In short, the most recent activity indicators for 2002 Q4 foreshadow continued weak quarter-on-quarter growth, within the range estimated by the European Commission (0.1%-0.4%), equivalent to a year-on-year rate of somewhat more than 1%. On the expenditure side, the composition would be similar to that of Q3, although it is possible that domestic demand will grow at a slightly lower rate. Investment expenditure could be stimulated by the growth of final demand, but the climate of high uncertainty and the financing difficulties of some firms in the face of high risk premiums and falling share prices may entail the postponement of decisions to purchase investment goods. On the other hand, it is likely that private consumption will continue to expand, albeit at moderate rates, in line with its determinants. Among them, the appreciation of the exchange rate and the moderation of inflationary pressures, along with the reduction in interest rates, should be conducive to some buoyancy in this variable. However, the negative trend in employment, the international uncertainty and the decline in fi-

Differences in the recent performance of economic activity in the euro area countries

Against a general background of mild recovery, marked by uncertainty over developments in the world economy, the National Accounts data for each country in 2002 revealed a wide variety of situations within the euro area. The year-on-year increase in the area's GDP in Q3, 0.8%, was the result of very different performances across countries. Among the countries for which quarterly information is available, two of them (Spain and Finland) grew at a rate of close to 2% and another three at around 1% (France, Belgium and Austria), while the remaining three (Germany, Italy and the Netherlands) failed to grow at a rate of more than 0.5%.

The top chart shows that there was a mild recovery in all the countries, except Italy, the Netherlands and Spain, although Spain stands out in the group of countries analysed as having had the highest and most stable growth rate in recent years. It can also be seen that the larger countries tend to have more stable rates of expansion, which may stem, inter alia, from their lower degree of openness (and, therefore, of sensitivity to external shocks) and from greater diversification in their productive structures. In the smaller countries, by contrast, growth has been more volatile, these being the only ones in which GDP growth was negative in late 2001 and in which the subsequent recovery has been clearer. Among these countries, Finland's buoyancy, driven by exports and consumption, has been notable.

The different rates of output growth are also related to very different contributions of domestic and external demand from country to country, there being a clear trade off between them. The differences in the contribution of domestic demand stem more from the contributions of gross fixed capital formation than from consumption, which seems reasonable when it is considered that investment is more strongly influenced by the short-term economic situation and outlook than is consumption. In the case of net external demand, the different contributions to output across the euro area countries reflect not so much the performance of exports, which are governed by similar fundamentals in all the countries, in terms of the exchange rate or world demand, as the behaviour of imports, which are basically determined by the different behaviour of domestic demand.

No common pattern is discerned in economic developments across the euro area countries and, therefore, it is not clear which behave very differently from the rest. That said, the performance of the German economy is of particular interest since it is the largest country in the area and its growth rates are very low. As seen in the bottom chart, in which the contribution to output of the main aggregates is compared in Germany and in the rest of the members of the euro area, the slackness of the German economy relative to the rest of the countries of the area is attributable to the weakness of domestic demand, both in its private consumption and gross fixed capital formation components. The behaviour of private consumption is primarily held back by the unfavourable performance of the labour market, which has a negative effect on consumer confidence. In fact, Germany is the only country in which private consumption growth was negative in 2002 Q3. As for investment, the different behaviour of Germany with respect to the rest of the euro area is attributable, not so much to the still adverse trend in machinery and equipment investment, which has affected most members of the euro area, as to the continued weakness of investment in construction. Finally, net external demand is seen to have made a significant positive contribution to growth, although it has been affected by the slackness of domestic demand, which has moderated the growth rate of imports.

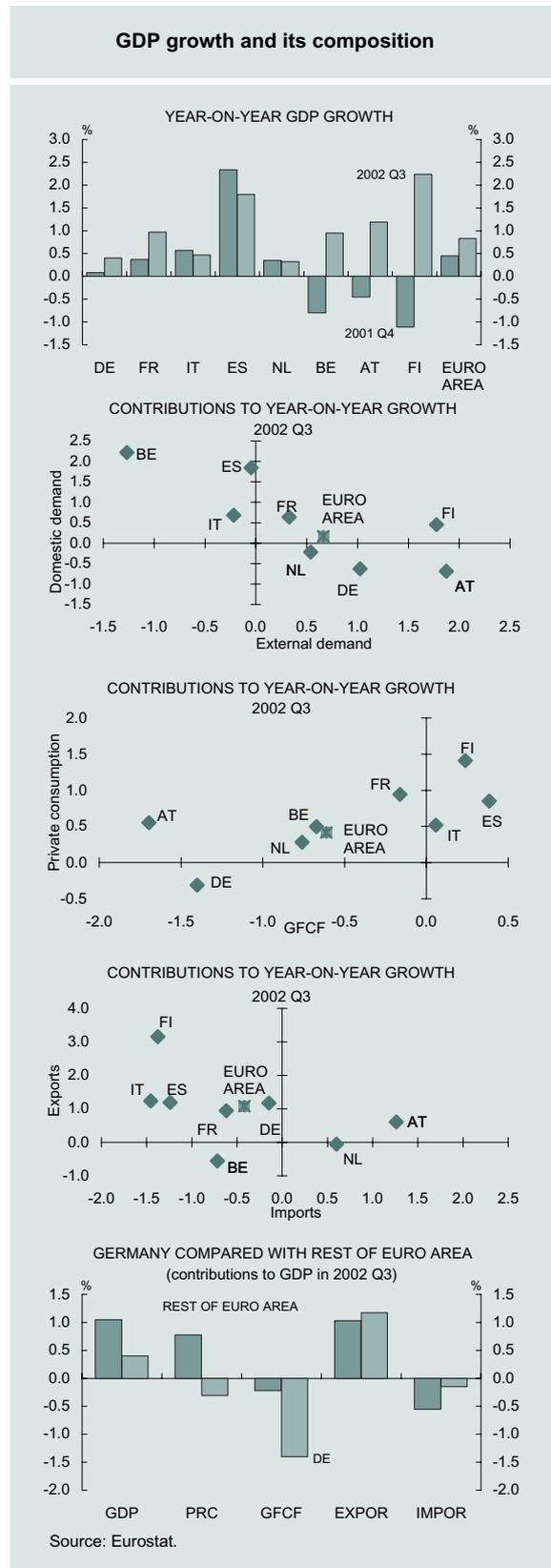
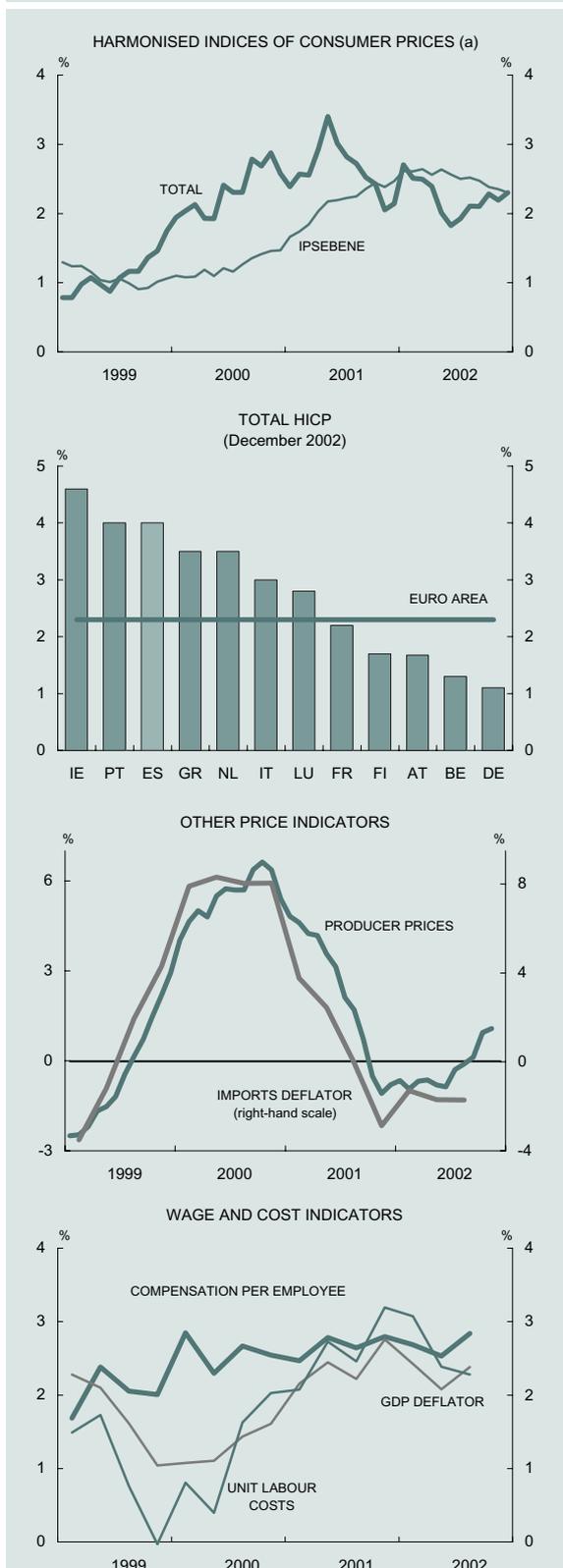


CHART 10

**Euro area. Price, wage and cost indicators**  
Year-on-year percentage changes



Sources: Eurostat and European Central Bank.  
(a) There is a break in January 2002, when the series was re-based to 2001.

financial wealth stemming from falling stock markets, could have a negative impact on agents' consumption expenditure.

As already mentioned at the beginning of this chapter, euro area price indicators showed an easing of inflationary pressures in 2002 Q4. As for the determination of domestic prices, unit labour costs increased in Q3 in line with the GDP deflator, so that margins were unchanged (see the lower panel of Chart 10). However, as seen in Box 2, the recent path of unit labour costs and of unit margins in the euro area reflects very uneven behaviour across countries. Productivity is expected to continue increasing in Q4, which would be conducive to unit labour cost moderation.

The HICP increased by 2.3% in December in year-on-year terms, 0.2 percentage points more than in September. However, it was the behaviour of the energy component alone that was responsible for this acceleration in consumer prices, since the rate of change of the other components moderated in the final quarter of the year (see Chart 10). The increase in the likelihood of military intervention in Iraq and the continuation of the general strike in Venezuela, which has reduced its oil exports, caused the price of Brent crude oil to stand at around USD 32 per barrel in mid-January, more than 30% higher than the average euro price in January 2002. The rate of change of the index of non-energy processed goods and services prices (IPSEBENE), covering the most stable components of the HICP, fell by 0.2 percentage points between September and December. As can be seen in the second panel of Chart 10, inflation continued to vary widely across countries. The inflation differential between the countries with the highest and lowest rates (Ireland with 4.6% and Germany with 1.1%) remained large and relatively steady in Q4. As for producer prices, the annual rate of change in the producer price index rose to around 1% in November, from 0.1% in September, owing to the increase in oil prices over the quarter.

Consumer prices in 2003 Q1 are likely to be strongly influenced by the increase in oil prices. However, in the more medium term, the direct effects of the appreciation of the euro on import prices and their gradual pass-through to the euro area economy and the current moderation of the rate of economic growth should contain inflationary pressures, with the rate of increase in the HICP stabilising at a level below 2% during 2003.

According to estimates published by the ECB, there was a current-account surplus of € 40.9 bn in the first ten months of 2002, com-

**Decomposition of the growth of the deflators of GDP and of final demand in the euro area**

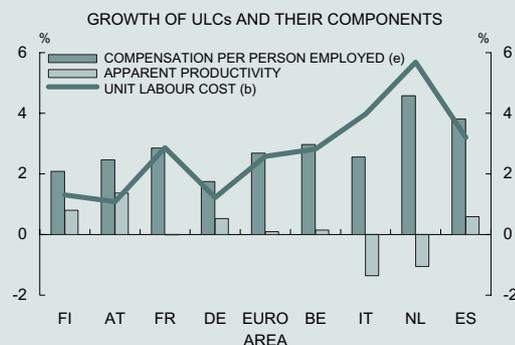
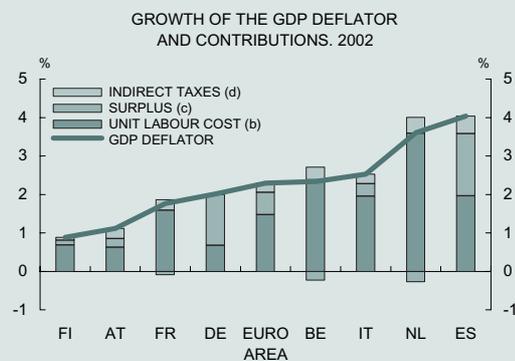
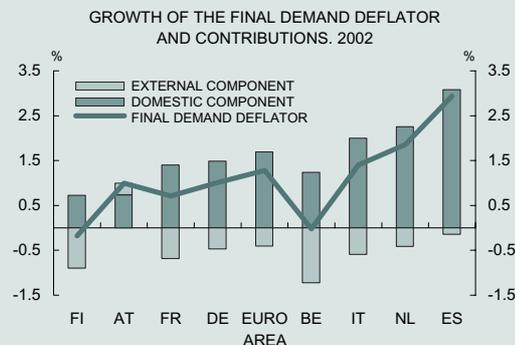
Within the framework of the quarterly national accounts, the production and the generation of income accounts provide useful information for analysing price formation in the euro area as a whole and the inflation differentials observed between the member countries. Starting from the identity between the economy's final demand and supply (GDP and imports), the final demand deflator can be broken down into the sum of the GDP deflator and the imports deflator, weighted according to their relative importance in final demand in real terms. Likewise, the breakdown of GDP at market prices between compensation of employees, the gross operating surplus and net indirect taxes on production and imports enables the GDP deflator to be decomposed into the contribution of each of these factors per unit of output.

The top chart shows the year-on-year growth of the final demand deflator in the first three quarters of 2002 as the sum of the contributions of the domestic and external components. The contribution of the domestic component is seen to predominate in the determination of the rates of change of the final demand deflator. In this period, the contribution of the external component was negative in almost all countries, as a consequence of the fall in both the euro prices of imports and in the import content of final demand, which has been conducive to the containment of inflation. That said, its influence has been distributed unevenly across the various countries. France and Belgium, for example, enjoyed approximately the same reduction in import prices in the period analysed, but in the second case, the greater loss of weight of imported products in Belgian supply amplified the negative contribution of the external component to the course of the final demand deflator.

The middle chart shows the existence of significant dispersion in the domestic growth rates of the GDP deflator, as well as in its composition. In most of the countries, arranged according to the rate of expansion of their GDP deflator, and in the euro area as a whole, the contribution of unit labour costs (ULCs) exceeds that of the other factors. The contribution of this component is especially high in the Netherlands and Belgium, followed by Spain and Italy. To determine the origin of this behaviour of ULCs, the bottom chart shows their rate of change broken down into compensation per employee and productivity increases. It can be seen that the divergences between the rates of growth of wages are not so high as those of ULCs, since in those countries in which compensation has grown most, the increase in productivity per person employed is lower, and yet in those countries with the largest increases in compensation per employee, productivity has expanded more strongly. Meanwhile, Germany and Spain are the countries in which the contribution of the gross unit operating surplus to the GDP deflator is greatest, both relative to that of other countries and to the contribution of the other components to the growth of their GDP deflators. Finally, net indirect taxes have also played a significant role in the determination of the GDP deflator, with a contribution that ranges from almost zero in Germany to half a percentage point in the case of the Netherlands and Spain.

The data analysed show that the differences between the rates of growth of the main deflators of the euro area countries reflect a number of different causes. Besides being related to the different cyclical positions of the countries, these causes are also related to their different degree of openness and to the diversity of their economic structures, product and factor markets (which determine the remuneration of these factors) and tax systems.

**Average year-on-year rates of change in 2002 (a) and contributions**



Source: Eurostat.  
 (a) Average rate for the first three quarters, except Belgium and the Netherlands (first two quarters).  
 (b) Labour cost per unit of GDP.  
 (c) Gross operating surplus (and mixed income) per unit of GDP.  
 (d) Net indirect taxes on production and imports per unit of GDP.  
 (e) Approximated by compensation per employee.

TABLE 1

General government budget balances of euro area countries (a)

% of GDP

|  | 1998 | 1999 | 2000 | 2001 | 2002 (b) | 2002 (c) | 2003 (d) | 2003 (c) |
|--|------|------|------|------|----------|----------|----------|----------|
| Belgium  | -0.7 | -0.5 | 0.1  | 0.2  | 0.0      | -0.1     | 0.0      | 0.0      |
| Germany  | -2.2 | -1.5 | -1.4 | -2.8 | -2.0     | -3.8     | -2.8     | -3.1     |
| Greece   | -2.5 | -1.9 | -1.8 | -1.7 | 0.8      | -1.3     | -0.9     | -1.1     |
| Spain  | -2.7 | -1.1 | -0.7 | -0.1 | 0.0      | 0.0      | 0.0      | -0.3     |
| France   | -2.7 | -1.6 | -1.3 | -1.5 | -1.4     | -2.7     | -2.6     | -2.9     |
| Ireland  | 2.4  | 2.2  | 4.4  | 1.5  | 0.7      | -1.0     | -0.7     | -1.2     |
| Italy  | -2.8 | -1.8 | -1.7 | -2.2 | -0.5     | -2.4     | -1.5     | -2.2     |
| Luxembourg   | 3.1  | 3.6  | 5.6  | 6.1  | 2.8      | 0.5      | -0.3     | -1.8     |
| Netherlands  | -0.8 | 0.7  | 1.5  | 0.1  | 1.0      | -0.8     | -1.0     | -1.2     |
| Austria  | -2.4 | -2.3 | -1.9 | 0.2  | 0.0      | -1.8     |          | -1.6     |
| Portugal   | -2.6 | -2.4 | -3.2 | -4.1 | -1.8     | -3.4     | -2.4     | -2.9     |
| Finland  | 1.3  | 1.9  | 7.0  | 4.9  | 2.6      | 3.6      | 2.7      | 3.1      |
| MEMORANDUM ITEM:   |      |      |      |      |          |          |          |          |
| Euro area  |      |      |      |      |          |          |          |          |
| Primary balance  | 2.5  | 2.9  | 3.1  | 2.5  | 2.7      | 1.5      |          | 1.6      |
| Total balance  | -2.2 | -1.3 | -0.9 | -1.5 | -0.9     | -2.3     | -1.8     | -2.1     |
| Public debt  | 73.5 | 71.9 | 69.4 | 69.3 | 67.2     | 69.6     |          | 69.1     |
| Sources: European Commission, national stability programmes and IMF.   |      |      |      |      |          |          |          |          |
| (a) As a percentage of GDP. Proceeds from the sale of UMTS licences not included. Deficit (-) / surplus (+). |      |      |      |      |          |          |          |          |
| (b) Targets of the stability programmes presented between November and December 2001.                        |      |      |      |      |          |          |          |          |
| (c) European Commission forecasts (November 2002).   |      |      |      |      |          |          |          |          |
| (d) Targets of the stability programmes presented between November 2002 and January 2003.                    |      |      |      |      |          |          |          |          |

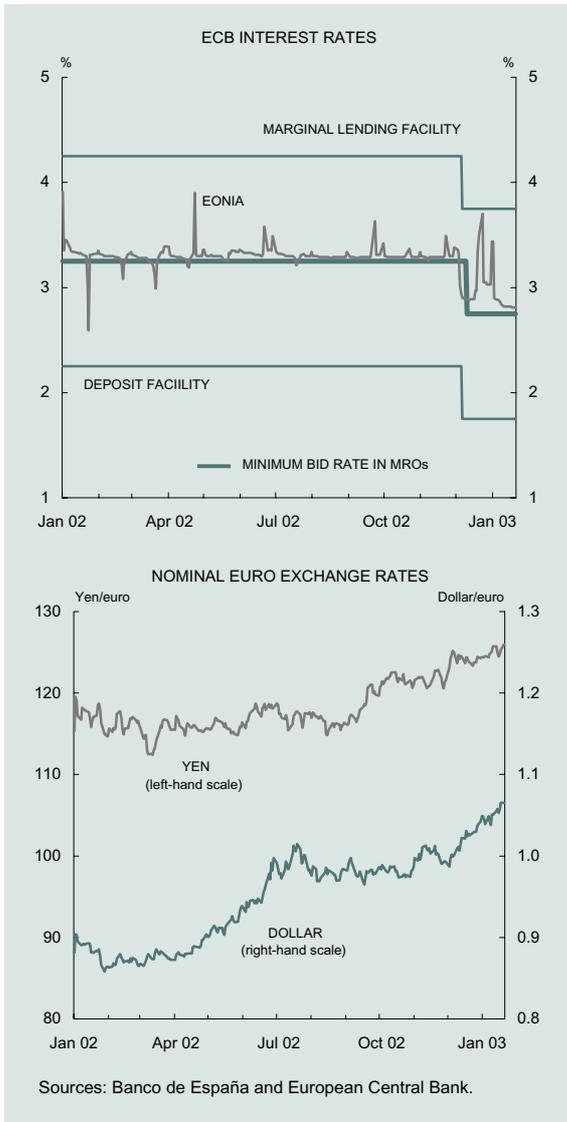
pared with a deficit of € 18.7 bn in the same period of 2001. This turnaround was largely the result of a substantial increase in the trade balance, which stemmed in turn from the slackness of import demand and from the improvement in the terms of trade. Taking into account, moreover, that direct and portfolio investment involved net inflows of almost € 40 bn (in contrast to the net outflows under the other headings of the financial account) the basic balance, which approximates the more permanent financing requirements of an economy, stood at € 80 bn in the first ten months of the year, so continuing the progress that it had made since 2001.

As regards fiscal policy, according to the information available the budget deficit of the area as a whole widened last year by 0.2 percentage points to 2.2% of GDP (see Table 1), so that the euro area budget position deteriorated for the second year running. According to European Commission calculations, on this occasion the widening of the deficit basically stemmed from the impact of the slowdown in activity. However, when the situation is analysed country by country the conclusion is somewhat different. The worsening was across the board, but in those countries that had achieved an underlying budget position close to balance before the deceleration in activity be-

gan, the action of the automatic stabilisers is apparent in the deterioration observed, and their cyclically adjusted balances did not significantly deteriorate. However, in those countries in which the structural imbalances were not corrected during the cyclical upturn, the budget position has been further worsened by the low growth phase and, in certain cases, by the application of discretionary expansionary measures, making for a very delicate situation in terms of the balances observed and compliance with the fiscal rules laid down in the Treaty and in the Stability and Growth Pact. A particular case in point is Germany, where the deficit in 2002, according to the estimates available, reached 3.7% of GDP. This was above the 3% limit laid down in the Treaty and so prompted initiation of the excessive deficit procedure. The Recommendation approved by the ECOFIN Council on 21 January urges the German authorities to correct the excessive deficit as soon as possible, by taking measures such as those proposed in its stability programme, although if growth proves to be worse than expected a more ambitious adjustment is not demanded. In France, meanwhile, the deficit stood at 2.8% of GDP in 2002, very close to the above-mentioned reference rate. This also represents a significant deviation from the 1.4% target set a year earlier in its stability programme, leading

CHART 11

**ECB interest rates and euro exchange rates**



the Council to issue an early warning requiring France to take all such measures as may be necessary to avoid the deficit exceeding 3% of GDP in 2003 and to ensure that the budget can be balanced in 2006. In Italy, the deficit stabilised in 2002 at around 2.2% of GDP, the level reached the previous year, although this was partly as a result of the application of temporary measures, which have not helped to improve the underlying situation of its public finances. Finally, in Portugal, following a deficit of 4.1% of GDP in 2001 and initiation of the excessive deficit procedure as a result, the authorities seem to have been successful in substantially correcting the budget deficit in 2002.

All the Member States of the area, with the exception of Luxembourg and Austria, have presented updated stability programmes, defin-

CHART 12

**Euro area Yield curve**

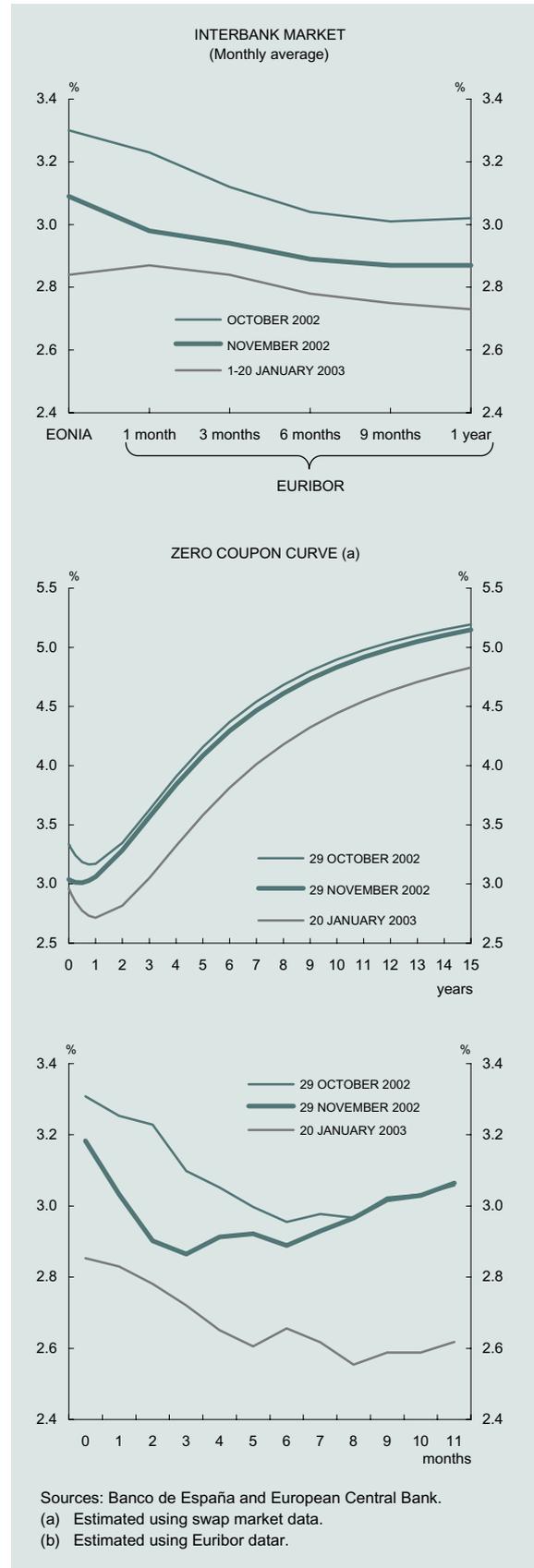
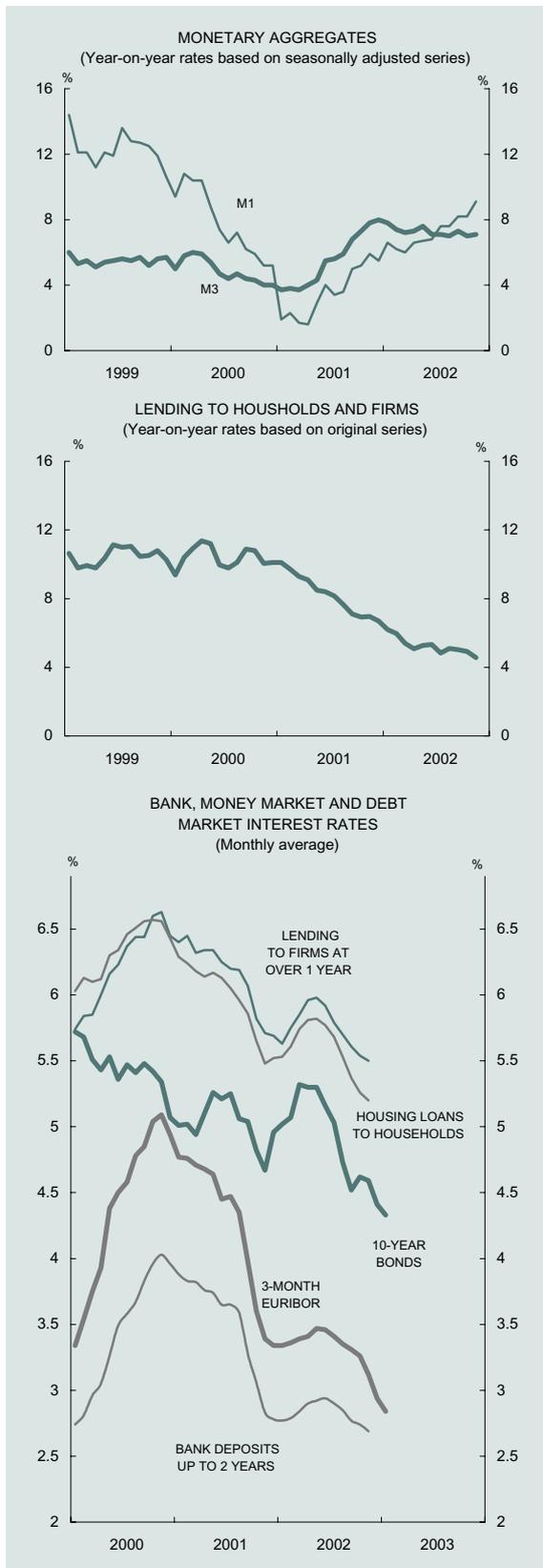


CHART 13

**Monetary and credit aggregates and interest rates in the euro area**



Sources: Banco de España and European Central Bank.

ing their respective medium-term budgetary strategies (generally up to 2006). Aggregating the budget targets of the individual countries gives a deficit for the area as a whole of 1.8% of GDP in 2003 and 1.1% in 2004. These projections are significantly rosier than those included in the European Commission's autumn forecasts, according to which these deficits will be 2.1% and 1.8% of GDP respectively (see Table 1). In part, the difference is explained by the fact that the economic growth assumptions contained in the programmes are more optimistic, although in many cases the Commission's forecasts had been published before the programmes had been presented and the macroeconomic environment had deteriorated further in the meantime. The discrepancies are also explained by the fact that the programmes generally anticipate the implementation of more ambitious fiscal consolidation policies, although in many cases the measures that would enable the targets to be achieved are insufficiently specified. The budget strategies designed by the countries with the largest imbalances broadly comply with the Eurogroup agreement, according to which the underlying fiscal position must improve by at least 0.5 percentage points of GDP per annum from this year. In the rest of the countries, the automatic stabilisers can be allowed to operate freely this year. Finally, according to the plans set out in the programmes, almost all the countries will achieve a position close to budget balance in 2006.

Finally, following a need identified by the Barcelona Council, the Commission published a Communication in November which aimed to examine how the co-ordination of budgetary policies within the EU can be strengthened. The Communication did not propose any changes to the legal framework set by the Treaty and the Stability and Growth Pact, but rather clarified the interpretation of these rules and made it more systematic. The most important proposals of the Commission, which will be discussed by the Council in the coming months, are: to evaluate the "close to balance or in surplus" requirement in the medium term on the basis of cyclically-adjusted balances; to attach more weight to government debt ratios and the sustainability of public finances when assessing fiscal policies; to monitor fiscal developments in upturns particularly rigorously, to avoid insufficient adjustments to the budgetary position; to permit, when certain relatively strict starting conditions are met, moderate deviations from budget balance, provided that the purpose is to finance structural reforms; and, finally, to try to strengthen disciplinary mechanisms by improving the quality of information on public finances, by clarifying the circumstances that may give rise to activation of the excessive deficit procedure

TABLE 2

Monetary and financial situation in the euro area and Spain

%

|   | 2000  | 2001  | 2002  |       |       |       | 2003  |         |
|---|-------|-------|-------|-------|-------|-------|-------|---------|
|   | DEC   | DEC   | AUG   | SEP   | OCT   | NOV   | DEC   | JAN (a) |
| MONETARY VARIABLES (b):   |       |       |       |       |       |       |       |         |
| Euro area   |       |       |       |       |       |       |       |         |
| M3  | 4.0   | 7.9   | 7.0   | 7.2   | 6.9   | 7.1   | 6.8   |         |
| M1  | 5.2   | 5.5   | 7.6   | 8.2   | 8.3   | 9.2   | 9.8   |         |
| Credit to private sector  | 10.1  | 6.7   | 5.1   | 5.0   | 4.9   | 4.6   | 4.7   |         |
| SPAIN   |       |       |       |       |       |       |       |         |
| Cash and cash equivalents   | 4.4   | 6.8   | 11.2  | 10.1  | 11.9  | 13.4  | 11.2  |         |
| Other bank liabilities  | 19.8  | 8.4   | 3.8   | 2.3   | 3.9   | 3.0   | 3.2   |         |
| Mutual funds (c)  | -27.1 | 26.2  | 20.1  | 17.9  | 15.8  | 13.3  | 11.7  |         |
| Financing to the private sector   | 18.8  | 15.1  | 14.7  | 14.0  | 14.7  | 14.3  | 14.1  |         |
| FINANCIAL MARKETS (d):  |       |       |       |       |       |       |       |         |
| EONIA   | 4.83  | 3.36  | 3.29  | 3.32  | 3.30  | 3.30  | 3.10  | 2.78    |
| Three-month EURIBOR   | 4.94  | 3.35  | 3.35  | 3.31  | 3.26  | 3.12  | 2.94  | 2.84    |
| Public debt   |       |       |       |       |       |       |       |         |
| Euro-area ten-year bond yields  | 5.07  | 4.96  | 4.73  | 4.52  | 4.62  | 4.59  | 4.41  | 4.26    |
| US/euro-area ten-year bond spread   | 0.25  | 0.16  | -0.43 | -0.60 | -0.68 | -0.53 | -0.32 | -0.20   |
| Spain/Germany ten-year bond spread  | 0.31  | 0.23  | 0.19  | 0.19  | 0.17  | 0.12  | 0.10  | 0.05    |
| Bank rates in Spain   |       |       |       |       |       |       |       |         |
| Synthetic deposit rate  | 3.02  | 2.22  | 2.29  | 2.22  | 2.22  | 2.20  | 2.06  |         |
| Synthetic lending rate  | 6.35  | 4.86  | 5.06  | 4.92  | 4.72  | 4.67  | 4.41  |         |
| USD/EUR exchange rate   | 0.897 | 0.892 | 0.978 | 0.981 | 0.981 | 1.001 | 1.018 | 1.058   |
| Equities (e)  |       |       |       |       |       |       |       |         |
| Dow Jones EURO STOXX broad index  | -5.9  | -19.7 | -26.0 | -39.1 | -31.5 | -27.2 | -34.5 | -7.6    |
| Madrid Stock Exchange General Index   | -12.7 | -6.4  | -18.8 | -30.1 | -22.0 | -15.9 | -23.1 | -0.6    |
| Sources: European Central Bank and Banco de España.   |       |       |       |       |       |       |       |         |
| (a) Monthly average to 27 January 2003.   |       |       |       |       |       |       |       |         |
| (b) Annual percentage rate.   |       |       |       |       |       |       |       |         |
| (c) Including euro-denominated FIAMMs and FIMs.   |       |       |       |       |       |       |       |         |
| (d) Monthly averages.   |       |       |       |       |       |       |       |         |
| (e) Cumulative percentage change during the year. End-of-month data. Latest month: 27 January for the EURO STOXX and for the Madrid Stock Exchange. |       |       |       |       |       |       |       |         |

or the issue of an early warning, and by making the process more transparent with the Commission publishing the documentation relating to the assessment of national stability and convergence programmes.

### 3.2. Monetary and financial developments

At its meeting on 5 December 2002, the Governing Council of the ECB, after assessing the improved inflationary outlook, the absence of signs of significant recovery in activity and the downward revision to the growth forecasts for the area, decided to reduce official interest rates by 50 basis points. These had remained unchanged since November 2001, when a similar decision was taken. The minimum bid rate on main refinancing operations was thus

reduced to 2.75%, and the interest rates on the deposit facility and the marginal lending facility to 1.7% and 3.75% respectively (see Chart 11).

In 2002 Q4, monetary conditions were broadly unchanged from the previous quarter, since the reduction in interest rates was more or less offset by the appreciation of the exchange rate. At the same time, although the financial conditions have not deteriorated further, the maintenance of relatively high risk premiums for private fixed income and the subdued stock market have not been favourable for the financing of agents and especially firms. These factors are reflected in the continuation of the slowdown in credit to the private sector in 2002 Q4, which took the year-on-year rate to 4.7% in December.

In October and November, as the perception took hold of a delay in the recovery of activity, money market interest rates fell. They continued to do so in December, after the reduction in official interest rates, and in the first few weeks of January. Thus, by mid-January, EURIBOR interest rates at terms of more than 6 months stood at around 2.7%, slightly below EURIBOR rates at shorter terms. As seen in the lower panel of Chart 12, the term structure of one-month forward rates reflects expectations of reductions in official interest rates of one quarter of a percentage point in the second quarter of the year. For their part, long-term interest rates in the euro area, following the increases in October and November, fell sharply in December and early January 2003 to around 4.3% by mid-January (see Table 2).

As seen in the lower panel of Chart 13, the lending and borrowing rates of euro area credit institutions continued to follow the downward path they embarked upon in 2002 Q2. Between September and November, the rate on housing loans to households was reduced by 17 basis points, and that on corporate loans at over one year by 11 basis points. At the same time the decline in the synthetic rate of Spanish banks was 15 basis points between September and December in the case of liability instruments and 50 in that of assets (see Table 2).

In the foreign exchange market, in the fourth quarter, the euro resumed the trend seen in Q2 of appreciation against most of the important currencies, particularly the US dollar. This trend became more pronounced in the first few weeks of January, so that by the end of the month the euro had appreciated by 10% with respect to the dollar and by 6% in nominal effective terms since September 2002 (see lower panel of Chart 11). The strength of the euro is largely the result of the depreciation of the dollar, which is probably being penalised for the authorities' failure to correct some of the basic imbalances in the US economy.

October and November saw a pause in the downward trend in stock markets, but it re-

sumed thereafter. Investor confidence was again reduced by the increasing tension in the Middle East and North Korea, and by the weakening of the optimism over short-term economic recovery in the euro area. The sectors most affected since the end of November have been telecommunications, technology and the financial sector, owing to the increasing scepticism over the earnings prospects of the firms in these sectors. In 2002 as a whole, the Dow Jones EURO STOXX broad index fell by 35%, the largest fall in recent years. In the first few weeks of 2003 this index was still on a downward trend.

M3 was highly buoyant in the final quarter. The strength of this aggregate is principally explained by investor preference for safe, liquid assets against a background of high uncertainty on financial markets. In December, M3 increased at a rate of 6.8% year-on-year, somewhat below the rates recorded in the preceding months. Meanwhile, the Governing Council of the ECB, at its meeting on 5 December, reviewed the reference value for monetary growth and decided to reconfirm the existing value of 4.5% for the annual growth of the broad monetary aggregate M3. Also, at the press conference following that same meeting of the Governing Council, President Duisenberg announced that an evaluation of the ECB's monetary policy strategy would be carried out in the first half of 2003.

Finally, as regards the counterparts of the monetary aggregates, credit to the private sector slowed again in the final quarter of the year, to a growth rate of 4.7% in December, down 0.3 percentage points from the rate in September. According to lending data broken down by purpose and agents available to 2002 Q3, the credit growth observed during that period was a result of the strength still displayed by housing loans to households, since the growth rates of the rest of the components were more moderate. In the case of Spain, financing to the non-financial private sector between September and December grew at a rate of 14%, well above the rate recorded in the euro area as a whole.

## 4. The Spanish economy

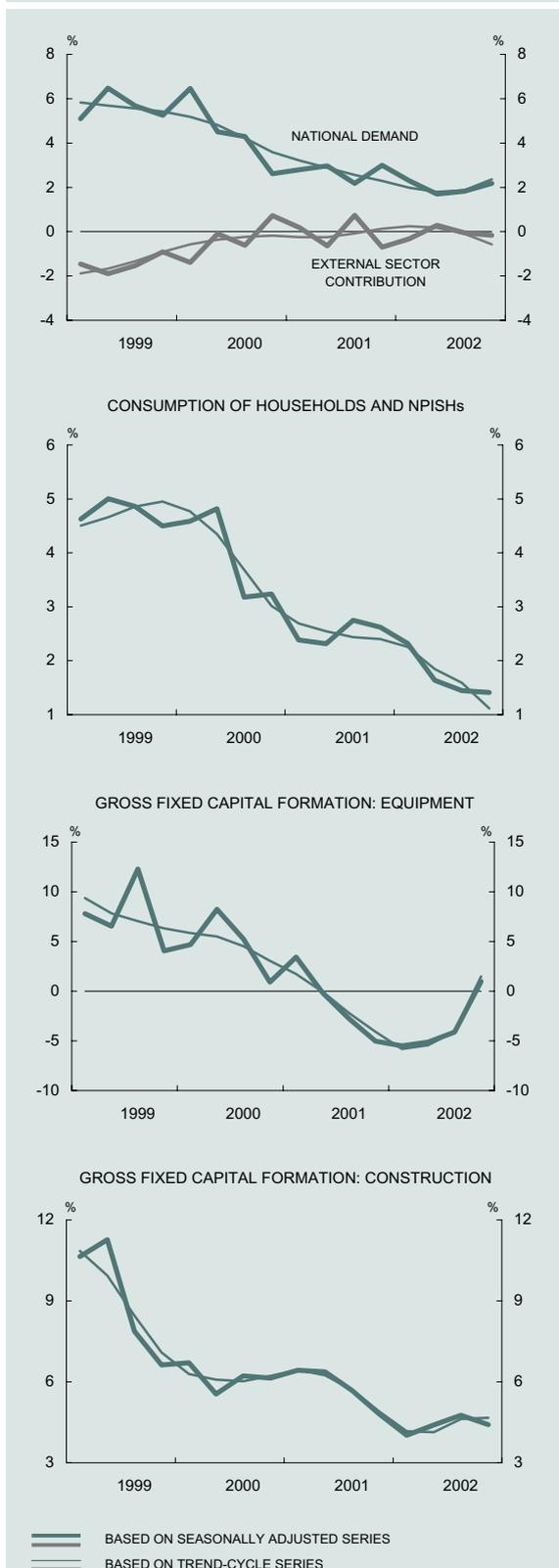
On end-2002 information, real GDP is estimated to have grown by 2.1% year-on-year in Q4, after increasing by 1.8% in Q3 according to QNA figures. In the second half of last year, therefore, the Spanish economy would have sustained a real growth rate close to that recorded in the first six months, giving rise to an average growth rate for output of 2% (see Chart 1). Behind the estimated path of GDP in Q4 is a pick-up in national demand (which would have increased by 2.2%) and, specifically, in investment in equipment, which might be reaching the end of its lengthy contractionary phase. The rate of expansion of private consumption would have tended to stabilise at 1.4%, bringing the mild slowdown seen in the previous quarters to a halt, and the pace of construction would have eased. The contribution of net external demand to GDP growth, which was lower in Q3 than in Q2, owing to the increase in imports, turned negative in the final quarter of the year (-0.2 percentage points), as the thrust of purchases from abroad held firm, in tow to the rise in domestic demand. Exports increased at a somewhat more moderate rate than in Q3, affected by the economic sluggishness in Europe.

As indicated, real GDP growth in 2002 as a whole was 2%, 0.7 points lower than was estimated for 2001, against an external background dominated by political and economic uncertainty. That has checked investment plans and made for dearer oil and the appreciation of the euro. The diminished buoyancy of output was the outcome of a slowdown on a similar scale in national demand (which grew by 2%) and of a slightly negative contribution of net external demand, similar to that of the preceding year (-0.1 percentage points). Consumption was moderate (increasing by 1.7%), owing to the low growth of real disposable income and to the pick-up in household saving. Meanwhile, gross fixed capital formation slowed to 1.6%, beset by the strong decline in capital investment in annual average terms. Despite recovering over the course of the year, the annual growth of exports of goods and services also declined, with the poor tourism performance in 2000 a contributing factor.

From the standpoint of the value added generated by the various productive branches, mention may be made of the recovery in industry in the second half of the year and the weakness of market services, the growth rate of which at the end of the year would have been lower than that of GDP. There were substantial falls in agricultural activity in the last two quarters of 2002 compared with the same period a year earlier, while construction, following the temporary rise in activity in Q3, resumed its de-

CHART 14

**Main demand aggregates**  
Percentage change on year ago



Sources: INE and Banco de España.

celerating path in Q4, albeit at still-significant rates of increase. Over 2002 as a whole, year-on-year growth rates in both industry, where activity stagnated, and in market services and construction declined, in contrast to the pick-up in energy activities. Employment slowed mildly throughout 2002, especially in market-gearred services, giving rise to a recovery in labour productivity; nonetheless, it is estimated that productivity increased at a low average rate of 0.7% for the year, both in the economy as a whole and in market activities. Although job creation has, by contrast, held relatively firm, ending the year at a rate close to 1%, this has not prevented a rise in unemployment owing to comparatively large numbers joining the labour market.

Consumer-price inflation held at a higher rate in 2002. Several specific factors contributed to this, such as the tax rises at the beginning of the year or the introduction of the euro. The CPI ended the year at a 12-month growth rate of 4%, reflecting the direct impact of dearer oil products in the closing months of 2002. The resulting annual average growth rate was 3.5%, slightly down on the previous year. The final demand and GDP deflators increased by 2.9% and 4%, respectively, also somewhat down on 2001. First, there was a notable restraining influence by foreign prices on final prices in the economy and, further, there were higher labour costs and wider margins in certain industries, which accounted for the notable growth of the GDP deflator. Turning to costs, compensation per employee increased at a rate of slightly over 4% in the market economy, virtually unchanged on 2001. Although the mild rise in productivity contributed to easing the increase in unit labour costs, these are estimated to have grown by around 3.4%.

**4.1. Demand**

During the first three quarters of 2002 the growth rate of Spanish household final consumption expenditure eased back, standing at 1.4% year-on-year in Q3 according to QNA estimates (see Chart 14). Although the uncertainty prevailing in the external environment did not diminish in Q4, making for a further deterioration in consumer confidence, the latest information provided by short-term indicators suggests that the year-on-year growth rate of consumption will have stabilised during this period at a similar rate to that posted in the summer (see Chart 15). This sustained expenditure was supported by job creation which, despite losing momentum in the final months, remained significant.

Among the indicators included in Chart 15, that of apparent consumption of goods, estimated drawing on as yet incomplete data for Q4, has remained on a rising trend, which reflects the behaviour of the non-food component, including consumer durables. The apparent consumption of services has continued on a decelerating path. Other indicators directly related to household expenditure – namely the retail sales index and the related confidence indicator – trended in a steadier fashion in the closing months of 2002. As to new car registrations, the strong contraction witnessed during the year slackened notably in the final months, resulting in a positive year-on-year growth rate of 6% in December, following ten consecutive months' decline.

Over the course of 2002, private consumption is estimated to have grown by 1.7%, having slowed more sharply than disposable income and given rise to a recovery in the household saving ratio. The lower growth of household real disposable income in 2002 is related to the rise in consumer prices. At current prices, income is estimated to have grown by the same amount as in 2001, since the diminished pace of total gross wages (the result of a slight slowdown in compensation per employee and of lower employment growth) was offset by a more expansionary contribution of net general government transfers and other non-wage income. The changes in household wealth had more complex effects: the decline in stock market prices translated into a fall in household financial wealth, which helps explain the fall-off in expenditure, while the significant rise in real estate assets last year had a positive impact on consumption, which did not offset in full the effect of the slide in financial wealth, giving rise to the aforementioned increase in saving.

In 2002 Q3, general government final consumption increased by 3.2% on the same period in 2001, 0.1 points up on the growth in the first half of the year. Following the significant upward revision by INE of the data for the first half of 2002 and the slight rise in Q3, the information currently available points to an additional minor rise in the final quarter of the year.

Gross fixed capital formation increased by 1.5% year-on-year in 2002 Q3, 0.4 points up on Q2, adding firmness to the recovery initiated last spring. This recovery reflects both the less contractionary performance of investment in capital goods, the year-on-year rate of decline of which fell from 5.1% in Q2 to 4.1% in Q3, and the greater momentum of investment in construction, which grew by 4.8%, 0.4 points up on Q2. Gross fixed capital formation is estimated to have quickened once more in the closing

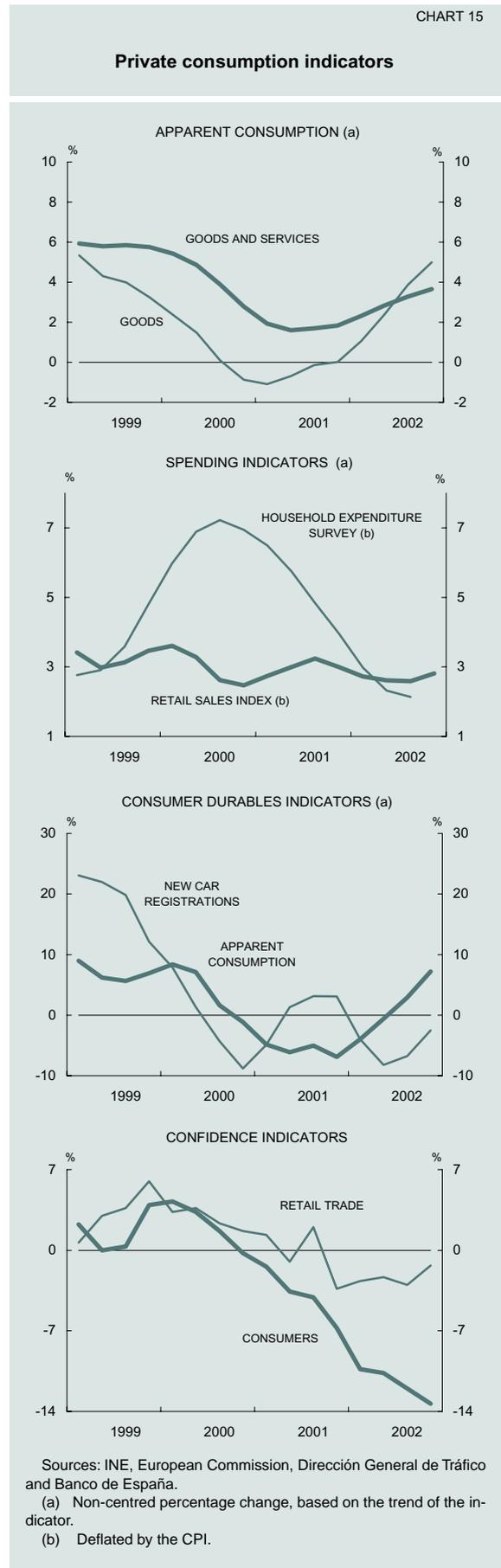
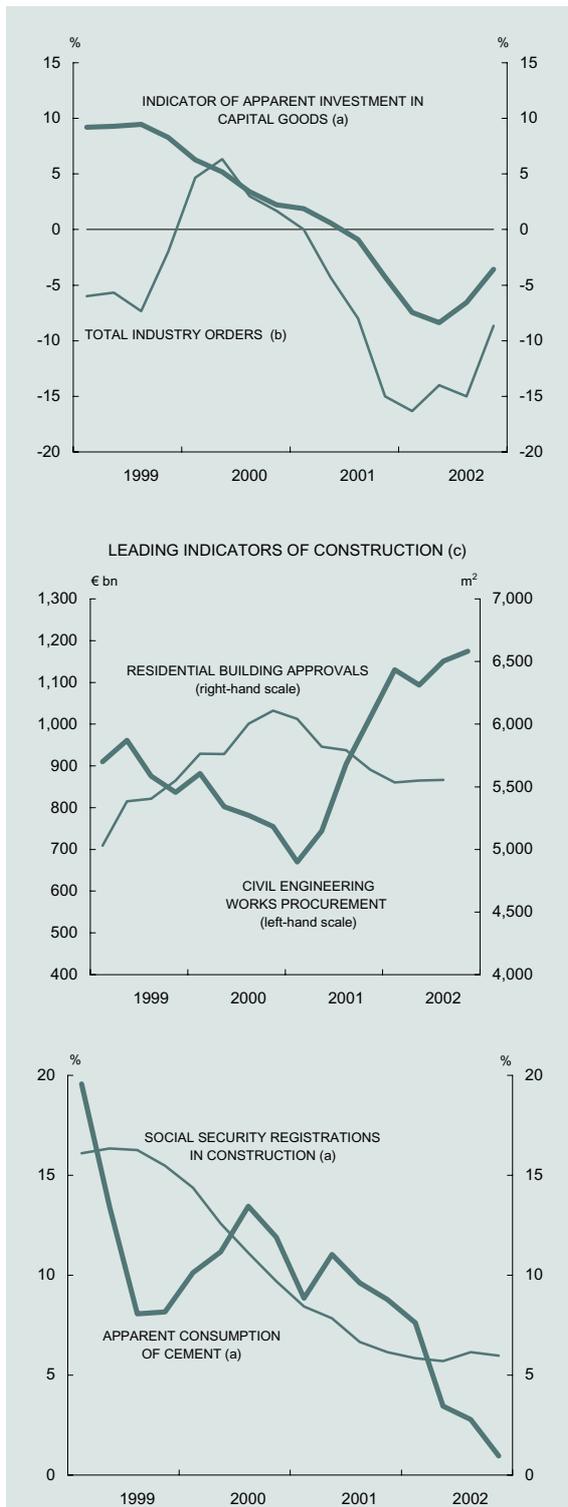


CHART 16

**Gross fixed capital formation indicators**



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

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

(b) Level of original series.

(c) Annual moving averages.

months of 2002 as a result of the trend of investment in equipment which, following six quarters of continuous decline, would have resumed a positive year-on-year rate. The considerable buoyancy of construction, meanwhile, would have eased slightly.

The turnaround in investment in equipment in Q3 was reflected by virtually all the short-term indicators available. The indicator of apparent investment in capital goods once again improved appreciably in the final quarter of 2002, due both to domestic output and, mainly, to the forceful momentum of imports. In line with these developments, the business confidence indicator also moved onto a recovering course as from Q2, driven by brighter output expectations and improved orders, especially in the domestic market (see Chart 16). Capacity utilisation increased considerably, rising to 79.3% early in Q4, above its historical average. Moreover, the results of the half-yearly survey of industry confirm a muted improvement in the investment outlook, evidencing a pick-up in investment plans scheduled for 2003.

Information from the Banco de España Central Balance Sheet Data Office Quarterly Survey shows that, in the first three quarters of 2002, non-financial corporations' return on net assets remained high, while the cost of financing tended to decline, with the differential between them (ROI – cost of debt) widening. The debt ratio, likewise measured with this information source, has tended to stabilise at the high level it reached in 2000. In sum, the financial position of Spanish corporations reveals continuing high profitability levels, which would be conducive to new investment projects. Their high debt, however, might check the force of any future recovery which, in any event, is not likely to gather significant steam while the climate of notable economic uncertainty remains in place and growth prospects do not improve.

Despite the acceleration in investment in construction in 2002 Q3, this variable is on a declining path which it has resumed in Q4 (see Chart 14). The quarterly Construction Industry Survey (ECIC) has confirmed (countering the projection released by Eurostat) a rise in the value of the work executed by construction companies in Q3. At the root of this was the impulse given to civil engineering and non-residential building, whereas residential building continued to decelerate, albeit at still-high rates. The economic information for Q4 substantiates the estimates of lower growth in the final months of 2002. Although the confidence indicator picked up slightly in this period, the construction activity indicators point to a weaker performance, as is the case with the apparent

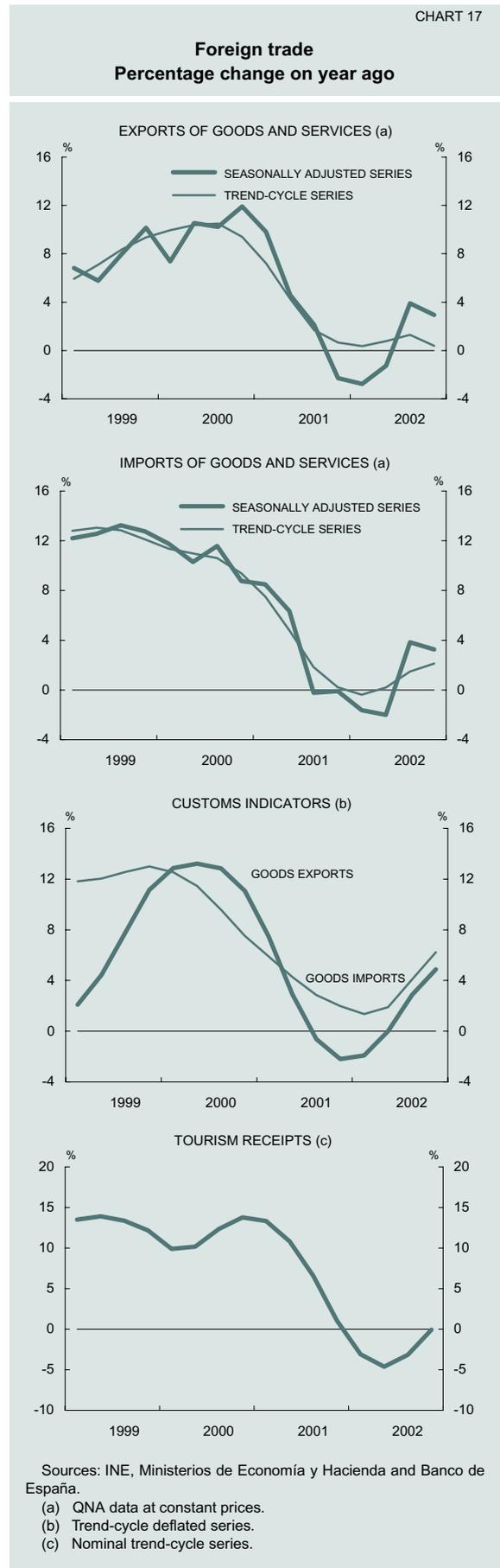
consumption of cement and Social Security registrations, both with data to December (see Chart 16).

Among the indicators of building starts and completed works, the number of finished houses appeared to peak in 2002, while that of housing starts progressively fell for the second year running. According to the data on building permits and approvals, the new surface area of residential building to be constructed tended to stabilise in 2002 after a marked fall-off in 2001 (see Chart 14). These developments are consistent with the slowdown estimated for residential investment. As to non-residential building, after a notable increase in permits and approvals in 2001, which would account for the rising trend reflected for this component by the quarterly Construction Industry Survey, this variable has levelled off in 2002. Lastly, official procurement figures show an increase in the nine months to September which is higher in the case of civil engineering works, although lower than the related increase in 2001.

On QNA figures, investment in inventories in 2002 Q3 contributed 0.1 points to the year-on-year growth of GDP. The latest information, drawn from the monthly business survey and running to November, shows a further build-up in stocks to relatively high levels. There is also evidence of an increase in oil stocks, due possibly to expectations of higher prices in the coming months. Overall, a zero or slightly positive contribution of stocks to the year-on-year increase in GDP in Q4 last year is once again estimated.

As indicated, it is estimated that the contribution of net external demand to GDP growth in 2002 Q4 will have turned negative, after having declined in the summer months when both exports and imports of goods and services rose significantly (see Chart 17). In the closing months of 2002, exports of goods and services held at a more moderate rate of increase than that posted in the summer, in step with the slow pick-up in world trade. In addition, the persistently higher growth of prices and costs than in other euro area countries and the appreciation of the euro have no doubt dampened sales abroad. The growth rate of imports also fell, albeit to a lesser extent, in the final months of 2002. Here, both the increase in domestic output and its associated lower relative prices will have contributed to holding up purchases abroad.

The figures for foreign trade in goods show that exports increased at a real rate of 4% year-on-year in October and November, somewhat down on Q3 (6.2%), although their under-



lying trend continued to improve (see Chart 17). Exports to non-Community areas gathered increasing steam during 2002, posting positive real rates of change as from Q2. As a result, they showed an increase of 5% in the first 11 months of the year, and of 15.6% in the two months spanning October to November. Exports to the central and eastern European economies, to OPEC members and to the Maghreb countries were notably buoyant, and sales to Asian countries and to the United States picked up. Conversely, exports to Japan and to Latin America remained very sluggish. Real exports to the EU declined by 1.2% in the period from January to October since, following their recovery in the summer months, they resumed a negative rate in October and November (-0.4%). In terms of the Member States, exports to Germany in France fell in the first eleven months of 2002 while those to the United Kingdom and to Italy remained fairly positive. As regards product groups, there was a pick-up in sales of capital goods and non-food consumer goods which, in real terms, increased by 6.4% and 8.2%, respectively, in October and November, whereas exports of non-energy intermediate goods, which had risen notably in Q3, slowed considerably in the final two months (1.7%).

QNA figures showed the continuing weakness of real tourism receipts, the year-on-year decline in which stood at 4.2% in 2002 Q3. Drawing on the latest information, it is estimated that the decline in this variable may have eased to a rate close to -3.5% in Q4. Among the real indicators, that of tourists entering Spain at borders has been expansionary in recent months (6.4% in Q4), while the number of foreign visitors staying in hotels has risen slightly; however, overnight stays in hotels fell by 3.7% year-on-year in Q4, after having fallen back by 5% in the summer months. The poor performance of tourism receipts last year was the result of weakness in certain European economies (such as Germany, one of our main customers), of the competition from other Mediterranean countries and of shifts in tourist preferences towards shorter stays, in non-hotel accommodation and with closer destinations which can be reached by car. The result has been a decline in average spending per tourist. Thus, although the number of tourists entering Spain at borders grew by 3.3% during the year as a whole, foreign visitors staying in hotels and related overnight stays fell by 1.2% and 5.1%, respectively.

According to foreign trade data, the notable recovery in goods imports in Q3 extended into October and November. During these latter months they grew by 7.8%, moving on a rising

trend in step with the positive performance of exports, the pick-up in domestic output and lower import prices in the light of the appreciation of the euro. By product group, there was a notable increase in non-food consumer goods imports in October and November (15.9% year-on-year in real terms), with the non-durables component particularly to the fore. Likewise, imports of non-energy intermediate goods and of capital goods climbed by 9.4% and 4.5%, respectively. Conversely, imports of energy products fell by 2.4% in this period. Despite the pick-up in imports in the second half of the year, they only increased by 2.7% on average in the first eleven months of 2002. Of note in this connection were the 6% fall in purchases of capital goods, and the increases of 6.5% and 4.6% in purchases of non-food consumer goods and of non-energy intermediate goods, respectively.

Lastly, real imports of services edged up by 1.2% in 2002 Q3, since the rate of decline of non-tourist services lessened as goods imports picked up. Tourist payments in real terms continued to grow at a notable rate of 7.5% in Q3, in keeping with the robustness of the nominal balance of payments data in this period. These trends would have continued into Q4.

#### 4.2. Output and employment

As can be seen in Chart 18, gross value added in the market economy was on a slightly recovering profile during 2002 in relation to a year earlier. This profile continued into Q4, underpinned by the favourable course of industrial activity and by a more stable increase in market services, following several quarters of deceleration. By contrast, activity in the construction industry would have moderated, while value added in the primary branches would have fallen off once more. Agricultural activity moved on a more contractionary course in Q3, slipping by 1.9% in year-on-year terms. In the closing months of the year, however, its rate of decline eased slightly, in step with the employment indicators and with the momentum of capital goods purchases in this sector. Moreover, rainfall in 2003 has so far been favourable, generating bright prospects for agricultural output this year.

The QNA data for Q3 confirmed the pick-up in industrial activity that was already perceptible in Q2, and the year-on-year rate of increase of value added in industry as a whole stood at 2.2%. The recovery was driven by the expansion of sales abroad and, drawing on the information provided by the industrial production index (IPI), took the form of a notable increase in

the production of consumer goods and a less negative performance in respect of the manufacture of capital goods. Almost all the economic indicators available indicate that the expansionary trend of industry continued during the final months of 2002. In October and November, the growth rate of the IPI improved, after adjustment for calendar effects, and the business confidence indicator also showed successive rises, while imports of intermediate goods continued to quicken. Moreover, capacity utilisation stood above its historical average. The production of capital goods, following 18 months of successive declines, significantly posted a positive growth rate – adjusted for calendar effects – in November, markedly intensifying the profile of recovery it had been showing.

Chart 18 shows that construction activity, following a similar profile to that of investment in construction, gathered momentum in 2002 Q3 with its value added increasing at a rate of 5.4% on the same period a year earlier, 0.8 points up on the growth rate in Q2. As indicated in the previous section, it appears this recovery was temporary: the indicators of inputs (such as cement consumption) and of employment (Social Security registrations and registered unemployment) would suggest a slowdown in Q4.

The gross value added of tertiary activities as a whole increased at a rate of 2% year-on-year in Q3 last year, 0.4 points down on the growth in the first half of the year. This performance was due to the lesser buoyancy in market services, the growth rate of which fell from 2.2% in Q2 on the same quarter a year earlier to 1.6% in the summer months, whereas activity in non-market services accelerated to 3.2% year-on-year. The information available for Q4 is supportive of a slight recovery in market services, based on the maintenance of consumption and on the incipient expansion of industrial activity. The composite market services indicator (ISIS), the slowdown in which slackened considerably in Q3, has tended to accelerate in the closing months of the year and the confidence indicators have behaved positively. At a more detailed level, the hotel and catering trade (with a stable increase in employment despite the fall-off in overnight hotel stays) and the wholesale and retail trade (where the employment indicators are also stable and where retail confidence has improved and retail sales risen) have both shown signs of recovery. Financial intermediation and transport, storage and communications activities show signs of slightly diminished momentum in the closing months of the year. These are more marked in communications, while in the transport sector the rate of increase has stabilised, bringing the process of recovery apparent in Q2 to a halt. Lastly, real

estate, rental and corporate service activities have slowed mildly, with a sharper deceleration in IT and R&D.

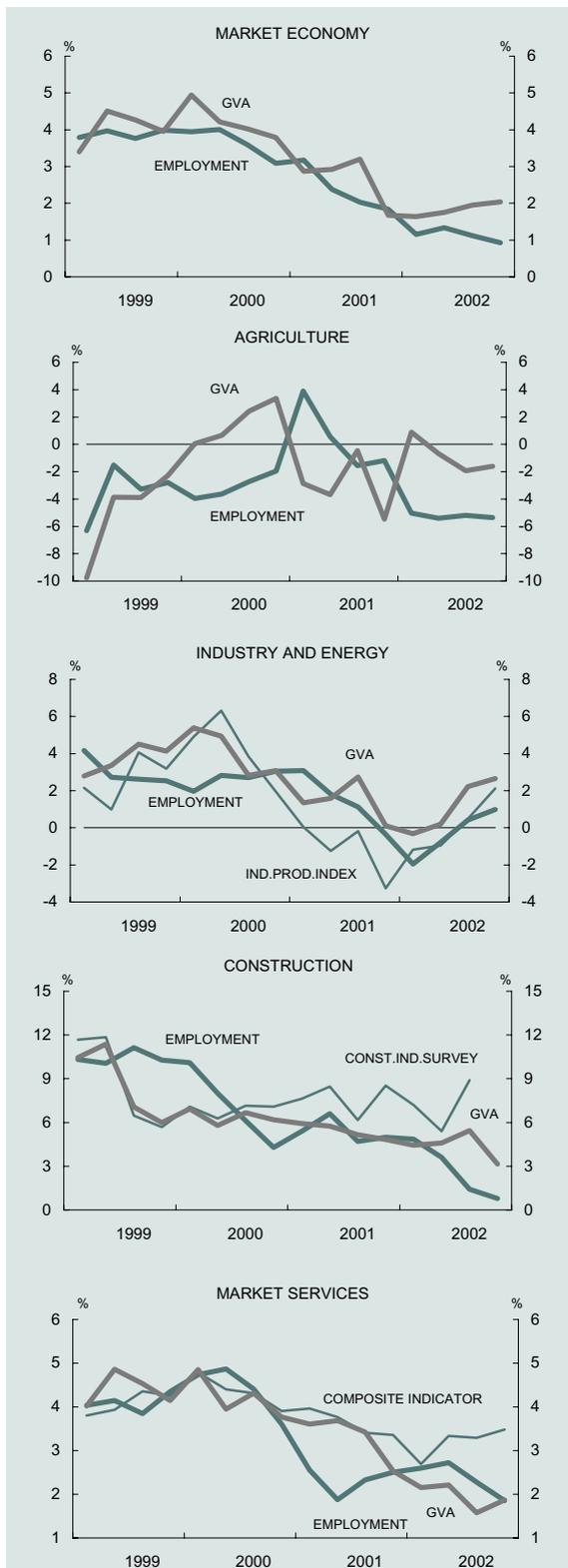
QNA estimates indicate that employment, measured in equivalent full-time jobs, grew at a rate of 1.4% year-on-year in 2002 Q3, 0.1 points down on the previous quarter. The cut in the rate of increase of employment was somewhat less than that in GDP, giving rise to an economy-wide slowdown in apparent labour productivity. In the market economy, however, apparent labour productivity grew by 0.8% year-on-year, significantly above the rise witnessed in Q2, owing to the reduction in the rate of increase of employment against the background of a slight rise in the growth of value added.

The QNA employment figures are in line with the EPA (Labour Force Survey), which showed a 1.8% increase in the number of employed in Q3, half a percentage point down on Q2. In the last quarter of 2002, employment would have seen its rate of increase cut further, in step with the information reflected by the various economic indicators. For one thing, the growth rate of Social Security registrations eased slightly in the October-December period to 3% on a year earlier, with a notable month-on-month reduction in the number of registrations in December (180,000 people), which left the year-on-year rate at 2.8%. The registered unemployment figures also suggest a reduction in the growth of employment in the closing months of 2002. There was a far greater increase in December than that seen in the same month of the previous year, which had already run counter to the systematic declines in unemployment seen in this month from 1994 to 2000. Lastly, the number of employment contracts fell by 2% in the final months of 2002 compared with the same period in 2001.

Across the different branches of activity, employment in Q3 trended in step with value added, except in construction, where the generation of new jobs lost momentum, giving rise to a significant increase in apparent labour productivity (see Chart 18). The pick-up in industrial activity in this period resulted in a modest year-on-year increase in employment of 0.4%, following three quarters of backsliding. Apparent labour productivity continued improving. In the primary industries, employment underwent a fresh and substantial cut, reflecting the contractionary trend of output. Lastly, in market services the rate of increase of employment slowed in Q3, departing from its rising trajectory, while job-creation in non-market services remained high. The disaggregated information on Social Security registrations in Q4 suggests a fresh slowdown in employment in market services

CHART 18

**Gross value added and employment by branch of activity**  
**Percentage change on year ago (a)**



Sources: INE and Banco de España.  
 (a) Seasonally adjusted series. Employment in terms of full-time equivalent jobs.

and, especially, in construction, though it remains stable in industry.

The number of dependent jobs showed higher growth than that of total numbers employed in the first three quarters of 2002, while there were successive cuts in the numbers of self-employed. However, according to QNA figures, dependent employment slowed to a greater extent than total employment in Q3. The more detailed information provided by the Labour Force Survey shows that there continued to be notable buoyancy in the rate of increase of permanent-contract employees in this period (3.9% year-on-year), while the brunt of the slowdown in the economy was borne by temporary employees, the numbers of which fell by 0.3% in the summer months compared with an increase of 1.9% in Q2. The differing trends of the two employment modalities gave rise to a significant reduction in the proportion of temporary to permanent employees, which stood at 31% (31.9% in 2001 Q3). After rising in Q2, the growth rate of full-time employment dipped to 2.5% in Q3 on the same quarter a year earlier, and the rate of change of part-time employment underwent a further cut, taking the number of part-timers as a proportion of total dependent employees to 7.9%, 0.1 points up on 2001 Q3.

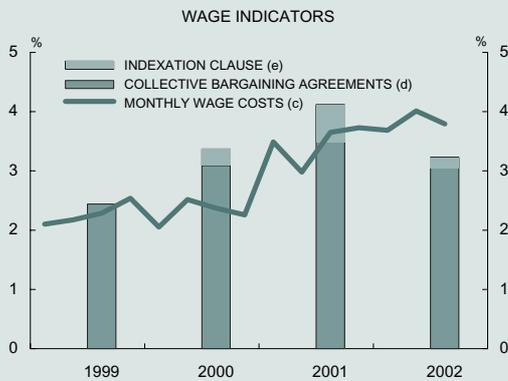
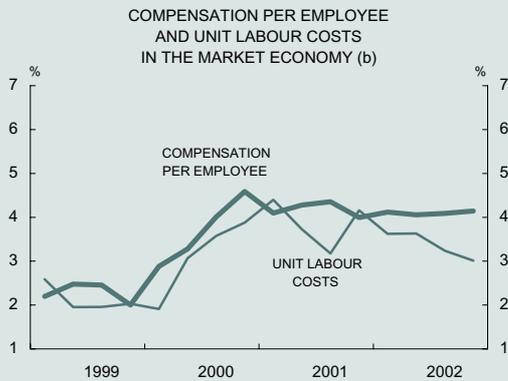
According to the Labour Force Survey, the participation rate increased in Q3 to 54.3%, 1.2 percentage points more than in the same quarter a year earlier. For the 16-64 year-old cohort, habitually used in international comparisons, the participation rate rose by 1.6 percentage points to a level of 67.5%. With these considerable numbers joining the labour market, despite job-creation losing steam, there was an increase in the level of unemployment: in relation to the spring, the unemployment rate climbed by 0.3 points to 11.4%, outpacing the rate for the same period a year earlier by more than one percentage point. The increase in unemployment affected men to a greater extent than women; notwithstanding, the female unemployment rate is twice the male one (16.5% against 8.1%). Finally, the incidence of long-term unemployment continued on a declining course, affecting 36.6% of the unemployed; that said, there was, for the first time in recent years, a slight increase among women.

**4.3. Costs and prices**

Unit labour costs tended to slow in the second half of 2002, set against the slight rise in apparent labour productivity both economy-wide and in market-gear activities. Specifically, on QNA estimates, unit labour costs slowed by 0.4 points in Q3 in both these cases, giving

CHART 19

Wages and labour costs (a)



Sources: INE, Ministerio de Trabajo y Asuntos Sociales and Banco de España.

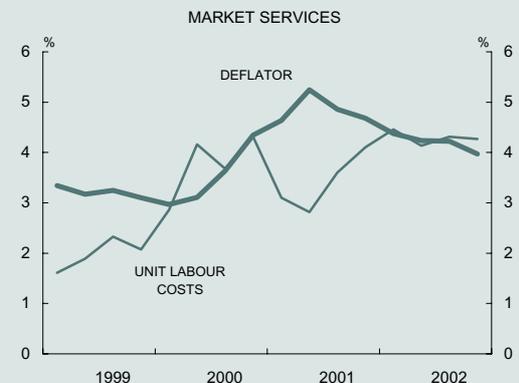
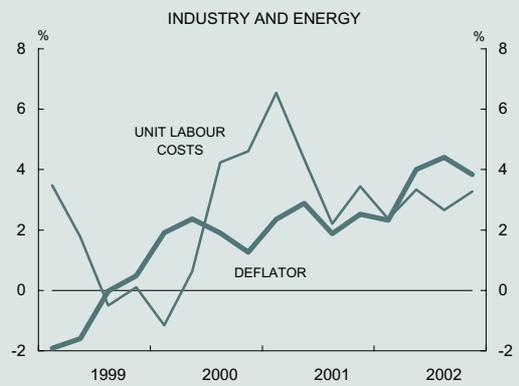
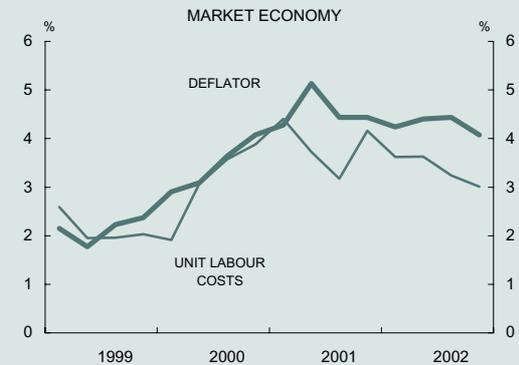
- (a) Percentage change on same quarter a year earlier.
- (b) Rates based on QNA seasonally adjusted series.
- (c) Total earnings.
- (d) Settlement in the year to date.
- (e) Previous year's indexation clause.

growth of 2.9% and 3.2%, respectively. In the market economy, compensation per employee grew at a stable rate of 4.1% during the first three quarters. This figure has yet to incorporate the effects of the activation of the indexation clauses tied to collective bargaining agreements for 2002, as a result of the deviation by inflation from its targeted reference of 2% (see Chart 19). Wage moderation in the public sector made for an economy-wide increase in compensation per employee of 3.7% in Q3.

Among the economic indicators of wages, the Labour Costs Index (LCI) showed an increase in total monthly costs per employee of 4% in Q3, 0.3 points down on the previous quarter. Behaviour differed in the various branches of activity covered by this statistic. The LCI increased by 5% in industry, a similar rate to the previous quarter, adding firmness to the strong acceleration then in train. In services, labour costs slowed by 0.6 points to 4.1%, while in construc-

CHART 20

Prices and costs by branch of activity (a)

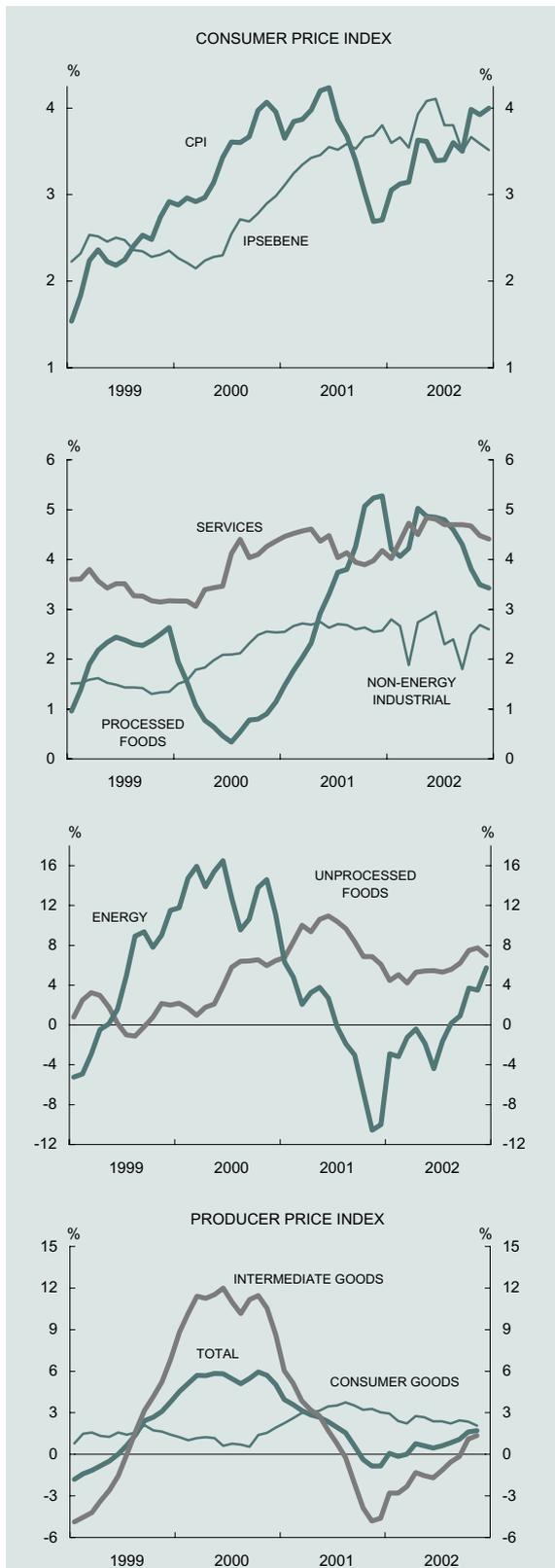


Sources: INE and Banco de España.

- (a) Non-centred percentage change on year ago based on QNA seasonally adjusted series.

CHART 21

**Price indicators (a)  
Spain**



Source: INE.  
(a) Twelve-month percentage change based on the original

tion they quickened significantly to 5.2%. As is habitual, the rise in wage settlements under collective bargaining agreements shows greater homogeneity between branches; agreements recorded to 30 November 2002 included an average settlement of 3%, compared with 3.5% in 2001, before including the indexation clauses (see Chart 19). The widespread use of these clauses, which affect more than three-quarters of employees subject to collective agreements, augur – along with the significant deviation by inflation from the official target of 2% – a considerable effect stemming from wage revision, which will ultimately be reflected in labour costs for 2002. The recent employer-trade union pact, which will act as a basis for collective bargaining in 2003, means a continuation of the patterns of wage determination may be projected for the current year, the final outcome of which will largely depend on the behaviour of prices.

On QNA estimates, the gross value added deflator of the market economy branches grew by 4.4% in 2002 Q3, a similar rate to the previous quarter and 0.3 points up on the related rate for the economy as a whole. The maintenance of the rate of increase of the value added deflator, against the above-mentioned backdrop of moderately slowing unit labour costs, gave rise to a considerable widening of the unit surplus, which has no doubt extended into the final quarter of the year (see Chart 20). Nonetheless, the behaviour of prices and margins has been uneven across the different branches of activity.

The latest QNA estimates indicate that the expansionary trend of the value added deflator in industry would have intensified in Q3, clearly outpacing unit labour costs. That would have allowed for a pick-up in the unit surplus, following a lengthy period of squeezed margins. In construction, unit labour costs slowed notably in Q3 on the back of the less expansionary behaviour of employment and the consequent pick-up in productivity, which made for a fresh and considerable widening of the operating margin. Lastly, according to these estimates, the pace of growth of the market services deflator would have stabilised at a rate very close to that of unit labour costs, with the unit surplus steady, although at a disaggregated level the behaviour of the various services activities is likely to have differed.

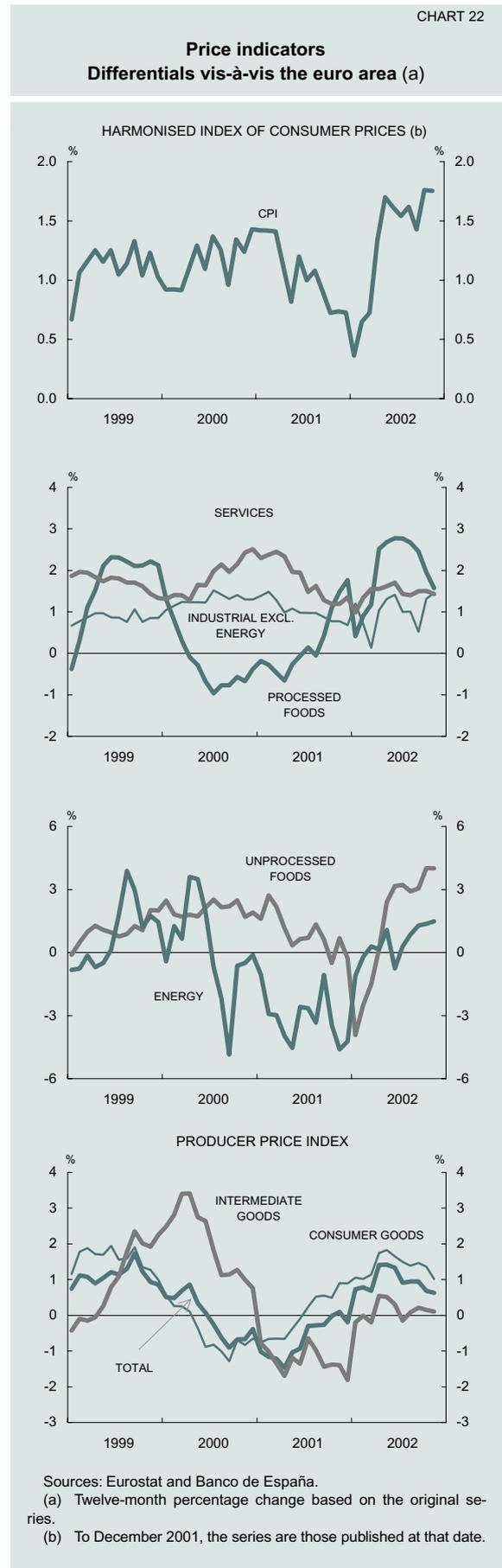
Final prices in the economy in 2002 were favoured by the sound performance of import prices, which tempered domestic inflationary pressures. The deflator of imports of goods and services declined by 1.6% in Q3 on a year earlier, enabling the growth of the final demand deflator to fall by 0.4 points to 2.7%. Nonetheless, in the case of consumer prices the moderating effect of foreign prices was limited, meaning that the

growth rate of both the private consumption deflator and the consumer price index (CPI) held at 3.5% in Q3, a similar rate to the previous quarter. In the final quarter of the year, the CPI accelerated appreciably, growing at an annual average rate of 4% (see Chart 21). However, the more stable components of the CPI, grouped together in the index of services and non-energy manufactured goods prices (IPSEBENE), grew at a year-on-year rate of 3.6% in Q4, 0.1 points down on the previous quarter. The poorer performance of the overall index in this period was mainly due to dearer energy and fresh food prices, although the prices of non-energy manufactured goods also rose slightly.

The strong increase in energy prices in 2002 Q4 was partly due to the base effect arising from the heavy price declines in the final months of 2001, and partly to the rise in oil prices on international markets last December, owing to the general strike in Venezuela and to the increased risk of war in Iraq. That accounts for the acceleration in the energy component of the CPI by more than four percentage points in Q4, which took the related year-on-year rate to 4.3%. The prices of non-energy industrial goods posted an increase of 2.6% year-on-year in Q4 last year, 0.4 points up on the previous quarter. Clothing and footwear prices once again showed the biggest increases, as articles for the new autumn season came on to the market. Unprocessed food recorded an increase of 7.4% in Q4 on a year earlier, compared with 5.7% in Q3. Among the products whose prices were most trending upwards were fish, pork and poultry.

The growth rate of services prices eased in the final two months of the year to 4.5% year-on-year, 0.2 points down on Q3. Behaviour differed across the various services components. There was a moderate acceleration in items relating to tourism and higher education, while the year-on-year rate of telephony and air transport services declined. Lastly, the slowing path of processed food intensified, with a notable moderation in the prices of olive oil and, to a lesser extent, of milk and wine.

The acceleration in inflation in terms of both the CPI and the HICP in Spain in Q4 last year outpaced that of the euro area as a whole. As a result, the inflation differential with the euro zone widened by 0.3 percentage points to 1.8 points, its highest level since this indicator first began to be used in 1996 (see Chart 22). Much of the increase in this differential stems from the fact that the incidence of the rise in oil prices has been greater in Spain than in the euro area, although the differential in respect of the non-energy industrial goods component has also widened. As regards services, the reduction in



the inflation rate has been on a similar scale in Spain and the euro area, with the gap holding at 1.4 percentage points.

Among the remaining price indicators, the producer price index quickened in the closing months of 2002 to a twelve-month growth rate of 2% in December. The acceleration in the overall index was essentially due to the strong rise in energy producer prices, the year-on-year rate of which was above 5% in December, compared with the negative rates it had posted until September. There was a somewhat more moderate acceleration in the producer prices of non-energy intermediate goods. Conversely, consumer goods prices slowed in November and December, the case both for food prices and, to a lesser extent, those of other consumer manufactures. Capital goods prices, meantime, were at a sustained growth rate of around 1.5%. The increase in the pace of producer prices in the euro area led the differential between Spain and the zone to narrow by 0.3 points from September to November (the time of the latest figure released). Finally, prices received by farmers continue to trend moderately, having increased by 0.9% in the twelve months since October 2001.

#### 4.4. The State budget

In December the Updated Stability Programme for Spain for the period 2002-2006 was unveiled. In addition to medium-term fiscal projections (which left the forecast of a balanced budget for 2003 unchanged), the Programme provided new closing figures on the general government accounts for 2002. The financial balance of the general government sector in National Accounts terms for last year would have increased slightly to 0.2% of GDP, against previous forecasts of a balanced budget. In terms of the different agents, the deterioration in the balance would be due to the upward revision of the Regional (Autonomous) Government deficit, at 0.5% of GDP compared with the forecast of a balanced budget. Conversely, for central government, the Programme envisages a surplus of 0.2% of GDP [a deficit of 0.6% of GDP for central government and a surplus of 0.8% of GDP for the Social Security System (see Box 3, which discusses the budget outturn)]. The State Budget Law for 2003, its accompanying complementary legislation (1) and legislation regulating local government tax offices (2) (see Box 4, which presents the main

budgetary measures for 2003) were also approved in December.

Despite the aforementioned central government forecast, on the latest data, to November, the State budget posted a surplus of 1.1% of GDP in 2002, against a surplus of 0.6% of GDP a year earlier. That said, November is traditionally a surplus month for the State due to the seasonality of the figures. In cash-basis terms, the State budget outturn to November resulted in a slight deficit of €332 million, compared with a surplus of €392 million in the same period in 2001 (see Table 3). Most of the discrepancies between both balances can be attributed to the adjustment for interest and the change in outstanding receivables and payables. The latest developments in State revenue and expenditure are discussed hereafter. Cash-basis data are used since the information published contains uniform revenue data for both years.

One month off the close for the year, both revenue and expenditure fell somewhat less than expected in the initial projection, although this discrepancy is greater in the case of revenue, whereby the expected increase in the cash-basis deficit for the year as a whole (26.5%) could be somewhat less, owing to the favourable trend of revenue. The surplus revenue could arise both from the greater buoyancy of tax receipts (especially corporate income tax and VAT) and of other non-tax revenue. The surplus expenses would be essentially due to greater current transfers and to higher capital expenditure (on real investment in particular).

As regards the budgetary data to November, the decline in revenue has quickened and that in expenditure has eased. For the analysis of revenue, uniform information is available both on the portion that continues to be assigned to the State and on that relating to the Regional Governments, although this information is not included in Table 3. These figures indicate that, as in Q3, direct tax takings accelerated in recent months, unlike the case for indirect taxes. The rate of change of personal income tax accelerated slightly, with a notable 8.6% increase in withholdings on income from work and fee-earning activities. Corporate income tax, by contrast, slowed, although its growth remained very high (17.2% to November). Nonetheless, the strong increase recorded was due above all to exceptional revenue linked to companies availing themselves of the Third Transitory Provision of the complementary legislation accompanying the 2002 Budget, which encouraged the integration into taxable income for the year 2002 of extraordinary profits pending such integration. In homogenous terms, VAT continued to slow during the final two months, posting growth of 6.4% against 7.4% in September. Ex-

(1) Law 52/2002 of 30 December 2002, and Law 53/2002 of 30 December 2002 on fiscal, administrative and social measures.

(2) Law 51/2002 of 27 December 2002 reforming Law 39/1988 of 28 December 1988 on the regulation of local tax offices.

**Social Security budget outturn**

On budgetary outturn data to October 2002, the Social Security System posted a surplus of €9.53 billion, €559 million (5.5%) less than in the same period a year earlier (see accompanying table). This decline in the surplus to October was still far lower than envisaged in the initial projection for 2002 compared with the outturn in 2001. As in the case of the State, the Social Security budget outturn figures for 2002 are affected by the new regional government financing arrangements, which entail a reduction in both revenue (owing to the transfers INSALUD – the Spanish National Health Service – receives from the State) and expenditure (owing to the health-care and social services responsibilities assumed). Revenue and expenditure alike sustained a reduction to October that was higher than initially budgeted.

The growth rate of receipts from social security contributions increased slightly in the closing months, standing at 6.1% in the period to October. However, this represents a considerable slowdown on the course they followed in 2001, and is due partly to a smaller increase in new Social Security registrations, namely 3% in 2002 as a whole compared with 3.9% in 2001. The growth rate of contributions to October 2002, though far higher than that drawn from the Budget, in comparison with the outturn the previous year, is in line with the official estimation of the outturn for the year as a whole (1). The other main source of receipts, namely current transfers, which are – virtually in their entirety – from the State, declined by 76.5% to October (a sharper fall than budgeted) as a result of the new regional government financing arrangements.

Expenditure on contributory pensions resumed a growth rate of 5.3%, in line with what was budgeted for the year as a whole. The number of contributory pensions is trending very moderately; their growth rate stands at 0.9% for 2002 as a whole, as forecast and slightly down on the growth recorded in 2001. Spending on sick pay held at a firm growth rate of 13.8%, in contrast to the fall forecast in the budget.

As regards INEM (National Employment Office) expenditure, that on unemployment benefits showed abnormally low figures in October and November, bearing in mind that registered unemployment increased by 7.4% over 2002 as a whole, compared with 0.1% in 2001, and that the eligibility ratio stood at 71.7% to November, against 68.5% at end-2001. As a result, the number of beneficiaries grew by 12.6% to November, compared with average growth of 5.9% in 2001.

Contributions received by INEM increased by 6.3% to July, against a budgeted projection of 9.4%, while employment-promoting concessions on employers' contributions climbed by 7.1% to August, somewhat up on forecast.

(1) The draft 2003 Social Security Budget estimates an increase of 6.1% in regular contributions to the general regime for the whole of 2002.

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

€ m and %

|                               | Outturn        | Budget        |              | Outturn      | Outturn JAN-OCT |               |              |
|-------------------------------|----------------|---------------|--------------|--------------|-----------------|---------------|--------------|
|                               | 2001           | 2002          | % change     | JAN-JUL      | 2001            | 2002          | % change     |
|                               | 1              | 2             | 3=2/1        | % change     | 5               | 6             | 7=6/5        |
| <b>Revenue</b>                | <b>100,265</b> | <b>83,282</b> | <b>-16.9</b> | <b>-21.9</b> | <b>84,772</b>   | <b>66,160</b> | <b>-22.0</b> |
| Social security contributions | 67,350         | 67,852        | 0.7          | 5.6          | 55,689          | 59,090        | 6.1          |
| Current transfers             | 31,383         | 14,389        | -54.2        | -72.7        | 27,880          | 6,542         | -76.5        |
| Other (d)                     | 1,533          | 1,042         | -32.0        | -60.1        | 1,203           | 529           | -56.1        |
| <b>Expenditure</b>            | <b>93,941</b>  | <b>79,411</b> | <b>-15.5</b> | <b>-23.1</b> | <b>74,687</b>   | <b>56,634</b> | <b>-24.2</b> |
| Wages and salaries            | 14,545         | 6,683         | -54.1        | -72.4        | 12,328          | 2,825         | -77.1        |
| Goods and services            | 9,188          | 4,214         | -54.1        | -74.6        | 7,534           | 1,713         | -77.3        |
| Current transfers             | 68,784         | 67,615        | -1.7         | -4.4         | 53,948          | 51,879        | -3.8         |
| Benefits                      | 68,326         | 67,615        | -1.0         | -4.3         | 53,882          | 51,878        | -3.7         |
| <i>Contributory pensions</i>  | 53,375         | 56,231        | 5.4          | 3.6          | 41,628          | 43,841        | 5.3          |
| <i>Sickness</i>               | 4,278          | 4,027         | -5.9         | 12.3         | 3,206           | 3,648         | 13.8         |
| <i>Other</i>                  | 10,673         | 7,358         | -31.1        | -47.0        | 9,049           | 4,389         | -51.5        |
| Other current transfers       | 457            | 0             | -100.0       | -98.4        | 66              | 1             | -98.5        |
| Other (e)                     | 1,424          | 899           | -36.9        | -72.5        | 876             | 217           | -75.3        |
| <b>Balance</b>                | <b>6,324</b>   | <b>3,871</b>  | <b>-38.8</b> | <b>-10.4</b> | <b>10,085</b>   | <b>9,526</b>  | <b>-5.5</b>  |

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 2002.

(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 3

## State Budget outturn

€ m and %

|  | Outturn        | Percentage   | Initial        | Percentage   | Outturn      | Outturn        |               | Percentage   |
|--|----------------|--------------|----------------|--------------|--------------|----------------|---------------|--------------|
|  | 2001           | change       | projection     | change       | JAN-SEP      | 2001           | 2002          |              |
|  | 1              | 2001/2000    | 2002           | 2002/2001    | change       | JAN-NOV        | JAN-NOV       |              |
|  |                |              |                |              | 2002/2001    | 6              | 7             | change       |
|  |                |              |                | 4=3/1        | 5            |                |               | 8=7/6        |
| <b>1. Revenue</b>                        | <b>125,187</b> | <b>5.5</b>   | <b>104,953</b> | <b>-16.2</b> | <b>-12.5</b> | <b>115,848</b> | <b>99,585</b> | <b>-14.0</b> |
| Direct taxes                             | 55,697         | 8.3          | 53,999         | -3.0         | -4.6         | 51,578         | 50,620        | -1.9         |
| <i>Personal income tax</i>               | 36,469         | 13.4         | 32,464         | -11.0        | -13.5        | 34,063         | 30,362        | -10.9        |
| <i>Corporate income tax</i>              | 17,217         | 0.1          | 19,703         | 14.4         | 19.0         | 15,799         | 18,520        | 17.2         |
| <i>Other (a)</i>                         | 2,012          | -3.0         | 1,832          | -9.0         | -22.3        | 1,715          | 1,737         | 1.3          |
| Indirect taxes                           | 53,157         | 3.7          | 37,276         | -29.9        | -26.0        | 50,239         | 36,429        | -27.5        |
| VAT                                      | 34,674         | 3.8          | 24,977         | -28.0        | -22.5        | 33,287         | 25,064        | -24.7        |
| <i>Excise duties</i>                     | 16,612         | 3.5          | 10,333         | -37.8        | -36.7        | 15,231         | 9,569         | -37.2        |
| <i>Other (b)</i>                         | 1,871          | 2.5          | 1,966          | 5.1          | 4.7          | 1,721          | 1,796         | 4.3          |
| Other net revenue                        | 16,333         | 2.1          | 13,678         | -16.3        | 16.4         | 14,031         | 12,537        | -10.7        |
| <b>2. Expenditure (c)</b>                | <b>128,072</b> | <b>5.7</b>   | <b>108,602</b> | <b>-15.2</b> | <b>-14.6</b> | <b>115,455</b> | <b>99,917</b> | <b>-13.5</b> |
| Wages and salaries                       | 16,827         | 3.5          | 17,643         | 4.8          | 3.7          | 14,710         | 15,328        | 4.2          |
| Goods and services                       | 2,554          | 7.7          | 2,680          | 4.9          | 3.8          | 2,216          | 2,355         | 6.3          |
| Interest payments                        | 18,264         | 3.1          | 19,070         | 4.4          | -3.5         | 17,696         | 18,681        | 5.6          |
| Current transfers                        | 77,151         | 5.9          | 57,038         | -26.1        | -24.9        | 69,924         | 52,560        | -24.8        |
| Investment                               | 6,461          | 7.1          | 6,263          | -3.1         | 10.7         | 5,368          | 5,739         | 6.9          |
| Capital transfers                        | 6,815          | 15.2         | 5,908          | -13.3        | -4.4         | 5,541          | 5,254         | -5.2         |
| <b>3. Cash-basis balance (3 = 1 – 2)</b> | <b>-2,884</b>  | <b>18.7</b>  | <b>-3,649</b>  | <b>26.5</b>  | <b>-33.4</b> | <b>392</b>     | <b>-332</b>   |              |
| MEMORANDUM ITEM: NATIONAL ACCOUNTS:      |                |              |                |              |              |                |               |              |
| Revenue                                  | 126,611        | 6.1          | 107,808        | -14.9        | -10.6        | 117,339        | 102,643       | -12.5        |
| Expenditure                              | 129,945        | 4.6          | 111,288        | -14.4        | -16.1        | 113,363        | 95,782        | -15.5        |
| <b>Net lending (+) or borrowing (-)</b>  | <b>-3,334</b>  | <b>-31.8</b> | <b>-3,480</b>  | <b>4.4</b>   | <b>—</b>     | <b>3,976</b>   | <b>6,861</b>  | <b>72.6</b>  |

Source: Ministerio de Hacienda.

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

(b) Includes taxes on insurance premiums and tariffs.

(c) Includes unclassified expenditure.

cise duties quickened slightly during this period, although their growth remained moderate. Finally, other revenue posted a decline of 10.7%, compared with growth of 16.4% the previous quarter. This change was mainly due to the elimination of the Social Security current transfer owing to the transfer of health-care responsibilities to the Basque Country and Navarre.

On the expenditure side there was an across-the-board acceleration in all current expenditure items, unlike with capital expenditure. That said, the changes were not particularly significant, with the exception of the strong accel-

eration in interest payments (which are determined by the timing of public debt redemptions) and, to a lesser extent, of goods and services acquisitions.

#### 4.5. The balance of payments

In the period from January to October 2002, the overall balance on current and capital account resulted in a deficit of €4.31 billion, against the deficit of €8.24 billion in the same period a year earlier. This notable improvement mainly reflects the increase in the capital sur-

## Main budgetary measures for 2003

The State Budget for 2003 is the first to be drawn up following the guidelines laid down in budgetary stability legislation. This involves, among other new features, the setting at a plenary Parliamentary session, prior to the Budget being drawn up, of a State spending ceiling, and the inclusion under such expenditure of a Contingency Fund (set at 2% of total State expenditure) to meet non-discretionary spending requirements initially unforeseen in the Budget arising from its implementation. The amount set for the Contingency Fund for 2003 is of a markedly restrictive nature, as it accounts for approximately half the average value of the amendments to budgetary appropriations applied to State expenditure in recent years. Significantly, however, Social Security benefits are not subject to this restriction; this is the case strictly for the State Budget.

Against this backdrop of general expenditure restraints, the State Budget for 2003 and its accompanying complementary legislation (*Ley de Acompañamiento*) nevertheless include a series of measures, detailed below, which are generally of an expansionary nature. This is particularly so on the revenue side, i.e. measures entailing fewer tax proceeds. Of note among these is the reform of personal income tax, which will involve an 11% cut in the average burden posed by this tax and an increase in average household disposable income of approximately 0.5 points of GDP. Supplementing this personal income tax reform is the reform of the legislation governing local tax (*Ley Reguladora de las Haciendas Locales*), the passage of which through Parliament ran parallel to that of the Budget. The reform has, among other amendments to local taxes, entailed exemption for a large number of taxpayers from the Local Business Tax (IAE by its Spanish name). The legislation reforming local tax stipulates that the State shall compensate the local government tier for forgone IAE takings, which will have a bearing on State spending to the tune of an estimated 0.1 points of GDP. Mention should also be made of the freeze on excise duties, the reduction – under the tax on hydrocarbons – of the rates applicable to liquefied petroleum gas used as general-purpose vehicle fuel and to kerosene used as heating fuel, and the setting of a zero rate for biofuels. Further, the VAT rate on specific feminine hygiene products has been reduced from 16% to 7%. Under corporate income tax the deduction from gross tax payable applicable to reinvested capital gains is raised to 20% (17% previously). The reduction in employer social security contributions for common contingencies in the case of employees aged over 60 is set at 60%, and both employer and employee contributions for workers aged over 65 with 35 or more years' actual contributions who remain in their posts are exempt. Countering this, i.e. entailing an increase in revenue, the maximum social security contribution base is once again updated to one point above the expected change in the CPI.

Charges will generally be raised in line with the foreseeable increase in the CPI (2%). New judiciary charges have been set, and the new railway infrastructure user charges payable by transport operating firms to GIF (the railway infrastructure operator) have been established and regulated.

The expenditure side notably reflects, first, the outcome of the Government/Unions pact approved by the Cabinet on 15 November 2002. As a result of this agreement, the replacement ceiling on public-sector hiring is raised to 100%, against the rate of 25% in force in previous years, with certain exceptions being retained in the administration of justice, the security forces and corps, and the armed forces. Moreover, new public-sector vacancies are to include all temporary posts created over the previous two years. Also, as a result of the aforementioned agreement, the overall compensation of public-sector employees is to be raised by 2%, along with improved supplementary payments.

Among the expenditure policies to be given priority in the 2003 Budget are law and order and justice, notably the Plan to Combat Crime and the application of the State Pact for Justice Reform, which will cost €136 million and €150 million, respectively.

Pensions will generally be updated in line with expected consumer-price inflation (CPI) in 2003. Widows' pensions will be raised from 46% to 48% of the associated regulatory base, and minimum pensions will also be supplemented. Further, the concessions on employer social security contributions for the promotion of stable employment are maintained, as is the re-insertion scheme income paid to the unemployed with special needs and difficulties in finding employment.

Finally, mention should be made of certain measures 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 (transfer from the State to the Social Security system in connection with the supplement to minimum pensions, up €300 million on the previous year), or because they are considered to be financial transactions. Among the latter are the provision of €1.2 billion to the pension reserve fund and the capital contribution of €1.27 billion to GIF (the railway infrastructure operator).

TABLE 4

**Balance of payments: Summary table (a)**

€ m

|                        | JAN-OCT        |                |
|------------------------|----------------|----------------|
|                        | 2001           | 2002           |
| <b>RECEIPTS</b>        |                |                |
| <b>Current account</b> | <b>194,977</b> | <b>194,979</b> |
| Goods                  | 109,862        | 109,753        |
| Services               | 54,799         | 55,485         |
| <i>Tourism</i>         | 31,649         | 30,540         |
| <i>Other services</i>  | 23,150         | 24,945         |
| Income                 | 18,234         | 16,607         |
| Current transfers      | 12,083         | 13,135         |
| <b>Capital account</b> | <b>5,408</b>   | <b>7,930</b>   |
| <b>PAYMENTS</b>        |                |                |
| <b>Current account</b> | <b>207,768</b> | <b>206,404</b> |
| Goods                  | 138,588        | 136,881        |
| Services               | 31,392         | 32,750         |
| <i>Tourism</i>         | 5,628          | 5,954          |
| <i>Other services</i>  | 25,763         | 26,796         |
| Income                 | 27,781         | 26,491         |
| Current transfers      | 10,008         | 10,282         |
| <b>Capital account</b> | <b>859</b>     | <b>811</b>     |
| <b>BALANCE</b>         |                |                |
| <b>Current account</b> | <b>-12,791</b> | <b>-11,425</b> |
| Goods                  | -28,726        | -27,128        |
| Services               | 23,407         | 22,734         |
| <i>Tourism</i>         | 26,021         | 24,586         |
| <i>Other services</i>  | -2,613         | -1,852         |
| Income                 | -9,547         | -9,884         |
| Current transfers      | 2,075          | 2,853          |
| <b>Capital account</b> | <b>4,549</b>   | <b>7,119</b>   |

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

plus, which was €2.57 billion higher than in the first ten months of 2001, and, to a lesser extent, a less negative current-account balance, the deficit on which was €1.37 billion lower. The latter reduction was due to the substantial correction of the trade deficit and the widening of the surplus on current transfers, which offset the deterioration in the tourism and income balances.

In the first ten months of 2002 the cumulative trade deficit narrowed by €1.6 billion in relation to the figure for the same period a year earlier. The significant improvement in the terms of trade, against the background of the strong appreciation of the euro, combined with the slowdown in real import flows over the period as a whole (despite their rise as from Q3),

were behind this correction of the nominal imbalance of trade in goods.

As to services, the cumulative positive balance in the January-October period stood at €22.73 billion, against €23.41 billion in the same period in 2001. This 2.9% reduction can be explained in its entirety by the decline in the tourism and travel surplus (-5.5%), while the deficit in respect of other services narrowed by 29%. Tourist flows slowed substantially over the first ten months of the year. This was especially so for receipts, which fell by 3.5%, in line with the moderation of tourists entering Spain at borders and the reduction in their average spending, as was reflected by the notable decline in overnight hotel stays. Tourism payments also slowed over this same period to 5.8%, in step with sluggish consumer confidence and as a result of the substitution of domestic travel for international travel, given worldwide instability.

In the January-October period the deterioration in the income balance worsened, with the resulting deficit standing at €9.88 billion, €337 million up on that recorded in the same period the previous year. Revenue fell by 8.9%, affected by the reduction in foreign investment in train since last year, against the background of lacklustre global activity and heightened uncertainty on financial markets, partly derived from the social and political crises beleaguering certain Latin American countries. Payments also declined over the first ten months of 2002 by 4.6%, influenced by the marked weakness of foreign investment in Spain in 2001. A fall in direct investment flows continued to be apparent in 2002, although both portfolio investment flows and short-term deposit placements rose.

The surplus on the balance of current transfers stood at €2.85 billion in the January-October period, up €778 million on the level in the same period a year earlier. Receipts climbed by 8.7% as a result of the notable momentum of flows from the EU relating to the European Social Fund, while those earmarked for the EAGGF-Guarantee fund fell slightly. Payments grew at a moderate rate of 2.7%, and there was a notable rise in emigrants' remittances.

Finally, the surplus on capital account stood at €7.12 billion over the first ten months of 2002, €2.58 billion up on the same period in 2001. This sizable improvement, signifying a rate of 56.5% year-on-year, is due to the notable increase in most of the structural funds from the EU, especially those relating to the Cohesion Fund and the EAGGF-Guidance fund and, to a lesser extent, to the European Regional Development Fund.

## 5. Financial developments

### 5.1. Overview

Developments on Spanish financial markets in the second half of 2002 were dominated by the international climate of uncertainty. This was principally related to the effects of a possible war in Iraq, to the doubts regarding economic recovery in certain countries and to the elections in Brazil. The Madrid Stock Exchange General Index fell by 20.3% in Q3, to make a total decline of 30% since the beginning of the year, and the implied volatility of the IBEX 35 reached historically very high levels, exceeding even those in the aftermath of the attacks of 11 September 2001 (see Chart 23). This climate of heightened uncertainty was also reflected in corporate risk premia, measured on the basis of the prices of the credit derivatives of the main Spanish firms, which reached three-year highs in Q3 (3). In Q4, however, the situation improved somewhat. The fall in the Madrid Stock Exchange General Index since the beginning of the year was reduced to 23.1%, while implied volatility and the premiums on credit derivatives both fell.

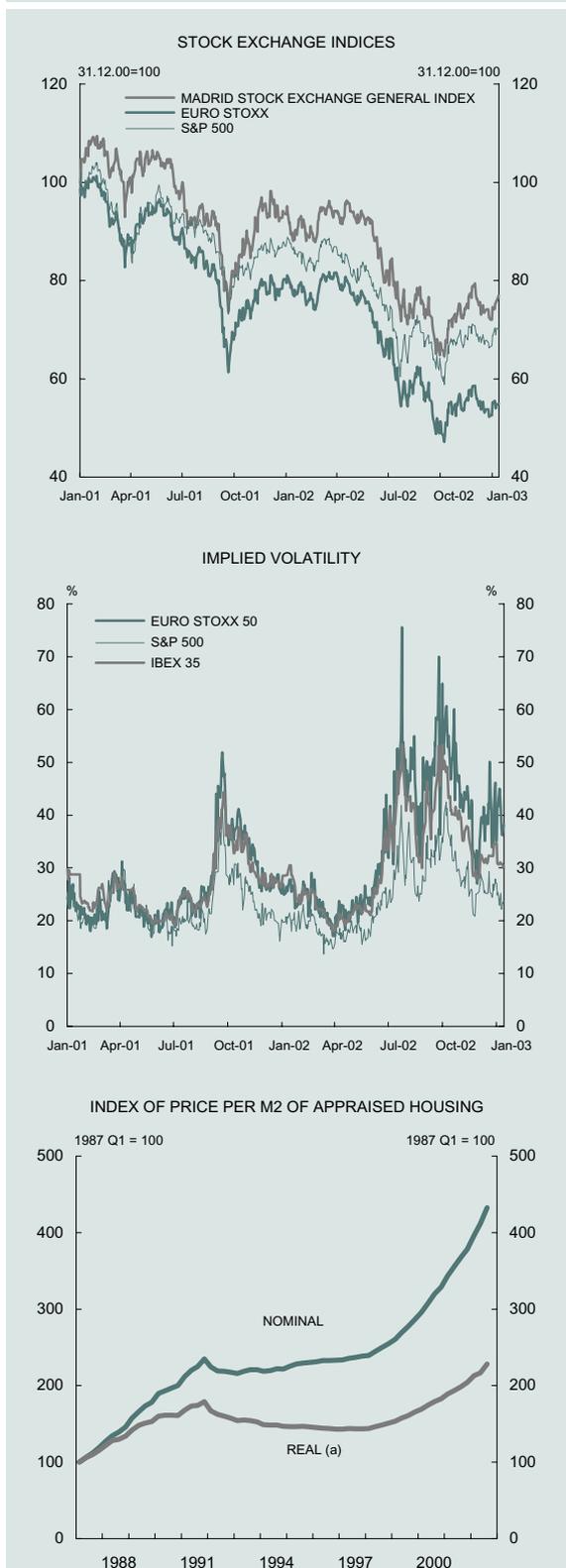
On government debt markets, in both Q3 and Q4, there was a reduction in yields at all maturities and, in particular, at those of less than one year. This trend was not equally strong in all the countries of the euro area, so that the spread between long-term yields on Spanish and German government debt narrowed significantly (see Box 5). Finally, the boom in house prices, dating back to 1997, continued in Q3 without any significant signs of flagging. The price per square metre of appraised housing rose in the quarter at a year-on-year rate of 17.7%, making a cumulative increase since 1997 of 59% in real terms.

Despite the background of greater uncertainty, financing to the non-financial private sector continued to increase at high rates during 2002 Q3. In the case of households, credit growth continued without any sign of a slowdown. In particular, credit for house purchase continued to expand at rates of around 18%. The mild slowdown in the external financing of non-financial corporations continued, although its rate of expansion is still high given the cyclical position of the Spanish economy. As in the case of households, the behaviour of property-related credit explains a large part of this high rate of growth. The provisional Q4 information does not appear to show any significant change

(3) For a more detailed analysis of the information drawn from credit derivatives, see the article by Roberto Blanco entitled "El contenido informativo de los derivados crediticios", published in the Boletín económico, Banco de España, January 2003.

CHART 23

Price indicators for various assets



Sources: Bloomberg and Banco de España.  
(a) Deflated with the CPI.

in the growth of financing to firms and households and, in particular, that granted by resident entities increased in December at a similar year-on-year rate to September.

In parallel with these developments in financing, the financial saving of the non-financial private sector deteriorated in Q3 (see Table 5). The financial saving of households remained positive, albeit at very low levels, while that of non-financial firms was significantly negative. The debt ratios of firms and households continued to rise, albeit less strongly than in previous quarters, so that the degree of their exposure to possible negative shocks to the cost of financing, to their wealth or to their present or future income has not been reduced.

Despite the deterioration in the net financial saving of firms and households, the debit balance of the nation's net financial transactions fell slightly, to stand at 1.6% of GDP, in cumulative four-quarter terms (4) (see Table 5). The sign of this change is explained by the behaviour of general government, with a positive saving ratio of 0.5%, which outweighed the private sector's greater recourse to external funds.

5.2. Households

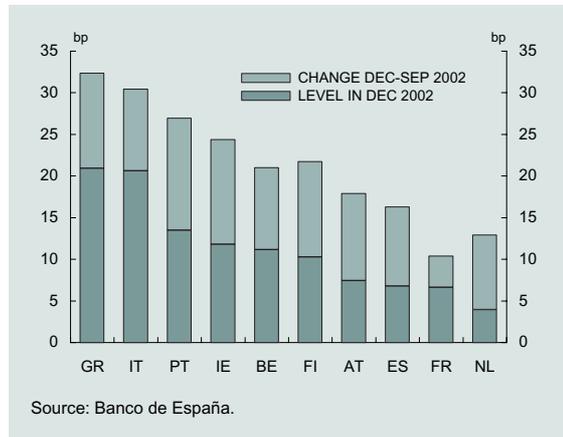
In Q3 the net financial saving of households was positive, amounting to 0.1% of GDP. In cumulative four-quarter terms it stood at 0.5% of GDP, as against 0.8% in the previous quarter (see Table 5). In terms of their gross disposable income, saving after debt service also fell, to 1.5% (see Chart 25). This low level of saving, against a background of high uncertainty and moderation of spending seems to be related, as mentioned in recent quarterly reports, to the level of the cost of financing and to the upward path of house prices. At the same time, the negative performance of the domestic and international financial markets led, for the second quarter running, to a decline in the financial wealth of households of more than 10% of GDP, in cumulative four-quarter terms (see Chart 24). Also, the level of their debt relative to both their financial wealth and their gross disposable income continued to rise although, obviously, the increase was smaller in terms of the latter. However, given the favourable trend in interest rates, this rise in debt did not lead to a significant rise in the debt service burden (see Chart 25).

(4) Throughout this section, in line with the information given in the tables and charts, the figures for financial flows refer to cumulative four-quarter data, unless otherwise indicated.

**Yield spreads on government debt in the euro area: recent developments**

The disappearance of foreign exchange risk in the euro area, when the euro was launched in 1999, means that the only factors currently affecting the yield spreads on the debt issued by the treasuries of the countries of the area are the different creditworthiness of the issuers and microstructural-type factors, such as the relative degree of liquidity. Since then, these spreads have displayed a high degree of stability while the lowest yield has been on German debt (especially at the longer dates), this being related to the strong creditworthiness of the Germany treasury and the high degree of liquidity of its bonds.

**Spreads on ten-year government debt over Germany**



Against this background, in 2002 Q4 there was a significant reduction in the yield spreads on the long-term government debt of the countries of the euro area over German bonds, as seen in the adjoining chart. With the exception of French debt, whose spread only narrowed by some 4 basis points (bp), the reduction was very similar across countries (between 9 and 13 bp). Following these movements, the spreads stand, in all cases, at their lowest levels since the introduction of the euro and, in most countries, at historic lows. Relative to swap rates, however, German and French bonds yields have risen by 9 and 5 bp respectively, while those of the other issuers of the euro area have held relatively steady. This suggests that the changes in the relative valuation of government bonds in the euro area are driven by idiosyncratic factors pertaining to the German and French economies.

These movements have coincided with downward revisions in the budget balances and economic growth estimated for 2002 and 2003 in most of the countries of the area, and particularly in France and Germany. The deterioration of the budget position in these two countries led to initiation by the European Commission, at the end of 2002, of the excessive deficit and early warning procedures for Germany and France respectively. According to the European Commission's autumn forecasts, the debt-to-GDP ratio will have increased in 2002 by 1.4 percentage points in Germany and 1.3 in France, and in 2003 it will rise by a further 0.9 and 0.7 percentage points respectively. It is therefore plausible to think that the revision in the valuation of German and French bonds during 2002 Q4 may have been related to the perception on the part of the markets of a deterioration in the creditworthiness of their issuers. However, part of the increase in the debt-to-GDP ratio in these countries had already been anticipated in the spring and in some countries, such as Italy and Greece, the rise in this ratio has been even larger, and yet the relative valuation of their debt relative to swap rates has not changed. Accordingly, other factors of a more microstructural nature may also have contributed to the changes in the relative prices of German and French debt. Indeed, the significant increase forecast for the coming months in bond issuance in these two countries might have exerted further upward pressure on the yields of these securities.

TABLE 5

**Net financial transactions and inter-sectoral flows  
(cumulative four-quarter data)**

% GDP

|  | NET FINANCIAL TRANSACTIONS |             |             |             |             |             |             |             |             |
|--|----------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
|  | 1997                       | 1998        | 1999        | 2000        | 2001        |             | 2002        |             |             |
|  |                            |             |             |             | Q3          | Q4          | Q1          | Q2          | Q3          |
| <b>Total economy</b>                             | <b>1.6</b>                 | <b>0.5</b>  | <b>-1.1</b> | <b>-2.5</b> | <b>-1.9</b> | <b>-2.0</b> | <b>-1.9</b> | <b>-1.8</b> | <b>-1.6</b> |
| <b>Non-financial corporations and households</b> | <b>4.0</b>                 | <b>2.2</b>  | <b>-0.4</b> | <b>-2.6</b> | <b>-2.1</b> | <b>-3.1</b> | <b>-3.7</b> | <b>-3.1</b> | <b>-3.5</b> |
| Non-financial corporations                       | -0.5                       | -1.1        | -2.4        | -3.5        | -4.3        | -4.1        | -4.6        | -4.0        | -4.1        |
| Households and NPISHs                            | 4.5                        | 3.3         | 2.0         | 0.9         | 2.2         | 1.0         | 0.9         | 0.8         | 0.5         |
| <b>Financial institutions</b>                    | <b>0.7</b>                 | <b>1.0</b>  | <b>0.5</b>  | <b>0.7</b>  | <b>0.8</b>  | <b>1.2</b>  | <b>1.4</b>  | <b>1.3</b>  | <b>1.4</b>  |
| <b>General government</b>                        | <b>-3.2</b>                | <b>-2.7</b> | <b>-1.1</b> | <b>-0.6</b> | <b>-0.5</b> | <b>-0.1</b> | <b>0.5</b>  | <b>0.0</b>  | <b>0.5</b>  |
|  | INTERSECTORAL FLOWS (a)    |             |             |             |             |             |             |             |             |
| <b>Households and NPISHs</b>                     | <b>4.5</b>                 | <b>3.3</b>  | <b>2.0</b>  | <b>0.9</b>  | <b>2.2</b>  | <b>1.0</b>  | <b>0.9</b>  | <b>0.8</b>  | <b>0.5</b>  |
| Vis-à-vis:                                       |                            |             |             |             |             |             |             |             |             |
| Credit institutions (b)                          | -6.7                       | -4.4        | 0.2         | -0.2        | -0.5        | -1.5        | -2.3        | -2.9        | -3.4        |
| Institutional investors (c)                      | 10.8                       | 7.5         | 0.8         | 0.5         | 3.1         | 3.6         | 3.4         | 3.4         | 3.2         |
| <b>Non-financial corporations</b>                | <b>-0.5</b>                | <b>-1.1</b> | <b>-2.4</b> | <b>-3.5</b> | <b>-4.3</b> | <b>-4.1</b> | <b>-4.6</b> | <b>-4.0</b> | <b>-4.1</b> |
| Vis-à-vis:                                       |                            |             |             |             |             |             |             |             |             |
| Credit institutions (b)                          | -3.1                       | -4.3        | -3.8        | -6.7        | -4.3        | -3.8        | -4.0        | -4.1        | -3.6        |
| Rest of the world                                | 1.7                        | 0.9         | -0.8        | 1.8         | -0.1        | -1.8        | -2.0        | -1.2        | -1.2        |
| <b>General government</b>                        | <b>-3.2</b>                | <b>-2.7</b> | <b>-1.1</b> | <b>-0.6</b> | <b>-0.5</b> | <b>-0.1</b> | <b>0.5</b>  | <b>0.0</b>  | <b>0.5</b>  |
| Vis-à-vis:                                       |                            |             |             |             |             |             |             |             |             |
| Credit institutions (b)                          | 1.4                        | 1.4         | 1.4         | 2.2         | -0.7        | -2.4        | -0.3        | -0.4        | 0.7         |
| Institutional investors (c)                      | -3.9                       | -2.6        | 1.7         | 3.9         | 3.0         | 2.9         | 1.6         | 1.3         | 0.6         |
| Rest of the world                                | -2.0                       | -1.1        | -4.4        | -6.0        | -3.1        | -1.7        | -1.8        | -1.6        | -1.6        |
| <b>Rest of the world</b>                         | <b>-1.6</b>                | <b>-0.5</b> | <b>1.1</b>  | <b>2.5</b>  | <b>1.9</b>  | <b>2.0</b>  | <b>1.9</b>  | <b>1.8</b>  | <b>1.6</b>  |
| Vis-à-vis:                                       |                            |             |             |             |             |             |             |             |             |
| Credit institutions (b)                          | 2.8                        | 7.1         | 2.0         | 5.2         | 4.5         | 3.8         | 2.7         | 3.9         | 3.3         |
| Institutional investors (c)                      | -2.5                       | -6.3        | -3.6        | -5.6        | -4.9        | -4.7        | -3.6        | -3.7        | -3.3        |
| Non-financial corporations                       | -1.7                       | -0.9        | 0.8         | -1.8        | 0.1         | 1.8         | 2.0         | 1.2         | 1.2         |
| General government                               | 2.0                        | 1.1         | 4.4         | 6.0         | 3.1         | 1.7         | 1.8         | 1.6         | 1.6         |

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.

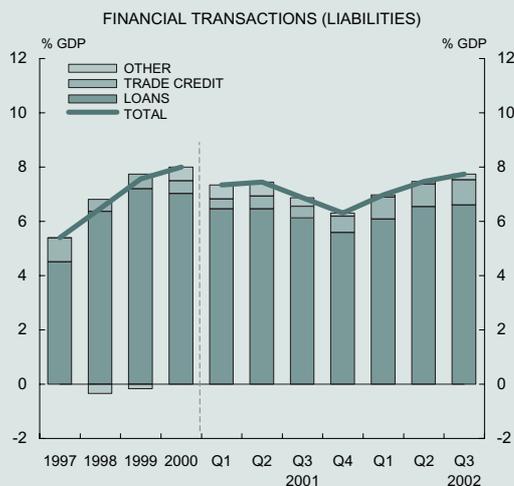
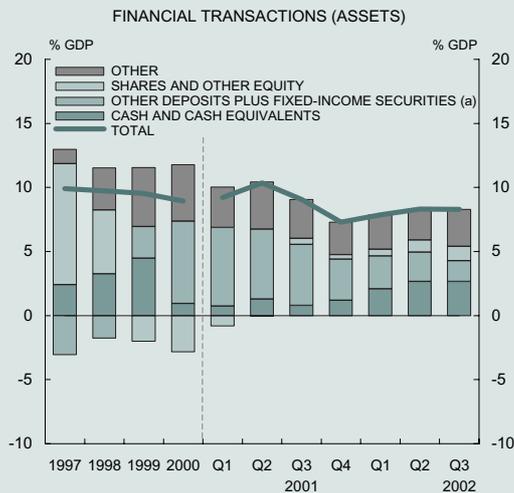
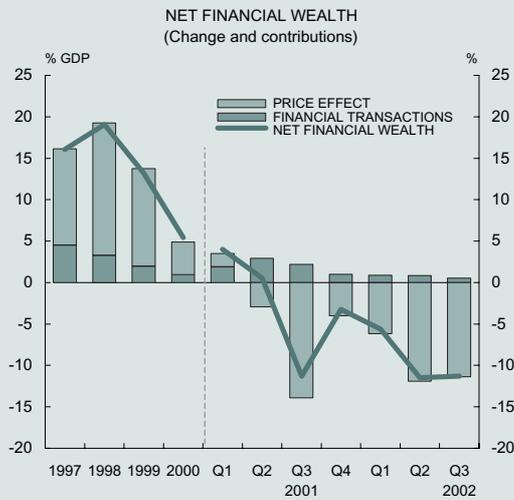
Finally, in relation to their portfolio decisions, the acquisition of financial assets by households, in cumulative four-quarter terms, stood at 8.3% of GDP, the same level as in Q2 (see Table 6). The composition by instrument of this flow shows some differences in relation to the preceding quarter. The shift in household portfolios towards more liquid assets seems to have moderated; there was a greater acquisition of shares and other equity, which amounted to 0.4% of GDP, as against 0.1% three months earlier (see Chart 24). The net acquisition of shares in mutual funds remained positive, since the increase in the net acquisition of shares in money-market

funds offset the decline in that of shares in other funds.

As for liabilities, total financing reached a year-on-year growth rate of 14.1%, as against 14% in the previous quarter. In terms of GDP, the flow of financing received from other sectors rose from 7.5% to 7.7%. The information on the distribution of loans by purpose reveals that this outcome was largely due to the notable buoyancy of loans for house purchase, the growth of which (18.1% year-on-year, as against 16.6% in June) offset the slowdown in loans for spending on current and durable goods.

CHART 24

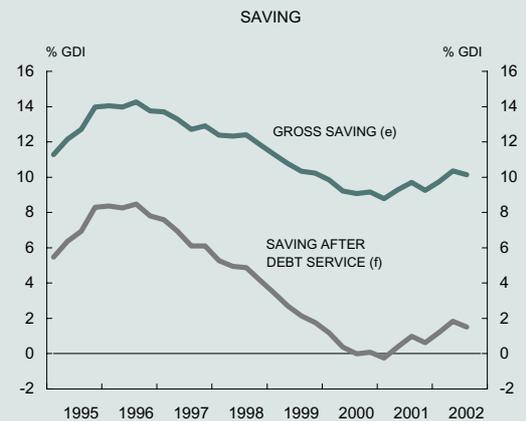
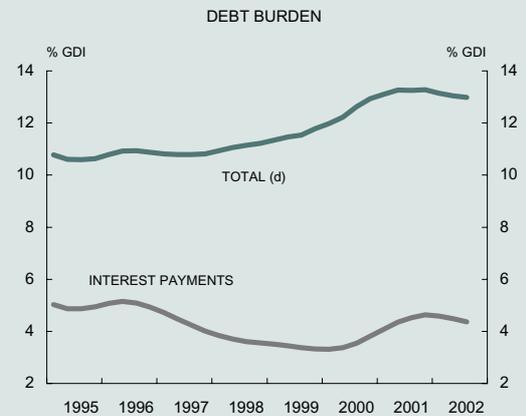
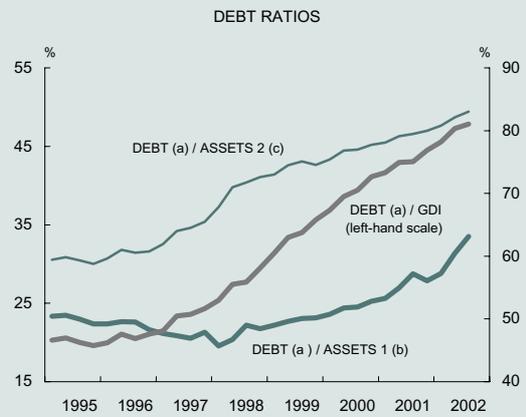
**Households and NPISHs  
(cumulative four-quarter data)**



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

CHART 25

**Indicators of the financial position of  
households and NPISHs**



Source: Banco de España.  
(a) Including bank credit extended by resident credit institutions, foreign loans, fixed-income securities and financing through securitisation funds.  
(b) Assets 1 = Total financial assets - "other".  
(c) Assets 2 = Assets 1 - shares - shares in FIM.  
(d) Calculated on the basis of bank credit extended by resident credit institutions.  
(e) Balance of households' use of disposable income account. Including interest payments.  
(f) Gross saving less estimated debt repayments.

TABLE 6

**Financial assets and liabilities of households, NPISHs and non-financial corporations  
(Cumulative four-quarter data)**

% GDP

|   | 1999        | 2000        | 2001        | 2002        |             |             |
|---|-------------|-------------|-------------|-------------|-------------|-------------|
|   |             |             |             | Q1          | Q2          | Q3          |
| <b>HOUSEHOLDS AND NPISHs:</b>                           |             |             |             |             |             |             |
| <b>Financial transactions (assets)</b>                  | <b>9.5</b>  | <b>8.9</b>  | <b>7.3</b>  | <b>7.9</b>  | <b>8.3</b>  | <b>8.3</b>  |
| Cash and cash equivalents                               | 4.5         | 0.9         | 1.2         | 2.1         | 2.7         | 2.7         |
| Other deposits and fixed-income securities (a)          | 2.5         | 6.4         | 3.2         | 2.6         | 2.3         | 1.6         |
| Shares and other equity (b)                             | 0.1         | 0.5         | -0.4        | -0.1        | 0.1         | 0.4         |
| Mutual funds  | -2.2        | -3.4        | 0.8         | 0.6         | 0.8         | 0.7         |
| <i>FIAMM</i>  | -1.4        | -1.4        | 1.3         | 1.4         | 1.2         | 1.0         |
| <i>FIM</i>  | -0.8        | -2.0        | -0.5        | -0.8        | -0.4        | -0.4        |
| Insurance technical reserves                            | 3.3         | 3.5         | 2.2         | 2.2         | 2.0         | 2.0         |
| Of which:   |             |             |             |             |             |             |
| <i>Life assurance</i>                                   | 2.0         | 1.9         | 1.5         | 1.5         | 1.3         | 1.4         |
| <i>Pension funds</i>                                    | 1.0         | 1.4         | 0.5         | 0.5         | 0.5         | 0.4         |
| Other   | 1.3         | 1.0         | 0.3         | 0.5         | 0.4         | 0.9         |
| <b>Financial transactions (liabilities)</b>             | <b>7.6</b>  | <b>8.0</b>  | <b>6.3</b>  | <b>7.0</b>  | <b>7.5</b>  | <b>7.7</b>  |
| Credit from resident credit institutions                | 6.5         | 6.8         | 5.1         | 5.7         | 6.1         | 6.3         |
| Securitisation funds                                    | 0.6         | 0.1         | 0.3         | 0.2         | 0.3         | 0.1         |
| Other   | 0.5         | 1.0         | 0.9         | 1.0         | 1.1         | 1.3         |
| <b>NON-FINANCIAL CORPORATIONS:</b>                      |             |             |             |             |             |             |
| <b>Financial transactions (assets)</b>                  | <b>17.8</b> | <b>27.2</b> | <b>17.6</b> | <b>17.6</b> | <b>14.3</b> | <b>13.9</b> |
| Cash and cash equivalents                               | 0.7         | 0.9         | 1.7         | 1.9         | 1.6         | 1.5         |
| Other deposits and fixed-income securities (a)          | -0.3        | 1.2         | 0.9         | 0.3         | 0.5         | 0.5         |
| Shares and other equity                                 | 8.2         | 14.1        | 4.2         | 4.6         | 3.7         | 3.2         |
| Of which:   |             |             |             |             |             |             |
| <i>Vis-à-vis the rest of the world</i>                  | 6.5         | 10.9        | 3.7         | 3.5         | 2.6         | 2.3         |
| Other   | 9.1         | 10.9        | 10.8        | 10.7        | 8.5         | 8.7         |
| <b>Financial transactions (liabilities)</b>             | <b>20.2</b> | <b>30.7</b> | <b>21.6</b> | <b>22.2</b> | <b>18.2</b> | <b>18.0</b> |
| Credit from resident credit institutions                | 4.8         | 6.7         | 6.0         | 6.5         | 5.4         | 5.5         |
| Securitisation funds                                    | 0.4         | 0.9         | 0.8         | 1.0         | 1.3         | 1.1         |
| Foreign loans   | 3.0         | 3.5         | 3.6         | 3.6         | 2.9         | 2.7         |
| Fixed-income securities (a)                             | 0.5         | -0.7        | 0.2         | 0.1         | 0.0         | 0.0         |
| Shares and other equity                                 | 5.0         | 12.1        | 3.8         | 3.4         | 2.9         | 2.7         |
| Other   | 6.4         | 8.1         | 7.3         | 7.6         | 5.7         | 6.0         |
| <b>MEMORANDUM ITEMS: YEAR-ON-YEAR GROWTH RATES (%):</b> |             |             |             |             |             |             |
| <b>Financing (c)</b>                                    | <b>19.5</b> | <b>18.8</b> | <b>15.1</b> | <b>16.1</b> | <b>14.4</b> | <b>14.1</b> |
| Households and NPISHs                                   | 19.6        | 17.3        | 12.4        | 13.4        | 14.0        | 14.1        |
| Non-financial corporations                              | 19.4        | 19.9        | 17.2        | 18.1        | 14.6        | 14.0        |

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, fixed-income securities and financing through securitisation funds.

### 5.3. Non-financial corporations

In 2002 Q3, the net balance of the financial transactions of non-financial corporations was -1.4% of GDP (against -1.3% in the same quarter a year earlier). In cumulative four-quarter terms, this balance was -4.1% of GDP (-4% in Q2, see Table 5). Similar stability was seen in the financing gap of this sector (see Chart 26).

Accordingly, despite the moderation with respect to early 2001, the dissaving of non-financial corporations remained at high levels, as reflected in the trend in the debt of the sector, which continued to rise in 2002 Q3 relative both to the gross operating surplus and, at least in the case of the firms reporting to the Central Balance Sheet Data Office, to their assets (see Chart 27). However, an increase in the debt

service burden was avoided on account of the favourable trend in interest rates. In any case, the exposure of Spanish firms to possible adverse shocks is now greater and, in consequence, their investment decisions will foreseeably be more influenced by the trend in the costs of financing than they were during the cyclical upturn in the previous business cycle (5).

The deceleration seen in previous quarters in corporate investment in financial assets continued, so that it fell to 13.9% of GDP, from 14.3% in Q2. This behaviour is the result of lower acquisition of shares and other equity, along with a mild reduction in liquidity requirements (see Table 6). By contrast, investment in the assets classified under the heading "other" in Table 6, which include trade credit, increased slightly (8.7% of GDP, as against 8.5% three months earlier). However, there was a similar change in the flows grouped under this heading on the liabilities side, so that, in all, there were no significant changes in the net flow of inter-company financing.

Meanwhile, liabilities transactions continued to slow, although less sharply than in the previous quarter. External financing granted to non-financial corporations grew at a year-on-year rate of 14%, as against 14.6% in the previous quarter. In cumulative terms, funds raised amounted to 18% of GDP (18.2% three months earlier). This slowdown affected most items, the main exception being, as mentioned above, those under the heading "other". Thus, the combined financing from credit granted by resident entities and from securitisation funds declined to 6.6% of GDP, while that channelled through foreign loans and obtained through shares and equity fell from 2.9% to 2.7%. The high rate of growth of financing is a result of different behaviour across the various sectors. The year-on-year growth rate of property-related credit (construction and property services) reached 22%, compared with 17% in the previous quarter. However, credit to industry, excluding construction, continued to increase at the low rates seen during the first half, while the financing received by the services sector, excluding services related to property activity, continued to grow at year-on-year rates of around 10%.

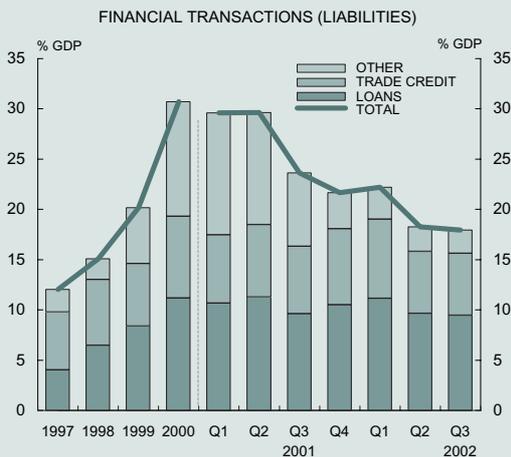
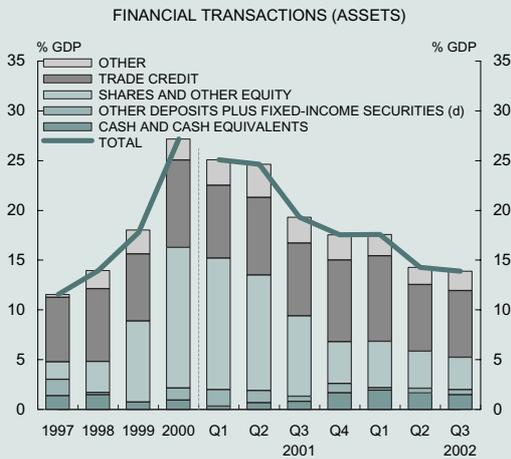
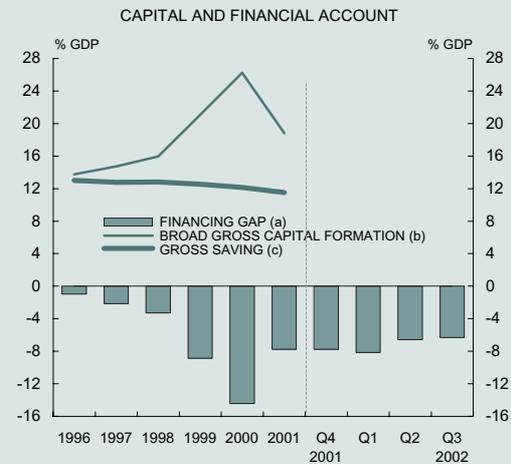
#### 5.4. General government

The net balance of the financial transactions of general government in 2002 Q3 was

(5) For further details see the article by A. Benito and I. Hernando, entitled "Los efectos de la presión financiera en el comportamiento de las empresas españolas", published in the Boletín económico, Banco de España, January 2003.

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

**Indicators of the financial position of non-financial corporations (a)**

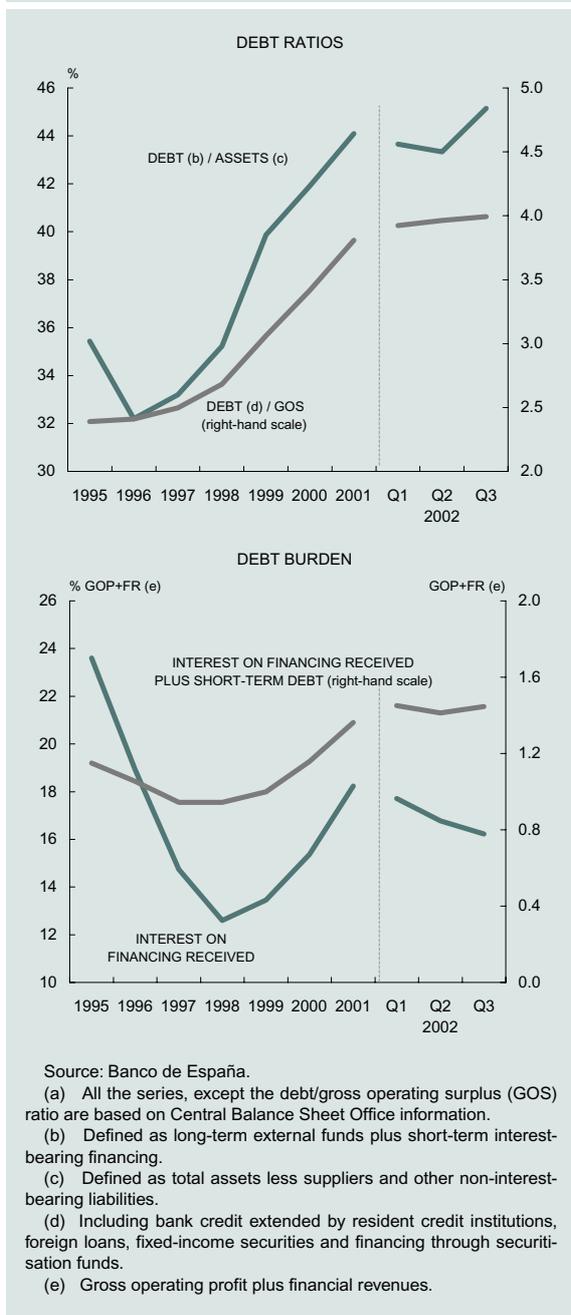
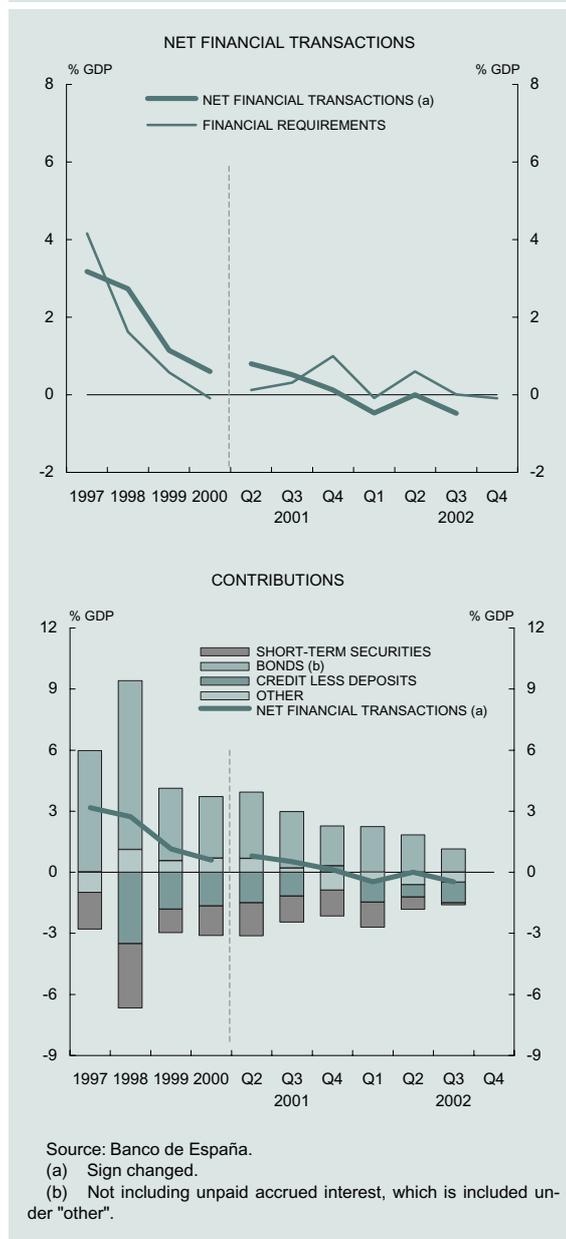


CHART 28

**General government (cumulative four-quarter data)**



positive, so that its financial saving, in cumulative four-quarter terms, rose to 0.5% of GDP (see Chart 28).

As regards its components, the lower financing requirements of general government during this quarter were reflected in a practically nil volume of net issuance of short- and long-term debt and significant repayment of financing received through loans. At the same time, the average term of general government debt continued to lengthen. Specifically, the outstanding

stock of general government bonds increased by 1.1% of GDP, while there was a net repayment of its short-term securities and loans net of deposits of 0.1% and 1% respectively. As for the distribution of government debt holdings among investors, there were no significant changes during this period, so that practically half the stock of outstanding bonds continued to be held by non-residents.

As for the fourth quarter, provisional information is contained in the financial requirements indicator. This indicator measures general government recourse to the financial markets and it fell to -0.09% of GDP, from 0.01% in Q3.

TABLE 7

**Financial transactions of the nation (cumulative four-quarter data)**

% GDP

|   | 1999        | 2000        | 2001        | 2002        |             |             |
|---|-------------|-------------|-------------|-------------|-------------|-------------|
|   |             |             |             | Q1          | Q2          | Q3          |
| <b>Net financial transactions</b>           | <b>-1.1</b> | <b>-2.5</b> | <b>-2.0</b> | <b>-1.9</b> | <b>-1.8</b> | <b>-1.6</b> |
| <b>Financial transactions (assets)</b>      | <b>14.8</b> | <b>24.5</b> | <b>10.8</b> | <b>8.7</b>  | <b>9.9</b>  | <b>10.6</b> |
| <b>Gold and SDRs</b>                        | <b>-0.2</b> | <b>0.0</b>  | <b>0.0</b>  | <b>0.0</b>  | <b>0.0</b>  | <b>0.0</b>  |
| <b>Cash and deposits</b>                    | <b>1.7</b>  | <b>2.8</b>  | <b>-2.6</b> | <b>-3.8</b> | <b>-0.4</b> | <b>1.0</b>  |
| Credit system                               | 3.7         | 2.5         | -2.7        | -3.3        | -0.6        | 0.2         |
| Other resident sectors                      | -2.0        | 0.4         | 0.1         | -0.6        | 0.2         | 0.8         |
| <b>Securities other than shares</b>         | <b>2.8</b>  | <b>3.8</b>  | <b>7.1</b>  | <b>7.4</b>  | <b>5.8</b>  | <b>5.6</b>  |
| Credit system                               | -0.9        | -0.3        | 2.0         | 2.3         | 1.0         | 1.3         |
| Other resident sectors                      | 3.7         | 4.1         | 5.1         | 5.1         | 4.9         | 4.3         |
| <b>Shares and other equity</b>              | <b>9.8</b>  | <b>15.1</b> | <b>3.7</b>  | <b>3.1</b>  | <b>2.7</b>  | <b>2.5</b>  |
| Credit system                               | 0.7         | 1.7         | -0.1        | -0.4        | 0.1         | 0.1         |
| Other resident sectors                      | 9.1         | 13.4        | 3.8         | 3.4         | 2.6         | 2.4         |
| Of which:                                   |             |             |             |             |             |             |
| Non-financial corporations                  | 6.5         | 10.9        | 3.7         | 3.5         | 2.6         | 2.3         |
| <b>Loans</b>                                | <b>0.7</b>  | <b>2.7</b>  | <b>2.6</b>  | <b>2.1</b>  | <b>1.8</b>  | <b>1.6</b>  |
| Credit system                               | -0.2        | 0.5         | 0.8         | 0.6         | 0.6         | 0.5         |
| Other resident sectors                      | 0.9         | 2.1         | 1.9         | 1.5         | 1.2         | 1.1         |
| <b>Financial transactions (liabilities)</b> | <b>15.9</b> | <b>27.0</b> | <b>12.8</b> | <b>10.6</b> | <b>11.7</b> | <b>12.2</b> |
| <b>Deposits</b>                             | <b>4.1</b>  | <b>6.8</b>  | <b>2.8</b>  | <b>1.1</b>  | <b>4.5</b>  | <b>4.6</b>  |
| Of which:                                   |             |             |             |             |             |             |
| Credit system                               | 4.1         | 6.8         | 2.8         | 1.1         | 4.5         | 4.7         |
| <b>Debt securities issued</b>               | <b>5.4</b>  | <b>6.9</b>  | <b>3.1</b>  | <b>3.1</b>  | <b>3.0</b>  | <b>3.8</b>  |
| Credit system                               | 0.9         | 0.7         | 0.6         | 0.8         | 0.2         | 0.7         |
| General government                          | 4.3         | 5.7         | 1.6         | 1.6         | 1.4         | 1.5         |
| Other resident sectors                      | 0.2         | 0.4         | 0.9         | 0.8         | 1.4         | 1.6         |
| <b>Shares and other equity</b>              | <b>3.9</b>  | <b>9.1</b>  | <b>3.5</b>  | <b>2.8</b>  | <b>2.1</b>  | <b>1.9</b>  |
| Credit system                               | 0.3         | 1.7         | 0.5         | 0.2         | 0.3         | 0.2         |
| Other resident sectors                      | 3.6         | 7.3         | 2.9         | 2.6         | 1.8         | 1.8         |
| <b>Loans</b>                                | <b>3.8</b>  | <b>4.5</b>  | <b>4.4</b>  | <b>4.6</b>  | <b>3.7</b>  | <b>3.6</b>  |
| General government                          | 0.1         | 0.1         | 0.1         | 0.2         | 0.2         | 0.2         |
| Other resident sectors                      | 3.7         | 4.4         | 4.3         | 4.5         | 3.5         | 3.3         |
| <b>Other, net (a)</b>                       | <b>-1.3</b> | <b>-0.2</b> | <b>-0.9</b> | <b>-1.1</b> | <b>-1.6</b> | <b>-1.7</b> |

Source: Banco de España.

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

### 5.5. The rest of the world

Between July and September 2002, the debit balance of the financial transactions of the nation fell slightly to stand at -1.6% of GDP in cumulative four-quarter terms (see Table 7). The flows of assets and liabilities vis-à-vis the rest of the world were significantly smaller than in the previous quarter, although on account of the base effect arising from the low volume between July and September 2001 (probably a

consequence of the events of 11 September), the cumulative four-quarter figures reflect an increase in both items. Equity flows declined again, affected by the climate of extreme volatility on the financial markets.

The net acquisition of financial assets increased to 10.6% of GDP from 9.9% three months earlier. This was the result of a significant increase in liquid assets (cash and deposits), with a cumulative flow of 1% of GDP, com-

TABLE 8

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

% GDP

|   | 1997         | 1998         | 1999         | 2000         | 2001         | 2002 (b)     |
|---|--------------|--------------|--------------|--------------|--------------|--------------|
| <b>Total economy</b>  | <b>-21.0</b> | <b>-21.6</b> | <b>-22.3</b> | <b>-20.5</b> | <b>-21.6</b> | <b>-24.0</b> |
| <b>Non-financial corporations and households and NPISHs</b> | <b>-10.9</b> | <b>-8.6</b>  | <b>-8.7</b>  | <b>-0.8</b>  | <b>-1.1</b>  | <b>-0.5</b>  |
| Non-financial corporations                                  | -17.2        | -14.8        | -16.3        | -8.4         | -8.9         | -8.8         |
| Households and NPISHs                                       | 6.3          | 6.2          | 7.6          | 7.6          | 7.8          | 8.3          |
| <b>Financial institutions</b>                               | <b>6.9</b>   | <b>4.8</b>   | <b>6.9</b>   | <b>5.1</b>   | <b>4.6</b>   | <b>2.1</b>   |
| Credit institutions (c)                                     | 2.4          | -5.4         | -7.5         | -12.5        | -14.5        | -15.3        |
| Institutional investors (d)                                 | 4.6          | 10.7         | 15.0         | 18.3         | 20.7         | 19.9         |
| Other financial institutions                                | -0.1         | -0.4         | -0.6         | -0.8         | -1.6         | -2.5         |
| <b>General government</b>                                   | <b>-17.0</b> | <b>-17.9</b> | <b>-20.5</b> | <b>-24.8</b> | <b>-25.1</b> | <b>-25.5</b> |

Source: Banco de España.  
 (a) Calculated as the difference between the stocks 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.

pared with -0.4% in the previous quarter, which offset the reduction in the other items. According to balance of payments information, foreign direct investment (that of a permanent nature), was significantly lower than in the same quarter a year earlier. Likewise, portfolio investment fell sharply to just 60% of its level in 2001 Q3.

The volume of liabilities increased to 12.2% of GDP from 11.7% in Q2. This outcome is primarily explained by the behaviour of securities other than shares, which recorded significant growth, to reach 3.8% of GDP. This increase is basically explained by the notable increase in the investment of non-residents in fixed-income securities issued by credit institutions. According to the information available in the balance of pay-

ments, foreign portfolio investment in Spain grew significantly relative to the same quarter a year earlier, while direct investment was unchanged.

As a result of the financial transactions with the rest of the world and the trend in the prices of financial assets and the exchange rate, the net debit position of the national economy vis-à-vis the rest of the world has increased to -24% of GDP in 2002 Q3 (see Table 8). This situation is a consequence of a decline in the net external assets of financial institutions, which has only been partly offset by the improvement in the overall external position of the rest of the sectors.

30.1.2003.