
Quarterly report on the Spanish economy

1. Overview

Against an international background of growing uncertainty, marked by doubts over the severity and duration of the US economic slowdown and its impact on other economic areas, the Spanish economy continued to grow vigorously in 2001 Q1. Real GDP growth is estimated to have been about 3.5 % in Q1, 0.3 percentage points down on the provisional figure released by the National Statistics Institute (INE) for the final quarter of last year.

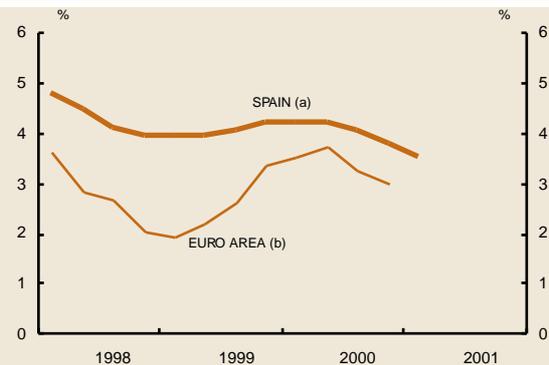
As will be recalled, growth in the Spanish economy followed a moderately declining path during the year 2000. This was a result of the loss of momentum of national demand, which saw a significant fall in its year-on-year growth rate (from 5 % in Q1 to 3.2 % in Q4), and of the change of sign in the contribution of net external demand, which started out negative but ended the year contributing 0.5 percentage points to GDP growth. In 2001 Q1, growth continued to show the same trends, although they were more moderate. In particular, national demand is estimated to have grown by around 3 % (scarcely 0.2 percentage points down on 2000 Q4), while the contribution by net external demand remained positive, although less so than in the latter months of last year.

Inflation held steady in Spain during 2001 Q1. It is expected to begin to slow significantly in the summer. In March, the twelve-month growth rate of the consumer price index (CPI) was 3.9 %, only 0.1 percentage points less than last December, despite the considerable slowdown in the prices of energy products. The growth rates of all the other components of the CPI rose, the largest increase being recorded by unprocessed food prices, with the worsening of the crisis in livestock farming. Underlying inflation, approximated by the index of non-energy processed goods and services prices (IPSEBENE), rose slightly to a twelve-month rate of 3.3 % in March. The inflationary situation in the euro area also worsened somewhat in Q1. This stemmed from the rises in food prices, but also from the delayed effects of the depreciation of the euro and the rise in oil prices during 2000. The inflation differential between Spain and the euro area, in terms of the harmonised index of consumer prices (HICP), held steady in Q1 at around 1.4 percentage points.

As mentioned above, the euro area's external environment showed signs of increasing weakness during the quarter, as the muted tempo of the US economy, the deterioration in the Japanese economy and the first signs of loss of buoyancy in some emerging economies became apparent. The effect of the US slowdown began to be noted in the latter economies, and in the case of the south-east Asian countries

CHART 1

Gross domestic product



Source : ECB, Instituto Nacional de Estadística and Banco de España.

(a) Non-centred annual rate of change calculated on the basis of the trend-cycle series.

(b) Non-centred annual rate of change calculated on the basis of the seasonally adjusted series.

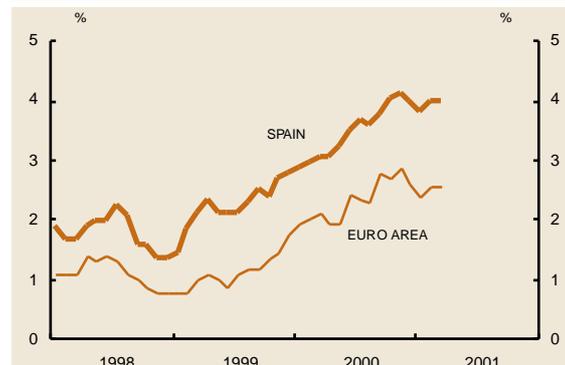
this was amplified by the economic situation in Japan and by the crisis in new technology markets. In the US, the slowdown in GDP growth since the middle of last year – despite 2001 Q1 National Accounts data being better than expected – has led the Federal Reserve to reduce its key interest rate on four occasions and by a total of two percentage points, to stand at 4.5 % on 18 April. US stock markets, which had incurred substantial losses during the first few months of this year (the severest in high-tech indices), reacted positively to the latest move and the dollar appreciated slightly, extending the path it has traced since the beginning of the year.

Though still substantially incomplete, the information available on activity in the euro area in Q1 generally shows a slight loss in pace, furthering the trend evident throughout 2000. Consequently, the year-on-year growth rate of GDP could be moderately below that for the previous quarter. Nonetheless, the consumption indicators remain notably buoyant, underpinned by sustained growth in employment and the positive impact on disposable income of the tax cuts made this year in many Member States. Against this, and in terms of the overall general government balance, progress towards a balanced budget in the year 2001 will be interrupted.

Inflationary pressures in the area are proving somewhat more stubborn than expected some months back. Evidence of this is the downward stickiness of the twelve-month growth rate of the HICP, which was 2.6 % in March. This is partly due to the behaviour of the more volatile

CHART 2

Harmonised indices of consumer prices



Source: Eurostat and European Central Bank.

components, as energy goods prices are falling less briskly than expected and unprocessed food prices are quickening, owing to the health problems in the meat sector. However, the prices of the remaining components –which are a proxy for core inflation– are also running at slightly higher growth rates. This is probably because the pass-through of past oil price rises and of the effects of the depreciation of the euro is not complete.

The persistence of inflationary pressures in the euro area in the year to date, against the backdrop of the moderate loss of steam in activity, led the ECB to hold its key rates at the levels agreed on last autumn (4.75 % for its main refinancing operations). The growth rate of M3, which is also an important variable for determining the single monetary policy stance, decelerated moderately, slowly drawing closer to the reference value set by the ECB (4.5 %), and lending to the private sector slowed mildly, although high growth rates persist. Short-term interest rates and euro area credit institutions' lending and deposit rates moved on a falling trend in the opening months of the year, while government debt yields were more stable after the declines posted in the final months of 2000. The downtrend occurring at the international level was reproduced in European stock markets, and the exchange rate of the euro depreciated moderately against the dollar, by 4.5 % since the start of the year, partly correcting its appreciation in the closing months of 2000.

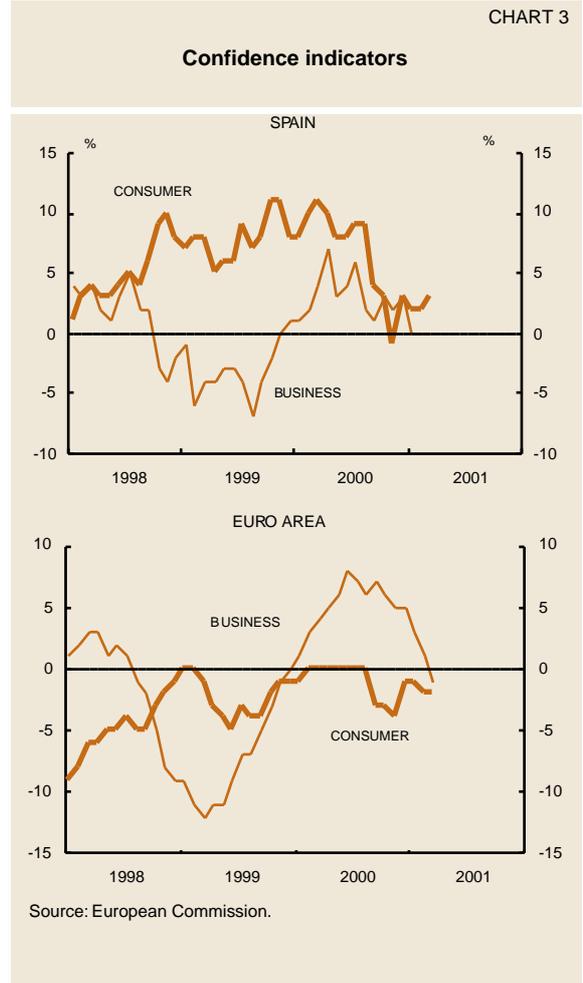
In Spain, the fall in credit institutions' lending and deposit rates were more moderate and the stock market performance somewhat more favourable, with the Madrid Stock Exchange General Index rising 5.5 % since the start of the year and the IBEX New Market Index slipping

9 %. Liquid financial assets continued on the accelerating path they have followed since early 2000, and financing to households and corporations decelerated once more, according to the latest information, though it continues to run at a rate of above 16 %. The monetary and financial conditions resulting from these developments are conducive to the promotion of economic activity in Spain.

General government conduct to date this year has been tailored to meeting the budgetary targets which, as will be recalled, involved achieving a balanced budget in 2001. The government-approved Updated Stability Programme in February integrated this target into a medium-term budgetary consolidation strategy geared to achieving public surpluses as from the year 2002 and to placing public debt as a proportion of GDP at 49.6 % in 2004. The State surplus to March stood at 0.1 % of GDP, the outcome of highly buoyant revenue, where the pick-up in VAT (takings of which had decelerated significantly in the closing months of 2000) and the high growth rates of income and wealth tax were prominent. Expenditure held at a moderate growth rate, in tune with the low growth of final consumption expenditure and of actual interest paid.

The agreement reached by the social partners in April to improve and develop the social protection system will have consequences for future general government conduct as it will introduce changes into the workings of the Social Security System aimed at improving revenue and expenditure management and reducing fraud. Nonetheless, the agreement postpones to 2003 the reforms needed to improve the Social Security financial position in the medium run, and it will involve an increase in public spending, mainly due to the rise in pensions for widows and orphans, the final scale of which is difficult to quantify.

Against the background of the economic policies implemented in the year to date, the slowing profile of national demand has eased, in line with the fresh downward correction to private consumption (albeit weaker than that of the previous quarter) and with the maintenance of moderate rates of increase for gross fixed capital formation, similar to those for the final months of 2000. The behaviour of private consumption was determined by the petering out of the expansionary effect of the rise in financial wealth and, perhaps, by the slowdown in employment. The latter, though modest, might have tempered the growth of disposable income, offsetting –at least in part– the one-off rise in compensation per employee stemming from the application of the inflation-adjustment

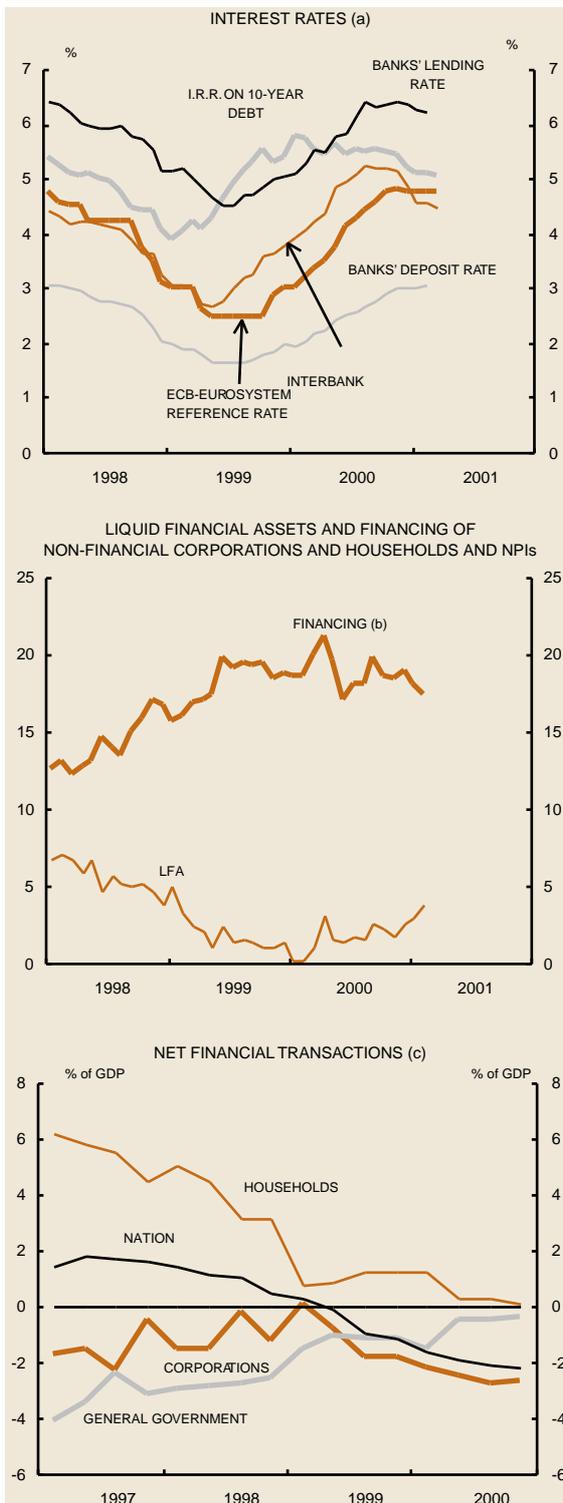


clauses built into collective wage agreements in 2000. This modest adjustment in consumption might mean that the downtrend of the saving ratio in recent years may have ceased.

The stabilising of the year-on-year growth rate of gross fixed capital formation would appear to reflect the continuing pattern of growth in construction, without any relevant changes appreciable in the weakness marking investment in capital goods. The indicators available on capital investment offer somewhat contradictory information, though they do generally show substantial weakness. Conversely, the information on the factors determining corporate investment decisions point to the presence of more favourable conditions. In this respect, mention may be made of the continuing, though diminishing, firmness of final demand and the high degree of capacity utilisation. The financial position of companies remains very sound, and the firming of real interest rates at low levels, by historical standards, would also warrant a better performance by capital investment. Turning to construction, the available indicators signal an extension of the pattern for the final months of

CHART 4

Financial indicators of the Spanish economy



Source: Banco de España.
 (a) The series are averages of daily data.
 (b) Financing includes bank loans extended by resident credit institutions, fixed-income securities, and financing through securitisation funds.
 (c) Cumulative four-quarter data.

2000. The buoyancy of civil engineering works should thus offset the moderation in residential investment caused by the modest slowdown in the rate of increase of real disposable income and by the increase in the user cost of housing.

The contribution of net external demand to growth remained positive throughout the opening months of the year, albeit somewhat lower than in 2000 Q4. According to Customs figures, exports held at a buoyant rate, with the consequences of the ongoing slowdown in world markets not yet discernible. And this in a situation in which the appreciation of the euro embarked upon in the second half of last year has come to a halt. Imports, for their part, picked up significantly. Following the significant adjustment in the final months of last year, this recovery is consistent with the moderate loss of momentum by domestic demand and with the slowdown in imported goods prices.

During the opening months of the year productive activity decelerated moderately as did, in conjunction, the growth rate of employment. Indicative of the latter was the smaller fall in registered unemployment and the reduction in the number of contracts registered with the National Employment Office (INEM), although the figures for new Social Security registrations remained very positive. The outcome of these factors has been very modest growth in apparent labour productivity. The slowing profile of employment may be mitigated in the coming months when the labour market measures approved by the government in March take effect. These broaden the incentives for permanent hiring and make the regulations governing part-time hiring more flexible (see Box 3 in section 4).

As regards price and cost formation, collective bargaining in 2001 Q1 resulted in a significant increase in wage rates negotiated to March, which climbed by a rate of 3.5%. And adding to this was the influence exerted by inflation-adjustment clauses (adjusting for the deviation by inflation from the related target for last year). This wage rise, coupled with the modest increase in apparent productivity, presages something of an acceleration in unit labour costs in the opening months of 2001 (whereby the growth differential with the euro area will have widened) and a squeeze on the overall economy's margins, albeit with differences from sector to sector (most severe in manufacturing and with increases in many services branches). Against this upward momentum of production costs, import prices slowed significantly in the opening months of the year. This deceleration affected all the associated

components and was notably intense in the prices of energy intermediate goods.

In addition to the foregoing factors, final prices indicators were also affected by the spread of the crisis in the livestock sector. As earlier discussed, the CPI stood at 3.9 % in March. This was a result of the unfavourable behaviour of unprocessed food prices and an acceleration in the prices of services and non-energy goods, cancelling out the decelerating impulse stemming from the decline in the growth rate of energy prices, which in any case appears to have halted, according to the latest data. The consumer price differential with the euro area has held unchanged for the third month running at 1.4 percentage points, the highest level posted since the start of Stage Three of EMU. Producer prices performed more favourably, prolonging in February the slowdown begun in the previous quarter and thus widening the differential (in this case negative)

with the euro area owing to the relative fall in the prices of intermediate goods.

In sum, the Spanish economy has sustained a pattern of high growth in the early months of 2001, allowing the process of job creation and the reduction in the unemployment rate in recent years to continue. The correction to the inflationary imbalance generated over the course of the previous year, essentially as a result of the rise in the price of energy imports, against a backdrop of high growth in expenditure, is proving slower than expected. In part, this is because of the influence of certain temporary factors. That said, collective bargaining arrangements and the widespread use of inflation-adjustment clauses are factors which may tend to delay the necessary slowdown in prices. And this, in the medium term, would ultimately affect the competitiveness of the economy at a time when the external environment has become less favourable.

2. The external environment of the euro area

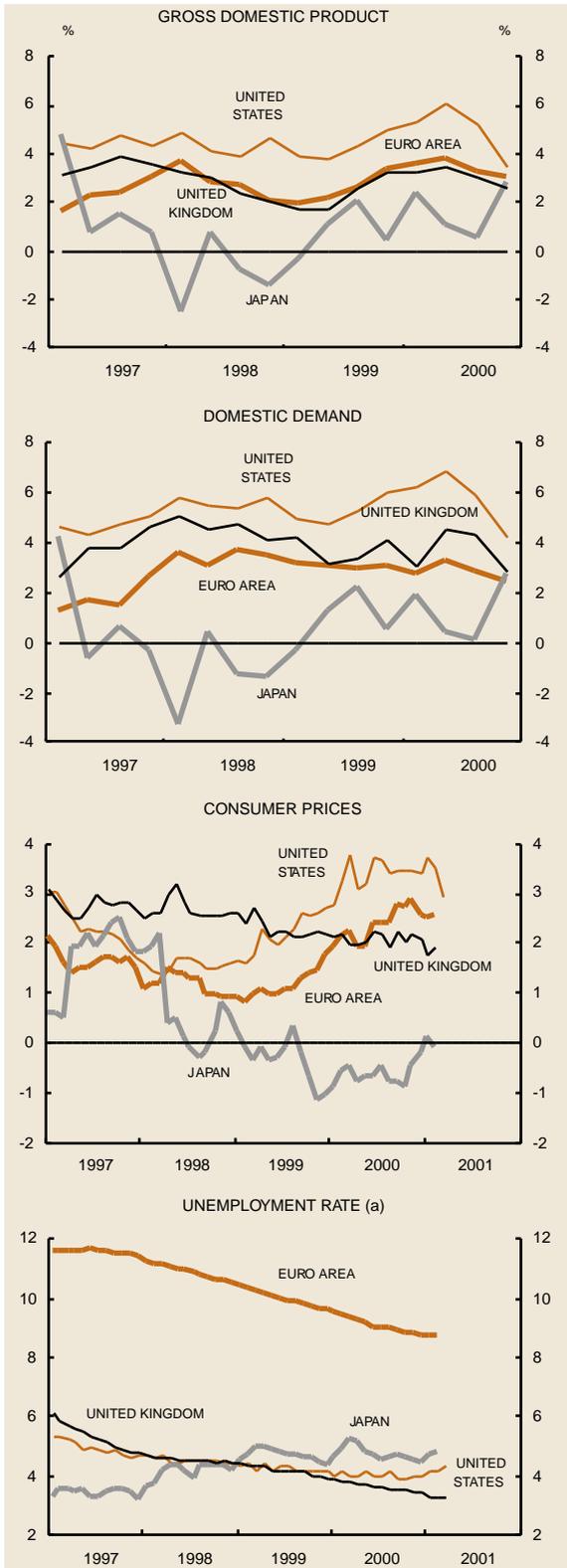
The latest information available on the external environment of the euro area confirms the features of weakness that began to become apparent in late 2000. The main causes are the fall in activity in the US – although first quarter national accounts data were better than expected – and the further worsening of the Japanese economic situation. To this scenario should be added the signs of loss of momentum in certain emerging economies, especially in Asia, where all countries felt the effects of the slowdown in the US economy and revised down their growth projections for 2001. This general deterioration has prompted more expansionary economic policies in many countries, especially in the monetary sphere, but also in the fiscal one. The most notable instances have been, in the US, four interest rate cuts (adding up to 200 basis points) and a clearly expansionary fiscal package, still being debated by the legislature; in Japan, a cut in interest rates, accompanied by a switch in monetary policy strategy to a quantitative target, and a Japanese government plan to nationalise poor quality banking assets; and interest rate reductions in the UK, Canada, Australia and a large number of Asian countries. These expansionary policies and the possibility that they will be strengthened over the year – most countries having some leeway to do so – may be effective in helping to reduce the risks of economic growth deviating from the central scenario. This predicts a significant, but brief, slowdown in the US economy and a moderate reduction in world growth in 2001. The alternative would be a more pessimistic scenario, involving a more severe and prolonged deceleration.

In the United States, first quarter indicators continued to show signs of weak activity. Manufacturing (on the production side) and investment in capital goods (on the spending side) were the areas in which this weakness was most clearly evident. In addition, the increase in the ratio of stocks to sales in Q1, despite the sharp decline in levels of stocks, shows that involuntary stockbuilding is continuing.

By contrast, private consumption and construction continued to show positive growth rates. The buoyancy of consumer credit is associated with the ongoing decline in the saving ratio, with spending still outpacing disposable income. The fall in stock markets, which seems to have had an adverse effect on confidence indices, has not, until now at least, had a substantial wealth effect on consumption. Even so, it should be noted that the recent negative employment data, the steady increase in unem-

CHART 5

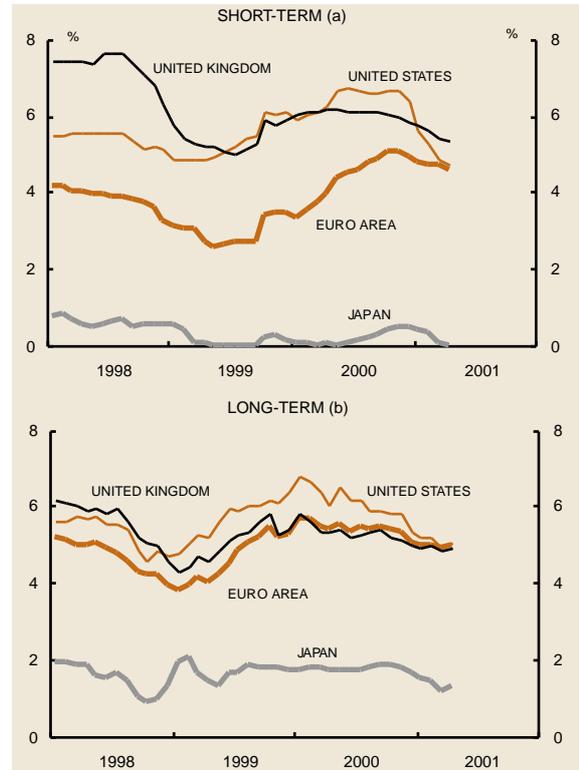
Main macroeconomic indicators.
Annual rates of change



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

CHART 6

Interest rates



Source: Banco de España.

(a) Three-month interbank market interest rate. Euro area: until December 1998, weighted average of the eleven euro-area countries; thereafter, three-month EURIBOR.

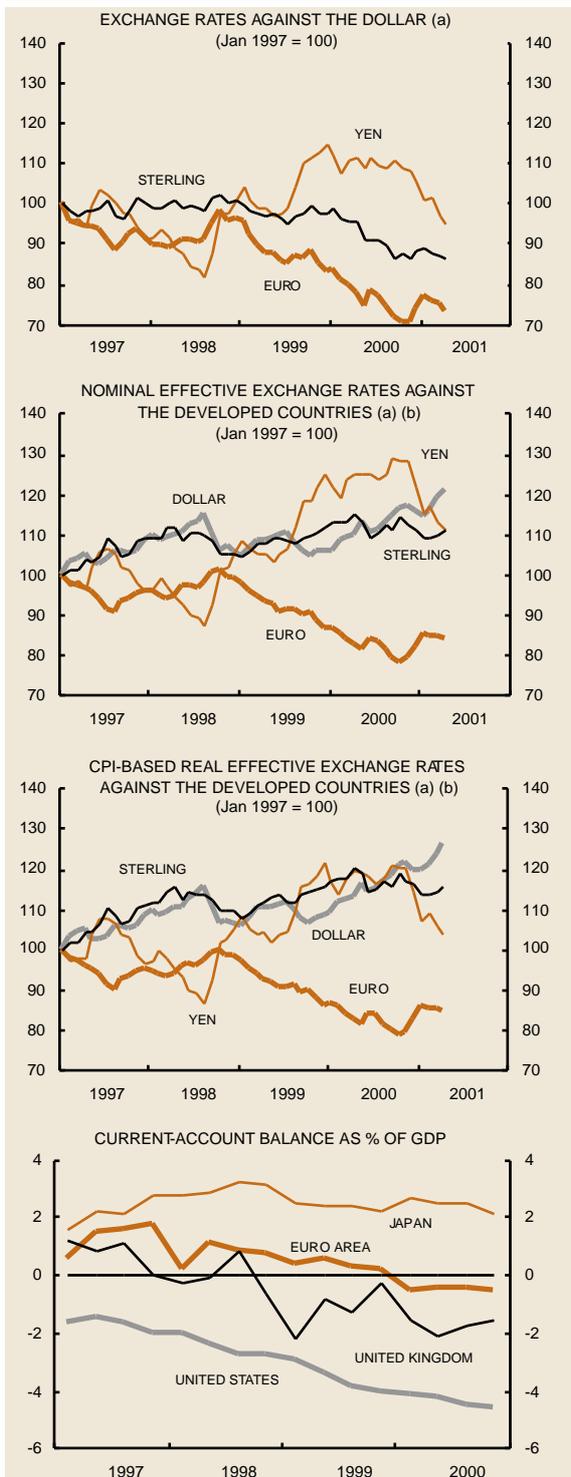
(b) Ten-year government bond yields. Euro area: until December 1998, weighted average of the eleven euro-area countries.

ployment benefit applications and the gradual rise in the rate of unemployment, which reached 4.3 % in March, may affect consumers' income expectations and begin to have an adverse impact on consumption. Construction has proved responsive to mortgage rate cuts and its indicators have shown signs of growth in Q1, following a very poor performance in the second half of 2000.

As regards prices, in recent months there has been a decline in actual inflation and an increase in underlying inflation, to twelve-month rates of 2.9 % and 2.7 %, respectively. This behaviour contrasts with that of the previous year, when these two price indices diverged significantly, by as much as 1.4 percentage points in March. Producer prices, which have accelerated significantly in recent months, moderated in March to a 12-month rate of 3.1 % (4 % in February). Wages continued to grow at rates of around 4.3 %, contributing to a squeeze a busi-

CHART 7

Exchange rates and current-account balances



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

ness margins. Despite certain worrying signs in price developments, the Federal Reserve has, since the beginning of the year, clearly shown that in its view the risks of recession are more significant than those of inflation, reducing official interest rates on four occasions (the latest on 18 April, again one month ahead of the next scheduled meeting), by a total of 200 basis points, to 4.5 %. These decreases have been passed through to all markets (albeit not in full). Yet private bond markets continued to show, through yield spreads with government bonds, signs of tension, possibly related to rising default rates and reductions in expected profits. The reaction of the equity markets to the rate cuts was different. Share prices fell sharply in Q1, the Dow Jones losing 8.5 %, while the NASDAQ fell by 33 %. In the first fortnight of April, however, markets recovered a more upbeat tempo and rose slightly.

The dollar has strengthened against almost all currencies, contrary to what would be expected given the weakness of the US economy, interest rate cuts and falling stock markets. In nominal effective terms, it appreciated by 4.6 % between the beginning of January and mid-April. In principle, this does not assist the correction of the macroeconomic imbalances in the US economy, the main one possibly being an external current account deficit of about 4.5 % of GDP. However, it would seem to indicate that foreign investors are basically confident of a swift recovery in the US economy and, in particular, of an early return to the strong rate of growth of productivity seen in recent years.

In addition to the resolute attitude of the monetary authorities, fiscal policy has been clearly expansionary, as a result of tax reductions, which were accompanied by a rise in spending of 5.4 % (as against 8 % in recent years). The net impact of these measures was a reduction in the budget surplus of some USD 50,000 million. It should be pointed out that this budget incorporates a very optimistic growth projection of 2.4 % in 2001, so that the automatic revenue and spending stabilisers may give rise to an even larger reduction in the budget surplus.

In Japan, the indicators available for 2001 Q1 point to further worsening of the economic situation, following the achievement of positive growth of 0.8 % in 2000 Q4. From the viewpoint of activity, there was a marked slowdown in the growth of industrial production during the first two months of the year and a deterior-

ration in the business confidence index of the Tankan survey for this period, especially as regards plans to reduce investment in the second quarter. The fresh increase in the rate of unemployment, to 4.8 % of the working population in February, has tended to accentuate the stagnation of private consumption, as reflected in the limited spending by households and the persistent signs of deflation (the index of wholesale prices was negative again in March). The data available on the external sector indicate a further slowdown in export growth, owing to the deceleration of the world economy and of the US in particular, despite the depreciation of the yen (in the first half of April, the rate reached more than JPY 125 per US dollar, as against JPY 110 to the US dollar in 2000 Q4).

Against this background, the Japanese authorities have taken various economic policy decisions aimed at reactivating the economy. On the monetary policy side, the Bank of Japan has decided to establish a quantitative target for the increase in the volume of reserves available to banks, set at a clearly expansionary rate. Also, it has increased the ceiling on the acquisition of public debt by the Bank of Japan. This amounts to a change of course in its monetary strategy, towards a quantity policy that is expected to be more effective in combating deflation than the interest-rate-based policy pursued hitherto. The Bank of Japan also announced that it will continue with this policy until the annual rate of inflation is positive. The second economic policy measure concerns the government. This consists of a project to help restructure bank assets, which would require banks, within a two-year period, to eliminate poor quality loans from their portfolios and to reduce (by a still unspecified proportion) the percentage of their capital held in equities. Furthermore, the government has decided to set up a new institution (presumably wholly or partly financed with public funds) that would absorb the poorest quality securities offloaded by the banks in order to comply with the new legal limit.

Turning to the EU countries outside the euro area, activity in the UK in 2000 Q1 continued to display the moderation of the last quarter of 2000, albeit with some buoyancy in consumption, as reflected by the upturn in retail sales and new car registrations in February. The purchasing managers' indicator held at levels indicating moderate growth in manufacturing, while employment developments were positive and the rate of unemployment fell slightly. Given that consumer prices were sub-

dued, their index – relevant for monetary policy – rising by 1.9 % in February (compared to the central target of 2.5 %), the Bank of England decided to reduce interest rates by half a percentage point, anticipating the foreseeable adverse effects of the US and world slowdown. However, continuation of this expansionary monetary policy may be jeopardised by the latest wage data, which show notable acceleration in February (5.9 % year-on-year, as against 4 % in January), clouding somewhat the prospects for continuation of the decline in inflation. Moreover, the government has presented a clearly expansionary budget (albeit in surplus), after several years of sizeable surpluses.

The south-east Asian economies have clearly decelerated in recent months, as was already beginning to become apparent in 2000 Q4 in most of them. The reasons for the slowdown lie, on one hand, in the general fall in external demand, as a consequence of the reduction in economic growth, especially in the US and Japan, and on the other, in the growing crisis in markets for new technologies and semiconductors, which represent on average around half of the exports of some of the main countries in the area (Singapore, Malaysia, China, Hong Kong and South Korea, in particular). Also, most Asian countries have a limited capacity for domestic demand growth, with the notable exception of China, which is estimated to have maintained a growth rate of 8 % in Q1. Against this background, the monetary and fiscal policies of most of these countries are significantly more expansionary than last year, in an attempt to mitigate the projected sharp decline in their levels of growth. Forecasts of output growth in 2001 in the great majority of the Asian countries are almost fifty per cent down on 2000.

The contractionary effect of US economic developments has also been felt in Latin America, although to a different extent and through different channels according to the country concerned. In Mexico, with its strong trade links to the US, there has been a sharp weakening of exports, which will possibly lead to a significant slowdown in the economy in 2001 and an increase in its current account deficit. That said, the prudence of the Bank of Mexico and the favourable reception for proposed fiscal reforms portend a smooth adjustment to the new circumstances. Brazil has been affected by the difficult situation in Argentina, which has entailed a higher risk premium and downward pressure on its real exchange rate, forcing the

central bank to change its monetary policy stance by raising interest rates and thus halting their downward path. This can only have restrictive effects on activity, which will last as long as the present financial pressures remain. As for Argentina, following a period of political turbulence the government has managed to approve an ambitious plan with four main aims, namely

to reactivate the economy, to fulfil its fiscal commitments linked to IMF assistance, to balance the external sector and to recover the confidence of international investors and lenders. The plan includes a special levy on financial transactions, a cut in tariffs on imports of capital goods, to reduce production costs, and an increase in those on consumer goods.

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

3.1. Economic developments

The latest data on economic developments in the euro area point to a continuation of the phase of less buoyant activity begun in 2000 Q3. However, the information at hand does not so far confirm that the economic slowdown is intensifying, despite the uncertainty over the international economic situation. As regards prices, inflationary pressures remain unabated. Here, predominantly temporary factors (such as the impact of the crisis in the meat sector on food prices) have combined with other more persistent factors (such as the delayed feed-through of the exchange rate depreciation and of the rise in oil prices to final prices). Against this backdrop, the ECB has held its key interest rates unchanged at the levels set last October.

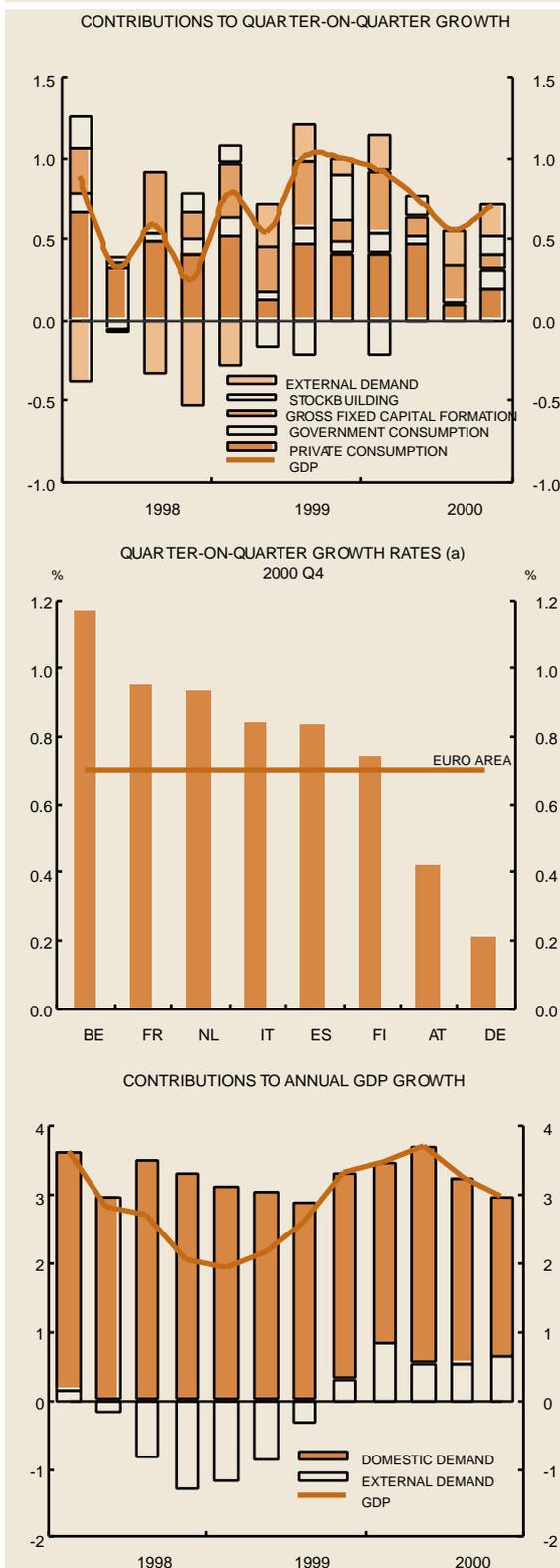
In 2000 Q4, GDP in the euro area grew at a quarter-on-quarter rate of 0.7 % (3 % in annual terms) according to the latest National Accounts estimate by Eurostat (see Chart 8). The increase of one-tenth of a point on the rate recorded in the previous quarter coincides with the rise in the contribution of stockbuilding to GDP, since the contributions of domestic demand and net exports remained unchanged at 0.4 and 0.2 percentage points, respectively. The performance of the external sector is the outcome of an acceleration in both exports and imports, while among the components of domestic demand, the notable slowdown in investment was offset by a slight increase in the pace of private consumption (whose growth remains modest) and by the greater buoyancy of government consumption. Among the various euro area economies, activity expanded notably in Belgium and, to a lesser extent, in France, Italy and the Netherlands. Conversely, activity lost steam in Germany, Spain, Austria and, especially, in Finland.

Taken as a whole, the data on GDP and its components in 2000 Q4 point to a stabilisation of the rate of expansion of economic activity, following the slowdown in the previous quarter. By productive sector, industry – excluding construction – and private services continued to grow in the second half of 2000 at annual rates of above 4 %, whereas the rise in value-added in the construction industry slowed substantially to around 0.5 %.

The indicators available for 2001 Q1 indicate the maintenance of the rate of expansion of activity or a slight quarter-on-quarter deceleration

CHART 8

GDP in the euro area



Sources: Eurostat and national statistics.

which would be more pronounced in year-on-year terms and compatible with a sustained rate of domestic demand. Thus, the business confidence indicator compiled by the European Commission has worsened progressively during Q1 (see the lower panel of Chart 9). Moreover, although all the associated components are affected by this deterioration, it is most pronounced in production expectations for the coming months. Also, the purchasing managers' indices for manufacturing and services (likewise constructed from survey results) have continued to move on the declining trend initiated in spring 2000 during 2001 Q1 down to their lowest levels since the opening months of 1999. Finally, although the industrial output data to February are difficult to interpret, as those for December and January are possibly distorted owing to an incomplete «calendar-effect» adjustment, they also appear to point to a moderate slowdown in activity in this sector. The deterioration in the industrial activity indices, along with the lost momentum of the export indicators, may be reflecting the lesser buoyancy of external demand in the opening months of the year.

As earlier mentioned, the domestic demand indicators allow a more favourable outlook to be discerned, particularly as regards private consumption. The consumer confidence and retail sales indicators stand at a somewhat higher level in Q1 compared with the average for 2000 Q4 (see the upper panel of Chart 9). Moreover, although retail sales to January and new car registrations to February have continued to exhibit the same relative weakness apparent since last summer, they have not worsened further. The fact household expenditure is relatively sustained has been helped by the continuing favourable financial conditions and the behaviour of household disposable income. This latter variable may be benefiting from the strength of job creation and from the application of tax cuts, which might offset the loss of purchasing power derived from the rising consumer prices, and the negative impact on household wealth of the decline in equity market prices. Turning to investment, the outlook is somewhat less favourable: for one thing, capacity utilisation declined, albeit modestly, in Q1; and for another, the half-yearly survey of investment intentions in manufacturing industry (likewise conducted by the European Commission) augurs a moderate loss of momentum in this component this year.

In these conditions, the deterioration of the international environment is the main risk to activity in the euro area in the coming quarters. Evidently, the most direct effect might be channelled through the reduction in the contribution of net external demand to GDP that the deceleration in export markets may bring about. Conceivably, too, net income from abroad may be reduced as a result, first, of stalling profits at the companies to which euro area residents' foreign direct investment is routed; and further, of the possible correction of the prices of international assets held by euro area agents. Nonetheless, as indicated, sustained household expenditure should help prevent unfavourable developments in the external economic environment (provided such developments are not severe and long-lasting) from leading to a sharp slowdown in activity in the euro area.

In the early months of 2001, the information available supports the assumption that labour market developments have remained favourable. Testifying to this, the unemployment rate in the euro area held at 8.7 % in February, unchanged on December, although this confirms the slowdown in the rate of reduction of joblessness seen since 2000 Q4. In this latter quarter, the year-on-year rate of job creation stood at around 2 %, a similar rate to that of the previous quarters. As regards wages, unit labour costs grew by 1.2 % in annual terms in 2000 Q3 (see the lower panel of Chart 10). The increase in this rate from its level of 0.5 % the previous quarter is due, in equal proportions, to the higher growth of compensation per employee and to the slowdown in apparent labour productivity. Hourly labour costs grew by 3.5 % year-on-year in 2000 Q4, three-tenths of a point below the related rate the previous quarter. Although continuing wage moderation is crucial for ensuring the prolongation of sustained employment growth, there is a risk that the loss of purchasing power may, despite the almost wholesale absence of indexing mechanisms in the euro area countries (see Box 1), entail an increase in workers' demands in future negotiations.

The different price indicators for the area continued to show persistent inflationary pressures. The 12-month growth rate of the HICP (including Greece in the baseline period on which the change is calculated) was 2.6 % in March (see the upper panel of Chart 10). Although this rate coincides with that posted in December, all the components have since

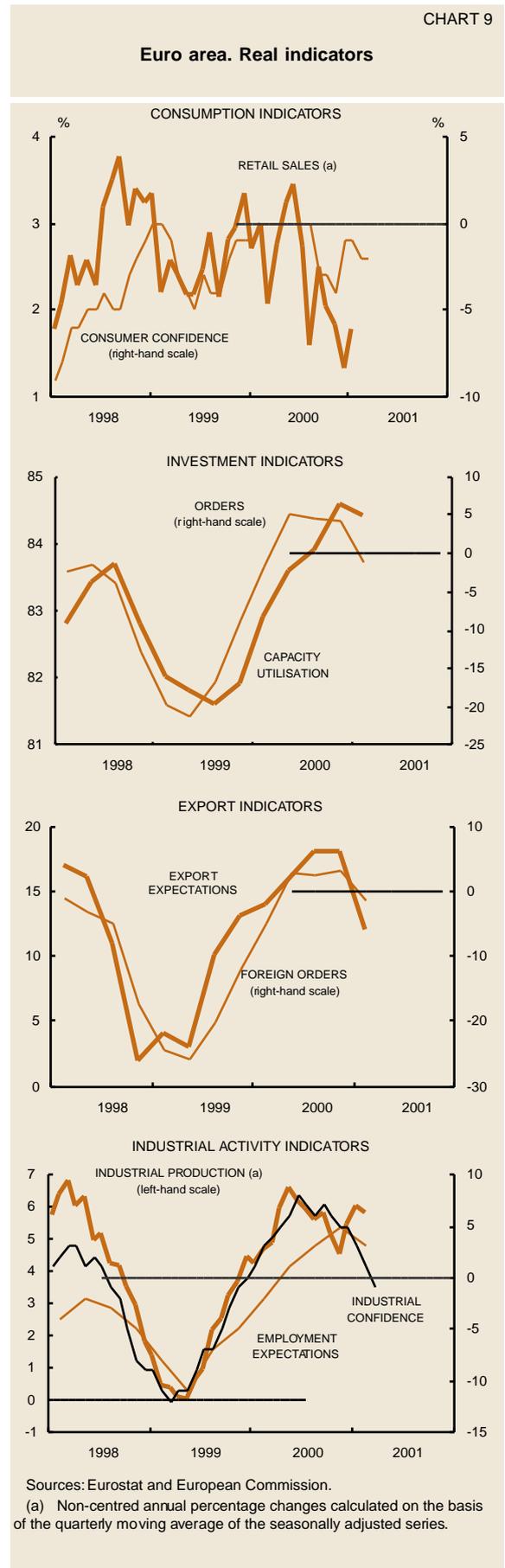
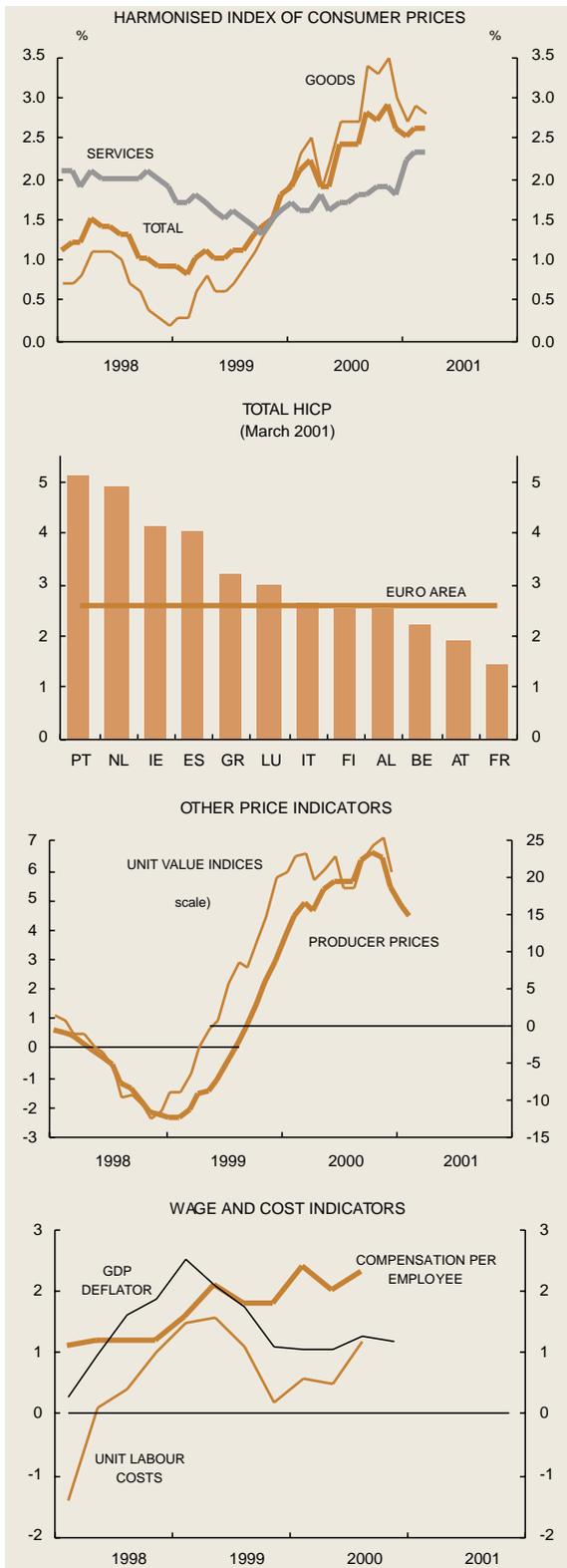


CHART 10

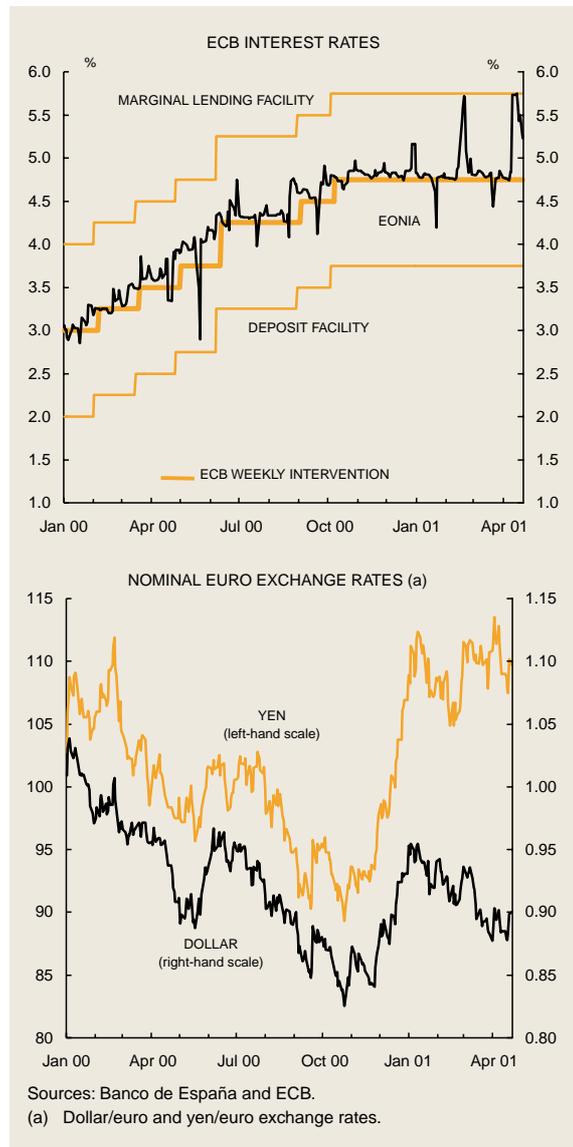
**Euro area. Price, wage and cost indicators
Twelve-month percentage change**



Sources: Eurostat and ECB.

CHART 11

**ECB interest rates
and euro exchange rates**



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

risen, except that of energy goods because of the fall in oil prices. The latter are, admittedly, still very volatile, but far off their peak in 2000 Q3. Prices of the other volatile component in the total index, namely unprocessed food, climbed notably in the opening months of the year. This was largely attributable to the impact of the crises affecting the meat sector. The upward course of the more stable prices can be seen in the performance of the core inflation index (excluding energy and unprocessed food prices), which rose by four-tenths of a point between December and March to 1.9 %. Responsible here were the tax rises at the beginning of the year, the increase in certain administered prices and the gradual pass-through to final

Wage indexing clauses in the euro area

The strong increase in oil prices in 1999 was a supply-side shock that affected all the euro area countries. But it appears to be having different effects in terms of growth and inflation in the various Member States. The factors that may account for a differing impact of dearer energy on the member countries are numerous. These include differing degrees of oil use, the position of economies in the cycle and the institutional features of labour markets, particularly regarding the degree of wage flexibility.

The adaptability of wages to changes in the economic situation depends on a large number of variables relating to the content and degree of centralisation of collective bargaining. Among these, one highly relevant factor in the current circumstances is the extension of wage indexing practices, as this bears notably on the intensity and duration of the effect of the oil shock on inflation and activity.

Indexing mechanisms, especially if automatic and generalised, hinder the workings of the economy's price and wage formation processes. Thus, any temporary shock to consumer prices will trigger indexing clauses involving a generalised wage increase. In the industries most sheltered from international competition, this increase in labour costs will lead, above all, to price rises, amplifying the effect and duration of the initial shock. In the industries most exposed to international trade, the increase in wages, if not accompanied by an increase in productivity, and because it cannot be fed through in the same proportion to prices, will initially squeeze companies' margins. That will hamper corporate profitability and, in this way, lower the economy's growth rate and job creation.

Wage indexing has been a very habitual practice in the second half of the past century in a large number of European countries. Its origins were in the post-war period, when inflation was very high and volatile. As the harmful effects of this system on the level and persistence of inflation were progressively acknowledged, most countries abandoned or altered the mechanism, making it more rational. At present, only Belgium, Luxembourg and Spain retain any form of automatic wage indexing, though there are notable differences in how they put it into practice. In Luxembourg, wages are indexed with a six-month moving average of the consumer price index (CPI). Belgian wages are formally linked to a price index equivalent to the CPI, with the alcohol, tobacco and fuel components stripped out. Indeed, it was decided in Belgium to take this price index so as to avoid the risk of oil price rises potentially triggering a wage-price spiral similar to that experienced during the crises in the seventies. Lastly, in Spain, although there is no formal system for generalised automatic wage indexing, most agreements signed (around two-thirds of the total) have wage-revision clauses built into them which take effect when year-end CPI growth has outpaced the rate taken as a reference for collective bargaining. That leads to wage growth rooting itself in line with actual inflation.

The accompanying chart reveals that only in three euro area countries were increases in compensation per employee above average HICP growth. Finland was notable in this connection, its high productivity growth (over 4 %) last year preventing the growth of compensation per employee from feeding through to unit labour costs. Conversely, this effect was absent in Spain and the Netherlands, since the increases in apparent productivity in both countries stood at around 1 %. In the Netherlands, labour market supply shortages, reflected in an unemployment rate below 3 %, may have contributed to this notable wage increase. In Spain, wage adjustments due to indexing clauses triggered by the deviation by inflation from the target taken for stipulating wage increases in 1999 have borne on the rise in compensation per employee. The bigger mismatch between the inflation expected on signing wage agreements and actual inflation at the end of 2000 will mean that indexing clauses will have a much more significant impact on labour costs this year. Lastly, in the euro area as a whole, and especially in Germany and France, real wages evidenced a negative rate of increase in 2000.

HICP and compensation per employee in 2000

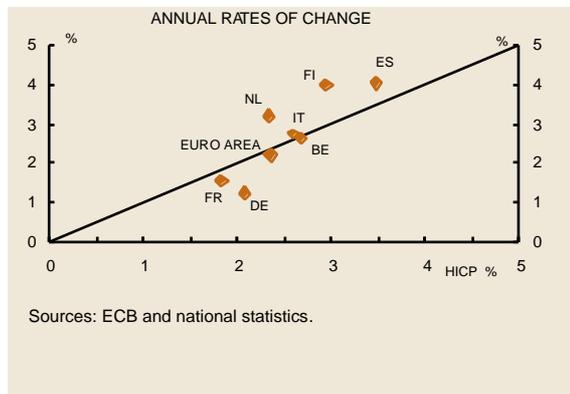


TABLE 1

General government financial balances of euro area countries (a)

	1996	1997	1998	1999	2000 (b)
Belgium	-3.8	-1.9	-0.9	-0.7	0.0
Germany	-3.4	-2.7	-2.1	-1.4	-1.0
Greece	-7.8	-4.6	-3.2	-1.8	-0.9
Spain	-5.0	-3.2	-2.6	-1.2	-0.4
France	-4.1	-3.0	-2.7	-1.6	-1.3
Ireland	-0.2	0.7	2.1	2.1	4.5
Italy	-7.1	-2.7	-2.8	-1.8	-1.5
Luxembourg	2.6	3.6	3.2	4.7	5.3
Netherlands	-1.8	-1.1	-0.7	1.0	1.3
Austria	-3.8	-1.7	-2.3	-2.1	-1.5
Portugal	-4.0	-2.7	-2.2	-2.0	-1.7
Finland	-3.2	-1.5	1.3	1.8	6.7
MEMORANDUM ITEM:					
Euro area					
Primary balance	1.4	2.5	2.5	3.0	3.3
Total balance	-4.3	-2.6	-2.1	-1.2	-0.7
Public debt	75.4	74.8	73.1	72.0	69.7

Sources: European Commission and ECB.

(a) Deficit (-) / surplus (+).

(b) Without including proceeds relating to UMTS licences.

prices of higher imported input prices over the past two years. In terms of individual members, the spread in March between the highest rate (5.1 %, in Portugal) and the lowest rate (1.4 %, in France) was 0.8 percentage points wider than in December.

The decline in the 12-month growth rate of the producer price index over the period from its peak last October to February masks the divergent performances of the intermediate and consumer goods components. While intermediate goods decelerated strongly, as a result of the firmer exchange rate and the fall in oil prices, the rate of increase of industrial consumer goods prices has intensified. Indeed, the consumer durables and non-durables components rose to stand in February at 1.9 % and 3.2 %, respectively. This adversely affects the inflationary outlook for the euro area given that these components are a leading indicator of final consumption prices.

According to ECB data, the current-account deficit of the eleven founding members of the Monetary Union totalled EUR 28.3 billion in the year 2000 as a whole, compared with a deficit of EUR 5.8 billion in 1999. This significant dete-

rioration is due, above all, to the heavy decline in the surplus on the merchandise balance, since the deficit on the income balance lessened and the deficits on the services and current transfers balances rose but modestly. The decline in the merchandise balance surplus is the outcome of the deterioration in the area's terms of trade, the result in turn of the rise in oil prices and of the depreciation of the euro. This translated into nominal import growth of 25.1 %, compared with a figure of 19.6 % for exports. In January 2001 the current-account deficit for the area (including Greece) fell, however, to EUR 8.5 billion, compared with 10.4 billion in the same period a year earlier, owing to the improvement in the balance of current transfers.

With regard to public finances, the aggregate budget deficit for the area as a whole stood at 0.7 % of GDP in 2000, once the proceeds from the sale of UMTS licences are stripped out (see Table 1). In 2001, this deficit might increase for the first time since 1993. On the forecasts available, the scale of the deterioration would be very small in terms of actual balances. But their size would be bigger in respect of the cyclically-adjusted balance given

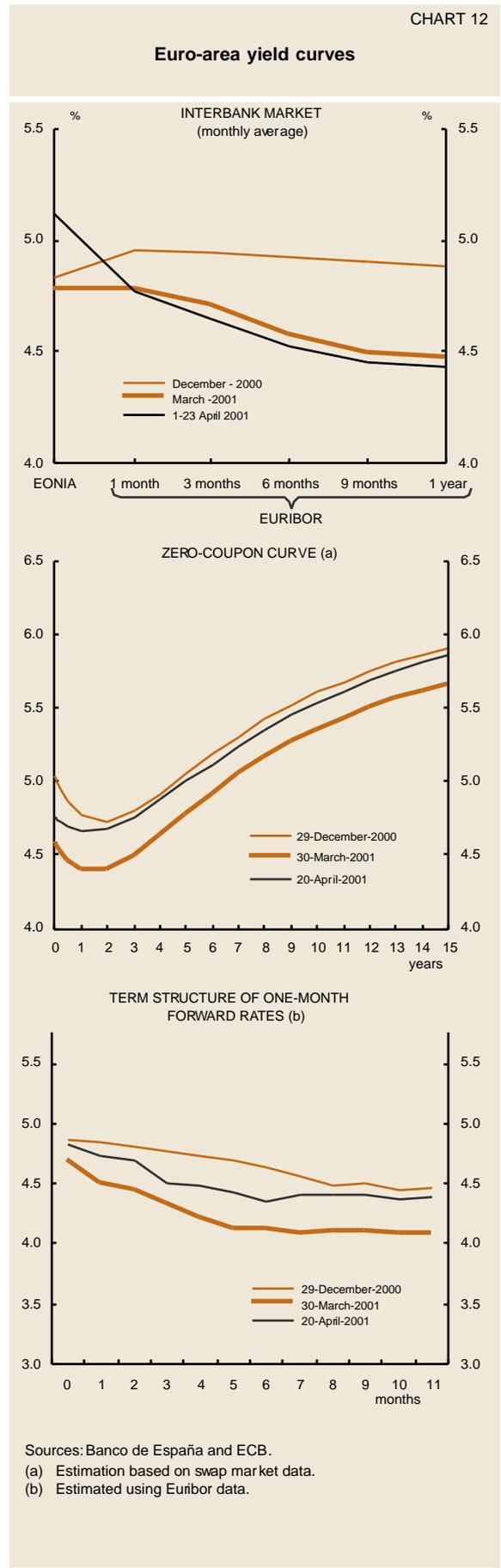
the relatively strong background against which economic activity will foreseeably unfold this year. This budgetary forecast responds to the virtually generalised application of – occasionally ambitious – cuts in taxes and social contributions. True, the introduction of these measures merits a favourable assessment insofar as they are supportive of higher employment and participation in the labour market; but the timing of their adoption might not be ideal in all cases for two different types of reason. First, because they involve a boost to demand that might exacerbate inflationary pressures. And second, because several of the countries that have introduced tax cuts have underlying budgetary positions that are still relatively far from balance.

3.2. Monetary and financial developments

Throughout 2001 Q1, the Governing Council of the ESCB held the minimum bid rate for its main refinancing operations unchanged at 4.75 % (see Chart 11). This decision was the outcome of balancing the persistence of inflationary pressures against the moderate loss of vigour in economic activity, against a background of growing uncertainty in the external environment of the euro area. In any event, monetary and financial conditions, measured by the levels of real interest rates and the exchange rate of the euro, and reflected in the monetary and credit aggregates, remain favourable to the growth of activity in the area as a whole. As has been the case since the outset of Monetary Union, the degree of generosity of monetary and financial conditions is greater in Spain's case, given the greater intensity of inflationary pressures, as the high rates of credit expansion show.

Between the beginning of the year and the end of March, expectations of a decline in interest rates in the euro area became more marked. However, in April these expectations have been easing (see Chart 12). At present, the term structure of implicit one-month forward rates is discounting a foreseeable modest reduction in the ECB's key rates in the period to September, with these rates subsequently holding steady up to the one-year horizon.

Euro area ten-year government bond yields have held stable at around 5 % in 2001 to date, after declining considerably in the closing months of last year (see Table 2). This has been due to the moderation of economic growth



prospects and, foreseeably, of the outlook for inflation. At the same time, the slowdown in the US economy has been a factor conducive to a fall in this country's bond yields, narrowing the spread over the German Bund to the point where it became negative in mid-March.

The interest rates applied by euro area credit institutions to lending and deposit transactions with their customers have been on a declining course since December 2000, reflecting the lower interbank rates during this period (see the lower panel of Chart 13). Among lending rates, the fall has been more pronounced in the case of financing extended to households for house purchases than in that extended to companies. Thus, in February (the latest month for which there is information) both interest rates stood at 40 and 20 basis points, respectively, below the levels prevailing in November last year. Rates on deposits maturing respectively at over and at less than two years had fallen by approximately 40 and 20 basis points over the same period. In Spain, the reduction in the synthetic lending rate between November 2000 and March 2001 was 30 basis points (see Table 2), although credit institutions do not yet appear to have passed through the fall in lending and money market rates to deposits. As a result, in the five months in question, the synthetic deposit rate showed no appreciable changes.

Against a background of high volatility, stock markets in the euro area remained on a downward trend until late March. Something of a recovery followed, and this was spurred by the cut in official US rates. From year-end to 20 April, the broad Dow Jones Euro Stoxx index slid by slightly less than 7 %, compared with the fall of 5.9 % in the year 2000 as a whole. The Spanish stock market performance, where the decline had been greater over the course of the previous year, has been more favourable in the period to date in 2001. The Madrid general stock exchange index is 5.5 % above its end-2000 level. The broadly adverse developments on European bourses, as on other industrialised economies' stock markets, reflects the heightening pessimism about the course of the world economy and the deterioration in corporate profit expectations, which have particularly affected the new technology sectors. High-tech stocks, grouped in the broad Dow Jones Euro Stoxx sectoral indicator, have posted losses of 20 % since the start of the year. Meantime, in the case of Spain, the IBEX New Market index has slipped by almost 9 % since the same date

and by 67 % since its inception in April 2000. Finally, the report by the so-called Committee of Wise Men with suggestions for the integration of euro area financial markets was published in February. The report's guiding principles are offered in Box 2.

The exchange rate of the euro against the dollar has not firmed at the levels attained after its strong appreciation in late 2000 (see the bottom half of Chart 11). To date in 2001, the euro's cumulative depreciation has been approximately 4.5 %. Given the financial difficulties the emerging economies have faced, the relative strength of the dollar may have been because of this currency's safe-haven status. The rising expectations of a slowdown in the United States and the narrowing of the positive spread of interest rates at all terms over the euro area (a trend which heightened following the cut in the Federal Reserve's intervention rates on 18 April) have led the euro recently to appreciate modestly against the dollar. The oscillations of the euro against the yen have been relatively minor since the start of the year, with the European currency appreciating by approximately 1.5 %.

The twelve-month growth rates of the euro area monetary aggregates continued to moderate to February. This was so because of the rise in the opportunity cost of holding very liquid assets, the result of the rises in official interest rates in the area between November 1999 and October 2000. Nonetheless, the twelve-month growth rate of M3 rebounded in March to 5 %, placing the average rate for the last three months for which there is information (and on which compliance with the reference value is assessed) at 4.8 %. The most liquid components of M3 are those which have most slowed, these being the most sensitive to interest rate movements in the area. Thus, the twelve-month increase in M1 in March stood at 2.1 %, compared with rates of over 10 % a year earlier.

In Spain, the rate of expansion of liquid financial assets (LFA) has been rising since 2000 Q4, standing in March at a rate of 4.7 % year-on-year. This acceleration is the result of the slowing year-on-year decline in placements in money-market and fixed-income funds. The growth rate of cash and cash equivalents, i.e. the most liquid financial assets included under the definition of LFA, has continued to moderate, standing in March at 2 % compared with a rate above 12 % a year earlier.

Report of the Committee of Wise Men on the regulation of European securities markets

Compared with the degree of integration attained by euro area money markets, that achieved by European securities markets is still insufficient. Against this background, a Committee of Wise Men comprising seven independent individuals of acknowledged professional prestige was created further to the mandate of the ECOFIN of 17 July 2000, under the chairmanship of Alexandre Lamfalussy. The remit of the Committee was to analyse the problem and propose solutions. On 15 February 2001, the Committee submitted its Final Report on the Regulation of European Securities Markets.

The Report begins highlighting the benefits that would be reaped from the greater integration of European financial markets. In the microeconomic field, reference is made to the advantages associated with the more efficient allocation of capital, the greater liquidity of financial assets (which would benefit companies, especially SMEs), the lower cost of capital and the higher investor returns that would ensue were cross-border clearing and settlement costs lower. In the macroeconomic realm, the rise in capital and labour productivity and the higher growth of output potential and employment are underscored.

The Report also describes the current situation of and salient trends on European securities markets, concluding that they are insufficiently developed and at a level far below their US counterparts. Among the factors hampering the growth and integration of European financial markets are the differences in the countries' legal and tax systems, and the presence of trade, political and cultural barriers across the Member States. A series of more specific factors are also indicated: the lack of a regulatory framework ensuring uniform implementation of Community rules in the different countries and of an effective decision-making process; the fact a large number of clearing and settlement systems remain in place, increasing transaction costs; and the scant expansion of pension funds in most EU countries. In any event, the Report concludes that the main problem slowing greater integration lies in how securities market legislation is produced and enacted in Europe. Indeed, it claims that the regulatory system as a whole is «too slow, too rigid, produces too much ambiguity and fails to distinguish between core principles and detail».

Having identified the problems, the Report sets out a series of recommendations to improve EU securities market integration. These can be grouped under two main headings. First, it is recommended that the lead time be shortened and new priorities set for the European Commission's Financial Services Action Plan (FSAP), including most notably: single securities issuance/admission prospectuses for issuers; modernisation of admission to listing requirements; home country control of major investors and definition of the profile of professional investors; modernisation of investment rules for Community investment funds and pension funds; adoption of International Accounting Standards; and a single passport for recognised stock markets.

The Report further proposes a new framework for establishing and implementing the European financial markets regulation based on a four-level approach. At the first level the general basic principles of the new regulatory directives on securities markets would be designed by the European Parliament and the Council of Ministers, on proposals by the Commission. These basic principles would contain the more political aspects and the conceptual guidelines of the new regulations. Moreover, it is recommended at this level that new open and transparent consultation mechanisms be set in place between the European Commission, the European Parliament, the Member States and their regulators, market participants and consumers and users. At the second level, the new regulations would be drafted on the basis of the general principles established at the previous level. To do this, two new committees would be created: the «European Securities Committee» and the «European Securities Regulators Committee». Both committees would keep the European Parliament informed at all times. At the third level, the European Committee of Securities Regulators would formulate administrative guidelines, draw up joint interpretation recommendations and would compare and examine national regulatory practices, all with a view to ensuring consistency in the transposition of Community legislation to national practices and its specific application across the various countries. Finally, at the fourth level, co-operation would be strengthened between the European Commission, the Member States, their regulators and the private sector so as to ensure tighter compliance with Community rules.

In the opinion of the Committee of Wise Men, this new framework should be operational before the end of 2001, with mechanisms in place to provide for the periodical review of its functioning in practice

TABLE 2

Monetary and financial situation in the euro area and Spain

	1998	1999	2000		2001			
	DEC	DEC	NOV	DEC	JAN	FEB	MAR	APR (c)
MONETARY VARIABLES (a):								
EURO AREA								
M3	4.8	6.2	5.0	5.1	4.7	4.7	5.0	
M1	9.2	10.1	5.1	5.7	1.3	2.0	2.1	
Loans to private sector	9.8	10.4	10.2	10.2	10.0	9.6	9.2	
SPAIN								
Liquid financial assets	3.8	1.5	1.9	2.6	3.0	4.0	4.7	
Cash and cash equivalents	12.1	12.7	4.4	4.5	3.3	2.9	2.0	
Financing to the private sector	16.9	18.8	18.5	18.9	18.0	17.7	16.7	
FINANCIAL MARKETS (b):								
EONIA	3.25	3.04	4.83	4.83	4.76	4.99	4.78	5.12
Three-month EURIBOR	3.25	3.44	5.09	4.94	4.77	4.76	4.71	4.65
Public debt								
Euro area ten-year bond yields	3.95	5.32	5.34	5.07	5.01	5.02	4.94	5.06
US-euro area ten-year bond spread	0.74	1.04	0.46	0.25	0.21	0.15	0.00	0.08
Spain-Germany ten-year bond spread	0.21	0.22	0.30	0.31	0.28	0.34	0.37	0.32
Spanish bank interest rates								
Synthetic deposit rate	2.06	1.98	3.01	3.02	3.03	3.04	3.02	
Synthetic lending rate	5.15	5.03	6.39	6.35	6.27	6.22	6.08	
US/EUR exchange rate	1.172	1.011	0.856	0.897	0.938	0.922	0.910	0.890
Equities (d)								
Dow Jones EURO STOXX Broad Index	29.8	39.5	-2.9	-5.9	1.3	-7.7	-11.2	-7.3
Madrid Stock Exchange General Index	37.2	16.2	-12.0	-12.7	9.3	3.0	0.9	1.2

Sources: European Central Bank and Banco de España.

(a) Annual percentage change.

(b) Monthly averages.

(c) Monthly average to 23 April 2001.

(d) Cumulative percentage change during the year. End-of-month data. Latest month: to 20 April 2001.

As regards the counterparts of the monetary aggregates, the rate of expansion of lending to the private sector in the euro area has remained very high in recent months, though it has slowed slightly to 9.2 % in March in relation to twelve months earlier. The moderation of the raising of finance may have come about due to the lesser significance of specific large-scale operations, relating to the financing of mobile telephony corporations, whereas unfavourable stock market developments must have borne adversely on euro area companies going to the equity markets. In any event, the slowdown in the momentum of economic activity has so far

had scant impact on the financing extended to households and companies in the area. In the case of bank lending, this might be the outcome of the above-mentioned decline in interest rates on banks' lending operations. The slowdown in Spain in financing extended to the private sector has been more discernible than in the euro area as a whole, though it continues to expand at substantially higher rates (16.7 % in March compared with 18.9 % in December). Lending from resident institutions (the main component of the financing received by the non-financial private sector) has grown at a rate of 14.3 % in March, against 18 % last December.

4. The Spanish economy

According to the National Institute for Statistics (INE), Spanish real GDP grew by 4.1 % in 2000, up 0.1 percentage points on the previous year. The increase in national demand was similar in magnitude to that of GDP, and the contribution of the net external balance was practically nil. During the year, the rate of increase of national demand fell significantly, but as the contribution of net external demand rose the slowdown in the rate of change of output was much more moderate. Specifically, in 2000 Q4 real GDP grew year-on-year by 3.8 % (0.4 percentage points less than in Q1), national demand by 3.2 % (1.8 percentage points less) and the net external balance contributed half a percentage point in Q4 (against -0.8 percentage points in Q1).

As already mentioned in Chapter one of this report, the data available for the first few months of 2001 point to continuation of these same trends (slowing demand and a positive contribution from the external balance), albeit with greater moderation. Indeed, estimates for growth of national demand and the contribution of net external demand in Q1 are around 3 % and slightly under 0.5 percentage points, respectively, which would make for real GDP growth of around 3.5 %. The modest reduction in the rate of growth of national demand, in comparison with its end-2000 levels, extends to most of its components. Exports and imports of goods and services remain notably buoyant; the slowdown in external markets has not yet significantly dented the former and the latter show no signs of demand being weaker than estimated. From the viewpoint of activity, all productive sectors have seen lower growth, with the sole exception of agriculture. As this has translated into a larger deceleration in employment, apparent labour productivity has increased slightly. The indicators available show a notable upturn in compensation per employee – of greater magnitude in the market economy – which will lead to a slight acceleration of unit labour costs. Against this background, the CPI continued to increase at high rates in Q1, without any reduction in the inflation differential vis-à-vis the other euro area countries.

4.1. Demand

On Quarterly National Accounts (QNA) estimates (1), the slowdown in national demand during 2000 was particularly severe in the case

(1) The QNA data presented in this article are trend-cycle data.

of private consumption and capital goods investment, while government consumption and investment in construction held steadier. The loss of momentum by consumer spending extended to almost all its components, although goods and, in particular, food and car purchases were affected to a greater extent.

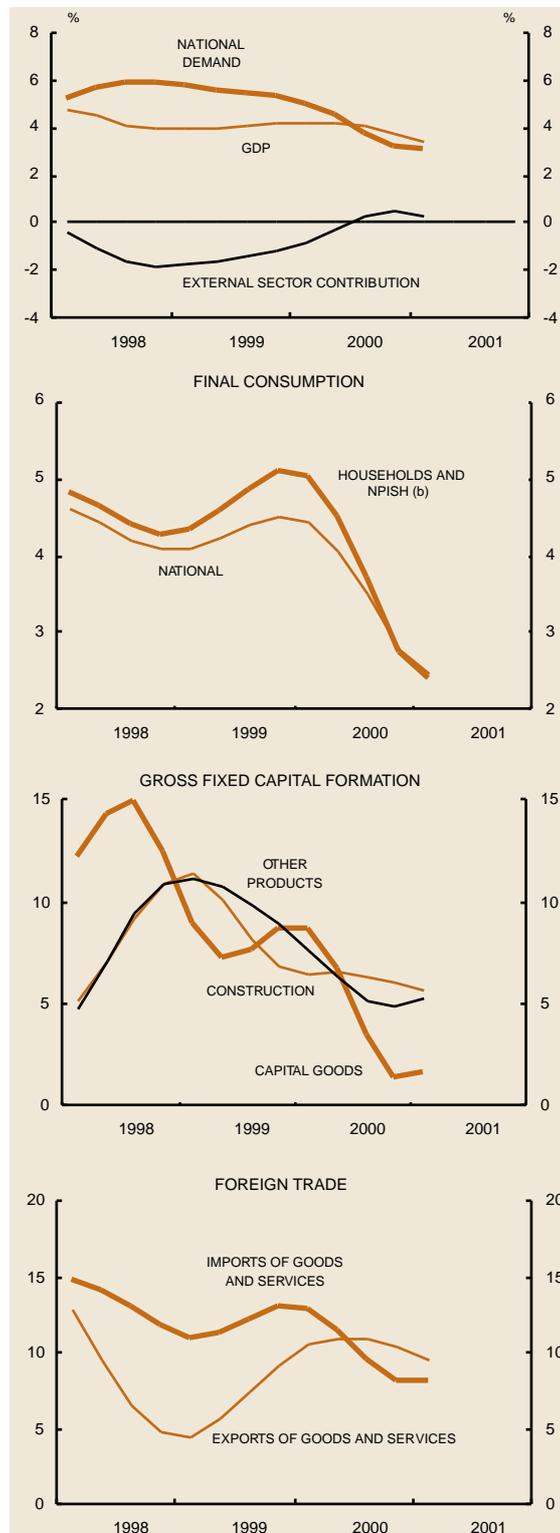
The still incomplete information from indicators available for 2001 Q1 points to a clear levelling out of the slowdown in private consumption. The consumer confidence indicator improved slightly in March, so that on average in Q1 it was unchanged on 2000 Q4, although the assessment of the general economic situation tended to worsen. The index of apparent consumption of consumer goods, for which only fragmentary information is available, has partially recovered, following the significant falls recorded in the second half of 2000. Of its various items, the food component was less contractionary in February, while apparent consumption of consumer durables worsened in the same month, in contrast to the recent trend in new car registrations which, according to the March figure, seem to have recovered from the sharp falls at the end of 2000. Finally, the index of retail sales increased at a real rate of 5 % in January, although the February figure shows a resumption of its mild downward trend, in line with the retail confidence indicator.

Analysis of the determinants of private consumption tends to confirm the trend discerned from the available indicators. The petering out of the expansionary effect of the revaluation of financial wealth, against a background of stable interest rates and relatively high inflation rates, is one factor explaining the reduced buoyancy of consumer spending in the latest quarters. The slowdown in employment would also tend to restrain consumer spending. Although very modest, it augurs a smaller reduction in unemployment than in recent years. However, the application of inflation-adjustment clauses in the collective agreements signed in 2000, as a consequence of the deviation by actual inflation from the official forecast, may have temporarily increased disposable income and, in consequence, held up private consumption in the first few months of the year.

On QNA estimates, in 2000 Q4, final consumption spending by general government rose year-on-year by 2.9 % in real terms, with a profile of progressive acceleration over the year. The information available for the first few months of 2001 and the budget plans for the whole year mean that a correction in this trend

CHART 14

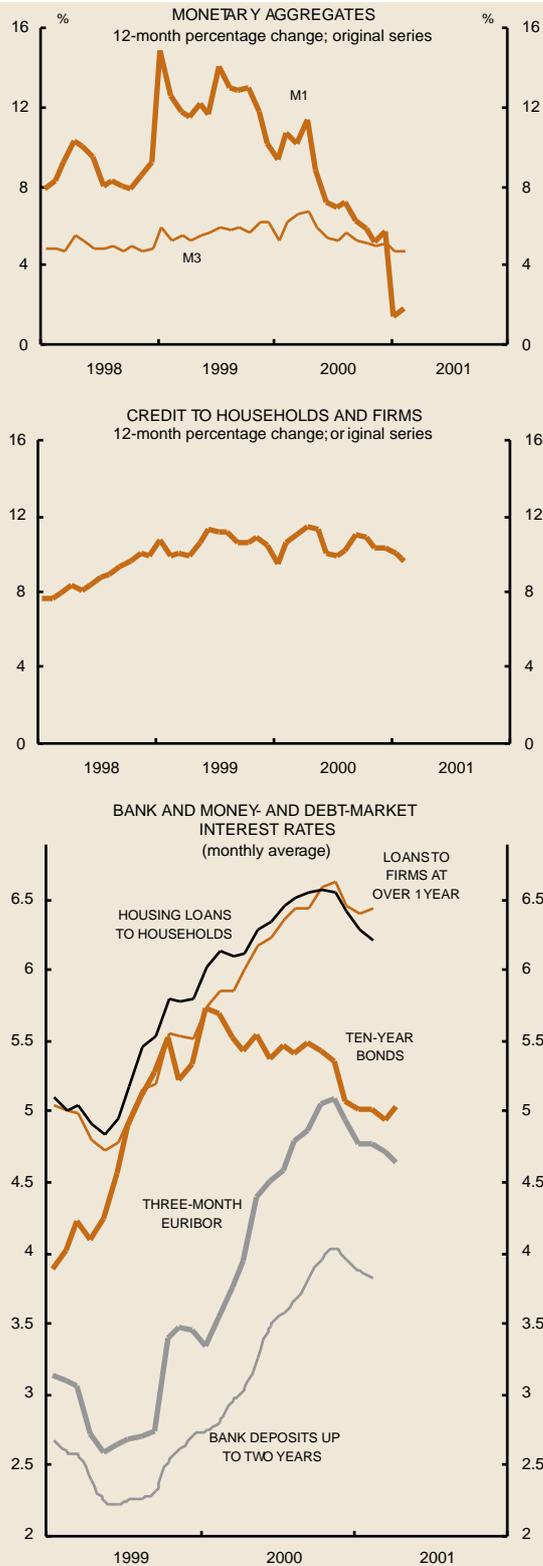
Main macroeconomic aggregates (a)



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

CHART 15

Private consumption indicators



Sources: Banco de España and ECB.

is expected, which will be reflected in the results for the whole year and is possibly apparent already in the Q1 magnitudes. This greater moderation would affect both compensation of employees and the other items of final consumption.

The slowdown in gross fixed capital formation, which dates back to the beginning of 1999, continued throughout 2000. In the final quarter the annual rate of change was 4.4 %, almost three percentage points down from Q1. This loss of buoyancy basically stems from the behaviour of investment in capital goods, which ended the year with a year-on-year growth rate of 1.4 %, seven percentage points lower than at the beginning of the year. The loss of momentum in the other components – construction and other products – was much more moderate, and they displayed increasing stability as the year elapsed.

The main indicators of investment in capital goods have extended this downward path during the first few months of 2001. Specifically, on data to February, apparent investment in capital goods continued its decline, the improvement that seemed discernible in the domestic production of such goods at the end of 2000 having been cut short, according to the latest data received. However, the main factor explaining the sharp decline in the indicator of apparent investment in capital goods continues to be the combination of strong export growth and the fall in that of imports, associated in turn with the differences in the rates of change of their related deflators. By type of product, the worsening in apparent investment in transport equipment is notable, following the rise in the first half of 2000. Meanwhile, the indicators provided by the Ministry of Science and Technology's business survey, on data to January, generally show a downward trend, especially those relating to the current trend in order books and to their future trend. By contrast, the business climate indicator of the capital goods industry, which summarises sentiment in the sector, is still holding at relatively high levels. Finally, according to the latest data of the Ministry of Science and Technology's semi-annual survey of investment in industry, the sample firms estimate that in 2001 investment will grow at a nominal rate of 8 %, a somewhat higher rate than in 2000. The main reasons for this investment were to increase productive capacity and improve performance.

The trends in the main determinants of investment in capital goods would support a more favourable path for investment than that augured by the short-term indicators, which is re-

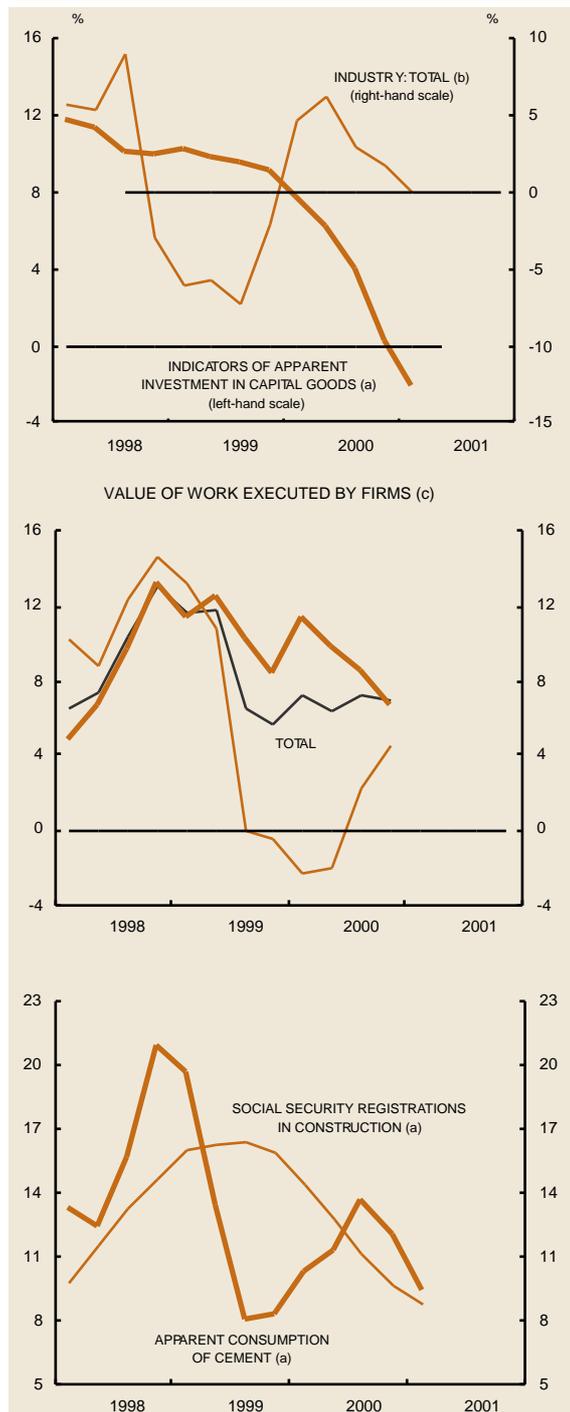
flected in QNA estimates. In fact, albeit with a declining profile, domestic demand is holding at a significant growth rate, exports remain notably buoyant and capacity utilisation is very high (above 80 % in 2001 Q1, according to European Commission data). The information provided by the Banco de España Central Balance Sheet Office quarterly survey confirms the healthy financial situation of Spanish firms. Analysis of profitability ratios shows that operating profits, relative to both net assets and equity, increased from the already high levels reached in 1999. Thus, despite the upturn in financial costs (owing to the rise in interest rates and the greater recourse by firms to external financing), financial leverage increased again during 2000, to reach a new peak. It is possible that the uncertainty prompted by the international environment has delayed some investment decisions by firms, which are, moreover, allocating a significant proportion of their financial resources to investment in international markets. An overall assessment of all these factors would anticipate stronger investment in capital goods, but the indicators currently available provide no basis for estimating a recovery by this variable in 2001 Q1. Even so, its annual rate of change should not differ significantly from 2000 Q4.

The short-term information on investment in construction continues to show steady growth, set against a declining trend that commenced in the second half of last year. According to the survey of the sector conducted by the Ministry for Public Works (the ECIC), the upturn in construction in 2000 Q4 was based on a stronger performance by civil engineering works, which partially offset the weaker performance of residential building, while non-residential building held fairly steady. According to the latest data, these trends are continuing, so that the year-on-year growth of this aggregate in 2001 Q1 will not be significantly different from at the end of last year.

The construction confidence indicator, following the decline in 2000 Q4, improved somewhat in 2001 Q1. The coincident indicators of activity in the construction industry do not, however, give an unambiguous message. As regards the indicators of intermediate consumption, on data to February, apparent consumption of cement remained on the downward path that commenced in the second half of 2000, while the production of construction materials picked up significantly in January. According to the figures for Social Security registrations, employment growth held steady in the first two

CHART 16

Gross fixed capital formation indicators

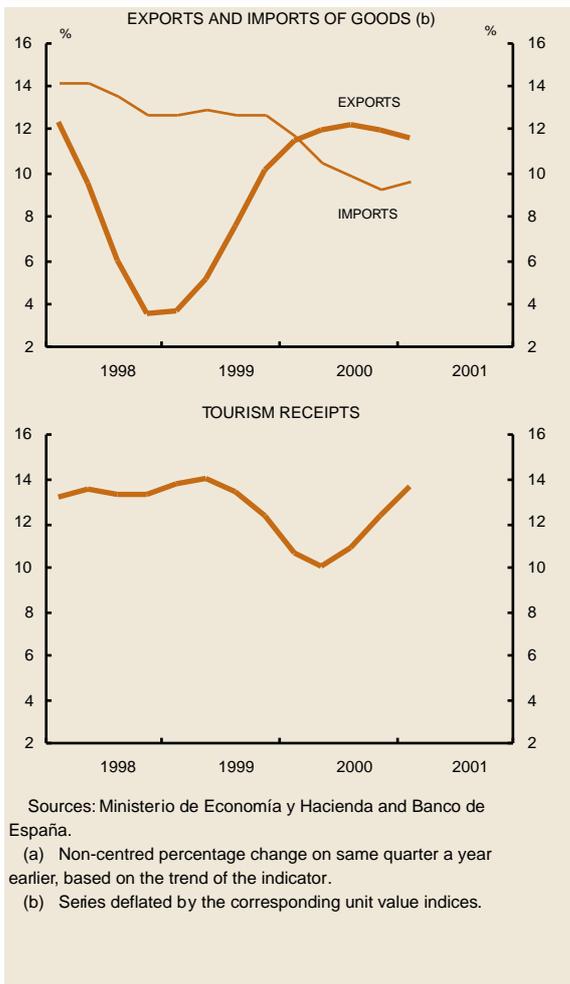


Sources: Instituto Nacional de Estadística, European Commission, Ministerio de Fomento, OFICEMEN, Instituto Nacional de Empleo and Banco de España.

- (a) Non-centred percentage change on same quarter a year earlier, based on the trend of the indicator
- (b) Level of original series.
- (c) Obtained from the quarterly construction industry survey and deflated by the construction costs indicator. Four-quarter rate of change based on original series.

CHART 17

Foreign trade (a)



months of the year, at an annual rate of change of around 8.5 %, while the figures for registered unemployment, to March, indicate a less vigorous pace of employment creation in the sector. Perhaps the most significant information is provided by the leading indicators (official tenders and approvals by architects' associations). These project continued buoyancy for civil engineering work in the coming quarters, while the outlook for residential building is for greater moderation and that for non-residential building one of stability.

According to the QNA, in 2000 Q4 stock-building contributed 0.1 percentage points to GDP growth, as against a deduction of 0.2 percentage points in the previous quarter. The latest information available from the business survey, relating to January, shows stocks in line with desired levels for industry as a whole. However, the breakdown by type of product shows an increase in the level of stocks in the interme-

diate goods industry, while there were falls in the consumer and capital goods industries.

As already mentioned at the beginning of this chapter, the contribution of net external demand to real GDP growth changed sign in 2000. Goods exports, against a background of notable expansion of foreign markets and with the assistance of depreciation of the euro, remained notably buoyant, while imports gradually lost their momentum, in line with domestic demand. The information on the first quarter of this year generally points to continuation of these trends, although the contribution of net external demand to GDP growth in that period would have been somewhat less than at the end of last year.

On customs data for the first two months of the year, goods exports grew at a real rate of 12.3 %, slightly up on 2000 Q4, while the 11.1 % increase in imports was significantly higher than in the last few months of 2000 (when the figures were possibly distorted downwards). The recovery in imports of consumer goods and non-energy intermediate goods was notable. Imports of capital goods, however, remained particularly sluggish in real terms, partly due to the surprising increases still being recorded in their prices (unit value). As for export growth by group of product, the buoyancy was considerably widespread, as was its distribution across geographical and economic areas. In the latter case, the nominal rate of growth in EU markets remained high, with rates of change of more than 14 %, as it did in markets outside the EU, where the increases almost reached 25 %. Only the growth rates of sales to the US have fallen drastically in the first two months of 2001.

The foreign trade data for the first months of the year also show a significant deceleration in the rates of change of the prices (unit values) of exports and imports. In the former case, the average growth in January and February (4.4 %) contrasts with the rate of 6.9 % in 2000 Q4. As for import prices, their slowdown has been more pronounced, not only due to developments in energy product prices, but also due to the significant fall in the rates of increase of the prices of non-energy goods, from 9.5 % at end-2000 to 2.9 %, according to the latest data released.

Finally, the indicators of developments in tourism during the first two months of this year (hotel stays and nights spent in Spain by foreigners) point to an ongoing recovery in tourism

receipts that was already apparent at the end of 2000, and which is confirmed by the January balance of payments data. There was also a large increase in tourism payments that month, and although no recent information is available on receipts and payments for other services, the trends of previous years should continue this year.

4.2. Output and employment

The slowdown in economic activity in 2000 Q4 affected all branches of production, with the exception of agriculture, which accelerated slightly, and non-market services, which held at a steady rate. The data available for the first few months of this year generally entail an extension of these trends, although a moderate loss of momentum is also discerned in non-market services, accelerated growth only being recorded in the primary sector. The moderation in productive activity during 2000 translated into a reduction in the rate of growth of employment, which rose by 3 % in year-on-year terms in Q4, 0.3 percentage points down on the increase in Q3, a trend which may have continued during the first few months of 2001. These developments in output and employment would have led to a slight rise in apparent labour productivity in Q1.

Activity in the primary sector in 2000 Q4, as during the rest of the year, was expansionary, reaching a year-on-year growth rate of 2.5 %, according to QNA estimates. As in previous quarters, the higher growth of this branch was based on crop production, while animal production continued to lose momentum. Overall, the outlook for production in 2001 in this branch is positive. The heavy rainfall in the latter winter months more than made up for the dry start to the year and means that a significant expansion in crop production can be forecast for 2001. However, the aggravation of the problems in livestock production, with the consequences arising from the existence of cases of BSE in Spain, and the decline in fish production caused by the breakdown of negotiations between Morocco and the EU are factors that will tend to reduce the aggregate growth of primary activities.

The reduced vigour of domestic demand and the expectations of a less favourable international setting are two of the main factors explaining the slowdown in industrial activity in the second half of 2000, which ended with a year-on-year growth rate of 4.9 %, according to the QNA. Energy production slowed more sharply,

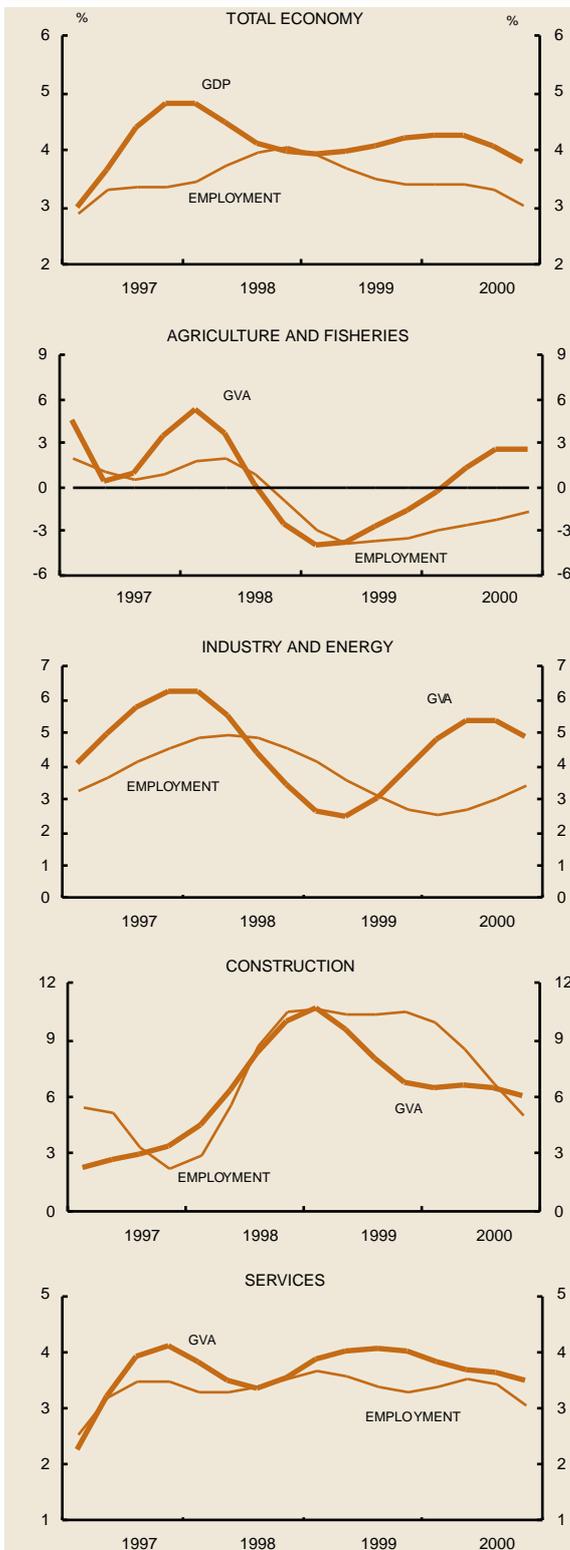
although it remained highly dynamic, with a notable deceleration in the manufacture and distribution of gas. The performance of the other industrial branches was rather varied. In mining and quarrying and the chemicals industry, the incipient recovery in the first few months of the year came to a halt. Notable at the other extreme was the expansionary profile of the metal processing industries in the final quarter of the year, and in particular the strong growth in products with a high technological content (office machinery and electronic equipment). The latest information confirms the ongoing loss of momentum in industrial activity. The index of industrial production recorded a further downturn in February, taking its trend growth rate to 0.9 % (1.7 % in December 2000), while the business confidence indicator in February seems to show an improvement in the projected trend of output.

The slightly decelerating trend which had been marking activity in construction since the beginning of 1999 continued in 2000 Q4 when, according to QNA data, the year-on-year growth rate was 6 %, 0.3 percentage points down on the previous quarter. The significant acceleration in civil engineering work in the latter months of 2000 was insufficient to offset the loss of momentum in building, which had until then been the most dynamic component. As mentioned when analysing the course of investment, the most up-to-date indicators of activity in the sector point to continuation of these trends in 2001 Q1.

The diminished buoyancy of the Spanish economy in 2000 Q4 was also reflected in services. The loss of vigour in domestic consumption and the lower growth of industrial production prompted a slight fall in the year-on-year growth rate of tertiary activities to 3.5 %, on QNA data, which extended the smooth deceleration observed during the rest of the year. The slowdown only affected market services, while the growth of services provided by general government held steady. The information relating to the first few months of 2001 points to continuation of this process in most of the activities of this branch. In particular, both the retail business climate indicator and Social Security registrations show less buoyancy, in line with the trend in private consumption. Meanwhile, the reduction in the rate of growth of Social Security registrations in the first few months of 2001 signals a further downturn in the transport, storage and communication sector. Against this, the recovery that appears to be occurring in hotels and catering, according to the behaviour of the

CHART 18

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



Source: Instituto Nacional de Estadística.

(a) Non-centred percentage change on same quarter a year earlier, based on the trend-cycle series published by INE. Employment refers to full-time equivalent jobs.

employment indicators in this sector during the first two months of the year is notable.

As mentioned at the beginning of this section, the moderation in productive activity in 2000 Q4 translated into a slowdown in employment growth of similar magnitude, entailing steady growth of apparent labour productivity, at around 0.7 %. The tendency for employment to increase more slowly seems to have continued in 2001 Q1, with a moderate recovery in productivity growth expected. Among the data available, notable was the large increase in the number of Social Security registrations in March, which made the year-on-year growth rate in Q1 similar to that in 2000 Q4 (4.6 %). It is not possible to know whether this very favourable figure may have been affected by the regulation processes that have recently taken place in relation to the employment situation of certain groups of immigrants. Meanwhile, the latest figures on the number of contracts registered with the National Employment Office (INEM) reflect a decline in comparison with the same period of the previous year (of 1.1 %). Also, the year-on-year rate of decline of registered unemployment fell from 3.8 % in 2000 Q4 to 3.2 % in 2001 Q1.

On QNA data, the deceleration of employment in 2000 Q4 was especially severe in construction and market services, where, up until then, the process of job creation had been strongest, with year-end annual growth rates of 5 % and 3.9 % respectively. In both cases the slowdown in employment over the year was steeper than that in GVA, so that apparent labour productivity showed a recovery. In industry, despite the loss of momentum of activity, employment growth continued to accelerate to Q4, when the annual rate reached 3.4 %, halting the path of recovery in productivity over the previous months. In terms of employment creation, the poorest performing sectors in 2000 were agriculture and services provided by general government. In the former there was a net loss of jobs and in the latter a stagnant level of employment. However, the growth profile of these two sectors showed gradual improvement over the year, in line with the more expansionary behaviour of GVA, and, as seen above, this trend seems to have continued during the first few months of 2001.

The foregoing analysis, based on QNA estimates of full-time equivalent employment, broadly coincides with Labour Force Survey (EPA) information, once the effect of renewal of the sample in Q1 is taken into consideration (2).

According to the EPA, in 2000 Q4 there was a loss of momentum both in the growth of workers with permanent contracts and temporary workers, although the former continues at a high rate (6.4 % year-on-year). In consequence, the ratio of temporary to total employment fell significantly, to 31.7 %, one percentage point lower than in 1999 Q4. With regard to the duration of the working day, in the final quarter of last year there was a significant deceleration in part-time employees, which increased by 2.2 %, while full-time workers increased by 4.2 %, a modest slowdown on the previous quarter.

From the viewpoint of the supply of labour, EPA data show a notable rise in the participation rate during 2000, to 51.4 % of the population over the age of 16 in Q4 (65.4 % if the over 65s are excluded). The female activity rate showed the larger increase, to 39.8 %, yet, given its past stability, the rise of 0.6 percentage points in the male rate (to 63.9 % in 2000 Q4) is more notable. The strength of job creation during the year more than made up for new entrants into the labour force, so that the rate of unemployment fell by almost two percentage points to stand at 13.6 % at end-2000. Finally, long-term unemployment (persons unemployed for more than one year) continued to fall as a proportion of total unemployment, to stand at 45.1 % in Q4.

4.3. Prices and costs

QNA data show, in 2000 Q4, a year-on-year increase in the GDP deflator of 3.4 %, down 0.1 percentage points on Q3. This slight deceleration was compatible with an expansion in the gross surplus per unit of output, since the increase in unit labour costs (of 3 %) was down 0.3 percentage points on the preceding quarter. The modest decline in the growth of unit labour costs was the result of a reduction in the growth of compensation per employee (in terms of full time equivalent jobs), since the growth rate of apparent labour productivity was unchanged.

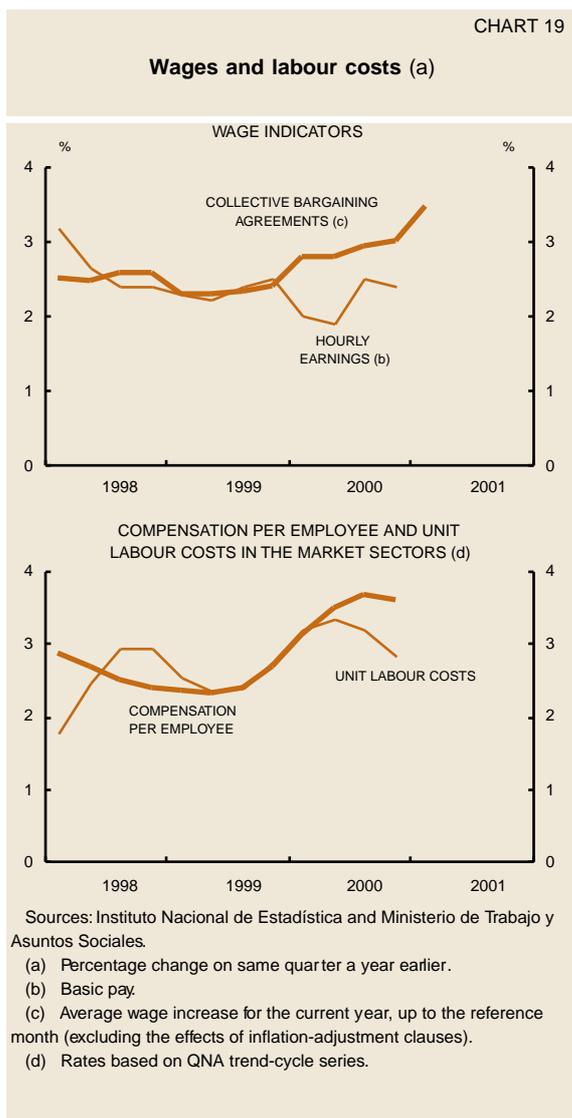
According to the Wages Survey, during 2000 Q4 the year-on-year rate of increase in average hourly earnings, in terms of total pay, was 2.5 %, similar to the Q3 rate. The increase in average monthly earnings was smaller (2.3 %), this being a slight deceleration on the summer

months. To assess these figures properly it needs to be taken into account that, owing to the partial renewal of the sample at the beginning of last year, certain industries that pay lower wages, in particular construction, now have a higher weight in the sample. This has pulled down aggregate wage growth. A more accurate view of wage dynamics last year may be obtained by analysing uniform data for the various industries. The high growth of wages in construction stands out, with a rise in average hourly earnings of 4.8 %, 0.8 percentage points more than in Q3, while in services there was an increase of 2.9 %, 0.2 percentage points up on Q3. At the other extreme was the slowdown in wages in industry, where average hourly earnings rose by 2.5 %, 0.8 percentage points less than in Q3.

The information available on collective bargaining during 2001 shows a significant pick-up in wages during Q1. The increase in wage rates negotiated in the collective agreements registered to 31 March was 3.5 %, significantly higher than last year's settlement, before taking into account the impact of the inflation-adjustment clauses that have been activated as a consequence of the deviation during 2000 of actual inflation from the projections established in that year's negotiations. The settlement in multi-year agreements was 3.4 %, and the notable acceleration seen in the first quarter of this year is due in part to the fact that the impact of the aforementioned clauses is reflected in this year's figures, their effect being assigned to 2001 as they are not retroactive. However, most of the inflation-adjustment clauses are retroactive, and therefore they are recorded in the statistics in 2000, although their economic impact and their effect on wage dynamics occurs in 2001. In accordance with the data released up until now, the impact of these clauses so far is 0.6 percentage points. Finally the increase in wages negotiated in newly signed agreements, still insignificant in number, is 4.1 % as at the end of March.

On QNA estimates, in 2000 Q4 the GVA deflator of the market economy grew at a similar rate to that of the economy as a whole, namely 3.4 %, the same rate as in Q3. The slowdown in unit labour costs was somewhat greater, down from 3.2 % in Q3 to 2.8 % in Q4, since the effect of the smaller increase in compensation per employee was reinforced by more dynamic productivity in the market economy. The development of collective bargaining in 2000 Q1 and the modest recovery that may be taking place in

(2) See the article in Spanish, «La evolución del empleo y del paro en el primer trimestre de 2000», published in the May 2000 edition of the Boletín Económico.



apparent productivity portend a further pick up in unit labour costs in this quarter.

The data available to 2000 Q4 show that the behaviour of prices and margins varied widely across branches of activity that year. In industry, the value-added deflator decreased substantially, while unit labour costs accelerated, mainly as a consequence of the sharp reduction in apparent labour productivity referred to earlier. As a result, the gross unit operating margin fell. However, these trends must be interpreted with some caution since the indicators available on price developments in industry did not show such negative rates as the provisional QNA estimates. The deflator of market services, meanwhile, accelerated mildly in the final quarter of the year, while unit labour costs fell sharply, as a result of a certain moderation in compensation per employee and of a less sharp fall in productivity. There was thus a recovery in unit

margins, following the deterioration seen in the preceding quarters. Finally, in construction, unit labour costs moderated significantly, while the deflator held at rates above 8.5 %. Accordingly, the unit surplus continued to widen throughout the year.

It would be rash to predict the behaviour of unit margins in the different productive branches during 2001 Q1. However, the data available on prices, wages, output and employment do permit a squeeze in margins to be predicted for the economy as a whole, which may have been distributed among the various industries rather unevenly. Specifically, it is in services that the impact of inflation-adjustment clauses tends to be smallest, so that, given the sharp increase in services prices, margins will foreseeably not have narrowed. The opposite may be the case in the industrial sectors.

The slight reduction in the GDP deflator in 2000 Q4 reflects the mild decline in the final demand deflator. The latter, nonetheless, continued to grow at a high rate (5 %), as a consequence of the continuing surge in import prices in the latter months of last year. The deflator of imports of goods and services increased at a year-on-year rate of 10.2 %, which meant that the accelerating path it had followed during the year until then, largely determined by the rising prices of energy imports, came to an end. The opening months of 2001 already show a significant slowdown in the prices of imported goods. According to the unit value index for imports estimated by the Ministry of Economy, on average in January and February the prices of all imports rose by 3.2 %, in contrast to the rate of 14.6 % in 2000 Q4. As analysed in section one of this chapter, this significant slowdown in the prices of imported goods also extends to non-energy products.

Two other factors – besides the recent moderation in import prices – determined the course of the main price indicators in the Spanish economy during 2001 Q1, namely the partial recovery in the euro/US dollar exchange rate and the worsening of the crisis in the livestock industry. The annual rate of increase in the CPI (the main indicator of final prices) stood at 3.9 % in March, only 0.1 percentage points down on December 2000 (see Chart 21). Meanwhile, the underlying rate of inflation, as approximated by the index of non-energy processed goods and services prices (IPSEBENE), continued to accelerate, its year-on-year rate of change reaching 3.3 % in March, 0.3 percentage points up on end-2000.

Urgent labour market reform measures contained in Royal Legislative Decree 5/2001

On 2 March 2001, Royal Legislative Decree 5/2001, on urgent measures to reform the labour market in order to increase employment and improve its quality, was approved. It now remains for its parliamentary stage to be completed. This decree introduces measures in the area of contract types, with other aspects of the labour market, notably collective bargaining still to be reviewed.

In the area of permanent contracts, the line of action commenced in 1997 has been continued, with an indefinite extension of the validity of the permanent employment-promoting contract, which was initially introduced on a temporary basis and ceased to be valid on 16 May 2001. The new permanent employment-promoting contract is aimed at a wider group of workers than that initially established in 1997. In particular, opportunities for gaining access to this type of contract are notably larger now that temporary contracts can be converted into this type of contract. Specifically, permanent employment-promoting contracts may be entered into with young unemployed persons aged from 16 to 30, unemployed women in professions with a low rate of female employment, the over 45s, unemployed persons registered as seeking employment for at least 6 months, the disabled and workers who, as at the date of execution of the permanent employment-promoting contract, have been employed by the same firm under a temporary contract entered into before 31 December 2003. The inclusion of the latter group means that practically any worker who has previously been hired by the firm with a temporary contract is now eligible for a permanent employment-promoting contract. In all cases, if the contract is terminated for objective reasons that are found to be unjustified, the amount of severance pay is 33 days of wages per year worked, up to a maximum of 24 months of wages. When contracts are terminated on disciplinary grounds found to be unjustified – a relatively normal practice, owing to the fact that tribunals continue to interpret the grounds justifying objective dismissals very narrowly – the severance pay is still 45 days of wages per year worked, up to a maximum of 42 months of wages, as in the case of ordinary permanent contracts.

Continuing the policy of promoting employment amongst groups that have the greatest difficulty finding work, incentives, in the form of reductions in social security contributions, for new permanent contracts (full or part time; ordinary or employment-promoting) entered into during 2001 with certain groups of worker have been raised. The groups most favourably treated are older and female workers, while the amount of the reductions, in comparison with the 2000 plan to promote permanent employment, has been decreased very significantly for young workers, being removed completely in the case of males.

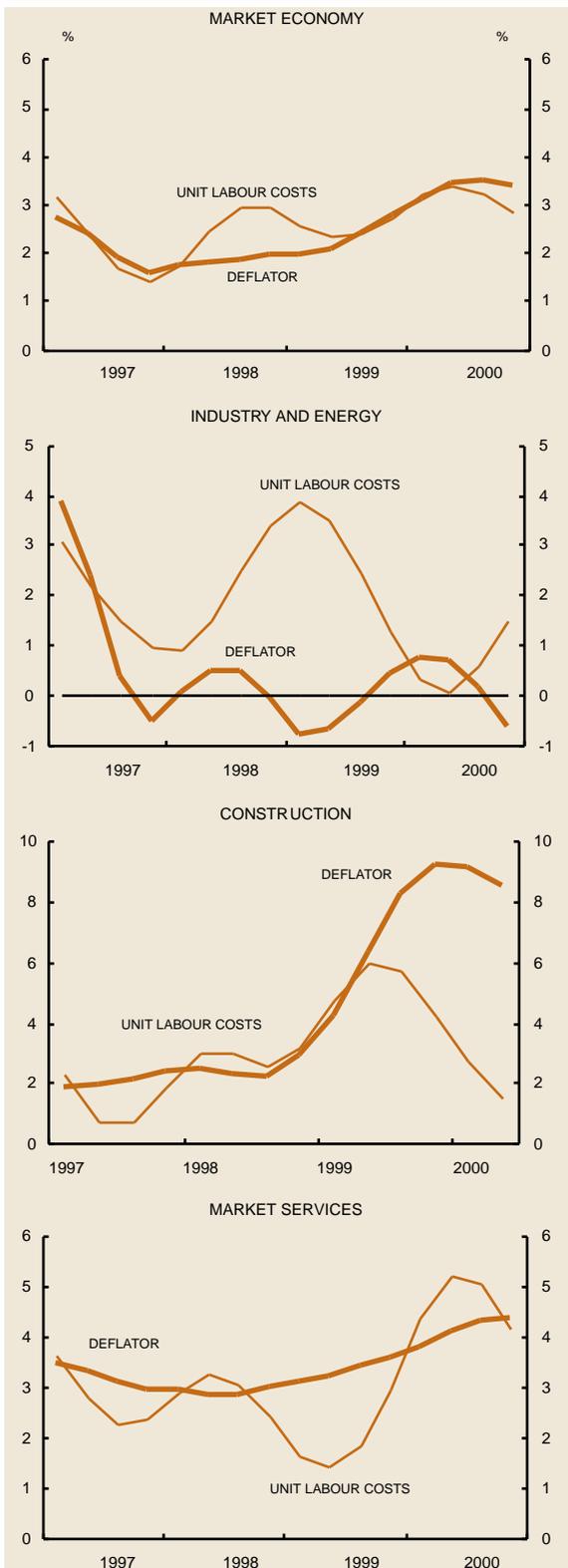
In relation to temporary employment, the possibility is envisaged of introducing limits through collective bargaining, in order to avoid the rolling over of temporary contracts and the abuse of temporary hiring. In addition, severance pay of 8 days of wages per year worked has been established for temporary contracts, except in cases of substitution, insertion and training contracts. As regards other forms of temporary contract, it should be pointed out that the maximum term of casual contracts is limited to one year and the training contract is widened to include workers over the age of 21 who belong to certain groups. In addition, an insertion contract has been established, which involves the hiring of a job seeker by general government to perform a task or service of general interest. Finally, other measures aiming to clarify permanent discontinuous contracts and to permit greater control over the subcontracting of tasks and services should be noted.

A number of measures have been introduced to promote part-time employment, which incorporate greater flexibility into part-time contracts. They should enable this type of contract to recover and regain the upward trend followed from the early nineties. In particular, the maximum limit of 77 % of normal working hours is removed for part-time contracts, the distribution of working hours is made more flexible and working hours are to be calculated on the basis of total hours worked, irrespective of their distribution. Also, the use of complementary hours (extra hours paid at the normal rate) is simplified. Together with this greater flexibility, the main elements introduced in the 1998 regulations, which tended to make this kind of contract more attractive to workers, are maintained. In particular, higher levels of social protection are guaranteed, overtime disappears, and complementary hours must have been specified and agreed in the contract.

The measures adopted amount to further progress in making the labour market more flexible, both by facilitating part-time hiring and by widening the group of workers eligible for permanent employment-promoting contracts, which at end-2000 represented about 20 % of employees with permanent contracts. With the changes introduced, the cost of a permanent employment-promoting contract during its first year of effectiveness approaches that of a temporary contract of similar duration – especially when the contract is for older workers, but big differences remain when the term of the contract is lengthened, especially from two years, when the subsidies disappear and severance pay mounts. That said, although the new regulations significantly broaden the group eligible for permanent employment-promoting contracts, certain problems remain that may limit the scope of these measures. In particular, the structure of incentives continues to be relatively complex. In addition to their revenue cost, this reduces transparency in hiring conditions and may distort employment decisions.

CHART 20

Prices and costs by branch of activity (a)



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

The annual rate of increase in the energy component fell steeply to 2.1 % at the end of Q1, down from 11.2 % in December 2000. This was a consequence of the reduction in electricity tariffs for domestic consumers and the favourable behaviour of vehicle and heating fuels, which considerably outweighed the sharp increases in calor and natural gas. In any event, the uncertainty over how far the deceleration in the prices of imported oil-related products will go has still not been completely dispelled. The component of the CPI that accelerated most in Q1 was unprocessed food prices. It reached a year-on-year rate of increase of 10 % (6.5 % in December 2000) as a consequence of the crisis in the livestock sector. This has led to large increases in most meat prices, with the exception of beef, which has seen only a moderate fall in price.

The generally more stable consumer prices (IPSEBENE) are continuing to display an upward trend that dates back to mid-2000. The acceleration of processed food, with a rate of increase of 2 % in March (1.1 % in December 2000), was notable, with the decreases in oil and wine prices only partially offsetting the increases in milk and meat prices. The annual rate of increase in the prices of non-energy industrial goods rose by 0.2 percentage points between December and March, to 2.7 %. Finally, the prices of services continued to accelerate, reaching an annual rate of increase of 4.6 % in March. Transport, medical insurance and home maintenance contributed to this acceleration.

In the first quarter, final prices in Spain and in the euro area as a whole, as measured by the HICP, behaved fairly similarly, so that the differential in the total HICP held steady at the December level of 1.4 percentage points. However, food and especially unprocessed food prices increased at higher rates in Spain than in the euro area, while the prices of industrial goods, specifically energy goods, decelerated faster. Finally, the differential in services prices narrowed only slightly, to 2.5 percentage points in February.

Of the other price indicators, the significant slowdown in recent months in import prices, in line with the prices of goods exports, has already been analysed. As for the producer price index, the reduction in its rate of increase from 5.7 % in November 2000 to 3.6 % in February should also be noted.

4.4. The State budget

The Updated Stability and Growth Programme has confirmed the target, established in the State budget, of balanced public finances in 2001, compared to a deficit of 0.3 % of GDP in 2000. The balanced budget target for general government as a whole in 2001 involves a State deficit of 0.3 % of GDP (0.6 % in 2000), offset by a Social Security surplus of the same size, while territorial government finances are planned to be in balance.

The first data available for the year 2001 in the National Accounts framework, to March, are favourable for meeting this target. In Q1 the State surplus was ESP 107 billion (0.1 % of GDP), as against a deficit of ESP 54 billion (0.1 % of GDP) in the same period a year earlier (see Table 3). Receipts increased by 6.5 %, basically owing to the strength of direct taxes and to the larger receipts of Banco de España ordinary profits. The buoyancy of VAT receipts is also notable, while other taxes on products declined slightly, owing to the lower receipts from tobacco taxes (which rose sharply at the beginning of 2000 because of the rise in tobacco prices) and on hydrocarbons. Meanwhile, expenditure grew by 3.2 % to March, as against 4.7 % during 2000 as a whole. The moderate rate of growth of spending in 2001 Q1 was mainly attributable to final consumption expenditure and accrued interest, while the growth of capital expenditure cannot be considered significant. On the other hand, the growth of 6.1 % in transfers within general government, as against 15 % in the whole of 2000, is notable. However, both the trend in these transfers and that in final consumption expenditure were affected by the ongoing transfer of responsibilities to the regional (autonomous) governments.

The available cash-basis data show a State deficit of ESP 927 billion to March 2001, as against a deficit of ESP 1,000 billion in the same period of 2000. The reduction in the cash-basis deficit in 2001 Q1 was attributable to an increase of 6 % in revenue, well above that projected in the budget and to the 3.8 % growth in expenditure. The details of receipts and expenditure are discussed below, using cash-basis information.

As regards receipts, total tax revenues increased by more than projected in the budget. However, there was divergent behaviour among the various taxes. Direct taxes increased at a notable rate, similar to that seen during 2000 as a whole, while indirect taxes recorded a more

CHART 21

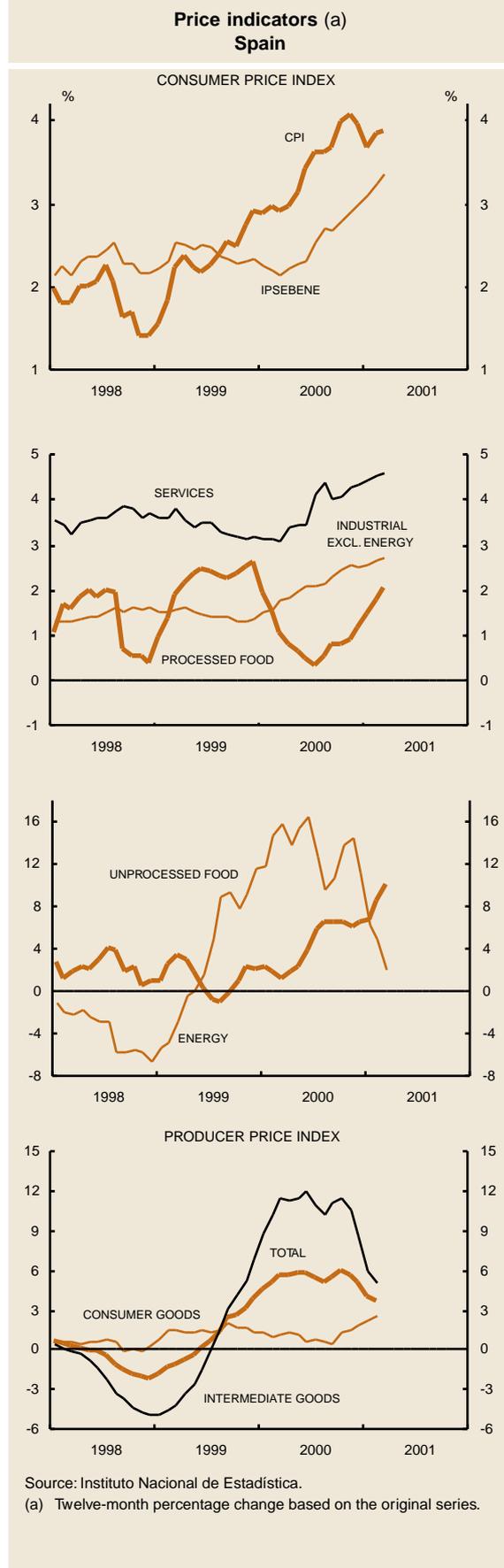
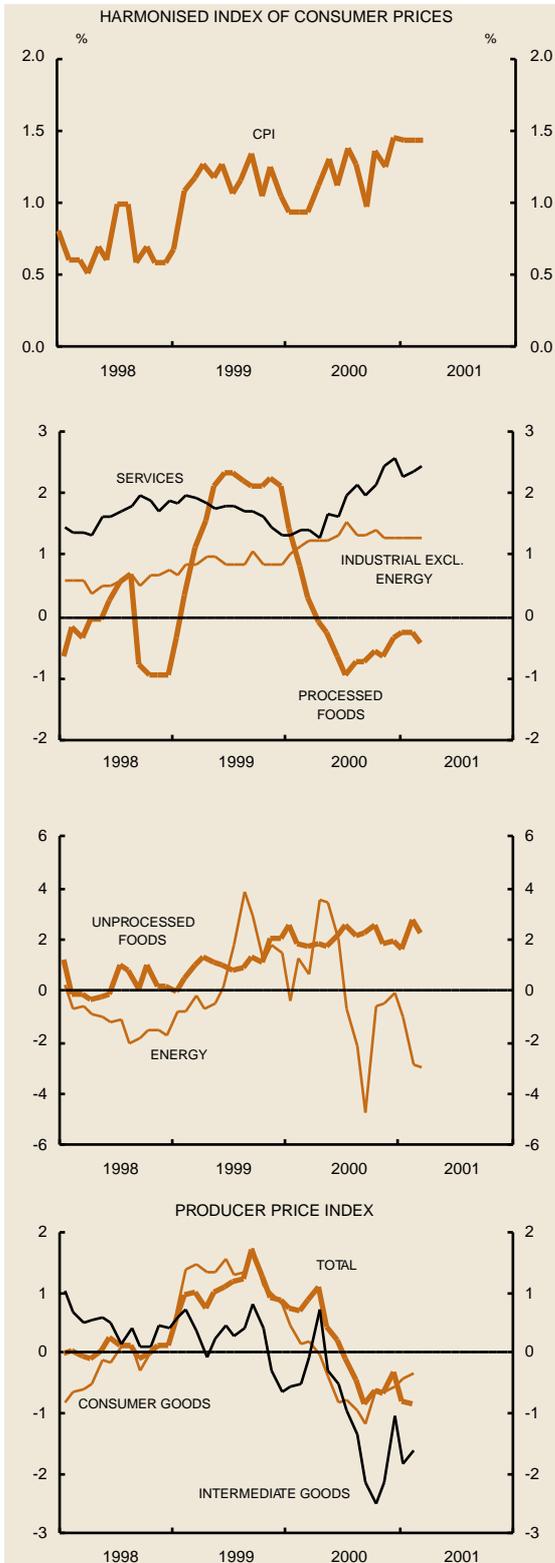


CHART 22

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



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

moderate increase, which in Q1 was less than projected in the budget. The large increase in personal income tax revenues was notable. This was due, in part, to the larger receipts of withholdings on earned income from the regional (autonomous) governments relating to previous years. As for the corporate income tax, its trend in Q1 is of little significance for the year as a whole and may have been mainly determined by lower rebates than in the same period of 2000.

As for indirect taxes, their low rate of growth to March was primarily attributable to the decline in receipts from excise duties. Notable, as mentioned earlier, was the fall in revenues from tobacco and hydrocarbons, although receipts from duties on electricity and on certain means of transport also decreased. On the other hand, VAT grew in Q1 at a very similar rate to in 2000 as a whole, and in line with the budget projection.

Non-tax receipts fell slightly to March, owing to lower capital transfers, most of which arise from transactions with the EU. However, as a consequence of the increase in profits from the Banco de España, the fall in total non-tax receipts in Q1 was very much smaller than projected in the budget.

As regards expenditure, its growth to March was greater than budgeted, owing to the increases in transfers (both current and capital), while goods and services and interest payments declined at a somewhat faster rate than projected in the budget. However, the rate of growth of expenditure in Q1 matched that for the whole of 2000, as the higher rates of change of capital spending, interest payments and wages and salaries was offset by the slower growth of current transfers. The latter two items have been affected by the aforementioned process of transfer of responsibilities to the regional (autonomous) governments. Payments to the latter in respect of their share in State revenues rose by 15 % to March (more than 30 % in 2000), while the contribution to INSALUD to finance health care rose by 6.5 % in 2001 Q1, slightly more than budgeted.

Finally, there follow a few comments on the first social security budget outturn data for 2001. Receipts of contributions (without including surcharges and fines) rose by 9.1 % in January, somewhat more than projected in the budget. The growth of these receipts continued to be driven by the buoyancy of registrations. On

TABLE 3

State Budget outturn

ESP bn and %

	Outturn		Budget		Outturn		
	2000	Percentage change 2000/1999	2001	Percentage change 2001/2000	2000 JAN-MAR	2001 JAN-MAR	Percentage change
	1	2	3	4=3/1	5	6	7=6/5
1. Revenue	19,749	7.5	20,421	3.4	4,866	5,159	6.0
Direct taxes	8,557	9.5	9,013	5.3	1,738	1,893	8.9
<i>Personal income tax</i>	5,350	4.9	5,675	6.1	1,589	1,767	11.2
<i>Corporate income tax</i>	2,863	17.5	3,022	5.6	43	88	104.8
<i>Other (a)</i>	345	21.8	316	-8.4	106	38	-64.5
Indirect taxes	8,532	7.3	9,117	6.9	2,505	2,649	5.7
<i>VAT</i>	5,557	8.7	6,022	8.4	1,777	1,928	8.5
<i>Excise duties</i>	2,672	4.1	2,778	4.0	657	646	-1.7
<i>Other (b)</i>	304	12.4	317	4.4	71	75	4.6
Other net revenue	2,659	2.4	2,291	-13.8	622	617	-0.8
2. Expenditure (c)	20,153	3.8	20,662	2.5	5,866	6,086	3.8
Wages and salaries	2,706	-9.2	2,770	2.4	628	644	2.6
Goods and services	395	-9.5	351	-11.1	133	116	-12.8
Interest payments	2,948	-7.3	2,836	-3.8	1,564	1,495	-4.4
Current transfers	12,117	12.1	12,533	3.4	2,930	3,150	7.5
Investment	1,004	4.9	1,097	9.3	373	386	3.5
Capital transfers	985	-7.4	1,075	9.2	238	295	23.6
3. Cash-basis balance (3 = 1 - 2)	-404	-61.7	-241	-40.5	-1,000	-927	-7.3
MEMORANDUM ITEM: NATIONAL ACCOUNTS:							
Revenue	19,835	7.6	—	—	4,842	5,157	6.5
Expenditure	20,461	4.7	—	—	4,896	5,050	3.2
Net borrowing (-) or net lending (+) (d)	-626	-43.3	-320	-48.9	-54	107	•

Source: Ministerio de Hacienda.

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

(b) Includes taxes on insurance premiums and tariffs.

(c) Includes unclassified expenditure.

(d) The annual figures (columns 1 and 3) are from the Spanish Finance Ministry's reply to the Excessive Deficit Protocol questionnaire.

the expenditure side, spending on contributory pensions grew by 6 % in January, in line with the budget, although had the compensation for the inflation deviation in 2000 been recorded in 2001, an acceleration in this item would have been expected. The number of contributory pensions rose by 1.3 % to March, in line with the budget projection and the increase in 2000. With respect to expenditure by INEM, that on unemployment benefits increased by 8 % to February. The increase in the number of beneficiaries of benefit for complete unemployment (3.1 % to February) and the decline in registered unemployment led to a further increase in

the eligibility ratio, which stood at 68.3 % to February.

4.5. The Spanish balance of payments and capital account

In January 2001, the current and capital accounts ran an overall deficit of EUR 926 million, down EUR 132 million on the same month a year earlier. This outturn reflects a more favourable performance by the current account in January; its deficit was EUR 344 million lower than in the same period a year earlier, owing to

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

	JAN-JAN	
	2000	2001
	Receipts	Receipts
Current account	14,491	18,243
Goods	8,402	10,167
Services	3,446	4,443
<i>Tourism</i>	1,816	2,290
<i>Other services</i>	1,630	2,153
Income	1,266	1,993
Current transfers	1,377	1,641
Capital account	717	505
	Payments	Payments
Current account	16,177	19,585
Goods	10,606	12,395
Services	2,367	2,867
<i>Tourism</i>	353	468
<i>Other services</i>	2,015	2,399
Income	1,868	3,122
Current transfers	1,335	1,201
Capital account	90	90
	Balance	Balance
Current account	-1,686	-1,342
Goods	-2,204	-2,228
Services	1,079	1,576
<i>Tourism</i>	1,464	1,822
<i>Other services</i>	-385	-246
Income	-602	-1,129
Current transfers	41	439
Capital account	627	415

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

the healthy performance of the tourism and current transfers balances, as well as the smaller deterioration in the trade balance, while the income deficit widened notably. However, the surplus on capital account moved adversely, to stand at EUR 415 million in January, down EUR 212 million from the same period a year earlier.

The drastic moderation in the rate of growth of the trade deficit, which rose by only 1.1 % in January, as against 30.3 % on average in 2000, was basically a consequence of the improvement in the terms of trade at the beginning of the current year, due to the moderation in the rate of increase of the prices of imported energy products and, to a lesser extent, the more subdued behaviour of the prices of non-energy im-

ports. Also, real goods exports remained highly dynamic in January, although the volume of imports also accelerated that month. The tourism surplus rose by 24.5 % in the first month of the year, with a strengthening of the upward trend seen in recent months, following the moderation in mid-2000. Tourism receipts were highly vigorous, with a rate of growth of 26.1 % in January, reflecting the improved behaviour of real indicators of tourist arrivals since the beginning of this year. Tourism payments, sustaining last year's buoyancy, also grew strongly, rising by 32.8 %. As for other non-tourism services, their deficit showed a mild improvement, as receipts grew at a higher rate than payments.

The data on foreign trade developments in February, show a very moderate increase in the trade deficit in relation to last year's outturn. Given the vigour displayed by the tourism indicators, this means that a further correction in the external imbalance in goods and services trade can be expected when the February balance of payments figures are released.

The income balance worsened in January by EUR 527 million, compared with the same month a year earlier. Receipts continued to grow at a very high rate (57.4 %), in line with the heavy investment abroad in recent years, while payments grew at an even higher rate (67.1 %), reflecting the vigorous growth in foreign investment in mutual funds and bonds and notes throughout the year 2000 and the greater buoyancy of short-term investment in deposits.

In January, the current transfers surplus rose by EUR 398 million from a year earlier, as a consequence of the notable growth in transfers to the private sector through EAGGF-Guarantee, while the flows from the EU under the European Social Fund fell slightly. Finally, the capital account surplus showed a deterioration of EUR 212 million in relation to January 2000, owing to the decline in structural funds from the EU under the ERDF and the Cohesion Fund, caused by the delays in the receipt of these flows, which take place at the beginning of the year, until the projects to be funded have been presented and finally approved.

The nation's lower net borrowing reflected by these data would be consistent with an improvement in the sectoral balances of households and corporations. This is, in turn, a consequence of the progressive slowdown in residential investment and private productive investment in recent months, against a background of more moderate economic growth.

5. Financial flows in the Spanish economy

5.1. Financial flows in the economy as a whole

During 2000 Q4 the balance of net financial transactions (3) of the nation was once again negative, at -0.4% of GDP. In terms of the institutional sectors, net household financial saving held at low levels, while the other resident sectors followed the pattern of the previous quarters. Over the year as a whole, the balance of the nation's financial transactions fell to -2.2% of GDP, compared with -1.1% in 1999 (see Table 5). This was due to the deterioration in net household financial saving and to the growing borrowing requirements of non-financial corporations, against a background in which general government net borrowing declined notably and in which financial corporations slightly increased their saving.

The greater dependence on foreign saving to finance domestic investment was, however, no obstacle to the continuing internationalisation of the Spanish economy's financial flows, a phenomenon affecting all resident sectors to a greater or lesser degree. Inter-sectoral flows (see the lower part of Table 5) show that general government continued reducing sharply the financing received from resident sectors, replacing it with financing from the rest of the world. This process, which began in 1999, moved onto a higher plane in the year 2000 when the financing extended by non-residents to general government rose to levels close to 6% of GDP. Institutional investors continue to increase their holdings of foreign financial assets; indeed, the volume of their transactions in 2000 amounted to 5.5% of GDP, in net terms. This internationalisation of institutional investors' holdings is ultimately the main channel through which part of Spanish household saving is being routed abroad.

Credit institutions have continued channelling saving from abroad to finance the gap between domestic investment and saving. Over the past year, this sector received net foreign financing amounting to 5.2% of GDP, and was thus able to meet the strong growth of the resident sectors' demand for credit, which stood at an annual rate of 18% in December 2000. Significantly, however, the monthly indicators of monetary and financial conditions in the Span-

(3) In ESA 79 terminology, the balance of the financial transactions account was called net financial saving. In the financial accounts according to ESA 95 methodology, this balance is now called net financial transactions. In this report both terms are used without distinction. Likewise, the names non-financial corporations and households (as used in previous reports) and non-financial corporations and households and non-profit institutions (the name of the same sectors in ESA 95) are also used without distinction.

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

TABLE 5

% of GDP

	NET FINANCIAL TRANSACTIONS								
	1995	1996	1997	1998	1999	2000			
						Q1	Q2	Q3	Q4
Total economy	1.0	1.2	1.6	0.5	-1.1	-1.6	-1.9	-2.1	-2.2
Non-financial corporations and households and NPIs	6.7	5.1	4.0	2.0	-0.5	-0.9	-2.1	-2.4	-2.5
Non-financial corporations	0.5	-0.1	-0.4	-1.2	-1.8	-2.2	-2.5	-2.7	-2.7
Households and NPIs	6.2	5.3	4.5	3.2	1.3	1.3	0.3	0.3	0.1
Financial institutions	1.0	1.0	0.7	1.1	0.5	0.7	0.7	0.8	0.7
General government	-6.6	-4.9	-3.2	-2.6	-1.2	-1.5	-0.4	-0.5	-0.3
	INTER-SECTORAL FLOWS (a)								
	1995	1996	1997	1998	1999	2000			
						Q1	Q2	Q3	Q4
Households and NPIs	6.2	5.3	4.5	3.2	1.3	1.3	0.3	0.3	0.1
Vis-à-vis:									
Credit institutions (b)	2.0	-2.6	-6.7	-4.4	0.3	2.2	1.5	1.6	-0.4
Institutional investors (c)	3.0	8.8	10.8	7.6	1.0	-0.9	-1.7	-1.3	0.0
Non-financial corporations	0.5	-0.1	-0.4	-1.2	-1.8	-2.2	-2.5	-2.7	-2.7
Vis-à-vis:									
Credit institutions (b)	-1.4	-0.4	-3.1	-4.2	-3.7	-5.1	-4.5	-5.4	-6.4
Rest of the world	-0.3	0.4	1.7	0.5	-0.4	0.3	-0.7	-0.7	1.1
General government	-6.6	-4.9	-3.2	-2.6	-1.2	-1.5	-0.4	-0.5	-0.3
Vis-à-vis:									
Credit institutions (b)	-3.1	-0.4	1.4	1.4	1.4	1.3	1.2	1.3	2.2
Institutional investors (c)	0.5	-5.9	-3.9	-2.6	1.7	1.7	3.3	3.5	3.5
Rest of the world	-3.4	-0.2	-2.0	-1.1	-4.3	-3.8	-3.8	-4.5	-5.9
Rest of the world	-1.0	-1.2	-1.6	-0.5	1.1	1.6	1.9	2.1	2.2
Vis-à-vis:									
Credit institutions (b)	-2.8	0.9	2.8	7.2	2.2	3.8	3.8	3.3	5.2
Institutional investors (c)	-0.5	-0.9	-2.6	-6.3	-3.5	-3.6	-3.9	-4.2	-5.5
Non-financial corporations	0.3	-0.4	-1.7	-0.5	0.4	-0.3	0.7	0.7	-1.1
General government	3.4	0.2	2.0	1.1	4.3	3.8	3.8	4.5	5.9

Source: Banco de España.
(a) A positive sign indicates the extension of financing to the counterpart sector. A negative sign denotes financing received by the counterpart sector.
(b) Defined in accordance with the First Banking Directive.
(c) Insurance corporations and collective investment undertakings.

ish economy show a moderate slowdown in the growth rate of credit extended to the private sector in the opening months of 2001 (see Chart 23). In particular, the annual growth rate of loans granted by resident credit institutions to the non-financial resident private sector, the main component of this sector's financing, has fallen to 14.3 % in March. The financing raised by the non-financial private sector via the issuance of fixed-income securities and securitisation funds continues to be scant and notably volatile.

The information for 2000 Q4 also shows that the process of banking reintermediation of household financial transactions witnessed over the course of 2000 may have come to a halt. This is because household net financing to credit institutions declined and, at the same time, there was an easing of the intensity with which the saving channeled towards institutional investors had been falling. In fact, there were fewer sales of mutual fund shares than in previous quarters and acquisitions of assets via pension funds and insurance corporations remained high.

5.2. Financial flows of households

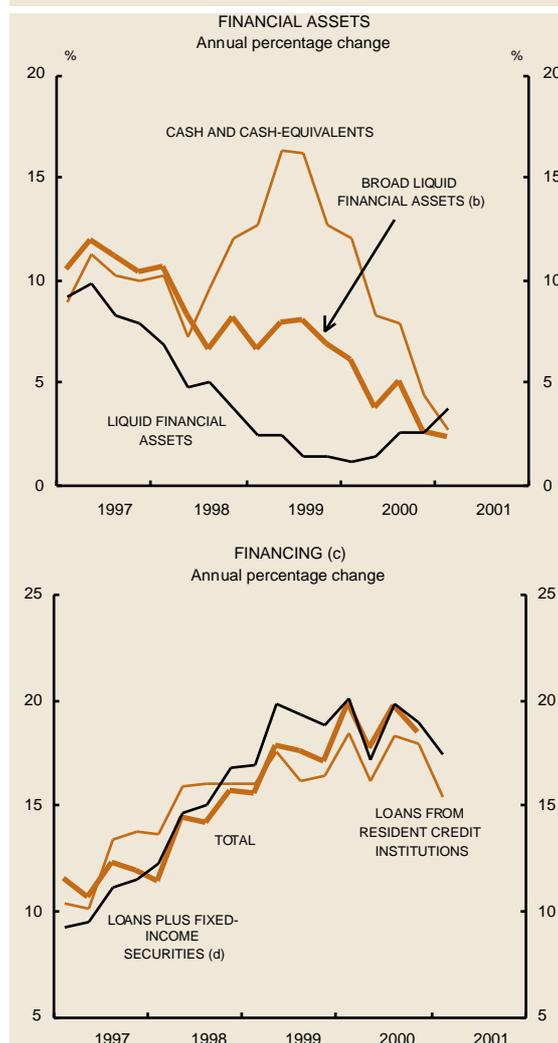
During 2000 Q4 the net financial saving of households and NPIs stood at 0.8 % of GDP. Nonetheless, it should be borne in mind that saving traditionally rises in this sector in the final quarter of the year. Indeed, in cumulative terms for the year as a whole, household financial saving stood at 0.1 % of GDP, compared with 1.3 % in 1999. The declining trend of saving evident since the mid-nineties has been against a backdrop of improved financing conditions, highly buoyant economic activity (accompanied by strong job creation), greater macroeconomic stability, rising property and financial asset values, and low real interest rates, by historical standards. Thus, households have been able to sustain relatively expansionary spending decisions and increase their debt without having to reduce their net wealth accordingly below the desired level. Nonetheless, since the start of the year 2000 there has been a series of events which might ultimately prompt a turnaround in household financial saving. Among these is the loss of impetus of the expansionary phase of the business cycle, the decline in wealth associated with the recent trend of share prices (markedly so as from 2000 Q2 — see Chart 24) and the rise in the cost of financing related to the change in the single monetary policy stance. On the as yet provisional information currently available, there are however no signs that these factors have begun to affect household saving decisions significantly.

Analysis of the components of net financial saving shows that household purchases of financial assets (see Chart 24 and Table 6) were less intense in 2000 Q4. In particular, there was significant disinvestment (in seasonally adjusted terms) in the most liquid financial assets or *cash and cash equivalents* (which include cash, overnight deposits and savings deposits), which is part of the downtrend in the demand for these instruments which began after the rise in short-term interest rates as from mid-1999. Investment also eased in *other deposits and fixed-income securities* (which include time deposits and repos); in the year as a whole, however, this amounted to 5.9 % of GDP, compared with 2.6 % in 1999. Lastly, payments to pensions schemes and insurance policies (included under other) remained high, while net investment in *shares and other equity* ceased to be negative as a result of the moderation of sales of shares in mutual funds, especially those with lower levels of risk (money market funds and national fixed-income funds).

The provisional monthly indicators available on monetary and financial conditions in the

CHART 23

Non-financial corporations, households and NPIs (a)



Source: Banco de España.

- (a) The data for 2001 Q1 are those for February.
- (b) Defined as liquid financial assets plus mutual funds other than money-market and fixed-income securities funds.
- (c) Including credit, securities and other borrowed funds.
- (d) Including loans from resident and non-resident credit institutions, securities issuance and financing through securitisation funds.

Spanish economy point to the possible continuation of the above-mentioned trends during the opening months of 2001 (4) (see Chart 23). Thus, according to the latest information for March, liquid financial assets (LFA) have quickened to a growth rate of 4.7 % as a result of the

(4) It should be clarified, however, that these indicators do not enable the components of households and non-financial corporations to be separately identified. Accordingly, the conclusions on household transactions should be interpreted with due caution.

TABLE 6

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

% of GDP

	1998	1999	2000	2000		
				Q2	Q3	Q4
HOUSEHOLDS AND NPIs:						
Financial transactions (assets)	10.3	9.8	8.0	1.6	2.2	1.5
Cash and cash equivalents	3.3	4.4	0.8	0.0	0.6	-0.6
Other deposits and fixed-income securities (b)	-1.7	2.6	5.9	1.8	1.3	1.1
Shares and other equity	5.3	-2.0	-3.0	-0.8	-0.8	0.0
Other	3.4	4.9	4.2	0.6	1.0	1.0
Financial transactions (liabilities)	7.0	8.6	8.0	2.1	2.2	1.8
Credit from resident credit institutions	5.9	6.4	6.9	1.5	1.9	2.0
Other	1.1	2.2	1.1	0.6	0.3	-0.2
NON-FINANCIAL CORPORATIONS:						
Financial transactions (assets)	14.3	18.0	28.8	7.0	10.3	6.6
Cash and cash equivalents	1.5	0.7	0.8	0.3	0.3	-0.2
Other deposits and fixed-income securities (b)	0.2	-0.2	1.1	0.4	1.0	-0.6
Shares and other equity	3.0	7.9	13.6	3.1	4.9	4.9
Other	9.7	9.5	13.3	3.2	4.2	2.6
Financial transactions (liabilities)	15.5	19.8	31.6	7.9	11.4	6.6
Credit from resident credit institutions	4.7	4.9	6.7	1.8	1.9	1.1
Foreign loans, fixed-income securities and securitisation funds (b)	1.7	3.9	3.0	0.9	1.7	0.2
Other	9.2	11.1	21.8	5.1	7.8	5.3
MEMORANDUM ITEM: YEAR-ON-YEAR GROWTH RATES (%):						
Liquid financial assets	3.8	1.5		1.5	2.6	2.6
Households and NPIs	4.0	0.7		0.0	0.7	0.9
Non-financial corporations	2.5	5.8		9.1	13.1	11.7
Financing (c)	16.9	18.8		17.2	19.9	19.0
Households and NPIs	19.3	19.6		17.4	17.5	17.3
Non-financial corporations	15.1	18.3		17.1	21.8	20.2

Source: Banco de España.

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

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

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

uneven performance of the growth rates of its two components: *cash and cash equivalents and other liquid assets*. The growth rate of *cash and cash equivalents* continued to decline, standing at 2 % in March, with the deceleration evident in all its components. Conversely, *other financial assets* continued to accelerate, with its growth rate standing at 7.2 % in March compared with 1 % in December 2000. Under these instruments, the growth of time deposits and repos held steady, and fewer capital losses in money market and domestic fixed-income funds were recorded. The remaining mutual funds -international and equity funds- saw a sizeable de-

pletion in their net worth, which accounts for the deceleration in the broad monetary aggregate *broad liquid financial assets*.

In 2000 Q4, total financing received by households was also more moderate, in seasonally adjusted terms, than in previous quarters (see the lower panel of Chart 23). However, the financing received via resident credit institutions grew once more (in seasonally adjusted terms), standing at 2 % of GDP in Q4 compared with 1.9 % in Q3. According to the information available on credit by type, financing for house purchases continued to be the main end-

use. However, in Q4 consumer credit also rose somewhat, reversing its downward trend since the beginning of the year.

During 2000 Q4, the wealth position of households, measured via their debt ratios (see Chart 25), worsened. Household debt – approximated by the sum of bank credit and financing intermediated by securitisation funds – held on a rising trend, climbing to 45 % of GDP. Although, as discussed, this sustained growth in household debt in recent years can be partly accounted for by greater macroeconomic stability and the favourable cyclical juncture, it has entailed a rapid, sharp increase in the sector’s degree of exposure to the risks associated with future financial and real asset prices.

5.3. Financial flows of non-financial corporations

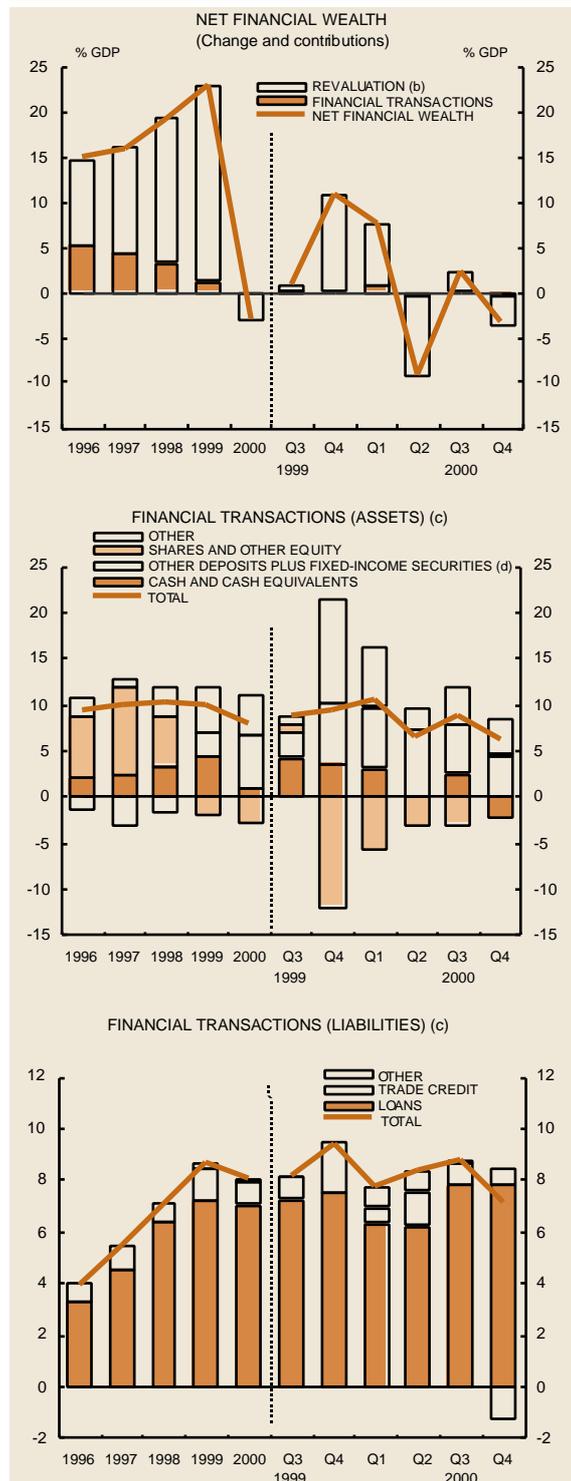
In 2000 Q4, the net financial saving of non-financial corporations stood at 0.1 %, although in cumulative four-quarter terms the level of net borrowing of previous quarters was maintained (see Table 5). Over the year as a whole, the net financing received by this sector amounted to 2.7 % of GDP, compared with 1.8 % in 1999. As a result of the growing internationalisation of this sector, the funds needed to finance gross capital formation (domestic investment) and foreign share purchases nevertheless increased during Q4, as had been the case in the preceding quarters (see Table 6 and Chart 26). On this occasion, a significant portion of the acquisition of shares issued by non-residents was related to a share-exchange operation between a resident company and a foreign company which did thus not entail greater indebtedness for the resident sector.

In terms of components, it should be pointed out that, although the volume of acquired financial assets and liabilities was less than the previous quarter (see Table 6), these volumes remain high and continue to hinge on the particular financial decisions of certain large resident corporations. During the final quarter of the year, the net increase in liabilities was substantially in the form of share issues which, on this occasion, were predominantly (over 80 %) unquoted shares (5). Financing obtained via bank loans was more moderate than in previous

(5) The data for both the third and fourth quarters of 2000 include a significant transaction involving the transfer of a credit institution’s industrial portfolio to a non-financial holding company. The creation of this holding company is recorded in the financial accounts as an increase in unquoted shares issued by non-financial corporations.

CHART 24

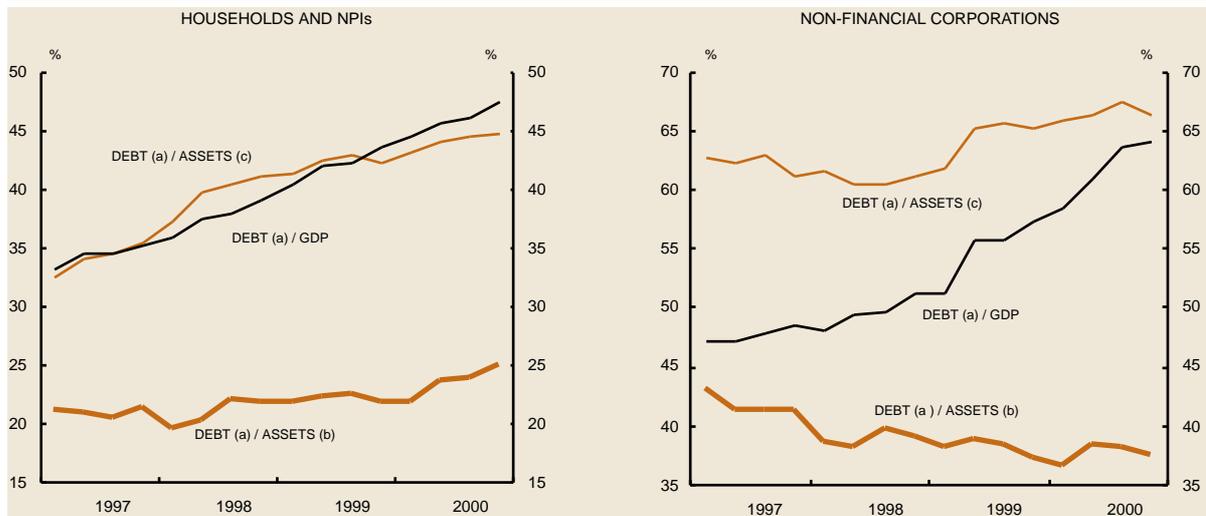
Households and NPIs (a)



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

CHART 25

Debt ratios



Source: Banco de España.

- (a) Including bank credit extended by resident credit institutions, foreign loans, fixed-income securities and financing through securitisation funds.
- (b) Total assets excluding other.
- (c) Total assets excluding other less shares and other equity (not including money-market funds).

quarters, although it should be recalled that the flow of financing in the preceding quarter was influenced by investment in UMTS mobile telephony licences. Overall, the year-on-year growth of financing obtained via bank loans, fixed-income securities issuance and securitisation funds was 20.2 %, compared with 21.8 % the previous quarter (see Table 6). On the information available on the breakdown of credit by productive sector for Q4, the services sector was again the main recipient of bank financing.

The initial and as yet provisional data available on the financing received by non-financial corporations from resident credit institutions in the opening months of 2001 appear to confirm the moderate slowdown recorded in 2000 Q4.

The debt of non-financial corporations as a proportion of GDP increased again in 2000 Q4 to a level of close to 65 % (see Chart 25). Although this level of debt is similar to that of other European countries, it is nonetheless high in historical terms.

5.4. General government financial flows

During the year 2000, general government net financial transactions remained on the de-

clining trend marking their course in recent years. The balance of these transactions thus stood at -0.3 % of GDP, compared with -1.2 % in 1999.

Financial requirements, which include the net resources obtained via the resort to markets through the issuance of securities, the obtaining of credit and use of balances held on deposit, were negative during 2000 Q4 (see Chart 27). Issues of medium- and long-term bonds were once more high, at a volume of around EUR 10 billion. These issues enabled general government to raise resources to pursue the redemption of short-term securities, the outcome for the final quarter of the year being net redemptions amounting to about EUR 1.2 billion. The resources obtained also translated into an increase in deposits by an amount exceeding EUR 8 billion.

One of the most salient phenomena of the past two years, which intensified in the second half of the year 2000, has been the replacement of financing from resident sectors by financing from the rest of the world. During 2000 Q4, the value of bonds taken up by non-residents amounted to over EUR 13 billion, in net terms. Taking stock for the year, net bond issues were somewhat over EUR 18 billion and bond purchases by non-residents amounted to EUR 33 billion.

CHART 26

Non-financial corporations (a)

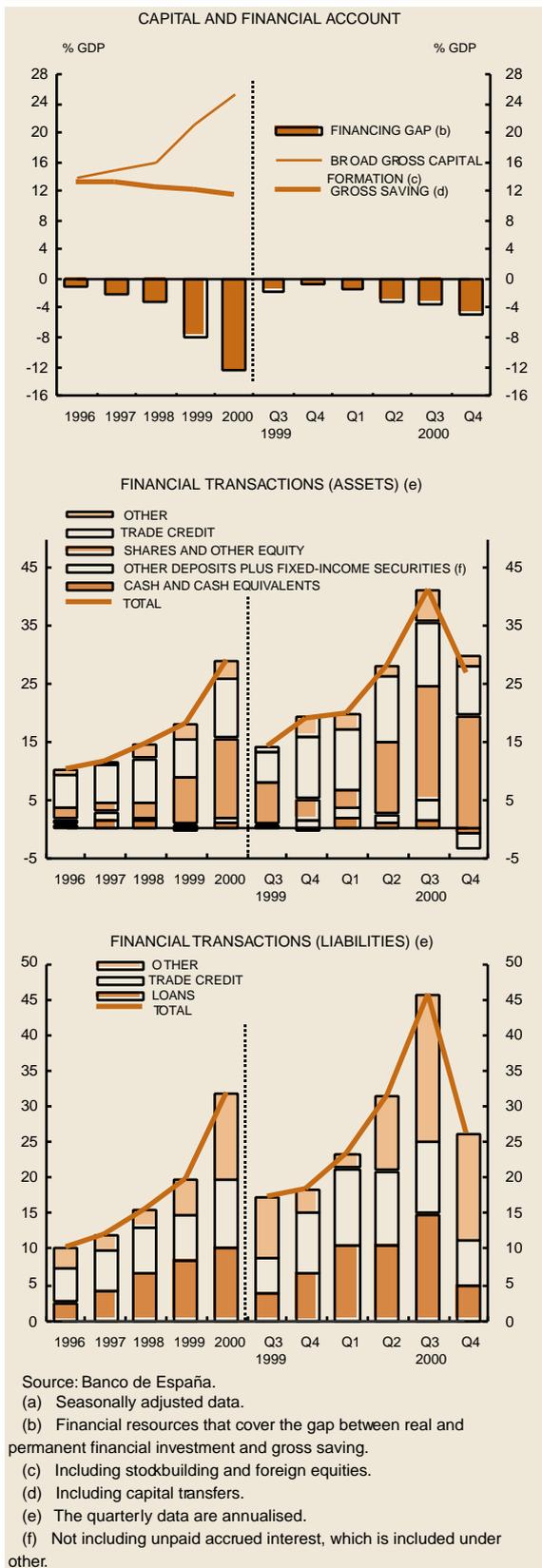
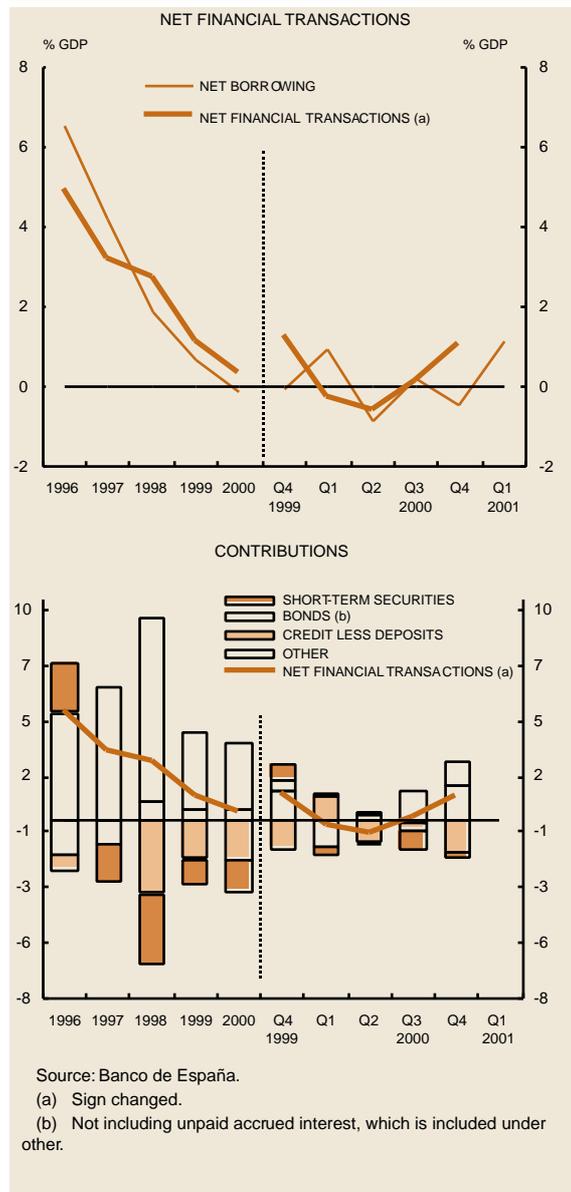


CHART 27

General government



The provisional information for 2001 Q1 indicates general government financial requirements to be practically nil. During this quarter there have been net redemptions of long-term securities, while net issues of short-term instruments were virtually nil. These net redemptions and higher interest payments during 2001 Q1 have been financed through a reduction in deposits.

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

As indicated, the balance of the nation's net financial transactions stood at -2.2 % of GDP in the year 2000, against -1.1 % in 1999 (see

TABLE 7

Financial transactions of the nation (a)

% of GDP

	1998	1999	2000	2000		
				Q2	Q3	Q4
Net financial transactions	0.5	-1.1	-2.2	-0.5	-0.6	-0.4
Financial transactions (assets)	12.8	14.9	25.0	4.3	8.9	8.1
Gold and SDRs	0.0	-0.2	0.0	0.0	0.0	0.0
Cash and deposits	3.2	1.8	2.6	-1.0	2.6	0.2
Credit system	0.0	3.7	2.6	-1.0	2.6	0.9
Other resident sectors	3.2	-1.9	0.0	0.0	0.0	-0.7
Securities other than shares	3.4	2.8	3.6	1.3	1.3	1.4
Credit system	-1.4	-0.9	-0.3	-0.2	0.4	-0.1
Other resident sectors	4.8	3.7	3.9	1.5	0.9	1.5
Shares and other equity	4.4	8.8	14.8	3.3	3.4	5.7
Credit system	0.4	0.5	2.0	0.5	0.6	0.4
Other resident sectors	4.0	8.3	12.8	2.7	2.8	5.3
Of which:						
Non-financial corporations	2.2	6.1	9.7	2.1	2.4	4.8
Loans	1.9	1.7	4.0	0.8	1.6	0.8
Credit system	0.2	-0.1	0.5	0.1	0.1	0.3
Other resident sectors	1.7	1.8	3.4	0.7	1.5	0.6
Financial transactions (liabilities)	12.3	16.1	27.3	4.9	9.5	8.5
Deposits	6.0	4.2	7.4	1.5	1.7	2.7
Of which:						
Credit system	5.9	4.1	7.3	1.5	1.7	2.7
Securities other than shares	1.0	5.5	6.8	1.0	2.3	2.2
Credit system	0.2	0.9	0.8	0.3	0.2	0.0
General government	1.0	4.3	5.6	0.6	2.0	2.1
Other resident sectors	-0.2	0.3	0.4	0.1	0.0	0.1
Shares and other equity	2.9	2.9	8.9	1.8	2.9	3.5
Credit system	0.1	0.3	1.6	0.5	0.7	0.1
Other resident sectors	2.8	2.7	7.4	1.4	2.2	3.4
Loans	3.0	4.9	5.1	1.2	2.4	0.6
General government	0.1	0.0	0.1	0.1	-0.1	0.0
Other resident sectors	2.9	4.8	5.0	1.2	2.5	0.6
Other, net (b)	-0.6	-1.5	-0.9	-0.6	0.2	-0.4

Source: Banco de España.

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

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

Table 7). The information for the fourth quarter does thus not reveal any changes in the trends observed over the course of the year. The volume of purchases of external financial assets and liabilities were high, reflecting the growing internationalisation of the Spanish economy. During the year 2000, therefore, net acquisitions of foreign financial assets held by resident sectors accounted for 25 % of GDP, compared with 14.8 % in 1999. The net rise in the nation's liabilities vis-à-vis the rest of the world amounted to 27.3 % of GDP, compared with 16.1 % in 1999.

Financial asset acquisitions were directed particularly at *shares and other equity* (5.7 % of GDP) during the quarter. This investment was mainly by non-financial corporations (4.8 %), although behind them may be credit institutions, which occasionally invest abroad through non-financial holding companies.

The cumulative volume of foreign liabilities was, as in the previous quarter, very high, standing at 8.5 % of GDP. Liabilities transactions were particularly sizeable in the case of non-financial corporations. During Q4, the rest

TABLE 8

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

% of GDP

	1995	1996	1997	1998	1999	2000
Total economy	-19.5	-19.7	-20.7	-21.7	-23.3	-24.8
Non-financial corporations and households and NPIs	-13.9	-13.3	-10.9	-9.0	-9.1	-4.8
Non-financial corporations	-17.9	-18.3	-17.3	-15.3	-16.5	-12.8
Households and NPIs	4.0	5.0	6.4	6.3	7.3	8.0
Financial institutions	9.2	8.8	7.2	5.2	6.5	4.9
Credit institutions (b)	8.0	6.7	2.4	-5.4	-7.9	-12.6
Institutional investors (c)	1.3	2.2	4.9	11.0	15.0	18.3
Other financial institutions	0.0	-0.1	-0.1	-0.4	-0.6	-0.8
General Government	-14.9	-15.2	-17.0	-17.9	-20.6	-24.8

Source: Banco de España.

(a) Calculated as the difference between the stock of financial assets and financial liabilities vis-à-vis the rest of the world according to quarterly financial accounts data.

(b) Defined according to the First Banking Directive.

(c) Insurance corporations and collective investment undertakings.

of the world acquired shares in this sector for a value accounting for approximately 3 % of GDP. The general government sector built up net foreign liabilities valued at 2.1 % of GDP. Lastly, funds raised abroad by resident credit institutions increased notably, especially those in the form of deposits. It is these resources which have ultimately enabled the shortfall in national saving in financing domestic investment to be made up.

As a result of these transactions in 2000 Q4, general government and, above all, credit institutions increased their debit position vis-à-vis the rest of the world as they had in previous quarters (see Table 8). Nonetheless, institutional investors continued to increase their net external assets and non-financial corporations reduced their liability position.

19.4.2001.