Quarterly report on the Spanish economy

1. Overview

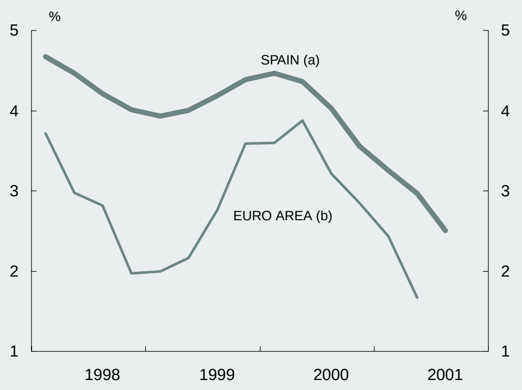
Amid heightening uncertainty, the year-on-year real growth rate of Spanish GDP during 2001 Q3 is estimated to have fallen to close to 2.5%, after having run at 3% the previous quarter and 4% a year earlier. These results are part of the process of deceleration in worldwide economic activity that began following the crisis in the US economy and spread through the various commodities and financial markets, posing serious difficulties for numerous emerging economies and exacerbating the critical situation of the Japanese economy. The euro area has also felt this deterioration in the external environment, showing less capacity than expected to pursue a process of independent and differentiated growth from the United States.

The dramatic events of 11 September have thus borne on an international economic situation which was already considerably depressed, further heightening the uncertainty over the intensity and length of the slowdown and, in general, over the conditions in which international and Spanish economic activity will unfold in the coming quarters. True, the shock caused by the terrorist attacks will have temporary effects on activity. But the onset and intensity of recovery will depend to some extent on the duration of the military response to the attacks and how it unfolds, as well as on the reaction by economic agents, i.e. consumers and corporations, to the situation of uncertainty. The rapid response of the economic authorities has contributed to overcoming the initial moments of heightened tension and, from a medium-term perspective, the fall in oil and other commodity prices and the subsequent improvement in inflationary expectations strike a positive note in these circumstances.

The reaction of the monetary authorities was initially intended to ensure the sound functioning of financial markets, supplying all the liquidity that might be needed. In this respect, on 12 September the Eurosystem conducted a very short-term fine-tuning operation to inject liquidity into the money markets, continuing the operation the following day. Moreover, the European Central Bank (ECB) entered into a swap operation with the Federal Reserve for USD 50 million to ensure the availability of the US currency on European financial markets, which at no time ceased to operate normally. A few days later, on 17 September, an extraordinary ECB Governing Council meeting agreed, in concert with a similar action by the Federal Reserve, to cut official interest rates by half a percentage point to 3.75%, at which level they currently remain. This decision was of an exceptional nature aimed at providing a secure environment that would mitigate, as far as possible, the deterioration in economic agents' expectations. It

CHART 1

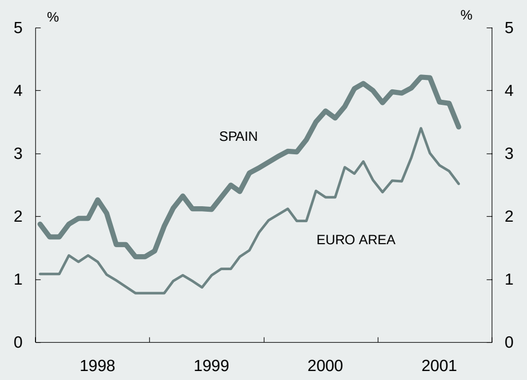
GDP



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

CHART 2

Harmonised indices of consumer prices



Sources: Eurostat and European Central Bank.

thus squares with the application, in such particular circumstances, of the medium-term stability criteria governing the Eurosystem's monetary policy decisions.

As far as fiscal policy was concerned, the US authorities reacted rapidly, providing additional support for the economy via an increase in public spending. This bolstered the move by the Federal Reserve, which once again cut its federal funds target rate on 2 October to 2.5 %. In Europe, where some countries' public finances are in a less healthy position, the scope available for fiscal policy action is confined to the settings established in the Stability and Growth Pact. These arrangements allow the automatic stabilisers to operate in those economies that have attained a budgetary balance at least close to equilibrium, while in the remaining cases public finances must be managed in such a way as to ensure continuity in fiscal consolidation.

At present the closing figures for Q3 for the various economies are not available and the information on indicators after the attack on 11 September is scant. In the United States, the confidence indices data released point to a sharp slowdown in consumer spending in the coming months. This was the sole demand component which, along with public spending on house purchases, had retained a positive – albeit declining – growth rate compatible with an increase in the saving ratio. The foreseeable decline in this aggregate, along with the protracted deterioration in private investment and exports (and, in general, in all industrial activity), accentuates the downside risks to the US economy. With regard to the euro area economies, most indicators showed that a cyclical peak was reached midway through last year. Since then, and according to National Accounts information, it has been private consumption (along with government consumption) which has retained a relatively firm growth rate, as opposed to the progressive deterioration in private investment and exports. This is a similar pattern, therefore, to the US economy, although it has unfolded, naturally, with a lag and less intensely. The initial data emerging on consumer and business confidence in some of the major euro area economies following the terrorist attacks augur the continuity, at least in the short run, of these trends.

The growth rate of the harmonised index of consumer prices (HICP) in the euro area as a whole slowed by six-tenths of a point during Q3 to stand at 2.5% in September. Admittedly, the slowdown has so far been centred on the energy and processed food components, without the related rates for services and non-energy industrial goods having turned down yet. But the change in the domestic economic outlook and the favourable movements on commodities markets mean a progressive approximation to the levels of stability established for the area as a whole may be forecast. In these circumstances, and against the backdrop of the decelerating growth rate of the credit aggregates, the Eurosystem's monetary policy stance was gradually eased, irrespective of the measures applied in response to the shock caused by the terrorist attacks. Indeed, prior to these measures, the ECB Governing Council had agreed to benchmark interest rate cuts of 25 basis points in May and in August.

The Spanish economy is following the same trends in respect of slowing growth and the turnaround in the inflation rate as the euro area; but the associated rates of change of both variables retain a positive spread. Thus, the Spanish growth rate continues to be higher than that of the euro area, furthering real convergence, even in this downturn. The maintenance of a positive growth differential with Europe had not been the case in other more recent cyclical downturns, which were marked, as is known, by sharp downward adjustments to redress the imbalances that had arisen during the upswing. The existence of this differential should largely be attributed to Monetary Union membership, which has protected the economy from certain factors (increases in long-term risk premia and exchange rate movements) that would have contributed to intensifying the slowdown. But belonging to a common monetary area also exacts its demands and, in this respect, retaining a positive inflation differential with the euro area countries may ultimately pose risks in terms of competitiveness, job creation and, in the final analysis, convergence itself.

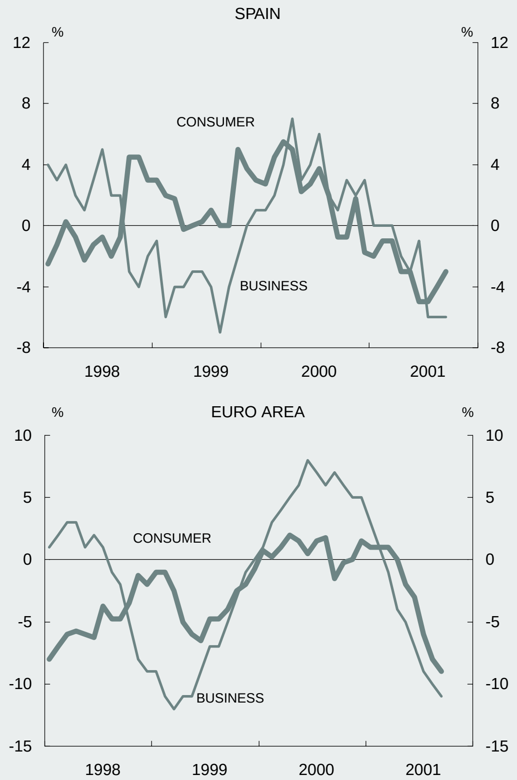
Exports and investment in capital goods are the two macroeconomic aggregates which, as in other areas that have been analysed, have proven most sensitive to the deterioration in the general economic outlook. Exports retained relatively high growth rates until the slowdown on markets affected the Community area. They have since been increasingly weaker, and the trend is spreading, albeit less intensely so far, to the tourism sector. The year-on-year growth rate of exports of goods and services during Q3 is estimated to be running slightly above 3%. As regards capital investment, the loss of momentum began much earlier and worsened once the change in the international environment affected business expectations. Foreseeably, this demand component will continue to post negative rates of change during Q3.

Consumption and investment in construction are therefore the two variables basically underpinning growth in the Spanish economy at present. But whereas the annual rate of increase of the former is slackening, the latter is holding firm. This is because the lesser buoyancy in the demand for housing is being offset by the resilience of civil engineering works. The growth rate of private consumption during Q3 may be marginally below 2.5% on average, while that of investment in construction will not differ significantly from the previous quarter (5.8%). And nor are considerable changes expected in the modest rate of increase posted by general government consumption in the first half of the year.

The factors determining household spending decisions (consumption and investment expenditure alike) are behaving differently. The key variable, disposable income, is running at a notable – albeit slowing – real growth rate. Other factors, such as losses in wealth or the deterioration in household confidence levels, have had an adverse bearing on real consumption, while house purchases have been boosted by the high returns they offer compared with other alternative financial investments. And this against a backdrop of low real interest rates that are conducive to indebtedness.

CHART 3

Confidence indicators

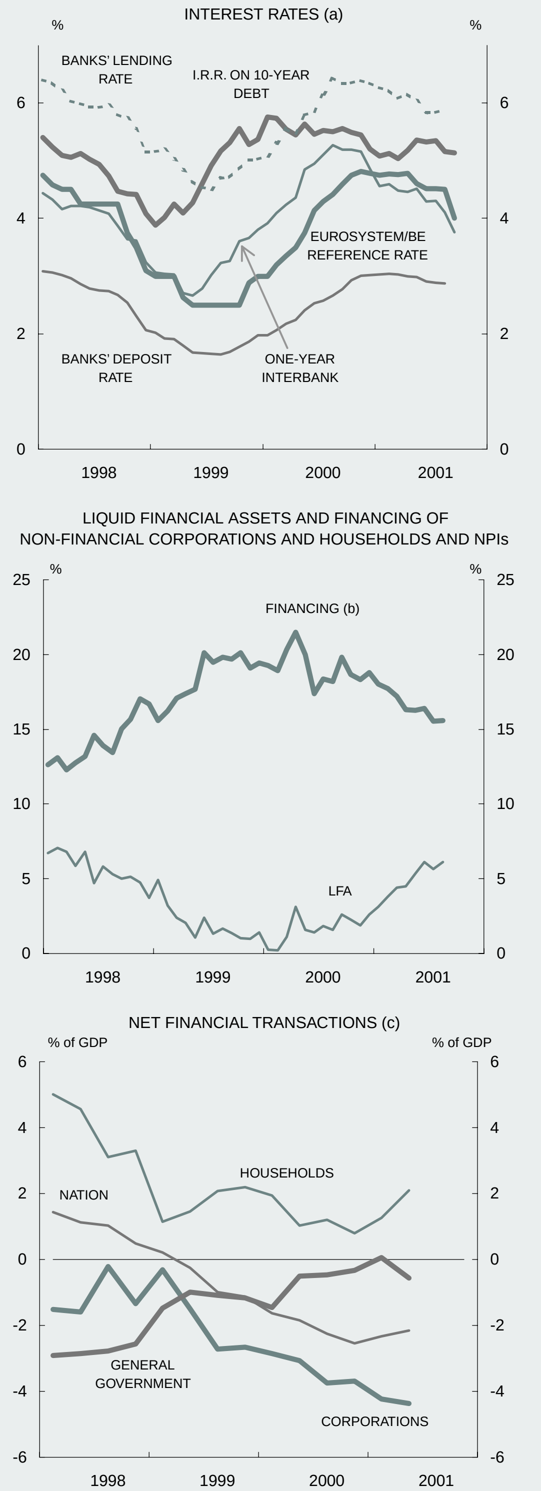


Source: European Commission.

As is known, the main component of household disposable income is employee compensation and, hereunder, the increase in employment is of particular importance. Maintaining a high growth rate in the creation of new jobs has thus been pivotal to sustaining household income, which tends to moderate as employment loses steam. But, in addition, consumers are trying to restore their saving ratios in the light of the decline in the value of their financial wealth and greater uncertainty as to the behaviour of their income in the future. This, combined with the onset of somewhat slacker in investment in housing, has led to an improvement in household lending capacity, which had fallen particu-

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.

larly low last year. The preliminary data of the Quarterly Financial Accounts for 2001 Q2 show an increase in household saving confirming the foregoing and, along with the growing trend of general government saving, this has led the nation's net borrowing to fall (see Chart 4).

As a result of all these factors, the real growth rate of the Spanish economy has continued to moderate during Q3. The rate of increase of national demand is estimated to be around 2.6%, with the slowdown in final demand on a greater scale (as a result of the export performance). That, in turn, explains the lesser buoyancy of imports, whose real rate of increase may only be marginally above 3.5%. There thus appears to have been a change in the growth pattern of the Spanish economy in relation to previous quarters, since net external demand has ceased to be a driving force of growth and will have subtracted one or two-tenths of a percentage point from real annual GDP growth, the rate of which will, as anticipated, be close to 2.5%. There are virtually no data at present reflecting information after 11 September, and it is thus hazardous to predict the consequences these events may have had on the behaviour of economic agents. It may reasonably be expected that, as in other economies, consumer and business confidence levels will be dented. However, the relatively favourable behaviour of the securities markets in recent weeks might be a sign of a degree of calm within the inevitable uncertainty surrounding agents' decisions.

The data available on employment in the summer months match the behaviour of the various productive branches, where the trends observed in the two previous quarters continued: namely, the persistence of the slowdown in activity (and employment) in industry and services and greater firmness in the construction industry. A slight recovery in apparent labour productivity, particularly in industry, is discernible.

It is important, if the decelerating effects from abroad are not to be accentuated, that the Spanish economy should sustain the relative vigour of employment generation evident throughout the recent upturn, even though this must naturally be accommodated in a less favourable economic climate. The growth rate of wages must thus be tailored to companies' circumstances and cease to incorporate temporary increases in the inflation rate. Such a pattern of behaviour tends to widen the Spanish economy's cost and price differentials with our trading partners, with the subsequent squeeze on margins in the industries most exposed to competition. The current deceleration in the growth rate of the consumer price index (CPI) and the discernible change in inflationary expectations should thus be reflected in wage bargaining, which must be attuned to the levels of price stability towards which the euro area economies are once more moving.

In September, the 12-month growth rate of the CPI stood at 3.4%, down from 4.2% in June at the end of Q2. The slowdown encompasses most groups, with the exceptions of processed food (whose rate of increase has quickened) and non-energy industrial goods (whose growth rate has remained unchanged between June and September). The biggest deceleration has been in the energy index, and it is moreover expected to continue. But there has been an equally notable slowdown in services, where methodological changes in the coverage of certain component items have increased their variability. The spread between the consumer price growth rates in Spain and in the euro area as a whole has been fluctuating for more than two years at around one percentage point, with changes among their various components. The latest data show that the differential is tending to narrow in the services component, while it is widening slightly in goods.

In any case, the most important event has been the favourable turnaround in international inflationary expectations. This is partly to do with oil and other commodity price developments, but a contributing factor has also been the slowdown in the growth rates of the various economies. We have already seen how the monetary authorities have reacted to this changed environment by setting more generous monetary conditions, especially in the wake of the terrorist attacks, whose influence still prevails. The Spanish economy shares these circumstances, but retains positive differentials in its growth rate and in its inflation rate vis-à-vis its trading partners. This means that the monetary conditions in force for the euro area countries may continue to be generous for the Spanish economy, where the growth rate of the credit aggregates, though tending clearly to turn down, remains relatively high. Although the risks posed by relatively easy monetary conditions are fewer in a context of slowing demand and falling inflation, the other realms of economic policy must still contribute to creating the appropriate environment for maintaining macroeconomic stability and the economy's competitiveness.

In this respect, the latest data on public finances (covering the first three quarters of the year) confirm that the balanced budget scheduled for the end of the year will be attained, albeit with certain differences in composition in respect of the agents involved. Specifically, there will be a bigger deficit in the State's accounts, where the change in the macroeconomic environment has affected certain taxes, and a bigger surplus in Social Security Funds.

The State budget for 2002 prolongs the fiscal policy strategy pursued in recent years. This strategy has provided for a balanced budget in the medium term, as established in the Stability and Growth Pact, and for regaining the necessary room for manoeuvre so that the automatic stabilisers may operate should the economic situation worsen. But this is to be achieved retaining a neutral fiscal policy stance, without adopting discretionary measures increasing the structural deficit and adding to the expansionary monetary impulse derived from the recent cuts in interest rates. Such fiscal conduct is of particular importance in the case of the Spanish economy, given the high inertia of certain public spending items in the past at times when the economy was slowing and the high cost of subsequently regaining a healthy fiscal position, which is vital for preserving an environment of macroeconomic stability and sustained growth.

2. The external environment of the euro area

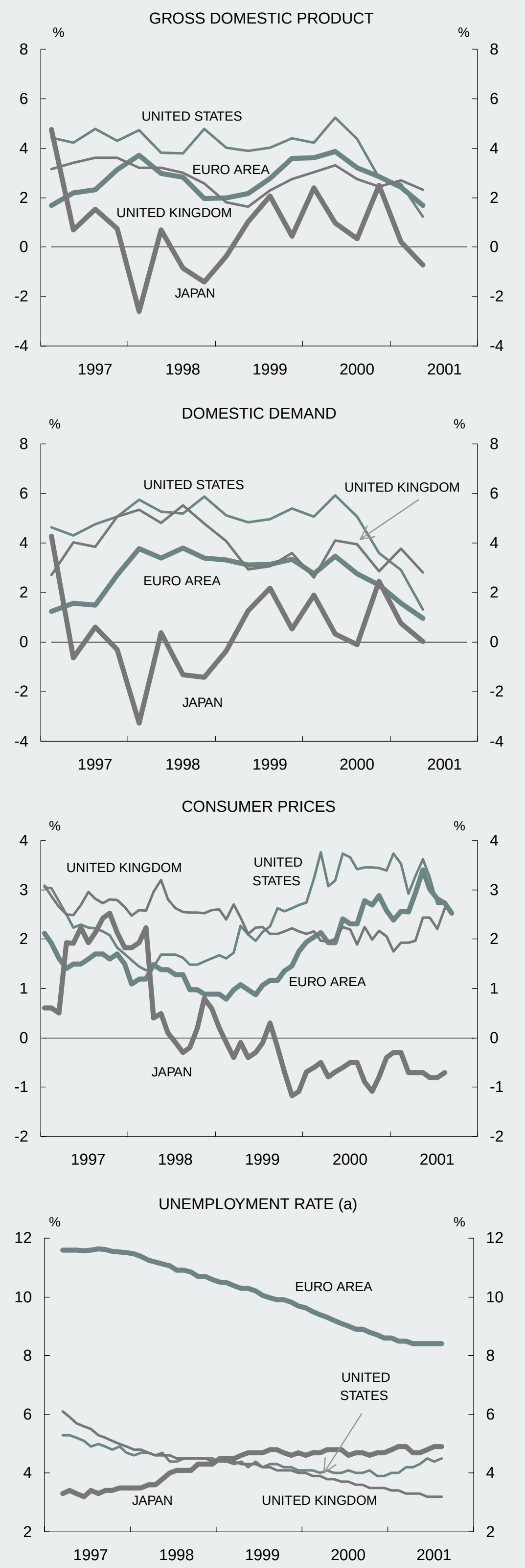
The information available on 2001 Q3 indicates that economic conditions in the external environment of the euro area have worsened significantly, particularly following the terrorist attack on 11 September. The attack and its as yet unknown consequences have heightened uncertainty considerably and have prompted a widespread retreat from risk by agents. The effects have been manifest in a lesser propensity to spend and a general increase in risk premia on private securities and in country risk. The latest indicators are emitting clearly recessionary signals in the United States and even more so in Japan. In this climate of greater risk aversion and slowing world trade, the growth expectations of the emerging countries have deteriorated substantially, especially in Latin America but also in Asia.

The final US data for Q2 showed an increase in GDP (at an annualised quarterly rate of 0.3%). This was largely thanks to the buoyancy of household consumption spending and investment in housing, the items that have been sensitive to the forceful reduction in interest rates, since productive investment spending trended very negatively. The pattern continued in August, when signs (such as the rise in industrial production and the improvement in the NAPM index) emerged that the recession in manufacturing might be touching bottom. However, subsequent indicators, especially those beginning partly to reflect the effects of the attack, painted a very different picture: corporations are cutting expenditure on staff (a decline in employment and a strong rise in the unemployment rate to 4.9%) and on capital (a fall in durable goods) and consumers are beginning to gear their financial positions more to saving, despite the tax refunds scheduled. As to corporations, their precarious financial position and surplus capacity suggest that the pick-up in productive investment will be slow.

Against such a backdrop of sluggish domestic and external demand, inflationary pressures have moderated. Testifying to this is the reduction in the private consumption deflator from 2.6% to 2.2% in the first two quarters of the year and, especially, the slowdown in producer prices, the 12-month growth rate of which has fallen from close to 5% at the start of the year to 1.6% in September. Moreover, certain index components, such as the underlying rate of intermediate goods and commodities, have been posting negative figures for four months. The CPI has also been more moderate, falling from 3.7% year-on-year in January to 2.6% in September, although the underlying rate has held at around 2.5% since January.

CHART 5

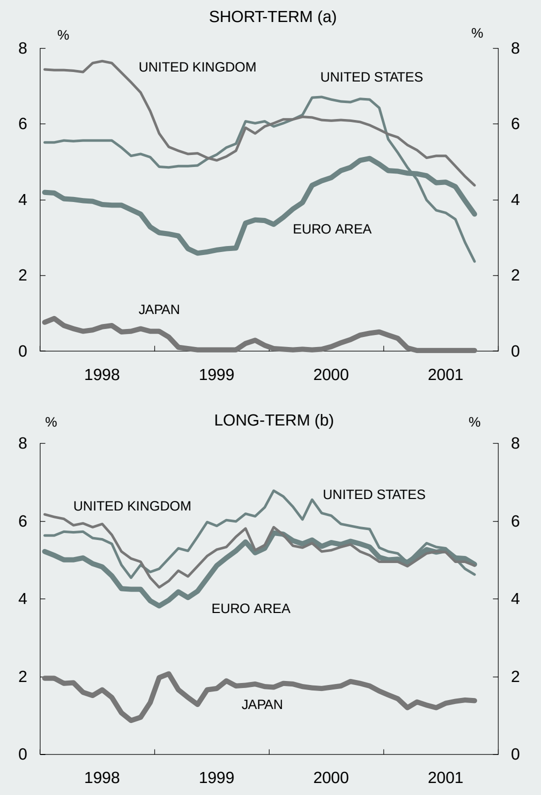
Main macroeconomic indicators. Annual rates of change



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

CHART 6

Interest rates

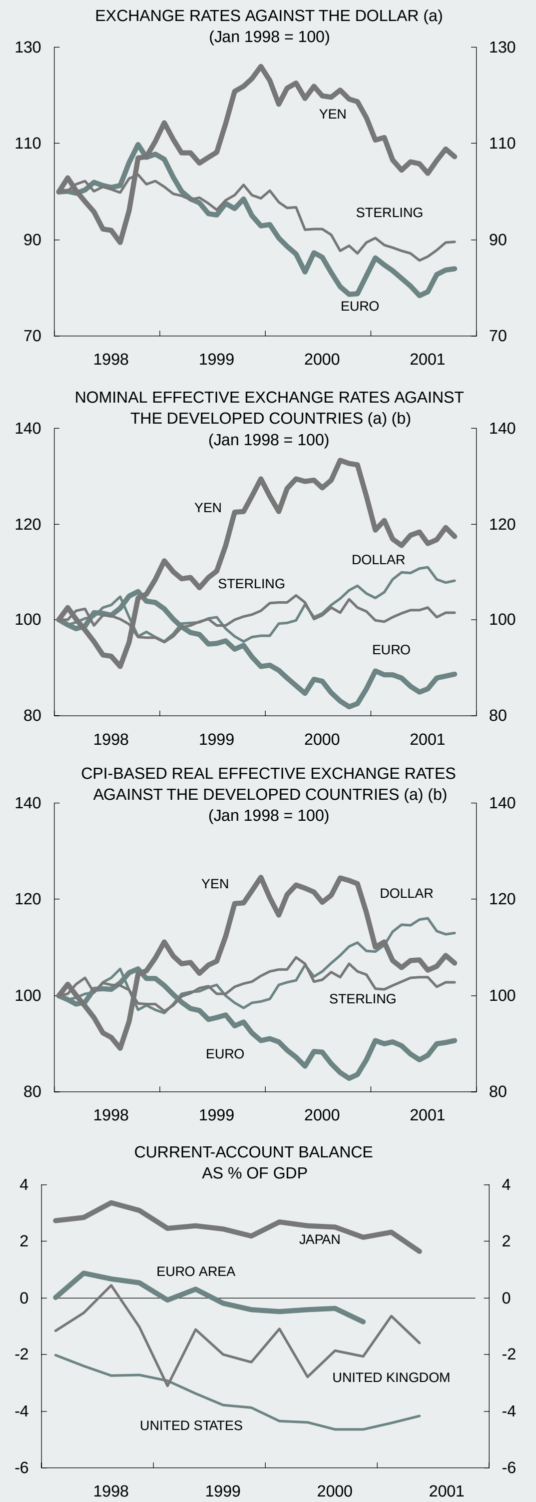


Source: Banco de España.
(a) Three-month interbank market interest rate. Euro area: until December 1998, weighted average of the eleven euro-area countries; thereafter, three-month EURIBOR.
(b) Ten-year government bond yields. Euro area: until December 1998, weighted average of the eleven euro-area countries.

The slowdown in prices gave the Federal Reserve additional leeway for further measures against recession and heightening uncertainty, and the US monetary authority seized the opportunity. The federal funds target rate was lowered by 0.25 points in August and twice by 0.5 points after the terrorist attacks, taking it to 2.5%. This is not only the lowest level since 1964, but also one of the most aggressive cuts seen, since rates stood at 6% at the beginning of the year. In the days following the attacks the Federal Reserve, in concert with the main central banks, injected sufficient liquidity into the markets to prevent pressures. This expansionary monetary policy conduct was accompanied by a demand-boosting fiscal package which will very likely be of the order of 1.5% of GDP in 2002. Along with the worsening economic outlook for next year, that would eliminate the envisaged fiscal surplus. US long-term government bond yields have fallen, but much less than proportionately, whereby the yield curve has steepened substantially.

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.

The reduction in interest rates and a fiscal package whose approval is expected shortly have had a positive effect on financial market expectations and have contributed to stabilising stock exchanges following the slump after 11 September. After depreciating heavily against the main currencies owing to the widespread uncertainty induced by the attacks, the dollar has picked up against the euro to a level close to USD 0.90/euro.

In Japan, real GDP fell in 2001 Q2 (for the first time this year) by 0.8% in non-annualised quarterly terms and by 0.7% year-on-year, as a result of both external and domestic demand. The main factors behind this fall were the quarterly declines in private investment (3.9%) and exports (2.9%), while private consumption remained relatively slack with a minor quarterly increase (0.5%). The main indicators of activity in Q3 fared even worse, overall, than in the previous quarter, auguring a fresh fall in real GDP. Mention should be made of the ongoing fall in the composite index of activity, industrial output, productive capacity and orders for industry. Likewise, the business confidence indices (the Tankan survey) continue to decline, especially in large manufacturing corporations. Unemployment climbed to 5% in August, a very high level compared to what the country is accustomed to. Consumer prices posted year-on-year falls of 0.8% and 0.7% in July and August.

Turning to monetary policy, the new strategy implemented in March by the Bank of Japan held short-term market interest rates at levels very close to zero and marginally raised the year-on-year growth of the money supply. But this has failed either to rid Japan of deflation, which was the implicit aim of the strategy, or to re-launch private-sector credit, which has continued falling at a rate of 3%. Ten-year bond yields have increased slightly. Deflation has placed real interest rates -although they are very low- at excessive levels for the current recession. Expectations worsened on the equity market, leading the Nikkei index to fall by 20% between June and October. The yen rose temporarily in August and in the first half of September due largely to the influx of capital as companies sought to close half-yearly balance sheets and, after 11 September, to the weakness of the dollar. The Japanese currency subsequently stabilised at around Y120 per dollar in the first fortnight of October.

In the United Kingdom, the resilience of private consumption (boosted by low interest rates), the rise in house prices and low unemployment have kept British GDP close to its trend growth rate, despite the global slowdown and the recession in the industrial sector. However, signs are emerging that the slowdown is spreading from industry to the rest of the economy. In particular, recent indicators of the service sector can be seen to be clearly decelerating, which would lead to lower growth and to higher unemployment. Inflation, for its part, has slowed. Although retail prices accelerated slightly in relation to the opening months of the year, they are below the Bank of England target, standing at 2.3% in September, excluding mortgage interest payments, and at 1.3% in terms of the harmonised rate. Moreover, producer prices, running at -0.2% year-on-year in September, show clear signs of slowing. The most serious inflationary threat is the buoyancy of wages, which continue to grow at rates in excess of 4%. The Bank of England has exercised prudence in lowering its rates, cutting its base rate twice by 0.25 points in August and September to 4.75% (compared with 6% at end-2000).

As regards the transition economies, the stagnation of the world economy, along with the rapid appreciation in real terms of certain currencies, has thwarted hopes of an export-led recovery this year. The latest data on economic activity point to a widespread slowdown in the region. Monetary and fiscal conditions have sustained domestic demand in the area, albeit at the expense of bigger fiscal and current-account deficits. Russian growth is proving resilient and could exceed 5% by the end of year, underpinned by appreciable public-sector and current-account surpluses and by high currency reserves.

During 2001 Q2 and Q3, the slowdown in external demand in the south-east Asian economies (except China) became more acute. That accentuated the negative trend initiated at the end of last year, as a result of the progressive decline in the US and Japanese growth rate. The process has accelerated as from 11 September, especially in the more open economies (Hong Kong and Singapore in particular, although also South Korea), which had already posted quarterly declines in real GDP in Q2. These developments have forced the governments of most countries in the area to ease their economic policies.

In Latin America, the deterioration in the world economy and the events of 11 September have had a marked effect, but one which has differed in each country depending on the prevailing channel of transmission (whether trade-related or financial). Argentina has remained beset during the quarter by serious domestic problems, which led to a heavy fall in deposits and reserves in July and August. Following the legally approved commitment to adhere strictly to a balanced budget and the IMF bail-out package, the situation stabilised, although doubts over fiscal compliance and the proximity of elections prompted a fresh widening of spreads along with deposit withdrawals and a loss of reserves in October. In addition, the main credit rating agencies downgraded Argentine debt once again. In Brazil, the new global environment has prompted a reduction in capital flows. The Brazilian central bank has sustained interest rates and has attempted to combat downward pressure on its currency via foreign exchange market interventions and liquidity-tightening measures. The Mexican economy has been very affected by the slowdown in the United States via the trade channel. Industrial activity, which is closely linked to the export sector, continues to post negative growth trades (-4.2% between June and August). This situation will foreseeably worsen in the wake of the effects of the terrorist attacks on US economic activity and international trade. The strong correlation between exports and imports (owing to the assembly of imported raw materials that are then exported to the United States) has meant that the US slowdown has not translated into an excessive worsening of the trade imbalance, as both imports and exports have moderated.

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

The information on economic activity in the euro area in Q3 points to sluggish growth in this period, along with signs of a significant deterioration following the terrorist attacks on 11 September. The sharp and protracted slowdown in international trade is holding back exports and tempering expectations of demand and, therefore, of investment. In turn, worsening consumer confidence, the cumulative decline in stock market prices and less buoyant employment appear to be influencing consumption adversely, despite the boost provided by recent tax cuts and lower oil prices. Consequently, the lack of data pointing to a significant pick-up in activity prior to 11 September, along with the foreseeable effects of the attacks and of the military response, has led to a downward revision of the GDP growth rates forecast by many official agencies for this year and, especially, for 2002. However, if the conflict were to unfold as expected, it is unlikely these events will have a lasting effect on economic activity in view of the strength of the euro area's fundamentals. In any event, the weakness of demand and the progressive slackening of the effects on prices of the supply shocks arising from dearer oil and the problems in the meat industry have resulted in an improved inflationary outlook. Against this background, the ECB twice cut its official interest rates in Q3 by a total amount of 0.75 percentage points. The interest rate on its main refinancing operations thus currently stands at 3.75%.

3.1. Economic developments

According to the second euro-area National Accounts estimate for 2001 Q2, GDP grew by 0.1% in relation to Q1, the lowest rate observed since the second half of 1995. In relation to the same quarter a year earlier, the loss of momentum translated into a GDP increase of 1.7%, seven-tenths of a point down on the previous quarter (see Chart 8). Behind this moderate quarter-on-quarter growth is a slowdown in consumption, in investment and, especially, in net external demand, as a result of a sharper fall in exports than in imports. The bigger contribution of stockbuilding to GDP partly offset the foregoing effects.

The country-by-country National Accounts data for 2001 Q2 generally show the same pattern of slowing output as in the euro area aggregate data. Notable amongst the biggest economies is the greater weakness of activity in Germany and Italy, where growth was zero in quarter-on-quarter terms. Significantly, private consumption in these two countries was relatively resilient, while gross fixed capital formation, especially in Germany, slipped most considerably. Output was somewhat more buoyant in France and Spain, while the deterioration was particularly notable in smaller countries such as Belgium and Finland.

The slowdown in economic activity in 2001 Q2 markedly affected industry (including energy), construction, and retail and wholesale, transport and communications services. In other services, however, the trend was similar to that of the preceding quarter. The moderation in productive activity in Q2 translated into a reduction in the growth rate of employment, which increased by around 0.2% on Q1, or by 1.5% on the same quarter a year earlier, i.e. almost half a point below the rate the previous quarter. These developments in output and employment mean virtually zero growth in apparent labour productivity in Q2.

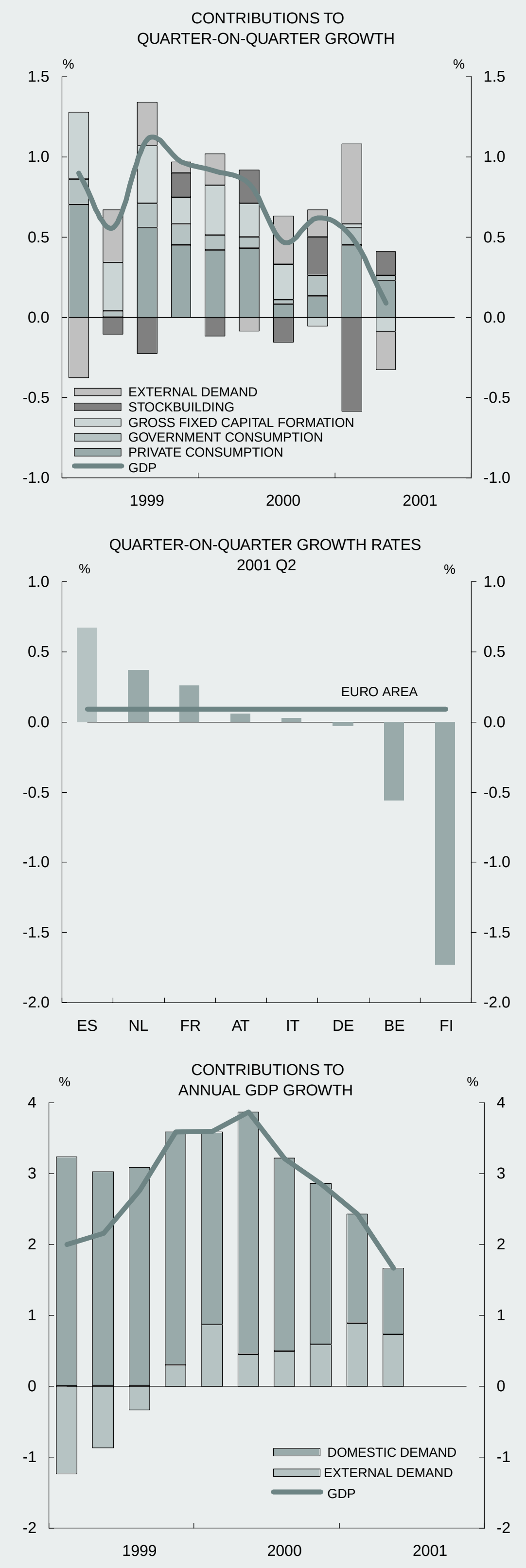
The information on the economic situation in the euro area for 2001 Q3 points to continuing weakness in the growth rate of economic activity in the region. After some positive signs in July and August, the latest available data are more unfavourable. This is particularly so in the case of the European Commission's confidence surveys for industry and services, which worsened in August and September despite not reflecting the effects of the terrorist attacks. And more recently, the purchasing managers' index for manufacturing, compiled after 11 September, has shown a most marked decline. Despite the favourable figure for August, the average of the industrial production index shrank slightly in July and August compared with Q2.

As can be seen in Chart 9, the economic indicators of private consumption show a further loss of momentum in this aggregate in relation to the first half of the year. This would be consistent with the adverse impact on household wealth of the fall in equity prices and with the climate of heightened uncertainty, which may be leading households to save for precautionary motives. As to disposable income, the tax cuts during the year are being partly offset by the ongoing moderation of job creation. Moreover, according to the European Commission's survey, consumers' confidence about their financial position over the coming months has diminished in Q3.

The available indicators of investment and exports show both these final demand components to be moving sluggishly in Q3. Hence, export expectations, the degree of capacity utilisation and both total and foreign orders for industry fell once more in this period. In addition to the impact of lower demand expectations on investment, the uncertainty surrounding international developments may delay investment de-

CHART 8

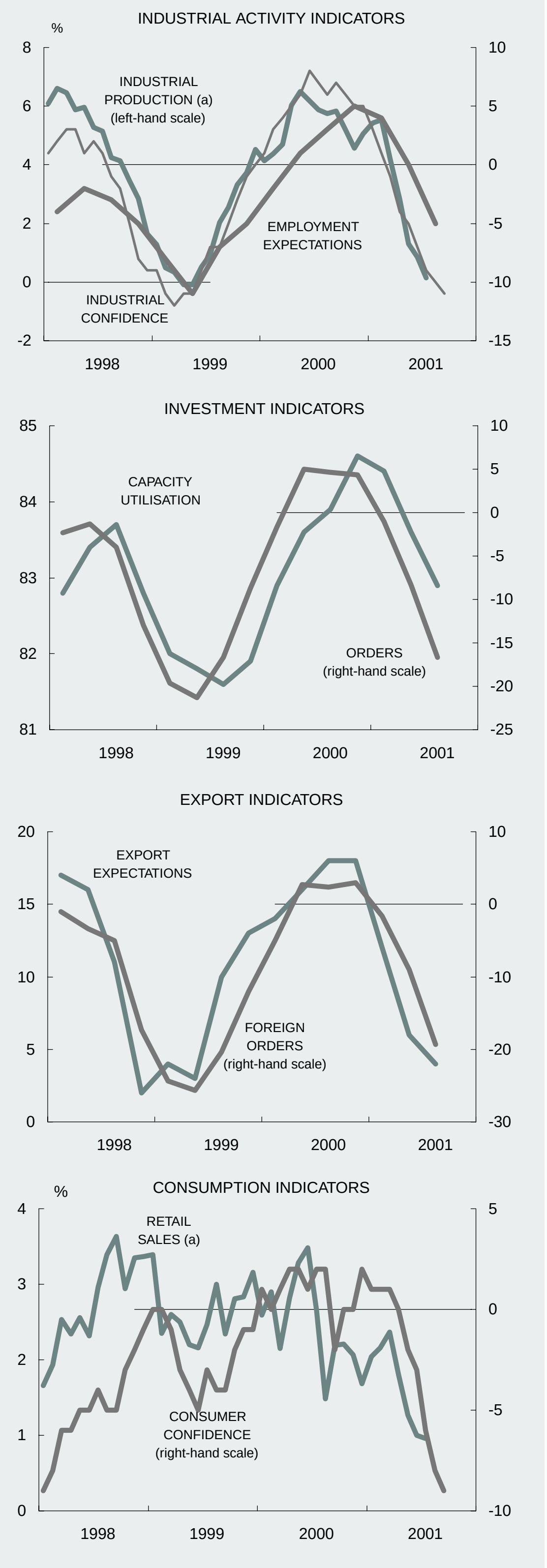
GDP in the euro area



Sources: Eurostat and national statistics.

CHART 9

Euro area. Real indicators



Sources: Eurostat and European Commission.
(a) Non-centred annual percentage changes calculated on the basis of the quarterly moving average of the seasonally adjusted series.

cisions and, therefore, entail a further deterioration in this variable.

As regards the labour market, the employment indicators drawn from surveys broadly show unfavourable developments in Q3. However, these are not yet manifest in the unemployment figures. The unemployment rate in the euro area stood in July and August at 8.3 %, one-tenth of a point down on Q2.

In sum, the foregoing developments point to growth in GDP close to zero in what remains of the year. This is largely as a result of the considerable deterioration in the international environment following the terrorist attacks, but is also due to the greater than initially expected effects of the slowdown in the US economy on the euro area. In any event, and with all due caution, it is likely that the euro area economy will move onto a path of recovery as from the end of this year.

The various euro area price indicators reveal an easing of inflationary pressures during Q3. Such moderation is largely due to the gradual disappearance of the effects of the supply shocks derived from the increase in oil and food prices last year. In respect of domestic prices, information is only available on the unit labour costs of certain EU member states to 2001 Q2. According to this information, unit labour costs grew by around 2% year-on-year, slightly up on the rate for Q1. Consequently, since the GDP deflator increased by 2.5% in the same period, business margins may have widened somewhat after having been moderately squeezed for two consecutive quarters (see Chart 10).

Turning to consumer prices, euro-area inflation in September 2001 measured in terms of the 12-month growth rate of the HICP stood at 2.5%, six-tenths of a point below the June figure. The favourable trend of consumer prices during Q3 was due to a considerable slowdown in the more volatile components, especially energy, the growth rate of which turned negative. By contrast, the rate of increase of the remaining components edged up during Q3, prompting a small rise in underlying inflation (measured by the IPSEBENE index, which excludes energy and unprocessed food) to 2.4% in September. Although the behaviour of prices has improved in most countries between June and September, the spread between the countries running the highest and lowest inflation rates (the Netherlands and France, respectively) has increased from 2.9 to 3.8 percentage points.

The producer price index also trended favourably in July and August, standing at 1.7% in the latter month, 1.5 points below the June figure. Behind this improvement is the appreciable slowdown in intermediate-good and energy prices and, to a lesser extent, in consumer goods. The slackening of inflation in the case of industrial goods intended for consumption augurs an easing of final consumption prices in the coming months. Elsewhere, the foreseeable weakening of import prices, owing to the absence of any further depreciations and, as set out in Box 1, to lower energy costs, will help the euro area inflation rate hold on its downward trajectory. Provided, that is, that moderate wage settlements are agreed in the new bargaining rounds envisaged for next year.

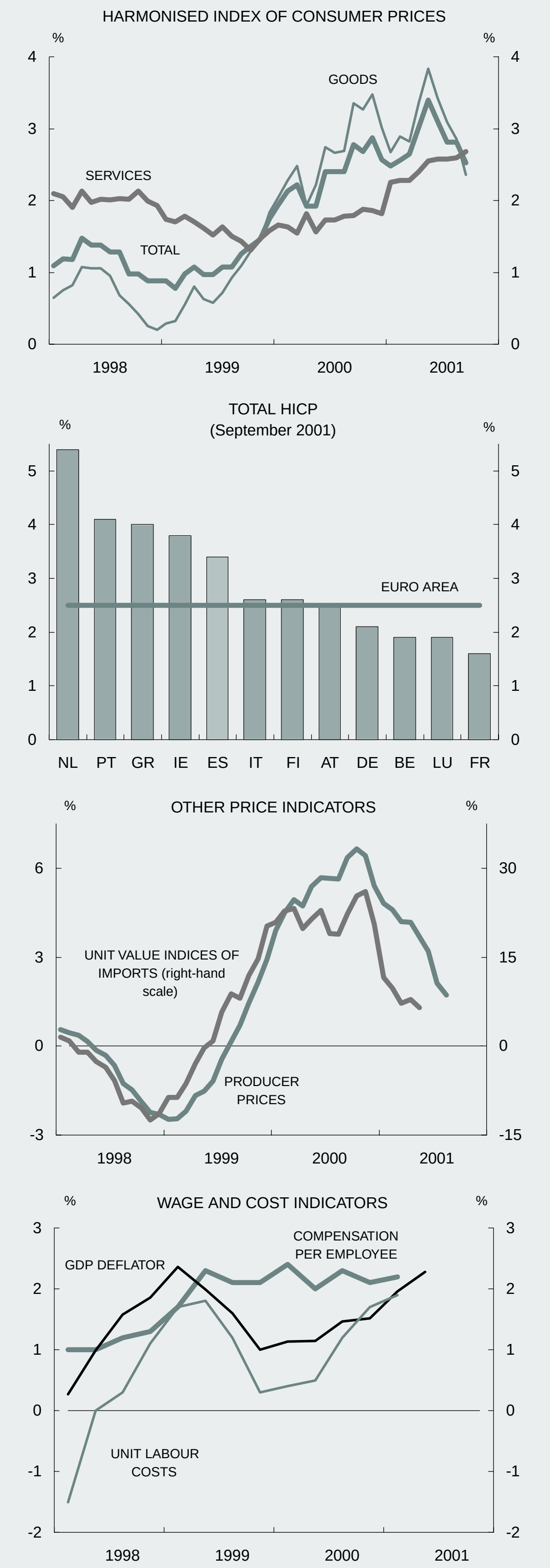
On ECB estimates, the current-account deficit for the area narrowed in the first seven months of 2001 to EUR 15.3 billion, EUR 23.2 billion less than in the same period in 2000. This reduction is mainly due to the considerable increase in the surplus on the merchandise balance (from EUR 18.2 billion to EUR 34.7 billion), which was greater than the EUR 7.6 billion increase in the income-balance deficit. The cumulative deficits on the balances of services and of current transfers increased only marginally. The growing cumulative surplus on the merchandise balance was attributable to a bigger increase in exports than imports (12.9% against 10.1%, respectively).

According to the information available on budget outturns in the period to date this year, it is likely that many countries will not attain the budget deficit targets established in their stability programmes (see Table 1). Such slippage is largely the outcome of the unfavourable trend both of expenditure and, in particular, of revenue, derived above all from the impact of the greater than expected slowdown in economic activity. However, on the revenue side, there may possibly have been an underestimation of the effects on takings of the tax reforms applied at the start of the year. On the expenditure side, the foreseeable deviations this year are combining with the recurrent slippage recorded in certain countries in recent years.

In Italy, the draft budget for the year 2002 retains last year's stability programme target of a deficit of 0.5% of GDP. To achieve this, the draft envisages an across-the-board cut in spending, along with increases in revenue stemming, among other sources, from a partial tax amnesty. In France, by contrast, the deficit in the year 2002 would, according to the draft budget, amount to 1.4% of GDP instead of the figure of 0.6% projected in the stability programme unveiled in December 2000. The budget includes measures not previously foreseen, such as direct aid to industries affected by the crisis and cuts in taxes on the lowest incomes

CHART 10

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



Sources: Eurostat and ECB.

TABLE 1

General government financial balances of euro area countries (a)

% of GDP

	1997	1998	1999	2000	2001 (b)
Belgium	-1.9	-0.9	-0.7	0.1	0.2
Germany	-2.7	-2.2	-1.6	-1.3	-1.5
Greece	-4.0	-2.5	-1.8	-1.0	0.5
Spain	-3.2	-2.6	-1.2	-0.4	0.0
France	-3.5	-2.6	-1.6	-1.4	-1.0
Ireland	0.7	2.1	3.9	4.5	4.3
Italy	-2.7	-2.8	-1.8	-1.5	-0.8
Luxembourg	3.6	3.3	2.3	4.1	2.6
Netherlands	-1.1	-0.8	0.4	1.5	0.7
Austria	-1.7	-2.3	-2.1	-1.1	-0.8
Portugal	-2.6	-1.9	-2.0	-1.8	-1.1
Finland	-1.5	1.3	1.9	6.9	4.7
MEMORANDUM ITEM:					
Euro area					
Primary balance	2.5	2.6	3.0	3.2	3.3
Total balance	-2.7	-2.2	-1.3	-0.8	-0.6
Public debt	74.7	73.1	72.7	70.2	67.7

Source: IMF.
(a) As a percentage of GDP. Proceeds from the sale of UMTS licences not included. Deficit (-) / surplus (+).
(b) Stability programme targets unveiled between September 2000 and January 2001.

and in corporate income tax (in the form of exceptional depreciation for the amount of 30% of the investment made before the end of 2002 Q1). Lastly, in Germany, the adaptation of macroeconomic forecasts to the new scenario has meant a delay in the presentation of the budget for the coming year.

The change in the macroeconomic environment has highlighted the advantages arising from the pursuit of fiscal policies consistent with maintaining a budgetary position close to balance or in surplus, on average, throughout the economic cycle. Thus, countries enjoying a healthy fiscal position at the time the economic slowdown struck will now have far greater scope for giving free rein to the automatic stabilisers than others which still had high deficits at the start of the new cyclical phase. In the case of the latter countries, the necessary continuity of the fiscal consolidation process will no doubt constrain the stabilising capacity of budgetary policy. In any event, the application of expansionary discretionary measures is, in general, inappropriate insofar as this may adversely affect European fiscal policy credibility, the attainment of which has required so much effort in recent years. In addition, such measures limit the capacity to face the challenges posed for public finances by population ageing.

1.2. Monetary and financial developments

Insofar as the loss of momentum in activity had, as set out in the preceding paragraph, translated into a gradual improvement in the inflationary outlook, the Governing Council of the ECB lowered interest rates by 25 basis points on 28 August. Subsequently, heightened uncertainty about the future course of the world economy and the negative repercussions of the terrorist attacks on agents' confidence led the ECB, in step with a similar measure by the Federal Reserve taken hours earlier, to shave another half-point off interest rates, lowering them to their current level of 3.75% (see Chart 11). Prior to this measure, the Eurosystem stated it would give priority after the attacks to ensuring the sound functioning of financial markets. It showed its readiness to provide whatever the liquidity needed to credit institutions, conducting two fine-tuning operations on the money market. In parallel, it entered into a swap with the US Federal Reserve so as to be able to provide dollar funds to those European banks that needed them to settle dollar-denominated operations in the immediate wake of the terrorist attacks.

During Q3, money market interest rates have been stable, swiftly adapting to the two successive cuts in official interest rates. Both

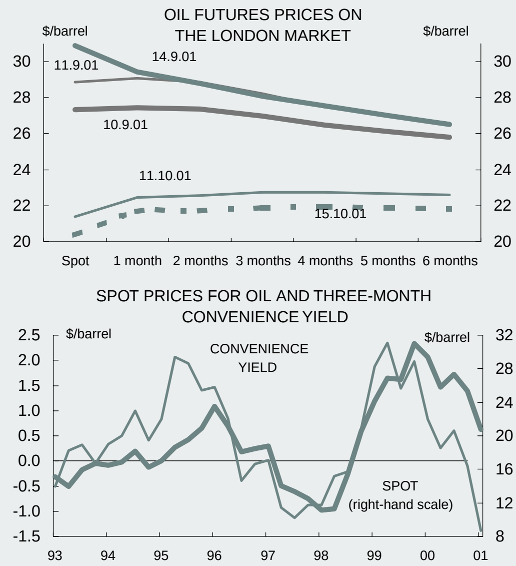
BOX 1

The outlook for oil prices

In the immediate aftermath of the terrorist attack in the United States on 11 September, oil prices in all trading segments surged, markedly so in the case of spot prices. The rise was, however, short-lived. Indeed, by 17 September prices had resumed their pre-attack levels. There was subsequently a sudden drop in prices, which placed London-traded Brent crude at around USD 20-21 per barrel, i.e. 20% below the average level in August. Insofar as the maintenance of the oil price at current levels over a sufficiently lengthy period would contribute to moderating the contractionary effects of the demand shock caused by the terrorist attacks and to containing consumer prices, it is well worth analysing the current situation of and outlook for the oil market.

Since mid-September there has been a downward shift and a flattening of the curve relating prices and terms in the oil market, contrasting with the negative slope it showed in the days following the terrorist attack (see top panel of the accompanying chart). The reduction in the level and the slope of this curve denotes significant changes in market operators' perceptions of the foreseeable course of prices. In fact, three basic components can be identified in the price of oil futures: expectations, storage costs and the convenience yield. The latter is a non-observable variable that measures the economic value attributed to the desirability of having a sufficient volume of crude stored to meet production and consumption requirements over a period of time. The convenience yield is positively correlated to the degree of uncertainty, since the more uncertain the regularity of supplies, the greater their value will be.

London oil market



Source: International Petroleum Exchange.

The reduced expectations about oil price movements, as indicated by the correction of future prices between mid-September and mid-October in the upper panel of the chart, can be explained by a conjunction of supply and demand factors. On one hand, the global economic slowdown will tend significantly to curb the demand for oil. The International Energy Agency (IEA), which has been scaling back its growth forecasts for world demand for crude in 2000 and 2002 since the beginning of the year, has again revised them downwards in its first report following the terrorist attack. And on the supply side, the information available suggests that, in the current circumstances, medium-term considerations are bearing significantly on OPEC decisions. Two of OPEC's objectives, namely to maintain market share and not to hold back a rapid and enduring recovery in world economic activity (on which its economies are highly dependent), could be jeopardised if it were to force prices back up to the reference level of USD 25 per barrel[1] established by the organisation in very different economic circumstances. Current OPEC production is estimated to be 5% above the maximum quota set at its July meeting and, although the price of its reference basket has been persistently below the intervention floor price of USD 22 per barrel, it has not triggered the 500,000 barrel-per-day cut in production designed to stabilise the market. Moreover, the various efforts by certain member countries to forge a common response to the situation[2], involving also certain non-OPEC producers such as Mexico, Norway and Russia, have proven unsuccessful. Consequently, supply and demand factors are in step with a perception that the oil price will remain moderate in the near future.

Furthermore, the estimated course of the convenience yield suggests there is little uncertainty over the availability of crude in the coming months. The lower panel of the chart plots, from end-1993, the quarterly average of spot crude prices and the implicit value of the convenience yield[3], calculated assuming fixed storage costs. The same chart reveals a high correlation between both variables and, indeed, evidence that the turning points of the convenience yield tend to lead those of spot prices. Hence, for example, as from 1996 the implicit average quarterly value of the convenience yield trended downwards, bottoming out in 1998 Q2, ahead - certain oscillations excepted - of the cycle of average crude prices. This relationship is equally visible in the subsequent upturn and, more recently, in the phase of moderation that began in mid-2000. Note that the current value is even below the 1998 trough.

Consequently, arguments can be drawn from the foregoing analysis that would warrant oil prices being maintained at around current or, perhaps, slightly lower levels in the near future. In any event, the internal cohesion of OPEC, though it may have been dented recently, might be restored with some speed against a backdrop of falling prices. Moreover, the non-OPEC oil-producing countries have already demonstrated their intention to avoid a collapse in prices similar to that in 1998. Both arguments make a persistent decline in crude prices far below current levels highly unlikely. In any case, the impossibility of anticipating at present how the political and military response to the terrorist attacks will unfold advises treating these conclusions with the utmost caution.

(1) This is the price of its reference basket, which usually hovers between USD 1 and 2 below the London Brent price.

(2) That might entail production adjustments or a downward revision of the reference band, maintaining or not its current width. The second option would be consistent with the foreseeable trend of the main determinants of oil prices.

(3) The figure for 2001 Q4 corresponds to the average of the daily data for the first fortnight in October.

TABLE 2

Monetary and financial situation in the euro area and Spain

%

	1999 DEC	2000 DEC	2001 MAY	2001 JUN	2001 JUL	2001 AUG	2001 SEP	2001 OCT (c)
MONETARY VARIABLES (a):								
EURO AREA								
M3	6.3	4.8	5.1	6.3	6.5	6.7	7.6	
M1	10.7	5.2	2.9	4.0	3.5	3.7	5.2	
Credit to private sector	10.3	10.1	8.5	8.4	8.1	7.6	6.9	
SPAIN								
Liquid financial assets	1.4	2.6	5.4	6.1	5.6	6.3	6.5	
Cash and cash equivalents	12.7	4.4	3.6	4.6	3.5	3.5	3.5	
Financing to the private sector	19.4	18.8	16.3	16.4	15.5	15.9	14.2	
FINANCIAL MARKETS (b):								
EONIA	3.04	4.83	4.65	4.54	4.51	4.49	3.99	3.83
Three-month EURIBOR	3.44	4.94	4.64	4.45	4.47	4.35	3.98	3.62
Public debt								
Euro area ten-year bond yields	5.32	5.07	5.26	5.21	5.25	5.06	5.04	4.89
US-euro area ten-year bond spread	1.04	0.25	0.18	0.12	0.05	-0.03	-0.26	-0.29
Spain-Germany ten-year bond spread	0.22	0.31	0.31	0.33	0.33	0.34	0.31	0.29
Spanish bank interest rates								
Synthetic deposit rate	1.98	3.02	2.98	2.91	2.88	2.87	2.67	
Synthetic lending rate	5.03	6.35	6.04	5.84	5.83	5.89	5.55	
USD/EUR exchange rate	1.011	0.897	0.874	0.853	0.861	0.900	0.911	0.913
Equities (d)								
Dow Jones EURO STOXX Broad Index	39.5	-5.9	-6.5	-10.4	-13.4	-19.7	-30.5	-28.2
Madrid Stock Exchange General Index	16.2	-12.7	3.8	-2.2	-6.0	-8.2	-18.0	-13.9

Sources: European Central Bank and Banco de España.
(a) Annual percentage change.
(b) Monthly averages.
(c) Monthly average to 16 October 2001.
(d) Cumulative percentage change during the year. End-of-month data. Latest month: to 15 October 2001.

the EONIA and EURIBOR rates at various terms have fallen by about 75 basis points since early July (see Table 2 and Chart 11). The gradual deterioration in the international environment and its feed-through to real activity in the euro area mean that expectations of official interest rate cuts for the region have remained in place, despite the adjustments made. This can be seen in the downward shift in the yield curve, though its slope has not changed substantially. In particular, the markets appear to be expecting another cut in rates of one-quarter of a point in the short term, and a similar-sized cut at the beginning of next year. As regards ten-year bond yields, these were at slightly less than 5% in the first half of October, some 30 basis points below the end-June level. Over this same period US bond yields fell even more, from levels of around 5.3% to 4.6%. That entails a change in the sign of the spread vis-à-vis European debt, which seems more related to the course of real interest rates than to changes in inflationary expectations (see Box 2).

Euro area credit institutions' lending and deposit interest rates to customers have continued on the declining trajectory initiated in December 2000, mirroring the lower interbank rates in force in this period. On information to August, interest rates on credit for house purchases and on credit to companies at over one year fell in the euro area by 20 basis points from the June level. In Spain, where the information to September is available, there was a further, significant reduction in credit institutions' lending and deposit rates that month. As Table 2 shows, the reduction in the synthetic rate between June and September amounted to 30 basis points in the case of asset-side instruments, and to somewhat less on the liabilities side.

BOX 2

Explanatory factors of recent long-term interest rate developments in the United States and the euro area

In recent years there has been a positive spread between US and euro-area long-term interest rates. However, in mid-2000, as expectations of a US economic slowdown began to become patent, this spread has narrowed, even turning negative recently. While similar trends were seen in the past, worthwhile consequences may be drawn from analysis of the recent course of long-term interest rates on both sides of the Atlantic.

Nominal interest rates can be broken down into the sum of three components: real interest rates, expected inflation and a risk premium related to the uncertainty surrounding the prediction of future inflation. Although this risk premium may have been important in periods of high inflation rates, its influence on long-term rates in an environment of price stability such as that at present is not very relevant.

The accompanying chart shows long-term interest rates since 1999 along with their two fundamental components: the real interest rate and expected inflation. The latter variable has been proxied by the difference between the interest rates on long-term public debt and the real interest rates on French and US indexed bonds. According to this chart, the average positive long-term interest rate spread between the United States and the euro area in the period under study appears mainly to respond to the different rates of expected inflation in the two areas. In recent months, however, this divergence in expected inflation rates has not changed substantially; consequently, as the bottom panel of the chart shows, the bigger slowdown in US real interest rates appears to have caused the change in the sign of the nominal interest rate spread.

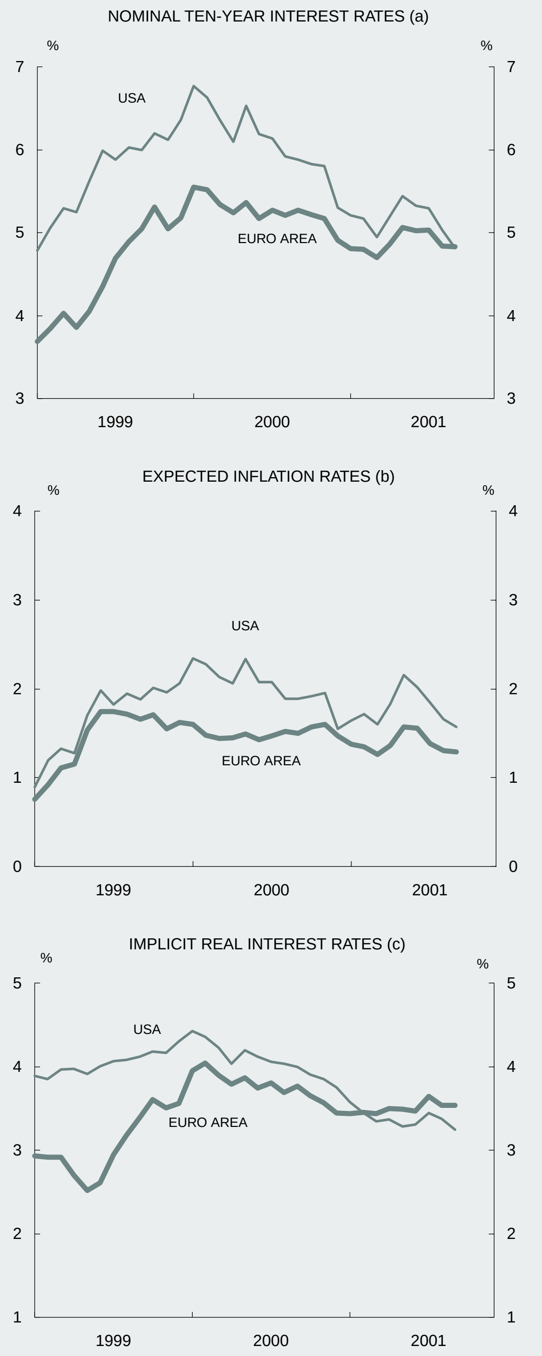
Under certain assumptions, real long-term interest rates should trend in accordance with the economy's long-term capital productivity, so that an investor would be indifferent to real investment in that economy or obtaining the yield on its public debt. However, the public debt market undergoes supply-side changes (derived, for instance, from greater fiscal discipline) that alter the price of such instruments irrespective of economic expectations.

The optimistic assessment of the scope of the New Economy and its positive effects on productivity and sustainable growth in the economy may thus have been toned down recently. The delay in setting in place projects connected with this phenomenon and the course of the shares of companies engaged in new technologies would point in this direction. In this respect, this correction may have affected Europe less than the United States, where the effect of the New Economy on economic growth appears more evident. This might therefore help explain the bigger decline in real rates in the US economy as from mid-2000.

As to changes in the public debt market that may have impacted long-term public debt assets yields, US fiscal consolidation figures to the fore. Indeed, the latest budget surpluses in the United States have led the traded volume of public debt to fall from 62.8% of GDP in 1998 to 56.9% in 2000. The effect of this factor in Europe has been in the same direction as in the United States: in fact, the public debt/GDP ratio in the euro area has dipped from 73.7% in 1998 to 70.1% in 2000. However, the still-high level of this ratio means that the likely impact of the scarcity premium is less relevant than for the US case.

In sum, it is admittedly difficult to pinpoint the explanatory factors of long-term interest rate developments. But both the changes in growth prospects over this horizon and, to a lesser extent, the reduction in supply in the public debt market appear to have contributed to the bigger decline in long-term bond yields in the United States than in Europe. In the recent period, it is significant that, following the terrorist attacks on 11 September and the fiscal expansion announced in the United States, the downward trend of long-term interest rates should not have been reversed. That would be consistent with the hypothesis that the incidence of revisions of economic growth potential explains much of the recent trend of US long-term interest rates.

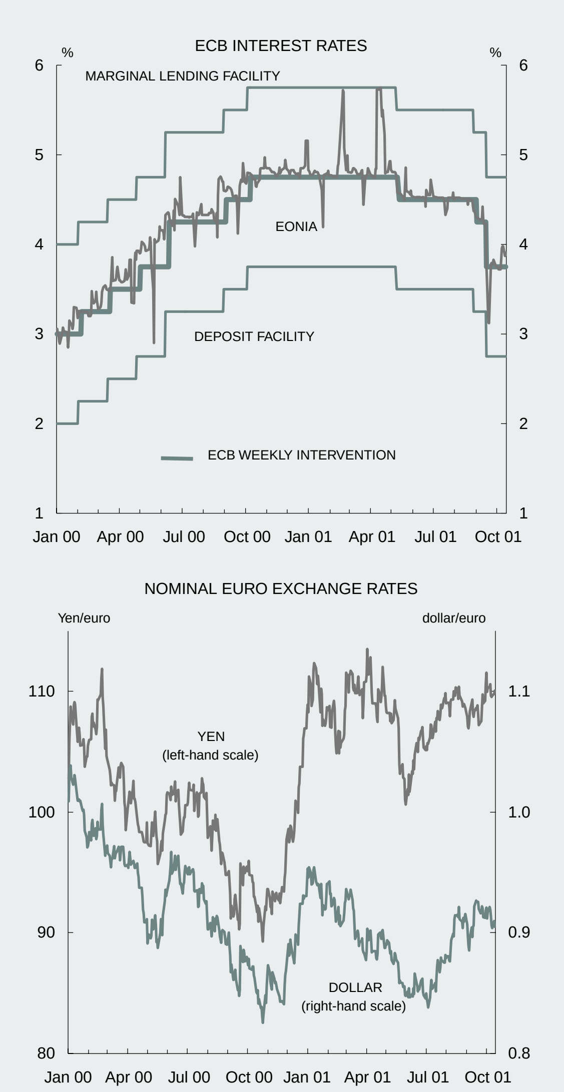
Long-term interest rates in the United States and the euro area



Sources: ECB, French Treasury and Reuters.
(a) Ten-year government bond yields in Germany and the United States.
(b) Implicit inflation rate on ten-year French and US indexed bonds.
(c) Difference between the nominal interest rate and the expected inflation rate.

CHART 11

ECB interest rates and euro exchange rates



Sources: Banco de España and ECB.

Heightening expectations of a slowdown in the US economy in the summer months led the euro to appreciate against the dollar between June and end-September to USD 0.92 per euro, 7% above its value in June. During October, the euro has stabilised at slightly lower values close to 0.90. Against the yen, the euro strengthened by about 5% in Q3. As this Bulletin went to press, the nominal effective exchange rate of the euro against the developed countries stood at 6.8% above its early-July level.

During Q3, euro area bourses were dragged downwards in the wake of bad news on developments in the US economy. These corrections became more acute after the attacks on 11 September, and stock markets reached a low on 21 September. Subsequently, prices rallied, coming to stand by mid-October above the levels observed before the attacks. Thus, profit warnings by US corporations (not only high-tech companies but also those in more traditional industries) were compounded as from 11 September by heavy falls in the share value of companies linked to air transport, tourism, and insurance and financial services, and these were mirrored in the shares of these industries traded on European bourses. By contrast, telecommunications and defence-industry corporations have, in principle, benefited from the events. The stock market turbulence translated into a fall of more than 30% in the Dow Jones EURO STOXX index in the period between end-June and the immediate aftermath of the attacks. The subsequent recovery, however, places the decline in this index at the time of this Bulletin going to press at around 17%. In Spain's case, the fall in the Madrid Stock Exchange general index has not been as sharp (11% since the end of June).

The euro area M3 monetary aggregate quickened notably in the summer months. By September it was running at an annual rate of 7.6%, one point above the related June figure. The three-month average of the annual growth rate of M3 rose from 5.9% in the period from May to July 2001 to 6.9% in the three months from June to September. Behind this marked expansion in M3 are changes in the composition of private investors' portfolios. After a period of uncertainty and falling equity prices, investors have opted to replace long-term equity or bonds with other short-term instruments included in M3. In addition, the ECB has announced a distortion in the M3 figures owing to the fact that money market instruments and short-term debt securities held by non-residents in the euro area are included in the aggregate. Stripping out these holdings could lower the annual growth rate of M3 by 75 basis points compared with the official figure released. The growth rate of the narrow aggregate M1 held firm in the period under study, despite the notable reduction still apparent in the demand for cash in the run-up to the euro coins and banknotes launch date.

As to the counterparts of the monetary aggregates, credit extended to the resident private sector in the euro area, which is the aggregate most closely linked to spending decisions, has for some months been slowing. In September it ran at a rate of 6.9%, more than one point below the related June figure. In respect of credit developments, therefore, the effect of the slowdown in output seems to prevail over that of the reduction in borrowing costs stemming from lower interest rates. According to the data on credit by end-use to the end of Q2, credit restraint is due both to the behaviour of non-financial corporations and of households. In Spain, the slowdown in financing to the private sector has been similar to that of the euro area as a whole, although it continues to expand at a substantially greater pace (14.2% in September, against 16.4% in June). Credit extended by resident institutions (the main component of financing received by the non-financial private sector) grew at a year-on-year rate of 12.4% in September, compared with 15% in June.

4. The Spanish economy

To date in 2001, certain macroeconomic aggregates (productive investment, exports and, to a lesser extent, consumption) have been less buoyant as a result of the Spanish economy's position in the cycle and the deterioration in the international – and, in particular, European – economic environment described in the preceding sections. Nonetheless, the macroeconomic policy stance, marked by the Eurosystem's decisions and by sound public finances resulting from budgetary consolidation, has tended overall to counter the economic deceleration. Against this backdrop, the change in the political and economic scenario wrought by the terrorist attacks in the United States on 11 September, and the subsequent military conflict, have considerably heightened uncertainty. That said, data providing for evaluation of the effects on growth are not yet available. Specifically, the projections made for 2001 Q3 have scarcely been affected by these events.

On QNA data, the pace of the slowdown in national demand in Q2 was checked. The real growth of this variable was 2.8% on a year earlier, and it is estimated to have eased further to 2.6% in Q3 (see Chart 14). Developments in aggregate spending were very similar to those in final household consumption, the growth rate of which was mildly cut, while the notable loss of momentum seen in gross capital formation since 2000 Q1 was interrupted. Albeit with rates of change that differ notably, the growth of both investment in capital goods and construction has stabilised, the former at negative rates (despite the somewhat irregular figure for Q2, as can be seen in Chart 14) and the latter retaining notable momentum. The contribution of net external demand to growth has been the combined outcome of the slowdown in exports, offset only in part by that of imports, whereby following a period of positive contributions, the sign of the contribution would have turned slightly negative in 2001 Q3. As a result of the mild loss of steam in domestic demand and of the change in the contribution of the external sector, annual GDP growth, which was 3% in Q2, three-tenths of a point down on Q1, dipped to a rate close to 2.5% in Q3, continuing on the slowing path witnessed since mid-2000.

The slowdown in GDP in 2001 Q2 corresponded to a more or less sharp loss of buoyancy in the value added of all the productive sectors, except energy. No doubt this trend has stepped up in Q3, especially in industry and market services. Although specific information is not yet available, it is possible that these industries began to see some of their activities paralysed in September as a result of the attacks in the United States. Employment, measured in terms of the number of full-time equivalent jobs, eased in Q2, growing at a year-on-year rate of 2.6%, four-tenths of a point down on the previous quarter. However, the high intensity of job creation that has characterised the recent economic upturn remains in place: apparent labour productivity increased very modestly, having grown 0.4% year-on-year in Q2 compared with 0.3% in Q1. It is estimated that both the downtrend in employment growth and the slight recovery in productivity have continued in Q3.

Lower growth in activity has been accompanied by an easing of inflationary pressures. Although unit labour costs quickened at the beginning of 2001, as a result of bigger wage settlements in the current round of collective bargaining and of the triggering of the inflation-adjustment clauses for the year 2000, import prices have tended to exert a moderating effect. This influence has stemmed both from the course of oil and other commodity prices and from the appreciation of the euro. These factors, along with less demand pressure, explain the change in the inflation rate, measured by the 12-month change in the CPI; after peaking at 4.2% in May and June, inflation stood in September at 3.4%.

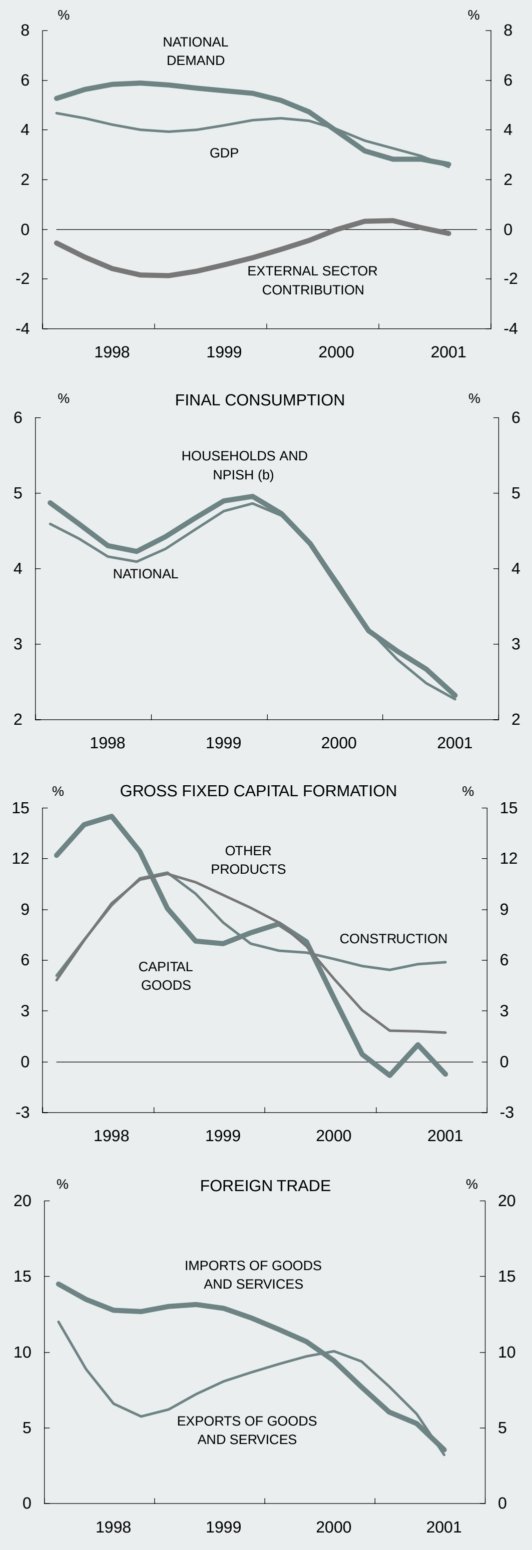
4.1. Demand

During the first half of the year, the real growth rate of household final consumption expenditure continued falling, standing at 2.7% in Q2. On the basis of the as yet incomplete information available for the summer months, it is forecast that this trend will have also continued in Q3. The moderation of consumption would be compatible with a recovery in the household saving ratio (which, having fallen to very low levels in historical terms, would be drawing close now to levels consistent with the recent trend of household financial wealth, adversely affected by changes in financial asset prices) and with a less optimistic economic and employment outlook than some months ago.

Drawing on the itemised information from the indicator of the apparent consumption of goods and services (see Chart 15), weaker consumption has been manifest mainly in durable goods purchases other than cars and in expenditure on certain consumer services. The notable declines in the goods component recorded at the beginning of the year have tended to moderate owing to the expansionary course of cars and the pick-up in the apparent consumption of food. This information is similar to that provided by the general retail sales index, which has also shown a strong increase in food sales. Albeit with a greater lag, the household

CHART 14

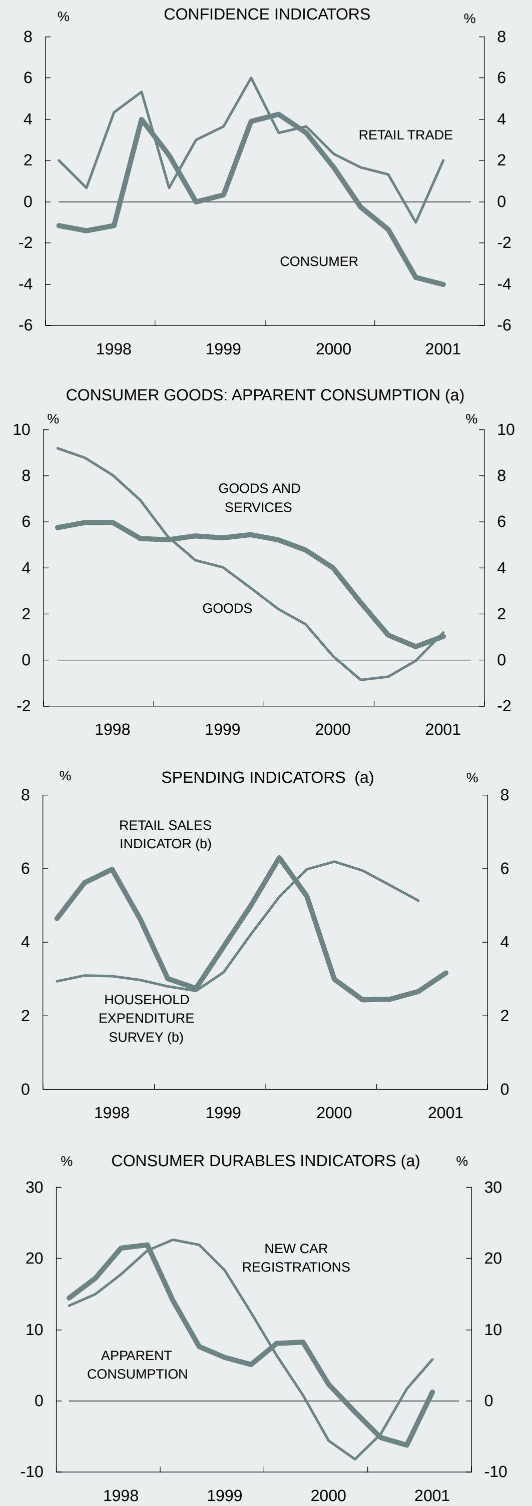
Main macroeconomic aggregates (a)



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

expenditure survey indicates a slowdown in total expenditure in Q2, and a reduction in the percentage of Spanish households viewing the economic situation favourably. Along the same lines, the consumer confidence indicator stood, in Q3, at around the same level as in Q2. Among the series making up this indicator, there has been a slight deterioration in the outlook for the overall economic situation and for unemployment, against a background of lower inflation expectations.

As indicated previously, the slowdown in household consumption in 2001 can be attributed to the main determinants of this variable. On available estimates, the growth of real disposable income for spending can be seen to have moderated: on one hand, the bigger increase in compensation per employee is being offset by the diminished pace of employment; and on the other, net general government transfers are contributing less expansively than in previous years to sustaining income, since fiscal drag has led to a bigger increase in direct tax payments. Against this backdrop of slowing income, the loss of value of financial wealth has dampened spending and propelled saving, for precautionary motives. Against this, the increase in household real estate net worth and interest rate cuts have contributed only to checking somewhat the slowdown in household expenditure.

General government final consumption in 2001 Q2 ran at a real growth rate of 1.9% year-on-year, five-tenths of a point down on Q1. This figure, which has risen after a notable revision of the profile of this aggregate for the preceding quarters, is difficult to explain if the strong increase in employment in market services (3.4% in Q2) is taken into account. The information available for Q3, obtained from the changes in State revenue and expenditure and from the budgetary plans drawn up for the year as a whole, points to a slight acceleration, without departing from the line of containment characterising government consumption in recent years.

Gross fixed capital formation posted a real year-on-year growth rate of 3.7% in 2001 Q2, eight-tenths of a point up on the previous quarter. This interrupted the strongly slowing trajectory this aggregate had followed throughout 2000 and in the opening months of the current year. Such developments were the outcome of the estimated recovery in investment in capital goods, the rate of increase of which climbed to 1% after having fallen 0.8% in Q1 (see Chart 14). Construction expenditure quickened by four-tenths of a point to 5.8%. Lastly, investment and other products, mostly including spending on services related to construction, held at a growth rate of 1.8%.

The indicators available on investment in capital goods in Q2 have not attested to the shift in this aggregate. The information relating to the summer months appears to show that, in this period, this aggregate followed a contractionary course. In particular, the indicator of apparent investment in capital goods held at a very negative rate of change in July and August, although the deterioration it had been evidencing appeared to be being contained somewhat (see the upper panel of Chart 16). The confidence of capital goods producers, which had held quite firm until 2001 Q1, worsened significantly from April, accompanied by a sharp fall in orders and a simultaneous increase in stocks. This would be indicative of a decline in the demand – both foreign and domestic – for these products.

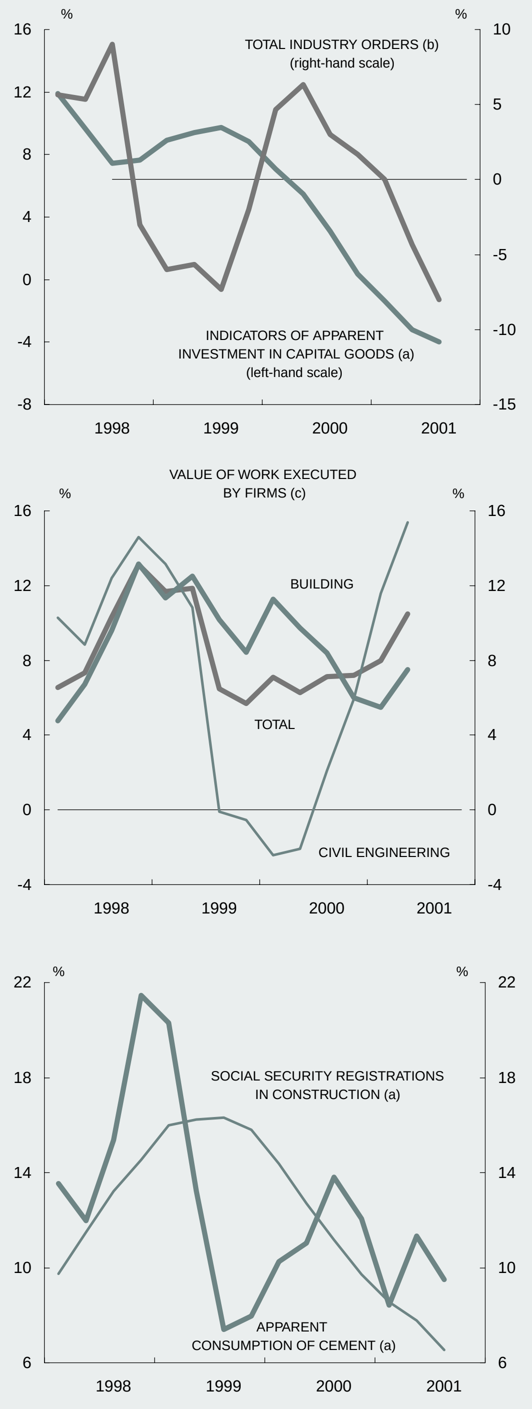
The declining path of productive investment in the first three quarters of 2001 is in step with the deceleration in final demand and with the perception that this slowdown may steepen in the coming months. Indeed, although final demand, contained as it has been, has held at what are still relatively high growth rates, current and foreseeable orders in the industry (a proxy for expected demand) have proven markedly contractionary, as can be seen in Chart 16. Furthermore, the information on non-financial corporations compiled by the Banco de España Central Balance Sheet Data Office confirms the slowdown in business activity. However, the financial position of corporations remains healthy, despite their greater debt, and the spread between the return on net assets and interest on borrowed funds (the leverage ratio) has widened slightly. Therefore, corporations remain in a sound position to re-launch their investment plans once the uncertainty surrounding the international economic context has abated.

Investment in construction continued to be the most dynamic component of domestic demand in the first half of the year. Indeed, it accelerated in Q2, growing at a year-on-year rate of 5.8%, four-tenths of a point up on Q1. According to ECIC (Construction Industry Survey) data, which are available to Q2 for the major aggregates and to Q1 in the case of more itemised information, the buoyancy of this variable was underpinned by the firmness of civil engineering works and non-residential building, which offset the slowdown in residential building.

The economic data relating to the summer months confirms the resilience of construction activity and, therefore, of construction spending in this period. That said, growth rates can be

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.

seen to be beginning to ease slightly, as augured by the new works variable in the ECIC survey. Among the indicators of inputs, the apparent consumption of cement, which is more intensively used in civil engineering works, points to a marginal weakening (see bottom panel of Chart 16), while the industrial production of construction materials ran at a negative growth rate in August. The employment indicators have also continued to slow in Q3.

The indicators relating to construction starts also project something of a slowdown in the coming quarters. In the case of private-sector building, the pace of growth of surface area to be built, whether according to local-government authorisations or to architect association approvals, has fallen on the related rates for the year 2000 as a whole, with the residential building component also declining. Government civil engineering tenders, with data for the January-March period, declined significantly, although the scale of the infrastructure projects still on order books (the development of which remains a budgetary priority) presages a more favourable performance than that suggested by this indicator for the coming months.

Consequently, it may be concluded that the buoyancy of investment in construction has extended into both Q3 and the subsequent months, underpinned by the gradual materialisation of public works investment plans (by general government and state-owned firms) and by non-residential investment. Conversely, against a background of slowing employment and disposable income, the expansion of the demand for housing for residential purposes has petered out, and only the demand for housing for investment motives, still spurred by price growth, is sustaining this type of expenditure.

On QNA data, the contribution of investment in stocks to GDP growth was positive in 2001 Q2, at one-tenth of percentage point. The monthly business survey showed a decline in stocks in July and August from the desired level, which could entail a lower – and even negative – contribution to GDP growth in Q3. This decline has been extensive to all types of goods (capital, intermediate and consumer goods).

In 2001 Q2, the net contribution of external demand to GDP growth remained positive, but fell to 0.1 percentage points, three-tenths of a point less than in Q1, thus interrupting the recovery discernible in the second half of the previous year. During this period, exports of goods and services began to decelerate slowly. The slowdown intensified in the first half of 2001, against a backdrop of notably sluggish world trade, taking the real growth rate of these exports to 5.9% in Q2. Imports of goods and services, which had been losing steam since the start of the year 2000, following the easing of domestic demand and the diminished thrust of industrial activity, grew in 2001 Q2 at a real rate of 5.3%. The as yet very incomplete information for Q3 points to a fresh reduction in the contribution of external demand, which may have turned negative owing to the strong deceleration in sales abroad.

According to Customs figures, the notably weakening trend of real goods exports became further entrenched in July; they declined at a rate of –2.9% compared with growth of 3.2% the previous quarter. During the first seven months of the current year, foreign sales grew by only 5.1% compared with 12% in the same period a year earlier (see Chart 17). This profile is consistent with the trend of the determinants of exports, fundamentally; with the sharp slowdown in world trade; and, to a lesser extent, with the losses in competitiveness – against a background of recovery not exempt from fluctuations in the euro – that are reflected by the relative prices and costs of Spanish products. In terms of regions, the nominal rate of exports to the EU in the January-July period eased to 9.7%, against 15.6% in the same period in 2000. There was a notable deterioration in exports to Germany and France, which is analysed in greater detail in Box 3. The slowdown in non-EU exports initiated in mid-2000 intensified. They grew at a nominal rate of 9.2% year-on-year between January and July as the crisis spread to various international markets. Mention should be made of the marked slackness of sales to the United States and of those to the NICs, in addition to the moderation of exports to Latin America. Sales to the central and eastern European markets, meanwhile, remained highly buoyant. In terms of product groups, capital goods fell back (–1.8% on average in the first seven months of 2001), consumer goods moderated (5.8%) partly as a result of the fall in the foreign demand for cars, and exports of intermediate goods were somewhat firmer (7%).

In 2001 Q2, the growth of tourism receipts stabilised at around 7.8%, marking a break in the sustained path of recovery they had shown since the end of the previous year. This pattern is similar to that of the real indicators of tourists entering Spain at borders and foreign visitors lodged in hotels, which slowed during this period. Nonetheless, tourism picked up in July and August. In the January-August period, and in terms of countries of origin, numbers of German and British tourists, who account overall for more than 50%, were contained, especially the former, while French tourists, by contrast, were up 19.7%. Among non-European countries,

BOX 3

Trade with France and Germany

Foreign trade with France and Germany accounts for a sizeable proportion of Spanish trade; namely, over 30% of its exports and imports. Analysis of recent trade developments with these two countries is therefore significant. Of the information provided in the accompanying table and chart, the following may be highlighted:

— The slowdown in Spanish exports to both markets is proving notable. It began to become apparent in the German economy and then extended to the French economy, where the loss of momentum of car sales, which account for almost 25% of Spanish exports to this country, has played an important role. It thus seems that, in the slowdown in exports to France and Germany (and as in the rest of the euro area), a significant demand component is at play.

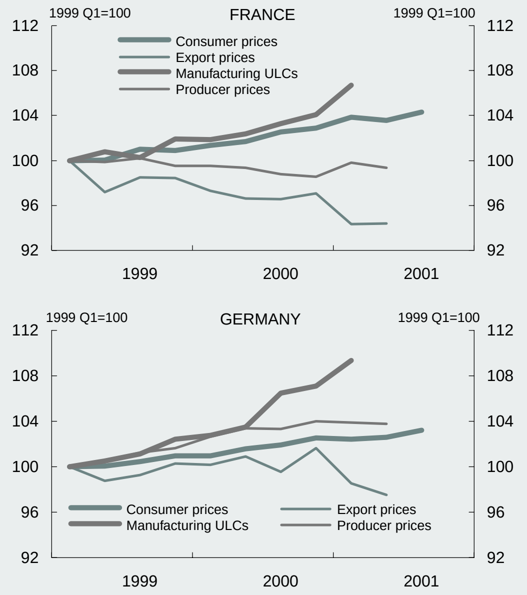
— The slowdown in exports to France and Germany is running in parallel to the deceleration in imports from these countries, although this is of much less significance given the greater dynamism of the Spanish economy. The slowdown in imports of French products began earlier and is much more intense. In this respect, the exceptional sustained buoyancy of imports of German consumer goods until very recently (largely associated with the demand for cars, especially those at the top of the range) is relevant. In the deceleration in imports from France, the slowdown in capital goods and intermediate goods (and, hereunder, those relating to transport equipment) has been prominent. Perhaps the falling off of sales of cars towards the lower end of the range (i.e. those made in Spain), both at home and in the rest of Europe – with the exception to date of the United Kingdom – may be related to this phenomenon, given the significance of trade within the car industry.

— The accompanying chart plots a set of variables that might be indicative of how the competitiveness of Spanish products may fare against that of the two economies considered. The four variables are relative consumer, ex-factory and goods-export prices, and relative unit labour costs. The cumulative rates of change of these variables have been depicted from the beginning of 1999 up to the time of the latest available information. A notable increase can be seen in the cumulative differential in consumer price growth rates, something not generally seen when the comparison is made with export or manufacturing prices. But the pivotal factor regarding competitiveness might be the notable differential building up in unit labour cost growth. Taken together, these two factors – holding producer and export prices at competitive levels and the growing imbalance in the behaviour of ULCs – may ultimately affect output and employment growth, especially at times like the present when foreign markets are contracting strongly.

	Structure	Annual percentage change				
	2000	2000	2001 (a)	Q1	Q2	JULY
EXPORTS:						
FRANCE-GERMANY	**31.8**	**15.6**	**6.7**	**12.2**	**5.8**	**-7.1**
France	**19.4**	**18.4**	**9.5**	**14.4**	**9.3**	**-4.1**
Consumer goods	9.1	18.5	10.2	20.0	6.3	-4.3
Cars	*4.7*	*24.9*	*4.9*	*23.0*	*-4.1*	*-12.8*
Capital goods	2.8	13.7	-0.4	-0.9	0.7	-2.1
Intermediate goods	7.6	20.2	12.1	13.6	16.2	-4.5
Transport	*1.0*	*26.8*	*-18.6*	*-16.3*	*-19.8*	*-21.7*
Germany	**12.4**	**11.5**	**2.2**	**8.8**	**0.2**	**-12.4**
Consumer goods	5.0	2.9	1.5	5.3	1.4	-11.7
Cars	*2.0*	*-1.2*	*-8.7*	*8.4*	*-15.1*	*-30.9*
Capital goods	1.6	17.0	0.9	20.8	-12.0	-14.3
Intermediate goods	5.8	18.7	3.3	9.1	2.6	-12.6
Transport	*0.5*	*17.3*	*-19.1*	*-11.3*	*-15.5*	*-53.1*
IMPORTS:						
FRANCE-GERMANY	**32.0**	**15.4**	**5.2**	**10.0**	**5.2**	**-7.8**
France	**17.1**	**15.3**	**0.2**	**3.7**	**-2.1**	**-2.9**
Consumer goods	4.6	10.3	12.1	6.8	18.5	8.3
Cars	*2.2*	*17.2*	*9.0*	*1.8*	*16.5*	*9.0*
Capital goods	3.4	15.9	-26.6	-1.9	-37.6	-48.0
Intermediate goods	9.2	17.6	3.8	3.8	1.6	11.1
Transport	*2.5*	*24.5*	*-36.5*	*-43.7*	*-38.3*	*-6.6*
Germany	**14.9**	**15.5**	**11.2**	**17.8**	**14.1**	**-12.7**
Consumer goods	3.6	11.0	19.1	37.7	42.5	-46.9
Cars	*2.0*	*9.7*	*15.9*	*39.9*	*44.8*	*-64.3*
Capital goods	3.4	15.0	5.5	9.4	0.2	12.6
Intermediate goods	7.8	18.0	9.9	12.7	9.3	4.1
Transport	*0.6*	*22.5*	*8.2*	*11.7*	*7.5*	*0.4*

Source: Departamento de Aduanas.
(a) The data for 2001 are to July.

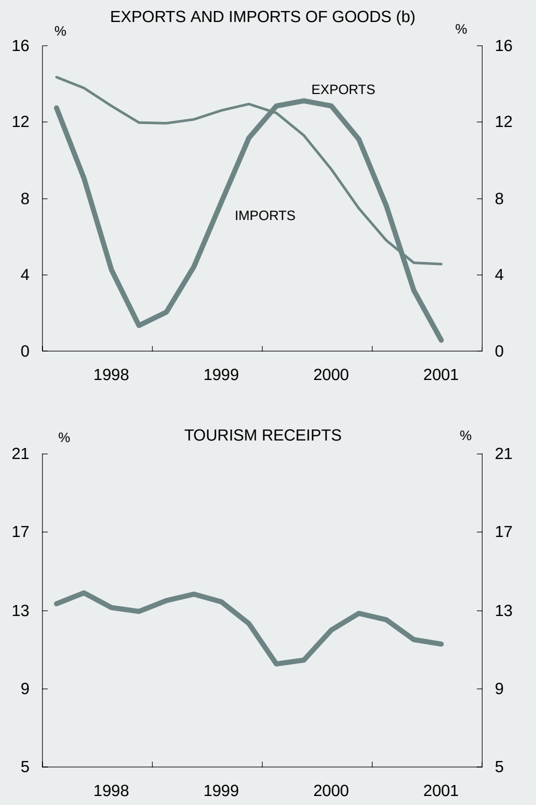
Relative prices and costs



Sources: Eurostat and Banco de España.

CHART 17

Foreign trade (a)



Sources: Ministerio de Economía, Ministerio de Hacienda and Banco de España.
(a) Non-centred percentage change on same quarter a year earlier, based on the trend of the indicator.
(b) Series deflated by the corresponding unit value indices.

there was a heavy fall in tourists from the United States and Latin America. Initial assessment of the impact that the events in September may have had on the tourist sector point to a significant contraction in receipts in the closing months of the present year. Services other than tourism, which were already slowing in Q2, in line with goods exports and tourism, will also be affected. So too will financial services, as a result of the diminished momentum of cross-border investment flows.

On customs figures, goods imports posted a negative rate of 4.6% in real terms in July, confirming the slightly slowing path it had been moving on previously. In the first seven months as a whole, imports grew at a real rate of 5%, down from 9.7% over the whole of the previous year. As indicated, this is consistent with the diminished momentum of final demand and industrial activity, in a context of falling relative prices, offset in part by a possible substitution of imports for domestic output. In terms of product groups in the January-July period, purchases of capital goods declined (–4% in real terms), while consumer imports accelerated in relation to the average for the previous year, underpinned by firm private consumption and, especially, car purchases. However, purchases of non-energy intermediate goods slowed considerably, in keeping with the deceleration in the industrial output of this type of good, after having been buoyant early in the year. Energy purchases grew by 2.6%, in volume, after increasing strongly in 2000 and despite the marked easing in the growth of energy prices.

Lastly, imports of services grew sustainedly throughout the first half of the year by around 7.8% in real terms. There was a notable surge in tourism expenditure, which ran at a rate of 13.1% in Q2. This may be due to the greater stability of the euro, following its substantial weakness the previous year, and to the high levels of consumer confidence apparent up to the early months of this year.

4.2. Output and employment

As indicated in the introduction to the section, activity has tended to slow in most productive industries in the period to date in 2001. In the primary sector, value added grew at a rate of 1.3% year-on-year in Q2, four-tenths of a point down on the first three months of the year according to QNA estimates (see Chart 18). Thus, despite the buoyancy of livestock farming (once the cattle market problems were largely behind), the contraction in agricultural output bore on the overall performance of this sector. Indeed, virtually all crops produced lower yields than in the year 2000. On this occasion, the poor results are apparently due to the adverse consequences of heavy rainfall this year, which did not coincide with the particular periods in which crops were maturing.

Against the background of a decelerating international economy, with increasingly gloomier expectations about domestic demand and with possible losses in competitiveness, industrial activity increased at a rate of 2.7% year-on-year in 2001 Q2, three-tenths of a point less than the QNA estimate in the opening months of the year. That said, energy activity quickened slightly. The loss of steam was particularly concentrated in the metal transforming industry, where the output of high-technology products such as electronic equipment and office machinery slipped appreciably, in line with the lesser momentum of these same industries internationally. The latest information maintains the prospect of slowing growth in both industrial and energy activity. Of note was the performance of the industrial production index, the slowing profile of which steepened at the start of 2001 Q3, although it ceased in August to post negative growth rates as it had in the previous six months. Nonetheless, the business confidence indicator fell again that month, as the decline in both orders and in the trend of output heightened. These factors, along with the high level of stocks of finished products, suggest that the slowdown in this activity may have steepened in Q3. In addition, the growth rate of social security registrations fell by nine-tenths of a point in Q3 compared with the previous quarter.

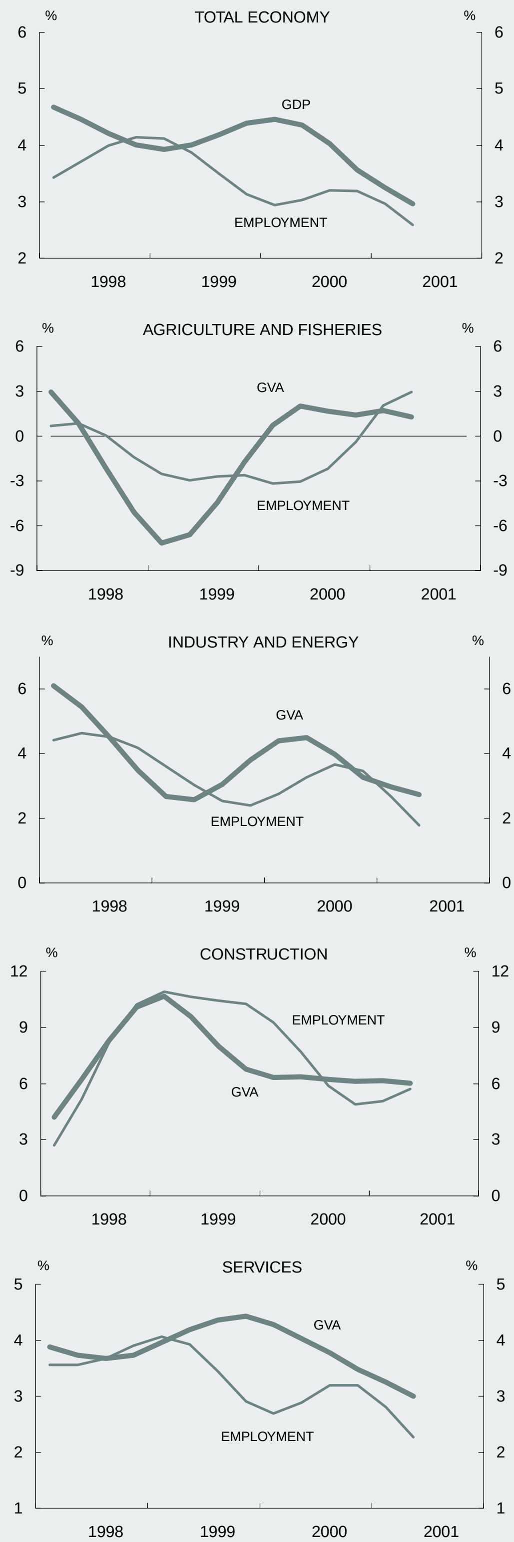
On the latest QNA estimates, value added in construction held at a steady growth rate throughout the year 2000 and in the first two quarters of 2001, progressing at around 6% year-on-year. As indicated on analysing investment in construction, the performance of this industry in recent quarters has been underpinned by the thrust of civil engineering works, since residential building has moved into a slowing phase. Information for Q3 shows that activity in the industry may have decelerated slightly.

Tertiary-sector activities slowed by three-tenths of a point to 3% in 2001 Q2. As in the opening months of the year, a lower rate of increase was common both to market and non-market services. In the case of the former, this was due to the lesser buoyancy progressively shown by consumption and demand in industry. The information available reveals that, in Q3, the loss of momentum of the different activities in this sector was not uniform. Wholesale trade and activities relating to vehicle maintenance and repair were quite stable, having regard to social security registrations to July. The retail trade confidence indicator picked up in Q3 after several very negative months. The retail sales index, which had slackened slightly in July, also picked up once more in August. Part of the momentum lost in the hotel and catering trade in Q2 was regained, although social security registrations have not reflected this recovery. This activity, like transport and, generally, all activities encompassed by market services, may have noted to a greater extent the effects of the September terrorist attacks in the United States.

On QNA figures, the growth rate of employment in 2001 Q2, measured in terms of full-time equivalent jobs, was 2.6%, 0.4 percentage points down on the previous quarter. Thus, for the first time since the current phase of economic deceleration began, the rate of the slowdown in employment exceeded the rate of GDP. The lesser vigour in the employment generation process is also discernible in other

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.

statistics which, moreover, show that the deceleration may have intensified in Q3. The Spanish Labour Force Survey (EPA), which had evidenced far higher increases in employment than QNA estimates during 2000, showed a year-on-year growth rate in numbers employed of 1.8% in Q2, compared with the 2.8% rise in the January-March period. Social security registrations, which had grown at a rate of 4.3% in the spring, ran at 3.4% year-on-year in Q3. Lastly, registered unemployment declined at a year-on-year rate of 1.8% during the summer period, almost half the rate in the first half of the year, while new employment contracts increased only modestly (1.5%).

Employment growth lost steam in 2001 Q2, especially in manufacturing and in the tertiary sector, with apparent labour productivity gains increasing in both cases. In construction and in agriculture (the latter undergoing job destruction in the two previous years), the growth rate of job creation increased (see Chart 18). In agriculture, the employment profile estimated by QNA trend-cycle figures is relatively out of step with that of activity, while EPA estimates have shown a trend closer to that of value added. Numbers employed in manufacturing decelerated notably in Q2, with growth of 1.8% against 2.7% in Q1. This was in line with the EPA and with the figures on general-regime social security registrations. Employment in construction increased by 5.7% year-on-year, six-tenths of a point more than at the beginning of the year, seemingly pointing towards a concentration in labour-intensive activities. Finally, numbers employed in services increased by 2.3% in the April-June period, compared with 2.8% in the first half of the year. And once again, the slowdown was more intense in the market-oriented activities.

Dependent employment according to QNA data increased by 2.8% in Q2, six-tenths of a point lower than the previous quarter, maintaining a different pattern to self-employment, which continued to recover (1.7%). Among the different forms of hiring, there was a notable increase, according to INEM figures, in permanent hiring in Q2. Above all, this was as a result of a significant reduction in temporary-to-permanent-contract conversions in the same period in 2000, when they were not subsidised. However, the vigour of permanent contracts subsided in Q3, showing that the response to the new regulatory amendments in March in respect of stable contract arrangements has been relatively muted. In any event, according to EPA temporary employment slowed to a greater extent than permanent employment, with the proportion of the former to the latter standing at 31.5% in Q2, eight-tenths of a point less than a year earlier. With the figures available to date, the regulatory amendments to part-time hiring, which have added greater flexibility, especially in the case of permanent contracts, have not yet significantly affected the labour market either. Indeed, part-time in proportion to total employment contracts remained at 8.2%, unchanged on the same period in 2000. The increase in part-time wage-earners was predominantly among temporary employees, with the weight of the permanent segment diminishing.

The growth rate of the labour force according to EPA once again moderated in 2001 Q2, running at 0.6% year-on-year. Behind this was the flat participation rate, which held at 51.3%, a similar level to a year ago. Considering solely the population aged 16-64, the participation rate was 65.6%, easing the rising trajectory of this rate in recent years. The lesser dynamism of the labour force was propitious to a fresh decline in unemployment (75,000 people in the quarter) and in the unemployment rate, which fell four-tenths of a point to 13%. Notwithstanding, the reduction in the number of unemployed continued to lose impetus in year-on-year terms, and registered unemployment to September exhibited a similar trend. The fall in the unemployment rate was more marked among men and, by age group, among the young. As to long-term unemployment, its weight continued to lessen in Q2 (42.9%), increasing among the over-55s.

4.3. Costs and prices

In the first half of 2001, unit labour costs quickened both in the economy as a whole and in market-economy industries, rising to a rate close to 3% in both cases in Q2. The source of this acceleration lay in developments in compensation per employee (calculated in terms of full-time equivalent jobs), which increased by 3.5% across the whole economy, three-tenths of a point above growth in Q1. The modest pick-up in the rate of increase of value added per employee to 0.5% was unable to offset this rise. In the market economy, the growth of compensation per employee was somewhat higher, standing at 4% (see Chart 19). It should be recalled that this figure includes not only wage settlements for 2001 but also the effect of the inflation-adjustment clauses in collective agreements in the year 2000.

Among the indicators relating to wage developments, the labour costs index (which has replaced the Wage Survey) posted a year-on-year increase, for actual hours worked, of 4% in Q2, the outcome of a 3.2% rise in wage costs and a 6.7% increase in other costs. The labour costs index increased by 4.8% in manufacturing, 4.9% in construction and 3.7% in services. The monthly growth figures per employee were somewhat lower: 3.6% for labour costs and 2.9% for wage costs. Although the wage increases reflected by this indicator are clearly higher than those given by the Wage Survey in 2000, the fact spliced series between both surveys are not available prevents any analysis based on these results. Moreover, the increase in wage settlements in collective agreements registered to 30 September was 3.4%, four-tenths higher than in 2000 (without including the inflation-adjustment clauses). The agreed increase to that point in revised agreements was 3.4%, and in newly signed agreements, 3.6%. The increase in construction was 4.2%, higher than that in services (3.2%), agriculture (3.8%) and manufacturing (3.4%). The effect of the inflation-adjustment clauses, triggered as a result of inflation in 2000 exceeding the official forecast, is estimated at seven-tenths of a point.

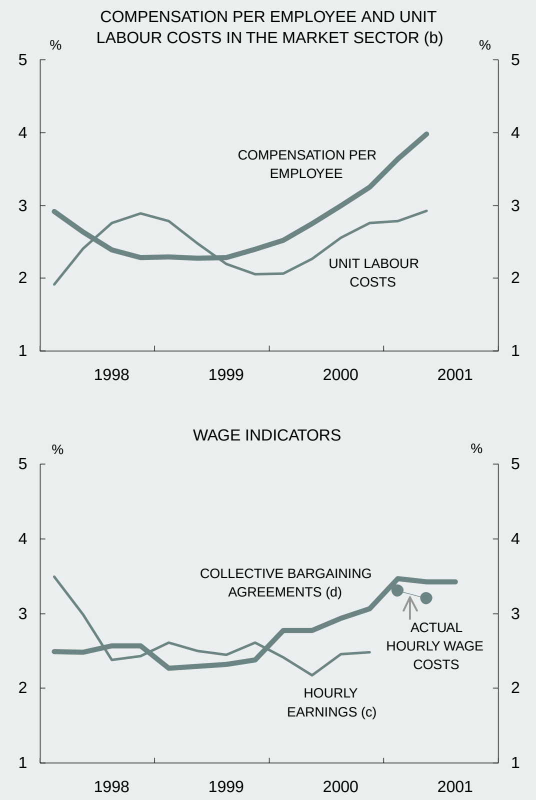
The gross surplus per unit of value added grew at slightly below the rate for the previous quarter. However, the strong rate of expansion of this aggregate (close to 7% for the economy as a whole, and somewhat higher for the market economy) means that margins have continued to widen in the first half of 2001. The higher growth of labour costs per unit of value added in 2001 Q2 and the behaviour of margins account for the growth rate of the gross value added deflator rising by one-tenth of a point to 4.3% in this period.

Chart 20 depicts the behaviour of the value-added deflators and of unit labour costs in the market economy and in three industries: manufacturing, construction and market services. Coinciding with the release of data for 2000 Q2, INE revised some of the aggregates that determine price formation in the market economy, whereby their profile is now more in keeping with what other related indicators had suggested. In the market economy, the growth of both the gross value added deflator and unit labour costs increased by one-tenth of a point in Q2 to 4.5% and 2.9%, respectively. As indicated, the surplus per unit of value added continued to grow sharply.

Across industry, the behaviour of prices and margins was uneven. In manufacturing, the value added deflator quickened sharply to 4.5%, while unit labour costs slowed as a result of the pick-up in productivity; consequently, the unit gross operating margin held on a path of recovery. In construction, the rising course of unit labour costs steepened, while the deflator, though growing at a high rate, continued to ease. As a result, the gap between both increases closed significantly, reflecting containment in the widening of unit operating margins. Lastly, the market services deflator grew slightly more than in the previous quarter, in line with the acceleration in unit labour costs, and the unit margin continued to grow.

CHART 19

Wages and labour costs (a)



Sources: Instituto Nacional de Estadística and Ministerio de Trabajo y Asuntos Sociales.

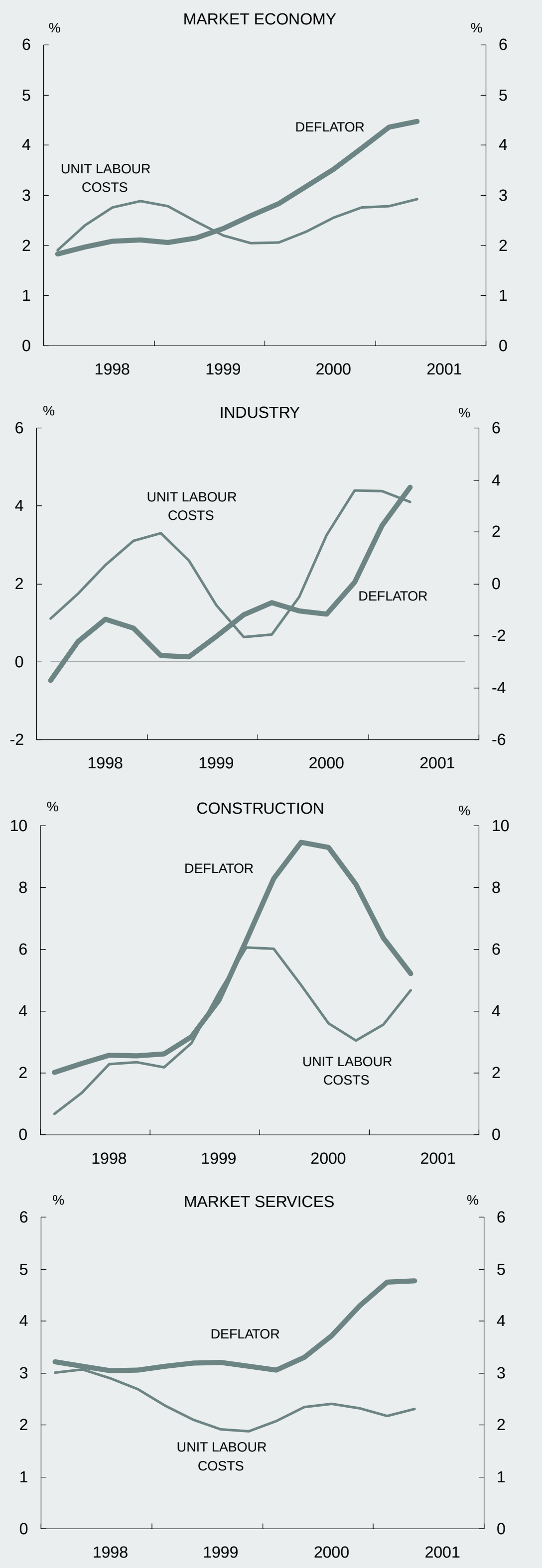
(a) Percentage change on same quarter a year earlier.
(b) Rates based on QNA trend-cycle series.
(c) Total earnings.
(d) Average wage increase for the current year, up to the reference month (excluding the effects of inflation-adjustment clauses).

In 2001 Q2, the growth rate of the final demand deflator declined by seven-tenths of a point to 3.6%, a lower rate than the GDP deflator (4%). This difference was the outcome of the renewed moderation of the imports deflator, the rate of increase of which fell back by 3.1 percentage points to 2.4%. Behind this behaviour is the significant slowdown in international prices, particularly energy (the price of oil imports in dollars fell by 2.1% in the period) and commodity prices. Nonetheless, these cuts did not pass through in full to import prices, since the euro depreciated slightly in Q2.

In Q3, the upward momentum that the CPI – the main indicator of final prices in the Spanish

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.

economy – had shown in the first half of 2001 was reversed. It moved onto a decelerating path which placed its 12-month growth rate at 3.4% in September, seven-tenths of a point below the rate posted at the end of Q2 (see Chart 21). However, the IPSEBENE index (one of the habitual measures of core inflation) continued to hover around a growth rate close to 3.5%.

Within the CPI, the growth rates of both the goods and services components declined. In the case of goods, this was due to unprocessed food prices, whose high growth rate diminished, and to the successive falls in energy prices, as a result of the cuts in natural gas and, especially, liquid fuel prices. The latter are benefiting from the favourable performance of international oil prices, against the background of the euro's relative stability. Processed food prices, however, rose significantly in Q3. This mainly reflects the bigger increases in olive oil and tobacco prices; the growth of non-energy industrial goods prices held stable at around 2.6% during the summer. Services prices improved in September, growing – for the first time in 2001 – at a 12-month growth rate below 4%. This moderation was mostly due to the easing of prices of services relating to tourism (hotels and other accommodation) and transport services.

The slowdown in consumer prices in Spain during Q3 (measured by the HICP) was sharper than in the euro area as a whole. As a result, Spain's inflation spread with the area narrowed by three-tenths of a point from June to 0.9 points in September. This reduction has been extensive to all components with the exception of processed food, the related differential of which has become unfavourable to Spain (see Chart 22).

The slowing trajectory evident in the producer price index since the end of last year ran to August. That month its 12-month growth rate was 1.6%, more than a percentage point below the rate posted in May. The favourable behaviour of the producer prices of intermediate and, especially, energy goods (which fell in both month-on-month and year-on-year terms) more than offset the upward slippage in the prices of non-durable consumer goods. The prices of consumer durables and capital goods remained stable. Lastly, the declining course in prices received by farmers evident since the start of the year was interrupted, and the related 12-month growth rate stood at 8.6% in August.

4.4. The State budget

The draft budget for the year 2002 includes an official estimate of the State revenue and ex-

BOX 4

Social security budget outturn

The Social Security System ran a non-financial surplus of ESP 912 billion to July 2001, according to budget outturn data, ESP 122 billion (15.4%) higher than in the same period of 2000 (see table below). This improvement contrasts with the reduction in the surplus projected in the initial budget for 2001 relative to the 2000 outturn. Revenue grew by 8.4% to July (somewhat less than to April, but well above budget), while expenditure increased by 7.7% (also exceeding the budget projection).

The high growth rate of receipts of social security contributions edged down to 9.5% to July, well above the 2.1% rate in the budget[1]. That was due, above all, to the buoyancy of the total number of persons registered, which grew at a year-on-year rate of 4.1% in the first nine months of 2001 (5% during 2000). The other major source of revenue, current transfers from the State, increased by 5.5%, in line with the budget.

As for expenditure, that on contributory pensions increased by 6.9% to July, as against 3.7% to April and the 3.9% rate in the initial budget for 2001. However, it should be taken into account that the comparison between the budget for 2001 and the outturn for 2000 is distorted by the fact that the latter includes both the payment to compensate for the deviation in the CPI in 1999 and that corresponding to 2000 itself. The number of contributory pensions rose by 1.1% to August 2001, in line with projections and with the growth recorded in 2000. Meanwhile, the growth rate of expenditure on sickness benefit stood at 14.5%, also above budget.

As regards INEM (National Employment Office) expenditure, spending on unemployment benefits increased by 10.4% to August 2001, as against a rise of 3.1% in 2000. This outcome was the result of the behaviour of the number of beneficiaries, which rose by 5.2% to July, as against an average reduction of 2.7% in 2000. The increase in the number of beneficiaries and the decline in the number of registered unemployed (0.8% to September, as against 4.5% in 2000 as a whole) gave rise to a further increase in the eligibility ratio, which stood at 68.4% in July (64.7% in 2000).

Meanwhile, contributions received by INEM rose by 9.8% to April, as against the 6.2% rate projected in the budget, while concessions to promote employment fell by 11.1% to April, in contrast to the 3% increase projected in the budget.

(1) However, the Social Security System's draft budget for 2002 contains a projected outturn that entails an increase of 6.5% in Social Security contributions for 2001 as a whole.

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

ESP bn and %

	Outturn	Budget		Outturn JAN-APR	Outturn JAN-JUL		
	2000	2001	% change	% change	2000	2001	% change
	1	2	3=2/1	4	5	6	7=6/5
1. Revenue	**15,364**	**15,736**	**2.4**	**9.1**	**9192**	**9962**	**8.4**
Social security contributions (c)	10,204	10,419	2.1	10.6	5879	6439	9.5
Current transfers	4,866	5,124	5.3	6.8	3204	3380	5.5
Other (d)	294	193	-34.1	6.5	109	143	31.9
2. Expenditure	**14,755**	**15,352**	**4.0**	**6.0**	**8402**	**9050**	**7.7**
Wages and salaries	2,264	2,388	5.5	6.8	1383	1465	6.0
Goods and services	1,426	1,492	4.6	9.4	820	887	8.2
Current transfers	10,854	11,233	3.5	5.2	6119	6602	7.9
Benefits	10,783	11,158	3.5	4.6	6111	6552	7.2
Contributory pensions	*8,499*	*8,826*	*3.9*	*3.7*	*4764*	*5095*	*6.9*
Sickness	*630*	*592*	*-6.0*	*18.8*	*320*	*367*	*14.5*
Other	*1,654*	*1,740*	*5.2*	*4.5*	*1027*	*1091*	*6.2*
Other current transfers	71	75	5.7	149.7	7	50	—
Other (e)	211	238	12.8	13.8	81	96	18.5
3. Balance	**609**	**384**	**-36.9**	**26.3**	**790**	**912**	**15.4**

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

(a) Only data relating to the System, not to the entire social security funds sector, are given. This is because the figures for other social security funds are only available to March.

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

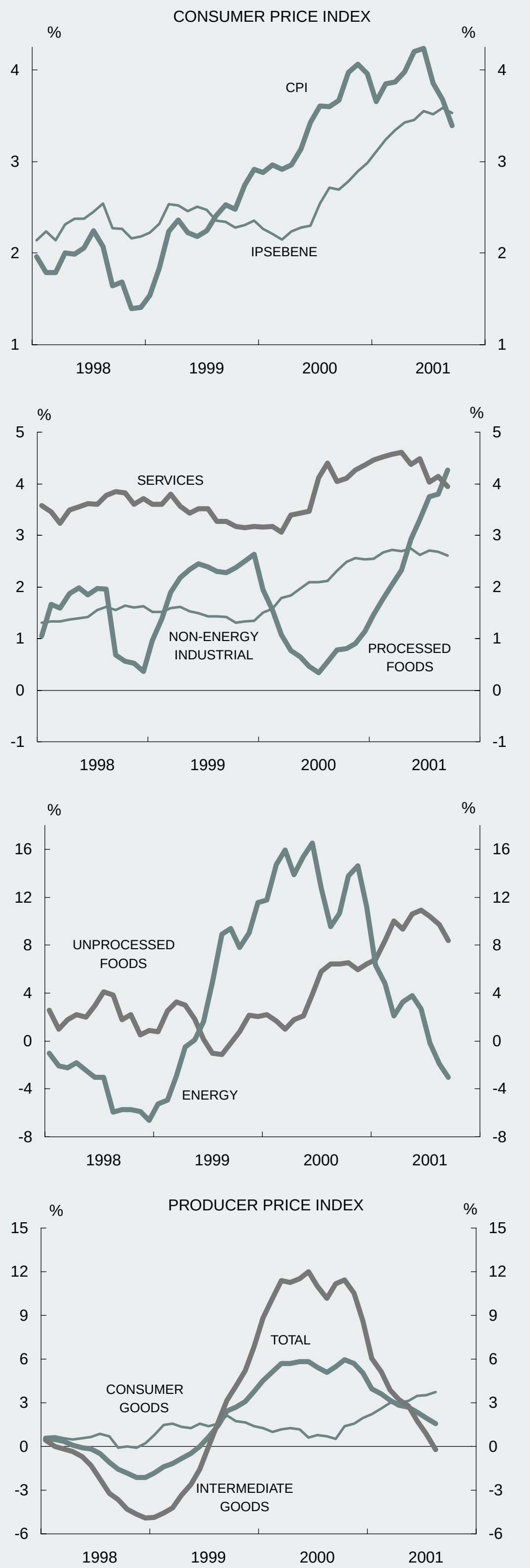
(c) Including surcharges and fines.

(d) Excluding surcharges and fines.

(e) Reduced by the disposal of investments.

CHART 21

Price indicators (a)
Spain



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

penditure outturn for the year 2001 according to National Accounts methodology. The State deficit would, according to this estimate, be 0.5% of GDP this year, an improvement of only one-tenth of a point on the previous year, compared with the target of 0.3% in the Stability Programme. The reduction in the deficit would be less than in the year 2000 owing, above all, to the slowdown in tax revenue. That reflects in turn the fact that real GDP growth in the year 2001 will be less than initially foreseen (3%, according to the Government's updated forecast, against 3.6% initially). The result, which is worse than expected for the State, would be offset by a better outturn for Social Security, which might run a surplus of up to 0.5% of GDP, against a target of 0.3%, while the territorial government accounts would be balanced. Hence, the overall general government accounts would attain the balanced-budget target established in the Stability Programme for this year.

The draft State budget also includes an initial projection of revenue and expenditure in cash-basis terms for the year 2001 (see Table 3, columns 3 and 4). According to this projection, the State will raise and spend 1.9% more (ESP 356 billion) than initially budgeted. The cash-basis deficit will, therefore, be equal to the amount budgeted, i.e. ESP 241 billion. The spending overrun is similar to that the previous year, while the increase in revenue above budget is significantly less than in the year 2000. The surplus revenue raised is attributable to personal income tax and to other revenue, the latter relating basically to Banco de España profits. By contrast, indirect tax revenue is lower than budgeted. As to expenditure, current payments increase more than budgeted, while capital payments grow less. Under current spending, all items post bigger-than-forecast increases, including most notably current transfers and interest payments, the deviation in which is due to debt conversion transactions. Of note under capital payments is the low outturn percentage forecast for investment.

In Q3 on National Accounts methodology, the State budget outturn to September 2001 resulted in a cumulative deficit of ESP 676 billion (0.6% of GDP) in respect of net borrowing, against a deficit of ESP 545 billion (0.5% of GDP) in the period January-September a year earlier (see Table 3). Revenue began to pick up significantly, with a growth rate of 3.8%, compared with 0.3% in the first half of the year, but still far off the 6.1% increase in revenue forecast in the initial projection. Expenditure slowed slightly in Q3, posting growth of 4.6% to September. The initial projection envisages an acceleration in expenditure to 5.5% for the year 2001 as a whole.

In cash-basis terms, the State budget outturn to September 2001 resulted in a deficit of ESP 1.65 billion, 22% higher than in the same period a year earlier, compared with the 35% increase in the cash-basis deficit in the period January-June. This slowdown in the deficit (which is still far from the 40% decline forecast in the initial projection for the year 2001 as a whole) was due to the pick-up in revenue, which ran at a growth rate of 3.4% to September (compared with the decline of 0.3% in the first six months of the year), since the growth rate of expenditure increased to 5.1%, against 3% to June. For the rest of the year, official estimates foresee a significant acceleration in revenue to 5.4%, and a slight reduction in the rate of increase of expenditure to 4.4%.

Tax revenue quickened considerably in Q3, driven by the continuing correction of the effect of having brought forward refunds for excess tax (personal income tax and corporate income tax alike) paid the previous year. Nonetheless, the growth rates of both taxes are still lower than foreseen in the initial projection for the year 2001. Excise duties also accelerated, rising to a great rate similar to that envisaged in the initial projection, while corporate income tax slowed considerably to a growth rate of only 0.3%, far below the figure of 5% forecast for the whole year. The decline in other net revenue slackened, but it is still greater than envisaged in the initial projection.

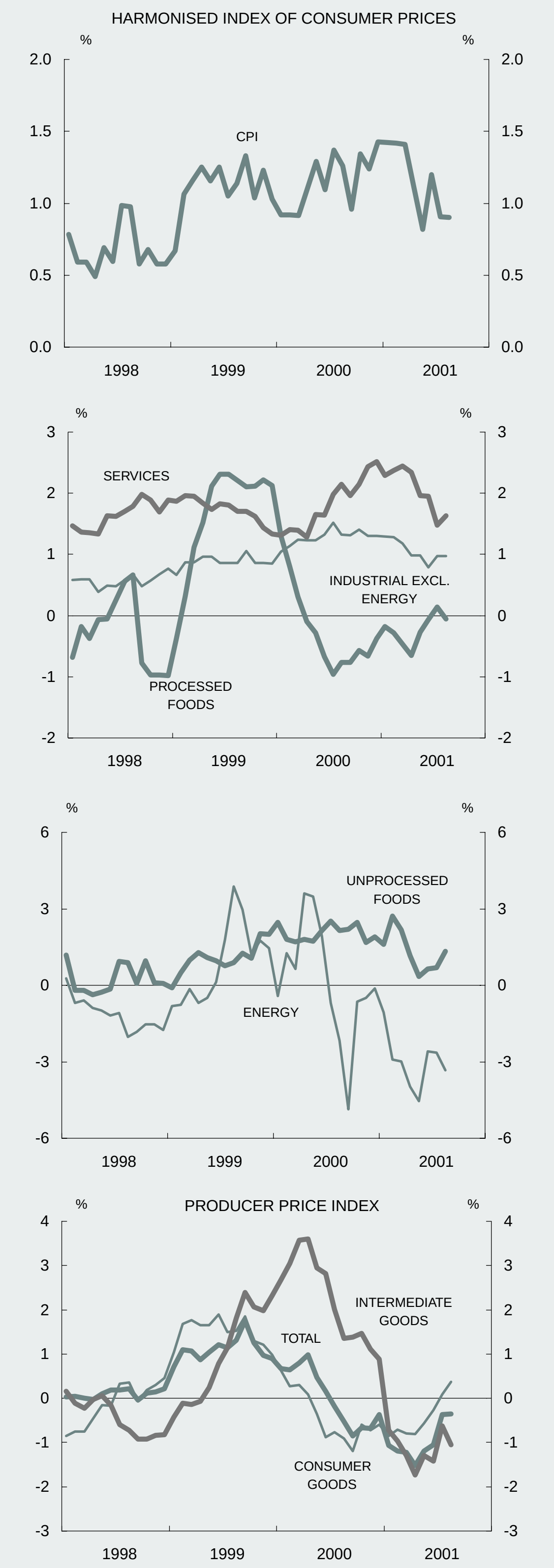
Turning to spending, current expenditure accelerated overall in relation to the first half of the year, driven by goods and services, interest payments (which continue to be affected by a greater concentration of public debt redemptions than in the same period a year earlier) and transfers. Capital payments, for their part, slowed. Official estimates foresee a slowdown during the rest of the year under all headings of current expenditure, except wages and salaries, and capital transfers. Conversely, investment should accelerate slightly, although it would still be running at a negative rate at the end of the year according to the initial projection, in contrast to the 9.1% increase initially budgeted.

4.5. The Spanish balance of payments and capital account

In the period from January to July 2001, the overall current- and capital-account balance ran a deficit of EUR 4.82 billion, EUR 1.02 billion less than in the same period a year earlier. The improvement is due both to the favourable performance of the current-account balance, the deficit on which declined by EUR 155 million in the January-July period compared with the

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.

TABLE 3

State Budget outturn

ESP m and %

	Outturn 2000	Percentage change 2000/1999	Initial proj. 2001	Percentage change 2001/2000	Outturn JAN-JUN Percentage change 2001/2000	Outturn 2000 JAN-SEP	Outturn 2001 JAN-SEP	Outturn Percentage change
	1	2	3	4=3/1	5	6	7	8=7/6
1. Revenue	**19,749**	**7.5**	**20,809**	**5.4**	**-0.3**	**13,847**	**14,323**	**3.4**
Direct taxes	8,557	9.5	9,302	8.7	-0.4	5,979	6,325	5.8
Personal income tax	*5,350*	*4.9*	*5,979*	*11.8*	*-0.6*	*3,881*	*4,213*	*8.6*
Corporate income tax	*2,863*	*17.5*	*3,007*	*5.0*	*4.8*	*1,808*	*1,814*	*0.3*
Other (b)	*345*	*21.8*	*316*	*-8.3*	*-13.8*	*290*	*298*	*2.8*
Indirect taxes	8,532	7.3	8,903	4.3	1.5	6,418	6,614	3.1
VAT	*5,557*	*8.7*	*5,833*	*5.0*	*1.2*	*4,181*	*4,310*	*3.1*
Excise duties	*2,672*	*4.1*	*2,751*	*3.0*	*1.8*	*2,013*	*2,071*	*2.9*
Other (b)	*304*	*12.4*	*319*	*5.1*	*4.0*	*224*	*233*	*4.2*
Other net revenue	2,659	2.4	2,604	-2.1	-7.2	1,451	1,384	-4.6
2. Expenditure (c)	**20,153**	**3.8**	**21,050**	**4.4**	**3.0**	**15,197**	**15,972**	**5.1**
Wages and salaries	2,706	-9.2	2,794	3.2	2.6	1,978	2,031	2.6
Goods and services	395	-9.5	400	1.4	1.7	279	288	3.5
Interest payments	2,948	-7.3	2,997	1.7	-4.0	2,656	2,762	4.0
Current transfers	12,117	12.1	12,897	6.4	5.0	8,892	9,491	6.7
Investment	1,004	4.9	957	-4.7	0.9	726	675	-7.1
Capital transfers	985	-7.4	1,005	2.1	12.6	666	725	9.0
3. Cash-basis balance (3=1-2)	**-404**	**-61.7**	**-241**	**-40.4**	**34.9**	**-1,350**	**-1,649**	**22.2**
MEMORANDUM ITEM: NATIONAL ACCOUNTS:								
Revenue	19,835	7.6	21,039	6.1	0.3	13,985	14,519	3.8
Expenditure	20,461	4.7	21,583	5.5	4.9	14,530	15,196	4.6
Net borrowing (-) or lending (+) (d)	**-626**	**-43**	**-544**	**-13.1**	**—**	**-545**	**-676**	**24.1**

Source: Ministerio de Hacienda.
(a) Includes the revenue from the tax on the income of non-residents.
(b) Includes taxes on insurance premiums and tariffs.
(c) Includes unclassified expenditure.
(d) The annual figures (columns 1 and 3) are from the Spanish Finance Ministry's reply to the Excessive Deficit Protocol, for 2000, and from the initial projection for 2001.

same period the previous year, and – essentially – to the better performance of the capital-account balance, the surplus on which climbed by EUR 867 million above the amount for the related period in 2000.

During the first seven months of 2001, the cumulative deficit on the trade balance improved by EUR 228 million in relation to the level in the same period the previous year. In terms of year-on-year rates, the deficit declined by 1.2%, compared with the 30.3% increase observed in 2000 as a whole. The strong containment of the trade deficit observed in the opening months of the year moderated during Q2, owing to the notable weakening in exports in real terms. In July, however, the slide in foreign purchases prompted a significant reduction in the deficit. Overall, in the January-July period the reduction in the nominal trade deficit was due to the sharp improvement in the terms of trade, given the easing in the prices of energy imports and, to a lesser extent, in the prices of non-energy purchases. In services, the cumulative positive balance amounted to EUR 15.36 billion, against EUR 13.2 billion in the same period a year earlier, signifying growth of 16.4%. Behind this increase is the 12.5% growth of the surplus on tourism and travel, and the 11.8% reduction in the deficit on other services. Nominal tourism receipts grew by 13.1% in the January-July period. Although they had eased during Q2, they rose anew in July, in line with the better performance in tourist arrivals between July and September. Nominal tourism expenditure grew by 16.1% in the first seven months of 2001, indicating a moderation in recent months in step with weakening consumer confidence (see Table 4).

The deficit on the income balance increased by EUR 2.15 billion in the January-July period compared with the negative balance in the same period a year earlier. Revenue continued to grow at a burgeoning rate (42.2%), as had occurred the previous year. That reflected the strong investment abroad in recent years, which has been interrupted in the course of the current year. Expenditure also grew at a high rate (41.9%), double the average rate for the year 2000. This is likewise attributable to the strong momentum of foreign investment in Spain the previous year, which has also weakened this current year.

The surplus on the balance of current transfers stood at EUR 2.02 billion in the first seven months of 2001, slightly down, by around EUR 83 million, on the balance in the same period a year ago. Revenue fared well, with increases in flows from the EU in respect of both the EAGGF-Guarantee fund and the European Social Fund. Payments, however, rose essentially as a result of a notable increase in outflows relating to emigrants' remittances. Finally, the capital-account surplus improved significantly by EUR 867 million in relation to the amount posted in the first seven months of 2000. This year-on-year growth of 25.8% is due to the pick-up in structural funds from the EU, which would be including lags originating in the previous year.

The nation's net borrowing fell slightly in 2001 Q2 owing to the altered patterns of expenditure and saving of the economy's various sectors. General government fiscal consolidation made further headway and the financial capacity of households and NPISH improved since their saving ratio increased more sharply than their investment. It is only in the corporate sector where net borrowing may have stepped up, despite the notable moderation of private productive investment.

TABLE 4

Balance of payments: summary table (a)

EUR m

	JAN-JUL	
	2000	2001
	Receipts	Receipts
Current account	**121,072**	**137,144**
Goods	71,508	78,643
Services	32,069	36,384
Tourism	18,487	20,907
Other services	13,582	15,477
Income	9,017	12,824
Current transfers	8,478	9,292
Capital account	**3,968**	**4,750**
	Payments	Payments
Current account	**130,282**	**146,198**
Goods	90,810	97,717
Services	18,868	21,025
Tourism	3,177	3,689
Other services	15,691	17,336
Income	14,227	20,183
Current transfers	6,377	7,273
Capital account	**603**	**519**
	Balance	Balance
Current account	**-9,210**	**-9,054**
Goods	-19,302	-19,074
Services	13,201	15,359
Tourism	15,309	17,218
Other services	-2,109	-1,859
Income	-5,210	-7,358
Current transfers	2,101	2,019
Capital account	**3,365**	**4,232**

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

5. Financial flows in the Spanish economy

5.1. Financial flows in the economy as a whole

In 2001 Q2, the net balance of financial transactions of the nation, at –2.2% of GDP, in cumulative four-quarter terms, was close to the level of the previous quarter. This figure involves a decline in the financial requirements of the Spanish economy relative to 2000 (–2.6% of GDP), which was distributed unevenly across the various sectors (see Table 5). The saving of households and NPIs recovered considerably from its level in 2000, while the financial requirements of non-financial corporations and of general government increased. Meanwhile, the net balance of the financial transactions of financial institutions held at a similar level to that recorded in 2000.

These changes in the net financial transactions of the various sectors took place against a background of moderate tightening of the monetary and financial conditions of the Spanish economy in 2001, which is apparent in the deceleration of the financing obtained by the non-financial private sector and, in particular, in the deceleration of bank lending. On provisional data, the annual growth of loans granted by resident credit institutions to the non-financial private sector fell to 12.4% in September, having stood at 18% at end-2000. The deceleration of bank lending is largely attributable to the slowdown in lending by the commercial banks, although, in Q2, it was the savings banks that moderated their loan growth most. Nonetheless, the slower growth of financing has not prevented rises in the debt ratios of corporations and households, both in terms of GDP and, in particular, of available financial assets.

There were a few changes in net inter-sectoral flows (lower part of Table 5) in the first half of 2001 relative to the situation in previous quarters. Institutional investors regained importance in the channelling of household savings, owing to the recovery of investment in money market funds (FIAMM), as described in greater detail in the next section of this chapter. By contrast, in 2001 Q2, the net financial transactions of general government with financial institutions changed sign, owing to the increase in the portfolio of government securities held by the latter. This increase, which amounted to a significant change from the declining trend of this variable in recent years, may be related to the need for a larger volume of collateral to participate in the liquidity tenders that the Treasury began to conduct in 2001 Q1.

5.2. Financial flows of households

The trend in the net financial transactions of households and NPIs during 2001 Q2 con-

TABLE 5

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

% GDP

	1996	1997	1998	1999	2000 Q2	2000 Q3	2000 Q4	2001 Q1	2001 Q2
NET FINANCIAL TRANSACTIONS									
Total economy	**1.2**	**1.6**	**0.5**	**-1.1**	**-1.8**	**-2.3**	**-2.6**	**-2.3**	**-2.2**
Non-financial corporations and households and NPIs	**5.1**	**4.0**	**1.9**	**-0.5**	**-2.0**	**-2.5**	**-2.9**	**-3.0**	**-2.3**
Non-financial corporations	-0.1	-0.5	-1.3	-2.7	-3.1	-3.7	-3.7	-4.2	-4.4
Households and NPIs	5.2	4.5	3.3	2.2	1.0	1.2	0.8	1.3	2.1
Financial institutions	**1.0**	**0.7**	**1.1**	**0.5**	**0.7**	**0.8**	**0.7**	**0.6**	**0.7**
General government	**-4.9**	**-3.2**	**-2.6**	**-1.2**	**-0.5**	**-0.5**	**-0.3**	**0.0**	**-0.6**
INTER-SECTORAL FLOWS (a)									
Households and NPIs	**5.2**	**4.5**	**3.3**	**2.2**	**1.0**	**1.2**	**0.8**	**1.3**	**2.1**
Vis-à-vis:									
Credit institutions (b)	-2.7	-6.7	-4.4	0.3	1.5	1.7	-0.2	-0.1	-0.2
Institutional investors (c)	8.8	10.9	7.5	1.1	-1.1	-0.8	0.2	0.7	1.6
Non-financial corporations	**-0.1**	**-0.5**	**-1.3**	**-2.7**	**-3.1**	**-3.7**	**-3.7**	**-4.2**	**-4.4**
Vis-à-vis:									
Credit institutions (b)	-0.3	-3.2	-4.3	-3.8	-4.5	-5.6	-6.5	-5.8	-4.5
Rest of the world	0.4	1.7	0.9	-0.7	-0.4	-0.6	1.5	1.0	-0.3
General government	**-4.9**	**-3.2**	**-2.6**	**-1.2**	**-0.5**	**-0.5**	**-0.3**	**0.0**	**-0.6**
Vis-à-vis:									
Credit institutions (b)	-0.4	1.4	1.4	1.4	1.3	1.3	2.2	0.3	-0.5
Institutional investors (c)	-5.9	-3.9	-2.6	1.7	3.3	3.5	3.5	3.8	3.6
Rest of the world	-0.2	-2.0	-1.1	-4.3	-4.0	-4.7	-6.1	-4.9	-4.6
Rest of the world	**-1.2**	**-1.6**	**-0.5**	**1.1**	**1.8**	**2.3**	**2.6**	**2.3**	**2.2**
Vis-à-vis:									
Credit institutions (b)	0.9	2.8	7.1	2.0	3.6	3.6	5.4	5.8	3.7
Institutional investors (c)	-0.9	-2.5	-6.3	-3.5	-4.1	-4.4	-5.7	-5.5	-5.2
Non-financial corporations	-0.4	-1.7	-0.9	0.7	0.4	0.6	-1.5	-1.0	0.3
General government	0.2	2.0	1.1	4.3	4.0	4.7	6.1	4.9	4.6

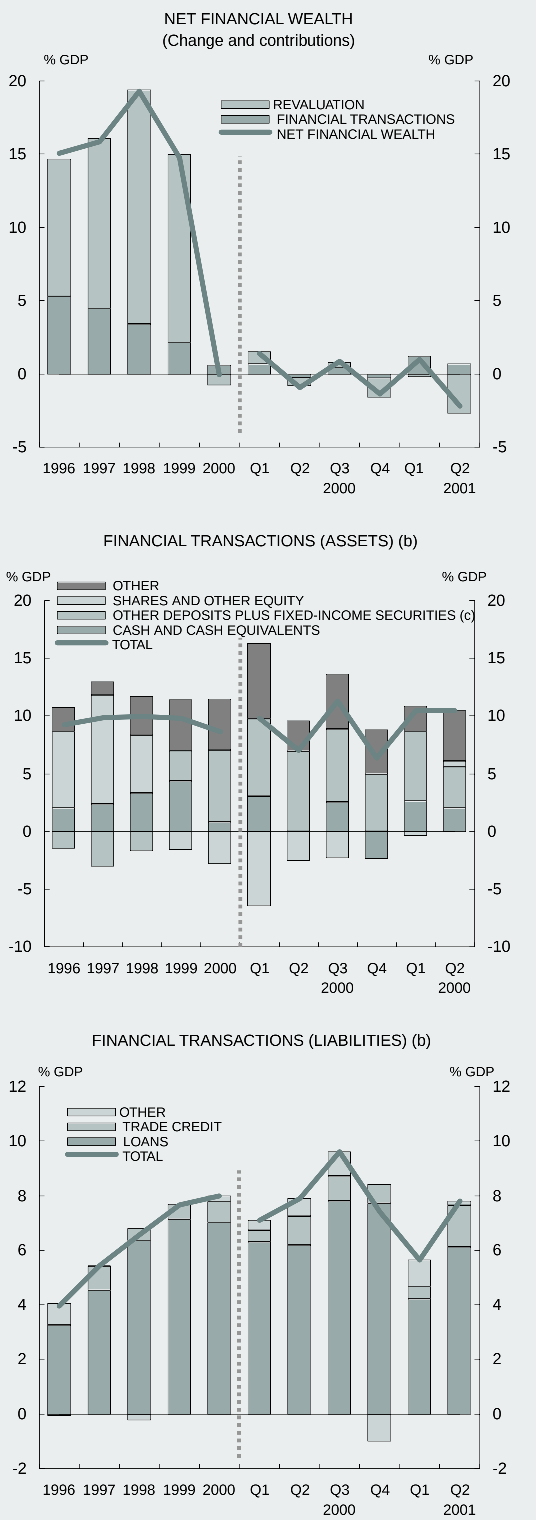
Source: Banco de España.
(a) A positive sign indicates the extension of financing to the counterpart sector. A negative sign denotes financing received from the counterpart sector.
(b) Defined in accordance with the First Banking Directive.
(c) Insurance corporations and collective investment undertakings.

firmed the signs of recovery that had been apparent since the first quarter of the previous year. The net balance of financial transactions amounted to 0.4 % of GDP in Q2, making for a cumulative four-quarter figure of 2.1% of GDP, as against 0.8% in 2000 (see Table 5). The factors that seem to explain this behaviour of household saving are, on one hand, the cyclical phase of weaker activity, which has tended to moderate household investment plans and, on the other, the need to compensate for the deterioration in household financial wealth. It seems likely that these factors, in a climate of general uncertainty that has increased since the terrorist attacks in September (see Box 5), will continue to operate. Accordingly, although nominal and real interest rates are at historically very low levels, the change in trend of household saving will probably firm.

Analysis of the financial transactions of this sector (see Table 6 and Chart 23) shows stability, in seasonally adjusted terms, in the acquisition of financial assets, which amounted to 2.6% of GDP in Q2. These flows were directed, as in the preceding quarter, towards more liquid and less risky assets. Net investment in cash and cash equivalents was only 0.5% of GDP, as a

CHART 23

Households and NPIs (a)



Source: Banco de España.
(a) Seasonally adjusted data.
(b) The quarterly data are annualised.
(c) Not including unpaid accrued interest, which is included under other.

consequence of the sharp reduction in the demand for cash in advance of the euro's arrival. Time deposits continued to attract a large part of household savings, although to a smaller extent than in previous quarters, following the recovery of investment in FIAMM. By contrast, redemptions of shares in equity and international funds remained high.

The monthly indicators available for the monetary and financial conditions of the Spanish economy in 2001 Q3 point to continuity of the trends seen in previous periods (1) (see Chart 24). Thus, the growth of time deposits remained high, albeit at lower levels than at the beginning of the year, while investment in money market funds and, to a lesser extent, in fixed-income mutual funds continued to increase.

The total financing received by households in the second quarter decreased, although to a lesser extent than in Q1. The flow of financing received was 1.9% of GDP, in seasonally adjusted terms. Although this is a higher volume than in the previous quarter, it is below the average levels in 2000 (see Chart 23). Thus, the year-on-year growth of the financing received by households stood at 15%, at the end of Q2, as against 17.3% in 2000 (see Table 6 and Chart 24). The provisional information available on 2001 Q3, however, indicates a sharper slowdown in this period. The lower confidence in the ability of households to meet future payments, as a consequence of the end of the cyclical upswing, and the greater degree of uncertainty must have affected both the demand for and the supply of credit.

According to the information on the distribution of credit by type in Q2, loans for house purchases were not affected by this slowdown; on the contrary, they sustained a high rate of growth (23% year-on-year). At the same time, although there was a certain pick up in financing for purchases of consumer durables during this quarter, other financing to individuals grew more moderately.

During Q2 there was a further deterioration in the balance-sheet position of households, in the form of a fall in their net financial wealth and an increase in their debt ratios (see Charts 23 and 25). Their debt-to-GDP ratio continued to rise, owing to the slower growth of nominal GDP, and despite the slowdown in the financing received by households. The decline in stock prices height-

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

BOX 5

Impact of the terrorist attacks in the United States on Spanish financial markets

The terrorist attacks of 11th September in the United States had a very pronounced impact on international financial markets, although its size varied from country to country and according to the type of instrument concerned. The *equity markets* were hardest hit by the attacks. The downtrend they had been displaying since the middle of the year intensified. The Ibex 35 fell by 15.4% between the 10th and 21st of September, a smaller reduction than that in the euro area Euro Stoxx stock exchange index (17.3%), but larger than the decline in the US S&P 500 stock exchange index (11.6%). At the sectoral level, and in line with events on international markets, the hardest hit securities on Spanish stock markets were those of the aircraft industry, tourism and banks. There was also a significant increase in implied volatility on equity options markets, a clear sign of the greater uncertainty generated by the attacks. As in the case of prices, the impact on volatility was weaker on Spanish markets than in the rest of the euro area, but larger than that on US markets. As from 21st September, a recovery began (by 16th October stock market indices stood at around their pre-attack levels), while implied volatilities fell (albeit remaining above their 10th September levels).

Movements on *bond markets* were in line with the rest of the euro area. The yield on medium-term government debt, as in the case of US Treasury debt, fell significantly, in all probability reflecting both a worsening of expectations for economic growth in the medium term, and a downward revision in the expected key interest rates for the coming months. At the longer maturities, unlike the case with US debt, there was a slight rise in yields in the euro area between the 11th and 21st of September. However, long-term rates tended to fall thereafter, and by 16th October they were standing below their pre-attack levels. Implied volatilities on bond options markets rose slightly to 21st September and were subsequently corrected. For their part, spreads over swap rates for private debt yields on the AIAF market widened following the attacks, reaching levels that have since remained steady. However, the movements of private bond prices on Spanish markets and in the rest of the euro area were smaller than those seen in the United States.

On the euro area *money markets*, as in the case of the US markets, there was a tightening of overnight rates following the attacks, as a consequence of the temporary liquidity shortages in certain European credit institutions. However, after the operations carried out by the Eurosystem over the next few days, the EONIA rate fell back to around the main refinancing operations rate. At longer maturities, the downward trend in interest rates seen since the beginning of the year intensified, reflecting the downward revision in key central bank rates expected for the coming months and the 50-basis-point cut in actual rates agreed on 17th September. As on other markets, the implied volatilities of 3-month interest rates also rose to 21st September, subsequently tending to return to their pre-attack levels.

Main financial indicators

%

	DEC 00	JUN 01	31.08.2001	10.09.01	12.09.01	21.09.01	16.10.01
MONEY MARKETS:							
Euro area							
Minimum rate on MROs	4.75	4.50	4.50	4.25	4.25	3.75	3.75
EONIA	5.16	4.72	4.38	4.28	4.42	3.12	3.91
Implied volatility of 3-month EURIBOR	11.37	13.57	7.65	15.04	21.64	24.00	18.04
United States							
Federal funds rate	6.50	3.75	3.50	3.50	3.50	3.00	2.50
Overnight euro deposits	7.05	4.21	3.71	3.54	6.00	2.16	2.51
Implied volatility of 3-month euro deposits	9.60	14.24	13.01	23.22	—	37.62	31.33
BOND MARKETS:							
Spain							
IRR on 10-year government bonds	5.15	5.45	5.06	5.09	5.12	5.15	4.93
AIAF 10-year private bond spread (a)	0.43	0.58	0.53	0.51	0.52	0.53	0.62
Euro area							
IRR on 10-year German bunds	4.86	5.09	4.77	4.81	4.81	4.86	4.66
10-year private bond spread (a)	0.83	0.72	0.72	0.70	0.69	0.80	0.81
Implied volatility on 10-year German bunds	4.65	4.30	4.41	4.73	5.10	5.14	4.64
United States							
IRR on 10-year US Treasury bonds	5.17	5.45	4.87	4.81	—	4.75	4.66
10-year private bond spread (a)	0.79	0.38	0.53	0.57	—	0.84	0.85
Implied volatility on 10-year US Treasury bonds	6.75	6.62	6.72	7.01	—	7.70	7.46
EQUITY MARKETS:							
Spain							
Change in IBEX 35 since 31.12.00	—	-2.54	-8.66	-15.71	-19.46	-28.67	-16.09
Change in IBEX 35 since 10.09.01	—	—	—	—	-4.45	-15.37	-0.46
Implied volatility of IBEX 35	27.56	19.72	24.94	29.84	37.05	45.73	34.54
Euro area							
Change in DJ Euro Stoxx since 31.12.00	—	-10.42	-19.65	-25.82	-30.01	-38.66	-27.03
Change in DJ Euro Stoxx since 10.09.01	—	—	—	—	-5.65	-17.31	-1.63
Implied volatility of DJ Euro Stoxx 50	24.09	20.59	25.27	33.98	43.53	51.88	37.76
United States							
Change in S&P 500 since 31.12.00	—	-7.26	-14.14	-17.25	-17.25	-26.85	-16.87
Change in S&P 500 since 10.09.01	—	—	—	—	0.00	-11.60	0.46
Implied volatility of S&P 500	23.63	18.41	21.73	24.80	—	34.79	27.13

Sources: Bloomberg, Reuters and Banco de España.

(a) Spread over swap rates.

TABLE 6

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

% GDP

	1998	1999	2000	2000 Q4	2001 Q1	2001 Q2
HOUSEHOLDS AND NPIs:						
Financial transactions (assets)	**9.9**	**9.8**	**8.6**	**1.6**	**2.6**	**2.6**
Cash and cash equivalents	3.3	4.4	0.8	-0.6	0.7	0.5
Other deposits and fixed-income securities (b)	-1.7	2.6	6.2	1.2	1.5	0.9
Shares and other equity	5.0	-1.6	-2.9	0.0	-0.1	0.1
Other	3.4	4.4	4.5	1.0	0.6	1.1
Financial transactions (liabilities)	**6.6**	**7.7**	**8.0**	**1.8**	**1.4**	**1.9**
Credit from resident credit institutions	5.9	6.4	6.8	2.0	0.9	1.5
Other	0.7	1.3	1.2	-0.1	0.5	0.4
NON-FINANCIAL CORPORATIONS:						
Financial transactions (assets)	**14.1**	**17.9**	**27.2**	**6.7**	**3.0**	**5.5**
Cash and cash equivalents	1.5	0.7	0.8	-0.2	-0.1	0.6
Other deposits and fixed-income securities (b)	0.3	-0.1	0.8	-0.6	0.9	-0.2
Shares and other equity	3.1	8.3	13.9	4.9	0.8	1.4
Other	9.2	9.1	11.6	2.5	1.5	3.8
Financial transactions (liabilities)	**15.4**	**20.6**	**31.0**	**6.8**	**4.3**	**6.8**
Credit from resident credit institutions	4.6	4.8	6.6	1.1	0.7	1.9
Foreign loans, fixed-income securities and securitisation funds (b)	1.8	4.0	3.8	0.3	1.4	0.9
Other	9.0	11.8	20.5	5.4	2.2	4.0
MEMORANDUM ITEM: YEAR-ON-YEAR GROWTH RATES (%):						
Liquid financial assets	**3.7**	**1.4**		**2.6**	**4.4**	**6.1**
Households and NPIs	3.9	0.7		1.2	4.2	5.7
Non-financial corporations	3.2	5.6		10.3	5.6	8.2
Financing (c)	**16.7**	**19.4**		**18.8**	**17.2**	**16.4**
Households and NPIs	19.3	19.6		17.3	15.5	15.0
Non-financial corporations	14.7	19.3		19.9	18.5	17.5

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.

ened the upward trend of debt in relation to the portfolio of financial assets, so that households continued to increase their degree of exposure to the risks associated with the future path of the price of financial and real assets. The debt of this sector, approximated by the sum of bank credit and the financing intermediated by securitisation funds represented, as at the end of 2001 Q2, 49% of GDP and 46% of the most liquid assets. In terms of a broader financial assets aggregate (including the equity portfolio and all the shares in mutual funds) the deterioration was somewhat stronger.

5.3. Financial flows of non-financial corporations

The net balance of the financial transactions of non-financial corporations deteriorated further in Q2, to stand at –1.1% of GDP. As a result, the financial saving of this sector reached –4.4% of GDP, in cumulative four-quarter terms, as against –3.7% in 2000. This deterioration is attributable to the fact that, in recent quarters, investment in financial assets has slowed by more than has the acquisition of liabilities, following the strong increases in both, in

1999 and 2000, linked to Spanish firms' investment abroad. The larger relative slowdown of investment in financial assets indicates that the gap between gross capital formation and gross saving has tended to widen. This is probably attributable to a deterioration in the funds generated by firms, given the slackness of gross capital formation.

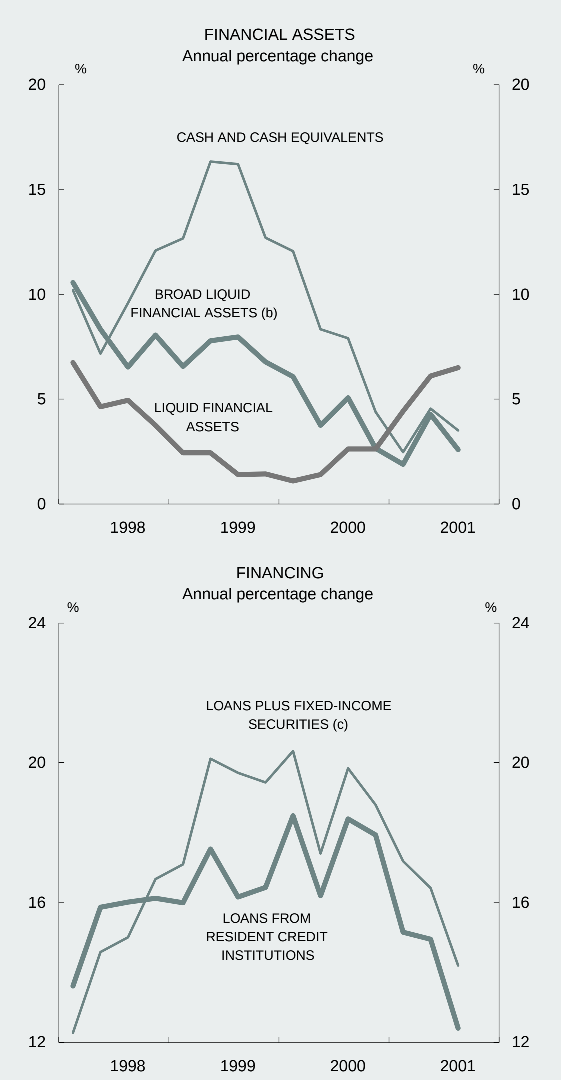
A study of the components shows that non-financial corporations also displayed a certain preference for more liquid and less risky financial assets (see Table 6). Cash and cash equivalents received a net investment inflow of 0.6% of GDP in this quarter, while, during the whole of 2000, this inflow was 0.8% of GDP. Net investment in shares and other equity also reached a significant volume, 1.4% of GDP, which was mainly directed at external investments of a permanent nature, according to balance of payments information. There was also a flow of funds to the subsidiaries of Spanish firms located abroad. This is tending to become a relatively permanent flow associated with the acquisition of businesses, arising from the normal shifts of funds between firms belonging to the same group. This indicates that, despite the uncertainty surrounding the international economic environment, the process of internationalisation of Spanish corporations has shown some continuity. That said, these figures are well below the extraordinary levels reached in 1999 and, especially, in 2000.

On the liabilities side, the slowdown in external financing, excluding the issuance of shares and other equity and credit from suppliers, that began in Q1 continued. The year-on-year growth of this variable fell to 17.5% in 2001 Q2, from 19.9% at end-2000 (see Table 6). However, this slowdown was not evenly distributed across the components, since the contribution of the flow of financing from abroad to the coverage of the financial requirements of the sector continued to increase. At the same time, the funds raised through the issuance of shares and other equity were higher in Q2 than in Q1, so that borrowed funds, excluding credit from suppliers, were close to the 1999 level in Q2, although below the 2000 level.

The information relating to the distribution by productive sector of the loans granted by resident credit institutions (banks, savings banks, credit co-operative banks and specialised credit institutions) indicates that financing to the services sector showed clear signs of deceleration in Q2, its year-on-year rate falling to 14%, from 20% in 2000. Loans to construction followed a similar path, their growth rate falling to 12.7%, from almost 21% in 2000. The contribution of these two sectors explains the greater part of the slowdown seen in the growth of financing to productive activities.

CHART 24

Non-financial corporations, households and NPIs (a)



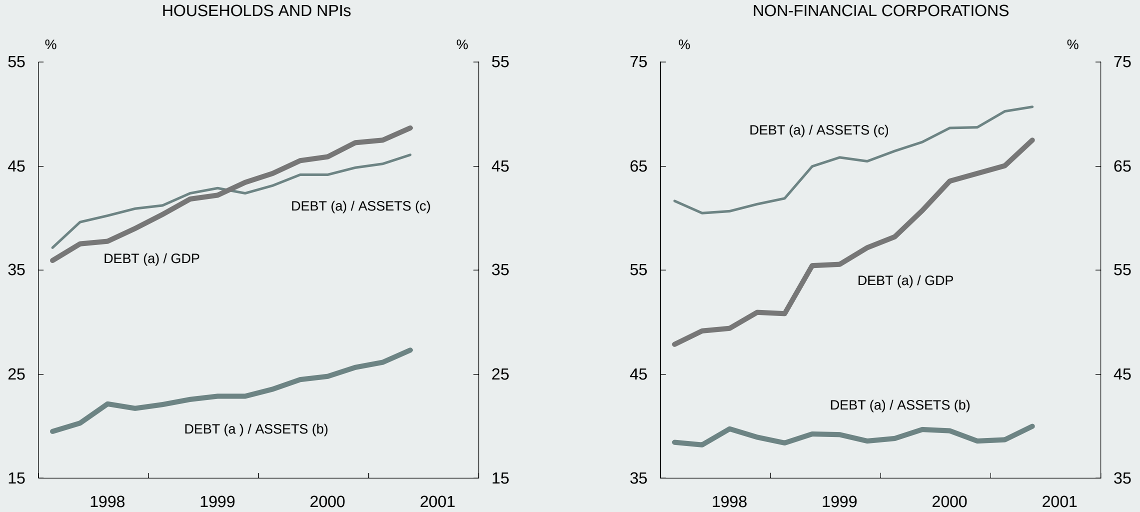
Source: Banco de España.
(a) The data for 2001 Q3 are provisional.
(b) Defined as liquid financial assets plus mutual funds other than money market and fixed-income securities funds.
(c) Including loans from resident and non-resident credit institutions, securities issuance and financing through securitisation funds.

The data available on the financing of non-financial corporations in 2001 Q3 indicates that financing from resident institutions continued to slow, although that from securitisation funds and foreign loans sustained high rates of growth.

The growth of the financing received by this sector continued to push up its debt ratios. The debt-to-GDP ratio stood close to 68 % (see Chart 25), very similar to the average level in

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) Financial assets (excluding other).
(c) Financial assets (excluding other) other than shares and other equity (not including money market funds).

the four largest euro area countries at end-2000 (see Box 6). The increase in the last quarter in the ratio of debt to the value of the portfolio of financial assets, which includes shares and other equity, is particularly significant. This was a result of both the increase in the financing of the sector and of the corrections in the prices of equity assets.

5.4. General government financial flows

The net balance of the financial transactions of general government was practically nil in 2001 Q2 (see Chart 27), although, in cumulative four-quarter terms, it deteriorated to –0.6% of GDP.

General government issued net long-term debt of EUR 7.5 billion in 2001 Q2, following the significant volume of redemptions in the previous quarter. The funds raised via this channel were used to make a large net repayment of short-term securities (EUR 4.3 billion) and to increase the balance of deposits held with the Banco de España and with deposit money institutions. The bonds issued were acquired mainly by financial institutions and, to a lesser extent, by non-resident investors. The greater need for collateral to obtain liquid funds in Treasury liquidity tenders could explain the increase in financial institutions' holdings of government securities in Q2.

Provisional Q3 data point to continuity in the net issuance of long-term securities and in the redemption of Treasury bills. Also, there was a reduction in the deposits held with the Banco de España and with other credit institutions. Consequently, the *financial requirements*, an indicator that reflects the recourse of general government to the financial markets and amounts to an approximation of sector saving (2), increased again in Q3.

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

The balance of the financial transactions of the nation in 2001 Q2 stood at –0.4% of GDP, implying lower financial requirements than in previous quarters. The cumulative figure for the last four quarters, which gives a better indication of the trend in this variable, stood at –2.2% of GDP, as mentioned at the beginning of this chapter. The acquisition of external assets and the accumulation of liabilities held at moderate rates during Q2, below those reached in the previous two years (see Table 7).

Investment in foreign assets was directed in this quarter in particular at fixed-income securi-

(2) The discrepancy between the indicator of financial requirements and the net financial transactions of general government is mainly due to the different time allocation of interest in these two variables.

BOX 6

Recent developments in the financing of the sector non-financial corporations in the euro area

Within the framework of economic and monetary union it is particularly important to identify those factors that give rise to differences between countries in the transmission mechanism of the single monetary policy. Along with the differences in the working of factor and product markets, the economic literature has assigned a prominent role to the financial structure of the economy and the patterns of saving and borrowing of economic agents in explaining the magnitude and speed of the impact of monetary impulses. In particular, an essential element of the transmission mechanism is the connection between monetary policy measures and the financial conditions that affect the development of corporate activity. Thus, factors such as the degree of bank intermediation, the level of use of alternative sources of financing (the securities market, business credit and foreign financing), the term structure of corporate liabilities and the degree of use of floating-rate instruments have an undoubted influence on the response of business investment to changes in the monetary policy stance.

International comparisons of the structure of corporate financing are hampered, even when limited to euro area countries, by the lack of standardisation of accounting regulations across countries. One way of trying to avoid this problem is to use, as a statistical base, information from national financial accounts for euro area non-financial corporations. When the composition of corporate liabilities (measured at market prices) is analysed, over the period 1996-2000, it can be seen that both in the individual countries and in the area as a whole, developments in the balance sheet at market prices were dominated, until early 2000, by the sharp rise in stock markets. In fact, the behaviour of prices can be said to have been the main determinant of changes in the debt-to-capital ratio over the period in question. This has increased the weight of own funds in total liabilities, relative to other sources of financing, a trend that was only interrupted in 2000.

Financing of the sector non-financial corporations

CHART 1. FINANCING TRANSACTIONS OF THE SECTOR NON-FINANCIAL CORPORATIONS (a)
(Averages 1996-2000)

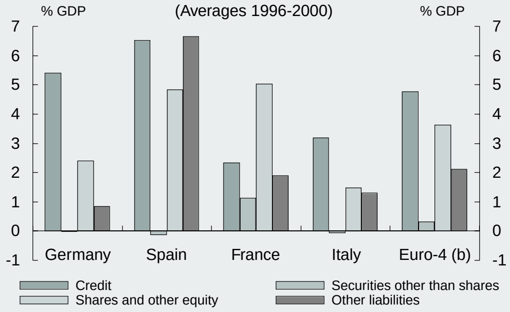
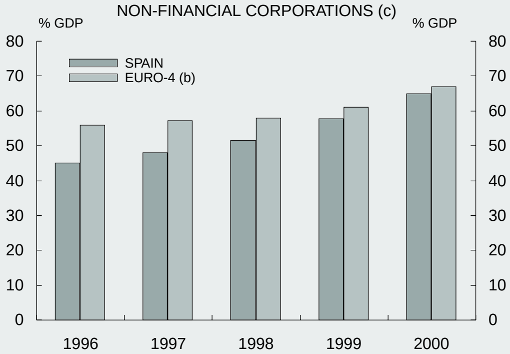


CHART 2. DEBT OF THE SECTOR NON-FINANCIAL CORPORATIONS (c)



Sources: National central banks.

(a) Unconsolidated data: net borrowing (+), net repayments (-).

(b) Average for the four countries analysed.

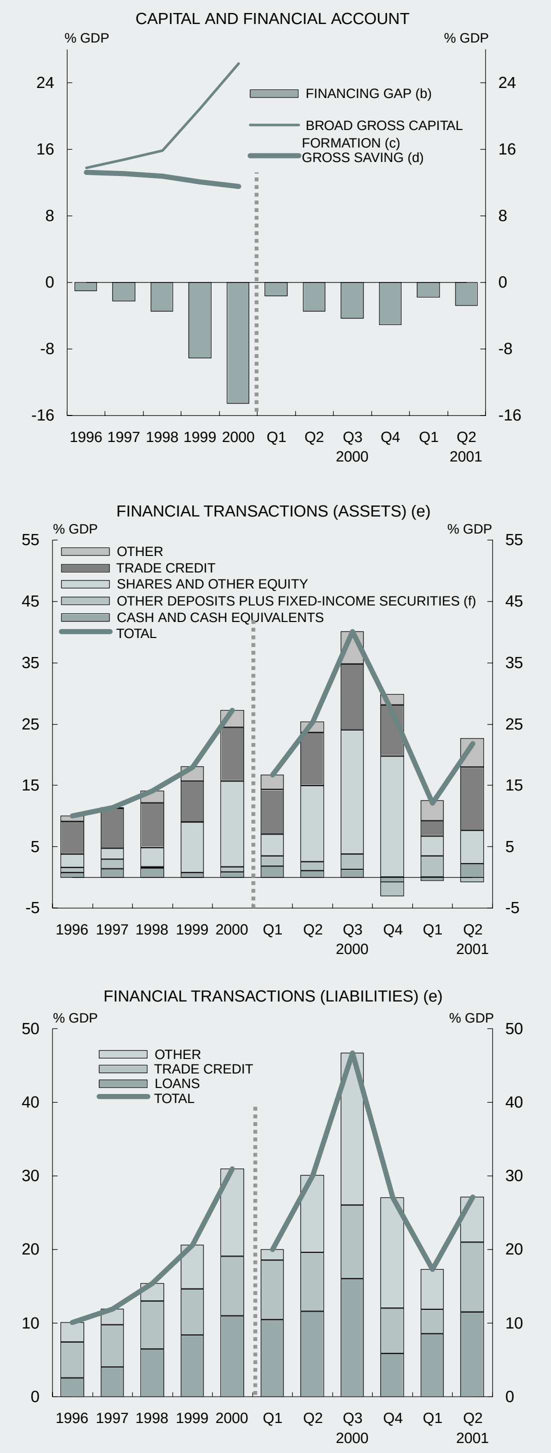
(c) Credit and securities other than shares.

Given that the effects of valuing shares and bonds can make it difficult to assess the relative size of new financing transactions, it is better to present information on net transactions (using the value of the transaction as the valuation criterion). For this purpose, Chart 1 shows the average, over the period 1996 to 2000, of the net external financing transactions of the sector non-financial corporations for the four largest countries in the euro area. First, it can be seen that, on average in the countries analysed, the change in credit accounted for about half of all flows of external financing in the period considered. At the other extreme, the issuance of fixed-income securities played a marginal role as a source of corporate finance. Second, this chart shows notable differences across countries in patterns of corporate financing. France is the country whose pattern departs most from the euro area norm. It is the only country in which flows of financing from the capital markets exceed flows of lending and in which there was a significant net issuance of securities other than shares. Credit finance predominated in Italy and Germany, especially in the latter country, where this form of finance accounted for around two-thirds of total net financial flows. Finally, Spain, apart from having a relatively large volume of financing transactions with suppliers, is the country with the largest volume of new financing transactions. In Chart 2, which shows total financial liabilities, excluding shares and other equity and intercompany financing, for the corporate sector in Spain and on average in the four countries analysed, it can be seen that the weight of corporate borrowing has risen more sharply in Spain. While in Spain the weight of corporate borrowing (as a percentage of GDP) rose from 45.1% in 1996 to 64.9% in 2000, on average in the four largest euro area countries it rose from 56% to 66.9% over the same period. Accordingly, despite its marked increase in recent years, the aggregate debt ratio of the sector non-financial corporations is still somewhat lower in Spain than in the main euro area countries.

The evidence presented in this box illustrates the existence in the recent past of significant discrepancies between euro area countries in terms of flows of corporate finance. These discrepancies reflect differences in certain institutional aspects of these economies. The economic literature has considered a wide range of factors that determine the structure of corporate liabilities: tax considerations, competition law, capital market regulations, the type of relationship between banks and firms, the composition of assets, cyclical factors, etc. There is an undeniable trend towards convergence in relation to some of these aspects, but the persistence of discrepancies in factors such as tax systems and legal mechanisms to protect the various kinds of creditors would suggest that significant differences in patterns of corporate financing will continue to exist in the near future.

CHART 26

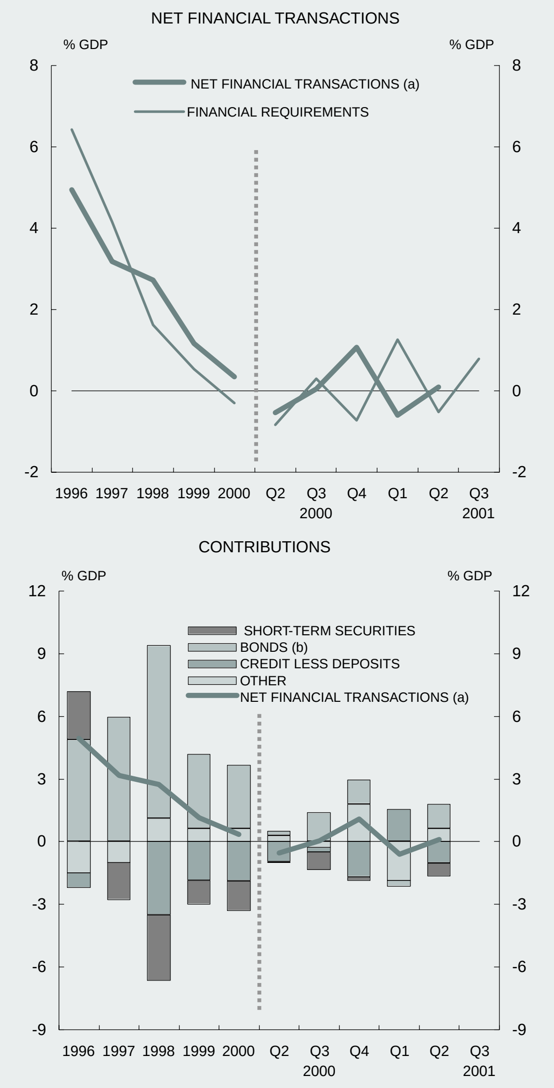
Non-financial corporations (a)



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

CHART 27

General government



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

ties, which were acquired by both credit institutions and by the rest of the private sector. Meanwhile, there was a relatively significant flow of investment in *shares and other equity* by the non-credit private sector (1.3% of GDP), although it was smaller than the average 1999 and 2000 flows, when there were large operations relating to the international expansion of Spanish corporations. Financial institutions, by contrast, made a net disinvestment in this kind of asset, although it should be borne in mind that a significant part of the foreign investment of this sector is made through holding companies that are included in the sector non-financial corporations. According to balance of payments

TABLE 7

Financial transactions of the nation (a)

% GDP

	1998	1999	2000	2000	2001	
				Q4	Q1	Q2
Net financial transactions	**0.5**	**-1.1**	**-2.6**	**-0.5**	**-0.5**	**-0.4**
Financial transactions (assets)	**12.3**	**15.0**	**24.3**	**7.9**	**4.6**	**2.4**
Gold and SDRs	**0.0**	**-0.2**	**0.0**	**0.0**	**0.0**	**0.0**
Cash and deposits	**3.2**	**1.8**	**2.8**	**0.2**	**1.8**	**-2.0**
Credit system	0.0	3.7	2.6	0.9	0.5	-1.8
Other resident sectors	3.2	-1.9	0.2	-0.7	1.3	-0.1
Securities other than shares	**3.4**	**2.8**	**3.8**	**1.4**	**1.2**	**2.6**
Credit system	-1.4	-0.9	-0.3	-0.1	0.3	1.1
Other resident sectors	4.7	3.7	4.1	1.5	0.9	1.5
Shares and other equity	**4.3**	**9.8**	**15.1**	**5.6**	**0.9**	**1.1**
Credit system	0.4	0.7	1.7	0.3	0.2	-0.2
Other resident sectors	3.9	9.0	13.3	5.3	0.7	1.3
Of which:						
Non-financial corporations	2.2	6.4	10.8	5.0	0.5	1.5
Loans	**1.4**	**0.8**	**2.6**	**0.7**	**0.7**	**0.6**
Credit system	0.2	-0.2	0.5	0.3	0.2	0.1
Other resident sectors	1.2	0.9	2.1	0.4	0.5	0.5
Financial transactions (liabilities)	**11.8**	**16.1**	**26.8**	**8.4**	**5.2**	**2.8**
Deposits	**5.9**	**4.2**	**7.3**	**2.7**	**2.9**	**-0.5**
Of which:						
Credit system	5.9	4.1	7.2	2.7	2.9	-0.5
Securities other than shares	**1.0**	**5.4**	**7.1**	**2.2**	**0.5**	**0.8**
Credit system	0.2	0.9	0.8	0.0	0.2	0.3
General government	1.0	4.3	5.8	2.1	0.1	0.3
Other resident sectors	-0.2	0.2	0.5	0.1	0.1	0.2
Shares and other equity	**2.9**	**3.9**	**8.9**	**3.5**	**0.8**	**1.6**
Credit system	0.1	0.3	1.6	0.1	0.2	0.1
Other resident sectors	2.8	3.6	7.3	3.3	0.6	1.5
Loans	**2.2**	**3.8**	**4.3**	**0.4**	**1.2**	**1.2**
General government	0.1	0.0	0.1	0.0	0.0	0.0
Other resident sectors	2.1	3.7	4.2	0.4	1.2	1.2
Other, net (b)	**-0.2**	**-1.2**	**-0.8**	**-0.3**	**-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.

data, most of the acquisition of shares and other equity corresponded to foreign direct investment. Also of some importance in Q2 was financing to investee companies located abroad (included under *loans* in Table 7), which tends to be associated with the growth of direct investment.

The volume of external liabilities accumulated was smaller than in previous quarters (2.8 % of GDP as against 5.2 % in Q1), largely owing to the reduction in the external liabilities of the credit system. Thus, financial institutions did not raise funds abroad in net terms, rather they made a net repayment during this quarter, which meant a break in the pattern of recent years (see Table 7). In the case of general government, financing through the acquisition by non-residents of fixed-income securities was also more moderate than it had been in the previous two years. By contrast, other resident

TABLE 8

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

% GDP

	1996	1997	1998	1999	2000	2001 (b)
Total economy	**-19.7**	**-20.6**	**-21.4**	**-22.8**	**-22.2**	**-22.3**
Non-financial corporations and households and NPIs	**-13.3**	**-10.8**	**-8.6**	**-9.3**	**-2.6**	**-1.6**
Non-financial corporations	-18.3	-17.1	-14.8	-16.9	-10.4	-9.3
Households and NPIs	5.0	6.3	6.2	7.7	7.9	7.7
Financial institutions	**8.8**	**7.2**	**5.1**	**7.0**	**5.2**	**4.0**
Credit institutions (c)	6.7	2.4	-5.4	-7.5	-12.5	-14.7
Institutional investors (d)	2.2	4.9	10.9	15.1	18.5	20.0
Other financial institutions	-0.1	-0.1	-0.4	-0.6	-0.8	-1.3
General government	**-15.3**	**-17.0**	**-17.9**	**-20.5**	**-24.8**	**-24.7**

Source: Banco de España.
(a) Calculated as the difference between the stock of financial assets and liabilities vis-à-vis the rest of the world according to quarterly financial accounts data.
(b) Q2 data.
(c) Defined according to the First Banking Directive.
(d) Insurance corporations and collective investment undertakings.

sectors, basically non-financial corporations, received significant net financing from abroad, essentially in the form of shares and other equity (1.5% of GDP) and loans (1.2% of GDP). A significant part of this financing corresponds to intercompany loans and the taking of holdings in Spanish firms.

As regards Q3, information is only available on the balance of payments for July, which indicates some continuity with the patterns observed in the previous quarter. The flows of direct investment were large in both directions and non-financial corporations continued to borrow from abroad through short and long-term intercompany and other loans.

As a result of these transactions and of the path of the exchange rate and of asset prices, the net external debit position of the national economy remained relatively steady, at slightly above 22% of GDP (see Table 8). The non-financial private sector improved its external position, owing to the change in the net financial assets of non-financial corporations, from –10.4% of GDP to –9.3% of GDP. Likewise, institutional investors continued to increase their net external assets. Credit institutions, by contrast, saw their position deteriorate, while the net debit position of general government vis-à-vis the rest of the world held steady.

24.10.2001.