# Quarterly report on the Spanish economy

## 1. Overview

It is estimated that Spanish real GDP posted a year-on-year growth rate of 3.8 % during the fourth quarter of 1999, slightly up on the provisional QNA figure for the preceding quarter (1). The indicators available for the final months of the year show that national demand held on a moderately decelerating path, which was checked by a less negative contribution of net external demand to the increase in GDP. This was because the real rate of increase of exports rose, underpinned by the pick-up on international markets, and imports held at a sustained level, similar to that of the previous quarters. Economic activity in the euro area is clearly assisting the recovery on world markets, as can be seen in its real GDP growth in the third quarter, running at 2.3 % year-on-year.

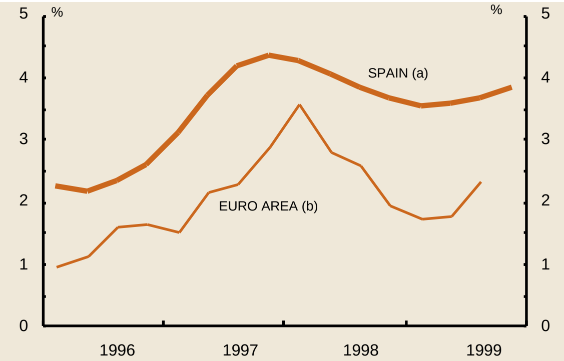
If confirmed, the figures estimated for the fourth quarter imply that the real rate of change of Spanish GDP was around 3.7 % on average in 1999, higher than forecast at the beginning of the year and only three-tenths of a percentage point down on 1998. The gap in relation to growth in the euro area as a whole remains considerable, although it is tending to narrow (see Chart 1). The contribution of national demand to the increase in Spanish GDP in 1999 was notable and extensive to most of its components. It is possible that its real rate of growth will not differ significantly from that recorded in 1998. The contribution of real external demand, however, was somewhat more negative, at around 1.3 percentage points. This was three-tenths of a point more than the previous year, in absolute terms, which explains the differences in the growth of real output between both years. The growth of employment in terms of equivalent jobs, in keeping with the QNA estimate, was notable for the third year running. The related rate was approximately 3.3 %, slightly lower than the previous year.

However, and as indicated, the pattern of behaviour discernible from the results for the year in average terms masks changes during the course of 1999, as the high, real growth rate of national demand tended to moderate and exports came more to the fore, bringing in tow industrial activity, which had been depressed at the start of the year. This pattern exhibits certain distinguishing features compared with developments in most of the euro-area economies. External demand is the factor driving recovery in the area whereas domestic demand, especially in Germany and Italy, is more muted but is now beginning to show the first signs of overcoming its past sluggishness. It

(1) Unless otherwise indicated, the year-on-year rates mentioned are calculated on the basis of QNA trend-cycle series.

CHART 1

**Gross domestic product**




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

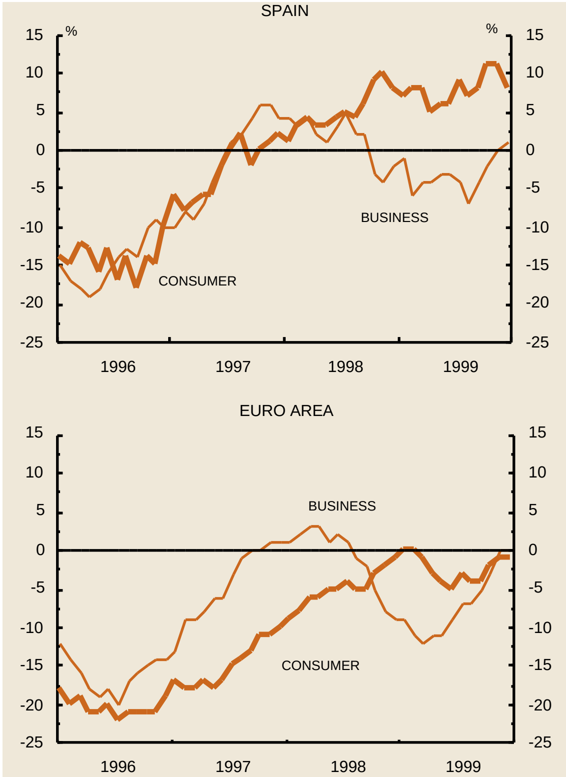
thus seems that the cyclical differences recorded in recent years, as a result of the resilience of Spanish national demand and also perhaps the lesser impact of the international crisis on our exports, are beginning to lessen, although domestic demand in Spain continues to play a considerably more prominent role.

Clearly, then, the firming of the favourable external environment is contributing decisively to recovery in the euro area and to its effects being felt also in the Spanish economy. The continuing strength of the US economy and a rapid recovery in the south-east Asian zone are the key underpinnings of the expansion of the world economy, and are seconded by a more incipient and hesitant improvement in Japan and in the Latin-American economies. Ongoing oil price rises on international markets are, however, an increasingly patent factor of risk. Far from turning down, as expected, the intensity of these rises appears to have gained in vigour at the start of the current year and their effects are, against the aforementioned background of growth in world activity, feeding through to other price indicators.

The harmonised index of consumer prices (HICP) for the euro-area countries rose in the second half of the year as a result of the ongoing acceleration in its energy component (set against the depreciation of the euro exchange rate) and the rise in the prices of certain unprocessed foods. The 12-month growth rate of the HICP last December was 1.7 %, almost one percentage point up on that recorded at the start of 1999 (see Chart 3). This bleaker outlook for future price developments and their possible influence on wage behaviour, the confirmation of greater buoyancy in the area (although certain doubts will linger until the recovery in domestic demand becomes widespread) and the persistence of generous monetary conditions all led the European Central Bank (ECB) to tighten its relaxed monetary policy stance.

CHART 2

**Confidence indicators**




Source: European Commission.

On 4th November, the Governing Council announced a rise of 50 basis points in the rate on the Eurosystem's main refinancing operations to 3 %. During the fourth quarter, the course of money market interest rates was marked, first, by this decision by the Eurosystem and, second, by the uncertainty surrounding the transition to the year 2000. The longer-dated rates responded to the aforementioned changes in domestic economic conditions and to the knock-on effects of the US bond market. The growth of the monetary and credit aggregates remained high, in step with the relatively low levels of interest rates and the brighter growth prospects for the area.

In this situation, the monetary and financial conditions of the Spanish economy continued to exert an expansionary affect during the fourth quarter of 1999. Although the interest rates applied by credit institutions to their customers began to rise mid-year, the increases were modest and, overall, interest rates continued to encourage debt as opposed to saving (see Chart 4). Indeed, it is estimated that lending to households and non-financial firms increased by 17 % in the fourth quarter of the year, entailing a slight deceleration in relation to the preceding quarters. Meantime, liquid financial instruments continued to increase at a more moderate rate.

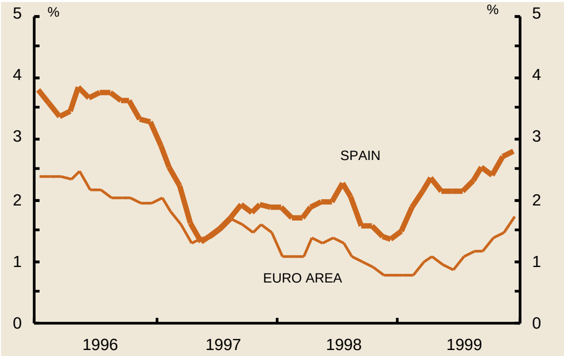
Turning to the public sector, the State accounts in the closing months of the year continued to move closer to the initial moderate path envisaged. The year closed with a cash-basis deficit of ESP 1057 billion, 5.1 % less than in 1998, with both revenue and expenditure posting growth rates higher than initially forecast. The contribution of general government to household income in 1999 was notable, owing to the effect of the personal income tax reform and, to a lesser extent, the favourable behaviour of social benefits.

Against this backdrop of recovery on external markets, employment growth and generous monetary conditions, with real interest rates encouraging expenditure, economic agents' decisions contributed to the Spanish economy maintaining a sustained growth rate in 1999, as reflected in the foregoing paragraphs. The resilience of consumer spending, the real annual average increase in which might even exceed that of 1998, was underpinned by the growth of disposable income, low real interest rates and the increase in wealth, with a moderate decline in the saving ratio being posted. As the year unfolded, purchases of certain durable goods tended to dip, following four years of notable buoyancy in the case of cars. The above-mentioned factors also help explain the increase in private residential investment, whereby household lending capacity fell considerably and household debt increased. Indeed, the quarterly-financial-accounts estimate of net household financial saving for the third quarter of the year places this variable below 2 % of GDP, and it is not expected to increase in the fourth quarter. This level is lower than the trough it reached in the second half of the eighties, which is indicative of the loose financial conditions prevailing and the favourable prospects harboured by households (see Chart 2) in the setting of employment growth and a diminishing unemployment rate.

The slowdown in investment in construction during the first three quarters of 1999, which ran into the fourth quarter, is mainly linked to the behaviour of public works; notwithstanding,

CHART 3

**Harmonised indices of consumer prices**




Sources: Eurostat and European Central Bank.

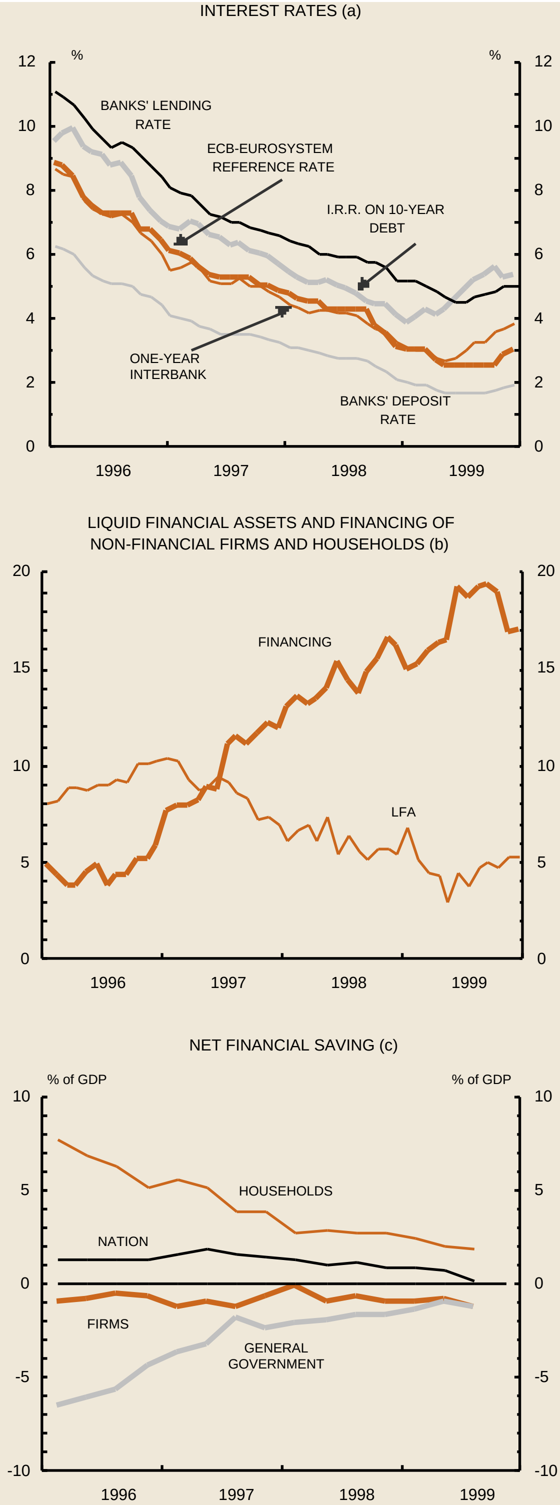
its annual average growth will far exceed that recorded in 1998. As to capital investment, the indicators available show that it will have ended the year with considerable strength, although its growth rate is tending to moderate. This latter feature is, as stated, common to most of the national demand indicators. The sound situation companies are enjoying (with high rates of return on assets and borrowing costs that are still falling as a result of the influence of earlier interest rate cuts) and the need to improve the efficiency of the productive system so it may hold up in an increasingly more competitive environment are among the reasons behind the persistence of this investment cycle. Unlike with households, this has not entailed a significant decline in companies' net financial saving.

As earlier stated, the growth of employment during the year has remained firm, and its slowing trend appears to have eased in recent months. The estimated increase for apparent labour productivity is once again abnormally low, for the second year running. But it has picked up slightly and is expected to continue doing so in the coming quarters. The slight moderation seen in unit labour costs is therefore not due to productivity gains but to wage moderation. Employee compensation is estimated to have increased by around 2.5 % on average during the year.

The 12-month growth rate of the consumer price index (CPI) stood at 2.9 % at the end of the year (2.8 % in terms of the harmonised index). This was essentially due to the increase in the price of oil products, and in that of certain foodstuffs, against a backdrop of persistently buoyant domestic demand and abundant financing of expenditure. The growth rate of other components, such as services and non-ener-

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 and non-resident credit institutions and fixed-income securities.

(c) Cumulative four-quarter data.

gy industrial goods, fell during the year, although less than expected. The gap between the growth of the Spanish harmonised index (HICP) and that of the euro-area countries, which had reached 1.3 points in September, stood at year-end at one point. The widening of the gap has been particularly marked in food products and, to a lesser extent, in industrial goods, while it has narrowed slightly in services. The pressures exerted by energy prices have been manifest in other price indicators such as the import unit value and wholesale industrial price indices, and they have worsened once more at the onset of the current year.

The previous quarterly report highlighted the danger of these price pressures –which, in principle, should be temporary– ultimately feeding into wage bargaining and becoming permanent, impairing the economy's competitiveness in the process. At a time when international markets are expanding considerably, the Spanish economy should direct all its efforts to entrenching an export- and investment-driven growth pattern. The persistence of inflation differentials with the euro-area countries, the strong increase in the external deficit in 1999 (which, after several years, has seen the resumption of a negative current- and capital-account balance, the expression of a shortage of saving in the economy) and low productivity growth are all factors clearly pointing to where economic policy measures and decisions should be directed. In short, the expansiveness of domestic demand has to be held in line with the supply side's capacity to respond.

In this respect, the success in cutting the budget deficit in 1999 and the targets included in the updated stability programme presented by the government are a step in this direction. Setting a scenario of stable growth firmly in place will no doubt help achieve these objectives, although fiscal policy strategy should continue to be steered by fresh efforts to contain expenditure. Further headway should be made in the structural reforms aimed at liberalisation in order to enhance the possibilities of meeting greater demand without incurring price and cost deviations or seeing competitiveness eroded.

## 2. The external environment of the euro area

The economic recovery initiated in the external environment of the euro area in mid-1999 continued into the fourth quarter of the year. The strong growth rate sustained by economic activity in the United States, the resilience of domestic demand in the United Kingdom, the vigorous recovery by the south-east Asian economies and, finally, the stabilisation of financial conditions in Latin America have been conducive to the economic upturn spreading to other areas that are behind in the business cycle. Against this backdrop of higher economic growth, inflation was generally low, albeit on a rising path fuelled by the feed-through of the high growth of oil prices to producer and consumer prices and by the pressures discernible in certain labour markets.

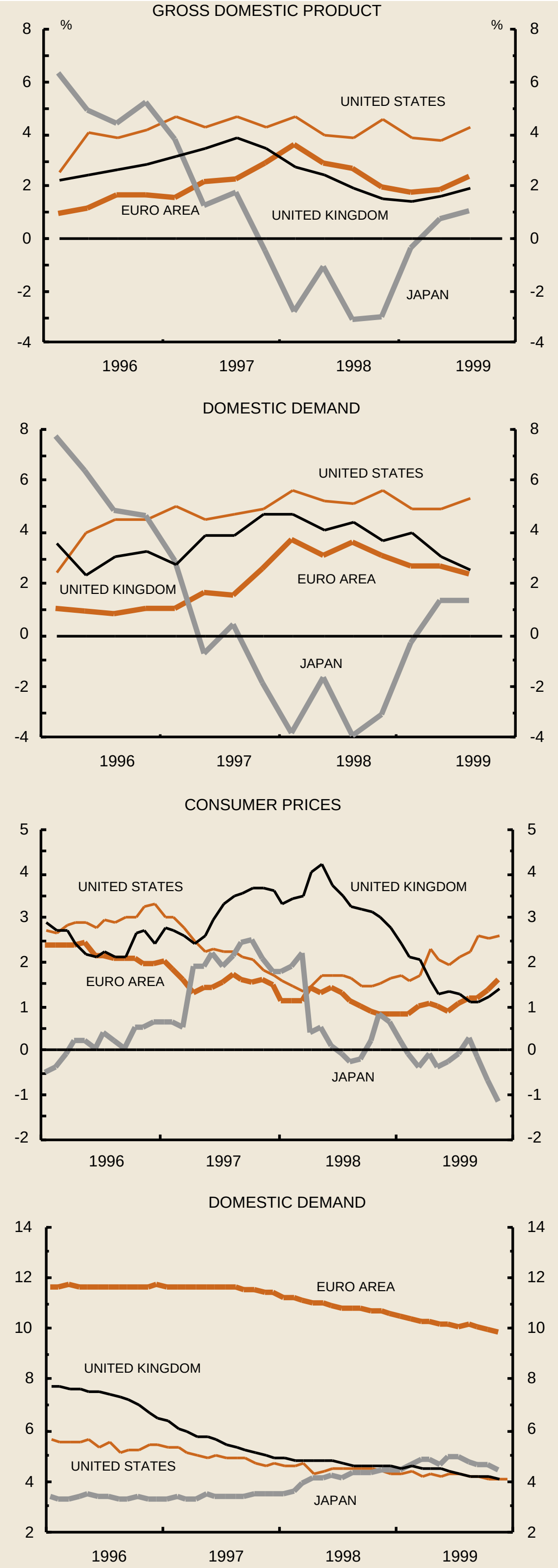
According to US national accounts data, GDP growth ran at a rate of 4.3 % year-on-year in the third quarter, slightly up on the two previous quarters. This was due both to the greater strength of all domestic demand components (see Chart 5) and to a less negative contribution of net external demand to GDP growth. The increase in world demand, against a background of the stability of the real effective exchange rate of the dollar, was propitious to the favourable trend of exports. The information available for the fourth quarter of 1999 indicates that the buoyancy of the US economy in the first half of the year continued and even heightened in the closing months (2). In this connection, mention may be made of the positive trend of consumption indicators, the rise in industrial production in the fourth quarter of the year and the strong increase in non-farm dependent employment in December.

Nonetheless, in the third quarter of 1999 the marked deterioration in the terms of trade checked the favourable course of real exports, prompting a further worsening of the trade balance in that period in relation to the preceding quarters. As a result, the trade deficit rose to $ 72.1 billion. The current-account deficit for the third quarter of 1999 stood at a record $ 89.9 billion, accounting for 3.9 % of GDP (see Chart 7). For the first three quarters of 1999, the current deficit climbed to –3.5 % of GDP, one point up on the deficit for the same period in 1998 (–2.5 %). The future correction of the US trade and current-account imbalance should be assisted as the respective growth rates of domestic demand in the United States and in the rest of the world progressively draw closer in the fourth quarter.

(2) After having closed this Bulletin, the provisional data for GDP growth in the fourth quarter were released, placing it at 5.8 % in annualised quarter-on-quarter terms and thus confirming the trends indicated.

CHART 5

**Main macroeconomic indicators**
**Percentage change on previous year**




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

Both consumer and producer prices (on information to November in the latter case) were, in contrast to the deterioration seen in the previous three quarters (see Chart 5), highly stable in the fourth quarter of 1999. The 12-month growth rate of the US CPI stood at 2.7 % in December, one-tenth of a point above the September figure, while the index excluding fresh food and energy grew 1.9 % in December, two-tenths of a point down on September. The latest information on wage costs reflected in the average hourly earnings indicator (see Box 1) points to growth of around 4 % year-on-year in October and November, showing no acceleration in relation to the opening months of the year, despite signs of labour shortages in various activities. In this respect, the unemployment rate fell further in the fourth quarter to 4.1 %. Nonetheless, strong labour productivity gains are expected to continue in the final months of the year. Such gains are easing the pressure of wage costs on prices, especially in the so-called «new technologies» sectors.

In Japan, GDP grew by 1 % year-on-year in the third quarter of 1999. Although this rate was slightly higher than that of the previous quarter (0.7 %), it continues to evidence the sluggishness of the recovery initiated in early 1999. The acceleration in activity was, above all, the outcome of a less negative contribution of net external demand derived from the high growth of exports of goods and services, as imports also gained in strength. The thrust of external demand in the third quarter of 1999 was favoured by the rapid pick-up in Asian markets last year and by the buoyancy of US imports, since the appreciation of the yen in the second half of 1999 is prompting a significant loss in the competitiveness of the Japanese economy (see Chart 7). The sluggishness of domestic demand reflects both continuing caution on the part of consumers and the financial and industrial restructuring in which Japan is immersed.

The indicators available for the fourth quarter of 1999 confirm the slow recovery in domestic demand and the thrust of the export sector. The unemployment rate has been on a moderately declining course, and deflationary pressures continue to affect prices. Indeed, in relation to a year earlier, consumer prices fell in the final quarter, with inflation standing at –1.2 % in November. Industrial prices have also continued to fall in year-on-year terms, although they have moderated in recent months.

Turning to the EU economies not currently forming part of the euro area, the pace of activity in the United Kingdom continued to improve

BOX 1

## Wage costs and productivity in the United States

The absence of inflationary pressures marking the current upturn in the United States is prompting the careful scrutiny of wage and productivity developments in the economy. Nonetheless, there is considerable confusion when it comes to assessing the course of wage costs; there are various indicators, devised with heterogeneous methodologies and differing scope, that offer information which does not always coincide. This is why it is best to list the main US wage cost indicators, pointing out their chief characteristics.

There are three basic statistical sources for labour costs in the United States: average hourly earnings (monthly), drawn from the «establishment survey» (employment report); the employment cost index (quarterly), which is published as part of the «employment cost trends programme»; and, lastly, compensation per hour (quarterly), which is included in the «productivity report». There are notable methodological differences in their content and the way they are prepared, and these are summarised below and illustrated in the adjoining table.

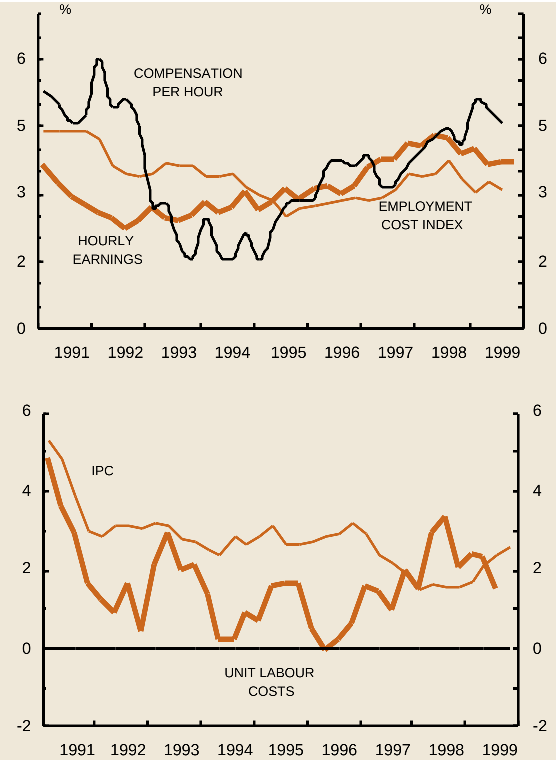
The monthly series of average hourly earnings is obtained from the monthly survey conducted by the Bureau of Labor Statistics. The series refers to non-management, non-supervisory payroll employees at non-farm private-sector companies. The measurement is in gross terms (before any deduction or withholding) and does not include payments in respect of commissions, bonuses, or any other non-wage payment unless it is regularly made. Further, it is published in levels, i.e. in the number of dollars per hour. This series covers approximately 82 % of private-sector employment and 68 % of total employment. It covers less than the other two indicators but, as it is published monthly, its advantage is that it can be taken as a leading indicator of the trend of wage pressures.

The quarterly series of the employment cost index is also obtained from a survey. It includes a series of regular payments (wages and salaries, productivity-linked commission), which account for 70 % of the index, and irregular payments (bonuses, overtime, contributions to pension schemes, private insurance and compulsory insurance), making up the remaining 30 % of the index. The population coverage of this indicator is the broadest of the three considered, since it refers both to the private sector and to the public sector: it accounts for approximately 95 % of total employment.

Compensation per hour is the overall cost incurred by employers for the work of their employees. It therefore includes wages and salaries, benefits (all sorts of paid leave, bonuses, incentive payments, employee discounts ...) and employers' contributions to employee welfare schemes (medical, life and unemployment insurance). The population covered is that of the non-farm private sector, and it is estimated drawing on the information provided by GDP from the income standpoint. The compensation per hour series has certain advantages over the other two indicators. It is based on national accounts, making it consistent with the other aggregates published within the national accounts framework, and it includes more wage items. On the other hand, it also has certain drawbacks. Its population coverage is less than that of the employment cost index, and it is published with something of a delay in relation to the other two. Dividing the prior series of compensation per hour by that of hourly productivity (obtained from the national accounts output series) gives the series of unit labour costs (ULCs).

The top chart tracks the three wage cost indicators in question in recent years. The interpretation of labour cost developments that may be inferred differs notably depending on the indicator monitored. Indeed, both the compensation per hour series and the employment cost index show a slowdown in wage costs in the first half of the nineties that is reversed from 1995 onwards. The average hourly earnings series, however, points to a gradual increase in wage costs over the same period. Further, the hourly earnings series and the employment cost index give a more favourable perspective of wage costs since end-1998 than the compensation per hour series. The lower chart depicts the change in unit labour costs and in the CPI. Productivity gains, running at a rate of close to 3 % year-on-year since 1996, had not sufficed to offset wage increases. As a result, ULCs have, as from that year, posted positive but lower rates of change than the rate of consumer-price inflation. Following a period in which the growth of unit labour costs outpaced that of inflation in 1998, the acceleration in productivity over the past year has meant that real wages have grown at lower rates than unit output, thereby easing the pressure of wages on prices.

**United States: wage costs**
**Annual percentage change**




Source: Bureau of Labor Statistics.

**Wage coverage**
**Components included in each indicator**

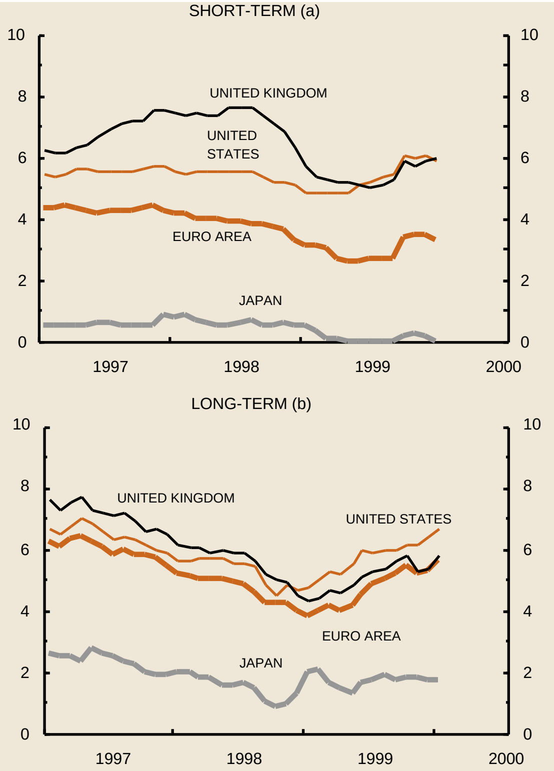
| | Average hourly earnings (a) | Employment cost index | Compensation per hour |
|---|---|---|---|
| COMPONENTS: | | | |
| Basic wage and salaries | x | x | x |
| Benefits | x | x | x |
| Overtime | x | x | x |
| Paid leave | x | x | x |
| Tips | | | x |
| Productivity payments and extra salary payments | | x | x |
| Severance payments | | x | x |
| Payments related to housing, withholdings and deferred payments | | | x |
| Stock options | | | x |
| Payments in kind | | | x |
| Contributions to pension schemes and insurance | x | x | x |
| Work disability insurance | | | x |

Source: Bureau of Labor Statistics.

(a) The monthly series of average hourly earnings may include some additional non-wage item if payment thereof is on a regular basis.

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; in 1999 and 2000, three-month EURIBOR.

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

during the second half of 1999. In the third quarter, economic growth quickened to a rate of 1.9 % year-on-year, four-tenths of a point up on the rate for the first half of 1999, owing to the less negative contribution of the external sector. The latest information appears to indicate that the favourable trend of activity has continued throughout the fourth quarter of the year. Labour market tightness is becoming increasingly evident. Indeed, the unemployment rate reached a new low of 4 % in December, whereas the year-on-year growth of employee compensation grew by 5.1 % in October, exceeding the average rate for the first nine months of the year by almost half a percentage point. However, the main consumer price indicators do not point to a significant rise in the inflation rate, although producer prices continue to rise at increasing rates.

As to the improvement in the south-east Asian economies, the data available for the third quarter of 1999 confirmed the broad recovery in the pace of economic activity. This seems to be particularly sound in economies such as South Korea, Malaysia and Singapore, where the respective year-on-year growth rates exceeded 12 %, 8 % and 6 % in this period. The average growth forecast for 1999 stands, for the area as a whole, at around 5 %, slightly above the estimates available in mid-1999.

Lastly, in the Latin American region, a large number of countries were still mired in recession during the second half of last year. As a result, 1999 will foreseeably close with a fall in the area's overall GDP. Brazil has seen a moderate recovery which, on the forecasts available, will allow growth of between 0 % and 1 % to be achieved for 1999 as a whole. Argentina, however, remains beset by a strong recession, testifying to which was the 4.1 % year-on-year decline in GDP in the third quarter of last year. Among the main economies of the area, only Mexico expanded significantly. In year-on-year terms its growth rate was 4.6 % in the third quarter of 1999, thanks to the strong knock-on effect from the US economy. Nonetheless, the relative stability of the financial markets in the second half of 1999 should be conducive to overcoming the recession beleaguering this region in 1999. Specifically, there has been a gradual reduction in long-term interest rates in the area, perceptible rises in the stock exchange indices of many of its economies and less exchange rate volatility. Lastly, it should be mentioned that the government of Ecuador, which is facing a deep-seated recession accompanied by the collapse of its currency against the dollar, has proposed substituting the dollar for its national currency against a background of great political instability.

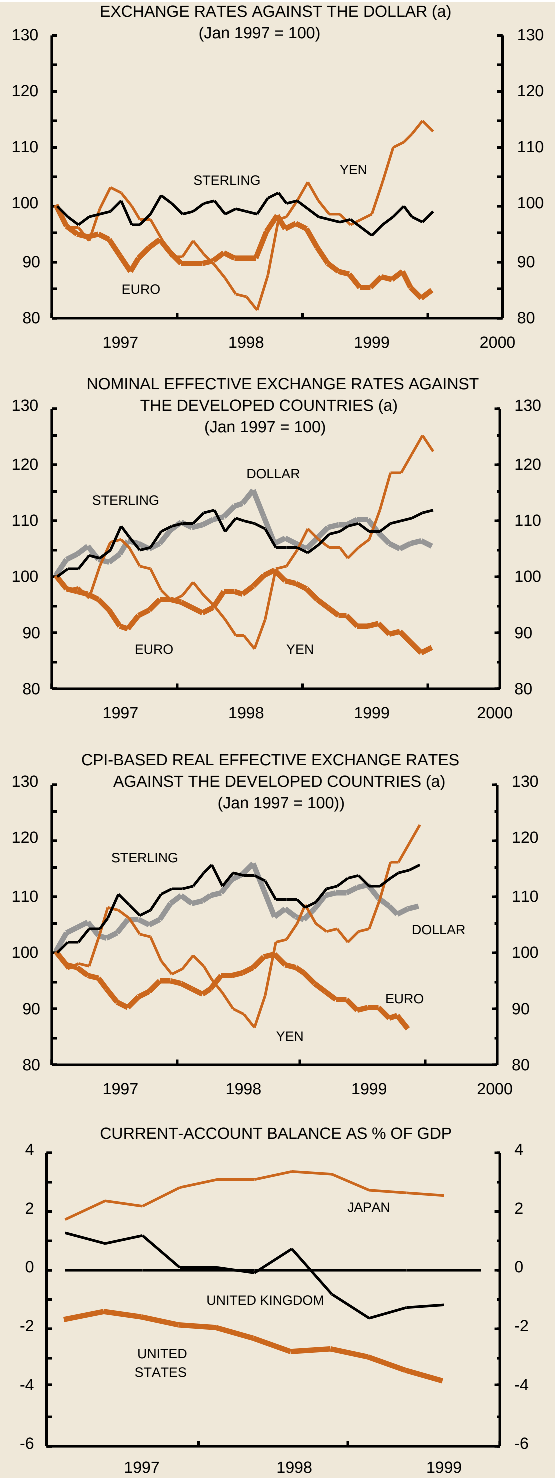
The keynote in terms of fiscal policy developments in the closing months of 1999 is the effect that the strength of US economic activity is having on the federal budget balance. Indeed, a general government financial surplus of close to 1.5 % of GDP is forecast for the year as a whole. Conversely, in Japan, recent forecasts for 1999 point to a sizeable budget deficit of around 7-8 % of GDP, accompanied by a strong increase in the level of gross public debt, which could climb to around 110-120 % of GDP. At the end of last November, the Japanese government approved a new supplementary fiscal package (which will come into force at the end of the first quarter of this year) for a total value of JPY 18 trillion, 6.8 trillion of which accounting for public spending programmes.

During the fourth quarter of 1999, there was a fresh phase of monetary policy tightening in the United States and in the United Kingdom. On 16th November the Federal Reserve decided to raise its two main reference rates by one-quarter of a point, placing the Federal funds target and discount rates at 5.5 % and 5 %, respectively. The Bank of England also raised its repo rate by one-quarter of a point on 4th November, implementing a fresh rise on 13th January 2000 and taking its main rate up to 5.75 %. The Bank of Japan has persisted with its policy of interest rates at close to zero, holding its discount rate at 0.5 % while its daily intervention rate has stood at 0.15 % since the fourth quarter of last year. On the international bond markets, the favourable conditions of the US economy and signs of latent inflationary pressures have prompted a significant rise in long-term interest rates (see Chart 6). Since the start of the final quarter of 1999, US 10-year bond yields have risen by almost half a percentage point to 6.65 % as of early January 2000. This tendency, which has also spread to the European markets, has not been seen in Japan, where 10-year government debt rates have held stable. Stock markets, for their part, have trended favourably. The New York and Tokyo stock exchange indices have posted increases for the year of close to 11 % and 7 %, respectively, in the fourth quarter of 1999, and have exhibited great stability in the opening weeks of January.

On the currency markets, the main developments in the fourth quarter were the dollar's depreciation against the yen and its appreciation against the euro. From September to December last year, the dollar depreciated 4.1 % (see Chart 7) in relation to the yen and appreciated 3.9 % against the euro. However, in the first fortnight of January, there was a turnaround in this trend with the dollar rallying against the yen and depreciating in relation to the euro. That said, this latter movement has been a temporary one since, on 20th January, the dollar/euro exchange rate stood once again very close to parity. In nominal effective terms, the dollar showed a high degree of stability against the basket of currencies of the developed countries during the fourth quarter of 1999, in notable contrast to the Japanese currency's sizeable loss of nominal and real competitiveness. Thus, while the dollar appreciated slightly by 0.2 % in the fourth quarter, the yen, on the upward path initiated at the end of the second quarter of 1999, appreciated in effective terms by 5.7 % against the developed countries over the same period. Lastly, on the request of the Greek authorities, the central parity of the drachma against the euro was revalued by 3.5 %.

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.

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

## 3.1. Economic developments

During the closing months of 1999 there was added impetus to economic activity in the euro area. The improvement in the external environment and the trend of the euro exchange rate gave renewed momentum to the area's exports. However, the recent course of inflation in the area highlights more sharply the effects of the rise in oil prices as the offsetting effect that had been exerted by the trend of other components has petered out.

On the latest Eurostat estimates (see Chart 8), GDP growth in the euro area in the third quarter of 1999 compared with the same period a year earlier stood at 2.3 %, notably up on the average rate posted in the first half of the year (1.7 %). In terms of quarter-on-quarter rates, GDP growth in the third quarter of 1999 has signified the extension of the recovery initiated in the euro area in early 1999.

The vigour of economic activity in the third quarter of 1999 (see Chart 8) was essentially due to the appreciable increase in the contribution of net exports to GDP growth. After having been negative for five quarters, this contribution has turned positive in year-on-year terms (0.1 percentage points). The contributions of private consumption and of government consumption also increased slightly, while that of gross fixed capital formation declined moderately. The negative contribution of the change in stocks, both in quarter-on-quarter and year-on-year terms, should be attributed to the lag with which production decisions may have reacted to increases in demand.

In the countries where the breakdown by component of the third-quarter national accounts results are known (Germany, France, Italy, Spain and Finland), a common component is the generalised recovery in exports, especially in relation to the second quarter of the year. Although activity has accelerated notably in Germany and Italy, these countries continue to post the most muted GDP increases (1.3 % and 1.2 %, respectively, in year-on-year terms). This is due to the limited buoyancy of domestic demand in both countries.

The indicators available on developments in the euro area in the fourth quarter of 1999 (see Chart 9) largely coincide in highlighting the ongoing recovery observed in the previous months. The industrial confidence indicator stood at year-end at a higher level than the average for the preceding ten years, with the sustained increase in both overall and foreign orders particularly prominent. With data to October, industrial production in the area reflects a mild acceleration in response (perhaps somewhat lagged) to the increase in orders. Regarding the consumption indicators, both the consumer confidence indicator (which stood in the closing months of 1999 at practically the same level as the historical high attained in the first quarter) and the retail sales indicator trended favourably in October.

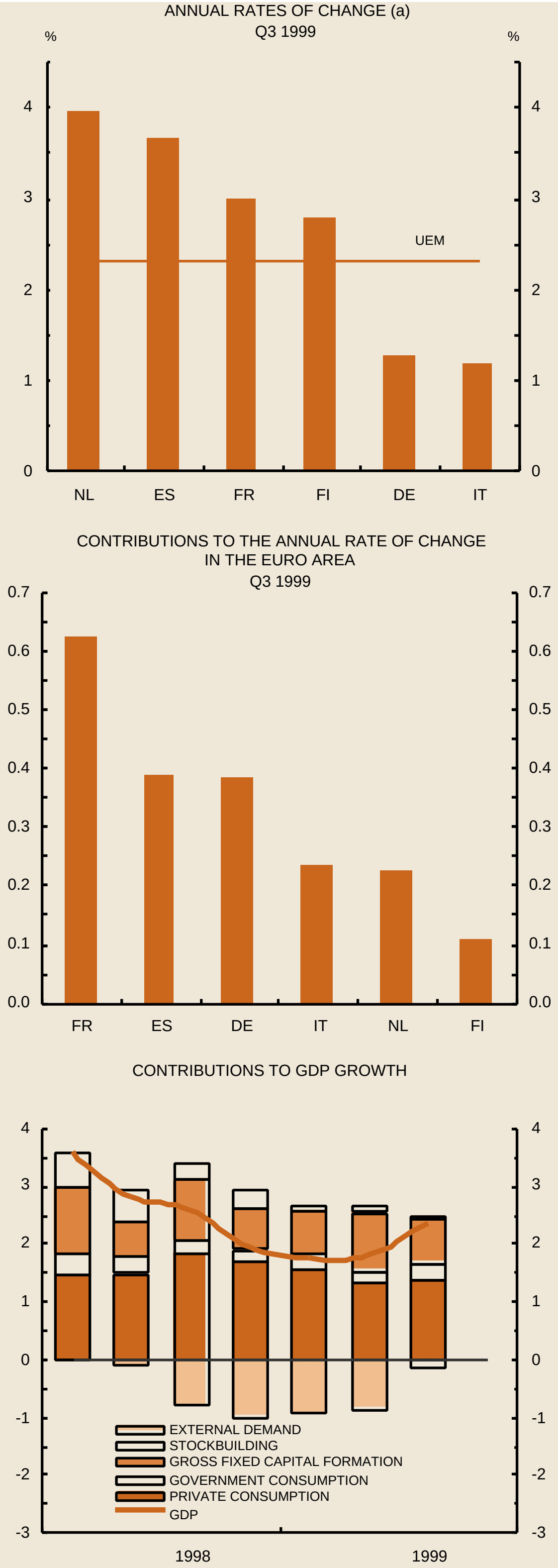
Turning to the labour market, the pace of employment creation is not yet reflecting the greater momentum of economic activity during 1999. In year-on-year terms, employment growth ran at 1.4 % in the third quarter, one-tenth of a point down on the previous quarter and two-tenths lower than in the first three months of the year. This has resulted in a significant pick-up in apparent labour productivity in the third quarter of 1999, after it had reached growth rates close to zero in the preceding quarters. Nonetheless, the unemployment rate has continued to fall moderately, standing at 9.8 % of the labour force in November. Wage costs, measured by the labour costs index, have quickened gradually since mid-1998, as reflected in the 2.2 % growth in this index in the third quarter of 1999 compared with the same period a year earlier. This figure is two-tenths of a point above the increase in the first half of last year.

In October 1999, the euro-area trade surplus widened to EUR 6.9 billion (EUR 2 billion in September), as a result of an acceleration in exports (9 % year-on-year compared with 6 % in September) and the sustained growth rate of imports (10 % in September and October). In the third quarter of the year, the current-account balance for the area ran a surplus of EUR 7.8 billion (ECU 15.5 billion in the same period in 1998). The services balance, for its part, showed a deficit of EUR 1.6 billion in the third quarter compared with a deficit of 0.4 billion in the same period a year earlier.

The most representative indicators of prices in the euro-area economy worsened during the fourth quarter. This was largely brought about by the upward trend of crude oil prices on international markets (a 145 % increase between February and December 1999), by the depreciation of the euro against the dollar (16 % over the course of the year) and by the turnaround in the falling trend of food prices. The annual percentage change in the HICP for the area was 1.7 % in December, five-tenths of a point above that of September (see Chart 10). The deterioration in the goods index during the year and the mild improvement in that of services has been conducive to convergence between the growth rates of both these components of the HICP. In December these rates were, in 12-

CHART 8

**GDP in the euro area**

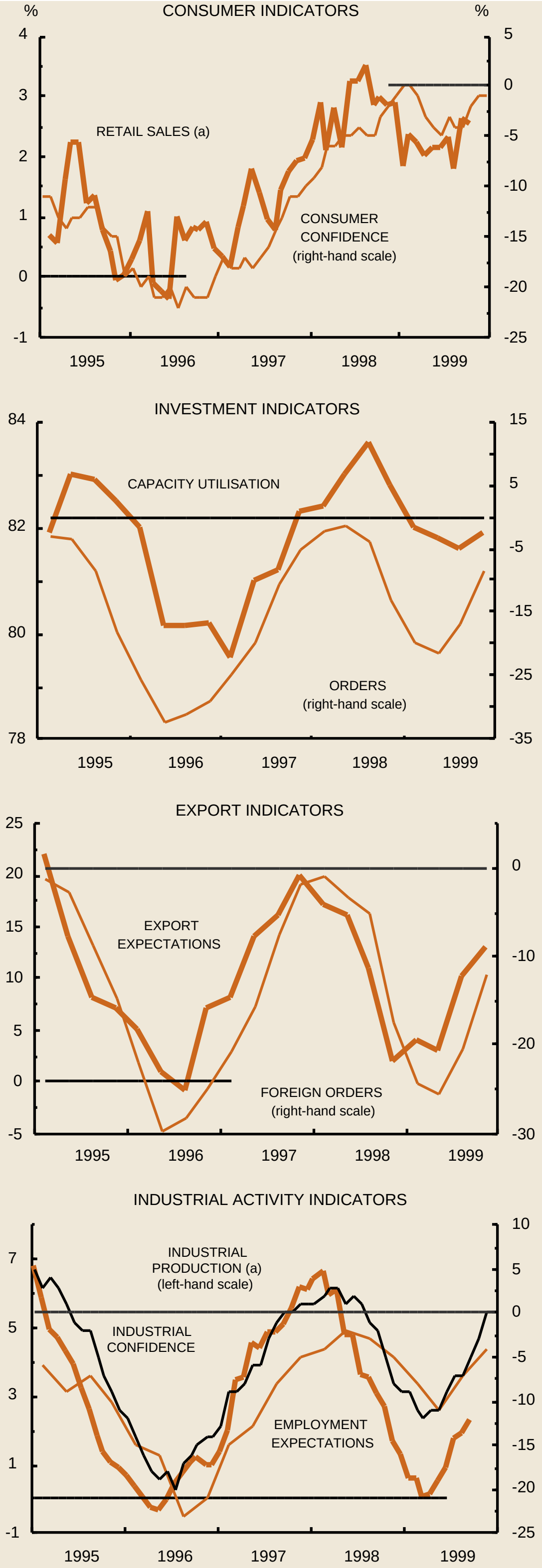



Sources: Eurostat and national statistics.

(a) Excluding Belgium, Ireland, Luxembourg, Austria and Portugal for which no quarterly national accounts data are available.

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.

month growth terms, 1.8 % and 1.5 %, respectively. Under the goods aggregate, both the index of foodstuffs and that of industrial goods worsened further during the fourth quarter. In the case of the food index, the deterioration was largely prompted by the unfavourable performance of unprocessed foods (which moved from a negative rate of –1.2 % in September to –0.3 % in December); and, in the case of industrial goods, by the rise in energy prices to a growth rate of 10.2 % year-on-year, almost four points up on September. Lastly, the growth of the other components of the goods aggregate remained virtually stable from September to December. Excluding the figure for Ireland, the latest HICP data continue to reveal a gradual reduction in the dispersion of the inflation rates of the various euro-area countries, set against the higher maximum and lower minimum values recorded since August. In the fourth quarter, the producer price index continued on the accelerating course it has followed since the start of 1999. It climbed to a 12-month growth rate of 3 % in November, in contrast to the negative rate it had posted from the second quarter of 1998 to July 1999.

The inflationary outlook is for fresh increases in the opening months of the current year, which should subsequently be reversed. Nonetheless, there are certain risks which may lead to a degree of persistence in price rises. Specifically, compounding the risk that the oil price may not moderate as from next spring is the possibility that the pass-through of dearer crude oil at source to final prices may intensify in the coming months in a context of vigorous final demand. Further, there are no foreseeable circumstances in which the uptrend in agricultural prices seen in recent months may be restrained. Accordingly, it does not seem that the food component of the HICP can continue, as it did until the third quarter of 1999, lessening the effects of the trend of the energy component on the general index. Moreover, there is a risk that the combination of wage bargaining with the temporary increase in prices may give rise to wage settlements that are not propitious to continuing low rates of inflation. Set against this, it is to be expected that the policies of deregulation and liberalisation in the markets for goods, services and factors applied in recent years will continue to exert a restraining effect on prices.

According to the notifications submitted by the Member States to the European Commission in September 1999, under the excessive deficit procedure, most countries will meet the targets for 1999 set in their original stability programmes, assisted by the expansion of tax revenue at a higher than expected rate (see Table 1). However, there may be some minor

TABLE 1

**General government financial balance of euro-area countries (as % of GDP)**

| | 1995 | 1996 | 1997 | 1998 | 1999 (a) |
|---|---|---|---|---|---|
| Belgium | –3.8 | –3.1 | –1.6 | –0.9 | –1.0 |
| Germany | –3.3 | –3.4 | –2.7 | –2.1 | –1.9 |
| Spain | –7.1 | –4.5 | –2.5 | –1.7 | –1.6 |
| France | –4.9 | –4.1 | –3.0 | –2.9 | –2.2 |
| Ireland | –2.1 | –0.2 | 1.0 | 2.4 | 3.2 |
| Italy | –7.7 | –6.6 | –2.7 | –2.7 | –2.4 |
| Luxembourg | 1.8 | 2.8 | 3.8 | 2.5 | 1.7 |
| Netherlands | –4.1 | –1.8 | –1.0 | –0.7 | –0.5 |
| Austria | –5.1 | –3.7 | –1.8 | –2.2 | –2.0 |
| Portugal | –5.7 | –3.3 | –2.5 | –2.2 | –1.8 |
| Finland | –4.6 | –3.1 | –1.2 | 1.0 | 2.5 |
| MEMORANDUM ITEM: | | | | | |
| Euro area | | | | | |
| Primary balance (b) | 0.7 | 1.3 | 2.5 | 2.4 | |
| Total balance (b) | –5.0 | –4.1 | –2.5 | –2.1 | |
| Public debt | 74.8 | 76.1 | 75.4 | 73.6 | |

Sources: European Commission and ECB (until 1998).

(a) Balances notified to the Commission under the excessive deficit procedure.
(b) Deficit (–) / surplus (+).

slippage in Austria and Italy. In the latter country, the deficit is finally expected to stand somewhere between the figure forecast in its stability programme (2 % of GDP) and the revised target of 2.4 % of GDP announced by the Italian authorities last spring.

Budgetary plans for the year 2000 indicate that fiscal consolidation will continue to be pursued by most countries in the area during the year. In many cases, the objectives set are more demanding than those reflected in the original stability programmes. Thus, in Germany and France, the deficits programmed for the current year are 1.25 % and 1.8 % of GDP, respectively, compared with the figure of 2 % in the programmes presented last year. In Italy, the budget seeks to hit exactly the target set in the 1998 stability programme (a deficit of 1.5 % of GDP). Austria faces the biggest problems in attaining its original target. There, the preparation of the budget continues to be delayed as a result of the difficulty in forming a government after the elections last autumn.

As to medium-term budgetary plans, mention may be made of the announced tax reform in Germany, which envisages a staggered reduction of the direct tax burden in the period to the year 2005. Income tax rates will be substantially cut, while minimum allowances and family allowances will increase. That entails bringing forward and stepping up the tax reduction previously announced in spring 1999. Finally, corporate income tax will be reduced from 40 % to 25 % at the outset of the year 2001.

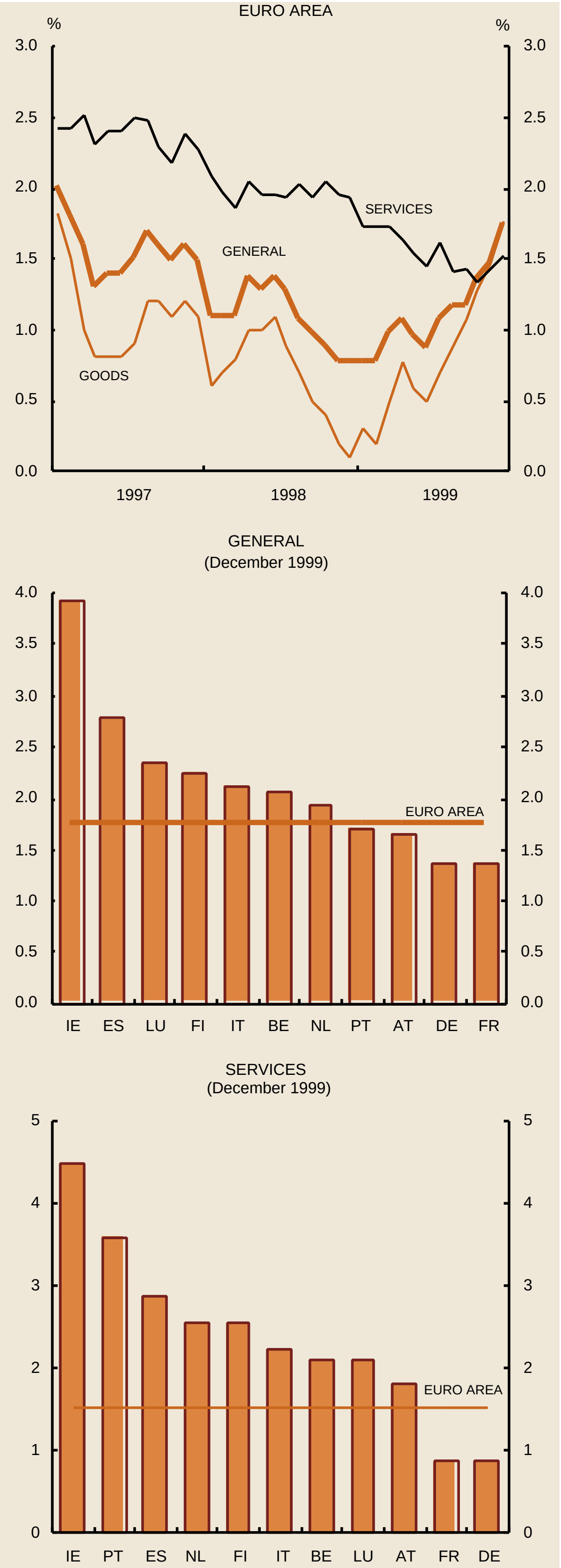
## 3.2. Monetary and financial developments

The fourth quarter of 1999 saw the continuation of relatively generous monetary and financial conditions in the euro area, despite the expectations of interest rate rises prevailing at the start of the quarter and the subsequent raising of ECB intervention rates decided upon by the Governing Council on 4th November (see Chart 11). In this respect, real short- and long-term interest rates remained very low, the former below 2 % and the latter between 3.5 % and 4 %. The tendency witnessed since the start of the year for the euro to depreciate against the dollar and the yen continued. Further, the reference monetary aggregate for the area, M3, and financing to the resident private-sector continued to display high growth rates. Regarding the reference value for M3, the Governing Council of the ECB announced on 2nd December 1999 that it would maintain the figure of 4.5 % as a reference for the year 2000. This was based on the fact that there had been no significant changes in the economic assumptions underpinning the setting of this value in December 1998. Likewise, it was announced that this reference would be revised annually.

On 4th November the Governing Council of the ECB announced a rise of 50 basis points in

CHART 10

**Harmonised indices of consumer prices**
**Twelve-month percentage change**




Source: Eurostat.

the interest rate on the main refinancing operations of the Eurosystem to 3 %, and a simultaneous increase in the rates on both the marginal lending facility and the deposit facility to 4 % and 2 %, respectively. Following this measure, the overnight interbank rate (EONIA) held at levels very close to 3 % except on 30th December, the last trading day in 1999. Then, owing to the uncertainty associated with the potential Y2K effect, and despite ample market liquidity, the EONIA stood at 3.75 %. The longer-dated interbank rates held fairly stable until late November, when they began to be affected, to differing degrees depending on the term, by market uncertainty over the possible effects of the transition to the year 2000. These effects were temporary and were corrected in the opening days of the current year. As a result of these movements, one- and three-month EURIBOR rates stood at 3.1 % and 3.3 %, respectively, on 21st January, 53 basis points and 58 basis points above their average levels in September 1999.

Long-term interest rates in the euro area had risen in October, placing 10-year interest rates at around 5.6 %. Days before the rise in intervention rates, long rates initiated a downward course that took them to levels close to 5 % in mid-November. Subsequently, they rose again as a result both of the increase in US bond yields and of the firming of brighter growth prospects for the area. A further probable cause was the perception by agents of certain risks to price stability in the area, as the Eurosystem had been warning. As a result of these movements, 10-year yields in the euro area stood on 19th January at 5.75 %, 52 basis points above the average level in September. These movements gave rise to upward shifts in the euro-area yield curve (see Chart 12), whose slope is currently significantly higher than was the case in December 1998.

Interest-rate movements in the euro area were, it is true, generally in the same direction as those on US markets. However, the 10-year yield spread over the United States tended to widen during the quarter as a whole, totalling 110 basis points on 19th January. The changes in this spread were quite in keeping with the euro's position against the dollar on the foreign exchange market. Thus, the euro appreciated against the dollar in October, rising to an average exchange rate of $1.071 and, subsequently, although somewhat volatile, it tended to depreciate, standing in the first fortnight of January at levels very close to parity with the US currency.

With regard to other interest rates relevant for economic agents' spending decisions, average retail bank lending rates in the euro area, which reflect with something of a delay the movements in money-market and long-term interest rates, increased in the fourth quarter in relation to their level in September. Nonetheless, in November (the latest month for which information is available) the rates on longer-dated loans to companies along with the rates on consumer credit and mortgage loans tended to stabilise and even to fall slightly. This ran counter to the rates on shorter-dated financing, which rose. In any event, the interest rates on bank lending transactions with the private sector remained below their average 1998 levels (see Chart 13).

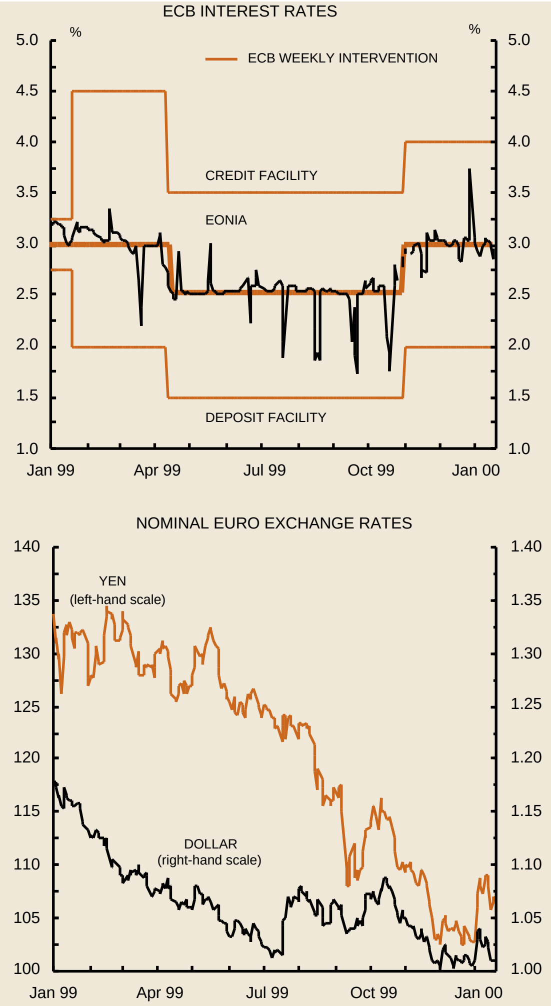
Equity markets in the euro area trended favourably during the fourth quarter of 1999, although they exhibited particular volatility in October. Generally, the course of prices on these markets was fairly independent of that of interest rates and, although it was linked to some degree to the situation on the US stock market, higher increases ensued. Hence, in December 1999 the average level of the Dow Jones EURO STOXX index stood 19.5 % above the related level for September. And by mid-January 2000, the index had risen by 34 % in relation to its average level in January 1999.

The euro-area monetary and credit aggregates continued to expand at high rates. This was largely related to the progressive improvement in growth prospects and to as yet relatively low interest rates. Up to December (the latest month for which information is available), the three-month moving average growth rate of the reference monetary aggregate, M3, stood at 6.1 % in relation to a year earlier, with the figure for this month at 6.4 %. The more liquid instruments making up this aggregate continue to expand forcefully, as testified by the behaviour of overnight deposits, which sustained year-on-year growth rates of around 13 % in the final quarter of the year. Likewise, there was a pick-up in the demand for negotiable instruments included in M3, such as shares in money-market mutual funds, and for other longer-dated financial assets not included thereunder, such as deposits maturing at over two years.

The year-on-year growth recorded in M3 throughout 1999 was persistently above the established reference value. That partly reflected the strong growth of overnight deposits in the euro area during the opening months of 1999, associated with certain one-off effects arising from the introduction of the euro and from the start-up of EMU. However, the expansionary behaviour of M3 continued in the subsequent months, thereby confirming that liquidity conditions in the area have been relatively generous during 1999.

CHART 11

**ECB interest rates and euro exchange rates**

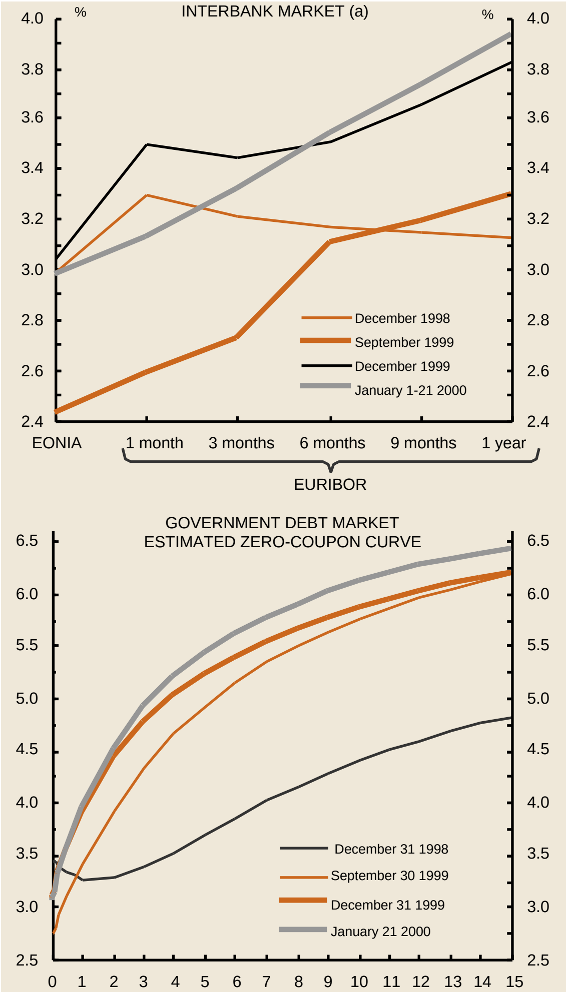



Sources: Banco de España and ECB.
(a) Dollar/euro and yen/euro exchange rate.

The foregoing monetary developments were compatible with the sustained, strong growth rate of finance extended to euro-area residents, which duly posted a year-on-year increase of 8.4 % in December. This was largely due to the behaviour of finance extended by MFIs to the private sector, which ran at 10.5 % in December on a year earlier, compared with the 2.5 % growth of finance extended to general government. The net external position of MFIs continued to diminish as a result of the gap between the growth of claims on residents and liabilities vis-à-vis this same sector, whereby this position had fallen by EUR 200 billion in December

CHART 12

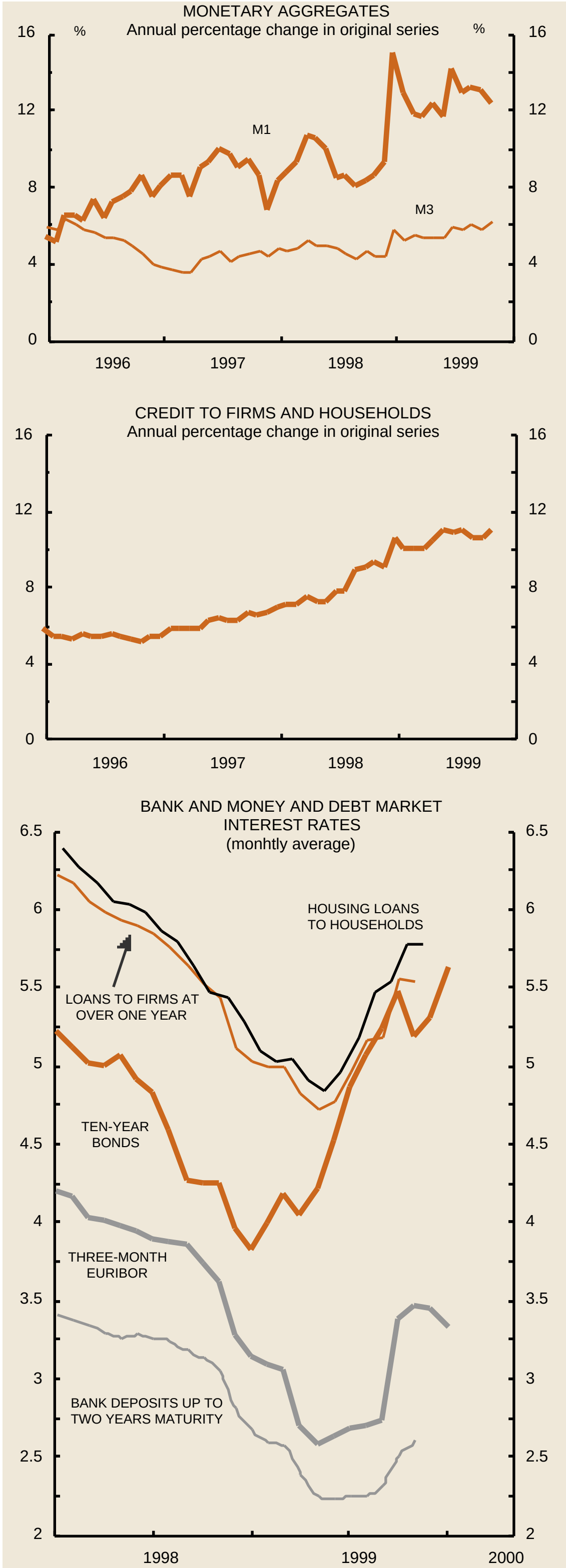
**Euro area yield curves**




Sources: Banco de España and ECB.
(a) For December 1998, average of euro-area countries' interbank interest rates.

CHART 13

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




Sources: Banco de España and ECB.

1999 compared with the same month a year earlier.

With regard to monetary policy implementation, the pattern mentioned in previous reports continued in place during the fourth quarter of 1999. That said, in order to pre-empt any possible influence derived from the transition to the new year, the ECB implemented some preventive measures aimed at ensuring sufficiently generous liquidity conditions in the opening days of the year 2000. In this respect, the ECB had already decided in May 1999 that the maturity date of the longer-term refinancing operation to be conducted on 30th September should be 23rd December rather than 30th December, as would have normally been the case. It was further announced in September that the main refinancing operation to be conducted in the first week of the year 2000 would be cancelled, extending, in turn, the maturity of the last two refinancing operations to be conducted in 1999 from two to three weeks. In addition, it was decided in October to increase the liquidity that would be allotted in the last three monthly longer-term refinancing operations by EUR 10 billion to EUR 25 billion. Likewise, in the main refinancing operation on 30th December, the amount allotted to MFIs was relatively large in an attempt to avert potential problems in the money market. All these measures helped ensure a problem-free transition to the new year. In this connection, it should be mentioned that, on 4th January, the ECB announced a fine-tuning operation –the first of its type since the start of the third stage of EMU– aimed at restoring normal liquidity conditions. This operation involved a variable rate tender on 5th January aimed at capturing one-week deposits in the Eurosystem and thus draining liquidity.

The liquidity provided by the Eurosystem during the last three reserve maintenance periods, the latest of which ended on 23rd December, amounted to EUR 187.7 billion, 194.3 billion and 214.7 billion, respectively. As has been the norm to date, the resort to the standing marginal lending and deposit facilities was relatively insignificant in these periods.

# 4. The Spanish economy

## 4.1. Demand

On INE data, national demand grew by 4.8 % (3) year-on-year during the third quarter of 1999, confirming the slight acceleration that began to be observed in the preceding quarter (see Chart 14). This behaviour was common to all the components of demand, unlike in the first half of the year, when the greater strength of household final consumption made up for the moderate loss of buoyancy of gross fixed capital formation. The reduced vigour of national demand in the summer months did not prevent GDP accelerating slightly, to a growth rate of 3.7 % year-on-year, since net external demand reduced its negative contribution to output growth considerably, to -1.1 percentage points. This was the result of a slight downturn in import growth and of the greater buoyancy of exports, which began to benefit from the strengthening economic recovery in certain areas of the world.

The information available at the time this report was prepared seems to suggest that these trends were sustained in the fourth quarter of 1999. On the basis of this information it is estimated that national demand continued to grow at high, albeit slightly lower, rates (of around 4.6 %), dragged down by the slowdown in gross fixed capital formation, and to a lesser extent, by household consumption. At the same time, the negative contribution from net external demand to output growth fell again in absolute terms. This was attributable to the recovery of exports, since imports remained vigorous. As a result, in the fourth quarter of 1999 GDP growth ran at around 3.8 % year-on-year, one-tenth of a percentage point higher than in the third quarter, making the increase in 1999 as a whole 3.7 %. This rate is three-tenths of a percentage point lower than in 1998, basically reflecting the impact of the International crisis, which was at its deepest at the end of that year and in early 1999. It is estimated that in 1999 as a whole the external sector reduced GDP growth by around 1.3 percentage points (three-tenths of a point more than in 1998), while national demand grew at a similar rate to the previous year (5 %).

In the third quarter of 1999, final consumption spending by households and private non-profit institutions grew in real terms by 4.2 % year-on-year, one-tenth of a percentage point below the second-quarter estimate (see Chart 14). This confirms the turning point, of which

(3) Quarterly National Accounts data, referred to in this chapter, are defined in trend-cycle terms, according to the terminology used by INE.

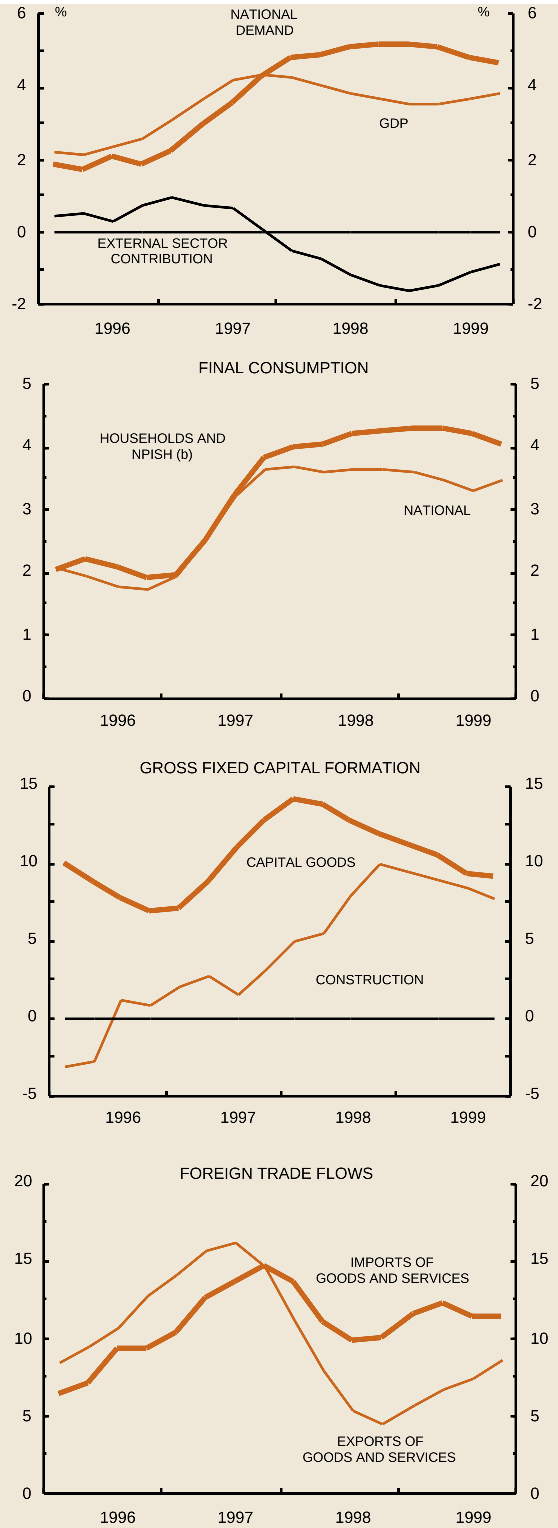
there was some indication in the previous quarter and which, in accordance with the latest short term indicators for this aggregate, was consolidated in the last quarter of 1999, when there was a further slight slowdown in consumption. In fact, as can be seen in Chart 15, the indicator of apparent consumption of goods and services (calculated on the basis of incomplete information) slowed slightly in the fourth quarter, while the growth in the index of retail sales flattened out. The weakness of indicators of consumption of durable goods was more marked, although new car registrations grew by more than 15 % in the year as a whole.

With the first INE sectoral accounts within the ESA 95 framework still to be released, the available information on certain items of household disposable income indicates that the increase, in real terms, in the purchasing power of households in 1999 may have been somewhat lower than in the previous year, compared with growth in consumption that was, on average, slightly higher than in 1998. Income from employment and net transfers from the public sector had opposite effects on real disposable income. Income from employment moderated to some extent, due to the more subdued performance of employment and the unexpected rise in the rate for inflation, which had a negative effect on the growth in the real wages of dependent employees. It should be recalled here that, although a high percentage of wage earners have inflation-adjustment clauses in their collective agreements which protect them when inflation is higher than forecast, the payments under these clauses will be received at the beginning of the year 2000. However, this does not prevent some households anticipating this income in their spending decisions. By contrast, the reform of personal income tax and the favourable trend in social benefits received by households amplified the expansionary impact of the public sector on household income. In the case of pensions, compensation for the higher-than-expected rate of inflation in 1999 will also be received this year.

As already mentioned, the path of disposable income in 1999 implies a reduction in the household saving ratio which would be consistent with the backdrop of growing optimism reflected by consumers and with the low level of interest rates. It should also be noted that, although household financial wealth rose in 1999 to a lesser extent than in previous years, due to stock market developments, the substantial rise in the price of housing meant that non-financial wealth still trended favourably.

CHART 14

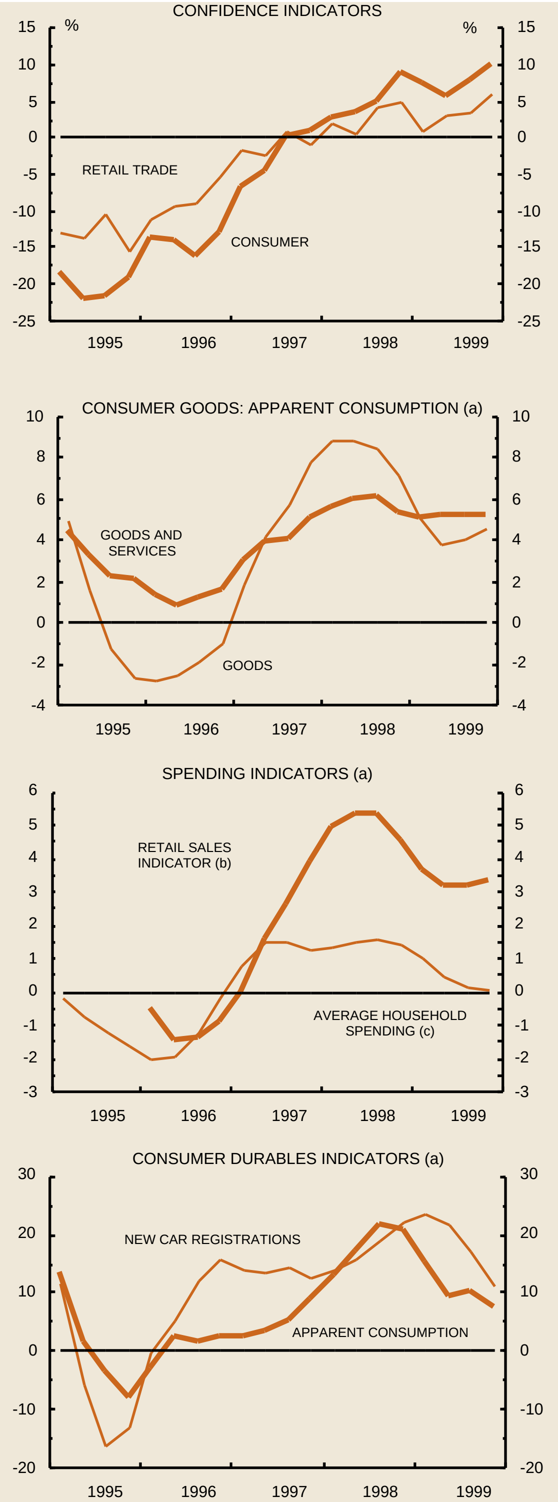
**Main macroeconomic aggregates** (a)




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

CHART 15

**Private consumption indicators**




Sources: Instituto Nacional de Estadística, European Commission Dirección General de Tráfico and Banco de España.

(a) Non-centred annual percentage change, based on the trend of the indicator.

(b) Deflated by the CPI.

(c) Household expenditure survey, deflated by the CPI.

On provisional Quarterly National Accounts (QNA) estimates, in the third quarter of 1999 general government final consumption expenditure grew in real terms by 0.3 % year-on-year, five-tenths of a percentage point less than in the second quarter. This would mean an intensification of the moderation already seen in previous quarters. However upward revisions to this variable can be expected with the close of the year, when more complete information on the whole of general government is incorporated. Particularly notable was the subdued behaviour of employee compensation, although expenditure on goods and services also moderated.

Gross fixed capital formation grew by 8.7 % year-on-the year in the third quarter of 1999, almost one percentage point less than in the second quarter. The slowdown, discernible in a weaker form since the beginning of the year, was strongest in the case of capital goods investment, but was also apparent in construction investment. The information on investment in the fourth quarter of 1999 suggests that there was a further deceleration (see Chart 16).

In the third quarter of 1999, real capital goods investment grew by 9.3 % with respect to the same period of the previous year, more than one percentage point down on the first half. The slowdown seems to have continued in the fourth quarter, according to the indicator of apparent expenditure on such goods. Both apparent investment in transport equipment and that in other capital goods displayed a similar profile, although the deterioration was less severe in the former case. However, the business confidence indicator in the capital goods sector has tended to indicate a progressively more optimistic situation, with the recovery in order books being especially notable. In any event, capital investment was highly buoyant, and this was associated with the growth in final demand, which has remained notably strong. At the same time, the slowdown in investment over the past year may have been induced by the completion of an equipment-renewal process set in train earlier, or by the deterioration in demand expectations at the beginning of the year, when the international crisis was that its most severe. That said, the current replacement of domestic by external demand, in the form of a surge in external orders, will help sustain current levels of investment. Moreover, according to the quarterly data of the Central Balance-Sheet Office (CBQ) the financial position of firms, with high levels of profitability, is still very healthy, even though the positive effect of the reduction in interest rates on funds generated is tailing off and business margins are tending to flatten out.

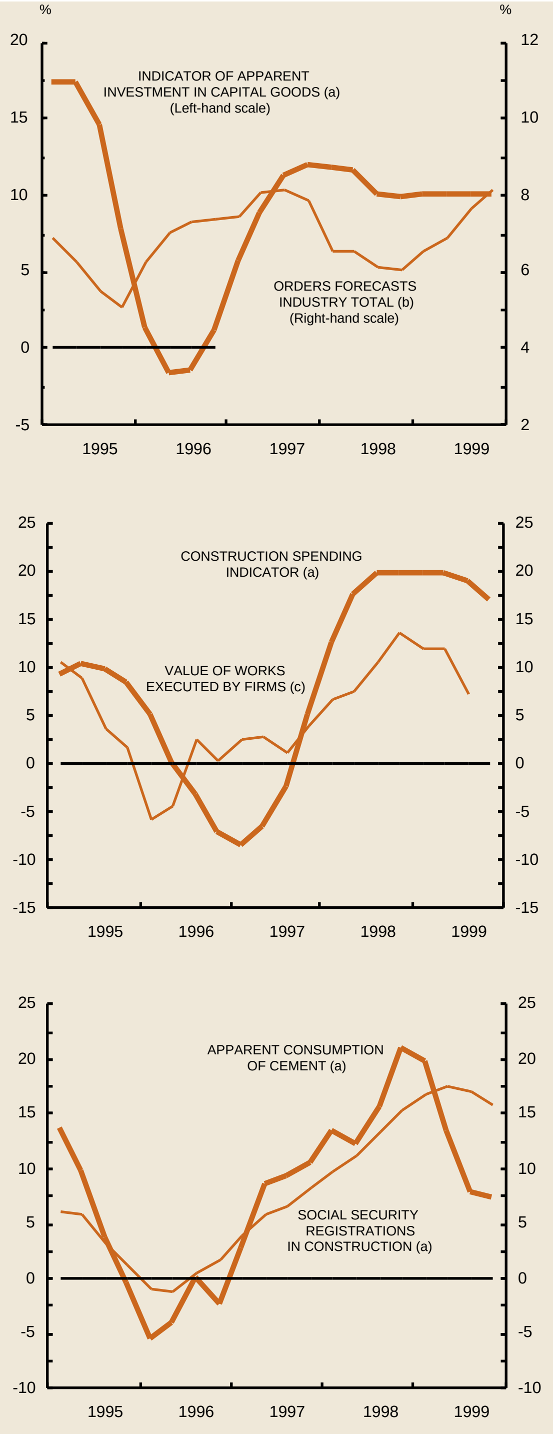
QNA data show a loss of momentum in construction investment in the third quarter of 1999, with real growth of 8.3 % on the same period of the previous year, as against 9.2 % in the first half of the year. According to the quarterly survey of the construction industry, the slowdown affected both civil engineering and building, and according to the trends in the most up-to-date indicators of construction activity construction investment continued to weaken in the fourth quarter. In particular, year-on-year growth of apparent consumption of cement fell again in October and November, to 3.9 %; the PPI for construction materials rose in October at a similar rate to that in the third quarter, and survey data showed a four-percentage-point reduction in the level of confidence of construction employers during the fourth quarter. From a medium-term perspective, the recent performance of leading indicators for construction also points to a further weakening in this component of demand. Government civil-engineering tenders in the first eight months of 1999 were 12.1 % lower than a year earlier, and according to project-approvals statistics, there was a slowdown in 1999 in the number of square metres to be built, especially in the case of non-residential construction. Residential investment shows signs of being more sustained, bolstered by the notable rise in demand, although indicators point towards a mild deceleration in the year 2000 following the strong increase in supply in 1999.

To round off the analysis of the components of gross capital formation, stockbuilding added two-tenths of a percentage point to the year-on-year rate of growth of GDP in the third quarter of 1999, in line with the first half of the year. Business sentiment indicators seem to indicate that stockbuilding was more moderate in the last quarter.

As mentioned previously, on QNA estimates the negative contribution of net external demand to year-on-year GDP growth fell in absolute terms to -1.1 percentage points in the third quarter of 1999. The smaller negative contribution by the foreign balance was primarily a consequence of the recovery in exports of goods and services, which rose in real terms by 7.5 % year-on-year. Although imports moderated slightly they still grew at the significant rate of 11.4 % year-on-year (see Chart 14). The incomplete information available for the fourth quarter (see Chart 17) indicates that there was a further correction in the negative contribution of the foreign balance to growth, stemming from the strengthening of foreign sales that has accompanied the significant improvements in the international environment and, to a lesser extent, from the depreciation of the euro against

CHART 16

**Gross fixed capital formation indicators**




Sources: Instituto Nacional de Estadística, Ministerio de Industria y Energía, Ministerio de Fomento, OFICEMEN, Instituto Nacional de Empleo and Banco de España.

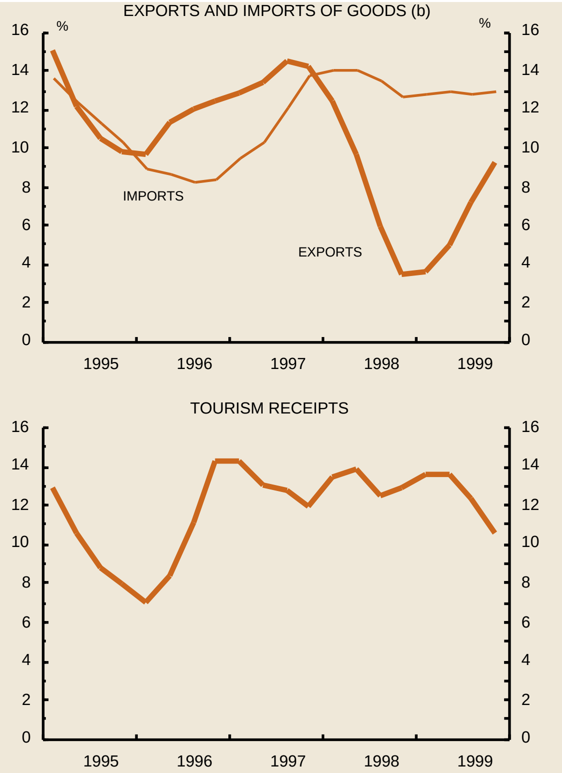
(a) Non-centred percentage change on same quarter a year earlier, based on the trend of the indicator.

(b) Trend level.

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

CHART 17

**Foreign trade** (a)




Sources: Ministerio de Economía y 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.

the dollar. The growing optimism of industrial employers about their future external orders corroborates these results.

On QNA data, goods exports, which had been notably weak since the second half of 1998, commenced a mild upturn from the second quarter of 1999, to reach a year-on-year growth rate of 5.7 % in the third quarter. Customs data for exports in October and November show an even more expansionary performance, associated with the renewed vigour of sales to the EU, including those to France and Germany (which had been the weakest) and with the recovery in markets outside the EU. This began with an improvement in the Asian economies and was strengthened more recently by the pick-up in exports to Eastern Europe and Latin America. As regards type of product, the strongest growth was in capital-goods exports, against a background of sharply falling prices, although the rest of the components displayed an accelerating profile. Tourism receipts, which were very expansionary throughout the year, were helped by the growing optimism of consumers in the euro area, the main source of tourists visiting Spain, and by the weakness of the European currency, which has attracted visitors from other areas, in particular the UK. Notwithstanding this, tourism receipts in the balance of payments tended to slow mildly from mid-1999. As for other services, receipts from financial, IT and insurance services were notably healthy.

Goods imports slowed slightly in the third quarter of 1999, growing by 11 % with respect to the same period of 1998, in line with the growth of domestic demand. However customs data for October and November indicate that they continued to be highly buoyant. By product group, purchases of capital goods and non-food consumer goods were the most expansionary (in step with the rise in these components of internal demand), although the latter moderated in the third quarter as the demand for consumer durables began to show signs of tailing off. As for imports of intermediate goods there was a notable difference between the profiles displayed by energy goods and by other intermediate goods; while purchases of energy products have been falling since the second quarter, as a consequence of the sharp rise in their prices, the profile of purchases of other intermediate goods shows consolidated recovery. Lastly, the growth of services imports held steady at very high rates (13.4 % year-on-year). This buoyancy extends both to payments for tourism and other services, which is related in turn to the high level of investment abroad in 1999.

## 4.2. Output and employment

From the viewpoint of the productive branches, the slight acceleration in GDP in the third quarter of 1999 was the result of differing behaviour by the more exposed and more sheltered sectors. There was a pick-up in both agriculture (whose negative contribution to GDP growth fell) and in the industrial and energy branches, while growth moderated in services and, above all, in construction, although these were still the most dynamic branches (see Chart 18). The available short-term indicators point to a strengthening of these trends in the fourth quarter. Employment generation continued to display notable vigour, with an increase in the number of full-time equivalent jobs of 3.2 % in the third quarter of 1999 on a year earlier. However, employment slowed somewhat with respect to the first half of the year, so that apparent labour productivity continued to recover, growing by 0.4 %. The branch of activity responsible for this upward productivity profile was industry, traditionally the most dynamic in this respect. None the less, productivity gains were still low compared with those achieved during the last decade. In the fourth quarter of 1999, the employment indicators display a stable growth rate, enabling the growth rate of apparent labour productivity to continue rising in that period.

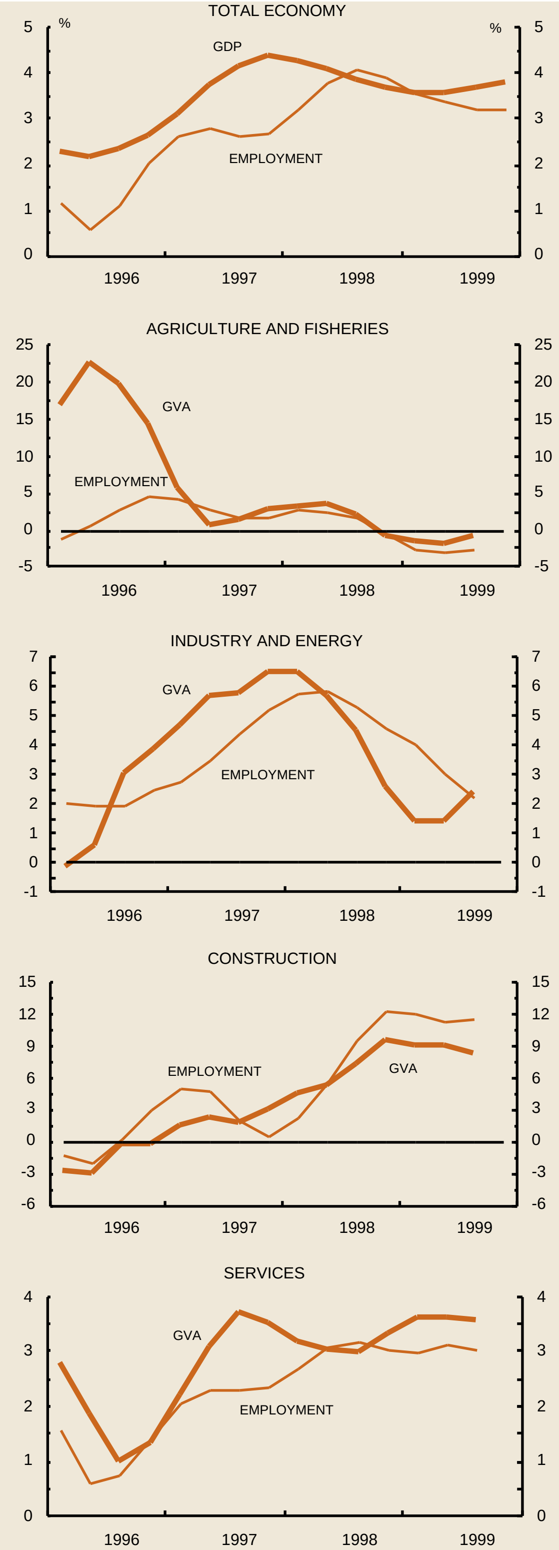
In the third quarter of 1999, agricultural activity fell by 1.1 % year-on-year, almost one percentage point less than in the preceding quarter. The ongoing decline in the gross value added of this branch is related to the scant rainfall in Spain over the past year, although the fact that the unfavourable weather conditions have not affected all regions equally explains why certain crops, such as cereals, tubers and olives were negatively affected, while there were significant increases in the growth rates of citrus and other fruits. Another effect of the scant rainfall was the reduction in pasture for cattle. As the latter was replaced by industrial feed, the estimated value-added of agriculture for a given level of output has been reduced. In any event, the improvement in the weather in the latter months of the year may prompt a more favourable performance in forthcoming quarters.

The progressive recovery in external demand has been the key factor explaining the upturn in industrial activity, which grew in the third quarter of 1999 by 2.3 % year-on-year, almost one percentage point more than in the preceding quarter. Moreover, the short-term indicators suggest that the expansion continued in the fourth quarter. Thus, although the industrial production index lost some of its momentum in October and November, it continued to grow at a healthy rate, and surveys indicate that the business climate improved in the fourth quarter of the year. At a more detailed level, some diversity is apparent in developments in industrial activity, since the recovery has been limited to a certain number of branches. While the recovery has gone practically unnoticed in the metal processing, clothing and footwear branches, in the chemicals and non-metallic minerals branches output growth is very high.

Construction activity, as already seen in the preceding section, remained very buoyant in the third quarter of 1999, but its growth rate, at 8.2 % year-on-year, was almost one percentage point lower than in the second quarter. The loss of momentum was greatest in civil engineering, although it also extended to building. The coincident indicators of activity show a further loss of steam in the fourth quarter, which could carry over into the year 2000, in view of the recent behaviour of the leading indicators.

CHART 18

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




Sources: Instituto Nacional de Estadística and Banco de España.

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

Value-added in services grew by 3.5 % year-on-year in the third quarter of 1999, one-tenth of a percentage point less than in the previous quarter. This slight slowdown was caused by non-market services, as market services held at a rate of 4.4 %. The scant information on the fourth quarter points to a further slowdown in services activity, which in the case of market services would extend to all the sub-branches, except for the restaurant and hotel industry, whose indicators have shown renewed vigour.

As mentioned above, the QNA data confirm that the Spanish economy continued to generate employment at a high rate in the third quarter of 1999. In terms of full-time equivalent jobs, a variable which standardises the measurement of employment in terms of working hours, employment grew by 3.2 % year-on-year, two-tenths of a percentage point less than in the preceding quarter. These figures are very similar to those in terms of the number of employed persons or of jobs, the other two variables estimated in the National Accounts framework. The fourth-quarter information on social security registrations indicates that they remained highly buoyant, and this is also confirmed by the rate of decline in registered unemployment. By branch of activity, the growth in employment in the third quarter was consistent with the differences in output growth. Thus, growth in construction and services was higher (11.4 % and 3 %, respectively) than in industry (2.3 %), while employment in agriculture continued to fall. As a result, with the sole exception of construction, there were increases in apparent labour productivity in all the branches. All the employment created was dependent employment, while self-employment continued to decline, as in the first half of the year.

For a more detailed analysis of the nature of the employment creation process in the third quarter it is necessary to consider the information provided by the Labour Force Survey (EPA). However, when analysing the results of the survey it is necessary to bear in mind that a number of changes were made to the survey at the beginning of 1999, in order to bring it into line with European legislation in this area. Although these changes have led to more precise measurement of the level of employment in Spain, they have affected comparisons over time in the historical series. In this respect, the year-on-year growth in the third quarter in the number of employed persons was 4.7 % according to the EPA, very much higher than what was finally estimated by the QNA, as in the two previous quarters. In terms of contract duration, the third-quarter EPA showed very similar growth in permanent and temporary wage-earners, so that the seasonally adjusted ratio of temporary to total employment held steady at around 33 %. In terms of the length of the working day, there was a greater increase in part-time than in full-time employment, which was reflected in a higher part-time ratio. Thus, the effects of the new regulations to boost permanent part-time employment, approved at the end of 1998, are beginning to be discerned.

The EPA recorded a rise in the labour force of 0.9 % with respect to the third quarter of 1998, a slight acceleration in relation to the first half of the year. As a result, the activity rate for the population between the ages of 16 and 64 years rose to 63.8 %, which means that it is getting closer and closer to the European average. Although this progressive rise certainly has a demographic component (particularly in the case of more mature women who have significantly lower activity rates than younger women), the healthy performance of the labour market must also be stimulating re-entry into the labour market of previously excluded sections of the population. Despite this, the rate of unemployment continued to fall, to stand at 15.4 %, more than three percentage points lower than a year earlier. In year-on-year terms, unemployment fell by 16 %, which was greater than the fall in registered unemployment. The latter indicator suggests that the unemployment rate continued to fall in the fourth quarter. Lastly, it should be noted that the reduction in unemployment is spreading to all groups (based on sex, age, qualifications and duration of unemployment), although with varying degrees of intensity.

### 4.3. Prices and costs

On QNA estimates, in the third quarter of 1999 the GDP deflator grew by 2.9 % year-on-year, three-tenths of a percentage point more than in the second quarter. This acceleration was attributable to the rise in the gross surplus per unit of output, since both unit labour costs and net indirect taxes per unit of output slowed slightly.

Unit labour costs grew by 1.9 % year-on-year in the third quarter of 1999, two-tenths of a percentage point down on the second, since the higher growth in apparent labour productivity more than offset the acceleration in employee compensation, which rose by 2.3 %, as against 2.2 % in the previous quarter. On wage survey data, the year-on-year growth in average hourly earnings, in terms of total pay, was 2.5 % in the third quarter, the same rate as in the second quarter. In terms of average monthly earnings, the rise was somewhat smaller (2.3 %), but this represented a slight acceleration. By branch of activity, in industry there was a slowdown in average hourly earnings, which rose by 2.3 %, while services (2.3 %) and construction (4.1 %) were characterised by stronger growth. Comparing these results with those for collective bargaining gives an approximation of wage drift. As in recent years, this was not significant, except in the construction branch. In fact, on data to 31 November, settlements held at 2.3 %, with those under existing agreements at 2.3 % and those under newly signed agreements at 2.4 %. Growth by branch remained very similar in the final quarter.

With regard to wage growth in 1999 and 2000, it should be noted that since the 12-month rise in the CPI in December was, at 2.9 %, well above the objective initially set in the budget (1.8 %) and the revised objective (2.4 %), the inflation-adjustment clauses included in many of the agreements signed in 1999 will be activated. This means that the wage settlement eventually shown by the statistics for 1999 will be somewhat higher than currently estimated, and the slowdown on 1998 will disappear. In terms of wage survey and QNA data, the payments arising under the inflation-adjustment clauses will be recorded when received by workers (presumably in the first quarter of the year 2000). Accordingly, wage acceleration can be expected to continue in forthcoming quarters, probably halting the downward trend in unit labour costs.

The upward profile of the GDP deflator was accompanied by an acceleration in the import deflator, so that the final demand deflator grew by 2.2 % in the third quarter, six-tenths of a percentage point more than in the preceding quarter. Import prices remained on an upward path throughout 1999. In terms of their unit value indices, their 12-month growth rate reached 4.9 % in October. The price of imported energy, pulled up by the rise in the price of a barrel of oil on international markets, was the main cause of this acceleration, although other goods have been purchased at progressively higher prices. As regards the final demand deflator, the upward trend spread to all its components, and the different indicators available for the fourth quarter signal a strengthening of these trends.

The 12-month rise in the main indicator of final prices, the CPI, was 2.9 % in December, four-tenths of a percentage point higher than in September (see Chart 20). This outcome is attributable to goods prices, since services prices rose by 3.2 % in December, one-tenth of a percentage point less than in September. The rise in goods inflation, from 2.2 % in September to 2.6 % in December, stemmed from the surge in its most erratic components, especially energy prices, which increased by 11.5 %, more than two percentage points up on September. Food prices also accelerated, growing by 2.4 % in December. The poor harvests, associated with the adverse weather conditions, problems with fish supplies and speculative behaviour in relation to certain products, seem to be the reasons for this outcome. Given that the prices of non-energy industrial goods only slowed slightly, the rate of growth of the index of non-energy processed goods and service prices rose to 2.4 % in December.

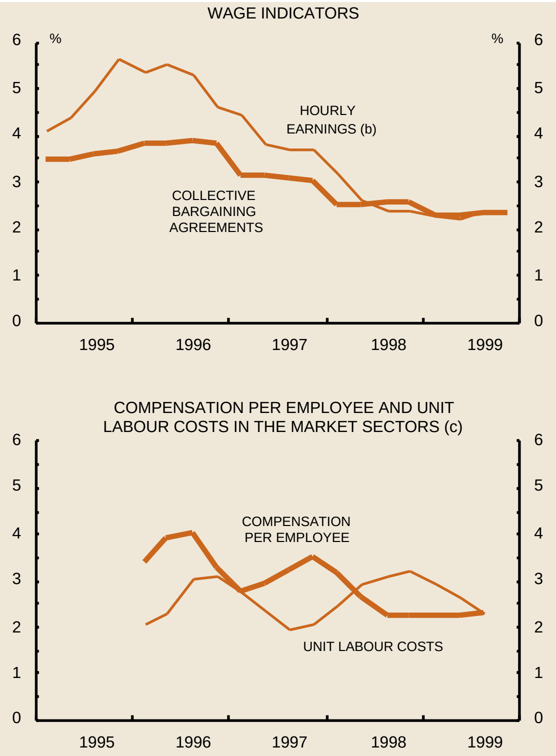
To make comparisons with price developments in the other EU countries and in the euro area it is better to use the harmonised index of consumer prices (HICP). In the case of Spain, the 12-month rise in the HICP at end-1999 was 2.8 %, one-tenth of a percentage point less than that of the CPI, making a differential with respect to the euro-area average of 1.1 percentage points. This differential was slightly smaller than in previous quarters. As seen in Chart 21, during 1999 there was a significant rise in the differential in the food components of the HICP. In the case of processed foods, this was associated, to a large extent, with oil and wine prices. These products also explain the widening in the differential calculated in terms of the prices of consumer industrial goods. At the same time, the rise in energy prices, which has affected the whole of Europe, has nonetheless been translated into a significant widening of the inflation differential, both in terms of the energy component of the CPI and of the related component of the producer price index.

As regards developments in other price indicators, the producer price index also accelerated in the latter months of 1999, to a 12-month rate of 3.1 % in November, seven-tenths of a percentage point higher than in September. The acceleration affected all its components. In contrast, the prices received by farmers continued to fall in the third quarter of 1999.

It is possible, on the basis of the price and cost information analysed above, to infer developments in the price formation process at the aggregate level and in the major branches of activity. As can be seen in Chart 22, until the third quarter of 1999 both final prices and average variable costs were tending to accelerate in the non-financial private sector as a whole, although the acceleration was greater in costs, so that the process of widening margins came to a halt. The acceleration in costs stemmed from inputs, while unit labour costs were compara-

CHART 19

**Wages and labour costs** (a)




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

(a) Percentage change on same quarter a year earlier.
(b) Basic pay.
(c) Rates based on QNA trend-cycle series.

tively more stable. At a more detailed level it can be seen that the services branches set this profile for margins. In manufacturing there was a stronger recovery in final prices than in variable costs, as the acceleration in input prices was partly offset by the slowdown in unit labour costs. In services, by contrast, the strong rise in intermediate costs (these branches are highly dependent on energy) produced an accelerating profile for variable costs. In any event, the slower growth in margins in services should be considered in the light of the significant expansion seen in previous years.

### 4.4. State budget

The state budget outturn in 1999 posted a deficit of ESP 1,057 billion, 5.1 % down on the 1998 deficit (see Table 2). In terms of the State borrowing requirement (National Accounts), figures are only available to November. These show a deficit of 0.3 % of GDP. In the light of the reduction in the cash-basis deficit for the year as a whole and the available National Accounts data, the objective for a general government deficit of 1.3 % of GDP in 1999, contained in the recently published Stability Programme update, can be expected to be met. The most recent developments in revenue and expenditure are discussed below, using cash-basis information, which was more up to date at the time this report was prepared.

The reduction in the State cash-basis deficit for 1999 as a whole, compared with the previous year's outturn, was due to higher growth in revenue (4.7 %) than in expenditure. As already pointed out in previous reports, on the revenue side, VAT and corporate income tax were particularly buoyant and, on the expenditure side, the restraint of government consumption and the strong growth of current transfers were notable. It should be noted that these two headings of expenditure are affected by the transfer of responsibilities for education to various Regional (Autonomous) Governments.

The reduction in the State budget outturn for 1999 was, however, somewhat lower than that officially estimated in the initial projection. This was a consequence of the slightly smaller than forecast increase in revenue, primarily attributable to lower receipts from current and capital transfers. By contrast, tax receipts exceeded the official forecast in the initial projection, largely as a result of the strong buoyancy of corporate income tax, and total State expenditure was slightly lower than forecast. This overall result for expenditure conceals, however, diverse behaviour among the various items. Current transfers paid were notably higher than forecast, this being more than offset by the better performance of the other headings.

In the fourth quarter of 1999, revenue accelerated with respect to the first nine months of the year. The year-on-year growth rate of receipts from direct and indirect taxes for the whole of 1999 was higher than that for the first three-quarters of the year, while the rate of decline in other net revenue was lower. At the same time the contrast between the strength of indirect taxes and the weak growth in direct taxes and, within the latter, between the growth in personal income tax and corporate income tax receipts was maintained.

Having fallen during the period to September by 3.8 % on the same period a year earlier, personal income tax receipts during the year as a whole rose by 2.1 % on the previous year, basically due to the cancelling out of the effect of rebates being paid earlier in 1998. The growth in withholdings on earned income, despite the im-

BOX 2

## Telephone services in Spain: competitions and prices

In recent years, telephony in Spain has been fundamentally transformed by the liberalisation that has accompanied the elimination of the monopoly regime in the provision of these services. This process was completed on 1 December 1998, with the complete liberalisation of the telephone service. This box provides a first approximation of the effects of opening up the sector, comparing with the other EU countries, given that this process has been guided by European guidelines for the implementation of the Single Market. It should be noted here that in most EU countries the sector was liberalised at least 11 months sooner than in Spain.4 In any event, it should be taken into account that very little time has elapsed since the introduction of competition and also that it is difficult to isolate the effects of liberalisation when significant technological progress is being made in this area and from the impact of certain administrative measures.

When analysing the growth in the number of operators, both the licences granted and the number of companies now operating in the various segments should be taken into account. As seen in the upper part of the adjoining table, in Spain, as in the other countries considered, there has been a very significant increase in the number of licences granted for fixed telephony, especially to operators permitted to offer services at the local level, a segment in which Spain stand outs within the EU. Although most of the licences correspond to cable operators, their market share is very low because, among other reasons, urban planning and environmental requirements have hampered the development of the necessary infrastructure. The number of operators now offering this kind of services is also higher in Spain than in the other EU countries (see the lower part of the table). The number of licences for national operators has also risen significantly, although there is a certain lag compared with the situation in other European countries. This lag is accentuated if the comparison is made in terms of the number of operators operating in the so-called national long-distance or international calls segments. This reflects, at least in part, the shorter time during which the sector has been deregulated in Spain5. Unlike in fixed telephony, there have been no significant advances in mobile telephony since the liberalisation of the sector, as the operators currently providing services (three digital and one analogue operator) are the same ones that had licences before 1 December 1998. Notwithstanding this, the situation in Spain is similar to that in the other EU countries (in which it is possible to find around one analogue licence and three or four digital ones).

Before analysing tariff developments, it should be recalled that the regime of administered prices is to be maintained for the former monopoly until 1 August of the year 2000. Thereafter, the Telecommunications Market Commission will establish maximum average prices that this company can charge for a basket of services, which will give it a certain margin to adjust the prices of the services included in this reference basket. The new companies are able to set their tariffs freely.

The elements that have traditionally made up telephone bills, apart from VAT, are the following: the subscription charge, the flat-rate charge per call and the cost of the units consumed. Moreover, the latter varied with the time of day and the type of call. To gain market share, the new operators have made changes to certain aspects of the aforementioned elements, reducing the cost of calls. For example, they began by introducing charges per second, instead of per unit. In addition, certain companies have eliminated the subscription charge and/or the flat-rate charge for each call, while low-tariff periods have been extended and the differences in the tariffs between certain kinds of call have even disappeared. The incumbent operator has also adopted some of these changes. As a result of all this, the Telecommunications Market Commission estimates that liberalisation of the sector has led to a reduction in telephone bills of more than 10 %.

Despite this significant cut, comparison of the tariffs of the dominant fixed-telephony operators with those in other EU countries shows the persistence of certain differences which could mean that there is room for further price reductions as a consequence of increased competition. The European Commission6, using August 1999 data, has compared the real cost (in terms of purchasing power parity) of a basket of national calls (local, provincial and inter-provincial) taking into account different times of day and days of the week. With the caveats required by the margin of uncertainty involved in these estimates, this information indicates that the real cost of the telephone service in Spain is still above the EU average, especially in the case of national business calls, a situation which seems to stem from provincial and inter-provincial calls. A similar exercise, comparing the prices of a basket of international calls to all the OECD countries, produces similar results.

### Number of authorised fixed telephony operators

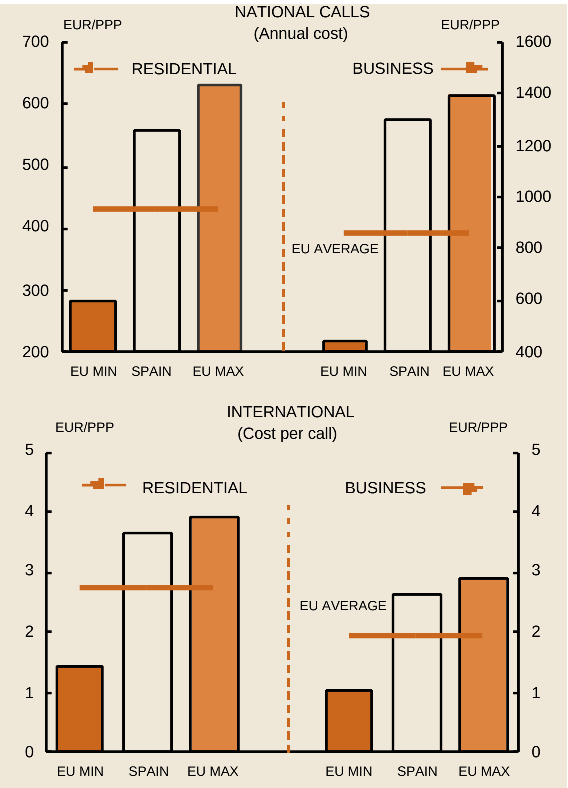
| Country | Local operators (a) | | National operators | |
|---|---|---|---|---|
| | August 1998 | September 1999 | August 1998 | September 1999 |
| A. AUTHORISED: | | | | |
| Germany | 95 | 147 | 21 | 47 |
| **Spain** | **22** | **63** | **3** | **27** |
| France | 36 | 59 | 24 | 40 |
| Italy | 9 | 39 | 5 | 36 |
| United Kingdom | 172 | 293 | 31 | 135 |

| Country | National calls | | International calls |
|---|---|---|---|
| | Local | Long-distance | |
| B. ACTUALLY OFFERING SERVICES September 1999): | | | |
| Germany | 22 | 47 | 47 |
| Spain | 26 | 10 | 10 |
| France | 8 | 31 | 31 |
| Italy | 1 | 12 | 12 |
| United Kingdom | 36 | 26 | 66 |

Source: European Commission

(a) IIncluding both national and local oerators authorised to offer local callss.

### Cost of telephone calls August 1999




Source: European Commission.

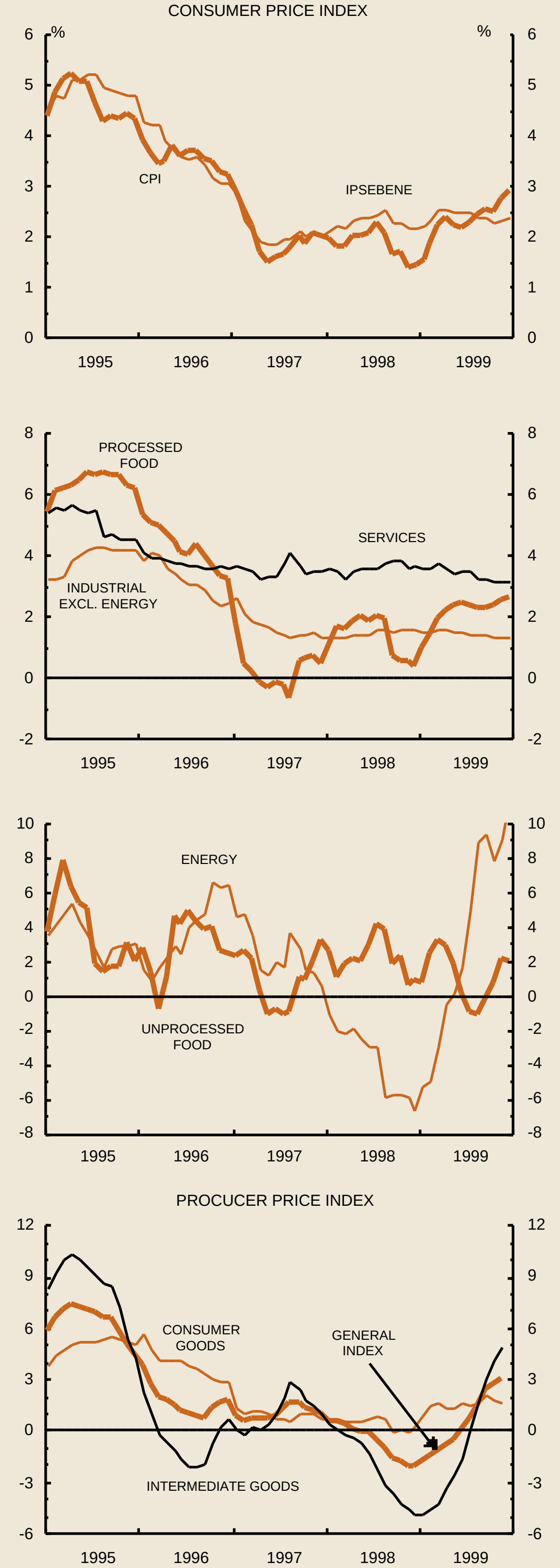
(4) Except for: Luxembourg, where liberalisation took place five months earlier; Ireland, where the timetable coincides with that of Spain; Portugal, where it is due in January 2000; and Greece, where it is due by the end of the year.

(5) It should be noted that countries such as the United Kingdom initiated deregulation in the eighties. This may distort the comparison of the figures in the adjoining table.

(6) “Fifth Report on the Implementation of the Telecommunications Regulatory Package”.

CHART 20

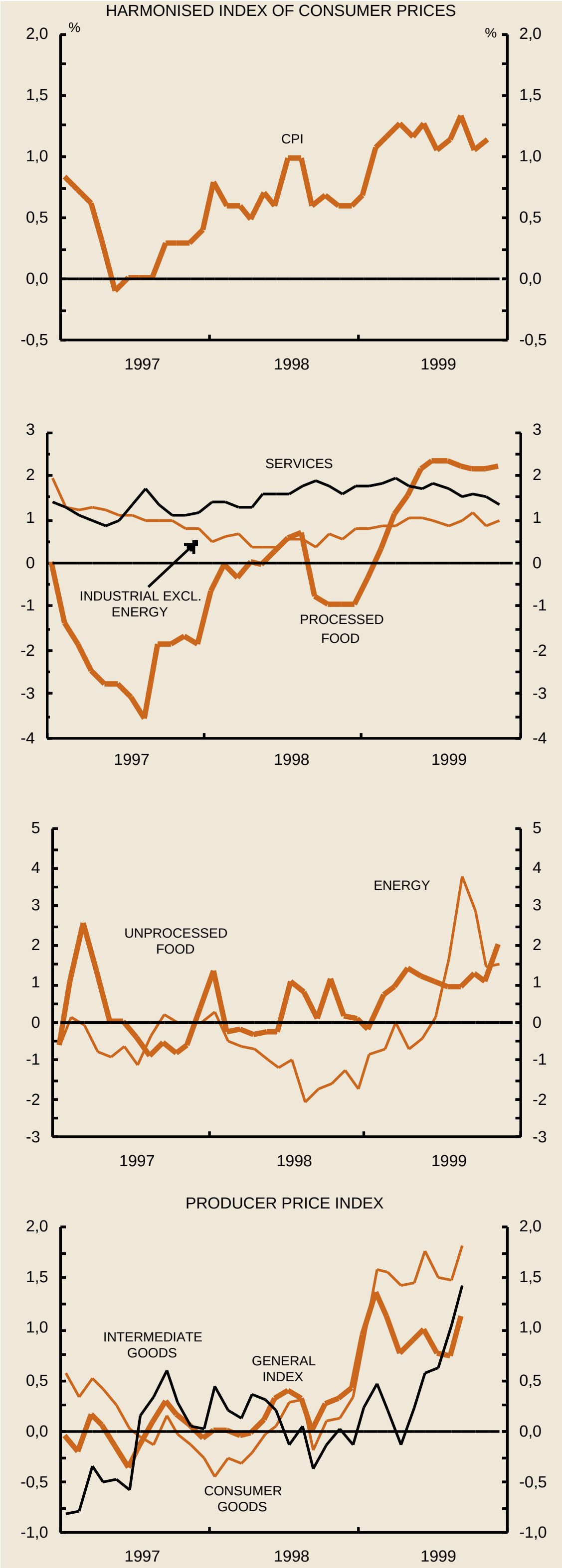
**Price indicators** (a)
**Spain**




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

CHART 21

**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 2

**State Budget outturn**

PTA bn and %

| | Outturn | Initial Projection | | Outturn JAN-SEP | Outturn | | |
|---|---|---|---|---|---|---|---|
| | 1998 | 1999 | Percentage change | Percentage change 1999/1998 | 1998 JAN-DEC | 1999 JAN-DEC | Percentage change |
| | 1 | 2 | 3=2/1 | 4 | 5 | 6 | 7=6/5 |
| **1. Revenue** | **17,534** | **18,450** | **5.2** | **3.9** | **17,534** | **18,364** | **4.7** |
| Direct taxes | 7,457 | 7,696 | 3.2 | 4.4 | 7,457 | 7,817 | 4.8 |
| *Personal income tax* | *4,992* | *5,103* | *2.2* | *–3.8* | *4,992* | *5,098* | *2.1* |
| *Corporate income tax*(a) | *2,324* | *2,430* | *4.5* | *27.0* | *2,324* | *2,558* | *10.0* |
| *Other* | *140* | *164* | *16.6* | *14.0* | *140* | *161* | *14.9* |
| Indirect taxes | 7,015 | 7,916 | 12.8 | 12.0 | 7,015 | 7,951 | 13.3 |
| *VAT* | *4,373* | *5,090* | *16.4* | *14.5* | *4,373* | *5,114* | *17.0* |
| *Execise duties* | *2,391* | *2,557* | *7.0* | *7.6* | *2,391* | *2,567* | *7.4* |
| *Tariffs* | *132* | *142* | *7.3* | *11.9* | *132* | *144* | *9.2* |
| *Other* | *120* | *127* | *5.9* | *4.1* | *120* | *126* | *5.3* |
| Other net revenue | 3,063 | 2,837 | –7.4 | –16.7 | 3,063 | 2,597 | –15.2 |
| **2. Expenditure** | **18,649** | **19,445** | **4.3** | **6.2** | **18,649** | **19,421** | **4.1** |
| Wages and salaries | 3,053 | 3,108 | 1.8 | –0.8 | 3,053 | 2,979 | –2.4 |
| Goods and services | 388 | 468 | 20.4 | 10.7 | 388 | 436 | 12.3 |
| Interest payments | 3,334 | 3,277 | –1.7 | 9.7 | 3,334 | 3,178 | –4.7 |
| Current transfers | 9,906 | 10,330 | 4.3 | 7.9 | 9,906 | 10,809 | 9.1 |
| Investment | 898 | 1,184 | 31.9 | 11.4 | 898 | 957 | 6.6 |
| Capital transfers | 1,071 | 1,079 | 0.7 | –8.1 | 1,071 | 1,063 | –0.8 |
| **3. Cash-basis deficit (3 = 1 – 2)** (b) | **–1,114** | **–995** | **–10.7** | **39.7** | **–1,114** | **–1,057** | **–5.1** |
| MEMORANDUM ITEM: NATIONAL ACCOUNTS (c): | | | | | | | |
| Revenue | 17313 | — | — | 6.2 | 15,880 | 17,037 | 7.3 |
| Expenditure | 18,529 | — | — | 8.8 | 16,129 | 17,307 | 7.3 |
| **Net borrowing (–) or lending (+)** (d) | **–1,216** | **–1,194** | **–1.8** | **49.9** | **–249** | **–270** | **8.2** |

Sources: Ministerio de Economía y Hacienda and Banco de España.

(a) The January-November 1999 outturn includes all revenue from the tax on the income of non-residents.
(b) This is the cash-basis deficit as defined by the IGAE (National Audit Office).
(c) The outturn figures in columns 5 and 6 correspond to the period January-November, as these are the latest available for 1999.
(d) The annual figures (columns 1 and 2) are drawn from the Spanish Finance Ministry's response to the Excessive Deficit Procedure questionnaire (ESA 79 methodology).

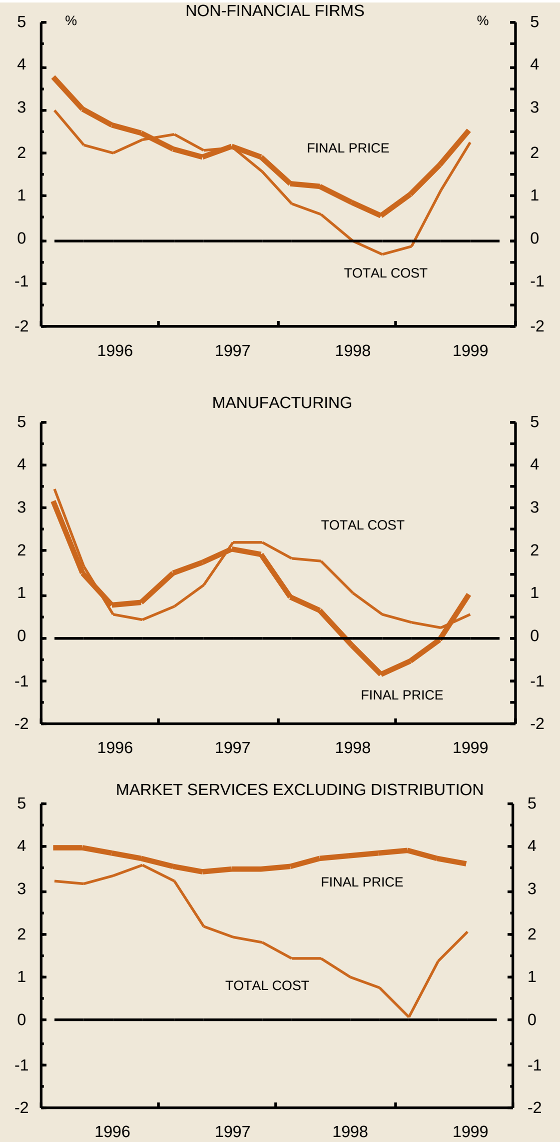
plementation of the reform of the tax, held at around 3.5 %, as a result of the positive employment developments. By contrast, the decline in withholdings on income from capital accelerated to a rate of -19.1 %, primarily as a consequence of the lower withholding rates applied in 1999. Unlike in the case of personal income tax, the growth rate of corporate income tax receipts for 1999 as a whole was lower than in the period to the third quarter, essentially due to the smaller capital gains realised in privatisation operations. Despite this, receipts still grew at a high rate. Besides the healthy corporate results, this was due to the lower rebates in the first few months of 1999 and, to a lesser extent, to the withholdings on capital gains on mutual fund shares (only applied from February 1999).

Receipts from indirect taxes accelerated in relation to the first nine months of the year, driven by VAT which, as mentioned in previous reports, posted in 1999 as a whole higher growth than, according to the historical relationships estimated, would be explained by consumption and imports. This buoyancy was also seen, albeit in a weaker form, in the other indirect taxes, notably the taxes on energy (due to the rise in oil prices) and the tax on certain means of transport, reflecting the strong growth in new vehicle registrations.

The decline in the rest of the revenue items was lower than in the period to September, primarily as a consequence of the trend in current and capital transfers. The decline in other net revenue in 1999 (-15.2 %) was mainly due to the fall in privatisation proceeds and to the differences between the value of public debt upon redemption and at issue. By contrast, the profits of the Banco de España posted strong growth, due to the capital gains generated by

CHART 22

**Price and cost indicators** (a)




Sources: Instituto Nacional de Estadística and Banco de España.

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

TABLE 3

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

EUR m

| | JAN-OCT 1998 | JAN-OCT 1999 |
|---|---|---|
| | Receipts | Receipts |
| **Current account** | **140,353** | **148,014** |
| Merchandise | 82,265 | 84,921 |
| Services | 37,238 | 42,122 |
| *Tourism* | *23,004* | *25,993* |
| *Other services* | *14,234* | *16,130* |
| Income | 10,655 | 10,014 |
| Current transfers | 10,195 | 10,957 |
| **Capital account** | **5,012** | **5,534** |
| | Payments | Payments |
| **Current account** | **138,783** | **154,250** |
| Merchandise | 94,958 | 106,597 |
| Services | 20,775 | 23,739 |
| *Tourism* | *3,791* | *4,321* |
| *Other services* | *16,984* | *19,418* |
| Income | 16,308 | 16,386 |
| Current transfers | 6,743 | 7,528 |
| **Capital account** | **607** | **757** |
| | Balance | Balance |
| **Current account** | **1,569** | **–6,236** |
| Merchandise | –12,693 | –21,676 |
| Services | 16,464 | 18,383 |
| *Tourism* | *19,213* | *21,672* |
| *Other services* | *–2,750* | *–3,289* |
| Income | –5,653 | –6,372 |
| Current transfers | 3,452 | 3,429 |
| **Capital account** | **4,404** | **4,777** |

Source: Banco de España,

(a) First provisional results.

the transfer of reserves to the European Central Bank.

Turning to expenditure, the year-on-year growth rate for 1999 as a whole was lower than in the period to September, basically due to interest payments. Having grown by 9.7 % to the third quarter, affected by the different timing of debt maturities in 1998 and 1999, interest payments fell by 4.7 % in 1999 as a whole. However, this heading of expenditure exceeded the initial forecast as a result of early redemption of debt for the purpose of its exchange. Current transfers grew by 9.1 %, mainly due to the transfers to the Social Security System and to Territorial Government, the increase of 14.9 % in transfers to the Regional (Autonomous) Governments in respect of their share in State revenue being notable. As stated in previous reports, part of this increase was attributable to the transfer to certain Regional (Autonomous) Governments of responsibilities for non-university education, which also explains the decline in State expenditure on wages and salaries. The contribution to the Social Security System to finance the current operations of INSALUD (the national health service) rose by 10.2 %, due to the assumption by the State of the full cost of healthcare. By contrast, transfers to INEM (the national employment office) fell by 28.5 %, as a consequence of the favourable labour market developments.

BOX 3

## Social security budget outturn

On budget outturn data to October 1999, the social security system ran a surplus of ESP billion 879 billion, ESP 374 billion higher than in the same period of 1998. This is a significant improvement on the budget forecast for the year as a whole, which was for an increase in the deficit of ESP 57 billion with respect to the 1998 outturn. It is also an improvement on the data to July, discussed in the previous «Quarterly report on the Spanish economy».

This performance results from growth in revenue of 8.2 % to October, well above the budget forecast (4.9 %), and an increase in expenditure of 4.8 %. Receipts from social security contributions rose by 8 % (6.3 % in the whole of 1998), exceeding the budget forecast by more than four percentage points. This was attributable, above all, to the notable buoyancy of registrations: the number of registered workers grew by 5.5 % in 1999, against 5.1 % in 1998. The other major source of revenue, current transfers from the State, also increased by more than budgeted.

The growth of expenditure during the first ten months of 1999 was somewhat below the budget forecast for the year as a whole. Developments in spending on contributory pensions were notable, with growth of 4.6 % to October (5.3 % in 1998 as a whole), more than one percentage point lower than budgeted. By contrast, growth in sick pay was still higher than budgeted.

As regards INEM (the National Employment Office), information is available on the unemployment contributions received to July, which grew by 11.3 % with respect to the same period a year earlier, and on unemployment benefits to November, which fell by 2.9 %. Both developments are explained by the healthy performance of employment. However, although registered unemployment fell in 1999 by more than in 1998, the decline in unemployment benefits was rather less than in 1998 as a whole (7.9 %). This may be due to the fact that the decline in unemployment seems to have been concentrated among certain groups, such as the long-term unemployed, who are not entitled to benefits, which led to a rise in the replacement ratio. Finally, employment-promoting rebates increased by 56 % to August.

**Social security system** (a)
**(Transfers to Regional Governments allocated)** (b)
**(Current and capital transactions, in terms of recognised entitlements and obligations)**

ESP bn and %

| | Outturn | Budgeted | | Outturn JAN-JUL | Outturn JAN-OCT | | |
|---|---|---|---|---|---|---|---|
| | 1998 | 1999 | % change | % change | 1998 | 1999 | % change |
| | 1 | 2 | 3=2/1 | 4 | 5 | 6 | 7=6/5 |
| **Revenue** | **12,891** | **13,519** | **4.9** | **8.5** | **10,893** | **11,785** | **8.2** |
| Social security contributions (c) | 8,715 | 9,032 | 3.6 | 8.2 | 7,155 | 7,722 | 7.9 |
| Current transfers | 4,023 | 4,326 | 7.5 | 8.9 | 3,617 | 3,931 | 8.7 |
| Other (d) | 153 | 160 | 4.3 | 9.4 | 122 | 132 | 8.1 |
| **Expenditure** | **12,909** | **13,593** | **5.3** | **4.9** | **10,388** | **10,905** | **5.0** |
| Wages and salaries | 2,049 | 2,144 | 4.7 | 5.8 | 1,744 | 1,837 | 5.3 |
| Goods and services | 1,249 | 1,285 | 2.9 | 6.3 | 1,010 | 1,077 | 6.6 |
| Current transfers | 9,438 | 9,959 | 5.5 | 4.5 | 7,531 | 7,881 | 4.6 |
| Benefits | 9,377 | 9,896 | 5.5 | 4.5 | 7,476 | 7,823 | 4.6 |
| *Contributory pensions* | *7,453* | *7,892* | *5.9* | *4.5* | *5,851* | *6,122* | *4.6* |
| *Sick pay* | *526* | *505* | *–4.1* | *2.1* | *406* | *414* | *1.9* |
| *Other* (e) | *1,397* | *1,499* | *7.3* | *5.1* | *1,219* | *1,287* | *5.6* |
| Outher current transfers | 61 | 64 | 4.3 | 6.0 | 55 | 58 | 5.8 |
| Other(f) | 174 | 205 | 18.2 | 10.9 | 103 | 110 | 6.8 |
| **Balance** | **–18** | **–75** | **—** | **134.8** | **505** | **879** | **74.1** |

Sources: Ministries of Economy and Finance and of Employment and Social Affairs, and Banco de España.
(a) Only data relating to the System, not to the entire Social Security Funds sector, are given. This is because the figures for other Social Security Funds for the year 1999 are not available.
(b) Transfers to Regional 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 1995 (the latest year available)
(c) Including surcharges and fines.
(d) Excluding surcharges and fines, and the contribution from the pharmaceutical industry.
(e) Reduced by the contribution from the pharmaceutical industry.
(f) Reduced by the disposal of investments.

As regards capital transactions, the growth of investment moderated, while capital transfers fell slightly. This was mainly due to the sharp decline in subsidies for interest paid on loans to purchase dwellings. By contrast, the payments to the Regional (Autonomous) Governments under the Inter-territorial Compensation Fund increased significantly.

## 4.5. The Spanish balance of payments and capital account

In the first ten months of 1999, the current and capital accounts ran an overall deficit of EUR 1,459 million, in marked contrast to the surplus of EUR 5,974 million in the same period a year earlier. This outcome basically reflects the strong rise in the trade deficit during this period, which was not fully offset by the notable improvement in the tourism surplus. Despite their recovery in recent months, goods exports posted moderate growth over the period as a whole, while imports remained highly vigorous. This, together with the sharp worsening in the terms of trade in recent months, prompted a significant deterioration in the trade balance (see Chart 3).

As for the other current-account items, the income deficit widened to EUR 719 million, due to the decline in the income of the credit system, which was only partially offset by the buoyancy of the income of the non-credit private sector, as a consequence of the strong growth in their external assets. On the payments side, there was sustained growth in those by the credit sector and the public sector, due to the increase in the bond investments of non-residents. The current-transfers surplus held steady at practically the same level as in 1998, while the surplus on capital account grew as a consequence of the higher growth in transfers from the EU under ERDF and EAGGF-Guidance.

Overall these data reflect a substantial increase in the nation's net borrowing, which would signal a simultaneous weakening in the non-financial balances of the household and corporate sectors, given the ongoing decline in general government net borrowing. In turn, the developments in household and corporate balances stem from the buoyancy of residential investment and private productive investment, against a background of favourable prospects for growth and progress in reducing the budget deficit.

# 5. The financial markets and flows of the Spanish economy

## 5.1. Interest rates and the financial markets

The Spanish, like the other European financial markets, were influenced in the fourth quarter by the rise of fifty basis points in the Eurosystem's intervention interest rate, which prompted increases in money market rates, and by the consolidation of a significantly higher level of long-term interest rates than at the beginning of 1999. Compared with interest rates in December 1998, three-month money market rates in January 2000 stood at a similar level (of around 3.3 %), while long-term interest rates are currently 170 basis points higher (see Chart 4).

On primary markets, the interest rates on the various issues made generally rose during the quarter, in line with developments on secondary markets. Thus, for example, the Treasury increased the marginal rate on one-year bills to 3.8 % at the latest tender in January, which is almost one percentage point higher than the yield offered at end-1998. In the case of ten-year bonds, the marginal issuance rate at the January tender stood at 5.8 %.

Domestic equity markets surged in the last quarter of 1999, especially in November and December. This was primarily a result of the lower uncertainty surrounding interest rates after the rise in the official Eurosystem rate, and of the favourable prospects for economic growth in the year 2000 in the euro area as a whole and in Spain in particular. The general index of the Madrid stock exchange recorded the highest growth in Europe in November and December, making for a rise of 16 % since end-1998, in contrast to the slackness to October. However, despite this favourable performance at the end of the year, the Spanish stock market rose less in 1999 than in 1998, when it moved up by 37 %. Also, these gains were smaller than those on the other European markets. In any event, it should be noted that the strong buoyancy of the stock market at the end of the year was characterised by considerable asymmetry, in so far as the price increases were concentrated in the telecommunications sector, while increases in the other sectors were modest. In January to date, the stock markets have again been characterised by highly erratic behaviour, and dominated by profit taking. Telecommunications is practically the only sector driving the market.

As regards bank rates, during the final quarter of the year banks continued to pass through to their deposit and lending transactions the increase in yields on financial markets. However, as mentioned in the latest monthly economic re-

TABLE 4

**Domestic interest rates and financial markets** (a)

| | 1998 | | 1999 | | | | Memorandum item: |
|---|---|---|---|---|---|---|---|
| | Q 3 | Q 4 | Q 1 | Q 2 | Q 3 | Q 4 | JAN 2000 |
| MONEY MARKET RATES: | | | | | | | |
| Three-month Euribor | 3.73 | 3.17 | 3.05 | 2.63 | 2.73 | 3.44 | 3.32 |
| RETAIL BANK RATES: | | | | | | | |
| Deposit synthetic rate | 2.67 | 2.06 | 1.91 | 1.66 | 1.69 | 1.93 | … |
| Lending synthetic rate | 5.80 | 5.15 | 5.02 | 4.54 | 4.71 | 5.03 | … |
| TREASURY RATES: | | | | | | | |
| 12-month Treasury bills (b) | 3.67 | 2.95 | 2.94 | 2.75 | 3.17 | 3.75 | 3.90 |
| 3-year government bonds | 3.96 | 3.54 | 3.51 | 3.29 | 4.28 | 4.56 | 4.83 |
| 10-year government bonds | 4.75 | 4.32 | 4.40 | 4.59 | 5.27 | 5.38 | 5.79 |
| SECONDARY MARKETS: | | | | | | | |
| 6/12-month Treasury bills | 3.64 | 2.88 | 2.91 | 2.68 | 2.99 | 3.60 | 3.54 |
| 10-year government bonds | 4.47 | 4.08 | 4.25 | 4.60 | 5.31 | 5.37 | 5.74 |
| Yield spread over German *bund* | 0.43 | 0.20 | 0.22 | 0.25 | 0.26 | 0.19 | 0.20 |
| Spread between commercial paper and Treasury bills | 0.19 | 0.33 | 0.18 | 0.21 | 0.20 | 0.17 | … |
| Spread between private bonds and public debt at over 2 years | 0.11 | 0.58 | 0.07 | 0.08 | 0.22 | 0.21 | … |
| Madrid Stock Exchange General Index (c) | 8.72 | 37.19 | –0.12 | 4.22 | –1.21 | 16.22 | –1.20 |

Source: Banco de España.

(a) Average daily data of last month in quarter.
(b) Marginal interest rate.
(c) Cumulative percentage change in index since start of year.
Latest data available: 20 January 2000.

ports, since the summer when rates on lending and deposit transactions reached a low, this process has been slow. Since July, the composite rate on deposits transactions has been revised upwards by almost 30 basis points, to 1.9 %. The banks have raised their rates on lending transactions more rapidly. From July they rose by 43 basis points to stand at 5 % at the end of the year. The rise in money market rates has meant that in the fourth quarter of 1999 Spanish bank rates were closer to those offered in the euro area as a whole, which depend, to a greater extent, on the path of long-term interest rates.

## 5.2. Financial flows in the economy as a whole

The third quarter information on the financial accounts of the Spanish economy show that the slow decline in the nation's net financial saving continued. This process, which began in the last few years, has been prompted mainly by the fall in private sector saving, that has only been partially offset by the rise in general government saving (see Table 5). This trend has a cyclical component, given that in times of high economic growth private-sector agents tend to borrow more while public finances improve, although overall the nation's saving falls as domestic demand expands at a higher rate than output. In the third quarter therefore the nation's net lending was close to equilibrium (at around 0.2 % of GDP), as against a level of almost 1 % of GDP in 1998.

A different view is obtained if the financial situation is analysed in terms of outstanding financial assets and liabilities. These balances are the outcome of both the financial transactions actually performed and the changes in the prices of financial instruments. So, for example, the debit balance of the nation's financial position, obtained as the difference between financial assets and liabilities vis-à-vis the external sector, fell in 1999 to stand in the third quarter at around -17.5 % of GDP (i.e. outstanding liabilities to the external sector exceeded the outstanding claims on non-residents). In the case of households and non-financial firms, the significant growth in their net financial position (sometimes also called net financial wealth) since 1992 came to a standstill in 1999. It

TABLE 5

**Saving and financial position**

| | FINANCIAL SAVING AS A % OF GDP (Cumulative data over four quarters) | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Average 1988-1992 | Average 1993-1997 | 1997 | 1998 | | | | 1999 | | |
| | | | | Q 1 | Q 2 | Q 3 | Q 4 | Q 1 | Q 2 | Q 3 |
| Financial saving of the nation | –2.6 | 0.5 | 1.5 | 1.3 | 1.0 | 1.1 | 0.9 | 0.9 | 0.7 | 0.2 |
| Non-financial firms and households | –0.2 | 4.9 | 3.1 | 2.6 | 2.0 | 2.1 | 1.7 | 1.5 | 1.1 | 0.7 |
| *Non-financial firms* | *–4.0* | *–0.7* | *–0.7* | *–0.1* | *–0.9* | *–0.7* | *–1.0* | *–0.9* | *–0.9* | *–1.2* |
| *Households* | *3.8* | *5.6* | *3.8* | *2.7* | *2.9* | *2.8* | *2.8* | *2.5* | *2.0* | *1.9* |
| Credit institutions (a) | 1.4 | 0.7 | 0.6 | 0.7 | 0.8 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| Institutional investors (b) | –0.2 | 0.1 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| General government | –3.8 | –5.3 | –2.4 | –2.2 | –2.0 | –1.7 | –1.7 | –1.4 | –1.1 | –1.3 |

| | FINANCIAL POSITION AS A % OF GDP (c) (Fourth-quarter data) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 (e) |
| Financial position of the nation | –16.5 | –18.9 | –19.3 | –18.0 | –17.7 | –18.1 | –19.2 | –17.6 |
| Non-financial firms and households | 39.4 | 47.5 | 52.9 | 59.2 | 68.5 | 77.2 | 86.2 | 86.2 |
| *Non-financial firms* (d) | *–17.1* | *–16.2* | *–13.6* | *–10.9* | *–6.8* | *–4.8* | *–0.4* | *0.8* |
| *Households* | *56.5* | *63.6* | *66.4* | *70.1* | *75.3* | *82.0* | *86.6* | *85.4* |
| Credit institutions (a) (d) | 12.4 | 13.9 | 12.9 | 12.1 | 12.8 | 14.2 | 14.2 | 14.7 |
| Institutional investors (b) | –1.1 | –1.2 | –1.0 | –0.9 | –0.6 | –0.5 | –0.6 | –0.6 |
| General government | –34.9 | –41.7 | –46.2 | –50.3 | –52.6 | –52.0 | –49.7 | –48.0 |

Source: Banco de España.
(a) Defined according to the 1st Banking Directive.
(b) Insurance companies, portfolio investment institutions and securities-dealer companies and securities agencies.
(c) Calculated as the difference between outstanding financial assets and liabilities.
(d) Shares excluded from liabilities.
(e) Third-quarter data.

should be noted that, apart from saving and borrowing transactions, changes in this position have been heavily influenced by the path of the prices of financial assets and, in particular, of equities. The slackness of the domestic stock markets during the first three quarters of 1999 affected developments in the financial position of households and firms. However, the recovery in prices in the final quarter of the year will have probably led to an increase in their net financial wealth at and-1999.

The developments described above in the nation's net financial savings are consistent with the available information on the financial account of the balance of payments for which data is currently available to October (see Table 6). According to this financial account the net flow of financing vis-à-vis the external sector changed direction in 1999. Thus, unlike in previous years, the Spanish economy obtained more financial resources from non-residents than it invested abroad. In the period January-October the net capital inflow totalled EUR 4,172 billion.

As regards assets acquired abroad, the most significant development during the first 10 months of 1999 was the sharp increase in direct investment, at double the rate in the same period of 1998. This process reflects the expansion of Spanish firms, especially in Latin America. In 1999 it was strongly influenced by the significant acquisition of external assets entailed by Repsol's takeover of the Argentine firm YPF. It should also be pointed out that the creation of the single currency and the progressive internationalisation of financial flows have stimulated the diversification of portfolio investment. Investment in domestic securities has been losing the attraction it had in the environment of a distinct domestic currency, and the domestic securities markets (especially the markets for private fixed-income securities and stock markets) are too narrow. The recent exemption from withholdings on account of corporate income tax granted to the income from the fixed-income securities of OECD countries may further boost the demand for foreign securities.

Adoption of the single currency has not led to an increase in the foreign deposits of the

TABLE 6

**Balance of payments on financial account**

EUR m

| | 1997 | 1998 | JAN-JUL 1998 | JAN-JUL 1999 |
|---|---|---|---|---|
| **BALANCE ON FINANCIAL ACCOUNT** | **–2,775** | **–1,188** | **–2,891** | **4,172** |
| **CHANGE IN LIABILITIES VIS-A-VIS EXTERNAL SECTOR** | **34,479** | **65,681** | **68,014** | **78,393** |
| **Direct investment** (a) | **5,621** | **10,152** | **7,913** | **7,898** |
| **Portfolio investment** (b) | 11,068 | 15,354 | 19,629 | 30,842 |
| General government | 9,952 | 4,125 | 9,409 | 18,226 |
| Other resident sectors | 1,183 | 8,469 | 7,732 | 6,621 |
| Credit system | –67 | 2,760 | 2,488 | 5,995 |
| **Other investment** | **17,790** | **40,176** | **40,472** | **39,653** |
| General government | 21 | 866 | –60 | –545 |
| Other resident sectors | 544 | 4,319 | 3,900 | 10,997 |
| Credit system | 17,226 | 34,991 | 36,632 | 29,201 |
| **CHANGE IN ASSETS VIS-À-VIS EXTERNAL SECTOR** | **37,255** | **66,870** | **70,905** | **74,221** |
| **Direct investment** | **10,970** | **16,507** | **14,440** | **29,708** |
| Other resident sectors | 9,844 | 14,756 | 12,199 | 30,656 |
| Credit system | 1,126 | 1,751 | 2,241 | –948 |
| **Portfolio investment** | **14,377** | **40,985** | **26,554** | **39,399** |
| Other resident sectors | 10,049 | 29,873 | 19,055 | 23,768 |
| Credit system | 4,328 | 11,112 | 7,499 | 15,631 |
| **Other investment** | **1,555** | **21,625** | **29,042** | **25,303** |
| General government | 331 | 388 | 308 | 154 |
| Other resident sectors | 12,392 | 17,668 | 20,236 | –6,168 |
| Credit system | –11,168 | 3,569 | 8,498 | 31,317 |
| **Reserves** | **10,352** | **–12,248** | **869** | **–20,189** |

Source: Balance of payments, Banco de España.
(a) Includes portfolio investment in unlisted shares.
(b) Includes direct investment in listed shares.

non-financial private sector; rather some of the deposits made previously have been cancelled. This could be a sign of the effectiveness of payment systems in the euro area, enabling payments to be made abroad safely and at a low cost without the need for funds to be held where they are needed. Finally, as mentioned in previous reports, the credit system's foreign deposits and loans followed a similar path to that of the previous year. The higher figure seen in Table 6 was largely a consequence of the claims on the Eurosystem arising in the balance sheet of the Banco de España as a consequence of the financial flows between Spanish credit institutions and the rest of the euro area.

The most significant developments in relation to external liabilities were, first, the recovery in placements of public debt abroad. This, together with the evidence on the portfolios of Spanish investors, suggests that a far-reaching process of portfolio diversification is under way in the euro area as a whole. Second, it should be noted that private-sector borrowing abroad has been relatively high compared to 1998. This may mean that some Spanish firms are financing their acquisitions of foreign assets with foreign funds. Third, Spanish credit institutions are continuing to depend heavily on foreign financing to cover the gap between the growth rates of lending and deposits. Finally, direct investment in Spain in the period of 1999 for which information is available has displayed a very similar profile to that of the previous year. This suggests that the Spanish economy has finally reached a level of maturity that is more conducive to its corporate sector investing abroad than to its being the target of foreign capital.

In short, considering capital flows by sector, it can be seen that the non-financial private sector has continued to acquire assets abroad in net terms. This capital outflow, together with the overall balance on current and capital account, has been financed by means of funds raised

TABLE 7

**Financial assets and liabilities of households and non-financial fimrs**

| | Latest quarter balance (a) (b) | Four-quarter %change | | | | | |
|---|---|---|---|---|---|---|---|
| | | 1998 | | 1999 (b) | | | |
| | | Q 3 | Q 4 | Q 1 | Q 2 | Q 3 | Q 4 |
| HOUSEHOLDS AND NON-FINANCIAL FIRMS: | | | | | | | |
| **Total financial assets** | **1,399.1** | **11.8** | **14.3** | **11.0** | **12.1** | **14.5** | **14.9** |
| Liquid financial assets | 568.8 | 5.1 | 5.4 | 4.5 | 4.4 | 5.1 | 5.4 |
| *Cash and cash equivalents* | *271.7* | *10.2* | *14.6* | *14.8* | *17.5* | *17.5* | *12.2* |
| *Other liquid financial assets* | *297.1* | *1.8* | *–1.1* | *–2.7* | *–4.9* | *–4.0* | *–0.1* |
| Other financial assets | 830.4 | 18.1 | 22.6 | 16.5 | 18.3 | 22.3 | 22.5 |
| **Total financial liabilities** | **910.4** | **11.6** | **13.2** | **14.4** | **16.3** | **16.8** | **15.8** |
| Bank financing plus fixed-income securities | 589.0 | 14.8 | 16.2 | 15.9 | 19.2 | 19.3 | 17.2 |
| *Credit from resident credit institutions* | *467.5* | *15.9* | *15.7* | *14.8* | *16.6* | *15.9* | *14.9* |
| Other financial liabilities | 321.4 | 6.4 | 8.3 | 11.9 | 11.2 | 12.5 | 13.4 |
| HOUSEHOLDS: | | | | | | | |
| **Total financial assets** | **888.3** | **9.0** | **12.9** | **8.7** | **9.1** | **11.7** | **12.0** |
| Liquid financial assets | 462.8 | 4.5 | 3.6 | 2.2 | 1.5 | 1.1 | 3.1 |
| *Cash and cash equivalents* | *205.6* | *6.5* | *8.9* | *10.5* | *14.1* | *15.3* | *14.1* |
| *Other liquid financial assets* | *257.2* | *3.3* | *0.4* | *–2.8* | *–6.3* | *–7.8* | *–4.3* |
| Other financial assets | 425.5 | 16.1 | 27.7 | 17.7 | 19.3 | 26.9 | 23.6 |
| **Total financial liabilities** | **369.7** | **11.1** | **13.3** | **15.4** | **15.1** | **15.7** | **14.7** |
| Bank financing plus fixed-income securities | 260.4 | 16.5 | 18.3 | 18.5 | 18.3 | 18.3 | 16.2 |
| *Credit from resident credit institutions* | *235.7* | *17.2* | *19.1* | *19.3* | *19.0* | *18.9* | *16.7* |
| Other financial liabilities | 109.2 | 0.8 | 3.4 | 9.0 | 6.0 | 9.8 | 11.2 |
| NON-FINANCIAL FIRMS: | | | | | | | |
| **Total financial assets** | **510.8** | **17.5** | **17.1** | **15.6** | **17.7** | **19.7** | **20.5** |
| Liquid financial assets | 106.0 | 8.6 | 14.8 | 17.2 | 19.6 | 26.4 | 17.1 |
| *Cash and cash equivalents* | *66.1* | *24.7* | *35.4* | *30.2* | *28.8* | *24.9* | *6.8* |
| *Other liquid financial assets* | *39.9* | *–9.9* | *–13.6* | *–1.4* | *6.1* | *28.6* | *39.5* |
| Other financial assets | 404.8 | 20.0 | 17.8 | 15.1 | 17.2 | 18.0 | 21.4 |
| Of which: *Claims on non-financial firms and households* | *190.6* | *10.5* | *8.3* | *8.5* | *9.0* | *8.9* | *10.5* |
| *Claims on rest of the world* | *124.2* | *61.2* | *48.4* | *37.3* | *41.7* | *39.9* | *44.8* |
| **Total financial liabilities** | **540.8** | **11.9** | **13.1** | **13.7** | **17.1** | **17.7** | **16.7** |
| Bask financing plus fixed-income securities | 328.6 | 13.5 | 14.5 | 13.7 | 19.9 | 20.2 | 18.0 |
| *Credit from resident credit institutions* | *231.8* | *14.7* | *12.5* | *10.4* | *14.2* | *13.0* | *13.0* |
| Other financial liabilities | 212.2 | 9.7 | 11.1 | 13.6 | 12.9 | 13.9 | 14.6 |

Source: Banco de España.
(a) EUR billions.
(b) The data for the fourth quarter of 1999 are provisional estimate.

abroad by general government and, especially, by credit institutions.

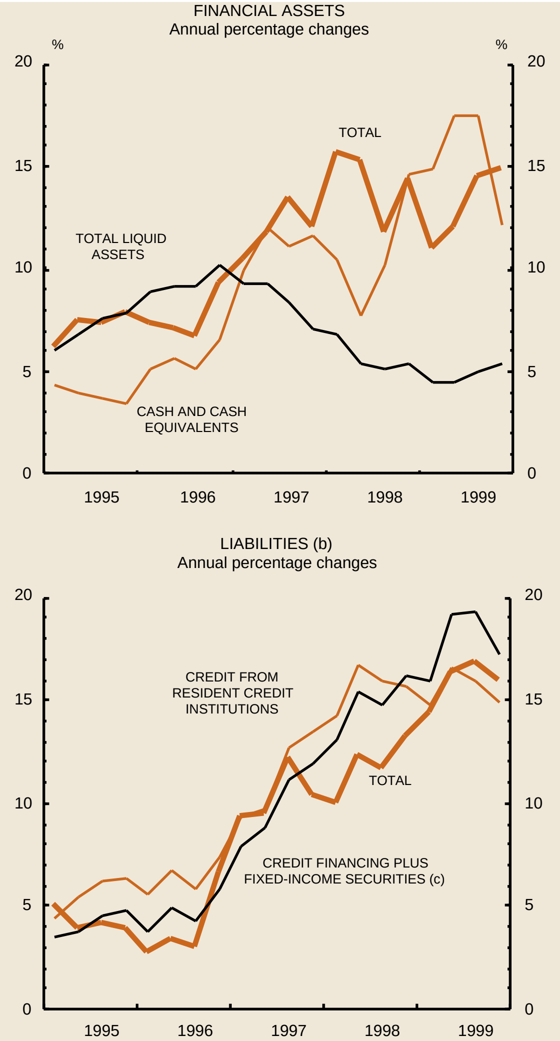
## 5.3. Financial flows of households and non-financial firms

In the third quarter of 1999, the net financial saving of the non-financial private sector fell by four-tenths of a percentage point from the previous quarter - to 0.7 % of GDP – a similar decline to that in the second quarter of the year. According to estimates based on the provisional information available on certain asset and financial liability items, in the last quarter of 1999 the fall in the financial saving of the private sector seems to have come to an end. The rate of investment in financial assets is expected to have recovered and the assumption of new liabilities to have moderated.

As regards financial assets, there has been a certain recovery in recent quarters in the rate of growth of the private sector's financial investments. As at end-1999, the year-on-year rate of growth may be almost 15 %. As seen in Table 7

CHART 23

**Non-financial firms and households** (a)




Source: Banco de España.

(a) The data for the fourth quarter of 1999 are provisional estimates.

(b) Excluding shares.

(c) Excluding trade credit.

and in Chart 23, growth rates vary considerably from instrument to instrument. While so-called liquid financial assets have grown at a year-on-year rate of 5 %, both cash and cash equivalents (the most liquid assets, which include cash and sight and savings deposits) and those financial assets not considered liquid (consisting, among others, of equities) have displayed very high rates of growth. In this respect, the strong expansion in cash and cash equivalents, which are especially linked to immediate spending decisions, and in other assets that are illiquid, but capable of giving rise to significant increases in the financial wealth of agents, through rises in their prices on financial markets, gives the impression that the current growth in the financial investments of households and firms can finance a continued expansion in demand, with some ease.

The information on the private sector's financial liabilities confirms this assessment, since various financing aggregates have been growing at high rates. The only sign of let-up is that the ongoing expansion of the indebtedness of households and non-financial firms reached a high in the third quarter of 1999. Thus, although it continued at very high rates, there was a slight slowdown in late 1999. In terms of the credit aggregate for which most information is available – namely financing to the private sector through bank credit and the issuance of fixed-income securities – its growth is estimated to have stood at around 17 % at end-1999, two percentage points lower than the growth rates in the second and third quarters of the year.

### *5.3.1. Financial flows of households*

In the third quarter of 1999 the gradual decline in the net financial saving of households continued. This decline began in 1995 and has accompanied the recovery in economic activity and the easing of financial conditions. In the present period of economic recovery, which dates back to 1995, the net financial saving of households has on average been 4 % of GDP, very similar to the rate in the period 1987-1991, the previous phase of expansion of output. However, at the peak of the previous cycle the low reached by saving (2 % of GDP in 1988) was higher than the level in the third quarter of 1999 which will foreseeably be surpassed by the year-end. This may be due to a more optimistic perception by households of economic prospects, to more expansionary financial conditions and, even, to the accumulation of a significant level of financial, and also real, wealth, which is encouraging borrowing and spending. In this respect, it should be recalled that while in the last economic cycle the net financial wealth of households was around 60 % of GDP, in the third quarter of 1999 this percentage was 85 % of GDP.

This rise in wealth is particularly significant if it is taken into account that it occurred during a period of strong growth in indebtedness. This means that there have been large capital gains, particularly favoured by the decline in interest rates, which has been reflected in rises in the prices of certain financial instruments (especially equities).

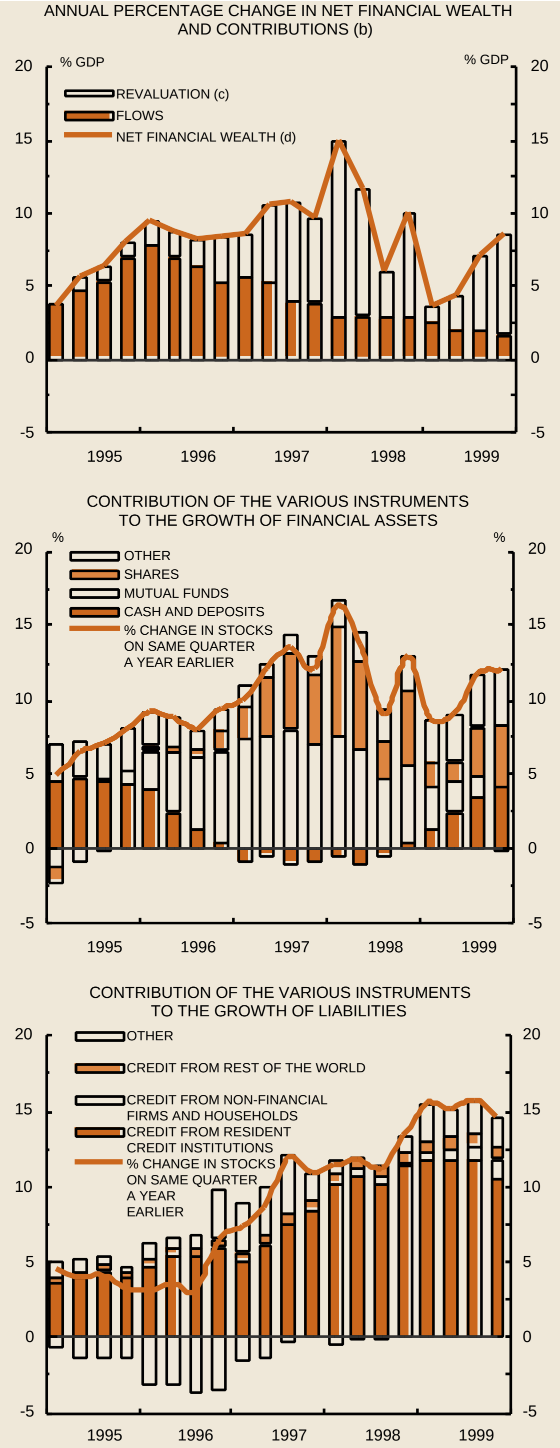
In the final quarter of 1999, the financial wealth of households recovered as a consequence of the rise in stock markets. As a result the same may have been the case in 1999 as in the previous two years, when most of the increase in the financial wealth of households was not due to new flows of saving, but to an increase in the price of the financial assets acquired (see Chart 24).

When households' financial assets and liabilities are analysed separately, it is seen that in 1999 there was a slight slowdown in the rate of growth of assets, while the rate of assumption of new liabilities was higher than in 1998. The most expansionary component of assets in 1999 was that made up of the least liquid financial assets (such as equities, shares in equity and international mutual funds and insurance products) which grew at rates of over 20 %. Although stock market expectations were not optimistic during much of 1999, savers continued to display a predilection for assets which, albeit with a greater risk, are capable of offering a higher return by way of compensation. A certain recovery has been detected in the growth rate of liquid assets in the final quarter of 1999, which may be due to the fact that the spread between long- and short-term interest rates fell during that period. Within liquid assets, cash and cash equivalents have continued to post the highest growth rates. The end-1999 rate was foreseeably over 14 %, in contrast to the year-on-year expansion in 1998 of less than 9 %.

The most dynamic component of household liabilities was bank credit, estimated to have grown at a year-on-year rate of 16 % in the fourth quarter of 1999. There was thus a slight slowdown in the rate of expansion of this form of indebtedness, since at the end of 1998 the growth rate was over 18 %. In any case, household indebtedness continues to grow at a rapid rate, and to represent a growing proportion of both GDP and household disposable income. The decline in interest rates between 1995 and 1999 made it possible for this increase in indebtedness to take place without an increase in financial costs. In terms of use, and on the basis of the latest information received, for the period to the third quarter of 1999, housing credit remained highly buoyant, while credit for the acquisition of durables moderated notably, to a year-on-year rate of 11 %, after more than two years of very high growth. The other financial liabilities of households, consisting essentially of trade credit, have grown at more moderate rates, although it should be pointed out that the importance of this component is small and the information available to estimate it less reliable.

CHART 24

**Households** (a)




Source: Banco de España.

(a) The data for the fourth quarter of 1999 are provisional estimates.

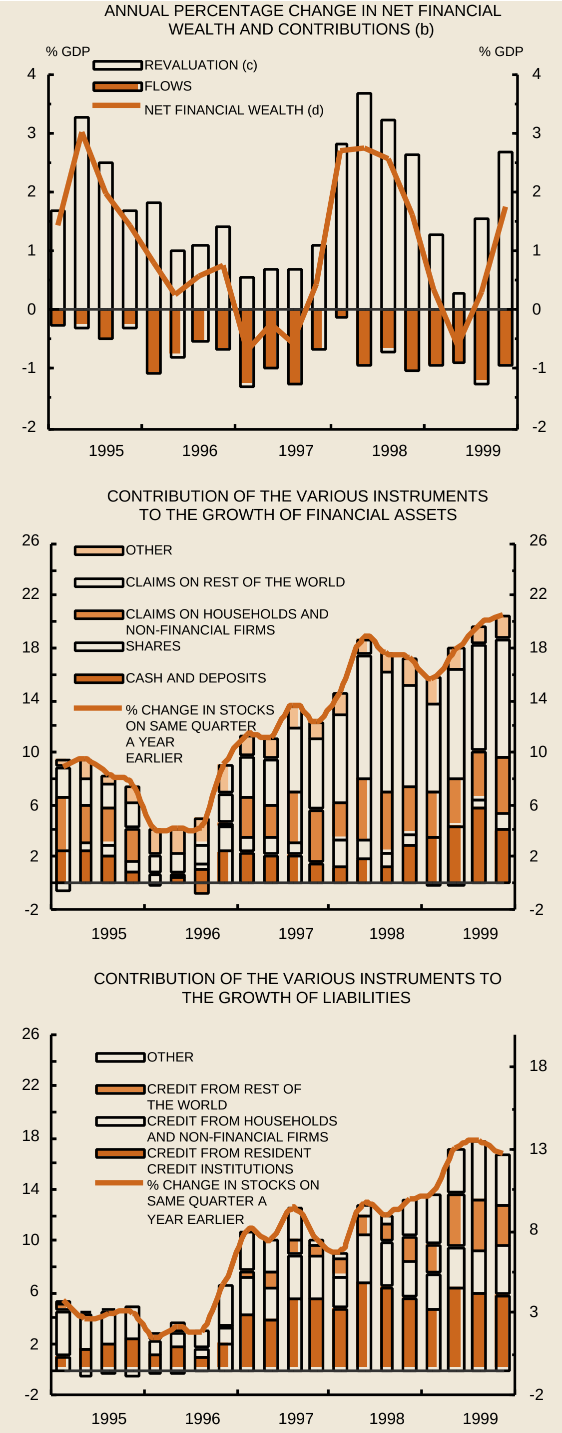
(b) The flows and revaluation are cumulative data for the latest four quarters.

(c) Difference between the change in the stock and the flow.

(d) Calculated using an estimate of the assets valued at market prices.

CHART 25

**Non-financial firms** (a)




Source: Banco de España.

(a) The data for the fourth quarter of 1999 are provisional estimates.

(b) The flows and revaluation are cumulative data for the latest four quarters.

(c) Difference between the change in the stock and the flow.

(d) Shares are not included in liabilities. Calculated using an estimate of the assets valued at market prices.

### *5.3.2. Financial flows of non-financial firms*

The net financial saving of non-financial firms fell in the third quarter of 1999 to -1.2 % of GDP. Unlike in the case of households, the current level of firms' net financial saving is not low in comparison with the equivalent stages of previous economic cycles. For example, in the period 1988-1991 the average net financial saving of non-financial firms in Spain was -3.6 % of GDP, while in recent years it has been around -1 % of GDP. The reasons for this include the lower investment requirements of Spanish firms in comparison with the period of rapid modernisation in the second half of the eighties and the more decisive orientation of Spanish firms towards investment abroad. Such investments require sufficient financial resources, whether these come from retained earnings or borrowing, but in principle they do not affect net financial saving since they involve a simultaneous rise in the stock of financial assets held by firms.

In terms of their financial assets and liabilities, in the second half of 1999 the firms displayed very expansionary behaviour. The rate of growth of their financial assets was around 20 % while their financial liabilities grew at around 17 %. The most dynamic component of financial assets was the acquisition of foreign assets, especially foreign equities. The purchase of external assets accounted for almost half of the increase in the financial assets held by firms (see Chart 25). Liquid instruments have also displayed very high rates of expansion, which may be indicative of the firms' healthy cash situation.

The rate of assumption of new liabilities by firms accelerated to the third quarter of 1999, to a year-on-year rate of growth of almost 18 % but, as in the case of households, it is estimated that this rate may have moderated slightly in the fourth quarter of the year. The most important and fastest growing item of liabilities was bank borrowing and the issuance of fixed-income securities. In the third quarter of 1999 this item grew at a year-on-year rate of over 20 %. Within this component, the most dynamic instrument was credit from abroad, which has been one of the main channels used by Spanish firms to finance their heavy foreign direct investment. The information on the destination of the credit shows that the year-on-year rate of growth of credit to the industrial sector and services fell in the third quarter of 1999, while credit to construction activity sustained an upward path throughout the year.

## 5.4. General government financial flows

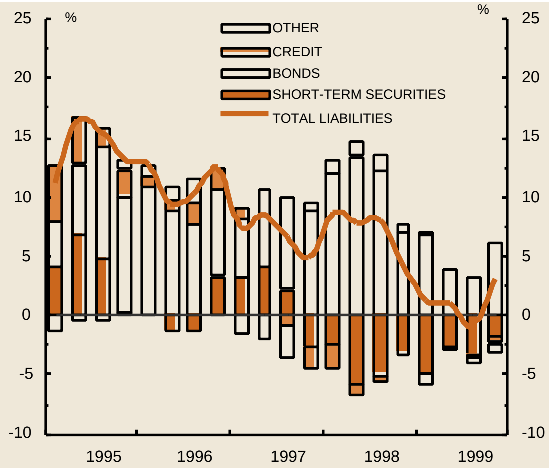
As mentioned in previous sections, the cumulative general government deficit during the four quarters to the third quarter of 1999 stood at 1.3 % of GDP. This is well below the average level for the period 1996-1998 of 3.5 %, and also one-tenth of a percentage point below the forecast for this variable contained in the year-2000 budget law of 1.4 % of GDP at end-1999.

The lower general government financing requirements are reflected in the stock of financial liabilities. The rate of growth of this stock has been falling, reaching a negative year-on-year rate of -0.9 % in the third quarter (see Chart 26). However, a certain rise in the rate of growth of liabilities is estimated for the fourth quarter of 1999. With regard to the composition of financing by instrument during 1999, fundraising was focused on the issuance of medium- and long-term securities (EUR 23 billion in net terms) to the detriment of short-term liabilities, the outstanding stock of which fell to around EUR 7 billion. As a result, the percentage of total outstanding liabilities corresponding to bonds stood at 64 % at end-1999, as against 59 % at end-1998. At the same time as changing the maturity structure of its debt, the State capitalised on the interest rate situation in 1999 to reduce the future financial cost of debt, by replacing liabilities issued in the past at higher rates of interest with securities yielding lower returns. This strategy led to the exchange of EUR 5.5 billion of medium and long-term debt.

The pattern of issuance at the January State tenders has been similar, with net issuance of almost EUR 2.8 billion in bonds and EUR –729 million in Treasury bills.

CHART 26

**Growth of general government liabilities**




Source: Banco de España.

With regard to financial assets, it is estimated that the heading of cash and transferable deposits, which includes the general government deposit with the Banco de España, increased during 1999 by around EUR 3.5 billion. However its behaviour over the year was not uniform. Thus, in the first and third quarters the balance of this heading fell, while a large increase is estimated for the fourth quarter. The growth of these deposits depends largely on the use made by the Treasury of the deposit held with the Banco de España, as this can be used to cover any mismatch between the Treasury's liquidity requirements and the net financial funds raised in the primary markets.

28.1.2000.