BANCO DE ESPAÑA

economic bulletin

July 2000

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Conventions used

M1	Money supply = Notes and coins held by the public + sight deposits.
M2	M1 + savings deposits.
M3	M2 + time deposits.
ALP	Liquid assets held by the public = M3 + other liquid assets.
ALPF	ALP + fixed-income mutual funds.
H1/H2	First/second half
bn	Billions (10^9).
m	Millions.
a	Projection.
p	After a date [January (p)], this means that all the related figures are provisional; after a figure, only said figure is provisional.
pp	Percentage points.
	Annual (1970) or quarterly data with this symbol are averages of the monthly data of the year or quarter; series of monthly, ten-day or weekly data are averages of the daily data for such periods.
...	Not available.
—	Nil, non-existence of the event considered or insignificance of changes when expressed as rates of growth.
»	Less than half of the last digit indicated in the series.
*	Series of seasonally adjusted data.

Abbreviations

AIAF	Association of Securities Dealers
BE	Banco de España
BIS	Bank for International Settlements
CNE	Spanish National Accounts
CNMV	National Securities Market Commission
CPI	Consumer price index
DM	Deutsche mark
EAGGF	European Agricultural Guidance and Guarantee Fund
ECB	European Central Bank
ECOFIN	EU Council (Economic and Financial Affairs)

EDP	Excessive Deficit Procedure
EMU	Economic and Monetary Union
EPA	Official Labour Force Survey
ERM	Exchange Rate Mechanism
ERM II	New Exchange Rate Mechanism for currencies of EU Member States outside the euro area
ESA 79	European System of Integrated Economic Accounts (1979)
ESA 95	European System of National and Regional Accounts (1995)
ESCB	European System of Central Banks
ESP	Pesetas
EU	European Union
EU-15	The fifteen current EU Member States
EUR	Euro
EUROSTAT	Statistical Office of the European Community
FIAMMs	Money-market funds
FIMs	Securities funds
GDP	Gross Domestic Product
GDP cp	GDP at constant prices
GNP	Gross National Product
GVA	Gross Value Added
G7	Group of Seven
HICP	Harmonised index of consumer prices
HF	Households and firms
IMF	International Monetary Fund
INE	National Statistics Office
INVERCO	Association of Portfolio Investment Institutions and Pension Funds
IPI	Industrial Production Index
MEFF	Financial Futures and Options Market
MFIs	Monetary financial institutions
MINER	Ministry of Industry and Energy
MMFs	Money-market funds
NBER	National Bureau of Economic Research
OECD	Organisation for Economic Co-operation and Development
PPI	Producer price index
R + D	Research and development
RENFE	National railway company
SEPI	State industrial holding company
SGP	Stability and Growth Pact
SIB	Stock-exchange interconnection system
TARGET	Trans-European Automated Real-Time Gross Settlement Express Transfer system
ULCs	Unit labour costs
VAT	Value Added Tax
WB	World Bank

Contents

Quarterly report on the Spanish economy

1. Overview

The behavioural patterns marking recent developments in the Spanish economy have not changed significantly in the period to date in 2000. The growth rates of output and job creation continue to be notable, national demand remains resilient and goods exports are, against a favourable international background, showing considerable strength, improving their position on foreign markets. Notwithstanding, the trade deficit is widening owing to the real growth of imports and the deterioration in the terms of trade. The latter is essentially due to the impact on import prices of dearer energy products and the depreciation of the euro.

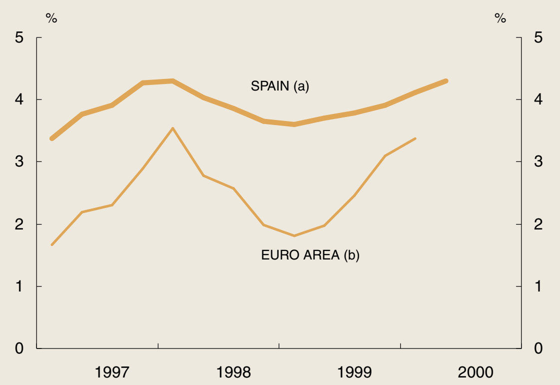
Given the usual caveats, the estimated real growth of Spanish GDP ran at around 4.2 % in 2000 Q2 compared with the same period a year earlier. This figure, irrespective of its quantification (INE has announced the revision of the QNA series over the coming months), accentuates, albeit only slightly, the buoyancy with which the year began. The growth rate of national demand also increased in relation to the preceding period, drawing close to 4.5 %, while no relevant changes are expected in the negative contribution of net external demand to GDP growth, which stands once again at around 0.3 percentage points. Comparing these figures with those – for Q1 – recently released for the euro area countries as a whole (3.4 % for real GDP growth, 2.7 % for domestic demand [with no change in stocks] and 0.7 percentage points for the positive contribution of the external balance), the gap between GDP growth rates can be seen to be continuing to narrow (see Chart 1).

Price trends remain marked by notably dearer energy products. The 12-month growth rate of the consumer price index (CPI) stood at 3.4 % in June, with the related rate of the harmonised index one-tenth of a point higher at 3.5 %, and the rate for the euro area as a whole at 2.4 %. Consequently, the inflation gap has held virtually stable (see Chart 2).

Against this background, economic policies have progressively been adapted to the targets set. The monetary policy defined for the euro area countries continued gradually to accommodate the conditions prevailing in the area, namely sustained growth and greater inflationary risks. But the somewhat tighter monetary policy stance is still relatively generous for those economies, such as Spain, which are ahead in the cycle. The Spanish fiscal authorities, for their part, have considered more demanding targets to correct the budget deficit, since tax revenue is increasing at a greater rate

CHART 1

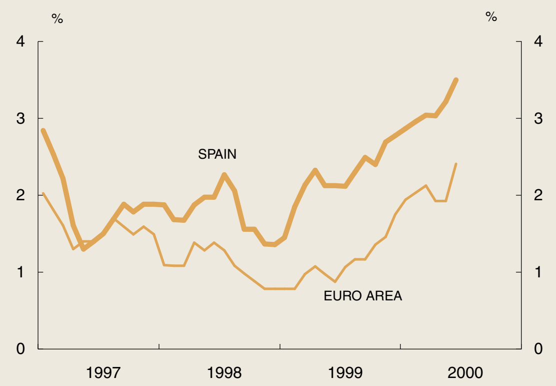
Gross domestic product



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.

CHART 2

Harmonised indices of consumer prices



Sources: Eurostat and European Central Bank.

than expected in line with the more expansionary macroeconomic scenario. Lastly, the government agreed recently to further boost liberalising measures by means of a series of actions aimed at improving the workings of and increasing competition in the various markets for goods and services. The effects of these measures will be felt, above all, in the medium term (see Boxes 1 and 2).

As in Spain, the international economic environment has not undergone significant changes during the first half of the year, and most organisations have retained highly optimistic forecasts for world growth this year and next. The United States economy remains remarkably buoyant, although signs of a slight slowdown in private consumption are perceptible. The improvements discernible in those areas lagging most behind in terms of recovery (Japan, Russia and certain Latin American countries) must generally be assessed with caution. The main inflationary risks continue to be associated with crude oil prices which, on international markets, are above the level that had been forecast for the second half of this year. Nonetheless, in recent days, and given expectations of future increases in production, oil prices have edged down to stand at around $26 per barrel.

Oil prices also pose the biggest risk for continuing stability within the euro area, now that virtually all EMU members are running at a sustained rate of expansion increasingly underpinned by the confidence of agents and the firmness of domestic expenditure (see Chart 3). Despite the fact there is a significant temporary component to the rise in consumer prices witnessed in recent months, derived from the trend in energy prices, if their impact on other sectors is to slacken, then the increase in unit labour costs must be contained by means of a combination of productivity gains, wage restraint and an ambitious policy of fiscal consolidation.

Given this situation, the European Central Bank (ECB) decided on June 8th to raise the interest rate on its main refinancing operations by 50 basis points to 4.25 %. As a result of this rise, the euro area benchmark interest rate has, in approximately one year, increased by almost two percentage points. And despite the fact the feed-through to the rates on banking transactions has been fairly swift, it is still too early to determine what the impact will be on the monetary and credit aggregates, whose rates of increase, though still generally high, have slowed over the past month.

The change in monetary policy stance, to which the stability of the price of the euro (which is still at a considerably weak level) has also contributed, can also be seen in the Spanish economy's interest rates (see top panel of Chart 4). The growth of financing received by households and firms is high, although incipient signs of a slowdown are apparent in the latest figures. Monetary conditions remain excessively generous for an economy in which agents' spending decisions have taken the nation's net financial saving to increasingly more negative levels, with household net financial saving at an historical low. The contribution of public finances to restoring more balanced financial conditions is undoubtedly proving significant. And this has again been manifest following the

BOX 1

Measures approved in June 2000 to liberalise and step up competition in the network industries

As part of a broader set of measures, two royal decrees were approved in late June which significantly amended the regulatory framework for the network industries, namely liquid hydrocarbons, electricity, natural gas and telephony. The aim was to step up competition in the related markets. The most significant changes are summarised below.

In the liquid hydrocarbons industry (fuel and other energy products), the measures adopted are aimed, first, at providing readier access for all operators to the wholesale distribution network on an equal footing; and further, at promoting greater competition in retail distribution via service stations. To achieve the first objective, limits have been set on shareholdings in the Compañía Logística de Hidrocarburos (Hydrocarbons Logistics Company) both for individuals or corporations (25 %) and for all refining companies existing in Spain (45 %). In this way it is sought to provide for the separation of logistic and transport activities from distribution and supply, which had hitherto evidenced a high degree of vertical integration. Likewise, to make the working of the network more transparent, the conditions entered into in all the contracts governing network access shall be publicly disclosed. As to the distribution of oil products in the retail segment, various measures have been taken to reduce the high concentration prevailing. First, operators have been prohibited from increasing the number of service stations over the next three or five years if their market share stands at between 15 %-30 % or exceeds 30 %, respectively. Further, it has been established that large retail outlets shall incorporate at least one service station which shall be supplied by at least two wholesale oil-product operators. Completing the measures shall be the obligation to provide information on the prices charged by service stations, which have begun to be published.

In the electricity industry two types of measures have been approved. Whereas some are aimed at increasing competition in the industry, others modify prices and rates. Regarding the first group, it should be recalled that that the strong vertical integration in the industry and the high degree of concentration in electricity generation inhibit, in practice, competition in retail distribution. In this setting, the possibilities of the retailing companies (which group together the demand by big consumers, i.e. those that can choose a supplier) acquiring electricity are broader; they can enter into electricity purchase contracts with foreign suppliers and with domestic «special-regime» (i.e. when electricity is produced in association with other unrelated activities or when waste or non-hydraulic renewable energies are used in its production) producers, and, from 2003 onwards, with «ordinary-regime» domestic producers. Accompanying these measures, electricity producers whose generation share exceeds 40 % are prohibited from increasing this share over the following five years. This prohibition will apply for only three years for those producers with a share of over 20 %. Further, the date from which all consumers may freely elect suppliers and, therefore, negotiate purchase prices has been brought forward to 1st January 2003 (four years ahead of schedule). In the period to that date, the steps required to acquire big-consumer status have, moreover, been simplified. Regarding the second types of measures, the tariffs for access to transport and distribution networks for big consumers have been reduced, so as to encourage resort to the market. Likewise, capacity payments have been reduced and a commitment has been made to restructure network access tariffs before 1st January 2001. Lastly, domestic consumer tariffs will be lowered by a maximum of 9 % during the period 2001-2003.

In the natural gas industry, the measures introduced are aimed, on one hand, at increasing competition in the various stages of the productive process and, on the other, at reducing charges and access payments in the industry. In the first group, mention should be made of those measures designed to rationalise the industry and to facilitate third-party access to the network for outsiders and the emergence of new operators. The measures include most notably the following: the creation of a «technical management» organisation for the gas system; the diversification of shareholdings in ENAGAS, via the setting of a limit of 35 % on the capital or the voting rights that any group of companies may hold; the transfer of 25 % of the rights on gas imported from Algeria to retailing companies other than ENAGAS; a limit on market share of 70 % for each gas supplier as from January 2003; and the bringing forward of the date from which new operators may construct their own distribution networks to 2005. Secondly, the timetables for the free selection of supplier by end-consumers are brought forward: liberalisation shall be applicable forthwith for those consuming more than three million standardised cubic metres and for all co-generation plants, and brought forward to 2003 for the rest. Further, all third-party access payments for reception, re-gasification, storage and transport facilities have been reduced by 8 %. Moreover, in early 2001 a new cost-based system of natural gas charges and payments applicable to the use of infrastructure by new operators shall come into effect.

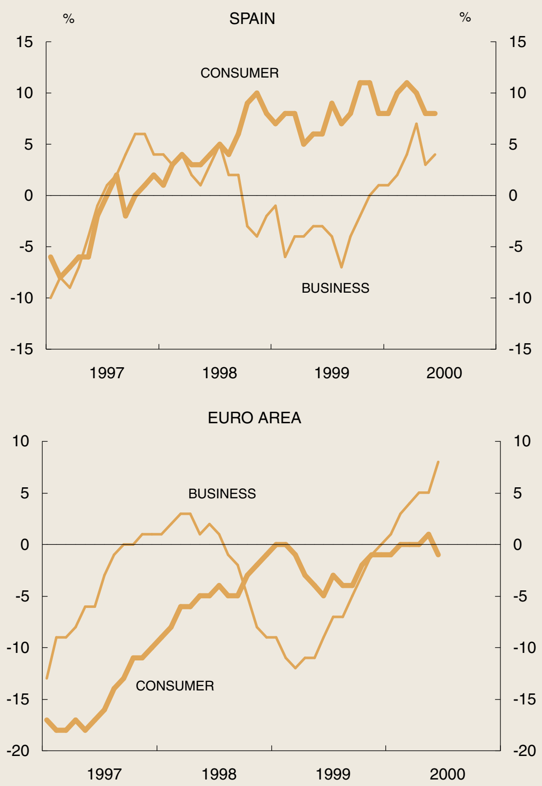
In telecommunications, the main measures affect local calls, a segment of fixed telephony which had, to date, remained outside the liberalisation process. It has been stipulated that, as from January 2001, the incumbent operators of fixed telephone public networks shall allow the exclusive lease to another operator of the final section of the fixed network arriving at users' homes (the subscriber's loop), or shall lease out on an exclusive basis at least high speed data (Internet) services. Further, by 15th November this year the pre-selection of local calls must have been made available. As concerns prices, the incumbent operator shall have provided flat rates, on one hand, for Internet in a limited time band, and, on the other, for Internet and local calls at different time bands. Before 15th September, reference interconnection tariffs for use of the fixed network of the former monopoly shall have been modified. However, the introduction of additional competition in mobile telephony has been left for a later date.

Lastly, for all four sectors (liquid hydrocarbons, electricity, natural gas and telecommunications), holdings by individuals or corporations in more than one company with the consideration of main operator are limited.

In sum, the measures introduced may have beneficial effects on competition in the network industries, as a result of the introduction of specific limits on concentration; the unbundling -in certain cases- of varied activities; the restrictions on shareholdings in more than one main operator; and the new arrangements for authorising mergers, which are discussed in Box 2. Significant steps have also been taken to increase transparency in the setting of prices, charges and access payments, and important segments of these markets have been opened up to real competition, especially that for fixed telephony. Though these measures are positive, some time may have to pass before they are fully effective. And it should further be stressed that, in some of these sectors, considerable concentration and obstacles to entry remain in place.

CHART 3

Confidence indicators



Source: European Commission.

economic authorities' revision of the budget deficit target for the current year, which has been altered from 0.8 % of GDP, as established in the Updated Stability Programme, to 0.4 % of GDP. The latest data on the State budget outturn in the first half of the year, or their expression in National Accounts terms, are in this respect highly favourable: tax revenue is proving considerably higher than forecast, both as regards indirect tax and, in recent months, direct tax, and the growth of spending is, overall, fairly moderate.

Against this backdrop, the Spanish economy is, for the fourth consecutive year, running a high real growth rate underpinned by the buoyancy of national demand and exports. As a result, the rate of increase of final demand has stabilised at a level of over 6 %; the growth of imports deducts approximately two percentage points from the expansion of output. With the exception of government consumption, which is growing at a much more moderate rate, the other components of domestic demand continue to show signs of considerable strength. Nonetheless, in some of the latest indicators of household consumption, there are signs of a slowdown, chiefly in the consumer durables segment. The rises in interest rates, the increase in energy products prices and the possible petering out of demand, after a lengthy period of growth (as may be the case of the automobile industry), might account for these results. In any event, the real rate of change of household consumption remains high, driven by the growth of disposable income and accumulated gains in wealth, and consumer confidence continues to stand at historically high levels; that said, the year-on-year growth rate in Q2 may be slightly lower than the figure of 4.5 % advanced by INE for the first three months of the year.

Investment in capital goods might, for its part, exceed in Q2 the figure it posted the previous quarter, which had checked the slowdown that took place throughout 1999. Although some of the latest indicators show a tendency towards stabilisation, corporate investment decisions are expected to gather greater steam insofar as final demand in the economy (both domestic and external) retains its current pattern of expansion and business results remain favourable, as reflected in the Central Balance Sheet Office data released last month and presented in this Bulletin. Business expectations and order books appear to attest to this estimate. Turning to investment in construction, the latest figures show signs of a slowdown in the demand for housing, whereas public works appear to be resuming a more sustained pace. The rate finally estimated does not differ substantially from the INE figure for Q1, which was 5.5 %.

The Q2 data on the external demand components are incomplete and the estimates offered are based on the results of the forecasting models habitually used and on the assessment of the trends discernible in the latest figures. These trends confirm the notable buoyancy of goods exports, which are gaining market share both in the EU and in other regions, with the odd exception such as China. The gains in competitiveness arising from the depreciation of the euro – which offsets the acceleration in export prices – and the strong growth of world trade are the factors traditionally behind this positive trend, to be confirmed by the figures in the coming months. These highly favourable trade results also extend to the tourist sector, despite the fact the latest indicators released were somewhat less buoyant. Lastly, the real growth forecast for imports is consistent – despite the erraticism seen in the previous months' data – with the expansionary behaviour

BOX 2

Liberalisation measures and stepping up of competition in other sectors

In addition to the measures affecting the network industries (see Box 1), many other varied measures were adopted bearing on a very wide and heterogeneous set of sectors. Notable among these are those that strengthen competition by means of amendments to the Competition Act (via the new merger authorisation system), those smoothing the on-going internationalisation of Spanish companies, and those aimed at removing obstacles to various professional activities. Outlined below in a non-exhaustive fashion are the most important measures.

Regarding the promotion of competition, notification to the Competition Service of mergers and takeovers (a requirement which, under current legislation, affects all operations above a certain threshold) has been stipulated. Such notification shall be before the operations begin, and they may not be carried out before the appropriate authorisation has been granted (previously, the notification could be obtained up to three months after having commenced the operation). Further, the procedures for the resolution of these cases have been made more flexible, and no more than three months (previously six) may elapse from the time of notification to the Competition and Fair Trading Board until the time the government makes a decision.

As to pharmaceutical products, the margins on drugs have once more been modified as from 1st August (the previous change in May 1999 involved a cut in the distributor's margin). Chemists' margins on advertised drugs (those sold without a prescription and which are not publicly funded) have been made more flexible, as discounts of up to 10 % may be applied. Further, both chemists' and distributors' margins on the most expensive products have been reduced, having been set at a fixed amount for all drugs exceeding ESP 20,000. To offer incentives on the sale of generic drugs, a margin of 33 % has been set for chemists for this type of product, which is higher than that applied to other drugs (where the maximum margin is 27.9 %). Elsewhere, the Social Security pharmaceutical bill has been reduced by means of deductions based on volume purchases.

As concerns opening hours, the weekly total has been notably extended in all regions from the 72 hours currently in effect to 90. In addition, Sunday and holiday opening has been liberalised for retail establishments of less than 300 square metres which do not belong to distribution chains. For other establishments, Sunday and holiday opening is gradually being extended from 8 days at present to 12 in 2004, at the rate of one additional day per year. However, the second-licence requirement for the opening of large retail outlets has not been changed.

Notaries public shall be allowed to apply discounts to fees of up to 10 %, while it is established that for documents exceeding a specific amount, the fee shall be freely applicable. The fees of property and mercantile registrars shall generally be reduced by 5 %, and by higher percentages if the registration of urban property documents (15 %) or the subrogation of mortgage loans for protected housing (50 %) is involved. Moreover, in the case of documents for amounts exceeding ESP 1 billion, the fee is limited to a fixed amount. Consequently, the regulated fees of these professionals have been lowered. In connection with mortgage loans, greater transparency is stipulated for the related information brochures as regards the borrower's right to select an appraiser, agent, insurer and notary public. These measures are reinforced by others aimed at the land-use and housing sector. Specifically, private enterprise shall be allowed to promote the transformation of buildable land, and the administrative procedures for approving development and town planning instruments shall be simplified. Further, property intermediation is liberalised and, under property tax, taxation of the habitual dwelling is exempt up to a maximum amount of ESP 25 million.

To increase competition in road passenger transport, the duration of exclusive concessions of regular services have been reduced from a range of 8-20 years to 5-10 years. Moreover, the technical inspection of vehicles has been liberalised, with the current fixed-rate concessionary system being replaced by a maximum-rate authorisation system.

Certain obstacles hindering professionals from engaging in their activity in regions other than that where they are officially registered have been eliminated. It is now forbidden to demand payments relating to professional eligibility, and that are not included in membership quotas, other than those required of regional registrants with such professional bodies.

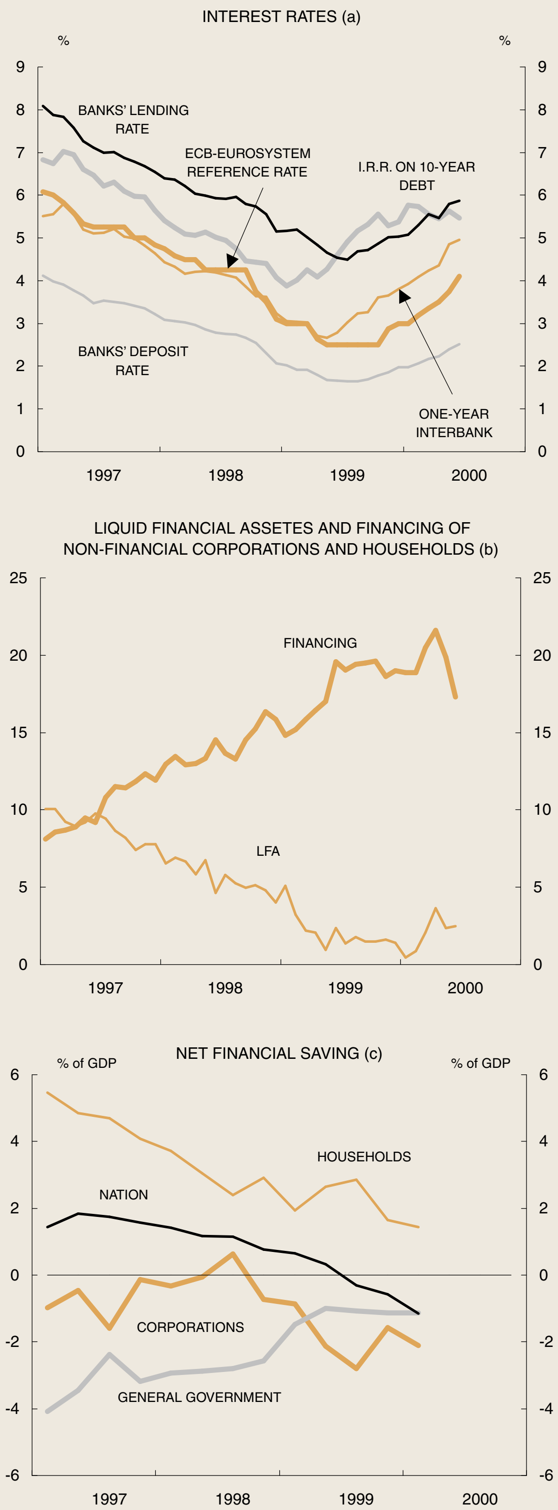
In the tobacco products sector, current restrictions on wholesale tobacco distributors have been eased insofar as they are not required to cover all the national territory and are allowed to distribute various other products at the same time. In exchange, manufacturers and importers are obliged to ensure their products can be obtained throughout the territory provided there is a demand for them.

Discounts on text books have been liberalised and the medical services of the mutual insurance companies covering temporary disability have been authorised to issue and cancel sick notes in this connection. Further, the formal obstacles to the establishment of new sales outlets for bunker fuel have been lifted.

In relation to foreign investment, the related regime has been altered to avoid double taxation on business activities engaged in abroad (by means of subsidiaries) and, to encourage internationalisation, payment of corporate income tax may be deferred when shareholdings are taken up in non-resident companies. In line with the recommendations of the Lisbon Summit, tax deductions for investment in new technologies, for staff training in such technologies and for SMEs' investment in R+D are appropriate steps for fostering the Information Society. Lastly, a further group of tax measures aimed at promoting saving was introduced (see the article on «Financial regulation: 2000 Q2» in this Bulletin).

CHART 4

Financial indicators of 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.

of their main determinant: final demand in the economy.

Turning to the productive branches, the indicators available for 2000 Q2 confirm the estimate of output growth discussed previously from the standpoint of demand. The main expansionary boost has stemmed from industrial activities, although it should be pointed out that the agriculture and fisheries branch has ceased to post negative rates of change. Meanwhile, the growth of market services has been more stable.

In this clearly expansionary setting, employment growth continues to be notable, as does the decline in the unemployment rate. Most of the latest indicators appear to show a modest loss of momentum in job creation, as a result of which apparent labour productivity is picking up, from very low levels. The increase in productivity has been greater in industry. And this, combined with the acceleration in industrial prices on both domestic and foreign markets, is driving the increase in corporate margins in the sector.

The wage rises being negotiated in collective bargaining agreements and the effect of the inflation-adjustment clauses that have been activated in the opening months of the year have accentuated the growth of compensation per employee. This is why, despite the moderate recovery in productivity, the growth of unit labour costs is holding at around 2 % (with significant differences across the various branches and industries), somewhat over one percentage point higher than the related euro area rate.

Most price indicators have worsened during Q2, with their growth rates rising. The gap between the growth rate of the Spanish HICP and that of the euro area as a whole has stabilised at around one percentage point since the beginning of 1999, after having been virtually zero in 1997 when the Spanish economy completed its process of nominal convergence with the countries in the area. The differences are wider and more persistent in the services sector, and fluctuate in the case of goods depending, basically, on the trend of food prices. In any event, it is in the non-energy industrial goods index where the differences between growth rates are tending to widen; indeed, there is already a gap of 1.5 percentage points.

The main challenge currently facing the Spanish economy is to prolong its expansionary phase, which is in its fourth consecutive year, so that real convergence with the EU countries may continue. For this to come about, the macroeconomic stability achieved must be maintained and competitiveness improved. In this respect, the firming of the differences between the rates of change of prices and production costs relative to the euro area countries, and the low growth observed in factor productivity, may pose an obstacle that should be obviated. To this end, and so that the persistence of a high growth rate of demand should not ultimately generate excessive imbalances, the potential for economic growth – preferentially investment- and export-led growth– should be increased, and the workings of markets made more efficient. In this respect, the recent government measures aimed at heightening competition in numerous markets for goods and services will contribute to increasing the capacity of aggregate supply to react and improving the economy's efficiency. This course of action, ini-

2. The external environment of the euro area

In 2000 Q2, the external environment of the euro area continued to move on an expansionary path. The United States economy remained very buoyant, although there has been a significant slowdown in private consumption. In Japan, the slow recovery that began a year back appears to be continuing, after having put behind the slowdown in the second half of 1999. Meanwhile, in the emerging south-east Asian and Latin American economies, economic growth continues to gather momentum. Against this background, prices have worsened in the industrialised economies, this having been largely brought about by the additional increase in oil prices in Q2, set against the greater uncertainty surrounding supply developments on the international markets for crude.

In the United States, the final National Accounts data for Q1 confirmed the economy's vigorous growth (5.3 % year-on-year) over this period (see Chart 5), driven by the expansion of private demand and exports. The information for Q2 points to the continuing buoyancy of the economy in this period, with GDP running at an annualised quarter-on-quarter growth rate of 5.2 % (6 % compared with the same period a year earlier). As in previous quarters, economic activity was based on the strong increase in domestic demand and in exports, although imports rose by a greater extent than exports. Nonetheless, private consumption slowed appreciably, posting in 2000 Q2 the lowest quarter-on-quarter growth rate since 1997 (3 % in annualised terms), thereby confirming the signals that the economic indicators had been providing. Fixed capital investment was as expansionary as in the preceding quarters, with the strong increase in inventories and in public spending (traditionally volatile components), which had run at negative quarter-on-quarter growth rates in the previous period, the main determinants of the acceleration in GDP in Q2.

During the period under review, no significant deterioration in the imbalances characterising this high-growth phase of the US economy was observed, but nor were there clear signs of any correction. In particular, after the current-account balance reached a new peak in Q1 (see Chart 7), the rate of deterioration of the trade deficit abated. On the Stock Exchange, there was a partial correction of the price rises seen in the opening months of the year.

Turning to prices and costs, and drawing on hourly earnings figures, the relative stability of wages throughout Q2 was notable, despite the tightening labour market. The unemployment rate has duly held at close to 4 %. Moreover, insofar as productivity growth is running at around 3 % year-on-year, unit labour costs are continuing to rise at very moderate rates. Consumer prices, however, worsened during Q2. They climbed to 3.7 % in June, essentially as a result of the impact of the hike in oil prices on world markets, although underlying inflation (excluding energy and fresh food prices) held at 2.4 % in May and June.

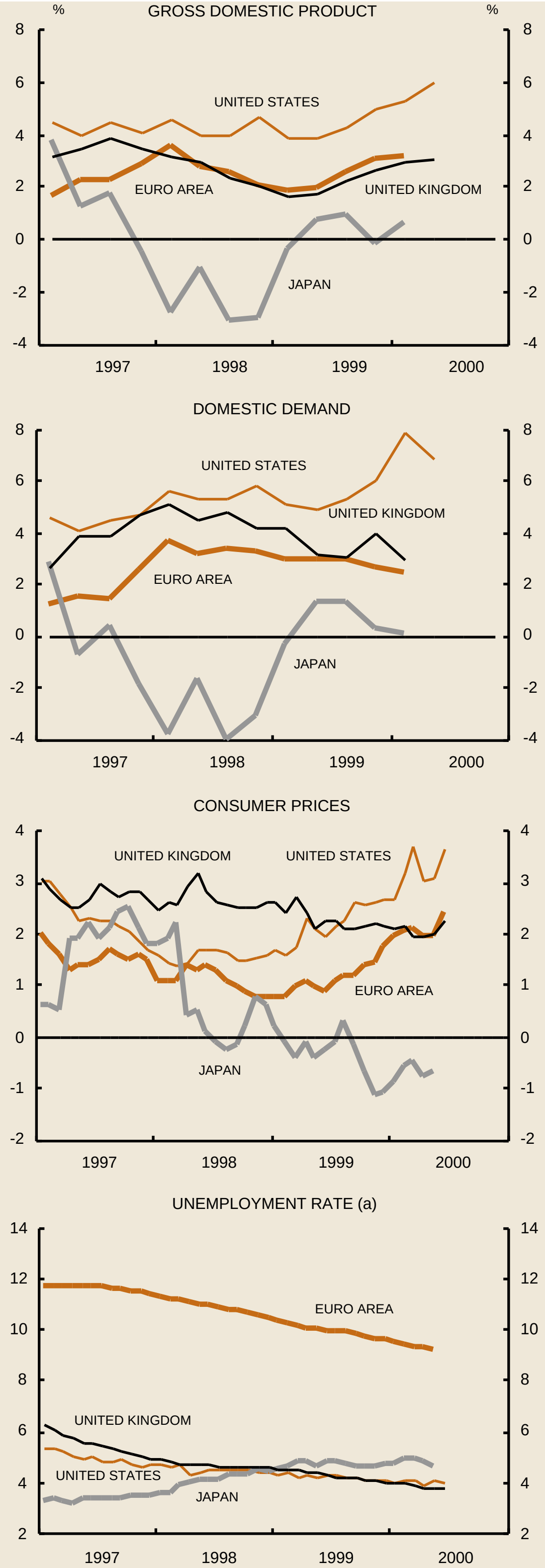
Against a backdrop of latent inflationary pressures, the Federal Reserve decided on May 16th on a further 50 basis points rise in its federal funds rate. This was the third such rise since January and the first on such a scale since the progressive tightening of monetary policy began in late June 1999. Subsequently, the incipient signs of a moderation in the growth rate of consumption, together with the ongoing rise in productivity, which prevented inflationary pressures from the labour market from materialising, led the Federal Reserve to keep its target interest rate unchanged at 6.5 % at the Open Market Committee meeting held at the end of June. Nonetheless, the US central bank continued to warn public opinion about the persistence of significant inflationary risks.

Japanese GDP grew by 2.4 % in 2000 Q1 compared with the preceding quarter and by 0.7 % compared with the same period a year earlier. This saw the economy emerge from the «technical recession» experienced in the second half of 1999. The favourable GDP performance was underpinned by the expansion of private demand and of exports; the boost to activity from the extraordinary fiscal package approved in late 1999 has yet to become manifest. Indeed, public investment fell heavily, and government consumption posted zero growth. As regards the components of private demand, both gross fixed capital formation (for the second quarter running) and consumption (which picked up substantially, running counter to the information provided by economic indicators throughout the period in question) trended favourably. Although imports were also very buoyant, the contribution of external demand to GDP growth was 0.6 percentage points, far above the figure of -0.2 points for the previous quarter.

The indicators available for 2000 Q2 point to no substantial change in the patterns hitherto witnessed. They reflect the sound performance of industry and the persistence of slack private consumption demand (although this is abating). The foreseeable increase in public investment, following the application of the latest fiscal package, and the continuing expansion of exports, in line with the economic recovery in Japan's main trading partners, may result in an additional boost to GDP growth during the period, despite the appreciation of the yen in effec-

CHART 5

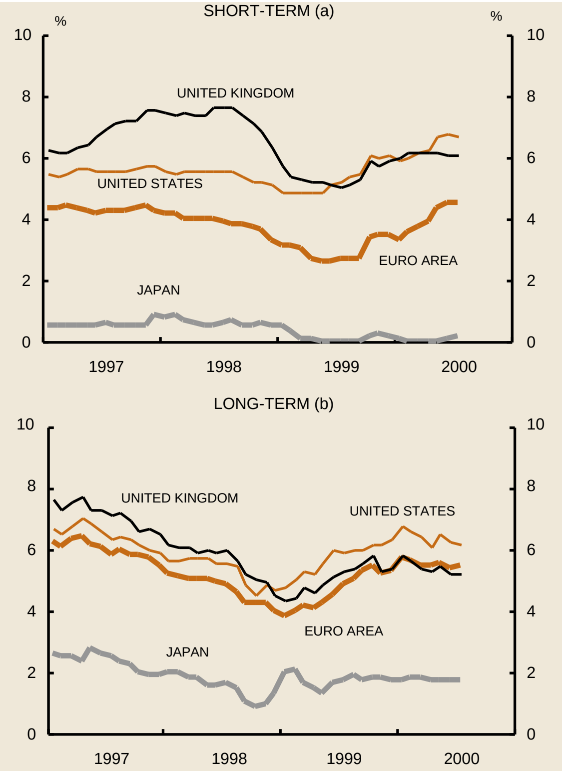
Main macroeconomic indicators. Percentage change on previous year



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

CHART 6

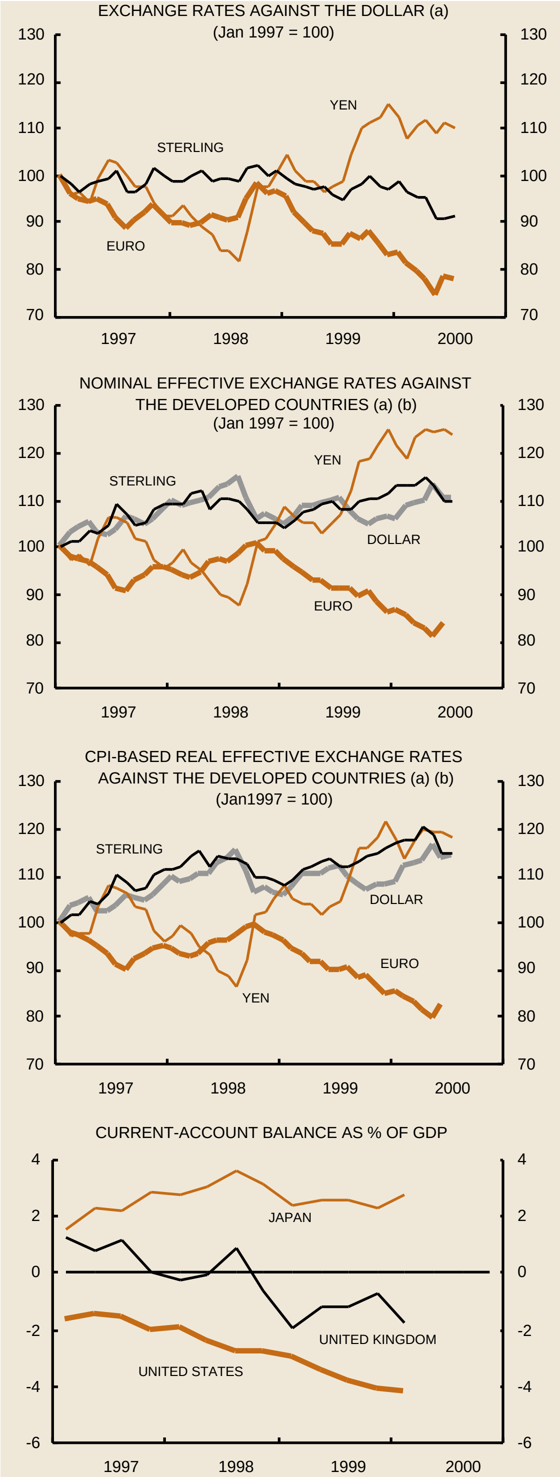
Interest rates



Source: Banco de España.
(a) Three-month interbank market interest rate. Euro area: until 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.

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.

tive terms during 2000 Q2. Finally, prices remain subject to deflationary pressures, as the 12-month growth rate of consumer-price inflation was -0.7 % in May, compared with -0.5 % in March. Given this setting, the Bank of Japan is considering a possible interest rate rise if economic recovery takes hold.

The United Kingdom posted GDP growth of 3 % year-on-year in 2000 Q1. Underpinning this growth was the expansion of private consumption and exports, since private investment slowed considerably. The indicators of economic activity available for Q2 do not generally point to any significant increase on the previous quarter, and this is reflected in the preliminary estimate of GDP growth in Q2 which, in year-on-year terms, has risen to 3.1 %. However, the recent depreciation of sterling against the euro (partly offsetting its strong appreciation in the previous months), the growing strength of euro-area demand and the recent announcement of a less restrictive fiscal policy for the coming years might provide a boost to economic growth. The inflation rate, measured by the retail price index excluding mortgage interest payments, rose to 2.2 % in June, two-tenths of a point above the March figure. The unemployment rate held stable throughout Q2, standing at 4.1 % in June. These signs of macroeconomic stability, and the possibility that further interest-rate rises might strengthen the exchange rate of sterling, once more dampening exports and industrial activity, have been influential in the Bank of England holding its main intervention rate at 6 % since mid-February.

Most of the south-east Asian countries recorded very high GDP growth in 2000 Q1, led by both the buoyancy of exports and of domestic demand. Notably, year-on-year increases in GDP of over 10 % were achieved in several economies in this area, namely Hong Kong, South Korea and Malaysia, while growth was close to this level in Singapore, Taiwan and China. In all these countries, the recent economic performance has been accompanied by a reduction in inflation rates and stable exchange rates.

The main central and south American economies have, in the opening months of 2000, furthered the process of improvement begun in late 1999. Their inflation rates have also been significantly corrected. World economic recovery and the climate of financial stability, assisted by the firm commitment of most of these countries' authorities to further fiscal consolidation and structural reform, have been the factors contributing most to overcoming the crisis. Nonetheless, the increase in US interest rates, with the subsequent rise in the cost of external borrowing, might weaken somewhat the expectations of economic expansion in the area. Country by country, Brazil has exhibited notable growth, essentially as a result of the robust recovery in external demand, with an increase in GDP of 3.1 % in 2000 Q1 over the same period a year earlier, accompanied by a decline in inflation to 6.5 % in May. In Mexico, greater financial stability and the strong knock-on effect from the US economy were conducive to year-on-year GDP growth in Q1 climbing to 7.9 %, the highest rate obtained since 1997 Q2, while 12-month inflation continued falling, reaching 9.5 % in May. In Argentina, the economy continued to show signs of weakness, with a high liability position vis-à-vis the rest of the world. That said, it ran a positive GDP growth rate of 0.9 % in Q1, over one point more than the related rate in 1999 Q4, and the scant indicators available for Q2 offer signs pointing to the continuity of the recovery. Finally, the inflation rate remains subject to deflationary pressures.

Developments on financial markets have been marked, in 2000 Q2, by the gradual rise in short-term rates (see Chart 6). This has arisen from the tightness of monetary policies on both sides of the Atlantic and from the reduction in long-term interest rates, especially in the United States, which reflect the downward revision of expectations about growth and inflation in the US economy. Yields on ten-year Federal Government bonds declined by an average of 32 basis points from Q1 to Q2, standing at 6.11 % in the closing week of July. The average three-month interest rate rose to 6.56 % in Q2, standing at over 6.6 % at end-July. This has led to the yield curve being inverted, and it is now negative. In Japan, short rates remained at minimum levels, while ten-year yields declined slightly during Q2, although both rose slightly once more as from mid-June, in line with the improved expectations about the pace of recovery of the Japanese economy. The decline on equity markets in the main economies which began between late March and early April continued until May. They picked up thereafter, but insufficiently so to offset the loss in value incurred in the first two months of Q2. The downturn in prices was particularly sharp in the New York NASDAQ index, and in the Tokyo NIKKEI index. Lastly, on the foreign exchange markets (see Chart 7), the US dollar held stable in Q2 in relation to the yen, appreciating against the euro by 5.73 %, in daily average terms, between Q1 and Q2. Nonetheless, there was a turnaround in this trend in June, with the dollar/euro exchange rate standing at end-July at similar levels to those seen in April.

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

3.1. Economic developments

The latest information on economic developments in the euro area depicts an outlook propitious to the expansion of activity, driven by highly buoyant net external demand fuelled, in turn, by sound world growth and by the euro exchange rate. The determinants of domestic demand are also trending favourably, and an increase in the contribution of this aggregate to GDP growth is foreseeable in Q2 2000. Prices have risen at growing rates in recent months as a result of a fresh rise in oil prices and the upward trend in certain foodstuffs. Nonetheless, even if the trend of these components should turn around, the lagging effect of the depreciation of the euro in the opening months of the year, against a background of growing strength in activity, might continue influencing the behaviour of prices over the coming months.

On Eurostat estimates, GDP in the euro area grew by 3.4 % in 2000 Q1 compared with the same period in 1999 (see Chart 8), three-tenths of a point higher than the related rate in 1999 Q4. The continuation of the path of acceleration of GDP was based on the favourable performance of the external sector, as the growth of domestic demand held stable. The fact that exports outpaced imports led the positive contribution of net external demand to be three-tenths of a point higher than the related contribution in 1999 Q4, rising to 0.7 percentage points. The contribution of domestic demand held at 2.7 points, with all of its components behaving similarly to the preceding quarter.

Looking at the various member states, there was a surge in the growth rate in Italy, brought about by the notable pick-up in private consumption and, above all, in exports. Admittedly, the vigorous expansion of exports since 1999 Q4 has been a common feature of other euro-area members. But it has been more intense in Germany and Italy, which have possibly benefited to a greater extent from the recovery of the south-east Asian and eastern European economies, given their greater trade exposure to these regions.

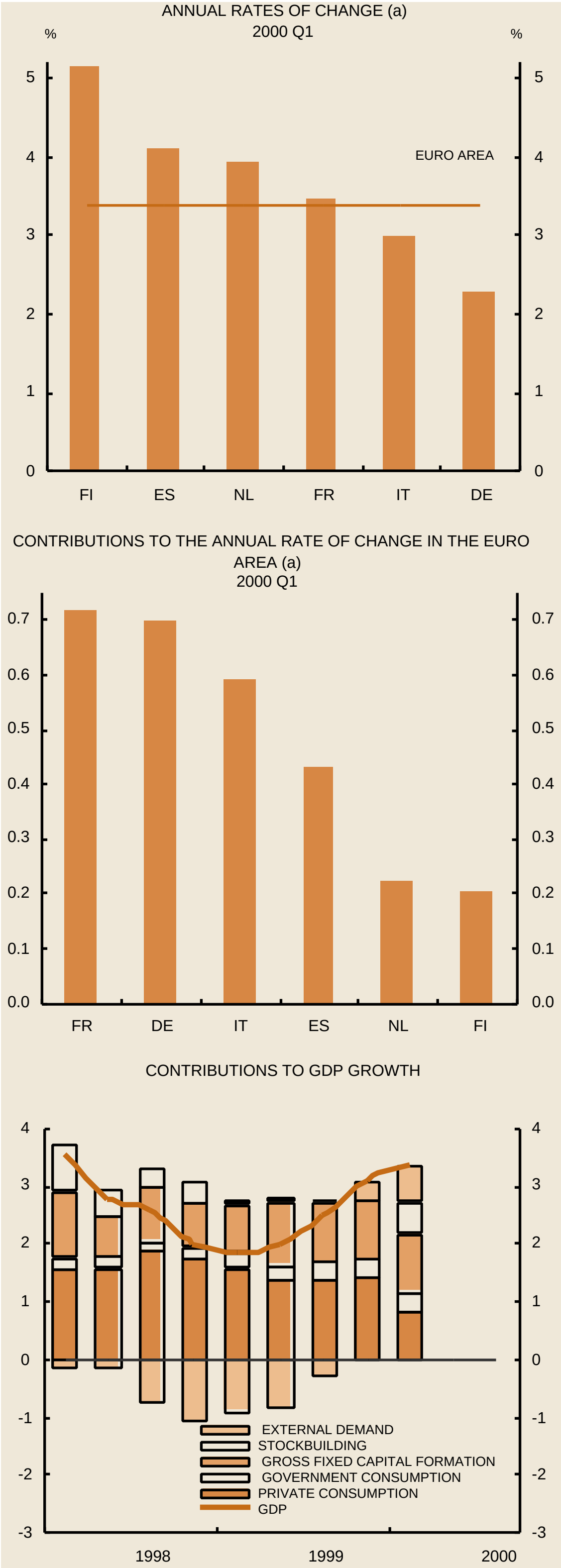
An assessment of the set of economic indicators relating to 2000 Q2 (see Chart 9) reveals that the accelerating profile of GDP has been maintained. The industrial production index for the area increased significantly to May, with a fairly generalised expansion being the case for the various countries and categories of goods, in keeping with the improvement in the business confidence indicator over the period under review. Furthermore, the private consumption indicators (retail sales, consumer and retail trade confidence, and, less clearly, new car registrations) have remained during the opening months of the year at the high level attained at end-1999. Hence, the favourable effect on household disposable income of the growth in employment and of the tax cuts announced or already implemented in numerous countries in the area have, along with the accumulated increases in financial wealth, shaped a setting conducive to the expansion of private consumption. Moreover, the economic vitality in the world's main geographical areas -though it might moderate if the signs of a slowdown in US activity were to be confirmed- and the lagged effects of the effective exchange rate of the euro should continue to boost exports. The resilience of the main components of private final demand should, for their part, help maintain the momentum of gross capital formation. Indeed, the results of the spring half-yearly investment survey recently released by Eurostat appear to testify to this, as they have signified an upward revision of the forecast for investment in manufacturing industry for the year 2000.

On provisional ECB estimates, employment increased by 1.3 % in 2000 Q1, one-tenth of a point up on the previous quarter. This moderate rise in employment, linked to the expansion of output, enabled apparent labour productivity to continue recovering to a year-on-year rate close to 2 %. In 2000 Q2, the sole employment indicator available, namely the unemployment rate, has continued on a downward course, falling to 9.2 % of the labour force in May (compared with 9.6 % at end-1999). The favourable performance of employment in the euro area countries is partly attributable to relative wage restraint and to the implementation in a large number of countries, albeit to differing degrees, of labour market structural reform. Hourly labour costs rose in Q1 to 3.6 % year-on-year (up from 2.4 % the previous quarter). However, given that wage settlements in collective bargaining agreements have been relatively moderate and that the acceleration does not appear due to non-wage labour cost trends, it might be ventured that the strong increase was partly reflecting temporary factors, such as the application of inflation-adjustment clauses and extraordinary payments related to the new millennium.

Euro-area inflation, measured by the 12-month rate of change of the HICP, stood in June at 2.4 % (see Chart 10), three-tenths of a point above the March figure. The significant increase in inflation during Q2 has been essentially due to unprocessed food prices, as the other components have remained relatively stable. The index excluding industrial energy

CHART 8

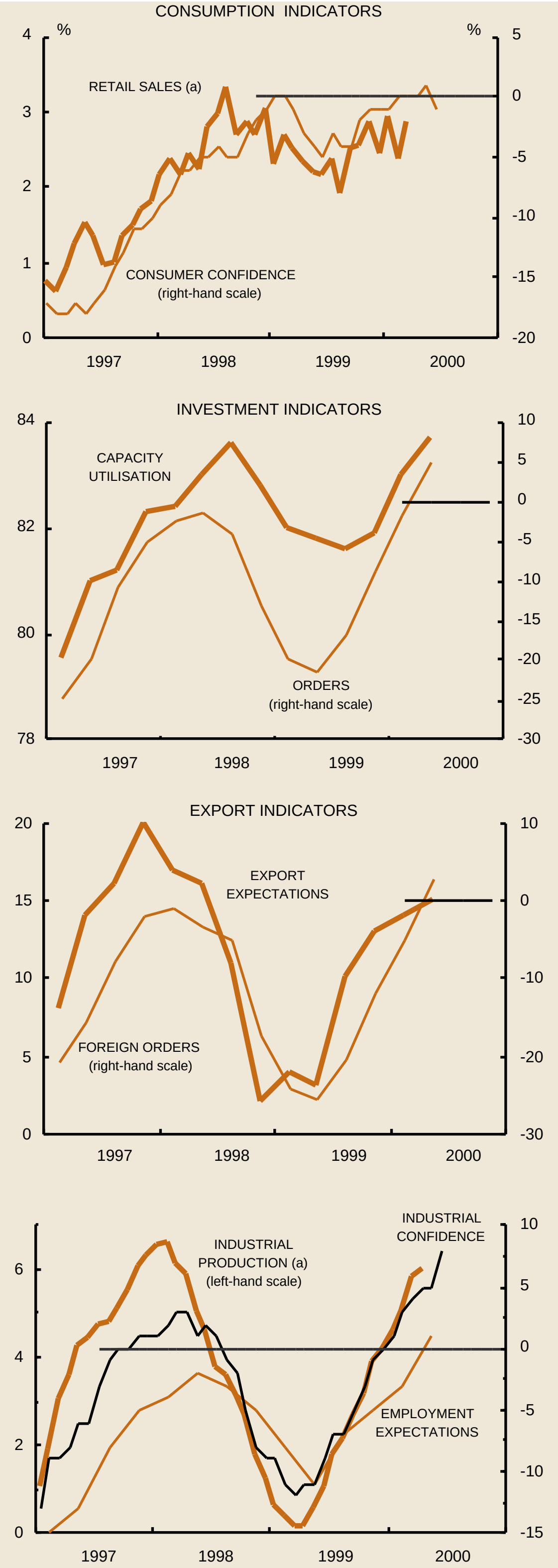
GDP in the euro area



Sources: Eurostat and national statistics.

CHART 9

Euro area. Real indicators



Sources: Eurostat and European Commission.

of the quarterly moving average of the seasonally adjusted series.

goods and unprocessed foods increased by one-tenth of a point from March to 1.2 % in June. The increase was due to the acceleration in service prices, as the growth rate of both non-energy industrial goods and processed food was unchanged during the period. Lastly, the growth rate of the energy component moderated slightly in June, compared with March, although it moved on to a pronounced upward path as from April. Country by country, the range in which the different countries' inflation rates stand in relation to March has not changed, although this has been the result of a widening of the range for services, offset by the opposite effect in the range for goods. Industrial prices have been on an accelerating course so far in 2000. In May they posted a 12-month growth rate of 6.5 %, i.e. 1.4 percentage points above the December 1999 figure, an increase linked predominantly to the impact of oil prices on intermediate goods. However, it should be pointed out that, although prices in the remaining sub-groups are continuing to grow moderately, they are clearly trending upwards, as rising intermediate goods prices are still feeding through to subsequent stages of the productive process.

Oil prices have continued to be the main conditioning factor of inflationary prospects for the area in recent months. After peaking in early March at around $32 per barrel, the oil price moved onto a declining path. It turned around as from mid-April (at which point it stood at $21), resuming levels exceeding $30 per barrel in the period from the second fortnight of June to mid-July, slipping back subsequently by almost $5 at the end of July. Paradoxically, it would seem, the increase in production quotas agreed on by the OPEC countries at their meeting on 21st June had a slightly upward influence on market prices, revealing itself insufficient to correct the imbalance between supply and demand. The firming of current crude price levels and the lagged effects of the effective depreciation of the euro are the main inflationary risks to the area. Such risks are further exacerbated by the progressive narrowing of the output gap. To date, the impact of the rise in foreign prices on euro-area inflation has been relatively limited. It is not yet possible to determine whether this is due to the offsetting effect of productivity gains on costs, or to a temporary squeeze on margins that might disappear, exerting pressure on consumer prices, in the near future.

On ECB estimates, the current-account balance of the area ran a deficit of EUR 4.4 billion in the four months to end-April. This was a notable deterioration on the 11.1 billion surplus recorded in the same period in 1999. Approximately half of the change was attributable to the decline in the merchandise balance surplus. The marked growth of imports, which was higher than that of exports, largely reflects the worsening of the terms of trade, owing to the combined effect of the rise in oil prices and the depreciation of the euro.

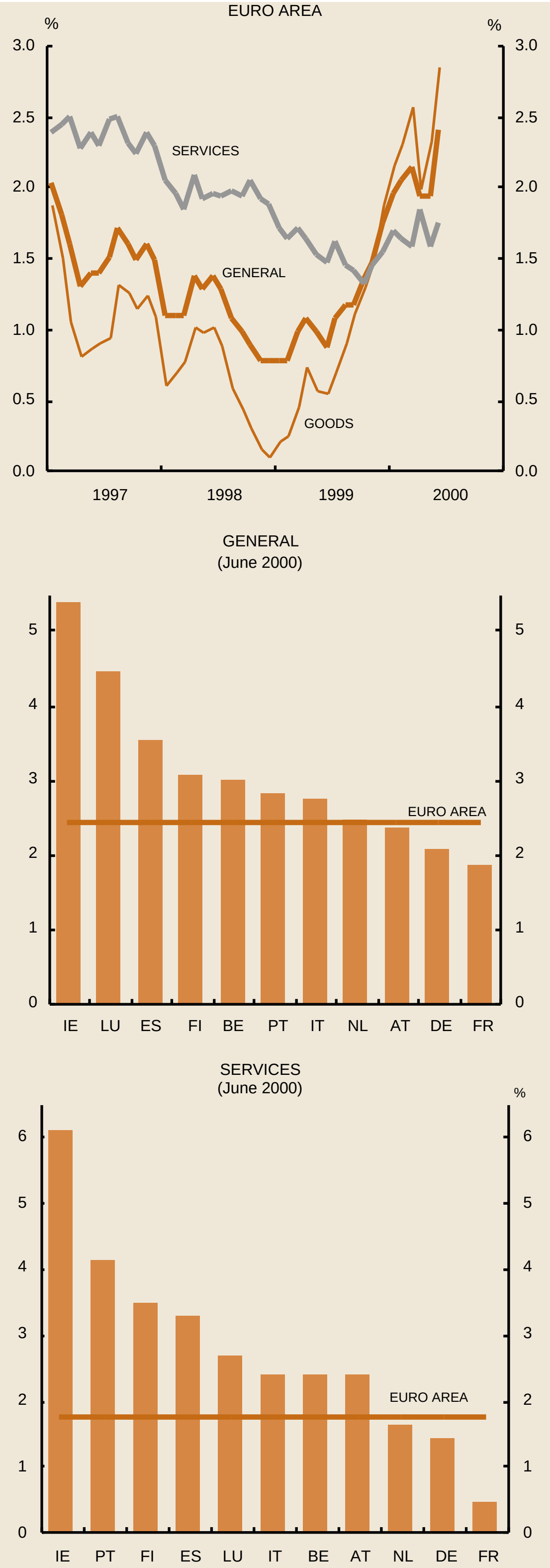
Regarding general government finances in the area, the budgetary outturn data for the period to date in 2000 mean that better-than-expected results for the year as a whole may be projected (see Table 1). Sound economic growth is driving direct tax revenue, while the relative strength of consumption and the increase in the prices of oil-related products is providing for buoyant indirect tax revenue. In addition, the rise in the numbers registered with the social security system is boosting the growth of social security contributions receipts, while the fall in unemployment is helping control spending. Nonetheless, in most member countries discretionary measures entailing improvements in structural balances have not been adopted, and the European Commission forecasts something of a deterioration in cyclically-adjusted primary balances in relation to 1999 in a large number of countries. This easing of fiscal policy is particularly inappropriate in those cases where the economy is ahead in the cycle, where the budgetary position is still far from balance or where the level of debt is high.

In step with the favourable trend of the cyclical component of budgetary balances, the authorities of certain euro area countries have revised their fiscal forecasts for 2000. In France and Italy, the new projections for the overall general government deficit are 1.5 % and 1.3 % of GDP, respectively, i.e. two-tenths of a point below the targets set in their stability programmes. In Germany, the government has approved the draft federal budget for next year, which foresees the nominal spending level being maintained and a fall in revenue as a result of the tax reform recently approved by Parliament. At the same time, discussions about reforming the State pensions system are under way.

The procedures for granting third-generation mobile telephony licences currently in train in most countries in the area have given rise to debate about how the sizeable revenue it is expected to obtain will be used. Generally, national authorities have announced their intention to employ at least most of the resulting resources to set aside reserve funds for State pensions systems or to reduce outstanding public debt.

CHART 10

Harmonised indices of consumer prices
Twelve-month percentage change



Source: Eurostat.

TABLE 1

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

	1996	1997	1998	1999	2000 (a) European Commission (b)	2000 (a) Latest official forecast (c)
Belgium	–3.7	–2.0	–1.0	–0.9	–0.5	
Germany	–3.4	–2.6	–1.7	–1.1	–1.0	–1.0
Spain	–5.0	–3.2	–2.6	–1.1	–0.7	–0.4
France	–4.2	–3.0	–2.7	–1.8	–1.5	–1.5
Ireland	–0.6	0.8	2.1	2.0	1.7	
Italy	–7.1	–2.7	–2.8	–1.9	–1.5	–1.3
Luxembourg	2.7	3.6	3.2	2.4	2.6	
Netherlands	–1.8	–1.2	–0.8	0.5	1.0	1.1
Austria	–3.8	–1.9	–2.5	–2.0	–1.7	
Portugal	–3.8	–2.6	–2.1	–2.0	–1.5	
Finland	–3.2	–1.5	1.3	2.3	4.1	4.8
MEMORANDUM ITEM:						
Euro area						
Primary balance (b)	1.4	2.5	2.7	3.1	3.1	
Total balance	–4.2	–2.6	–2.0	–1.2	–0.9	
Public debt	74.7	74.5	73.0	72.1	70.3	

Source: European Commission

(a) Déficit (–) / surplus(+).
(b) Spring forecast.
(c) Includes data only for countries authorities have published official forecasts after the release of the European Commission's spring forecasts.

3.2. Monetary and financial developments

The monetary policy stance in 2000 Q2 has continued to adapt to the improved economic outlook in the euro area. After raising the Eurosystem's interest rates by 50 basis points in Q1, the ECB Governing Council again raised rates on 27th April and 8th June by 25 and 50 basis points, respectively (see Chart 11). At the cut-off date for this quarterly report, the interest rate on the main refinancing operations stood at 4.25 %, 175 basis points higher than a year earlier.

With the delay typical to the process of transmission of the monetary authorities' signals on economic variables, the rise in official interest rates has led to progressively dearer bank credit and to an increase in the return on saving. It is more difficult to detect the effects of interest-rate rises on the euro-area monetary and credit aggregates, since in recent months they have continued to exhibit growth rates that may be considered high. Although the depreciating trend of the euro was curtailed in the second quarter, with the currency even appreciating moderately, its effective exchange rate against the developed countries remains at a very favourable level for the expansion of economic activity across the area.

As in previous months, monetary and financial conditions in Spain remained more generous than in the euro area as a whole. This was essentially due to the greater intensity of demand and price pressures in the Spanish economy which, among other things, have been reflected in the form of very high growth rates of cash and cash equivalents, and of financing raised by the private sector.

The EONIA rate held at levels very close to the rates on the main refinancing operations during Q2, except, as usual, during the final days of the reserve requirement maintenance periods. In the maintenance period ending 23rd June, temporary liquidity pressures led the EONIA to rise significantly above the interest rate on the main refinancing operations, prompting the Eurosystem to conduct a liquidity injection through a fine-tuning operation on 21st June. Under the current Eurosystem operational framework these operations are exceptional and, indeed, since the outset of Monetary Union only one such operation -in January this year- had been undertaken in order to absorb the surplus liquidity provided during the Y2K transition. Despite the increase in official interest rates, the financial markets continue to forecast a degree of monetary policy tightening in the future (see Chart 12).

During Q2 longer-dated interest rates were somewhat volatile. This was seemingly due more to external factors (such as developments on US financial markets) than to movements on euro area money markets. After varying fluctuations, long-term interest rates stood as from end-June at levels similar to, or even below, those prevailing at the end of Q1. In the case of Spain, these rates trended, as was to be expected, similarly to those in the other countries of the area, although the long-term interest rate spread over Germany increased slightly (see Table 2). Previous movements had brought about a levelling of the yield curve for the area as a whole. As a result, while expectations of further increases in short-term interest rates remained in place, the expected levels for these rates at horizons of over one year held fairly stable.

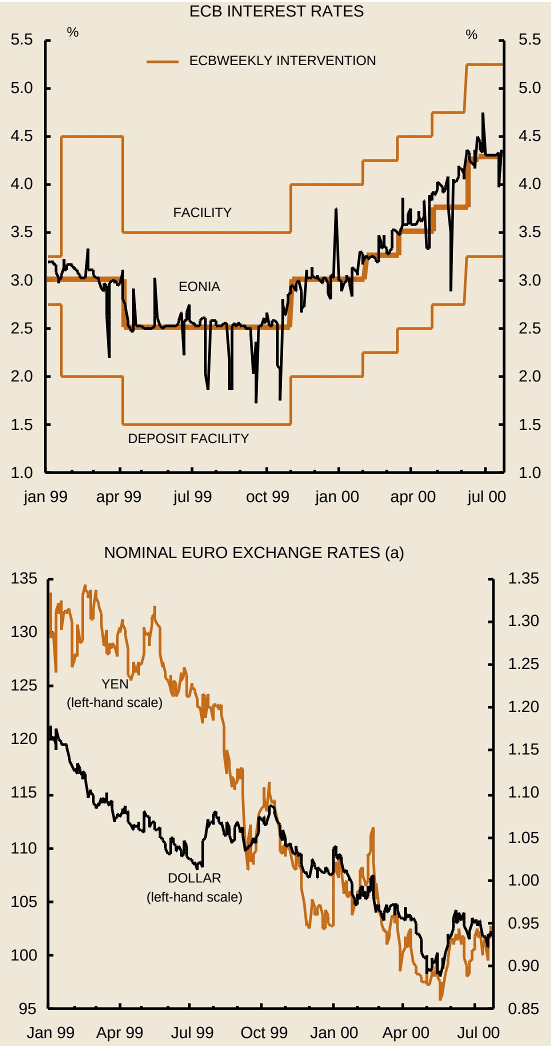
In April and May, the euro remained on a fairly sharp depreciating trend, taking its value on certain days to below $0.90 per euro. Subsequently, it began to pick up and, on the cut-off date for this report, it stood at $ 0.94, a similar level to that observed in April this year.

As earlier discussed, bank lending rates in the euro area (which are, perhaps, of most importance for determining agents' spending decisions) progressively reflected increases in money market interest rates. However, the feed-through has, as usual, been partial: whereas the three-month EURIBOR rate rose by 175 basis points between June 1999 and May 2000, the interest rates on credit to households and firms increased very unevenly over the same period, from 40 basis points in the case of consumer credit, to 135 basis points in the case of housing loans and loans to companies at over one year (see Chart 13). In Spain, the interest rates applied by resident Monetary Financial Institutions (MFIs) in their private-sector lending operations have also risen across the board: again for the June 1999-May 2000 period, the synthetic interest rate on credit to the private sector in Spain rose by 125 basis points, in line with the euro area as a whole.

Turning to the stock markets, the volatility of euro-area equity markets heightened during April and until early June. Thereafter, however, these markets were more stable, with rises on the Dow Jones Euro Stoxx index that took its cumulative percentage change during the year to almost 5 % as of the time of this report going to press. These movements were very similar to those on the main international bourses (generally led by developments on the US market) and came about against a backdrop of interest rate rises in the area and the high volatility of technology stock prices. In Spain, equity price

CHART 11

ECB interest rates and euro exchange rates



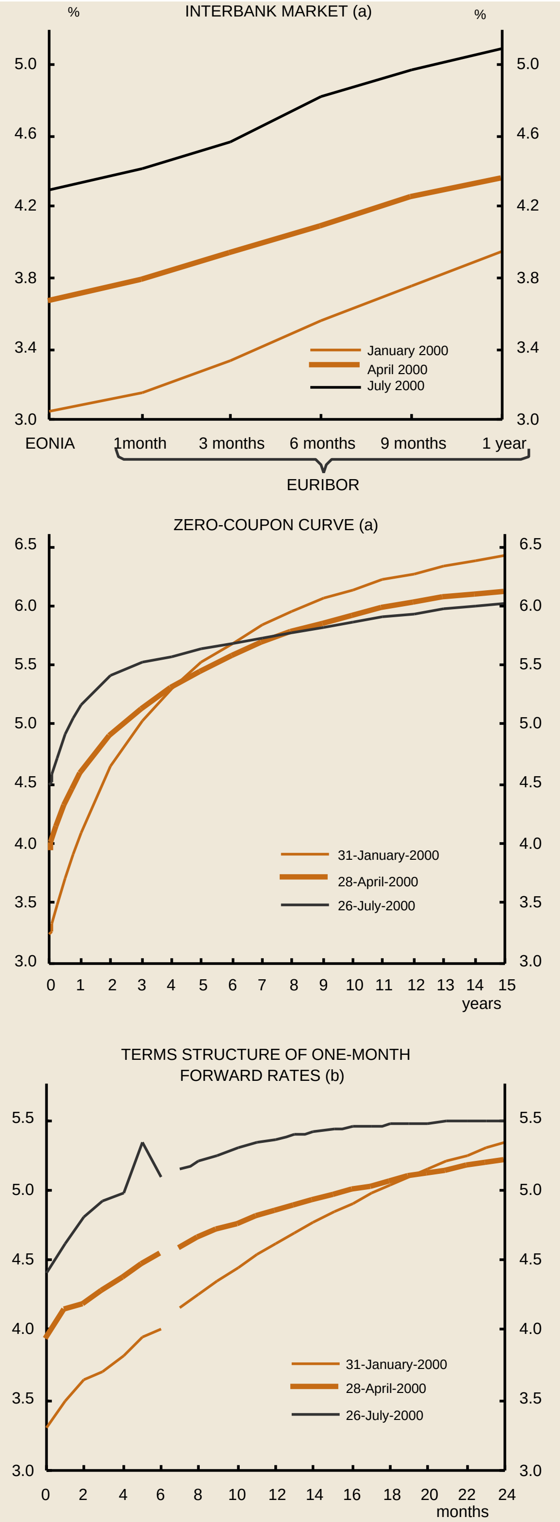
Sources: Banco de España and ECB.
(a) Dollar/euro and yen/euro exchange rate.

volatility remained more marked. Although the Madrid Stock Exchange General Index has rallied somewhat in July, the change in the year to date remains negative.

Although the May and June figures on the growth of the monetary and credit aggregates in the euro area appear to show a slowdown in their hitherto buoyant trend, the rates of increase remain high, in line with continuing optimistic growth expectations, with the as yet relatively low interest rate levels and with the lack of a full transmission of past monetary policy measures to financial conditions in the economy and to agents' spending decisions. Until May, the three-month moving average of the year-on-year growth of the benchmark mone-

CHART 12

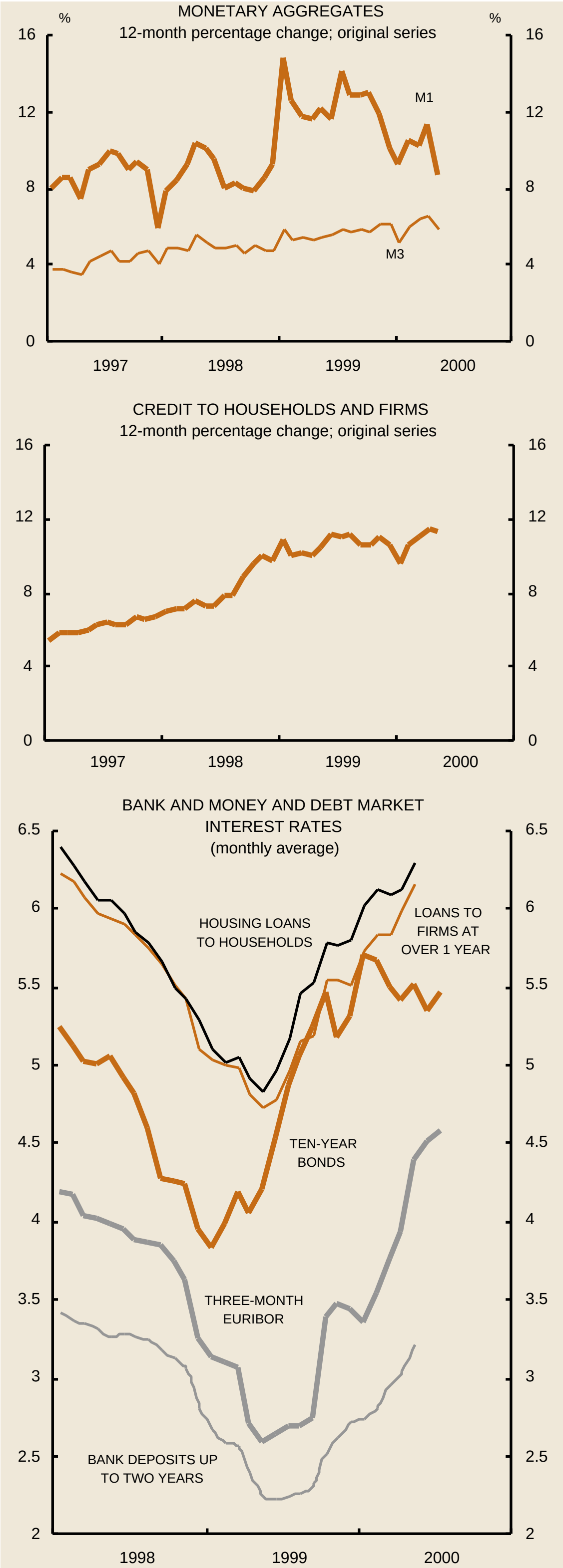
Euro area yield curves



Sources: Banco de España and ECB.
(a) Estimation based on money and swap markets data.
(b) Implied rates up to 6 months for EUROIBOR and estimated rates with zero-coupon curve for longer horizons.

CHART 13

Monetary and credit aggregates and interest rates in the euro area



Sources: Banco de España and ECB.

TABLE 2

Monetary and financial conditions in the euro area and Spain

	1999	2000						
	DEC	JAN	FEB	MAR	APR	MAY	JUN	JUL (c)
MONETARY VARIABLES (a):								
EURO AREA								
M3	6.1	5.2	6.0	6.4	6.5	5.9		
M1	10.0	9.2	10.5	10.2	11.3	8.6		
Loans to private sector	10.5	9.5	10.5	10.9	11.4	11.3		
FINANCIAL MARKETS (b):								
EONIA	3.04	3.05	3.28	3.51	3.67	3.92	4.29	4.30
Three-month EURIBOR	3.44	3.34	3.54	3.75	3.93	4.38	4.50	4.57
Public debt								
Euro area ten-year bond yields	*5.31*	*5.70*	*5.66*	*5.49*	*5.41*	*5.52*	*5.35*	*5.46*
USA – Euro area ten-year bond spread	*1.06*	*1.08*	*0.97*	*0.88*	*0.63*	*1.03*	*0.85*	*0.68*
Germany-Spain ten-year bond spread	*0.22*	*0.22*	*0.22*	*0.22*	*0.23*	*0.25*	*0.26*	*0.27*
Spanish bank interest rates								
Synthetic deposit rate	*1.98*	*1.97*	*2.06*	*2.17*	*2.23*	*2.40*	*2.52*	
Synthetic lending rate	*5.03*	*5.08*	*5.30*	*5.55*	*5.47*	*5.79*	*5.87*	
USD/EUR exchange rate	1.011	1.014	0.983	0.964	0.947	0.906	0.949	0.941
Equities (d)								
Dow Jones EURO STOXX Broad index	*39.5*	*–4.1*	*6.8*	*6.0*	*2.9*	*2.5*	*2.0*	*4.6*
Madrid Stock Exchange Broad Index	*16.2*	*–3.4*	*11.4*	*7.5*	*3.8*	*–2.5*	*–3.4*	*–1.7*

Sources: ECB and Banco de España.

(a) Annual percentage change.
(b) Monthly averages.
(c) Monthly average up to latest available data.
(d) Cumulative percentage change over the year. End-of-month data. Latest available day for the latest month.

tary aggregate, M3, stood at 6.3 %, with the 12-month growth rate for this month at 5.9 % (see Table 2). The increase in interest rates has translated into a change in the composition of M3 growth, showing a slowdown in the pace of the most liquid assets making up this aggregate (insofar as the opportunity cost of holding these liquid positions is increasing) and a higher rate of expansion of the negotiable instruments included in M3. In the recently released data for June, this changing composition continues to be seen, along with a slowdown in the growth rate of M3, which stands at 5.4 % year-on-year.

A lower growth rate of cash and cash equivalents held by households and non-financial corporations was also seen in Spain in 2000 Q2. The non-financial private sector's overall liquid assets continued to run at very moderate growth rates as a result of the ongoing disposal of shares in money market and fixed-income mutual funds, intense purchases of real assets and the greater diversification of financial saving, which has largely been channelled to liquid assets such as insurance products and international assets.

In the euro area as a whole, financing extended by MFIs to euro zone residents has been expanding at a rate of around 8 %, although this growth rate has been the outcome of highly differing behaviour across the economic sectors. Financing to the private sector has run at rates above 11 % in recent months, while credit extended to general government has continued to exhibit a negative growth rate. As in the case of M3, credit to resident sectors also decelerated in June, whereby the associated year-on-year rate of expansion of financing extended by MFIs to the private sector stood below 10 %. The continuing difference between the rate of expansion of credit and of M3 has been financed, among other channels, via an increase in MFIs' foreign debt.

In Spain, the rate of expansion of financing extended to the non-financial private sector has slowed in recent months. Compared with growth rates of close to 20 % at the start of the year, the year-on-year rate dipped to around 17 % in June. In any event, this trajectory is still a very expansionary one, especially when compared with the euro area as a whole. The sharp growth of financing led the Spanish authorities to alert institutions about the potentially adverse affects of a possible easing of their lending policies. Moreover, the progressive feed-through of the increase in monetary policy interest rates to bank lending rates should contribute to moderating the rate of expansion of loans extended by banks to the private sector.

With regard to monetary policy implementation by the Eurosystem, the ECB Governing Council decided on June 8th, in response to the excessive level of overbidding at the tenders for the main refinancing operations, that, starting from the operation to be settled on 27th June, such operations would be conducted as variable rate tenders, applying the multiple rate auction procedure. It further set a minimum bid rate of 4.25 % for the tender. The initial tenders conducted using the system have unfolded very satisfactorily. As a result, marginal rates very close to the minimum rate set have been established and, on the money markets, the rates negotiated following the tenders have held close to the marginal rate.

4. The Spanish economy

Against the background of the expansion of the world economy in the first half of the year (in both the euro area and other regions) and under financial conditions which remain generous, the Spanish GDP growth rate has posted further increases in the first two quarters of the year 2000. At the same time, the economy has shown high job creation capacity. The progressive improvement in international markets and the depreciated level of the euro have translated into a strong expansion of exports, which has given an additional boost to corporate investment plans. Further, household spending has grown at a higher rate over this period, fuelled by the notable growth of real disposable income and by a higher level of confidence about the economic situation. Consequently, on provisional Quarterly National Accounts figures for Q1, the year-on-year growth of GDP is running at 4.1 % (1) in real terms, compared with 3.9 % the previous quarter. And according to Banco de España estimates, GDP growth may have risen to 4.2 % in Q2 (see Chart 14).

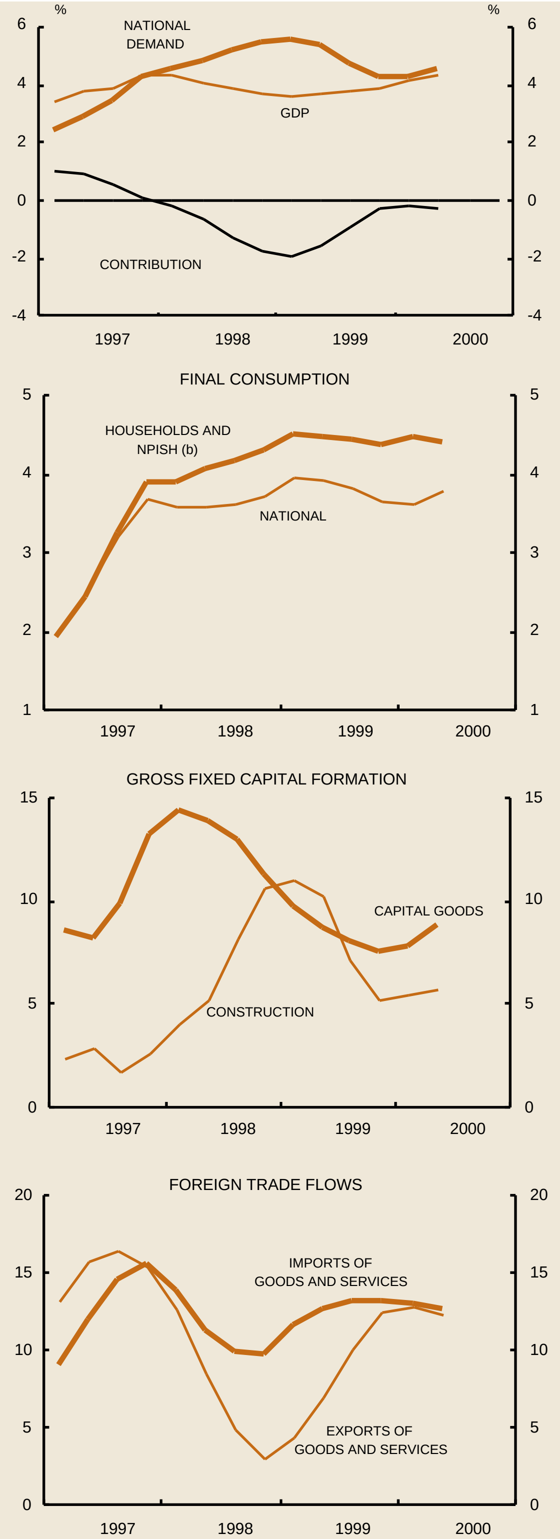
The acceleration in GDP in the first half of 2000 largely reflects the course of national demand, the ongoing deceleration in which throughout 1999 was halted. Domestic expenditure increased at a rate of 4.2 % in Q1 and at an estimated rate of close to 4.5 % in Q2, as a result of the recovery of gross capital formation. Meanwhile, private consumption grew at a stable and high rate, and general government demand held on a moderate path. The contribution of net external demand to GDP growth stabilised at negative levels close to those recorded at end-1999, following the substantial improvement in the first three quarters of last year. Specifically, on QNA figures, the negative contribution of the external balance in 2000 Q1 was 0.2 percentage points (-0.3 the previous quarter), and the scant data available for Q2 point to a similar or slightly more negative contribution.

The strong job creation (3.4 % year-on-year in Q1) accompanying the acceleration in output has only permitted a muted recovery in apparent labour productivity, which has continued growing at very low rates. This recovery has essentially been in industry, where employment has slowed despite this being the sector that has recorded the most forceful recovery, inducing marked moderation in unit labour costs. In other productive activities, such as construction and market services, the rate of job creation has remained very high or has even increased.

(1) Unless otherwise indicated, the rates of change of the Quarterly National Accounts series in this section relate to trend-cycle series.

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.

In recent months, the upward course of final prices witnessed in Q1 has continued, owing mainly to dearer energy products. Nonetheless, signs that higher costs (associated with oil and other commodity price rises) are feeding through to the final prices of other goods and services are becoming discernible. And this feed-through is being assisted by the buoyancy of expenditure. The rate of increase of wages has also been trending upwards, leading to an acceleration in unit labour costs in certain activities, such as services. These upward pressures on prices have contributed to the inflation differential with the euro area remaining at more than one percentage point, despite the fact that final prices have also quickened in other European economies.

4.1. Demand

Within the national demand aggregates, household final consumption spending in real terms has posted a high and stable growth rate since the start of 1999, and the information available suggests it may have run in 2000 Q2 at a similar – or slightly lower – rate than the INE estimate of 4.5 % for the preceding quarter (see Chart 15). Of note in respect of the consumption components is the slowdown in durable goods purchases, especially cars, while there appears to have been a sustained increase in the consumption of services. There are also signs of a pick-up in spending on food, which had been very depressed the previous year.

Most consumption indicators tend to confirm the stability of, or something of a downturn in, the growth rate of this aggregate, which would be consistent with the profile of the consumer confidence index. In Q2 this indicator fell slightly from the levels attained in Q1, and a somewhat less optimistic assessment of the overall economic situation and a lesser inclination to purchase durable goods could be perceived. Among the indicators best approximating spending, the rate of increase of the aggregate index of apparent consumption of goods and services tended to ease in 2000 Q2 (for which period only partial information on this indicator is available). Notable here was the lesser buoyancy of the goods component, the growth rate of which stabilised at substantially lower levels than those observed during 1999. New car registrations slowed significantly to June, following the burgeoning increases they had shown in the first two months of the year. Lastly, the retail sales index was on a rising course in April and May, though a tendency for it to stabilise at high rates is discernible.

In any event, private consumer spending has remained notably strong in the first half of 2000, above the growth estimated for real disposable income. It continues to be boosted by the increases in financial wealth recorded in previous years, to which the recent rise in property-related wealth should be added. Household disposable income has continued to grow significantly, against a backdrop of accelerating wages and a sustained rate of high job creation. The personal income tax reform implemented early last year has also exerted an expansionary effect on household income, albeit on a much lesser scale than that seen in 1999. However, the absence of additional improvements to Spanish household confidence levels, the recent tightening of financial and monetary conditions and the petering out of the effects arising from the tax reform might temper spending increases in the coming months.

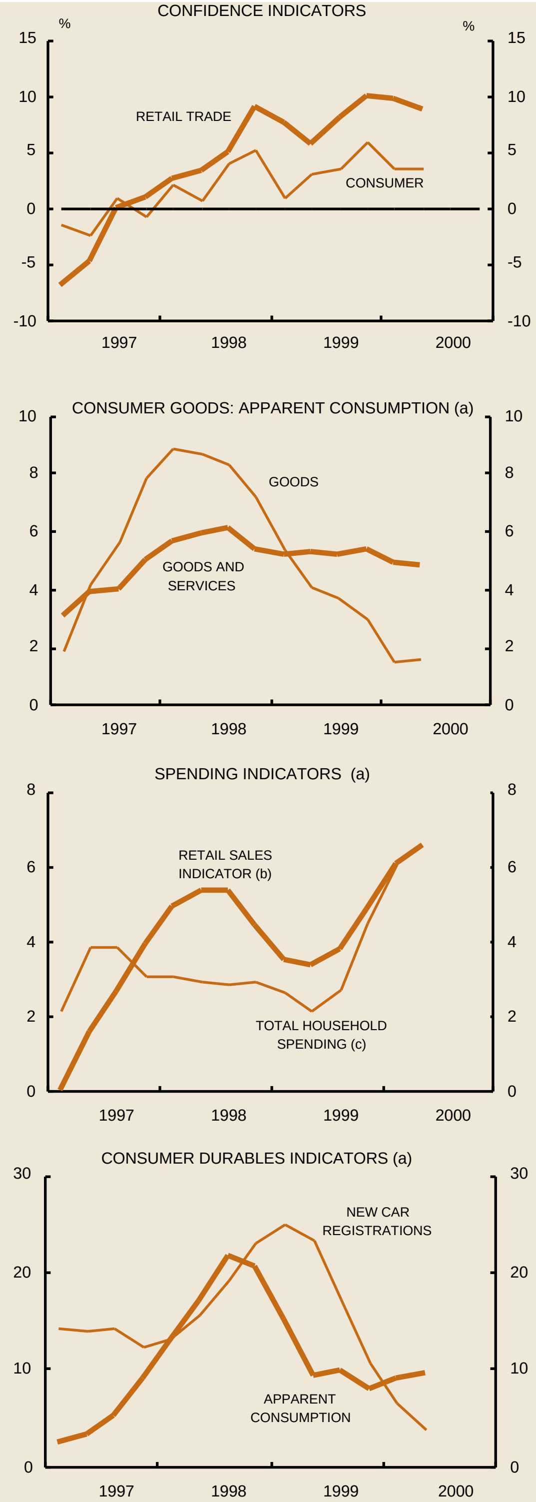
On provisional QNA estimates, general government final consumption spending grew by 0.7 % in real terms in 2000 Q1 compared with the same period a year earlier. The information on State receipts and expenditure available for Q2 and the budgetary plans drawn up for the year as a whole confirm the moderate trend of this expenditure item, although the associated rates of change are closer to those recorded on average last year, when government consumption increased by 1.8 %.

Gross fixed capital formation in Q1 ceased to move on the downtrend it had followed during 1999, growing at a rate of 6.3 % year-on-year, three-tenths of a point up on the previous quarter. The greater buoyancy of investment was a result of the strength of its two components: investment in construction, up four-tenths of a point to a growth rate of 5.5 %, and capital investment, which accelerated by two-tenths of a point to 7.7 %. In general, these trends have firmed in Q2, and it is estimated that both components of gross fixed capital formation have gained further momentum.

As can be seen in Chart 16, the growth rate of the index of apparent investment in capital goods (compiled using domestic production data to May and foreign trade data to April) was on a mildly declining trend until 2000 Q1, owing to the loss of steam of capital goods purchases abroad. However, there has been an ongoing recovery in the domestic production of investment goods, which has notably stepped up according to the May figure and which has translated into a strong improvement in the index under review here. The recent trend of this index appears to be more in step with the acceleration of capital investment suggested by the QNA data and with business optimism about

CHART 15

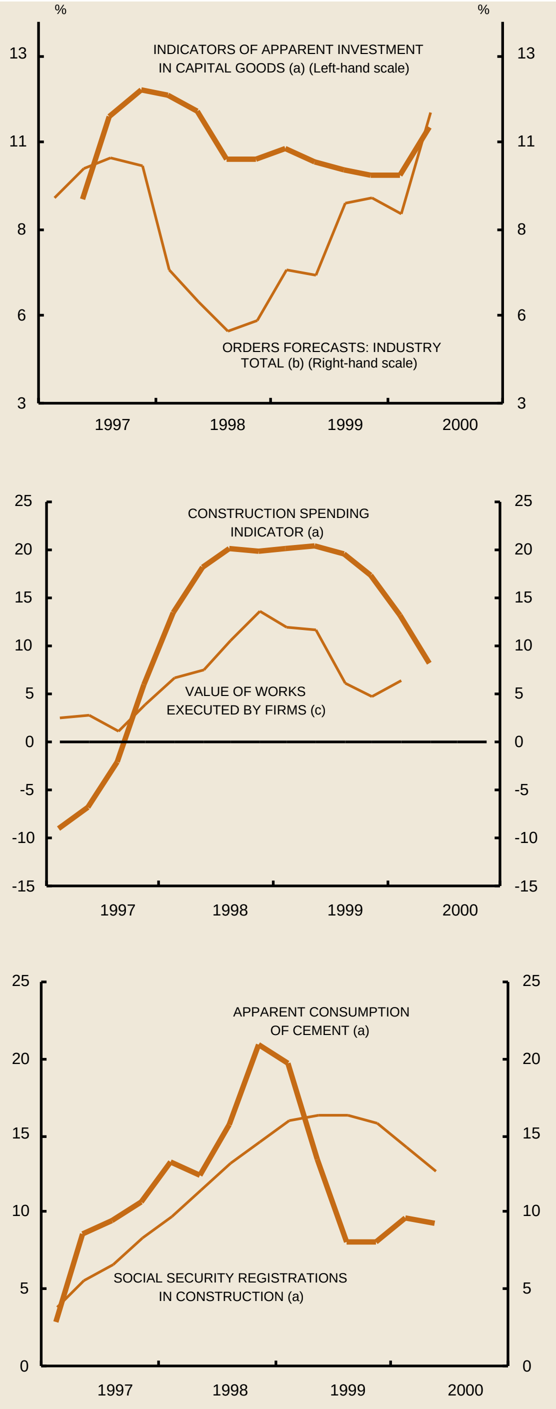
Private consumption indicators



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

CHART 16

Gross fixed capital formation indicators



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.

the course of demand. In this respect, the results of the monthly business survey highlight a notable rise in orders forecasts in industry.

The main determinants of capital investment reveal the continuing presence of an environment propitious to the pursuit of investment plans. Final demand has gained fresh momentum, driven by the buoyancy of exports and the resilience of domestic demand (the increase in turnover reported in the Central Balance Sheet Office CBQ survey in Q1 illustrates this strength). As a result, the degree of capacity utilisation has remained high, heightening the need to add to productive equipment. Moreover, according to the aforementioned CBQ figures, corporate profitability levels have continued to improve, despite the fact that financial costs embarked on a rising course in Q1 against a background of higher interest rates and higher corporate debt. In fact, the financial leverage ratio, which measures the difference between the return on assets and the cost of borrowed funds, increased once more in Q1, and the results of the half-yearly investment survey in industry, relating to spring 2000, continue to highlight the financial situation as one of the main factors behind investment, along with demand.

Investment in construction grew by 5.5 % year-on-year in 2000 Q1, interrupting the gradual slowdown it had shown during 1999. According to the results of the related survey for the sector, the greater buoyancy of construction spending in Q1 was underpinned by the building component, as civil engineering works slipped back to a sharper degree than in previous quarters. Given the inertia habitually characterising this spending component and the short-term information available, it is estimated that investment in construction continued its recovery in Q2 on the basis of the strength of residential building (as the conditions of access to housing remain favourable, despite the recent increases in house prices and in interest rates) and the more favourable trend of civil engineering works. Non-residential building, for its part, has also continued growing at a sustained rate, in line with the other components of corporate investment.

The coincident indicators of construction in Q2 have, overall, trended very favourably. However, some moderation in comparison with Q1 is generally discernible, probably as a result of the heavy rainfall during the spring, which may have hampered construction activity. The rates of increase of the indicators of inputs (apparent consumption of cement and the production of construction materials) tended to ease in April and May after having clearly picked up in Q1.

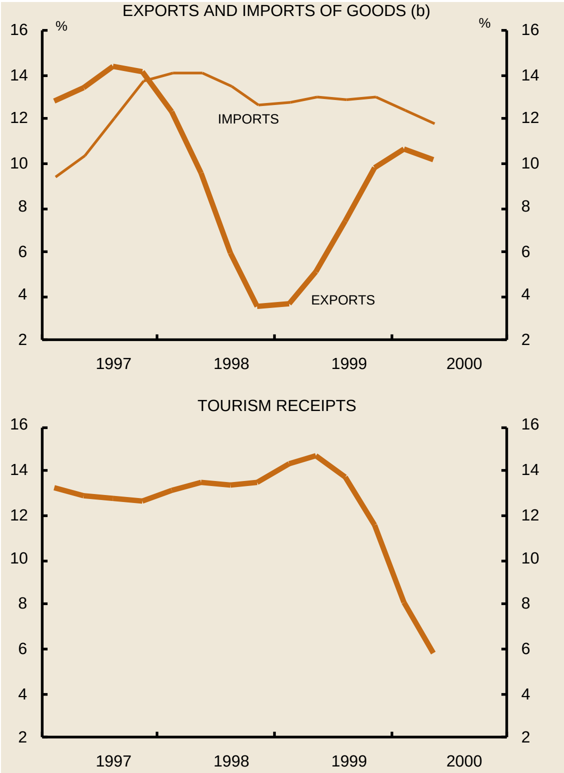
The latest employment indicators for the sector (registered unemployment and social security registrations) continued to slow in Q2, albeit retaining considerable vigour. As to the indicators relating to works started, general government procurement tenders increased by 12.8 % in Q1 compared with the same period a year earlier, after undergoing a very significant cut in 1999. This, combined with the Spanish Development Ministry's investment plans, which envisage a notable increase in infrastructure (especially concerning railways and airports), means greater civil works expenditure may be projected for the rest of the year 2000. With regard to building, the number of square metres to be built, according to project-approval statistics, accelerated in the opening months of the year. That said, these figures should be interpreted with caution, as they might reflect the bringing forward by builders of project-approval applications, so as to avoid the increase in costs entailed by the obligatory insurance aimed at covering structural flaws in housing, which came into force on 6th May.

The contribution of stockbuilding to the year-on-year growth of GDP in 2000 Q1 was zero, as in the two previous quarters. Information from the monthly business survey points to a slight increase in the involuntary component of stocks in Q2, as the proportion of entrepreneurs reporting higher-than-desirable stock levels has increased.

On QNA data, the negative contribution of net external demand in real terms to year-on-year GDP growth declined by one-tenth of a point to –0.2 percentage points in 2000 Q1, continuing the improvement witnessed since 1999 Q2. This result reflects the strength of goods exports during this period, which offset the slowdown in tourism receipts. Imports, for their part, held at a sustained growth rate. The information available for Q2, relating exclusively to balance of payments and foreign merchandise trade figures for April, shows a moderate slowdown in trade flows in respect of both exports and imports, which may have been influenced by the fact that the Easter holiday period fell that month (see Chart 17). In any event, the main exports determinants attest to the highly expansionary behaviour of this aggregate in Q2, against a backdrop marked by the progressive improvement in world economic growth (with the euro area economies furthest behind in the cycle, and which are Spain's main export markets, picking up notably) and the weakness of the euro. The growth rate of imports may have slackened somewhat as a result of strong increases in their prices, although they will have continued to run strongly, underpinned by the

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.

strength of final demand and the recovery in industrial production.

According to official customs figures, goods exports grew by 12.8 % in real terms in the first four months of the year compared with the same period in 1999, building on their buoyancy in the closing months of last year. This expansionary behaviour was due both to the bigger increase in sales to the EU and to the sharp acceleration in exports to third countries' markets, once the effects of the international financial crisis were behind. By type of good, all components exhibited high growth rates; there was a notable acceleration in sales of non-food consumer goods, and in particular of cars, boosted by the improvement in demand and heightened consumer confidence in EU. As to exports of services, tourism receipts were very moderate in the first four months of the year 2000, in sharp contrast to their strength during 1999. Both nominal tourism receipts and the real indicators for the sector (foreign visitors lodged in hotels and tourists entering Spain at borders) slowed in the opening months of the present year. Nonetheless, given the volatility habitually characterising these indicators and the limited representativeness of these results, given that they refer to an off-season period, it will be necessary to wait for the coming months to determine whether the moderation perceived holds firm. Lastly, exports of other services remained buoyant in 2000 Q1, with a strong recovery in transport revenue (linked to the vigour of merchandise exports) and resilient financial services, insurance and IT services.

The pace of goods imports slowed slightly in the first four months of the year, according to customs figures, posting real growth of 11.1 % compared with 13.9 % in 1999 Q4. The slowdown is attributable, at least in part, to the notable increase in import prices, influenced by the depreciation of the euro and the upward course of international prices. Although the biggest price rises have been in energy products, manufacturing import prices have also quickened notably in recent months. In terms of the composition of imports, the marked buoyancy of capital-goods and non-food-consumer-goods imports seen in 1999 moderated. Notable among the latter was the slowdown in car purchases, in step with the ongoing deceleration of consumer durables. Conversely, purchases of non-energy intermediate goods retained the strength they had shown in the final months of 1999, driven by the progressive recovery in industrial production and the thrust of exports (the production of which involves a very high proportion of imported inputs). Finally, purchases of energy intermediate goods were very depressed following the stock replenishment process undertaken by Spanish refineries in the opening months of the year. Moreover, imports of services lost steam during 2000 Q1, although they remained at a high rate: the pace of tourism payments eased slightly, probably influenced by the rise in the cost of foreign travel resulting from the depreciation of the euro, and other non-tourist services slowed across the board, significantly so in the case of payments linked to merchandise and passenger transport.

4.2. Output and employment

The renewed momentum of national demand and the strength of exports were conducive to a growing expansion of GDP in 2000 Q1. From the standpoint of the various productive activities, this took the form of an accelerating profile for industrial activity and a resumed expansionary path for construction. By contrast, there was a notable decline in agriculture, while services held at a sustained rate of increase. The economic information available for Q2 indicates that, in general, these trends tended to extend into this quarter, further accelerating GDP. As earlier discussed, the expansion of economic activity continues to be accompanied by a high rate of job creation, which has provided for a mild though continuous recovery in apparent labour productivity (see Chart 18).

During the opening months of 2000, unfavourable weather continued to exert a highly adverse influence on activity in the primary sector. On QNA estimates, the contraction in the gross value-added of this sector witnessed throughout 1999 intensified, slipping back to a year-on-year rate of –2.4 % in Q1 compared with –2 % in 1999 Q4. This was the result of the sharp contraction in agricultural output during the quarter owing to the heavy fall in winter cereal and olive yields induced by scant rainfall. In addition, livestock production decelerated, with its main components – meat, milk and eggs – losing momentum. As regards Q2, the abundant rainfall in April and May may have provided for a recovery in agricultural output, having occurred at a most propitious time for vegetable produce. In this respect, although the information is as yet very scant, the projected figures for arable land-use and agricultural output furnished by the Ministry of Agriculture, Fisheries and Food show an improvement in the expected output of certain fruit and vegetable products.

The current expansion in industrial activity is a result of the progressive improvement in the international economic environment which, given the weakness of the euro, has entailed a notable increase in exports. Likewise, the buoyancy of certain domestic demand components in the first half of the year has also exerted a positive influence on industrial activity, where gross value-added (including energy) trended strongly, furthering the recovery on which it had embarked in the second half of 1999 and increasing by 3.9 % in real terms in 2000 Q1 compared with the same period a year earlier. The economic information available for Q2 points to an additional strengthening of this branch: the industrial production index grew by 7 % year-on-year in the first five months of the year, up on the level observed at end-1999, while the business confidence indicator held at a very positive level in Q2, incorporating clearly upward output prospects for the coming months. The number of Social Security registrations accelerated again in the period from April to June, thereby entrenching the rising course of employment in industry in the preceding quarters. Generally, the expansion in industry is firmly underpinned, and has extended to most of the associated branches with odd exceptions such as the chemical industry and certain traditional manufacturing industries.

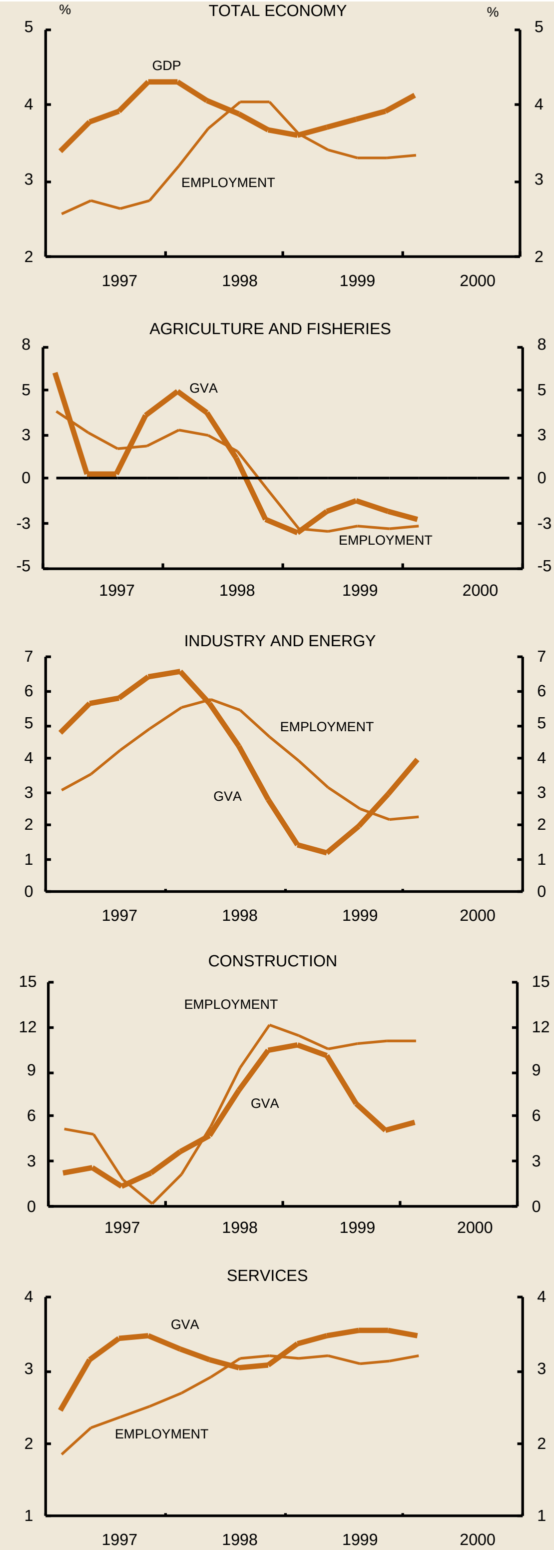
Value-added in construction rose by 5.6 % in 2000 Q1 on the same period a year earlier, turning upwards in a similar fashion to that estimated for investment in construction. As earlier discussed in connection with the behaviour of investment, the renewed momentum of construction in this period was based on the vigour of the building component, since civil engineering works continued to run at negative rates. Nonetheless, this latter component has foreseeably begun a recovery in Q2, to judge by the rising trajectory of the leading indicators of government procurement tenders in the opening months of the year. This development, coupled with the continuing thrust of building, should have further increased the pace of construction in Q2. Indeed, the substantial improvement in construction industry surveys in this period would testify to this fact.

Services activity in 2000 Q1 held on the sustained growth path characterising it in 1999, running at a rate of 3.5 % year-on-year, a very similar figure to the preceding quarters. As was the case in 1999, the buoyancy of this activity was based fully on the vigour of market services, as there was a fresh cut in the growth rate of non-market services. The economic information available for Q2 points to the continuing momentum of market services, with some changes in the activity of the various branches they comprise. Specifically, the hotel and restaurant trade appears to have regained the strength of previous quarters, after slowing in the opening months of 2000 owing to fewer foreign tourists, while the growth rate of retailing and repair activities has tended to stabilise. Lastly, transport, storage and communications services, along with financial intermediation services, have remained buoyant.

As earlier indicated, the Spanish economy continued forcefully generating employment in 2000 Q1, against a more dynamic economic background. On QNA figures, the number of full-time equivalent jobs posted an increase of 3.4 % year-on-year, one-tenth of a point up on the previous quarter, and apparent labour productivity accelerated by the same amount, prolonging the mild course of recovery it had initiated in 1999 Q1. By branch of activity, the pattern of employment was generally in step with that of output, as discussed above (see Chart 18). A key feature was the slight pick-up in industrial employment in Q1, interrupting the declining course it had shown in 1999. Moreover, the greater buoyancy of employment in this branch was compatible with a notable increase in apparent productivity, which resumed growth rates

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-cycles series published by INE. Employment refers to

more in line with those recorded in the past. In any event, the branches where the biggest growth in employment was seen were market services and, above all, construction, while the process of job destruction continued in agriculture and in non-market services. Job creation continue to be centred on dependent employees, while there was a further decline among the self-employed.

The employment indicators available for 2000 Q2 were very expansionary, although their growth rate tended to ease slightly. Social security registrations slowed during the spring months, running at 5.1 % compared with the increase of 5.4 % recorded in Q1. This moderation was the outcome of the slowdown in the number of employees is registered in construction, while in industry, by contrast, numbers increased with greater vigour, and held virtually stable in services. The mild slowdown in employment, set against the acceleration in activity, should have made for a further increase in apparent labour productivity in Q2.

As usual, the detailed analysis of employment developments is made using EPA (Labour Force Survey) figures. However, regard should be had, when interpreting the results to the successive changes and improvements in this Survey, which have temporarily affected the growth rates of the main variables on which it focuses. The EPA results for Q1 differ from QNA estimates in that they indicate a significant cut in the rate of increase of employment in this period, which stood at 4.7 % [when adjusted for the censual update made in that quarter (2)], five-tenths of a point down on the previous quarter. This deceleration might be partly related to the Easter holiday period falling in 2000 Q2, although it should also be recalled that the year-on-year employment growth rates in the EPA in 1999 might be affected by the changes introduced into the Survey at the beginning of that year. Leaving aside these changes and turning to contract duration, the EPA figures indicate that the various measures to promote stable employment have continued exerting a favourable influence in early 2000, since all the dependent jobs created in Q1 were under the fixed-employment contract category, while numbers of dependent employees with temporary contracts moderated notably. Consequently, the proportion of temporary to total employees was 31.7 %, over one percentage point below the figure for the previous quarter, although two-tenths of this decline would be attributable to the impact arising from the renewal of the sample. As regards the duration of the working day, although part-time employment decelerated markedly in Q1, the associated rate of increase exceeded that for full-time workers, taking the proportion of part-time to total employees to 8.2 % (8.4 % in homogenous terms).

Finally, according to EPA results the labour force followed an expansionary course in 2000 Q1. This is in line with the economy's current cyclical phase, which is encouraging greater labour market participation, and with the gradual increase in the proportion of women in employment. Specifically, the labour force grew by 2.3 %, according to the homogenous sample (2.8 % if the new sections are used), compared with 1.8 % in 1999 Q4, and the participation rate for the over-16s rose to 51 %. By sex, the participation rate remained higher among males (63.5 %) than females (39.5 %), although the gap between both groups has narrowed, partly because the updating of the sample had a more marked effect among women. Despite the acceleration in the labour force, the ongoing strength of job creation led to a further fall in the unemployment rate, which stood at 15 % of the labour force, four-tenths of a point less than the previous quarter. Nonetheless, the rate of decline in the number of unemployed was considerably cut, in keeping with the trend reflected in the registered unemployment figures in the opening months of the year.

4.3. Prices and costs

In the early months of 2000, the pace of the main price indicators intensified, against a backdrop of dearer energy product prices on international markets and the depreciation of the euro. On QNA figures for the first three months of the year, both domestic produce prices and import prices rose significantly, markedly so in the case of the latter.

The year-on-year growth of the GDP deflator rose to 3.8 %, one-tenth of a point more than the previous quarter. This slight acceleration was the result of the greater expansion by unit labour costs and net taxes per unit of output, while the unit surplus continued to grow significantly, prompting a fresh increase in operating margins. In turn, the acceleration in unit labour costs reflected sharper growth in compensation per employee (2.8 % against 2.5 % the previous quarter), which was only partly offset by the greater buoyancy of productivity. The raw-data QNA series reveal that the acceleration in compensation per employee in Q1 is some eight-

(2) In 2000 Q1, INE updated the censual sections considered in the Survey. To avoid the problems that may arise on calculating rates of change using different samples, INE conducted a parallel survey based on the old sample, thus allowing uniform rates of change to be obtained for 2000 Q1.

tenths of a point greater, largely reflecting the impact arising from the application of inflation-adjustment clauses under 1999 collective bargaining agreements, which were activated in the opening months of 2000 owing to the deviation by inflation during 1999 from the official forecast.

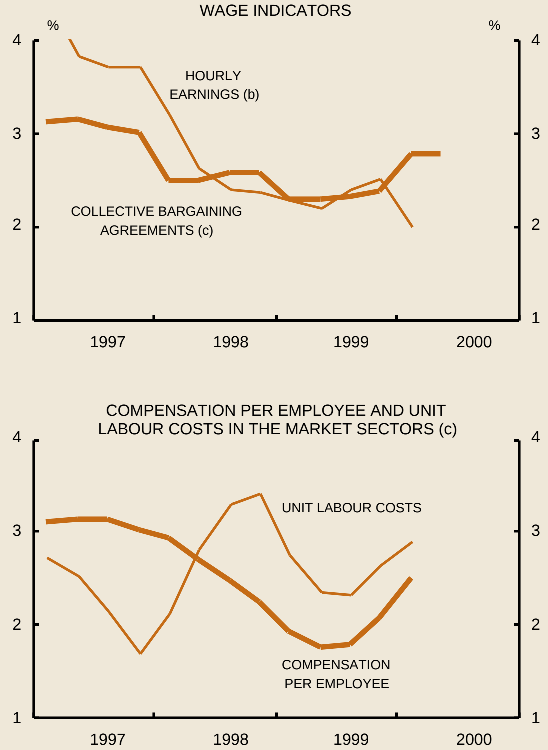
The QNA estimates of compensation per employee contrast with the results of the Wage Survey for Q1, which showed an increase of 2.4 % in total average hourly earnings, signifying a slowdown of two-tenths of a point compared with the increase observed in 1999 Q4. The increase in average hourly earnings in terms of basic pay was even lower (2.1 %), due partly to the fact that these figures exclude the impact derived from the inflation-adjustment clauses (see Chart 19). The wage increases reflected in the Survey in Q1 may be affected to some extent by the sample renewal undertaken at the beginning of each year, and which in the current year has entailed an upward revision of the relative weight of those branches, such as construction, where wage levels are lower. In fact, an analysis of figures by branch of activity shows, in general, an acceleration in wage growth. The biggest increase in average hourly earnings in Q1 was in construction (4.4 %), where there are signs of labour shortages. Wage increases were more moderate in industry and in services (3 % and 2.8 %, respectively).

Set against the aggregate results of the Wage Survey, the increase in wage rates under collective bargaining agreements entered into in the period to 30th June stood at 2.8 %, three-tenths of a point above the related rise in 1999. Most collective agreements registered to date this year have been revised agreements, incorporating a wage settlement of 2.7 %. In newly signed agreements, the average settlement has been 3 %; but this is hardly indicative of how wage negotiations are unfolding this year, since the number of newly signed agreements registered to date has been very limited. By branch of activity, the average settlement in agriculture has been 3.4 %, higher than that in services (2.8 %), industry (2.7 %) and construction (2.5 %).

As regards the value-added deflators and unit labour costs in the main market economy branches, the performance of prices and margins in industry and in market services can be seen to have differed appreciably (see Chart 20). In industry, the value added deflator accelerated significantly in Q1, while unit labour costs tended to moderate as a result of the recovery in productivity in this branch. The depreciation of the euro and the current acceleration,

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) Average wage increase for the current year, up to the reference month. Without inflation-adjustment clause.

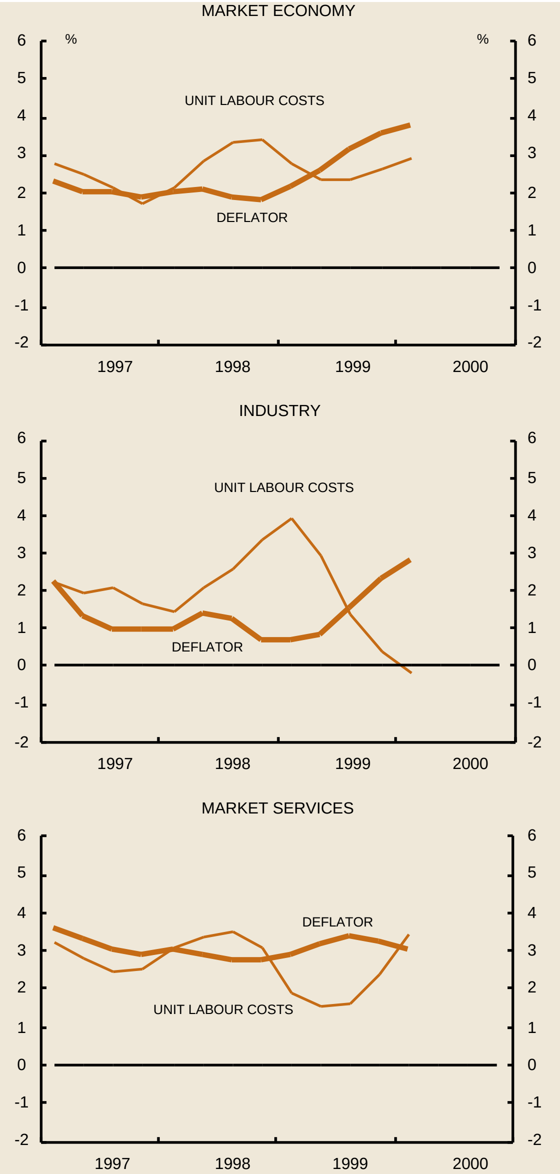
(d) Rates based on QNA trend-cycle series.

in general, in the prices of imported products that are competing with domestic produce have enabled industrial entrepreneurs to continue pursuing a less moderate price-setting strategy, providing for a pick-up in their operating margins, which had dwindled during 1999. The market services deflator eased slightly, while unit labour costs, reflecting a fresh slowdown in apparent labour productivity, increased by one point more than in 1999 Q4. The growth gap between the deflator and costs closed, giving rise to a minor squeeze on margins. In any event, these trends should be judged in qualitative terms, in view of the difficulties and uncertainty involved in measuring and interpreting apparent productivity and, consequently, the behaviour of unit labour costs.

As in the second half of 1999, the acceleration of the GDP deflator in 2000 Q1 was accompanied by a notable expansion of import prices (6.5 %), such that the year-on-year rate of the

CHART 20

Prices and costs by branch of activity (a)



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

final demand deflator rose to 4.3 %, three percentage points above the related rate in the same period a year earlier. The performance of the import unit value indices (UVIs), which grew by 12.2 % in the first four months of the year, would indicate that the upward course of import prices may have steepened in Q2. The high growth of this index mainly reflects dearer oil prices on international markets. Nonetheless, driven by the depreciation of the euro and the rise in international prices, the UVIs of non-energy products also accelerated significantly in the first four months of the year to 3.5 % year-on-year, compared with 0.9 % in 1999 Q4.

In this setting, the rising trend marking the course of the main price indicators in the Spanish economy over the preceding quarters has recently been accentuated. The 12-month growth rate of the consumer price index (CPI) stood at 3.4 % in June, half a point above the March level (see Chart 21). This increase was mainly due to the rise in the energy and unprocessed food components. Underlying inflation – for which the index of services and non-energy processed goods prices (IPSEBENE by its Spanish name) provides an approximation – edged up slightly in Q2 to 2.3 % in June. Foreseeably, the measures recently adopted by the government (see Boxes 1 and 2) will contribute to tempering the prices of certain specific products (such as text books or pharmaceuticals). That said, the short-term impact on overall inflation will be scant judging by the limited relative significance of these products in the consumer basket. In any event, the measures planned for key sectors such as gas and electricity production and the distribution of hydrocarbons will no doubt have a beneficial effect over a lengthier horizon.

All the basic components of the CPI accelerated in Q2, with the exception of processed food prices. Assisting the moderation of this item was the fact that the notable price rises posted by specific products (olive oil and wine) in the opening months of 1999 were stripped out of the index. The 12-month growth rate of the energy component climbed to 16.5 % in June following a transitory cut in April which placed it at 13.9 %. The increases in oil production agreed upon by the OPEC countries in the spring have proven clearly insufficient to ease the imbalances in this market, against a background of expanding international economic activity. Nevertheless, expectations of production increases in the coming months have led the price of crude to fall, prior to the cut-off date for this bulletin, to around $26 per barrel. The year-on-year rate of non-energy industrial goods prices increased once more in Q2 to 2.1 % in June, compared with 1.3 % in December 1999. This behaviour suggests that the increases in production costs in Spanish companies, resulting from the rise in the oil and other imported input prices and which have caused a gradual deterioration in wholesale prices, are beginning to feed through also to consumer prices. Services prices quickened in Q2, largely due to the rise in hotel and restaurant prices. Finally, the inflation rate of unprocessed food ran at 3.9 % in June, influenced by meat prices and, over the last month, by potato prices.

The comparison between the Spanish inflation rate and that of the euro area as a whole using the harmonised indices of consumer prices (HICP) shows that the inflation spread with the euro area has held (with fluctuations from one month to another) at slightly over one percentage point since the start of 1999 (see Chart 22). Specifically, it stood at 1.1 percentage points in June. Component by component, there was a gradual increase in the differential for non-energy industrial goods, and the services differential remained in place. In the case of energy product prices, the growth differential has held at high levels, despite having narrowed, owing possibly to the Spanish economy's greater dependence on imports of this type of good.

As regards the other price indicators, the 12-month growth rate of the producer price index remained on a rising trend until June, when it stood at 5.8 %, in tow to the notable increases posted by energy products and, to a lesser extent, to the persistent acceleration in non-energy intermediate goods. The remaining components generally held at more moderate growth rates. Lastly, farm-gate prices, which are a leading indicator of unprocessed food prices, are running at negative rates.

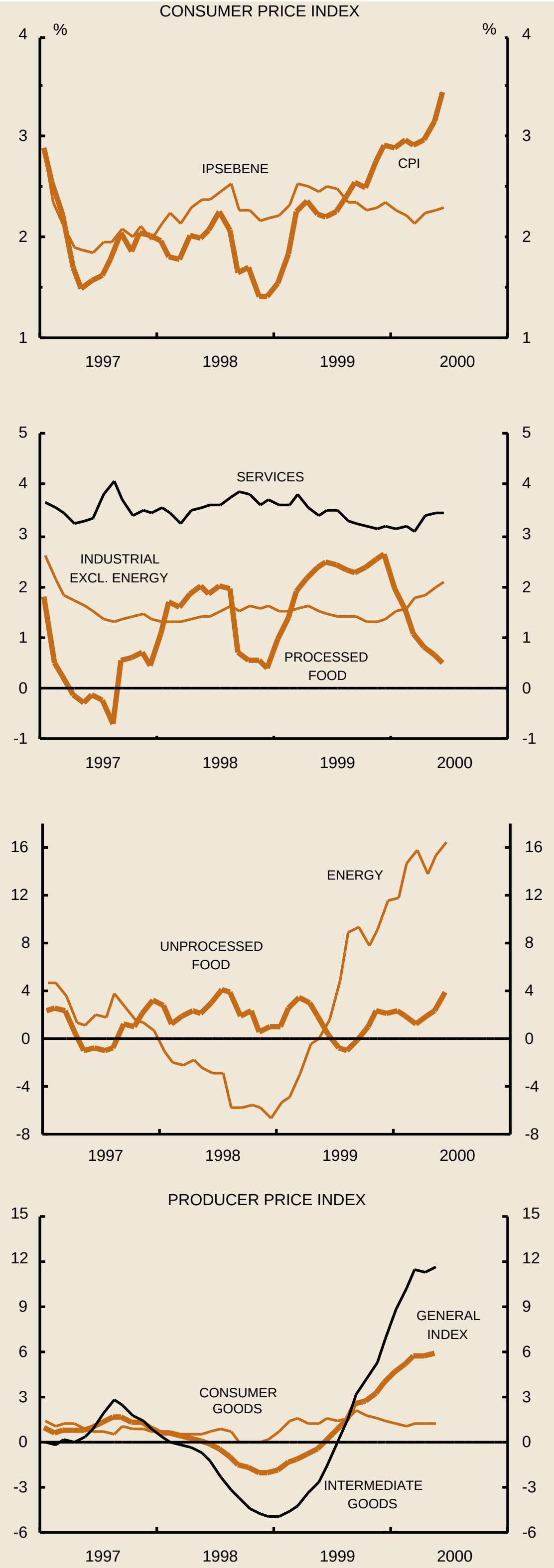
4.4. State budget

Public finances performed very favourably in 2000 Q2, in line with the budget deficit target for this year which has been revised downwards by the government from 0.8 % of GDP, for the overall general government financial balance established in the Updated Stability Programme, to 0.4 %.

Under National Accounts methodology, the State budget outturn to June resulted in a deficit of ESP 129 billion (0.1 % of GDP), a significant improvement on the deficit of ESP 548 billion (0.6 % of GDP) recorded in the same period a year earlier (see Table 3). During Q2, the growth rate of revenue increased while expenditure slowed notably. Revenue rose by 9.2 % (against 8 % in Q1), owing essentially to the strength of taxes on consumption, production and imports, and in particular to value-added tax (VAT), which grew by 17.7 %. Nonetheless, the marked buoyancy of these taxes has moderated in recent months, lowering their growth rate to around four points below that recorded in Q1. Conversely, direct taxes accelerated substantially to 7.7 % (3.4 % to March). As in the previous quarter, other current revenue was considerably cut, mainly as a result of lesser revenue in respect of Banco de España ordi-

CHART 21

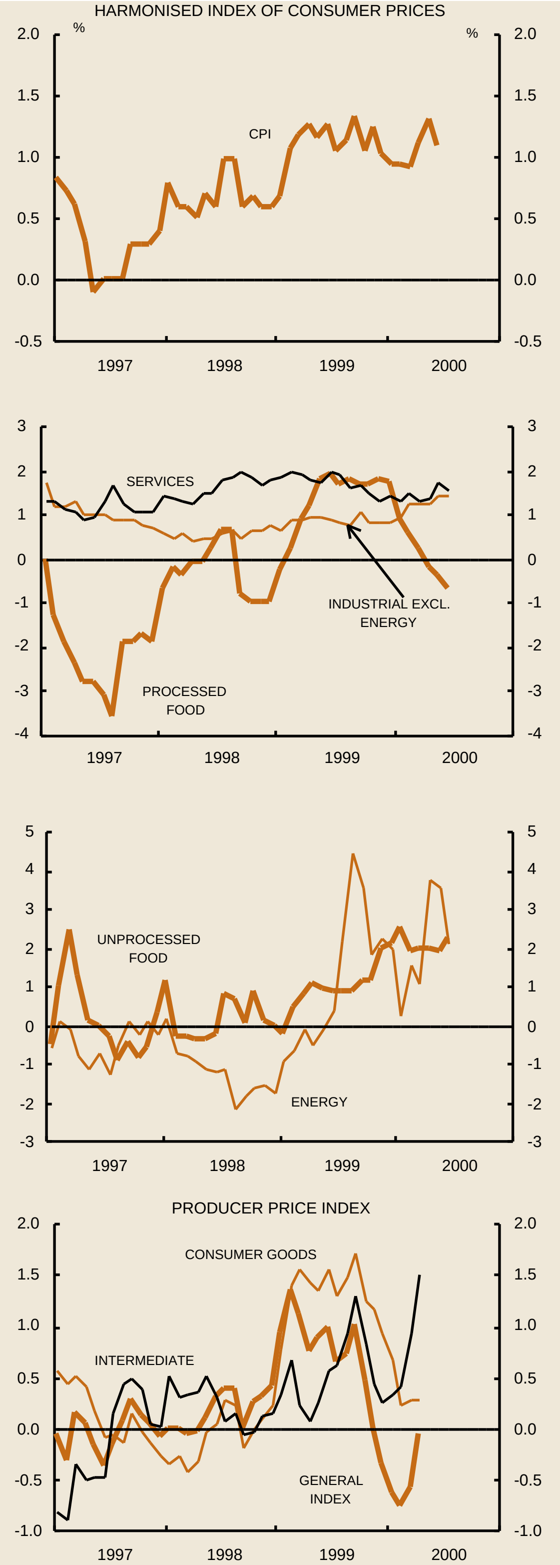
Price indicators (a)
Spain



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

CHART 22

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



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

nary profits, while capital revenue, principally from the EU, increased notably.

The growth rate of expenditure stood at 4.3 % (8 % in Q1). The slowdown was attributable above all to the trend of final consumption expenditure, which fell by 12.2 % to June, as a result of the transfer of responsibility for non-university education to the regional (autonomous) governments. For this same reason, current transfers to other general government units increased by 14.7 % in the first half of the year. Finally, mention should be made of the reduction in accrued interest.

In cash-basis terms, the State deficit to June 2000 was ESP 989 billion, down 1.7 % on the same period a year earlier. The improvement in the cash-basis balance, which is in line with the budgeted figure, began in April, once an adjustment had been made for the calendar effects falling in the first three months of the year. The main factor behind the improvement has been the buoyancy of tax receipts. Overall revenue posted growth of 4.4 % in the first half of the year (against a decline of 2.7 % to March), exceeding the initially projected figure for the year as a whole (2.1 %) and also outpacing the increase in expenditure (3.8 % to June, a similar rate to Q1). The breakdown of revenue and expenditure in cash-basis terms is discussed below.

Under revenue, the growth rate of tax receipts intensified in Q2, outpacing the budgetary forecast. However, this overall behaviour masks uneven developments across the various components. Direct taxes increased moderately in the period to June, although they accelerated notably in Q2, while indirect taxes remained very buoyant. Personal income tax receipts, having decreased by 5.3 % to March, picked up to 3.7 % in the period to June. The improved performance of personal income tax was due above all to the trend of withholdings on earned income, which incorporated additional income from the regional governments in Q2. Moreover, receipts relating to withholdings on moveable capital income, though affected by the reduction in the withholding percentage applied to dividends, also quickened in Q2. The rate of decline of corporate income tax slackened substantially as a result of the favourable course of the first pre-payment of this tax in April. The cumulative decline in revenue in respect of this tax was 2.8 % to June (compared with a fall of 66.9 % to March), chiefly as a consequence of the strong increase in tax refunds.

The growth rates to June of all the indirect tax components far outstripped those initially budgeted. As earlier stated, VAT was notably strong, partly because of dearer fuel prices

BOX 3

Social security budget outturn

On budget outturn data to April 2000, the Social Security system ran a surplus of ESP 800 billion, ESP 160 billion (25 %) higher than in the same period of 1999. This performance is the result of growth in revenue of 10.6 % to April, well above the budget forecast (7.9 %), and an increase in expenditure of 8.4 %.

Receipts from social security contributions rose by 9.7 % (6.6 % in the whole of 1999), far above the budget forecast of 6.2 %. This was attributable, above all, to the notable buoyancy of registrations, which grew by 5.2 % year-on-year in the period to June (against 5.5 % throughout 1999). This figure compares with a budget forecast of only 3 % for the increase in the level of contributions by employed workers. The other major source of revenue, current transfers from the State, also increased by 11.3 %, in line with budget forecasts.

The growth of expenditure during the first four months of 2000 stood above the budget forecast for the year as a whole, owing basically to the payment of ESP 66 billion in February as compensation for excess inflation in 1999. Spending on contributory pensions rose by 8.6 % to April; however, this increase is expected to revert somewhat over the next few months. Accounting for the effect of the above-mentioned one-off payment, the increase in contributory pensions amounts to 5.6 %, a figure fairly consistent with the budget forecast. The number of contributory pensions grew by 1.2 % to April, in line with forecast and with the increase observed in 1999. By contrast, sick pay benefits showed a percentage change well above the budget forecast.

As regards INEM (the National Employment Office) expenditure, spending on unemployment contributions grew by 1.3 % to June, compared with a decrease of 2.9 % for 1999 as a whole. This development was attributable to changes in the number of beneficiaries, which fell to 4.4 % in the period to May, in comparison with an average decrease of 9.5 % for 1999. This latter figure captures the slower decline in registered unemployment (6 % to June, compared to 11.7 % in the whole of 1999). In step with the trends observed in 1999, the fall in the number of unemployed entitled to unemployment benefits ran, to May, below the reduction in the number of registered unemployed. The replacement ratio duly rose to 64 % (62.9 % in the first five months of 1999).

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

ESP bn and %

	Budgeted			Outturn JAN-APR		
	1999 (c) 1	2000 2	% change 3=2/1	1999 4	2000 5	% change 6=5/4
1. Revenue	**13,519**	**14,583**	**7.9**	**4,801**	**5,309**	**10.6**
Social security contributions (d)	9,032	9,589	6.2	2,987	3,277	9.7
Current transfers	4,326	4,825	11.5	1,766	1,966	11.3
Other (e)	160	169	5.8	47	66	39.0
2. Expenditure	**13,589**	**14,432**	**6.2**	**4,161**	**4,509**	**8.4**
Wages and salaries	2,144	2,267	5.7	761	809	6.3
Goods and services	1,281	1,381	7.9	433	459	6.1
Current transfers	9,959	10,567	6.1	2,926	3,196	9.2
Benefits	9,896	10,499	6.1	2,900	3,168	9.3
Contributory pensions	*7,892*	*8,342*	*5.7*	*2,221*	*2,412*	*8.6*
Sick pay	*505*	*528*	*4.7*	*143*	*162*	*12.8*
Other (f)	*1,499*	*1,628*	*8.6*	*535*	*594*	*11.1*
Other current transfers	64	68	6.9	26	28	6.3
Other (g)	205	217	5.7	41	45	9.4
3. Balance	**–71**	**151**	**—**	**640**	**800**	**25.0**

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

(a) Only data relating to the System, not to the entire Social Security Funds sector, are given. This is because the figures for other Social Security Funds for the year 2000 are not available.
(b) Transfers to Regional Governments to finance the health-care and social services responsabilities 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.
(c) For comparative purposes, the budgeted figures are based on the 1999 budget. This is because no data are available yet for that year's overall outturn.
(d) Including surcharges and fines.
(e) Excluding surcharges and fines, and the contribution from the pharmaceutical industry.
(f) Reduced by the contribution from the pharmaceutical industry.
(g) Reduced by the disposal of investments.

TABLE 3

State Budget outturn

ESP bn and %

	Outturn 1999	Percentage change 1999/1998	Budget 2000	Percentage change	Outturn JAN-MAR Percentage change 2000/1999	Outturn 1999 JAN-JUN	Outturn 2000 JAN-JUN	Outturn Percentage change
	1	2	3	4=3/1	5	6	7	8=7/6
1. Revenue	**18,364**	**4.8**	**18,742**	**2.1**	**–2.7**	**9,158**	**9,561**	**4.4**
Direct taxes	7,817	4.8	8,008	2.4	–6.6	3,839	3,984	3.8
Personal income tax	*5,098*	*2.1*	*5,149*	*1.0*	*–5.3*	*3,059*	*3,172*	*3.7*
Corporate income tax	*2,436*	*10.0*	*2,563*	*5.2*	*–66.9*	*624*	*606*	*–2.8*
Other (a)	*283*	*14.9*	*296*	*4.5*	*100.9*	*156*	*205*	*31.8*
Indirect taxes	7,951	13.3	8,558	7.6	15.9	3,954	4,480	13.3
VAT	*5,114*	*17.0*	*5,655*	*10.6*	*19.0*	*2,591*	*3,026*	*16.8*
Excise duties	*2,567*	*7.4*	*2,630*	*2.5*	*9.0*	*1,233*	*1,306*	*5.9*
Tariffs	*144*	*9.2*	*143*	*–0.9*	*12.9*	*67*	*77*	*14.7*
Other	*126*	*5.3*	*130*	*3.3*	*7.6*	*63*	*71*	*12.3*
Other net revenue	2,597	–14.8	2,176	–16.2	–36.4	1,366	1,097	–19.7
2. Expenditure (b)	**19.421**	**4.2**	**19,769**	**1.8**	**3.4**	**10,164**	**10,550**	**3.8**
Wages and salaries	2,979	–2.4	2,888	–3.0	–4.3	1,525	1,369	–10.2
Goods and services	436	12.3	340	–22.0	0.2	227	202	–10.9
Interest payments	3,178	–4.7	2,806	–11.7	–1.8	2,183	2,035	–6.8
Current transfers	10,809	9.1	11,664	7.9	9.9	5,203	5,962	14.6
Investment	957	2.6	1,012	5.8	–8.8	582	531	–8.7
Capital transfers	1,063	6.6	1,059	–0.3	9.2	445	450	1.1
3. Cash-basis deficit (3 = 1 – 2)	**–1,057**	**–5.1**	**–1,028**	**–2.8**	**48.6**	**–1,006**	**–989**	**–1.7**
MEMORADUM ITEM: NATIONAL ACCOUNTS:								
Revenue	18,796	8.7	—	—	8.0	8,999	9,826	9.2
Expenditure	19,882	3.5	—	—	8.0	9,547	9,955	4.3
Net borrowing (–) or lending (+) (c)	**–1,087**	**–43.4**	**–788**	**–27.5**	**12.1**	**–548**	**–129**	**–76.5**

Source: Ministerio de Hacienda.

(a) Includes all revenue from the tax on the income of non-residents.
(b) Includes unclassified expenditure.
(c) The annual figures (columns 1 and 3) are drawn from the Spanish Finance Ministry's response to the Excessive Deficit Procedure questionnaire (ESA 95 methodology).

since the beginning of the year (3). Nonetheless, VAT revenue slowed in Q2, increasing by 16.8 % to June (compared with 19 % in Q1). The growth rate of excise duties also declined (from 9 % to March to 5.9 % in the first half of the year), although the duties on tobacco and car registration remain very buoyant.

The rate of decline of other revenue items eased notably in Q2. This was due above all to the extraordinary revenue arising on the concession of four mobile telephony licences, for an amount close to ESP 86 billion (4), and to the acceleration in capital transfers from the European Union. However, revenue relating to profits and dividends diminished by 33.3 % to June owing to a reduction in revenue from the Banco de España, both that derived from capital gains (5) and that relating to ordinary profits. Further, lower positive debt issuance premia had a bearing on the reduction in the aggregate of other revenue.

As regards expenditure, the slight acceleration seen in Q2 was due to the performance of current transfers, whose growth rate rose from 9.9 % in March to 14.6 % in June. This acceleration was due in particular to the behaviour of transfers to the Community budget, which increased by 11.8 % (after having declined by 9.9 % in Q1), while transfers to regional govern-

(3) Dearer fuel prices do not affect takings relating to the excise duties on hydrocarbons, since a fixed amount is involved. In contrast, VAT (with a rate of 16 % in this case) is applied to the price.

(4) According to a recent decision by Eurostat, this revenue is, under National Accounts methodology (ESA 95), computed as disposals of non-financial assets, i.e. as a deduction from capital expenditure, which reduces the budget deficit.

(5) This extraordinary revenue is not computed on obtaining the balance in National Accounts terms.

ments in respect of their share in State revenue posted the same growth rate as in Q1 (this was a very high rate as a result of the transfer of responsibility for education). The growth rate of the contribution to the Social Security system to finance INSALUD (Spanish Health Service) current transactions also held stable at 6.4 % (as budgeted). Conversely, the rate of decline of interest charges intensified on adjustment of the calendar effect observed in the period to March. Operating expenses (wages and salaries, and goods and services) fell at a sharper rate in Q2, running at close to 11 %. In the case of wages and salaries, this reduction is far higher than budgeted. As for capital transactions, the reduction in real investment was similar to that observed in Q1, in contrast to the budgeted increase, while the growth of capital transfers decelerated substantially to 1.1 %. This increase was due to the absence of payments to RENFE (the State-owned railway company) for most of 1999 owing to the delay in the approval of its Contract-Programme.

4.5. The Spanish balance of payments and capital account

In the first four months of 2000 the current and capital accounts ran an overall deficit of EUR 3,126 million, marking a significant deterioration on the EUR 142 million surplus recorded in the same period a year earlier (see Table 4). This result largely reflects the sharp increase in the trade deficit during this period, essentially due to dearer energy imports, as exports and imports of non-energy goods showed very similar rates of change, in both nominal and real terms. The rate of improvement of the tourism surplus was checked owing to the moderate pace of receipts during this period, and the deficit relating to other services widened as a result of strong growth in payments, especially under communications.

The investment income balance also worsened slightly, reflecting the notable fallback in credit-system income. This was linked to the decline in short-term investment abroad and portfolio investment. Meanwhile, the income of other resident sectors held at a strong pace, in step with the forceful foreign investment of recent years. In addition, payments by general government also increased, owing to the increase in the purchase of government debt purchases by non-residents. The surplus on current transfers held virtually stable, since the increase in flows from the EU in connection with the EAGGF-Guarantee and the European Social Fund was offset by the rise in payments under the Additional Resource (GNP). Finally, the surplus on capital account widened notably in the period under review further to the increase in EU structural funds, specifically the ERDF.

The increase in the nation’s net borrowing reflected in these data denote a weakening of the sectoral balances of households and corporations, against the backdrop of the lower household saving ratio and the marked buoyancy of residential investment and private productive investment. Conversely, the figures available for the first two quarters of the year indicate that the headway in reducing the budget deficit continues apace.

TABLE 4

Balance of payments: summary table (a)

EUR m

	JAN-APR 1999	JAN-APR 2000
	Receipts	Receipts
Current account	**56.361**	**64.115**
Goods	32.514	38.576
Services	14.051	15.199
Tourism	*7.968*	*8.346*
Other services	*6.083*	*6.854*
Income	4.488	4.569
Current transfers	5.308	5.771
Capital account	**1.960**	**2.614**
	Payments	Payments
Current account	**57.828**	**69.586**
Goods	39.439	48.997
Services	8.582	10.108
Tourism	*1.424*	*1.585*
Other services	*7.158*	*8.523*
Income	6.567	6.784
Current transfers	3.240	3.696
Capital account	**351**	**269**
	Balance	Balance
Current account	**–1.466**	**–5.471**
Goods	–6.925	–10.421
Services	5.470	5.091
Tourism	*6.544*	*6.761*
Other services	*–1.075*	*–1.669*
Income	–2.079	–2.215
Current transfers	2.068	2.074
Capital account	**1.609**	**2.345**

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

5. Financial flows in the Spanish economy (6)

5.1. Financial flows in the economy as a whole

The information for 2000 Q1 from the financial accounts of the Spanish economy confirms the deterioration in the nation's net financial saving (7) that was apparent in the 1999 figures. Thus, taking cumulative data over four quarters, the stock of the Spanish economy's financial transactions with the rest of the world was –1.1 % of GDP at the end of 2000 Q1 (see Table 5). This was essentially the result of the decline in the saving of households and non-financial corporations, since the contribution of general government was similar to that in 1999 and the credit balance of financial institutions' financial transactions with other sectors rose marginally. The performance of the nation's saving is in step with the Spanish economy's cyclical position, which continues to be one of strong growth largely sustained by the vigour of domestic demand. The Spanish economy's financial position, i.e. the difference between the stock of financial assets and liabilities vis-à-vis the rest of the world (which includes, along with net financial transactions, valuation changes), likewise highlights an increase in the debit balance vis-à-vis the external sector at the end of 2000 Q1.

A more detailed breakdown of the items at the root of this net indebtedness can be obtained drawing on the information from the balance of payments financial account for the period January-March 2000. According to this information, the Spanish economy's net external liabilities increased by 0.7 % in 2000 Q1, in terms of annual GDP, substantially up on the figure for the same period in 1999 (see Table 6). This net indebtedness, which reflects the widening of the gap between non-resident investment in Spain and Spanish investment abroad, is in line with the significant increase in the current- and capital-account deficit, which is analysed in section 4 of this quarterly report.

(6) The information from the financial accounts acting as a basis for this report incorporates ESA 95 methodological criteria. The article «Presentation of the Financial Accounts of the Spanish Economy. ESA 95. 1995-1999» in this Economic Bulletin and Box IV.3 of the Banco de España Annual Report examine the changes introduced into the analysis of the Spanish economy's financial flows by the new criteria. However, economic indicators 8.3 to 8.8 published at the end of this Bulletin do not yet include these new methodological criteria.

(7) In ESA 79 terminology, the balance of the financial transactions account was called net financial saving. In the financial accounts according to ESA 95 methodology, this balance is now called net financial transactions. Likewise, the difference between the stock of financial assets and liabilities of a sector, which was previously called net financial wealth, is now called net financial assets. No distinction is made between both terms as used throughout this report.

TABLE 5

Saving and financial position

	FINANCIAL SAVING AS A % OF GDP (Cumulative data over four quarters)								
	1995	1996	1997	1998	1999				2000
					Q 1	Q 2	Q 3	Q 4	Q 1
Financial saving of the nation	1.0	1.2	1.6	0.8	0.6	0.3	–0.3	–0.6	–1.1
Non-financial corporations and households	6.6	5.0	3.9	2.2	1.1	0.5	0.1	0.1	–0.7
Non-financial corporations	*0.3*	*0.2*	*–0.1*	*–0.7*	*–0.9*	*–2.1*	*–2.8*	*–1.6*	*–2.1*
Households	*6.3*	*4.8*	*4.1*	*2.9*	*1.9*	*2.6*	*2.8*	*1.6*	*1.4*
Financial corporations	1.0	1.2	0.8	1.2	1.0	0.8	0.7	0.5	0.7
Credit institutions (a)	0.8	0.7	0.6	0.9	0.8	0.6	0.6	0.3	0.5
Institutional investors (b)	*0.0*	*0.3*	*0.0*	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*
Other financial institutions	*0.2*	*0.2*	*0.2*	*0.2*	*0.2*	*0.1*	*0.1*	*0.1*	*0.1*
General government	–6.6	–5.0	–3.2	–2.6	–1.5	–1.0	–1.1	–1.1	–1.1

	FINANCIAL POSITION AS A % OF GDP (c) (Fourth-quarter data)					
	1995	1996	1997	1998	1999	2000 (e)
Financial position of the nation	–19.6	–19.8	–20.9	–22.0	–24.9	–25.7
Non-financial corporations and households (d)	82.3	99.6	114.8	148.0	162.1	165.6
Non-financial corporations (d)	*–13.6*	*–6.4*	*–0.8*	*14.6*	*20.0*	*21.7*
Households	*95.9*	*105.9*	*115.7*	*133.5*	*142.1*	*143.9*
Financial corporations (d)	13.6	19.8	24.0	33.6	37.1	38.1
Credit institutions (a) (d)	*12.8*	*17.4*	*20.9*	*28.6*	*32.2*	*33.1*
Institutional investors (b) (d)	*1.1*	*2.7*	*3.6*	*5.3*	*5.5*	*6.0*
Other financial corporations (d)	–0.2	–0.4	–0.5	–0.3	–0.5	–1.0
General government	–49.2	–53.4	–52.5	–52.4	–46.5	–45.1

Source: Banco de España.

(a) Defined according to the 1st Banking Directive.
(b) Insurance corporations and portfolio investment institutions.
(c) Calculated as the difference between outstanding financial assets and liabilities.
(d) Liabilities do not include shares.
(e) First-quarter data.

The main trends observed over the past two years as regards capital inflows and outflows continued during 2000 Q1, albeit, in general, with lesser intensity (see Table 6). Regarding Spanish investment abroad, the most sizeable item was portfolio investment, with net purchases by the non-credit private sector equivalent to 2.4 % of GDP (compared with 1.8 % of GDP in the same period a year earlier). Overall, direct investment abroad was along the lines of the volume recorded in 1999 Q1, although the relative weight of credit institutions increased and that of non-financial corporations diminished. Also, unlike in 1999, the non-credit private sector increased its deposits abroad. Finally, the cumulative change in reserve assets in the period January-March 2000 was a minor one. Broadly, the balance of payments information for April is confirming the aforementioned trends.

As to inward investment in Spain, the pace of direct and portfolio investment inflows was sustained, while indebtedness via credit and deposits fell in comparison with 1999 Q1. Specifically, the ongoing moderation of the credit system's debt continued (assisted by the notable growth of residents' bank deposits), as did the diversification of its sources of financing, with a greater relative resort to long-term deposits and fixed-income securities as opposed to loans and short-term deposits, which accounted in the past for most of credit institutions' external debt.

The sectoral structure of cross-border financial flows retains similar characteristics to those of previous years, albeit now with a net debit balance for the Spanish economy as a whole. In aggregate terms, non-credit private-sector purchases of net assets vis-à-vis the rest of the world has continued to be financed by the in-

TABLE 6

Balance of payments on financial account

% of GDP

	1997	1998	1999	1999 JAN-MAR	2000 JAN-MAR
BALANCE ON FINANCIAL ACCOUNT	**–0.6**	**0.0**	**2.0**	**0.1**	**0.7**
CHANGE IN FOREIGN LIABILITIES	**7.0**	**12.8**	**16.3**	**5.6**	**3.7**
Direct investment (a)	**1.1**	**2.0**	**1.6**	**0.3**	**0.4**
Portfolio investment (b)	2.3	2.9	7.8	2.1	1.6
General government	2.0	0.8	4.5	1.5	0.8
Other resident sectors	0.2	1.6	1.8	0.3	0.4
Credit system	0.0	0.5	1.4	0.3	0.5
Other investment	**3.6**	**7.9**	**6.9**	**3.2**	**1.6**
General government	0.0	0.2	0.0	–0.1	–0.1
Other resident sectors	0.1	0.8	2.7	0.6	0.1
Credit system	3.5	6.8	4.3	2.7	1.5
CHANGE IN FOREIGN ASSETS	**7.6**	**12.8**	**14.3**	**5.5**	**2.9**
Direct investment	**2.2**	**3.3**	**5.9**	**0.7**	**0.7**
Other resident sectors	2.0	2.9	6.0	0.7	0.4
Credit system	0.2	0.3	–0.1	0.0	0.4
Portfolio investment	**2.9**	**7.9**	**7.8**	**2.6**	**2.2**
Other resident sectors	2.0	6.0	5.4	1.8	2.4
Credit system	0.9	2.0	2.4	0.8	–0.2
Other investment	**0.3**	**4.0**	**4.2**	**4.0**	**0.0**
General government	0.1	0.1	0.0	0.0	0.0
Other resident sectors	2.5	3.3	–1.6	0.3	0.8
Credit system	–2.3	0.6	5.8	3.7	–0.8
Reserve assets	**2.1**	**–2.3**	**–3.7**	**–1.8**	**0.0**
MEMORANDUM ITEM: DISTRIBUTION OF FLOWS BY SECTOR (CHANGE IN LIABILITIES – CHANGE IN ASSETS):					
Credit system (excluding Banco de España)	4.7	4.5	4.1	2.2	1.8
Banco de España (c)	–2.1	2.3	–2.7	–1.9	0.8
General government	2.0	0.9	4.4	1.4	0.7
Other resident sectors	–5.1	–7.8	–3.8	–1.6	–2.6

Source: Balance of Payments, Banco de España.

(a) Includes portfolio investment in unlisted shares.
(b) Includes direct investment in listed shares.
(c) Includes reserve assets and intra-system assets.

debtedness of the public sector and of the credit system (see lower part of Table 6).

5.2. Financial flows of households and non-financial corporations

The decline in the saving of households and non-financial corporations referred to above was due to a minor fall in the volume of household saving and to a somewhat more marked reduction in that of non-financial corporations (see Table 5). As a result, household net financial transactions in 2000 Q1, taking cumulative data over four quarters, stood at 1.4 % of GDP, while those relating to non-financial corporations amounted to –2.1 % of GDP. Further, purchases of assets and liabilities in 2000 Q1 ran at a brisk pace, with flows clearly outpacing the seasonal pattern of previous years. Compared with its expansionary behaviour in recent years, private-sector net financial wealth, measured as the difference between the stock of financial assets and liabilities (excluding the stock of shares and other equity), increased only slightly in 2000 Q1 (see the lower part of Table 5).

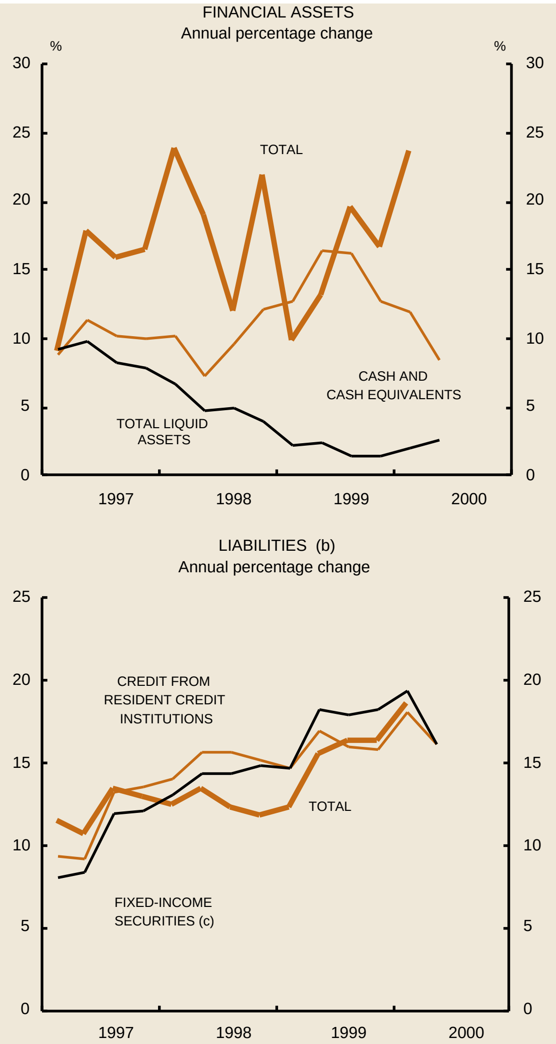
The sizeable volume of financial assets acquired by households and non-financial corporations during the first three months of the year gave rise to notable growth in the stock of assets, the annual rate of which stood at close to 25 % at the end of Q1 (see Chart 23). During this period, cash and cash equivalents continued on the decelerating course they had initiated in mid-1999. Conversely, the growth rate of time deposits increased to an annual rate of 20 %. However, other liquid financial assets taken as a whole (including, in addition to time deposits, repos and shares in money-market and fixed-income mutual funds) continued to run at negative growth rates owing to sales of shares in these collective investment schemes and to the decline in their realisable value. The pace of other financial assets was very intense during Q1, owing first, to the rise in the value of the equity portfolio that has built up in recent quarters and, further, to purchases of foreign assets and to the growth of trade credit.

The expectations of interest rate rises that have firmed since mid-1999 and the greater volatility apparent on equity markets have detracted from the attractiveness of investing in products whose realisable value fluctuates with the price of financial assets (equity and mutual funds). At the same time, they have also raised the opportunity cost of holding very liquid assets, giving rise to a shift in saving from highly liquid assets and high-risk products towards fixed-income investments. Despite the lower growth of cash and cash equivalents, the information available for Q2 indicates a progressive acceleration in liquid financial assets, as a result of the high rate of expansion of time deposits (see Chart 23). The rate of decline of mutual funds, for their part, appears to have moderated.

The year-on-year growth of the liabilities of households and non-financial corporations increased once more in 2000 Q1. This was principally due to the brisker pace of credit from resident banks, the annual rate of which stood at 18 % at the end of Q1. The surge in the growth rate of bank financing in this period, above the habitual seasonal pattern, could denote a bringing forward of the demand for financing given the expectations of interest rate rises that have prevailed during this quarter. Increases in other sources of financing, such as bond and equity issues, were relatively insignificant, although foreign financing continued to provide a constant flow of funds to Spanish companies. The information for Q2 suggests something of a slowdown in financing to households and corporations; having grown at a rate of close to 20 % in recent quarters, it might now be at a level of 16 %-17 %.

CHART 23

Non-financial corporations and households (a)



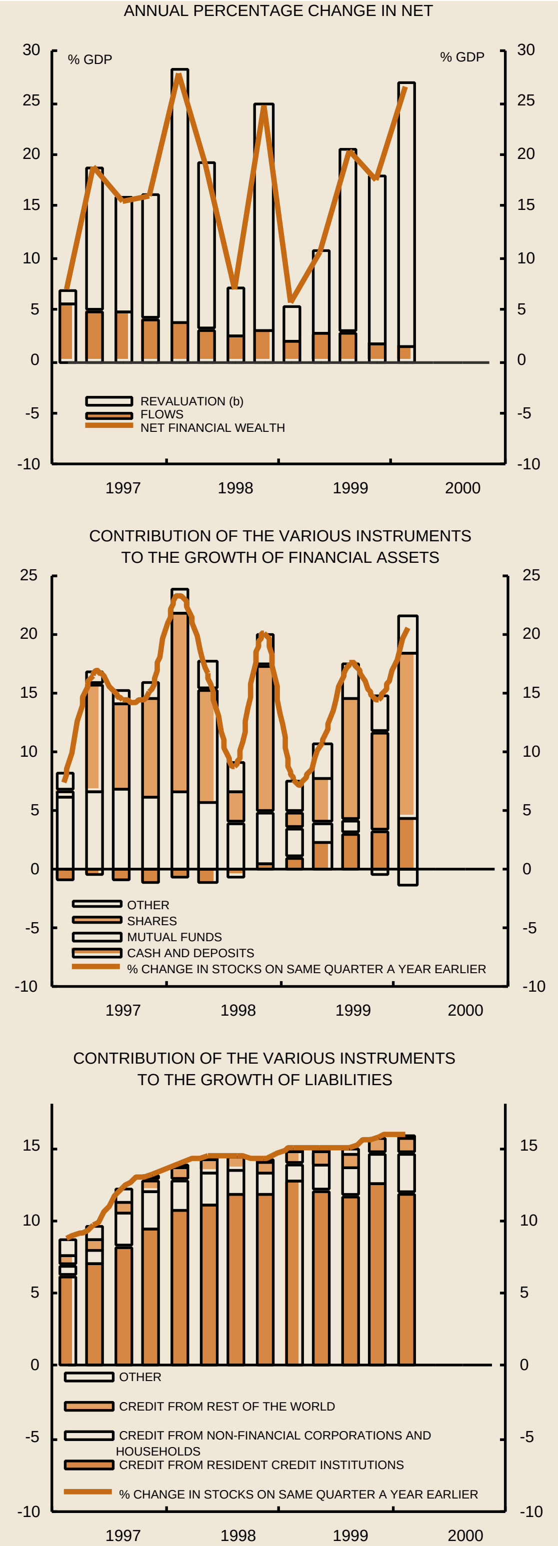
Source: Banco de España.
(a) The data for 2000 Q2 are provisional estimates.
(b) Excluding shares.
(c) Excluding trade credit.

5.3. Financial flows of households

Household financial saving fell moderately in 2000 Q1 following the notable decline in 1999. In any event, the average trend in recent quarters is that of a reduction in the volume of this sector's saving, driven by consumption growth outpacing that of disposable income, and by sustained investment in real assets. Moreover, despite recent interest rate rises, financing conditions remained conducive to households sustaining a high rate of acquisitions of liabilities. Insofar as bank financing progressively incorporates the latest interest-rate rises (in terms both of extending new financing and of revising lending extended at a floating rate), moderation in household private spending and in the associated demand for financing is likely to be detected.

CHART 24

Households (a)



Source: Banco de España.

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

(b) Change in the stock - flow - changes in volume.

These developments in households' net financial transactions, along with a limited contribution by the revaluation of financial assets, restrained the growth rate of their financial wealth in the first three months of the year. Bearing in mind equity market prices, a fresh slowdown in the growth of households' net financial assets may be expected in 2000 Q2.

As a result of the expansion of domestic demand and favourable finance conditions, the growth of financial resources obtained by households remained at high levels of around 16 % (see Chart 24) in 2000 Q1. The latest information on bank credit to households indicates that this rate of expansion is holding in 2000 Q2. The main end-use of this finance continued to be housing and staple consumer goods purchases. Credit for the purchase of consumer durables, which is one of the uses most sensitive to interest rate changes, continued on the slowing trend initiated in late 1999.

The growth rate of the stock of financial assets held by households increased in 2000 Q1 (see Chart 24), placing the year-on-year rate at 20 %. Contributing significantly to this growth was the rise in equity prices during 1999. The flow of asset purchases was in step with seasonal patterns, following the limited volume observed in 1999 Q4. The value of shares in mutual funds contributed negatively to the growth of household financial assets, although disinvestment from this type of instrument moderated in relation to the preceding quarter. In 2000 Q1, asset purchases continued to be centred on time deposits and, to a lesser extent, on contributions to pension and insurance schemes, although the information on the latter instruments is still provisional. Cash and cash equivalents continued decelerating in the first half of 2000 in the face of the rise in their opportunity cost. The information for 2000 Q2 suggests the continuation of the above-mentioned trends, with high growth in time deposits, slowing cash and cash equivalents and the disposal of shares in mutual funds. Likewise, the sizeable volume of public share offerings with retail-investor tranches in Q2 augurs an increase in household holdings of these securities.

5.4. Financial flows of non-financial corporations

The net saving of non-financial corporations declined in 2000 Q1 to –2.1 % of GDP, in cumulative terms over four quarters (see Table 5). This deterioration reflects the widening of the gap between gross capital formation and gross saving, as a result of the notable rate of advance of the former. If, moreover, regard is had to the acquisition of foreign companies by Spanish corporations (and which constitute installed plant which is not computed in the capital account of non-financial corporations), the financing gap between gross saving and gross capital formation, in Spain and abroad, would have increased by somewhat more than two percentage points of GDP in annual average terms over the past two years.

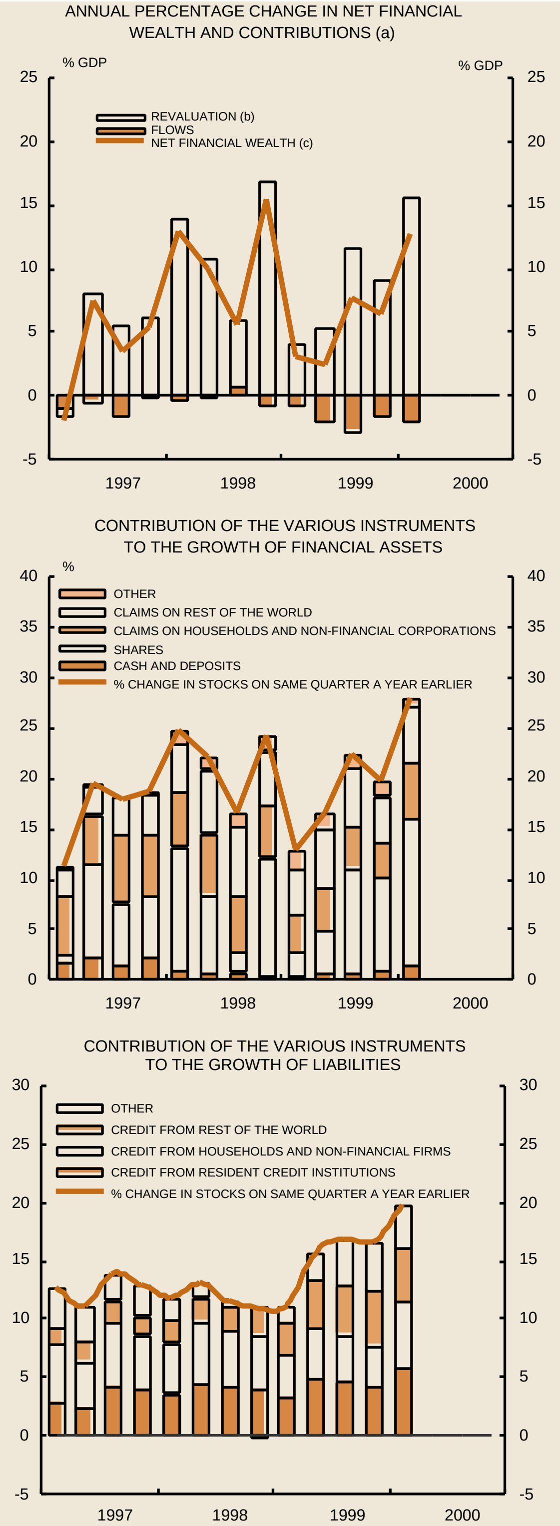
The financing of gross capital formation, enlarged with investment in foreign corporations, means that the equity and borrowed funds of Spanish corporations are having to grow sizably. This process has gathered steam in 2000 Q1, in which the flow of liabilities has increased by a far greater amount than would correspond to the seasonal pattern at this time of year. As earlier discussed, this behaviour may be in response to an attempt to bring forward the raising of resources in view of expectations that financing conditions may tighten in the future. In this way, the aggregate comprising the financing of resident credit institutions, fixed-income securities issues and foreign loans grew by almost 24 % in 2000 Q1, after having held at around 21 % in the second half of 1999. Nonetheless, the growth of this aggregate dipped at the end of Q2, due largely to the mechanical effect on its annual rate of the purchase by Repsol of YPF, which gave rise to a change in the level of the stock of credit in June 1999. Further, non-financial corporations have raised funds of considerable significance in the capital increases that took place during Q2.

Information on the destination of bank finance for 2000 Q1 indicates something of an acceleration in lending extended to productive activities, the year-on-year growth rate of which stood two percentage points above that for 1999 Q4. All sectors contributed to this acceleration, except agriculture, where growth moderated. Financing to construction showed the most expansionary behaviour, running at 24 % year-on-year. However, it was once again the services sector and industry, excluding construction, which most contributed to the growth of the total stock of bank credit, posting annual growth rates of 13 % and 16 %, respectively.

Non-financial corporations purchased a high volume of financial assets during 2000 Q1, essentially in the form of foreign assets and trade credit. Investment in foreign assets accounted for approximately 40 % of total asset purchases in this quarter, and was the outcome of various placements, such as equity purchases, loans to affiliated companies and deposits. In terms of stocks, it was foreign assets and the national equity portfolio which most contributed to the annual growth of corporate assets (see Chart 25).

CHART 25

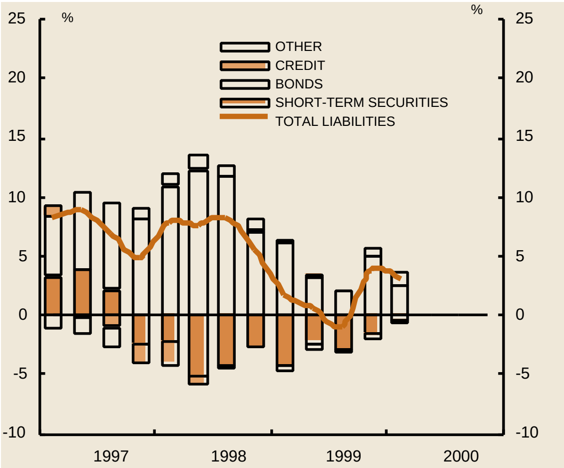
Non-financial corporations (a)



Source: Banco de España.
(a) The flows and revaluation data are cumulative data for the latest four quarters.
(b) Change in the stock - flow - changes in volume.
(c) Shares are not included in liabilities.

CHART 26

Growth of general government liabilities



Source: Banco de España.

The pace of cash and cash equivalents and other liquid financial assets increased somewhat in relation to the previous quarter, although their contribution to the growth of the stock of assets is very small.

5.5. General government financial flows

Over the four quarters to 2000 Q1, general government financial saving stood at –1.1 % of GDP, at a similar level to that seen in 1999 (see Table 5). During the first three months of 2000, the growth of general government liabilities slowed, largely due to interest payments in respect of medium- and long-term government bonds. These payments were concentrated in the opening months of the year (8), offsetting net issues of these securities (see Chart 26). The net volume of such issues amounted to EUR 3.5 billion, despite the fact that there were redemptions for a sizeable amount in March. Once again, there was a negative net issue of short-term securities in 2000 Q1, following positive net issues in the second half of 1999. The data on gross issues indicate an increase in the average amount thereof since end-1999, apparently in response to the greater attractiveness of these securities for investors, in a setting in which expectations of interest rate rises have prevailed. These developments have meant that the average life of peseta-denominated government debt was 5.3 years at the end of 2000 Q1, a similar figure to end-1999. Finally, a large portion of financial requirements during Q1 were met by drawing down transferable deposits, fundamentally the deposit at the Banco de España, the outstanding balance of which declined by almost EUR 6 billion.

The partial information available on the volume of funds raised by general government in Q2 indicates there was a negative net issue of Treasury bills, but only for a minor amount (EUR –339 million). By contrast, there was a net issue of long-term securities totalling EUR 1.5 billion, after redemptions amounting to over EUR 7 billion. Overall, the financing raised by the State via securities issues in Q2, which was EUR 594 million down on that for Q1, is in line with the progressive decline in its borrowing requirements.

31.7.2000.

(8) In accordance with ESA 95 methodological criteria, net financial transactions (flows) and the stock of debt incorporate the net amount of interest accrued and unpaid and, therefore, are reduced when the interest is paid. See the article in this Bulletin referred to in footnote 6.

Results of non-financial corporations in 2000 Q1 (1)

1. INTRODUCTION

The Central Balance Sheet Office Quarterly Survey data for 2000 Q1 show that reporting corporations have maintained the positive performance initiated in the second half of 1999. Their gross value added (GVA) increased at a nominal rate of 5.7 % in the first three months with respect to 1999 Q1. This was largely due to the favourable developments in exports and domestic demand observed throughout the previous year and confirmed by other sources. Manufacturing industry was notably buoyant, favoured by the recovery in exports and the increase in capital investment, since the negative impact of the rise in oil prices on inputs has not fully affected the performance of the corporations' GVA. In fact, there is evidence that oil price increases have affected the GVA and the operating margins of oil-refining corporations (classified as manufacturing firms) and of oil-retailing corporations (classified in the distributive trade sector) differently. The GVA of oil-refining corporations has trended favourably, while that of fuel-retailing corporations reveals a negative performance, suggesting that higher input prices are not being passed through in full in the latter.

Growth in productive activity has led to substantial job creation, despite staff adjustments in major corporations in sectors undergoing liberalisation in recent quarters. Specifically, the net rate of change of employment in reporting corporations is clearly positive, moving away from a pattern hitherto dominated by the over-representation of restructuring corporations. The data available show that in 2000 Q1 most corporations in the sample increased their workforce, especially in the distributive trade, corporate services and construction. Average compensation rose at a rate of 3.7 %, compared with the same period the previous year, furthering the trend observed in the second half of 1999. This marks something of a break in the wage moderation recorded up to 1999 Q3. The increase has affected most sectors, regardless of their relative position. As a result of employment growth and average compensation, personnel costs grew at a rate of over 5 % which, as it was below the performance of GVA, allowed the gross operating result to increase at a rate of over 6 %. Financial costs showed a positive rate of change of 17 %, in

(1) The information in this article relates to 723 corporations that have reported their quarterly data to the Central Balance Sheet Office (the CBQ survey) to 15 June 2000. These firms account for 15.3 % of total activity –as measured by gross value added (GVA) at factor cost– in the non-financial corporations sector.

TABLE 1

Profit and loss account. Year-on-year performance
(Growth rates of the same corporations on the same period a year earlier/
% of GVA at factor cost in the case of the net result)

Data Bases	CBA		CBQ		
	1997	1998	99Q1-Q4 / 98 Q1-Q4 (a)	99Q1/ 98 Q1	00 Q1/99 Q1
Number of corporations / Total national coverage	8046 / 38,9 %	6806 / 37,1 %	854 / 17,4 %	912 / 19,8 %	723 / 15,3 %
1. VALUE OF OUTPUT (including subsidies)	10.1	6.5	8.8	2.8	24.0
Of which:					
1. Net amount of turnover and other operating income	10.0	7.1	9.9	4.5	23.8
2. INPUTS (including taxes)	11.6	6.3	13.1	2.8	37.7
Of which:					
1. Net purchases	11.9	3.7	16.1	–0.2	54.2
2. Other operating costs	10.8	11.2	10.0	10.6	9.1
S.1. GROSS VALUE ADDED AT FACTOR COST	7.1	6.8	2.4	2.8	5.7
3. Personnel costs	4.0	5.3	1.9	2.0	5.2
S.2. GROSS OPERATING RESULT	11.0	8.5	2.9	3.5	6.2
4. Financial revenue	11.0	9.5	26.1	26.5	14.8
5. Financial costs	–13.9	–8.7	–7.1	–11.6	17.0
6. Corporate income tax	23.0	29.8	21.3 (c)	13.6	17.1 (c)
S.3. FUNDS GENERATED FROM OPERATIONS	17.2	10.3	7.8	8.1	6.0
7. Depreciation and provisions (b)	25.0	18.7	6.1	9.9	–0.2
S.4. TOTAL NET RESULT (% of GVA at factor cost)	14.8	15.5	20.2	22.4	29.1
PROFITABILITY RATIOS					
R.1. Ordinary return on net assets (before taxes) (b)	7.6	8.3	8.7	8.5	8.3
R.2. Interest on borrowed funds/ interest-bearing borrowing	6.7	5.7	4.9	5.1	4.9
R.3. Ordinary return on equity (before taxes) (b)	8.1	9.6	10.5	10.1	9.9
R.4. *Debt ratio*	38.9	39.3	38.5	38.3	37.3
R.5. Financial leverage (before taxes) (R.1 – R.2) (b)	0.9	2.6	3.8	3.4	3.4

Source: Banco de España.
(a) All the data in this column have been calculated as the arithmetic mean of the quarterly data.
(b) Ratios calculated according to the new methodology, as explained in the Central Balance Sheet Office's annual monograph.
(c) Adjusted for one-off transactions.

CHART 1

Non-financial corporations reporting to the Central Balance Sheet Office (a)

NUMBER OF CORPORATIONS

CBA	8,111	8,019	8,046	6,806		
CBQ	723	726	724	833	854	723

% OF GDP OF NON-FINANCIAL CORPORATIONS SECTOR

CBA	36.9	38.6	38.9	37.1		
CBQ	21.5	20.9	20.7	19.9	17.4	15.3

NUMBER OF CORPORATIONS

CBA	8,111	8,019	8,046	6,806		
CBQ	723	726	724	833	854	723

% OF GDP NON-FINANCIAL CORPORATIONS SECTOR

CBA	36.9	38.6	38.9	37.1		
CBQ	21.5	20.9	20.7	19.9	17.4	15.3

CBA datal. CBQ data.

Source: Banco de España.

(a) Information available to June 16th 2000 (CBA and CBQ).

(b) The 1995, 1996, 1997 and 1998 data are based on information from the corporations included in the annual survey (CBA) and the average of the four quarters of each year in relation to the previous year (CBQ).

(c) Average of the four quarters of 1999 in relation to the same period in 1998.

(d) First quarter of 2000 on first quarter of 1999.

TABLE 2.a

Value added, employees, personnel costs and compensation per employee
Breakdown by size, ownership status and main activity of corporations
(Growth rates of the same corporations on the same period a year earlier)

	Gross value added at factor cost				Employees (average for period)				Personnel costs				Compensation per employee			
	CBA	CBT			CBA	CBT			CBA	CBT			CBA	CBT		
	1998	99 Q1-Q4 (a)	99 Q1	00 Q1	1998	99 Q1-Q4 (a)	99 Q1	00 Q1	1998	99 Q1-Q4 (a)	99 Q1	00 Q1	1998	99 Q1-Q4 (a)	99 Q1	00 Q1
Total	**6.8**	**2.4**	**2.8**	**5.7**	**3.4**	**–0.2**	**–0.6**	**1.4**	**5.3**	**1.9**	**2.0**	**5.2**	**1.9**	**2.0**	**2.6**	**3.7**
Total, except electricity sector	**7.9**	**2.1**	**2.5**	**6.6**	**3.8**	**0.6**	**0.2**	**2.0**	**5.8**	**2.7**	**2.9**	**6.2**	**2.0**	**2.2**	**2.7**	**4.2**
SIZE:																
Small	8.5	—	—	—	4.3	—	—	—	7.3	—	—	—	3.0	—	—	—
Medium	9.9	7.2	10.5	9.1	5.7	5.5	4.6	4.8	8.7	7.1	7.6	8.1	2.9	1.5	2.8	3.2
Large	6.3	2.1	2.3	5.5	2.9	–0.8	–1.2	1.0	4.8	1.4	1.5	4.9	1.8	2.2	2.7	3.8
STATUS:																
Public-sector	5.0	1.9	1.9	3.0	–1.4	0.9	1.4	–0.1	2.1	4.9	5.2	5.4	3.5	4.0	3.8	5.5
Private-sector	7.1	2.6	3.0	6.2	4.5	–0.6	–1.3	1.9	6.1	0.8	0.9	5.1	1.5	1.4	2.2	3.1
BREAKDOWN OF ACTIVITIES BEST REPRESENTED IN THE SAMPLE:																
Manufacturing industries	6.7	0.5	–2.2	18.8	2.3	–0.5	–0.2	–0.1	5.5	2.1	3.0	4.5	3.2	2.6	3.2	4.6
Production and distribution of electricity, gas and water	0.2	3.8	3.8	2.7	–5.8	–8.2	–8.9	–4.9	–1.7	–5.4	–5.2	–3.7	4.3	3.1	4.0	1.3
Distributive trade	13.9	6.9	9.9	4.9	8.2	6.4	5.0	7.2	9.5	7.6	9.3	9.3	1.3	1.1	4.1	2.0
Transport, storage and communications	5.6	0.3	2.2	–2.3	–0.4	–4.6	–4.8	–2.1	3.2	–0.2	–1.7	4.2	3.7	4.7	3.3	6.4

Source: Banco de España.
(a) All the data in these columns have been calculated as the arithmetic mean of the quarterly data.

TABLE 2.b

Employment and personnel costs
Detail according to changes in staff levels

	Total CBQ firms 2000 Q1	Corporations increasing (or not changing) staff levels	Corporations reducing staff levels
Number of corporations	**723**	**454**	**269**
Personnel costs			
Initial situation 1999 Q1 (EUR millions)	4,059.3	1,968.2	2,091.1
Rate 00 Q1/99 Q1	5.2	12.7	–1.9
Average compensation			
Initial situation 1999 Q1 (EUR)	8,924.4	8,073.2	9,908.3
Rate 00 Q1/99 Q1	3.7	3.6	5.4
Number of employees			
Initial situation 1999 Q1 (thousands)	455	244	211
Rate 00 Q1/99 Q1	1.4	8.7	–7.0
Permanent			
Initial situation 1999 Q1 (thousands)	*392*	*193*	*199*
Rate 00 Q1/99 Q1	*–0.2*	*5.9*	*–6.1*
Non-permanent			
Initial situation 1999 Q1 (thousands)	*63*	*51*	*12*
Rate 00 Q1/99 Q1	*11.4*	*19.3*	*–21.7*

Source: Banco de España,

line with the pick-up seen in 1999 Q4. This increase, departing from the chain of reductions recorded since 1995, is mainly due to the growth of the cost of debt which has exceeded the lagged effect of the decline in interest rates, which remains negative. This significant resort to credit is not evident in the debt ratio (R.4). This ratio continued decreasing after the strong growth recorded in equity (self-financing and capital increases), which is in the denominator of this ratio. In any event, the overall indication is that the growth in financial costs will continue over the coming quarters, given the recent course of interest rates and the upward trend in the cost of debt, linked to the buoyancy in investment fostered by favourable business expectations.

The aforementioned positive performance of the gross operating result fed through, despite the increase in financial costs, to funds generated by corporations, which continued increasing in 2000 Q1, albeit at a more subdued rate of change than in the previous period. In turn, the total net result, which already stood at an exceptionally high level at end-1999, has benefited from the growth in funds generated and, dur-

TABLE 3

Purchases and turnover of corporations reporting data on purchasing sources and sales destinations
Structure

	CBA	CBQ	
	1998	99 Q1 to Q4 (a)	00 Q1/99 Q1
Total corporations	**6,806**	**854**	**723**
Corporations reporting source/destination	6,806	802	689
	%	%	%
Net purchases	**100.0**	**100.0**	**100.0**
SOURCE OF PURCHASES:			
Spain	65.4	74.0	75.6
Total abroad	34.6	26.0	24.4
EU countries	*24.2*	*16.9*	*13.7*
Third countries	*10.5*	*9.0*	*10.7*
Net turnover	**100.0**	**100.0**	**100.0**
SALES DESTINATIONS:			
Spain	79.9	88.6	87.3
Total abroad	20.1	11.4	12.7
EU countries	*15.0*	*7.5*	*7.6*
Third countries	*5.1*	*3.9*	*5.1*

Source: Banco de España.
(a) All the data in this column have been calculated as the arithmetic mean of the relevant quarters, including the figure for the total number of corporations.

ing the same period, from the capital gains arising on the partial privatisation of a major state-owned enterprise. Thus, non-financial corporations have reached a new high of 29 % in net results as a proportion of GVA (even without the aforementioned capital gains, the level of results obtained will reach an historic high of 23 % of GVA). This accounts for the improvement in the ordinary return ratios both on net assets (R.1) and on equity (R.3). As these developments were accompanied by a reduction in the cost of debt (R.2), financial leverage (the difference between the ordinary return on assets and the cost of debt) was, during 2000 Q1, at the same level as at the end of 1999. Therefore, favourable expectations of growth, investment and employment were confirmed. Against this background, the key risk is that derived from price pressures, especially in the case of oil-derived products, which bears on firms' cost structures and, therefore, on their competitiveness.

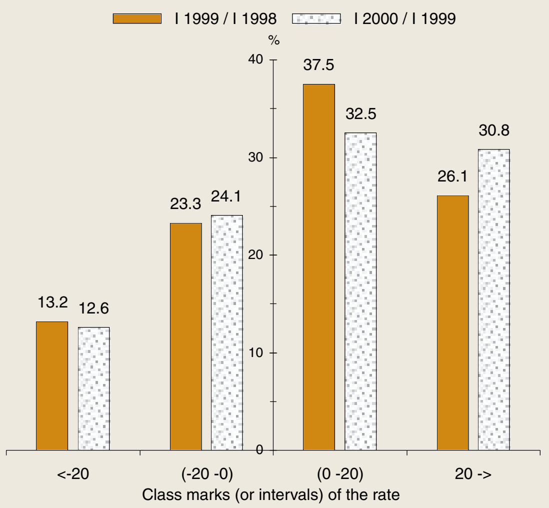
2. ACTIVITY

As mentioned in the introduction, the Central Balance Sheet Office Survey data show that 2000 Q1 was a period of across-the board growth in basically all sectors. GVA grew by 5.7 % in this quarter, compared with 2.8 % in the same period a year earlier (2) (see Table 1 and Chart 1). The generalisation of the increase in GVA to the different groups of corporations, both by size and nature (see Table 2.a), and especially to the aggregate made up by medium-size private corporations, confirms the extent of this phenomenon. Moreover, as can be seen in Chart 2, which shows the distribution of corporations according to the rate of change of GVA, without any account being taken of size,

(2) The strong growth in purchases and sales in 2000 Q1 is also a consequence of the unbundling (of production, transport, distribution and marketing activities) in the electric utilities. This does not directly affect the value added, but does bear on current flows, of production and inputs.

CHART 2

Distribution of corporations by rate of change in GVA at factor cost (99 Q1/98 Q1 and 00 Q1/99 Q1)



Source: Banco de España.

production is growing in the core corporations. Therefore, although the proportion of firms with increases in GVA remained stable in 2000 Q1 (activity grew in 63 % of corporations) with respect to the same period in 1999, this was accompanied by a significant shift towards the segment of corporations with GVA growth exceeding 20 %. In 2000 Q1, 30.8 % of reporting corporations were in this segment, while in the same period of 1999 the figure was 26.1 % of the sample total.

Sales abroad, especially in EU countries, and in the domestic market (see Table 3) evidence the effect of the increase in domestic and foreign demand on corporations during the first three months of 2000. While in 1999 growth in activity was due almost exclusively to the favourable performance of domestic demand, the wearing off of the effects of the international financial crisis, the stabilisation of foreign markets, the upturn in international economies and the downward trend of the euro have exerted a growing influence on the recovery in exports. Thus, manufacturing industry (more open to foreign markets) has shown higher increases in value added (18.8 %). However, there is a notable price effect incorporated into this aggregate due to the nominal rate of change of GVA of the oil-refining sector, which accounts for 30 % of growth in manufacturing firms in 2000 Q1. The oil-refining corporations, whose operating margin was drastically reduced (by half) in 1999, have managed to hold the margin steady in 2000 Q1 and to increase their GVA further to the rise in oil prices. At the same time, this price effect explains the very high rates in production and inputs (24 % and 37 %, respectively) in the aggregate of corporations, as can be seen in Table 1. As the full effect has not been passed through to final consumers by the distributing firms, these have seen their GVA greatly reduced in Q1. And that also explains the apparent slowdown in the distributive trade sector as a whole. Chart 3 shows the difference in 2000 Q1 between the GVA of the two sectors (fuel refining and retailing) and the changes in the prices of inputs and outputs that account for these developments.

The performance of the distributive trade sector as a whole during 2000 Q1, in which activity – driven by the ongoing buoyancy of private consumption – continued growing for a further quarter, should be evaluated from this perspective. As discussed earlier, nominal activity grew at a more muted pace than the previous year, posting rates of change in GVA of 4.9 % in 2000 (as against 9.9 % in 1999 Q1). In turn, the electricity, gas and water production and distribution sector, favoured by the expansion in economic activity, also showed increases in GVA during 2000 Q1, albeit at a nominal rate of 2.7 %, which is lower than the rate of change for non-financial corporations. This increase was due, on one hand, to the strong growth in electricity demand (8.1 % according to sources in this sector), which did not feed through similarly to GVA, given the average reduction in rates (of about 1 %) agreed at the beginning of the year; and, on the other, to the adverse performance of corporations in the gas sector, affected by the rise in input prices, which have not fed through in full to the sale price. Finally, the transport and communication sector showed a nominal fall in GVA of -2.3 % during 2000 Q1. Heightening competition, with the entry of new market participants, is leading to price reductions accompanied, in some cases, by increases in the cost of promotion. As can be seen, in these instances the nominal growth of GVA does not reflect the expansion and buoyancy of the sector, especially in telecommunications.

3. EMPLOYMENT AND PERSONNEL COSTS

Personnel costs at the CBQ corporations grew by 5.2 % in 2000 Q1, against 2 % in the same period of 1999. This sharp increase is due to a higher level of job creation in the corporations included in the sample, and to by the increase in personnel costs per employee which, at 3.7 %, were significantly higher than in 1999 Q1 (2.6 %). Net job creation, which at 1.4 % marks a peak in the quarterly time series,

BOX 1

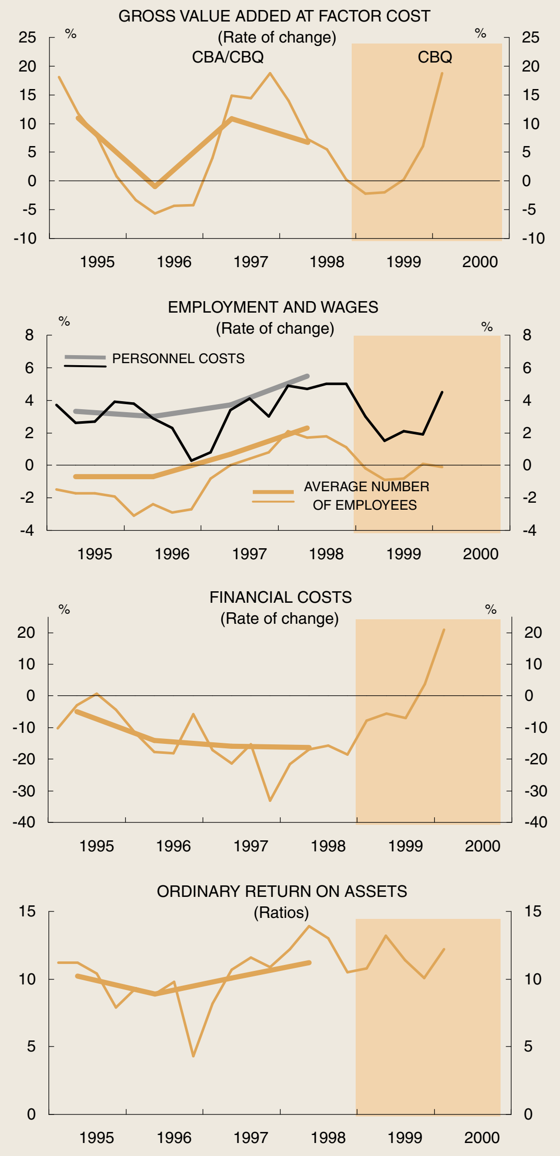
Analysis of the manufacturing sector

As is customary, the manufacturing sector, owing to its weight and representativeness in the CBQ sample, is analysed in somewhat greater detail. In 2000 Q1, activity in this sector increased strongly with a nominal rate of change of GVA of 18.8 % and increases in all the sub-sectors making up the aggregate. This significant rise is attributable to the strengthening of foreign demand, which corporations met by substantially increasing their exports, and also of domestic demand, where investment in capital goods remained vigorous and corporations producing this type of good recorded high rates of activity. Finally, a third major effect stems from developments in crude-oil prices and in the prices applied by oil-refining corporations.

The sharp rise in these prices throughout 1999 notably reduced the business margins of oil-refining corporations, which halved in value with respect to the beginning of the year. Only in the first three months of 2000 did further increases in world crude-oil prices not adversely affect these margins once more.

Maintaining operating margins in 2000, against a background of sharp rises in input prices, entailed a parallel increase in the nominal value added of these corporations, the effects of which were passed through to manufacturing industries (accounting thereby for one-third of the increase in their GVA). In any event, the recovery in activity, which, as mentioned above, affected all the manufacturing sub-sectors, has not to date translated so clearly into net job increases. During the three months under review, the percentage changes in employment were virtually nil and were affected by the restructuring under way in certain companies. However, the rate of change was slightly higher than in 1999 Q1 and in 1999 as a whole. Only in the electronics sub-sector is the number of staff increasing significantly. Over the coming quarters, the current expansion in productive activity should entail clear growth in employment. As for average compensation, the increase was 4.6 %, in line with the trends observed for the total sample. This figure is notably high with respect both to previous periods and to the rate of inflation. It would be desirable for this trend not to firm in the medium run, especially insofar as current inflationary pressures should be successfully vanquished. The overall course of employment and compensation per employee triggered a rise in personnel costs of 4.5 % in 2000 Q1. The lower growth rate exhibited by this variable with respect to productive activity led to a strong expansion of the operating surplus (gross operating results increased by 39 %) over this period. Moreover, the rise in financial costs is due to the use of fresh borrowing in view of the attractive commercial expansion and investment projects and of the affordable interest rates prevailing in the market. By contrast, trends in the cost of financing, which in 2000 Q1 stood at the same level as in previous periods (4.5 %), were not influential here. Despite the growth in financial costs, the sharp growth in gross operating results enabled corporations in this sector to increase their funds generated (by 41.5 %) and to obtain increasingly high ordinary returns on assets with respect to the corresponding period of 1999. The combination of these two effects (high returns and low financing costs) led, once more, to strongly positive leverage, indicating the sound health of the industrial sector for which, as for other areas of the Spanish economy, prospects are very favourable.

Performance of the manufacturing corporations reporting to the Central Balance Sheet Office (a)



NUMBER OF CORPORATIONS

	1995	1996	1997	1998	1999	2000
CBA	3,258	3,225	3,346	2,787		
CBQ	385 374 362 348	371 364 349 336	360 351 343 337	408 398 391 383	426 409 396 368	343

% OF GDP OF NON-FINANCIAL CORPORATIONS SECTOR

	1995	1996	1997	1998	1999	2000
CBA	39.3	38.2	38.5	31.7		
CBQ	25.0 25.2 22.7 22.6	25.3 25.4 22.6 22.6	25.0 25.6 22.3 22.9	24.3 25.1 22.0 21.0	23.5 24.3 20.3 19.7	17.1

CBA data.
CBQ data.

Source: Banco de España.
(a) Information available to June 15th 2000 (CBA and CBQ). The CBQ data are growth rates on the same quarter of the previous year.

TABLE 4

Personnel costs, employees and average compensation
% of corporations in specific situations

	CBA		CBQ			
	1997	1998	98 Q1 to Q4 (a)	99 Q1 to Q4 (a)	99 Q1	00 Q1
Number of corporations	**8,046**	**6,806**	**833**	**854**	**912**	**723**
Personnel costs	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Falling	24.0	21.1	27.8	30.2	28.2	22.4
Constant or rising	76.0	78.9	72.2	69.8	71.8	77.6
Average number of employees	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Falling	28.3	25.4	40.1	38.9	41.2	37.2
Constant or rising	71.7	74.6	59.9	61.1	58.8	62.8
Average compensation (relative to inflation) (b)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Lower growth	44.0	40.3	43.0	48.7	46.0	41.8
Higher or same growth	56.0	59.7	57.0	51.3	54.0	58.2

Source: Banco de España.
(a) Arithmetic mean of the relevant quarters for each column.
(b) Twelve-month percentage change in the CPI.

is even more significant considering, first, the particular features of the sample (some of the larger corporations in the electricity and in the transport and communications sectors are still undergoing special restructuring operations), and further, the fact that jobs are being created, as a rule, in most corporations, as explained below. Table 2.a shows that, excluding the "Production and distribution of electricity, gas and water" sector (where the employment rate was –4.9 %), the employment figure for the rest of the sample would rise to 2 %. In manufacturing, staff figures practically levelled off during 2000 Q1 (changes in employment were virtually zero). Prospects for the coming quarters are also positive, given the strength of the recovery in the activity of these industries.

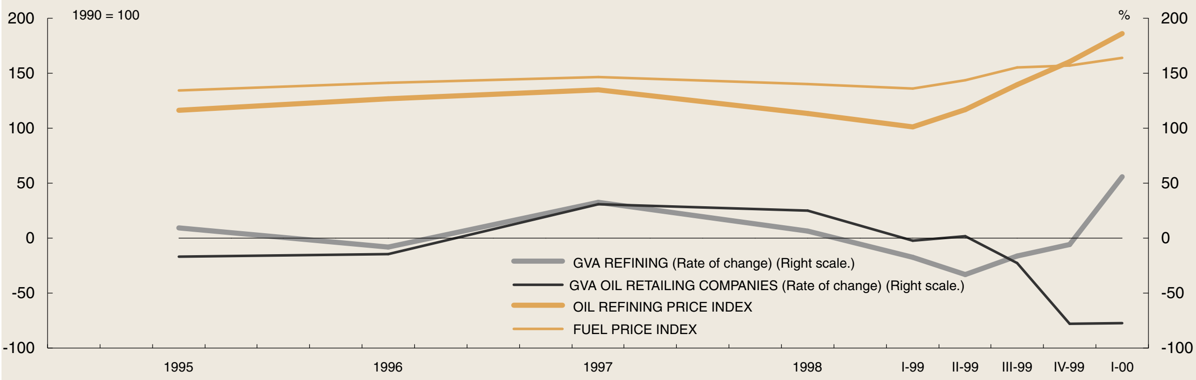
The upward revision of average compensation is explained by the inclusion in collective bargaining agreements of the impact of inflation increases. Only the "Distributive trade" and "Production and distribution of electricity, gas and water" sectors recorded slightly more moderate increases (2 % and 1.3 %, respectively), although the rise was merely an accounting phenomenon in the latter sector. In the "Distributive trade" sector, the lower compensation levels for new hires helped keep rates below average levels. As for the second sector, dismissal costs are fully provided for and payments against the related account are not shown under compensation in profit and loss accounts (CBQ data do not include allocations of provisions for staff restructuring, which are included in the CBA data). In sum, in the "Distributive trade" sector, only compensation by employee grew at below-average levels.

The main conclusions drawn above are confirmed in Table 2.b, where the corporations are broken down into two clearly contrasting groups (those creating employment and those shedding staff). Corporations in the first group (454 firms, or 63 % of the sample) created permanent and non-permanent employment at a rate of 8.7 %; this trend was also consistent with an increase in average compensation of 3.6 %. At the same time, corporations included in the second group downsized their staff in 2000 Q1 by 7 % (with permanent jobs almost 6 % down, and non-permanent posts 21.7 % down), with an increase in compensation per employee of 5.4 %. However, the amount of dismissals shows that the associated costs (severance payments) were not fully reflected in the profit and loss account under "personnel costs", because provisioning was made in advance. Therefore, the above-mentioned rate (5.4 %) will rise for the group of corporations reducing employment when annual data become available in November 2001.

Finally, Table 4 shows that, despite the pick-up in prices over the past few months, almost 58 % of corporations saw their average com-

CHART 3

Developments in crude oil prices and their impact on added value



Sources: Banco de España and INE.

pensation rise at rates equal to or above the rate of inflation, four percentage points up on the related rate in 1999 Q1 (then, average compensation rose at above the rate of inflation prevailing in 54 % of corporations). Evidently, this divergent trend between wages and prices may ultimately affect the competitiveness of our companies and, in the long run, hamper the above-mentioned process of job creation.

4. RESULTS, MARGINS AND PROFITABILITY

As a result of productive activity accelerating in 2000 Q1 at a more buoyant pace than the increases in personnel costs, the gross operating result grew at a quicker rate than in the previous period. As can be seen in Tables 1 and 5, the gross operating result increased by 6.2 % in 2000 Q1, far above the rate of 3.5 % in the same quarter a year earlier, and of 2.9 % throughout 1999. Sector by sector, growth was notably strong in manufacturing industry (the gross operating result rose by 39 %, reflecting the significant momentum attained in all subsectors), confirming its recovery and making it the most dynamic sector in the economy. Box 1 analyses these developments in greater detail. The growth rate of the gross operating result in the distributive trade sector slowed substantially, running at practically zero, mainly due to the effect of the rise in oil prices (and, in parallel, in oil-refining) on the costs of fuel-retailing corporations. The operating margin of these corporations in 1999 Q4 and in 2000 Q1 declined to such a low level that it can hardly continue this path in the coming quarters. With regard to other sectors, electricity, gas and water production and distribution showed lower growth than the previous year, standing at 4.4 % in 2000, in keeping with the aforementioned course of the GVA of these corporations. Finally, the GVA of transport and communications companies decreased, having been affected by heightened competition and the reduction in prices resulting from the ongoing opening up of this sector to the market.

As regards financial costs, a notable turnaround has occurred given that, for the first time since 1995, positive rates of change were posted. In order to analyse the reasons for this change it is necessary to know to what extent this increase is due to interest rate fluctuations and which portion is attributable to changes in debt levels. This information can be seen below:

	00 Q1/99 Q1
Change in financial costs	*17.0 %*
A. Interest on borrowed funds (1+2)	*17.3 %*
A.1 Due to the cost (interest rate)	*–5.0 %*
A.2 Due to the amount of interest-bearing debt	*–22.3 %*
B. Commissions and cash discounts	*–0.3 %*

This confirms that interest-rate cuts in the previous period continued to pass through to corporate costs, and that the latter have not yet been affected by recent interest-rate increases, which will gradually occur as previously agreed interest-bearing loans mature. At the same time, the increase in the level of debt is indicative of greater business buoyancy, as it is

TABLE 5

Gross operating result, funds generated, ordinary return on assets and leverage
Breakdown by size, ownership status and main activity of corporations
(Growth rates of the same corporations on the same period a year earlier)

	Gross operating result				Funds generated				Ordinary return on assets (R.1) (a)				Leverage (a)			
	CBA	CBT			CBA	CBT			CBA	CBT			CBA	CBT		
	1998	99 Q1-Q4 (b)	99 Q1	00 Q1	1998	99 Q1-Q4 (b)	99 Q1	00 Q1	1998	99 Q1-Q4 (b)	99 Q1	00 Q1	1998	99 Q1-Q4 (b)	99 Q1	00 Q1
Total	**8.5**	**2.9**	**3.5**	**6.2**	**10.3**	**7.8**	**8.1**	**6.0**	**8.3**	**8.7**	**8.5**	**8.3**	**2.6**	**3.8**	**3.4**	**3.4**
Total, except electricity sector	**10.8**	**1.5**	**2.2**	**7.0**	**11.6**	**8.4**	**11.8**	**11.9**	**8.6**	**8.8**	**8.1**	**8.3**	**2.7**	**3.9**	**5.3**	**3.7**
SIZE:																
Small	10.4	—	—	—	14.6	—	—	—	10.4	—	—	—	3.3	—	—	—
Medium	11.7	7.2	14.6	10.2	12.6	16.3	16.0	12.1	10.9	10.4	11.7	15.7	4.8	5.9	7.1	10.9
Large	8.1	2.7	3.0	5.9	9.9	7.5	7.8	5.6	8.0	8.6	8.3	8.0	2.4	3.7	3.2	3.1
STATUS:																
Public-sector	18.2	–3.5	–6.1	–5.8	10.0	9.8	–8.9	0.1	0.8	3.3	1.8	2.2	–4.7	–1.8	–3.6	–2.9
Private-sector	8.0	3.8	4.4	6.8	10.3	7.8	9.8	6.4	10.3	10.0	10.3	9.4	4.5	5.1	5.3	4.5
BREAKDOWN OF ACTIVITIES BEST REPRESENTED IN THE SAMPLE:																
Manufacturing industries	8.3	–1.0	–8.6	39.0	9.9	2.7	–5.0	41.5	11.2	11.4	10.8	12.2	5.4	6.6	6.1	7.7
Production and distribution of electricity, gas and water	0.8	6.8	6.4	4.4	5.3	7.6	0.0	–8.4	7.5	8.3	9.4	8.2	2.2	3.5	4.4	3.0
Distributive trade	20.4	6.8	10.6	0.4	19.2	10.6	11.4	7.1	11.7	11.1	13.1	10.8	6.2	6.3	7.7	6.4
Transport, storage and communications	7.8	0.6	5.2	–6.2	10.6	5.5	9.7	0.6	7.1	6.7	5.1	6.2	0.8	1.7	–0.4	1.5

Source: Banco de España.
(a) *Ratios* calculated according to the new methodology, as explained in the Central Balance Sheet Office's annual monograph.
(b) All the data in theses columns have been calculated as the arithmetic mean of the quarterly data.

sought to take advantage of the improved market conditions for financing and the favourable relationship between the cost of borrowed funds and the return on productive assets in order to undertake new expansion projects. The resort to borrowed funds is thus spreading in the business sector. This greater resort to credit is not apparent in the debt ratio (which relates borrowed funds to total interest-bearing liabilities) as a result of equity (which is included in the denominator of the ratio) having substantially increased, both through self-financing and capital increases. The strength of the increase in financial costs means that funds generated have undergone a certain slowdown compared in relation to 1999 Q1. While in that quarter funds generated rose by 8.1 %, in 2000 Q1 they totalled 6 %. By sector of activity, there was notably strong growth in this variable in manufacturing corporations (and in all their sub-sectors), where funds generated grew by 41.5 %, whereas in the sectors of electricity, gas and water production and distribution, and transport, storage and communications the related contribution was limited, or even negative (in the case of energy), in the period under review.

The foregoing has led to the attainment of exceptional results which, expressed as a percentage of GVA, exceeded the results in 1999 to stand at 29.1 % of GVA. This time series high remains high even when stripping out the effect of the partial privatisation of Iberia, which generated significant capital gains in the parent company in 2000 Q1. Precisely in order to avoid the bias introduced by such exceptional

TABLE 6

Structure of reporting corporations' ordinary returns on net assets and on equity

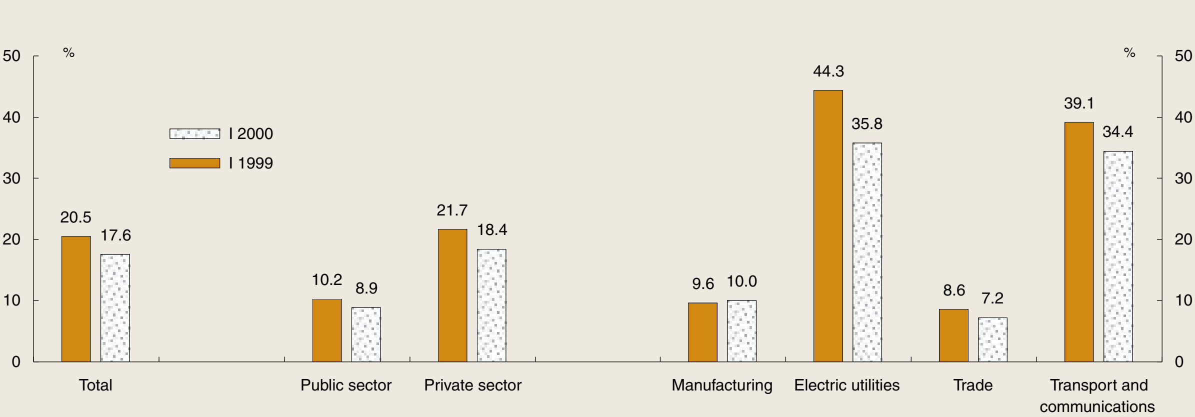
	CBQ			
	Ordinary return on net assets (R.1)		Ordinary return on equity (R.3)	
	99 Q1	00 Q1	99 Q1	00 Q1
Total corporations	**100.0**	**100.0**	**100.0**	**100.0**
R 0 %	20.0	19.0	24.0	23.0
0 % < R 5 %	18.4	16.6	14.3	13.7
5 % < R 10 %	15.5	13.4	11.4	9.4
10 % < R 15 %	13.5	11.6	11.8	8.6
15 % < R	32.6	39.4	38.5	45.3
Number of corporations	**912**	**723**	**912**	**723**
MEMORANDUM ITEM:				
Average return	8.5	8.3	10.1	9.9

Source: Banco de España.

capital-gains-generating operations (in terms of both their amount and timing), the analysis of returns has been based, since 1999 Q3, on the study of typical or ordinary income in corporations as a ratio of the balance sheets proxying their current values. As a sign of the excellent situation of corporations, the ordinary return on assets (R.1) remained at a high level, similar to the previous year, both in the total of the sample (8.3 %) and in the manufacturing sector, where it reached 12 %, more than a percentage point up on the same quarter in 1999. By size, returns were substantially higher in medium-size corporations (15.7 %, compared with 11.7 % in 1999 Q1). High returns, together with the fact financing costs held at low levels (in Q1 this ratio was 4.9 %), enabled the attainment, one more quarter, of markedly positive leverage, both for the total of corporations (3.4) and for all sectors reported. Only the transport and communications sector, which in a context of strong competition has seen its surplus dwindle, obtained a low -albeit positive- value in this ratio (in this sector leverage was 1.5 %). Finally, Table 6 allows the distribution of corporations to be analysed in terms of the return obtained, ir-

CHART 4

Business margins (a)



Source: Banco de España.
(a) Gross operating results/net turnover and other operating income.

respective of size and nature. The table shows not only the (admittedly slight) reduction in the proportion of corporations with negative returns but, especially, the shift towards the segment reflecting the number of corporations with higher returns. Therefore, whereas in 1999 Q1 the return on net assets of 32.6 % of corporations was above 15 %, in the same quarter of 2000 this percentage rose to 39.4 %, i.e. 7 percentage points more than the previous year. Regarding the ordinary return on equity, that obtained by shareholders, the percentage increased to 45 %, i.e. almost half of all corporations have an ordinary return on equity higher than 15 %. In short, corporations showed robust and well-sustained growth in 2000 Q1 against a background of increases in domestic and foreign demand. The adverse effects that the pass-through of inflationary pressures may have on corporate costs and business competitiveness might jeopardise the expectations derived from the data available in the CBQ survey. Obviously, only by maintaining and improving competitiveness may Spanish corporations continue to move in the virtuous circle of activity, investment, generation of income and employment creation.

22.6.2000

Presentation of the Financial Accounts of the Spanish Economy. ESA 95. 1995-1999

1. INTRODUCTION

As is the case for the other EU Member States, Spain is obliged to comply with Council Regulation (EC) 2223/96, of 25 June 1996, on the European System of National and Regional Accounts in the European Community (ESA 95), which comprises the main macroeconomic aggregates, the accounts (financial and non-financial, and flow and balance-sheet) of the institutional sectors and also employment data. Regarding the main characteristics of ESA 95, mention may first be made of the fact that it is the first national accounts system to be set in place by a legal instrument and, therefore, all its elements are obligatorily applicable to all EU Member States, thereby ensuring the use of a uniform methodology in all countries. Second, ESA 95 is a harmonised accounting system in other respects, given that, as it is the European version of the fourth revision of the System of National Accounts (SNA 93) of the Statistical Office of the United Nations and of other international agencies, it has the same conceptual basis as the IMF Balance of Payments Manual, 5th edition, and the International Investment Position, and the basis underpinning the ongoing revision of the IMF Public Finances Statistics Manual. Of particular significance in the European realm is the inclusion in the System of a specific sub-sector in the sector Financial institutions, namely the sub-sector Monetary Financial Institutions (MFIs), which is the grouping the European System of Central Banks (ESCB) defines as the money creating sector, which reinforces the link between monetary and national accounts statistics. Moreover, ESA 95 has provided for harmonisation as regards the deadline for data availability and the periodicity of the statistical series (1), which must be the same in all countries. Lastly, Eurostat has laid down a single design for data transmission. Significant practical implications arise from the foregoing, since this provides for the compilation of aggregates for economic areas such as the EU and the euro zone, it means such aggregates adhere more closely to their very definition and it enables the lag in the publication of the Accounts to be shortened.

The entry into force of ESA 95 is being staggered following a timetable – laid down in the

(1) ESA 95 envisages annual series generally and quarterly series only for the main macroeconomic aggregates. This limitation is substantial given the growing importance of the non-financial and financial accounts for analysing the economic situation. Accordingly, several legislative projects are under way in the EU Commission to oblige countries to compile relevant statistics, such as general government statistics, with a quarterly periodicity. And regarding financial accounts, many Community countries – Spain among them– have decided to adopt the quarterly frequency as the norm for the compilation and dissemination of these accounts.

Regulation – which began in April 1999 and will run to the end of 2003 (2). Thus, the main aggregates of the total annual and quarterly resident sectors for the period 1995-1998 were sent to the Commission (Eurostat) in April 1999; the main aggregates of the general government sector for the same period, among which the deficit, were sent in August 1999; and the Notification relating to the Protocol on the procedure applicable in the event of excessive deficit (EDP) had to be made in accordance with the new methodology, for the first time, and for the same years, in February 2000.

As regards the Financial Accounts, the deadline for transmission to the Commission (Eurostat) is September 2000. However, given that the data on the main aggregates and the general government accounts with the ESA 95 methodology are known, and as the National Statistics Institute (INE) is on the point of releasing the non-financial accounts of the remaining sectors under the new system, the Banco de España, like its EU central bank counterparts, decided to speed up the work on compiling the *Financial Accounts of the Spanish Economy* (FASE) with the new methodology. The aim was to provide for readier analysis of the non-financial and financial approach in an integrated framework. This work has recently been completed with the compilation of a first version of the Financial Accounts, of quarterly periodicity, which will also present annual totals, for the period 1994 Q4-1999 Q4. The *Financial Accounts of the Spanish Economy, 1995-1999,* in terms of ESA 95, quarterly and annual series, and in the form of a Spanish-English bilingual edition, were published for the first time in mid-June 2000 in a monograph similar to that disseminated since 1990. As usual, it was distributed along with the *Informe anual.* It was likewise published on the Banco de España website. Successive quarterly updates of the Accounts will be regularly disseminated on this site, with a lag of about sixteen weeks in relation to the latest quarter to which they refer. The first release of the FASE was accompanied by an explanatory note on the application in practice of the new methodology. In this context, this article seeks to provide an overview of the most significant changes the new system has entailed for the financial accounts in general and for those relating to the Spanish economy in particular. In addition to such changes, the ESA 95 Accounts include other differences, reported below, arising from the use of new sources of information and from the improved quality of pre-existing sources.

The article comprises nine sections, including this introduction. The following section discusses the change in the scope of the ESA 95 Accounts. Sections 3 and 4 respectively address the differences in the sectorisation and in the financial instruments between both systems. Section 5 turns to the effect that the change in the time period allocation of interest income has had on the financial part of the Accounts. Section 6 highlights the impact that the obligation under ESA 95 to value financial instruments at market price has had on the Accounts, describing the practical application of such valuation. Section 7 reports the amendments made that are not linked to the change in methodology under the new system. Since the changes reflected in the previous sections affect the various sectors differently and, on occasions, have opposite effects on the instruments they affect, section 8 offers a summary of the overall repercussion of the most important changes on the sectors into which the economy is divided and on the economy as a whole. Despite the substantial changes ESA 95 has entailed, certain additional modifications remain to be made to the FASE. This matter is discussed in section 9.

2. SCOPE OF THE ACCOUNTS

ESA 79 only envisaged the compilation of *financial transactions* accounts. However, that did not prevent the FASE, in publication since the early eighties and with series available from 1970, from including financial balance sheets, which were called financial assets and liabilities accounts (3). ESA 95 includes a full system of accounts comprising financial *balance sheets* and flows accounts, which explain the changes between the opening and closing balance sheets of each period. In addition to encompassing *financial transactions,* the flows accounts also address *other changes in financial assets [and in liabilities]* (4). The latter are

(2) Nonetheless, some Member States have a derogation clause for several aspects, such as coverage, detail, lag and transmission methods, which extends in certain instances to January 2005.

(3) This is not the place to set out the conceptual basis of the financial assets and liabilities accounts hitherto published in the FASE, but it should be borne in mind that, as a general rule, these stocks were recorded at their face value. However, there were exceptions to this principle arising from the valuation rules incorporated into the data that were the source for compiling the Accounts (see the Methodological Notes of the 1999 edition in relation to the 1987-1998 series).

(4) All financial assets are, from the standpoint of the issuer/debtor, liabilities, which is why these clarifying brackets are not repeated hereafter. All liabilities are, by definition, financial, while there are non-financial assets (the capital stock of the various sectors) which are not reflected in the financial accounts. The difference between financial assets and liabilities is comprised of the net financial assets, also called “financial wealth”, of the institutional grouping involved.

made up, in turn, of: *a) accounts of other changes in the volume of financial assets,* which reflect the changes in the amount of financial assets and of liabilities as a result of the emergence or disappearance thereof (e.g. write-down/off of loans or sectorisation changes); and *b) revaluation accounts,* which include changes in the value of assets and of liabilities as a result of changes in the prices thereof or in the exchange rate of the currency in which they happen to be denominated. Accordingly, the ESA 95 Accounts constitute a perfectly integrated whole in which, for each sector and sub-sector, the difference between financial stocks or balance sheets at two moments in time are explained by the three types of account indicated: financial transactions, revaluation and other changes in the volume of financial assets.

3. SECTORISATION

Scheme 1 compares the sectorisation of the Accounts under ESA 95 with that under ESA 79. Apart from the change in terminology in defining certain sectors or sub-sectors, the notable differences between both systems are:

a) In ESA 95 the sector *Financial corporations* is broader than that of Credit institutions in ESA 79. This is because it additionally includes 1) the sub-sector *Financial auxiliaries* [most of whose units were classified under ESA 79 in the sector Non-financial enterprises (5), and 2) *Insurance corporations and Pension funds,* which were an independent sector in ESA 79. Further, as indicated below, some of the units of the sub-sector *Other financial intermediaries, except insurance corporations and pension funds* were not part either of the sector Credit institutions in ESA 79.

As regards the various sub-sectors of the sector *Financial corporations* in ESA 95, the following changes should be highlighted:

- The sub-sector *Monetary financial institutions (MFIs)* is, as indicated in the introduction, the grouping that defines the money creating sector in the monetary statistics. It is made up of the Central Bank (Banco de España) and *Other monetary financial institutions.* In Spain's case, the latter are made up of *Credit institutions* [banks, savings banks, credit co-operatives, the Official Credit Institute and specialised credit institutions] and of *Money market funds* (FIAMMs). Under ESA 79 all these, except the Banco de España and banks, savings banks and credit co-operatives (the grouping of these last three institutions was known as "Other monetary institutions" in ESA 79), were included under the sub-sector Other credit institutions.

- The sub-sector *Other monetary financial institutions* in ESA 95 covers *Other financial intermediaries, except insurance corporations and pension funds, Financial auxiliaries and Insurance corporations and pension funds.* Unlike the sub-sector "Other credit institutions" in ESA 79, *Other financial intermediaries* do not include either the OCI, Specialised credit institutions and Money market funds (now classified under MFIs) or *Securities agencies,* which are now classified under *Financial auxiliaries.* Moreover, *Other financial intermediaries in ESA 95 include Securitisation funds* and *Venture capital companies and funds,* groupings which have been directly estimated for the first time in the context of the financial accounts. In ESA 79, these groups of units were included in the sector Non-financial enterprises.

b) As regards the sector *General government,* the changes arising from sectorisation are:

- Now incorporated into this sector are certain state-owned enterprises hitherto included in the sector Non-financial enterprises. The reason for this change was the setting of more precise criteria in ESA 95 than in ESA 79, so as to determine when a state-owned enterprise should be sectorised in General government. In fact, on one hand, both systems exhibit similarities in that: 1) they define in virtually the same terms the activity and main function of the units to be included in the sector General government, in which the consideration of whether the goods they produce are market (ESA 79) or non-market (ESA 95) is fundamental; and 2) they give priority to an economic criterion over a legal-institutional one in order to establish this classification. However, on the other hand, they differ in certain respects. For instance, ESA 79 envisages a list of certain services which, by convention, are always considered as market services, in which case the institutional unit that produces them has to be sec-

(5) See the breakdown of the units included in this new sub-sector in the memorandum item at the foot of Scheme 1. Note that now included in this new sub-sector are Deposit guarantee funds, which were formerly classified under Other monetary institutions.

SCHEME 1

Sectorisation according to ESA 79 and ESA 95 (a)

ESA 79	ESA 95
S.40 CREDIT INSTITUTIONS	**S.12 FINANCIAL CORPORATIONS**
A. Monetary institutions	**A. Monetary Financial Institutions**
S.41 Central banking authorities	S.121 Central Bank
S.42 Other monetary institutions *Banks* *Savings banks* *Credit co-operatives* *Deposit guarantee funds*	S.122 Other monetary financial institutions *Banks* *Savings banks* *Co-operative credit banks* *Official Credit Institute* *Specialised credit institutions* *Money market funds (MMFs)*
B. Non-monetary institutions	**B. Non-monetary financial corporations**
S.43 Other credit institutions *Official Credit Institute* *Specialised credit institutions (Specialised lending institutions until 1997)* *Stockbrokers and jobbers* *Collective investment schemes in transferable securities*	S.123 Other financial intermediaries, except insurance corporations and pension funds *Collective investment schemes other than MMFs* *Asset securitisation funds* *Venture capital funds and companies* *Securities dealer companies*
	S.124 Financial auxiliaries (b) (See detailed scheme in the memorandum item)
S.50 INSURANCE ENTERPRISES *Private insurance corporations* *Non-profit insurance entities* *Insurance Compensation Consortium* *Pension funds*	S.125 Insurance corporations and pension funds *Private insurance corporations* *Non-profit insurance entities* *Insurance Compensation Consortium* *Pension funds*
S.60 GENERAL GOVERNMENT	**S.13 GENERAL GOVERNMENT**
S.61 Central government	S.1311 Central government
S.62 State and local governments *State government* *Local government*	S.1312 Regional (autonomous) government S.1313 Local government
S.63 Social security funds	S.1314 Social security funds
S.10 NON-FINANCIAL CORPORATE AND QUASI-CORPORATE ENTERPRISES	**S.11 NON-FINANCIAL CORPORATIONS**
S.70 PRIVATE NON-PROFIT INSTITUTIONS SERVING HOUSEHOLDS (PNISH)	**S.15 NON-PROFIT INSTITUTIONS SERVING HOUSEHOLDS (NPISH)**
S.80 HOUSEHOLDS	**S.14 HOUSEHOLDS** S.141 + S.142 Employers (including own-account workers) S.143 Employees S.1441 Recipients of property incomes S.1442 Recipients of pensions S.1443 Recipients of other transfer incomes S.145 Other households

SCHEME 1 (continuation)

Sectorisation according to ESA 79 and ESA 95 (a)

ESA 79	ESA 95
S.90 REST OF THE WORLD	**S.2 REST OF THE WORLD**
S.91 Member countries of the European Communities	S.21 European Union
	S.211 Member countries of the EU
	S.212 Institutions of the EU
S.92 Institutions of the European Communities	
S.93 Third countries and international organisations	S.22 Third countries and international organisations

MEMORANDUM ITEM:

Detail of sub-sector 124: Financial auxiliaries (ESA 95)

Deposit guarantee funds (c)
Money market intermediaries
Appraisal companies
Mutual guarantee companies
Foreign exchange bureaux
Pension fund management companies
Insurance brokers
Stock exchange management companies
Futures and options market management companies
Securities clearing and settlement service
Association of Securities Dealers
Securities agencies (c)
UCITS management companies and portfolio management companies
Mortgage securitisation fund management companies
Asset securitisation fund management companies
Venture capital fund management companies
Insurance Company Liquidation Board

Source: EUROSTAT (ESA 79 and ESA 95) and Banco de España.

(a) The numbered sectors and sub-sectors are the only ones considered by the accounting manuals (ESA 79 and ESA 95). The additional details therein relate to specific Spanish institutional units.
(b) In ESA 79 part of this sub-sector was classified as non-financial enterprises.
(c) In the FASE adaptation to ESA 79 these units were classified as "Other credit institutions", and the rest as "non-financial enterprises".

torised outside General government. It then provides another list of output of services in which, to define sectorisation outside General government, the economic criterion is that market services "are produced by a unit whose resources are mainly ("mainly" is taken to mean about 50 % or more of total current resources) derived from the sale of its output and resources of the production unit shall, mostly, arise from the sale of their production". By contrast, ESA 95 does not establish a priori any list of services deemed to be market services; rather, it subjects any production unit to the 50 % rule to determine its sectorisation, this rule being defined such that only units covering at least 50 % of their production costs with the proceeds of their sales shall not be included in General government.

This change in the sectorisation of a group of corporations has affected the General government accounts mainly in 1998 and 1999, increasing the currency and deposits captions in both transactions and in stocks, on the assets side, and in loans on the liabilities side. The opposite effect has, logically, been recorded in the sector Non-financial corporations.

- The ESA 79 sub-sector *Territorial governments* disappears in ESA 95 and is split into two: Regional governments and Local governments. Since the FASE had already been providing this breakdown, the change is minimal in the ESA 95 version of the Accounts.

c) ESA 95 addresses the sector *Non-profit institutions serving households (NPISH),* while institutions of a similar nature serving corporations are included in the sector Non-financial corporations. ESA 79 included both groups in a single sector called *Private non-profit institutions serving households.*

d) The remaining sectors of ESA 95 coincide virtually with those of ESA 79 (see Scheme 1), since the greater detail provided under ESA 95 for the sector Households will not be used for the time being in the Accounts, as will neither the breakdown of the sector *Rest of the world.* Further, in the first version of the ESA 95 accounts, and owing to limitations in the database information, *Households and Non-profit institutions serving households* will be included in a joint sector, as had been the case in the financial accounts compiled in accordance with ESA 79. The aim is to publish separate financial accounts for both sectors in the near future.

4. FINANCIAL INSTRUMENTS

Scheme 2 compares the instruments explicitly reflected in both systems. The main differences are: the degree of detail envisaged by each manual in certain headings, indicative of the relative significance of such headings at the different times the two systems came into being; the change in the treatment of monetary gold and special drawing rights (SDRs); and the consideration of *financial derivatives* under ESA 95.

Regarding the first type of differences, ESA 79 envisages greater detail than ESA 95 for deposits and the currencies in which they are denominated. By contrast, ESA 95 includes greater detail than ESA 79 for securities other than shares, and for shares and other equity. Nonetheless, with ESA 79 the FASE had never shown such an extensive breakdown as that envisaged by this manual for deposits, and it also displayed other differences with the theoretical scheme indicated, such as, for example: *a)* the net position in the IMF and, subsequently, that of the EMCF/EMI/ECB was incorporated under a caption called *Gold and positions in international organisations; b)* the loans heading was a single one and no distinction was made between the short, medium or long term. Nor was there any distinction in the form of an explicit heading between trade credit and other loans; rather, in the counterpart details provided by the FASE, those recorded in assets and liabilities between non-financial enterprises and households corresponded to trade credits; and *c)* no breakdown of insurance technical reserves by end-use was provided.

The breakdown by instrument in the FASE compiled in accordance with ESA 95 omits only the breakdown into short and long-term in loans and into quoted and unquoted shares. These omissions will progressively be rectified in subsequent versions of the Accounts.

Regarding Monetary gold and SDRs, the ESA 95 ceases to consider them as liabilities of the Rest of the world account, as they are not liabilities to any agent. Instead, it treats them as assets with a negative sign in the same account.

Turning to *financial derivatives,* ESA 79 did not envisage these instruments, given their virtual non-existence when the manual was devised. ESA 95 does consider them, but only if they have a market value, either because they are traded or cleared on the market. Under this category, ESA 95 explicitly recognises the following financial derivatives: options tradeable on organised and over-the-counter (OTC) markets; warrants; futures; swaps; and forward rate agreements (FRAs).

In the current version of the FASE according to ESA 95, data are presented for the financial derivatives heading only in the financial transactions account, and not in the financial balance sheets. For derivatives transactions it is possible, using the data provided by credit institutions, collective investment undertakings and insurance corporations, on one hand, and the Balance of Payments, on the other, to estimate reasonably the breakdown by sector of these types of transactions. However, in the case of balances, data from the International Investment Position are lacking, and those available from the above-mentioned institutions refer only to options and are not sectorised.

5. TIME PERIOD ALLOCATION OF INTEREST INCOME

Under ESA 95, the accrual principle is applied to transactions. In non-financial transactions, the application of this principle particularly affects the recording of interest income. Under ESA 79, the recording of these transactions adhered to a criterion of callability, which was somewhat confusing. Indeed, in the original English draft of the ESA 79, the interest on these

SCHEME 2

Financial instruments according to ESA 79 and ESA 95

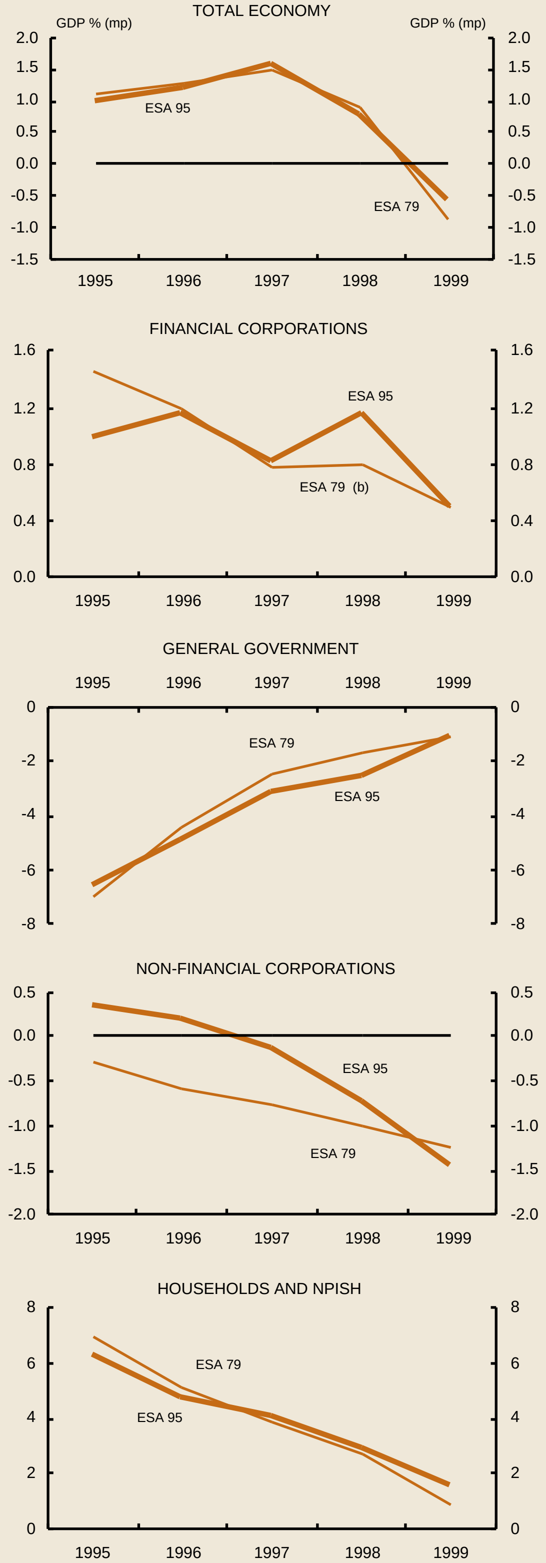
ESA 79	ESA 95
F.00 FINANCIAL GOLD	**F.1 MONETARY GOLD AND SDRs**
F.10 SPECIAL DRAWING RIGHTS (SDRs)	F.11 Monetary gold
	F.12 Special drawing rights (SDRs)
F.20 CURRENCY AND TRANSFERABLE SIGHT DEPOSITS	**F.2 CURRENCY AND DEPOSITS**
F.21 Currency and transferable sight deposits in national currency	F.21 Currency
F.22 Currency and transferable sight deposits in foreign currency	F.22 Transferable deposits
F.23 Net position in the IMF	F.29 Other deposits
F.30 OTHER DEPOSITS	
F.31 Other deposits in national currency	
F.311 Time deposits in national currency	
F.312 Sight savings deposits in national currency	
F.313 Time savings deposits in national currency	
F.32 Other deposits in foreign currency	
F.40 BILLS AND SHORT-TERM BONDS (a)	**F.3 SECURITIES OTHER THAN SHARES** (b)
F.50 LONG-TERM BONDS (c)	F.33 Securities other than shares, excluding financial derivatives
	F.331 Short-term
	F.332 Long-term
	F.34 Financial derivatives
F.60 SHARES AND OTHER EQUITIES	**F.5 SHARES AND OTHER EQUITY**
F.61 Shares	F.51 Shares and other equity, excluding mutual funds shares
	F.511 Quoted shares
	F.512 Unquoted shares
	F.513 Other equity
F.62 Other equities	F.52 Mutual funds shares
F.70 SHORT-TERM LOANS	**F.4 LOANS**
F.71 Short-term trade credit	F.41 Short-term loans
F.72 Accounts receivable and payable	F.42 Long-term loans
F.79 Other short-term loans	
F.80 MEDIUM AND LONG-TERM LOANS	
F.81 Medium and long-term trade credit	
F.89 Other medium and long-term loans	
F.90 INSURANCE TECHNICAL RESERVES	**F.6 INSURANCE TECHNICAL RESERVES**
F.91 Actuarial reserves against outstanding risks and reserves for with-profits insurance	F.61 Net equity of households in life insurance reserves and in pension funds
	F.611 Net equity of households in life insurance reserves
	F.612 Net equity of households in pension funds reserves
F.92 Prepayments of premium and reserves against unsettled claims	F.62 Prepayments of insurance premium and reserves for outstanding claims
OTHER (d)	**F.7 OTHER ACCOUNTS RECEIVABLE/PAYABLE**
	F.71 Trade credits and advances
	F.79 Other accounts receivable/payable, except trade credits and advances
	F.M MEMORANDUM ITEM: DIRECT FOREIGN INVESTMENT

Source: EUROSTAT (ESA 79 and ESA 95).

(a) Non-marketable bills and short-term bonds should be included in *"Other deposits".*
(b) Non-marketable securities other than shares should be include in *"Loans".*
(c) Non-marketable long-term bonds should be included in *"Other medium and long-term bonds".*
(d) ESA 79 did not include this item, unlike the Financial Accounts of the Spanish Economy, which always have.

CHART 1

Net financial transactions (a)



Source: Banco de España.
(a) Net financial asset acquisitions less net liabilities incurred.
(b) Credit institutions plus insurance enterprises.

transactions would be computed when it fell due. This wording and other similar expressions led to a degree of ambiguity, which proved particularly thorny when the recording of interest bore seriously on the estimation of the budget deficit under the EDP/SGP. The underlying problem was that ESA 79 had retained in their entirety the principles adopted by the ESA 70 drafted at the end of the sixties, when most of the securities in which debt materialised were short-term, issued at their face value and with coupon payments. In an attempt to attain a degree of harmonisation which, to some extent could integrate into ESA 79 the treatment of the interest on securities that came into being after ESA 79 had been drafted (zero-coupon bonds, tranche issues, index-linked securities, etc.), Eurostat initiated a series of consultations with the competent fora and finally, having been duly advised, adopted a series of Decisions within the scope of its remit. These Decisions were disseminated via press releases over the course of the years 1996 to 1998, and some of their consequences in the case of interest are highlighted in Box III.7 of the Banco de España's 1999 *Annual Report.* The chart and table in this box indicate the repercussion of this change on the data on interest paid by Spanish general government. With the entry into force of ESA 95 and the introduction of the accrual principle, such interpretations have ceased to be meaningful, which is a great advantage for analysts and compilers.

This change of criterion in the recording of interest in the non-financial transactions accounts affects the financial approach of the accounts. This is because applying the accrual principle means, in turn, including the interest accrued on financial transactions up to the time of payment. In connection with this incorporation into the financial account, which in principle could be done under the heading of other accounts receivable/payable, or else in the very instrument generating the interest, ESA 95 requires that the second of these options be applied in the case of issued securities. However, for the interest on deposits and loans, ESA 95 leaves the option open. Therefore, in the case of securities, the interest accrued is treated as if it were re-invested in the same instrument from which it stems, with a disinvestment from the related instrument coming about at the time of payment of the interest. The financial instrument in question shall be valued at market price, according to ESA 95 (6), with accrued interest being precisely one of the components of the change in market prices. Consequently, the

(6) The following section address the valuation criteria established under ESA 95.

counterpart in the financial account of the interest accrued in the non-financial account is the incorporation of the accrued interest at the price of the liability.

This methodology, which is obligatory under ESA 95, has been adopted for securities in the FASE. In contrast, that applied in the FASE according to ESA 79 generally computed securities issues at face value, reflecting the interest recorded and unpaid in an asset-side financial account heading called *other.* The reflection of this change in the FASE has been a decrease in the asset heading other in the general government financial transactions account and a decrease in the counterpart item (liabilities-side *other*) of the holding sectors of these securities: Financial corporations, Non-financial corporations, Households and Rest of the world. Nonetheless, these changes have been partly offset by the incorporation into the heading *other accounts receivable/payable* of the interest accrued but not yet paid on bank loans and deposits, since this interest has not been included in the transactions as in the case of securities.

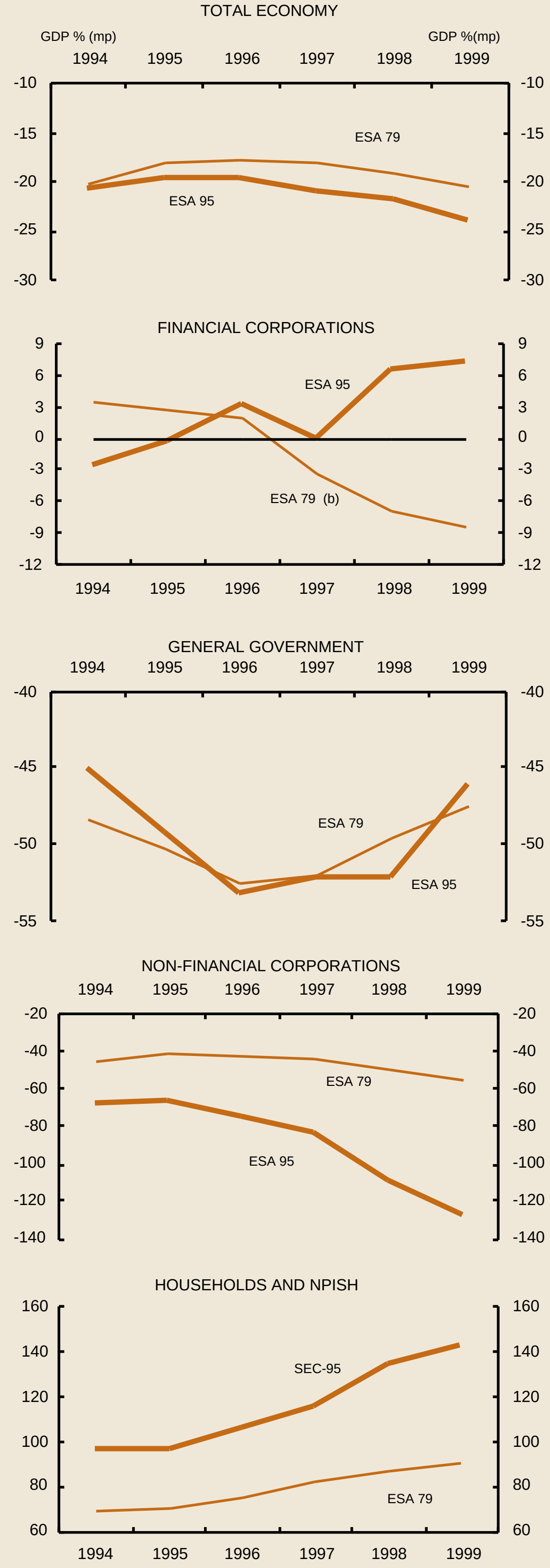
6. VALUATION OF FINANCIAL INSTRUMENTS

The ESA 95 methodology establishes that the valuation of financial balance sheets or stocks of financial assets and liabilities shall be at market price. To date, in the Financial assets and liabilities accounts compiled by the Banco de España, valuation was highly heterogeneous (face value, historical cost, accumulation of flows), except in the case of quoted shares, which were recorded at the market price. This is the most significant change in the Accounts and it affects, to varying degrees, all sectors of the economy. The categories most affected are *shares and other equity* and, to a lesser extent, *securities other than shares.* It is these which largely explain the difference in level and profile of the net financial assets of the various sectors shown in Chart 2. Section 8 offers a summary of how these changes have affected the results obtained.

In connection with the valuation of financial instruments at market price established by ESA 95, the practical application of this rule poses difficulties for those instruments where said valuation cannot be calculated directly. Indeed, market price can only be accurately recorded in the case of securities quoted on the Banco de España book-entry market (these are the bulk of securities other than shares in circulation) or on other organised markets, those with reasonable liquidity and quoted shares. Estimates have been made for the remaining securities.

CHART 2

Financial balance sheets
Net financial assets (a)



Source: Banco de España.
(a) Financial assets less liabilities.

The valuation methods used for the main instruments affected by this rule are discussed below. Evidently, these valuations are identical where the instruments are financial assets or liabilities; nonetheless, since the availability of sufficiently detailed information differs for securities issues and portfolios, the estimation procedure followed in each case shall be separately discussed.

Issues

a) Securities other than shares

- *Monetary financial institutions*

Issues with periodic payment of interest have been valued at market price. In the case of zero-coupon issues, the amount of the unmatured interest accrued has been added to the actual value at issue.

- *Non-financial corporations and other agents issuing securities other than unquoted shares*

  The market value has been calculated using issuance data of similar characteristics relating to quoted securities. To make these estimates resort was had first, to zero-coupon bonds, and further, to other issues.

b) Shares

- *Quoted*

  Stock market capitalisation has been applied directly.

- *Unquoted*

  Banks: the market price has been obtained by applying to their own funds the market value/own funds (capital plus reserves) ratio of banks whose shares are quoted. This is the procedure recommended by the ECB and Eurostat (7) to value the unquoted shares of corporations whose sector is well represented on the stock market.

  Other financial corporations: issues have been valued according to their own funds (capital plus reserves).

  Non-financial corporations: unlike with banks whose shares are not quoted, most unlisted Spanish corporations do not have a sufficiently broad sectoral representation on stock markets. Hence, to value the shares of these corporations, it has been necessary to resort to procedures other than those discussed for banks. In this case the valuation procedure used by the Central Balance Sheet Office, based on the discounting of estimated ordinary results, has been incorporated. The *discount factor* applied is made up of a long-term interest rates plus a risk *premium* minus the *expected growth rate of profits* relating to a perpetual income. The risk premium includes various factors such as: *a)* the *structural risk* associated with the possibility of the corporations going bankrupt and *b)* the *liquidity risk* and *other factors* arising from the fact that the shares are not quoted on an organised market and that the life of many corporations cannot be considered as perpetual (a frequent occurrence in unlisted corporations, most of which small) Finally, in the case of non-financial corporations with net losses in the past five years, their value has been considered to be zero (8).

c) Other equity

- *Mutual funds*

  According to their realisable value.

- *Non-financial corporations*

  According to their own funds.

Regarding the procedures described for estimating the market price of unquoted shares and the equity of Non-financial corporations, the Central Balance Sheet Office data are only available to 1998; the 1999 data have been estimated via extrapolation.

Portfolios

From the standpoint of *holders* (financial assets), the estimation of the market-price-valued portfolios of the various sectors, sub-sectors and agents has been carried out by distributing the stocks of liabilities valued at market price (following the above-mentioned procedures) in

(7) The valuation of unquoted shares was studied by a purpose-designed sub-working group set up under the aegis of both organisations.

(8) For greater detail on these matters, see Boxes 7 and 8 of the Banco de España publication (in Spanish) "Central de Balances. Resultados anuales 1998".

direct proportion to the book or face values (whichever is appropriate) featuring in their portfolios or in the statements of securities deposited at credit institutions. Nonetheless, although it is this procedure that has been generally applied, additional information has also been taken into account, e.g. the fact that, in credit institutions' financial statements, the trading portfolio is already valued at market prices.

An exception to this general portfolio valuation rule has been *foreign direct investment in resident corporations.* To date, the International Investment Position statistics are reflecting this under the procedure of cumulative balance of payments flows. Consequently, since such investment is not valued at market prices, the application solely of the foregoing method would lead to an overvaluation of the portfolios of non-financial corporations and households sectors that are jointly obtained residually. To prevent this overvaluation, the revaluation it is estimated corresponds to the non-resident portfolios has been adjusted in the stock of liabilities. Nor has any valuation at market prices been made, so far, for *residents' direct investment in non-resident corporations.*

Finally, regarding the valuation in the ESA 95 Accounts of *loans* and *deposits,* their effective value is taken.

7. OTHER CHANGES IN THE ACCOUNTS NOT LINKED TO THE INTRODUCTION OF ESA 95

As indicated in the introduction, the changes to the FASE following ESA 95 methodology go beyond those relating to the rules laid down in this manual. The most important changes are due to the use of greater information from the Central Balance Sheet Office, now that the work providing for a relatively efficient use of the financial statements that corporations are obliged to file yearly with the Mercantile Registry has been concluded. This work involved first, editing the Mercantile Registry data in order to select the set of corporations whose data pass certain statistical tests. Second, this information was contrasted with that in INE's hands. This cross-checking was one of the tasks undertaken by a working group made up of staff from INE, the Banco de España and IGAE (the Audit Department of the Spanish Ministry of Finance) which has helped ESA 95 be set in place (see section 8.3). Finally, computer programs were designed enabling the entire process to be managed rapidly and efficiently. This improvement in the availability of information means data from over 200,000 corporations – compared with the approximately 8,000 firms regularly reporting to the Central Balance Sheet Office – can be incorporated into the FASE. This enlarged number of corporations is important not only quantitatively, given the access to a larger amount of data, but also qualitatively, in that the extra corporations on which data are now available are small- and medium-sized and have different financial structures from large corporations, which are predominantly those that report habitually to the Central Balance Sheet Office. The categories in the FASE that have been most affected by this are *shares, other equity and trade credits.* The nature of the changes in the accounts attributable to access to greater information, and to other reasons, is discussed below.

- *Shares and other equity*

  As indicated in the methodological notes accompanying previous editions of the annual FASE, one of the limitations of the work was that the outstanding balance of *shares and other equity,* and more specifically of unquoted shares and other equity issued by non-financial corporations, was underestimated. On the side of the holders, this underestimation was reflected in the portfolio of the joint sector *Non-financial corporations and households.* The above-mentioned work in the Central Balance Sheet Office has largely enabled this shortcoming to be rectified and, drawing on the data from the Mercantile Registries, it has been possible to estimate the total of unquoted shares issued by Non-financial corporations and of equity in corporations with a legal status other than that of public limited company (essentially private limited companies).

- *Trade credits*

  Under ESA 79, trade credits appeared explicitly only in the accounts of non-financial corporations and households; in the other sectors they were included in the sub-category other. The approximation of the national total of credits was made on the basis of the set of corporations reporting to the Central Balance Sheet Office by means of the application of ratios relating trade credits granted (to customers) to those received (from suppliers). The latter were then related to the bank credit received by this set of corporations which, in turn, was related to the bank credit extended to the total number of resident corporations, obtained from credit institutions. Based on this estimate, the separation of trade credits into corpo-

TABLE 1

Financial balance sheets. Comparison between ESA 95 and ESA 79
Average stocks in the period 1995-1999

% of GDP

	Total economy	Non-financial corporations	Financial corporations	General government	Households and NPISH	Rest of the world
NET FINANCIAL ASSETS (a):						
Financial balance sheet ESA 95	–21.33	–94.51	3.53	–50.55	120.19	21.33
Financial balance sheet ESA 79	–19.06	–47.42	–3.31	–51.09	82.79	19.04
Difference	–2.27	–47.09	6.84	0.55	37.40	2.29
Methodology and sources	*–2.61*	*–48.58*	*6.90*	*–0.25*	*39.30*	*2.63*
Change-in-GDP effect	*0.34*	*1.49*	*–0.06*	*0.80*	*–1.90*	*–0.34*
FINANCIAL ASSETS:						
Financial balance sheet ESA 95	586.02	129.23	255.99	28.26	172.53	87.81
Financial balance sheet ESA 79	499.28	84.64	249.10	22.27	143.27	79.90
Difference	86.74	44.59	6.89	5.99	29.26	7.91
Methodology and sources	*95.99*	*46.63*	*10.93*	*6.44*	*31.98*	*9.29*
Change-in-GDP effect	*–9.25*	*–2.04*	*–4.04*	*–0.45*	*–2.72*	*–1.39*
LIABILITIES:						
Financial balance sheet ESA 95	607.35	223.74	252.46	78.81	52.34	66.48
Financial balance sheet ESA 79	518.34	132.06	252.42	73.36	60.48	60.86
Difference	89.01	91.68	0.05	5.45	–8.14	5.61
Methodology and sources	*98.60*	*95.21*	*4.03*	*6.69*	*–7.32*	*6.66*
Change-in-GDP effect	*–9.59*	*–3.53*	*–3.98*	*–1.24*	*–0.83*	*–1.05*

Source: Banco de España and Instituto Nacional de Estadística (as regards GDP).
(a) Financial assets less liabilities.
GDP ESA 95 (average 1995-1999): EUR 494,962 m.
GDP ESA 79 (average 1995-1999): EUR 487,272 m.

rations and households was made on the assumption that the relationship between credits granted by non-financial corporations and by households (insofar as this latter group includes individual entrepreneurs) is the same as that existing between the trade bills discounted by non-financial corporations and households at credit institutions.

In compiling the FASE with ESA 95, two changes have come about in trade credits. First, these credits appear explicitly in other sectors in addition to those of non-financial corporations and households. Access to additional sources of information and the improvement in the cross-checking of data from the different sectors have made for an acceptable estimate of the trade-credit-granting sector (non-financial corporations, households and rest of the world) and the credit-receiving sectors (general government, corporations, households and rest of the world). Mention should be made of the general government contribution to this improvement in information quality in recent years, which has provided for a greater breakdown of certain categories. This has allowed the estimated trade credit data drawn from this source to be checked against those obtained by the Central Balance Sheet Office, with most satisfactory results.

Further, by using data from a greater number of corporations which, as earlier indicated, are mostly small, the trade credits/bank credit and trade credits/discounted bills ratios have changed significantly.

- *Other accounts receivable/payable, except trade credits*

This category (other, under the ESA 79 terminology) is, along with that of securities and that of trade credits, one of those to have been most thoroughly revised in the ESA 95 Accounts, its amount diminishing in terms of both transactions and stocks. The main reason stems from the aforementioned improved estimation of trade credits, since the omission of a large portion of these meant that the category other was overvalued, as it included residually trade credits not appearing explicitly in the Accounts. A further – albeit lesser – cause for the reduction in the relative significance of this category is the reflection of the State's net position vis-à-vis the EU as a net liability to the rest of the world in the general government transactions accounts and balances. This form of accounting matches that adopted in the statistics of the International Investment Position. Formerly, this net position was separately included under assets (EAGGF-Guarantee and ESF funds) and liabilities (ERDF, EAGGF-Guidance and FIFG).

- *Other changes pending application in the Accounts*

— *Short-term securities issued by Monetary financial institutions*

These issues had hitherto been included along with deposits. In the ESA 95 they are classified under the category short-term securities. The main reasons for this change have been the renewed vigour of these issues over the past year and their inclusion for trading on the AIAF market. Prior to this, these securities were scarcely traded, whereby their classification among deposits was warranted according to ESA 79 (see Scheme 2, footnote 1).

— *Securities categories in general*

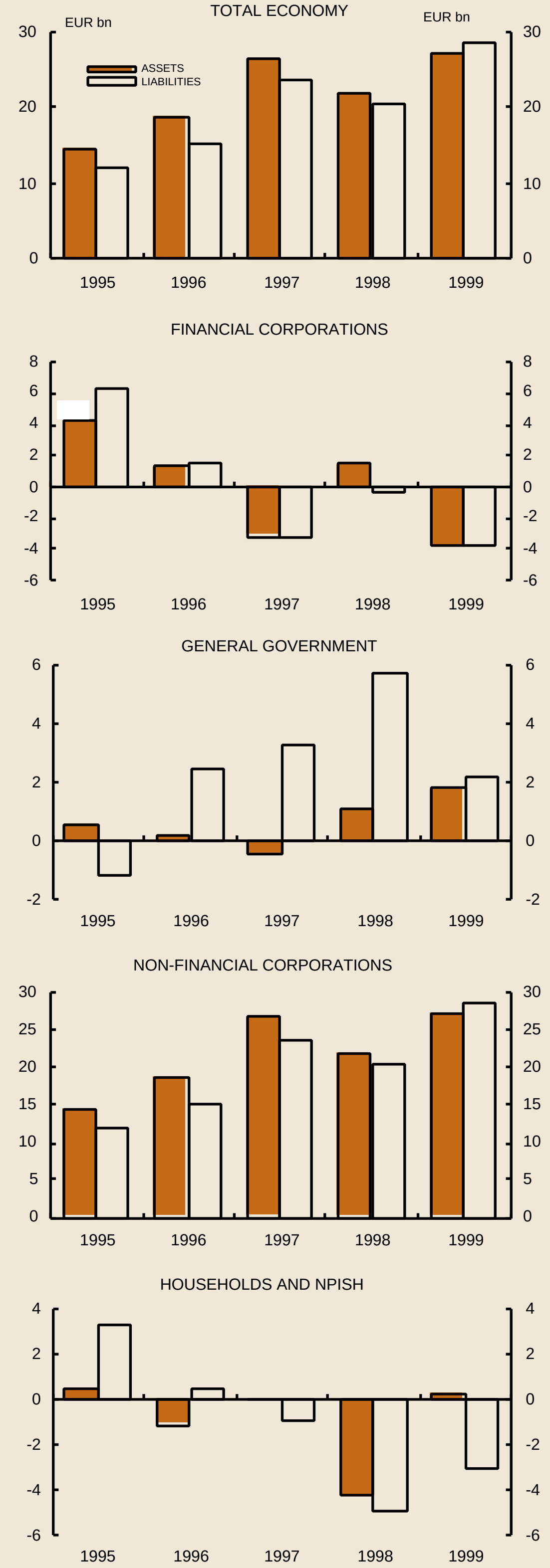
As a result of the methodological changes made and of other changes or additions, all the information on the securities categories has been revised in order to maintain the system's consistency and to adopt new procedures for compiling the ESA 95 series. By way of example, it may be stated that comprehensive information on holders of shares in mutual funds has been available since mid-1999 and that the annual revision of Balance of Payments data, which is one of the most frequently used sources, is conducive to certain changes in the Accounts.

— *Classification by instrument of international reserve assets*

Under ESA 79, these assets were classified in the annual FASE in the categories *gold and position in international organisations* and in *currency and transferable sight deposits.* In the quarterly FASE, these instruments were included in the categories *Gold and position in international organisa-*

CHART 3

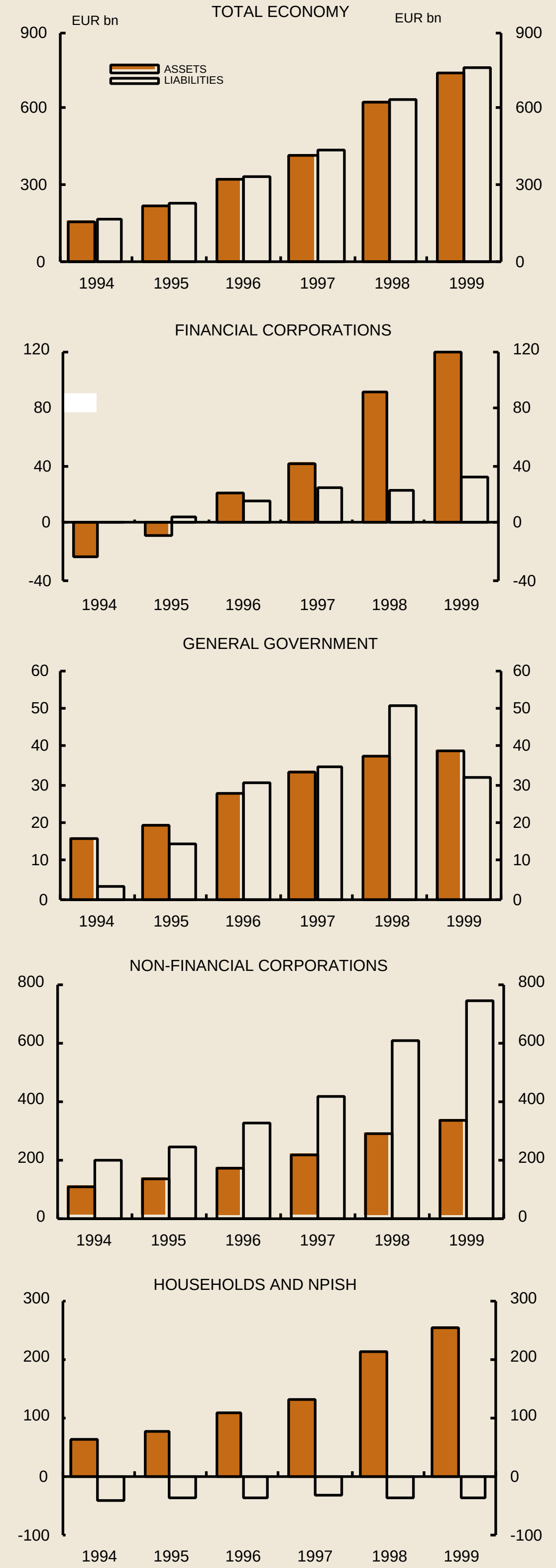
Net acquisition of assets and liabilities incurred
Difference between ESA 95 and ESA 79



Source: Banco de España.

CHART 4

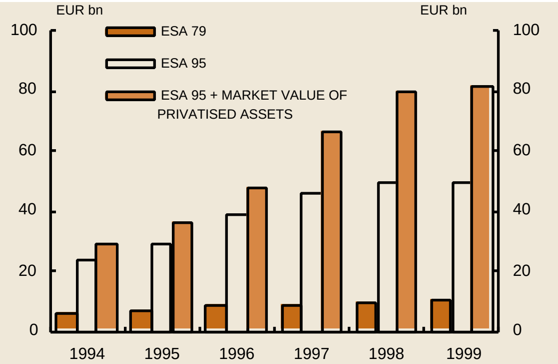
Financial assets and liabilities
Difference between ESA 95 and ESA 79



Source: Banco de España.

CHART 5

General government shares and other equity
Impact of privatisation of state-owned enterprises



Sources: Ministerio de Economia, Ministerio de Hacienda and Banco de España.

tions and in *Other reserve assets.* In the ESA 95 FASE, external reserves have been broken down into the instruments whose forms they have taken.

8. SUMMARY OF RESULTS OBTAINED

8.1. Main differences between ESA 95 and ESA 79 estimates

Table 1 and Charts 1 to 4 offer a summary by sector (including Rest of the world), and for the Spanish economy as a whole, of the main changes in the transactions and in the financial balance sheets recorded by the ESA 95 FASE compared with those previously published following ESA 79 methodology. To obtain an overview of the entire period 1995-1999, in Table 1 and in the comments that follow, the comparison between both systems has been made in terms of the average stocks for these years as a proportion of GDP. Table 1 indicates what portion of the change is due to the change in GDP.

Considering firstly the *Financial corporations* sector, *net financial assets* according to ESA 95 have grown by 6.8 % of GDP on average in the period 1995-1999. The changes that have most affected this sector relate to sectorisation (as indicated in section 3) and, as in other sectors, the market-price-valuation of securities, on both the asset and liabilities sides.

As regards *financial assets,* average increases of 6.9 %, 10.7 % and 14 % of GDP, respectively, were recorded in the categories *total assets, securities other than shares* and in *shares and other equity,* essentially due to the change to market-price-valuation of the agents' portfolios making up this sector. Conversely, *other accounts and other instruments* show an opposite result (–8.2 % and –9.7 %, respectively). The decline in the stock of *other* is due virtually in its entirety to the elimination from the Banco de España balance sheet of the Accounts *category other reserve assets* (i.e. reserve assets other than monetary gold and the position in international organisations). In the current version of the Accounts, these reserve assets are included in the financial instruments whose form they have taken; essentially, *securities other than shares,* which, in turn, explains part of the growth of this above-mentioned category.

Turning to *liabilities,* the instruments whose stocks post the biggest growth are *shares and other equity* (6.3 %) and *securities other than shares* (2.2 %). In addition to being due to the market price valuation, this result, in the case of the second of these categories, is attributable to the inclusion in this sector of Securitisation funds (formerly included under Non-financial enterprises) and to the incorporation of negotiable notes issued by credit institutions (formerly included as deposits).

In the general *government* sector, *net financial assets* show negligible average growth (0.6 % of GDP). This is the outcome of a 6 % increase in *financial assets* and a 5.5 % rise in *liabilities.* Under assets, a key feature of this sector is the increase in the value of *shares and other equity* (6.9 % of GDP), despite the intense process of privatisation of state-owned enterprises during the period covered by the Accounts. Chart 5 and Table 3 have been drawn up to explain this effect. Chart 5 compares the value of this set of assets in the ESA 79 accounts and that in the ESA 95 accounts. Next to the latter a third bar has been added, indicating the value the portfolio would show according to ESA 95 if there had been no privatisations. Table 3 furnishes some additional details on changes in these general government assets over the period as a whole, thus complementing the information in the chart.

Another aspect of some importance regarding the assets of this sector is the reduction in *other categories* (–1 % of GDP). This result is due virtually in its entirety to the cancellation of the loan vis-à-vis RUMASA, which was among the financial assets of the State as this firm had been incorporated into the general government sector under the new sectorisation criteria.

Notable among *liabilities* are the following: growth of the order of 4 % of GDP of *securities other than shares,* as a result of the valuation of outstanding public debt at market prices; the higher stock of *trade credits* (2.5 %), further to the improved estimation of this category, as discussed in section 7; and the likewise positive change in the stock of *loans* (0.5 %), resulting from the inclusion of a group of state-owned enterprises in the general government sector for the reasons set out in section 3. These enterprises did not, however, have debt in the form of securities. The improved estimation of *trade credits* accounts for most of the reduction in

CHART 6

Comparison between stocks of capital transaction account and of net financial transactions

Source: Banco de España.

*other accounts payable (–1.5 %), since this was where they were forme*rly included.

Turning to the sector *Non-financial corporations,* the stock of *net financial assets* has undergone a fall in the new FASE of 47.1 % of GDP as a result of a 91.7 % increase in the total stock of *liabilities* and a 44.6 % rise in that of *financial assets.* Under liabilities there was a notable increase of almost 68 % of GDP in the stock of *shares and other equity.* This is due both to the rise in the value of these liabilities, following the application of market prices, and to the increase in the stock of unquoted shares and participations, further to the inclusion of the data from the Mercantile Registries on small- and medium-sized companies (as discussed in section 7). The latter also explains the increase of somewhat over 27 % in the stock of *trade credits.*

On the *assets* side, the instruments exhibiting most growth are *shares and other equity* (24 % of GDP) and *trade credits* (25 %), due in both cases to the reasons given in connection with these same instruments on the liabilities side.

The divergence between ESA 95 and ESA 79 in the sector *Households and NPISH* is the opposite to that in the sector Non-financial corporations. Indeed, the average stock of *net financial assets* of Households and NPISH shows an increase between both versions of the Accounts of 37.4 % of GDP as a result of a 29.3 % increase in the stock of *financial assets* and a fall of 8.1 % in that corresponding to liabilities. The increase in assets is due almost in full to the rise in the value of the portfolio of *shares and other equity* (almost 28 %), owing to the aforementioned market-price valuation and the incorporation of the data from the Mercantile Registries. As regards the decline in the stock of liabilities, the main reasons are the fall in the stock of *trade credits* (–4.1 %) and in *other accounts payable* (–3.8 %).

The overall outcome of these changes in the various sectors for the *total economy* is a reduction in the stock of *net financial assets* of 2.3 % of GDP, which arises from a 86.7 % increase in *financial assets* and a 89 % increase in *liabilities.* The impact on the economy of the market-price valuation of securities, the increase in the stock of shares and other equity and the increase in trade credits account for these high-percentage increases in assets and liabilities. Conversely, the categories *other accounts receivable* (asset-side) and *payable* (liabilities-side) have declined considerably. This is a very favourable result in the Accounts, as it has enabled the stock of those categories including instruments not explicitly identified to be reduced significantly.

The analysis for the national economy can also be interpreted from the standpoint of the sector Rest of the *world* which, in keeping with the previous paragraph, sees its *net financial assets* rise by 2.3 % of GDP. The estimation of this limited increase, resulting from the increases in the rest of the world's financial claims on Spain and from the increase in its liabilities to the country (see Table 1), has a shortcoming. In fact, as stated in the following section, market-price valuation has yet to be applied to the liabilities of the resident sectors (financial assets of the rest of the world) which are the vehicle for direct investment. The same valuation has also yet to be done for the financial assets of the resident sectors which are liabilities of the rest of the world.

8.2. Link between the capital accounts and the financial account

The co-ordination between INE, which compiles the non-financial accounts of the institutional sectors in the context of the National Accounts, and the Banco de España, which compiles the Financial Accounts, is evident in the link between the balancing item of the capital transactions account (net lending/net borrowing) and the balancing item of the financial transactions account (net financial transactions) (9). Completing the co-ordination process is the contribution of the IGAE in respect of the accounts of the general government sector. As a result of this co-ordination, the balancing items of both accounts for the sectors *Rest of the world, Credit institutions and General government* coincided already in the series available in ESA 79 terms, and the same is the case for the balancing items of the sectors *Rest of the world, Financial corporations and General government* in ESA 95. However, the heterogeneous and non-integrated information available to national, financial and non-financial accounts practitioners means discrepancies arise between the balancing items of the aforementioned sectors *Non-financial corporations and Households and non-profit institutions serving households,* in both ESA 79 and ESA 95, to a

(9) Following the OECD, the version of the FASE formerly prepared by the Banco de España in ESA 79 terms called this balancing item "net financial saving", an expression which, as experience shows, is equivocal. Eurostat recommends not calling the balancing item of the financial account the same as that of the capital account (theoretically they should be identical, since one is the counterpart of the other) in order to highlight the fact that, in many cases, the estimation of both accounts draws on non-integrated information.

TABLE 2

Links between initial and final financial balance sheets
Period 1995-1999. December 1994=100

	Initial financial balance sheet (31.12.1994)	Transactions (1995-1999)	Revaluations (1995-1999)	Other changes in volume (1995-1999)	Final financial balance sheet (31.12.1999)
	Financial assets				
Total economy	100.0	58.4	38.1	–1.9	194.6
Non-financial corporations	100.0	85.6	53.8	–4.3	235.2
Financial corporations	100.0	58.8	20.0	–1.6	177.2
General government	100.0	43.8	23.2	0.0	167.0
Households and NPISH	100.0	41.9	58.8	–1.2	199.5
Rest of the world	100.0	97.4	25.3	0.2	222.9
	Liabilities				
Total economy	100.0	55.2	39.0	–0.7	193.5
Non-financial corporations	100.0	51.9	95.9	–0.2	247.7
Financial corporations	100.0	55.6	16.1	–1.0	170.7
General government	100.0	47.6	8.0	–1.3	154.3
Households and NPISH	100.0	75.0	–2.0	0.0	173.0
Rest of the world	100.0	147.1	11.2	–11.7	246.6

Source: Banco de España.

similar extent to those that appear in other European countries. Chart 6 shows the discrepancies that have arisen on preparing the transactions accounts within the framework of the two systems. It can be seen how the scale of these discrepancies has diminished and how their profile has drawn nearer over time. This has been the result of greater co-ordination between compilers during the implementation stage of ESA 95. Foreseeably, such co-ordination will become stronger in the future implying, inter alia, an increasingly more specific use of the Central Balance Sheet Office's information in the preparatory work for the Accounts.

8.3. Link between the financial balance sheets at the beginning and end of the period in the 1995-1999 series in ESA 95

Table 2 shows the link between the balance sheet at the beginning of the series (December 1994) and at the end (December 1999) for the various sectors. The period is extensive enough to accord generality to the conclusions drawn. In principle, it is sought to highlight the important role played by the revaluation accounts in the link. These capture the effect of the changes on the prices of financial assets and liabilities in the starting balance sheet. These revaluations were not explicit in ESA 79, because the scope of that system was confined to the transactions accounts and not to the starting balance sheets. Readers of the FASE hitherto published by the Banco de España, which also included financial balance sheets (called financial assets and liabilities accounts), should be mindful of the fact that, as mentioned above, such accounts were compiled without reference to any standardised system. Accordingly, in valuing various assets and liabilities, it was decided to take the value available, which in most cases was the face value. And that, on attempting to reconcile the opening and closing balance sheets, would mask the effect of revaluations.

8.4. The FASE in ESA 95 terms and general government portfolios

Besides their general usefulness for describing the process of financing of the economy, the FASE compiled in terms of ESA 95 reveal particularly interesting aspects of developments in the different sectors. Table 3 and Chart 5 attempt to reflect in a summarised fashion how certain aspects of the privatisation process have been recorded in the accounts, i.e. the sale to other sectors of financial assets in the form of shares and other equity, which featured in the general government portfollio. The estimated amounts in the sector's portfolios were notably small in the series prior to ESA 95 being set in place owing to the fact that, as indicated on repeated occasions, the valuation followed until ESA 95 was established used het-

TABLE 3

Breakdown of general government shares and equity

EUR million

	Final balance sheet 1994	Transactions (a) (1995-1998)	Revaluations (1995-1998)	Final balance sheet 1998	Memorandum item: final balance sheet 1999
Shares and other equity (ESA 95)	26,163	–6,445	33,508	53,226	53,605
Telefónica, Tabacalera, Aldeasa and Argentaria	*5,221*	*–9,556*	*4,335*	*72*	*0*
Other	*20,942*	*3,111*	*29,173*	*53,154*	*53,605*
MEMORANDUM ITEM:					
Shares and other equities (ESA 79)	8,078	–6,209	10,180	12,049	12,592

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

(a) Negative amounts: net privatisations. Positive amounts: net contribution of funds.

Valuation: 1) Quoted shares: stock market capitalisation. 2) Unquoted shares: estimation of ordinary returns discounted at the discount factor mentioned in the article. The value of corporations with net losses over the past five years is considered to be zero. 3) Equity: as per amount of own funds (capital plus reserves).

Note: The ESA 79 only defines transactions, not financial balance sheets. Therefore, columns 1, 4 and 5 in the memorandum item are based on estimations drawn from heterogeneous sources: book values, accumulated flows, nominal values, etc. See comments in section8.4.

erogeneous criteria in the absence of a system of reference (ESA 79 restricted itself to recording the operations). This heterogeneous valuation considered, on a case-by-case basis, nominal values, accumulation of flows, book values, etc. in the manner explained in the methodological note disseminated each year in the Spanish publication *Cuentas financieras de la economía española.* It is also evident that disposals of a portion of these financial assets, as a result of privatisation, have not entailed their reduction in absolute terms owing to revaluations coming into play. Obviously, net contributions or injections of funds also arise, i.e. conventional or more specific asset-increasing operations. An example of the former is budgetary contributions in the strict sense, an example of the latter being the recording, as contributions, of equity increases at non-financial corporations or financial institutions in which general government has an ownership interest, or the instance of the conversion of general government loans to the aforementioned corporations and institutions into capital contributions.

9. CHANGES STILL TO BE MADE IN THE ACCOUNTS

— Despite all the amendments incorporated into the Accounts, there are others pending which it has not so far been possible to undertake but which will be addressed as information becomes available, in some cases, and as the work under way is finalised, in others. A non-exhaustive list of such changes follows:

— *Financial derivatives:* inclusion of stocks in the category of securities other than shares. As indicated, at present only financial transactions are included.

— *Foreign direct investment:* pending is the valuation at market prices in the dual approximation of resident sectors' liabilities and rest of the world assets (portfolios).

— *Short-term issues of the rest of the world:* these do not appear in the Accounts as a specific category. The amounts under this item in the Balance of Payments and the International Investment Position are incorporated, along with medium- and long-term bonds, into the sub-position of long-term securities other than shares. Once the work under way aimed at reconciling the estimates obtained for this sub-position from alternative sources has been concluded, they will be correctly recorded as short-term securities.

— *Currency-exchange bureaux and insurance agents and brokers:* to date, information is not available on these corporations. Once it is, they will be incorporated into the Accounts under Financial Auxiliaries and, therefore, in the sector Financial Corporations.

22.5.2000.

Financial regulation: second quarter of 2000

1. INTRODUCTION

Relatively few financial provisions were enacted during the second quarter of the year 2000, which coincided with the beginning of the seventh parliamentary session. However, they were of a certain importance.

At the Community level, the Governing Council of the European Central Bank (ECB) was authorised to increase its capital and to effect further calls of foreign reserve assets from the national central banks, in the event of need. Moreover, all the directives relating to the taking up and pursuit of the business of credit institutions were coded and grouped into a single directive.

The Banco de España (BE), meanwhile, published four provisions. The first reinforces the ordinary clearing and payment mechanisms by providing additional media to allow the remote exchange of data, and by integrating the unavailability of such media into the legal framework of the Spanish Electronic Clearing System *(Sistema Nacional de Compensación Electrónica – SNCE).* The second supplements the general rules of procedure of the Banco de España Settlement Service *(Servicio de Liquidación del Banco de España – SLBE)* and of the Public Debt Market Book-Entry System *(Central de Anotaciones del Mercado de Deuda Pública),* in accordance with Law 41/1999 of 12 November 1999 on payment and securities settlement systems. The third establishes the basic rules of procedure of the Spanish Interbank Payment Service *(Servicio Español de Pagos Interbancarios – SEPI),* currently operated by the Madrid Banking Clearing House. The fourth specifies the concept of net provisions for loan losses that credit institutions are required to set up, in relation to their statistical coverage.

With regard to financial institutions, a number of solvency standards were amended to enable Spanish institutions to compete with their Community counterparts on an equal footing.

As regards government debt, the legal regime for market makers and dealer entities has been revised to redefine and improve the conditions under which they engage in their activity, in the competitive environment in which they operate along with other euro area entities.

Two important provisions should be noted in relation to securities markets: first, under the regulation of securities issues and public offerings, a specific standard form is introduced for atypical financial contracts, since the existing standard forms are hardly appropriate for such products. Second, and with respect to the management of investment portfolios, the rules of conduct that must govern the relations between the portfolio management entities and their clients are specified, as are the standard agreements in which such relations are formalised.

A series of liberalising and competition-enhancing measures and a package of fiscal measures favouring household saving are mentioned. They have been introduced by the government in order to maintain stable economic growth and reduce inflationary risks.

Finally, a procedure has been established for making withholdings or establishing exemption therefrom, in respect of interest and dividends arising from negotiable securities, that are received without a permanent establishment by taxpayers under the tax on the income of non-residents, when financial institutions domiciled in Spain are involved in the payment procedure.

2. EUROPEAN CENTRAL BANK: CAPITAL INCREASES

Article 28 of the Statute of the European System of Central Banks (ESCB) requires that the ECB be provided by the national central banks with capital of EUR 5000 million, which is to become operational upon the establishment of the ECB. This capital may be increased by such amounts as may be decided by the Governing Council of the ECB, within the limits and under the conditions set by the Council of the European Union (EU).

Pursuant to *Council Regulation (EC) 1009/2000 of 8 May 2000* (OJ of 16 May 2000), the Governing Council of the ECB has recently been authorised to increase the capital of the ECB by an additional amount of up to EUR 5000 million.

3. EUROPEAN CENTRAL BANK: FOREIGN RESERVE ASSETS

Article 30 of the Statute of the ESCB requires that the ECB be provided by the national central banks of participating Member States with foreign reserve assets up to an amount equivalent to EUR 50000 million. Likewise, further calls of foreign reserve assets beyond the said limit may be effected by the Governing Council of the ECB.

Pursuant to *Council Regulation (EC) 1010/2000 of 8 May 2000* (OJ of 16 May 2000), the Governing Council of the ECB may effect further calls of foreign reserve assets (1) from the national central banks beyond the limit set in Article 30, up to an amount equivalent to an additional EUR 50000 million, in case of need for such foreign reserve assets.

4. EUROPEAN DIRECTIVE RELATING TO THE TAKING UP AND PURSUIT OF THE BUSINESS OF CREDIT INSTITUTIONS

The Treaty establishing the European Community, signed in Rome on 25 March 1957, called for the creation of a large financial market. In 1985, the European Commission published a White Paper on the Internal Market, defined as “an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured”, which should be achieved over a period expiring on 31 December 1992. In 1986, the Single European Act incorporated into the Treaties establishing the European Communities the basic principles set out in the White Paper, which thus acquired the nature of primary legislation.

In the financial sphere, the establishment of a single market required the abolition of obstacles to the free movement of capital and the freedom to provide financial services throughout the EU. Therefore, given the great diversity of conditions existing in the various Member States, the approach adopted in timetable form in the White Paper was to achieve essential legislative harmonisation and to apply the principle of mutual recognition. Essential harmonisation had to embody at least the regulations relating to the supervision of financial institutions and the protection of savers in order not to jeopardise the orderly and stable functioning of the European financial system and impair competition between these institutions.

One of the first steps in this direction was the publication of Council Directive 73/183/EEC of 28 June 1973 on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of self-employed activities of banks and other financial institutions. This was followed by the publication of Council Directive 77/780/EEC of 12 December 1977 relating to the taking up and pursuit of the business of credit institutions, also called First Banking Co-ordination Directive. This directive stated that, in order to make it easier to take up

(1) In this regulation, foreign reserve assets mean any official foreign reserve assets of the participating Member States held by national central banks that comprise currencies, units of account or gold other than Member States’ currencies, euro, IMF reserve positions and SDRs.

and pursue the business of credit institutions, it was necessary to eliminate the most obstructive differences between the laws of the Member States and to specify certain minimum requirements to be imposed by all Member States.

Subsequently, Council Directive 89/646/EEC of 15 December 1989 (2), the Second Banking Co-ordination Directive, was the cornerstone of a common sphere of activity for credit institutions. It was based on two principles: first, the right of establishment or single licence (3) to pursue the business of credit institutions throughout the EU, meaning that an institution authorised to carry on its activities within the territory of a Member State is automatically authorised to carry on such activities in the other Member States; second, the *principle of home Member State supervision and control.*

That same year, common basic standards for the own funds of credit institutions were set in Council Directive 89/299/EEC of 17 April 1989 on the own funds of credit institutions and Council Directive 89/647/EEC of 18 December 1989 (4) on a solvency ratio for credit institutions, which involved a change in the associated legal provisions. Directive 89/299/EEC harmonises the items that may be included, as a maximum, in the own funds of credit institutions to cover normal banking risks. This Directive establishes minimum requirements and the Member States remain free to apply more stringent provisions. As for the solvency ratio, it expresses own funds as a proportion of risk-adjusted total assets and off-balance sheet items. The minimum solvency ratio was set at 8 %, though Member States were authorised to set higher minimum ratios, if deemed necessary.

Two additional Directives were published in this field in 1992: Council Directive 92/30/EEC of 6 April 1992 (5) on the supervision of credit institutions on a consolidated basis and Council Directive 92/121/EEC of 21 December 1992 (6) on the monitoring and control of large exposures of credit institutions (i.e. exposures whose value is equal or exceeds 10 % of the credit institution's own funds). Directive 92/30/EEC establishes that all banking groups, including those whose parent undertaking is not a credit institution, should be supervised on a consolidated basis. Likewise, they should have sufficient own funds to cover the risks assumed by the group as a whole, thus being required to comply with the solvency ratio on a consolidated basis. Directive 92/121/EEC sets quantitative limits to large exposures. Specifically, a credit institution may not incur an exposure to a client or group of connected clients the value of which exceeds 25 % of its own funds, or large exposures which in total exceed 800 % of its own funds.

Since most of the aforementioned directives have been amended on several occasions, for the sake of rationality and clarity, they were coded and grouped in an orderly way into a single document: *Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000* (OJ of 26 May 2000). This new directive is organised under eight titles (7): definitions and scope; requirements for access to the taking up and pursuit of the business of credit institutions; provisions concerning the freedom of establishment and the freedom to provide services; relations with third countries; principles and technical instruments for prudential supervision; Banking Advisory Committee; powers of execution; and transitional and final provisions.

5. SPANISH ELECTRONIC CLEARING SYSTEM: COMMUNICATION MEDIA

Royal Decree 1369/1987 of 18 September 1987 (8), Ministerial Order of 29 February 1988 (9) and BE Circular 8/1988 of 14 June 1988 (10) regulated the structure and operation of the Spanish Electronic Clearing System *(Sistema Nacional de Compensación Electrónica – SNCE),* composed of the Spanish Exchange System *(Sistema Nacional de Intercambios – SNI)* and the Spanish Settlement System *(Sistema Nacional de Liquidación – SNL).* Later, BE Circular 11/1990 of 6 November 1990 (11) de-

(2) See "Regulación financiera: primer trimestre de 1990", in *Boletín económico,* Banco de España, April 1990, pp. 71 and 72.

(3) Single licence means that credit institutions authorised to carry on their activities within the territory of a Member State are automatically authorised to operate throughout the Community, either by the establishment of a branch or directly by way of the provision of services.

(4) See "Regulación financiera: primer trimestre de 1990", in *Boletín económico,* Banco de España, April 1990, p. 72.

(5) See "Regulación financiera: segundo trimestre de 1992", in *Boletín económico,* Banco de España, July-August 1992, p. 86.

(6) See "Regulación financiera: primer trimestre de 1993", in *Boletín económico,* Banco de España, April 1993, pp. 90 and 91.

(7) It also includes six annexes.

(8) See "Regulación financiera: cuarto trimestre de1987", in *Boletín económico,* Banco de España, January 1988, p. 51.

(9) See "Regulación financiera: primer trimestre de 1988", in *Boletín económico,* Banco de España, April 1988, p. 65.

(10) See "Regulación financiera: segundo trimestre de 1988", in *Boletín económico,* Banco de España, July-August 1988, p. 79.

(11) See "Regulación financiera: cuarto trimestre de 1990", in *Boletín económico,* Banco de España, January 1991, pp. 31 and 32.

fined the rules of procedure of the current account cheque and promissory note sub-system, which is integrated into the SNI and is regulated by SNCE Regulation 004 (hereafter SNCE-004). Subsequently, the aforementioned Circular was amended by BE Circulars 5/1991 of 26 July 1991 (12), 1/1995 of 30 June 1995 (13), 2/1998 of 27 January 1998 (14) and 9/1998 of 30 October 1998, which incorporated the clearing of new documents and payment means into this sub-system.

On certain occasions, the communication media customarily used by the SNI are wholly or partly unavailable, thus preventing the correct operation of the system. In these cases, data must be exchanged on magnetic media, which largely excludes the use of remote communication media. Besides, the exchange of media is not embodied into the legal framework of the SNCE.

BE Circular 2/2000 of 28 March 2000 (BOE (Official State Gazette) of 11 April 2000) was published to avoid these drawbacks by providing additional communication media to allow the remote exchange of data and by integrating the unavailability of such media into the legal framework of the SNCE.

As a result, when it is not possible, for any reason, to use ordinary logical media for the transmission of data evidencing documents, extraordinary logical media, which shall however be of the same nature as the unavailable ones, will be used. Similarly, when these extraordinary logical media are exceptionally unavailable, other physical and logical media (magnetic or other) will be used for the transmission of data evidencing documents, provided that they do not modify the nature of these data.

6. GENERAL RULES OF PROCEDURE OF THE BANCO DE ESPAÑA SETTLEMENT SERVICE AND THE SPANISH PUBLIC DEBT BOOK-ENTRY SYSTEM

Law 41/1999 of 12 November 1999 (15) on payment and securities settlement systems incorporated into Spanish legislation the requirements laid down in Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems, which basically aims at contributing to the efficient operation of cross-border payment and securities settlement arrangements in the EU by harmonising the laws of Member States. Furthermore, Law 41/1999 required designated payment and securities settlement systems to publish their general rules of procedure and membership in the Official State Gazette (BOE).

In relation to the two designated systems operated by the BE, i.e. the *Banco de España Settlement Service (Servicio de Liquidación del Banco de España – SLBE)* and the *Spanish Public Debt Book-Entry System (Central de Anotaciones del Mercado de Deuda Pública),* most of the requirements set out in the said law had already been published in previous provisions (16). A few pending aspects were recently regulated by *BE Circular 3/2000 of 31 May 2000* (BOE of 12 June 2000).

First, BE Circular 11/1998 of 23 December 1998 on the SLBE and BE Circular 16/1987 of 19 May 1987 (17) on public debt book entry are amended. Such amendments are intended to specify the moment when, in each of the aforementioned systems, transfer orders (of cash or securities, respectively) are considered to have been accepted and received, as provided for in Law 41/1999 with respect to the validity and finality of transfer orders and to the effects on transfer orders and netting.

Second, BE Circular 3/2000 introduces in the foregoing circulars the requirement laid down in Law 41/1999 that no transfer order by a participant that is subject to insolvency proceedings shall be accepted once the system is aware of the opening of such proceedings.

Finally, the new circular amends BE Circular 5/1990 of 28 March 1990 to make more flexible the holding of cash accounts with the BE, which may now be opened in exceptional cases, duly justified on technical grounds.

(12) See "Regulación financiera: tercer trimestre de 1991", in *Boletín económico,* Banco de España, October 1991, pp. 53 and 54.

(13) See "Regulación financiera: segundo trimestre de 1995", in *Boletín económico,* Banco de España, July-August 1995, p. 107.

(14) See "Financial regulation: first quarter of 1998", in *Economic Bulletin,* Banco de España, April 1998, pp. 104 and 105.

(15) See "Financial regulation: fourth quarter of 1999", in *Economic Bulletin,* Banco de España, January 2000, pp. 103 and 104.

(16) See, inter alia, BE Circular 5/1990 of 28 March 1990 (BOE of 23 April 1990), regulating the Money Market Telephone Service *(Servicio Telefónico del Mercado de Dinero),* as amended; BE Circular 11/1998 of 23 December 1998 (BOE of 30 December 1998) on the Banco de España Settlement Service; BE Circular 16/1987 of 19 May 1987 (BOE of 1 June 1987) on public debt book entry, as amended.

(17) See "Regulación financiera: segundo trimestre de 1987", in *Boletín económico,* Banco de España, July-August 1987, pp. 46-48.

7. BASIC RULES OF PROCEDURE OF THE SPANISH INTERBANK PAYMENT SERVICE

The creation of the SNCE by Royal Decree 1369/1987 of 18 September 1987 was an important step in the modernisation of the payment system, which was provided with the infrastructure required to meet the demand for smooth transactions and their immediate finality on the national market. Since clearing houses are expected to disappear progressively on a voluntary basis or to be reorganised by their members as a result of the rapid expansion of electronic processes, the Ministerial Order of 26 February 1996 (18) simplified the administrative procedure to which they were subject. Moreover, the documents cleared in the traditional clearing houses are a minor portion of those cleared through current electronic systems. The special nature of these documents, which are difficult to shift to electronic systems, has led institutions to design a procedure, called the Single Clearing House System, which is in accordance with the requirements of the aforementioned Ministerial Order of 6 February 1996 and has been approved by the Banco de España.

The *Resolution of 19 May 2000* (BOE of 30 June 2000), recently published by the Executive Commission of the Banco de España, approves the basic rules of procedure of the Spanish Interbank Payment Service *(Servicio Español de Pagos Interbancarios – SEPI),* currently operated by the Madrid Banking Clearing House.

The function of the SEPI is to ensure the exchange, netting and settlement of payment orders in euro or in any other currency, as may be required. The SEPI also provides control mechanisms to monitor default risk, settlement being ensured even in the event that the participant with the largest debit position fails to settle its end-of-day debit obligations.

The resolution includes, among others, the following sections:

— Conditions for participation in the SEPI as direct or indirect participants. Direct participants participate in the exchange of payment orders with the other direct participants and in the netting and settlement of such orders in accounts held with the Banco de España. Indirect participants participate in the exchange, netting and settlement of payment orders through a direct participant, which represents them for all purposes.

— Minimum settlement capacity. To be allowed to participate in the SEPI as direct participants, entities are required to be granted bilateral credit lines by at least 50 % of the other direct participants, for a minimum amount of EUR 600,000 per line.

— Collateral security. Direct participants shall provide collateral security to the clearing house to guarantee the settlement of both their multilateral debit position (defined in the operating instructions) and their additional settlement commitment.

— Daily settlement rules. Inter alia, opening hours, settlement and collateral provision procedure, realisation of securities provided as collateral and additional settlement commitment.

— Irrevocable payment orders.

— Obligations and liability of both direct and indirect participants and the clearing house.

Finally, mention should be made of the creation, within the clearing house, of a monitoring committee of experts appointed by the executive board and in charge of ensuring compliance with the basic rules and operating instructions.

8. AMENDMENT OF ACCOUNTING RULES FOR CREDIT INSTITUTIONS

BE Circular 4/1991 of 14 June 1991 (19) setting out the accounting rules and financial statement formats for credit institutions has frequently been amended to incorporate the changes which have affected the credit system. One of the latest amendments was made by BE Circular 9/1999 of 17 December 1999 (20), which introduced new coverage standards for the recognition and prevention of potential medium and long-term default risk. Specifically, BE Circular 9/1999 incorporated into the treatment of loan losses a provision for the statistical coverage of such losses, to be set up by charging to the profit and loss account of each financial year the positive difference between the statistical estimate of overall latent loan lasses in the various homogeneous risk portfolios and the *net provisions* for loan losses already realised as a result of default or other reasons. For the purposes of this Circular, net provisions for loan losses

(18) See "Regulación financiera: primer trimestre de 1996", in *Boletín económico,* Banco de España, April 1996, p.131.

(19) See "Regulación financiera: segundo trimestre de 1991", *Boletín económico,* Banco de España, July-August 1991, pp. 58-60.

(20) See "Financial regulation: fourth quarter of 1999", in *Economic Bulletin,* Banco de España, January 2000, pp. 101 and 102.

meant the difference between provisions for loan losses (specific and general coverage) plus writing-off of bad debts less recovery from the provision for loan losses (specific and general coverage) and recovered written-off assets.

BE Circular 4/2000 of 28 June 2000 (BOE of 1 July 2000) has recently specified the conceptual definition of net provisions, excluding changes in the general coverage from their calculation.

9. AMENDMENT OF SOLVENCY STANDARDS FOR FINANCIAL INSTITUTIONS

Law 13/1992 of 1 June 1992 (21) on own funds and supervision on a consolidated basis incorporated into Spanish legislation the requirements laid down in the Community Directives on own funds and solvency ratio. However, the scope of these directives was extended to other groups of financial institutions – securities dealer companies and agencies and insurance companies –, giving a homogeneous treatment to all of them. The aforementioned law was first implemented by Royal Decree 1343/1992 of 6 November 1992 (22), which gave a special treatment to three types of financial institutions: credit institutions, securities dealer companies and agencies and insurance companies, and their respective groups. Subsequently, the Orders of 30 December 1992 (23) and 29 December 1992 (24) implemented and specified capital requirements for credit institutions and their groups and securities dealer companies and agencies, respectively.

To enable Spanish financial institutions to compete in the euro area, Spanish legislation should not impose on them heavier burdens than those imposed on their Community counterparts.

The *Ministerial Order of 13 April 2000* (BOE of 26 April 2000), amending the Ministerial Order of 29 December 1992 on the own funds and supervision on a consolidated basis of securities dealer companies and agencies and their groups and the Ministerial Order of 30 December 1992 on solvency standards for credit institutions, was published to this end.

(21) See "Regulación financiera: segundo trimestre de 1992", in *Boletín económico,* Banco de España, July-August 1992, pp. 82-86.

(22) See "Regulación financiera: cuarto trimestre de 1992", in *Boletín económico,* Banco de España, January 1993, pp. 65-71.

(23) See Footnote 22.

(24) See Footnote 22.

The Ministerial Order of 13 April 2000 transposes Directive 98/32/EC of 22 June 1998 (25), amending Directive 89/647/EEC on a solvency ratio for credit institutions, which allows supervisors to apply a 50 % weighting to securities backed by mortgages on property. This weighting is already applied to Spanish mortgage securitisation bonds. However, the range of eligible assets should be extended in compliance with the directive, so as to include, in particular, securities fully and directly backed by a pool of mortgages, which are in turn secured by a first mortgage on property, provided that the creditor's right associated with the securities is not of a subordinated nature with respect to other creditors of the issuer.

The foregoing Ministerial Order amends, in accordance with Community legislation, the weighting of mortgage bonds, which is lowered from 20 % to 10 %, owing to the high credit standard of these instruments. The treatment of these mortgage bonds is also improved in respect of the regulation of large exposures and specific trading portfolio risk. The 10 % weighting includes bonds issued by credit institutions authorised in the EU, to which the said weighting is applied by home supervisors.

The Ministerial Order also improves the treatment of asset securitisation regulated by Royal Decree 926/1998 of 14 May 1998 (26). Thus, bonds issued by asset securitisation funds, whose repayment is not subordinated to that of other bonds issued by the fund or of loans extended to the fund by credit institutions, will be given the weighting applied to the asset with the higher weighting in the fund.

Furthermore, risks secured by mutual guarantee companies are granted a treatment similar to that given to risks secured by credit institutions, i.e. a 20 % weighting. This is due to the fact that Law 1/1994 of 11 March 1994 (27) on the legal regime of mutual guarantee companies regulates the supervision of these institutions in a similar way to that of credit institutions. Therefore, the credit standard of the counterparty which issues the guarantee is similar to that of credit institutions.

Finally, in line with the changes in Community legislation, the period during which property

(25) See "Financial regulation: third quarter of 1998", in *Economic Bulletin,* Banco de España, October 1998, pp. 75 and 76.

(26) See "Financial regulation: second quarter of 1998", in *Economic Bulletin,* Banco de España, July-August 1998, pp. 86-88.

(27) See "Regulación financiera: primer trimestre de 1994", in *Boletín económico,* Banco de España, April 1994, pp. 98 and 99.

leasing transactions concerning assets for public-service use are applied a 50 % weighting is extended from 31-12-2000 to 31-12-2006.

10. STATE DEBT: CHANGES IN THE REGULATIONS FOR "MARKET MAKERS" AND "DEALER ENTITIES"

A resolution of the Banco de España Executive Commission dated 19 January 1988 established the status of market maker *(creador de mercado)* and specified the requirements for acquiring and retaining such status, as well as the relations between market makers and the Banco de España.

These requirements have been revised on a fairly regular basis by various ministerial orders (28). The most recent is the Ministerial Order of 10 February 1999 (29), which was implemented by the Resolutions of the Directorate General of the Treasury and Financial Policy (DGTPF) of 11 February 1999 (30) and of 4 March 1999 (31). It laid down the basic principles for the regulation of Spanish government debt market makers and dealer entities *(entidades negociantes),* as well as the procedure for acquiring such status, the rights and obligations inherent thereto, the criteria for assessing their activity and the circumstances that give rise to the loss of such status or of some of their rights.

The introduction of the single currency, by reducing the differences between the national markets for euro-denominated government bonds, has made the products issued by the Treasuries of the euro area more substitutable one for another. To compete in this new environment it is necessary to have a group of institutions committed to the liquidity of the government bond market. Also, the growing importance of electronic platforms in the trading of fixed-income securities has made it necessary to redefine the conditions under which the entities that work with the Treasury to ensure the liquidity of the secondary market operate.

These two needs have given rise to two *DGTPF Resolutions of 10 April 2000* (BOE of 18 April 2000), which amend the Resolutions of 11 February 1999 and of 4 March 1999, respectively.

With regard to access to second rounds, a system of incentives has been created for the most active *market makers.* In general, each market maker may obtain in the second round the maximum amount resulting from applying their percentage shares in the allotments of the last two auctions. However, the Treasury shall be entitled in each auction to increase by 20 % the percentage shares of those market makers who, according to the monthly assessment, were most active during the period preceding the auction.

As regards their obligations, market makers shall continue to ensure secondary market liquidity, but the specific conditions under which they shall quote certain issues of government bonds chosen as benchmarks (32) are amended. As well as establishing maximum bid-offer spreads they shall also specify minimum volumes. The conditions for the obligatory quotation of four series of non-benchmark government bonds are also amended. There is also a new obligation to quote, in accordance with the maximum bid-offer spread and minimum volume conditions specified in the resolution, two government bond strips and, in addition, two further issues which may be either strips or bonds with residual maturities of more than five years. Likewise, they shall continue to quote the MEFF 10-year notional bond contract with a maximum bid-offer spread of 10 ticks and minimum amounts of 40 contracts for each position. Those market makers who, for technical reasons, are unable to quote the MEFF notional bond future, shall instead quote an amount of the ten-year benchmark bond equivalent to the said 40 contracts. Finally, there is a new obligation to ensure through their actions the smooth working of the market, respecting the operational obligations that may be established. Specifically, they shall take such measures as are necessary to ensure the maintenance of complete separation of the operations of members of the electronic dealing system and third parties.

Finally, the areas of activity to be considered by the Treasury in its monthly assessment of market makers have been widened, and the circumstances established in the Resolution of 11 February 1999 for loss of market maker status are tightened.

As regards government debt *dealer entities*, they shall no longer have exclusive access to

(28) The Ministerial Order of 24 July 1991, partially amended by the Ministerial Order of 29 March 1994, which defined their functions and the content of the obligations and rights inherent to their status, and the Ministerial Order of 19 June 1997 which regulated the stripping and reconstituting of government bonds and empowered the Treasury to authorise specific market-makers to undertake stripping and reconstituting operations, provided that they undertook to meet the requirements laid down by the Treasury.

(29) See "Financial Regulation: first quarter of 1999", in *Economic Bulletin,* Banco de España, April 1999, pp. 60-62.

(30) The Resolution of 11 February 1999 was subsequently amended by another DGTPF Resolution of 23 July 1999.

(31) See Footnote 29.

(32) Standard bond benchmark.

the Network of Book-Entry Government Debt Inter-Dealer Brokers, which shall in future be known as INFOMEDAS (33). However, the possibility of acquiring the status of market maker in the way and on the conditions established previously for the latter is maintained.

The obligations established in the Resolution of 4 March 1999 are partially amended and new ones are added. As regards the former, the increase in the requirement for the share of dealer entities in monthly INFOMEDAS dealing, which rises from 1 % to 2 % of total turnover, should be noted. For the purposes of compliance with this obligation, the trading of government bonds on other electronic platforms determined by the Treasury may also now be taken into consideration.

With reference to the new obligations, they shall provide such information as the Treasury may request on the government debt market in general and the activity of the dealer entity in particular, as well as ensuring the smooth operation of the market, respecting the operating conditions that may be established. Finally, the Treasury shall assess monthly the compliance of dealer entities with their obligations, anticipating that in exceptional market circumstances it may exempt them from complying with some of these obligations.

11. SECURITIES MARKET: PROSPECTUSES FOR ATYPICAL FINANCIAL CONTRACTS

Law 37/1998 of 16 November 1998 (34) to reform Securities Market Law 24/1998 of 28 July 1998 (35) extended its scope of application to include, in addition to negotiable securities issued by public and private-sector individuals and entities, several financial instruments. The rules laid down in this law for negotiable securities were, with the necessary modifications, to be applicable to such instruments.

Recently, credit institutions have been entering into financial contracts with investors with diverse economic and legal characteristics. Many of these contracts have linked the funds raised to the performance of one or more listed securities or of an index. While this extends merely to the remuneration of such funds, then the transactions are deposits with variable remuneration, but when credit institutions do not agree to full and unconditional repayment of the principal, this also being linked to the performance of the price of the securities, the transaction cannot be so clearly classified as a deposit. It may instead resemble the sale of a financial derivative instrument and require instruments for investor protection similar to those applied to the latter. It has also been shown that the standard forms established for prospectuses for negotiable securities, in general, are hardly appropriate for such products, which means that it is necessary to regulate a new standard form better adapted to their characteristics and to the type of investor to whom they are offered.

Meanwhile, Royal Decree 2590/1998 of 7 December 1998 (36), which amended Royal Decree 291/1992 of 27 March 1992 (37) on issues and public offerings of securities, introduced important changes into the regulation of public offerings and issues of securities. Inter alia, it authorised the CNMV to approve the standard forms for prospectuses in accordance with the particular characteristics of the issuer, of the amounts of the issue concerned or of the securities in question. Pursuant to this authorisation, CNMV Circular 2/1999 of 22 April 1999 (38), amended certain types of prospectus that are currently regulated to adapt them to the special characteristics of the issues.

Recently, the CNMV has published *CNMV Circular 3/2000 of 30 May 2000* (BOE of 13 June 2000) which amends CNMV Circular 2/1999 in order to introduce the standard form for prospectuses for atypical financial contracts. The Circular defines them as contracts that are not traded on organised secondary markets, under which the credit institution receives money or securities, or both, from their customers and assumes a repayment obligation consisting either of the delivery of such unlisted securities or the payment of a sum of money, or both, in accordance with the performance of the price of one or more securities or the performance of a stock index, without undertaking to repay the entire amount of the principal received.

Credit institutions which enter into atypical financial contracts with their customers shall be required to incorporate into the contract which

(33) The possibility remains open for other types of entity with special articles of association to operate in INFOMEDAS.

(34) See "Financial Regulation: fourth quarter of 1998", in *Economic Bulletin,* Banco de España, January 1999, pp. 90-98.

(35) See "Regulación financiera: tercer trimestre de 1988", in *Boletín económico,* Banco de España, October 1988, pp. 61-62.

(36) See Footnote 35.

(37) See "Regulación financiera: primer trimestre de 1992", in *Boletín ecónomico,* Banco de España, April 1992, pp. 70-72.

(38) See "Financial regulation: second quarter of 1999", in *Economic Bulletin,* Banco de España, July 1999, pp. 65-66.

they sign the text of the prospectus (form CFA1, which appears in the annex to the Circular) verified by the CNMV.

12. GENERAL CODE AND RULES OF CONDUCT FOR THE MANAGEMENT OF INVESTMENT PORTFOLIOS AND STANDARD FORMS FOR STANDARD MANAGEMENT AGREEMENTS

Securities Market Law 24/1988 of 28 July 1988 (39) included in its recitals the need to incorporate into Spanish law certain minimum rules of conduct for those operating in the securities markets, basically to defend the interests of investors and to safeguard market transparency at all times. These principles were implemented by Royal Decree 629/1993 of 3 May 1993 (40), on rules of conduct in securities markets and compulsory registrations, the purpose of which was to contribute to market transparency and to the protection of investors, establishing a general code of conduct to govern relations between entities operating in the market and their clients. It also gave the CNMV responsibility for verifying that the standard agreements regulating activities or operations in the securities market contain all the information required by current legislation.

Subsequently, the Ministerial Order of 7 October 1999 (41) adapted the general code and rules of conduct of Royal Decree 629/1993 to the particularities of investment portfolio management, in order to create a body of rules of conduct specifically designed to govern the relations between entities managing portfolios and their clients. In particular, it established that the relations between clients and their portfolio managers should be properly formalised through a standard portfolio management agreement, in accordance with the provisions of the Ministerial Order of 25 October 1995 (42). It also specified the minimum content of such agreements in greater detail than the said Ministerial Order. Further, it authorised the CNMV to develop the content of such agreements and in particular to approve the standard forms for standard agreements, as well as to establish deadlines for adapting those agreements entered into in the past.

Exercising this power, the CNMV has issued *CNMV Circular 2/2000 of 30 May 2000* (BOE of 13 June 2000), which establishes an optional standard form for standard contracts for the management of portfolios. At the same time, it took the opportunity to specify certain aspects of the minimum content of standard contracts for the deposit of financial assets and of the filing of the supporting documentation for specific orders received from clients with portfolio management agreements. Finally, the Circular establishes the requirements that must be met by global accounts ("omnibus" accounts) for their use in portfolio management activity.

The entities can adopt as their standard portfolio management agreement the *standard form* annexed to the Circular, in which case they must send the CNMV a letter certifying that the entity has adopted said standard form. Otherwise, the agreements drawn up by the entities shall contain at least the points required in the regulatory provisions in force from time to time. In all cases they shall specifically state whether or not the content chosen by the entity is in line with the standard form approved by the CNMV. The text of the standard form is the minimum content of such standard agreements.

The accounts for securities and financial instruments and for cash subject to the management shall be identified in the clauses of the standard agreement or else in its annexes. The deposit or recording of such assets shall be carried out in individual accounts opened in the name of the client, either directly by the client or through the management entity under a specific power of attorney. Cash accounts must be opened at a credit institution. However, in the case of temporary vehicle credit accounts, they may also be opened with securities-dealer companies and securities agencies.

Finally the acquisition or disposal of securities or financial instruments on behalf of clients may be recorded in *global accounts* ("omnibus" accounts) when the entity operates in foreign markets in which normal practice requires the use of global accounts for securities or financial instruments for all the clients of each entity. Before opening global accounts, entities must fulfil the following requirements: *a)* the control unit of the management entity shall issue, for each financial institution with which it is intended to open an account, a report on its credit rating and its risks; *b)* the own account of the entity

(39) See Footnote 36

(40) See "Regulación financiera: segundo trimestre de 1993", in *Boletín ecónomico,* Banco de España, July 1993, pp. 105-106.

(41) See "Financial regulation: fourth quarter of 1999", in *Economic Bulletin,* Banco de España, January 2000, pp. 107-108.

(42) This ministerial order partly implemented Royal Decree 629/1993 of 3 May 1993 on rules of conduct in securities markets and compulsory registrations, and established the system of tariffs to be applied by the entities to their clients, the rules they must respect on making available to their clients securities and funds corresponding to the transactions executed, as well as the delivery of the relevant contractual documentation.

and that of third parties shall be completely separate, with no possibility of the positions of the entity and of its clients being recorded in the same account; *c)* the entity shall establish an internal procedure enabling the position of each client to be individually ascertained; *d)* it shall be necessary to obtain the written authorisation of each client, informing them of the risks they assume as a consequence of the operations, as well as of the identity and credit rating of the financial institution acting as depository for the global accounts.

13. URGENT MEASURES TO STIMULATE HOUSEHOLD SAVING, SMALL AND MEDIUM-SIZED BUSINESSES AND COMPETITION, AND MEASURES TO LIBERALISE CERTAIN SECTORS

For the purpose of ensuring stable economic growth and forestalling possible upsurges in inflation, several royal legislative decrees have been promulgated. These approve a package of liberalising and competition-enhancing measures that affect certain sectors as well as a series of fiscal measures to favour household saving.

There follows a brief account of the most important aspects of those measures of a financial and fiscal nature, that are contained in *Royal Legislative Decree 3/2000 of 23 June 2000* (BOE of 24 June 2000), to approve a package of urgent fiscal measures to stimulate small and medium-sized businesses and in *Royal Legislative Decree 6/2000 of 23 June 2000* (BOE of 24 June 2000) on urgent measures to strengthen competition in goods and service markets (43).

13.1. Financial system

In the financial sphere, transparency has been increased in prospectuses relating to the execution of *mortgage loans* to private individuals for the acquisition of housing, to give borrowers the right to participate in the designation of the agents involved in the operation. Credit and other financial institutions shall thus state in the prospectus the right of the borrower to designate, with the agreement of the lender, the person or entity that is to carry out the appraisal of the property to be mortgaged, the person or entity that will be responsible for the administration of the operation, as well as, if applicable, the insurance company which, is going to cover the contingencies that the lender requires to be covered for execution of the loan.

13.2. Collective investment

With regard to *mutual funds,* in view of the sharp fall in interest rates and the reduction in the range of currencies in which assets are denominated, the ceilings for management fees have been reduced.

As regards *pension funds,* first, the general limits for deducting contributions to pension schemes from the tax base are raised, as are those applicable in the case of elderly and disabled contributors. Specifically, the general limits have been increased from ESP 1,100,000 to ESP 1,200,000, and from 20 % to 25 % of net income from employment and from economic activities. In the case of the elderly, the contribution ceilings are raised by ESP 300,000 and 20 percentage points, to stand at ESP 2,500,000 and 40 % of income, respectively. Finally, in the case of the disabled, the absolute limit is raised by ESP 300,000, to stand at ESP 2,500,000.

Second, the tax regime for pension schemes has been extended to spouses who work at home. The measure incorporated into the decree entails a favouring of household saving and responds to a currently existing social demand. With this amendment, up to ESP 300,000 per annum of contributions made to pension schemes in the name of spouses with earnings from employment and economic activities of less than ESP 1,200,000 can be deducted from the tax base of the other spouse.

Finally, in addition to the improvements in the tax regime for pension schemes, the taxation of payments under *life assurance* is also improved, with an increase in the reducing coefficients that are applied to determine the relevant net income.

13.3. Changes to personal income tax

With regard to *personal income tax,* the tax treatment of capital gains and losses has been improved. First, those arising from the transfer of assets acquired more than one year previously are included in the special part of the tax base, which involves a reduction in the two-year period hitherto in force. At the same time, the rate of tax applicable to this type of income is reduced from 20 % to 18 %, which brings it into line with the lower rate at which tax is charged on the general part of the tax base. Second,

(43) For further details of the rest of the urgent measures adopted which affect, inter alia, small and medium-sized businesses, the property and transport sectors, spending on pharmaceutical products, goods and services markets, the telecommunications sector, see Boxes 1 and 2 of the "Quarterly report on the Spanish economy" in this bulletin.

and consistent with the new tax rate, the withholding applicable to income obtained as a consequence of transfers or redemptions of shares or other holdings in portfolio investment institutions is reduced from 20 % to 18 %. Third, in order to complete the reform of personal income tax with respect to the treatment of habitual dwellings and taking into account the complementary nature that their treatment should have under the wealth tax, the taxpayer's habitual dwelling is exempt from this latter tax, at least insofar as its tax value does not exceed ESP 25,000,000. Finally, the tax regime for securities loans is established under personal income tax and corporate income tax, in order to facilitate these operations in Spanish financial markets.

14. TAX ON THE INCOME OF NON-RESIDENTS: PROCEDURE TO MAKE WITHHOLDINGS OR TO ESTABLISH EXEMPTION

Law 41/1998 of 9 December 1998 on the income of non-residents and tax provisions, regulated the taxation of non-residents under income taxes in one single text. The law determined the persons obliged to make withholdings and payments on account, with respect to the income subject to this tax, indicating their limits or, where applicable, the rules established in an applicable convention for the avoidance of double taxation.

The current system of withholdings and payments on account requires that, in the payment of interest or dividends arising from the issuance of negotiable securities, the withholder must know the status of the recipient as a taxpayer of the tax on the income of non-residents owing to the receipt of income without having a permanent establishment, as well as, where applicable, the recipient's country of residence for tax purposes, in order either to effect the withholding or payment on account of interest and dividends, or to establish their exemption owing to their treatment as exempt income. However, the fact that negotiable securities are generally deposited with certain financial institutions gives rise to practical problems in applying withholdings, since the withholder-issuer makes the income payments to the depository financial institutions, so that the latter may, in turn, pay the holders of the securities, without the issuer knowing the status of the final recipients or their country of residence.

A *Ministerial Order of 13 April 2000* (BOE of 18 April 2000) has been published to overcome these problems. It establishes a procedure for making withholdings at the rate applicable in each case, or for establishing exemption from withholdings, in respect of interest or dividends arising from negotiable securities, obtained without a permanent establishment by taxpayers of the tax on the income of non-residents, when financial institutions domiciled, resident or represented in Spain are involved in the payment process, whether as depositories or as managers of the receipt of the income on such securities. Interest on government securities is excluded from the scope of application of this Order, as it is subject instead to a different procedure with a similar purpose.

The procedure for establishing exemption from withholding, or for making the withholding at a reduced rate owing to application of the limits on taxation established in conventions for the avoidance of double taxation signed by Spain, shall comply with certain requirements. The issuer shall transfer to the depository on each interest payment date or at the time of distribution of the dividends the net amount resulting from application of the general withholding rate in force under personal income tax and corporate income tax rules (currently 18 %). Before the 10th day of the month following the month in which the coupon matured or the dividend was paid, the depository shall submit to the issuer a list of the holders who are taxpayers under the tax on the income of non-residents owing to their receipt of income in Spain without a permanent establishment. This list shall include certain information, such as the Taxpayer Identification Number *(NIF)* of the holder of the securities, the country code of the holder's tax residence and the excess percentage and amount withheld for each holder. As soon as the issuer has received the list of holders, it shall transfer to the depository the amounts withheld from the taxpayers entitled to exemption from withholding or the amounts withheld in excees of the taxation limits established in the respective conventions. Finally, the depository shall pay these amounts to the taxpayers concerned forthwith.

To evidence their tax residence, the said holders shall present a certificate issued by the tax authorities of their country of residence evidencing the reasons for exemption from withholding, either through the application of Spanish domestic law or of a particular convention.

Likewise, similar requirements must be fulfilled with respect to the procedure to carry out the withholding at the general rate of article 24.1.*a)* of Law 41/1998 (set at 25 %), when the issuer entity has initially made the withholding at the general rate under personal income tax and corporate income tax.

10.7.2000.

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