1. Overview

The high year-on-year growth rate of the Spanish economy eased in 2000 Q3. In the first six months of the year the real rate of GDP held stable at 4.2 %, the result of a modest slowdown in national demand combining with more favourable – albeit still negative – net external balance figures. Now the latest data generally show the growth of domestic spending to be slackening, without any discernible significant changes in the contribution of external demand. The external environment continues to be favourable, although greater uncertainty associated with the volatility of stock and foreign exchange markets and with the persistence of high crude oil prices is apparent. The expansionary climate in the euro area has firmed, while the growth of consumer prices has rebounded, essentially as a result of the rises in the energy component. Against this background, the European Central Bank (ECB) has continued gradually raising its interest rates.

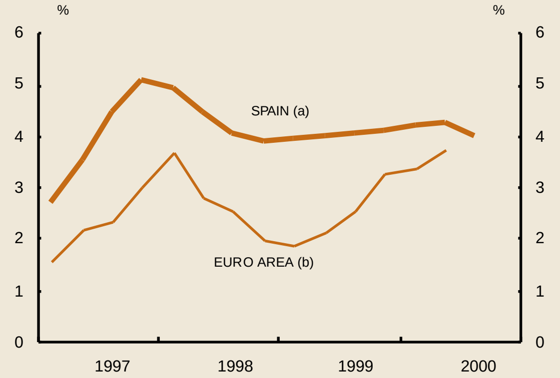
With the usual caveats, real GDP growth in the Spanish economy in 2000 Q3 is estimated to have run at around 4 % on a year earlier, with national demand slightly below 4.5 % (4.8 % on average in the first half of the year) and a negative contribution of net external demand of about half a percentage point, similar to that of the previous quarter. Exports of goods and services slowed, for their part, due above all to tourism results in the summer months, while the growth rate of imports progressively moved more into line with the somewhat less expansionary rate of final demand.

As Chart 1 shows, the real growth rate of the Spanish economy has been drawing closer throughout the year to that of the euro area as a whole. In Q2 (the latest data available) real GDP growth in the euro zone was 3.7 %, three-tenths of a point up on the previous quarter. The narrowing of the growth differential with the euro area should be interpreted as a logical consequence of the Spanish economy being ahead in the cycle; indeed, it is now in its fourth year of uninterrupted growth. The inflation gap, measured by the harmonised indices of consumer prices (HICP), has been fluctuating at around one percentage point since mid-1998 (see Chart 2). In September this difference was three-tenths of a point less than the previous month, owing basically to the fact that the acceleration in energy prices in the euro area as a whole was far higher than that in the Spanish economy.

Against this backdrop of economic growth and rising inflationary risks, the monetary policy stance implemented for the euro-11 countries has become increasingly tighter; the price of the euro on the markets weakened, only to improve

CHART 1

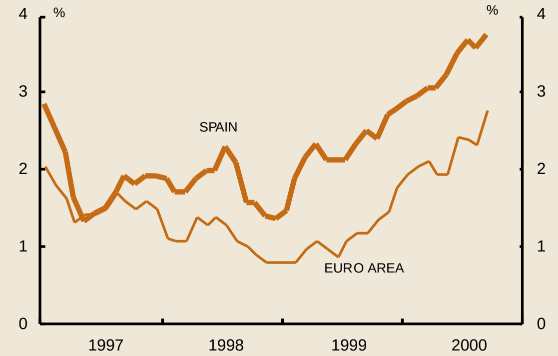
Gross domestic product



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.

subsequently. Fiscal policy in the area continues to benefit from the expansionary climate, without any additional spending-containment drive generally being discernible. In the case of the Spanish economy, the initial estimates for the close of the year 2000 accompanying the presentation of the draft State budget for 2001 assume an overall general government deficit of 0.4 % of GDP, notably lower than scheduled, as a step towards achieving a balanced budget in the coming year (see Box 1). That said, the favourable course of the budget outturn has subsequently meant that the final announced result could be one-tenth of a point lower.

As indicated, the data on developments in the international environment during 2000 Q3 confirm that high growth rates have continued to be posted in most areas. And to date, no significant impact of the rise in oil prices on activity has been appreciable. The price of crude oil, which appeared to have eased at the beginning of the spring, then underwent a fresh rise to the point of exceeding USD 30 per barrel in recent months. In the case of the US economy, this markedly prolonged expansionary climate is not generating substantial inflationary pressures thanks – among other factors – to high productivity growth. In south-east Asia and Latin America, recent developments have generally been favourable and are contributing significantly to the increase in world trade.

As stated, real GDP growth in the euro area in 2000 Q2 was 3.7 %. Chiefly influential here were the expansionary effect of consumer spending and the flatness of investment, there having been no further increases in the positive momentum provided by external demand. As to consumer prices, the September figure of 2.8 % for the HICP is unprecedented since the start of monetary union and is essentially due, as indicated, to the rise in energy prices. On a lesser scale, so far, are the indirect effects seemingly apparent in the other components. Admittedly, the persistence of high oil prices on international markets (far beyond what was initially expected) has meant a deterioration in inflationary expectations. But wage restraint in most euro area countries and the consequent containment of the growth rate of unit labour costs (to which the observed growth of productivity is also contributing) will, if sustained, allow price growth to slacken and provide for a prompt slowdown in the inflation rate, to which the progressively tighter monetary policy stance implemented by the ECB over the past year will also contribute. Specifically, on both 31st August and 5th October the General Council of the ECB raised its reference interest rate by 25 basis points, taking it to 4.75 % on the latter occasion. Although the weakness of the euro on foreign exchange markets has remained – with few exceptions – the keynote of recent months, the area-wide monetary and credit aggregates are now showing incipient signs of a slowdown when compared with the values recorded in Q2.

The gradual change in monetary conditions in the area can also be seen in the variables of the Spanish economy, although the scope thereof remains limited to date (see Chart 4). The liquid financial assets of the non-financial private sector continue to grow at moderate rates, notably down on those of financing received. Nonetheless, there are some – as yet insufficient – signs that the growth of liabilities is moderating, while there is greater buoyancy on

BOX 1

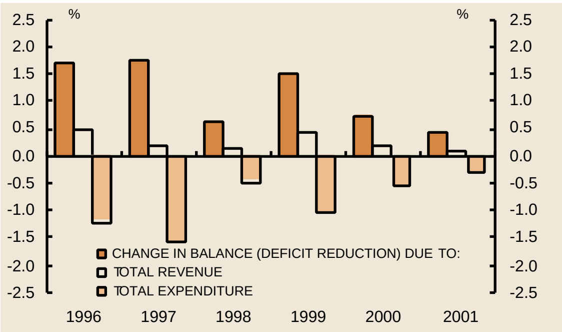
Draft State Budget for 2001

The draft Budget is based on a macroeconomic scenario in which the pace of growth of the Spanish economy is moderating gradually, reaching a real GDP growth rate of 3.6 % for next year as a whole compared with the figure of 4.1 % forecast for the current year. The slowdown in domestic demand lies behind the lesser growth of GDP.

Using National Accounts methodology, it is forecast that the budgetary figures will take the balance of general government non-financial transactions into equilibrium in 2001, after an estimated deficit of 0.4 % of GDP for the year 2000. In relation to the objectives of the Updated Stability Programme, this means bringing the attainment of a balanced budget forward one year, although the scheduled cut in the deficit for 2001 in the draft Budget is similar to that included in this Programme. Indeed, in this latter case the starting point was a higher forecast deficit in 2000 (0.8 % of GDP). In terms of the various agents, the main improvement will be in the State accounts, with a reduction in the deficit of three-tenths of a point to 0.3 % of GDP in 2001. Territorial governments will see a reduction in their debit balance of one-tenth of a point of GDP, and will run a balanced budget. And the Social Security system will, for the third consecutive year, run an estimated surplus of 0.3 % (see adjoining table).

The budgetary figures for the State foresee rates of increase of 9 % in revenue (7.4 % in 2000) and of 4.5 % in expenditure (4.8 % in 2000). Overall, a deficit of ESP 241 billion is targeted, entailing a 77 % reduction in relation to the previous year's budget. Nonetheless, the estimated growth for revenue and expenditure in 2001 falls substantially to 4.7 % and 2.5 %, respectively, when the comparison is made in terms of the official latest estimates for the year 2000 (see section 4.4 of this Report). In the case of revenue, the slowdown forecast for 2001 is due to the estimated moderation of the receipts from various taxes, in a scenario in which the growth rate of activity and employment will be lower and in which charges and excise duties will be frozen. In this context, the biggest boost to revenue will stem from the revision of the rate charged on access to the public domain radioelectric spectrum. On the expenditure side, the lower growth rates in 2001 are attributable to the containment of current expenditure (mainly in State overheads and in interest payments), while a significant acceleration is foreseen in capital expenditure. Notable in connection with spending policies is the scheduled growth above nominal GDP in Justice, Law and Order, Welfare Benefits, Health, Education, Infrastructure and Research, areas the government has stated it will prioritise.

Breakdown of the change in the general government deficit



Net Lending/Net Borrowing (% GDP)

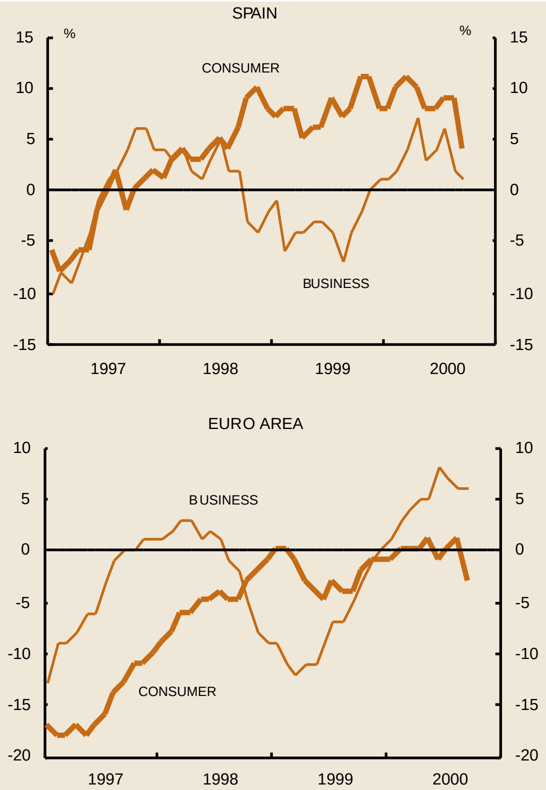
	1995	1996	1997	1998	1999	2000	2001
Gen. gov.	**-6.6**	**-4.9**	**-3.2**	**-2.6**	**-1.1**	**-0.4**	**0.0**
Central gov.	-5.7	-3.9	-2.7	-2.1	-1.1	-0.6	-0.3
Soc. sec. syst.	-0.3	-0.4	-0.2	-0.1	0.2	0.3	0.3
Territorial gov.	-0.7	-0.6	-0.3	-0.2	-0.2	-0.1	0.0
MEMORANDUM ITEM:							
Stability Programme (b)							
Gen.gov. balance					-1.3	-0.8	-0.4
Central gov.					-1.1	-0.8	-0.5
Soc. sec. syst.					0.0	0.1	0.1
Territorial gov.					-0.2	-0.1	0.0

Sources: Ministerio de Hacienda and Banco de España.
(a) Draft State budget for 2001.
(b) Updated programme (January 2000).

In sum, the official target for 2001 entails a fresh cut in the general government deficit, albeit one on a lesser scale than in previous years. This reduction, against a background of economic expansion, will continue to be underpinned by a positive contribution of public revenue and by the containment of expenditure (see adjoining chart). In this respect, the main risk contained in these forecasts would arise from a more unfavourable international setting that were to lead to a sharper slowdown in domestic economic activity. However, the budgetary figures for 2001 present a balanced budget position which is feasible, given the economic forecasts available, and which marks a significant step forward in respect of the commitments made under the Stability and Growth Pact. Public finances in Spain, as in most European countries, face a series of challenges in the medium term which will require mechanisms to be set in place that can secure in a durable fashion this equilibrium position and ensure its sustainability. The challenges pose the need, acknowledged at the European Union level, to improve the quality of public finances (via selective reductions in the tax burden and changes in the composition of public spending) and to have sufficient leeway to fund growing expenditure in the face of the ageing of the population. In this connection it will be necessary to further progress in the control of expenditure and in fiscal discipline, making more restrictive use of authorised budgetary appropriations and securing the commitment of the various territorial governments vis-à-vis the balanced budget goal, in line with the measures in the planned Budgetary Stability Law, which will come into force in 2002.

CHART 3

Confidence indicators



Source: European Commission.

the asset side, which is consistent with the increase seen in interest rates. In this situation, the figures on the net financial position of non-financial private agents in Q2 were an extension of the pattern of the previous quarters. There was a fresh decline in corporate (negative) and household (positive) saving, to a historical low in the latter case. It is only the improvement in the general government balance which has checked the deterioration in the nation's net financial saving.

In this respect, the State budget outturn figures to September are in line with the scheduled path. In relation to the data for the first half of the year, the buoyancy of tax revenue can be seen to hinge to a greater extent on direct taxes (corporate income tax in particular) than on indirect taxes, where the growth rate of VAT receipts has slowed slightly. No relevant differences are discernible on the expenditure side.

External factors and economic policy decisions determined the environment in which economic activity in Spain unfolded during 2000 Q3. Although activity has been robust, there are signs of a slowdown in national demand. The main factors restraining growth, in addition to those proper to an economy that is ahead in the cycle, stem from the erosion in real income induced by the rise in oil prices (see Box 2). The very uncertainty inherent to this process (see Chart 3) and the influence of a necessarily more cautious monetary policy so as to address changes in the inflationary outlook would also have to be added to these factors.

Among the demand components, the slowdown in real private consumption is due, in addition to the above-mentioned factors (namely the slowdown in real disposable income and the rise in interest rates), to the petering out of the expansionary effect exerted on household spending by the strong gains in wealth built up in previous years. And the influence on the consumer-durables-spending indicators has been especially noticeable. In any event, the estimated real growth rate of household consumption in 2000 Q3 should be assessed taking into account the prolonged period of expansion of this aggregate, with rates well above 4 % since the second half of 1997; their level in the latest quarter, which may be slightly below 4 %, far outpaces the related euro-area figures for the preceding quarter. Some of the foregoing reasons may also be given in explaining household investment in housing, the expansionary cycle of which might have peaked. Public works, however, appears to be more buoyant, as a result of which the estimated growth for this aggregate may not differ significantly from the second-quarter figure. As to capital investment, the loss of momentum reflected by the revised QNA figures has been greater than expected. Although the business confidence indicators have worsened in recent months and there has been a slight squeeze on margins in some industries, the ongoing growth of final demand and the favourable conditions that companies are enjoying do not appear to warrant the continuation of this process, at least not with the intensity shown by the data released. Finally, the modest growth of government consumption in the summer months is expected to have increased.

As discussed earlier, no significant changes are expected in the contribution of net external demand to real GDP growth in 2000 Q3. The estimated slowdown for exports is derived basically from that recorded in tourist receipts during the summer campaign, and the associated contractionary effect will be offset by the lower growth of imports, in line with the trend of final demand. The growth of goods exports in the first seven months of the year (the period covered by the data available) remains the driving force of aggregate demand in the economy;

BOX 2

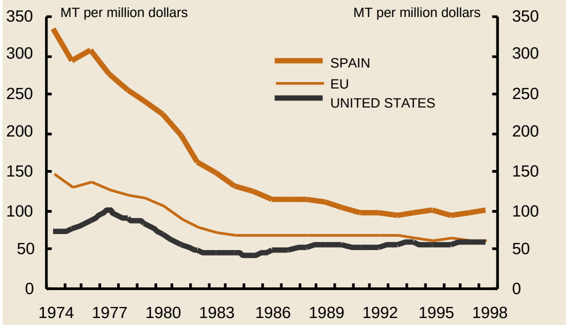
Energy dependence in the Spanish economy

In mid-1997 oil prices began to slow considerably. Faced with this situation, the OPEC countries decided to cut their oil production quotas. Against the background of a recovering world economy, this ultimately had substantial effects on the price of crude on international markets. The price of Brent oil climbed to USD32.5 per barrel on average in September, practically three times as much as the low of USD10.5 in February 1999. In addition, the course of the euro against the dollar has intensified the increase in crude import prices in the euro area countries. From a historical perspective, the rise in oil prices is on a scale similar to that observed during the second energy crisis in the late seventies.

The influence of a shock of this nature on economic growth and inflation is difficult to quantify. First, dearer oil prices prompt a deterioration in the terms of trade in oil-importing economies and, consequently, they worsen trade balances and raise the consumer prices of products derived from oil. The scale of this direct impact on the trade balance can vary substantially across economies, depending on the share of energy imports in total imports. As the adjoining table shows, in the case of the Spanish economy the weight of net energy imports has diminished appreciably in recent decades. This means that, although the rise in energy prices is on a scale similar to that of the late seventies, the impact on the trade balance is less. Indeed, according to the estimates made, the increase in the energy bill (which is equivalent to the increase in the trade deficit) might be close to 1.2 percentage points of GDP in the year 2000, while the impact of the crises in the seventies was, in both cases, close to 3 % of GDP. Moreover, again drawing on the accompanying table, this impact would be greater in Spain than in the European economies as a whole.

The direct impact on consumer prices in the various economies will depend on the weight of oil derivatives in the consumer basket and on other factors such as the existence of regulated prices, the influence of the indirect taxes applied to these products or the degree of competition among oil refining and distribution corporations. Applying the weights derived from the CPI structure, it has been estimated that the direct impact on Spanish consumer prices might amount to 0.9 percentage points in the year 2000.

Net oil imports per unit of GDP (a)



Net energy imports as % of total imports

	EU (b)	Spain
1970	7.2	10.5
1975	14.8	24.5
1980	15.7	36.1
1981	16.9	39.3
1985	12.0	28.6
1990	5.5	8.9
1991	5.3	8.9
1992	4.7	8.0
1993	4.5	8.7
1994	4.0	7.7
1995	3.6	6.8
1996	4.1	7.2
1997	3.9	6.8
1998	2.7	4.8
1999	2.8	5.0

Sources: International Energy Agency, OECD, Eurostat, Instituto Nacional de Estadística and Departamento de Aduanas.
(a) The GDP series have been converted into US dollars using the 1990 GDP purchasing power parities given in OECD publications.
(b) Pre-1990 data do not include Austria, Sweden and Finland.

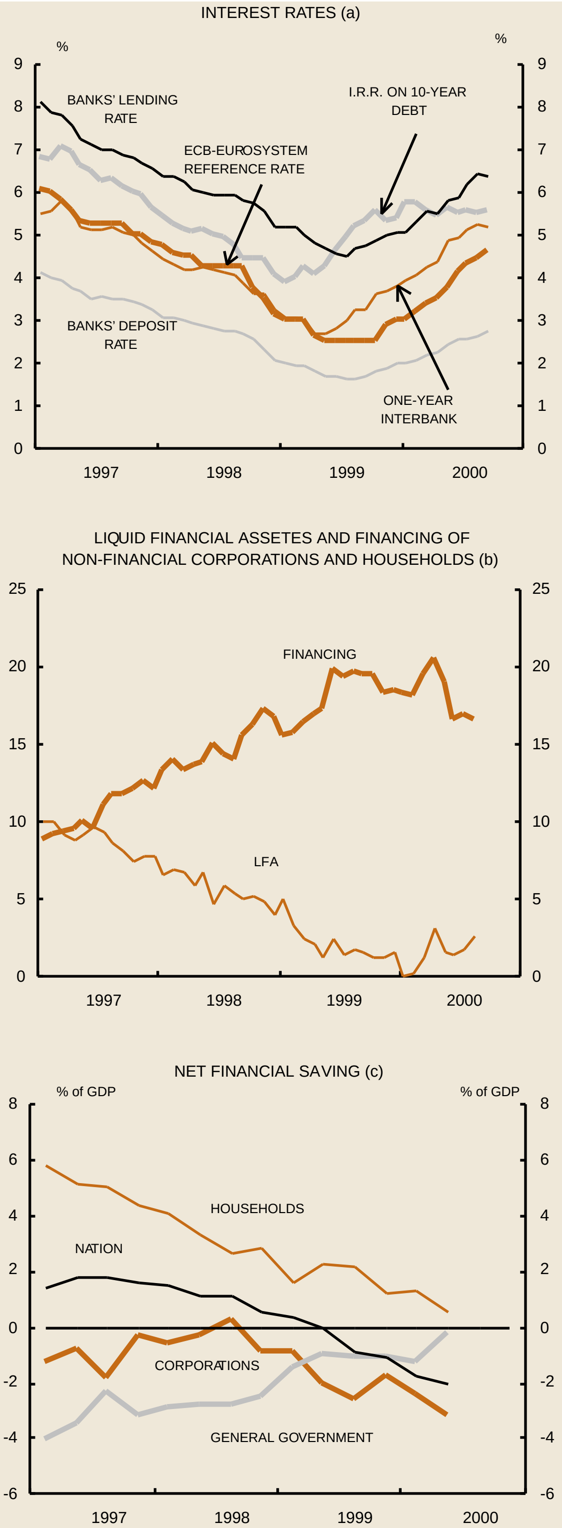
Moreover, the indirect impact is channelled through the increase in production costs incurred by companies that use oil or its derivatives as inputs. The scale of this impact will initially depend on the degree of energy dependence of the productive system. In this respect, the accompanying chart shows that the Spanish economy's degree of dependence (proxied by the net oil imports/GDP ratio) has diminished substantially, in line with what has occurred in other industrialised countries. That said, Spain continues to evidence a higher degree of dependence than these economies.

In any event, the final impact will hinge on the reaction of economic agents to the loss of real income arising from the increase in prices. Specifically, if economic agents (corporations and workers) attempt to avoid such loss through increases in margins and wage rises, a permanent deterioration in the inflationary situation could arise, with the subsequent loss in competitiveness and a reduction in the rate of economic growth and employment creation.

In short, energy conservation policies have no doubt lessened the vulnerability of the industrialised economies to the vagaries of crude oil prices. In any event, the intensity of the oil price rises and their persistence, for far longer than was initially thought, pose factors of some risk for the development of the international economy in the near future. In that respect, the experience gained during previous energy crises, when the reaction of agents and of economic policy ultimately ushered in a period of low growth and high inflation rates in the world economy, offers a warning about the need to tackle this situation with the austerity required so as to accommodate the losses in income from the external sector. Only thus may the impact on inflation and growth be minimised and confidence about the medium-term performance of the economy sustained.

CHART 4

Financial indicators of the Spanish economy



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

notwithstanding, the results obtained so far might be less than would be warranted by the associated determinants. The cumulative loss in competitiveness vis-à-vis the euro area, which is the result of persisting price and cost differentials that cannot be offset via the exchange rate, is the factor that explains why full advantage is not being taken of the buoyancy of foreign markets. This factor has also clearly influenced the above-mentioned tourism results.

The estimated rate for real GDP growth in Q3 this year (approximately 4 %) is based, as regards productive activities, on the strength of construction, although the growth rates of this sector, manufacturing industry and market services appear to have slackened slightly. Set against this moderate slowdown, the rise in employment remains notable, as a result of which the growth of apparent labour productivity has levelled off at below 1 %. Given this situation and the rebound in wage growth (due largely to the activation of the inflation-adjustment clauses contained in last year's collective bargaining agreements), the growth of unit labour costs continues to outpace significantly that in the euro area countries, where such growth is generally being contained.

The rise in the 12-month growth rate of the consumer price index (CPI) during 2000 Q3 has been considerable, with the September figure (3.7 %) outstripping the figure last June by three-tenths of a percentage point. The growth rate of all the components increased during the period, with the exception of energy, precisely the aggregate which has recorded the biggest increase. The data reflect transitory increases in the prices of some unprocessed foods and the figures for the latest month show a partial reversal of the strong increase in certain tourism services during the summer. The rate of increase of non-energy industrial goods continues gradually to intensify. The correction seen in the inflation gap with the euro area countries in September (it narrowed once more to one percentage point according to the harmonised indices) is essentially due to the negative differential which has built up in the energy component. In the other aggregates, the changes have been on a lesser scale: of note, for their persistence, are the differences in services and non-energy industrial goods.

As earlier indicated, the persistence of significant price and cost growth differentials with the euro area countries determines, in the medium term, the competitive position of the Spanish economy in the area, along with its capacity to compete with these economies in other markets, including the Spanish market. This is particularly significant at a time such as the present juncture, in which the loss of real income vis-à-vis the rest of the world, as a result of the increase in oil prices, has to be assumed by private economic agents. Any attempt to avoid this by means of wage rises or higher operating margins will, in the long run, be in vain, and lower GDP and employment growth rates will ensue. The consequences will be the same if the weight of the adjustment falls on the State. Efforts to improve the competitiveness of markets must therefore continue, and moderation must be the watchword for wage bargaining for next year. Wage negotiations should take into account not the past inflation rate, which will tend to turn downwards as from the end of this year, but the medium-term target, which is shared by all the euro area countries with which Spain must converge.

2. The external environment of the euro area

The latest available information on economic activity in the external environment of the euro area indicates that growth was sustained at high rates in Q3. That said, a number of factors that may heighten inflationary pressures in certain areas and even moderate growth prospects in the coming months have strengthened. In particular, the price of crude oil, which stood at around USD 30 a barrel in October, may not only adversely affect inflation and activity, but also generate imbalances between geographical areas, depending on their degree of vulnerability to oil market shocks (see Box 3). In the coming months, several factors will be conspiring to keep prices above OPEC's target range: the seasonal increase in the demand for oil with the onset of winter in the northern hemisphere; the decline in the level of stocks in consumer countries; the high degree of capacity utilisation in the various stages of the refining process; and political events in the Middle East. Pressures in the oil market have arisen against a background of relative instability in exchange rates and on stock markets; the euro reached historic lows and there were sharp share-price corrections, particularly in the case of high-technology companies.

In Q2, GDP in the United States rose by 6.1 % year-on-year. This was considerably higher than the 5.3 % rate recorded in Q1, owing largely to the significant levels of stockbuilding and the buoyancy of government spending, which offset the slowdown in consumption (see Chart 5). The preliminary National Accounts estimate for Q3 indicates that GDP slowed, with annualised quarter-on-quarter growth of 2.7 %, well down on the 5.6 % rate recorded in Q2. Nonetheless, comparing with the same period of 1999, the slowdown was less pronounced, with the growth rate falling to 5.3 %. The moderation in the growth rate was due to weaker domestic demand, since the strength displayed by exports in the summer, despite the appreciation of the effective dollar exchange rate, led to a decline in the negative contribution of net external demand to GDP growth for the third quarter in a row.

On the demand side, all the components, except consumption, recorded more moderate growth rates. The quarter-on-quarter growth in consumption suggests that there was a slight recovery in this aggregate between July and September, following the slowdown in Q2. This recovery may have been helped by the moderation in long-term real interest rates (see Chart 6) and the favourable movements in share prices. As a result, there was a further reduction in the savings ratio to –0.4 % of disposable income in August. However, given the relatively high sensitivity of US consumption to

BOX 3

Changes in dependence on oil

In view of the recent sharp rise in the price of oil, which has tripled since 1999, it is helpful to explore the trends in recent years in the degree of vulnerability of various geographical areas to possible oil market shocks. To do this, it would seem appropriate to use indicators that provide information on the foreseeable impact on prices and activity of changes in the cost of oil. First, oil consumption per unit of GDP may give an indication of the sensitivity of domestic prices to a rise in the price of a barrel of oil. It should be noted that, even when some of domestic demand can be supplied by domestic production, in the absence of energy-consumption subsidies, the prices of oil products will, in any case, be closely governed by international prices. Second, net oil imports per unit of GDP give an indication of the possible impact of increases in the price of crude on an economy's terms of trade.

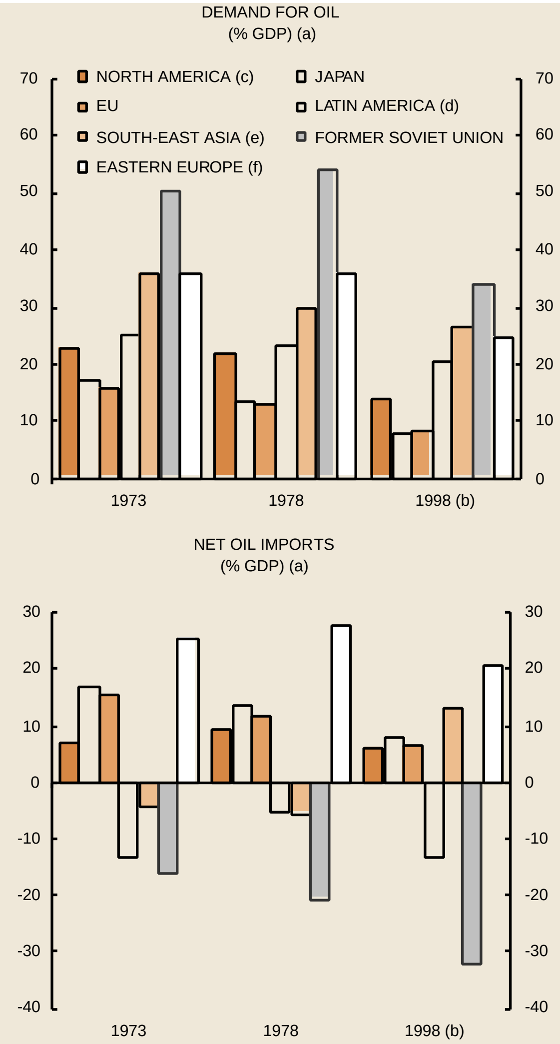
The upper chart shows the first indicator of dependence for various geographical areas since 1973. As can be seen, at the time of the first oil crisis the intensity of oil consumption differed significantly across the various economic areas. It was relatively low in North America, Latin America, the present European Union and Japan, and considerably higher in the Asian economies, Eastern Europe and the former Soviet Union. This situation remained basically unchanged until the 1979 crisis, when most countries embarked on a process of energy diversification and saving, which led to a substantial across-the-board decline in oil consumption per unit of GDP.

This process was particularly intense in those economies that started with relatively high dependence ratios, such as Western Europe and the former Soviet Union. By contrast, the fall in the demand for oil per unit of output in the emerging Latin American and south-east Asian economies, also highly dependent on oil, and in the industrialised economies, whose initial position was more favourable, has been more moderate. The result is that, although the intensity of oil use has diminished significantly in the world economy as a whole, at the end of the period considered there were still significant differences in the degree of exposure of the various geographical areas to the international crude-oil market. In fact, consumption per unit of GDP today in the emerging and transition economies is generally higher than it was in the more developed countries in the period prior to the oil crises of the 1970s.

In step with the moderation in the demand for oil over the last two decades, net imports of oil products have been falling, in terms of GDP, in the main advanced economies and in Eastern Europe, as can be seen in the lower chart. In the case of the EU, these developments have also been helped by the expansion of petroleum extraction activity in the North Sea. Meanwhile, the former Soviet Union has increased its exporting capacity considerably during this period. The trend in this indicator has been less favourable in the regions of south-east Asia and Latin America. In south-east Asia, the net exporting position shown by the data for 1973 to 1978 has disappeared. In 1998, this area had a very high dependence on imported oil, twice that of North America, Japan and the European Union, making its national income very sensitive to movements in international energy prices. As for Latin America, the reduction in the dependence on oil of the world economy as a whole has led to a certain reduction in its exporting capacity (concentrated, in any case, among a few countries); its 1998 exports, in terms of GDP, were somewhat lower than in 1973, although higher than in 1978.

In sum, if we consider both of these dependence indicators together, it may be inferred that the world economy is generally less vulnerable to oil market disturbances than 20 years ago, both in terms of their possible inflationary impact and as regards changes in the terms of trade. However, while in the industrialised economies of Europe, North America and Japan the current situation is significantly more solid than in the 1970s, the trend has been less positive in the emerging and transition economies, where the demand for oil is still very high in comparison with the more developed countries, most of which are largely supplied through imports.

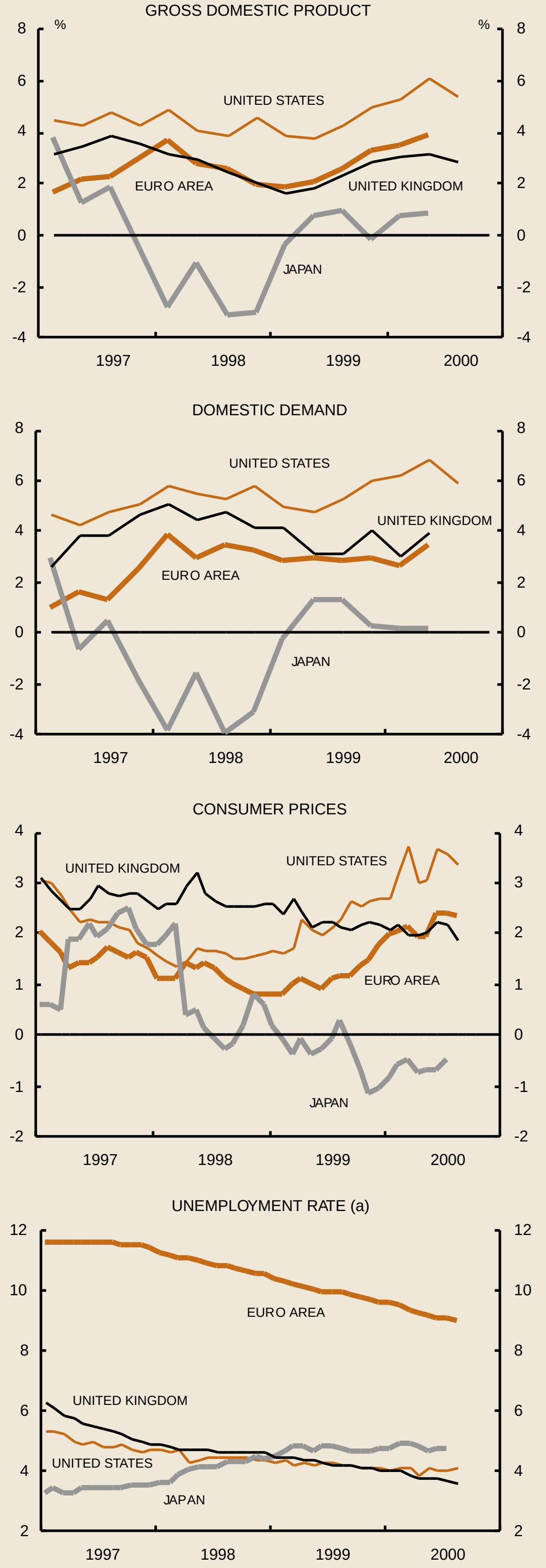
Demand for oil and net oil imports



Source: OECD.
(a) Metric tonnes of oil as a proportion of real GDP in 1990 dollars.
(b) 1997 for non-OECD members.
(c) United States and Canada.
(d) Argentina, Bolivia, Brazil, Chile, Colombia, Cuba, Ecuador, Guatemala, Mexico, Peru and Venezuela.
(e) Korea, Indonesia, Malaysia, Philippines, Singapore and Thailand.
(f) Czech Republic, Hungary, Poland, Albania, Bulgaria, Romania, Slovakia, Bosnia, Slovenia and former Yugoslavia.

CHART 5

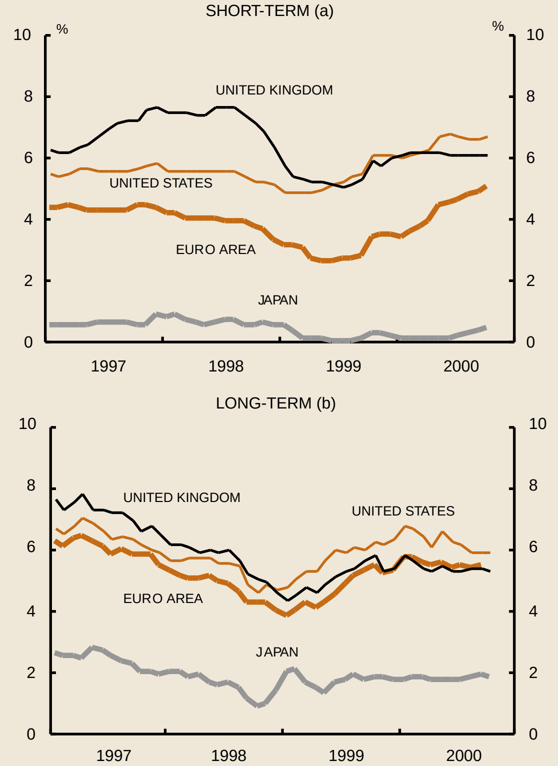
Main macroeconomic indicators. Percentage change on previous year



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 December 1998, weighted average of the eleven euro-area countries; in 1999 and 2000, three-month EURIBOR.
(b) Ten-year government bond yields. Euro area: until December 1998, weighted average of the eleven euro-area countries.

changes in wealth arising from share price movements, their decline in October, against a general background of greater international economic and political uncertainty, may lead to moderation in private spending in the coming months. In fact, the New York Stock Exchange indices, following their rise in the summer, began to decline from mid-September, with the losses on the Nasdaq and Dow Jones reaching 15 % and 9 %, respectively, by mid-October.

Private gross capital formation recorded decelerations in all its components, particularly residential investment.

As for the external sector, the current account deficit in Q2 deteriorated by a further 0.1 percentage points to reach 4.3 % of GDP. In Q3, the August trade balance recorded a deficit of USD 29.4 billion, slightly lower than the June deficit of USD 30 billion, owing to the strength of exports in August.

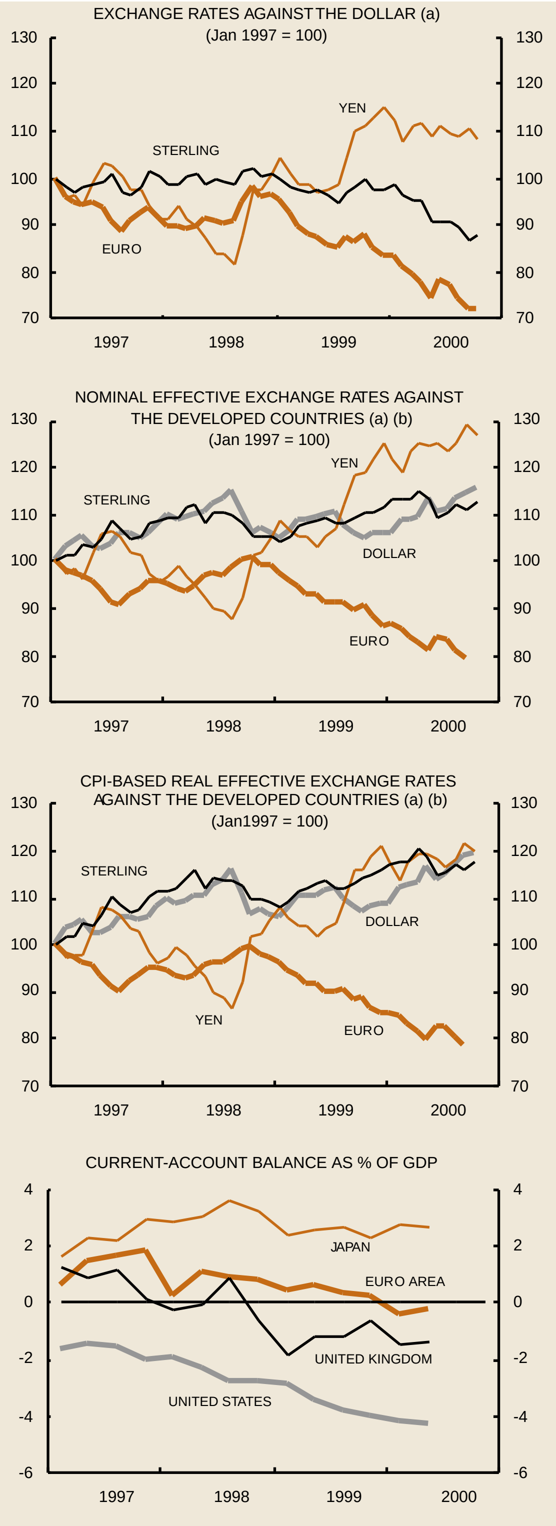
The rate of employment creation edged down in the summer, as shown by the reduction in the volume of hiring and the rate of growth of hours worked. However, there is still considerable pressure in the labour market, with an unemployment rate of 3.9 % in September. Price and cost indicators did not display any significant signs of worsening in the third quarter. Despite the low rate of unemployment, the growth in hourly earnings held steady at 3.6 % in September. Also, productivity growth seems likely to record high rates again in Q3, tempering the effect of the wage increases on domestic costs. The inflation rate, as measured by the twelve-month change in the CPI, moderated in Q3, falling from 3.7 % in June to 3.5 % in September. Nonetheless, excluding unprocessed food and energy, the index rose in the same period by 0.2 percentage points to 2.6 % in September.

The absence of excessive inflationary pressures on costs and prices, along with the signs of incipient moderation in activity, led the monetary authority to hold the federal funds target interest rate unchanged from May, when it was raised to 6.5 %. However, in recent public announcements the Federal Reserve has stated that the main risks to the future inflation rate are on the upside and associated with the tightening of the labour market and energy price developments. The budgetary policy outturn has been determined by a rate of growth of tax revenues that exceeded the growth in nominal GDP, and was well above official forecasts. Accordingly, despite the considerable increase in spending, the fiscal surplus may exceed the IMF's forecast of 1.4 % of GDP.

GDP in Japan rose at a year-on-year rate of 0.8 % in 2000 Q2, 0.1 percentage points higher than in the preceding quarter, with external demand continuing to contribute more to growth than domestic demand. Against this background, the moderate increase in consumption was virtually cancelled out by the deterioration in gross fixed capital formation. The structural reforms and macroeconomic policies implemented in the last two years have helped the Japanese economy, in a favourable international setting, to recover and sustain positive growth rates. However, the increase in GDP in the first few months of 2000 appears somewhat fragile, since household spending, which accounts for somewhat more than 60 % of GDP in the Japanese economy, has still not gained momentum.

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.

BOX 4

The composition of the fiscal adjustment in Latin America

In late 1999, most Latin American economies began to show the first signs of a recovery in activity following the recent crisis. Reasons that might justify a rapid emergence from recession include, unlike in previous crises, the application of adjustment plans compatible with macroeconomic stability, with the maintenance of fiscal discipline being a key objective of the strategies pursued by the economic authorities. Apart from the one-off measures taken, many countries have tried to introduce far-reaching reforms, aimed at strengthening tax systems, controlling spending and involving lower levels of government in the fiscal-discipline drive. These attempts have frequently (particularly in the latter case) run up against the difficulty of forging a broad consensus in favour of reform among the agents concerned. All this has taken place within the framework of commitments made to the IMF.

Certainly, fiscal adjustment has been implemented in a complicated setting, characterised by the decline in public revenue as a percentage of GDP, as a result of the slowdown in economic activity, and by the autonomous rise in a significant component of expenditure (debt-interest payments), stemming from the successive financial and exchange-rate crises that have afflicted these countries since 1997. In fact, as can be seen in the adjoining table, in almost all the countries there was an increase in the public deficit or a reduction in the surplus, generally as from 1997. This trend was driven, except in the case of Chile, by the large increase in debt-interest payments which rose, between 1997 and 1999, in Argentina and Colombia by 1.1 and 1.4 percentage points of GDP, respectively, and, between 1998 and 1999, by 0.4 percentage points in Mexico. A further factor has been the decline in commodity prices

Fiscal variables (a)

% GDP

	1995	1996	1997	1998	1999	2000
Argentina						
Primary balance	-0.4	-1.1	0.3	0.5	-0.7	1.1
Total balance	-2.3	-3.2	-2.0	-2.1	-4.1	-2.8
Total revenue	23.2	22.1	23.1	23.7	24.2	24.6
Primary expenditure	23.6	23.2	22.8	23.2	24.9	23.5
Brazil						
Primary balance	0.3	-0.1	-0.9	0.0	...	...
Total balance	-4.8	-3.8	-4.2	-7.6	...	...
Total revenue	32.9	29.9	30.3	31.2	...	...
Primary expenditure	32.6	30.0	31.2	31.2	...	...
Mexico						
Primary balance	...	3.9	2.0	1.4	2.0	2.1
Total balance	...	0.3	-0.8	-1.2	-1.0	-1.0
Total revenue	...	23.1	22.8	20.4	20.8	21.5
Primary expenditure	...	19.2	20.8	19.0	18.8	19.4
Chile						
Primary balance						
Total balance	3.6	2.0	0.9	-1.2	-2.5	...
Total revenue	32.7	33.4	32.2	30.8	30.4	...
Primary expenditure	29.1	31.4	31.3	32.0	32.9	...
Colombia						
Primary balance	1.5	0.4	-1.2	-0.5	-2.3	0.6
Total balance	-0.8	2.3	-3.8	-3.8	-6.3	-3.6
Total revenue	25.4	27.0	27.4	26.5	27.3	27.5
Primary expenditure	23.9	26.6	28.6	27.0	29.6	26.9
Venezuela						
Primary balance	0.2	12.8	5.4	-3.2	-3.0	-1.3
Total balance	-6.9	7.2	1.9	-6.7	-7.0	-5.1
Total revenue	25.8	34.6	30.8	20.7	21.5	22.7
Primary expenditure	25.6	21.8	25.4	23.9	24.5	24.0

Sources: IMF and national statistics.
(a) Primary and total balances: (+) surplus/(-) deficit. Data refer to the whole of the public sector (except in the case of Brazil, where they refer to general government).

BOX 4

The composition of the fiscal adjustment in Latin America (cont.)

which, in the cases of Chile, Venezuela and Mexico, has been responsible for a large part of the decline in public resources.

Against this background, the authorities have generally reacted in two ways. First, they have implemented public-spending cuts in the areas they control directly: total current expenditure in Mexico; the compensation of public-sector employees in Argentina, Brazil, Venezuela and Colombia; and public investment in Argentina and Mexico. However, as the ratio of public spending to GDP was already very low, further contraction tends to generate social pressures (most notably in Argentina) that may reduce the consensus in their favour. Accordingly, most governments have tried to speed up deferred structural reforms, in order to avoid fiscal adjustment continuing to depend on one-off spending measures.

Thus, the authorities in most of the countries of the region have announced measures to strengthen the efficiency of the tax system, including, in particular, widening tax bases (especially for VAT), reforming tax administration and fighting tax fraud. In Argentina, the latest reforms have concentrated on raising the rates at which income tax and various indirect taxes are levied. In Brazil, the plan to reform the tax system, under discussion since 1995, remains on the agenda. Its most important measure would be to replace cumulative multistage indirect taxes by a tax on value-added. However, the structural reforms in the area of public finances go beyond tax reforms. Thus, the approval in 1999 and during the first few months of 2000 of fiscal responsibility laws in Argentina and Brazil, and of a multi-year expenditure programme in Mexico, will permit legal restriction of governments' ability to present unbalanced budgets. As regards budget implementation, the case of Mexico should be mentioned. There the budget includes, since 1999, rules under which hypothetical excess tax receipts are used to reduce the deficit, while automatic mechanisms have been put in place to reduce spending if tax receipts are lower than budgeted.

All these reforms, however, come up against a truly complicated challenge, namely how to discipline the finances of regional and local government, which have large powers in relation to spending, as Argentina, Brazil, Colombia and Mexico are federal states with a high degree of decentralisation. In fact, the restrictive and firm fiscal policy stance of these countries is implemented at the federal level, while the contribution of regional governments to fiscal consolidation efforts has frequently been negative. Mexico and Colombia are in the process of modifying the financial relations between the different levels of government. These reforms generally involve territorial government having a greater share of public revenue, with an equivalent reduction in transfers from central government. In Argentina, central government has negotiated adjustment programmes with the most indebted provinces, as the quid pro quo for its support in the restructuring of debt, and has recently announced a law that would limit the capacity of local government to incur debt, although this has still not been implemented. Finally, the Brazilian fiscal responsibility law, applicable to all levels of general government, places limits on the deficit of each government body (which may not exceed capital spending) and on net indebtedness, which may not exceed ceilings fixed, as a proportion of tax revenues, by legislation. The law, approved by the Senate at the beginning of October will, nonetheless, not enter into force until all the pending appeals alleging its unconstitutionality have been heard.

The indicators available for the third quarter point to an extension of the pattern of slight improvement in investment and slack consumption spending. In July and August the CPI sustained year-on-year falls, although wholesale prices seem to have commenced an upward trend in the third quarter, bolstered by the increase in energy prices on international markets. Finally, exports can be expected to maintain their high rate of growth, despite the adverse effect that would arise from appreciation of the yen in effective terms during Q3, owing to the healthy economic performance of Japan's main trading partners (see Chart 6).

On 11th August, the Bank of Japan decided for the first time in the last five years to raise its overnight target rate from 0.10 % to 0.25 %. This measure, which had been announced several months previously, was justified by the existence of clear signs of a recovery that would halt the deflationary process within the time period relevant to monetary policy decisions. Short-term market rates immediately reflected this decision, while long-term rates rose gradually during subsequent weeks, by a total of nearly 10 basis points. In the fiscal arena a further package of measures is expected to be introduced, presumably in November, to supplement the budget for the current fiscal year, with a total value of JPY 3.8 billion. This is much less than the value of the last spending programme (JPY 6.8 billion).

In south-east Asia, the rate of growth of the main economies remained high during the first half of 2000, when net external demand replaced the recovery in domestic demand as its driving force. However, this area (see Box 3) is highly vulnerable to changes in oil prices, so that future developments in economic activity are subject to more uncertainty than in other areas.

The Latin American economies continued to recover gradually from the sharp deceleration in activity sustained during 1999, although significant differences persist between them. In particular, GDP in Mexico grew by 7.9 % in Q2, boosted by the buoyancy of consumption and exports. The indicators for Q3 suggest that the expansion continued, while further progress was made in fighting inflation. Brazil, meanwhile, recorded notable GDP growth in Q2 (3.9 %). The strong employment creation and the increase in industrial production in the summer presage a continuation of this trend in Q3. The rise in the price of crude oil and poor harvests are exerting upward pressure on the rate of inflation, although this should still stay below the 8 % upper limit to the target range established for the year as a whole. Lastly, among the economies displaying greater strength, Chile stands out, with a GDP growth rate of 6.1 % in Q2. This was attributable to the high buoyancy of private consumption, in contrast to the slackness characterising investment and, to a lesser extent, exports. The economic boom being enjoyed by these countries, against a background of stability on debt markets, has been conducive to progress in fiscal consolidation (see Box 4). The success of Brazil and Mexico in this sphere has led to the ratings of their debt issues being revised upwards by international agencies. By contrast, Argentina recorded very subdued growth in the first half of the year (less than 1 %), as a consequence of the high real interest rates, the cumulative competitiveness losses and the repeated cuts in public spending. The indicators for the summer months show no signs of a turning point being reached. The weakness of activity has made it difficult to achieve the plans to reduce the public deficit, and this in turn has led to an increase in the interest-rate spread between the Argentine peso and the US dollar.

Finally, as regards the EU economies outside the euro area, GDP in the UK rose by 3.2 % in year-on-year terms in 2000 Q2, 0.1 percentage points more than in the first quarter. As regards its components, the contribution of domestic demand increased in Q2, basically as a consequence of the notable acceleration in government consumption, while that of net external demand declined. The latest indicators are ambiguous regarding the path of GDP in Q3 (1), although they suggest a certain containment of private consumption, which would be consistent with the recent developments in some of its determinants, in particular, lower wage growth (which is proving compatible with further reductions in the rate of unemployment) and the moderation in the prices of real assets. At the same time, the slight depreciation of sterling in effective terms in Q3 may prompt a pick-up in exports.

As regards inflation, the wage moderation in Q2, together with the significant recovery in productivity, led to a notable reduction in the growth of unit labour costs, which stood, for the first time since 1998, below the increase in the GDP deflator. Finally, consumer price growth held steady during Q3, with the index which excludes mortgage interest payments recording a rate of 2.2% (1% in terms of the index harmonised with the rest of the EU), the same rate as in June. The sharp slowdown in property prices should be specially noted, their year-on-year rate having halved in six months. The absence of significant inflationary pressures led the Bank of England to keep its official interest unchanged from February, when it was set at 6%. However, greater fiscal laxity, reflected in the strong increase

(1) On provisional data of the UK Office for National Statistics, GDP grew by 2.9 % year-on-year in 2000 Q3.

in government consumption, may constrain the monetary policy stance in the near future.

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

3.1. Economic developments

The latest data on activity in the euro area highlight the strong economic growth in 2000 Q3. The rise in oil prices has, to date, had a scant contractionary effect. As regards prices, by contrast, dearer crude oil and the depreciation of the euro, against a backdrop of sound domestic demand, has adversely influenced the inflationary situation and outlook. Against this background, the European Central Bank has raised interest rates on three occasions since early June by a total amount of 100 basis points.

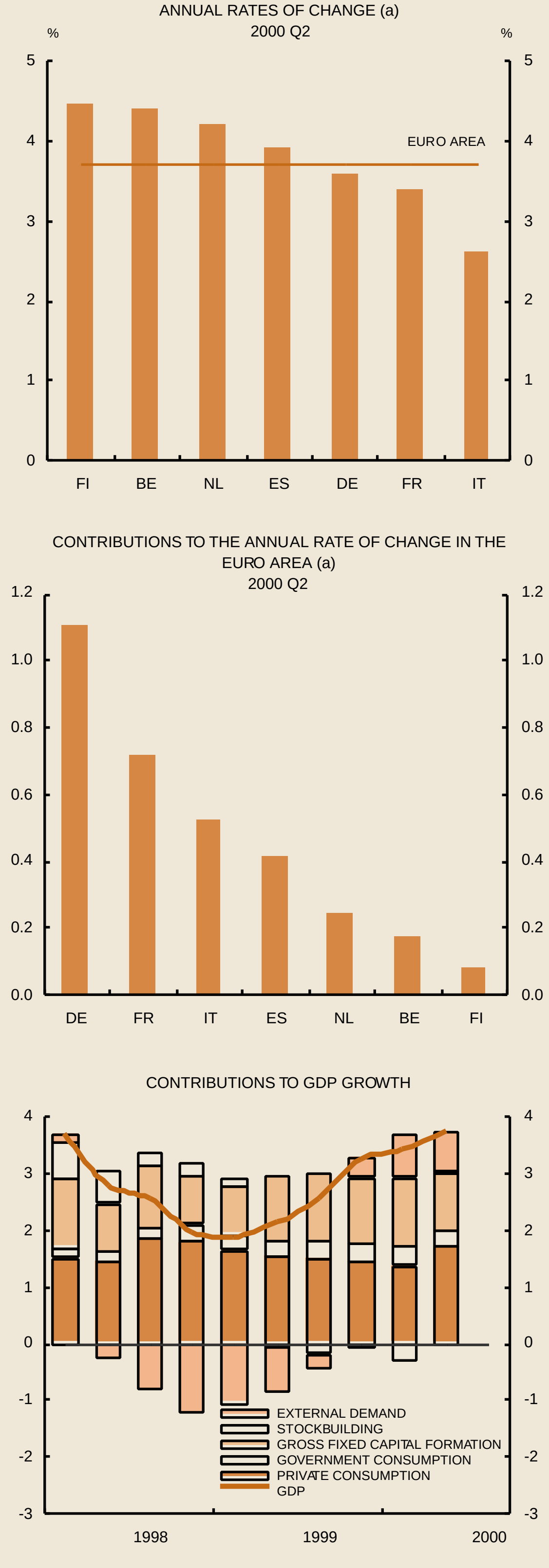
According to the second Eurostat National Accounts estimate for the area in 2000 Q2, GDP increased in this period at a year-on-year rate of 3.7 %, three-tenths of a point quicker than in Q1 (see Chart 8). Unlike in previous quarters, when the boost to growth was essentially from the increase in the net contribution of the external sector, the acceleration in output was due on this occasion to two factors. First, the increase by one-tenth of a point in the contribution of domestic demand, which stood at three percentage points. And further, the disappearance of the negative contribution of stockbuilding (from –0.3 to 0 percentage points). Private consumption quickened notably, running at 3 % in relation to the same period a year earlier. By contrast, the rate of increase of fixed capital investment fell by almost one percentage point. The external sector ceased to move on the recovering trend it had embarked on in early 1999, and its contribution to growth fell to 0.7 percentage points. This is the outcome of the acceleration in imports outpacing that in exports, although the latter continue to grow at high rates as a result of the depreciation of the euro and the buoyancy of activity in the rest of the world economy.

Admittedly, GDP growth for the euro area as a whole in 2000 Q2 has been high. But the trend of activity in certain euro-area countries has not been so expansionary. In Italy, in particular, the growth rate dipped notably in Q2, basically as a result of the strong increase in imports brought about, possibly, by statistical problems in the measurement of this item. In France, the moderation in consumption in Q2 on National Accounts data, beyond what the underlying fundamentals would in principle warrant, has meant that the French economy grew below forecast in this period. Conversely, Germany, Spain, the Netherlands, Belgium and Finland exhibited very favourable results in this quarter.

Most of the as yet incomplete euro-area economic indicators relating to 2000 Q3 (see

CHART 8

GDP in the euro area



Sources: Eurostat and national statistics.

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

Chart 9) generally point to the continuation of the current phase of economic growth, although there have been some signs of this process stabilising or moderating in recent months. From the standpoint of the supply-side indicators, the industrial production index for the area resumed in July the rising trend initiated in 1999, albeit at a slightly lower rate than in Q1. The business confidence indicator, which shows a high correlation with the rate of change of GDP, has held relatively stable throughout Q3. As regards the consumption indicators, retail sales in the area climbed 2.7 % year-on-year in July, a somewhat more subdued rate than in the previous quarter (around 3.4 %). Lastly, the consumer confidence and retail trade confidence indicators fell back in the summer months, though they remain at levels close to their historical highs.

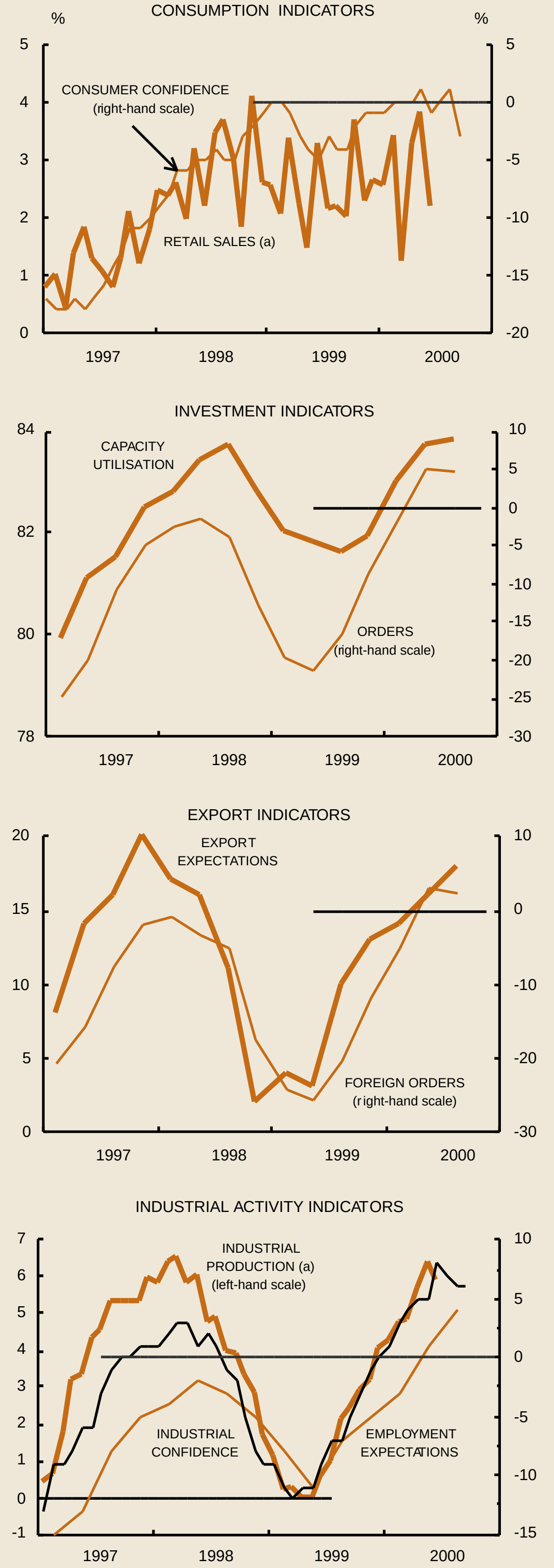
In any event, the trend in recent months of most demand determinants suggests spending will hold at a high growth rate in Q3. In particular, the favourable effect on disposable income of employment growth, the low level of real long-term interest rates and the cuts announced in or applied to direct taxes may offset the loss of purchasing power arising from the increase in consumer prices and from the deterioration of the terms of trade. Likewise, the depreciation of the euro and the booming international economic climate should continue to be propitious to export growth.

Turning to the labour market, full information on employment in the euro area during Q2 is not yet available. However, on ECB estimates, employment in this period grew at an annual rate of around 2.2 %, almost half a percentage point up on Q1. Sector by sector, the provisional data relating to the first four months of the year indicate a slight deceleration in the annual rate of job creation in construction, while in other industries this variable may have increased in relation to the same period a year earlier for the first time since 1998 Q4. The unemployment rate in August stood at 9 %, extending the ongoing reduction seen since autumn 1997. As regards wage costs, Eurostat's hourly labour costs indicator grew by 3.5 % year-on-year during Q2, one-tenth of a point less than the previous quarter. Nonetheless, according to the ECB estimate, compensation per employee slowed by five-tenths of a point to 1.7 % in Q2, thereby allowing the growth of unit labour costs to hold stable at around 0.5 %, despite the increase in apparent labour productivity moderating. The favourable course of unit labour costs has helped slacken the growth rate of the GDP deflator, which stood at 0.8 % in Q2.

Inflation in the euro area has continued to rise in recent months, especially in September,

CHART 9

Euro area. Real indicators

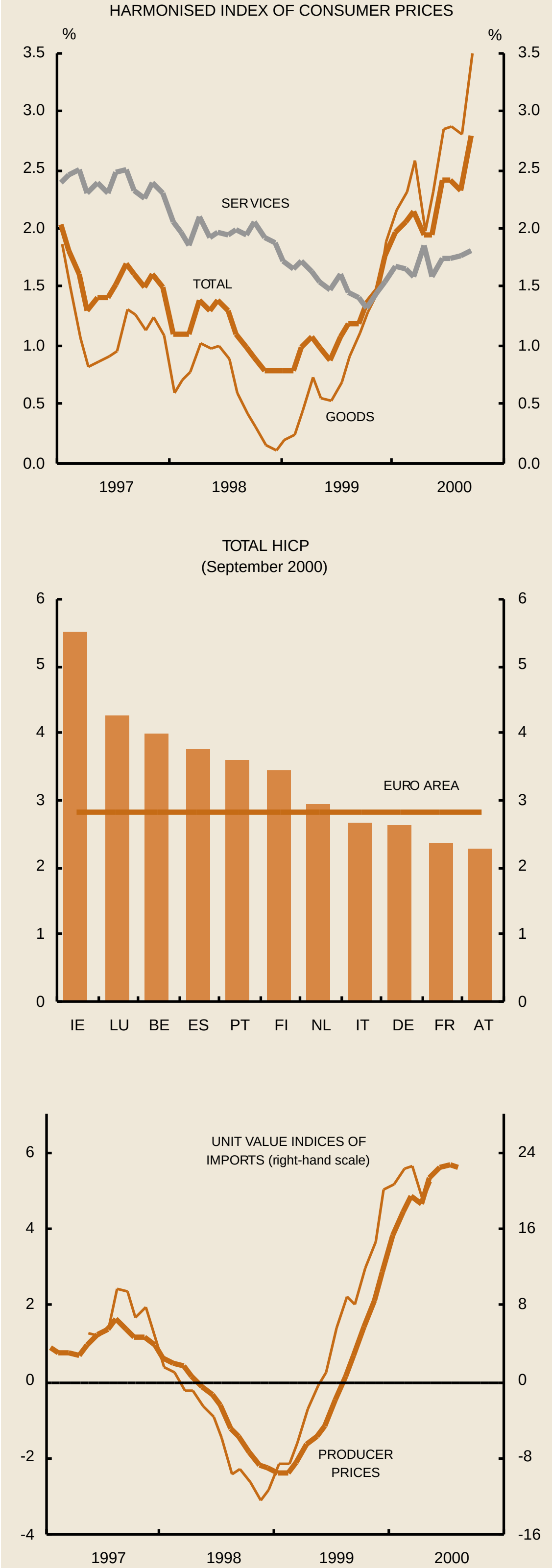


Sources: Eurostat and European Commission.

(a) Non-centred annual percentage changes calculated on the basis of the quarterly moving average of the seasonally adjusted series.

CHART 10

Euro area. Price indicators
Twelve-month percentage change



Source: Eurostat.

TABLE 1

General government financial balance of euro-area countries (a)

% of GDP

	1996	1997	1998	1999	2000 (b) (c)	2000 (b) (d)
Belgium	-3.8	-1.9	-0.9	-0.7	0.0	
Germany	-3.4	-2.7	-2.1	-1.4	1.4	-1.1
Spain	-5.0	-3.2	-2.6	-1.1	-0.3	-0.4
France	-4.1	-3.0	-2.7	-1.8	-1.4	
Ireland	-0.2	0.7	2.1	1.9	4.2	
Italy	-7.1	-2.7	-2.8	-1.9	-0.4	-1.3
Luxembourg	2.6	3.4	3.7	4.4	2.6	
Netherlands	-1.8	-1.1	-0.7	1.0	1.7	1.0
Austria	-3.8	-1.7	-2.3	-2.1	-0.9	-1.7
Portugal	-4.0	-2.6	-2.3	-2.0	-1.5	-1.8
Finland	-3.2	-1.5	1.3	1.9	4.0	
MEMORANDUM ITEM						
EURO AREA						
Primary balance	1.4	2.5	2.6	3.0	4.3	
Total balance	-4.2	-2.6	-2.1	-1.3	0.2	
Public debt	74.5	74.2	73.5	72.2	70.2	

Sources: European Commission and Member States' official notifications under the excessive deficit procedure.
(a) Deficit (-) / surplus (+).
(b) Autumn forecasts.
(c) Including revenue from award of UMTS licences.
(d) Excluding revenue from award of UMTS licences.

as a result of dearer oil and the depreciation of the euro. In nominal effective terms vis-à-vis the developed countries, the euro fell by more than 5 % between June and September. In this latter month, the 12-month growth rate of the HICP rose to 2.8 % (see Chart 10), essentially as a result of the strong growth of energy prices (16 %). Nonetheless, some of the more stable components, such as processed food and non-energy industrial goods, both climbed by two-tenths of a point in this period, in line with the upward course of the producer prices of these goods. Services prices, though they continue to grow at moderate rates, have been on an accelerating course for several months due largely to the impact of dearer oil on transport services, despite the ongoing decline in telecommunications services prices. Consequently, the HICP index excluding fresh food and energy exhibited growth of 1.4 % in September, two-tenths of a point above the June figure. Country by country, the maximum spread between the highest and lowest inflation rates stood at 3.3 percentage points in September, having narrowed from 3.9 percentage points in the two previous months. Industrial prices grew by 5.6 % in August, unchanged on the two preceding months, owing to the slowdown in intermediate and in capital goods, while the rate of change of consumer goods increased by one-tenth of a point in relation to July.

On ECB data, the euro-area current-account balance ran a deficit of EUR 14 billion in the first seven months of the year 2000. That marks a considerable deterioration on the surplus of EUR 21.4 billion in the same period a year earlier. The result was mainly due to the decline in the surplus on the goods balance and to the increase in the deficit on the services balance and on that of income and current transfers. The notable decline in the goods balance, arising from a nominal increase in imports (32 %) that was far higher than that in exports (21.9 %), must essentially be attributed to the worsening of the terms of trade as a result of dearer oil and the weakening of the euro.

As regards public finances in the area, the data available on the budget outturn in the year to date and the latest official forecasts suggest that, even if the exceptional proceeds from the sale of mobile telephony licences are excluded, the year will close in almost all members with more favourable figures than those originally foreseen in the respective national budgets and stability programmes (see Table 1). These developments can mostly be explained by the strong buoyancy of economic activity and employment. This has provided for a higher than envisaged increase in tax takings and in revenue from social security contributions, along with a significant containment of spending on unemployment benefit. However, beyond the improvement in the balances observed, brought on by the positive contribution of the economic cycle, there are signs of a foreseeable worsening of structural balances in the year 2000 in a large number of countries.

Many Member States' budgetary plans for 2001 include substantial tax cuts which may help mitigate the distortions present in the euro-area countries' tax systems. Nonetheless, if these cuts are not accompanied by measures geared to permanently reducing expenditure, they might slow the process of fiscal consolidation against a background in which many countries still have structural deficits and public debt in excess of 60 % of GDP. Moreover, any tax reform prompting an increase in the budget deficit will give a pro-cyclical tone to fiscal policy that is most inappropriate at a time at which inflationary risks have increased appreciably in the euro area.

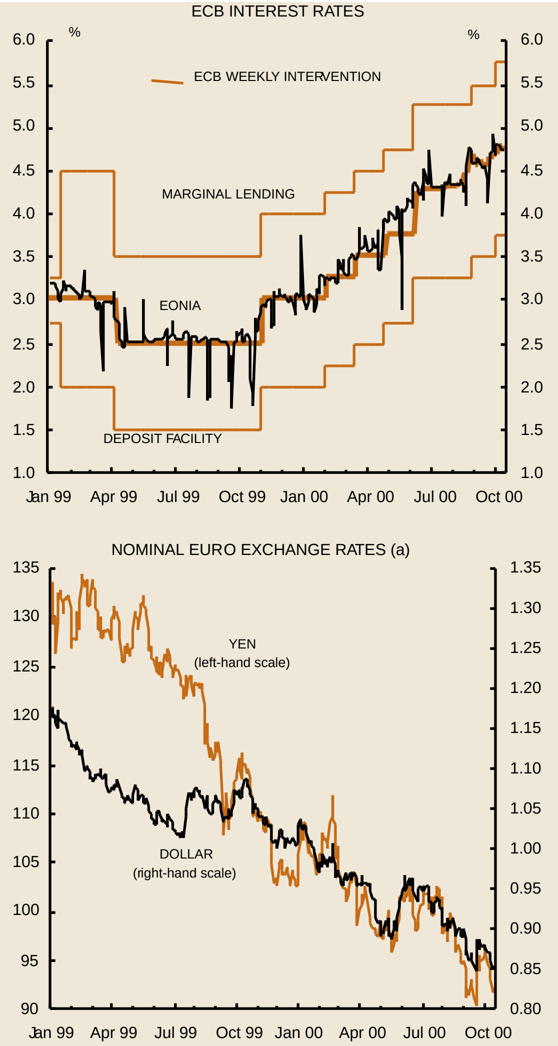
3.2. Monetary and financial developments

The Eurosystem continued throughout Q3 with the pattern of progressive intervention rate increases initiated in November 1999. This course is warranted by an economic outlook characterised by high growth and a certain deterioration in inflationary prospects as a result, above all, of developments in oil prices and the depreciation of the euro against the dollar. The ECB Governing Council decided on 31 August to raise its intervention rate by 25 basis points and, into the final quarter of the year, it again increased this rate on 5 October, by the same amount, to its present level of 4.75 %. Thus, since November last year, there has been a total increase in intervention rates of 225 basis points (see Chart 11). In any event, even bearing in mind the latest decisions by the ECB, real interest rates are still at historically low levels and monetary and financial conditions (determined both by the level of interest rates and by the exchange rate) are relatively generous.

The monetary and financial conditions in Spain are somewhat more expansionary than in the euro area as a whole, although the increase in economic growth in the main European countries and the greater degree of monetary tightness have brought these conditions closer to those that the Spanish cyclical position would require. It should be highlighted that the higher inflation rate in Spain cannot be attributed fully

CHART 11

ECB interest rates and euro exchange rates



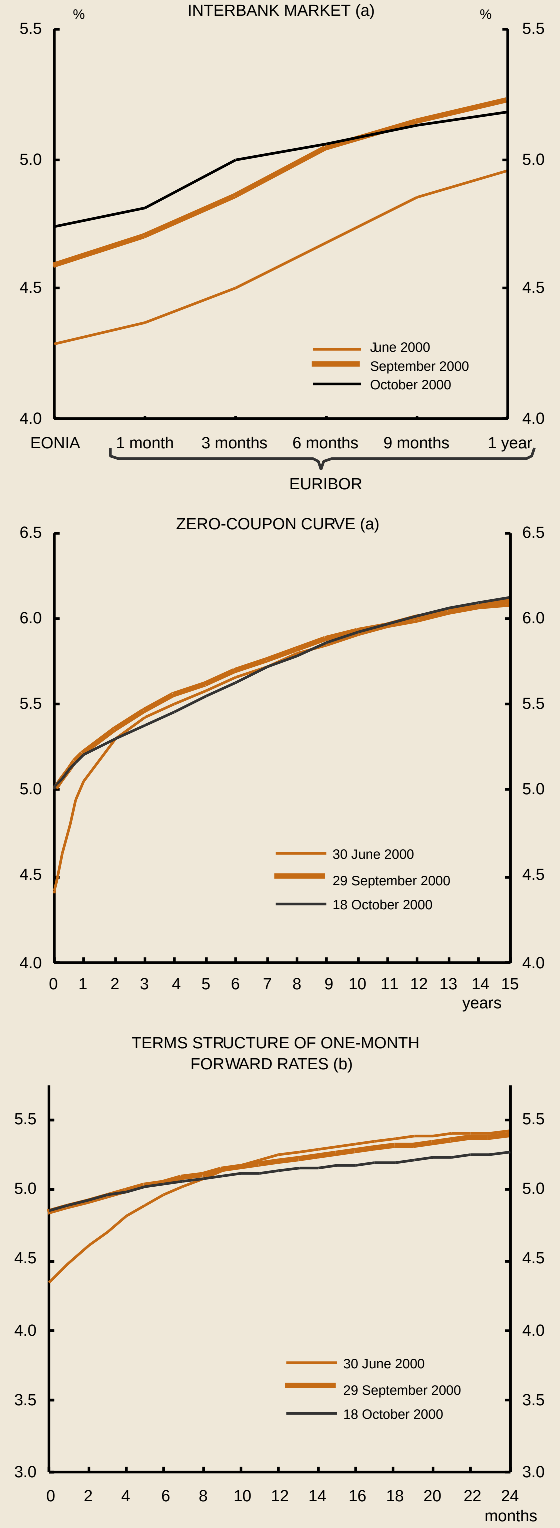
Sources: Banco de España and ECB.
(a) Dollar/euro and yen/euro exchange rates.

to the greater intensity of economic growth since it is largely due to the presence of certain supply-side rigidities that monetary policy cannot correct. In Spain's case, the reflection of these monetary and financial conditions has been the low level of real interest rates (calculated on the basis of actual inflation) and fairly sharp growth in lending to the private sector.

The trend of short-term interest rates in the euro area shows that the markets largely discounted the decisions by the ECB to raise rates. Hence, the differential shown by one-month forward rates between the terms of one month and two years (100 basis points at end-June) narrowed to 50 basis points after the last two intervention rate rises (see the lower panel of Chart 12). Following these movements, the

CHART 12

Euro-area yield curves



Sources: Banco de España and ECB.
(a) Estimation based on money and swap markets data.
(b) Estimated using the zero-coupon curve.

one-month forward rate curve can be seen to be flatter than in June as a result of higher rates in the short-dated terms (after the increases applied by the ECB) and lower rates beyond eight months.

The recent increase in uncertainty on international financial markets, owing to higher-than-expected oil prices taking root and to the conflict in the Middle East, has had repercussions for the securities and foreign exchange markets. Generally, the setting may be said to have led to a greater preference for fixed-income instruments denominated in dollars. Despite the observed rise in inflation, long-term interest rates on the bond markets have been notably stable. This may be the outcome both of investors' greater preference for these instruments and of the favourable performance of public finances in the euro area (see the middle panel of Chart 12).

During Q3 there has been persistently high volatility on stock markets, heightened in recent weeks by the Middle East crisis. The cumulative annual return on the Dow Jones broad Euro Stoxx index was –5 %, while the Madrid Stock Exchange General Index had declined by 6 % over the same period (see Table 2). The release of rather unfavourable data on the profits of new-technology companies added a further motive for uncertainty, the repercussions of which affected most stock market sectors. The IBEX New Market index, created in April this year and which groups together the shares of companies in this sector, was 37 % down in the period to mid-October, a loss similar to that in other equivalent European indices and notably greater than in global indices. In any event, the course of share prices should be linked to the substantial gains posted in recent years: in the 1997-99 period, the Dow Jones broad Euro Stoxx index increased by 148 % and the Madrid Stock Exchange General Index by 127 %.

Despite the cyclical positions of the euro area and the United States drawing closer and the progressive narrowing of the interest-rate spread between both regions, the exchange rate of the euro against the dollar continued to slip during Q3 this year. This trend warranted an orchestrated intervention in favour of the euro by the European Central Bank, the Federal Reserve, the Bank of Japan and other central banks on 22nd September. For a few weeks, this measure helped stabilise the exchange rate at around 0.88 dollars per euro. Subsequently, however, the political conflict in the Middle East has prompted a depreciation of the exchange rate of the euro as capital has fled to dollar-denominated assets, as usually occurs at times of international tension.

The lending and deposit interest rates applied by financial institutions to their customers in the euro area continued to reflect the increases in monetary policy rates. In August, lending interest rates for households and corporations showed a cumulative rise of close to 175 basis points from the lows reached in mid-1999 (see the lower panel of Chart 13). In Spain, the behaviour of the interest rates applied by deposit money institutions to their deposit and lending operations was similar to that in the euro area: the synthetic interest rate for lending to the private sector increased by 50 basis points from June to September, meaning the cumulative increase since the lows in 1999 amounts to 185 basis points. The synthetic interest rate for deposits rose by 25 basis points between June and September, signifying a cumulative rise since 1999 of 110 basis points. As is foreseeable in phases of tighter monetary policy, banks thus appear to be widening their net interest margin.

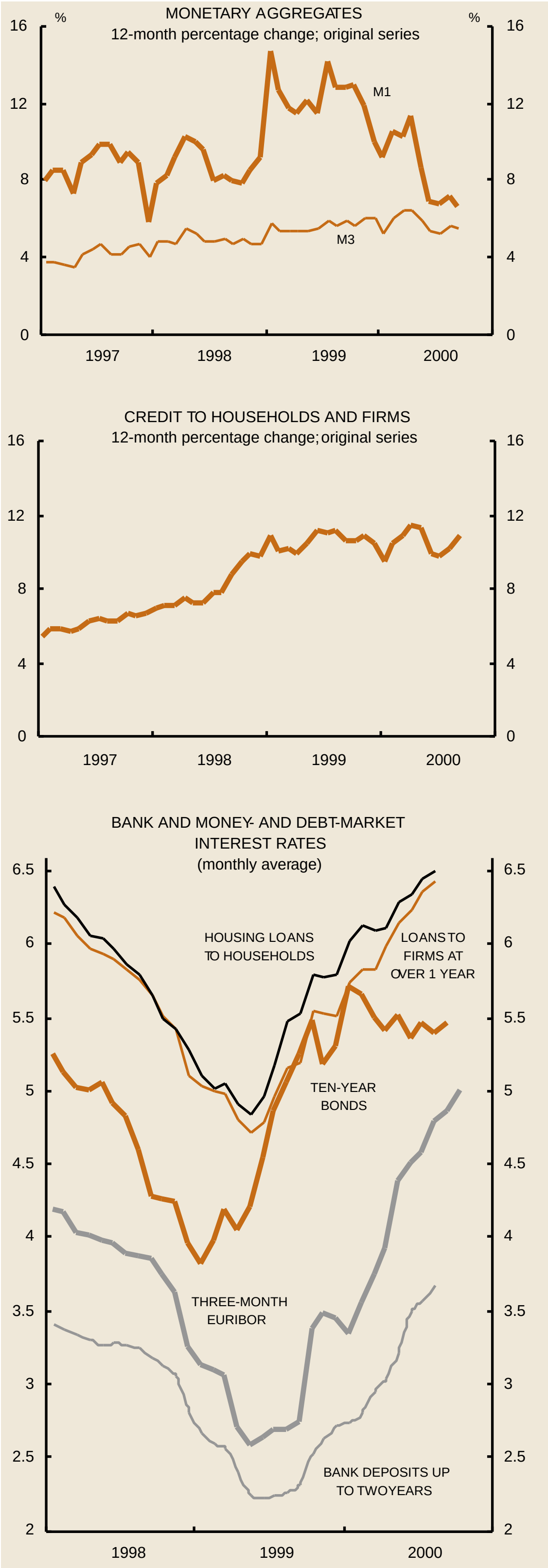
The euro-area monetary aggregates have behaved relatively moderately in Q3, in line with developments in the previous months. M3 grew at an annual rate of 5.5 % in September, appreciably down on the rates observed in the opening months of this year, though still far off the reference rate of 4.5 %. The behaviour of the more liquid monetary aggregates was more sensitive to interest rate developments in the euro area, and their growth slowed to a greater degree. The rate of expansion of M1 stood at 6.6 % in September, almost three percentage points less than at the beginning of the year.

In Spain, liquid financial assets (LFA) rebounded in Q3, running at an annual rate of 4.4 %. This relatively moderate performance is the outcome of the reduction in placements in money-market and fixed-income mutual funds, which are included in the definition of LFA, and of the growing demand for financial instruments that are not considered liquid, such as shares in international mutual funds and certain insurance transactions. The most liquid financial assets, which are included in the category known as cash and cash equivalents, ran at higher growth rates than those of LFA, although in recent months their rate of expansion has slowed sharply from 12 % at the end of Q1 to below 8 % in September.

Credit extended to the private sector in the euro area continued to show high growth rates. The effect of the higher economic growth rate taking root in the euro area has been offset by dearer credit: thus, this variable can be seen to have held at relatively stable rates of expansion of around 10 % since 1998. In any event, the progressively higher rates applied to credit,

CHART 13

Monetary and credit aggregates and interest rates in the euro area



Sources: Banco de España and ECB.

TABLE 2

Monetary and financial situation in the euro area and Spain

%

	1998 DEC	1999 DEC	2000 MAR	JUN	JUL	AUG	SEP	OCT (c)
MONETARY VARIABLES (a):								
EURO AREA								
M3	4.7	6.1	6.5	5.3	5.2	5.6	5.5	
M1	9.2	10.0	10.0	6.8	6.7	7.1	6.6	
Loans to private sector	9.6	10.3	10.9	9.9	9.8	10.1	10.8	
SPAIN								
Liquid financial assets	4.0	1.5	1.3	1.5	1.8	2.6	4.4	
Cash and cash equivalents	12.1	12.7	12.1	8.3	7.5	6.8	7.6	
Financing to the private sector	16.8	18.5	19.4	16.5	17.3	16.9	17.8	
FINANCIAL MARKETS (b):								
EONIA	3.25	3.04	3.51	4.29	4.31	4.42	4.59	4.74
Three-month EURIBOR	3.25	3.44	3.75	4.50	4.58	4.78	4.85	5.00
Public debt								
Euro area ten-year bond yields	3.95	5.31	5.49	5.35	5.45	5.40	5.46	
US-euro area ten-year bond spread	0.74	1.06	0.88	0.85	0.69	0.52	0.42	
Spain-Germany ten-year bond spread	0.21	0.22	0.22	0.26	0.26	0.29	0.29	0.27
Spanish bank interest rates								
Synthetic deposit rate	2.06	1.98	2.17	2.53	2.56	2.65	2.77	
Synthetic lending rate	5.15	5.03	5.55	5.85	6.16	6.43	6.35	
USD/EUR exchange rate	1.172	1.011	0.964	0.949	0.940	0.904	0.872	0.867
Equities (d)								
Dow Jones EURO STOXX Broad Index	29.8	39.5	6.0	2.0	2.5	4.4	-1.2	-5.0
Madrid Stock Exchange General Index	37.2	16.2	7.5	-3.4	-3.1	0.5	1.0	-6.1

Sources: European Central Bank and Banco de España.
(a) Annual percentage change.
(b) Monthly averages.
(c) Monthly average up to latest available data.
(d) Cumulative percentage change during the year. End-of-month data. Latest available day for the latest month.

combined with the unfavourable trend of stock markets and the stability of long-term interest rates, has encouraged European companies to increase their resort to the bond markets. Indeed, the year-on-year growth rate of the outstanding stock of fixed-income securities issued by euro-area non-financial corporations stood, in August, at 17 %, notably above the related rate of bank lending.

Financing to the private sector in Spain continued to grow at notably higher rates than those in the euro area. The year-on-year rate of expansion (which was almost 18 % in September) is similar to that in Q2, but slightly lower than the rates of close to 20 % witnessed in the opening months of the year. This mild slowdown may be attributed to both demand- and supply-side factors. In the first instance, dearer credit has discouraged new borrowing, while on the supply side, banks may be exercising greater caution in extending credit. The latter may be due, among other factors, to the entry into force of the new statistical provision (which requires a greater proportion of funds to be set aside at the top of the cycle) and to the fact that the loan default ratio, though still at very low levels, began to increase in July and August.

4. The Spanish economy

The latest QNA estimates, covering the period to 2000 Q2, have significantly revised the Spanish economy's growth rates for recent years, and in particular for 1998 and 1999. Specifically, the GDP profile for 1999 entails higher real growth rates, but with a milder acceleration than previously estimated; this acceleration culminates in the first half of the year 2000, in which period the real growth rate of the economy held stable at 4.2 % (2), with a positive growth differential with the euro area still in place. The new INE data confirm the notable expansion by national demand since 1997, although it has been on a moderately slowing course since the start of 1999 which has continued into the year 2000. In Q2 this year real national demand grew by 4.6 % year-on-year, compared with 5 % the previous quarter, and the economic information available for Q3 generally points to a fresh slowdown in this aggregate to 4.4 % (see Chart 14). This deceleration is essentially due to private consumption, which has been affected by the lower growth of real disposable income and by the incipient tightening of the economy's monetary and financial conditions, as gross fixed capital formation has held at a stable growth rate since late 1999, the result of an acceleration in construction and of a deceleration in capital investment. The negative contribution of the external sector to real GDP growth in Q2 continued to lessen, dipping from –0.9 percentage points to –0.5 points. This result was the combination of a subdued slowdown in exports of goods and services and a sharper fall in the growth rate of imports. In Q3, the negative contribution of the external sector should have stabilised at this new level. Consequently, the estimated growth rate of GDP in Q3 was 4 %, marking the start of a mildly slowing path.

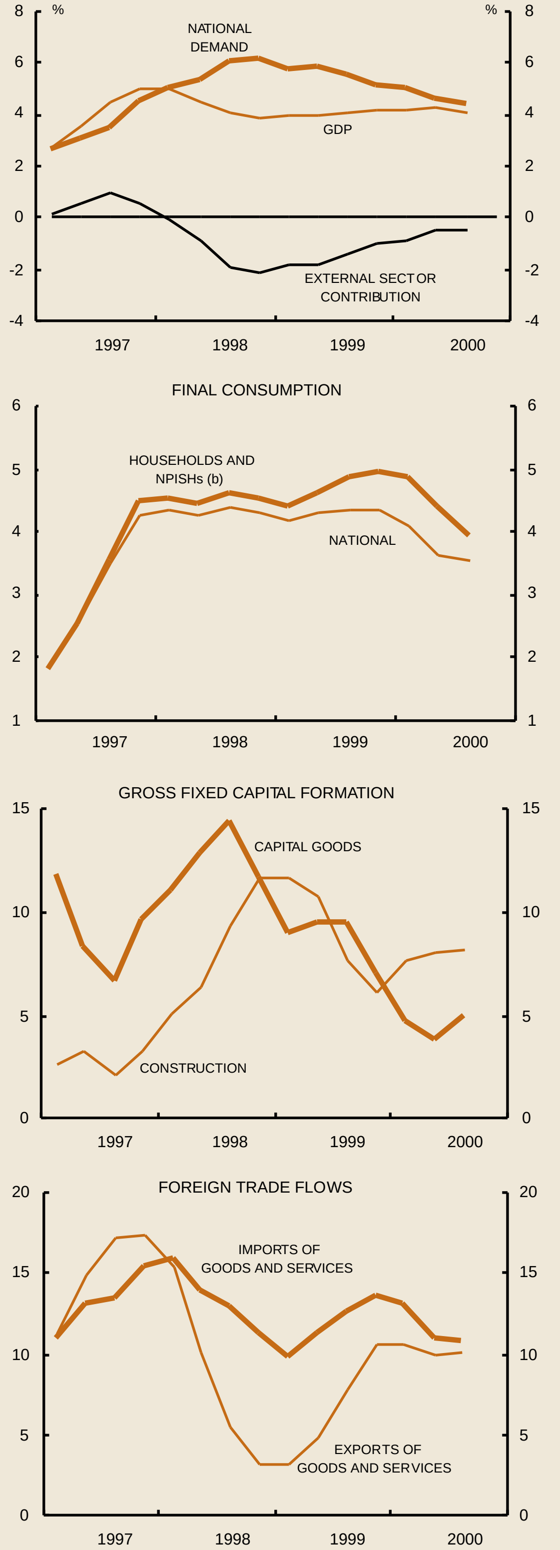
From the standpoint of productive activity, the GDP profile is generally in line with that of the industrial and energy branches as a whole. Here, too, there are signs of a slight loss of steam in the Q3 indicators. Employment generation, which retains significant momentum (It increased by 3.3 % year-on-year in 2000 Q2), has been showing signs of moderating for several quarters now. This tendency extended into Q3, with the pace of apparent labour productivity recovering to rates more in keeping with its historical trend.

Compensation per employee has begun to rebound, increasing by close to 3.5 % in the first half of the year. This rate reflects both

(2) Unless otherwise indicated, the growth rates of the QNA series mentioned in this section refer 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.

bigger negotiated wage increases and the wage drift arising from, among other causes, the application of inflation-adjustment clauses under collective bargaining agreements. The effect of this greater increase in wages on unit labour costs is being countered by the productivity gains stemming from the slowdown in employment, these gains being especially marked in the industries most exposed to competition.

Despite the relative containment of unit labour costs (which continue growing more than in the euro area as a whole nevertheless), the Spanish inflation rate has continued to incorporate the direct and indirect effects arising from the strong increases in import prices, these being in turn the result of dearer oil and of the depreciation of the euro. Among the main price indicators, the year-on-year growth rate of the CPI was 3.6 % in Q3 as a whole, compared with 3.2 % the previous quarter. Within the QNA framework, it is estimated that both the private consumption and GDP deflators have followed a similar course to that of the CPI, allowing a fresh widening of unit operating margins. Overall, there are no clear signs that economic agents are adjusting to the relative loss in purchasing power entailed by the rise in oil prices.

4.1. Demand

As indicated, the moderation of national demand has largely been determined by the trend of household final consumption spending. In 2000 Q2, private consumption grew by 4.4 % in real terms compared with 4.9 % the previous quarter, and most indicators tend to confirm a fresh downturn in the growth rate of this aggregate in Q3. Among the consumption components, this trend is mainly due to the behaviour of durable goods purchases, especially cars, and to the lower growth of spending on other consumer goods, excepting food expenditure, which has tended to pick up after having been very flat the previous year. The consumption of services has continued growing at a stable rate.

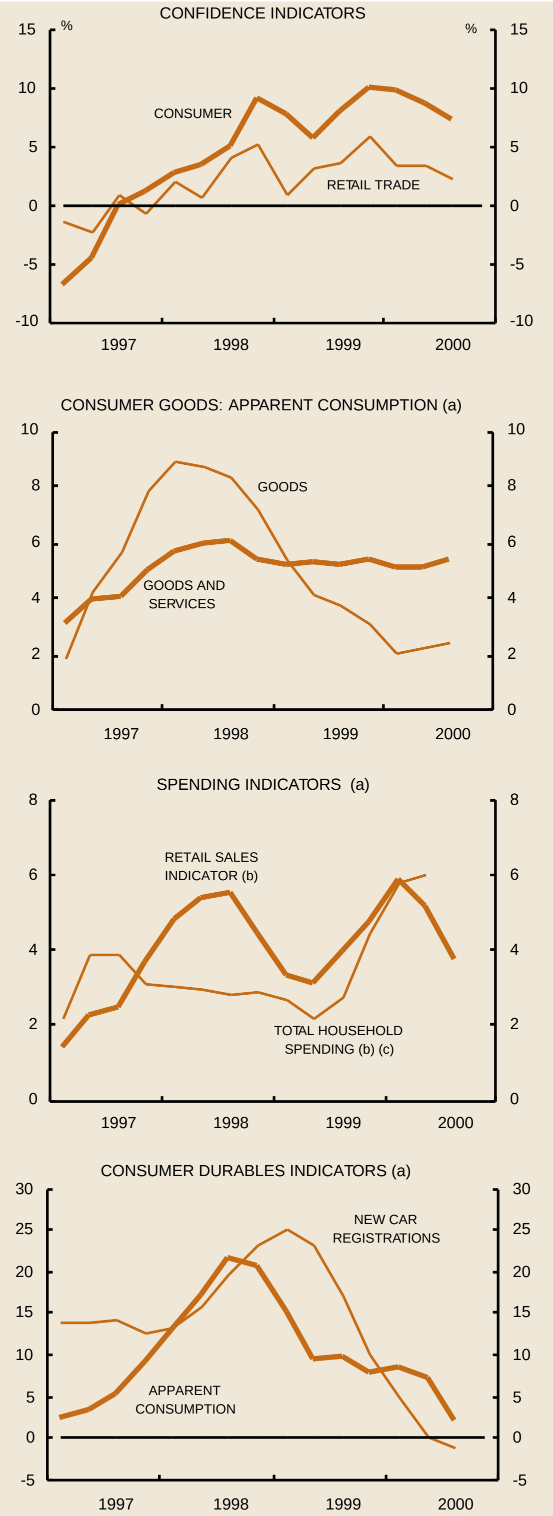
The pace of household consumption has continued to decline in Q3, in line with the profile of the consumer confidence index. This indicator has fallen in Q3 in relation to the levels of previous quarters, and the assessment by consumers of both the overall economic situation and that of households has worsened (see Chart 15). The index of apparent consumption of goods and services held on a stable course in Q3 (for which period only partial information is available), with the food component increasing slightly. New passenger car registrations slowed strongly to September, confirming the downtrend in durable goods spending. Further, the retail sales index and the retail trade confidence indicator, which are also depicted in Chart 15, show that spending was less buoyant last summer and that the outlook for the coming months is one of moderation.

Most of the determinants of consumption have contributed to the progressive moderation of this aggregate, in particular the slowing behaviour of household real income, the lesser effects derived from the rise in the value of their financial wealth and the tightening of expenditure financing conditions. With the partial information available on sectoral accounts, real household income is estimated to be growing in the year 2000 at a lower rate than in the preceding period, as a result of the increase in the inflation rate detracting from purchasing power. In nominal terms, however, income growth is estimated to be higher than in 1999, owing to the greater buoyancy acquired by total gross wages, despite the lower rate of job creation. Likewise, the contribution of general government to the growth of real income is proving less expansionary than in 1999, owing to the petering out of the effect of the personal income tax reform undertaken at the start of last year. Against this background, the growth of consumption continues as in previous years to outpace real income, prolonging the ongoing reduction in the saving ratio. This behaviour may in turn be attributed to the now minimal effects arising from the rise in the value of financial wealth that took place in previous years, to the rise in the value of real estate wealth that has occurred recently and to the still-high level of consumer confidence, albeit now on a declining trend as earlier mentioned. In any event, and on the basis solely of these provisional estimates, the household saving ratio and, to a greater extent, the lending capacity of households (having taken into account spending on residential investment) have now reached very low levels in terms of GDP.

On QNA estimates, general government final consumption spending in 2000 Q2 grew in real terms by 1 % year-on-year, compared with 1.5 % the previous quarter. The information available for Q3 (relating exclusively to state revenue and expenditure) and the overall general government budgetary plans for 2000 confirmed the moderate trend of this expenditure item, albeit with higher rates of change than those provisionally estimated for the first half of the year.

CHART 15

Private consumption indicators



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

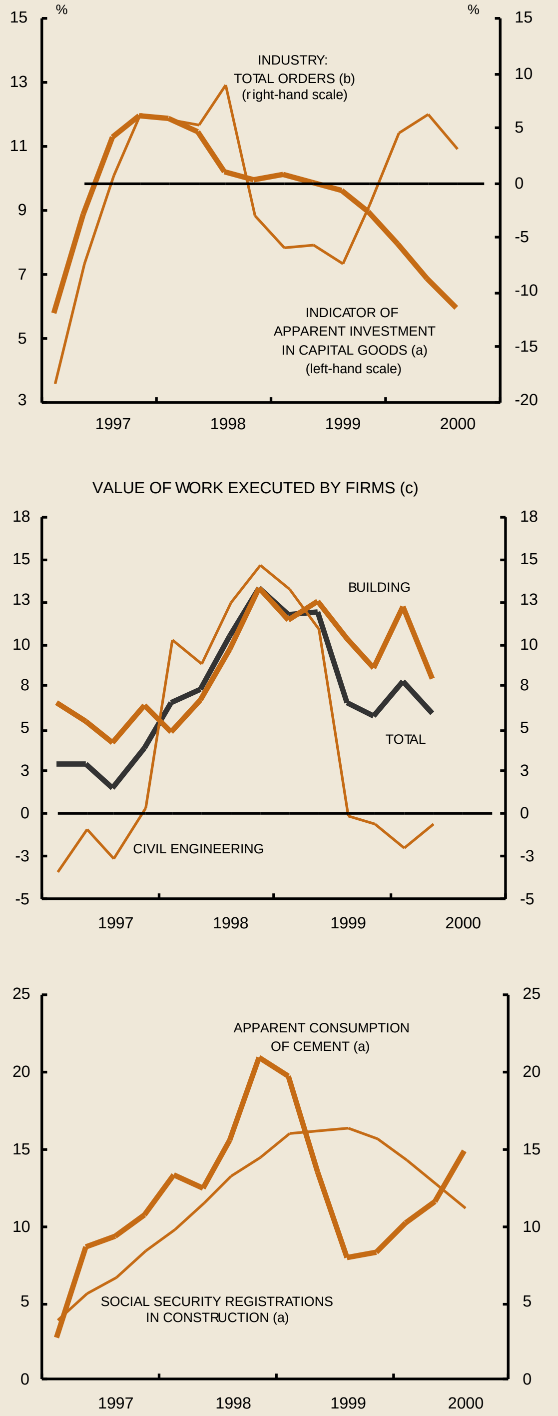
(a) Non-centred annual percentage change, based on the trend of the indicator.

(b) Deflated by the CPI.

(c) Household expenditure survey.

CHART 16

Gross fixed capital formation indicators



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

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

(b) Balances of replies, seasonally adjusted.

(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 pace of gross fixed capital formation stabilised in 2000 Q2 at a similar rate to that of the two preceding quarters, running at 6.5 % year-on-year. This was the result of the uneven behaviour of its two components. On one hand, construction expenditure gained fresh momentum, with its year-on-year growth rate increasing by four-tenths of a point to 8.1 %, while the growth of capital investment fell by around one percentage point on the preceding quarter to 3.8 %. In connection with this latter investment component, the trend of the main economic indicators and corporations' economic and financial situation both appear to be underpinning a somewhat more favourable performance than may be deduced from the QNA estimates. Partly as a reflection of this, and bearing in mind the scant information available, gross fixed capital formation in 2000 Q3 is estimated to have grown at a slightly higher rate than in the previous quarter, the result of the stable and high growth rate of investment in construction and of the check on the slowdown in investment in capital goods.

Among the main indicators, the index of apparent investment in capital goods, with data to July, has continued on a mildly decelerating path throughout the year. As Chart 16 shows, however, the slowdown has been less pronounced than that estimated by INE for the first six months of 2000. The course of the indicator was due to the lesser force shown by imports of capital goods since the start of the year, as domestic output has picked up from the low rate at which it was standing at end-1999.

The trend of the main determinants of capital investment shows that a favourable environment remains in place for further investment. National demand and exports continue to post high growth rates, as reflected by the Banco de España Central Balance Sheet Office Quarterly Survey (CBQ) turnover figures for 2000 Q2, which have enabled capacity utilisation to hold at levels above 80 %. The result of business surveys in industry continue to show orders and business confidence at a high level (even though these have slipped back somewhat in August and September) which should further underpin investment (see Chart 16). Moreover, companies continue to post high rates of return on their assets and, despite interest rate increases, the leverage ratio (measuring the difference between the return on net assets and the cost of borrowed funds) increased further in Q2 according to CBQ data.

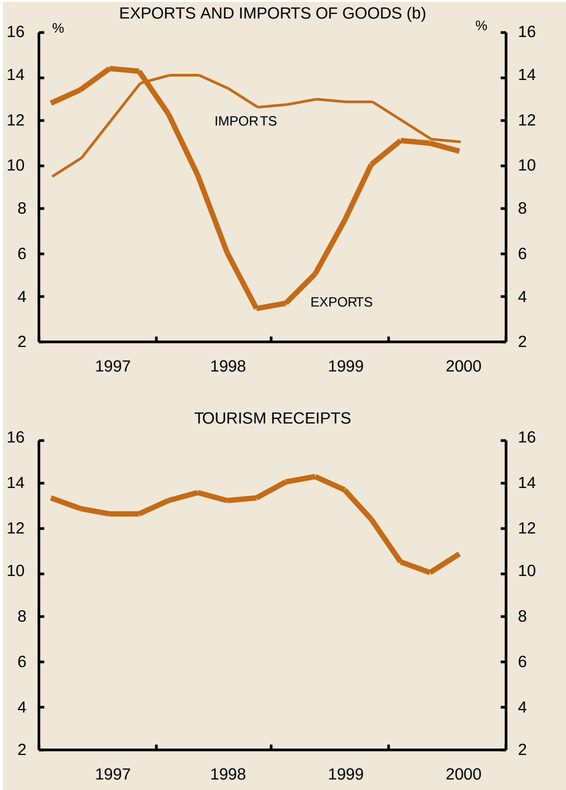
Investment in construction grew by 8.1 % in 2000 Q2, extending the recovery that began the previous quarter. According to the results of the survey for this sector (ECIC), the thrust of construction in Q2 was underpinned by the better performance of civil engineering works, despite the fact this variable is still running at negative rates, and by the ongoing robustness of expenditure on building, which continued to post a very high growth rate, albeit a more modest one than in the previous quarter (see Chart 16). In Q3, it is estimated that investment in construction has generally followed the same pattern, with civil engineering expenditure continuing to pick up and further high growth in investment in both residential and non-residential building. Nevertheless, the surge in housing prices (14.3 % in Q2 compared with the same period a year earlier) and the recent interest rate rises might temper further investment in housing in the coming months.

The latest - and as yet rather incomplete - indicators for Q3 confirm the resilience of investment in construction, against a background of optimism in the industry, as reflected by the information from the business surveys to August. Nonetheless, there was a sharp and notable deterioration in the confidence indicator in September. Among the indicators of inputs, the apparent consumption of cement grew by 12.1 % in July, up from 7.8 % for Q2 and in line with the better performance of civil engineering works, where cement is intensively used in the initial stages. The indicators of employment in construction showed a high growth rate, retaining the decelerating profile they have shown since 1999 Q2. Specifically, the number of registered employees in construction was up 9.8 % in the period from July to September, a similar year-on-year rate to the previous quarter, and the rate of decline of registered unemployment in the sector also stabilised in relation to Q2. As to the indicators related to works starting, these appear to project a moderate slowdown in spending in the coming quarters. Government civil engineering tenders increased by 0.2 % on average in the January-May period, compared with a fall of 12.8 % in 1999. But the growth rate of the leading indicators of private-sector building (the number of square metres to be built according to permits extended by municipal authorities and project approvals) has lessened from that attained in 1999 as a whole. Specifically, the number of square metres to be built according to project management approvals grew by 14.6 % in the first four months of the year, down from 22 % the previous year.

On the latest QNA data, the contribution of stockbuilding to GDP growth in the first half of the year 2000 was positive. This was associated with the good results foreseen for cereal

CHART 17

Foreign trade (a)



Sources: Ministerios 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.

crop yields which, according to ESA 95, should be considered as produce in progress until harvested in the second half of the year.

Trade developments in mid-2000 have taken place against the background of an international environment characterised by generalised growth in activity in the industrialised countries and by clear recovery in other regions. Nonetheless, growing uncertainty has arisen over the potential consequences for this favourable environment of the continuous oil price rises and depreciation of the euro. In the period from March to June the contribution of net external demand in real terms to GDP growth improved by four-tenths of a percentage point to -0.5 points. Concurrently, real flows of foreign trade in goods and services lost some impetus: the year-on-year growth rate of exports slipped by seven-tenths of a point (to 10 %) compared with the previous quarter, and imports slowed by 2.3 percentage points (to 10.9 %). In 2000 Q3, in which period some of the above-mentioned uncertainties have heightened, the information available on the behaviour of foreign trade points to the negative contribution of the net external balance stabilising. This should be accompanied by a stable growth rate for exports and imports, in step with what the real indicators of merchandise trade flows signal (see Chart 17). Other indicators, such as foreign orders, corroborate this behaviour of exports on the basis of the main determinants thereof: a high rate of growth in world trade and the improved competitiveness of Spanish products, at the root of which is the depreciation of the euro. In this respect, it should be pointed out that Spain maintains positive price and cost growth differentials over its main competitors, the effects of which on competitiveness are not mitigated by the exchange rate in trade with the euro area. As the euro zone is Spain's main market, that could endanger the sustained growth of Spanish exports to this market. Turning to imports, the growth during Q3 was the result of the increase in final demand, despite the slight deceleration estimated for this aggregate, and in industrial output.

According to QNA figures, goods exports grew by 11.1 % in real terms in 2000 Q2 compared with 11.8 % the previous quarter. The slight loss of steam in exports was also witnessed in Customs trade figures for the same period. Nonetheless, during the first seven months of the year sales abroad increased, according to these same figures, by 12 % in real terms compared with 2.9 % in the same period in 1999. All product groups showed high increases in exports, with a slight acceleration in exports of consumer goods (especially food) and of non-energy intermediate goods. Exports of capital goods, which had regained in Q2 the high point from which they had fallen in the opening months of the year, once again showed very low growth rates in the figures for the latest two months. In terms of region of destination, Customs figures showed there to be a relative loss of weight in exports targeted on the euro area as opposed to those intended for the «rest of the world» during the first seven months of the year. The vigour of exports outside the euro area has been thanks to the boom in sales to the United States (whose economy is still running at a notable growth rate and whose currency, moreover, continues to appreciate) and to other regions, including Latin America and Asian and eastern European countries. It should be noted, however, that the information for July has altered the growth rates of sales to some of these regions, there having been in particular a heavy loss of momentum in exports to Latin America.

Again on QNA figures, real exports of services increased by 7.6 % year-on-year in Q2, compared with 8.2 % the previous quarter. This result shows how the boom in tourism has abated; having posted a year-on-year increase of 4.1 % in real terms in Q2 (1.4 percentage points down on the preceding quarter), the deterioration in tourism seen since the start of the year 2000 has continued. Also reflecting this slackness are the indicators of foreign visitors lodged in hotels and tourists entering Spain at borders. The rate for the former grew by 1.7 % in the period from January to September, similar to that for the latter between January and August, markedly slower than the rate of over 9 % in the same period a year earlier. British and German visitors accounted for approximately 50 % of non-resident tourists, growing at a very moderate rate in the first half of the year (4 % and 1 %, respectively), although the number of British tourists has begun to pick up since June. Tourism from other countries grew across the board, with Italy and Portugal particular cases in point. The excellent results obtained in the three previous years might be indicating that a ceiling has been reached in catering for the present type of international tourism. However, there are other more circumstantial factors that have also influenced the sluggishness of tourism. These include the hike in fuel prices, which has considerably reduced overland road entries; the stiff competition from other Mediterranean countries, which have managed to attract tourists with low prices now certain factors of domestic instability are behind; and the strong increase in Spain in hotel prices and tourist services.

The QNA figures indicate that in 2000 Q2 the growth rate of real goods imports moderated to 9.8 % against 12.2 % the previous quarter. Customs figures, likewise in real terms and relating to the same period, have confirmed the slowdown in goods imports. It is attributable, at least in part, to the notable increase in the prices of products bought abroad. The moderation of imports, which increased by 9.7 % according to figures from January to July compared with 13.3 % in 1999, fed through with differing degrees of intensity to all the associated components, with the exception of energy products. Of particular note was the slowdown in imports of capital goods, especially in July, and of non-food consumer goods which, however, retain a high growth rate. Purchases of non-energy intermediate goods, which had been most robust the previous quarter as they were fuelled by the progressive pick-up in industrial output and the vigour of exports, have also decelerated substantially since, which might anticipate something of a slowdown in industrial activity. Food imports have been affected by an anomalous figure for July, which hampers analysis, although in the first seven months as a whole they grew at a similar real rate to that in the same period in 1999. Finally, purchases of intermediate energy goods grew substantially in 2000 Q2, after having stabilised in the previous quarter. This was because operators stepped up the rate of their purchases once it was confirmed that the oil price was on an upward course, even on the futures markets.

The real growth rate of services imports moderated slightly to 16.9 % in Q2. Tourism imports, influenced probably by the progressive depreciation of the euro, grew at a real rate of 12.3 %, further prolonging the mildly slowing path seen in the previous quarter. In any event, this variable continued to run at a substantial rate, in step with the high level of Spanish consumer confidence against a background of notable rises in employment and in output.

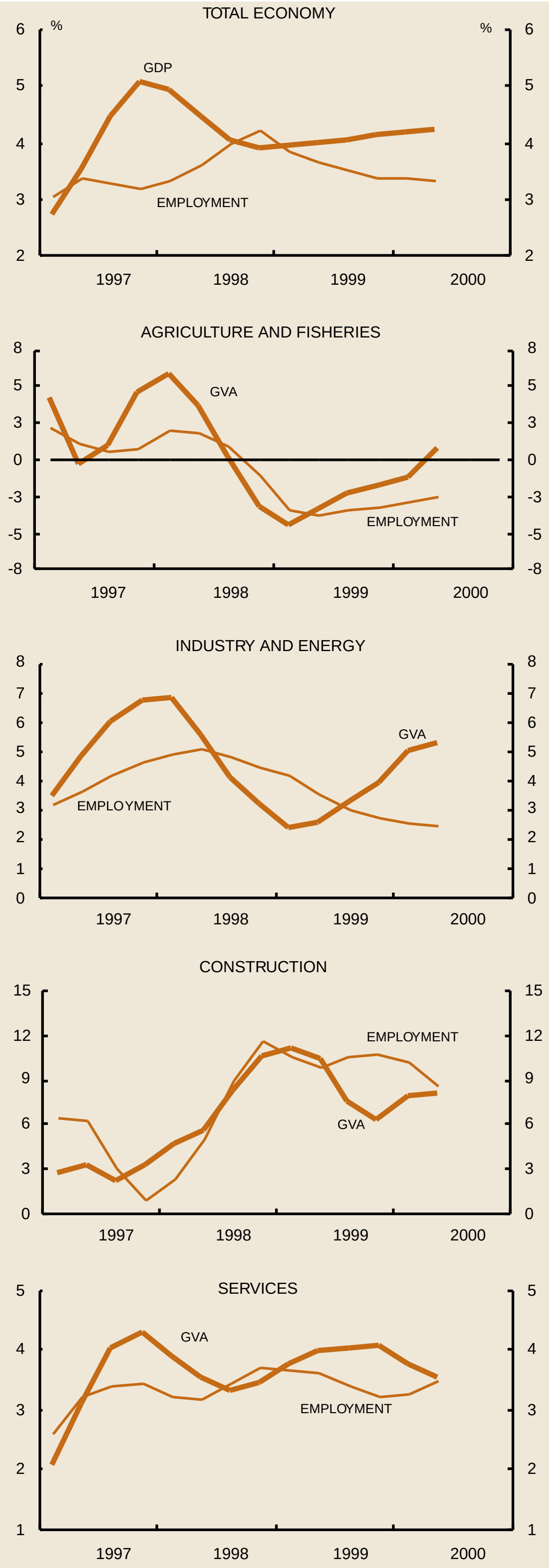
4.2. Output and employment

As indicated, GDP grew at a year-on-year rate of 4.2 % in Q2, a similar rate to the previous quarter. From the standpoint of activity, performance differed from branch to branch. Thus, whereas construction retained the thrust characterising it since the start of the year, remaining the most buoyant activity, agriculture (whose performance is linked to the weather) and energy picked up significantly in terms of their growth rates. However, industry and services slowed slightly, albeit sustaining high growth rates. It is estimated that the counterpart of the slowdown in GDP growth in Q3 to 4 % will have been the extension of the mildly moderating trend of activity in industry and services. Employment generation remained notably robust in Q2, achieving growth of 3.3 % in terms of full-time equivalent jobs, one-tenth of a point down on the previous quarter (see Chart 18). As a result, the growth rate of apparent labour productivity remained on a gradually recovering course since bottoming out at a rate close to zero in the opening quarters of 1999.

Value added in the primary branches, where the appreciable improvement in the weather proved propitious, posted a year-on-year growth rate of 0.7 % in 2000 Q2, two percentage points up on the previous quarter and the first positive rate recorded since end- 1998. This greater buoyancy was mainly the result of the higher levels of agricultural output since crops, especially cereals and pulses, benefited from abun-

CHART 18

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



Sources: Instituto Nacional de Estadística and Banco de España.
(a) Non-centred percentage change on same quarter a year earlier, based on the trend-cycle series published by INE. Employment refers to full-time equivalent jobs.

dant rainfall in the spring. Livestock farming, for its part, has been slowing since mid-1999. The slight improvement in meat production (centred on beef and lamb) did not suffice to offset the reduction in the production of milk and eggs. The indicators prepared by the Ministry of Agriculture, Fisheries and Food point to fresh improvements in agricultural output (despite the fact the extreme lack of rain during the summer has led the previous excellent prospects for the grape and olive harvests to be toned down) and a moderate recovery in livestock farming, whose gross value added has benefited from a notable reduction in input costs.

During the first half of 2000, the economic background to industrial activity was one of sound growth both domestically and abroad, despite progressive oil price rises and the dearer energy bill in euro. In this setting, gross value added in the industrial and energy branches as a whole, which had been gathering steam since the start of 1999, rose to 5.2 % year-on-year in Q2. The acceleration was sharper in energy, specifically in the production of hydroelectric power and gas, which remained most buoyant. However, gross value added in the non-energy industries slowed slightly. According to the information from the industrial production index, the growth of activity in metal processing and other manufacturing industries tended to recover, although from higher rates in the case of the former. Conversely, there was a strong slowdown in mining and quarrying and in chemicals, furthering the slackness seen in previous quarters. The short-term economic information for Q3 points to a fresh deceleration in activity in industry, marking a turnaround in the current upturn. The industrial confidence indicator, which had maintained a positive view both of the present and future situation, fell in August and September as the assessment of total orders and the trend of output declined. The Industrial Production Index revealed a mild slowdown in output in July and August, with a similar profile to that of Social Security registrations in Q3 as a whole. Though remaining at high levels, capacity utilisation in industry has tended to turn down slightly.

On QNA estimates, construction advanced at a year-on-year rate of 8 % in 2000 Q2, three-tenths of a point more than the previous quarter. As earlier indicated when discussing investment in construction, residential building remained considerably buoyant, while civil engineering works also began to pick up. The information available for Q3 points to the high growth profile of this variable stabilising or slowing slightly. In this respect, mention may be made of the number of Social Security registrations and the construction-industry business confidence indicator, the average for which was lower in Q3 than in the previous quarter.

Finally, the slowdown already discernible in services in 2000 Q1 continued, albeit more moderately. The QNA estimate of the growth rate for Q2 compared with the same period a year earlier was 3.5 %, two-tenths of a point less than in the previous quarter. This behaviour was seen in market and non-market services alike, which both slowed by two-tenths of a point. Under market services, the behaviour of certain branches was expansionary, including most notably telecommunications, real estate services and business services. On the contrary, the growth rates of the distributive and the hotel and catering trades fell appreciably. The scant information available for Q3 suggests the gradual loss of momentum will continue, extending to most of the activities included under market services. The retail trade sales index and the retail trade confidence indicator have weakened in recent months, and some hotel occupation statistics have recently been running at negative rates. Social Security registrations have also slowed slightly in Q3, despite strong growth in September.

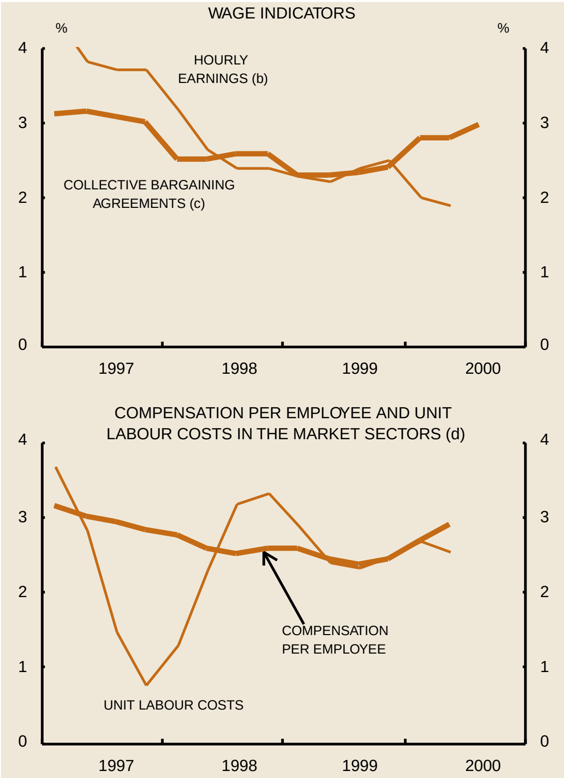
As indicated in the introduction to this section, the QNA figures show that the growth rate of employment, measured by the number of full-time equivalent jobs, slowed slightly in Q2 to 3.3 %. In a branch by branch analysis of activity, buoyant job creation in construction and services, where the related growth rates were 8.5 % and 5.3 %, respectively, may be highlighted. That said, employment in construction slowed by over one percentage point. In industry, employment stabilised at a rate of 2.5 %, while in agriculture and non-market services, where there had been job destruction the previous quarter, the rate of decline abated, whereby these two sectors contributed to a lesser deceleration in overall employment. In step with the slight moderation in employment, and against a backdrop of stable output growth, the rate of change of apparent labour productivity picked up again, sharply so in energy and construction, where the growth rate of employment moderated most. An analysis of the type of employment generated shows that net job creation in Q2 continued to be concentrated among wage-earners. There was a year-on-year increase of 4.2 % in this group, the counterpart of which was a fresh decline in the numbers of self-employed. The employment indicators available for 2000 Q3 point to further moderation in growth here. Specifically, total numbers registered with the Social Security system grew by 5 % from July to September, slightly less than in the April-June period. The rate of decline of registered unemployment also abated in Q3 (declining at a year-on-year rate of 4.2 % against 7.2 % in previous quarters) and did so in all branches, albeit to a lesser extent in construction.

A detailed analysis of the job creation process is usually conducted with EPA (Labour Force Survey) figures. It should first be recalled that the updating of the censual sections undertaken in Q1 (3) will affect comparisons with 1999 throughout the year. Bearing this in mind, the results of the employment analysis undertaken with EPA data do not differ significantly from those obtained in QNA terms, with the possible exception of the rate of increase of employment in industry which, with the EPA employment figures, increased in Q2 and which, with the QNA trend-cycle series, stabilised. In disaggregated terms, and with regard to the contract duration of dependent employees, the EPA for Q2 reflected a moderation in permanent employment while the growth rate of temporary employment stepped up. As a result, temporary employees as a proportion of total wager-earners increased by four-tenths of a point to 32.1 %. The slowdown in permanent employment, which nevertheless increased by 7.6 % on a year earlier, may have been the outcome of the reduction in the number of temporary contracts being converted into permanent ones, owing to the constraints governing such conversion. The contracts entitled to conversion are limited to training or stand-in contracts. In terms of the length of the working day, the part-time ratio held stable in Q2, while in terms of year-on-year rates the numbers of part-time employees grew at a lower rate than in the previous quarter.

As in previous quarters, the rate at which people, and women in particular, join the labour market remained very high in Q2. Specifically, according to the EPA, the labour force grew by 2.9 % in relation to the same period a year earlier and the participation rate among the 16-64 year-old population rose to 64.7 %, three-tenths of a point higher than in the January-March period, drawing closer to the European average. Against this background, the participation rate

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 (excluding the effects of inflation-adjustment clauses).

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

for the youngest cohort (the under 20s) increased, offsetting the slight reduction recorded among 20-29 year-olds. Finally, unemployment fell by one percentage point between the first and second quarters to a rate of 14 per cent sign of the labour force. As observed in previous quarters, the reduction in the unemployment rate was more marked among women, the level for whom (20.4 %) is nevertheless twice that for men (9.6 %). The cut in the unemployment rate was seen in virtually all age groups, and the incidence of long-term unemployment (over one year) fell once more.

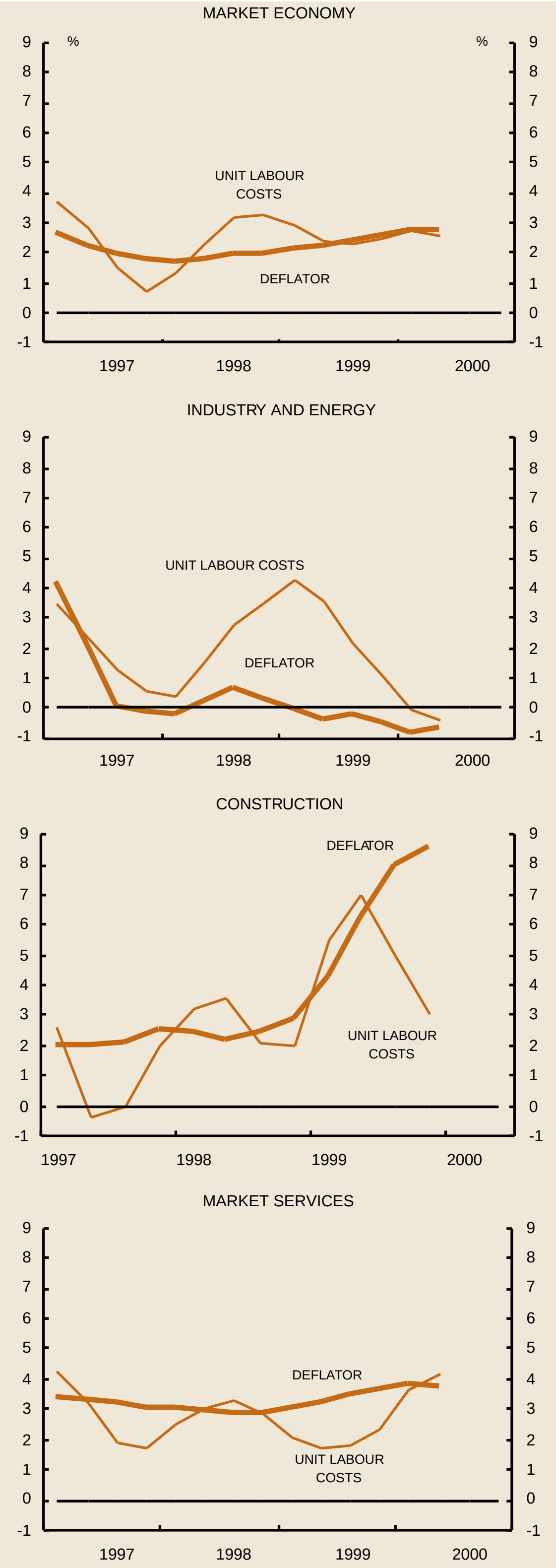
4.3. Prices and costs

The Spanish economy's main price indicators have been on a rising trend in the period to date in 2000, chiefly as a result of inflationary pressures from abroad, the reflection of which has been considerably dearer imports. Nonetheless, the indicators tracking domestical-

(3) In 2000 Q1 INE updated the censual sections considered in the preparation of this survey. Nonetheless, to avoid the problems that might arise in calculating rates of changes using different samples, INE conducted a parallel survey on the former sample, thus enabling homogeneous rates of change to be obtained for the year 2000, which are the rates used in this Report. In any event, on comparing the rates of change in employment observed during 1999, it should be taken into account that these rates may be affected by the methodological changes introduced with the EPA at the beginning of this year.

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.

ly originated inflation have also accelerated. Specifically, the year-on-year growth rate of the GDP deflator was 3.1 % in Q2, similar to the previous quarter but above the increases seen in 1999. Among the components of the deflator, unit labour costs posted a growth rate of 2.6 %, two-tenths of a point down on Q1. This reflected the greater buoyancy of productivity and a slight slowdown in compensation per employee. The contribution of net taxes per unit of output to the rise in the GDP deflator was also significant during the first half of the year. As a result the economy's value-added deflator, which excludes these taxes, increased by 2.8 % in Q2, below the GDP deflator. Lastly, the operating surplus, proxied by the difference between the value added deflator and labour costs per unit of value-added, accelerated slightly, giving rise to a widening of the gross operating margin measured in this way.

Among the components of unit labour costs, compensation per employee slowed slightly in Q2 to 3.4 %, against 3.5 % in Q1. This deceleration, which is more marked when calculated taking the QNA raw data series, is partly attributable to the application in the opening months of 2000 of the inflation-adjustment clauses included under 1999 agreements. These came into effect as a result of inflation deviating in 1999 from the official forecast. The wage survey also showed a slowdown in average hourly earnings in Q2 which, in terms of total earnings, ran at a rate of 2.2 %, two-tenths of a point less than in Q1. However, the increase in average monthly earnings was greater than in the previous quarter (2.5 %). In any event, the results of the survey continue to be affected by the partial renewal at the beginning of the year of the sample, as a result of which branches such as construction, where wage levels are lower, have gained in weight. Across the productive branches, there was a striking acceleration in average monthly earnings in services. The biggest increase in average hourly earnings was in construction (4.2 %), a high figure that may reflect a labour shortage problem. In industry, the related increase was 2.6 %, while in services it was 2.5 %.

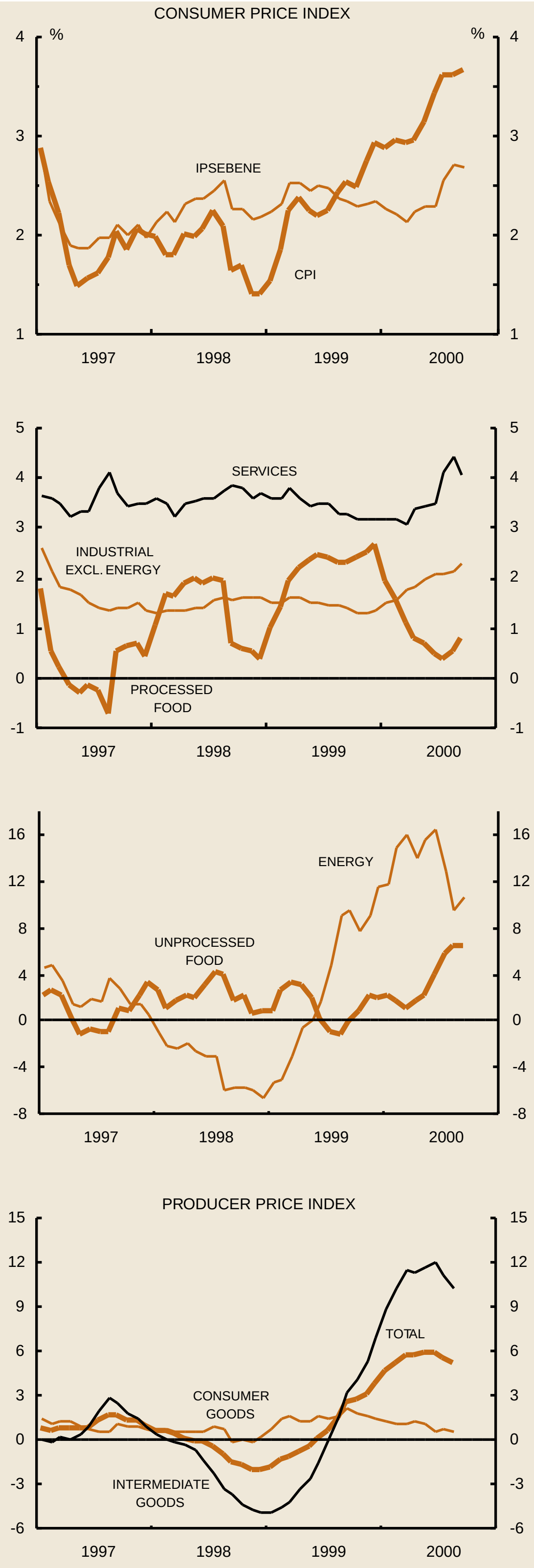
Set against the wage survey results, the increase in wage settlements under collective bargaining agreements entered into in the period to 30th September was 2.9 %, half a point above the related settlement in 1999, prior to inclusion of the inflation-adjustment clause (see Chart 19). Notably, the increase agreed upon has risen significantly in the past quarter, in line with the rise in inflation. Most of the agreements recorded in the period to date this year have been revised agreements, incorporating an increase in wage rates of 2.9 %. Meanwhile, in newly signed agreements, the increase agreed upon is 3 %. Branch by branch, the biggest wage increases have been in agriculture and in construction (3.4 %), which jointly account for around 20 % of the workers subject to collective bargaining, while in services and in industry the increase was 2.9 %. In construction there was an increase of almost one percentage point in the wage settlement agreed upon in July.

The gross value added deflator of the branches making up the market economy grew by 2.8 %, one-tenth of a point more than the previous quarter. This prompted a slight recovery in operating margins (see Chart 20). Across the various branches, prices and margins behaved unevenly. In the industry and energy sector, the value-added deflator sustained a negative change similar to that of the previous quarter, and unit labour costs continued to moderate, mainly as a result of the buoyancy of productivity, while compensation per employee posted low growth. Consequently, the contraction of the gross unit operating margin was slightly less than in previous quarters. The breakdown of information between industry and energy suggests that margins are continuing to widen in energy, while in the industrial branches they deteriorated considerably. In any event, these trends should be viewed with some caution, as other indicators have not exhibited such negative price growth rates in industry as those estimated on QNA figures. In market services the deflator held at a similar growth rate to that of the previous quarter, while unit labour costs accelerated slightly as a result of the bigger increase in compensation per employee. There was thus a minor squeeze on margins. Lastly, there was a fresh widening of operating margins in construction, arising from the strong growth of the deflator and from the reduction in unit labour costs, against a backdrop of improved productivity and unchanged compensation per employee.

Changes in the GDP deflator in 2000 Q2 were accompanied by a notable expansion of import prices, whereby the year-on-year rate of the final demand deflator rose to 4.6 %, four-tenths of a point up on the preceding quarter. The deflator of goods and services imports ran at a rate of 10.2 % in this period on a year earlier, heightening the acceleration recorded in the preceding quarters. Strongly influencing this behaviour are energy import prices, driven by the upward course of oil on international markets. Nonetheless, the non-energy-product import unit value indicators have also accelerated signifi-

CHART 21

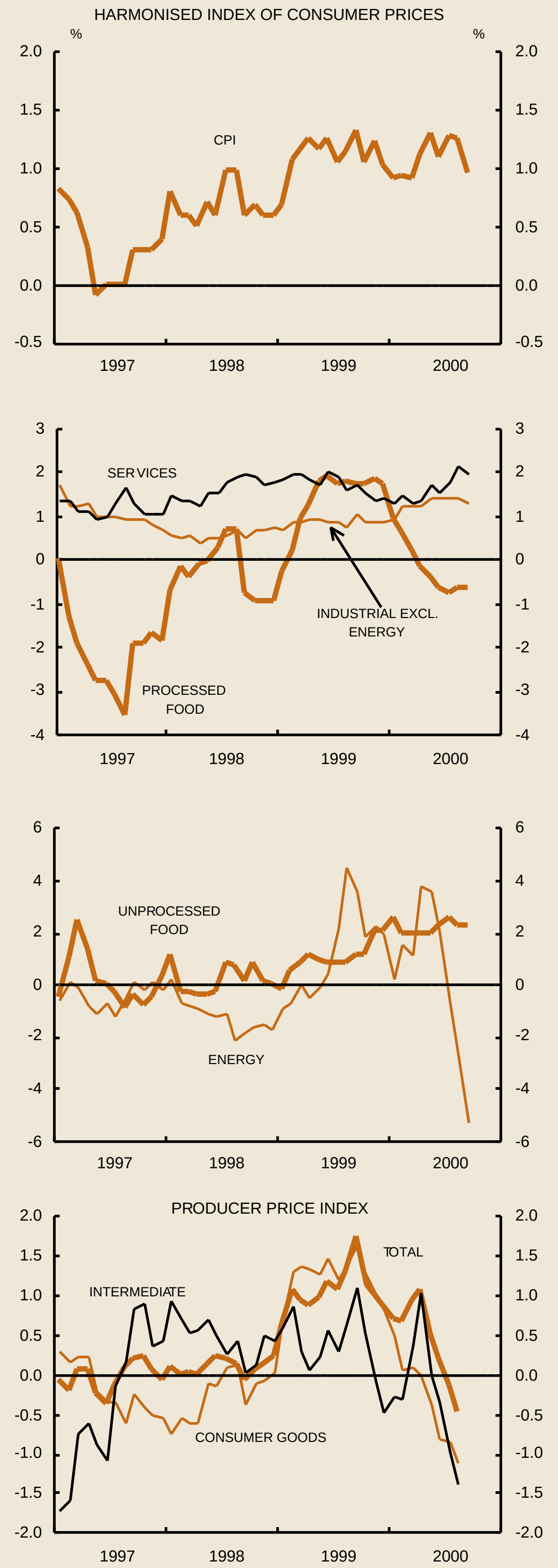
Price indicators (a)
Spain



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.

cantly, propelled by the depreciation of the euro and dearer international prices. Compared with the same period a year earlier, they posted growth of 6.5 % in the first seven months of 2000.

Along the lines of the final demand deflator, the upward course of the main indicators of the Spanish economy's final prices continued in the first half of the year, accelerating further in Q3. The 12-month growth rate of the CPI stood at 3.7 % in September, three-tenths of a point up on June. Behind this increase were the unprocessed food and services components, while the energy component was on a slightly slowing trend, albeit running at high growth rates. Underlying inflation, approximated by the IPSEBENE (index of non-energy processed goods and services prices), also worsened during the quarter, with growth of 2.7 % in September compared with 2.3 % in June.

Although the energy component continued to post the highest growth rates (10.6 % in September), in Q3 as a whole year-on-year growth fell from the highs recorded in June as a result of the acceleration in this component in the second half of 1999. Likewise, dearer crude oil on international markets in Q3 (USD 32.5 per barrel in September) was not reflected uniformly in the final price of the various energy components; there was a bigger increase in heating fuel than in fuels as a whole. The sharpest acceleration was in unprocessed food, which climbed to 6.4 % in September from 3.9 % in June as a result of changes in the prices of certain meats.

Among the components usually trending in a stable fashion, mention must be made of the acceleration in services prices in Q3. The 12-month growth rate of this component rose from 3.5 % in June to 4 % in September. This was essentially due to the strong growth in prices of tourism-related services, where there is great demand pressure, and to a lesser extent to the telephony caption, as a result of the increase in subscription charges by Telefónica, and to transport prices, where the effect of the upward revision of certain airlines' charges can be seen. The other components grouped in the IPSEBENE also accelerated, albeit less sharply. On one hand, processed food posted a growth rate of 0.8 % in September against 0.5 % in June, the outcome of the increase in the price of tobacco, which countered the favourable performance of the price of olive oil. On the other, the growth of non-energy industrial goods edged up by two-tenths of a point in September to 2.3 %, following three months of relative stability. The source of this rise was in the increase in the prices of periodical publications and of secondary education.

Comparison of the respective Spanish and euro-area inflation rates using the harmonised indices of consumer prices (HICP) shows a difference of one percentage point in September, one-tenth of a point less than in June. The reason for the spread narrowing has been a substantial increase in inflation in the euro area in September, since in Spain, as indicated, inflation has increased. Component by component, the inflation differential has worsened notably in services, widening to two percentage points, and it has remained at high levels in the case of non-energy industrial goods and unprocessed food. Conversely, the slowdown in the energy component in 2000 Q3, greater than that in the euro-area countries, has given rise to a sizeable negative differential in this period (see Chart 22).

Lastly, the performance of the producer price index in Spain has been rather more favourable than that of final prices, as its 12-month growth rate dipped from 5.8 % in June to 5.1 % in August. This has been due to the behaviour of energy and non-energy intermediate goods and of capital goods, while the growth of consumer goods stabilised. However, the index of prices received by farmers grew forcefully in June and July following several months of negative changes, and this has begun already to pass through to fresh food prices.

4.4. State budget

The draft State Budget for 2001 includes an initial projection of revenue and expenditure for the current year that allows the data available on the State Budget outturn to be analysed with greater accuracy. This information, which is given in Table 3 (columns 3 and 4), replaces the initial budget figures for 2000 used in previous reports. According to this projection, the State will raise 4.1 % more revenue (ESP 765 billion) and will incur 1.9 % more expenditure (ESP 380 billion) than initially budgeted. This will provide for a reduction in the State cash-basis deficit in the year 2000 of 39.3 %, much greater than initially foreseen (2.8 %). According to these figures, the surplus revenue will arise mainly from direct taxes (both personal and corporate income tax) and from greater profit and dividend income, partly as a result of the extraordinary proceeds arising in connection with the award of mobile telephony licences. On the expenditure side, the main deviations will be in current transfers (chiefly to households) and in financial charges, owing to debt conversion operations.

Public finances continued to trend favourably during 2000 Q3, in line with the official estimates of the budget deficit for this year, which have been revised successively downwards by the government from 0.8 % of GDP (the initial objective) to 0.4 % (in the draft budget) and recently, during the parliamentary debate, to 0.3 % for general government as a whole. Under National Accounts methodology, the State Budget outturn to Q3 resulted in a deficit of ESP 452 billion (0.5 % of GDP), a substantial improvement on the deficit of ESP 782 billion (0.8 % of GDP) recorded in the January-September period in 1999 (see Table 3). Overall revenue increased by 8 % to September 2000 (compared with 9.2 % in the first half of the year), slightly above the figure initially projected. VAT, which grew by 11.5 %, was particularly strong. Nonetheless, the marked buoyancy of this tax has continued to moderate in recent months, whereby its growth rate has come to stand at over six points below the figure for the first six months of the year. Conversely, direct taxes accelerated anew, because of corporate income tax, and rose to a rate of 10.1 % (7.7 % to June). Expenditure increased by 5.2 % to September, above the initial projection and the figure of 4.3 % recorded in the first half of the year. Of note was the high growth rate of transfers paid to other levels of government, which was higher than the official estimate for the whole year. The rate of decline of both final consumption expenditure and actual interest payments has slackened in recent months.

In cash-basis terms, the State ran a deficit of ESP 1,350 billion to September 2000, signifying growth of 14.4 % on the deficit accumulated in the same period a year earlier, in contrast to the marginal reduction (1.7 %) observed to June and to the heavy cut envisaged in the initial projection. Nonetheless, the trend of the cash-basis deficit to Q3 has been distorted by the greater concentration of interest payments. If this calendar difference is taken into account along with the acceleration in profit and dividend income and in current transfers expected during the final quarter of 2000, the budget outturn to September is consistent with the forecast for the whole year. Overall revenue grew by 4.5 % to September, virtually unchanged on the first half of the year although below (owing to the aforementioned non-tax revenue pending) the figure of 6.2 % forecast in the initial Budget projection. Expenditure growth ran at 5.3 % to September. This figure, affected by the aforementioned concentration of interest payments, was above the increase posted to June (3.8 %) and the initial Budget projection (3.7 %). A breakdown of revenue and expenditure is discussed below using the cash-basis information.

Under revenue, tax proceeds held at a similar growth rate to that witnessed in the first half of the year and to that foreseen in the initial projection. Further, there was an appreciable narrowing in Q3 in the difference between the growth rate of direct taxes, which continued to accelerate, and of indirect taxes, the force of which slackened notably. The acceleration in direct taxes was due to corporate income tax which, owing to the inclusion of revenue relating to net tax payable, switched from a negative rate of -2.8 % to June to a rate of increase of 10.1 % to September. Personal income tax revenue stood at a rate of 3.8 % at the end of Q3, virtually unchanged from the figure at the end of Q2. The increase in personal income tax is still less than forecast in the initial projection. This might be due to the speedier refund of excess tax payments made in the 1999 fiscal year.

Although the growth rates of all the main indirect tax components declined in Q3, there was a notably strong slowdown in VAT to a rate of 11.3 % to September, compared with the increase of 16.8 % to June. However, this growth rate, affected by the rise in the price of fuel since the beginning of the year (4), continues to outpace the rate forecast in the initial projection (9.5 %). The growth rate of excise duties edged down slightly (to 5.3 % in September), placing it in line with the forecast for the whole year.

The rate of decline of non-tax revenue held virtually unchanged in Q3. The strong growth of capital transfers from the European Union remains prominent, as does the reduction in profit and dividend income due to the revenue from the Banco de España (ESP 359 billion to September 2000 compared with 701 billion in the same period the previous year), both that arising from capital gains (5) and that relating to ordinary profits. Elsewhere, lower debt issuance premia had a bearing on the reduction in the «other net revenue» aggregate.

Turning to the expenditure captions, and as earlier discussed, the main reason behind their acceleration was the trend of interest payments, the rate of decline of which slowed considerably (0.8 % to September against 6.8 % to June) as a result of the above-mentioned calendar effect. The rate of decline of operating expenses (wages and salaries, and goods and services) eased in Q3, standing at close to 9 %. This reduction, in the case of goods and services, is lower than foreseen in the initial projection. The inverse relationship witnessed in recent years between the State's operating expenses and its current transfers, as a result of the transfer of the responsibility for education to the regional governments, determined a slowdown in current transfers in Q3 as opposed to an acceleration in operating expenses, whereby the growth rate of the former dipped from 14.6 % in June to 12.8 % in September, in line with the forecast for the year as a whole. As regards capital transactions, their two components also behaved unevenly during Q3: real investment grew by 2.3 % to September, after a cumulative decline in the first six months of the year, while the growth rate of capital transfers fell to a negative rate of -3.3 %. In any event, both rates of change are higher than envisaged in the initial projection for the year 2000.

4.5. The Spanish balance of payments and capital account

From January to July, the current and capital accounts ran a deficit of EUR -6579 million, compared with a negative balance of EUR -503 million in the same period a year earlier (see Table 4). Marking this result was the high increase in the deficit on the trade balance (43.7 %), adding to which was the deterioration in the income balance and the lower surplus in the sub-balance of current transfers. The capital-account balance, which ran a surplus of EUR 3445 million, was 6.1 % up on the same period the previous year.

As in the preceding quarters, the sharp increase in the trade deficit was predominantly due to the deterioration in the terms of trade (the relationship between export and import prices) derived from dearer import prices (in particular energy prices). Excluding the energy component, nominal exports posted a slightly higher growth rate than that of imports. At a greater level of detail, an analysis of the structure of flows of goods to or from the euro area

(4) Dearer fuel prices do not affect the revenue raised in connection with the hydrocarbons excise tax since this tax is a fixed amount. VAT (at 16 % in this case), on the other hand, is applied to the price.

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

BOX 5

Social security budget outturn

On budget outturn data to July 2000, the Social Security System ran a surplus of ESP 739 billion, ESP 261 billion (54.6 %) higher than in the same period of 1999 (see table below). This improvement in the balance, greater even than that recorded to April, was the result of growth in revenue of 10.4 %, virtually the same as to April, and of the moderate increase in expenditure (7.7 %, against 8.4 % to April).

Receipts from social security contributions held at a growth rate of 9.7 % to July (6.8 % in the whole of 1999), far above the budget forecast of 3 %(1). This was attributable, above all, to the buoyancy of registrations, which grew by 5.2 % year-on-year in the period to September (against 5.5 % throughout 1999). This figure compares with a budget forecast of only 3 % for the increase in the number of contributions by employed workers. The other major source of revenue, current transfers from the State, also increased by 11.6 %, in line with budget forecasts.

The growth of expenditure to July 2000, despite an ongoing deceleration in recent months, stood above the budget forecast for the year as a whole, owing largely to the payment of ESP 66 billion to pensioners in February as compensation for the deviation by inflation from the official forecast in 1999. Spending on contributory pensions rose by 7.4 % to July (against 8.6 % to April), slightly above the budget forecast (7 %); however, this rate, affected by the above-mentioned one-off payment, is expected to ease somewhat over the coming months. The number of contributory pensions grew by 1.2 % year-on-year to September, in line with forecasts 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 quickened notably in August, growing in cumulative terms by 5 % in the first eight months of the year compared with a decline of 2.9 % for 1999 as a whole. The acceleration was due to changes in the number of beneficiaries, which fell by 3.7 % in the period to August, compared with an average decrease of 9.5 % for 1999. This latter figure captures the slower decline in registered unemployment (5.1 % to September, against 11.7 % for 1999 as a whole). In line with the trends observed in 1999, the fall in the number of unemployed entitled to unemployment benefits ran, to August, below the reduction in the number of registered unemployed. As a result, the replacement rate increased to 64.5% (63.4 % in the first eight months of 1999).

Contributions received by the INEM rose by 10.4 % in the period to June, despite the 0.25 percentage points cut in the unemployment contribution rate, while concessions on employers' contributions for employment-promoting contracts increased by 18.7 % to May, against the 1.9 % reduction forecast in the budget.

(1) However, the social security budget draft for 2001 forecasts an increase of 10.2 % in regular contributions to the general regime for the whole of 2000.

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

ESP bn and %

	Outturn	Budgeted		Outturn JAN-APR	Outturn JAN-JUL		
	1999 1	2000 2	% change 3=2/1	% change 4	1999 5	2000 6	% change 7=6/5
1. Revenue	**13,832**	**14,583**	**5.4**	**10.6**	**8,326**	**9,192**	**10.4**
Social security contributions (c)	9,310	9,589	3.0	9.7	5,361	5,879	9.7
Current transfers	4,349	4,825	10.9	11.3	2,872	3,204	11.6
Other (d)	173	169	-2.3	39.0	92	109	17.8
2. Expenditure	**13,582**	**14,432**	**6.3**	**8.4**	**7,848**	**8,453**	**7.7**
Wages and salaries	2,129	2,245	5.4	6.3	1,309	1,396	6.6
Goods and services	1,341	1,397	4.2	6.1	765	815	6.5
Current transfers	9,916	10,570	6.6	9.2	5,698	6,159	8.1
Benefits	9,851	10,502	6.6	9.3	5,655	6,114	8.1
Contributory pensions	*7,796*	*8,342*	*7.0*	*8.6*	*4,437*	*4,764*	*7.4*
Sickness	*555*	*528*	*-4.7*	*12.8*	*278*	*320*	*15.1*
Other (e)	*1,501*	*1,631*	*8.7*	*11.1*	*940*	*1,029*	*9.5*
Other current transfers	65	68	4.4	6.3	43	45	6.1
Other (f)	195	220	13.0	9.4	76	83	9.2
3. Balance	**250**	**151**	**-39.6**	**25.0**	**478**	**739**	**54.6**

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

(a) Only data relating to the System, not to the entire social security funds sector, are given. This is because the figures for other social security funds for the year 2000 are not available.

(b) Transfers to regional (autonomous) governments to finance the health-care and social-services responsibilities they have assumed have been distributed among the various expenditure captions on the basis of the percentages resulting from the general government accounts for 1996.

(c) Including surcharges and fines

(d) Excluding surcharges and fines, and the contribution from the pharmaceutical industry.

(e) Reduced by the contribution from the pharmaceutical industry.

(f) Reduced by the disposal of investments.

TABLE 3

State Budget outturn

ESP bn and %

	Outturn 1999	Percentage change 1999/1998	Initial projection 2000	Percentage change 2000/1999	Outturn JAN-JUN Percentage change 2000/1999	Outturn 1999 JAN-SEP	Outturn 2000 JAN-SEP	Outturn Percentage change
	1	2	3	4=3/1	5	6	7	8=7/6
1. Revenue	**18,364**	**4.8**	**19,507**	**6.2**	**4.4**	**13,254**	**13,847**	**4.5**
Direct taxes	7,817	4.7	8,438	7.9	3.8	5,593	5,979	6.9
Personal income tax	*5,098*	*2.0*	*5,361*	*5.2*	*3.7*	*3,740*	*3,881*	*3.8*
Corporate income tax	*2,436*	*9.9*	*2,772*	*13.8*	*-2.8*	*1,643*	*1,808*	*10.1*
Other (a)	*283*	*15.2*	*304*	*7.5*	*31.8*	*210*	*290*	*38.2*
Indirect taxes	7,951	13.4	8,593	8.1	13.3	5,868	6,418	9.4
VAT	*5,114*	*17.1*	*5,600*	*9.5*	*16.8*	*3,757*	*4,181*	*11.3*
Excise duties	*2,567*	*7.3*	*2,689*	*4.8*	*5.9*	*1,912*	*2,013*	*5.3*
Other (b)	*270*	*5.9*	*304*	*12.6*	*13.6*	*199*	*224*	*12.5*
Other net revenue	2,597	-14.6	2,476	-4.6	-19.7	1,793	1,450	-19.1
2. Expenditure	**19,421**	**4.2**	**20,149**	**3.7**	**3.8**	**14,435**	**15,197**	**5.3**
Wages and salaries	2,979	-2.4	2,765	-7.2	-10.2	2,170	1,978	-8.8
Goods and services	436	12.3	379	-13.1	-10.9	305	279	-8.5
Interest payments	3,178	-4.7	2,947	-7.3	-6.8	2,678	2,656	-0.8
Current transfers	10,809	9.1	12,126	12.2	14.6	7,883	8,892	12.8
Investment	957	6.6	950	-0.7	-8.7	710	726	2.3
Capital transfers	1,063	-0.8	982	-7.6	1.1	688	666	-3.3
3. Cash-basis balance (3=1-2)	**-1,057**	**-5.1**	**-642**	**-39.3**	**-1.7**	**-1,180**	**-1,350**	**14.4**
MEMORANDUM ITEM: NATIONAL ACCOUNTS:								
Revenue	18,804	8.8	20,160	7.2	9.2	13,220	14,280	8.0
Expenditure	19,901	3.6	20,785	4.4	4.3	14,002	14,732	5.2
Net borrowing (-) or lending (+)	**-1,097**	**-42.9**	**-625**	**-43.0**	**-76.5**	**-782**	**-452**	**-42.2**

Source: Ministerio de Hacienda.
(a) Includes the revenue from the tax on the income of non-residents.
(b) Includes taxes on insurance premiums and tariffs.

or the «rest of the world» shows that the weight of exports to the euro area diminished in the first half of 2000 in relation to those to the rest of the world. In addition to the impulse that the depreciation of the euro is giving to sales to the rest the world, this might indicate that Spain's price and cost differentials with the euro area might be adversely affecting sales of Spanish products in these markets. The services deficit, for its part, held virtually unchanged; however, the composition of its tourism and other services items was altered. In the first seven months of the year, the tourism balance was chiefly marked by sluggish receipts, which further checked its rate of increase to 8.8 % (compared with 13.2 % in the same period a year earlier), while payments quickened slightly, due partly to their price component. The deficit of the «other services» caption grew sharply; that said, both receipts and payments once again evidenced the notable boom in cross-border flows of services recently. By type of service, and in addition to the increase in receipts and payments relating to transport services, linked to trade flows, both receipts and payments in transactions relating to communication and IT services, to business services and to cultural services stood out, with growth rates exceeding 20 %.

The income balance, which is traditionally in deficit, worsened slightly (see Table 4). However, investment income receipts grew more than the associated payments. The changes under way in international financial flows - and which are reflected in the altered structure of the various institutional sectors' income accounts (credit, general government and other resident sectors) and of the various instruments (direct and portfolio investment and interest on loans and deposits) - heightened during the first half of 2000. This phenomenon can be seen on analysing the rates of change recorded in the various sub-items. Nonetheless, given the current volatility of investment income flows over periods of less than one year, it would be advisable to wait for the changes to become embedded in the annual data before analysing them in detail. The surplus on current transfers worsened notably as receipts grew less in percentage terms than payment. On one hand, flows from the EU (under the EAGGF-Guarantee and the European Social Fund) fell heavily, while payments to the EU accelerated. On the other, receipts relating to current transfers from other resident sectors grew relatively less than the corresponding payments. Under this caption it can be seen that the emigrants' remittances sub-item, though at very low levels, is growing substantially on the payments side. Finally, the capital-account surplus declined moderately during the quarter, in which flows relating to structural funds from the EU contracted slightly.

The increase in the nation's net borrowing reflected in the data would denote the ongoing weakening of the sectoral balances of households and corporations, in a period in which the household saving ratio continues to shrink and in which residential investment and private productive investment are sustaining a high growth rate. By contrast, the figures available for the first two quarters of the year indicate that the headway made in reducing the budget deficit remains notable.

TABLE 4

Balance of payments: summary table (a)

EUR m

	JAN-JUL 1999	JAN-JUL 2000
	Receipts	Receipts
Current account	**103,234**	**119,776**
Goods	59,976	71,320
Services	28,145	31,219
Tourism	*16,960*	*18,369*
Other services	*11,186*	*12,851*
Income	7,028	8,728
Current transfers	8,084	8,508
Capital account	**3,862**	**3,942**
	Payments	Payments
Current account	**106,983**	**129,800**
Goods	73,642	90,964
Services	16,038	18,434
Tourism	*2,787*	*3,145*
Other services	*13,251*	*15,289*
Income	11,998	14,039
Current transfers	5,306	6,364
Capital account	**616**	**497**
	Balance	Balance
Current account	**-3,750**	**-10,024**
Goods	-13,666	-19,644
Services	12,108	12,786
Tourism	*14,172*	*15,224*
Other services	*-2,065*	*-2,438*
Income	**-4,970**	**-5,311**
Current transfers	2,778	2,144
Capital account	**3,247**	**3,445**

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

5. Financial flows in the Spanish economy

5.1. Financial flows in the economy as a whole

The latest information from the national and financial accounts shows a rapid deterioration in the nation's net financial saving (6) in 1999 and in 2000 to date. The net balance of the Spanish economy's financial transactions with the rest of the world was -2.1% of GDP over the four quarters to the end of 2000 Q2, having been -1.1% of GDP in 1999 with the new National Accounts figures (see Table 5). This was essentially the result of the decline in the net financial saving of households and non-financial corporations, which had fallen to very low levels. General government net borrowing continued to decline during the first half of 2000, and the credit balance of the financial institutions sector's financial transactions with other sectors increased.

The trends in inter-sectoral flows contain important elements for understanding some of the processes taking place since the end of 1999. In the case of households, along with the trend decrease in their net financial saving, in recent quarters there has been an increase in intermediation by credit institutions in their financial flows. This follows the accumulation in recent years by households of net assets vis-à-vis institutional investors, to the detriment of saving channelled through credit institutions (see the bottom of Table 5). In any case, within the group of institutional investors, there are some instruments that continue to capture a high volume of household saving, such as international investment funds and unit linked. It should be noted, for example, that the external assets of Spanish mutual funds currently represent 38% of their total portfolio. Non-financial corporations, meanwhile, have increased their net borrowing, by borrowing from credit institutions and, to a lesser extent, running down their net assets vis-à-vis the rest of the world, although, as mentioned in section 5.4, this net decline is small relative to the flows of funds to and from abroad. The general government sector is also covering its requirement for funds with financing from the rest of the world, given the scantness of domestic saving. In the economy as a whole, the institutional investors sector has continued to invest heavily abroad (as part of the process

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

TABLE 5

Net financial saving and intersectoral flows
(Cumulative data for the last four quarters)

% GDP

	NET FINANCIAL SAVING							
	1995	1996	1997	1998	1999 Q3	1999 Q4	2000 Q1	2000 Q2
Total economy	**1.0**	**1.2**	**1.6**	**0.5**	**-0.9**	**-1.1**	**-1.8**	**-2.1**
Non-financial corporations and households and NPIs	**6.6**	**5.0**	**4.0**	**1.9**	**-0.5**	**-0.5**	**-1.2**	**-2.6**
Non-financial corporations	0.2	-0.1	-0.4	-0.9	-2.7	-1.8	-2.5	-3.2
Households and NPIs	6.5	5.1	4.4	2.8	2.2	1.2	1.3	0.6
Financial institutions	**1.0**	**1.2**	**0.8**	**1.2**	**0.7**	**0.5**	**0.7**	**0.8**
General government	**-6.6**	**-4.9**	**-3.2**	**-2.6**	**-1.1**	**-1.1**	**-1.2**	**-0.2**

	NET FINANCIAL TRANSACTIONS (a)							
	1995	1996	1997	1998	1999 Q3	1999 Q4	2000 Q1	2000 Q2
Households and NPIs	**6.5**	**5.1**	**4.4**	**2.8**	**2.2**	**1.2**	**1.3**	**0.6**
with:								
Credit institutions (b)	1.4	-3.1	-6.1	-5.3	-1.1	-0.6	1.3	1.1
Institutional investors (c)	3.1	9.0	10.7	7.7	3.2	1.1	-0.6	-1.4
Non-financial corporations	**0.2**	**-0.1**	**-0.4**	**-0.9**	**-2.7**	**-1.8**	**-2.5**	**-3.2**
with:								
Credit institutions (b)	-2.2	-0.8	-2.8	-4.8	-5.5	-4.1	-5.4	-4.6
Rest of the world	-0.3	0.3	1.7	0.9	0.6	-0.3	0.4	-0.5
General government	**-6.6**	**-4.9**	**-3.2**	**-2.6**	**-1.1**	**-1.1**	**-1.2**	**-0.2**
with:								
Credit institutions (b)	-3.2	-0.4	1.3	1.4	-0.8	1.4	1.3	1.4
Institutional investors (c)	0.6	-6.0	-3.9	-2.6	1.4	1.7	1.7	3.3
Rest of the world	-3.3	-0.4	-2.0	-1.0	-3.0	-4.4	-3.8	-3.8
Rest of the world	**-1.0**	**-1.2**	**-1.6**	**-0.5**	**0.9**	**1.1**	**1.8**	**2.1**
with:								
Credit institutions (b)	-2.9	0.9	2.8	7.1	6.5	1.9	3.5	3.3
Institutional investors (c)	-0.5	-0.9	-2.6	-6.1	-5.6	-3.5	-3.6	-3.9
Non-financial corporations	0.3	-0.3	-1.7	-0.9	-0.6	0.3	-0.4	0.5
General government	3.3	0.4	2.0	1.0	3.0	4.4	3.8	3.8

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

of international diversification of portfolios). This, together with the deficit on the economy's current and capital accounts, has led to growing indebtedness of those sectors best able to tap international financial markets: credit institutions and, to a lesser extent, general government.

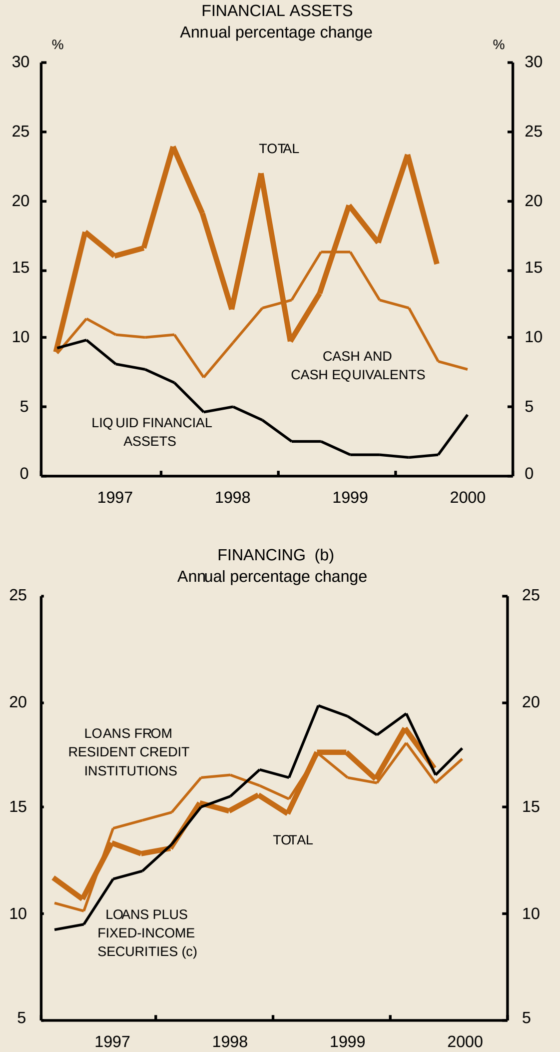
5.2. Financial flows of households and non-financial corporations

The net financial saving of households and non-financial corporations declined again in 2000 Q2, to -2.6% of GDP, in cumulative four-quarter terms. Both the households and non-financial corporations sectors contributed to this decline, each reducing their net financial saving by 0.7 percentage points. Despite this decline in the net financial transactions of the non-financial private sector as a whole, there was a high rate of acquisition of assets and liabilities, but these figures are inflated by specific transactions for the reorganisation of corporate groups.

Despite the significant volume of financial assets acquired by households and non-finan-

CHART 23

Non-financial corporations, households and NPIs (a)



Source: Banco de España.

(a) The data for 2000 Q3 are provisional estimates.

(b) Including credit, securities and other borrowed funds.

(c) Including loans from abroad and financing through securitisation funds.

cial corporations during the first two quarters of the year, the year-on-year growth rate of the total stock of assets fell at the end of the first half of 2000 (see Chart 23). This deceleration was basically due to the redemption and decline in value of mutual fund shares. The scant revaluation of share portfolios in the last four quarters also helps to explain this lower rate of growth of assets. As for liquid financial assets, they continued to grow at a very low rate in Q2 (see Table 6). The factors explaining this trend, from the sectoral viewpoint, are the ongoing negative growth of the liquid financial assets of households, strongly influenced by the reduction in the net asset value of mutual funds, and the low relative weight of the assets of corporations, which means that the contribution of the sector was small, despite its sustained high growth rate. The information available on Q3 indicates an increase in the rate of growth of liquid financial assets (to around 4.5%), as a result of a deceleration in cash and cash equivalents in Q2, an acceleration in repos and growth in mutual funds at lower negative rates.

The rate of increase in the financing obtained by households and non-financial corporations decelerated in Q2. Thus, the year-on-year growth rate of the aggregate made up of credit from resident credit institutions, credit intermediated by securitisation funds, foreign loans and securities issuance was 16.5%, as against 19.4% in 2000 Q1, owing both to the deceleration of credit from resident banks and the lower contribution of foreign loans and securities issuance. The information on Q3 indicates an increase in the growth rate at the end of the first half of the year, which may be related to the financing received by certain firms to pay for UMTS licences in Europe.

5.2.1. Financial flows of households

Household net financial saving fell significantly in 2000 Q2, to 0.6% of GDP, in cumulative four-quarter terms, an historic low for this variable. In the last two years, the trend decline in the volume of net financial saving of this sector has been driven, on one hand, by consumption growth, which has outpaced that of disposable income, stimulated by the revaluation of real and financial wealth and interest rates that are still low, and on the other hand, by the rapid growth in investment in real assets. During 2000 to date the rise in interest rates and the smaller revaluation of financial assets have produced monetary and financial conditions less favourable to sustaining spending at its 1999 level. When the historically low level of household net financial saving is added to this factor, it seems unlikely that the situation of 2000 Q2 can continue for long.

The trend in household financial transactions, together with the decline in the value of financial assets, led to a reduction in the market value of household financial wealth in Q2 (see Chart 24). Taking into account the unfavourable trend in bond and equity market prices in Q3, a further fall can be expected in the financial wealth of households in that period.

The information on 2000 Q2 indicates that the rate of acquisition of financial assets by

TABLE 6

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

% GDP

	1998	1999	1999		2000	
			Q3	Q4	Q1	Q2
HOUSEHOLDS AND NPIs:						
Change in assets	**9.6**	**9.1**	**2.3**	**1.8**	**2.7**	**1.5**
Cash and cash equivalents	3.0	4.2	1.1	0.7	0.8	0.0
Other deposits and fixed-income securities (b)	-1.6	2.4	0.5	1.9	1.7	1.7
Shares and other equity	4.9	-1.8	0.2	-2.5	-1.8	-0.9
Other	3.2	4.3	0.4	1.8	2.0	0.7
Change in liabilities	**6.8**	**8.0**	**2.0**	**1.9**	**1.9**	**1.7**
Credit from resident credit institutions	5.9	6.5	1.5	1.9	1.5	1.4
Other	0.9	1.5	0.5	0.1	0.4	0.3
NON-FINANCIAL CORPORATIONS						
Change in assets	**15.0**	**17.0**	**4.1**	**3.5**	**5.4**	**6.7**
Cash and cash equivalents	1.6	0.8	0.5	-0.5	0.7	0.5
Other deposits and fixed-income securities (b)	0.3	-0.2	0.0	0.4	0.5	0.5
Shares and other equity	3.5	7.5	1.7	0.6	0.9	2.7
Other	9.6	8.9	2.0	3.0	3.3	3.1
Change in liabilities	**16.0**	**19.0**	**5.0**	**4.0**	**6.3**	**7.4**
Credit from resident credit institutions	4.8	5.0	1.0	1.0	2.0	1.6
Foreign loans, fixed-income securities and securitisation funds (b)	1.8	3.6	0.5	0.8	0.3	0.9
Other	9.4	10.3	3.5	2.2	4.0	5.0
MEMORANDUM ITEM: YEAR-ON-YEAR GROWTH RATES (%):						
Liquid financial assets	**4.0**	**1.5**	**1.5**	**1.5**	**1.3**	**1.5**
Households and NPIs	4.1	0.5	1.0	0.5	-0.3	-0.1
Non-financial corporations	3.8	7.1	3.9	7.1	9.6	9.7
Financing (c)	**16.8**	**18.5**	**19.4**	**18.5**	**19.4**	**16.5**
Households and NPIs	19.3	19.6	19.8	19.6	18.2	17.3
Non-financial corporations	14.9	17.6	19.1	17.6	20.4	15.9

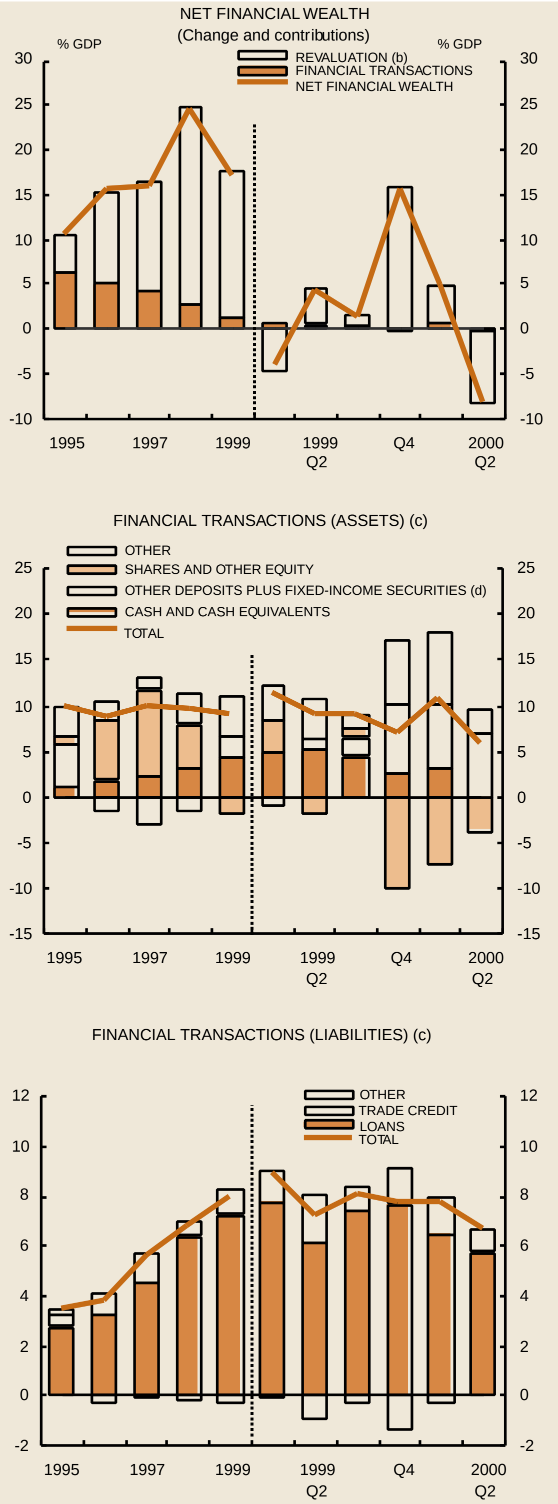
Source: Banco de España.
(a) Seasonally adjusted data
(b) Not including unpaid accrued interest, which is included under other.
(c) Including bank credit extended by resident credit institutions, foreign loans, fixed-income securities and financing through securitisation funds.

households is down on previous quarters. This was the result of almost zero growth in lower-yield assets, such as cash and cash equivalents, and the decline in net subscriptions for shares in mutual funds. The main increase in the portfolio of assets of households took the form of an increase in time deposits and, to a lesser extent, insurance transactions (see Table 6). This redistribution between financial assets was prompted by the increase in the tax-adjusted return on bank deposits and the lower attractiveness of highly liquid assets and equity products at times of tightening financial conditions. Nonetheless, households acquired shares in net terms during Q2, in the public offerings of very specific companies, which continued to attract the interest of investors owing to their expected profits.

The volume of financing obtained by households in 2000 Q2 was somewhat lower than in previous quarters, as a consequence of the decline in loans from resident credit institutions, although the latter continue to grow at a high

CHART 24

Households and NPIs (a)



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

year-on-year rate, which stood at 16.6% at the end of the first half of the year (see Chart 24 and Table 6). Credit for the acquisition of staple consumer goods contributed most to this small deceleration, while financing for house purchases held steady at the Q1 level.

One way of assessing the financial situation of a sector is to compare its debt with its available resources, whether in terms of the stock of financial assets or the current flow of income. Some ratios of this kind are presented in Chart 25. These show that the proportion of household debt to total financial assets has remained relatively stable over the last three years. However, the data for the last quarter show an increase in this proportion due to lower growth in financial assets, as a result of the loss of value of those whose market prices fluctuate more widely (equities and shares in securities funds). If the latter, whose realisable value is uncertain, are excluded, then a trend growth in household indebtedness is seen, with a similar profile to that obtained when the growth of debt is compared with that of GDP. At the same time, the increase in indebtedness in recent quarters has occurred against a different financial background than existed previously, since the increases in interest rates are being progressively incorporated into the cost of financing.

5.2.2. Financial flows of non-financial corporations

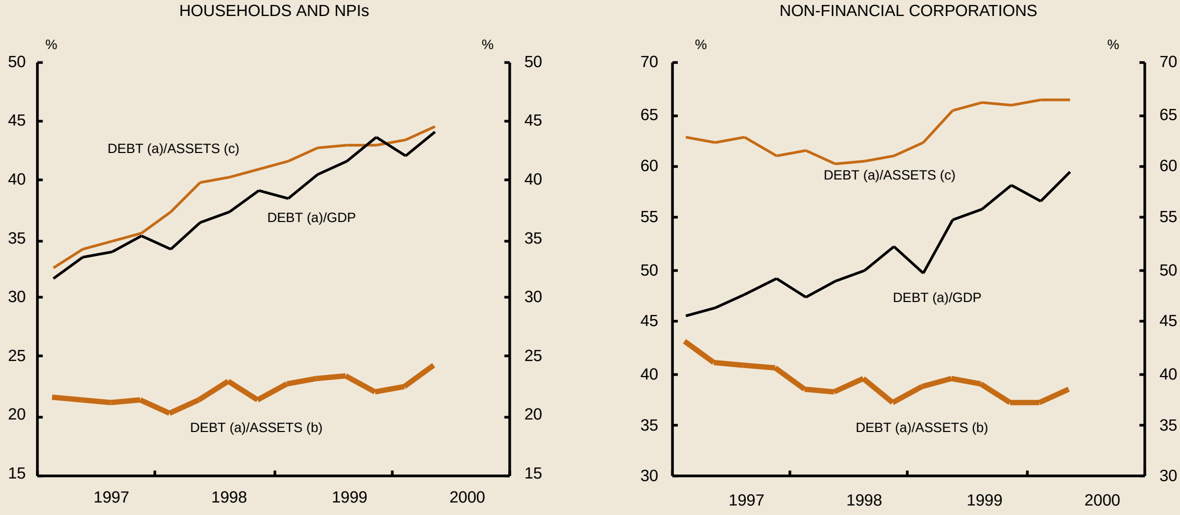
The net financial saving of non-financial corporations continued to decline in 2000 Q2, to stand at -3.2% of GDP, in cumulative terms over four quarters (see Table 5). This deterioration shows that the gap between gross capital formation and gross saving continued to widen during the first half, leading to a rise in the sector's indebtedness (see Chart 26). Net borrowing was increased by company acquisitions, both at home and abroad, which are reflected in an increase in the portfolio of shares and other equity.

The volume of financial assets acquired by non-financial corporations in 2000 Q2 was basically in the form of foreign assets and trade credit. The fastest growing components of the portfolio of external assets were shares and other equity. Cash and cash equivalents and other liquid financial assets recorded a similar increase to the previous quarter, which was above that of 1998 and 1999, but their contribution to the growth of the total flow of assets continued to be very small.

The financing of gross capital formation and financial investments continued to require high

CHART 25

Debt ratios



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

growth of Spanish firms' equity and borrowed funds. The volume of loans obtained in domestic and international markets in 2000 Q2 is comparable, in annualised terms, to the 1999 flow of financing, although the year-on-year rate of growth of total financing (which includes that from resident credit institutions, the issuance of fixed-income securities and foreign loans) slowed somewhat, when the impact of the acquisition of YPF by REPSOL had ceased to affect the annual rate. However, it is difficult to assess adequately the financial flows of firms in this quarter, as the figures are strongly affected by transactions to reorganise corporate groups, referred to above.

As for the destination of bank financing, the information on 2000 Q2 indicates an acceleration in credit to the services sector, which was offset by a lower rate of growth in that to other productive activities. However, the loans granted to construction firms continued to display the highest rate of expansion, at slightly above 20%.

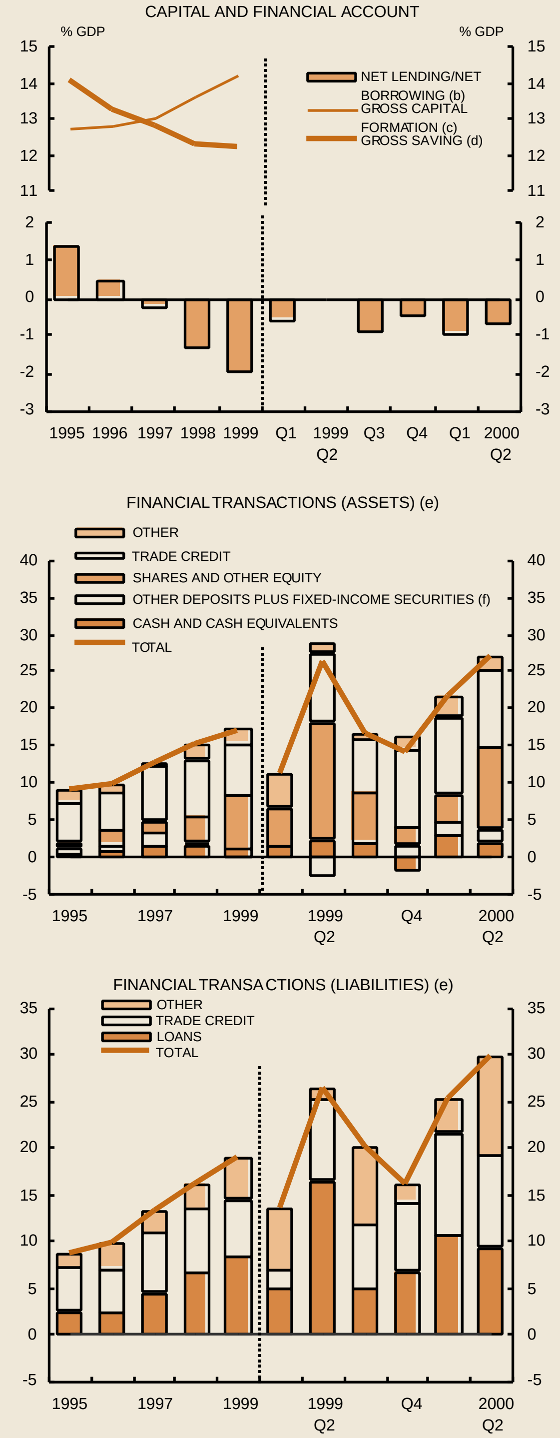
The increase in the level of indebtedness of non-financial corporations, as measured by the stock of debt relative to GDP, has not entailed a serious deterioration in the financial position of the sector, if the debt is compared to the stock of financial assets (see Chart 25). This ratio displays a slight downward trend, as a result of the revaluation of the financial assets held by non-financial corporations over the last three years. Even when equities, which were revalued considerably, are excluded, the increase in the level of indebtedness is still relatively moderate. It should be taken into account that a significant part of the increase in the indebtedness of non-financial corporations has been accompanied by intense growth in longer-term financial investments, such as company acquisitions and the purchase of significant holdings. In any event, as in the case of households, the rise in interest rates is causing financial costs to increase, which may have repercussions for the future borrowing capacity of non-financial corporations.

5.3. General government financial flows

During the first two quarters of 2000, general government net financial saving was positive, although the four-quarter cumulative total was still slightly negative (-0.2% of GDP) at the end of the first half of the year (see Chart 27). General government net borrowing was therefore less than in 1999. At the same time, the recourse to the financial markets through the issuance of securities, the obtaining of credit and the use of balances held on deposit, which has been called, in aggregate, financial requirements (an indicator that approximates the sector's financial saving), was somewhat more changeable during the first half. In Q1, the sig-

CHART 26

Non-financial corporations (a)



Source: Banco de España.
(a) Seasonally adjusted data.
(b) The quarterly data are for net financial saving (not annualised).
(c) Including stockbuilding.
(d) Including capital transfers.
(e) The quarterly data are annualised.
(f) Not including unpaid accrued interest, which is included under other.

nificant amount of interest payments gave rise to a positive recourse to the financial markets. In Q2, by contrast, the lower financing needs led to an increase in deposits with the banking system and, in consequence, a recourse to the markets that was negative.

In 2000 Q2, both the assets and the liabilities of general government increased. The increase in the gross issuance of short-term securities gave rise to a less negative volume of net issuance than in previous periods. By contrast, the net issuance of bonds was positive, albeit for a small amount (EUR 1.3 bn). These developments in issuance led to a slight increase in the average life or State debt denominated in domestic currency (5.4 years at the end of the first half of the year), compared to the end-1999 level. Finally, the net flow of credit and deposits was negative, owing to the increase of EUR 6.5 bn in general government deposits with financial institutions.

The incomplete information available on the volume of funds raised by General government on the markets in Q3 indicates that there was a high volume of net issuance of long-term securities by the State (EUR 10.6 bn), while the net issuance of Treasury bills was again negative (EUR -5.7 bn). Overall, the financing obtained by the State through the issuance of securities in Q3 was higher than in Q2, while its deposit with the Banco de España declined, indicating a significant increase in the financial requirements in the latter period.

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

As mentioned at the beginning of this section, the nation's net financial saving continued to decline during the first half of the year 2000, to stand at -2.1% of GDP, in cumulative four-quarter terms. This trend in the nation's saving is explained, on one hand, by the cyclical position of the Spanish economy, which is running at a high rate of growth (largely sustained by strong growth in domestic demand) and, on the other hand, by the deterioration in the terms of trade, as a result of the sharp rise in the price of oil. From the viewpoint of financial transactions, balance of payments information indicates that the decline in the nation's net financial saving is explained by the fact that external liabilities increased by more than external assets (7.9% as against 6.6% of GDP, respectively, in the first half of 2000). As a result, the debit balance on the financial account stood at 1.3% of GDP in the first half of the year, so that the balance for the year as a whole can be expected to exceed that of 1999, which was 2% of GDP (see Table 7).

The pattern of cross-border capital flows of recent years remained largely unchanged in the first half of the year 2000. The volume of net acquisition of external assets held at a high level, although direct investment in the first half of the year was somewhat lower than in the same period of 1999 when, it should be recalled, the purchase of YPF by REPSOL took place. There was also a smaller increase in portfolio investment as a result of the lower acquisitions by the credit system, since the private sector continued to invest significant funds in foreign securities. The level of reserve assets hardly changed in this period, while the credit system's external assets, which include the Banco de España's claims with the Eurosystem, fell in net terms.

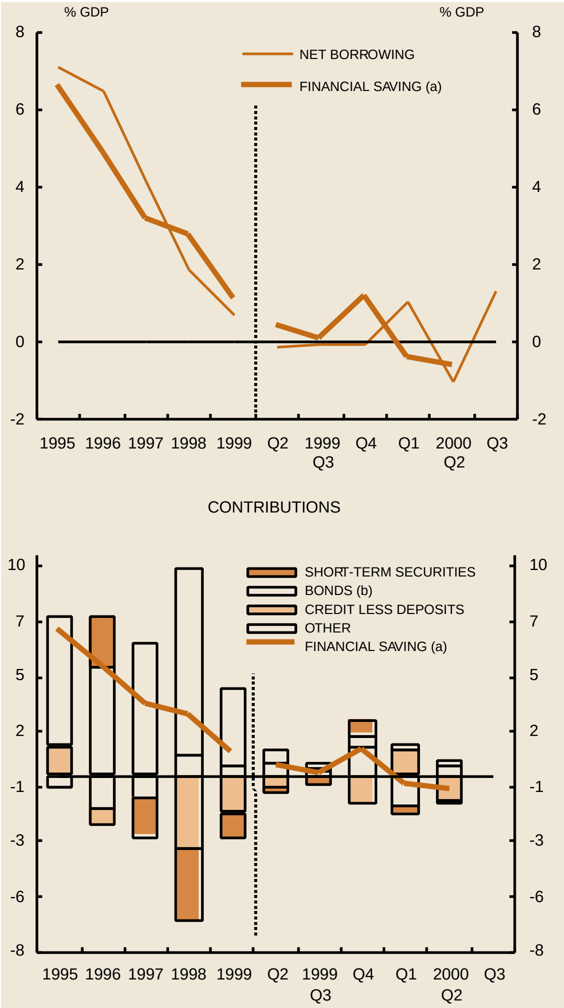
As regards foreign investment in Spain the high volume of direct investment in the first half of 2000 was notable, being well above the levels of recent years. There was also a significant volume of acquisition of Spanish securities by non-residents, although it was smaller than in the same period a year earlier. In comparison with 1999, non-residents acquired a smaller volume of securities issued by general government and non-financial corporations, while credit institutions raised more funds through the placement of bonds and equities. During the first six months of the year the credit system continued to increase its level of indebtedness, although by a smaller amount than in the same period of 1999. The term structure continued to be weighted towards long-term loans, which represented 60% of the volume of liabilities assumed by monetary financial institutions under the heading of other investment. Meanwhile, in contrast to 1999, the non-credit private sector received hardly any foreign loans in the first half of the year 2000.

July balance of payments information indicates a significant increase in the annual amount of Spanish foreign direct investment. Also, the amount of portfolio investment by non-residents increased notably in July 2000, owing to the acquisition of public debt and the shares of listed Spanish firms.

The sectoral structure of cross-border financial flows was similar to that of previous years, albeit with a net debit balance for the Spanish economy as a whole. In aggregate terms, the borrowing of credit institutions and, to a lesser extent, of the public sector must cover the deficits on current and capital account and the net acquisition of external assets by the non-credit private-sector, which includes households, non-financial corporations and institutional investors (see the memorandum item in Table 7).

CHART 27

General government financing



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

The decline in the financial saving of the Spanish economy during the first half of the year entailed a scant increase in the nation's external debit position (see Table 8). This is explained by the fact that this financial position, defined as the difference between the stock of financial assets and liabilities, is affected by both flows of net financial saving and changes in the prices of the various financial instruments. The sectors whose debit position increased were general government and, in particular, credit institutions, which have had nega-

TABLE 7

Financial account of the balance of payments

% GDP

	1997	1998	1999	JAN-JUN 1999	JAN-JUN 2000
BALANCE ON FINANCIAL ACCOUNT	**-0.6**	**0.0**	**2.0**	**0.5**	**1.3**
CHANGE IN EXTERNAL LIABILITIES	**7.0**	**12.7**	**16.1**	**10.0**	**7.9**
Direct investment (a)	**1.1**	**2.0**	**1.6**	**0.8**	**2.4**
Portfolio investment (b)	**2.2**	**2.9**	**7.7**	**3.1**	**2.5**
General government	2.0	0.8	4.5	2.0	1.3
Other resident sectors	0.2	1.6	1.8	0.5	0.1
Credit system	0.0	0.5	1.4	0.6	1.2
Other investment	**3.6**	**7.8**	**6.9**	**6.1**	**3.0**
General government	0.0	0.2	0.0	0.0	0.0
Other resident sectors	0.1	0.8	2.7	2.0	0.4
Credit system	3.5	6.8	4.2	4.1	2.6
CHANGE IN EXTERNAL ASSETS	**7.6**	**12.8**	**14.2**	**9.6**	**6.6**
Direct investment	**2.2**	**3.2**	**5.9**	**4.2**	**2.8**
Other resident sectors	2.0	2.9	6.0	4.4	2.2
Credit system	0.2	0.3	-0.1	-0.2	0.6
Portfolio investment	**2.9**	**7.9**	**7.8**	**6.1**	**4.3**
Other resident sectors	2.0	5.9	5.4	3.8	4.2
Credit system	0.9	2.0	2.4	2.4	0.1
Other investment	**0.3**	**4.0**	**4.2**	**2.5**	**-0.4**
General government	0.1	0.1	0.0	0.0	0.0
Other resident sectors	2.5	3.3	-1.6	-0.7	0.8
Credit system	-2.3	0.6	5.7	3.3	-1.3
Reserve assets	**2.1**	**-2.3**	**-3.7**	**-3.3**	**-0.1**
MEMORANDUM ITEM: DISTRIBUTION OF FLOWS BY SECTOR (CHANGE IN LIABILITIES - CHANGE IN ASSETS):					
Credit system (excluding Banco de España)	4.7	4.5	4.0	4.7	3.2
Banco de España (c)	-2.1	2.3	-2.7	-2.2	1.2
General government	2.0	1.0	4.4	2.0	1.3
Other resident sectors	-5.1	-7.8	-3.8	-4.1	-4.4

Source: Balance of Payments. Banco de España.
(a) Including portfolio investment in unquoted shares.
(b) Including direct investment in quoted shares.
(c) Including reserve assets and intra-Eurosystem claims.

tive net financial assets vis-à-vis the rest of the world since 1998. By contrast, the debit position of non-financial corporations declined, while institutional investors continued to increase their net external financial assets. From a medium-term perspective, the most striking feature of the developments in the net external financial assets of each sector is the strong increase in those held by institutional investors, which simply channel private-sector saving and, in particular, that of households. This increase, which represents more than 16 percentage points of GDP in the period 1995-2000, was financed by a larger placement of general government se-

TABLE 8

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

% GDP

	1995	1996	1997	1998	1999	2000 (d)
Total economy	**-19.6**	**-19.7**	**-20.7**	**-21.7**	**-24.4**	**-24.6**
Non-financial corporations and households and NPIs	**-13.9**	**-13.3**	**-10.9**	**-8.7**	**-10.5**	**-7.5**
Non-financial corporations	-18.1	-17.7	-16.1	-14.9	-17.6	-15.1
Households and NPIs	4.1	4.4	5.3	6.2	7.1	7.5
Financial institutions	**9.2**	**8.8**	**7.1**	**4.9**	**6.6**	**4.3**
Credit institutions (b)	7.9	6.7	2.4	-5.5	-8.0	-12.6
Institutional investors (c)	1.3	2.2	4.8	10.8	15.0	17.6
Other financial institutions	0.0	-0.1	-0.1	-0.4	-0.5	-0.7
General government	**-14.9**	**-15.2**	**-17.0**	**-17.9**	**-20.5**	**-21.3**

Source: Banco de España

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

(b) Defined according to the First Banking Directive

(c) Insurance corporations and collective investment undertakings

(d) Q2 data.

curities abroad (which accounted for 6 percentage points of GDP in this period) and, above all, by the increase in the debit position of credit institutions vis-à-vis the rest of the world (more than 20 percentage points of GDP).

31.10.2000.