Quarterly report on the Spanish economy

1. Overview

The international economic outlook has continued to worsen during the year 2001. The only indication of a future correction in price growth rates in numerous economies and of an alleviation of contractionary trends is the lessening of tension on the oil market that appears to have taken hold. Against this background, the growth rate of the Spanish economy has declined, but its real year-on-year GDP growth rate appreciably exceeds that of most of its trading partners.

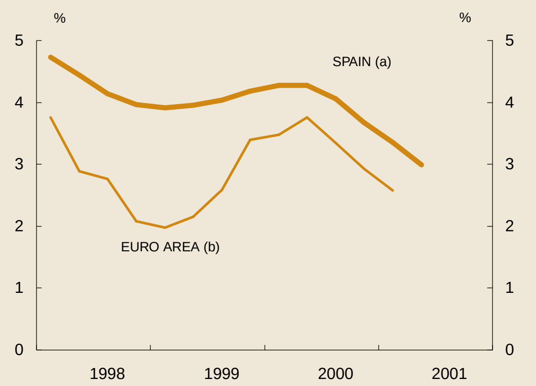
Specifically, the Spanish economy's real GDP growth in 2001 Q2 was estimated at 3 %, four-tenths of a percentage point down on the provisional figure released by INE for the first three months of the year. There have been no significant changes in the patterns that have determined this outcome: a gradual slowdown in domestic demand, tending to stabilise at a real rate of around 2.5 %, and a positive contribution of net external demand to GDP growth. Employment growth is slowing, but remains notable. And the expected and foreseeable decline in the inflation rate, the differential of which with the euro area countries is fluctuating at slightly over one percentage point, has not yet come about. It would appear that the more contained pace of economic activity, affecting above all the industrial sectors and capital goods investment decisions, will not jeopardise the envisaged target of balanced public finances at the end of the year.

Recent indicators of the US economy do not presage a rapid recovery. Following the 25 basis points cut in the federal funds target rate last June to 3.75 %, the markets expect fresh interest rate cuts in the coming months. It is expected that this, combined with the scheduled fiscal measures (some of which back-dated), will provide the necessary stimulus for a turnaround in economic activity. The slackness of growth has so far been based more on investment and exports than on consumption, which has remained more buoyant. The ongoing stagnation in Japan has boosted the contractionary effect exerted by the US situation on other areas of the world economy. Growth prospects have also been adversely influenced by the impact of the Argentinean crisis in Latin America and the vulnerability of other south-east Asian and eastern European economies to the greater instability of financial markets.

The European economies have been affected by this unfavourable environment, but to rather differing degrees depending on their initial exposure to developments in the crisis-ridden markets. Real GDP growth in the euro area as a whole during Q2 is expected to be lower than in Q1 (2.6 %). In the latter quarter, the sluggishness of domestic demand (where ex-

CHART 1

GDP



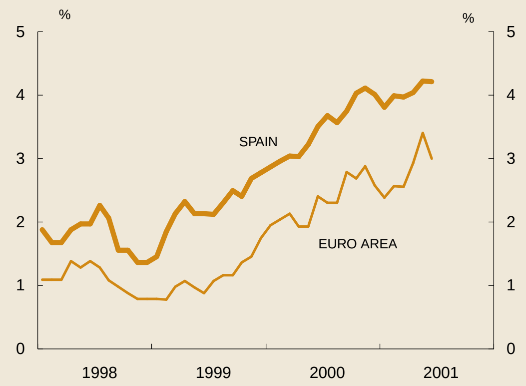
Sources : ECB, Instituto Nacional de Estadística and Banco de España.

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

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

CHART 2

Harmonised indices of consumer prices



Sources: Eurostat and European Central Bank.

ceptional factors such as the heavy decline in the construction industry in Germany came into play) was offset in part by the improved contribution of the net external balance, and by the slowdown in imports in particular. The latest available indicators show private consumption, the variable that is proving most reluctant to slow, to be somewhat more depressed.

The European Central Bank has been carefully analysing the conditions in which the euro area economies are moving, paying particular attention to expectations about the future course of inflation and its determinants. On the basis of this analysis, the ECB cut its official interest rates last May by 25 basis points, taking the main refinancing rate to 4.5 %. The latest data on the monetary aggregates show a rise in the growth rate of M3, while private sector credit, despite slowing, is running at a relatively high growth rate of 8.4 %. The exchange rate of the euro was once again prone to bouts of weakness, at a time in which uncertainty over developments on financial markets is strengthening the role of the dollar as a safe-haven currency. Nonetheless, in recent weeks the euro has picked up.

In June, the harmonised index of consumer prices (HICP) for the euro area countries ran at a 12-month growth rate of 3 %, partly correcting the rise the previous month, which was associated, in turn, with the behaviour of energy and fresh food prices. The pace of the aggregate that excludes these two components appears to have stabilised at a rate of slightly over 2 % since the start of 2001, compared with 1.4 % on average in 2000 Q4. The future course of this aggregate will depend, among other factors, on the temporary increase in its other two components not feeding through to the rest of the economy through the wage negotiations currently under way.

Lastly, as repeatedly noted by numerous Community agencies, the fiscal stimuli being applied in certain economies would not seem the most appropriate means for boosting current growth rates, especially if the targets envisaged in the Stability and Growth Programmes are jeopardised thereby. European economies should focus on restoring the confidence levels of economic agents and on making the workings of their markets and institutions more flexible. And they should further resolve to increase the rate of investment, which is the soundest way of reducing their still-high unemployment levels.

The monetary conditions prevailing in the euro area are more expansionary in the Spanish economy; as stated, Spain's growth rate is higher than the area average, as is its inflation rate. In recent months, bank rates have declined. And this, combined with the behaviour of the euro exchange rate, has meant that the indices that seek to measure the economy's monetary conditions have once again fallen, thereby illustrating a more generous monetary environment. Lending to the private sector has decelerated moderately, since the demand for financing for housing shows considerable flatness.

Turning to fiscal policy, the budgetary results for the first half of the year reveal a slowdown in takings for certain taxes, in step with the course of the economy. In some instances, however, they are the outcome of specific factors which will be corrected in the coming months. Such is the case of the bringing forward of personal income tax refunds for excess tax paid in the year 2000. Expenditure is broadly running to plan, and budgetary forecasts are expected to be met at the end of the year, assisted by the most favourable results in the social security accounts.

Against the international background and within the framework established by macroeconomic policies, the Spanish economy has sustained a high though diminishing real growth rate during the first half of the current year led essentially by exports and investment in the construction sector. The slowdown in consumer spending has moderated and, in relative terms, has held at a more sustained pace, while investment in capital goods has been the component most marked by the change in expectations.

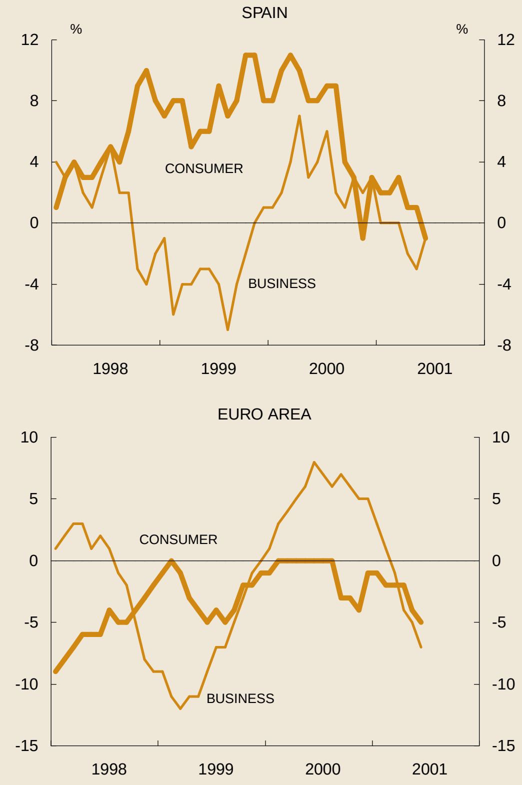
The indicators available on consumer spending in 2001 Q2 generally confirm the diagnosis made: though slightly lower than in the first quarter, the year-on-year growth rate of this variable is tending to stabilise. The pick-up in car sales (though not that of other consumer durables) and in food products has been significant. The rise in employment is the main factor underpinning the growth of household disposable income, offsetting - at least in part - the contractionary effect on real income arising from the acceleration of consumer prices. Other more transitory factors operating in one direction or another, such as the revision of income in the opening months of the year or erratic price movements in certain food products, do not have the same effect on sustaining household spending power. The medium-term expectations for this latter variable are essentially associated with the maintenance of a high and stable employment growth rate and the containment of prices. Continuity in the ongoing creation of new jobs and the subsequent decline in the unemployment rate explain, at least in part, why consumer confidence indices, despite having fallen, remain positive.

The ongoing slowdown in real household income and the fall in household wealth have affected investment in housing. However, the increase in house prices and the decline in returns on other alternative financial assets have fuelled residential demand for investment motives, although the latest indicators released appear to show signs of this process petering out.

As a result of all these factors relating to household conduct, the household saving ratio and household lending capacity can be seen, during the year in course, to be on an improving trend (or, at least, the previous deterioration can be seen to have ended). The restructuring of household balance sheets, by means of an increase in their financial assets and of a slowdown in their liabilities is, on the latest provisional data available, boosting their net financial saving.

CHART 3

Confidence indicators



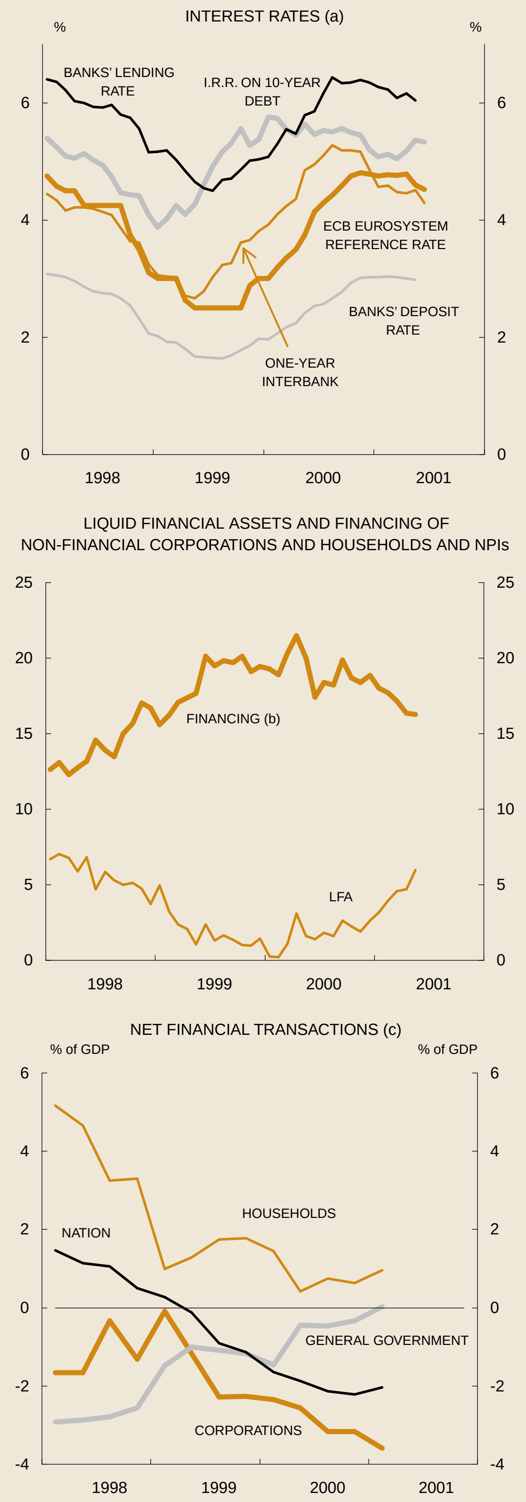
Source: European Commission.

The signs of deceleration in investment in housing are running in parallel with the pick-up in civil engineering works. As a result, the estimated rate of investment in the construction industry during 2001 Q2 compared with a year earlier is virtually unchanged on the previous quarter.

Such stability is not discernible in the indicators on investment in capital goods, which continue to worsen. This, at least, is what the index of apparent investment in capital goods reflects. The expected recovery in this variable as the year unfolded has not come about, despite the favourable financial conditions facing firms. Possibly, the worsening international outlook, especially in certain particularly sensitive areas

CHART 4

Financial indicators of the Spanish economy



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

for Spanish companies, has put the start of this process on hold.

Significant changes are not apparent either in government consumption or in stockbuilding. These variables are trending as previously observed, whereby the estimated growth of the Spanish economy's national demand during Q2 compared with four quarters earlier has been around 2.6 %, one-tenth of a percentage point down on the previous quarter. Since the estimated rate for real GDP is 3 %, the contribution of net external demand to the increase in output is expected to be positive, though lower than in Q1.

The real growth rate of goods exports continued to slow during Q2. They remain sustained in the EU market, but have declined notably in non-Community markets, particularly in Latin America. This is despite the fact that the depreciation of the euro has meant that there have been gains in competitiveness in all areas. The growth of exports in European markets over the first five months of the year (the period the available data cover) is due, in part, to the car industry. Here, nominal sales increased by 17 %. Nonetheless, the latest figures show a loss of buoyancy in this export segment, especially in certain euro area countries such as Germany. Tourism industry indicators show the same pattern of behaviour as goods exports: high but falling growth rates.

Turning to imports, their real rate of increase has tended to stabilise (following the cut in recent quarters), in step with the course of national demand. In any event, the lesser buoyancy of imports has, along with the notable slowdown in import prices (which is associated, though not exclusively, with oil market trends), provided for a significant correction in the energy and non-energy external imbalances. Indeed, the trade deficit has narrowed by 3 % during the January-May period according to Customs data, after having widened by 46 % in the same period a year earlier.

The real growth rate of the Spanish economy has thus continued to adjust to the pattern marked by the external environment. That said, it retains momentum which, assisted by relatively generous monetary conditions, is underpinned also, to a large extent, by increases in employment. In this situation, some of the imbalances arising from the long cyclical upturn (external deficit, decline in the household saving ratio) have begun to be corrected. And other advances, associated both with cyclical factors and with policies implemented, have progressively taken root. Such is the case with the fall in the unemployment rate and the headway made towards sound public finances.

The inflation rate, approximated by the behaviour of the consumer price index (CPI) or by the harmonised index of consumer prices (HICP), shows greater reluctance to slow, however. This is partly because pressures on oil markets have persisted for longer than expected and because of the rise in certain food prices. Yet this inertia is also due to the storing up of inflationary pressures in certain productive sectors over recent years as a result of persistently high demand growth rates and the imperfections of certain markets. Indeed, the less variable CPI components, namely services and non-energy industrial goods, are maintaining high growth rates and persistent differentials with the euro area countries. Temporary price increases have already begun to be stripped out (energy products are a case in point), but this process must spread to the other CPI components so that the Spanish economy may resume a path of stability.

In this connection, a containment of labour cost growth dynamics and an improvement in the efficiency of certain markets, where the growth of business margins is considerable, must be brought about. Wage increases during the current year are running high as a result of the combination of inflation-adjustment clauses and wage bargaining where past - temporary - price increases are being built in. This curtails the dynamics of wage restraint that have characterised the recent upturn in the Spanish economy and that have been a key factor in the rise in job creation capacity in recent years.

This process has proven most uneven across the various productive branches, since the least competitive industries may pass through labour cost increases to prices, retaining or even widening their operating margins. By contrast, the sectors most exposed to competition cannot do this, since the resulting losses in competitiveness would ultimately cancel out their growth capacity. In fact, the increase in business surpluses in the economy as a whole, according to the latest available figures, are concentrated essentially in the construction and energy industries and in certain services branches, but not in many industrial activities.

The desirability of improving the workings of markets and containing the growth of labour costs is thus based on the need to retain a pattern of job creation conducive to growth and investment in the most dynamic and efficient industries. Through gains in competitiveness, this will further enable the Spanish economy to continue its process of real convergence, even under the less favourable conditions of the current international environment.

2. The external environment of the euro area

The latest information on the external environment of the euro area shows, for 2001 Q2, a reduction in the growth of the world economy. This is concurrent with the slowdown in the United States, deepening economic stagnation in Japan and a sharp decline in the growth of many emerging economies (especially in south-east Asia and, to a lesser extent, in Latin America). Growth forecasts for 2001 have thus been scaled back across the board and, although uncertainty over these forecasts remains high, there appear to be more downside than upside risks.

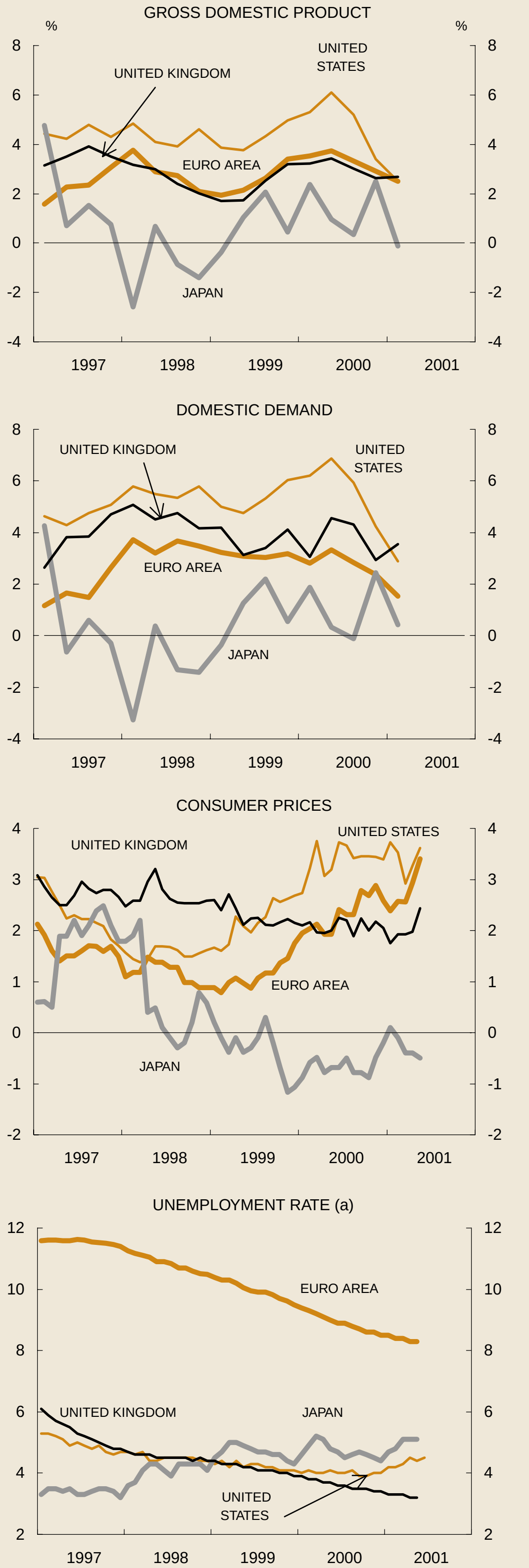
Inflation moderated slightly in most countries, helped by the recent stabilisation of energy prices. In the United States, the Federal Reserve made three further official interest rate cuts during Q2 (making a total of six since the start of the year), lowering the federal funds rate to 3.75 %. In Japan, monetary policy has been made more expansionary following the change in strategy in March towards a bank reserves target.

The revised US National Accounts data for Q1 showed annualised quarterly growth of 0.3 % for GDP. They also evidenced a less unfavourable performance by domestic demand than initially expected, thanks to the resilience of private consumption (whose quarterly growth was revised upwards by one-tenth of a point to 0.8 %). Private investment (especially that in the capital goods and new technologies sectors) and exports evidenced the greatest weakness. The Q2 indicators generally show the persistence of sluggish economic activity, although there are differing signals. Despite the fact industrial output posted fresh falls in Q2 compared with a year earlier, the NAPM index improved slightly in relation to the previous quarter. Private consumption remained fairly firm, judging by the positive year-on-year figures for retail sales throughout the quarter, the reduction in the personal savings ratio as a percentage of disposable income in the period to May and the improvement in the consumer confidence indicator in May and June. However, the labour market continued to worsen, as seen in the quarter-on-quarter fall in non-farm employment and the rise in the unemployment rate to 4.5 % in June. Investment demand improved slightly in May, although it continued to run at a very negative rate in year-on-year terms. Across the various industries, orders continued to be cut heavily in the new technologies sectors, as did earnings expectations, while construction industry indicators exhibited a positive trend in April and May.

Inflation, despite the increase in the overall index, gave relatively less cause for concern if

CHART 5

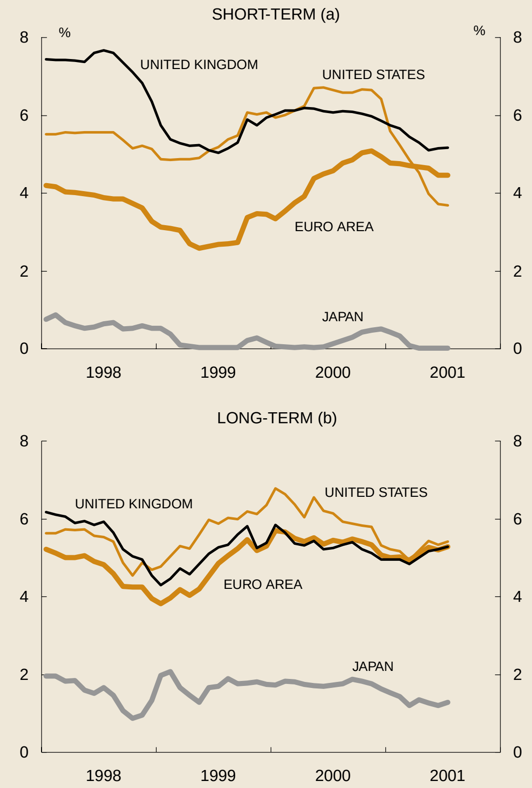
Main macroeconomic indicators
Annual rates of change



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

CHART 6

Interest rates



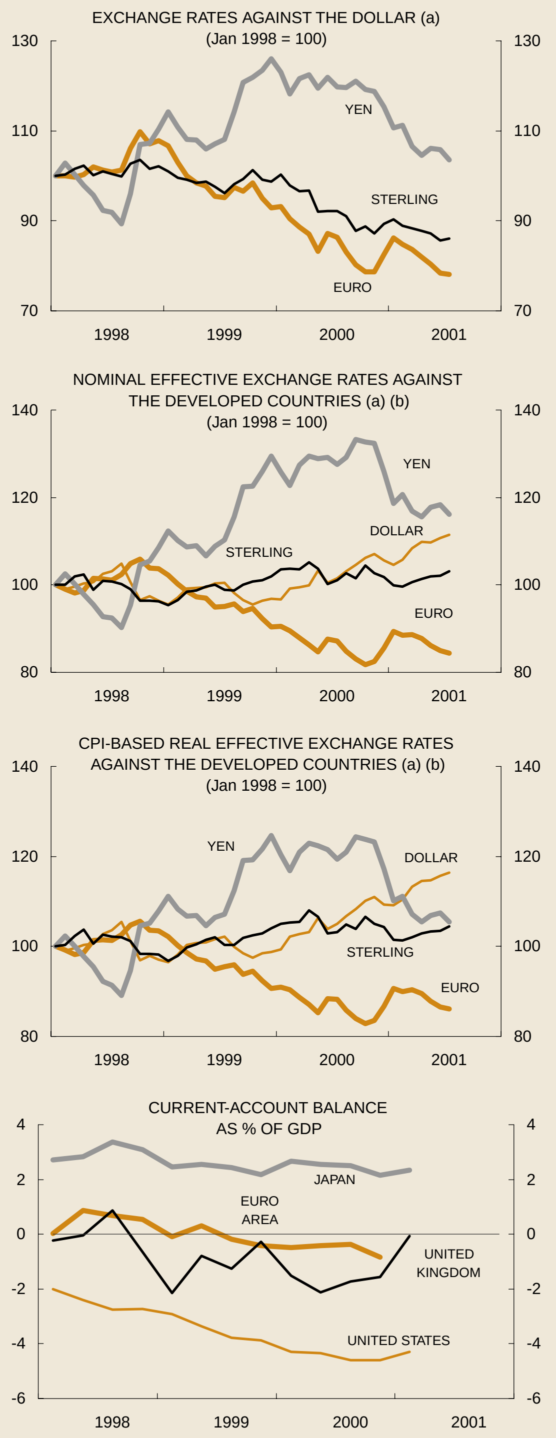
Source: Banco de España.
(a) Three-month interbank market interest rate. Euro area: until December 1998, weighted average of the eleven euro-area countries; thereafter, three-month EURIBOR.
(b) Ten-year government bond yields. Euro area: until December 1998, weighted average of the eleven euro-area countries.

regard is had to energy prices and to the containment of business margins in various industries. Output prices slowed by one percentage point from April to June, reaching a low for the year (2.5 % year-on-year). Underlying inflation, measured by consumer prices excluding fresh food and energy prices, declined to 2.4 % in May, its lowest level this year. Even so, the rise in energy prices and in wages (to 4.2 % in June on 12 months earlier) has led the overall consumer price index to quicken in April and May to a 12-month growth rate of 3.6 %.

The three further cuts by the Federal Reserve in the last quarter, for a total of 125 basis points, have fed through almost in full to short-term money market interest rates (the three-month interbank rate has fallen by 115 basis points between March and June). But this was not the case for 10-year government bond yields on the secondary market, which aver-

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.

aged 5.3 % in Q2 and rose to 5.4 % in the first fortnight of July. The equity markets responded positively to the cuts at first, but they have trended more negatively recently. The Dow Jones index rose between March and May, but fell once more in June and held virtually stable in the first half of July. The Nasdaq index, though more volatile, followed a similar course.

The dollar continued to appreciate against the yen and the euro, despite the weakness of the US economy. Although the rising course of the dollar does not help correct the US macroeconomic imbalances, it does point to confidence on the part of foreign investors in a prompt recovery in the US economy. And this has also been reflected in an increase in capital inflows into the United States this last quarter.

In Japan, real GDP fell by 0.2 % in Q1 on the preceding quarter, with zero growth in domestic demand and a negative contribution by external demand. There was zero growth in private consumption, but it was the declines in private investment and in exports (of 1.8 % and 3.6 %, respectively) which compounded the deterioration recorded in National Accounts. This was because these latter variables had been the sole driving force of the modest economic growth recorded the previous year. The GDP deflator also fell once more in year-on-year terms, albeit on a lesser scale than in the previous quarters.

The economic activity indicators available for Q2 reveal an additional deterioration, which will probably lead to a fresh decline in GDP. On the supply side, the composite indicator of activity improved slightly in April and May, but remains negative. Compared with the same period a year earlier, industrial production also fell in April and May to levels not seen over the past two years, in step with the worsening industrial activity climate shown by the Tankan survey for Q2. On the demand side, the further year-on-year declines in retail sales and in household spending in April and May reveal the paralysis of private consumption in Q2, in association with the deterioration in the labour market. Indeed, employment in April and May fell on a year earlier for the first time in 2001, although the unemployment rate stabilised at 5.1 %. The decline in activity fuelled deflationary pressures, whereby consumer prices ran once more at a negative 12-month rate of 0.5 % in May, with the underlying inflation rate falling even more, with a year-on-year decline of 0.7 %. Although production prices grew in Q2, owing to the impact of import prices, their domestic price component also fell in year-on-year terms.

Despite the falling trend of the yen against the dollar (which was interrupted only in May and which stepped up in the first half of July, taking the Japanese currency to an annual low), exports continued to fall due to the weakness of foreign demand. In the period to May this year, the trade and current-account surpluses were cut substantially.

Turning to monetary policy, the strategy initiated in March by the Bank of Japan to expand the monetary base held short-term market interest rates at levels very close to zero and slightly raised the year-on-year growth of the money supply (to 3.1 % in June, from 2.6 % in March). But it has not managed to extricate Japan from deflation, which was its implicit aim, and 10-year bond yields on the secondary market have not picked up, having stabilised rather at 1.3 %. And nor has a bigger fall in private sector credit been averted (down 2.7 % in May on 12 months earlier). The equity market saw a rise in the Nikkei index of 11 % in April, following the introduction of the new quantitative monetary policy. But it moved once more onto a clearly declining trend from May as the deterioration in the economic situation was confirmed.

In the EU countries not belonging to the euro area, the United Kingdom saw an appreciable slowdown in economic activity during 2001 Q2, following growth of 2.7 % in Q1. Manufacturing output in particular declined in both April and May on a year earlier. Since June, the slowdown in activity has spread to services, judging by the reduction in the year-on-year growth of retail sales and orders in this industry. The unemployment rate stabilised at 3.2 % in April and May. In these two months inflation quickened, with the 12-month growth rate of the index measuring consumer prices rising to 2.4 % in May (from 1.9 % in March). This contributed to the Bank of England not cutting rates, despite the economic slowdown. Market interest rates held virtually stable in the short term, while 10-year bond yields on the secondary market rose moderately. The equity market has been on a falling trend since April.

The south-east Asian economies, except China, proved particularly vulnerable to the slowdown in the growth of their external demand as from the beginning of the year (especially in the high technology industries, in which many of these countries have specialised), and the process accelerated substantially during Q2. Following the progressive decline in the exports of most of these countries, and despite the practically across-the-board depreciation of their currencies against the dollar, the pace of activity in the region diminished continuously. That has given rise to a marked and generalised downward revision of their growth forecasts for the current year. Conversely, economic growth in China during the first half of the year (despite moderating exports) ran at almost 8 % year-on-year, a similar rate to that recorded in the second half of last year. Against this background, most of the countries in the region tended to adopt looser monetary and -especially- fiscal policies to counter slowing growth.

The slowdown in economic activity in Latin America brought about slightly negative GDP growth in quarter-on-quarter terms in the area as a whole. And judging by the data available for virtually all the economies in the area, this trend appeared to accelerate in Q2. A key development is the exacerbation of the financial crisis in Argentina following three years of recession. The Argentine public finances have worsened substantially and there has been growing external fragility during the course of Q2. The effects of this financial turbulence have spread discernibly to a good number of South American economies, despite their differing overall and financial circumstances. Brazil has been most affected by the Argentine crisis, and its currency has depreciated sharply (21 % against the dollar so far this year to end-July). The response of the Brazilian authorities was to raise interest rates and step up intervention on the foreign exchange markets. Chile, too, despite the prior soundness of its macroeconomic magnitudes, is in an increasingly weak position, though it retains considerable scope for economic policy action in the short run. Finally, Mexico exhibited a marked dichotomy between the current weakness of its domestic economic activity (more affected than the above-mentioned economies by the US slowdown) and the buoyancy of its foreign investment inflows in recent months. Such inflows, unlike in most of the area's economies, have caused its currency to appreciate in the year to date.

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

The latest data on economic developments in the euro area point to a slight reduction in the pace of GDP in 2001 Q2, thereby prolonging the trend observed in the preceding quarters. The slowdown in activity has essentially come about due to the weakness of external demand and to the adverse real effects of two concurrent supply shocks, namely the rise in oil prices and the crisis in the food industry. The inflationary situation has been affected by these shocks and by the sizeable cumulative depreciation of the euro. Against this background, the ECB has maintained a cautious stance, based on a thorough evaluation of the real and monetary situation and, in particular, of the economy's inflationary outlook. The evaluation of these factors led it to cut official interest rates moderately in mid-May by 25 basis points to 4.5 %.

3.1. Economic developments

According to the second National Accounts estimate, euro area GDP posted quarter-on-quarter growth of 0.6 % in 2001 Q1, a similar rate to the previous quarter. Taking a slightly longer view, the rate of expansion of economic activity can be seen to have lost steam; after having averaged growth of around 3.5 % during the first half of 2000 on a year earlier, the rate dropped to 2.6 % in 2001 Q1, a similar figure to that recorded in mid-1999 (see Chart 8).

Underlying the stability of the quarterly growth rate of GDP is, however, a significant slowdown in final demand. This derives both from the sluggishness of domestic demand and from exports, meaning the main driving force of GDP growth is the notable containment of imports. The loss of momentum of final demand has come about due to the erosion of real income caused by price increases and the slackness of foreign demand. And neither the continuing relative generosity of monetary and financial conditions (which will be analysed in greater detail in the following section) nor the expansionary effects of the fiscal reforms applied in certain countries have been able to counter these factors. In Q1 this year private consumption grew by 0.4 %, one percentage point up on the previous quarter but less vigorous than in the first half of the year 2000. Government consumption remained the most buoyant domestic demand component, though it was less robust in Q1, having followed a slightly slowing course since the second half of 2000. Gross fixed capital formation shrank notably (by almost half a percentage point compared with the previous quarter) due largely to the slackness of demand and to the favourable performance of construction investment in Germany (see Box 1). Finally, the marked 1.2 % decline

BOX 1

Economic growth and investment in construction in the euro are

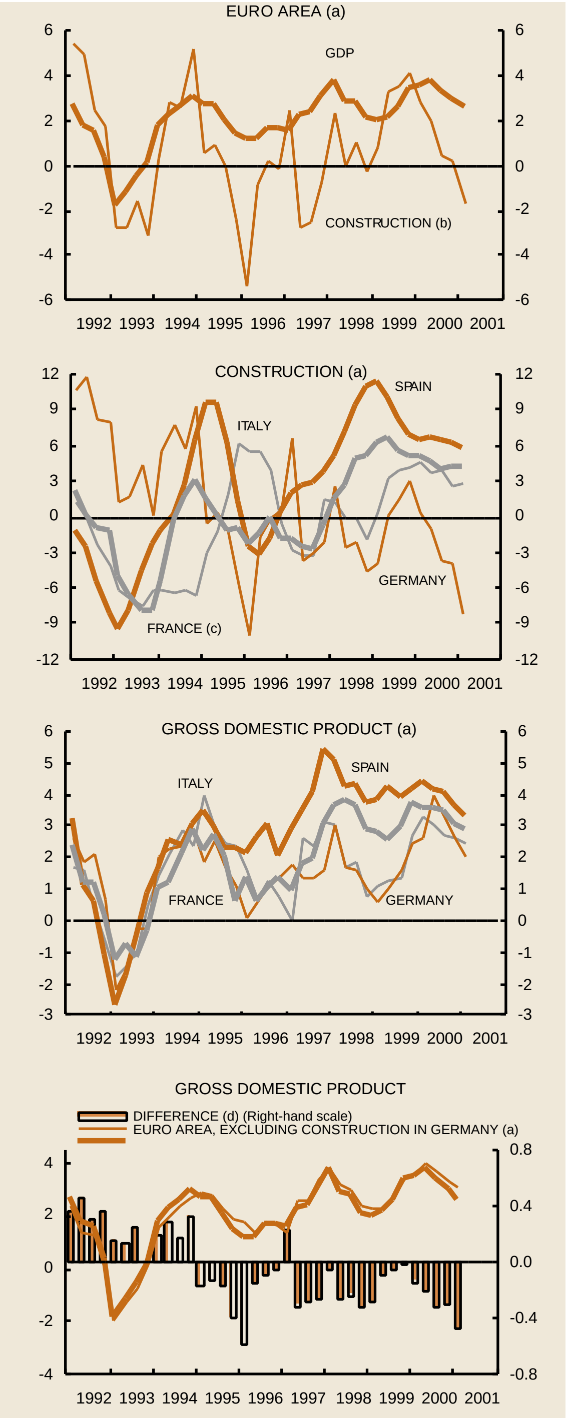
The slowdown in GDP in 2001 Q1 was attributable to several factors, including most notably the slackness of gross fixed capital formation, particularly in Germany, where it declined significantly by 2.5 % on the previous quarter. Underlying this downturn was the sharp fall in investment in construction, amounting in Germany's case to negative rates of 5.7 % and 8.2 % on a quarter and on a year earlier, respectively. The result suggests a need to examine developments in this sector at EU level over the last few years, so as to identify parallel trends and similarities among the largest countries and assess their contribution to growth.

Owing to the lack in several euro area countries of gross fixed capital formation data broken down by industrial grouping, the Statistical Office of the European Communities (EUROSTAT) does not report any series for investment in construction for the area as a whole. Consequently, this box approaches the concept by using the information available for the four countries with the biggest weights, namely Germany, France (1), Italy and Spain, which account for around 80 % of euro area GDP. Based on these data, investment patterns in the construction sector of these four countries have been analysed in relation to the overall business cycle.

The accompanying charts show that the growth of investment in construction in the euro area fluctuates much more sharply than GDP growth since, contrary to other spending decisions, it is highly sensitive to changes in agents' expectations. Moreover, while output growth in these four countries evidences significant cyclical synchrony, construction investment growth patterns have been divergent in the countries under review.

In this respect, developments in the construction sector in France, Italy and Spain exhibit common features which are not generally shared by Germany. In the first three countries, the decrease in construction activity in the early nineties was triggered by the sharp European recession. Similar patterns were also apparent by the end of the decade, such as the return to positive growth rates fuelled by the fall in long-term interest rates and by higher rates of economic growth. Specifically in France and Spain, house-building has been very intense over the past few years. Moreover, investment in construction in these countries exhibits high cyclical synchrony with GDP, a development that is not so clear in Germany, where growth rates in construction were more volatile and on a falling trend throughout the decade. This suggests that special factors were at play here.

The strength of German investment in construction in the early nineties coincided with the boom in the wake of re-unification, whereby investment in the Eastern Länder (regional governments) was encouraged through Government subsidies. This led to an excessive build-up of capital and, subsequently, to excess supply. For the country as a whole, a historical peak of 600,000 finished dwellings was reached by the mid-nineties. The existence today of a significant stock of non-occupied housing in the Eastern regions (more than 10 % of the total) is such a sizeable deterrent for residential investment that, in 2000, the number of finished dwellings in Germany fell to 425,000. In addition, the entry into force of fiscal measures in early 1999 and 2000 reducing government housing subsidies may also have played a part in the recent deterioration in residential investment in Germany. The ongoing adjustment of demand to the excessive stock of buildings poses a significant barrier to economic growth not only in Germany, but also in the euro area as a whole. And this to such an extent that, during 2001 Q1, the deceleration in the German construction sector subtracted almost half a percentage point (in annual terms) and two-tenths of a percentage point (in quarterly terms) from euro area output growth (see the bottom panel of the chart). Only once over the past decade – in 1996 Q1 – was the size of this negative contribution surpassed.

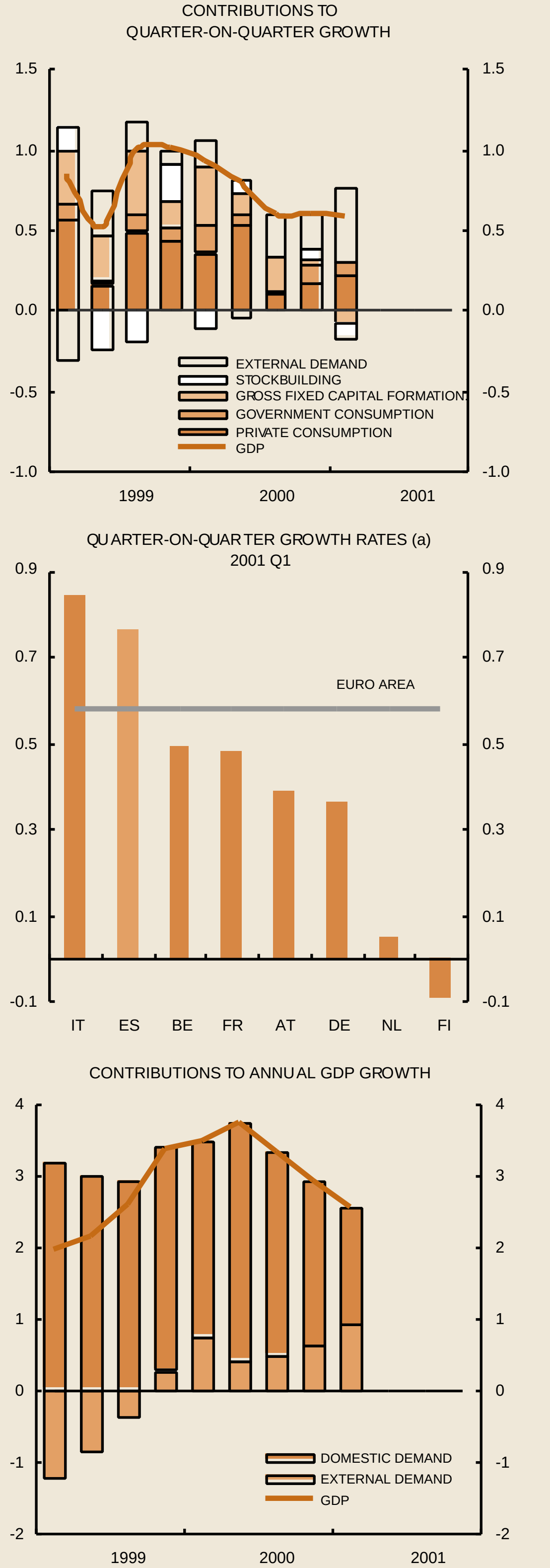


Sources: Eurostat and national statistics.
(a) Year-on-year percentage changes.
(b) Aggregation of the four countries under review.
(c) Proxied by the difference between total gross fixed capital formation and investment in capital goods.
(d) Euro area year-on-year percentage change minus euro area year-on-year percentage rate excluding construction in Germany.

(1) Since no quarterly data on gross fixed capital formation (GFCF) in construction are available for France (only for total GFCF and for the machinery and capital goods component), it has been proxied as the difference between total GFCF and investment in machinery and capital goods. This means that the data proxied for investment in the French construction sector also include the GFCF component called "other investment".

CHART 8

GDP in the euro area



Sources: Eurostat and national statistics.
(a) Excluding Greece, Ireland, Luxembourg, Austria and Portugal, for which there is no information on the quarter concerned.

in imports in relation to 2000 Q4 meant that, despite the weakness of exports (whose growth was virtually zero), the contribution of net external demand to the quarterly growth of GDP was five-tenths of a point, far outpacing the one-tenth of a point contribution of domestic demand.

Across the economic sectors, gross value added in manufacturing in 2001 Q1 increased more than in previous periods, exhibiting a quarter-on-quarter growth rate of 1.4 %, compared with 0.6 % in 2000 Q4. Nonetheless, this increase was virtually neutralised by the strong contraction in value added in the construction industry. The services sector remained on a relatively stable trajectory in relation to the previous quarters.

The latest economic information points to a further loss of buoyancy in activity in Q2 (see Chart 9). Thus, in the period from April to June the business confidence and manufacturing industry purchasing managers' indices declined in relation to the average for the three previous months. The industrial production index has slowed progressively in the year to date, posting a negative rate of 0.1 % in May compared with a year earlier, far below the figure of 8.2 % in December 2000. Services sector indicators drawn from qualitative surveys also showed a loss of steam in Q2 compared with Q1. Lastly, the confidence indicator for the construction industry worsened further in the period from March to June.

From the demand standpoint, the consumption indicators were generally less buoyant in Q2. The levels of both the consumer and retail trade confidence indicators, though relatively high, fell from the first to the second quarter of the year, while the retail sales indicator posted a year-on-year rate of increase in April below the average for the three previous months of the year. Elsewhere, the deterioration in the consumer durables indicators in the first half of the year has been more pronounced than in the total consumption indicators. This is consistent with the fact that these goods habitually follow a more marked cyclical pattern; in Q2, however, they exhibited a more favourable trend. The indicator of new car registrations improved slightly in Q2 and consumer readiness to make purchases of this type of good (as reflected in the consumer confidence survey) showed a lesser deterioration than in the composite index.

The information available on fixed capital investment presages further moderation in this component in Q2. In this period, the surveys for this industry that are most closely connected with capital goods purchases slowed notably (see Chart 9). Nonetheless, drawing on data from the European Commission's half-yearly investment survey in spring 2001, the manufacturing companies examined had maintained their expectations expressed in the previous survey last autumn that investment could reach growth of 5 % in the year 2001. Lastly, the export indicators also point to further moderation in this variable in the period analysed.

Despite the weakness of activity in the first half of the year, GDP growth is still likely to accelerate somewhat in the second half of 2001. That would be consistent with a somewhat more favourable international context (in particular in the United States) and with the entrenchment of a declining inflationary trend that would boost income and expenditure, all against a backdrop of generous financial conditions.

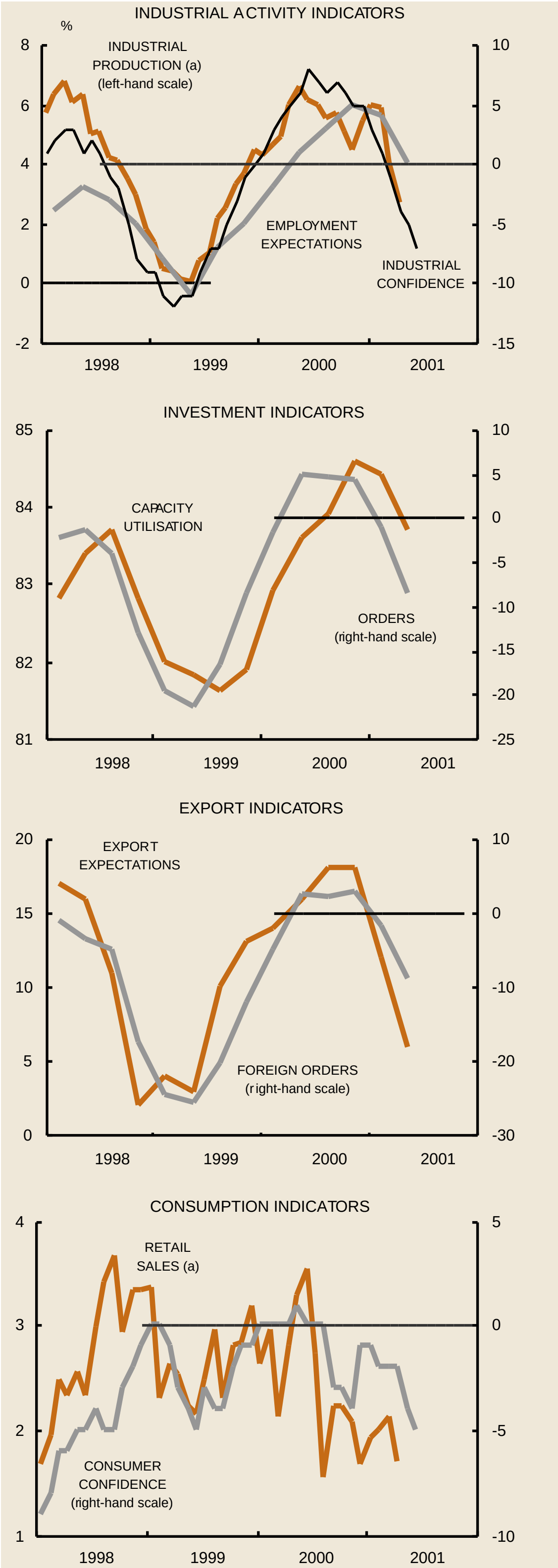
Turning to the labour market indicators, employment performed relatively favourably in Q2, despite being less robust than in the previous periods. The unemployment rate thus edged down, standing at 8.3 % in May, one-tenth of a point less than in March. In addition, employment expectations worsened somewhat in the April-June period, although employment in both manufacturing and services remains above the average in recent years.

The main price indicators for the euro area economy have been on a rising trend in the first half of 2001. This has been mainly due to the unfavourable course of oil and certain food prices, and to the lagged effects of past increases in import prices. In this respect, the GDP deflator, which approximates the domestic component of inflation, climbed to 1.9 % in 2001 Q1. As to the main components of this deflator, the information on unit labour costs is only available to 2000 Q4, when the related year-on-year rate rose to 1.6 % as a result of the substantial fall in productivity in the economy, as compensation per employee slipped slightly (see the lower panel of Chart 10).

As regards the first half of 2001, the as yet incomplete information on wages appears to confirm a degree of stability in the growth rate of compensation per employee, as indicated by the data available for some countries and by the hourly labour costs indicator for the euro area in Q1. With regard to consumer prices, the inflation rate for the area in the period from April to June, measured by the HICP that includes Greece in the year 2000, rose by 0.5 percentage points to 3.1 % (see Chart 10). Almost all the HICP components fared unfavourably, and it was those related to processed and unprocessed food whose growth rates most steepened during this period. The energy component in particular underwent a notable correction,

CHART 9

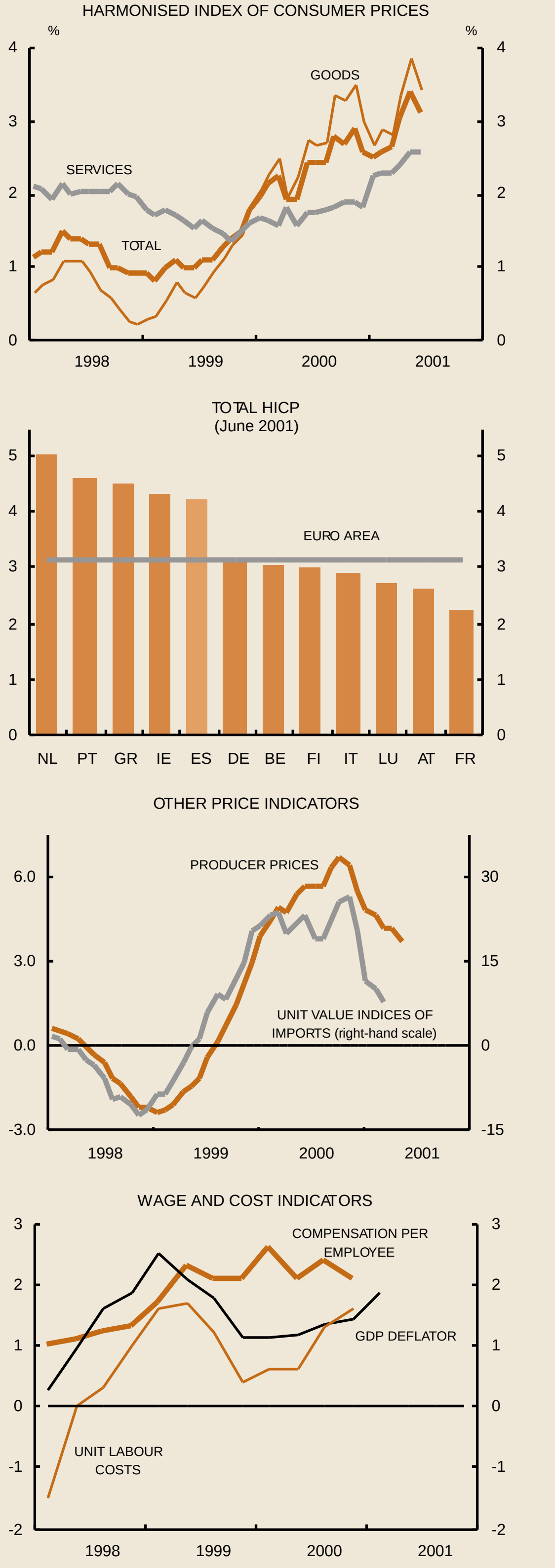
Euro area. Real indicators



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, wage and cost indicators
Twelve-month percentage change



Sources: Eurostat and ECB.

bringing it to 5.5 % year-on-year in June, one-tenth of a point down on the March figure. The so-called IPSEBENE index, which strips out fresh food and energy goods prices, also worsened significantly in this period; its 12-month growth rate in June stood at 2.2 %, a rise of three-tenths of a point on March. The deterioration in the performance of prices was across the board in the euro area. The inflation differential within the zone has narrowed by nine-tenths of a point from March to June as a result of the more pronounced rise in inflation in France than in the Netherlands, the countries with the lowest and highest HICP rates, respectively.

Among the remaining indicators of the inflationary situation, there was a notable cut in the growth rate of the producer price index in April and May, which fell to 3.6 % in this latter month against 4.2 % in March. This was the outcome of the slowdown in the intermediate goods component and of the considerable stability of the remaining groupings. In this respect, the curtailed advance of the prices of industrial consumer goods presages a lower rate of increase in final consumption prices in the medium term, given the fact the former variable is a leading indicator. The recent trend of the main short-term determinants of prices in the euro area (with a reduction in oil prices, relative stability in the exchange rate of the euro and the possible end to the recent food crises) also suggests that inflation might slow in the short run. However, from a medium-term perspective, there are risks workers will seek to regain lost purchasing power by demanding higher wage rises. That could jeopardise the containment of inflation (see Box 2).

On ECB estimates, the euro area current-account balance ran a cumulative deficit in the first four months of the year amounting to EUR 12.5 billion, which is an improvement when set against the EUR 18.5 billion deficit recorded in the same period a year earlier. This result was due to the sound performance of the merchandise balance, the outcome in turn of exports being more robust than imports in the period in question.

According to the information available on the budgetary outturn in the opening months of the year, it is highly likely that the budgetary targets set in stability programmes will not be met in certain Member States (see Table 1). This will mark a halt in the trend of recent years, characterised by the achievement of better than initially envisaged results, owing to buoyant revenue. Revenue is now growing less as a consequence of the tax cuts introduced in many countries and of less resilient activity. In those Member States that have already obtained what

TABLE 1

General government financial balances of euro area countries (a)

	1997	1998	1999	2000	2001	
					Stability programme targets	European Commission spring forecasts
Belgium	-1.9	-0.9	-0.7	0.0	0.2	0.5
Germany	-2.7	-2.1	-1.4	-1.0	-1.5	-1.7
Greece	-4.7	-3.1	-1.8	-0.9	0.5	0.0
Spain	-3.2	-2.6	-1.2	-0.4	0.0	0.1
France	-3.0	-2.7	-1.6	-1.4	-1.0	-1.1
Ireland	0.7	2.1	2.1	4.5	4.3	3.9
Italy	-2.7	-2.8	-1.8	-1.5	-0.8	-1.3
Luxembourg	3.6	3.2	4.7	4.7	2.6	4.0
Netherlands	-1.1	-0.7	1.0	1.3	0.7	0.8
Austria	-1.7	-2.2	-2.1	-1.5	-0.8	-0.7
Portugal	-2.7	-2.3	-2.1	-1.7	-1.1	-1.5
Finland	-1.5	1.3	1.8	6.7	4.7	5.3
MEMORANDUM ITEM:						
Euro area						
Primary balance	2.5	2.6	3.0	3.3	3.3	3.1
Total balance	-2.6	-2.1	-1.2	-0.7	-0.6	-0.8
Public debt	74.7	73.1	72.1	69.8	67.7	67.7

Source: European Commission.
(a) Without including proceeds relating to UMTS licences. Deficit (-) / surplus (+).

is close to a balanced budget or that are running a surplus, this deviation might not be a serious cause for concern insofar as it is the outcome of the automatic stabilisers operating. However, in those countries still exhibiting structural deficits or high public debt ratios, it will be advisable to adopt discretionary measures aimed at preventing failure to comply with the stability programme targets, so as to ensure continuing fiscal consolidation.

In recent months, several countries have approved – or are about to do so – various budgetary measures. In May, the Belgian authorities agreed on the final details of the reform of direct tax on households, aimed at reducing the tax burden on the labour factor. In the Netherlands, the government agreed, for the present and coming year, on substantial spending increases on health, education and law and order, which will be partly offset by spending cuts in other areas. Acting in the opposite direction, the Portuguese government submitted a spending reform programme in June including measures that will reduce expenditure in 2001 by 0.3 % of GDP. This would offset – albeit not in full – the deviation from the initial target brought about by weak revenue and overspending in certain areas (on public health in particular). Moreover, the programme submitted sets a growth target for overall primary current spending of 4 % in annual terms in the period 2002-2004, compared with the figure of 5.9 % implicit in the stability programme in force. Finally, Austria is finalising preparations for legislation on the so-called National Stability Pact. The aim of this Pact is to ensure that the lower tiers of government are involved to a greater extent in achieving the budgetary goals set for the overall Austrian general government sector.

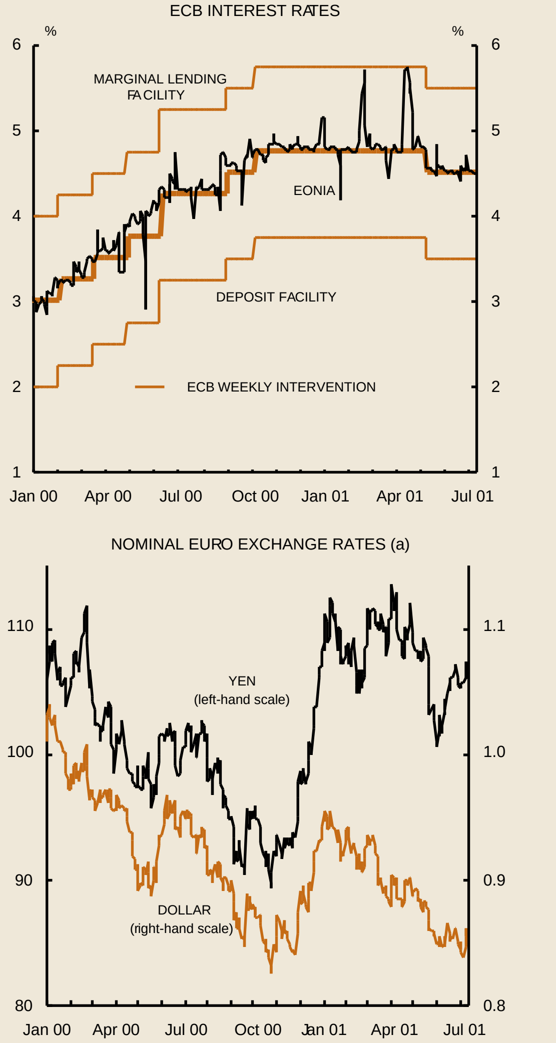
3.2. Monetary and financial developments

The economic context described in the foregoing section, marked by weakening economic activity and the persistence of relatively high inflation rates, led the Governing Council of the ECB to be particularly prudent in terms of its monetary policy decisions in the recent period. Following the moderate 25 basis points cut on 10 May, official interest rates were held unchanged at the subsequent fortnightly meetings. Currently, the rate on the main refinancing operations stands at 4.5 %, and at 3.5 % and 5.5 % for the deposit and marginal lending facilities, respectively (see Chart 11).

The slowdown in economic activity has meant that agents have discounted reductions in official rates since the opening months of the year. This has been conducive to a certain reduction in bank rates, contributing to sustaining the growth of lending extended by banks. The M3 monetary aggregate continued to expand at a rate above its reference value of 4.5 %. More-

CHART 11

ECB interest rates and euro exchange rates



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

over, the depreciation of the euro and the rise in inflation have amplified the generosity of monetary and financial conditions, despite the performance of stock market prices, which have fallen notably to date in 2001. Monetary and financial conditions have been more generous in Spain, as reflected, for instance, by the greater rate of expansion of credit.

Throughout Q2, money market interest rates have been broadly stable, edging down since the last cut in official rates (see Table 2 and Chart 11). Likewise, the three- and six-month Euribor rate has hovered in June and the opening weeks of July at around 4.4 %, i.e. some 25 basis points below the March level. In any event, after the monetary policy decision on 10 May, the markets have continued discounting an additional cut of one quarter of a point before year-end. As regards long-term interest rates, the yield on 10-year bonds in the euro area has stood, in the period to date in July, at 5.3 %, about 35 basis points above the March level, although this increase was less than that seen in US government bonds (see Chart 13). The spread between German and Spanish bonds is holding at around 30 basis points.

Bank lending interest rates in the euro area (which are those most directly related to agents' spending decisions) have remained very stable throughout the period. They have incorporated only partially the movements on money markets, given the lags in the transmission process. Interest rates on mortgage loans and corporate loans at over one year fell in the period from January to May 2001 by 25 and 10 basis points, respectively, while the level of interest rates on personal loans did not alter. In the case of Spain, the rate on bank lending transactions has fallen somewhat more sharply, declining by 30 basis points between January and May (see Table 2).

In the period between March and the cut-off date for this Bulletin, the euro depreciated once more against the dollar, although in recent weeks it has edged up. In mid-July, the exchange rate stood at around US$ 0.85 per euro, signifying a loss of value of about 7 % in relation to the March level (see Chart 11). Against the yen, the euro also lost ground (by around 5 %) during the period under review. At the end of June, the nominal effective exchange rate of the euro against the developed countries stood at 2.3 % below its March level, while in Spain the nominal component of the competitiveness index has remained virtually unchanged over the same period.

Turning to the stock markets, the performance of the European markets has been uneven while on a declining trend, dragged down by the new technologies stocks. The announcement of the prospect of lower earnings by some of the main high-technology corporations in the industry in the United States and by several major European companies have heightened uncertainty and the lack of confidence. This has translated into a slide in the Dow Jones Euro Stoxx index which, at the time of this Bulletin going to press, had undergone a cumulative 15 % decline since the start of the year. In the case of Spain, this downward trend has steepened recently owing to uncertainty in Latin America, especially in Argentina. As a result, the stock market recovery observed to May on the markets has been reversed as from June, and to date this year the Madrid stock ex-

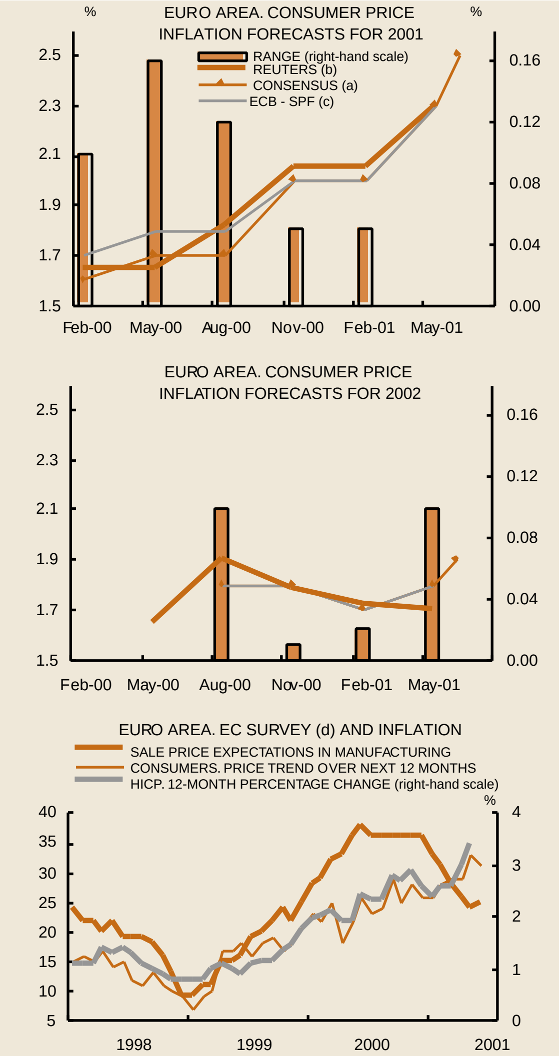
BOX 2

Surveys and inflation expectations in the euro area

The positive differential between the growth rate of the euro area HICP and the upper bound of the price stability definition (2 %) has gradually widened since the first half of 2000 to one percentage point at present. True, the reasons for this increase in inflation are basically temporary. But the persistence of this differential might trigger a revision of inflation expectations which, if they were to firm, would hinder the disinflation process expected in the next few months. This box analyses recent developments in inflation expectations in the euro area, as reflected in the main surveys available.

The formation of expectations by economic agents takes place in different ways. This is due, inter alia, to differences in the datasets agents use, and to how they are interpreted. Several indirect and direct methodologies have been developed to measure expectations. The former, making certain theoretical assumptions, seek to extract the information in financial asset prices. The latter are based on surveys, where a representative sample of economic agents are asked directly about their expectations. These can be qualitative or quantitative surveys, depending respectively on whether they offer a view on the direction of the expected change in the variable or, conversely, provide a specific figure quantifying this change.

The first two panels of the accompanying chart show quantitative measures of inflation expectations for 2001 and 2002 devised by experts. Between February 2000 and May 2001, there has been a general deterioration in the forecasts of average inflation in the euro area for 2001. Accepting that the width of the expectations range is a reasonable proxy to the degree of uncertainty associated with average expectations, it can be concluded that in May agents attributed high probability to the average inflation rate in 2001 being 2.3 %. With regard to 2002, the May surveys presaged considerable moderation in inflation, since the average rate of increase of prices was expected to be between 1,7 % and 1.8 %, i.e. between five-tenths and six-tenths of a percentage point below the expectations for 2001. Subsequently, the results of the Consensus survey for June have been published, showing a worsening in inflation expectations to 2.5 % in 2001 and 1.9 % in 2002.



(a) Monthly Survey of Professional Forecasters.
(b) Quarterly Survey of Long-Term Forecasts (Professional Forecasters).
(c) Quarterly Survey of Professional Forecasters.
(d) EC Consumer and Business Surveys.

Turning to the qualitative surveys of the European Commission (EC), divergence has most recently been observed between household expectations as to consumer prices over the next twelve months and firms' expectations about manufacturing sale prices in the coming months. However, this divergence has narrowed slightly in June. At the current juncture in which the inflation trend is turning, these differences may add friction to wage negotiations. Indeed, since end-1999 the pace at which consumers have revised expectations has been slower than in manufacturing industry. In mid-2000 expectations as to manufacturing sale prices stabilised, and this was followed by a downward revision as from the end of that year. Conversely, consumers have retained upward inflation expectations throughout the most recent period, contrary to the simultaneity of the turnaround in both series since the beginning of 1999 (see lower panel of the chart). That reflects a higher relative weight of the backward-looking component in the determination of household price expectations compared to manufacturing employers (1). Moreover, since manufacturing is a sector highly exposed to competition, its price expectations reflect the predominantly "price-taker" nature of its constituent companies. At present, these should take on board the effects of headway in the commercial integration of the area, the weakness of world demand and, possibly, the transparency of prices that the actual implementation of the euro as the single currency for transactions within the euro area will entail.

In sum, the information analysed in this box reveals the prevalence of disinflation expectations in the euro area for 2002. However, the expectations formation mechanisms have been seen not to be uniform, seeming rather to differ in terms of the type of agent considered. Thus, while consumers tend to set greater store by past price developments, employers and analysts incorporate forward-looking considerations to a greater extent. This characteristic means that, in the current environment, where after a longer-than-initially-expected delay the euro area inflation rate appears to be beginning to slow, frictions might arise in wage-setting processes and jeopardise the maintenance of price stability.

(1) In "The information content of survey data on expected price developments for monetary policy", Deutsche Bank (2001), Monthly Report, January, there is quantitative evidence of the relative importance of the backward-looking component within the structure of consumer expectations.

TABLE 2

Monetary and financial situation in the euro area and Spain

	1999	2000	2001					
	DEC	DEC	FEB	MAR	APR	MAY	JUN	JUL (c)
MONETARY VARIABLES (a):								
EURO AREA								
M3	6.1	4.9	4.4	4.6	4.7	5.3	6.3	
M1	10.0	5.7	2.0	2.1	1.6	3.2	4.2	
Loans to private sector	10.3	10.2	9.7	9.3	9.1	8.6	8.4	
SPAIN								
Liquid financial assets	1.4	2.6	3.9	4.6	4.7	6.1	6.9	
Cash and cash equivalents	12.7	4.4	3.1	2.5	2.5	3.9	4.8	
Financing to the private sector	19.4	18.8	17.7	17.2	16.6	16.8	16.7	
FINANCIAL MARKETS (b):								
EONIA	3.04	4.83	4.99	4.78	5.04	4.65	4.54	4.53
Three-month EURIBOR	3.44	4.94	4.76	4.71	4.68	4.64	4.45	4.47
Public debt								
Euro area ten-year bond yields	5.32	5.07	5.02	4.94	5.10	5.26	5.21	5.29
US-euro area ten-year bond spread	1.04	0.25	0.15	0.00	0.09	0.18	0.12	0.14
Spain-Germany ten-year bond spread	0.22	0.31	0.34	0.37	0.35	0.31	0.33	0.32
Spanish bank interest rates								
Synthetic deposit rate	1.98	3.02	3.04	3.03	3.00	2.98		
Synthetic lending rate	5.03	6.35	6.22	6.08	6.16	6.04		
US/EUR exchange rate	1.011	0.897	0.922	0.910	0.892	0.874	0.853	0.849
Equities (d)								
Dow Jones EURO STOXX Broad Index	39.5	-5.9	-7.7	-11.2	-5.7	-6.5	-10.4	-14.6
Madrid Stock Exchange General Index	16.2	-12.7	3.0	0.9	6.3	3.8	-2.2	-8.0

Sources: European Central Bank and Banco de España.
(a) Annual percentage change.
(b) Monthly averages.
(c) Monthly average to 13 July 2001.
(d) Cumulative percentage change during the year. Latest month: to 12 July 2001.

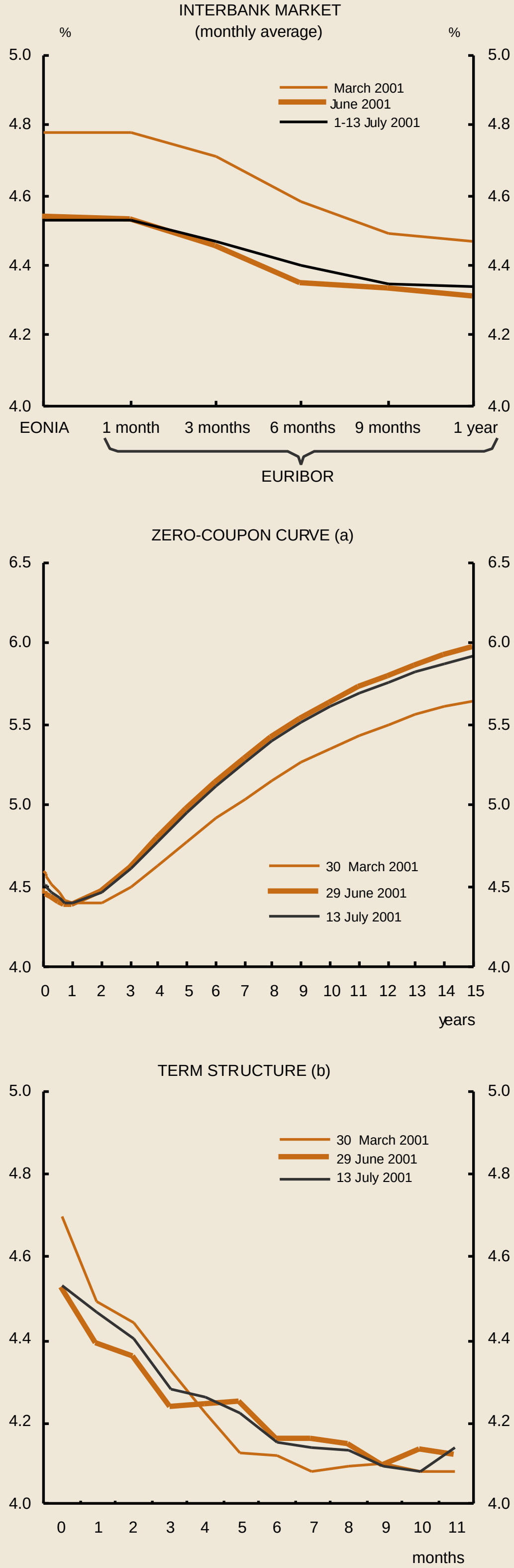
change general index is 8 % down. Broadly, the uncertainty surrounding equity markets may have prompted shifts in agents' portfolios towards fixed-income securities.

The growth rates of the monetary aggregates in the euro area have risen during Q2, thus curtailing the progressively moderating path seen since 2000 Q3 (see Chart 13). The year-on-year change in the M3 aggregate accelerated in June to 6.3 % (as calculated on the original series), placing the average for the last three months at over 5 %. Significantly, the ECB has revised in this period the official series of the benchmark M3 aggregate, eliminating from its calculation the holdings by non-residents of money market funds. Despite the importance this caption had acquired since the advent of EMU, it had not been possible to make the adjustment previously since there was not sufficient statistical information to isolate this effect. Besides, the recent trend of the monetary aggregates has been dominated by the relative buoyancy of the less liquid assets and a more moderate course of the components making up the narrow M1 aggregate. In Spain, liquidity has moved in line with that of the rest of the euro area. Accordingly, the average growth rate of liquid financial assets (LFA) accelerated in Q2 to 5.9 %, against 3.9 % in Q1. A more detailed assessment of recent developments in liquid assets in Spain can be found in section 5 of this report.

As regards the counterparts of the monetary aggregates, financing extended in the euro area to the private sector has continued to lose steam, slipping to a year-on-year rate of 8.4 % in June, almost one percentage point down on the related rate in March. That said, in historical terms this is still a relatively high rate of expansion. As to the end use of bank financing, the

CHART 12

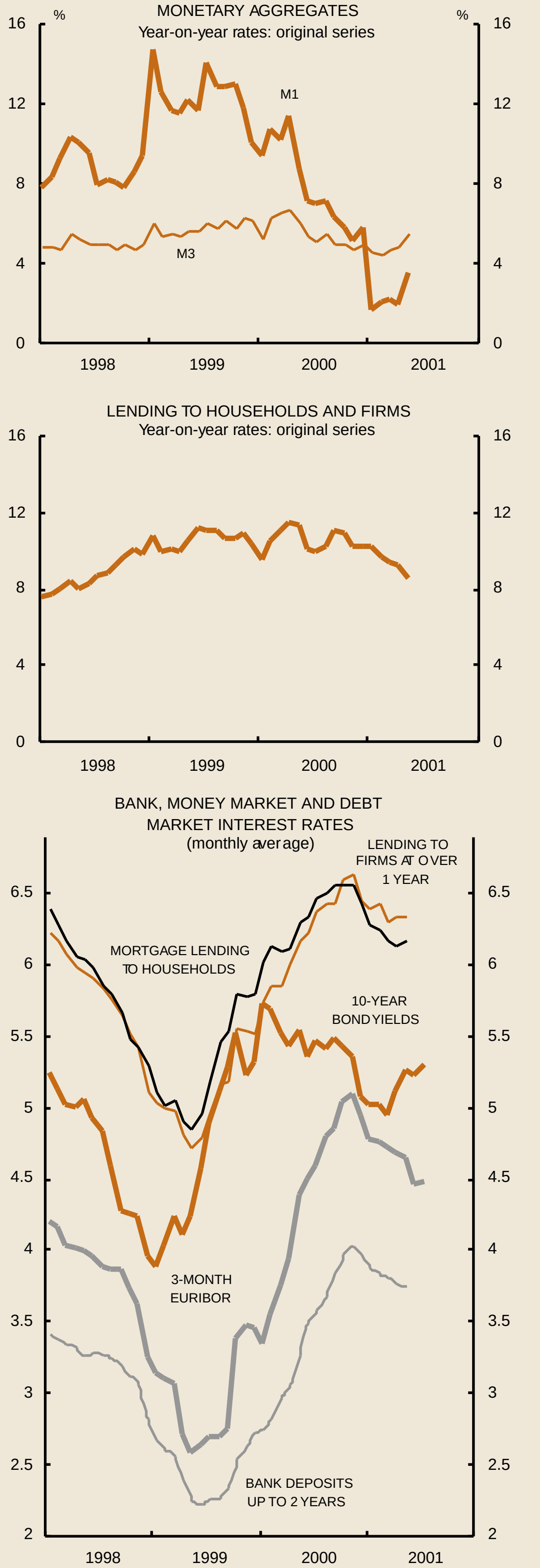
Euro-area yield curves



Sources: Banco de España and ECB.
(a) Estimation based on swap market data.
(b) Estimated using Euribor data.

CHART 13

Monetary and credit aggregates and interest rates in the euro area



Sources: Banco de España and European Central Bank.

information available for Q1 indicates that it is households which have most contributed to tempering lending, the consumer segment of which has proven intense. In any event, it should be recalled that there are sources of financing other than bank lending, such as corporate financing via fixed-income issues, which is progressively acquiring considerable importance. In the case of Spain, the growth of financing to non-financial corporations and households and non-profit institutions is being contained to some degree, although the associated rates of expansion are still high at 16 % year-on-year. Section 5 offers a more exhaustive evaluation of the financing of these economic sectors.

4. The Spanish economy

On QNA estimates, GDP remained in 2001 Q1 on the decelerating path initiated in the second half of the previous year, posting a real growth rate of 3.4 % (1) on a year earlier, three-tenths of a point less than the previous quarter (see Chart 14). This profile was determined by the slowdown in the main components of national demand, both private consumption and gross fixed capital formation, placing the year-on-year rate of change of this aggregate at 2.7 %. The contribution of net external demand to GDP growth, for its part, held at the higher level reached the previous quarter (0.6 percentage point). The short-term economic information available for 2001 Q2 points to a moderate and further slowdown in national demand to a rate of around 2.5 %, and a somewhat less positive contribution by the external sector, the result of weaker exports. Overall, GDP is estimated to have held on a slowing path in 2001 Q2, and its year-on-year rate to have fallen to 3 %.

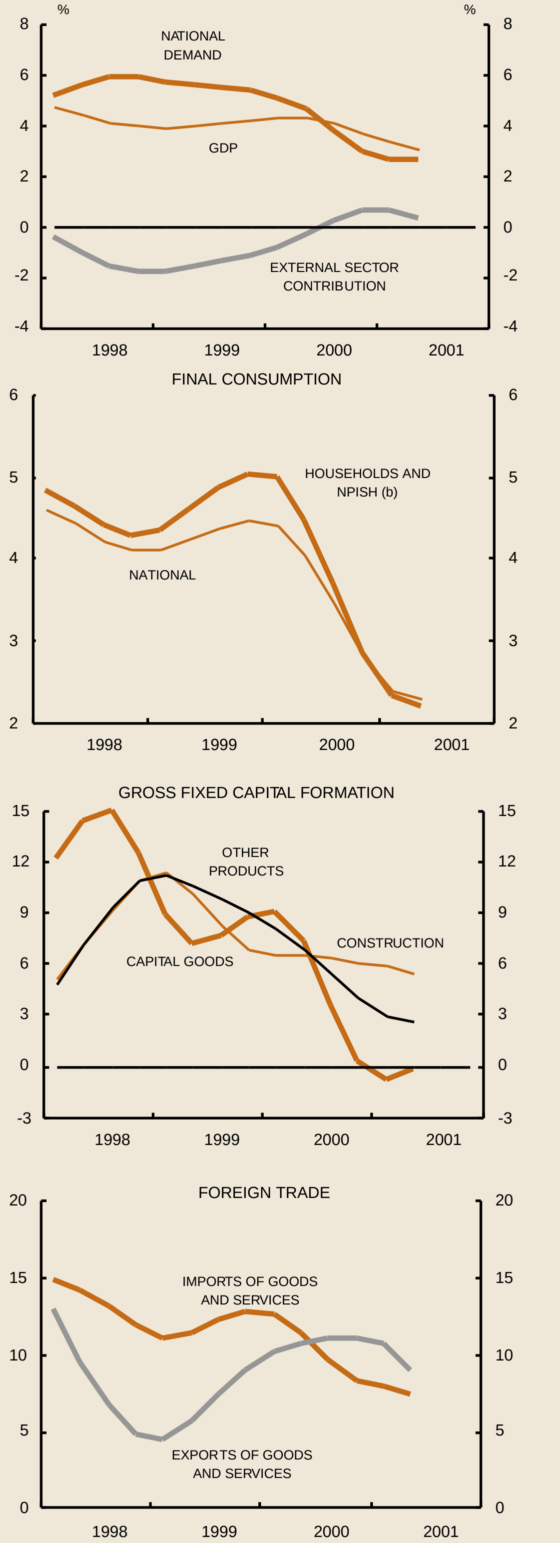
All the productive branches saw a lessening of the pace of activity during Q1, in line with final demand. The loss of momentum was sharper in the industrial and energy branches, as these were affected by a less favourable international background and by the weakening of the investment climate, a pattern that has continued into Q2. Apart from in market services, the slowdown in activity did not pass through in full to employment, giving rise to a fresh fall in the rate of increase of apparent labour productivity. Compensation per employee in the market economy increased by a similar amount to that at the end of last year (3.7 %), contributing to a slight rise in unit labour costs in this group of activities.

As early as last year, wage increases began to incorporate, in part, the upward effects on the inflation rate derived from oil price rises and from the successive crises besetting the food industry. This process has continued into the current year. Against this backdrop, where fresh direct upward effects on prices (stemming from changes in the market for certain meat products) have combined with the effects derived from higher wage and intermediate costs, the 12-month growth rate of the CPI has risen anew

(1) 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 trend-cycle components.
(b) Non-profit institutions serving households.

to levels not seen since the mid-nineties. However, given that some of these factors have been common to other Member States, the inflation spread with the euro area has remained at around one percentage point.

4.1. Demand

According to the latest QNA figures, household final consumption slowed by five-tenths of a point in 2001 Q1 to a rate of 2.3 % in real terms, thus contributing significantly to the lesser buoyancy of national demand in this period. This loss of momentum affected more intensely spending on services and on durable goods other than cars.

The information available on the behaviour of consumption in Q2 shows the deceleration to be continuing, albeit less sharply than in the preceding quarters. According to consumer surveys, the household confidence indicator stood at the end of Q2 at lower levels than those observed the previous quarter (see Chart 15), with all its constituent series declining, especially regarding the assessment of the current and future situation of the country. Moreover, consumers expected inflation and unemployment to trend upwards. Among the indicators most directly related to expenditure, the index of apparent consumption of goods and services continued to decelerate in Q2. Here, the services component moved at a slower pace while the deterioration in the goods component was checked. Under the latter component, the apparent consumption of food was slightly expansionary, following the fall posted the previous year, whereas that of durables other than cars continued to decline. New car registrations to July have reaffirmed the pick-up evident since the start of the year. Lastly, the overall index of retail sales has held on a growth path of around 2.5 % in recent months. Hereunder, the growth of foodstuffs has been prominent whereas sales of other products have been less buoyant.

The slowdown in consumption in the first half of 2001 is primarily related to the lower growth of real household income compared with a year earlier. In turn, this reflects a lower rate of job creation, as well as the effects of the increase in the inflation rate on purchasing power. The adverse behaviour overall of financial wealth and the deterioration in consumer confidence (interrelated factors which drove the strong expansion in consumption in the past) also help explain the lesser robustness of spending. This latter variable would be growing at similar rates to real income, marking a turning point in the squeeze on the saving ratio, which reached a low in the year 2000.

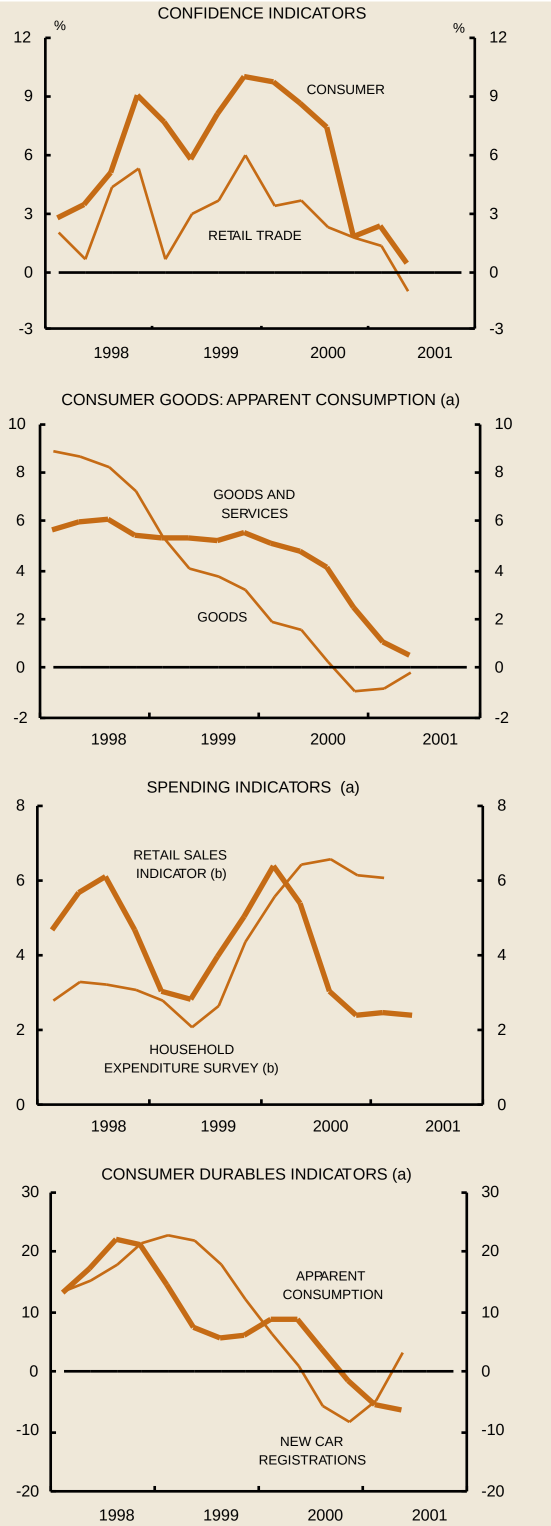
In 2001 Q1, general government final consumption spending grew by 2.6 % in real terms compared with a year earlier, one-tenth of a point less than in the previous quarter. The slowdown was more marked in nominal terms owing to the reduction in the growth rate of compensation per employee in this sector, which passed through to the deflator. The information available for Q2 points to the growth of general government final consumption spending stabilising in step with employment developments in this sector.

The declining course followed by gross fixed capital formation during the year 2000 continued into the opening months of 2001, dipping to a year-on-year increase of 3.2 %, almost one percentage point down on 2000 Q4. The loss of momentum was common to the three components of investment, although it was once again particularly intense in the case of gross fixed capital formation in capital goods, which posted a decline of 0.8 % in Q1 compared with the same period a year earlier (see Chart 14). Investment in construction and in other products also grew at lower rates than those of Q4. It did, however, retain greater momentum, especially that in construction, which climbed by 5.8 % in year-on-year terms, only slightly below the growth for the year 2000.

The information on investment in capital goods indicates that this aggregate has held at a negative rate of change in 2001 Q2. Nonetheless, judging by the index of apparent investment in capital goods with data to May (see Chart 16), the deterioration in this item has been checked. The expectations of producers of this type of goods, summarised in the monthly business survey, deteriorated most significantly in Q2, with a notable decline in the current assessment of output and of orders. However, entrepreneurs were somewhat more optimistic in their forecasts on the future course of these two variables.

CHART 15

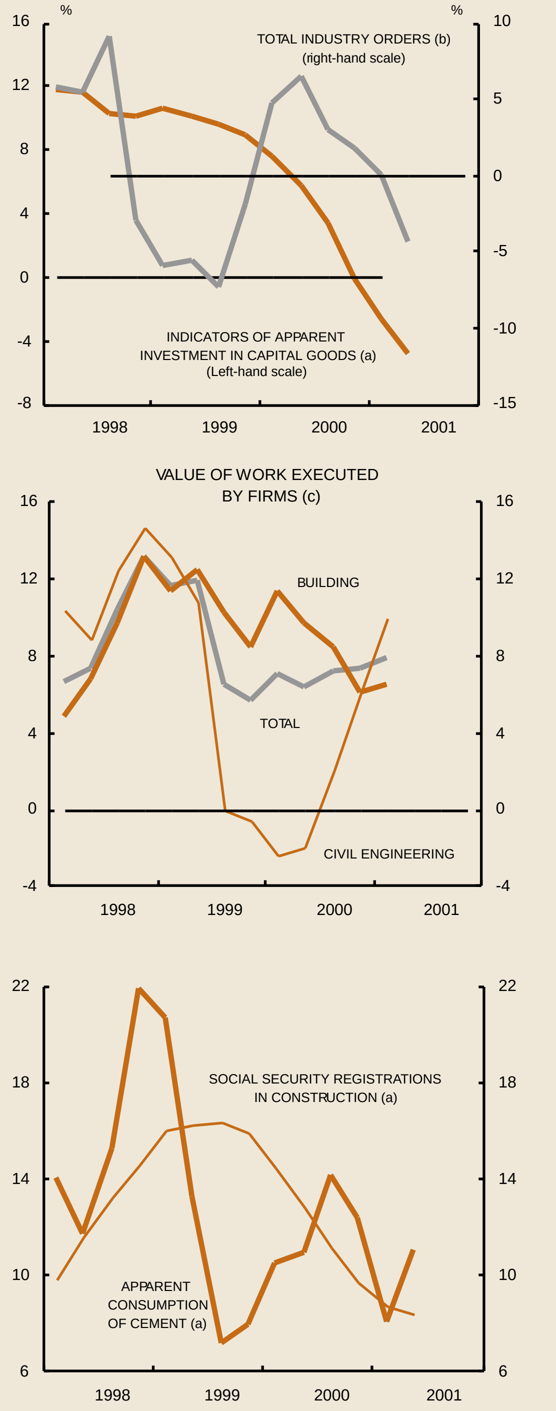
Private consumption indicators



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

CHART 16

Gross fixed capital formation indicators



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

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

(b) Level of original series.

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

The main determinants of productive investment help explain the lesser momentum of this aggregate in recent quarters. That said, the intensity of the slowdown, with rates of decline not seen since 1994, is more difficult to account for. Final demand has been on a markedly slowing path since the second half of 2000, although it continues to post relatively high growth rates, underpinned by construction, sales abroad and, to a lesser extent, private consumption. The moderation of demand has fed through to current and expected orders in industry, and is likewise reflected in the results of the half-yearly investment survey conducted by the Ministry of Science and Technology. According to this survey, industrial businessmen (especially those producing capital goods) consider that demand, in 2001, is proving to be a rather less favourable factor in investment decisions than in 2000. The Central Balance Sheet Office Quarterly Survey (CBQ) showed the deceleration in business activity in Q1, which led to a decline in the degree of capacity utilisation in industry to 79.7 %. Meanwhile, according to the opinions reflected in the half-yearly survey, the financial situation has also declined in weight as a factor driving investment, at least in industry. However, real interest rates remain low and the latest CBQ information, relating to 2000 Q1, shows that ordinary profit rates are still high (slightly higher than the rates achieved in the same period a year earlier), so that the leverage ratio is still clearly positive, despite the rise in the cost of financing. In these circumstances, the growing uncertainty stemming from the international environment and the intensity of flows of investment towards international markets seem to be affecting the rhythm of investment in Spain.

Investment in construction remains the most dynamic component of national demand (rising by 5.8 % year-on-year in Q1), and the one that shows fewest signs of fading. According to the survey of the sector conducted by the Ministry for Public Works (the ECIC), with data available to the first quarter, this dynamism has been underpinned by a strong pick-up in civil engineering work, which has been sufficient to offset the slowdown that has taken place in residential building in particular (see Chart 16).

The latest indicators of construction confirm its sustained growth. The indicators of inputs, used more intensively in civil engineering, reflect a relative strengthening in Q2, when the downtrend in the apparent consumption of cement that had prevailed since the second half of the previous year was broken, and the producer price index for construction materials emerged from the zone of negative rates of change seen in the previous quarter. The trend in the employment indicators was also favourable (Social Security registrations rose by around 8.3 % in April and May), and the construction confidence indicator held at levels close to the average for 2000.

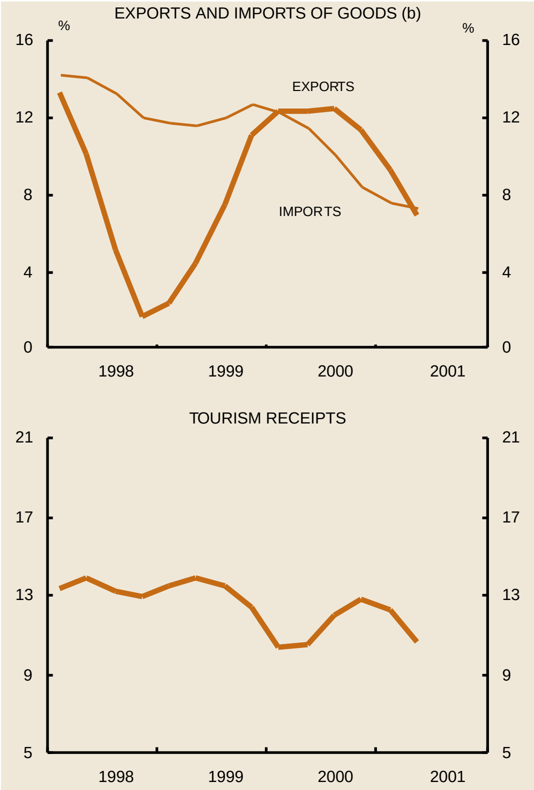
As for the leading indicators, planned residential building, according to architect association approvals, recorded a significant fall at the beginning of this year, which points to a further slowdown in residential investment, in line with the slower growth in real income and with the rise in housing prices. As regards civil engineering work, the declines recorded in government civil-engineering tenders at the beginning of the year would suggest that this component will be weaker, although the size of the infrastructure projects that remain on order books means that a favourable performance can be expected in coming quarters.

Stockbuilding contributed one-tenth of a percentage point to GDP growth in 2001 Q1, having made a negative contribution of similar magnitude the previous quarter. The survey of the industrial sector has shown an increase in the level of stocks, relative to the desired levels, in April and May, which may underpin a further positive contribution in Q2. This rise was especially large in the case of producers of capital and intermediate goods.

In Q1, net external demand, in real terms, made a positive contribution of 0.6 percentage points to output growth, similar to the level recorded since 2000 Q2. Exports of goods and services, following the path of mild slowdown that commenced in 2000 Q4, grew by 10.7 % in real terms. They were affected by the deceleration in world trade and by the recovery of the euro during the first quarter of the current year. The behaviour of exports was determined by the goods component, since the acceleration in that of services, which commenced in the second half of last year, continued. Imports, meanwhile, grew at a rate of 8 % during 2001 Q1,

CHART 17

Foreign trade (a)

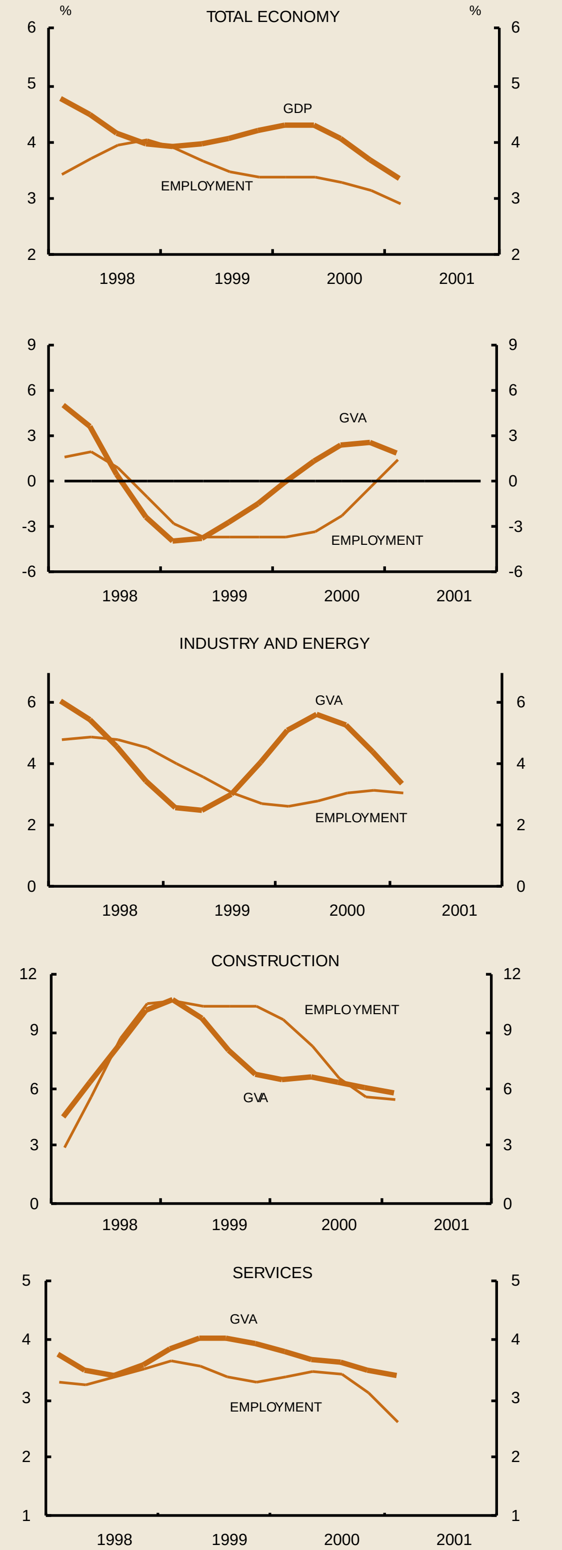


Sources: Ministerio de Economía, Ministerio de Hacienda and Banco de España.
(a) Non-centred percentage change on same quarter a year earlier, based on the trend of the indicator.
(b) Series deflated by the corresponding unit value indices.

slowing down in step with domestic demand and the reduced strength of industrial activity, although less sharply than in the second half of 2000. The information on trade flows for April and May and on the main determinants of external demand indicates that exports continued to lose strength in Q2 as a consequence of the weakening of world trade, which was only partially offset by the competitiveness gains arising from depreciation of the euro. Even so, exports are still relatively buoyant, underpinned by European markets where the slowdown in activity is proving less marked than in countries linked to the dollar. Imports, likewise, continued their mild decline, in line with the slower rate of growth of final demand, and against a background of moderation in their prices. Overall, it is estimated that in Q2 the positive contribution of net external demand to output growth must have been smaller than in previous quarters.

CHART 18

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



Source: Instituto Nacional de Estadística.

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

According to the latest customs data, in the period January-May goods exports extended the slowdown seen since the end of the previous year, growing by 8.4 %, in real terms, in the period as a whole, and by 6.1 % in April and May. The slowdown was concentrated in sales outside Europe. Exports to the EU remained buoyant in April and May, growing by 10.2 % in real terms, with a good performance in most markets in this area, with the exception of Germany. By contrast, the slowdown in exports outside the EU sharpened. They fell by 2.8 %, in real year-on-year terms, in April and May, following a rise of 12.1 % in Q1 and 19 % in 2000. The slackness of sales to the United States was notable, as was the intense moderation of those to the NICs and the drastic cut in those to Japan and Latin America in May. On the other hand, exports to Eastern Europe continued to grow at high rates. By group of product, the slowdown was across the board, with the exception of sales of food consumer goods, which recorded real growth of 7.6 % to May. Among the most dynamic groups, exports of non-energy intermediate goods rose by 10.4 % in that period and those of non-food consumer goods by 10 %, bolstered by the positive behaviour that car sales are still displaying in certain markets.

As for service exports, although the recovery in nominal tourism receipts that was already apparent at the end of 2000 strengthened in 2001 Q1, the April data showed this acceleration cut short. The cumulative increase during the first four months was 14.9 %, against a background of accelerating prices for these services. Likewise, the growth of real indicators (tourist arrivals and foreign visitors staying in hotels), having accelerated in the first three months, tended to moderate subsequently. Thus, the rate of growth of tourist arrivals fell to 2.5 % in May, from 4.9 % in Q1. The decline in the numbers of tourists from Germany should also be mentioned here.

Following the notable moderation in May, goods imports in the first five months of 2001 grew at 6.7 % in real terms. This was still above the rate at the end of 2000, but the path was one of gradual slowdown (see Chart 17). The determinants of imports fully explain this slight slowdown in Q2. It was linked to the loss of momentum in final demand and industrial activity, and took place in spite of the deceleration of import prices.

By group of product, the strong growth in real terms of purchases of food consumer goods stands out (27 % in the period January-May). This was affected by the low levels recorded in the same period last year, when all the imports of tobacco during these months were recorded in July 2000. At the same time, the May figures showed a moderation of the notable recovery that had been recorded until then by purchases of non-energy intermediate goods, against a background of very moderate growth in their prices. However, purchases of non-food consumer goods remained highly buoyant in May. In the first five months of 2001 they increased by 7.9 %, boosted by the transfer to January of certain purchases of transport equipment corresponding to December 2000. Imports of capital goods continued to display a very subdued tempo throughout this period, with a fall of 2.4 % in real terms. As for energy purchases, intermediate goods grew in real terms by 4.3 % in the first five months of the year, with their rate of growth declining again in relation to the previous year, despite the sharp reduction in the rate of growth of their prices.

Finally, the growth of services imports rose slightly in 2001 Q1 in real terms, to 10.3 %. However, as in the case of receipts, the pick-up in nominal tourism payments was cut short in April. Even so, they rose by 22.4 % to that month. Services other than tourism continued to display sustained growth, notable being the growth in payments relating to passenger transport services and that of those linked to financial services, in line with the buoyancy of Spanish investment abroad.

4.2. Output and employment

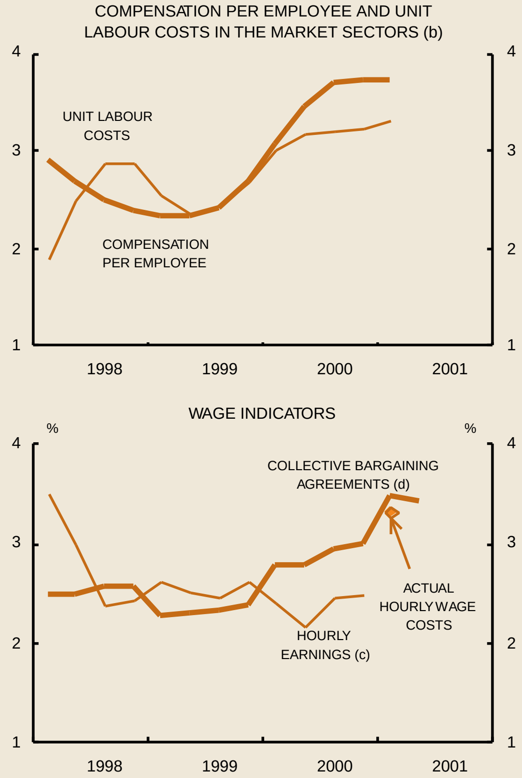
As mentioned at the beginning of this chapter, the rate of growth of GVA in 2001 Q1 fell in all productive branches (see Chart 18). In the case of the primary sector, the growth rate fell to 1.7 %, year-on-year, cutting short the trend of recovery displayed by this activity in 2000. The loss of vigour was concentrated in crop farming, while both livestock farming and fishing recorded rates of decline in activity similar to those of the final months of the year 2000. Paradoxically, the abundant rainfall (the factor responsible for the recovery in the sector last year) was the cause of the reduced momentum of agricultural output at the beginning of the year, as it prevented certain crops from developing normally, such as winter cereals, whose output is estimated to have fallen by 20 %. Despite this, there are other crops which will benefit from the high rainfall, so that in the year 2001 as a whole this sector can be expected to post a positive performance. That said, these favourable prospects depend on the performance of the livestock industry, since any worsening of the health problems in pig-farming could offset the recovery from those previously affecting beef production.

The performance of industrial activity in the first few months of 2001 continued to be governed by the loss of vigour in domestic demand (especially capital goods investment) and by the deteriorating international environment. On QNA data, in 2001 Q1 the rate of growth of activity in the industrial and energy branches fell by one percentage point, to 3.3 %. As in the previous quarter, energy production recorded a larger deceleration, although it remained the most dynamic sector. Industry also slowed, continuing to do so in Q2, according to the latest information. The index of industrial production deteriorated further in April and May, well into the zone of negative rates of change, and the industrial confidence indicator slipped in Q2, owing to the worse assessment by businessmen of their order books and the undesired increase in stocks. At a less aggregated level, the deceleration affected both mining and chemicals and, more markedly, metal processing, where problems have been discerned in relation to the products with the highest technological content, such as electronic equipment and office machinery. Manufacturing output has, for its part, remained stuck at negative rates of change.

Construction continued to be the most dynamic activity in Q1, with the exception of energy, despite moderating further. On QNA data, the year-on-year rate of growth of value added in construction was 5.7 %, 0.3 percentage points less than in the previous quarter. As already mentioned when discussing investment in construction, the information available points to continuation of this moderate slowdown in Q2.

CHART 19

Wages and labour costs (a)



Sources: Instituto Nacional de Estadística and Ministerio de Trabajo y Asuntos Sociales.
(a) Percentage change on same quarter a year earlier.
(b) Rates based on QNA trend-cycle series.
(c) Total earnings.
(d) Average wage increase for the current year, up to the reference month (excluding the effects of inflation-adjustment clauses).

Activity in the tertiary sector was not immune to the general trend of slower growth. On QNA estimates, gross value added in services decelerated in 2000 Q1 by one-tenth of a percentage point to 3.4 % year-on-year. This slowdown affected both market services and services provided by general government, halting the mild acceleration that took place in 2000. The information relating to Q2 shows no change in these trends. The distributive trade and repair industry recorded reductions in their growth rates, in line with the reduced momentum of private consumption, as inferred from Social Security registrations and from the retail trade confidence indicator, which was strongly affected by an unfavourable assessment of the current business situation. Hotels and catering, meanwhile, was subject to the same trends. Both the indicators of activity (overnight hotel stays and hotel visits) and Social Security registrations point to a slowdown in Q2. Social Security registrations also show a profile of ongoing loss of momentum in transport, storage and communication.

On the latest QNA data, employment (2) rose by 2.9 % year-on-year in 2001 Q1 and continued to slow as it had been doing for the past year. However, the slowdown in employment was less steep than that of activity, so that apparent labour productivity grew at a slower rate than in the previous quarter (0.5 %, against 0.8 % in 2000) (see Chart 18). The Labour Force Survey showed annual growth in employment of 2.8 % in 2001 Q1, which was similar to the QNA rate. However, the path of deceleration was more marked in this case, which may be attributable to the fact that the figure for 2000 Q4 was still affected by the changes made to the survey during the previous two years (3). The indicators available for Q2 show that the job creation process continued to lose steam at a moderate rate. Social Security registrations grew by 4.3 % in that quarter, as against 4.6 % in Q1, and registered unemployment also showed signs of slightly less favourable growth, falling by 3 % between April and June, when it had fallen by 3.2 % in Q1. Finally, contracts signed in spring picked up somewhat, after falling at the beginning of the year, with a rise of 1.7 % year-on-year.

By branch of activity, it was those branches which generated most jobs, in net terms, during the previous year that governed the path of slowdown of the aggregate in Q1, especially in the tertiary sector. On QNA data, jobs in services grew by 2.6 % year-on-year, 0.5 percentage points less than at the end of 2000, with a deceleration in market services, where they grew by 3.1 % (a reduction of 0.8 percentage points in the rate of change) and a gradual recovery in non-market services. In construction, employment rose by 5.4 % with respect to 2000 Q1, 0.2 percentage points down on the end-2000 rate, leading to a slight rise in productivity gains, which might be related to the greater vigour of civil engineering work. Employment in industry grew at a stable rate of 3.1 %, which

(2) The concept used is that of full-time equivalent jobs, which is more suitable for comparisons with activity.
(3) See the article “La evolución del empleo y del paro en el primer trimestre de 2000”, in the May 2000 edition of the *Boletín económico.*

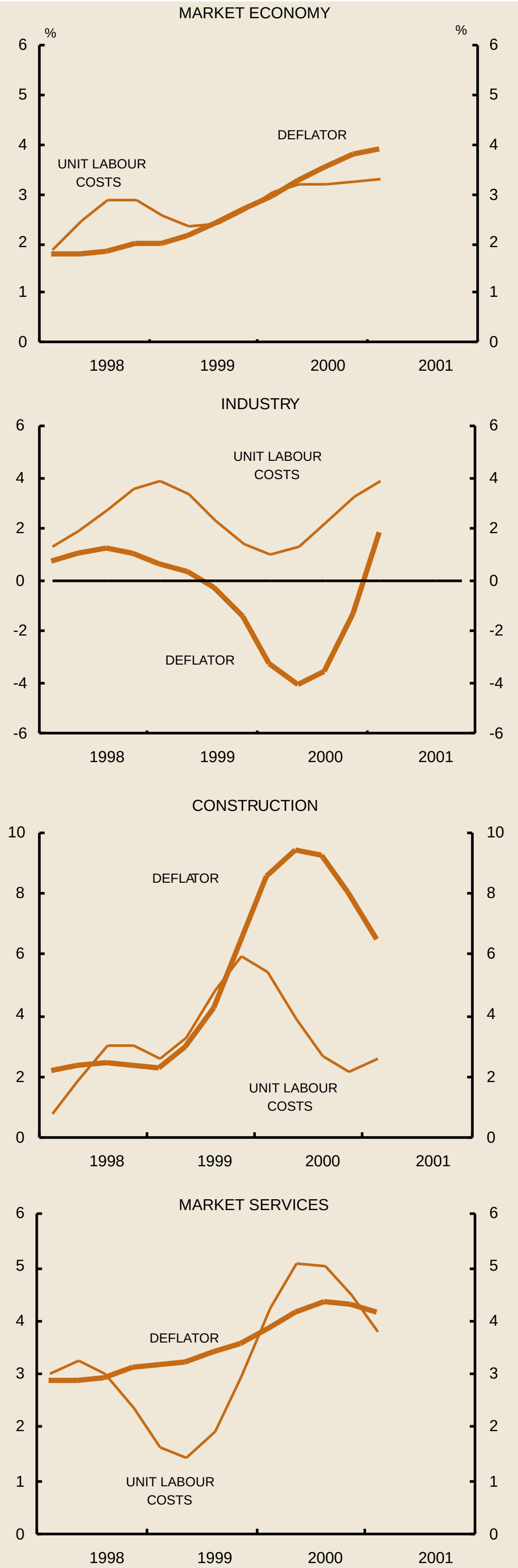
contrasts with the slowdown in activity (giving rise to substantial losses of apparent productivity) and with the information provided by other indicators, such as the Labour Force Survey and Social Security registrations. According to the latter statistic, job creation in industry weakened in Q2. In agriculture, employment picked up, rising by 1.5 %, which meant that it lagged somewhat behind output (see Chart 18).

In terms of the composition of the employment generated, the lower job creation in the first few months of 2001 mainly affected dependent employment, whose rate of change, according to the QNA was 3.2 %, 0.4 percentage points down on 2000 Q4, while the number of self-employed displayed an upward trend, rising by 1.3 % in Q1. On Labour Force Survey data, the slowdown in dependent employment only affected workers with permanent contracts, whose growth rate fell to 3.6 % year-on-year, while the number of temporary contracts rose by 2.8 %, which was higher than the end-2000 increase. Nonetheless, the ratio of temporary to total employment fell by 0.2 percentage points, relative to 2000 Q1, to 31.5 %. In line with this development, the number of permanent contracts recorded by INEM fell in the first quarter, although in the second, after the reforms introduced in March, their number grew substantially, especially through the conversion of contracts into permanent ones. As regards working hours, the Labour Force Survey indicates that full-time employment and part-time employment underwent a similar deceleration in Q1, the ratio of part-time to total employment standing at 8.2 %, the same level as a year earlier.

From the viewpoint of the supply of labour, it should be pointed out that in 2001 Q1 the process of incorporation of the working-age population into the labour market slowed down again, the labour force recording a year-on-year increase of 1 %, according to Labour Force Survey data. The activity rate edged down to 51.3 % for the population aged 16 and over, holding at 65.4 % if the over 65s are excluded. The reduced buoyancy of the labour force and the ongoing generation of employment, despite its deceleration, enabled a further cut to be made in the total number of unemployed and in the unemployment rate, which stood at 13.4 %, 0.2 percentage points down from end-2000. Long-term unemployment continued to fall, ac-

CHART 20

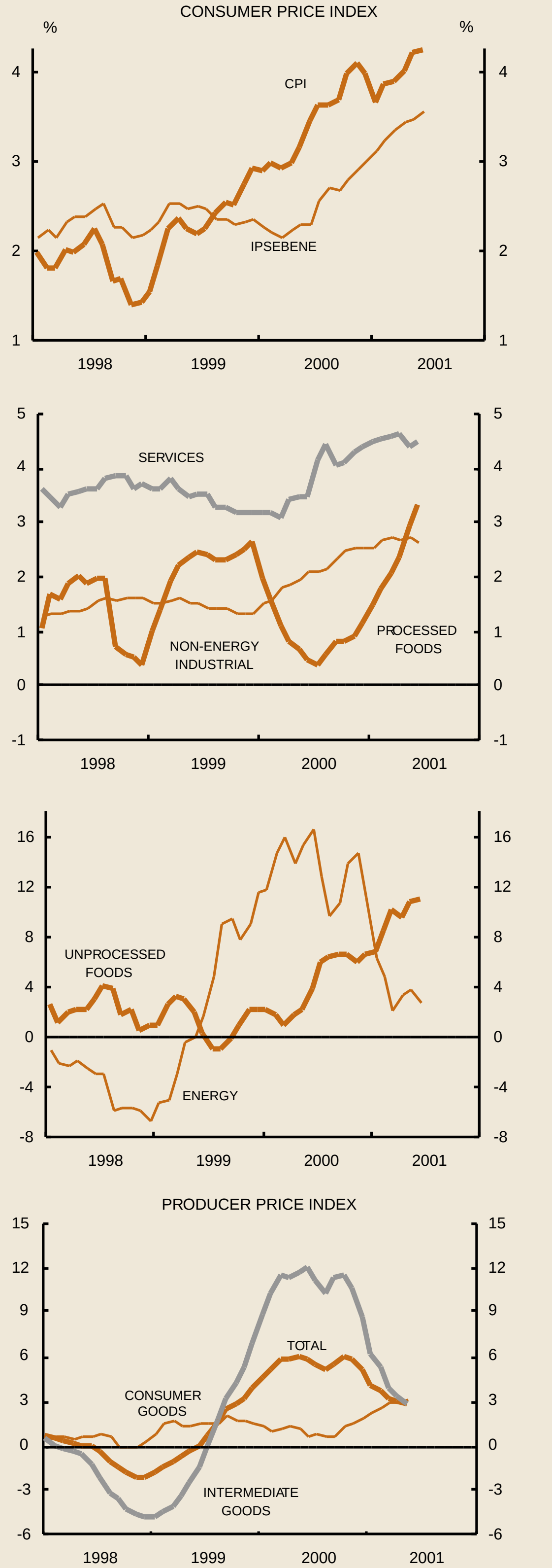
Prices and costs by branch of activity (a)



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

CHART 21

Price indicators (a)
Spain



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

counting for 44.5 % of total unemployment in Q1. The reduction was concentrated among the young, while the incidence of long-term unemployment among the 45-65 age group increased further.

4.3. Costs and prices

The previous section described how the slowdown in activity and employment in 2001 Q1 also gave rise to a slight slowdown in apparent labour productivity. Compensation per employee, for its part, calculated in terms of full-time equivalent jobs, rose by 3.8 %, as against 4 % in the previous quarter and in 2000 as a whole, giving rise to a stable trend in unit labour costs (ULCs), which rose by 3.4 % year-on-year. Aggregate productivity in the branches making up the market economy behaved similarly to that of the whole economy. However, compensation per employee grew at a similar rate to the preceding period (3.7 %) and ULCs accelerated slightly, to 3.3 % (see Chart 19).

Among the data available on remuneration in the first few months of 2001, the new index of labour costs (ICL), compiled by INE to replace the former Wages Survey, should be mentioned. In Q1 the ICL per hour of work rose by 4.2 % year-on-year (a larger rise than the one estimated by the QNA for compensation per employee) as a result of an increase of 3.3 % in wage costs, and of 6.7 % in other costs. The wage settlement negotiated in collective agreements recorded to 30 June was 3.4 %, 0.3 percentage points higher than the increase in 2000, before including the effects of inflation adjustment clauses. Wage rates in revised agreements rose by 3.4 %, while the settlement in newly signed agreements was 4 %, although their level of representativeness is still low. Also, the effect of the inflation adjustment clauses, that were triggered as a consequence of the deviation of actual inflation in 2000 from the official forecast, is estimated to be 0.6 percentage points, which will increase the wages actually received in 2001.

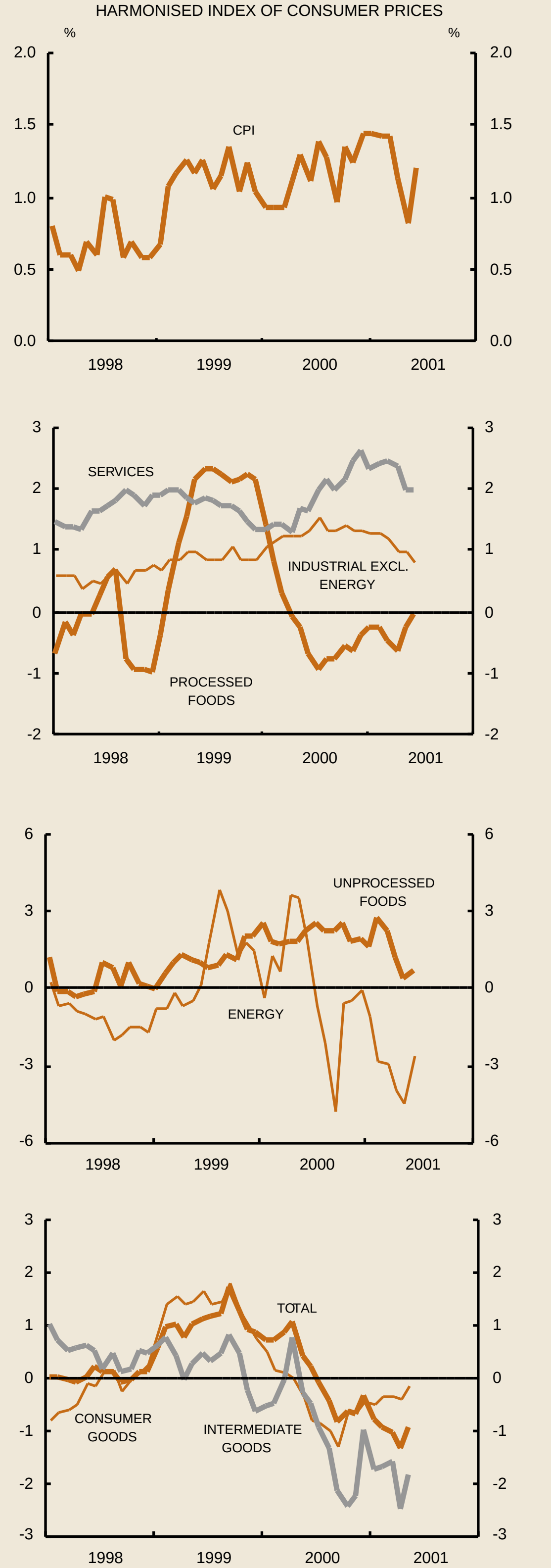
From the viewpoint of price formation in the market economy, the slight acceleration in ULCs in 2001 Q1 would have been accompanied by continuation of the upward path of the unit surplus, giving rise to a 3.9 % increase in the GVA deflator, 0.1 percentage points up on its average growth in 2000 (see Chart 20). These data reflect the domestic inflationary pressures to which the economy has been subject in the first half of the year. On QNA estimates, the behaviour of prices and margins across branches of activity has been uneven. In industry, the value added deflator displayed a positive annual rate of increase in Q1 (1.8 %), after the sharp falls in 2000, while unit labour costs accelerated forcefully, owing to the increase in compensation per employee and, especially, to the estimated losses in apparent productivity. In consequence, margins in industry continued to narrow, albeit at a slower rate than in previous quarters. The rate of growth of the market-services deflator edged down on the preceding quarter, while unit labour costs decelerated substantially, as a result of the improvement in productivity. Against this background, unit margins tended to pick up following the deterioration seen in 2000. Finally, in construction, the notable growth of compensation per employee gave rise to an acceleration in unit labour costs, while the deflator continued to record high rates of growth. Margins thus continued to widen in this sector, albeit at a lower rate.

The deflator for the GDP of the whole economy, following the path of the GVA deflator, increased by 3.9 % in 2001 Q1, 0.2 percentage points up on the increase in the previous quarter. However, this performance of the domestic component of prices was accompanied by a notable slowdown in the deflator of imports of goods and services, which rose by 5.8 %, so that the annual rate of increase of the final demand deflator fell to 4.3 %, 0.6 percentage points less than in the preceding period. The path of the unit value index of goods imports during the first five months of the year, when it rose by 2.1 %, would point to a continuation of the slowdown in Q2. However, the depreciation of the euro may curb this trend.

The CPI, the main indicator of final prices in the economy, had a profile in 2001 Q1 concordant with the final demand deflator, its annual rate of increase falling in that period. However, the Q2 data have shown an acceleration in this indicator, to a year-on-year rate of 4.2 % in June (see Chart 21). Also, underlying inflation as measured by the IPSEBENE (index of non-energy processed goods and service prices) was on an upward path, increasing in June at

CHART 22

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



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

TABLE 3

State Budget outturn

ESP bn and %

	Outturn 2000	Percentage change 2000/1999	Budget 2001	Percentage change 2001/2000	Outturn JAN-MAR Percentage change 2001/2000	Outturn 2000 JAN-JUN	Outturn 2001 JAN-JUN	Outturn Percentage change
	1	2	3	4=3/1	5	6	7	8=7/6
1. Revenue	**19,749**	**7.5**	**20,421**	**3.4**	**6.0**	**9,561**	**9,531**	**-0.3**
Direct taxes	8,557	9.5	9,013	5.3	8.9	3,984	3,967	-0.4
Personal income tax	*5,350*	*4.9*	*5,675*	*6.1*	*11.2*	*3,172*	*3,154*	*-0.6*
Corporate income tax	*2,863*	*17.5*	*3,022*	*5.6*	*104.8*	*606*	*636*	*4.8*
Other (a)	*345*	*21.8*	*316*	*-8.4*	*-64.5*	*205*	*177*	*-13.8*
Indirect taxes	8,532	7.3	9,117	6.9	5.7	4,480	4,546	1.5
VAT	*5,557*	*8.7*	*6,022*	*8.4*	*8.5*	*3,026*	*3,063*	*1.2*
Excise duties	*2,672*	*4.1*	*2,778*	*4.0*	*-1.7*	*1,306*	*1,330*	*1.8*
Other (b)	*304*	*12.4*	*317*	*4.4*	*4.6*	*148*	*154*	*4.0*
Other net revenue	2,659	2.4	2,291	-13.8	-0.8	1,097	1,017	-7.2
2. Expenditure (c)	**20,153**	**3.8**	**20,662**	**2.5**	**3.8**	**10,550**	**10,865**	**3.0**
Wages and salaries	2,706	-9.2	2,770	2.4	2.6	1,369	1,405	2.6
Goods and services	395	-9.5	351	-11.1	-12.8	202	205	1.7
Interest payments	2,948	-7.3	2,836	-3.8	-4.4	2,035	1,953	-4.0
Current transfers	12,117	12.1	12,533	3.4	7.5	5,962	6,258	5.0
Investment	1,004	4.9	1,097	9.3	3.5	531	536	0.9
Capital transfers	985	-7.4	1,075	9.2	23.6	450	506	12.6
3. Cash-basis balance (3=1-2)	**-404**	**-61.7**	**-241**	**-40.5**	**-7.3**	**-989**	**-1,334**	**34.9**
MEMORANDUM ITEM: NATIONAL ACCOUNTS:								
Revenue	19,835	7.6	—	—	6.5	9,646	9,674	0.3
Expenditure	20,461	4.7	—	—	3.2	9,837	10,316	4.9
Net borrowing (-) or net lending (+) (d)	**-626**	**-43**	**-320**	**-48.9**	**—**	**-191**	**-642**	**236.3**

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

an annual rate of 3.6 %. Energy prices contributed to the acceleration of the CPI in the quarter as a whole, owing to the rise in the price of calor gas in April and, especially, to the rise in the prices of vehicle and heating fuels, boosted by the upward path of crude-oil prices on international markets, in April and May, and by the level of the euro. However, in June and especially in July substantial reductions were recorded in the price of petrol, foreshadowing a change to the upward trend in energy prices. Notable developments in the other components of the CPI in the latest period included: the strong and growing increases in both processed and particularly unprocessed food prices; the stability in the annual rate of increase in the prices of non-energy industrial goods, at around 2.7 %; and, finally, the high rates of increase recorded by the services component (4.5 % in June).

BOX 3

Social security budget outturn

The Social Security System ran a surplus of ESP 1,032 billion to April 2001, ESP 215 billion (26.3 %) higher than in the same period of 2000 (see table below). This outturn was the result of growth in revenue of 9.1 %, above the 7.9 % rate projected in the budget, which exceeded the increase in expenditure (6 %).

Receipts from social security contributions rose by 10.6 % to April, well above the rate of 8.7 % projected in the budget. The growth of these receipts continued to be driven by the buoyancy of the total number of persons registered which grew by 4.4 % to June (5 % during 2000). The other major source of revenue, current transfers from the State, increased by 6.8 %, in line with the budget.

As for expenditure, that on contributory pensions increased by 3.7 % to April, a rate that may be distorted by the different criteria used to record extraordinary payments to compensate for the deviation in the inflation rate, since that made in February 2000, for the deviation in 1999, was recorded at the date of payment, which does not seem to have been the case with that paid in January 2001, for the deviation in 2000. If the amount of such payment is deducted from spending on pensions to April 2000, the growth in this expenditure in the first four months of 2001 would rise to 6.6 %, somewhat higher than budgeted. The number of contributory pensions rose by 1.2 % in 2001 Q1, in line with projections and with the growth recorded in 2000.

As regards INEM (National Employment Office) expenditure, spending on unemployment benefits increased by 9.9 % to June 2001, as against a rise of 3.1 % in 2000. This outcome was the result of the behaviour of the number of beneficiaries, which rose by 4.5 % to April, as against an average reduction of 2.7 % in 2000. The increase in the number of beneficiaries and the decline in the number of registered unemployed (1.3 % to June, as against 4.5 % in 2000) gave rise to a further increase in the eligibility ratio, which stood at 68 % to April (64.7 % in 2000).

Meanwhile, contributions received by INEM rose by 9.5 % to February, as against the 6.2 % rate projected in the budget, while concessions to promote employment fell by 10 % to March, in contrast to the 3 % increase projected in the budget.

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

ESP bn and %

	Budgeted			Outturn JAN-APR		
	2000 (c) 1	2001 2	% change 3=2/1	2000 4	2001 5	% change 6=5/4
1. Revenue	**14,583**	**15,736**	**7.9**	**5,309**	**5,794**	**9.1**
Social security contributions (d)	9,589	10,419	8.7	3,277	3,624	10.6
Current transfers	4,825	5,124	6.2	1,966	2,100	6.8
Other (e)	169	193	14.3	66	70	6.5
2. Expenditure	**14,432**	**15,352**	**6.4**	**4,492**	**4,762**	**6.0**
Wages and salaries	2,247	2,388	6.3	801	855	6.8
Goods and services	1,388	1,492	7.5	462	506	9.4
Current transfers	10,579	11,233	6.2	3,184	3,350	5.2
Benefits	10,509	11,158	6.2	3,172	3,319	4.6
Contributory pensions	*8,342*	*8,826*	*5.8*	*2,412*	*2,502*	*3.7*
Sickness	*525*	*592*	*12.6*	*162*	*192*	*18.8*
Other	*1,641*	*1,740*	*6.1*	*598*	*625*	*4.5*
Other current transfers	71	75	6.4	12	31	149.7
Other (f)	217	238	9.6	46	52	13.8
3. Balance	**151**	**384**	**154.5**	**817**	**1,032**	**26.3**

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 2001 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 1997.

(c) The budgetary reference takes the Budget for the year 2000 as its basis for comparison, since the full outturn for this year is not yet available.

(d) Including surcharges and fines.

(e) Excluding surcharges and fines.

(f) Reduced by the disposal of investments.

TABLE 4

Balance of payments: summary table (a)

EUR m

	JAN-APR 2000	JAN-APR 2001
	Receipts	Receipts
Current account	**64,824**	**76,983**
Goods	38,641	44,561
Services	15,643	18,014
Tourism	8,444	9,698
Other services	7,199	8,315
Income	4,832	7,724
Current transfers	5,707	6,685
Capital account	**2,603**	**3,154**
	Payments	Payments
Current account	**69,748**	**80,663**
Goods	48,829	54,181
Services	10,175	11,497
Tourism	1,587	1,943
Other services	8,588	9,554
Income	7,041	10,936
Current transfers	3,703	4,049
Capital account	**347**	**284**
	Balance	Balance
Current account	**-4,924**	**-3,679**
Goods	-10,188	-9,620
Services	5,468	6,517
Tourism	6,857	7,755
Other services	-1,388	-1,238
Income	-2,209	-3,212
Current transfers	2,005	2,636
Capital account	**2,257**	**2,870**

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

The acceleration of consumer prices in Spain (as measured by the HICP) in Q2 was less than in the euro area as a whole, so that the inflation differential with the area edged down to one percentage point in Q2 (from 1.2 percentage points in June). This reduction was common to the prices of goods and services. However, the latter component continues to have the widest differential, which was still close to two percentage points in June (see Chart 22).

In contrast to the CPI, and more in line with import prices, the producer price index displayed a downward trend in the first five months of 2001, with its year-on-year growth rate standing at 2.7 % in May (see Chart 21). The moderation in the prices of intermediate goods over the period as a whole was notable.

4.4. The State budget

On National Accounts methodology the State deficit in the first half of 2001 was ESP 642 billion (0.6 % of GDP), as against a deficit of ESP 191 billion in the first half of 2000 (see Table 3). In relation to Q1 2001, revenue decelerated significantly, while the growth rate of expenditure rose. This deterioration in the State budget outturn, largely determined by the rise in tax rebates, appears to be compatible with the target of achieving balanced public-sector finances this year, taking into account the favourable Social Security developments.

Total State revenue increased by 0.3 % to June, as against 6.5 % in Q1, basically due to the sharp slowdown in tax resources. Income and wealth taxes fell by 0.1 % in the first half owing to earlier payment of income tax rebates this year, while VAT revenue, affected by an increase in repayments, grew by only 0.7 % to June, as against 9 % in Q1. On the other hand, the growth rate of other taxes on products picked up somewhat (to 2.7 %). Other current revenue remained highly buoyant (with a rise of 31.9 %), reflecting the significant growth in revenue from ordinary profits of the Banco de España recorded in February.

Turning to expenditure, its growth rate rose to 4.9 % in Q1, which was higher than the rate of 3.2 % to March and the 4.7 % rate recorded in 2000 as a whole. Both current and capital expenditure accelerated. Final consumption expenditure rose by 1.3 %, compared with a fall of 6.3 % to March, owing to the fact that compensation of employees grew by 0.3 %, after having fallen by 2.3 % in Q1, and that other final consumption expenditure increased by 7.5 %, in contrast to the sharp reduction to March. Transfers to the rest of general government grew by 5.3 %, as against 15 % in 2000. However, both these transfers and final consumption expenditure are affected by the ongoing transfer of responsibilities to the regional (autonomous) governments. Finally, the growth rate of capital expenditure cannot be considered significant, given the low level of this spending in the first half.

In cash terms, the State recorded a deficit of ESP 1,334 billion in the first half of 2001, up 34.9 % on that recorded in the same period a year earlier. The increase in the cash-basis deficit in the first half was due to the decline of 0.3 % in revenue, compared with the growth projected in the budget, and to the 3 % increase in expenditure.

According to cash-basis information, during the period January-June, both direct and indirect taxes grew at lower rates than during 2000 as a whole and than projected in the budget. Notable, in particular, was the decline in receipts from personal income tax, as a consequence, as already mentioned above, of the earlier payment of rebates in 2001 in respect of tax paid in 2000. This temporary phenomenon affecting personal income tax, together with the moderate increase in receipts from corporate income tax and the sharp fall in receipts from the tax on the income of non-residents, meant that revenue from direct taxes grew in the first half of the year at well below the rate forecast for the year as a whole.

As for indirect taxes, on cash-basis data, their growth rate to June is also well below the budget projection. Most notable was the low rate of growth of VAT (1.2 %), in contrast to the 8.4 % rate projected in the budget and to the 8.5 % rate recorded in Q1. As for the other indirect taxes, receipts from excise duties accelerated in Q2, although the growth rate to June (1.8 %) is still below that forecast for the year as a whole (4 %).

Non-tax revenue recorded on a cash basis fell in the first half, owing to smaller transfers of capital, which mostly arise from transactions with the European Union. However, as a consequence of the increase in profits received from the Banco de España, the fall in total non-tax resources in the first half was less than projected in the budget.

As for expenditure, its growth in Q2 slowed in relation to Q1, although the rate for the first half continued to exceed the budget projection. This was a consequence of current expenditure, since all its components, other than interest payments, displayed higher-than-budgeted growth rates, with goods and services being especially notable in this respect. By contrast, the growth rate of capital expenditure was below budget, due to the growth of investment, since capital transfers were higher than projected.

4.5. The Spanish balance of payments and capital account

In the period January to April 2001 the current and capital accounts of the balance of payments ran an overall deficit of EUR 809 million, EUR 1,859 million less than in the same period a year earlier. This improvement is explained by the favourable trend in the current account deficit, which in the first four months was reduced by EUR 1,245 relative to the same period a year earlier, and by the good performance on the capital account, where the surplus rose by EUR 613 million on the same period a year earlier (see Table 4).

Between January and April, the trade deficit improved by EUR 569 million in comparison with the same period of 2000. In terms of year-on-year rates, the deficit fell by 5.6 %, in contrast to the average increase of 30.3 % last year. The behaviour of nominal flows of exports and imports of merchandise, which grew by 15.3 % and 11 %, respectively, was mainly determined by the improvement in the terms of trade from the beginning of the year, stemming from a moderation in the rate of increase of both energy and non-energy import prices. Moreover, as already mentioned in section 4.1, goods exports were also more buoyant than imports in real terms.

The surplus recorded on the services account to April was EUR 6,517 million, as against EUR 5,468 million in the first four months of 2000. This growth is explained by the 13.1 % rise in the surplus on tourism and travel and by the 10.8 % reduction in the deficit on other services. Both receipts (14.9 %) and, especially, payments (22.4 %) relating to tourism and travel were expansionary. However, tourism receipts, which had been more dynamic in 2001 Q1, began to slow in April in line with the moderation in the tourist arrivals indicator. This moderation continued in May.

During the period January-April, the income deficit rose by EUR 1,003 million from the same period a year earlier. Receipts continued to rise at a significant rate (59.8 %), reflecting the strong investment abroad in recent years. Payments also grew by 55.3 %, with notably high growth in the income paid by the private sector, in step with the recent buoyancy of foreign portfolio investment, in the form of mutual funds and bonds.

In the first four months of 2001, the transfers surplus amounted to EUR 2,636, a rise of EUR 631 million on the same period of 2000. This increase was attributable both to flows from the EU to the private sector, under the EAGGF-Guarantee, and to flows to the public sector, under the European Social Fund. Finally, the capital account surplus rose by EUR 613 million relative to the first four months of 2000. This growth, which in terms of year-on-year rates was 27.2 %, is explained by the pick-up in structural funds from the EU, especially those relating to the ERDF, although transfers received from the EAGGF-Guidance also increased. Presumably the increase in current and capital transfers is incorporating lags arising in the previous year.

The nation's lower net borrowing, reflected by these data, is consistent with the progress made in correcting the budget deficit and with the slowdown in economic activity in recent quarters. This would explain the improvement in the balance of the corporate sector, stemming from the deceleration in private productive investment. Also, the decline in household net lending is estimated to have been checked as a consequence, on one hand, of the moderation in private consumption, which has enabled the downward trend in the saving ratio to be turned around and, on the other, of the slowdown in residential investment.

5. Financial flows in the Spanish economy

5.1. Financial flows in the economy as a whole

National Accounts and financial accounts data for 2001 Q1 show a mild pick-up in the net financial saving of the nation, for the first time in three years. The net balance of financial transactions of the Spanish economy with the rest of the world stood at –2 % of GDP at the end of 2001 Q1 (in cumulative four-quarter terms), having reached –2.2 % of GDP at end-2000 (see Table 5). This decline in the nation's financial requirements was attributable to the recovery in household financial saving and to the ongoing decline in general-government net borrowing. By contrast, non-financial corporations recorded a further fall in their net financial transactions with other sectors and there was a slight decline in the credit balance on the financial transactions of the sector of financial institutions. In any event, the rate of growth of credit obtained by households and non-financial corporations remained high, particularly credit for house purchases and to finance property activities. According to the provisional information available, in June 2001 the annual growth of credit from domestic institutions to the non-financial private sector was 14.5 %.

5.2. Financial flows of households and NPIs

The net financial saving of households showed signs of recovery in 2001 Q1, standing at 1 % of GDP, in cumulative four quarter terms (see Table 5). This recovery is explained by the notable decline in flows of financing during the first few months of the year and the more moderate reduction in the acquisition of financial assets. There are a number of circumstances to suggest that this development involves a change in the trend of saving, which has been falling continuously since the mid-1990s. First, the slowdown in activity in recent quarters may have led to a downward revision in expectations of future household income, thereby boosting saving as a means of guaranteeing a specific level of future spending. Second, the loss in value of financial wealth that took place in 2000 must have helped to worsen such expectations, while requiring an increase in saving to offset the reduction in household net wealth.

In 2001 Q1, the acquisition of financial assets rose relative to the previous quarter, basically owing to the growth of cash and cash equivalents (see Chart 23 and Table 6). Time deposits and fixed-income securities also contributed to this acceleration. By contrast, the sharper fall in the portfolio of shares and other equity (owing to disinvestment in equity and international mutual

TABLE 5

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

% of GDP

	NET FINANCIAL TRANSACTIONS								
	1996	1997	1998	1999	2000				2001
					Q1	Q2	Q3	Q4	Q1
Total economy	**1.2**	**1.6**	**0.5**	**-1.1**	**-1.6**	**-1.9**	**-2.1**	**-2.2**	**-2.0**
Non-financial corporations and households and NPIs	**5.1**	**4.0**	**2.0**	**-0.5**	**-0.9**	**-2.1**	**-2.4**	**-2.5**	**-2.6**
Non-financial corporations	-0.1	-0.5	-1.3	-2.3	-2.4	-2.6	-3.2	-3.2	-3.6
Households and NPIs	5.3	4.6	3.3	1.8	1.4	0.4	0.8	0.6	1.0
Financial institutions	**1.0**	**0.7**	**1.1**	**0.5**	**0.7**	**0.7**	**0.8**	**0.7**	**0.6**
General government	**-4.9**	**-3.2**	**-2.6**	**-1.2**	**-1.5**	**-0.4**	**-0.5**	**-0.3**	**0.0**
	INTER-SECTORAL FLOWS (a)								
	1996	1997	1998	1999	2000				2001
					Q1	Q2	Q3	Q4	Q1
Households and NPIs	**5.3**	**4.6**	**3.3**	**1.8**	**1.4**	**0.4**	**0.8**	**0.6**	**1.0**
Vis-à-vis:									
Credit institutions (b)	-2.7	-6.7	-4.5	0.3	2.1	1.4	1.4	-0.6	-0.4
Institutional investors (c)	8.8	10.9	7.7	1.1	-0.8	-1.4	-1.0	0.3	0.6
Non-financial corporations	**-0.1**	**-0.5**	**-1.3**	**-2.3**	**-2.4**	**-2.6**	**-3.2**	**-3.2**	**-3.6**
Vis-à-vis:									
Credit institutions (b)	-0.3	-3.2	-4.3	-3.8	-5.1	-4.4	-5.3	-6.2	-5.7
Rest of the world	0.4	1.7	0.5	-0.5	0.5	-0.5	-1.1	0.7	0.2
General government	**-4.9**	**-3.2**	**-2.6**	**-1.2**	**-1.5**	**-0.4**	**-0.5**	**-0.3**	**0.0**
Vis-à-vis:									
Credit institutions (b)	-0.4	1.4	1.4	1.4	1.3	1.3	1.3	2.2	0.3
Institutional investors (c)	-5.9	-3.9	-2.6	1.7	1.7	3.3	3.5	3.5	3.5
Rest of the world	-0.2	-2.0	-1.1	-4.3	-3.9	-3.9	-4.6	-6.0	-4.9
Rest of the world	**-1.2**	**-1.6**	**-0.5**	**1.1**	**1.6**	**1.9**	**2.1**	**2.2**	**2.0**
Vis-à-vis:									
Credit institutions (b)	0.9	2.8	7.2	2.3	3.9	3.9	3.4	5.1	5.4
Institutional investors (c)	-0.9	-2.6	-6.3	-3.5	-3.7	-4.1	-4.4	-5.6	-5.5
Non-financial corporations	-0.4	-1.7	-0.5	0.5	-0.5	0.5	1.1	-0.7	-0.2
General government	0.2	2.0	1.1	4.3	3.9	3.9	4.6	6.0	4.9

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

funds) had an opposite effect. However, the behaviour of net purchases of shares in mutual funds was hardly uniform during this quarter, since although shareholders in equity and international funds continued to redeem their shares at a high rate, for the first time in the last two years there was a positive net inflow into money-market funds (FIAMM). This recovery of FIAMM is partly attributable to the recovery in their returns, which stood at similar levels to those on time deposits, and also, to a certain extent, to a preference on the part of investors for safer assets, in view of the fall in value of funds oriented towards higher-risk assets. Finally, purchases of pension schemes and insurance (included in the item "Other" in the above-mentioned chart and table) stood below the average level in 2000, a period in which there were significant flows of savings towards the type of life assurance known as "unit linked".

The information from monthly indicators available for 2001 Q2 suggests that the acquisition of financial assets has continued to increase. The uncertainty hanging over the prospects for the US and European economies has introduced doubt over the future path of interest rates in the euro area, boosting the growth of cash and cash equivalents (Chart 24) and of lower risk assets. Thus, time deposits have continued to grow at a high rate, while purchases of shares in money-market funds continued to rise and net purchases of shares in fixed-income funds turned positive. The net asset value of these funds also began to increase, following a period of somewhat more than one year of continuous decline.

Turning to their financing, households in 2001 Q1 obtained a volume of funds which, in seasonally adjusted terms, is below the level of recent years (see lower panel of Chart 23). The growth of loans granted by resident credit institutions, the principal source of financing for this sector, explains this reduction in the acquisition of liabilities. In terms of the annual rate, financing to households and NPIs grew by 15.3 % in Q1, 2 percentage points down on the end-2000 rate. (see Table 6). The slowdown in consumption spending and the reduced confidence in the ability of households to make future payments are two factors that must have affected the demand for financing by this sector. This seems to be corroborated by the information relating to the distribution of credit by use, which shows that financing to individuals for use other than to purchase housing continued to slow in 2001 Q1. The basic use of financing extended to households continues to be to acquire housing, which recorded a very high rate of growth (23 % year-on-year).

The available data on the financing of households in 2001 Q2 indicates that it continued to slow, year-on-year, although at a slower rate than in Q1.

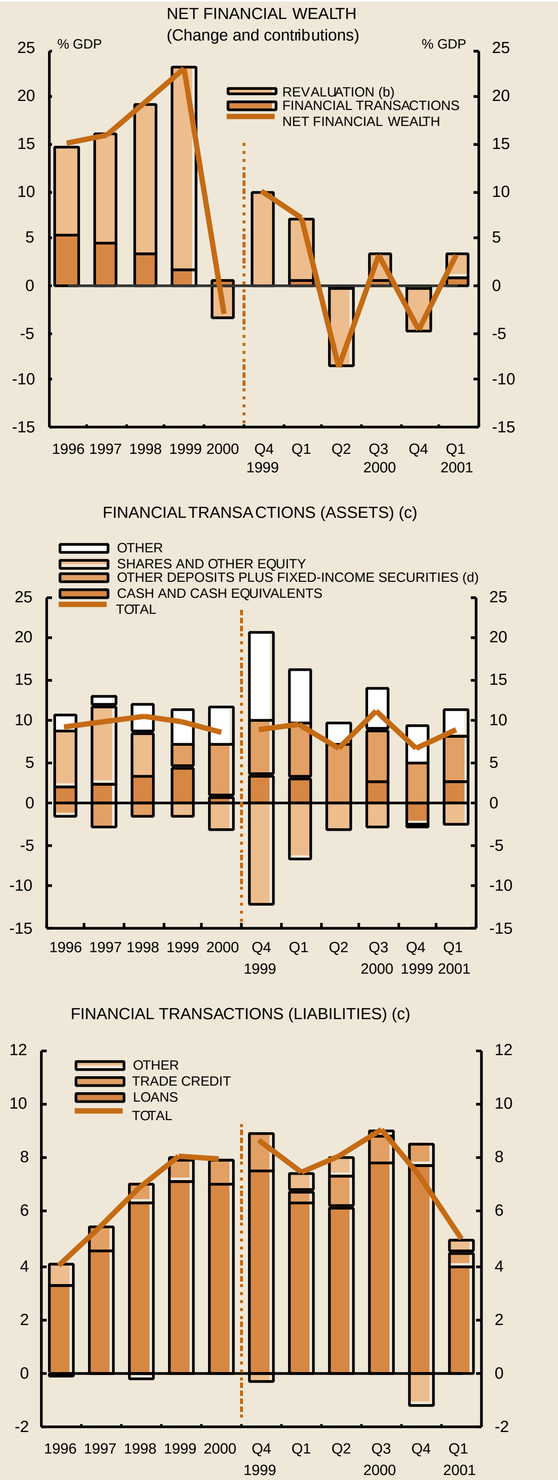
The growth of financial assets and liabilities forecast for 2001 Q2, on the basis of the partial information available (5) seems to confirm a further increase in the net financial saving of households, in cumulative four quarter terms. This growth of net financial transactions may however prove insufficient to offset the decline in the prices of financial assets that occurred in Q2. As a result, the value of financial wealth might have edged down somewhat, following the small increase in Q1 (see the upper panel of Chart 23).

Another important aspect of the financial situation of households is their level of indebtedness. This rose moderately during the first three

(5) It should be noted that the monthly indicators relate to aggregate information, so that the components corresponding to households and non-financial corporations cannot be precisely identified. The conclusions on the growth of the financial transactions of each of these sectors must therefore be interpreted with due caution.

CHART 23

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.

TABLE 6

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

% of GDP

	1998	1999	2000	2000 Q3	2000 Q4	2001 Q1
HOUSEHOLDS AND NPIs:						
Financial transactions (assets)	**10.3**	**9.7**	**8.4**	**2.7**	**1.6**	**2.2**
Cash and cash equivalents	3.3	4.4	0.8	0.6	-0.6	0.7
Other deposits and fixed-income securities (b)	-1.8	2.6	6.3	1.6	1.2	1.4
Shares and other equity	5.3	-1.8	-3.3	-0.7	-0.1	-0.7
Other	3.4	4.5	4.7	1.2	1.1	0.8
Financial transactions (liabilities)	**6.9**	**8.0**	**8.0**	**2.3**	**1.8**	**1.2**
Credit from resident credit institutions	5.9	6.4	6.9	1.9	2.0	0.9
Other	1.0	1.6	1.1	0.3	-0.1	0.4
NON-FINANCIAL CORPORATIONS:						
Financial transactions (assets)	**14.2**	**18.5**	**27.8**	**10.1**	**6.8**	**3.4**
Cash and cash equivalents	1.5	0.7	0.8	0.3	-0.2	-0.1
Other deposits and fixed-income securities (b)	0.3	-0.1	0.8	0.7	-0.8	0.7
Shares and other equity	3.0	8.6	14.2	4.9	5.0	0.6
Other	9.5	9.3	12.0	4.2	2.7	2.1
Financial transactions (liabilities)	**15.5**	**20.8**	**31.1**	**11.6**	**6.8**	**4.4**
Credit from resident credit institutions	4.6	4.8	6.7	1.9	1.1	0.7
Foreign loans, fixed-income securities and securitisation funds (b)	1.8	4.0	3.9	2.0	0.4	1.4
Other	9.1	11.9	20.5	7.8	5.4	2.2
MEMORANDUM ITEM: YEAR-ON-YEAR GROWTH RATES (%):						
Liquid financial assets	**3.7**	**1.4**		**2.6**	**2.6**	**4.6**
Households and NPIs	4.0	0.7		0.8	1.1	4.2
Non-financial corporations	2.5	5.8		12.6	10.6	6.4
Financing (c)	**16.7**	**19.4**		**19.9**	**18.8**	**17.2**
Households and NPIs	19.3	19.6		17.5	17.3	15.3
Non-financial corporations	14.7	19.3		21.7	20.0	18.6

Source: Banco de España.
(a) Seasonally adjusted data. Annual GDP has been used to obtain the figures as a % of GDP.
(b) Not including unpaid accrued interest, which is included under "Other".
(c) Including bank credit extended by resident credit institutions, foreign loans, fixed-income securities and financing thorugh securitisation funds.

months of 2001, the ratio of debt to GDP standing close to 48 % (see Chart 25), although in terms of financial wealth the level of household indebtedness held steady.

5.3. Financial flows of non-financial corporations

The net financial saving of non-financial corporations continued to decline in 2001 Q1, to stand at –3.6 % of GDP in cumulative four quarter terms (see Table 5). This behaviour, which contrasts with that described for the households and NPIs sector, is explained by reductions in the acquisition of both financial assets and liabilities, with the former being more intense. The Q1 data show a moderation in the acquisition of financial assets and liabilities, following the extraordinary levels reached in 2000 and part of 1999, which were affected by the accumulation of specific transactions involving major Spanish firms (see Chart 26). However, this return to normality continues to be characterised by a high rate of accumulation of liabilities by non-financial corporations, which stands above the level in 1998, a period hardly affected by the transactions of major corporations.

In 2001 Q1, the acquisition of financial assets by non-financial corporations fell notably, to below the average 1998 level (see Table 6 and Chart 26). This reduction was virtually across the board, with the exceptions of deposits with the rest of the world and financing to foreign subsidiaries.

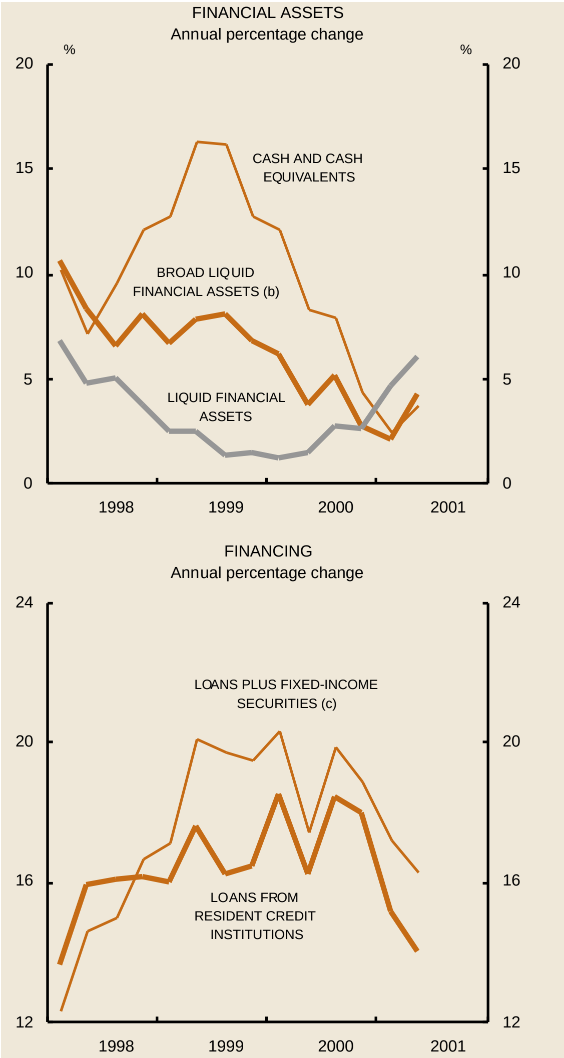
The financing obtained by non-financial corporations fell significantly in 2001 Q1, to stand well below the average level of the last two years (see Chart 26). This reduction is basically explained by the lower amount of increases in capital and funds involved in the reorganisations of corporate groups and by the smaller volume of funds obtained from resident credit institutions (see Table 6), since the flow of financing intermediated by securitisation funds and that originating from the rest of the world entailed an increase in the contribution of these sources to the coverage of the financial requirements of the sector. As a result, the funds raised by firms, excluding the issuance of shares and other equity, fell less steeply than those obtained through bank credit. Accordingly, the annual growth of the financing obtained through bank loans, the issuance of fixed-income securities, securitisation funds and foreign loans stood at 18.6 % at the end of Q1, 1.5 percentage points below the end-2000 level (Table 6), while during the same period, bank credit to firms slowed by 3.5 percentage points to stand at 14.8 % in March 2001.

As regards the use of financing by productive sectors, the information on 2001 Q1 indicates that credit extended by commercial banks and savings banks to the services sector continued to grow at a high rate (17 % year-on-year), albeit below the end-2000 rate, while that to construction clearly slowed. However, both sectors continued to be the main beneficiaries of bank financing to productive activities. Loans to industry (excluding construction) slowed more sharply, so that their contribution to the growth of bank credit was small.

The information available from monthly indicators shows that the financing obtained from resident credit institutions continued to moderate during 2001 Q2, although that obtained from securitisation funds has increased and the flow of funds from the rest of the world has tended to hold at high levels.

CHART 24

Non-financial corporations. Households and NPIs (a)

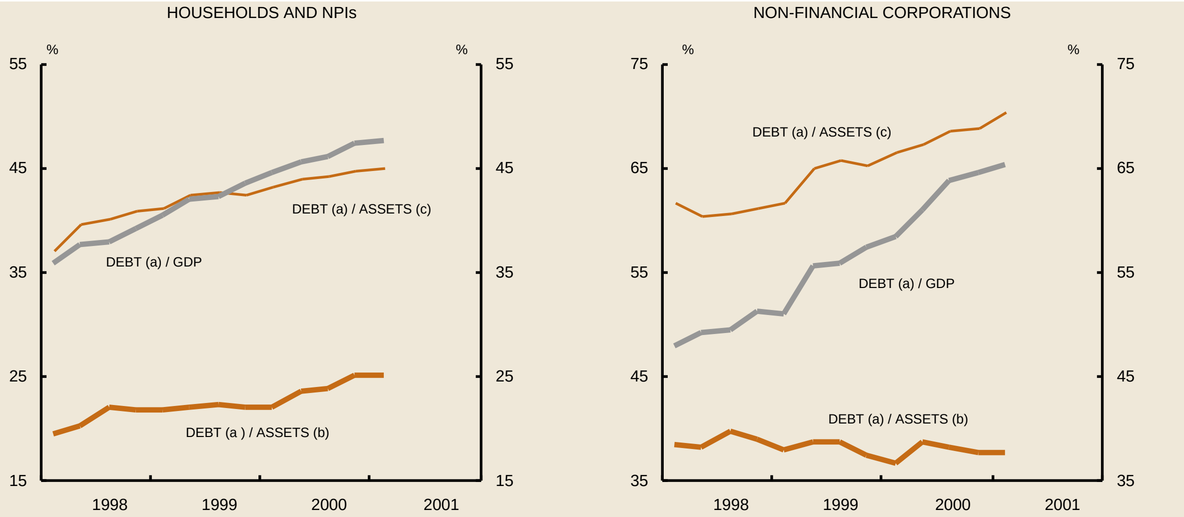


Source: Banco de España.
(a) The data for 2001 Q2 are those for May.
(b) Defined as liquid financial assets plus mutual funds other than money-market and fixed-income securities funds.
(c) Including loans from resident and non-resident credit institutions, securities issuance and financing through securitisation funds.

One of the most important aspects of the balance sheet of non-financial corporations has been the rapid growth in their indebtedness over the last three years; as a proportion of GDP debt stood close to 65 % at the end of 2001 Q1 (see Chart 25). Moreover, bank credit from resident institutions represented 43 % of GDP at end-2000, above the euro-area average. The financial requirements of some major Spanish firms, which have increased their indebtedness as a way of financing their international expansion strategies, have contributed significantly to this growth.

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).

5.4. General government financial flows

In 2001 Q1, general government net financial saving turned positive (see chart 27), making the cumulative amount over the last four quarters that corresponding to budget balance (0.0 % of GDP). The information from the financial requirements indicator, which reflects the recourse by general government to the financial markets and is an approximation to the financial saving of the sector, suggests that this recourse was negative in 2001 Q2, so that the financial saving of the sector can be expected to be positive again (6).

In 2001 Q1, the net issuance of marketable securities was negative owing to the high volume of bond redemptions (EUR 14 billion), which exceeded the amount of the gross issuance of such securities (EUR 11.9 billion). The net issuance of short-term securities, meanwhile, was almost nil. Against this background, the funds needed to cover general government financial requirements came from a significant reduction in deposits with credit institutions, which fell by EUR 18.3 billion. During this quarter, the State began to carry out a new kind of transaction in order to optimise its cash management. Since February, the State has transferred to credit institutions, at the end of each day, part of the balance that it holds at the Banco de España, thereby obtaining remuneration. The following morning the credit institutions return these funds, so that the State can make its current payments (see Box 4).

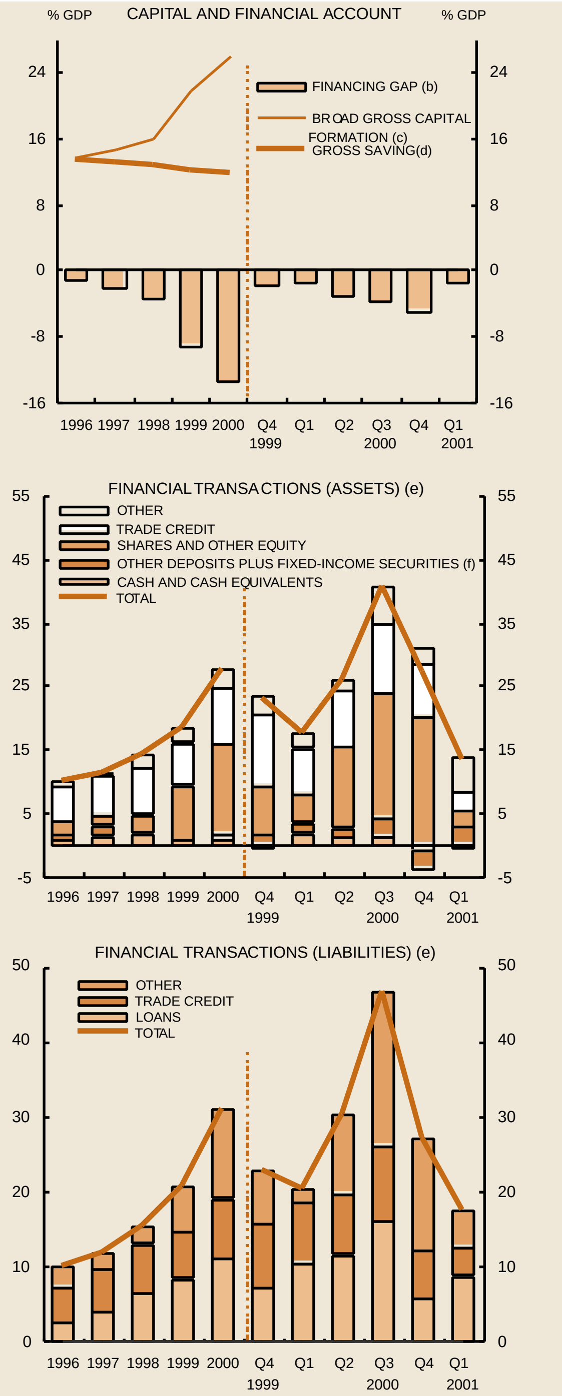
As a consequence of the significant volume of government bond redemptions, the holdings of these securities declined in all sectors, except among foreign investors, whose holdings recorded a positive net change. Meanwhile, the sector to record the largest reductions in its holdings of government securities was resident financial institutions (credit institutions and institutional investors).

The partial information available on the volume of funds raised by general government on the markets during 2001 Q2 indicates a recovery in the net issuance of long-term securities by the State, which turned positive again (EUR 8.3 billion), while the outstanding stock of Treasury bills was reduced again as a consequence of negative net issuance. Finally, deposits with the credit system increased during this quarter by EUR 6.4 billion, in contrast to their behaviour in the previous quarter. Accordingly, the financial requirements of general government, which indicator includes securities issuance, bank credit and the use of deposits, fell in 2001 Q2 to become negative again (see Chart 27).

(6) The discrepancy between the net financial saving and financial requirements of general government in 2000 Q4 and 2001 Q1 is due to the difference in the timing of the recording of interest in these two variables.

CHART 26

Non-financial corporations (a)



Source: Banco de España.

(a) Seasonally adjusted data.

(b) Financial resources that cover the gap between real and permanent financial investment and gross saving.

(c) Including stockbuilding and foreign equities.

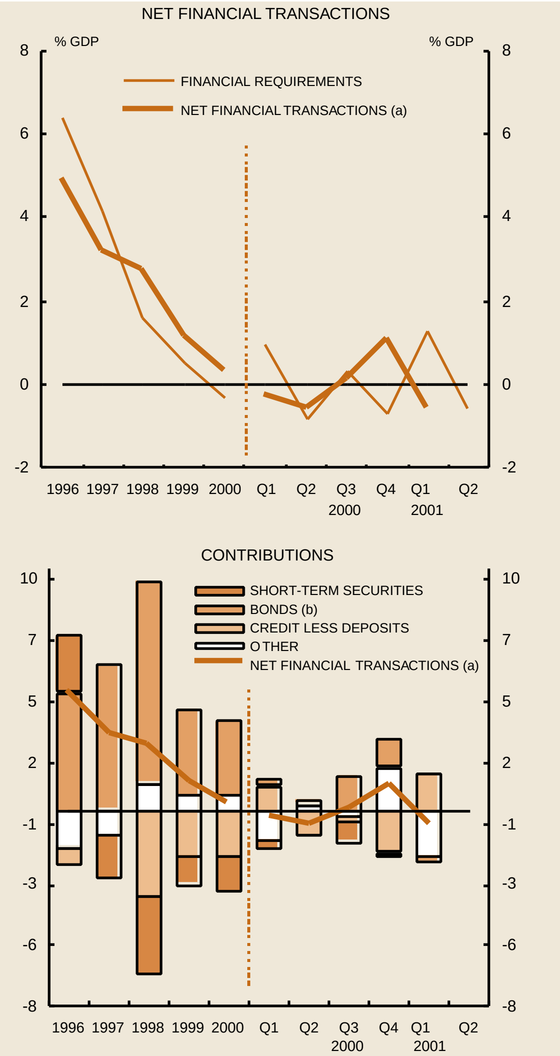
(d) Including capital transfers.

(e) The quarterly data are annualised.

(f) Not including unpaid accrued interest, which is included under other.

CHART 27

General government



Source: Banco de España.

(a) Sign changed.

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

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

The negative net balance of the financial transactions between the Spanish economy and the rest of the world was reduced in 2001 Q1, to –2 % of GDP, in cumulative four quarter terms. The net balance corresponding to Q1 was –0.5 % of GDP, as a result of a significant decline in the acquisition of financial assets from abroad and the accumulation of liabilities (see Table 7). Following sustained growth, over the last three years, of the volume of external assets and liabilities, stemming from the inter-nationalisation of major Spanish firms and the

TABLE 7

Financial transactions of the nation (a)

% of GDP

	1998	1999	2000	2000 Q3	2000 Q4	2001 Q1
Net financial transactions	**0.5**	**-1.1**	**-2.2**	**-0.6**	**-0.4**	**-0.5**
Financial transactions (assets)	**12.8**	**15.1**	**24.9**	**8.8**	**8.1**	**4.7**
Gold and SDRs	**0.0**	**-0.2**	**0.0**	**0.0**	**0.0**	**0.0**
Cash and depoits	**3.2**	**1.8**	**2.7**	**2.7**	**0.1**	**1.7**
Credit system	0.0	3.7	2.6	2.6	0.9	0.5
Other resident sectors	3.2	-1.9	0.1	0.1	-0.8	1.2
Securities other than shares	**3.4**	**2.8**	**3.8**	**1.3**	**1.5**	**1.2**
Credit system	-1.4	-0.9	-0.3	0.4	-0.1	0.3
Other resident sectors	4.8	3.7	4.1	0.9	1.5	0.9
Shares and other equity	**4.4**	**9.8**	**15.1**	**3.4**	**5.7**	**0.9**
Credit system	0.4	0.5	2.0	0.6	0.4	0.2
Other resident sectors	4.0	9.4	13.1	2.8	5.3	0.7
Of which:						
Non-financial corporations	2.2	6.9	10.2	2.4	4.9	0.5
Loans	**1.9**	**0.8**	**3.2**	**1.3**	**0.9**	**0.8**
Credit system	0.2	-0.2	0.5	0.0	0.3	0.2
Other resident sectors	1.7	1.0	2.7	1.2	0.6	0.6
Financial transactions (liabilities)	**12.3**	**16.2**	**27.1**	**9.3**	**8.5**	**5.2**
Deposits	**6.0**	**4.2**	**7.3**	**1.7**	**2.7**	**2.9**
Of which:						
Credit system	5.9	4.1	7.3	1.7	2.7	2.9
Securities other than shares	**1.0**	**5.5**	**7.0**	**2.4**	**2.1**	**0.6**
Credit system	0.2	0.9	0.8	0.2	0.0	0.2
General government	1.0	4.3	5.7	2.0	2.1	0.2
Other resident sectors	-0.2	0.2	0.5	0.1	0.1	0.1
Shares and other equity	**2.9**	**3.9**	**9.0**	**2.9**	**3.5**	**0.8**
Credit system	0.1	0.3	1.6	0.7	0.1	0.2
Other resident sectors	2.8	3.6	7.4	2.2	3.4	0.6
Loans	**3.0**	**4.1**	**4.9**	**2.5**	**0.6**	**1.3**
General government	0.1	0.0	0.1	-0.1	0.0	0.0
Other resident sectors	2.9	4.1	4.9	2.6	0.5	1.3
Other, net (b)	**-0.6**	**-1.4**	**-1.1**	**-0.1**	**-0.4**	**-0.3**

Source: Banco de España.
(a) Annual GDP has been used to obtain the figures as a % of GDP.
(b) Includes the asset-side caption reflecting insurance technical reserves.

process of portfolio diversification by institutional investors, 2001 Q1 was hardly affected by transactions relating to the international expansion of Spanish firms.

As regards external financial assets, in 2001 Q1 the increase in the foreign deposits of Spanish firms was notable. Investment in fixed-income securities held at a similar level to that of previous quarters as a result of the ongoing process of international diversification of the portfolios of resident sectors (mainly credit institutions and institutional investors). On the other hand, the acquisition of shares and other equity in foreign corporations declined significantly from the levels reached in 2000. This decline affected to a lesser extent the extension of financing to subsidiaries, which was similar in amount to the quarterly average in 2000 (see Table 7).

BOX 4

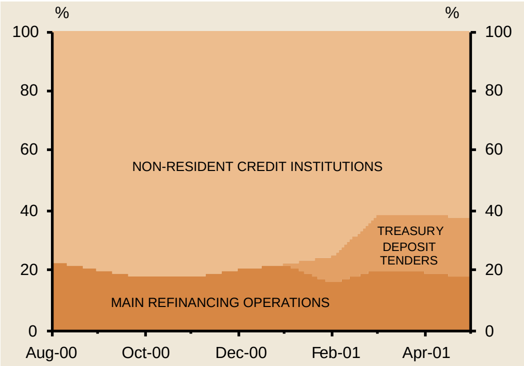
Treasury liquidity tenders and Spanish credit institutions' demand for liquid funds

Credit institutions operating in Spain demand liquid funds to cover the requirements that arise, on one hand, from the existence of reserve requirements that must be met, and on the other, from changes in the so-called autonomous factors (items of the Banco de España (BE) balance sheet, like Treasury deposits, that are not directly under the control of the Eurosystem, but affect the liquidity available in the system). The demand can basically be satisfied in two ways: through the main refinancing operations conducted by the BE within the framework of the single monetary policy and through recourse to other credit institutions which, in the case of resident institutions as a whole, must be non-resident institutions. Sufficient underlying assets must be provided as collateral for loans obtained from the BE (not necessarily for those obtained from other credit institutions).

Against this background, mechanisms were put in place in February to enable the Treasury to transfer daily, at the close of business, most of its deposits with the BE (1) to resident credit institutions. Thus, once a month, a tender is conducted in which credit institutions bid for a percentage of the funds that, at the end of each day of the so-called the tender period (approximately one month), will be transferred overnight from the Treasury's account with the BE to the successful bidders. The bid must also specify the interest rate that will be paid for these funds, expressed in terms of the spread over the EONIA interest rate in force at the time of transfer of the deposits. The transfer shall be executed in the form of a purchase of government securities under a repurchase agreement, so that, as in the case of the recourse to the BE, the institutions provide collateral for the funds they obtain from the Treasury.

The adjoining chart shows the liquid funds obtained by the institutions through the Treasury liquidity tenders (2), together with those obtained from non-resident credit institutions and from MROs. In principle, since collateral has to be provided both for loans from the BE and for the funds obtained from the Treasury, the new liquidity tenders might be expected to entail basically a smaller recourse to the central bank, without excessively affecting the interbank position. However, although it is still early for the results to be conclusive, it appears that the new funds are replacing both liquidity obtained from the BE and, especially, from non-resident institutions. The adjoining table offers a possible explanation for this behaviour.

Liquidity sources: percentage breakdown



Source: Banco de España.

Relative cost of funds from Treasury liquidity tenders

Basis points

Data	Spread vis-à-vis EONIA(a) Marginal	EONIA(a) Average	MRO (b) Marginal	MRO (b) Average
8/02/01	-20	-16	-19	-16
5/03/01	-14	-13	-6	-6
3/04/01	-10	-8	-6	-4
4/05/01	-15	-13	-8	-7
Averages	*-14.75*	*-12.5*	*-9.75*	*-8.25*

(a) Marginal or average spread of each tender.
(b) Difference between the sum of the average EONIA for the five days prior to the liquidity tender and the marginal (or average) spread of that tender, on one hand, and the marginal (or average) rate of the last

According to the results of the liquidity tenders conducted between February and May, the replacement of interbank financing (at the EONIA interest rate) by Treasury deposits has entailed an average reduction in costs for the institutions of 13 basis points (15, if the marginal tender rates are considered), although it should not be forgotten that the new source of liquidity involves an additional cost arising from the need to provide government debt as collateral for the funds. The expected saving from replacing funds obtained through MROs is not directly observable, but may be estimated by assessing the expectations of the institutions regarding the future paths of EONIA (3) and the rate of interest on MROs. If future EONIA rates are approximated by the average value of this rate of interest on the five days prior to the deposits tender, and the expected rates on MROs by those of the latest main refinancing operation conducted, the average (expected) saving from the replacement of recourse to the BE by Treasury deposits would have been, on the days the tenders were conducted, around 8 basis points (10, if marginal rates are considered). This saving could be considered net, to the extent that both these alternative sources of liquidity require the use of underlying assets (4). However, the analysis presented, seems to imply that the margins obtained by the successful bidders in the new tenders offsets the cost of mobilising collateral not used in transactions with the Eurosystem, so that it is profitable for them to maintain the bulk of their recourse to the BE while reducing significantly their loans from abroad.

(1) For further details of this new Treasury cash-management procedure, see the article "Financial regulation: 2001 Q1", in the April 2001 issue of the *Economic bulletin.*

(2) Technically the transfer of funds from the Treasury's account with the Banco de España to the institutions involves a contraction of the autonomous factors reducing the liquidity available in the system. They thus diminish the liquidity requirements of the institutions and, therefore, their recourse to the BE and/or to non-resident institutions.

(3) The sum of the average expected EONIA rate during the tender period and the spread (average or marginal) of the Treasury liquidity auction enables the expected (average or marginal) cost for the institutions of the transferred Treasury deposits to be estimated.

(4) It should however be noted that, in the case of recourse to the BE, the set of eligible underlying assets is wider.

TABLE 8

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

% of GDP

	1996	1997	1998	1999	2000	2001 (b)
Total economy	**-19.7**	**-20.6**	**-21.7**	**-22.7**	**-22.7**	**-23.2**
Non-financial corporations and households and NPIs	**-13.3**	**-10.8**	**-8.9**	**-9.1**	**-3.1**	**-1.9**
Non-financial corporations	-18.3	-17.2	-15.2	-16.9	-11.1	-9.8
Households and NPIs	5.0	6.4	6.3	7.8	8.0	7.9
Financial institutions	**8.8**	**7.2**	**5.1**	**7.1**	**5.2**	**3.5**
Credit institutions (c)	6.7	2.4	-5.4	-7.5	-12.6	-14.5
Institutional investors (d)	2.2	4.9	10.9	15.2	18.5	18.9
Other financial institutions	-0.1	-0.1	-0.4	-0.6	-0.8	-0.9
General government	**-15.3**	**-17.0**	**-18.0**	**-20.6**	**-24.8**	**-24.8**

Source: Banco de España.
(a) Calculated as the difference between the stock of financial assets and liabilities vis-à-vis the rest of the world according to quarterly financial accounts data.
(b) Q1 data.
(c) Defined according to the First Banking Directive.
(d) Insurance corporations and collective investment undertakings.

As already mentioned, in 2001 Q1, the volume of external liabilities accumulated by the Spanish economy fell substantially. The net acquisition of securities issued by general government by non-residents fell, owing to the significant volume of redemptions during that quarter. Likewise, the acquisition of shares and other equity in Spanish firms also fell. Credit institutions, by contrast, continued to raise large amounts of funds abroad in the form of deposits, while the non-financial private sector obtained a significant volume of financing from the rest of the world.

As regards 2001 Q2, only balance-of-payments information to April is available. According to the latter, non-financial firms received a high volume of financing that month, part of which came from foreign parent companies. For its part, foreign direct investment, in the form of shares, showed signs of recovery.

The negative balance of the Spanish economy's net financial transactions with the rest of the world helped to increase its external debit position during 2001 Q1 (see Table 8). By sector, resident credit institutions increased their net debit position (by almost 2 percentage points of GDP), while the net foreign assets of non-financial corporations and institutional investors continued to rise. For its part, general government hardly changed its net debit position with the rest of the world. The growth of the net external assets of non-financial corporations in recent quarters has been affected by exchange rate movements, which have tended to increase the euro value of foreign investments. This effect was very significant during 2000, owing to the rapid rise in the acquisition of external assets that year. This revaluation was not offset by similar changes in the euro value of liabilities with the rest of the world, since, among other factors, the market value of the shares of national firms held by non-residents fell last year.

30.7.2001.