Quarterly report on the Spanish economy

1. Overview

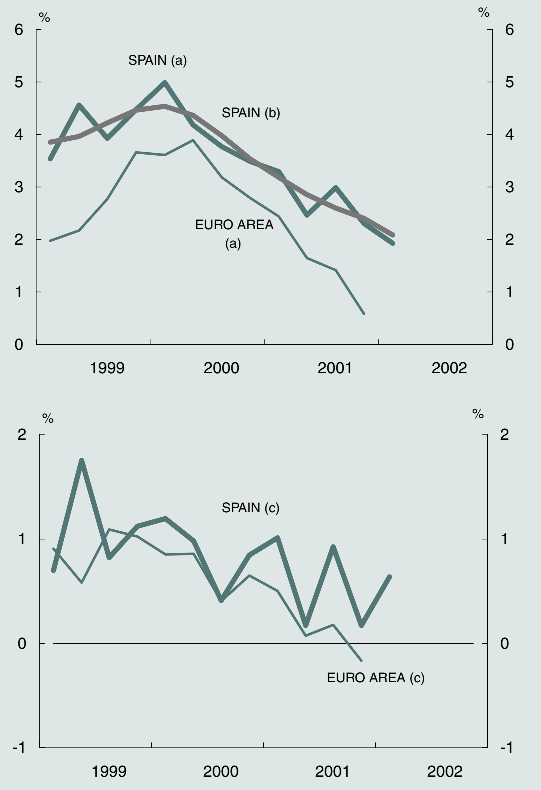
As the year 2002 unfolds, the prospects of a pick-up in the world economy have firmed. Testifying to this are the data available for the United States, for the euro area as a whole and for numerous Asian economies, including Japan. The only notable exception is Latin America. However, a lack of confidence and a climate of uncertainty remain in place, associated mainly with certain imbalances in the US economy and with the media revelations questioning the solvency of or accounting practices applied in certain corporations. This has prompted a forceful stock market correction, which may jeopardise recovery and restrict its intensity. Macroeconomic policies, and monetary policy in particular, have generally remained expansionary. On the foreign-exchange markets there has been an extensive but orderly turnaround in the exchange rate of the US dollar, which has depreciated notably against the main currencies. The euro has appreciated by about 15% against the dollar, placing the European currency at a level more in keeping with its fundamentals. The rally has contributed to easing the underlying inflationary pressures in certain euro area economies.

Against this background, the Spanish economy has maintained a sustained growth rate, with no significant changes discernible in relation to the initial results released by INE (the National Statistics Office) for 2002 Q1. Specifically, on the information currently available, and drawing on the seasonally adjusted series, the real year-on-year growth rate of GDP during Q2 is estimated to have been around 2%, unchanged on the preceding quarter. In quarter-on-quarter terms, the rate of increase was 0.4%, one-tenth of a point less than the previous quarter. The figures calculated on the basis of the trend-cycle series – which are characterised, as is well known, by their greater stability – confirm that the slowdown marking 2001 has touched bottom at values of around 2%. That places the Spanish economy in a favourable starting position to progressively consolidate its growth rate in the coming months, if the recovery in the world economy takes root.

The contribution of net external demand to real GDP growth was modest but positive in Q2, although household spending (on consumption and house purchases) has once more been the most buoyant component of final demand in the Spanish economy in this period, coupled with the notable vigour of general government investment. Though less than last year, the growth of real disposable income has been a determining factor of household spending decisions. Yet, against a backdrop of particularly low interest rates, households have continued to resort intensely to debt to finance con-

CHART 1

Gross domestic product



Sources: ECB, INE and Banco de España.

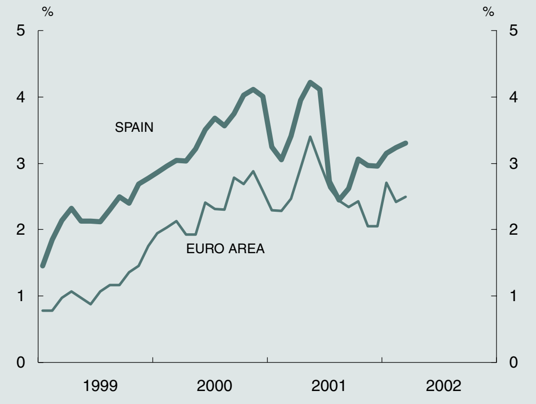
(a) Non-centred annual rate of change calculated on the basis of the seasonally adjusted series.

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

(c) Quarter-on-quarter rates of change calculated on the basis of the seasonally adjusted series.

CHART 2

Harmonised indices of consumer prices



Sources: Eurostat and European Central Bank.

sumption and, in particular, house purchases. Corporate debt levels have also grown recently, although they seem to be stabilising, without business investment actually taking off. On the supply side, there are signs of an incipient recovery in industrial activity, and employment growth is slowing. Lastly, although the rate of increase of unit labour costs has fallen, price differentials with the euro area remain high.

The expansionary policies pursued have boosted US growth since the start of the year. The indicators available for Q2 confirm this process to be continuing, albeit with less vigour than the previous quarter. The heavy fall on stock markets, which stand below pre-September 11 levels, does not appear to have affected household spending so far, although it might do in the future. This aggregate (which is partly sustained by rising house prices) and government consumption are currently the most buoyant elements of the US economy. Productivity growth rates remain quite high but are particularly based on the relatively unfavourable behaviour of employment, with no pick-up in corporate investment perceptible yet. In this setting, and given the absence of changes in the inflationary picture, the Federal Reserve has retained the low interest rates in place since last December. The fact that the phase of economic recovery has begun without the financial imbalances of households and corporations being remedied and with a growing external deficit is a source of further factors of risk that might jeopardise a consolidated recovery. In this respect, and although it is difficult directly to link both events, the recent depreciation of the dollar may contribute to redressing the swollen trade deficit.

Recovery in the euro area is following a different course to that in the US economy. The monetary policy stance remains expansionary and, although fiscal policy has not been similarly geared or on an equivalent footing to that of the United States, there have been deviations from budget targets in certain countries that have tended to loosen public finances discipline in the area as a whole. The growth of real GDP in Q1 (0.3%, both in year-on-year and quarter-on-quarter terms) has largely been underpinned by the contribution of external demand, since internal expenditure showed no signs of a clear recovery, despite the fact that employment is proving more sustained than in previous cyclical phases. The indicators available for recent months point to a modest – albeit somewhat less robust than expected – recovery in consumption and investment, in a context of uncertain expectations and considerable instability on stock markets.

The growth rate of consumer prices (HICP) has tended to ease in the last two months following the rebound at the beginning of the year. The HICP stood at 1.8% in June. The same factors that fuelled its rise, namely energy and food prices, have now provided for its correction, though this has not yet covered the more stable component of the index (services and non-energy manufactured goods prices), whose rate of increase has stabilised at slightly over 2.5%. The acceleration in unit labour costs in Q1, as modest productivity growth combined with relatively high wage settlements, might hinder the slowdown in the inflation rate. That said, relatively sluggish demand, the favourable behaviour of prices on world markets and the appreciation of the euro should contribute in this respect.

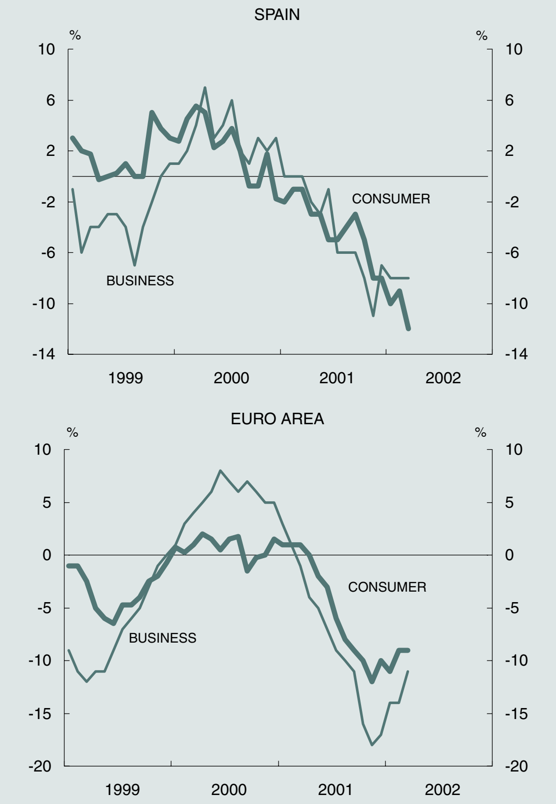
In these circumstances, the ECB has kept its benchmark interest rate unchanged since last November at 3.25%. The growth of the reference monetary aggregate has tended to quicken in the past two months. This acceleration might, once again, be related to the instability of financial markets. The rate of increase of lending to the private sector, meanwhile, has stabilised at a level lower than that prevailing at the start of the year. Overall, expectations of future interest rate rises have tended to be deferred and to be scaled back appreciably.

Developments in the Spanish economy have, according to the information available for the first six months of the year, been in step with the expansionary monetary context characterising the common monetary policy, but along a stricter fiscal policy line. Overall, the behaviour of tax revenue is proving favourable, with notable growth in indirect tax and, hereunder, VAT. The growth rate of personal income tax takings is expected to ease over the year as a whole compared with 2001, in line with the behaviour of wage and capital income. On the expenditure side, the biggest increases have been in capital expenses and in social benefits. One of the consequences of these results (the slowdown in personal income tax and the increase in social benefits) is that the contribution of general government to sustaining household disposable income is proving considerable.

As stated, the estimated year-on-year growth rate of real GDP for 2002 Q2 is (at 2%, in terms of the seasonally adjusted series) similar to that of the previous quarter. Notable in this connection is the contribution of private consumption and investment in construction (in both its residential and civil engineering facets), and a modest positive contribution of net external demand. The growth rate of household consumption might have slowed slightly during Q2, while investment in construction remained notably robust. The rate of increase calculated for national demand is slightly below that for Q1, when a value of 2.1% was attained, since the effect of stripping out the strong stockbuilding included in the INE figures for the first three months of the year must be added to the slackness of investment in equipment.

CHART 3

Confidence indicators



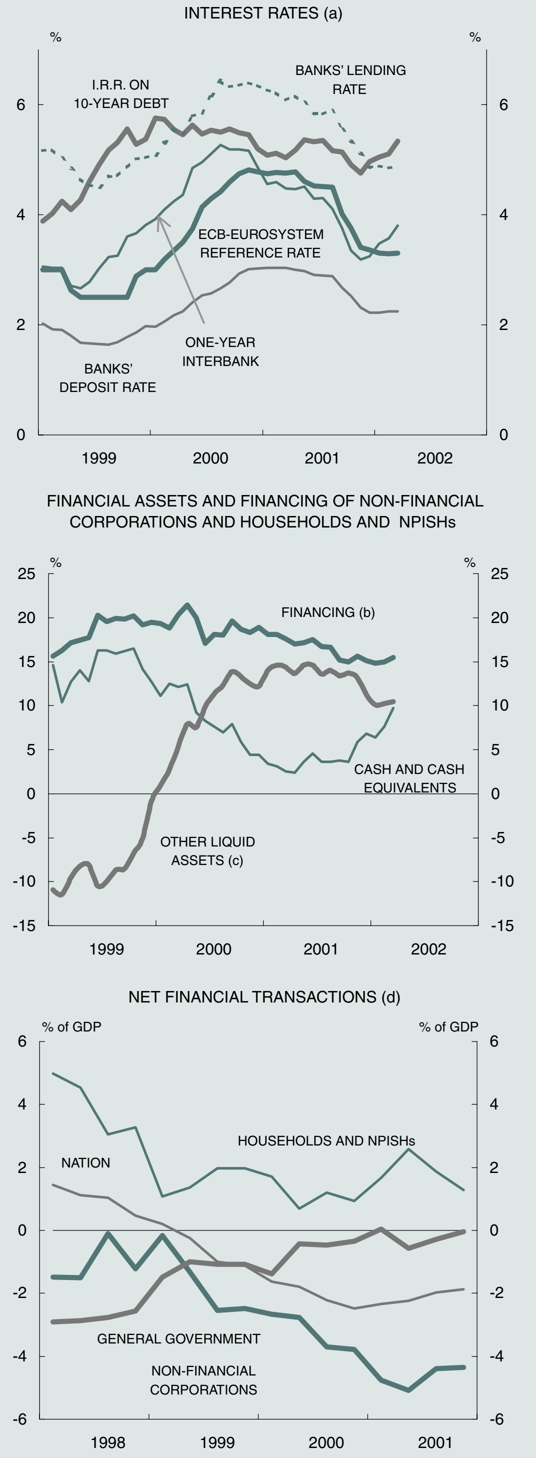
Source: European Commission.

The turnaround in the contribution of net external demand to real GDP growth has been the result, on one hand, of a slight pick-up in the rate of change of exports which, like imports, in any event remain sluggish. The weakness of the tourist industry, already discernible in the indicators available for the opening months of the year, appears to have worsened in Q2, although its final impact differs appreciably both with regard to the countries of origin (where the fall-off in German and British tourism are prominent) and to destinations.

One of the significant features of the Spanish economy's current pattern of growth is the private sector's heavy resort to debt. Neither the saving ratio nor the lending capacity of the private sector have managed to recover, and this has subsequently borne on the net borrowing of the economy as a whole. Also indicative

CHART 4

Financial indicators of the Spanish economy



Source: Banco de España.
(a) The series are averages of daily data.
(b) Includes bank loans extended by resident and non-resident credit institutions, fixed-income securities and financing through securitisation funds.
(c) Includes deposits with agreed maturity, repos, bank securities, residents' cross-border deposits and shares in money-market funds.
(d) Cumulative four-quarter data.

here are the estimates for net financial transactions corresponding to 2002 Q1, where net household financial saving can be seen to be continuing to decline (in terms of its share in GDP), while the result for net financial transactions of the non-financial corporations sector has stabilised at considerably high negative values. Recent data on lending confirm this diagnosis since, in Q1, the growth rate of financing extended to households has recovered and, hereunder, there has been a notable increase in house-purchase credit.

Household debt levels are, it is true, similar to those in other European economies and are largely a result of economic agents adapting to a more stable financial environment in which, moreover, interest rates are currently particularly low. But the consequences in the medium term must be carefully considered, especially as regards the risks arising from developments in the housing sector.

In these circumstances, if recovery in the Spanish economy is to take root as the improvement in the world economy is progressively confirmed, it must be underpinned by robust exports, business investment and, by extension, industrial activity. Continuing buoyant household spending based on well-founded expectations about future income will also be pivotal. The foundations for this are, in principle, suitable.

The growth of employment in Q2 has slowed, but is higher than in other similar cyclical phases and is, therefore, playing a key role in maintaining the economy's growth rate. Wage increases have moderated and, in combination with a slight pick-up in productivity, have contained the rises in unit labour costs. Corporate profitability is high and debt ratios, which had grown appreciably, are tending to stabilise; a slight recovery in industrial activity and in business confidence indicators is thus finally discernible.

Set against these favourable developments, the widening of the inflation gap with the euro area countries during Q2 this year harbours a warning about potential competitiveness problems which would ultimately restrict the pace of recovery in the Spanish economy. The differential in terms of the 12-month growth rate of the HICP was 1.6 percentage points in June and, significantly, the related differentials for services and non-energy industrial goods were 1.7 and 1.4 percentage points, respectively.

The fact that the increases in the growth rate of prices should have occurred concurrently with the containment of the growth rate of unit labour costs is illustrative of the continuing rigidity in the behaviour of certain markets. The widening of margins inferred from these results (bigger price increases and a slowdown in unit labour costs) is prominently concentrated, in fact, in construction and market services, while it is much more limited in manufacturing industry which is where, in a competitive environment, employment creation has been lowest.

In sum, conditions are in place for the Spanish economy to resume, in the second half of 2002, a more dynamic path based on the foreseeable recovery in the external environment and on the factors driving domestic spending, including most notably the maintenance of employment creation. Nonetheless, the heightened international uncertainty being channelled through the financial markets may pose an obstacle to the climate of confidence required. For the recovery to be sustainable in the medium term, private-sector debt must be contained and continuous improvements in the economy's competitiveness achieved.

2. The external environment of the euro area

The pick-up in world economic growth continued during 2002 Q2, albeit at a moderate rate and with a somewhat different geographical distribution than was perceptible at the start of the year. The recovery is proving more robust in the United States and Asia, and less so in Europe and Latin America. In most countries growth was led by the favourable behaviour of external demand, in particular US demand for imports. At this initial stage of the cycle, that appears to highlight a certain dependence of world economic growth on the behaviour of the US economy.

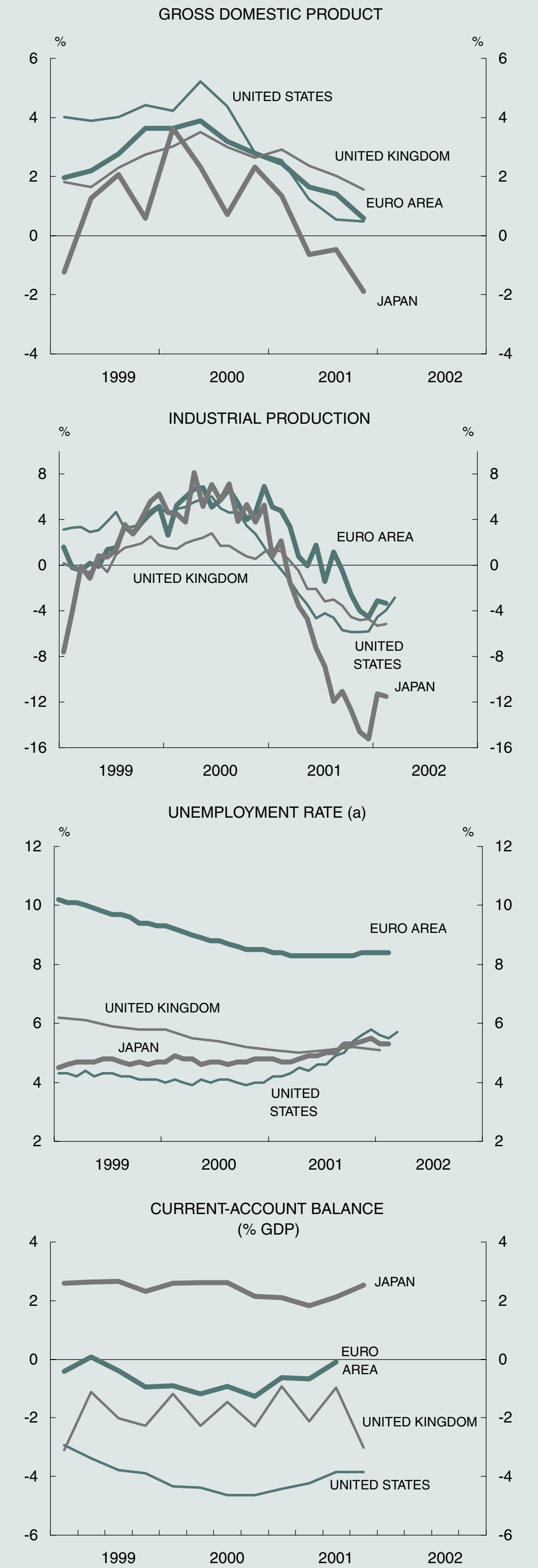
Running counter to the relatively favourable economic picture, the stock markets fell heavily during the quarter. As a result, the recovery seen from October to March was fully reversed, and most US and European indices were at their lowest levels for the past three or four years. This behaviour has been associated with the lack of confidence about the quality of accounting information provided by companies, further to the disclosure of numerous cases of accounting irregularities and fraud, possibly arising during the final years of the bull market. The lack of confidence has heightened uncertainty about the proper valuation of asset prices, which appears to be at the root of the portfolio switching during the quarter from equity and low-rating corporate securities to safer assets such as Treasury bonds and high-grade, liquid corporate securities.

The dollar depreciated in a continuous but orderly fashion against most currencies, with the exception of those of the Latin-American countries. The depreciation was 8% in effective terms, 11% against the yen and 15% vis-à-vis the euro, against which the dollar is at its low for the past two years. Turning to the emerging economies, political instability in various Latin American countries combined with a slower-than-expected recovery in growth in the region as a whole has led to a highly differentiated and clearly more negative performance by Latin American financial markets as compared with the other two emerging areas, namely Asia and Eastern Europe.

In the United States, GDP in Q1 was revised upwards to an annualised quarterly growth rate of 6.1%. That placed the year-on-year rate at 1.7%, compared with 0.5% in 2001 Q4, highlighting the firmness of the recovery. In terms of components, the growth rates of private and government consumption (3.3% and 6.6%, respectively, in annualised quarterly terms), the moderation of the decline in gross capital formation excluding stocks (0.8%) and, above all, quickening stockbuilding, whose contribution to GDP growth was 3.4 percentage points, were

CHART 5

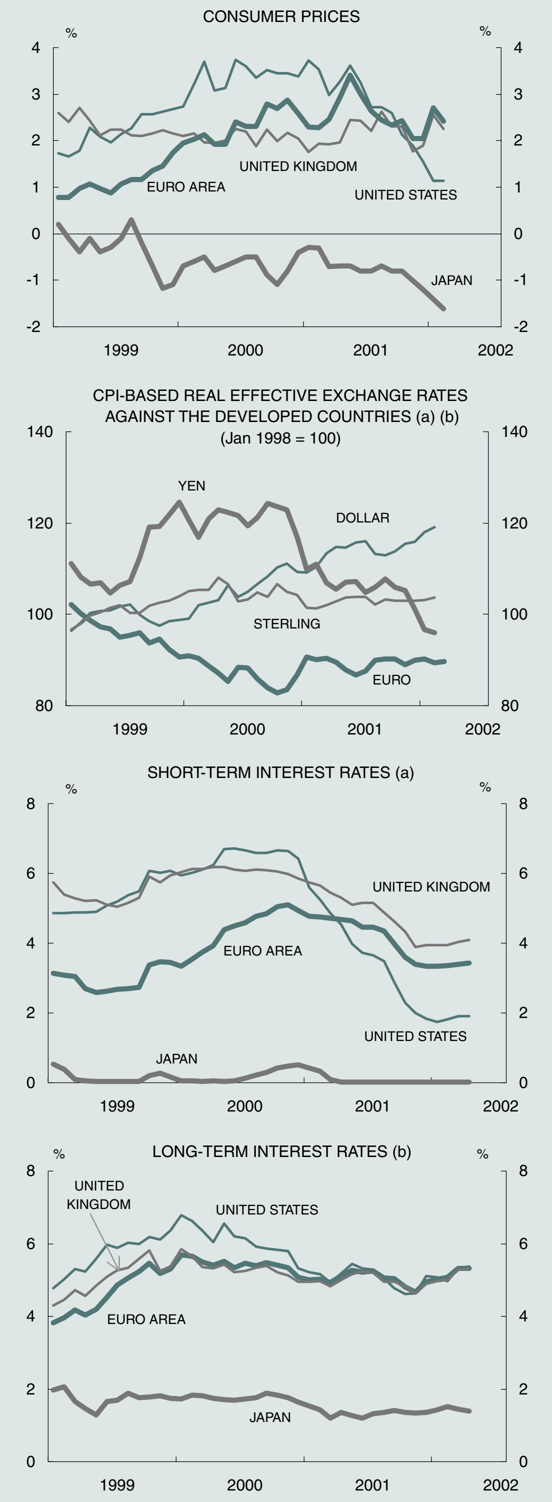
Main macroeconomic indicators
Annual rates of change



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

CHART 6

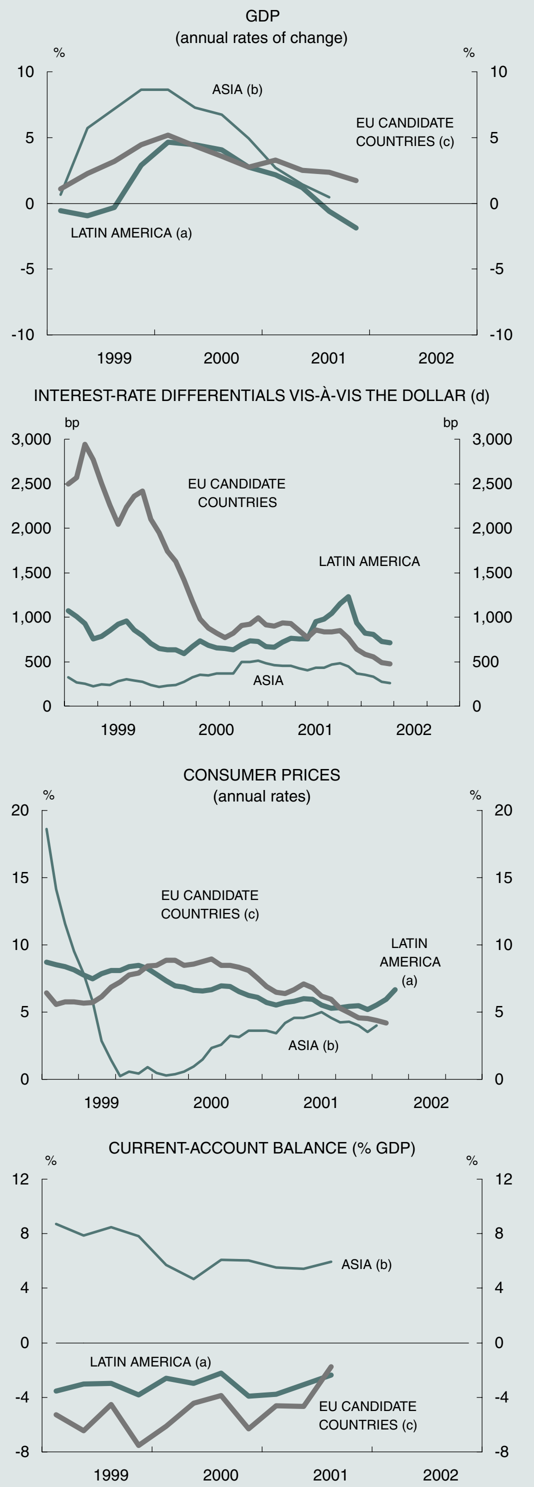
Prices, real exchange rates and interest rates



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.

CHART 7

Main macroeconomic indicators



Sources: National statistics and JP Morgan.
(a) Argentina, Brazil, Chile, Mexico, Colombia, Venezuela, Peru.
(b) Malaysia, Korea, Indonesia, Thailand, Hong Kong, Singapore and Taiwan.
(c) Latvia, Lithuania, Estonia, Czech Republic, Hungary, Poland, Slovenia and Slovakia.
(d) Differentials according to JP Morgan's EMBI+ index. Russia is included among the EU candidate countries.

all notable. External demand continued to shave a few decimals off growth (0.75 points), albeit to a lesser extent than in previous quarters. The moderate behaviour of prices was also prominent: the GDP deflators posted year-on-year growth rates of 1.2% (overall) and 1% (consumption). The lack of inflationary pressures is also apparent in the behaviour of consumer prices, the 12-month growth rate of which fell to 1.1% in June, with the underlying inflation rate dropping to 2.3%.

The indicators for Q2 signal that the economic recovery remains on track, although certain signs that the high growth rates recorded in the opening months of the year are easing can be seen. As regards the demand indicators, mention may be made of the sound performance of the real estate sector, where new house sales quickened and housing starts held at positive growth rates against a background of low mortgage interest rates and readily accessible mortgage refinancing facilities. Retail sales trended unevenly, but it appears their growth over the quarter as a whole may have even outpaced that in Q1. On data to May, personal income continued growing at around 3%, although personal consumption appears to have eased somewhat. All these developments suggest moderate private consumption growth will prevail during the quarter, at a less buoyant rate than in Q1, against a backdrop of scant net employment creation and a stabilising of the unemployment rate at a still-high level of around 5.9% of the labour force. As regards expectations, consumer confidence indicators remained strong for most of the quarter, but the latest data for June and, to a greater extent, July suggest that the stock market deterioration and the slackness of the labour market are exerting a negative influence on consumer sentiment.

The prospects of an improvement in investment appear to be firming due, among other factors, to the recovery in durable goods orders, especially in the capital sectors, excluding defence, and to the increase in the output of technological goods. There are also signs that the inventory adjustment has virtually concluded in many industries, that sales and earnings prospects appear to have improved, that financing costs are low and that productivity remains robust, even at the trough of the cycle. And insofar as this is the case, the foundations for a gradual recovery in investment in the coming months may be expected to firm. Set against this favourable scenario, the main factor of risk and uncertainty is the downward trend of stock markets which, were it to worsen, might hamper the financing of corporations and affect earnings and economic growth expectations. With regard to the external sector, the current-account deficit widened in Q1 to 4.3% of GDP, from 3.9% in 2001 Q4, while the trade deficit increased once again in April at a monthly rate of 10.4%, owing to the significantly stronger growth of imports (4.7% in monthly terms) compared with exports (2.2%).

On the supply side, the indicators have generally performed favourably. Industrial output grew during Q2 at slightly more moderate (though still clearly positive) rates than in Q1, and the purchasing managers' indices appear to augur a robust pick-up in activity in the coming months. In sum, the expected pattern of recovery, characterised by moderate consumption and a progressive rise in investment, has not altered this quarter. Undoubtedly, though, deteriorating financial markets pose a downside risk. Against this background, the Federal Reserve has kept its federal funds target rate unchanged at 1.75%, while market expectations of a rise in interest rates in the United States have been put back to next year.

In Japan, following three quarters of continuous decline, GDP posted a quarter-on-quarter increase of 1.4% in Q1. This rise in output appears to confirm the end of the recession in the technical sense of the term. In any event, the recovery is but at an incipient stage and its firmness to be confirmed in the coming months. GDP grew thanks to the recovery in exports (6% in quarterly terms) and to the moderately favourable behaviour of private consumption (1.2%), in contrast to the decline in private residential and non-residential investment. From the standpoint of prices, the fresh year-on-year fall in the GDP deflator (0.9%) is notable, although the negative trend has eased in relation to previous quarters.

The indicators for Q2 released to date appear to point to a progressive pick-up in activity judging by the leading and composite indicators, due essentially to the notable increase in exports. On the supply side, industrial production quickened, the degree of capacity utilisation increased in manufacturing, industrial orders levels recovered and, generally, the business climate appears to have improved somewhat if regard is had to the Tankan survey. The recovery is, however, running at two speeds and is underpinned by the foreign sector and by the major manufacturing companies, while the indicators of consumer demand (household spending and retail sales, in particular) do not show a comparable improvement but a still-sluggish and irregular rate of activity in most cases. Further, in April and May, there were declines in employment and the unemployment rate continued rising to 5.4% in May. In this setting, the appreciation of the yen against the dollar is taking place at a delicate moment for the incipient recovery of growth in Japan. Indeed, this prompted statements by the Japanese monetary authorities and their intervention on the foreign exchange market early in the quarter. As regards monetary policy, the Japanese central bank did not alter its interest rates although, unlike in Q1, it pursued a policy restricting the supply of liquidity. As a result, the growth of the money supply slowed to 3.4% year-on-year in June, from 3.7% in April. The Japanese stock market benefited from the improvement in growth expectations and managed to close the quarter with minimal losses, in contrast to developments on other global stock markets. Reflecting this performance was the bond market, where yields trended upwards at the start of the quarter, in parallel with a degree of portfolio switching towards equities. However, this trend appears to have been reversed over the past month, with yields falling once again towards levels of 1.3%.

In the United Kingdom, the GDP growth rate moderated in Q1 from 1.5% to 1.1% year-on-year, due essentially to the fall in investment and in external demand and, on the supply side, in industrial output. In Q2, however, the economic indicators point to a recovery in industry and in exports, mainly as a result of increased demand from the United States. And, at the same time, domestic demand remains vigorous, whereby GDP growth is expected to rebound strongly. The unemployment rate has been stable at 5.1%, while wage growth held at around 3% year-on-year. The 12-month growth rate of inflation dipped to 1.8% in May, its lowest level since 1975. As a result, the Bank of England has kept its official interest rates at 4%, despite the constant rise in house prices, which are running at a rate of 20% on a year earlier.

In Asia, the recovery in exports and industrial output made for strong growth during Q1. And, according to the indicators released, this has continued into Q2. The exchange rates of the currencies of Korea, Thailand, Indonesia and Singapore appreciated notably against the dollar during the quarter, while China, Hong Kong and Malaysia, which are pegged to the dollar, have improved their competitive position following the depreciation of the US currency.

In the central and eastern European countries, growth in Q1 moderated owing to the lack of buoyancy of external demand, although domestic demand continued to show signs of robustness. These trends appear to have continued into Q2, except in the case of Poland, where industrial output remains weak and the high level of real interest rates appears to constrain the prospects of a significant pick-up in the near future. The inflation rate has continued falling in most of these countries. This has been the particular case of the Czech Republic, whose year-on-year rate stood at 1.2% in June, owing to the appreciation of the koruna, and of Poland, whose rate was 1.9% in May due to weak growth and falling food and energy prices. In Turkey, despite the improvement in economic indicators and compliance with the IMF programme, the government crisis has adversely affected market confidence.

After a bright start to the year in Latin America, in which the main economies had been relatively unaffected by the Argentine crisis, the situation worsened during Q2. On one hand, recovery in the economies of the region is proving slower and less dynamic than expected. On the other, various difficulties, in particular the political situation, have dominated events and weighed heavily on countries' expectations by interacting unfavourably with the vulnerabilities inherent in their economies. The upshot of these negative expectations has been a widespread deterioration in financial indicators, markedly so in Brazil, Uruguay and Venezuela, which have seen their credit ratings downgraded by the main agencies. At the other end of the scale, in those countries with investment grades (Chile and Mexico) and in Colombia, the deterioration has been more limited. In any event, the greater degree of risk aversion on international financial markets, which have become highly sensitive to the prolongation of the crisis in Argentina and to other global factors, has borne negatively on the region as a whole.

Argentina has admittedly seen some headway in setting a new economic programme in place. But essential aspects remain unresolved, including most notably the plans to restructure the financial system or the definition of a monetary programme that will allow inflation expectations to be anchored. The exchange rate managed to stabilise at around 3.60-3.70 pesos per dollar towards the end of the quarter, and the impact on inflation (which stood at a 12-month rate of 28% in June) has so far been limited. The GDP data for Q1 showed that the pace at which activity has been deteriorating has stepped up (-16.3% year-on-year), although possible signs that the depression may have touched bottom are discernible. Brazil, where expectations improved substantially in Q1, has been affected by the increase in political uncertainty. Although public-sector borrowing requirements have been covered for this year, the size of public debt and, above all, its structure, which is highly sensitive to changes in the real's exchange rate and in short-term interest rates, are a source of potential vulnerability in a region alerted by the Argentine crisis. On the economic front, the indicators show a gradual though slower-than-expected recovery in activity, which is being held back by the slackness of domestic demand. The economic indicators in Mexico show a progressive pick-up in activity thanks to favourable developments in the US economy. In Chile the monetary authorities, faced with the relative flatness of economic growth (1.5% in Q1 on a year earlier), have cut official rates to 3.75%, using the margin for manoeuvre provided by the moderate inflation rate.

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

The information available on economic developments in the euro area in Q2 confirms the prolongation of the recovery in activity seen since the start of the year. However, activity is proving less robust than initially expected since internal demand has not yet gathered sustained pace. The current setting is characterised by the absence of significant macroeconomic imbalances, continuing favourable financial conditions and the gradual strengthening of activity in the rest of the world. The factors needed for a progressive pick-up in growth rates are thus in place. Moreover, the appreciation of the euro may galvanise private consumption in the short term insofar as household real disposable income improves. Nonetheless, two factors may slow the pace of recovery: the fall on stock markets, through the impact on household wealth and the greater difficulties corporations face in financing their investment projects, and the effect of the appreciation of the euro on the export sector. Lastly, the difficulties of certain Member States in meeting the fiscal commitments they entered into pose a challenge for the effectiveness of the economic policy co-ordination and multilateral surveillance mechanisms.

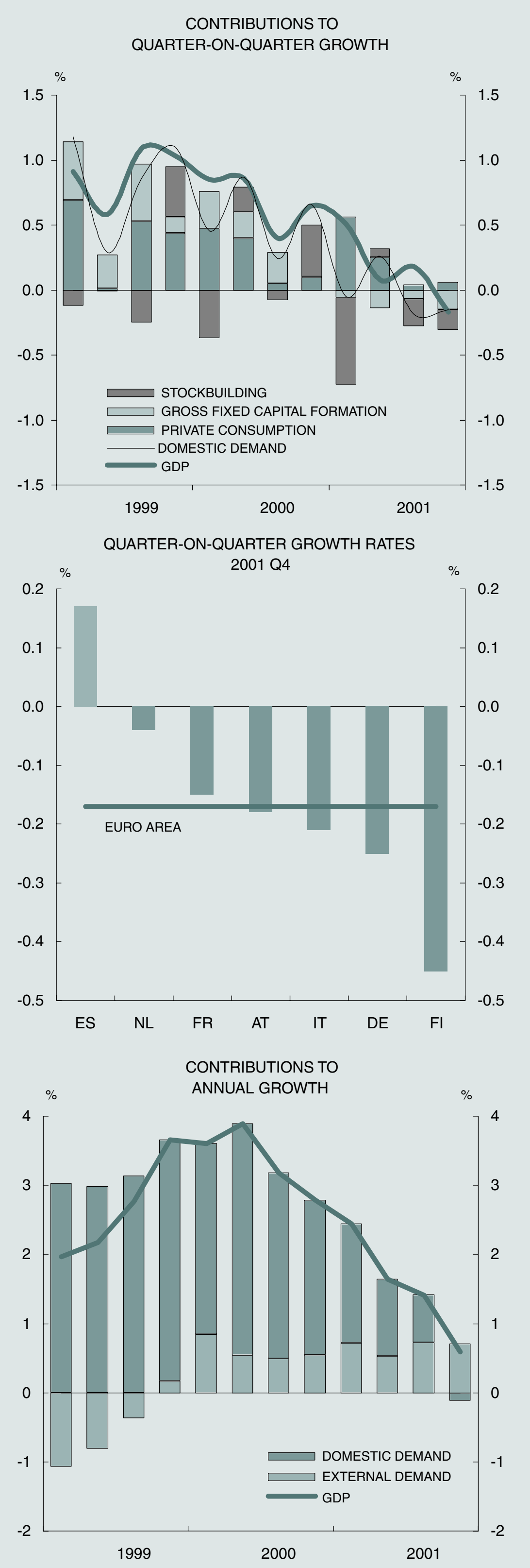
3.1. Economic developments

According to the second National Accounts estimate for the area, GDP grew by 0.3% in quarter-on-quarter terms in Q1, compared with a decline on the same scale in the final quarter of 2001 (see Chart 8). In year-on-year terms, the rate was also 0.3%, one-tenth of a percentage point down on the previous quarter. The pick-up in output in relation to the preceding quarter was due to the behaviour of the external sector, whose contribution to growth was half a percentage point, after a zero contribution in 2001 Q4. This change in the contribution of external demand to GDP growth was due to the notable improvement in exports, since the rate of decline of imports slackened. Internal demand (excluding stocks) contributed only one-tenth of a point to output growth, as was the case the previous quarter. Private consumption remained flat at the level of the closing three months in 2001, while the decline in gross fixed capital formation slowed. Finally, the inventory run-down continued, whereby the contribution of stocks to economic growth remained negative (three-tenths of a point).

The National Accounts figures for euro members in Q1 reveal that, among the eight countries for which data are available, only Finland continued to show a negative quarter-on-quarter growth rate, while this had been the case in seven Member States in 2001 Q4. The

CHART 8

GDP in the euro area



Sources: Eurostat and national statistics.

four biggest euro area economies accelerated clearly, although growth was more robust in Spain and France, with rates of 0.5% and 0.4%, respectively, than in Germany and Italy, where output expanded by 0.2% (see the middle panel of Chart 8). The biggest difference between both groups of countries is the differing buoyancy of internal demand. Whereas in France and Spain consumption and gross fixed capital formation posted positive growth rates, these two aggregates contracted in Italy and Germany. Further, the improvement in exports in Q1 in the euro area was not across the board. Whereas sales abroad were very buoyant in Germany and France, negative quarter-on-quarter rates were recorded in Italy and Spain in this connection.

Notable across the branches of production was the strong recovery in value added in industry which, after falling by 1.6% in 2001 Q4, increased by 0.8% in the first three months of this year. That is consistent with the rebound in exports, given the greater proportion of tradable goods in this sector. Value added in the services sector grew by 0.3% in 2002 Q1, a rate somewhat down on the average recorded last year.

As regards Q2, the supply-side indicators available point to an additional strengthening of activity, as a result of which a growth rate similar to or somewhat higher than that of Q1 may have been attained. In particular, the indicator drawing on the European Commission's monthly business confidence survey has held at slightly more favourable levels throughout Q2 than those recorded at the end of Q1, standing at around pre-September 11 volumes. In contrast, the manufacturing purchasing managers' index has improved unequivocally in comparison with these reference periods. However, the improvement in the related indicator for the services sector has been more moderate. Finally, despite trending somewhat erratically in the March-April period, the industrial production index has been on a rising trend since the beginning of the year to May (see the upper panel of Chart 9).

In the case of the internal demand indicators, the signs of improvement are less conclusive. In particular, the consumption indicators do not show an across-the-board increase. Whereas the consumer confidence indicator improved slightly in Q2, the retail trade index deteriorated further (see the lower panel of Chart 9). Retail sales worsened in April, while the rate of decline of new car registrations has been slackening in the March-June period. Turning to the demand for capital goods, the results in April of the European

Commission's half-yearly investment survey reveal a decline in 2002 in real spending on this demand component, the scale of which is greater than was expected in November 2001. As to the foreseeable trend of inventories, the proportion of respondents who considered their stocks to be above the desired level fell in Q2 according to the results of the related question of the business confidence survey. Finally, as regards external demand, export indicators have improved once more in Q2, as the middle panel of Chart 9 shows.

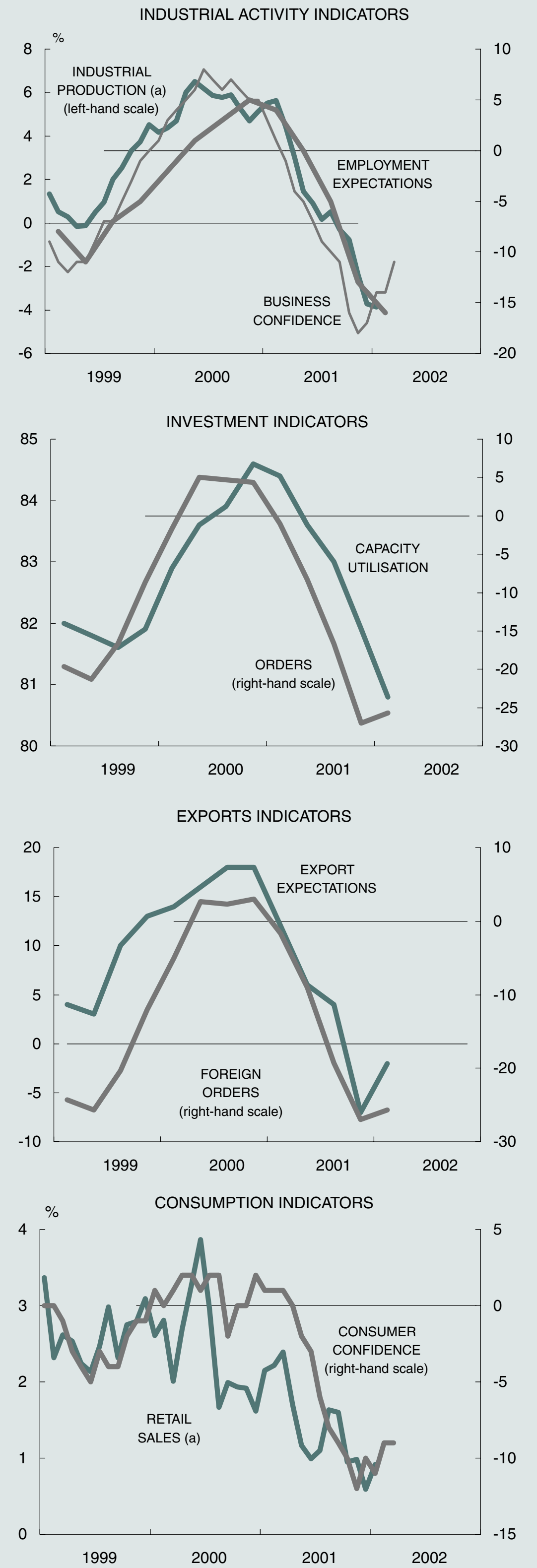
The strengthening in the rate of increase of GDP signalled by the indicators of activity might be based, on the demand side, on the extra momentum in exports and, probably, in investment, and in the petering out of the inventory run-down, while private consumption is likely to sustain a weak rate of increase in line with the course of its determinants. Of these determinants, it is estimated that real disposable income is running at a less intense growth rate than in 2001, given lower employment creation and the absence of tax cuts, although the current appreciation of the euro, should it hold, might partially moderate the foreseeable slowdown in real disposable income. The heavy decline in stock prices throughout Q2 might have a negative effect on household spending decisions via the loss of value of their financial wealth. As analysed in Box 1, the pattern of the recovery does not differ substantially from that seen in similar cyclical episodes.

With respect to the euro area labour market, employment growth in Q1 was 0.2% according to ECB estimates, slightly down on the rate for the second half of 2001. Consequently, the year-on-year rate stood at 0.8%, its lowest value since 1997. The slowdown in the pace of employment generation has been accompanied by a slight rise in the unemployment rate which, in May, stood at 8.2% of the labour force, two-tenths of a point above the end-2001 level. However, as Box 2 shows, the employment indicators drawing on surveys have improved recently.

Consumer prices in the euro area were marked in Q2 by a notable easing off of the rate of increase of the harmonised index of consumer prices (HICP), which dipped from 2.5% in March to 1.8% in June (see Chart 10). However, this decline has essentially been due to the behaviour of the more volatile components (fresh food and energy), whose rate of increase has moderated notably in the April-June period, while the prices of the other groups of goods have shown considerable downward stickiness. The rate

CHART 9

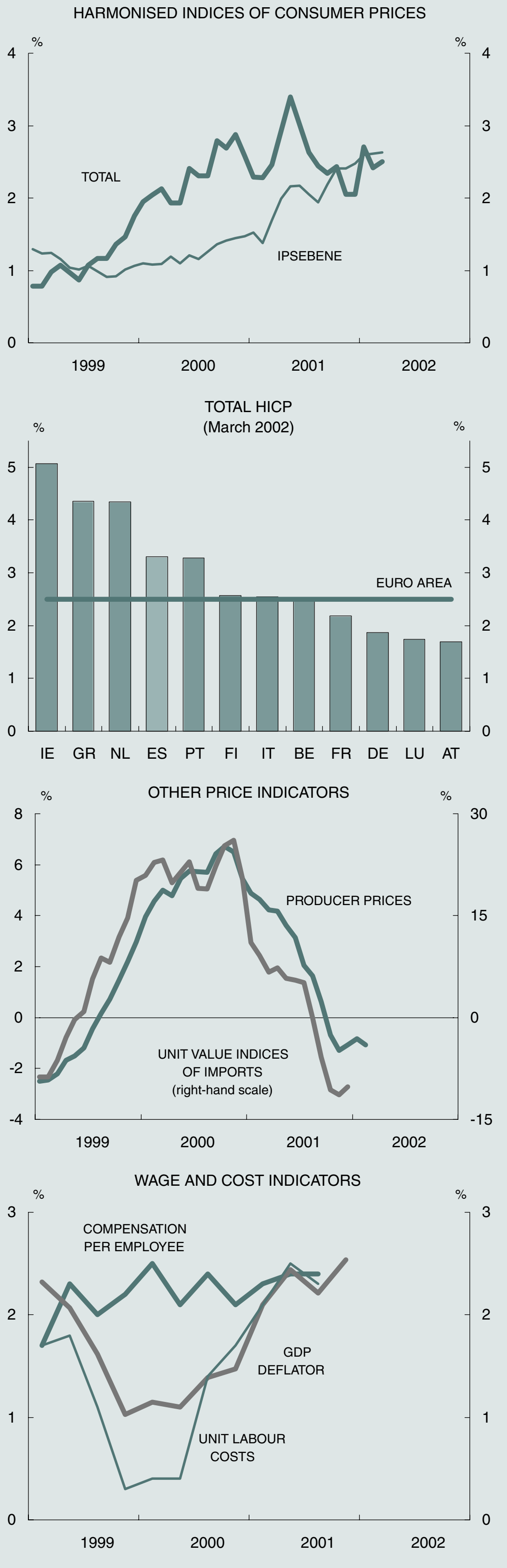
Euro area. Real indicators



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

of increase of the indicator covering the prices of services and non-energy goods thus held stable at 2.6% in the period from January to June. In particular, services inflation, which stood at 3.2% in June, is a cause for concern in the euro area since the persistence of such a high rate of increase for these prices is occurring against a background of weak internal demand. Nonetheless, this inflationary behaviour may still be capturing the delayed effects of a high number of recent shocks, relating to oil prices, the sharp depreciation of the euro, food crises and the introduction of euro notes and coins. But these effects should gradually diminish. Country by country, six Member States have an inflation rate of over 2%, the upper boundary of the reference interval in the price stability definition adopted by the ECB, while the gap between the rates of the two most and least inflationary countries (Ireland and Germany, respectively) currently stands at 3.8 percentage points, i.e. four-tenths of a point above the March figure. The 12-month growth rate of the producer price index fell by 1% in May, a similar rate of decline to that seen since last autumn. In terms of its different components, the positive growth rates of consumer goods prices continued to moderate (as has been the case since early 2001), while the decline in intermediate goods producer prices tended to slow in April and May.

It is worth examining to what extent the appreciation of the euro may change the inflation outlook. In principle, a rise in the euro against the dollar helps relieve inflationary pressures insofar as the pass-through to oil import and other commodity prices is swift and very high. In this respect, the depreciation of the dollar has lowered the national-currency price of oil, which has trended throughout Q2 at around $25 per barrel. Although in nominal effective terms the appreciation of the euro has been more limited, in the coming months it will foreseeably begin to feed through to the import prices of other goods. However, along with this positive factor, the course of domestic costs raises doubts about the price outlook. The growth rate of unit labour costs rose by half a percentage point in Q1 to 3.9%, as a result of both employee compensation holding at a high rate of increase and, above all, the decline in labour productivity. The GDP deflator grew by 2.3% in Q1, two-tenths of a point less than the previous quarter, whereupon the acceleration in unit labour costs has entailed a slowdown in margins (see Chart 10).

The euro area current-account deficit narrowed in the first four months of 2002 to €1.5 billion, compared with €17.2 billion in the same

BOX 1

Patterns of cyclical recovery in the euro area

The latest Eurostat data confirm that economic activity in the euro area began to pick up in the opening months of the current year after reaching a trough in 2001 Q4. In order to evaluate the prospects of recovery, it is worth comparing recent developments in GDP and its main components with those observed in previous cyclical episodes.

The accompanying charts show the three main cyclical episodes in the euro area during the nineties, which have been identified by approximating the GDP cycle in terms of its quarter-on-quarter growth rates based on deviations from its long-term trend1. The same procedure has been applied to the main components of output. The chart in the upper panel shows GDP one year before and after reaching its cyclical trough, while the other charts depict the deviations by each component from its trend growth in the same periods, allowing their contribution to the slowdown in output and to its recovery to be analysed.

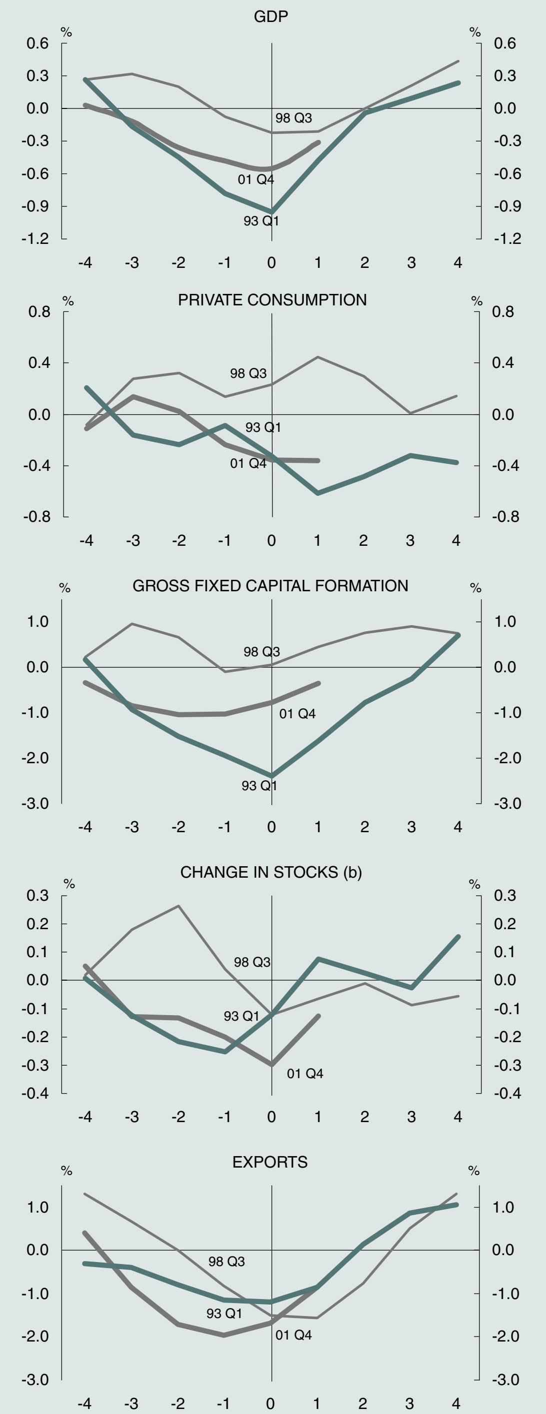
Although the intensity of the slowdown differs in the cyclical episodes analysed, a common feature to all is the fact that output resumes its trend growth fairly quickly, two quarters after the related trough. The contribution of economic variables to the cycle has been different in each case. In 1992 and 1993, the slowdown was particularly marked owing to the decline in internal demand, in particular in gross fixed capital formation. The main determinant of the cyclical slowdown in 1998 was the fall-off in exports, the result of the crisis of the Asian emerging economies and of the financial instability in Russia, while internal demand held relatively stable.

In its deceleration phase, the current cycle shared certain features with the two aforementioned episodes, as it was characterised by a fairly sharp fall in exports, as in 1998, and by a contraction in internal demand which, in the case of private consumption, was similar to that observed in 1992-1993. The reduction in exports was the natural consequence of the international origin of this period of slowing activity and declining world trade, whereas the deterioration in consumer and business confidence and higher energy prices accounted, in part, for the slowdown in internal demand. In any event, the combined effect of these factors led to a more moderate slowdown in GDP than in the 1993 recession. Moreover, the contribution of the change in stocks to output showed a run-down process similar, but more lagged, to that of 1993. Finally, imports also slowed notably, in line with the moderation of final demand.

Regarding the current phase of recovery, exports have begun to improve ahead of the cyclical trough, as was the case in 1993. Gross fixed capital formation has also embarked on a mild but sustained path of recovery, leading that of output, and appears to have firmed in 2002 Q1. However, it seems it is construction rather than investment in capital goods that is driving this recovery. As regards private consumption, there are no signs of a clear path of recovery for the moment. That said, as occurred in the early nineties, this component may be lagging the other variables slightly. Finally, the run-down of stocks has already begun to be corrected in the opening months of 2002, albeit while still subtracting from output growth.

(1) Specifically, the Hodrick-Prescott filter has been applied drawing on the trend-cycle component, extracted by means of the TRAMO-SEATS procedure. See Kaiser, R. and Maravall A. (1999), Short-Term and Long-Term Trends, Seasonal Adjustment, and the Business Cycle, Working Paper no. 9918, Servicio de Estudios, Banco de España.

Deviation from trend growth (a)
Quarter-on-quarter growth



Sources: EUROSTAT, ECB and Banco de España.
(a) Estimated by the HP filter applied to the trend-cycle component. The four quarters before and after the turning point are depicted.
(b) Contribution to GDP growth.

TABLE 1

General government budget balances of euro area countries (a)

% of GDP

	1998	1999	2000	2001	2002 (b)	2002 (c)
Belgium	-0.8	-0.6	0.1	0.0	0.0	-0.2
Germany	-2.2	-1.6	-1.3	-2.7	-2.0	-2.8
Greece	-3.1	-1.8	-0.8	-0.4	0.8	0.3
Spain	-2.6	-1.1	-0.4	0.0	0.0	-0.2
France	-2.7	-1.6	-1.4	-1.5	-1.4	-2.0
Ireland	2.3	2.3	4.5	1.7	0.7	0.4
Italy	-2.8	-1.8	-1.7	-1.4	-0.5	-1.3
Luxembourg	3.5	3.7	5.7	5.0	2.8	2.0
Netherlands	-0.8	0.4	1.5	0.2	1.0	0.0
Austria	-2.4	-2.2	-1.5	0.1	0.0	-0.1
Portugal	-2.4	-2.1	-1.9	-2.7	-1.8	-2.6
Finland	1.3	1.9	7.0	4.9	2.6	3.3
MEMORANDUM ITEMS:						
Euro area						
Primary balance	2.6	3.0	3.3	2.6	2.7	2.3
Total balance	-2.2	-1.3	-0.8	-1.3	-0.9	-1.5
Public debt	73.7	72.6	70.2	69.1	67.2	68.6

Sources: European Commission, national stability programmes and Banco de España.
(a) As a percentage of GDP. Proceeds from the sale of UMTS licences not included. Deficit (-) / surplus (+).
(b) Targets in the stability programmes presented between November and December 2001.
(c) European Commission projections (spring 2002).

period of 2001. Behind this improvement is the better performance of exports and the improved terms of trade, which have contributed to increasing the surplus on the merchandise balance. In respect of the financial account, cumulative net outflows of direct and portfolio investment fell in the first four months of the year to €35.2 billion, against €97.5 billion in the same period in 2001, as a result of the reduction in euro area residents' foreign direct and portfolio investment.

In the fiscal policy sphere, the authorities of several Member States that have not yet achieved a balanced budget have recently released information that suggests a more unfavourable fiscal position than initially envisaged. The Portuguese government acknowledged that its general government deficit exceeded 3% of GDP in 2001, which will trigger the application by the European Commission of the excessive deficit procedure. At the same time, the Portuguese authorities have adopted a set of budgetary measures to prevent this limit being breached during the present year. In France, in late June, the new government submitted the results of a public finance audit and, shortly after, tabled draft legislation revising the State budget for the year 2002, which includes a 5% cut in personal income tax contributions. As a result, the initial general government deficit target for 2002 (1.4% of GDP) has been revised to 2.6% of GDP (see Table 1). Finally, the Italian deficit may reach 2.2% of GDP in 2001 after having been revised upwards by 0.6 percentage points further to the Eurostat resolution in early July concerning the method of recording various operations transacted recently in several countries. In particular, the resolution addresses the correct form of recording certain asset securitisation operations conducted in 2001 by the Italian government. Furthermore, the Italian authorities announced at the start of June that public finances would not reach a position close to a balanced budget until 2004, one year later than initially scheduled.

In this respect, the recommendations of the 2002 Broad Economic Policy Guidelines (formally adopted by the ECOFIN after the Seville European Council) reiterate the need, in 2004, for all Member States to have attained a close-to-balance or in-surplus position. The visibility of this commitment advises making every possible effort to meet the commitment on schedule, so as to reinforce the credibility of the fiscal discipline mechanisms in place in the area.

BOX 2

Employment prospects in the euro area

Achieving a sustained recovery in the euro area depends on the reactivation of internal demand and, in particular, given its relative significance, of private consumption. The behaviour of this variable largely responds to developments in the labour market. This is because employment is a fundamental determinant of disposable income and, moreover, consumer confidence is highly sensitive to changes in unemployment.

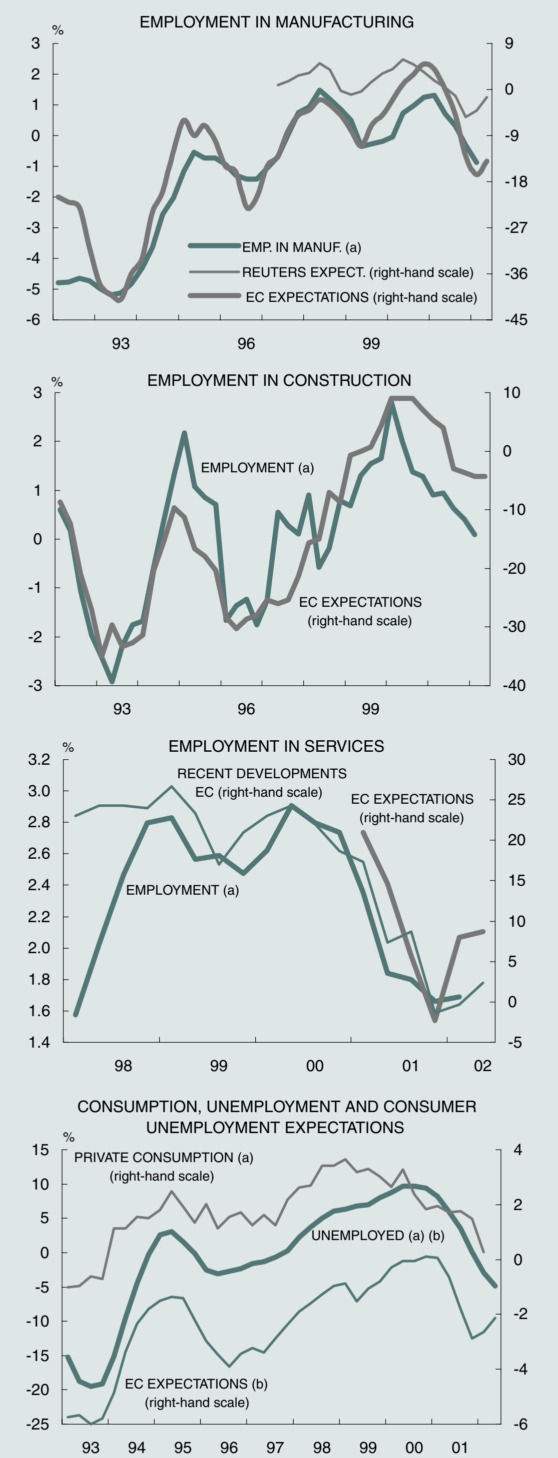
The lag with which National Accounts employment data in the euro area are released conditions their use for short-term economic analysis. Specifically, at the time of this bulletin going to press, the latest employment figure for the area was for 2001 Q4, although an ECB estimate for 2002 Q1 calculated on the basis of data from certain countries is available. The information on the unemployment rate is released with much less of a lag, though its use for drawing conclusions on employment is conditioned by its dependence on the behaviour of the labour force.

In analysing the labour market situation, and to compensate for the lag in the release of the official employment data, information from surveys is used. In particular, the European Commission (EC) and Reuters surveys provide indicators that are highly correlated with actual employment and unemployment developments. The EC survey furnishes monthly indicators of short-term employment prospects in manufacturing, construction and services, of recent employment developments in services and of consumer expectations about unemployment over the next 12 months. Reuters publishes indicators on the direction of changes in employment for the current month compared with the previous one in industry and in services, along with a composite index of both. In addition, Reuters provides predictions of the level of the unemployment rate over the next seven quarters. Currently, information from both sources to June 2002 is available. This offers an up-to-date, though preliminary, evaluation of the labour market situation.

As the accompanying chart shows, employment prospects in the euro area as reflected in these surveys have been recovering in the first half of 2002 from their trough at the end of last year. The EC and Reuters survey results on employment in the manufacturing sector show a turnaround in 2002 Q1 which is particularly noticeable given the close link between the survey turning points and those for total employment in the euro area. In the construction industry, the indicators signal a halt in the slowdown in employment and, in services, indicators of the current situation have shown a slight improvement since end-2001, which has been most marked in the case of expectations.

As regards the unemployment indicators, prospects as stated by consumers in the EC survey (which are closely related to actual movements in unemployment) show a turning point in 2001 Q4 (see the lower panel of the accompanying chart). Further, these variables can be seen to be highly correlated with private consumption. Consequently, in line with the gradual improvement in economic activity initiated at the start of the year, employment will foreseeably pick up slightly in mid-2002, thereby boosting private consumption and economic expansion. On this occasion, it also seems that the pattern seen in previous cyclical phases is holding; namely, that labour market variables only react with a lag to cyclical changes, as the result of an incomplete adjustment of this production factor in the short term.

Employment and unemployment indicators



Sources: European Commission, ECB and Reuters.

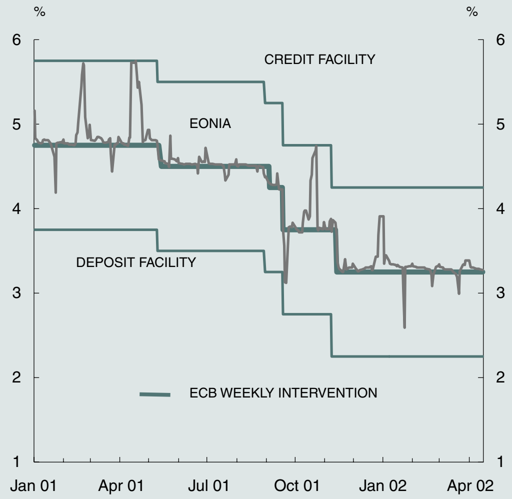
(a) Year-on-year rate of change.

(b) Inverted scale.

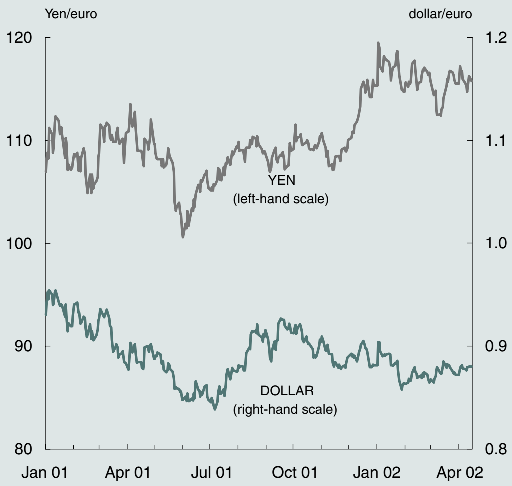
CHART 11

ECB interest rates and euro exchange rates

ECB INTEREST RATES



NOMINAL EURO EXCHANGE RATES

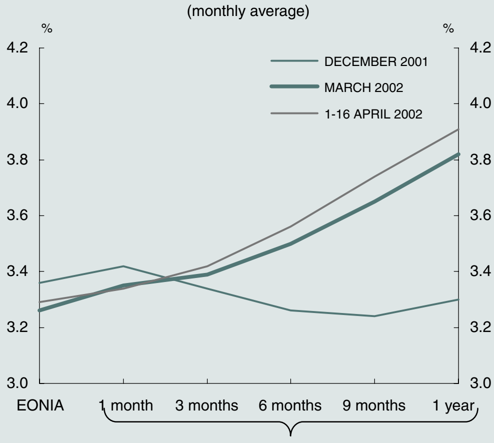


Sources: Banco de España and ECB.

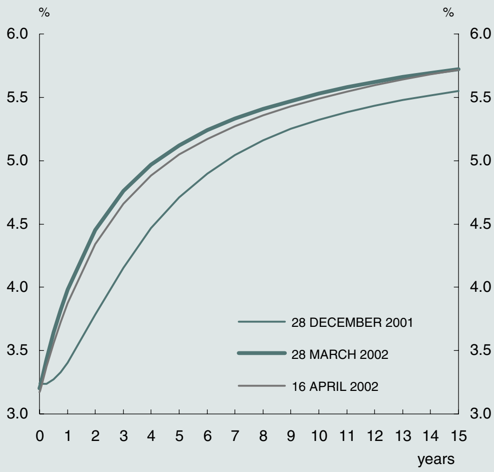
CHART 12

Euro area Yield curves

INTERBANK MARKET
(monthly average)



ZERO-COUPON CURVE (a)



TERM STRUCTURE OF ONE-MONTH FORWARD RATES (b)

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

3.2. Monetary and financial developments

The monetary policy decision-making context has been marked by high uncertainty over the inflation outlook. This is because, on one hand, certain doubts remain over the intensity of the economic recovery and it is to be expected that the appreciation of the euro will alleviate price pressures. Meantime, on the other hand, the downward stickiness of services prices and the behaviour of labour costs are causes for concern. Against this background, the ECB Governing Council has decided to keep its official interest rates unchanged. The minimum bid rate on the main refinancing operations has thus held at the level of 3.25% set on November 8 last year.

TABLE 2

Monetary and financial situation in the euro area and Spain

%

	1999	2000	2001		2002			
	DEC	DEC	NOV	DEC	JAN	FEB	MAR	APR (c)
MONETARY VARIABLES (a):								
EURO AREA								
M3	5.8	4.1	7.9	8.1	7.9	7.4	7.3	
M1	10.7	5.3	5.9	5.4	6.4	6.0	5.8	
Credit to private sector	10.3	10.1	6.9	6.8	6.3	6.0	5.4	
SPAIN								
Cash and cash equivalents	12.7	4.4	5.9	6.8	6.4	7.6	9.7	
Other bank liabilities	3.9	19.6	11.0	8.4	7.0	7.1	6.8	
Mutual funds	-21.9	-27.1	23.3	26.2	29.0	28.5	30.1	
Financing to the private sector	19.5	18.9	15.6	15.1	14.8	15.0	15.5	
FINANCIAL MARKETS (b):								
EONIA	3.04	4.83	3.51	3.36	3.29	3.28	3.26	3.28
Three-month EURIBOR	3.44	4.94	3.39	3.35	3.34	3.36	3.39	3.41
Public debt								
Euro-area ten-year bond yields	5.32	5.07	4.67	4.96	5.02	5.07	5.32	5.31
US-euro area ten-year bond spread	1.04	0.25	-0.02	0.16	0.05	-0.09	0.02	0.04
Spain-Germany ten-year bond spread	0.22	0.31	0.31	0.23	0.19	0.19	0.18	0.17
Spanish bank interest rates								
Synthetic deposit rate	1.98	3.02	2.31	2.22	2.22	2.25	2.25	
Synthetic lending rate	5.03	6.35	5.11	4.86	4.88	4.85	4.88	
USD/EUR exchange rate	1.011	0.897	0.888	0.892	0.883	0.870	0.876	0.882
Equities (d)								
Dow Jones EURO STOXX Broad Index	39.5	-5.9	-22.3	-19.7	-2.2	-3.2	1.6	-0.1
Madrid Stock Exchange General Index	16.2	-12.7	-6.4	-6.4	-2.6	-1.3	0.6	2.3

Sources: ECB and Banco de España.
(a) Annual percentage change.
(b) Monthly averages.
(c) Monthly average to 16 April 2002.
(d) Cumulative percentage change during the year. End-of-month data. Latest month: 15 April for the EURO STOXX and 16 April for the Madrid Stock Exchange.

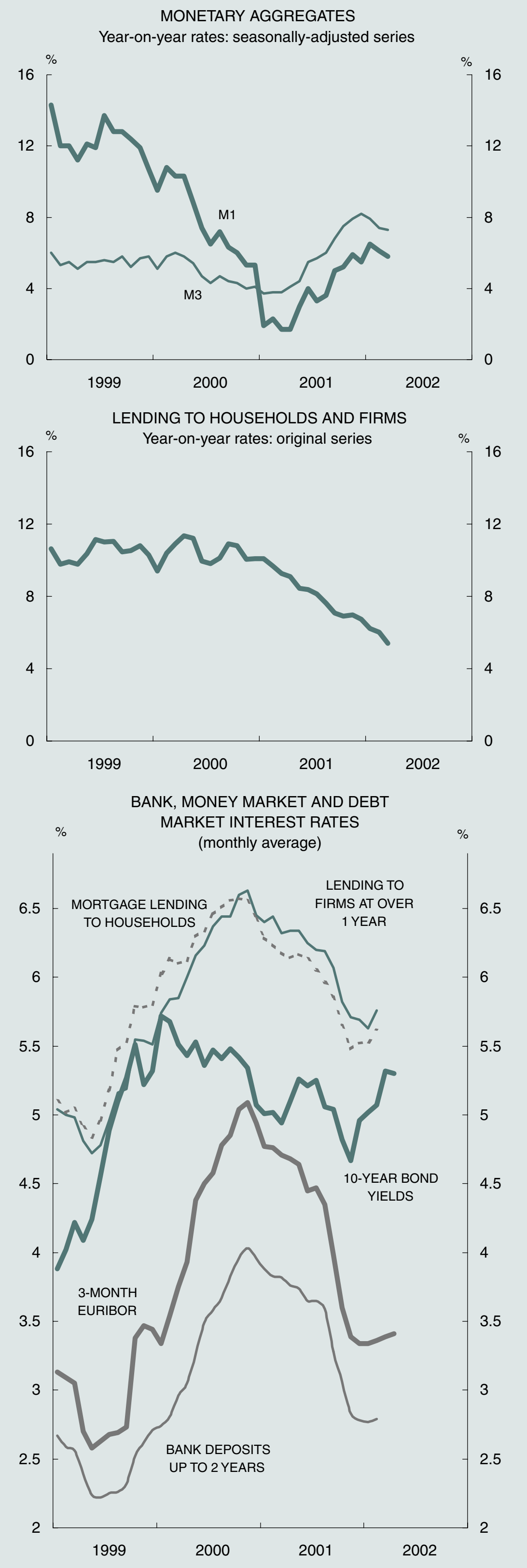
As Chart 12 shows, there were two clearly differentiated phases in the money market yield curve during the quarter. Until end-May, the yield curve shifted upwards, possibly as a result of the worsening price outlook. However, thereafter yields began to decline, further to the progressive reduction in expectations of future official rate increases (see lower panel of Chart 11). Undoubtedly, this process has been linked to the appreciation of the euro, insofar as the exchange rate is contributing to easing inflationary pressures in the area by reducing the generosity of monetary and financial conditions.

In the debt markets, yields have fallen at all maturities since mid-May. There was a reduction of approximately 30 basis points, to below 5.1%, in 10-year bond yields. The decline in the yield on US government debt was sharper, whereby the differential with the euro area (which was negative of the order of five basis points in mid-May) has widened to around 30 basis points.

The interest rates applied by euro area credit institutions to transactions with customers remained until May on the rising trend initiated around the start of the year, in step with the trend of money market rates until last month (see the lower panel of Chart 13). The interest rates on credit to corporations at over one year and on house-purchase credit stood at around 20 and 30 basis points, respectively, above their levels at end-2001, while the increase during the same period of the return on deposits with an agreed maturity of less than two years was 14 basis points. In Spain, the increases in credit in-

CHART 13

Monetary and credit aggegates and interest rates in the euro area



Sources: Banco de España and ECB.

stitutions' synthetic rates from December 2001 to May 2002 were similar (see Table 2).

Euro area stock market indices, which had moved in a relatively narrow range between December 2001 and the end of May, embarked thereafter on a very sharp fall, in line with the main international bourses. The broad Dow-Jones Euro Stoxx index and the Madrid General Stock Exchange index have in 2002, to the time of this Bulletin going to press, posted approximate declines in excess of 25% and 20%, respectively, and now stand at similar levels to those observed in the wake of the September 11 terrorist attacks. Among the likely causes for this is the loss of confidence by market participants in the reliability of corporations' accounting information, following the spate of financial scandals in the United States.

On the foreign exchange market, the euro has risen during this period against the US currency (by around 16%, momentarily breaching parity with the dollar) and, to a lesser extent, against most of the currencies of the euro area's main trading partners. The nominal effective exchange rate of the euro has appreciated by more than 6% since end-April.

The M3 monetary aggregate held at a relatively high growth rate in Q2, posting a year-on-year rate of 7.1% in June (see Table 2 and Chart 13). The average year-on-year growth in the April-June period was 7.4%, a very similar figure to that recorded in Q1. This expansion in the aggregate perhaps reflects portfolio shifts by agents towards short-term liquid assets, as a result of the two bouts of instability on the financial markets in autumn 2001 and in spring 2002. The existence of this substantial liquidity does not necessarily entail inflationary risks in the medium term, inasmuch as it primarily reflects portfolio decisions unrelated to agents' spending plans. The narrow aggregate, M1, which had been slowing in Q1, rebounded in Q2 to a year-on-year rate of almost 7% in June.

With regard to the counterparts of the monetary aggregates, the slowdown in credit extended to resident private agents came to a halt in Q2, with its year-on-year rate standing in June at 5.4%, a similar level to that observed at the end of Q1. In a context in which favourable conditions in terms of the cost of financing remain in place, the foregoing developments may be related to the recovery in economic activity in the area. In Spain, the growth of financing extended to the private non-financial sector remained fairly high in Q2, growing at a year-on-year rate of above 14%, substantially up on the related rate for the area as a whole.

4. The Spanish economy

The QNA data for 2002 Q1 confirmed that Spanish GDP held on a slowing course in this period, dipping to a year-on-year growth rate of 2% (1) in real terms, in line with the estimates presented in the previous quarterly report (see Chart 1). On the basis of the economic data currently available, output is estimated to have held at a growth rate of around 2% year-on-year in Q2 also, the result of a moderate and further slowdown in national demand (to which the mild containment of household expenditure and the cut in stocks would have contributed) and of a slightly positive contribution by the external sector (see Chart 14). In any event, the most buoyant components of spending have continued to be consumption (government and private alike) and construction, while exports have tended to pick up after declining heavily in the two previous quarters and investment in capital goods has continued to post negative year-on-year rates of change.

From the standpoint of the productive branches (in addition to construction which, in step with the increase in spending, has remained notably robust), market services grew at relatively high rates, albeit down on those attained last year. Conversely, a clear profile of recovery is not discernible in the industrial branches. Reflecting the moderation of productive activity has been the downward trajectory of the rate of employment creation, such that productivity has grown at similar rates to those recorded since the second half of 2001. In industry, where employment has been contracting since the end of last year, productivity has tended to pick up.

Against this background, the slight slowdown in employee compensation in the first two quarters of 2002 (in a climate of contained wage increases) has borne favourably on unit labour costs, the growth rate of which has declined. Conversely, final prices in the economy, and consumer prices in particular, have accelerated in the first half of the year virtually across the board, though more markedly so in services. That has given rise to a recovery in margins, which has probably been more intense in those sectors where demand has retained greater momentum. Consequently, the inflation differential with the euro area has widened significantly.

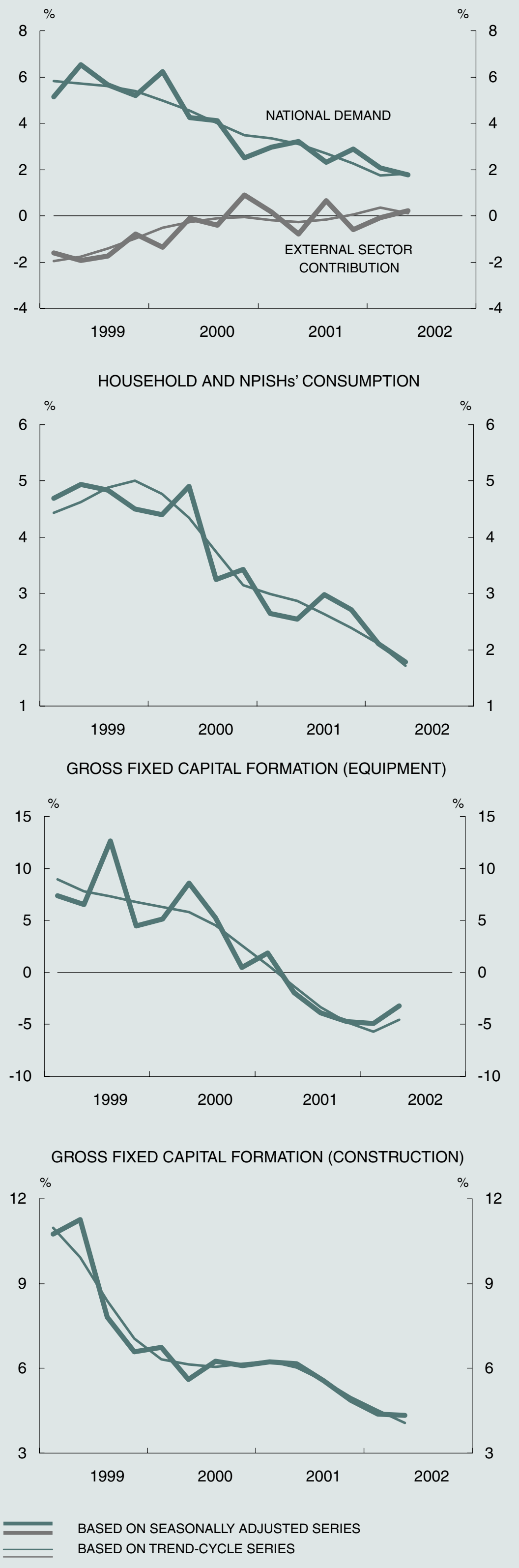
4.1. Demand

Given its weight in expenditure, household final consumption has largely contributed to

(1) QNA rates will be expressed in terms of the seasonally adjusted series, unless otherwise indicated.

CHART 14

Main demand aggregates
Percentage change on year ago



Sources: INE and Banco de España.

moderating the rate of increase of national demand in recent quarters, although it has also enabled this aggregate to maintain higher growth rates than those of other European countries. As can be seen in Chart 14, consumption slowed by six-tenths of a point in 2002 Q1 on QNA estimates, taking its real rate of change to 2.1%. And the as yet very partial information available on this variable in Q2 would point to a further slowdown, albeit not as sharp as in the previous quarter.

The loss of steam in consumption has essentially been centred on spending on food and on car purchases. Among the usual indicators, the rate of increase of the index of apparent consumption of goods and services has tended to stabilise in Q2 (see Chart 15), underpinned by the non-food goods component, while food fell back slightly. The index of apparent consumption of durables has held at negative rates of change, reflecting the fall in car purchases, and consumer surveys on the timeliness of buying durable goods have slipped during the first half of the year. Other spending indicators, such as the index of retail sales, which does not include motor vehicle sales, signal a degree of stability. The consumer confidence indicator has declined only marginally in Q2, after the deterioration at the beginning of the year, and it reveals a somewhat more positive assessment of the economic situation expected over the coming 12 months.

The trend of consumption in the first half of 2002 is consistent with the lower estimated growth of real household income compared with the previous year. This is the result, first, of moderating wages and a lower rate of employment creation; and further, of the rise in the inflation rate. Both factors have more than offset a somewhat more expansionary contribution by the general government sector to the increase in income. In addition, the diminished value of financial assets linked to the securities markets and heightened uncertainty (illustrated by the deterioration in consumer confidence) help explain the lesser buoyancy of consumption. On the estimates available, the growth rate of consumption would have adjusted to that of real income, stabilising the saving ratio.

General government final consumption grew by 3% in 2002 Q1, two-tenths of a point less than the previous period. Along with construction, it remains one of the most buoyant components of national demand. On the latest information, the pace of employment creation in the general government sector is holding at slightly lower rates than those posted in 2001, and the rates of change of other consumption spending are continuing to fall. As a result, a mild slowing pattern is also estimated for Q2.

In 2002 Q1, gross fixed capital formation continued on the declining trend marking its course during 2001. Its year-on-year growth rate stood at 0.9%, two-tenths of a point less than in 2001 Q4. The lesser thrust of investment was due to the behaviour of capital goods, which continued to worsen notably and whose year-on-year rate of decline stepped up to 4.9%. Construction also grew at a lower rate than in Q4, although it was once again the most expansionary aggregate of national demand, advancing at a rate of 4.5%. The rate of decline of investment in other products slackened somewhat to –0.1% year-on-year.

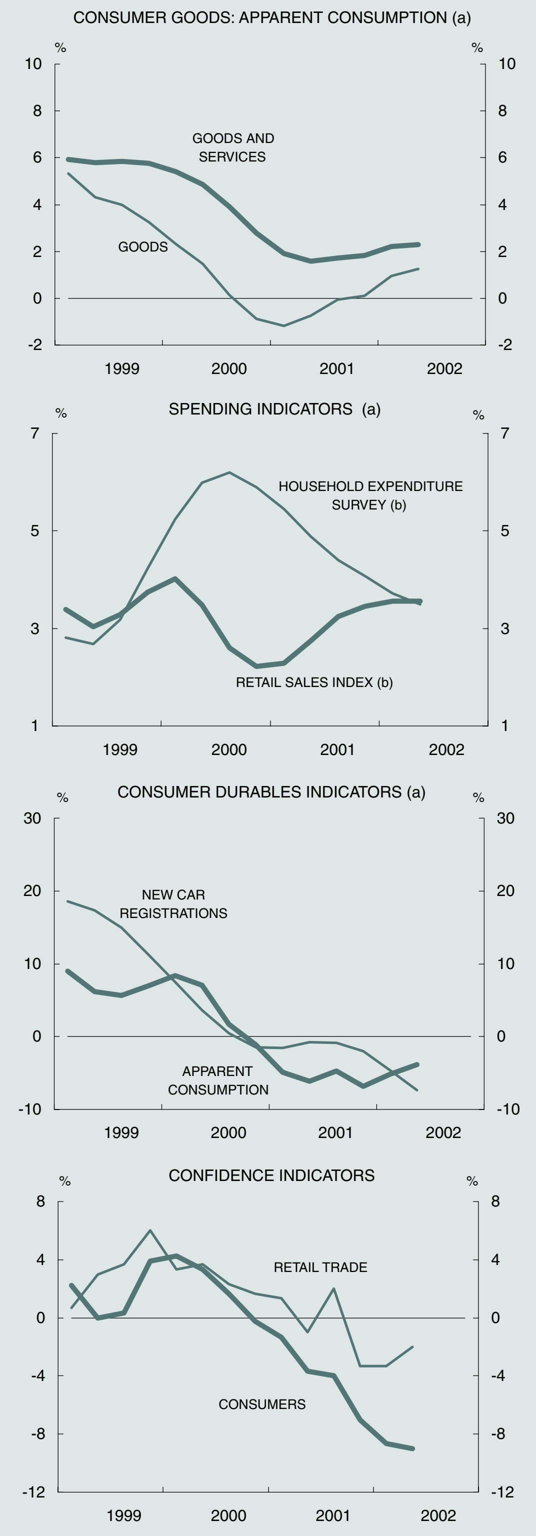
The scant information on the behaviour of investment in capital goods in 2002 Q2 suggests that this aggregate is holding at a fairly negative rate of change. Specifically, the index of apparent investment in capital goods would have fallen back further in this period owing to the decline in industrial production and in imports of investment goods (see Chart 16). Along these same lines, the spring data for the half-yearly investment survey of industry show that industrial corporations have revised their investment plans downwards for 2002. There has now been a 6% decline in this type of expenditure in nominal terms (compared with –2% in the autumn data).

According to this survey, the contribution of total demand as an influential factor on investment decisions has deteriorated appreciably in the past two years, and the influence it currently exerts is hardly favourable in this respect. However, other indicators of demand pressure have trended somewhat better in recent months: the assessment of orders in industry as a whole was less negative in Q2 than in the previous quarters, breaking with its declining trend, and the business climate indicator for the capital goods-producing sector also ceased to worsen. Capacity utilisation has increased slightly by seven-tenths of a point in the opening months of the current year to 77%, but is still below its historical average.

Data drawn from the Banco de España quarterly Central Balance Sheet Data Office survey (CBQ) for 2002 Q1 show that the ongoing slowdown in business activity, which has affected industrial corporations to a greater extent, has passed through to lower growth in the net ordinary result. Nonetheless, profitability ratios remain at relatively high levels and the leverage ratio is still clearly positive, in this latter case thanks also to the decline in the cost of borrowed funds, down 0.8 percentage points on 2001 Q1. As regards debt, according to the CBQ the related ratio stood in Q1 at 1.2 points below the average for last year. Other sources, such as the Finan-

CHART 15

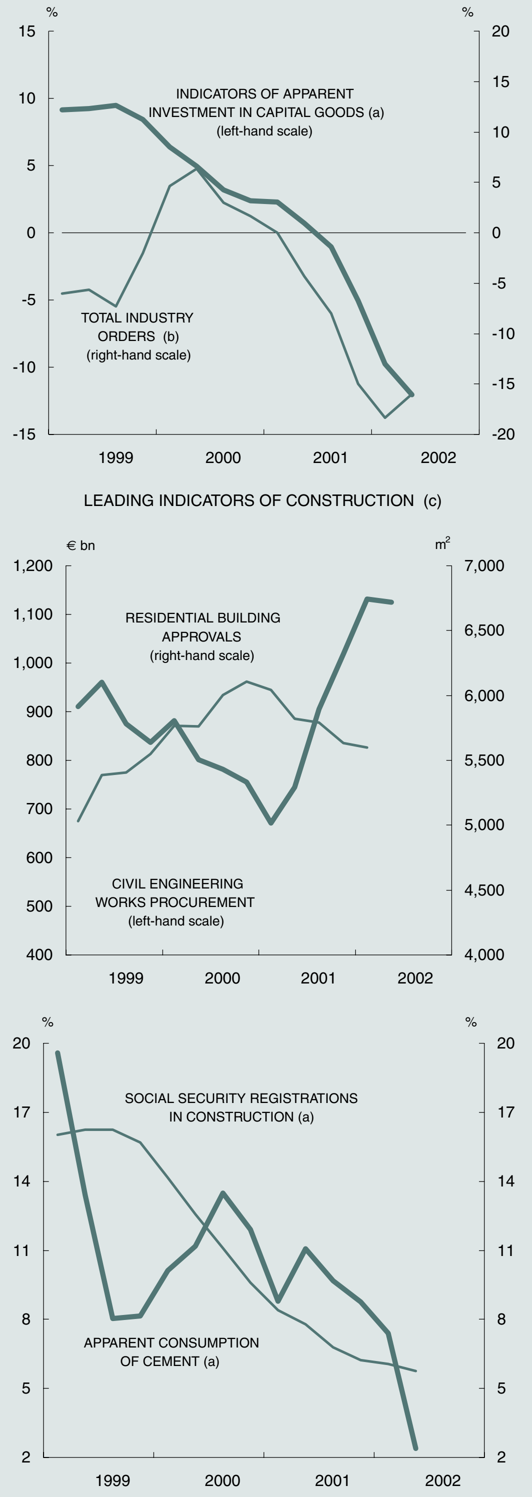
Private consumption indicators



Sources: INE, 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: INE, 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) Annual moving averages.

cial Accounts, point rather to this ratio stabilising or even increasing slightly on the high levels attained, a fact that may condition the strength of the recovery in investment.

It is estimated that investment in construction remained the most dynamic component of national demand in 2002 Q2. Signs that its expansionary phase is tailing off are moderate and in line with the mild slowdown it has undergone since the start of 2001. Regarding the composition of spending, data from the Construction Industry Survey (ECIC) for 2002 Q1 show the behaviour of building and that of civil engineering to differ somewhat from what other indicators reflect. Specifically, the thrust in civil engineering witnessed last year has been checked while, under building, the residential component maintains an accelerating profile and the non-residential component stands at a very moderate rate.

Among the coincident indicators of construction, the growth of the apparent consumption of cement fell significantly in Q2 (see Chart 16). However, the production of construction materials and indicators of employment in the sector (such as Social Security registrations) are looking more sustained, although registered unemployment climbed strongly in June. The business climate indicator for the construction industry also increased by four points in Q2 further to the improved level of orders and of employment prospects.

Turning to the indicators of construction starts, there was, as indicated, a year-on-year decline of 9.3% in 2001 Q4 in square metres to be constructed, according to residential building licences, followed by a fresh cut of 4% between January and February 2002. These data point to a slowdown in this construction investment component in 2002, in line with the deceleration of real household income and with house price rises. As regards civil engineering works, the strong growth of official procurement since the second half of last year would be sustaining robust construction in this segment.

In 2002 Q1, stockbuilding contributed one-tenth of a point to year-on-year GDP growth, compared with five-tenths of a point the previous quarter. Information drawn from the industrial survey to June shows a reduction in the level of stocks in relation to desired levels. This has been generalised, although more intense in the consumer goods-producing industry, and on a lesser scale at producers of capital goods and intermediate goods.

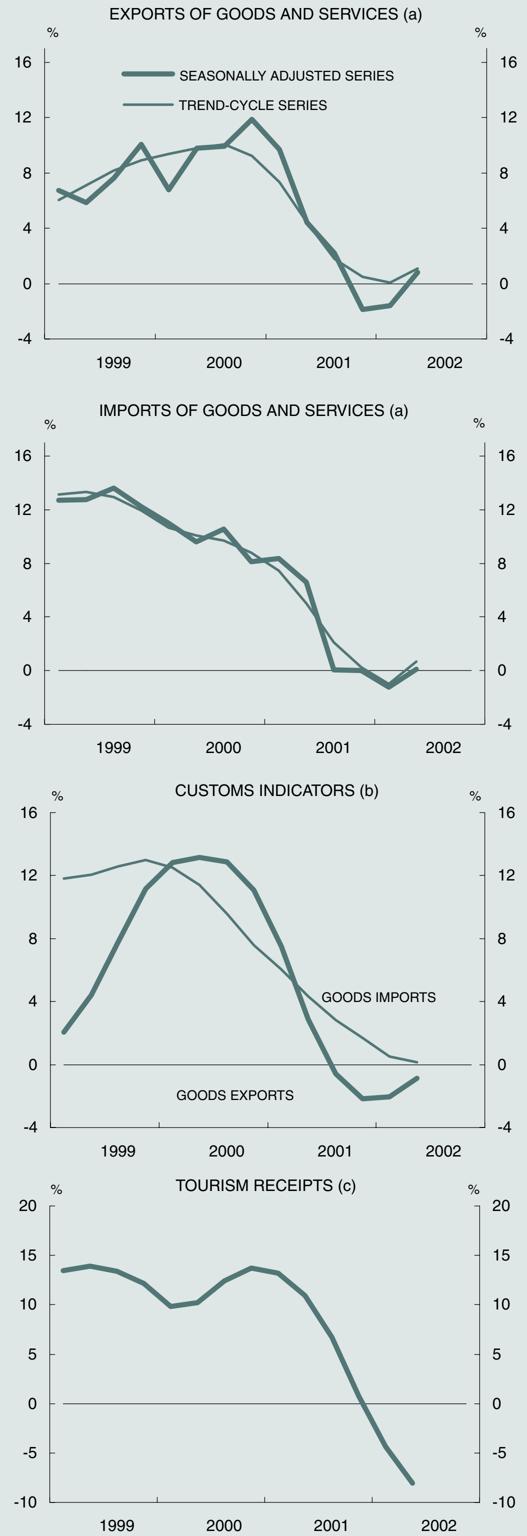
During the first half of the year, the contribution of net external demand to GDP growth has improved following the sizeable negative contribution recorded in 2001 Q4. Thus, in 2002 Q1, it subtracted only one-tenth of a point of GDP growth, against a background in which exports of goods and services once more declined notably in real terms in relation to the same period a year earlier (1.6%), given the persisting weakness of world trade and worsening competitiveness vis-à-vis the euro area countries (see Chart 17). The slowdown in imports in this period stepped up, falling by 1.2% year-on-year, influenced by the loss of momentum of final demand. Estimates for 2002 Q2 show a further improvement in the contribution of net external demand to GDP growth in this period, in which it would have been slightly positive. Exports, without growing significantly, would have picked up slightly, underpinned by the rebound in world trade. That would have enabled the momentum experienced by imports in the light of the improvement in industrial activity and in exports themselves to be offset.

The slowdown in goods exports intensified in 2001 as the economic crisis spread to Europe, the main market for Spanish products. Goods exports ended last year at a negative rate of change of 4.5% in real terms, and they continued to fall off during the first three months of the current year, posting a year-on-year decline of 4.3%, very close to that of the previous quarter. According to Customs data, which depict a similar profile to that of QNA figures, exports fell by 4.2% year-on-year in May, after growing 7% in April, this latter figure being positively affected by the Easter holiday period effect. Over the first five months, exports decreased by 2.3% year-on-year, checking the strong rate of decline characterising them in the final months of 2001 (see Chart 17). This export performance is consistent with the incipient recovery in world markets, especially those linked to the dollar area. Yet this recovery could be curtailed by the widening of Spanish cost and price differentials vis-à-vis the developed countries, against the backdrop of the notable appreciation of the euro.

By product group, capital goods exports were notably weak in the first five months, when they fell back by 19.1% in real terms, further to forceful price rises in these products. There was slight growth in consumer goods sales (0.2%), despite the fact car sales remained significantly sluggish owing to the decline in the demand for these goods in Europe. Sales of intermediate goods increased by 1.9%, in step with the incipient recovery in global activity. In terms of geographical areas, exports to non-Community zones increased slightly by 0.6%, in real terms, during the first four months of the year. That contrasted with the significant slippage record-

CHART 17

Foreign trade
Percentage change on year ago



Sources: INE, Ministerio de Economía, Ministerio de Hacienda and Banco de España.
(a) QNA data at constant prices.
(b) Trend-cycle deflated series.
(c) Nominal trend-cycle series.

ed since 2001 Q2. This better performance is a result of the pick-up in certain markets, such as the United States or the south-east Asian countries, and of the notable buoyancy of sales to central and eastern European countries, while the Japanese and Latin American markets have continued to weaken. Sales to the EU worsened in the first four months of the year, declining 2.8% in real terms compared with the same period a year earlier. The fall was due to poor results in sales to the two main markets in the area, namely Germany and France. Conversely, exports to the United Kingdom showed renewed vigour.

The slowing path of exports of tourist services, measured by QNA, ran into 2002 Q1 posting a real rate of change of 1.9% year-on-year, four-tenths of a point down on the previous quarter. The real indicators of tourism have fallen more sharply, as is also the case with tourism receipts in the balance of payments (see Chart 17). The number of tourists entering Spain in the first half of the year was similar to that in 2001, with a notable decline in Germans and a slowdown in the case of Britons, the two main markets supplying tourists for Spain. That said, numbers of tourists from France and the Netherlands increased significantly. Foreigners lodged in hotels and overnight stays fell back at rate of 2.3% and 5.5%, respectively, in the first half of the year, and there was also a sizable fall in reservations for July and August (–12.7%). Non-tourist services, which grew by 7.5% in 2002 Q1, slowed notably in relation to their trend in years prior to 2001. This was consistent with weaker goods exports and fewer foreign visitors, and also with lower investment flows abroad.

In the first three months of the year, the substantial deceleration characterising real goods imports since mid-2001 became steeper; they declined by 2.1% year-on-year, affected by the progressive slowdown in final demand. The Customs data for May showed a fall of 2.7%, following the small 1.7% increase in April, although this rate is also positively influenced by the Easter holiday period effect. In the first five months of the year as a whole, imports were 0.8% down. Capital goods imports declined significantly (9.7%), in keeping with the ongoing fall in private productive investment. Consumer goods purchases eased off considerably in this period (0.5%), due partly to the adverse behaviour of motor vehicle purchases and to the slowdown in other durables. Imports of non-energy intermediate goods grew at a very moderate rate of 0.6%, retaining the slackness of the previous year. Conversely, purchases of energy products were considerably robust (8.2%), driven by oil prices which, although they increased in this period, were at lower levels than in the first half of 2001.

Lastly, real services imports, though they rebounded slightly in Q1 growing at a rate of 3.4% in relation to the same period a year earlier, have retained the moderate pace of the previous year. That is in step with the slowdown in goods imports and the fall in foreign investment. Non-tourist services grew by only 2.5% in this period, in contrast to the notable buoyancy seen in the first half of 2001. Tourist payments slowed during the period, although they continued growing at a high rate (7.3% according to QNA figures). The balance of payments figures, however, show a sharper slowdown that is more in keeping with the prevailing low consumer confidence levels.

4.2. Output and employment

As can be seen in Chart 18, value added in the market economy is estimated to have increased in 2002 Q2 at a similar year-on-year rate to that at end-2001, in which period it slowed sharply. The primary branches of activity started the year on the contractionary footing they had shown in 2001. The contraction was, however, less intense than in the closing months of the previous year, and in line with the more favourable setting in which activity in this branch is unfolding during the current year. Indeed, the first four months of 2002 have been marked, on the whole, by rainfall which, though not notable in terms of abundance, has been timely in terms of its distribution over time and territory. Consequently, very sizeable crops of certain important products such as cereals and legumes are expected, with slightly more moderate yields for fruit. Nonetheless, this optimism has been qualified somewhat by the deterioration in the weather in May (scant rainfall, with frost and hail in certain areas). But in any event, the outlook remains favourable for the sector.

After ending 2001 on a clearly contractionary note, industrial activity posted zero growth in 2002 Q1 on a year earlier, encouraged perhaps by the muted signs of recovery in the international economic setting. The deterioration in the production of private transport equipment became more acute in this period, as did that of footwear, clothing and textiles. However, the manufacture of household durables quickened. In any event, the information available for 2002 Q2 does not fully offer a clear profile of recovery in industrial activity: despite the positive trend of the business climate indicator, the pick-up in orders and the decline in unwanted stocks, the essential indicator in this connection, the industrial production index, fell back in May and checked the recovery heralded by the April figure. Further, in Q2 the consequences of the strike on 20 June on the growth of industrial output will become manifest.

In keeping with the resilience of investment in construction, activity in this branch was, as has been the case since mid-1998, the most buoyant in 2002 Q1. An ongoing though slight loss of momentum is, however, also observable. On QNA estimates, the year-on-year growth of GVA in the opening months of 2002 was 4.6%, four-tenths of a point less than the previous quarter. As earlier discussed in connection with investment in construction, activity in this branch in Q2 would have remained most buoyant while at the same time holding on a slowly decelerating path.

The slowing profile marking tertiary activities in 2001 Q4 continued into the opening months of 2002, and GVA grew at a year-on-year rate of 2.6%, four-tenths of a point less than in the three previous months. The loss of momentum in growth was greater in non-market services, whose rate of increase fell by one percentage point. Market services also slowed, albeit to a lesser extent than the previous quarter, influenced by the weakening of private consumption and sluggishness in industry. The latest indicators point to the continuation of these lower growth rates in Q2. In fact, even though surveys are showing increasingly positive results, Social Security registrations decelerated further between April and May, and analysis of the branches making up the sector shows a loss of steam in many of them. The distribution trade, burdened by the fall in vehicle sales, evidenced low confidence levels to May, and employment, proxied by Social Security registrations, slowed in April despite the acceleration in retail sales that month. The situation was worse in the hotel and catering trade, as illustrated by the rapid loss of momentum in employment creation, which may be associated with the fall in tourism. In the transport and communications industry, and despite the greater robustness of land and maritime transport, the weakness of air transport has intensified and postal and communications services have faltered. As regards financial intermediation, the data on Social Security registrations denote a pattern in step with the general economic circumstances, their rate of increase having dipped slightly. Finally, the real estate, rentals and business services branches are the only ones where growth has been sustained to some extent, according to Social Security registrations, despite the slump in what was until recently an extremely dynamic sector, namely IT and R+D.

CHART 18

Gross value added and employment by branch of activity
Percentage change on year ago (a)

Sources: INE and Banco de España.
(a) Seasonally adjusted series. Employment in terms of full-time equivalent jobs.

On QNA figures, employment (2) rose by 1.4% in 2002 Q1 on the same period a year earlier, two-tenths of a point down on the increase in the closing period of 2001 (see Chart 18). The slowdown in employment was on a similar scale to that of GDP in this period, whereby the increase in apparent labour productivity held stable. Nonetheless, the rate of increase of GVA in the market economy branches rose somewhat, prompting a modest pick-up in productivity to 0.8%, since the growth rate of employment eased slightly to 1.2%.

The short-term economic indicators also displayed the lesser momentum of employment creation in the first half of 2002. In the case of the EPA (Labour Force Survey) (3), estimates of numbers employed in the economy revealed an increase of 2.2% year-on-year in Q1, compared with 3.1% at end-2001. This was a similar slowdown to that captured by QNA figures, once the EPA data are seasonally adjusted. Social Security registrations grew by 3% in Q1 as a whole, three-tenths of a point less than in the previous period (a similar reduction to that in the seasonally adjusted series). In Q2, there has been a sustained increase in registrations of around 3%, although business forecasts for the non-farm market economy were somewhat gloomier according to the latest figures released by labour market surveys. Overall, a rate of increase in productivity close to that observed the previous quarter may be estimated, albeit with notable variations from branch to branch

In 2002 Q1, increases in employment were recorded only in construction and services, while jobs were destroyed in agriculture and in industry, the sole branches where a pick-up in apparent labour productivity was noted. In year-on-year terms, construction stood out for the high use of the labour factor, since employment climbed 5% in Q1 (4.9% in the previous quarter) according to QNA figures. The creation of new jobs in the tertiary sector advanced at a rate of 2.3% in early 2002, slightly up on the end-2001 figure of 2.1%. This profile reflects the behaviour of employment across the market economy branches; extending the upward path initiated in spring 2001, its rate of increase climbed seven-tenths of a point to 2.5% year-on-year. In non-market activities, the process of job-creation continued to weaken (growing by 1.9% against 2.7% the previous period). As regards agriculture, job destruction became more acute with a year-on-year decline of 4.6% (three points up on that recorded at the end of the previous year). In industry (including energy), numbers employed fell between January and March by 1.7% in relation to the same period in 2001, compared with a fall of 0.7% in the preceding quarter. The latest economic information on registrations in April and May points to a slight moderation in job destruction in industry and in the rate of increase of market services employment, while job creation in construction remains notably buoyant.

In respect of the distinction between dependent employment and self-employment, there was a change in trend in the latter in 2002 Q1; after having increased significantly in 2001 (2.8%), it fell by 0.5% year-on-year, growing solely and notably in construction. Conversely, the rate of increase of dependent employees held stable at 1.7%, underpinned by the significant acceleration in market services, which – drawing on QNA figures – countered the lesser increase (or decline) in the other branches. According to the EPA, the increase in the number of dependent employees (based on the original series) fell by 0.6 percentage points owing to the diminished vigour of temporary employment, the growth rate of which dipped from 3.1% at end-2001 to 1.3%, while the growth of permanent employees held at a sustained pace (3.4%). As a result, the proportion of temporary to permanent employees fell by almost half a percentage point in relation to 2001 Q1 to 31.2%. The information on employment contracts suggests that the greater weight of permanent hiring during the quarter resided largely on the conversion of temporary contracts. This followed the reintroduction in March 2001 of rebates for, and greater scope for resorting to, employment-promoting contracts. Between April and June, however, the statistics displayed less momentum in stable hiring. Lastly, part-time employment slowed to a greater extent than full-time work, according to the EPA. Nonetheless, given that the former continues to post high growth rates (5.2% year-on-year), the part-time/full-time ratio increased slightly to 8.3% in Q1.

From the standpoint of labour supply, there was a significant increase in EPA-based unemployment (4) in 2002 Q1 (8.6% year-on-year), and a rise in the labour force (2.9% year-on-year), giving rise to an increase of one percentage point in the participation rate compared with early 2001, said rate standing at 53.5%. The unemployment rate edged up to 11.5% in

(2) Measured in terms of full-time equivalent jobs.

(3) In accordance with the new 2002 methodology.

(4) With the release of the data for 2000 Q1, INE has introduced some important methodological changes into the EPA. These are detailed in an article in Spanish in the April 2002 edition of the *Boletín económico* entitled “Cambios metodológicos de la EPA en 2002”.

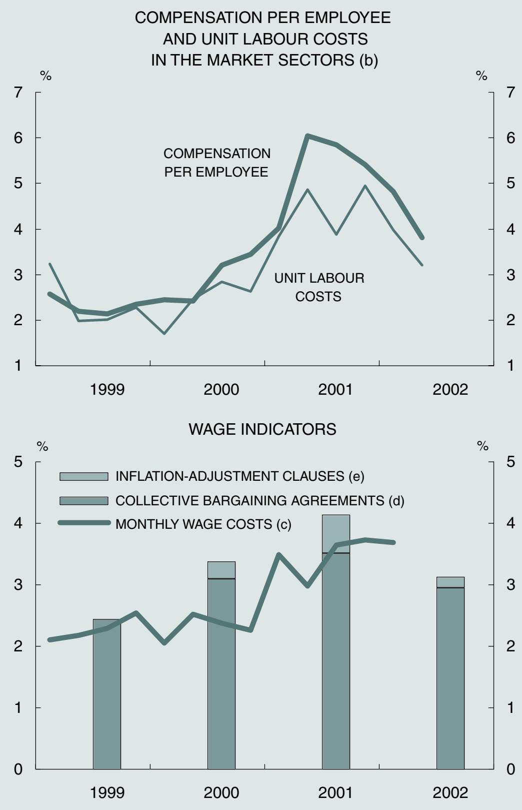
2002 Q1, against 10.9% in the same period a year earlier. Both the male and female unemployment rates rebounded significantly, up to 8.2% in the former case and 16.5% in the latter. By age group the increase in unemployment was across the board, albeit somewhat bigger for the over-45s, whose joblessness rate moved up to 7.3%, and for the under-30s (up to 17.9%). The incentives in place for hiring the long-term unemployed continued to have a significant impact in reducing this phenomenon: the associated rate fell by four points over the past 12 months to 38.1% of the total numbers of unemployed. Registered unemployment, for its part, grew by 3.5% in Q1, and by 7.1% in Q2, prolonging the rising path embarked upon in late 2001.

4.3. Costs and prices

The QNA figures for 2002 Q1 placed the increase in compensation per employee for the whole economy at 4.2% year-on-year, against 4.8% at end-2001, following a notable acceleration throughout the year. The slowdown in compensation at the beginning of 2002, against a background of stable growth in apparent labour productivity, gave rise to a deceleration in unit labour costs to 3.5%, nine-tenths of a point less than the previous quarter. In the market economy, the slowdown in employee compensation was on a similar scale to that of the whole economy (from 5.4% in 2001 Q4 to 4.8% at the onset of 2002), although in this case the less stable profile of productivity intensified the slowdown in unit labour costs, which grew by 4% against 4.9% the previous quarter (see Chart 19). It is estimated that the slowdown in both compensation and in unit labour costs will have run into Q2.

CHART 19

Wages and labour costs (a)



Sources: INE and Ministerio de Trabajo y Asuntos Sociales.
(a) Percentage change on same quarter a year earlier.
(b) Rates based on QNA seasonally adjusted series.
(c) Total earnings.
(d) Wage increase for the current year, up to reference month.
(e) Previous year's clauses.

According to the information provided by the Spanish Ministry of Labour and Social Affairs on collective bargaining in the opening months of 2002, collective agreements affecting approximately 5.5 million workers, just over half the total employees covered by collective bargaining the previous year, were registered to 30 June. Wage settlements for 2002 under these agreements stand at 2.95%, against 3.5% in 2001 (see Chart 19), marking a note of restraint in negotiated wage increases. Most of the agreements registered to that date are revisions of agreements entered into in previous years, and include a wage rise of 2.8%. Wage settlements in newly signed agreements stand at 5.1%. However, this figure is rather unrepresentative, since it affects about 400,000 workers only. The new agreements are expected to be more in line with the content of the Employer/Union Pact (Acuerdo Interconfederal) signed in December, under which the social partners have undertaken to use the official inflation forecast (2%) as a basic bargaining reference.

The growth of the index of total labour costs per employee in 2002 Q1 was 4% on the same period a year earlier, signifying a deceleration of three-tenths of a point in relation to 2001 Q4. Within this index, the increase in wage costs held for the third quarter running at 3.7%, while non-wage costs, which account for around 25% of total labour costs for corporations, grew by 5% in 2002 Q1, having slowed by 1.5 percentage points compared with the previous quarter. Across the various branches, total costs per employee grew by 3.7% in industry (4.3% in 2001 Q4), while the related increases in construction and services were 4.6% and 4.4%, respectively (compared with increases of 4.7% and 4.5% in 2001 Q4).

Set against the slowdown in labour costs, and on QNA estimates, the gross value added

CHART 20

Prices and costs by branch of activity (a)

Source: INE.

(a) Non-centred annual percentage changes based on the QNA seasonally adjusted series.

deflator in the market economy grew by 3.9% in 2002 Q1, three-tenths of a point up on the previous quarter. As a result, the surplus per unit of value added picked up notably, and it is estimated this trend may have intensified in Q2. As Chart 20 shows, unit labour costs in industry and energy have been growing, in an oscillating fashion, around the value-added deflator, after a period of heavy squeezes on margins which concluded in mid-2001. The competitive conditions under which activity in this branch unfolds constrain the growth of the attendant prices. Consequently, the recovery in margins, against a background of expanding compensation, tends to come about via the productivity gains achieved by means of the contraction of employment. That has been the pattern in 2002 Q1. In market services, QNA figures have shown a notable slowdown in the value-added deflator as from 2001 Q4, which would have given rise to a contraction of margins. However, the rise in final prices of services in the first half of 2002 means this behaviour cannot be extrapolated to the coming quarters. Finally, in construction, unit labour costs have been growing below the deflator, making for a widening of margins, which is consistent with the strong demand pressure present in this branch.

In line with the gross value added deflator in the market economy, the GDP deflator for the whole economy accelerated in 2002 Q1. It posted growth of 3.5%, two-tenths of a point up on the previous quarter. The performance of the domestic component of prices was accompanied by a slight year-on-year increase of 0.5% in the deflator of goods and services imports, compared with the 2.5% reduction in external prices at end-2001. Consequently, the final demand deflator increased by 2.8% year-on-year in Q1, one percentage point up on the previous period. The indicators of final prices in the economy, and in particular the consumer price index (CPI), have captured this increase in inflation at the beginning of the year, and which has run into Q2. Specifically, the CPI rose by 3.5% over the course of Q2 in relation to the same period a year earlier, four-tenths of a point up on the previous quarter. Meantime, underlying inflation, measured by the IPSEBENE (index of prices of services and non-energy manufactured goods), climbed by 4% in relation to 2001 Q2. In June, the 12-month rate of the CPI was 3.4% and that of the IPSEBENE 4.1% (see Chart 21).

The main components of the CPI contributed to its acceleration in Q2, albeit to differing degrees. On one hand, services prices increased by 4.7% over the quarter as a whole, three-tenths of a point more than in the previous period. Services prices relating to tourism and leisure, and to the hotel and catering trade, remained on a rising course. On the other, non-energy industrial goods, whose 12-month rate of change had declined sharply in March, resumed in April the rates attained in previous months and increased by 2.8% in Q2. The greater volatility in this component is closely linked to the methodological changes introduced into the CPI at the start of the current year and, in particular, to the inclusion of sales prices in calculating the index. These have particularly affected those items where sales are most influential: clothing, footwear and household textile goods. Other items of this component have performed very moderately, with the downward trajectory of prices of video, sound and photographic equipment and computers a case in point.

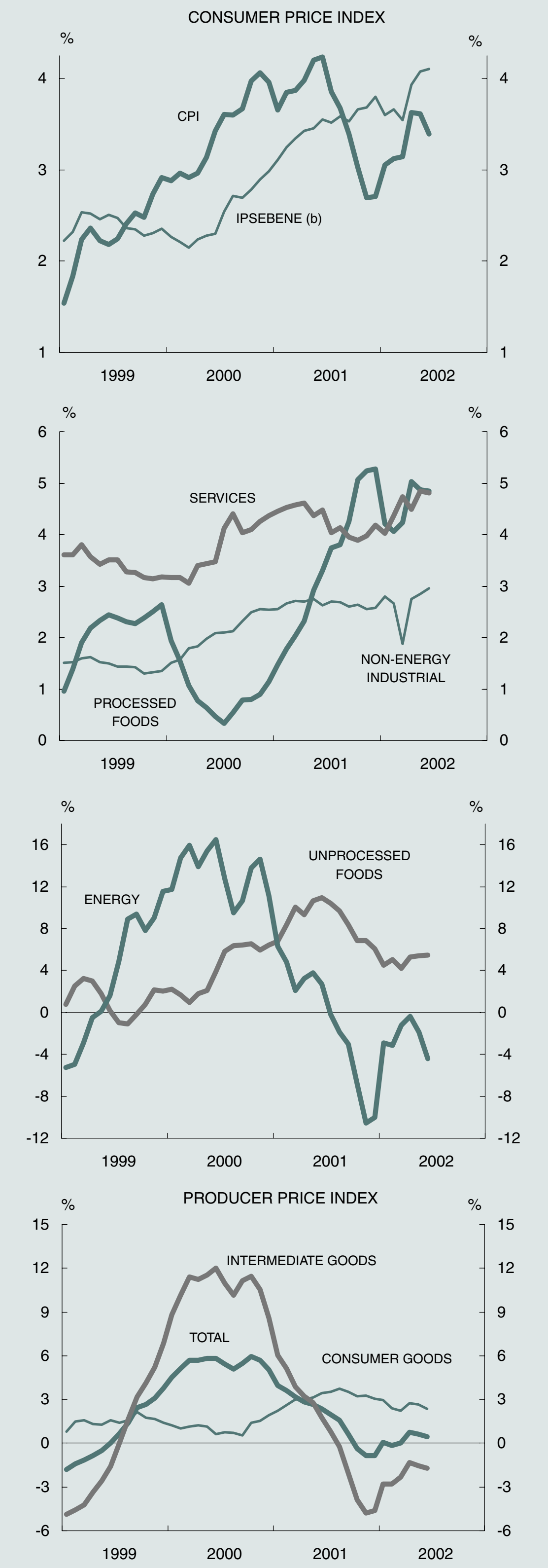
The CPI component of energy prices continued to post negative 12-month growth rates during Q2, close to those of Q1. Butane gas prices fell in April, although the increase in fuel and heating fuel prices intensified that same month, holding fairly stable subsequently until the last week of May, when they began to fall. This trajectory is in step with international crude oil prices and with the appreciation of the euro against the dollar in the past two months. The prices of both processed and unprocessed food quickened significantly from Q1 to Q2. Notable under the former is the substantial increase in tobacco prices in April, along with the continuing high growth rates of edible oil prices. Prominent under unprocessed food is the heavy increase in the price of poultry and of crustaceans and molluscs; moreover, fresh fruit and vegetable prices continue to post high rates of change.

The acceleration in consumer prices in Spain in Q2 is also reflected in the harmonised index of consumer prices (HICP), and is in contrast to the slowdown in the euro area as a whole in this period. As a result, the inflation gap with the euro area has widened to 1.6 percentage points in June. The widening of the differential has been of greater intensity in the case of goods rather than services, whereby it is now the same for both. Under goods, there has been a sizable increase in the inflation differential for food which, having been favourable to Spain in Q1 as a whole, has changed sign in recent months and now exceeds the euro area figure by two percentage points (see Chart 22).

The 12-month growth rate of the producer price index also increased in 2002 Q2 to 0.6%, having held stable in the previous quarter. However, the biggest rise in these prices came about in April, and they moderated slightly thereafter (see Chart 21). Component by com-

CHART 21

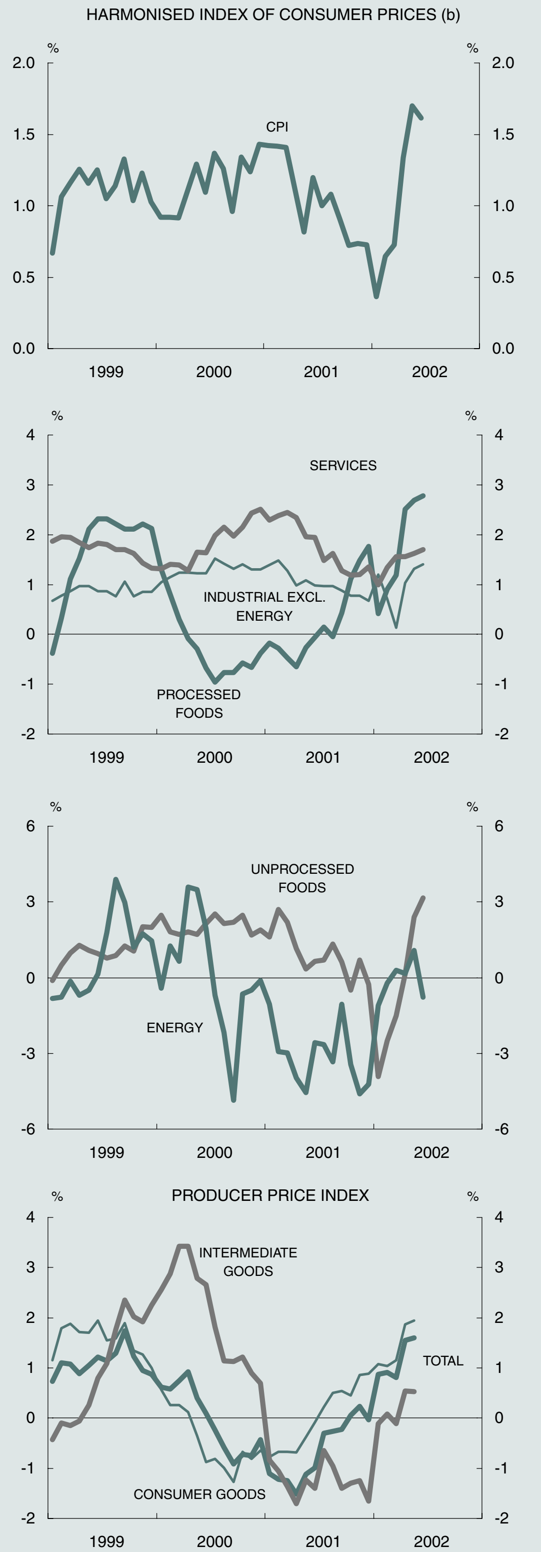
Price indicators (a)
Spain



Source: INE.
(a) Twelve-month percentage change based on the original series.
(b) Index of services and non-energy manufactured goods prices.

CHART 22

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



Sources: Eurostat and Banco de España.
(a) Twelve-month percentage change based on the original series.
(b) To December 2001, the series are those published at that date.

ponent, the year-on-year rate of consumer goods, which peaked at 2.8% in April, has declined to 2.4% in June. Following a similar pattern, investment good prices stood at 1.5% in June compared with 12 months earlier. Finally, the heavy cut in energy producer prices in June offset the smaller decline in non-energy intermediate goods.

4.4. The State Budget

The National Accounts figures on the State budget outturn to June 2002 show a notable reduction in the State deficit compared with the same period a year earlier. However, it should be borne in mind that revenue and expenditure in 2002 reflect (in both National Accounts and cash-basis terms) the new financing arrangements for the Autonomous (Regional) Communities. While these changes should not in principle affect the balance on public finances for the year as a whole, as the arrangements are freshly in place it is not possible to evaluate to what extent the reduction in the deficit in the first half of the year might be reflecting changes in the seasonality of the figures. Moreover, the deadline in 2002 for submitting positive (payable) personal income tax returns was put back to 1st July, whereas in 2001 the closing date was in June, a fact that has influenced revenue and, therefore, the deficit.

The National Accounts data available show net borrowing totalling €2.46 billion (0.4% of GDP) to June 2002 for the State, compared with the deficit of €3.88 billion (0.6% of GDP) built up in the same period of 2001. Both revenue and expenditure fell notably in relation to the same period the previous year as a result of the changes mentioned in the foregoing paragraph. Among the captions not affected by these changes are, under other current revenue, the charge levied for use of the radioelectric spectrum (not applied the previous year) and the strong increase in capital transfers received (mostly from the European Union). Under expenses, those relating to wages and salaries, and goods and services have been contained somewhat, with growth less than that of nominal GDP.

In cash-basis terms, the State budget outturn to June 2002 (the Social Security budget outturn is discussed in Box 3) resulted in a deficit of €8.48 billion, slightly higher than the deficit of €8.02 billion in the same period of 2001. It is estimated that most of the discrepancy with National Accounts figures is due to other accounts receivable and to the difference between interest paid and accrued. Although both revenue and expenditure posted falls to June, that

BOX 3

Social Security budget outturn

The Social Security System posted a surplus of €5.1 billion in the period to April 2002, €1.26 billion (19.8%) down on that recorded in the same period the previous year (see accompanying table). As in the case of the State Budget, these figures are affected by the new regional financing arrangements, which entail a reduction in both receipts (owing to the transfers INSALUD – the Spanish national health service – receives from the State) and expenditure (owing to the transfers to finance the health-care and social services assumed). In the first four months of 2002, these reductions proved much higher than those envisaged in the Budget.

Receipts from social security contributions increased by 5.5% to April, a considerable slowdown in relation to 2001 and far lower than the budgeted figure of 8.4%. This deceleration is partly due to the lower growth in the number of Social Security registrations, which was 3% to June (3.9% in 2001 as a whole). The other main source of receipts, namely current transfers, virtually all of which are from the State, fell by 73.5% to April (more sharply than budgeted) as a result of the new regional government financing arrangements.

Expenditure on contributory pensions rose by 5.4% to April, somewhat below the figure budgeted for the year as a whole. The number of contributory pensions continues to trend very moderately. Their growth rate in the period to June was 0.8%, in line with forecasts and slightly below the growth recorded in 2001.

With regard to INEM (National Employment Office) expenditure, that on unemployment benefits increased by 15.9% to June 2002. Behind this increase were the increase in registered unemployment (6.9% to June, against 0.1% in 2001 as a whole) and the rise in the eligibility ratio, which stood at 72.4% in May against 68.5% at end-2001. As a result, the number of beneficiaries grew by 13.3% to May, compared with 5.9% average growth in 2001.

Contributions received by INEM climbed by 6.2% to March, against a budgeted projection of 9.4%, while employment-promoting concessions on employers' contributions were up 0.2% in Q1, below the budgeted increase of 5.6%.

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

€ millions and %

	Budget			Outturn JAN-APR		
	2001 (c)	2002	% change	2001	2002	% change
	1	2	3=2/1	4	5	6=5/4
1. Revenue	**94,576**	**83,282**	**-11.9**	**34,825**	**26,555**	**-23.7**
Social security contributions (d)	62,618	67,852	8.4	21,783	22,987	5.5
Current transfers	30,796	14,389	-53.3	12,620	3,350	-73.5
Other (e)	1,162	1,042	-10.4	422	219	-48.2
2. Expenditure	**92,267**	**79,411**	**-13.9**	**28,467**	**21,455**	**-24.6**
Wages and salaries	14,355	6,683	-53.4	5,138	1,573	-69.4
Goods and services	8,967	4,214	-53.0	3,038	742	-75.6
Current transfers	67,514	67,615	0.1	19,978	19,065	-4.6
Benefits	67,063	67,615	0.8	19,949	19,065	-4.4
Contributory pensions	*53,047*	*56,231*	*6.0*	*15,036*	*15,841*	*5.4*
Sickness	*3,557*	*4,027*	*13.2*	*1,156*	*1,195*	*3.4*
Other	*10,459*	*7,358*	*-29.6*	*3,757*	*2,028*	*-46.0*
Other current transfers	451	0	-100.0	30	0	-98.7
Other (f)	1,432	899	-37.2	312	74	-76.3
3. Balance	**2,309**	**3,871**	**67.7**	**6,358**	**5,101**	**-19.8**

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

(a) Only data relating to the System, not to the entire Social Security Funds sector, are given. This is because the figures for Other Social Security Funds are only available for 2002.

(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 2001 Budget as its basis for comparison, since the full outturn for that year is not yet available.

(d) Including surcharges and fines.

(e) Excluding surcharges and fines.

(f) Reduced by the disposal of investments.

TABLE 3

State Budget outturn

€ millions and %

	Outturn	Percentage change	Budget	Percentage change	Outturn		
	2001	2001/2000	2002	2002/2001	2001 JAN-JUN	2002 JAN-JUN	Percentage change
	1	2	3	4=3/1	5	6	7=6/5
1. Revenue	**125,187**	**5.5**	**110,620**	**-11.6**	**31,005**	**27,948**	**-9.9**
Direct taxes	55,697	8.3	52,084	-6.5	11,375	10,327	-9.2
Personal income tax	*36,469*	*13.4*	*30,967*	*-15.1*	*10,619*	*9,326*	*-12.2*
Corporate income tax	*17,217*	*0.1*	*18,982*	*10.3*	*528*	*601*	*13.8*
Other (a)	*2,012*	*-3.0*	*2,134*	*6.1*	*228*	*400*	*75.8*
Indirect taxes	53,157	3.7	45,489	-14.4	15,919	13,751	-13.6
VAT	*34,674*	*3.8*	*30,266*	*-12.7*	*11,590*	*10,600*	*-8.5*
Excise duties	*16,612*	*3.5*	*13,170*	*-20.7*	*3,880*	*2,681*	*-30.9*
Other (b)	*1,871*	*2.5*	*2,052*	*9.7*	*449*	*470*	*4.9*
Other net revenue	16,333	2.1	13,047	-20.1	3,711	3,870	4.3
2. Expenditure (c)	**128,072**	**5.7**	**114,294**	**-10.8**	**36,579**	**30,794**	**-15.8**
Wages and salaries	16,827	3.5	17,525	4.1	3,873	3,843	-0.8
Goods and services	2,554	7.7	2,320	-9.2	697	565	-19.0
Interest payments	18,264	3.1	17,736	-2.9	8,986	7,465	-16.9
Current transfers	77,151	5.9	62,890	-18.5	18,930	15,373	-18.8
Investment	6,461	7.1	6,978	8.0	2,322	2,095	-9.8
Capital transfers	6,815	15.2	6,845	0.4	1,770	1,452	-17.9
3. Cash-basis balance (3=1-2)	**-2,884**	**18.7**	**-3,675**	**27.4**	**-5,573**	**-2,846**	**-48.9**
MEMORANDUM ITEM: NATIONAL ACCOUNTS (d):							
Revenue	126,338	5.9	—	—	31,007	28,476	-8.2
Expenditure	129,380	5.0	—	—	30,375	24,810	-18.3
Net lending (+) or borrowing (-)	**-3,042**	**-22.3**	**-3,525**	**15.9**	**632**	**3,666**	—

Source: Ministerio de Hacienda.
(a) Includes the revenue from the tax on the income for non-residents.
(b) Includes taxes on insurance premiums and tariffs.
(c) Includes unclassified expenditure.
(d) The figure for the forecast for 2002 (column 3) is from the Spanish Finance Ministry's reply to the Excessive Deficit Protocol.

of revenue has proven greater, unlike in Q1. Revenue thus recorded a rate of –16.7% (compared with –9.9% in Q1), while that of expenditure was –14% (against –15.8%).

For the analysis of revenue, homogenous data including the full takings from the main taxes are available, for both the portion assigned to the State and that relating to other government tiers (which are not included in Table 3). In homogenous terms, direct taxes slowed appreciably in Q2, reflecting the path followed by most of its components. Personal income tax declined by 5.8% to June, in contrast to its growth of 4.2% in Q1. This slowdown is mainly due to the calendar change for the submission of returns for tax payable, which was extended to 1st July, whereby a notable fall has been seen in net tax payable. Conversely, revenue relating to withholdings on salaried income and on income from movable capital has quickened in relation to Q1. This calendar effect has also borne on property tax, albeit to a much lesser extent. As to corporate income tax, there has been a notable slowdown following the first payment on account from 13.8% to 6.8% at end-

June. The growth rate of indirect taxes was virtually unchanged in Q2, posting a rate of 7.8% to June (7.6% to March). VAT quickened during Q2 to a rate of 9.5% in homogenous terms, compared with 8.7% in Q1, offsetting a slight deceleration in excise duties which, in homogenous terms, increased by 4.2% against 4.8% in the period to March.

On the expenditure side, the fall in current transfers was slightly greater than forecast in the Budget for 2002 as a whole (reflecting the aforementioned change in regional government financing), this being the only caption which slowed in relation to Q1. There was a notable containment in operating expenses (wages and salaries, and goods and services), which are not affected by the new regional financing system and which continued to run at a lower rate of change than that of nominal GDP. Expenditure relating to interest payments diminished substantially, albeit due to the government debt maturity calendar; it may therefore be expected to continue quickening in the coming quarters. There were also falls in capital expenses (in both investment and transfers). Nonetheless, these may be expected to pick up over the course of 2002, especially in the case of real investment, in line with the Budget and with the guidelines laid down in the Stability Programme.

4.5. The balance of payments

In the period January-April 2002, the joint balance on current and capital account resulted in a deficit of €2.67 billion, compared with the likewise negative balance of €607 million in the same period the previous year. This deterioration is essentially due to the unfavourable performance of the main components of the current-account balance, with the exception of the merchandise balance. The surplus on capital account also diminished slightly.

In the first four months of the year, the trade balance deficit narrowed by €827 million (8.6%) in relation to the same period in 2001. This reduction of the trade imbalance was due to the smaller increase in the deficit in real terms (as analysed in a previous section) and to the fresh improvement during the period in the terms of trade, arising fundamentally from the reduction in the prices of imported energy products.

Turning to services, the cumulative positive balance in the January-April period stood at €5.89 billion, compared with €6.41 billion in the same period in 2001. This deterioration made for a year-on-year fall of 8.1%, which is due to the decline in the surplus on tourism and travel (8.2%), since the deficit on other services diminished by 8.8%. The slowdown in tourist flows intensified in this period, especially receipts, which fell by 6.1% year-on-year, in line with the sluggishness of foreign tourist arrivals. The increase in payments was checked (2.1%) in the first four months, in step with the weakening of consumer confidence and the substitution of domestic for foreign tourism, against a background of international instability.

In the January-April period, the deterioration in the balance of income became notably sharper. Its deficit stood at €4.23 billion, €1.35 billion above the level recorded in the same period the previous year. Receipts dropped by 20.8%, affected by the decline in investment

TABLE 4

Balance of payments: summary table (a)

€ m

	JAN-APR	
	2001	2002
	Receipts	Receipts
Current account	**18,524**	**18,827**
Goods	10,193	10,337
Services	4,604	4,353
Tourism	*2,367*	*2,094*
Other services	*2,237*	*2,259*
Income	2,083	1,958
Current transfers	1,643	2,180
Capital account	**507**	**1,644**
	Payments	Payments
Current account	**19,807**	**20,208**
Goods	12,435	12,675
Services	2,994	3,365
Tourism	*528*	*553*
Other services	*2,466*	*2,812*
Income	3,152	3,198
Current transfers	1,227	969
Capital account	**105**	**89**
	Balance	Balance
Current account	**-1,283**	**-1,381**
Goods	-2,242	-2,338
Services	1,610	988
Tourism	*1,839*	*1,541*
Other services	*-229*	*-553*
Income	-1,068	-1,241
Current transfers	417	1,211
Capital account	**403**	**1,555**

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

flows abroad in train since last year, which is associated with the sluggishness of global activity, with heightening uncertainty on financial markets and with the social and political crises besetting certain Latin American countries. Payments also fell in this period, albeit at a lesser rate of 2.8%. They were likewise influenced by the weakness in 2001 of foreign investment in Spain, although these flows have increased this year, especially non-resident investment in fixed-income securities and short-term deposit placements.

The surplus on the balance of current transfers stood at €1.8 billion in the January-April period, entailing a decline of €821 million compared with the related period in 2001. Receipts fell back by 10.8%, the result of the decline in flows from the EU in respect both of EAGGF-Guarantee funds and, to a greater extent, of the European Social Fund, which last year included sizable advances. Payments advanced moderately by 2.4%, although emigrants' remittances once again climbed substantially.

Finally, the capital-account surplus stood at €2.65 billion in the January-April period, €198 million down on the same period in 2001. This year-on-year decline of 7% is due to the reduction in structural funds from the EU earmarked for EAGGF-Guidance funds and the Regional Development Fund, which were also affected by the advances made last year on account of the new programme for the period 2000-2006. Meantime, EU funds for the Cohesion Fund increased notably.

5. Financial flows in the Spanish economy

5.1. Financial flows in the economy as a whole

In 2002 Q1, economic agents' financial decisions were taken against the backdrop of a faltering business cycle and heightened uncertainty over the course the recovery in the international economy would take and over economic and political developments in certain Latin American countries. This picture, coupled with the emergence of fresh instances of accounting irregularities in US corporations, has made for very high volatility on the main stock market indices, which have slumped by over 20% in the year to date.

However, this highly uncertain economic and financial setting did not provide for a recovery in private-sector financial saving in Q1 according to the latest information available from the quarterly financial accounts. Hence households, despite the slowdown in consumption and employment, continued to raise a high volume of funds through credit. Indeed, the debt ratios for both households and firms continued to rise. Provisional information for Q2 points to a mild moderation in the growth rate of financing which, nonetheless, is holding at a level comparable with that at end-2001. In particular, financing extended to the private non-financial sector by resident credit institutions grew by 13.3% in Q2 in relation to the same period a year earlier, against 13.4% at end-2001.

During 2002 Q1, the debit balance of the net financial transactions of the nation was slightly lower at 1.8% of GDP in cumulative four-quarter terms (5) (see Table 5). This slight reduction in foreign capital inflows was the outcome of different behaviour by the various resident sectors. The general government sector was the only non-financial sector to post positive financial saving (0.5% of GDP). In the case of corporations, the value of their net financial transactions was similar to that of the same quarter a year earlier. Therefore, non-financial corporations continued receiving net resources from other sectors for a high amount, totalling 4.4% of GDP. Finally, the financial transactions of households showed a debit balance in Q1, whereby their net financial saving fell to a similar value to that in 2000 (0.9% of GDP in cumulative four-quarter terms).

The information on inter-sectoral flows in the bottom half of Table 5 shows that both households and non-financial corporations saw an increase in net resources received from resident

(5) Throughout this chapter, in keeping with the information in the tables and charts, the figures refer to cumulative four-quarter data, unless otherwise stated.

TABLE 5

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

% of GDP

	1997	1998	1999	2000	2001 Q1	2001 Q2	2001 Q3	2001 Q4	2002 Q1
	NET FINANCIAL TRANSACTIONS								
Total economy	**1.6**	**0.5**	**-1.1**	**-2.5**	**-2.3**	**-2.2**	**-2.0**	**-1.9**	**-1.8**
Non-financial corporations and households and NPISHs	**4.0**	**2.1**	**-0.5**	**-2.8**	**-3.1**	**-2.5**	**-2.5**	**-3.1**	**-3.5**
Non-financial corporations	-0.5	-1.2	-2.5	-3.8	-4.9	-5.3	-4.6	-4.4	-4.4
Households and NPISHs	4.5	3.3	2.0	0.9	1.8	2.8	2.1	1.3	0.9
Financial institutions	**0.7**	**1.0**	**0.5**	**0.7**	**0.7**	**0.8**	**0.8**	**1.2**	**1.2**
General government	**-3.2**	**-2.6**	**-1.1**	**-0.3**	**0.0**	**-0.6**	**-0.3**	**0.0**	**0.5**
	INTER-SECTORAL FLOWS (a)								
Households and NPISHs	**4.5**	**3.3**	**2.0**	**0.9**	**1.8**	**2.8**	**2.1**	**1.3**	**0.9**
Vis-à-vis:									
Credit institutions (b)	-6.7	-4.4	0.2	-0.1	-0.2	0.0	-0.5	-1.5	-2.3
Institutional investors (c)	10.8	7.5	0.8	0.4	1.6	2.5	3.1	4.2	3.7
Non-financial corporations	**-0.5**	**-1.2**	**-2.5**	**-3.8**	**-4.9**	**-5.3**	**-4.6**	**-4.4**	**-4.4**
Vis-à-vis:									
Credit institutions (b)	-3.2	-4.3	-3.8	-6.7	-5.7	-4.4	-4.3	-3.8	-4.1
Rest of the world	1.7	0.9	-0.8	1.7	1.0	-0.3	-0.1	-1.9	-1.9
General government	**-3.2**	**-2.6**	**-1.1**	**-0.3**	**0.0**	**-0.6**	**-0.3**	**0.0**	**0.5**
Vis-à-vis:									
Credit institutions (b)	1.4	1.4	1.4	2.2	0.5	-0.3	-0.8	-2.5	-0.4
Institutional investors (c)	-3.9	-2.6	1.7	3.9	4.1	3.8	2.9	2.6	1.4
Rest of the world	-2.0	-1.1	-4.4	-6.0	-4.8	-4.5	-3.1	-1.8	-2.1
Rest of the world	**-1.6**	**-0.5**	**1.1**	**2.5**	**2.3**	**2.2**	**2.0**	**1.9**	**1.8**
Vis-à-vis:									
Credit institutions (b)	2.8	7.1	2.0	5.2	5.4	3.3	4.7	3.9	2.7
Institutional investors (c)	-2.5	-6.3	-3.6	-5.7	-5.4	-5.1	-5.0	-4.7	-3.4
Non-financial corporations	-1.7	-0.9	0.8	-1.7	-1.0	0.3	0.1	1.9	1.9
General government	2.0	1.1	4.4	6.0	4.8	4.5	3.1	1.8	2.1

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

credit institutions. Households, moreover, reduced saving intermediated via institutional investors to 3.7% of GDP, although this remains a relatively high volume in relation to the 1999-2001 period. The general government debit balance vis-à-vis the rest of the world continued to rise (up to 2.1% of GDP), while still falling vis-à-vis institutional investors (by 1.4% of GDP). These data show that investors are continuing to restructure their fixed-income portfolios, a process that began with the introduction of the euro. Likewise, the diversification of asset portfolios is also manifest in the high volume of saving that institutional investors have routed abroad, totalling around 5% of GDP in annual average terms since 1998 (see Box 4).

5.2. Financial flows of households

During 2002 Q1, households received net resources from other sectors in the economy for a value of 0.12% of GDP. The incipient recovery in financial saving in this sector seen in the first half of 2001 was thus interrupted, with this variable standing at 0.9% of GDP, a similar val-

BOX 4

Changes in Spanish mutual funds' portfolios since the introduction of the euro

Recent deregulation in the national and international financial sphere, through the liberalisation of capital movements and cross-border financial services, has driven market integration and encouraged greater competition in this sector. Combined with significant advances in information technologies, this has contributed to increasing the range of investment possibilities by means of an intense process of financial innovation.

The introduction of the euro has seen the disappearance of foreign exchange risk in investments by euro area investors in all EMU member countries. In principle, this factor promotes the internationalisation of portfolios, since it lowers transaction costs and eliminates foreign exchange risk hedging costs. But, at the same time, the disappearance of foreign exchange fluctuations entails a reduction in the overall range of investment possibilities, which could lead to less diversification between instruments issued within the euro area and, possibly, to an increase in the demand for instruments denominated in currencies other than the euro.

As an initial step for analysing changes in the composition of mutual funds' aggregate portfolio, it is worth studying the breakdown of the portfolio by instrument, distinguishing between monetary assets, fixed-income assets and equities. The top panel depicts the proportion each instrument accounts for in the composition of the portfolio. This chart shows how investment in monetary assets has gradually lost ground to fixed income and equities. True, the introduction of the euro would not appear to have had a direct influence on the composition of the portfolio in terms of instruments. But the low interest rates accompanying the convergence process and expectations of macroeconomic stability have led agents to reduce the weight that monetary assets formerly had in their portfolios and to seek higher returns on fixed income and equities.

However, where the direct effect exerted by the introduction of the euro on the composition of funds' portfolios can best be seen is in the analysis of investment grouped by currency. In this connection the portfolio for each instrument has been divided into three groups: domestic assets, non-domestic assets issued in euro and other. The chart depicts the composition by currency of investment in each of the three groups of instruments.

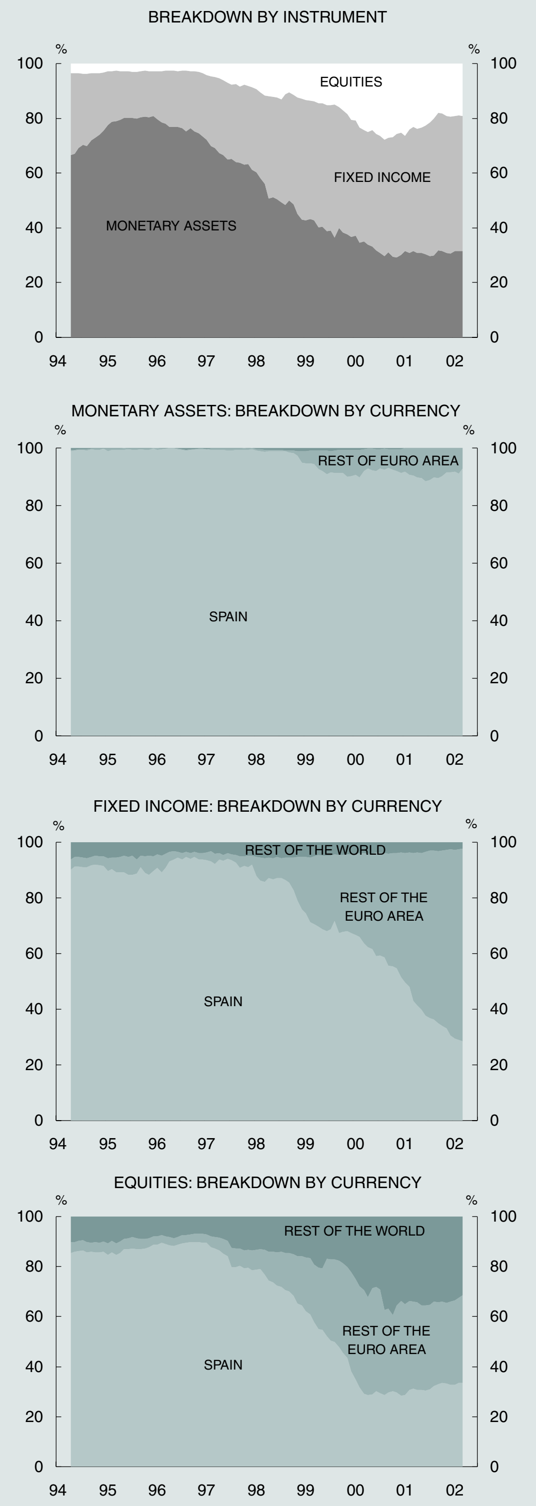
Firstly, in the case of monetary assets, since the introduction of the euro the percentage share of investment in instruments issued in euro has climbed from virtually zero to close to 10%, a figure that has held throughout the period. These monetary assets are essentially repos, which currently account for 70% of the domestic stock of these instruments.

Turning to fixed income, there has been a very marked increase in the share of instruments issued in euro outside Spain. This proportion has not ceased growing since the introduction of the single currency, and at present accounts for 70% of the total fixed-income instruments in funds' portfolios, equally divided between government and private securities.

Investment in equities has also been affected by the introduction of the euro, and there has been a notable reduction in the domestic bias. Investment in equities issued by residents has come to account for only 30% of Spanish mutual funds' total investment in equities, compared with 85% on average in the 1994-1998 period. In this case, much of the investment in equities has shifted to euro countries, although the share of other developed countries – essentially dollar investment – in the equities portfolio has also risen. It appears clear in the first of these shifts that the disappearance of foreign exchange risk has played a key role, as it has enabled fund managers to diversify the equity portfolio without having to bear exchange rate risk or incur the attendant hedging costs.

The conclusion may thus be drawn that the introduction of the single currency appears to have contributed, amid the globalisation of financial activity, to the diversification of Spanish mutual funds' portfolios. In turn, that has made for a reduction in the domestic bias of investment in both fixed income and equities.

Portfolios: percentage structure



Source: CNMV.

TABLE 6

Financial assets and liabilities of households, NPISHs and non-financial corporations (Cumulative data for the last four quarters)

% of GDP

	1998	1999	2000	2001		2002
				Q3	Q4	Q1
HOUSEHOLDS AND NPISHs:						
Financial transactions (assets)	**9.8**	**9.6**	**8.9**	**9.0**	**7.8**	**8.0**
Cash and cash equivalents	3.2	4.5	1.0	0.8	1.2	2.1
Other deposits and fixed-income securities (a)	-1.8	2.5	6.4	4.7	3.0	2.4
Shares and other equity (b)	0.0	0.1	0.5	0.3	-0.5	-0.3
Mutual funds	5.0	-2.2	-3.4	0.2	0.8	0.4
FIAMM	*-1.1*	*-1.4*	*-1.4*	*0.7*	*1.3*	*1.4*
FIM	*6.1*	*-0.8*	*-2.0*	*-0.5*	*-0.5*	*-0.9*
Insurance technical reserves	2.4	3.3	3.4	2.6	2.8	2.6
Of which:						
Life assurance	*1.2*	*2.0*	*2.0*	*1.0*	*1.7*	*1.7*
Pension funds	*1.0*	*1.0*	*1.1*	*1.3*	*0.8*	*0.6*
Other	0.8	1.2	1.0	0.4	0.4	0.7
Financial transactions (liabilities)	**6.5**	**7.6**	**8.0**	**6.9**	**6.5**	**7.1**
Credit from resident credit institutions	5.9	6.5	6.8	5.8	5.1	5.8
Securitisation funds	0.5	0.6	0.1	0.2	0.3	0.2
Other	0.1	0.5	1.0	0.9	1.1	1.1
NON-FINANCIAL CORPORATIONS:						
Financial transactions (assets)	**14.0**	**17.8**	**27.6**	**19.3**	**17.6**	**17.9**
Cash and cash equivalents	1.5	0.7	0.9	0.8	1.6	1.9
Other deposits and fixed-income securities (a)	0.2	-0.2	1.3	0.4	0.7	0.0
Shares and other equity	3.1	8.2	14.1	8.1	4.2	4.5
Of which:						
Vis-à-vis rest of the world	*2.2*	*6.5*	*10.9*	*7.6*	*3.7*	*3.7*
Other	9.2	9.2	11.3	10.0	11.1	11.5
Financial transactions (liabilities)	**15.3**	**20.3**	**31.3**	**23.9**	**22.0**	**22.3**
Credit from resident credit institutions	4.6	4.8	6.7	5.3	6.0	6.5
Securitisation funds	0.2	0.4	0.9	0.9	0.8	1.0
Foreign loans	1.6	3.0	3.5	3.3	3.6	2.8
Fixed-income securities (a)	0.0	0.5	-0.5	0.2	0.1	0.1
Shares and other equity	2.7	5.1	12.3	7.2	3.9	4.0
Other	6.2	6.4	8.4	7.0	7.6	8.0
MEMORANDUM ITEMS: YEAR-ON-YEAR GROWTH RATES (%):						
Financing (c)	**16.7**	**19.5**	**18.9**	**15.2**	**15.1**	**15.2**
Households and NPISHs	19.3	19.6	17.3	14.0	12.3	13.4
Non-financial corporations	14.7	19.4	20.0	16.0	17.2	16.6

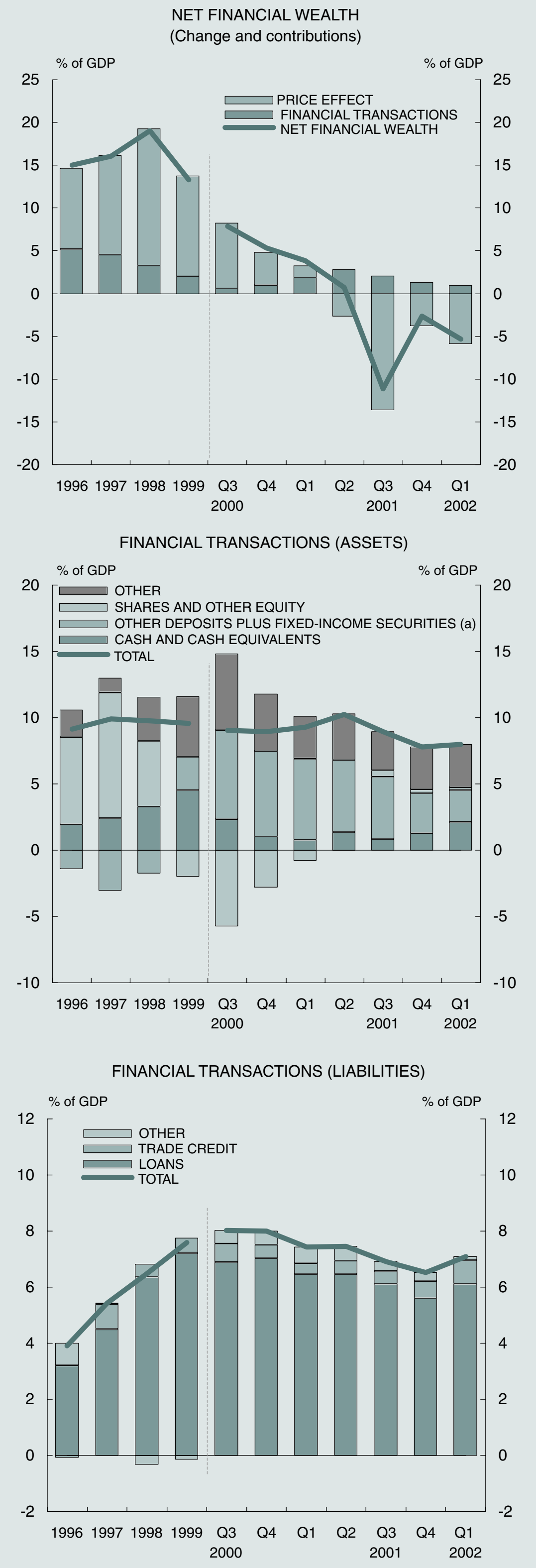
Source: Banco de España.
(a) Not including unpaid accrued interest, which is included under "Other".
(b) Not including mutual funds.
(c) Including bank credit extended by resident credit institutions, foreign loans, fixed-income securities and financing through securitisation funds.

ue to the low reached in 2000 (see Table 5). As discussed in the previous Quarterly Report, the slowdown in household financial saving in the second half of 2001 was due, at least in part, to the relative strength of consumption. However, during 2002 Q1 there was a slowdown in household spending which has not passed through commensurately to household demand for financing; indeed, this latter variable has remained high, underpinned by a low level of interest rates and higher house prices.

The acquisition of financial assets by households was slightly higher than in the same quar-

CHART 23

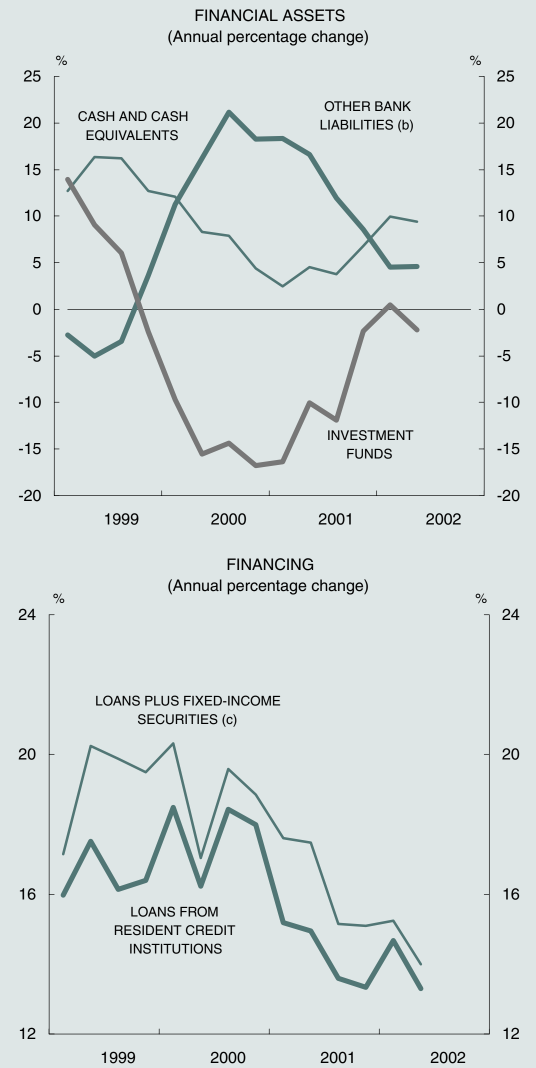
Households and NPISHs
Cumulative four-quarter data



Source: Banco de España.
(a) Not including unpaid accrued interest, which is included under "Other".

CHART 24

Non-financial corporations.
Households and NPISHs (a)

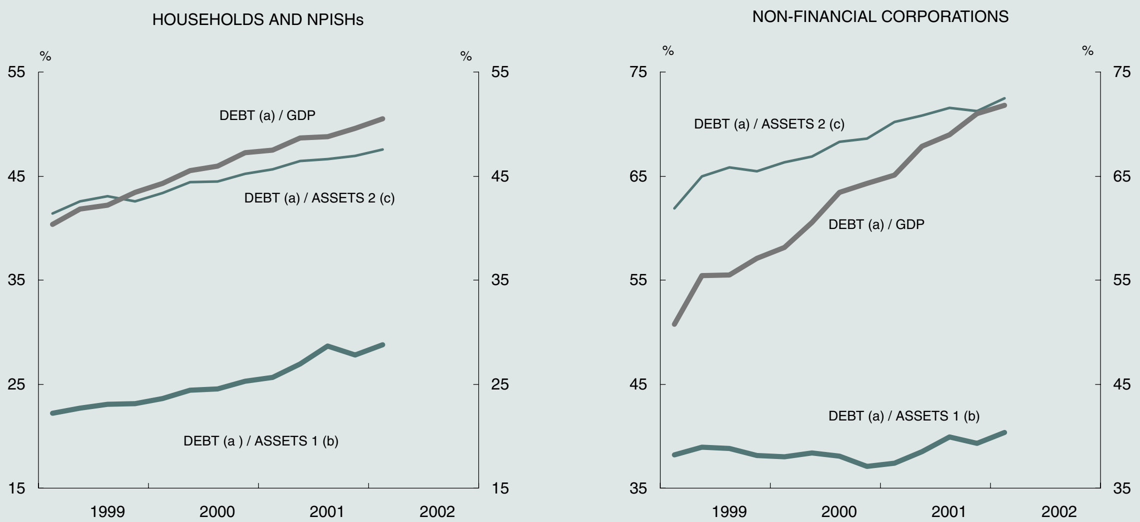


Source: Banco de España.
(a) The data for 2002 Q1 are provisional.
(b) Includes deposits with an agreed maturity, repos, bank securities and deposits abroad.
(c) Including loans from resident and non-resident credit institutions, securities issuance and financing through securitisation funds.

ter a year earlier (equivalent to 8% of GDP) and, as has previously been the case, was centred on the most liquid assets (see Table 6 and Chart 23). The demand for cash and deposits accounted for 74% of the flow of investment by households in financial assets. Saving in the form of cash and cash equivalents increased to 2.1% of GDP, largely due to the greater demand for cash following the changeover to the euro. Saving deposits grew by close to 15% year-on-year, while deposits at an agreed maturity expanded at a rate of 7.7%, moving on a slowing trend. Net subscriptions of shares in mutual funds were negative and, in cumulative

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) Assets 1 = Total financial assets - "Other".
(c) Assets 2 = Assets 1 - shares - shares in FIM.

four-quarter terms, amounted to 0.4% of GDP. As has occurred since mid-1999, households continued selling shares in securities funds and investing in money market funds for an amount equivalent to 1.4% of GDP. Investment in technical insurance reserves fell moderately compared with the same quarter a year earlier and stood at 2.6% of GDP. Finally, net purchases of shares and other equity were positive and were largely in unquoted shares, thereby reducing the negative value of cumulative four-quarter investment to –0.3% of GDP.

As regards liabilities-side transactions, the financing received by households was high at 7.1% of GDP, against 6.5% the previous quarter. In terms of components, bank credit posted the highest volume (5.8% of GDP compared with 5.1% the preceding quarter). Consequently, the year-on-year growth rate of financing – considering bank loans and financing intermediated by securitisation funds – quickened to 13.4%, against 12.3% the previous quarter (see the memorandum item in Table 6).

The information available on the end-use of credit extended by resident institutions indicates that the higher funds obtained by individuals financed both investment in housing and consumer spending. Loans intended for house purchases thus grew by 17%, compared with 16.5% at end-2001. In terms of the two types of institution involved, savings banks increased their portfolio of this form of loan by 18.8% year-on-year, while banks did so by 14.3%. Credit intended for spending on current and durable goods held at a growth rate of over 20%, although its weight in respect of total loans extended to individuals is limited and lower than 15%.

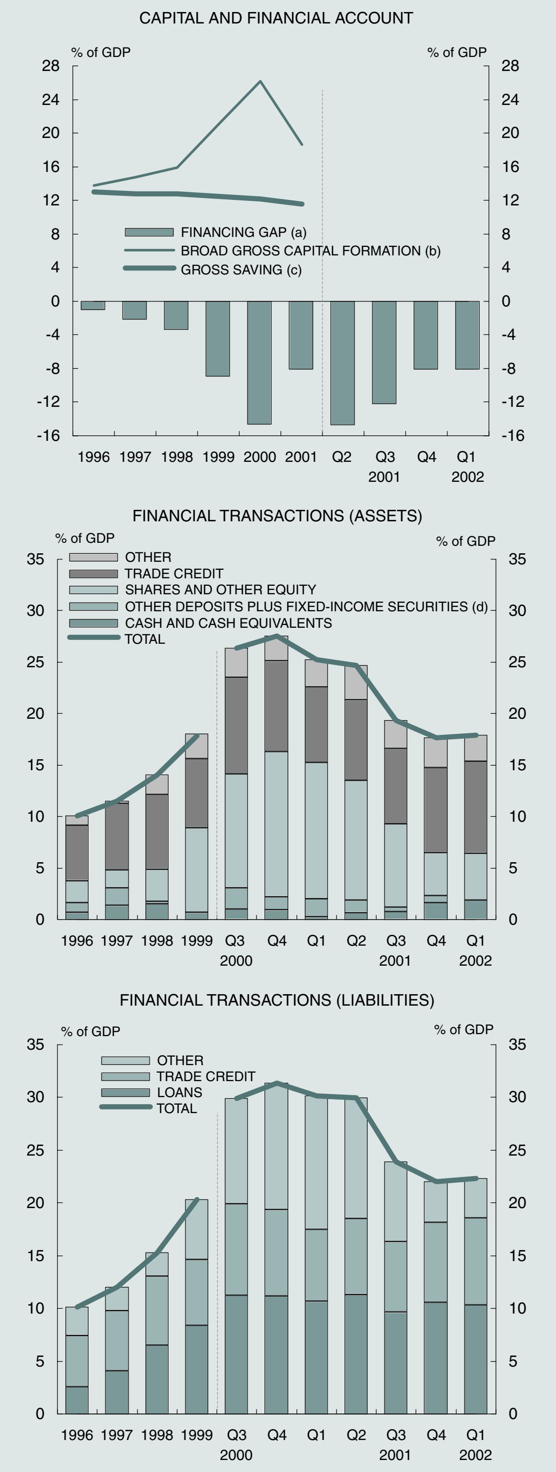
The provisional information on monetary and financial conditions in the Spanish economy during 2002 Q2 indicates very few changes in the processes described previously (6) (see Chart 24). The most liquid assets have continued to grow at a high rate, with the particularity that cash and cash equivalents have slowed slightly and the growth rates of other bank liabilities have ceased to move on a declining trend. Moreover, the value of holdings in mutual funds has once again turned down. And, on the financing side, the extension of credit to the private sector by resident institutions has moderated somewhat, growing at a similar rate to that at end-2001, namely 13.3%.

Finally, with regard to the wealth position of households, mention should be made of the ongoing reduction in the sector's net assets as a result of the growth of its liabilities

(6) Note that these indicators provide aggregate information on the sectors households and non-financial corporations. Consequently, conclusions on household transactions should be interpreted with due caution.

CHART 26

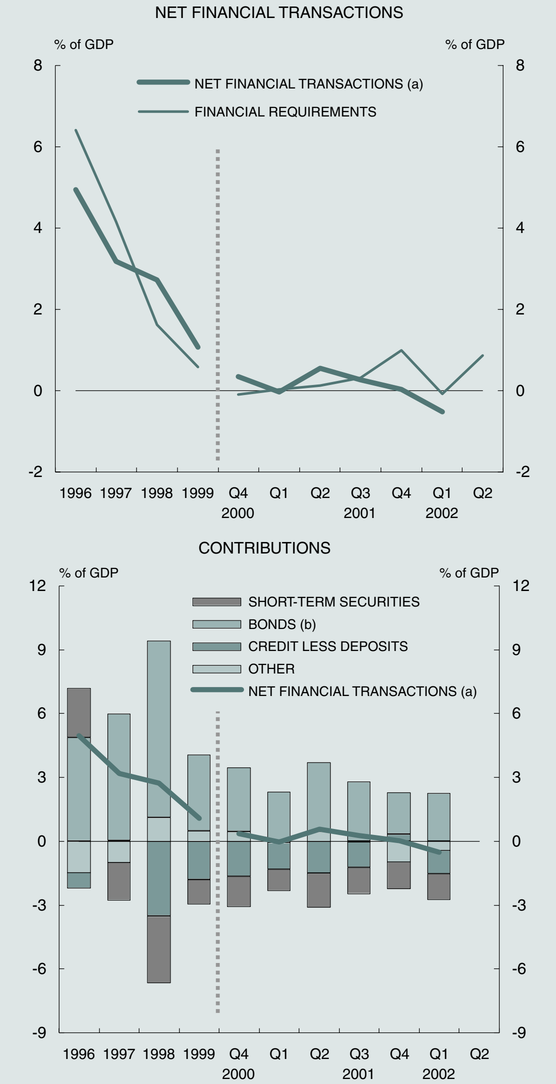
Non-financial corporations
Cumulative four-quarter data



Source: Banco de España.
(a) Financial resources that cover the gap between real and permanent financial investment and gross saving.
(b) Including gross capital formation, stockbuilding and foreign equities.
(c) Including capital transfers.
(d) Not including unpaid accrued interest, which is included under "Other".

CHART 27

General government
Cumulative four-quarter data



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

and the loss of value of its holdings of shares and units in mutual funds. Net financial wealth stood at 115.5% of GDP, compared with 135% in 1999 Q4. Likewise, debt as a proportion of GDP and of the value of holdings of the most liquid and least risky assets increased once again to 50.5% and 47.6%, respectively (see Chart 25).

5.3. The financial flows of non-financial corporations

In the period from January to March 2002, the balance of the financial transactions of

TABLE 7

Financial transactions of the nation. Cumulative data for the last four quarters

% of GDP

	1998	1999	2000	2001 Q3	2001 Q4	2002 Q1
Net financial transactions	**0.5**	**-1.1**	**-2.5**	**-2.0**	**-1.9**	**-1.8**
Financial transactions (assets)	**12.3**	**14.8**	**24.5**	**16.4**	**10.8**	**8.8**
Gold and SDRs	**0.0**	**-0.2**	**0.0**	**0.0**	**0.0**	**0.0**
Cash and deposits	**3.2**	**1.7**	**2.8**	**-0.5**	**-2.6**	**-3.8**
Credit system	0.0	3.7	2.5	-0.5	-2.8	-3.3
Other resident sectors	3.2	-2.0	0.4	0.1	0.1	-0.6
Securities other than shares	**3.4**	**2.8**	**3.8**	**6.0**	**7.1**	**7.4**
Credit system	-1.4	-0.9	-0.3	1.0	2.0	2.3
Other resident sectors	4.7	3.7	4.1	5.1	5.1	5.2
Shares and other equity	**4.3**	**9.8**	**15.1**	**8.1**	**3.7**	**3.1**
Credit system	0.4	0.7	1.7	0.3	-0.1	-0.4
Other resident sectors	3.9	9.0	13.4	7.8	3.8	3.5
Of which:						
Non-financial corporations	2.2	6.5	10.9	7.6	3.7	3.7
Loans	**1.4**	**0.7**	**2.7**	**2.7**	**2.7**	**2.1**
Credit system	0.2	-0.2	0.5	0.7	0.8	0.6
Other resident sectors	1.2	0.9	2.2	2.0	1.9	1.5
Financial transactions (liabilities)	**11.8**	**15.9**	**27.0**	**18.4**	**12.7**	**10.6**
Deposits	**5.9**	**4.1**	**6.7**	**5.0**	**2.8**	**1.1**
Of which:						
Credit system	5.9	4.1	6.8	5.0	2.8	1.1
Debt securities issued	**1.0**	**5.4**	**7.0**	**4.0**	**3.1**	**3.2**
Credit system	0.2	0.9	0.8	0.6	0.6	0.8
General government	1.0	4.3	5.7	3.0	1.6	1.7
Other resident sectors	-0.2	0.2	0.5	0.4	0.9	0.8
Shares and other equity	**2.9**	**3.9**	**9.1**	**5.8**	**3.5**	**3.7**
Credit system	0.1	0.3	1.7	0.4	0.5	0.2
Other resident sectors	2.8	3.6	7.4	5.3	3.0	3.5
Loans	**2.2**	**3.8**	**4.5**	**4.0**	**4.4**	**3.8**
General government	0.1	0.1	0.1	0.0	0.1	0.1
Other resident sectors	2.1	3.7	4.4	4.0	4.3	3.7
Other, net (a)	**-0.2**	**-1.4**	**-0.3**	**-0.4**	**-1.1**	**-1.3**

Source: Banco de España.
(a) Includes the asset-side caption reflecting insurance technical reserves.

non-financial corporations was similar to that in the same quarter a year earlier (–1.8% of GDP). Thus, in cumulative four-quarter terms, their net financial requirements amounted to 4.4% of GDP. As discussed in previous reports, these financial requirements are due to the diminished capacity of corporations to generate funds internally, since both domestic and foreign investment have slowed significantly (see Chart 26).

Investment in financial assets increased slightly in relation to the same quarter a year earlier and stood at 17.9% of GDP. This increase was primarily the result of greater investment in cash and cash equivalents, amounting to 1.9% of GDP; however, the demand for other liquid assets, reflected under other deposits and fixed-income securities, declined considerably (see Table 6). Moreover, the acquisition of quoted and unquoted shares

TABLE 8

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

% of GDP

	1997	1998	1999	2000	2001	2002 (b)
Total economy	**-20.9**	**-21.6**	**-22.3**	**-20.6**	**-22.4**	**-23.0**
Non-financial corporations and households and NPISHs	**-10.8**	**-8.6**	**-8.7**	**-0.8**	**-1.7**	**-1.7**
Non-financial corporations	-17.1	-14.8	-16.3	-8.5	-9.3	-9.6
Households and NPISHs	6.3	6.2	7.6	7.6	7.5	7.9
Financial institutions	**6.9**	**4.8**	**6.9**	**5.1**	**4.6**	**3.4**
Credit institutions (c)	2.4	-5.4	-7.5	-12.5	-14.6	-15.4
Institutional investors (d)	4.6	10.7	15.0	18.4	20.7	20.7
Other financial institutions	-0.1	-0.4	-0.6	-0.8	-1.6	-1.8
General government	**-17.0**	**-17.9**	**-20.5**	**-24.8**	**-25.2**	**-24.8**

Source: Banco de España.
(a) Calculated as the difference between the stocks of financial asssets and of 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.

was somewhat more positive at 4.5% of GDP, compared with 4.2% the previous quarter. Finally, investment in assets grouped under the heading *other* in Table 6 edged up to 11.5% against 11.1% the previous quarter as result of a higher volume of trade credit.

Turning to liabilities-side transactions, the resources obtained by non-financial corporations rose to 22.3% of GDP. Financing obtained via loans and securities other than shares slowed overall, and it was other debt instruments which grew most. Loans from resident institutions and financing intermediated via securitisation funds increased considerably to 7.5% of GDP, compared with 6.8% the previous quarter. The issuance of fixed-income securities remained very low, standing at 0.1% of GDP. Foreign loans decelerated substantially, which might be indicative of the lesser resort by large corporations to financing. Resources raised through foreign loans amounted to 2.8% of GDP, compared with 3.6% the preceding quarter. The year-on-year growth of financing extended to corporations thus stood at 16.6%, a slightly slower rate (see the memorandum item in Table 6). The remaining corporate liability instruments increased slightly. Hence, the issuance of shares and other equity (primarily unquoted shares) amounted to 4% of GDP, and the remaining instruments (included under the item *other* in Table 6) to 8% of GDP, influenced by the increase in trade credit.

The information on the breakdown of resident institutions' credit by productive activity indicates that the acceleration in loans was across the board. The growth rate of the main component, credit for the services sector, climbed from 12.1% at end-2001 to 13.6%. Meantime, loans to industry grew by 8.6% and those to construction by 12.1%.

Although the volume of financing – total loans and securities other than shares – slowed slightly during 2002 Q1, its growth remains high in relation to economic growth. Consequently, the sector's debt, measured by the debt/GDP ratio, held on a growing path, standing at 71.8%. The value of this debt in relation to corporations' financial assets portfolio rose even more, up to 40.3%, given the diminished value of share holdings.

5.4. General government financial flows

The positive balance of general government financial transactions in 2002 Q1 was higher than a year earlier. In cumulative four-quarter terms, the improvement saw this sector's financial saving come to stand at 0.5% of GDP (see Chart 27).

During Q1, the Treasury launched a new issue of 15-year bonds for a value of €5 billion. As a result, in cumulative four-quarter terms, the outstanding balance of general government bonds increased by 2.26% of GDP, compared with 1.27% the previous quarter. Issues of short-term securities were low and, again on a cumulative four-quarter basis, redemptions amounted to 1.25% of GDP. The net resources obtained with the issues contributed to increasing deposits (net of loans) by 1.09% of GDP. During Q1, moreover, public debt portfolio switching from institutional investors to non-residents continued, with the latter agents' holdings of bonds now accounting for somewhat over 50% of the total outstanding balance issued.

The provisional information for Q2 shows a fresh increase in funds obtained via securities. Net issues of government bonds have been earmarked, to a lesser extent, to redeeming short-term securities and, consequently, the *financial requirements* indicator, which reflects general government resort to financial markets and proxies saving in the sector, has risen to 0.87% of GDP in Q2 (see Chart 27).

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

Between January and March 2002, the balance of the nation's financial transactions was somewhat less negative than in the same quarter a year earlier (–0.50% of GDP), whereby capital inflows from abroad totalled 1.8% of GDP in cumulative four-quarter terms (see Table 7). As had been the case in the preceding quarters, flows of net acquisitions of external financial assets and liabilities continued to decline, with said purchases predominantly of high-liquidity and low-risk instruments amid the heightened uncertainty on capital markets.

Net acquisitions of external assets amounted to 8.8% of GDP, against 10.8% the previous quarter. Both credit institutions and *other resident sectors* reduced their holdings of foreign deposits. Investment in securities continued to be predominantly in fixed-income instruments. Acquisitions of securities other than shares increased to 7.4% of GDP, while equity purchases were lower at 3.1% of GDP, compared with 3.7% in 2001 Q4. This lesser investment in shares was due to financial institutions, since non-financial corporations sustained an investment flow equivalent to 3.7% of GDP. According to Balance of Payments data, foreign direct investment declined by more than 50% in relation to that in the same quarter a year earlier. In particular, inter-company debt transactions fell more sharply than direct investment in shares and other equity. Loans abroad by non-financial corporations amounted to 1.5% of GDP, against 1.9% in 2001.

The volume of cross-border transactions on the liabilities side was also lower, standing at 10.6% of GDP compared with 12.7% the previous quarter. This decline was mainly the result of less investment in deposits by non-residents and of a reduction in foreign loans received by non-financial corporations. However, non-resident investment in securities increased moderately on the same quarter a year earlier, taking the form in particular of direct investment. Consequently, direct investment flows turned negative once again, i.e. foreign direct investment in Spain exceeded Spanish investment abroad. The latest Balance of Payments information, for April, clearly shows these patterns to be continuing.

As a result of foreign financial transactions and of changes in financial asset prices and in the exchange rate, the debit balance of net external assets increased. The improved general government position did not offset the deterioration in credit institutions' net external assets (see Table 8).

30.7.2002.