Quarterly report on the Spanish economy

1. Overview

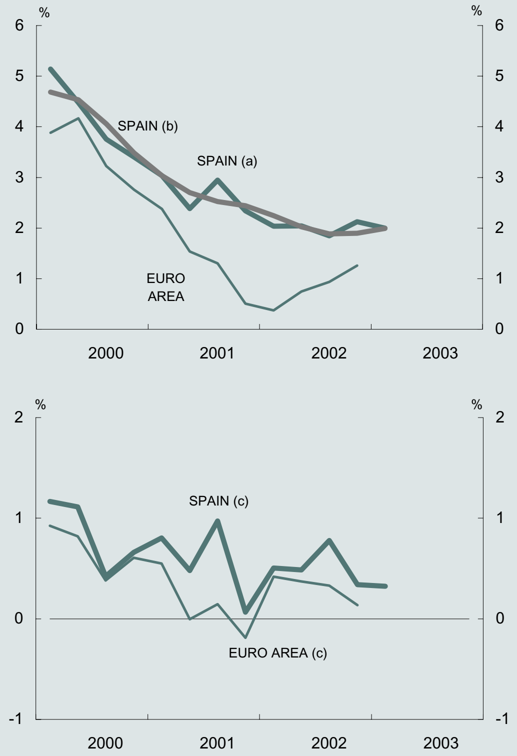
The international economic situation at the onset of 2003 is particularly complex. The war in Iraq has hampered assessment of the figures available, without it being possible to discern to what extent such data are in response to the climate of uncertainty associated with the conflict or whether they rather and moreover reflect other types of factors potentially hindering the recovery of the world economy. Against this background, first-quarter results are expected to be broadly similar to or indeed worse, in the odd country, than those for the final months of 2002. The most promising developments, along with the rapid winding up of the war, are the tendency of crude oil prices to stabilise and the more favourable performance of certain financial markets, particularly in specific Latin American economies.

Set against this still-uncertain backdrop, real GDP in the Spanish economy is estimated to have grown at a year-on-year rate of around 2% in the first three months of 2003, in terms of the seasonally adjusted series, a similar rate to the QNA figure (2.1%) released for 2002 Q4. Indeed, the quarter-on-quarter growth rate for both periods would have been identical (0.3%). These results are a continuation of the pattern marking developments in the Spanish economy last year and – as is widely known – are largely underpinned by sustained household spending. Household disposable income has continued to grow appreciably. Contributing factors in this connection have been the increase in employment (the growth rate of which, according to the EPA [Spanish Labour Force Survey] results released as this Bulletin was going to press, would have quickened to 2.3%) and in employee compensation, along with lower personal income tax rates. Moreover, household debt levels have continued to rise against a background of downward-trending interest rates. Investment in non-residential construction by companies and general government have, together with general government consumption, also helped sustain activity.

Along with the growth in employment, the keynote at the start of 2003 has been the improvement in inflationary expectations. In March, the rate of increase of the HICP stood at 3.7% and the differential with the euro area countries narrowed to 1.3 p.p. (1.7 points at end-2002). The slowdown in prices is partly due to the fact that the upward impact of the introduction of the euro, which particularly affected certain components of the services and non-energy industrial goods indices, is being overcome. The improvement in the inflation rate is expected to continue in the coming months as the growth rate of energy and certain food prices slackens.

CHART 1

Gross domestic product



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

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

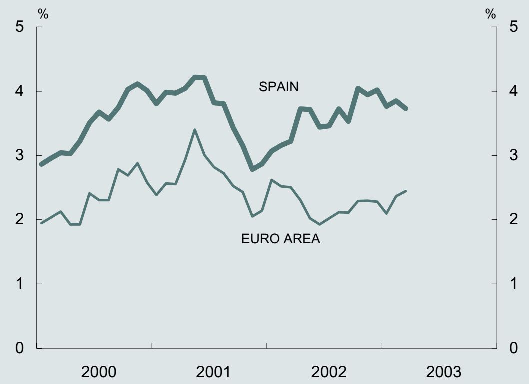
(b) Non-centred annual rate of change calculated on the basis of the trend-cycle series.

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

The signs of a pick-up in the US economy discernible in 2002 Q4 have not continued. The latest data are generally less favourable, particularly in respect of job creation. As earlier indicated, it is difficult to determine whether this has been in response to the imminence of war breaking out and how it would unfold or whether there are deeper-seated causes related to the persistence of imbalances which, originating in both the private and public sectors, extend to the whole economy. The most favourable data are to be found in productivity growth, which remains notable (though it resides on job destruction), and in the control of inflation. That allows the US authorities, whose scope for pursuing expansionary macroeconomic policies has practically been used up, to be optimistic about a rapid upturn in the economy once geopolitical uncertainties have been dispelled. From this standpoint, more dynamic growth based on the incorporation of technological improvements may help ease some of the imbalances that have built up.

CHART 2

Harmonised indices of consumer prices (a)



Sources: Eurostat and European Central Bank.

(a) Annual percentage change. To December 2001, the rates relate to those published as at that date.

The outlook for other regions is likewise uncertain. Recent indicators in Japan offer mixed signals and it is difficult, as in other areas, to gauge the specific impact of the Iraq war. In any event, however, Japan's structural problems persist. The pace of growth in some of the more buoyant regions has eased off slightly, as is the case of the EU candidate countries. Greater calm appears to preside over the Latin American financial markets, and some of the main economies, especially Brazil, have substantially improved their terms of access to international financing. The start of a recovery in the Argentine economy is also worth noting.

Into 2003, the euro area has retained the sluggishness marking the end of 2002, with no factors presaging a swift recovery. The employment figures have not been favourable and the growth of consumption, which had sustained demand in past quarters, is tending to stagnate. The rebound in investment in the odd country in the area in Q4 appears to be incidental, meaning that in the short run only external demand can provide the momentum needed to kick-start growth. And this against a background in which the contribution of general government to stabilising demand may be affected by the budgetary position in certain countries, which has worsened significantly in the past year.

The inflation rate climbed to 2.4% in March, 0.1 p.p. up on December. The rise was due to the increase in the prices of energy products. Inflation is, however, expected to ease in the coming months, as the trend of the more stable components of the consumer price index is already suggesting. For this to come about, the growth rate of wages must slacken, as the slowdown in unit labour costs has essentially been due to the productivity gains associated with the decline in employment.

Given a situation in which some of the main euro area economies face the need to redress their budgetary balances (in keeping with the commitments entered into under the Stability and Growth Pact, which have recently been reaffirmed and clarified by Ecofin), monetary policy leeway has been used prudently. A cut of 25 basis points in the European Central Bank's key interest rates was decided in March, meaning that the rate on the Eurosystem's main refinancing operations has since stood at 2.5%. Following the end of the war in Iraq, there appears to be greater optimism on financial markets: the yield curve on money markets has flattened, indicating that expectations of further interest rate cuts have moderated, while the cumulative decline in stock market prices to March appears to have been corrected in April. The changes in monetary aggregates have continued to be largely due to the increase in the public's preference for liquidity, while the growth rates of the credit aggregates have been stable at around 5%, with notable differences across countries and with financing extended to households – particularly for house purchases – accounting for a greater proportion.

Early in 2003, then, the Spanish economy continues to evidence generous financing conditions, which are contributing to sustaining private-sector expenditure, in a relatively unfavourable environment that has affected the growth rate of exports and corporate capital-goods investment decisions. General government conduct is also contributing to tempering the slowdown in demand, both through the operation of the automatic stabilisers (after having achieved sound budgetary stability conditions) and through the direct effect exerted on household income, via lower tax rates. The data on the State budget outturn for Q1 are broadly in line with this, with something of a slowdown perceptible in the revenue from certain taxes, while the growth of other spending captions has been on the rise.

In these circumstances, the estimated growth of Spanish real GDP in 2003 Q1 (2% year-on-year) is underpinned by the behaviour of domestic demand, the rate of increase of which may be standing at around 2.3%, not far off the figure for 2002 Q4 if the impact of stockbuilding in both periods is stripped out. The negative contribution of net external demand has thus continued to be notable (of the order of 0.4 p.p.), while of a lesser amount than the preceding quarter. From the standpoint of the productive branches, and together with the

CHART 3

Confidence indicators

Source: European Commission.

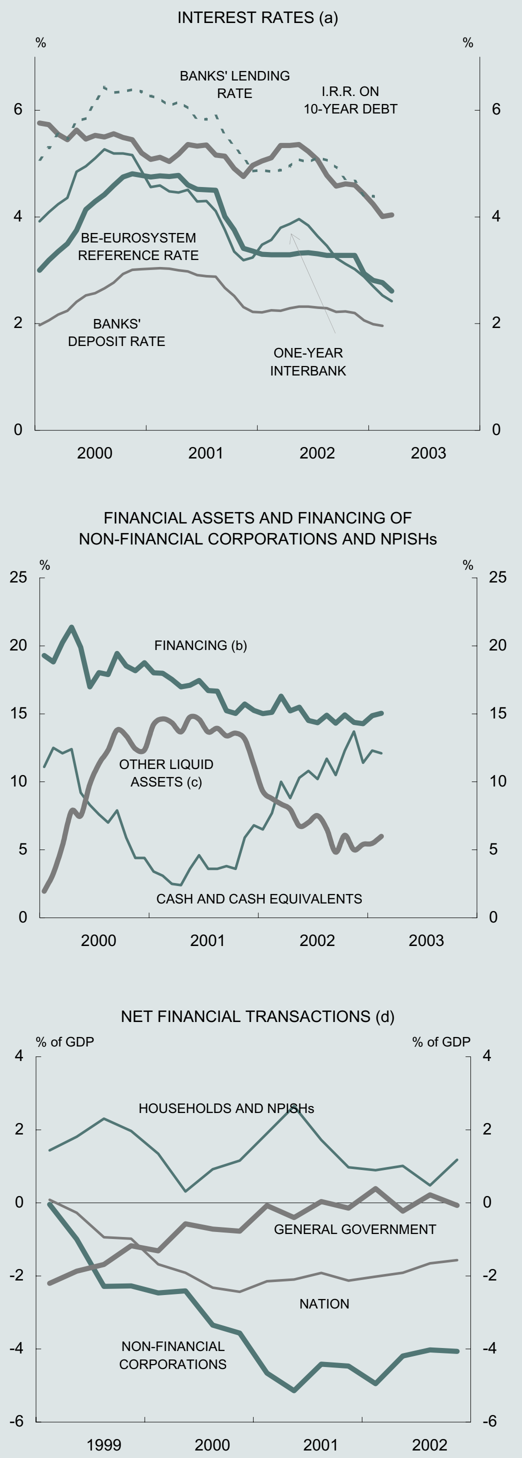
aforementioned buoyancy of construction, both manufacturing and market services have remained on a path not dissimilar to that marking their course at the end of 2002.

The factors behind the growth of household disposable income have been identified above. The indicators available point to private consumption growth similar to or slightly lower than that in Q4, which could be compatible with a continuation of the modest pick-up in the saving ratio seen last year. The notable increase in household spending invested in house purchases continues to be based on the resort to debt. Indeed, the growth rate of credit extended to households, especially mortgage credit, quickened in 2002 Q4, and there are no signs that it has slowed in 2003 Q1.

Business investment spending, however, is being restricted by the uncertainty surrounding corporate decision-making. Possibly, the real year-on-year growth of capital investment in 2003 Q1 has been practically flat. While that is a poor result, it counters the negative rates posted on average in the two preceding years. Business investment in non-residential con-

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 credit institutions, foreign loans, fixed-income securities and financing through securitisation funds.
(c) Includes deposits with an agreed maturity, repos, bank securities, residents' cross-border deposits and shares in money-market funds.
(d) Cumulative four-quarter data.

struction is alone in showing signs, as earlier mentioned, of substantial vigour.

The favourable financing conditions currently available for households and firms mean that these sectors can continue sustaining expenditure flows higher than they could withstand on the basis of their current resources. This has prompted an increase in debt levels, more so – as seen – in the case of households. The figures for 2002 Q4 confirm this trend, which appears to have continued into the opening months of 2003. Although the financial burden is holding relatively stable, and has even diminished slightly of late as a result of interest rate movements, the rise in debt entails greater exposure to any potential emergence of sharp changes in certain debt determinants. Likewise, the build-up in liabilities restricts the headroom available for spending by the sector to continue residing, in the future, on the resort to financing to the same extent as in recent years.

The indicators on the behaviour of employment in 2003 Q1, to which the EPA has just been added, confirm that the Spanish economy's job-creation capacity remains notable. The estimated growth rate for employment in Q1 is 1.3%, in homogenous National Accounts terms, meaning that the pick-up in productivity observable in the 2002 Q4 figures has been halted. In this situation, unit labour costs continue to post growth in excess of 3%, since although the information on the course of collective bargaining is still relatively insignificant, the growth of wage costs appears to have been substantial (no less than 4%) owing to the payment of indexation clauses. The results of wage bargaining must conform to the change in the inflationary outlook for the economy perceptible at the start of this present year. In that way, once the largely temporary increases that took place last year are stripped out of the twelve-month growth rate of consumer prices, the slowdown in the inflation rate may continue and the differential with the euro area countries may narrow. And this without a squeeze on the margins of the companies most exposed to foreign competition.

The slowdown in the growth rate of consumer prices during 2003 Q1 has been especially significant in the case of the services component. In terms of the harmonised index (HICP), the spread between the growth rate of these prices and those for the euro area as a whole stood at 0.9 p.p., when in the last quarter of 2002 it was 1.5 points on average. This performance is in contrast to the forceful differential in the case of food prices, although the related spread for unprocessed food is tending to lessen, and is expected to continue to do so in the coming months. More difficult to assess are the differences in the growth of non-energy industrial goods prices since, in the case of the Spanish economy, the influence of the sales season means that not only quarter-on-quarter rates but also year-on-year rates fluctuate considerably.

The Spanish economy has commenced 2003 under the effects of a particularly uncertain international environment. That said, it has kept in place conditions favourable to a pick-up in activity in the second half of the year, though this will largely depend on how international events unfold. The growth rate remains appreciable – in what is a rather lacklustre context – and inflationary expectations have improved, though for these to firm it is crucial that the moderation marking the recent course of unit labour costs should not be abandoned. Furthering improvements in competitiveness and in the workings of markets is the best safeguard for obtaining the maximum benefit from the change it is expected will take hold in the world economy during this year.

2. The external environment of the euro area

In the last few months the economic situation in the external environment of the euro area has been marked by the considerable geopolitical uncertainty associated with the Iraq war and its impact on the prospects for world economic recovery and by a sharp general deterioration in confidence indicators, which has been particularly notable in the US owing to the high dependence of the world economy on this country's performance.

The international financial markets have also been affected by this climate of uncertainty. The stock markets posted notable losses until mid-March, which counteracted the positive performance in 2002 Q4. Subsequently, coinciding with the start of the military campaign, the stock markets rose sharply, amid high volatility. Government bond prices in the industrialised countries continued to move in the opposite direction to the stock markets, in keeping with the role they have been playing as an alternative investment to shares: they rose significantly in Q1 and fell from April, although their yields remain at historically very low levels. In these months the dollar showed a significant tendency to depreciate, which on occasions took it to more than USD 1.10 per euro. Oil prices have been highly volatile. After a sharp increase to USD 35/barrel before the Iraq war, the prompt end to the conflict triggered a fall to around USD 25, facilitated also by the rise in OPEC production and a certain normalisation of the situation in Venezuela.

The United States recorded growth of 2.4% in 2002, driven mainly by private consumption, which grew by 3.1%. As mentioned above, the beginning of this year unfolded under the strong influence of the Iraq conflict and its effect on confidence. In January the indicators showed signs of greater vigour in spending decisions by consumers and firms but, as the start of the war approached, there was an across-the-board downturn in the indicators. The decline in real consumer spending together with the fall in March consumer confidence to 1993 levels and the fall in house sales in January and February, in which climatic factors also played a role, are all evidence of a slowdown in private consumption. Noteworthy in business investment was the reduction in orders of durable goods, particularly capital goods, which fell by 1.8% after rising 3.6% in January. The manufacturing and services confidence indices stood well below the levels compatible with output growth, although the best indicator of business reluctance to invest is the fall in the number of employed by more than 460,000 in February and March, which has left the unemployment rate at 5.8%.

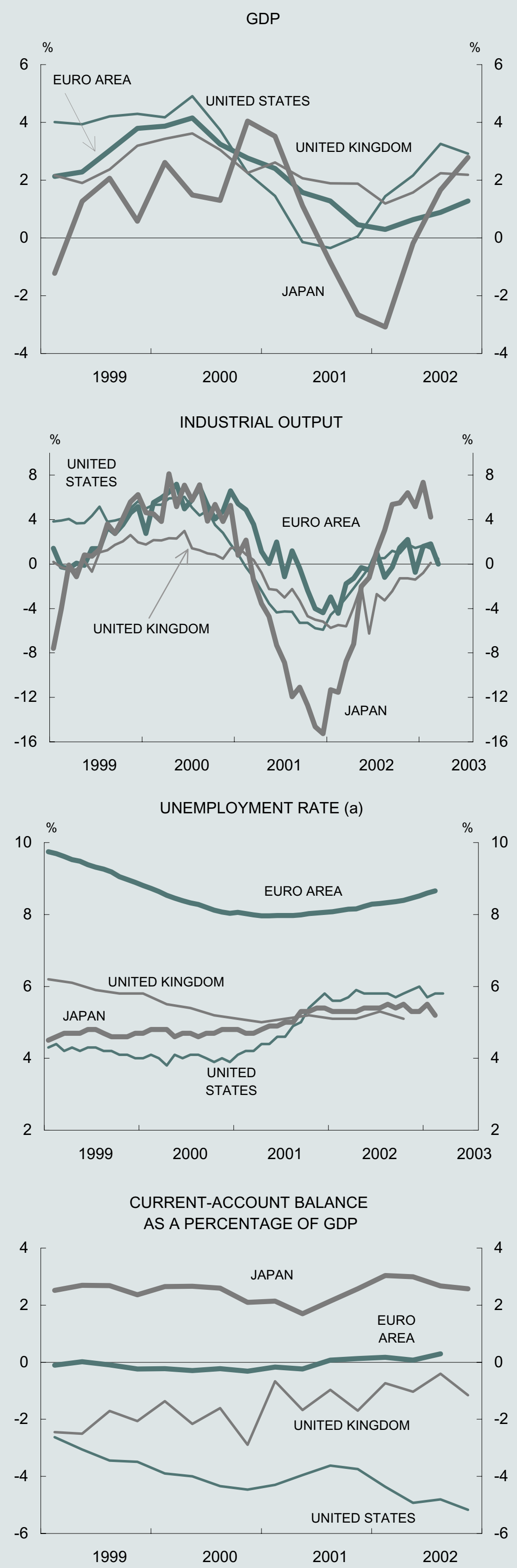
The March CPI accelerated to 3% year-on-year, largely due to the rise in oil prices, yet the core inflation rate continued to decelerate and its level of 1.7% year-on-year was the lowest in nearly forty years. Against this background, at the end of March the Federal Reserve decided to keep official interest rates at 1.25%, arguing that the accommodative stance in monetary policy coupled with productivity gains would suffice to improve the economic climate once the geopolitical uncertainties about Iraq cleared. As regards fiscal policy, it is uncertain whether the proposed wide-ranging package of tax cuts will be approved, since the Senate has proposed scaling it down it as a means of offsetting the war expenditure. The General Government deficit, which amounted to 3.6% of GDP in 2002, might exceed 4% this year.

Japan grew by 0.3% year-on-year in 2002 thanks to the fact that activity in the second half exceeded initial expectations. Growth was driven mainly by external demand, which made up for weak domestic demand, hampered by sluggish private consumption. The indicators available for 2003 Q1 are mixed, being dragged down somewhat by the uncertain international environment. The latest data show that industrial production slowed in February after January's good figure, although the rates remain positive in year-on-year terms (5.8% on average in the first two months of the year). Another encouraging development is January's rise in capacity utilisation in the manufacturing sector, buoyed by the favourable earnings trend. Nonetheless, the persistent deflation (–0.2% year-on-year in February and –0.7% for the underlying component) and the falls in employment mean that signs of a clear recovery in household spending are lacking, despite the recent fall in the unemployment rate (5.2% in February). Finally, in line with developments in the external environment, trade flows slowed moderately in January and February in both imports and exports.

The United Kingdom's real growth of 1.8% in 2002 was underpinned by the buoyancy of private consumption, which offset the contraction in investment and the deterioration in the trade balance. The economy has been weaker in 2003 Q1 according to supply indicators, which suggest that the economic slowdown has spread to all sectors. Demand indicators also show a clear deterioration, particularly in consumption, so far the main force behind activity. Nonetheless, the labour market data continue to show some strength: the unemployment rate is 5.1% and wages are growing at 3%. The inflation rate has risen to 3%, half a point higher than the government's target, and house prices continue to increase at around 25% year-on-year.

CHART 5

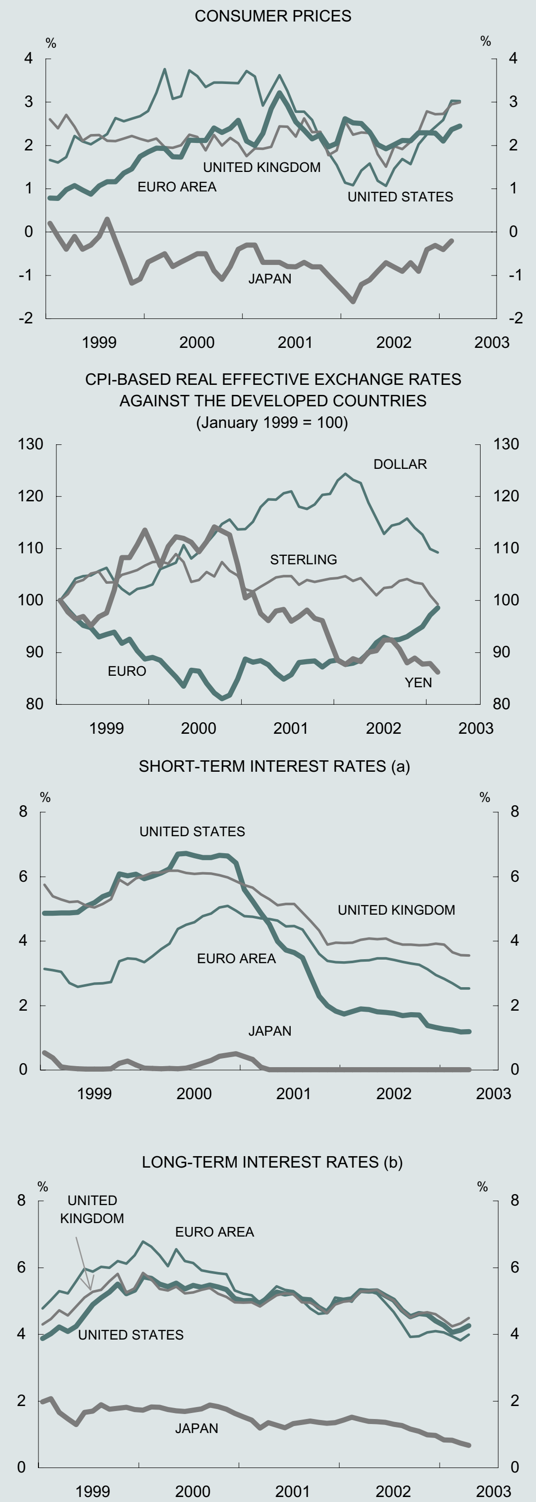
Main macroeconomic indicators
Annual rates of change



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



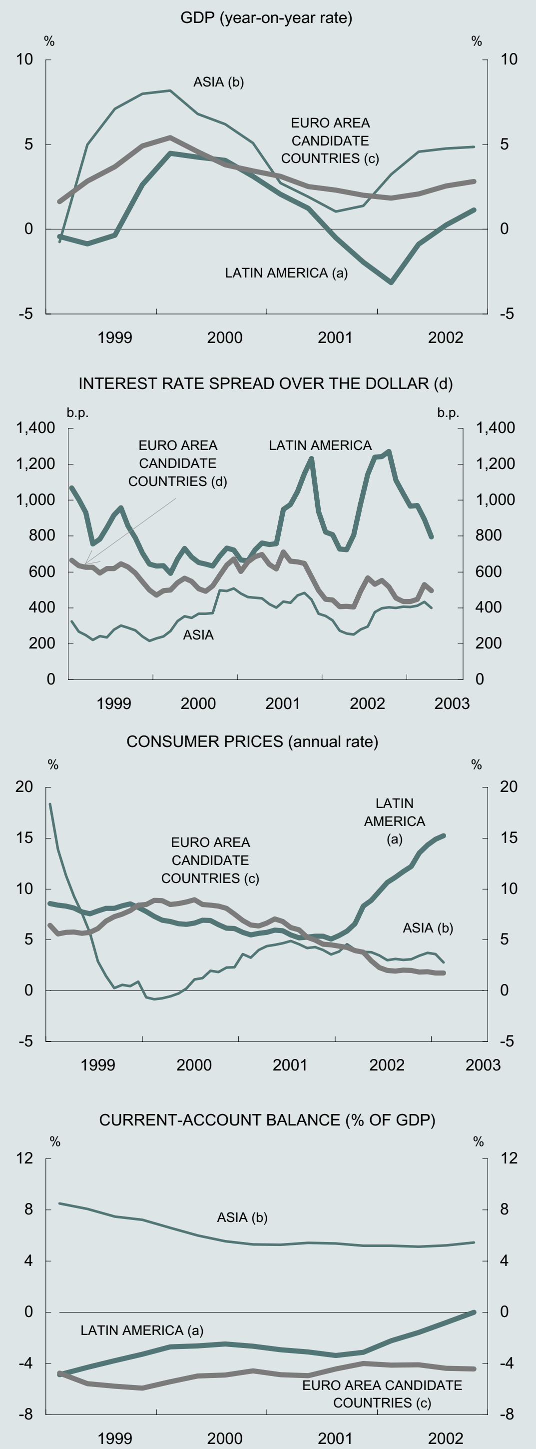
Source: Banco de España.

(a) Three-month interest rates on the interbank market. Euro area: weighted average of the eleven countries to December 1998; three-month EURIBOR as from 1999.

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

CHART 7

Emerging economies: main macroeconomic indicators



Source: National statistics and JP Morgan.

(a) Argentina, Brazil, Chile, Mexico, Colombia, Venezuela and Peru.

(b) Malasia, Korea, Indonesia, Thailand, Hong Kong, Singapore and Taiwan.

(c) Latvia, Lithuania, Estonia, Czech Republic, Hungary, Poland, Slovenia and Slovakia.

(d) Spreads according to JP Morgan's EMBI index. The candidate economies are an in-house estimate using data on Bulgaria, Hungary, Croatia, Turkey and Poland.

The GDP growth of the European Union candidate countries in 2002 Q4 was generally higher than in the preceding quarter, owing to the contribution of private consumption, which offset the fall in investment and the lack of buoyant external demand. In 2002 as a whole, however, the growth of these economies was, with certain exceptions, lower than in 2001. The economic indicators for 2003 Q1 continue to show a certain weakness reflected, among other things, in record unemployment rates in certain countries such as Poland and the Czech Republic. Meanwhile, inflation has continued its general downward course, helped along in many cases by currency appreciation. Some countries are enjoying historically low inflation, which has enabled them to reduce their official interest rates. Finally, Slovenia, Hungary and Malta held their respective referendums on whether to join the European Union, with a favourable outcome in all cases.

The Latin American economies began the year in a climate of relative calm which allowed, on the one hand, a significant improvement in their financial indicators and, on the other, consolidation of the incipient recovery in certain economies. This process was hastened by the approval of numerous financial agreements with the IMF. The yield differentials with respect to US bonds have narrowed notably by around 200 basis points for the region as a whole to the levels prevailing before last summer's turmoil in the lead-up to elections in Brazil. Another factor contributing to this has been the search for optimum returns in the international environment. Also, public and private bond issues have increased substantially compared with the levels of 2002. Exchange rates have diverged, with strong recoveries in Argentina and Brazil and further depreciation in Uruguay and Venezuela. A less welcome development has been the increase in inflation, which has obliged many countries to implement more restrictive monetary policies.

Country by country, a recovery is increasingly evident in Argentina, driven by the external sector and, to a lesser extent, by domestic demand. Fiscal and monetary commitments made to the IMF in January's temporary agreement have been met. The stabilisation of inflation and the recovery in the exchange rate have enabled a good part of the banking and exchange restrictions to be lifted. In Brazil, external demand underpinned by the depreciation of the real contributed to increasing activity, withstanding the erosion of real income caused by accelerating inflation and tighter credit conditions. Activity in Mexico continues to be weak, in line with developments in the US. The moderate overrun of inflation targets was accompanied by rises in interest rates, while the peso fell to a historical low in late February, from which it has recovered remarkably. Finally, the Venezuelan economy remains in a deep recession despite the end of the oil strike, and its public debt is growing.

3. The euro area and the monetary policy of the ECB

On the latest information, the opening months of the year saw a prolongation of the sluggishness shown by economic activity in the euro area at the end of 2002. Based on the forecasts of the main international bodies, annual GDP growth will be around 1% in 2003. This will require an acceleration in activity in the second half of the year, prompted by a normalisation of the international political situation which should spur the expansion of spending in the major economies. The factors in the euro area contributing to the crystallisation of this scenario are the maintenance of relatively favourable monetary conditions and the absence of widespread macrofinancial imbalances. The main risks standing in the way of this forecast are the still uncertain course of the geopolitical tension and its impact on oil prices and the financial markets, and the worsening of the US external and budget deficits, which makes it difficult to rule out the possibility of market adjustments that may adversely affect activity in the rest of the world. Although the outlook for prices is generally favourable, it depends on the behaviour of oil prices and on the outcome of wage negotiations for the current year.

Against this background of shaky recovery and an improving inflationary outlook, the ECB trimmed interest rates by 25 basis points at the beginning of March, as a result of which the rate on the Eurosystem's main refinancing operations stood at 2.5%, the lowest level for official rates since the creation of the single currency. As regards fiscal policies, the budgetary position in some countries has continued to worsen considerably. As a result, the European Commission initiated an excessive deficit procedure for France, which comes on top of those already in progress for Portugal and Germany. In this context, the authorities re-examined the criteria employed in the application of the Stability and Growth Pact. As a result, they have reaffirmed the usefulness of this instrument in helping to maintain disciplined fiscal policies and, at the same time, they have adopted a pragmatic approach allowing the specific circumstances of each Member State to be taken into account.

3.1. Economic developments

In the light of the second euro area National Accounts estimate, GDP grew at a quarter-on-quarter rate of 0.1% in 2002 Q4, which was 0.2 percentage point (p.p.) less than the increase in the previous quarter (see Chart 8). The contribution of domestic demand to GDP held steady and that of stockbuilding increased, so the slowdown in GDP growth was due to the negative contribution of external demand (because exports slowed more than imports). The developments in external trade last year, both by geographical area and by product, are analysed in detail in Box 1. It should be clarified that the relative strength of domestic demand in the second half of 2002 with respect to the first half was due to certain special factors which temporarily boosted gross fixed capital formation in that period. In particular, the termination of tax rebates for capital investment in Italy in 2002 may have encouraged companies to bring forward their spending decisions, while in Germany the repair of buildings following the deterioration in the summer floods also spurred investment more strongly than its usual determining factors would have done.

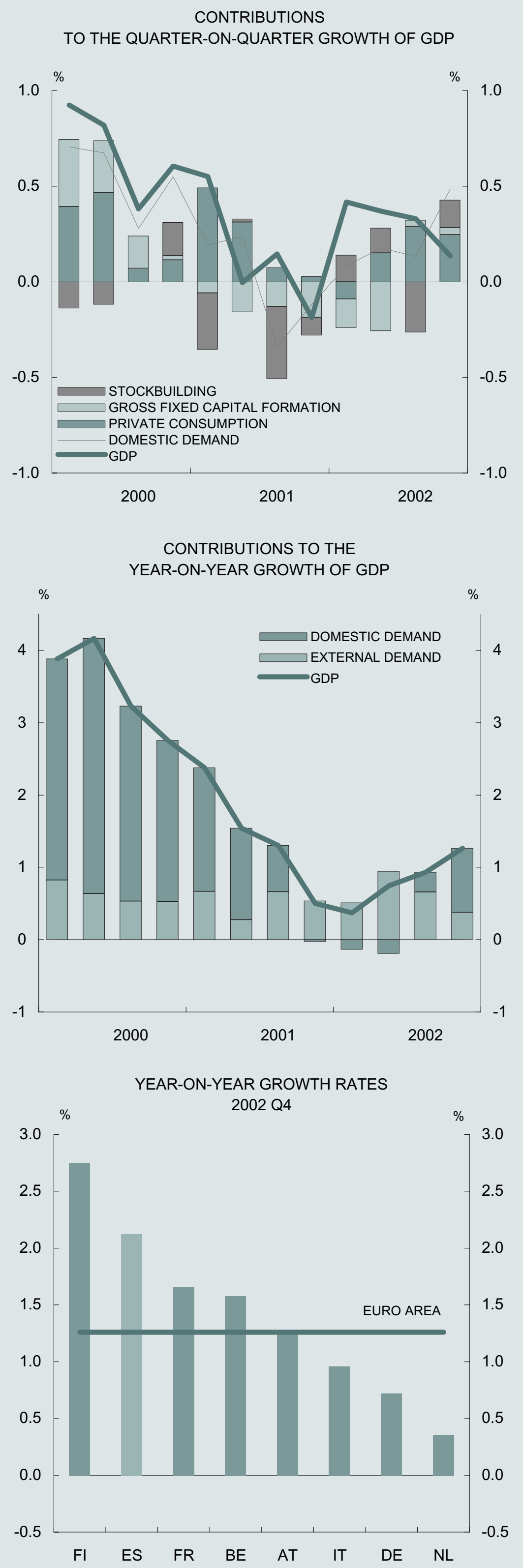
The breakdown of the National Accounts by country in Q4 shows that quarter-on-quarter growth slowed in most of them. Notable among the larger economies was the GDP stagnation in Germany due to the sharp slowdown in all the components of final demand except for investment, due partly at least to the reasons mentioned in the preceding paragraph. In France the lower GDP growth was attributable to the moderation of the export growth rate, since the contribution of domestic demand remained constant. Meanwhile, in Italy the upturn in private consumption and in investment countered the more negative contribution of external demand, resulting in a slightly higher rise in GDP than in the previous quarter.

From the standpoint of supply, the slower GDP growth in 2002 Q4 was due to the sharp slowdown in the value added of industry, which, along with that of construction, showed negative rates of change. The other sectors, however, were more buoyant than in the previous quarter. According to provisional data on the labour market, quarter-on-quarter employment growth was zero or slightly positive in Q4. The lesser vigour of employment in comparison with GDP allowed some recovery in apparent labour productivity.

The economic indicators published on activity in 2003 Q1 do not generally point to an improvement in the rate of GDP growth. Indeed, the quarter-on-quarter growth range estimated by the European Commission for that period, which is from –0.2% to 0.2%, is equivalent to a year-on-year rate of around 1%, which is less than that in 2002 Q4. This perception is backed by the absence of signs of recovery in the industrial sector confidence indicators and by the notable worsening in those relating to the services sector. However, it should also be mentioned that the industrial production index performed relatively well in January and February compared with the previous quarter, and the

CHART 8

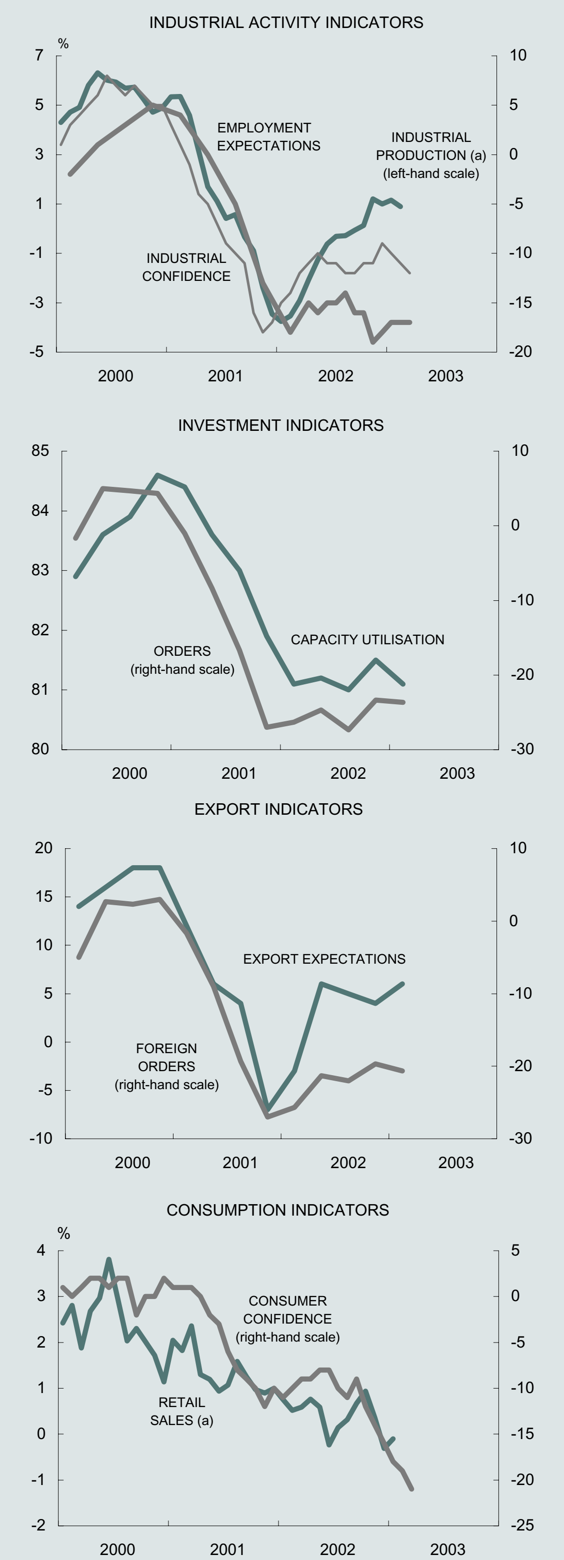
GDP in the euro area



Sources: Eurostat and national statistics.

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.

construction sector confidence indicator improved slightly (see Chart 9).

From the standpoint of demand, clear signs of recovery are also lacking. In particular, the private consumption indicators compiled from opinion surveys worsened in the first three months of 2003. Thus the EC consumer confidence indicator slumped to its lowest values in recent years (see Chart 9). The retail confidence indicator also worsened, although to a lesser extent. It is likely, however, that the fall in consumer confidence has an element of overreaction, as a consequence of the tense international political situation in the opening months of the year. Meanwhile, the investment indicators based on the EC industry survey also worsened. The assessment of order books weakened and the degree of capacity utilisation decreased. Also, the business survey indicated that stocks are still well above the desired level, although there has already been a certain adjustment with respect to 2002 Q4. In addition, analysis of the determinants of consumption and of gross fixed capital formation does not suggest that demand will overcome the weakness shown by it in the closing months of 2002. In this connection, the high uncertainty regarding the economic situation and employment have foreseeably led companies to postpone their investment plans and raised households' propensity to save. Also, the continuing deterioration in stock market prices and the efforts by certain companies to ameliorate their financial position have not been conducive to spending decisions.

The export indicators point to a slight improvement in 2003 Q1. Thus the Q1 export expectations indicator according to the quarterly business survey and the January balance of payments data on exports outside the area improved. However, the opposite trend was shown by the external order book assessment indicator based on the monthly business confidence survey, which declined slightly on average in the first three months of the year, although remaining above the 2002 average. Therefore, foreseeably the greater sluggishness of domestic demand perceived for Q1 will be partially offset by a greater contribution from external demand, derived both from growth in exports and from a lower relative weight of imports, despite exchange rate appreciation. Finally, the indicators resulting from employment surveys suggest that the deterioration apparent throughout 2002 will come to a halt, although the euro area unemployment rate rose slightly to stand at 8.7% in February, 0.2 p.p. above that in the previous quarter.

The euro area price indicators generally showed a slight moderation in inflationary pres-

BOX 1

Change in the volume of euro area foreign trade by geographic destination and product type

According to National Accounts data, the euro area's exchanges of goods and services with other countries in 2002 exhibited, for the second year running, considerable sluggishness: exports grew by 1.2% and imports declined by 0.3%. Taking into account the estimated slight rise of 2.9% in world trade in that period, the euro area's export share in the foreign markets foreseeably decreased in 2002.

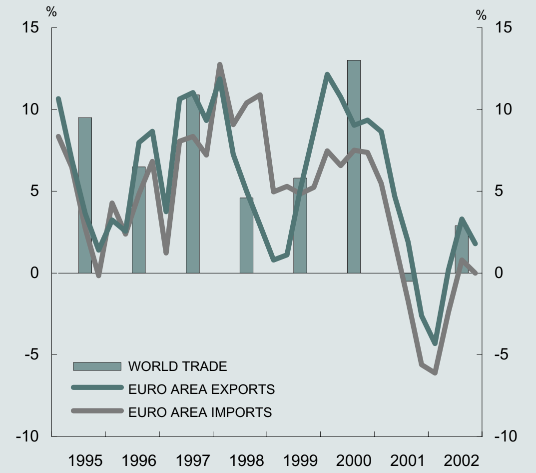
To analyse in detail, by geographic destination and by product, the changes in the euro area's trade flows in 2002, use is made of the information furnished by Eurostat on merchandise trade in volume terms. According to this information, which is shown in the accompanying table, merchandise exports only grew by 0.1% in 2002, while imports decreased by 2.2%. The chart shows that the growth of the area's total exports reached a low in the first quarter and then initiated a moderate rise, which was interrupted in the closing months of the year.

The relative strength of trade with non-euro area markets in 2002 prevented a more marked deterioration in exports since, although the slowdown affected all regions, the rate of change of extra-euro area sales remained positive. In particular, the buoyancy of non-community sales was due to the strong demand from the countries that have recently signed the Treaty of Accession to the EU, the weight of which in total trade (which includes intra-Community trade) has now reached 6.7%, and from China, while exports to other markets grew at a rate that was negative or very near zero. In line with the notable crisis in certain Latin American countries, exports to this area decreased significantly in 2002. Sales to South-East Asia also worsened considerably in 2002, although they picked up as the year progressed. Finally, exports to the United States and to the United Kingdom stagnated, which may be related to the strength of the euro against the currencies of these two countries.

The sluggishness of purchases from abroad was general. Hence it seems that, in the year as a whole, the decline in the relative price of imports from outside the euro area with respect to intra-Community purchases due to the appreciation of the euro did not significantly influence behaviour. Also, imports from the candidate countries and China were those that increased the most, so these countries prolonged their period of market-share gains in the European markets in 2002.

Turning to the breakdown by product, a noteworthy element of the sluggishness of manufactures was the decrease in imports of *machinery and transport equipment*, in line with the notable slowdown in capital goods investment in 2002. However, mention should be made of the relative importance of chemicals purchases from abroad, with annual growth of 9.1%. In exports, it was also *machinery and transport equipment* and *chemicals* that showed the greatest decline and the greatest growth, respectively, evidencing the importance of intra-industrial trade flows between the various economic areas. The strength of chemicals sales is particularly notable, since it is the only product group in which the euro area managed not to lose share in world exports during the 1990s.

Changes in real merchandise trade
(Year-on-year rates of change)



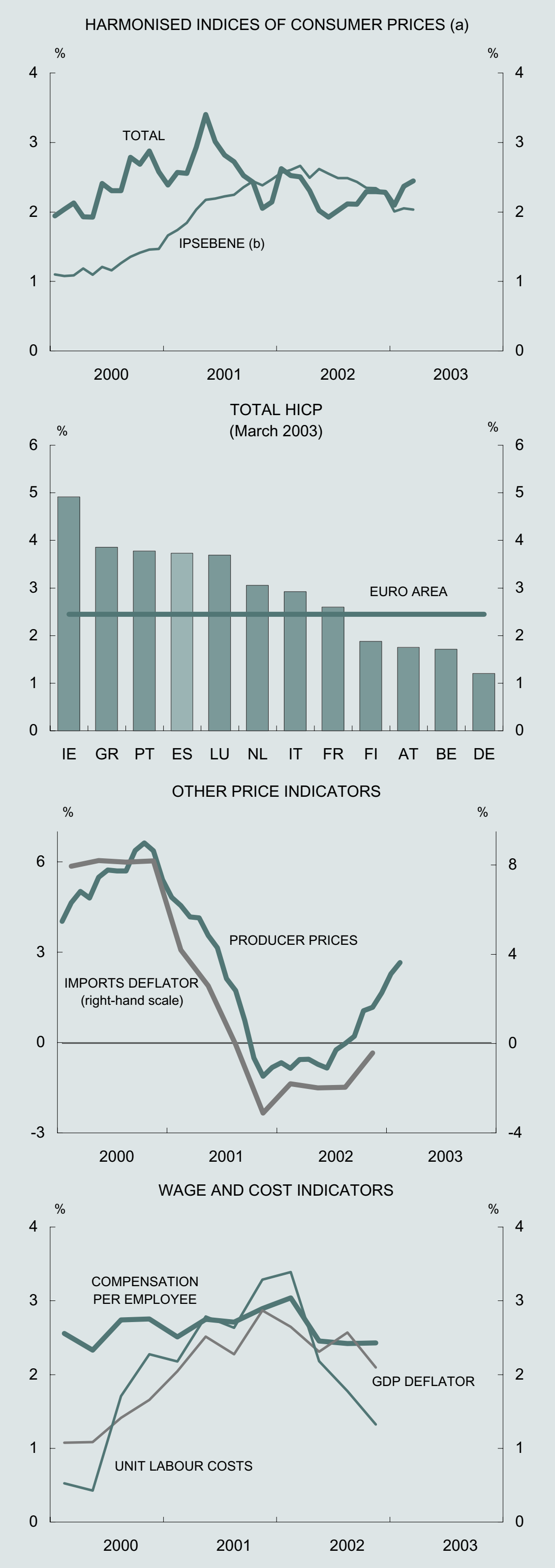
%	Year-on-year rate of change					
		2002 (a)				
2001	2001	YEAR	Q1	Q2	Q3	Q4

	2001 (%)	2001	YEAR	Q1	Q2	Q3	Q4
EXPORTS - BREAKDOWN BY AREA:							
Total		**3.0**	**0.1**	**-4.3**	**0.2**	**3.3**	**1.8**
Intra-euro area	50.2	1.0	-1.5	-6.2	-2.2	1.9	2.3
Extra-euro area	49.8	5.1	1.6	-2.3	2.7	4.7	1.2
United Kingdom	9.5	6.7	0.0	1.9	1.2	0.1	-4.5
Candidate countries	6.4	0.9	8.1	-0.6	12.3	12.8	7.9
United States	8.5	3.8	0.9	-4.2	0.1	5.1	3.7
Latin America	2.3	5.5	-11.6	-16.5	-10.9	-9.2	-9.0
Japan	1.6	2.0	-2.7	-12.9	-2.2	4.3	2.4
China	1.2	21.4	19.2	14.7	18.4	21.6	22.0
South-East Asia	1.6	7.6	-8.4	-16.2	-7.2	-7.4	0.4
IMPORTS - BREAKDOWN BY PRODUCT:							
Total		**-0.1**	**-2.2**	**-6.1**	**-2.4**	**0.8**	**0.0**
(Of which, extra-euro area	50.0	-1.0	-2.2	-6.1	-1.4	0.8	-1.4)
Food	6.6	2.6	-0.7	-1.7	-1.6	0.2	0.8
Raw materials	3.7	-3.5	-3.7	-7.2	-3.3	-1.1	-2.6
Oil and oil products	9.6	2.9	0.0	1.9	0.5	-0.3	-3.1
Manufactured goods	76.5	-0.2	-4.1	-9.1	-4.5	-0.3	-1.2
Chemicals	11.7	5.2	9.1	6.7	10.1	11.3	7.9
Products derived from raw materials	14.1	-2.7	-4.2	-9.8	-4.3	-0.1	-1.5
Machinery and transport equipment	38.8	-1.2	-8.1	-14.1	-8.7	-3.8	-3.5
Other	11.9	0.7	-4.1	-6.4	-5.2	-1.6	-2.7

Sources: Eurostat and IMF.
(a) Information up to November.

CHART 10

Euro area. Price, wage and cost indicators.
Year-on-year percentage changes



Sources: Eurostat and Banco Central Europeo.
(a) There is no break in January 2002 when the series was rebased to 2001.
(b) Index excluding more volatile fresh food and energy prices.

sure in 2003 Q1. Despite the inertia shown by wages, unit labour costs were contained in Q4, due to the recovery in productivity. It is foreseeable that in the opening months of 2003 the productivity gains of around 1% will have helped to alleviate the pressure on domestic prices.

The HICP increased in March by 2.4% year-on-year, 0.1 p.p. more than in December. This rise was due mainly to the behaviour of energy prices, given the moderation in the growth rate of those for services and for non-energy industrial goods (see Chart 10). Therefore, in March the rate of change of the index of non-energy processed goods and service prices (IPSEBENE by its Spanish name) decreased by 0.3 p.p. with respect to that in December 2002. The course of prices in the euro area countries continued to be notably uneven, as evidenced by the high inflation differentials (nearly 4 p.p.) between Ireland and Germany. Finally, producer prices incorporated the effect of the rise in energy prices and, as a result, in February the producer price index grew by 2.7% year-on-year, as against 1.7% in December.

Inflation is expected to decelerate in the coming months, mainly because of the normalisation of supply conditions in the oil market following the end of the war in Iraq, although the political instability in the Middle East has far from disappeared. This factor, together with the euro's appreciation against the dollar and the scant pressure of demand, should help to bring the year-on-year rate of change of the HICP back to levels below 2% in the coming months. The likelihood of this being consolidated in the medium term depends crucially on sustained wage moderation, which would also be conducive to the recovery of employment in the near future.

Since the only information available on the balance of payments is that relating to January, it is difficult to draw conclusions on the patterns observed and possible future developments in this regard. According to the data published by the ECB, in January 2003 the current account recorded a deficit of € 6.4 billion, against a situation nearly in balance in the same month a year earlier. This was due both to an increase of € 3.7 billion in the income account deficit and to reductions of € 2 billion and € 2.5 billion in the surpluses on the goods and current transfers balances, respectively. In contrast, the services account deficit decreased by € 1.9 billion. Direct and portfolio investments showed net capital outflows of € 16.5 billion, mainly as a result of the net purchases of negotiable assets abroad (€ 14.7 billion). The basic balance, which includes the current account balance and the balance of di-

TABLE 1

General government budget balances of euro area countries (a)

% of GDP

	2000	2001	2002	2003 (b)	2003 (c)
Belgium	0.1	0.2	0.1	-0.2	0.0
Germany	-1.4	-2.8	-3.6	-3.4	-2.8
Greece	-1.9	-1.9	-1.2	-1.1	-0.9
Spain	-0.9	-0.1	-0.1	-0.4	0.0
France	-1.4	-1.6	-3.1	-3.7	-2.6
Ireland	4.3	1.1	-0.3	-0.6	-0.7
Italy	-1.8	-2.6	-2.3	-2.3	-1.5
Luxembourg	6.1	6.4	2.6	-0.2	-0.3
Holland	1.5	0.1	-1.1	-1.6	-1.0
Austria	-1.9	0.3	-0.6	-1.1	-1.3
Portugal	-3.1	-4.2	-2.7	-3.5	-2.4
Finland	6.9	5.1	4.7	3.3	2.7
MEMORANDUM ITEM:					
Euro area					
Primary balance	3.0	2.3	1.5	1.1	
Total balance	-1.0	-1.6	-2.2	-2.5	-1.8
Public debt	70.2	69.2	69.2	69.9	

Sources: European Commission, national stability programmes and IMF.
(a) As a percentage of GDP. Proceeds from the sale of UMTS licences not included. Deficit (-) / surplus (+).
(b) European Commission forecasts (April 2003).
(c) Targets of the stability programmes presented between November 2002 and January 2003.

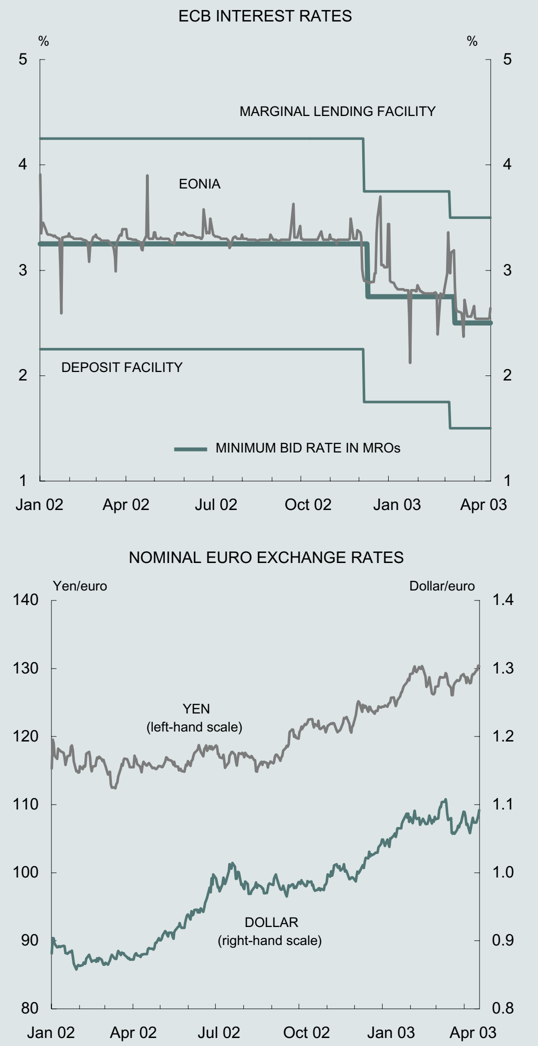
rect and portfolio investments and thus approximates the economy's financing needs, had a deficit of € 22.9 billion in January.

With regard to fiscal policy, the national figures that have been issued show that in 2002 the budget deficit of the area as a whole rose by 0.6 p.p. to 2.2% of GDP. This worsening was the result of an increase of 0.5 p.p. in primary expenditure's share of GDP and a decrease of 0.3 p.p. in the share of overall income, with interest payments falling by 0.2 p.p. The results were particularly unfavourable in Germany and France, where the deficit exceeded the limit of 3% of GDP set in the Treaty establishing the European Union (see Table 1). In the case of France, the publication of these budget data led to the initiation of an excessive deficit procedure, which came on top of those already initiated earlier for Germany and Portugal.

In March the Ecofin Council adopted a report on the strengthening of fiscal policy co-ordination (subsequently backed by the Brussels European Council). The report – prepared on the basis of a proposal submitted by the Commission in November 2002 in response to a request from the Barcelona European Council of March that same year – seeks to clarify certain aspects of the application of the Stability and Growth Pact in the light of the experience gained over the six years it has been in force. To this end, the text adopts an approach that enables disciplinary considerations to be combined with the need to provide an appropriate response to certain specific situations. In particular, the Council renewed the Eurogroup agreement of October 2002 whereby the countries that have high deficits, and are thus still far from being close to a balanced budgetary position, will correct their cyclically adjusted balances by an annual minimum of 0.5% of GDP. In assessing this improvement, regard will be had to what extent use has been made of actions that only have temporary effects on the position of public finances. In addition, the report asserts that in assessing the budgetary position of the various countries, greater importance should be given to aspects such as long-term sustainability (and thus they should step up their efforts to obtain adequate and homogeneous forecasts on the budgetary effects of population aging) and the rate of decline of the debt to GDP ratio in the countries in which it remains at particularly high levels. Further, the text includes a reminder that it is important to avoid pursuing procyclical policies at times of high economic growth, especially in countries still showing imbalances.

CHART 11

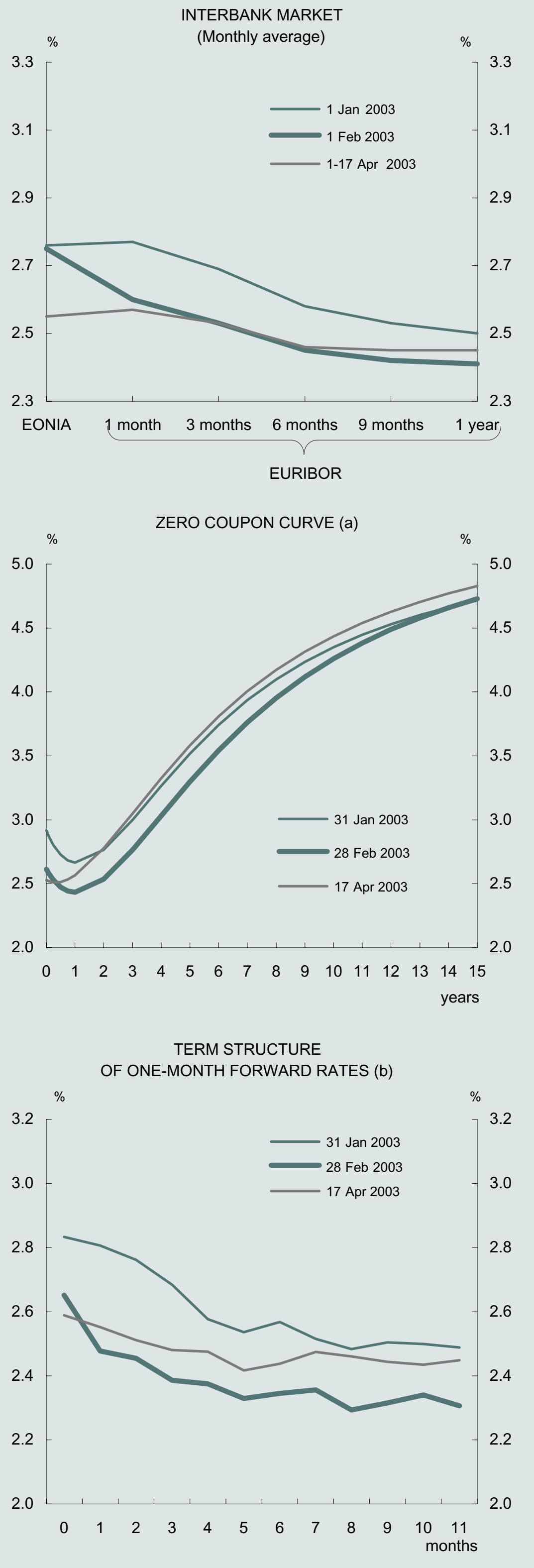
ECB interest rates and euro exchange rates



Sources: Banco de España and European Central Bank

CHART 12

Euro area Yield curve



Sources: Banco de España and European Central Bank.
(a) Estimated using swap market data.
(b) Estimated using Euribor data.

Except for their examination of the Netherlands and Austria, the European Commission and the Ecofin Council have finished examining the updates of the stability programmes prepared around the end of 2002. According to these documents, the area as a whole should reach a deficit of 1.8% and 1.1% of GDP in 2003 and 2004, respectively. In subsequent years, the Member States plan to progressively reduce the negative balance of their General Government, which would be brought into balance in aggregate terms in 2006. However, according to the Commission's spring forecast, the reduction in the 2003 and 2004 deficits will be 0.7 and 1.3 p.p., respectively, less than that entailed by the targets set in the programmes. A part of these notable differences can be explained by the substantial worsening in the ar-

TABLE 2

Monetary and financial situation in the euro area and Spain

%

	2000	2001	2002		2003			
	DEC	DEC	NOV	DEC	JAN	FEB	MAR	APR (a)
MONETARY VARIABLES (b):								
EURO AREA								
M3	4.1	7.9	7.0	6.9	7.2	7.9	7.9	
M1	5.2	5.4	9.1	9.9	9.5	10.3	11.6	
Credit to private sector	10.1	6.7	4.6	4.7	4.8	4.9	4.6	
SPAIN								
Cash and cash equivalents	4.4	6.8	13.7	11.4	12.3	12.1	11.0	
Other bank liabilities	19.8	8.4	3.3	4.1	3.9	4.3	3.6	
Mutual funds (c)	-27.1	26.2	12.9	11.1	13.2	20.3	18.7	
Financing to the private sector	18.8	15.7	14.9	14.5	14.8	15.0	13.5	
FINANCIAL MARKETS (d):								
EONIA	4.83	3.36	3.30	3.10	2.79	2.76	2.75	2.55
Three-month EURIBOR	4.94	3.35	3.12	2.94	2.83	2.69	2.53	2.53
Public debt								
Euro-area ten-year bond yields	5.07	4.96	4.59	4.41	4.27	4.06	4.13	4.26
US/euro-area ten-year bond spread	0.25	0.16	-0.53	-0.32	-0.21	-0.12	-0.31	-0.28
Spain/Germany ten-year bond spread	0.31	0.23	0.12	0.10	0.06	0.06	0.04	0.02
Bank rates in Spain								
Synthetic deposit rate	3.02	2.22	2.20	2.06	1.99	1.96	1.83	
Synthetic lending rate	6.35	4.86	4.67	4.40	4.39	4.36	4.25	
USD/EUR exchange rate	0.897	0.892	1.001	1.018	1.062	1.077	1.081	1.076
Equities (e)								
Dow Jones EURO STOXX broad index	-5.9	-19.7	-27.2	-34.5	-4.8	-9.2	-12.9	-2.2
Madrid Stock Exchange General Index	-12.7	-6.4	-15.9	-23.1	-1.6	-1.2	-3.1	7.2

Sources: European Central Bank and Banco de España.
(a) Monthly average to 17 April 2003.
(b) Year-on-year rate of change.
(c) Including euro-denominated FIAMMs and FIMs.
(d) Monthly averages.
(e) Cumulative percentage change in the year. End-of-month data. Latest month: 17 April 2003.

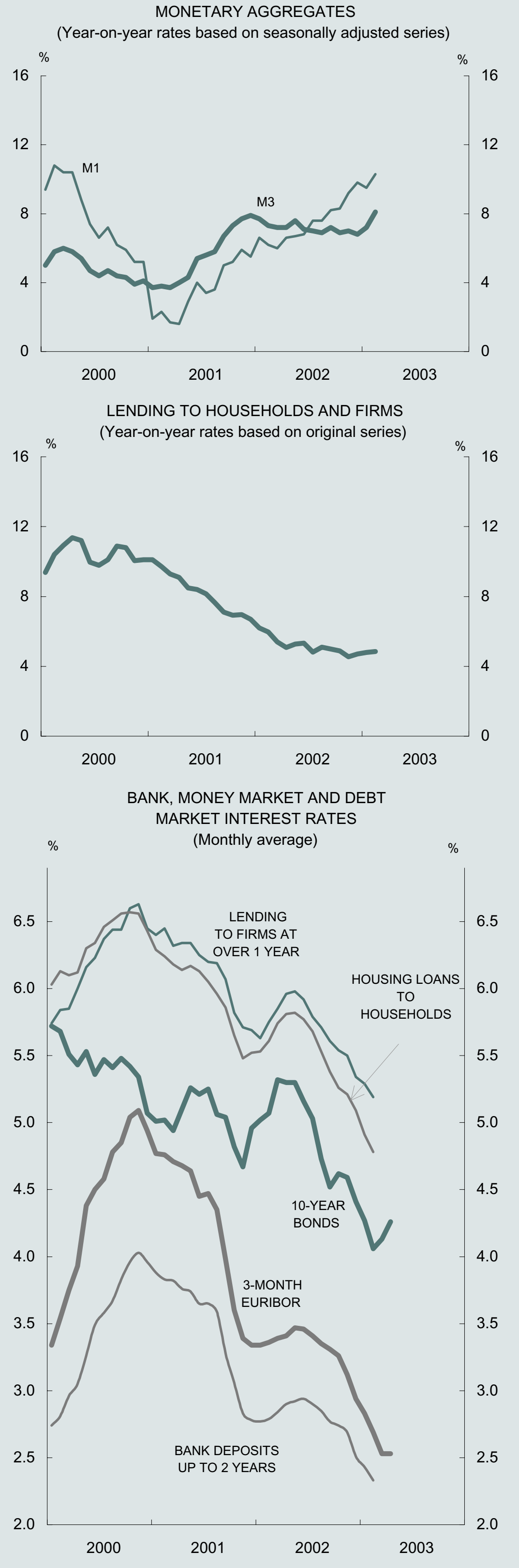
ea's growth outlook between the formulation of the programmes' macroeconomic scenarios (early autumn 2002) and the April 2003 forecasts prepared by the European Commission. However, according to the latter forecasts, the cyclically adjusted balance will only be subject to a slight adjustment between 2003 and 2004, whereas the programmes indicate an approximate improvement of 1 p.p. in those years. As regards the outlook of the various countries considered individually, the Member States still showing imbalances generally plan to meet the requirement to improve their cyclically adjusted balances by an annual minimum of 0.5% of GDP, although in certain countries the adjustment does not start until 2004. Although, according to the programmes, no country would infringe the deficit ceiling of 3% of GDP in 2003 and 2004, the Commission's forecasts prepared on the assumption of unchanged policies point to failure to comply with this requirement by Germany in 2003, by Italy in 2004 and by France and Portugal in both years.

3.2. Monetary and financial developments

Against a background of favourable inflationary prospects and weak economic activity, on March 6 the Governing Council of the ECB reduced official interest rates by 25 basis points, which left the minimum rate on the main financing operations at 2.5%, that on the deposit facility at 1.5% and that on the marginal lending facility at 3.5% (see Chart 11). The previous decision to cut interest rates (by 50 basis points) was in December 2002. Subsequently, at its 3 April meeting the ECB decided

CHART 13

Monetary and credit aggregates and interest rates in the euro area



Sources: Banco de España and European Central Bank.

not to change interest rates in view of the exceptional circumstances of the international political situation, which enormously complicated the task of properly assessing the economic outlook.

In Q1 the monetary and financial situation continued to be conditioned by the expectations of weak growth in the real economy and of sustained sluggishness and volatility in the stock markets, to which was added the uncertainty caused by the geopolitical tension derived from the preparations for military intervention in the Middle East. Following the outbreak of the Iraq war in mid-March, the financial markets started to reflect the news being received about the possible duration of the war and its impact on activity. It was then possible to discern a tendency towards a modest recovery in stock market prices and an upturn in long-term interest rates, which to some extent reflected an improvement in the expectations of growth after the end of the war.

Money market interest rates followed a downward path as a result of the expectations of interest rate cuts, which were fulfilled in March. In the first three weeks of April the EURIBOR yield curve showed average rates of around 2.5% all along the maturity spectrum. Indeed, in the last few days the yield curve for 1-month forward interest rates has flattened, although the market still feels that there is a significant likelihood of an additional interest rate cut in the next few months (see Chart 12).

In the foreign exchange markets, the opening months of the year saw the euro continue to appreciate against the main currencies and, in particular, against the dollar. As a result, in the third week of April it was 5.7% higher than its level in December 2002. This strengthening of the euro since mid-2002 might be related to the worsening of the US external imbalance, which has been aggravated by the reappearance of a substantial US fiscal deficit, partly linked to the budgetary impact of the Iraq war.

The falls in stock market prices continued from the onset of the year to mid-March as a consequence of the geopolitical uncertainty and the still scant signs of recovery in the main economies. However, the stock market performance of the different sectors was uneven. Thus in the first quarter the financial sector was most strongly affected by the falling stock market, followed by energy and consumer goods. The moderate falls suffered by the telecommunications, technology and manufacturing sectors may be a sign that investors feel that their prices are already in line with their fundamental determinants following the adjustments in the recent past. The general recovery of

BOX 2

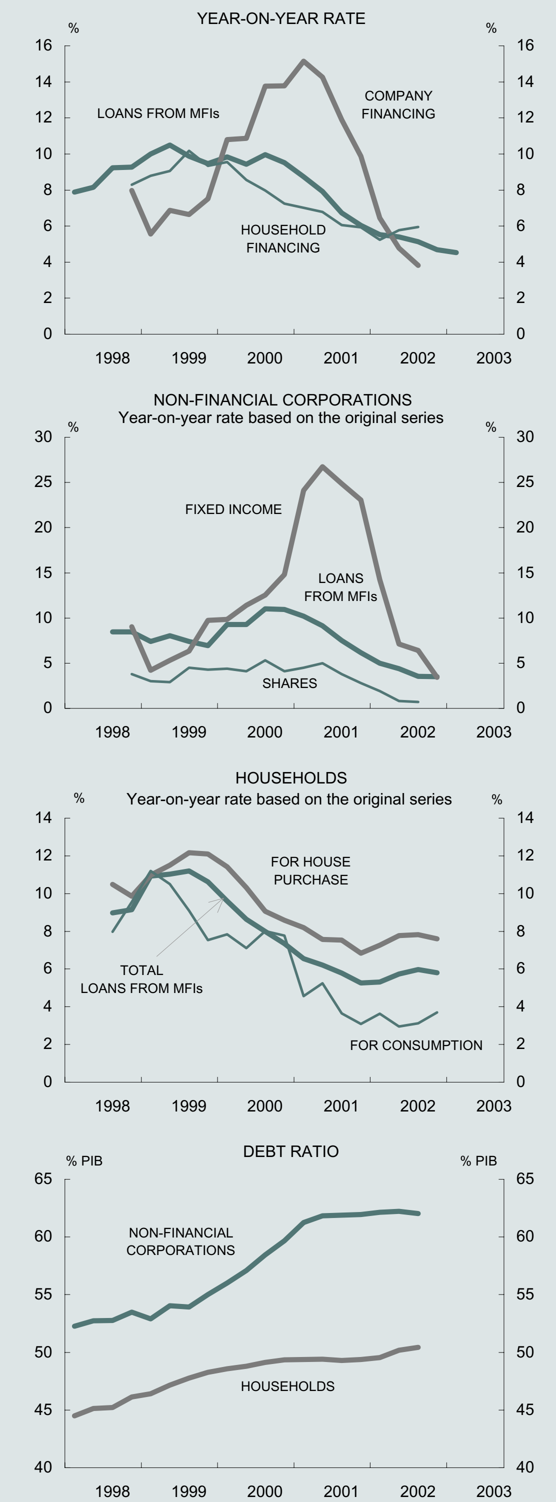
Recent changes in private-sector financing in the euro area

The behaviour of private-sector financing is strongly procyclical. It is thus natural that the economic slowdown in 2001 and 2002 should be reflected in lower growth rates of borrowing by non-financial corporations and households. The available information on total financing, which runs to 2002 Q3, shows a slowdown in this variable for both non-financial corporations and households. The growth rate of financing to non-financial corporations slowed much more sharply, dropping from around 15% in 2001 to below 4% in 2002 Q3, whereas in the case of households the year-on-year expansion of financing fluctuated between 10% and 6% in those periods (see upper panel of adjacent figure). The greater volatility of investment, in comparison with the relative stability of household spending decisions, may partly explain these differences in the patterns seen in the two sectors. In the light of the information on loans by MFIs to the non-financial private sector, which are its main source of financing, these patterns do not seem to have changed in recent months, since growth has remained at rates slightly below 5% in year-on-year terms up to March.

In the case of non-financial corporations, the last few years have seen a persistent slowdown in loans by MFIs, which were expanding at a year-on-year rate of 3.7% at the end of 2002. More significant is the sharp decrease in financing through the issuance of fixed-income securities, which, after increasing at rates in excess of 20% in 2001, have in recent months been behaving similarly to loans. This reflects both the cyclical slowdown and the higher returns demanded by investors in these securities, particularly if the issuer does not have a high credit standing. The second panel from the top in the adjacent figure also shows that the funding obtained through the issuance of listed shares decreased appreciably in 2002. Although this instrument is not included among the components of financing, it can be an important source of funding. That said, even in stock market booms it did not reach the rates of expansion of fixed-income securities. Examination of the total financing obtained by non-financial corporations, which along with loans from MFIs and the balance of fixed-income securities, also includes loans from non-euro area credit institutions and pension fund liabilities, shows that the sustained rise in 1999 and 2000 in the debt-to-GDP ratio halted in 2001 and remained steady throughout 2002 at a level somewhat above 60% (see lower panel). This may be a result both of sluggish investment and of efforts by some companies to put their finances back on a healthy footing after the upsurge in indebtedness of prior years.

In the case of households, the main source of financing is obviously loans from MFIs. As with companies, there has been a slowdown in such borrowing by households in the last few years, although the deceleration has been milder and has petered out, even reversing itself slightly in 2002. Perusal of the purposes for which this financing was granted shows that the greatest expansion was in house purchase loans (which account for two-thirds of the total), with a year-on-year rate of nearly 8%, which can be considered fairly high considering the cyclical position of the euro area economy. This is largely explained by a combination of low interest rates and house price movements (with significant recent rises in certain euro area economies). Meanwhile, the financing granted for the purchase of consumer durables and for other purposes grew at rates below 4% in 2002, and was thus more in line with aggregate demand. As a result of these developments, the debt-to-GDP ratio of households has increased steadily over the last few years. In 2002 Q3 this ratio stood at 51%, which is lower than in the United States and the United Kingdom. In any event, in many of the newer euro area countries, once the effects of the change of regime entailed by joining the euro area have dissipated, household debt may be expected once more to move more in step with the economic cycle.

Private-sector financing in the euro area



Sources: European Central Bank and Banco de España.

the stock market from mid-March was a reflection, within the prevailing uncertainty, of greater optimism about a rapid outcome of the Iraqi conflict and its positive consequences for world growth. In this regard, the cumulative loss of the broad Dow Jones EURO STOXX index in 2003 Q1 was largely corrected in the first half of April (see Table 2).

During the first quarter the M3 monetary aggregate posted increasing rates of growth which were even higher than those of the previous quarter (see Chart 13). This buoyancy was due to the strong preference, amid considerable uncertainty, shown by agents for the liquid assets included in the aggregate. Thus in March the aggregate grew by 7.9% year-on-year. Finally, in the opening months of 2003 credit to the private sector held at rates slightly below 5%, similar to those in 2002 Q4. Box 2 analyses in detail the recent developments in the indebtedness of non-financial corporations and households in the euro area. In the case of Spain, lending to the private sector continued to grow at a sustained pace, with a year-on-year rate of 13.5% up to March.

4. The Spanish economy

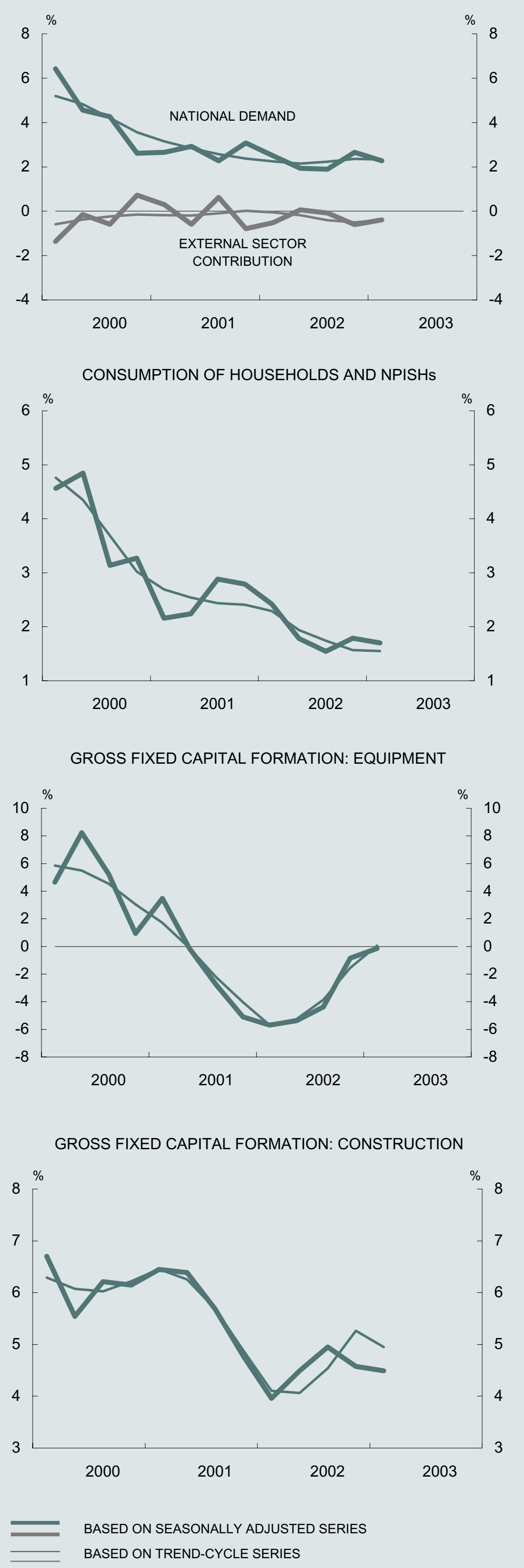
On the basis of the QNA information available for the first few months of 2003, real GDP is estimated to have grown by 2% year-on-year in the first quarter, following growth of 2.1% in 2002 Q4. Underlying this performance was a slowdown in national demand, which increased by 2.3% year-on-year, 0.4 percentage points less than in 2002 Q4. Stockbuilding contributed to this slowdown on account of its reduced buoyancy. The rate of growth of private consumption stabilised, its recovery in late 2002 thus coming to an end, while investment in capital goods was reaching the end of its long downturn, a substantial reduction being estimated in its year-on-year rate of decline. As for construction, the trend of mild deceleration is estimated to have continued (see Chart 14). The contribution of net external demand to GDP growth was again negative in Q1, although less so than in the preceding quarter. Both imports and exports grew at more moderate rates than in the previous quarter, although the former grew faster than the latter.

From the viewpoint of the value added by the various productive sectors, 2002 ended with activity recovering in industry and stabilising in market services, at relatively moderate rates, while construction decelerated and agriculture contracted sharply. The information on Q1 points to a containment of the expansion in industry, while market services continued to grow at similar rates to those recorded in the second half of 2002 and the rate of decline in agriculture was reduced. Meanwhile, employment is estimated to have started the year with greater vigour than in 2002 Q4, so that apparent labour productivity gains remained low in Q1.

During 2002, labour costs per unit of output stabilised at rates of around 3.2%, as a result of an expansionary trend in compensation per employee which rose by 4%, and a modest recovery in apparent labour productivity. The estimates for 2003 project a slight additional increase in compensation, that may be passed through to labour costs. Meanwhile, the prices of imported products have been having a moderating effect on final prices, intensified by the appreciation of the euro. Against this background, the rate of increase in final prices turned downwards in the first quarter of 2003, from the high rates recorded at the end of the previous year. Thus, the consumer prices index stood in March at a year-on-year rate of 3.7%, 0.3 percentage points down from December 2002, certain temporary effects having been stripped out, such as those arising from the changeover to the euro and the increases in indirect taxes at the beginning of 2002. Profit margins have widened significantly, although this

CHART 14

Main demand aggregates
Percentage change on year ago



Sources: INE and Banco de España.

widening has been confined to certain specific activities.

4.1. Demand

During 2002, the year-on-year growth of household final expenditure moderated gradually, although it accelerated somewhat – seemingly temporarily – in the final quarter (see Chart 14). The average increase in consumption during the year was 1.9%, 0.6 percentage points down on the previous year. However, the slower annual consumption growth was accompanied by a strengthening of real gross disposable income, so that the decline in the savings ratio, recorded during the preceding years, came to an end and the ratio increased slightly. The still incomplete information on the behaviour of consumption in 2003 Q1 indicates that, following the rise in Q4, the year-on-year rate of growth of this aggregate edged down below the end-2002 rate of 1.8%, against a background of steady growth in disposable income.

The indicators most directly related to household spending (shown in Chart 15) point to moderation in the rate of expansion of non-durable and durable consumer spending in the first three months of 2003. Apparent consumption of consumer goods (food and non-food) is estimated, in the absence of complete information for the period, to have grown at a slower rate than in the preceding quarters. The retail trade confidence indicator deteriorated somewhat to March, while the index of retail sales showed greater stability, albeit with a trend of mild deceleration. Among the indicators of durable consumption, apparent durable consumption was less buoyant than in the previous quarter and new car registrations fell significantly, while consumer sentiment regarding the purchase of such goods reached very low levels. Finally, the consumer confidence indicator fell again between December and March, dragged down by a further decline in sentiment regarding economic prospects for households and for the economy in general.

As already indicated, household disposable income is estimated to be increasing in 2003, in real terms, at similar or slightly higher rates than in 2002. The resilience of household disposable income stems from employment and the growth of nominal wages (including the effect of the indexation clauses included in the 2002 collective agreements), as well as from the more expansionary contribution of net transfers from general government, due to the lowering of personal income tax. Meanwhile, the latest information on house prices indicates that the value of real-estate assets has continued to rise at significant rates, and that they are therefore still helping to prop up consumption. However, share prices again recorded significant falls at the start of the year (although they rose during April). Along with the decline in consumer confidence, this helps to explain the relatively muted behaviour of spending in the first few months of 2003. Overall, the available estimates indicate that consumption grew by less than disposable income in Q1 and that the saving ratio continued to recover.

General government final consumption grew by 3.8% on average in 2002. The still-highly-incomplete conjunctural information available points to an acceleration in this aggregate in 2003 Q1, partly as a result of the measures introduced for this year in relation to personnel costs and the extraordinary expenses arising from the sinking of the Prestige.

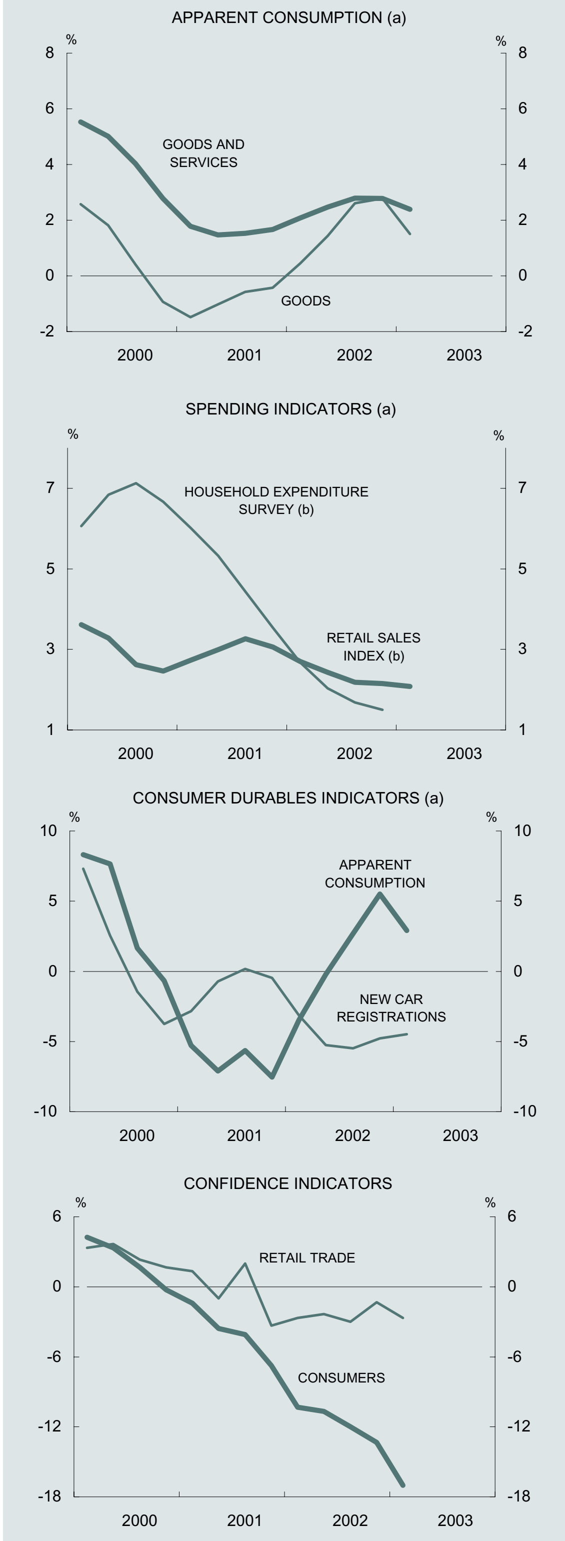
Gross fixed capital formation rose by 2.5%, year-on-year, in 2002 Q4, giving rise to average growth of 1.4% during the year. The acceleration in investment in Q4 was a consequence of the slower rate of decline of investment in capital goods, since investment in construction and in other products continued to grow, albeit at more moderate rates than in the preceding quarters. These patterns seem to have continued to apply during 2003 to date, so that the growth of the investment aggregate would have held at around 2.5%.

As regards investment in capital goods, the last quarter of 2002 saw a break in the previous pattern of sharp declines, in line with the upturn signalled by the main indicators of such investment, although its year-on-year rate of growth remained negative at –0.8% (see Chart 16). According to the index of apparent investment in capital goods this negative rate was reduced further in 2003 Q1, so that the path of the year-on-year growth of this investment is one of recovery, even though a reduction in the momentum of domestic output has been discerned. Indeed, there was a notable improvement in the industrial confidence indicator and in the orders of capital-goods producers to February, but this was cut short in March. Meanwhile, in 2003 Q1 the index of industrial capacity utilisation fell slightly, although the trend in industrial sentiment is one of improvement, as shown by the orders series.

The quarterly data of the Banco de España Central Balance Sheet Data Office, to 2002 Q4, shows an increase in the return on investment of non-financial corporations last year, while the cost of external financing fell slightly. The differential between these two variables widened significantly, laying the foundations for a strong-

CHART 15

Private consumption indicators



Sources: INE, European Commission, Dirección General de Tráfico and Banco de España.
(a) Non-centred 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.

er recovery in investment. This improvement in business profitability has occurred, however, against a background of moderate growth in output and a slowdown in funds generated, which has entailed an increase in levels of debt, especially in energy- and services-related sectors. As mentioned on other occasions, these relatively high levels of debt may limit the future strength of the recovery.

According to the latest information, investment in construction is still relatively buoyant, although since mid-1999 it has been following a path of mild slowdown. In 2002 Q4 its year-on-year growth was 4.6%, a rate which estimates suggest may have fallen slightly in the first quarter of this year (see Chart 16). The strength of construction is currently underpinned mainly by civil engineering work as a consequence of the implementation of infrastructure plans. This can be seen in the quarterly construction industry survey (ECIC) to 2002 Q3 and in the indicators of project starts, such as official procurement. The latest data available on approvals and licences point to a recovery in new residential building, but this is still not discernible in the indicator of house starts, which recorded significant year-on-year declines up to 2002 Q4.

In line with the continued notable strength of construction spending, despite its mild slowdown, the industry's confidence indicator improved significantly in 2003 Q1, reflecting a more optimistic perception of turnover and the trend in employment. Social security registrations, to March, recorded higher year-on-year growth than in 2002 Q4, and unemployment in the sector, even though it continued to increase at high rates, slowed significantly from 2002 Q4.

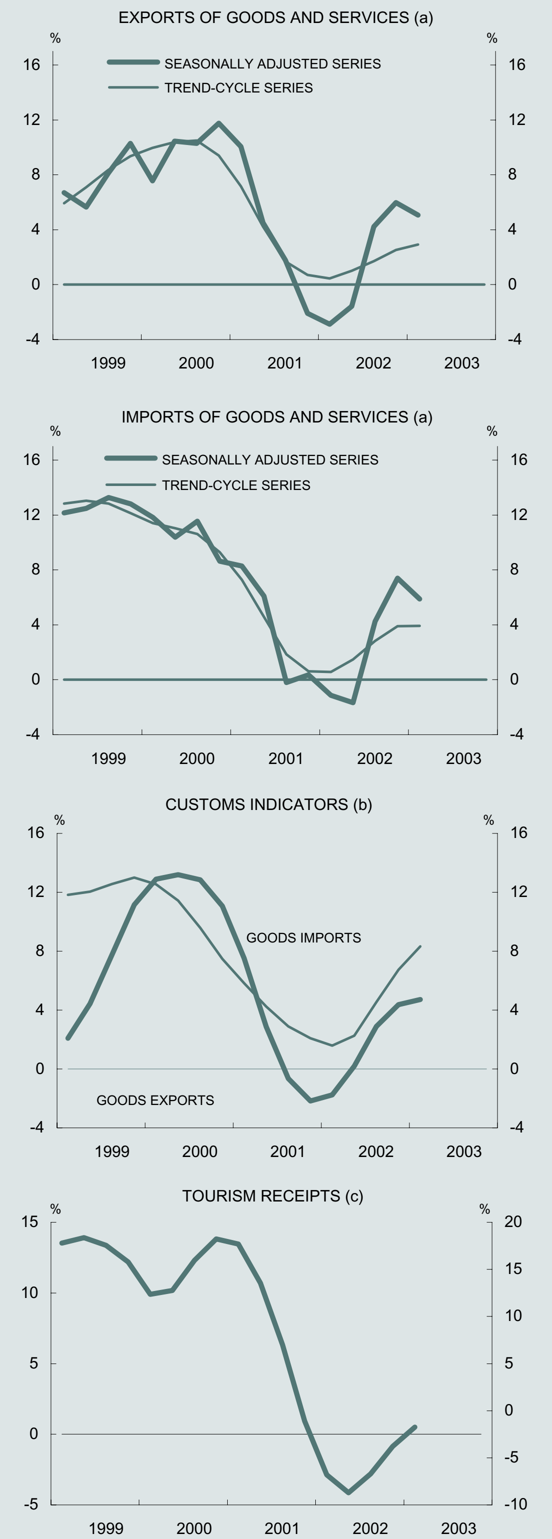
According to the latest QNA data, net external demand was even more contractionary in 2002 Q4, subtracting 0.6 percentage points from GDP growth, so that its contribution to growth in the year as a whole was –0.3 percentage points (see Chart 14). In 2002 Q4, exports and, even more so, imports of goods and services stepped up the recovery that started in Q3, with year-on-year growth rates of 6% and 7.4% respectively, following the negative growth of the first half of the year. From Q2, exports were boosted by the recovery in certain markets, such as the United States and South-East Asia, and in the second half of the year, by the moderate recovery in EU imports. However, in 2002 sales abroad were held back by the losses of competitiveness suffered by Spanish products, as a result of higher price and cost inflation in Spain and the notable appreciation of the euro exchange rate. Imports, on the other hand, reflected the recovery in exports and the incipient recovery in industrial activity in the second half of 2002. The still-highly-incomplete information on 2003 Q1 points to a somewhat smaller reduction in net external demand than in 2002 Q4. The buoyancy of exports seems to have moderated, against a background of great uncertainty regarding the recovery in world activity and tourism demand, while imports also seem to have decelerated, in line with the reduced momentum of exports and domestic output, against a background of sharply rising prices for oil and non-energy commodities on international markets.

On QNA data, goods exports gained momentum over the second half of 2002. Customs data for January show a significant moderation in the rate of growth of exports that month (when they grew by 1%), although given the variability of these flows and the strong seasonality of the January data, this figure needs to be assessed with caution. In terms of their trend (see Chart 17), the path of exports points to a slowdown in the most recent months. By geographical area, exports outside the EU were still the most dynamic in January (rising by 2.9% in real terms). The buoyancy gained by those to the United States and the continued strength of those to China and the Maghreb countries were noteworthy. Exports to the EU scarcely grew by 0.2% in real terms, although the Italian and French markets also performed well.

As for exports of services, real income from tourism, on QNA data, fell by 2.7% in 2002 Q4, which slightly reduced the year-on-year growth rate. During the year as a whole, however, it declined by an average of 4%. These results were shaped by the notable moderation in global tourist demand – triggered by the 11th September attacks and reinforced by the world economic slowdown – and by the low levels of consumer confidence. In addition, the widening of price differentials vis-à-vis the developed countries and the strong appreciation of the euro have entailed a loss of competitiveness relative to our main customers. Real indicators of tourism (tourist entries, foreign travellers staying in hotels and overnight stays) showed a certain improvement during the second half of 2002, which was maintained in January of this year. However, this pattern changed from February when, in the climate of run up to war, there was a slowdown in tourist entries and a notable decline in travellers staying at hotels, as well as in overnight stays. In Q1, there were falls in both foreign travellers staying at hotels and, even more sharply, in overnight stays, in contrast to the increase in tourist entries. These results suggest that there has been a progressive shift of tourists towards non-hotel establish-

CHART 17

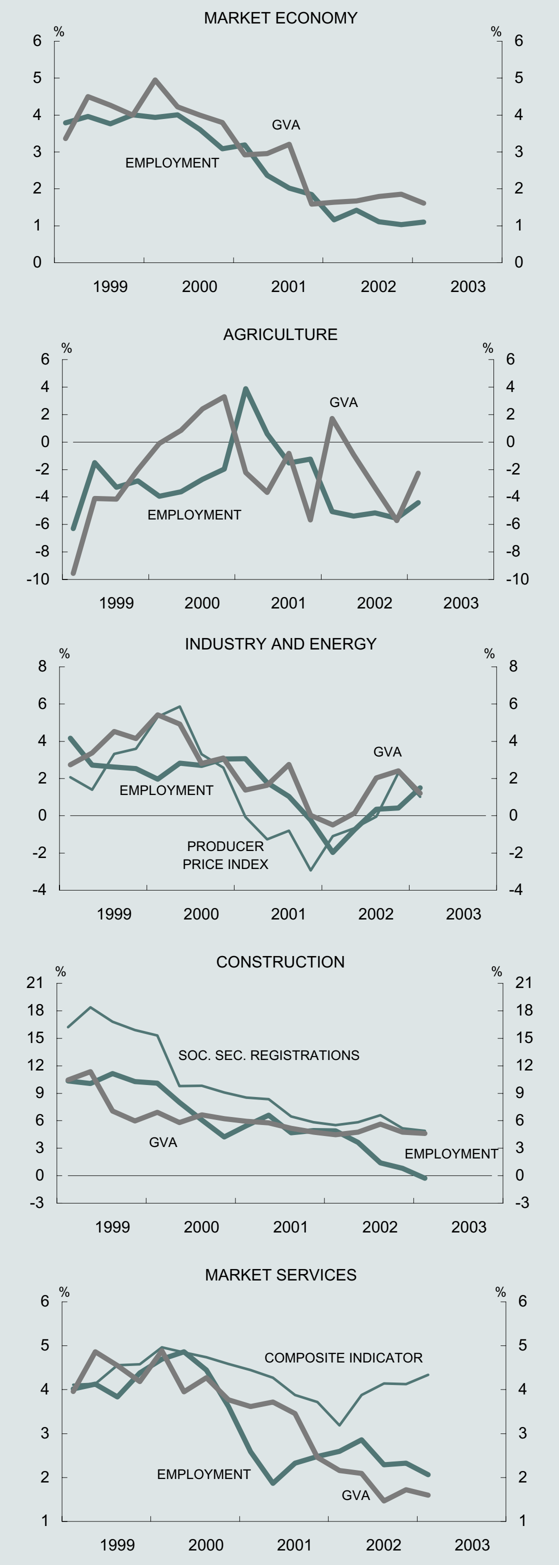
Foreign trade
Percentage change on year ago



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

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.

ments. The outlook for the spring months has worsened significantly, given the delay in tourists' travel decisions linked to the war in Iraq.

The slowdown in exports of non-tourism services steepened in 2002 Q4, with growth of 2.9%, in line with the deceleration in the balance-of-payments indicator. In the year as a whole, their growth fell to 3.9%, from 9.8% in 2001, reflecting the sharp fall in investment abroad during the period.

Real imports of goods, like the aggregate for goods and services, accelerated significantly in the second half of 2002 in line with final demand. Customs data for January 2003, however, show a sharp slowdown to a slightly negative year-on-year rate (–0.1%). Again the variability of this series means that it must be assessed in terms of its trend, which displays a moderation in its rate of expansion at the beginning of 2003 (see Chart 17). Purchases of energy intermediate goods decreased significantly in January, affected by the steep rise in the price of oil on international markets, while non-energy imports slowed notably (1.5%). Among the latter, the most buoyant components were non-food consumer goods, despite the reduction in car imports. Imports of capital goods grew at a very moderate rate, while those of non-energy intermediate goods fell, in strong contrast to the momentum they gained in the second half of 2002.

Finally, real imports of services increased by 2.5% in 2002 Q4, slightly down from the preceding quarter's rate of 3.1%. This trend was displayed by both residents' consumption abroad (4.7%), amid a sharp decline in consumer confidence and a shift from foreign to domestic tourism, and by non-tourism services (2.1%).

4.2. Output and employment

Value added in agriculture and fishing contracted further in 2002 Q4, falling by 5.7%, year-on-year. (see Chart 18). The primary sector was thus clearly contractionary in 1992 as a whole (–2.1%), reflecting the low rainfall, which affected certain vegetable products, and especially the production of olive oil. In 2003 Q1 there may have been a certain recovery in the sector, reflected in the positive performance of the employment indicators, given the favourable start to the year's rainfall; even so, value added would have fallen again in year-on-year terms.

Activity in industry and energy began to recover in 2002 Q2, reaching a rate of change of 2.4% in Q4. This recovery reflected the greater buoyancy of the production of intermediate goods, basically in their non-energy component, as well as less contractionary behaviour in the manufacture of capital goods. However, some indicators of activity in 2003 Q1 seem to show a faltering in the recovery, against a background of notable uncertainty. This has affected exports, which are an essential engine of industrial activity. Thus, the industrial production index (IPI) slowed down in the first two months of the year (with an increase of 1.2%, in terms of the calendar-adjusted series, as against 2.5% in the previous quarter), the level of capacity utilisation and new orders declined slightly, imports of non-energy intermediate goods increased much less than in 2002 Q4, and social security registrations declined year-on-year between January and March, having stagnated in 2002 Q4. However, other indicators were more positive, giving scope for a stepping up of the industrial recovery. Worth mentioning here, besides the recent EPA (Labour Force Survey) employment figures, is the improvement in the business confidence indicator and in sentiment regarding the future trend in output. The continuity of the recovery in the output of capital goods, which in February reached a positive year-on-year rate for the first time since 2001, is also encouraging. In any case, the external sector is still hardly in a position to boost activity in this sector in the short run.

In 2002 construction was again the most dynamic sector in the market economy, although its rate of growth fell slightly, to 4.9%. In the final quarter of the year, construction activity decelerated, but it still grew at a rate of 4.8%. As indicated in the last section, residential building tended to weaken over the year, while non-residential building was buoyant and civil works benefited from infrastructure investment plans. The beginning of 2003 has been marked by continuity in this pattern of growth, and the available indicators confirm that the year-on-year rates of change held very close to those of late 2002.

In 2002, the tertiary sector grew by 2.2%, one percentage point down on the previous year, despite the greater vigour of non-market services, which accelerated by 0.6 percentage points to 3.5%. The value added of market services grew by 1.9%, decelerating over the first three quarters and accelerating slightly in the fourth. The information on market services in the first quarter of 2003 indicates that year-on-year rates have at least held at similar levels to those in the second half of 2002 (see Chart 18). Social security registrations in Q1, employment, the trend in the synthetic indicator (ISIS) and the different survey indicators point in this direction. Among the activities included in market services, wholesale and retail trade and repairs was in step with private consumption, while the deterioration in the outlook for tourism has fed through to the activities related to this sector and, in particular, to hotels and restaurants. Transport indicators, especially the employment ones, have been displaying stable growth, with a slight upturn in air transport, based on the domestic transport of travellers. However, the great sensitivity of this activity to tourism presages a slowdown. Finally, real estate, renting and business activities followed the general trend, weakening in the first quarter of 2003, according to social security registrations.

Employment, on QNA data, grew by 1.3% on average in 2002. With the exception of a slight upturn in Q2, this variable continued to follow the downward path it had embarked upon in early 2001, so that by the end of the year the rate of year-on-year growth had fallen to 1.1%. The moderation in employment in 2002 relative to the preceding year was more pronounced than that in activity, giving rise to higher growth of apparent labour productivity which, nonetheless, remained very modest (0.7%). In the market economy employment rose by 1.2%, less than the whole-economy rate, partly owing to the steeper slowdown in GVA, the recovery in apparent productivity (to 0.6%) being somewhat less sharp in this case. The employment indicators reflect the reduced vigour of job creation in 2002, although to a varying extent. According to the EPA, employment suffered a considerable loss of momentum, growing by 2%, 1.7 percentage points less than in the previous year. Social security registrations, on the other hand, slowed more moderately, increasing by 3% in 2002, almost one percentage point less than in the previous year. Registrations of non-EU foreign workers made a substantial contribution to this growth (over a third), which may help to explain the discrepancy with the EPA. Finally, the number of contracts signed in 2002 increased by 0.9%, as against 1.6% in 2001. However, in 2003 Q1 there was an upturn in the main employment indicators, with growth in registrations of 3.3% and an increase in employment of 2.3%, according to the EPA figures that have just been published. Employment growth in the market economy is thus estimated to have accelerated.

At the industry level, jobs were lost in agriculture in 2002 at an annual rate of –5.3%, which accelerated in the final quarter of the year (see Chart 18). Employment also fell in the industrial sector, by 0.5% on average although, in step with the improvement in activity in the sector, industrial employment displayed a profile of recovery to September, and stood at 0.4% in Q4. Both the EPA and general-regime registrations had a similar profile. Construction, meanwhile, continued to be the most dynamic sector in terms of employment, although its rate of job creation suffered a notable loss of buoyancy from 2001, falling from 5.4% to 2.7% in 2002. A significant increase in the presence of immigrants in this sector means that general-regime registrations show a much smaller loss of momentum. Finally, in terms of employment, market services was the best-performing sector in 2002, its average rate of growth edging up to 2.5%. The latest EPA data, for Q1, reflect a higher rate of job creation in non-agricultural sectors.

Numbers of employees grew by 2% in 2002, 0.8 percentage points less than in the preceding year, while self-employment fell by 2.1%, displaying its traditionally countercyclical behaviour. In terms of contract type, according to the EPA, numbers of employees with permanent contracts remained very buoyant in 2002 and, although the rate of growth fell by 0.8 percentage points, they increased by 3.8% on average during the year, with a slight upward profile. Conversely, in the second half of the year, temporary jobs began to decline in net terms, in line with the slowdown in activity, so that their average annual rate of growth was 0.6%, almost 3 percentage points down on the preceding year. The ratio of temporary to total employment fell by 0.7 percentage points to 31%. Notwithstanding this, the proportion of permanent contracts fell slightly in 2002, according to INEM figures. As for working hours, both full-time and part-time employees were affected to the same extent by the slowdown in employment. As a result, in 2002, the ratio of part-time to total employment increased by only 0.1 percentage points, to 8.2%.

The notable vigour of the labour force in 2002 was one of the most striking features of the labour market that year. Despite the slowdown in activity, the labour force grew by 3%, according to the EPA, close to the rate in 2001, its accelerating profile only being broken in the final quarter, when it grew by 2.7%. This inflow to the labour market was due mainly to the increase in the rate of activity of 1.1 percentage points, to 54% (67.1% if the over-65s are excluded). In turn, the growth of the labour force, together with the moderation in job creation, led to an increase in average unemployment of 11.4%, with a markedly upward profile to the third quarter, in line with that of the labour force. In consequence, the rate of unemployment stood at 11.4%, in the year as a whole, with a markedly upward profile until Q3, in line with the profile of the labour force. In consequence, the rate of unemployment stood at an average rate of 11.4% over the year as a whole. The performance of registered unemployment last year was also unfavourable. It rose by 6%, although in the first few months of 2003 its rate of growth slowed to 4.6%, as seen in the EPA figures just released, although this is consistent with the percentage of unemployed in the labour force having increased in that period, to stand at 11.7%. Box 3 summarises the reform of protection carried out in 2002, although it is still premature to assess its impact.

4.3. Costs and prices

On QNA data, the cost of labour per unit of value added grew by 3.2% in 2002 Q4, both in the economy as a whole and in the market economy (see Chart 19). In the market economy, apparent labour productivity recovered somewhat in the final quarter. This was accompanied by stable growth in compensation per employee, and therefore gave rise to a slight deceleration in costs, relative to the previous quarter. It is estimated that unit labour costs rose in 2003 Q1, owing to the stronger growth in compensation and to the decline in productivity.

The information on collective bargaining indicates that by the end of February collective agreements had been registered for four million workers, approximately 45% of all workers covered by collective bargaining in 2002. The average wage settlement agreed for 2003 is 3.5%, as against 3.1% in 2002, before including the effect of indexation clauses. The initial estimate of this effect for 2002 is approximately 0.7 percentage points, which would be added to the wage increase in 2003. As regards the agreements signed for 2003, the average settlement in newly signed agreements is 2.7%, which is in line with the Inter-confederal Agreement on Collective Bargaining, although this still only affects a very small number of workers. The average settlement in revised agreements, the registration of which is well advanced, is 3.5%.

According to the labour costs index, the total monthly cost per employee rose by 4.6% in Q4, 0.3 percentage points more than in the previous period. There was a pick-up in the growth rate of both the components of labour costs, although wage costs accelerated by only 0.1 percentage points (to 3.9%), while other costs grew by 6.6% (up 0.8 percentage points on the previous quarter). Over the year as a whole, total monthly labour costs per employee increased by 4.4%, 0.3 percentage points up on the previous year's growth. The growth of wage costs accelerated to 3.9%, while non-wage costs, despite a mild deceleration, continued to grow at a very high rate (6%). At the sectoral level, in

BOX 3

Reform of unemployment protection

The approval on 12 December last year of Law 45/2002 on urgent measures to reform the system of unemployment protection and to improve employability, made a number of changes to the system of unemployment protection, which are examined below. The measures contained in this Law can be grouped under three major headings: i) changes in the conditions of eligibility for unemployment benefit; ii) changes to the rules governing wages payable upon dismissal and in the unemployment benefits for specific groups, and iii) prevention of access of new claimants to the agricultural unemployment benefit scheme in Andalucía and Extremadura. Finally, there is a brief discussion of the new benefit system for these two regions approved by Royal Decree 426/2003 of 11 April 2003.

First, changes have been made to the conditions of eligibility for unemployment benefit. Thus, it is now an essential requirement for eligibility that unemployed persons sign a commitment stating their readiness to perform all such actions as may improve their employability and to accept any job offer received. That said, an initial period of 100 days has been established, during which unemployed persons are not obliged to accept the measures proposed by the Public Employment Services (SPE). Also, the definition of appropriate employment has been changed, to encourage the acceptance of more job offers, as has the penalty system, so that unemployment benefit is progressively lost in the event that offers are rejected.

All in all, these measures affect the general conditions of eligibility for contributory unemployment benefits, aiming to increase both active job searching by the unemployed and the incentives to accept job offers made by the SPE. However, if they are to have a significant effect on the working of the labour market, it is essential that they be accompanied by a substantial enhancement of the role of the public employment offices as intermediaries in the labour market (1), with an increase in the offers made to unemployed persons and an improvement in the activities designed to achieve their professional reinsertion. In turn, the flexibility granted to the offices by the new definition of appropriate employment must be used in such a way that the penalties imposed are compatible with an efficient search for the best job possible.

Second, the rules on wages payable upon dismissal have been changed and modifications have been made to the system of unemployment benefits in relation to returned emigrants, the receipt of benefit during periods of holiday not taken, the compatibility of benefit with wages for certain groups, the redefinition of income incompatible with unemployment subsidy and the beneficiaries of re-insertion scheme income, discontinuous permanent workers and, finally, a 100% rebate of Social Security contributions for a year has been introduced for women who are unemployed after having a child.

As regards wages payable upon dismissal, the Law has made it possible for employers to admit the unfairness of a dismissal and avoid legal proceedings, paying the relevant compensation to the worker before the conciliation hearing (2). From then on the employer is no longer required to pay any more wages, and if the admission is made within 48 hours no wages shall be payable for the period following notification of dismissal. Under the new rules firms can therefore reduce the costs of dismissal by about one month's wages, by immediately admitting that the dismissal is unfair, in which case the dismissed employee shall be legally unemployed from the notification of dismissal and shall receive compensation for unfair dismissal. However, it should be noted that this new rule may reduce the number of fair dismissals even further, even though the compensation payable is less than for unfair ones.

The other measures involve adjustments to unemployment protection with effects for specific groups of minor importance for the general functioning of the benefit system. Note that unemployment protection is maintained for workers with discontinuous permanent contracts in the case of contracts for activities with a definite data, provided that they were signed prior to the reform of March 2001. Following this reform, all contracts previously signed as "discontinuous permanent contracts for activities with a definite date" are now considered to be part-time contracts.

Third, under the reform of the agricultural unemployment benefit scheme in Andalucía and Extremadura, no new claimants can gain access to the current system, a contributory system is set up for casual agricultural workers in all regions and various measures have been taken to boost the geographic mobility of the current claimants. However, the recently approved Royal Decree 426/2003 introduces a new protection scheme for the agricultural workers of Andalucía and Extremadura excluded by this reform, with similar features to the previous one.

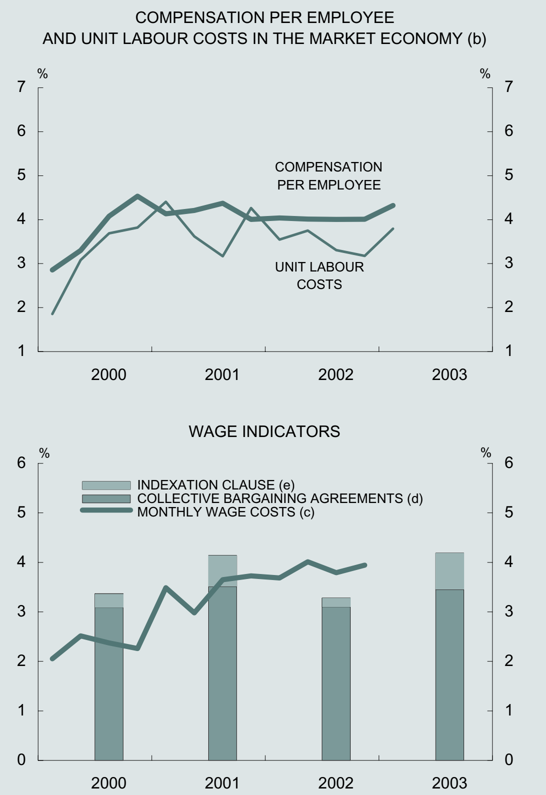
The reform approved by Law 45/2002 entails the gradual disappearance of the current system of agricultural subsidy for casual agricultural workers in Andalucía and Extremadura. This may have positive effects insofar as the current system has evident shortcomings as regards the incentives for claimants to find work. As an alternative, first, a pure contributory system is introduced for the casual agricultural workers of all regions (which is less generous than the general contributory system). Second, the Royal Decree approved on 11 April 2003 establishes an agricultural unemployment benefit scheme for claimants excluded by Law 45/2002, which is, in some respects, very similar to that existing previously. However, it contains various changes designed to reduce some of the basic problems of the old system. For example, it limits the number of benefit applications to a maximum of six, to avoid indefinite periods in the benefit system, labour-market re-insertion measures are established, which the INEM should design for unemployed agricultural workers, and it incorporates incentives to work more than the minimum of 35 days.

(1) Their role is currently more focused on benefit administration, and they only handle about 15% of registered placements.

(2) Previously, the conciliation hearing was the first opportunity for employers to admit the unfairness of a dismissal and to pay the relevant compensation to the dismissed worker. About one month's wages were, on average, payable by that time.

CHART 19

Wages and labour costs (a)



Sources: INE, Ministerio de Trabajo y Asuntos Sociales and Banco de España.
(a) Percentage change on same quarter a year earlier.
(b) Rates based on QNA seasonally adjusted series.
(c) Total earnings.
(d) Settlement in the year to date.
(e) Previous year's indexation clause.

2002 Q4 monthly labour costs per employee increased by 5.4% in industry (4.8% in the year as a whole), by 4.4% in services (4.4% in the year) and by 4.7% in construction (4.8% on average in the year).

Against this background of stable growth in unit labour costs, the rate of increase of the value added deflator for the market economy also held steady in the second half of 2002 (the increase in the year as a whole reaching 4.5%), although it may have slowed slightly at the beginning of 2003. In any event, the gross surplus per unit of output continued to grow at a higher rate than the deflator throughout this period, giving rise to widening profit margins, as seen in Chart 20. The chart also shows significant differences across sectors. In Q4 the value-added deflator for industry and energy slowed by 0.6 percentage points to 4.5%, while unit labour costs only slowed by 0.3 p.p., as a result of the greater buoyancy of productivity. Thus, the

CHART 20

Prices and costs by branch of activity (a)

Sources: INE and Banco de España.
(a) Non-centred percentage change on year ago based on QNA seasonally adjusted data.

growth rate of the unit surplus decelerated, although it continued to exceed that of prices. In market services the deflator grew by 0.2 percentage points more than in the preceding quarter, while unit labour costs slowed by the same amount, giving rise to a widening of margins (the unit surplus growing faster than the deflator) for the first time in the year. Finally, in construction, unit labour costs declined, while the deflator accelerated significantly; the unit surplus therefore grew at very high rates and margins widened notably.

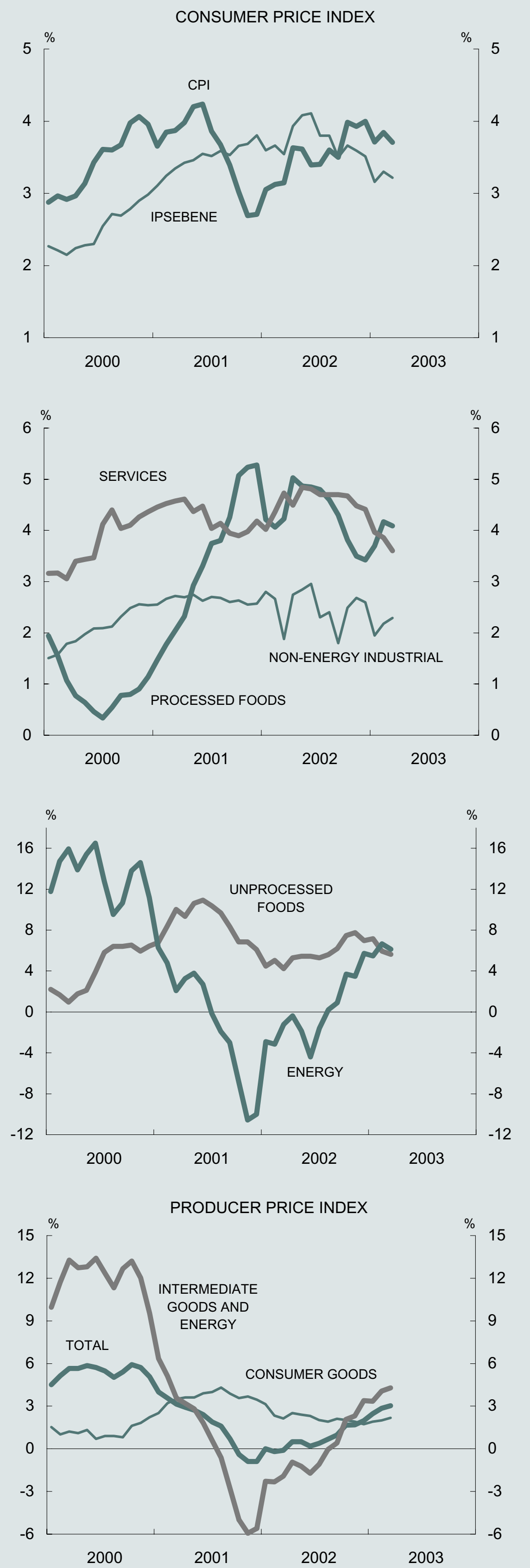
The valued added deflator for the economy as a whole recorded more moderate rates of change than that for the market economy in 2002 (growing by 4.1%), although its accelerating profile was similar. The final demand deflator increased by 3.1% in 2002, reflecting the moderating impact of falling import prices (the relevant deflator fell by 0.9%), although by year-end it had risen to 3.4%. The final price indicators available for the first few months of 2003 indicate that price increases moderated.

In line with the comments on the final demand deflator, the year-on-year rate of change of the CPI rose in the final quarter of last year, to reach 4%. However, in 2003 Q1 price pressures moderated and CPI growth stood at 3.7% in March (see Chart 21). The rate of increase of the IPSEBENE, one of the customary measures of core inflation, fell by almost 0.3 percentage points, to a year-on-year rate of 3.2% in March. The total index was affected by large increases in energy prices and, to a lesser extent, by increases in food prices. By contrast, the prices of services and of non-energy industrial goods moderated considerably in 2003 Q1.

The CPI has been strongly affected by the sharp deterioration in energy prices, as a consequence of rising oil prices on international markets, given the uncertainty generated by the war in Iraq. From April there were again significant downward adjustments, which will be felt in the coming months. The year-on-year rate of increase in the prices of non-energy industrial goods was 2.3% in March, 0.3 percentage points down on December, which may partly reflect the disappearance of the upward effects arising from the introduction of the euro. The prices of services, meanwhile, maintained the downward trend that commenced in the middle of last year, and their year-on-year growth rate fell to 3.6% at the end of the first quarter, almost one percentage point down on their average rate in 2002 Q4. In this case too the decline in the year-on-year rate reflects the stripping out of the possible upward effects arising from the euro cash changeover. Among the items that may have been most affected by this were those

CHART 21

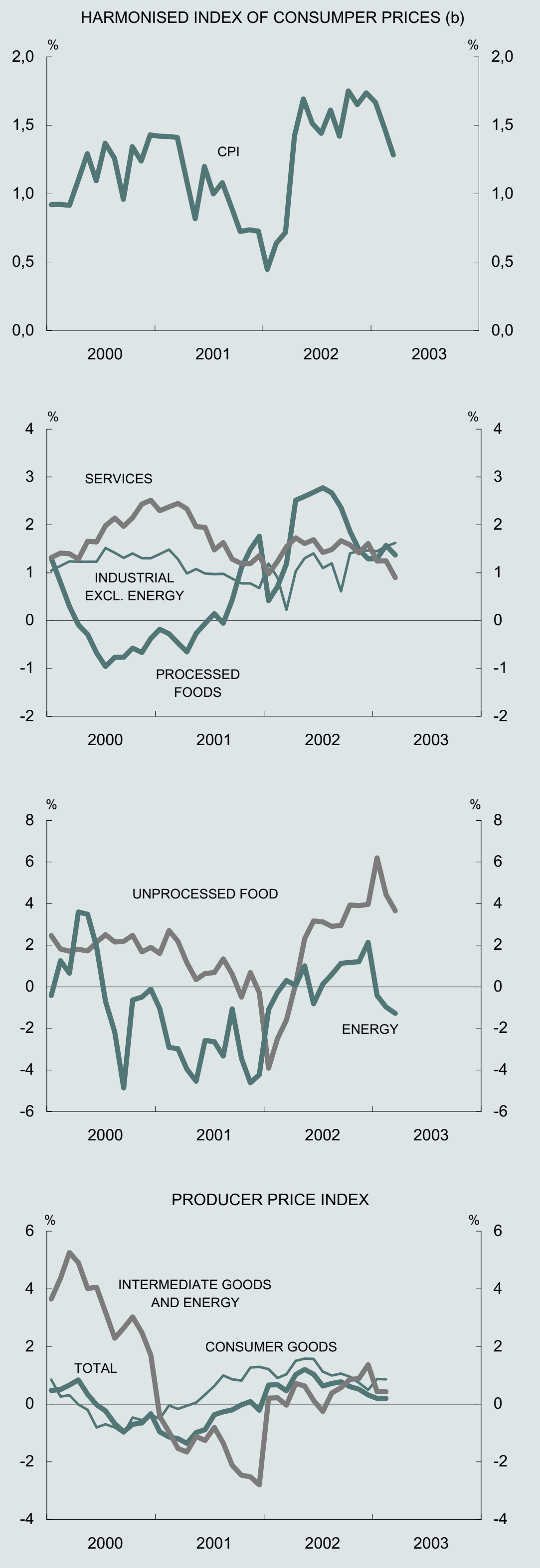
Price indicators (a)
Spain



Source: INE.
(a) Twelve-month percentage change based on the original series.

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.

relating to tourism and hotels and restaurants. In addition, at the beginning of this year there was a rise in communications prices, owing to an increase in the subscription charge of the main fixed-telephony operator and an increase in postal charges. Finally, the rate of increase in food prices in 2003 Q1 was very similar to that in the final quarter of 2002 (4.8%), the acceleration in the prices of processed foods having been offset by the favourable movement in unprocessed foods. The increase in the price of tobacco and the tightening of the price of wine were of note, as were the heavy falls in some meat prices.

The deceleration in 2003 Q1 of consumer prices in Spain (now measured by the HICP) contrasts with the slight upturn in the euro area as a whole, so that Spain's inflation differential with the euro area narrowed by 0.3 percentage points, to 1.4 percentage points in February (see Chart 22). Both the prices of services and of energy helped to reduce the differential, which in the latter case was in Spain's favour. The inflation differential for non-energy industrial goods held relatively steady, while in the case of food prices it widened.

The producer price index accelerated in the first quarter, reaching a year-on-year rate of change of 3% in March, more than one percentage point up on the average rate in 2002 Q4. The acceleration was basically due to energy producer prices, whose year-on-year rate of change stood at 9.5%. In the same period, the acceleration in the prices of non-energy intermediate goods came to a halt, at a rate of change of 1.5%, while the producer prices of consumer goods continued to accelerate, growing by 2.2% year-on-year in March. The prices of capital goods are increasing at a rate of 1.4%.

4.4. The State budget

The figures published for the State budget outturn, in National Accounts terms, to March 2003 show an increase in the surplus on the same period a year earlier. However, it should be pointed out that the comparison with the 2002 figures (both in National Accounts and cash terms) may be affected by the transfer of responsibilities for revenue raising and spending to the regional (autonomous) governments carried out during 2002, although to a lesser extent than in the previous year. At the same time, the timetable for receipt from general government of the tax withheld on earned income has been changed and, since the beginning of this year, this revenue is now transferred monthly (whereas the revenue corresponding to 2002

TABLE 3

State Budget outturn

€ m and %

	Outturn 2002	Percentage change 2002/2001	Budget 2003	Percentage change 2003/2002	Outturn 2002 JAN-MAR	Outturn 2003 JAN-MAR	Outturn Percentage change
	1	2	3	4=3/1	5	6	7=6/5
1. Revenue	**108,456**	**-13.4**	**105,696**	**-2.5**	**27,948**	**27,085**	**-3.1**
Direct taxes	55,531	-0.3	55,218	-0.6	10,327	11,147	7.9
Personal income tax	*32,268*	*-11.5*	*32,217*	*-0.2*	*9,326*	*10,930*	*17.2*
Corporate income tax	*21,420*	*24.4*	*21,090*	*-1.5*	*601*	*-173*	—
Other (a)	*1,843*	*-2.9*	*1,911*	*3.7*	*400*	*391*	*-2.3*
Indirect taxes	38,026	-28.5	37,741	-0.7	13,751	12,740	-7.3
VAT	*25,720*	*-25.8*	*25,742*	*0.1*	*10,600*	*10,015*	*-5.5*
Excise duties	*10,347*	*-37.7*	*9,880*	*-4.5*	*2,681*	*2,233*	*-16.7*
Other (b)	*1,959*	*2.5*	*2,119*	*8.2*	*470*	*493*	*4.7*
Other net revenue	14,898	-8.8	12,736	-14.5	3,870	3,197	-17.4
2. Expenditure	**111,082**	**-13.3**	**114,517**	**3.1**	**30,794**	**29,891**	**-2.9**
Wages and salaries	17,554	4.3	18,490	5.3	3,843	4,200	9.3
Goods and services	2,843	11.3	2,491	-12.4	565	648	14.6
Interest payments	18,863	3.3	19,672	4.3	7,465	7,575	1.5
Current transfers	58,324	-24.4	57,500	-1.4	15,373	13,682	-11.0
Contingency fund	—	—	2,290	—	—	—	—
Investment	7,043	9.0	7,247	2.9	2,095	2,211	5.5
Capital transfers	6,455	-5.3	6,827	5.8	1,452	1,576	8.5
3. Cash-basis balance (3 = 1 – 2)	**-2,626**	**—**	**-8,821**	**—**	**-2,846**	**-2,807**	**—**
MEMORANDUM ITEM: NATIONAL ACCOUNTS (c) :							
Revenue	110,819	-12.5	—	—	27,858	27,639	-0.8
Expenditure	114,395	-12.4	—	—	24,694	23,997	-2.8
Net lending (+) or borrowing (–)	**-3,576**	**—**	**-3,620**	**—**	**3,164**	**3,642**	**—**

Source: Ministerio de Hacienda.
(a) Includes revenue from the tax on non-residents.
(b) Includes taxes on insurance premiums and tariffs.
(c) Figures in conformity with method used in Excessive Deficit Procedure.

Q1 was received in April that year). Also, a significant part of personal income tax revenue in Q1 was still not affected by the reduction in the rate of withholding entailed by the reform of this tax. The rates of change in the final column of Table 3 allow for these facts.

In the first three months of the year, the State recorded a surplus of €3,642 million (0.5% of GDP), as against €3,164 million (the same percentage of GDP) in the same period of the previous year (see Table 3). Both revenue and expenditure fell slightly from a year earlier (by 0.8% and 2.8%, respectively), owing to the residual effect of the change in regional government financing. Notable among the items not affected by this change was the lower revenue from property income, owing to reduced Banco de España profits, and on the expenditure side, the growth of goods and services (30.1%) and of investment (65%).

In cash terms, the latest available data indicate that in 2003 Q1 there was a slight reduction in the State deficit, which stood at €2,807 million, as against €2,846 million in the period January to March 2002. This reduction in the cash-basis deficit contrasts with the increase budgeted

TABLE 4

Balance of payments: summary (a)

€ m

	JANUARY-JANUARY 2002	2003
	CREDITS	
Current account	**19,024**	**20,046**
Goods	10,385	10,592
Services	4,431	4,751
Tourism	2,094	2,121
Other services	2,337	2,630
Income	2,025	1,953
Current transfers	2,185	2,751
Capital account	**1,639**	**1,378**
	DEBITS	
Current account	**20,099**	**22,246**
Goods	12,718	13,286
Services	3,332	3,575
Tourism	553	578
Other services	2,778	2,997
Income	3,072	3,816
Current transfers	977	1,568
Capital account	**93**	**101**
	BALANCE	
Current account	**-1,075**	**-2,199**
Goods	-2,334	-2,694
Services	1,099	1,176
Tourism	1,541	1,543
Other services	-442	-367
Income	-1,048	-1,864
Current transfers	1,207	1,183
Capital account	**1,547**	**1,276**

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

for the year as a whole (Table 3), although the calendar effects referred to above, which have a bearing on the comparison with the previous year, should be taken into account.

To analyse revenue developments, data are available on the total revenue from the main taxes, including both the portion assigned to the State and that which corresponds to the regional (autonomous) governments, the latter portion not being included in Table 3. Total personal income tax receipts grew by 14.7% in Q1, a notable acceleration from the rate for 2002 as a whole. However, this strong acceleration in personal income tax was a consequence of the calendar effect mentioned above in relation to tax withheld on earned income. Indirect taxes, meanwhile, grew in Q1 at a similar rate to the previous year as a whole. VAT grew, on a homogeneous basis, by 6.1% (as against 6.4% in 2002), while excise taxes increased by 5.3% (4.6% in the preceding year). Finally, it should be added that the fall in non-tax receipts reflects the reduction in the State's property income and that the data for corporate income tax are still not representative.

On the expenditure side, there was a fall in Q1 with respect to the same period a year earlier, owing to the current transfers caption which, still affected by the new regional government financing system, declined by 11% (see Table 3). Meanwhile, operating costs (wages and salaries and goods and services) increased significantly, especially in the case of goods and services, which rose by 14.6%, in sharp contrast to the fall of 12.4% budgeted for 2003 as a whole. Finally, capital expenditure also increased by more than budgeted, both in the case of investment and in that of capital transfers.

As regards the budget outturn for the Social Security System, only partial information is available, for January. In terms of recognised rights, there was a significant acceleration in social contributions, which were 8% higher than in January 2002. Only a small part of this acceleration is explained by higher growth in the number of persons registered with the Social Security System, the rate of growth being 3.1% in January 2003, further accelerating to 3.3% in March (3% in 2002). On the expenditure side, pensions increased by 5.5% in January 2003 with respect to the same month a year earlier, in line with the growth budgeted for the year as a whole. The number of contributory pensions showed very moderate growth (1% in January). Unemployment benefit fell by 3.4% to February, in line with the slowdown in registered unemployment (it grew by 5.1% to March, as against 7.4% in 2002 as a whole) and the reduction in the eligibility ratio, which stood at 70.8% to February, as against 71.6% at the end of 2002.

4.5. The balance of payments and the capital account of the economy

In January 2003, the overall balance on current and capital account was a deficit of €923 million, as compared with a surplus of €423 million in January 2002. This result basically reflects the deterioration on current account, the deficit widening by €1,124 million to €2,199 million. The €270 million decline in the capital account surplus also contributed. The deterioration of the current account was across the board, with the exception of the services account which improved; the income account deteriorated significantly, the trade deficit widened considerably and the current transfers surplus fell slightly.

In January 2003, the trade deficit was €361 million higher than in January 2002, a rise of 15.5% in year-on-year terms. This represented a continuation of the deterioration seen in the final months of 2002, and was related to the strong rise in the prices of imported oil products in this period. As for services, in January 2003 there was a surplus of €1,176 million, €77 million higher than in January 2002. This improvement is explained by the 16.9% correction in the non-tourism services deficit, since the tourism surplus was very similar to that a year earlier. Tourism credits grew by 1%, maintaining the slightly positive trend that commenced in late 2002, while debits rose by 4.6% in January 2003, continuing to display the more moderate tone recorded in the previous quarter.

The income deficit worsened by €816 million euro in January 2003, relative to the same month a year earlier, to reach €1,864 million. Credits fell by 3.6%, affected by the lower profits on foreign investments, as a result of the weakness of world activity, as well as the decline in such investments in recent years. Debits, however, rose significantly in January (24.2%), owing to the notable increase in those made by the non-financial private sector.

The current transfers surplus stood at €1,183 million in January 2003, €24 million down on the level a year previously. Credits rose by 25.9%, a result of the notable boost to flows from the EU's EAGGF Guarantee Section, while debits continued to grow at a high rate (60.4%) owing to the increase in payments to the EU in respect of VAT resource and additional GNP resource.

Finally, the capital account surplus stood at €1,276 million in January 2003, €270 million down on the same month of 2002, owing to the delay in payment of most of the EU structural funds. That said, these payments usually do suffer delays in the first few months of the year.

5. Financial developments

5.1. Overview

During 2002 Q4 there was something of a pick-up on international financial markets, which was also seen in Spain (see Chart 23). The Madrid Stock Exchange General Index (IGBM by its Spanish abbreviation) rose 10%, reducing the cumulative losses for the year to 23.1%. This was accompanied by a fall in the implied volatility on the IBEX 35 and in the credit risk premia negotiated by Spanish firms on credit derivatives markets, following the high levels attained in Q3 (Box 4 explains the information content of the latter). Yields on government debt markets remained on a declining course and the spread between Spanish and German long-term government bond yields narrowed by 11 basis points (b.p.) to 8 b.p. On the housing market, prices continued to show no signs of slowing and ended the year with a rise of 17.4%, placing the related real cumulative change since 1997 at 60.7%.

In 2003 to date, prices on Spanish stock markets have been highly volatile, this being essentially connected with the uncertainty over the effects of the Iraq war. As at mid-April, the IGBM was around seven percentage points above its end-2002 level, a somewhat more favourable performance than the average for the euro area. On the derivatives markets, the credit risk premia of the main Spanish corporations in the telecommunications and utilities sectors have held stable, while they have fallen significantly for the oil industry. Finally, yields on the government debt markets have been on a declining course at all maturities. This trend reversed in March in the case of long-term instruments, with interest rates coming to stand at levels very close to those at the start of the year. By contrast, the yield on short-term debt closed Q1 34 b.p. down on its end-2002 level.

Against this background, the financial saving of the non-financial private sector recovered moderately in 2002 Q4, taking the sector's net borrowing to 2.9% of GDP (see Table 5). This development, together with the slight dissaving of the general government sector, meant that the debit balance of the nation's net financial transactions stood at 1.6% of GDP.

Financing extended to the non-financial private sector continued to show high growth during 2002 Q4. In the case of households, there was even something of an acceleration in the rate of expansion of credit. More specifically, credit for house purchases continued advancing at a rate of around 17%, while that intended for the acquisition of durable and current goods slowed notably. Borrowed funds raised by non-financial corporations grew at a slightly lower rate than the previous quarter (13.9%). This trend led to a fresh increase in the level of households' and non-financial corporations' relative indebtedness, which did not make for increases in the associated financial burden, owing to the favourable behaviour of the cost of debt. On provisional information for 2003 Q1, the resources raised by Spanish corporations and households continue to expand at a rate of close to 14%.

Spanish households and firms thus continued to resort during 2002 Q4 (as they probably will have done into 2003) to borrowed funds in order to sustain spending levels higher than those that would befit the current trend of their income. This resort to financing, based on their confidence in the maintenance of the current framework of macroeconomic stability, is contributing positively to moderating the intensity of the cyclical slowdown undergone by the Spanish economy. Likewise, the loose conditions in which both sectors are raising new funds mean that the financial burden associated with this greater indebtedness is not increasing. Accordingly, at the aggregate level, the financial position of households and firms does not appear to be posing an obstacle to either future consumption or investment.

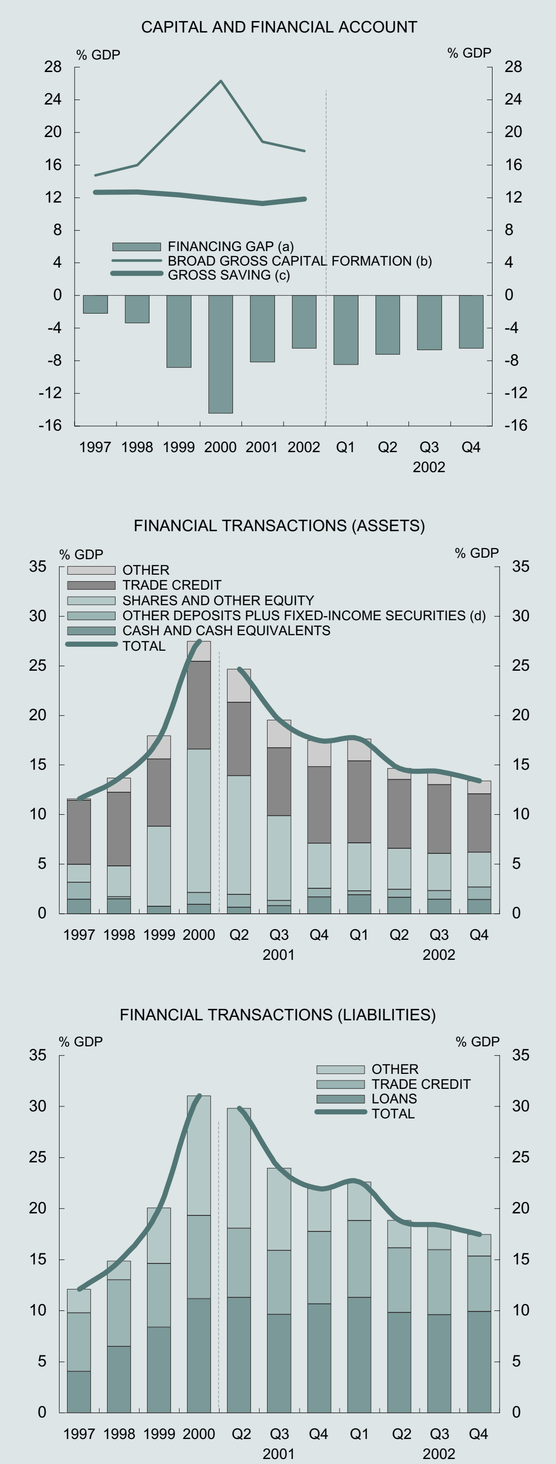
Nonetheless, the greater volume of liabilities incurred entails less scope to continue sustaining these sectors' spending decisions in the form of intensive recourse to borrowed funds. Analogously, the greater indebtedness of households and firms also involves the greater sensitivity of their spending decisions to changes in the determinants of both the costs of such debt and of the sector's capacity to meet the attendant debt servicing requirements.

5.2. Households

In 2002 Q4 the net financial saving of households amounted to 0.9% of GDP, thereby taking it in cumulative four-quarter terms to 1.2% of GDP (see Table 5). This involved a certain pick-up on the previous year, albeit a moderate one, particularly bearing in mind the climate of uncertainty and the cumulative reduction in household financial wealth of 12% of GDP in 2002 as a whole (see Chart 24). As regards their GDI, saving not earmarked for debt servicing diminished once again to 1.1%, while the level of indebtedness in terms both of financial wealth and of GDI increased anew (see Chart 25). Further to this fresh increase, the debt/GDI ratio, though still below that of the United Kingdom and the United States, has already reached the average euro area level. Nonetheless, as was the case the previous quarter, the declining course of interest

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) Includes gross capital formation, stockbuilding and foreign equities.

(c) Includes capital transfers.

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

TABLE 5

Net financial transactions and inter-sectoral flows (cumulative four-quarter data)

% GDP

	NET FINANCIAL TRANSACTIONS								
	1997	1998	1999	2000	2001 Q4	2002 Q1	2002 Q2	2002 Q3	2002 Q4
National economy	**1,5**	**0,2**	**-1,0**	**-2,4**	**-2,1**	**-2,0**	**-1,9**	**-1,7**	**-1,6**
Non-financial corporations and households and NPISHs	**3,9**	**2,1**	**-0,3**	**-2,4**	**-3,5**	**-4,1**	**-3,2**	**-3,5**	**-2,9**
Non-financial corporations	-0,6	-1,1	-2,3	-3,6	-4,5	-4,9	-4,2	-4,0	-4,1
Households and NPISHs	4,5	3,3	2,0	1,2	1,0	0,9	1,0	0,5	1,2
Financial institutions	**0,8**	**1,1**	**0,5**	**0,7**	**1,5**	**1,6**	**1,5**	**1,7**	**1,4**
General government	**-3,2**	**-3,0**	**-1,2**	**-0,8**	**-0,1**	**0,4**	**-0,2**	**0,2**	**-0,1**
	INTER-SECTORAL FLOWS (a)								
Households and NPISHs	**4,5**	**3,3**	**2,0**	**1,2**	**1,0**	**0,9**	**1,0**	**0,5**	**1,2**
Vis-à-vis:									
Credit institutions (b)	-6,7	-4,6	0,5	-0,2	-1,6	-2,3	-3,0	-3,6	-2,9
Institutional investors (c)	10,9	7,6	0,8	0,4	3,7	3,4	3,4	3,2	2,8
Non-financial corporations	**-0,6**	**-1,1**	**-2,3**	**-3,6**	**-4,5**	**-5,0**	**-4,2**	**-4,0**	**-4,1**
Vis-à-vis:									
Credit institutions (b)	-3,0	-4,5	-4,1	-6,8	-4,0	-4,1	-4,3	-3,8	-2,7
Rest of the world	1,7	0,9	-0,8	1,9	-2,1	-2,3	-1,5	-1,6	-1,2
General government	**-3,2**	**-3,0**	**-1,2**	**-0,8**	**-0,1**	**0,4**	**-0,2**	**0,2**	**-0,1**
Vis-à-vis:									
Credit institutions (b)	1,4	1,4	1,4	2,2	-2,3	-0,2	-0,2	0,9	1,0
Institutional investors (c)	-3,9	-2,6	1,7	3,9	2,9	1,6	1,3	0,6	0,3
Rest of the world	-2,0	-1,1	-4,4	-6,0	-1,6	-1,8	-1,6	-1,6	-1,3
Rest of the world	**-1,5**	**-0,2**	**1,0**	**2,4**	**2,1**	**2,0**	**1,9**	**1,7**	**1,6**
Vis-à-vis:									
Credit institutions (b)	2,8	7,1	2,0	5,2	3,8	2,7	3,9	3,3	2,9
Institutional investors (c)	-2,5	-6,3	-3,6	-5,6	-4,8	-3,7	-3,8	-3,4	-2,5
Non-financial corporations	-1,7	-0,9	0,8	-1,9	2,1	2,3	1,5	1,6	1,2
General government	2,0	1,1	4,4	6,0	1,6	1,8	1,6	1,6	1,3

Source: Banco de España.

(a) A positive sign denotes the extension of financing to the counterpart sector. A negative sign indicates financing received fom the counterpart sector.

(b) Defined in accordance with the First Banking Directive.

(c) Insurance corporations and collective investment undertakings.

rates meant that the increase in the level of cumulative household debt did not feed through to a heavier financial burden for them.

With regard to portfolio decisions, the acquisition of financial assets by households was higher than that of the previous quarter, standing at 9.1% of GDP in cumulative four-quarter terms (see Table 6). In terms of instruments, switching to lower-risk assets continued; however, unlike in 2001, net acquisitions of equities (in cumulative four-quarter terms) posted positive values. Thus, net investment in shares and other equities accounted for 0.7% of GDP, while net subscriptions of mutual fund shares remained positive, though limited, as a result of the increase in shares in money-market mutual funds exceeding the decline in shares in securities funds.

Turning to liabilities transactions, the financing received by households quickened in 2002 Q4 and grew at a year-on-year rate of 14.8%. This flow accounted for 7.9% of GDP, the same figure as the previous quarter. As to the breakdown of loans by purpose, the trend of financing is once again the outcome of the forceful expansion of loans for house purchases (17.3%), while credit for the purchase of durable and current goods slowed notably, dipping from a year-on-

BOX 4

The information content of credit derivatives

Credit derivatives are financial instruments that can be used to transfer credit risk from agents that are exposed to it to others that wish to assume it. Trading in these instruments began in the early nineties, and activity over the past three years has grown exponentially. Single-name credit default swaps (CDSs), the most actively traded instruments, provide protection against the risk of a credit event occurring (bankruptcy, failure to pay creditors or others) at a company or sovereign issuer. The agent acquiring the protection makes a periodic payment (premium) to the attendant counterparty until the maturity of the transaction or until the credit event against which protection is being purchased occurs. In this latter instance, the buyer of the protection is compensated by the loss, which is equal to the difference between the par value of the bond or loan and its market value after the credit event.

Consequently, CDS prices provide relevant information on the credit status of benchmark entities. Thus, faced with increases (reductions) in the market-estimated probability of default, premia will tend to rise. In the absence of distortions, there is a non-arbitrage relationship which ensures the equality of the CDS premia and the credit spread of the bonds (the difference between the yield on the bond and that on a risk-free asset), which is the traditional indicator of corporate risk. The CDS premium offers, however, some practical advantages over this traditional indicator. CDS prices reflect the risk over a fixed term, while on the bond market the information available refers to instruments whose residual life diminishes over time. Hence, to calculate a risk indicator at a constant maturity, it is necessary to change the asset periodically. Moreover, on the bond market, generally more than one instrument of a single issuer, with similar maturities and, occasionally, different prices is traded. In such circumstances it is not clear which is the most representative instrument that should be chosen. Conversely, on the CDS market a single instrument for each maturity is traded.

The accompanying table shows the main results of the comparison between CDS premia and credit spreads (calculated using swap rates to approximate the risk-free interest rate) for a sample of European and US corporations (1). The first two columns show the average value of the spread between both indicators (or the “basis”) and the absolute value for the full total of issuers in the sample and for certain specific groups. As can be seen, the average basis is positive in all the cases considered, although it is very close to zero, indicating that in the long run the information provided by both indicators is the same. The absolute value of the basis is likewise small, suggesting that, in the short run, CDS premia do not differ significantly from the credit spreads. There are, however, issuers for which this does not hold, principally among the lower-rated European companies, for which CDS premia tend to be higher than the bond credit spread.

The fact that the information provided by the two indicators is the same in the long run for most issuers does not prevent information in the short run being incorporated previously into one of the indicators. To address this question, the last column in the table shows the contribution of the CDS market to price discovery, using a measure habitually employed in the literature. Values higher (lower) than 50% would indicate that CDSs, set against bonds, incorporate the information earlier (later). The results clearly suggest that the indicator based on the derivatives market tends to react more swiftly to changes in the credit status of firms. This characteristic, along with greater ease of calculation, makes the CDS premium a preferable indicator for analysing changes in the creditworthiness of companies.

Further, for those companies in which the information content of the two indicators is different, there are grounds for considering that the best option for analysing changes in the credit status of these companies would be to combine both indicators, taking the price of CDSs as a higher boundary of credit risk, while the credit spread would provide a low.

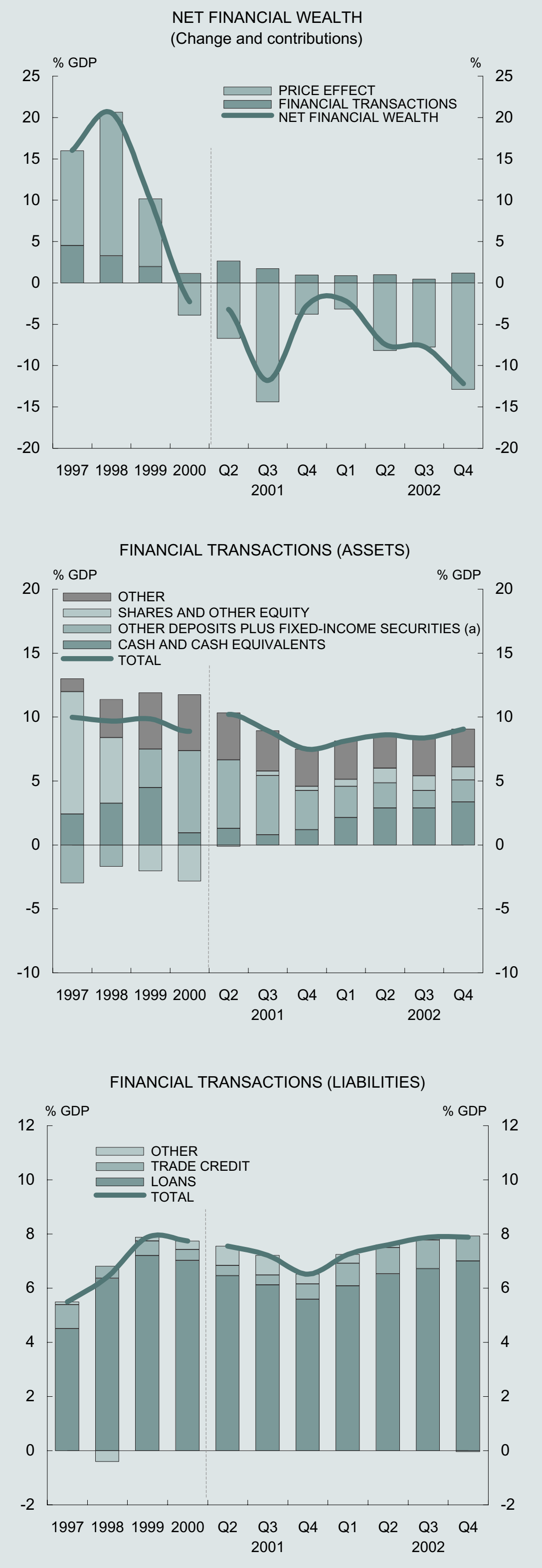
(1) For further details see the article (in Spanish) “El contenido informativo de los derivados crediticios” by Roberto Blanco, in the January 2003 edition of the *Boletín económico.*

CDS premia versus credit spread of bonds

	CDS premium-credit spread of bonds (bp)		Contribution of CDS market to price formation (%)
	Average level	Average of absolute value	
Sample total	5.5	14.6	77.8
Companies with AAA-AA rating	6.9	11.6	89.3
Companies with A rating	0.5	13.0	69.1
Companies with BBB rating	14.9	22.5	84.8
European companies	7.4	17.3	69.3
US corporations	3.5	11.7	83.7

CHART 24

**Households and NPISHs
(Cumulative four-quarter data)**

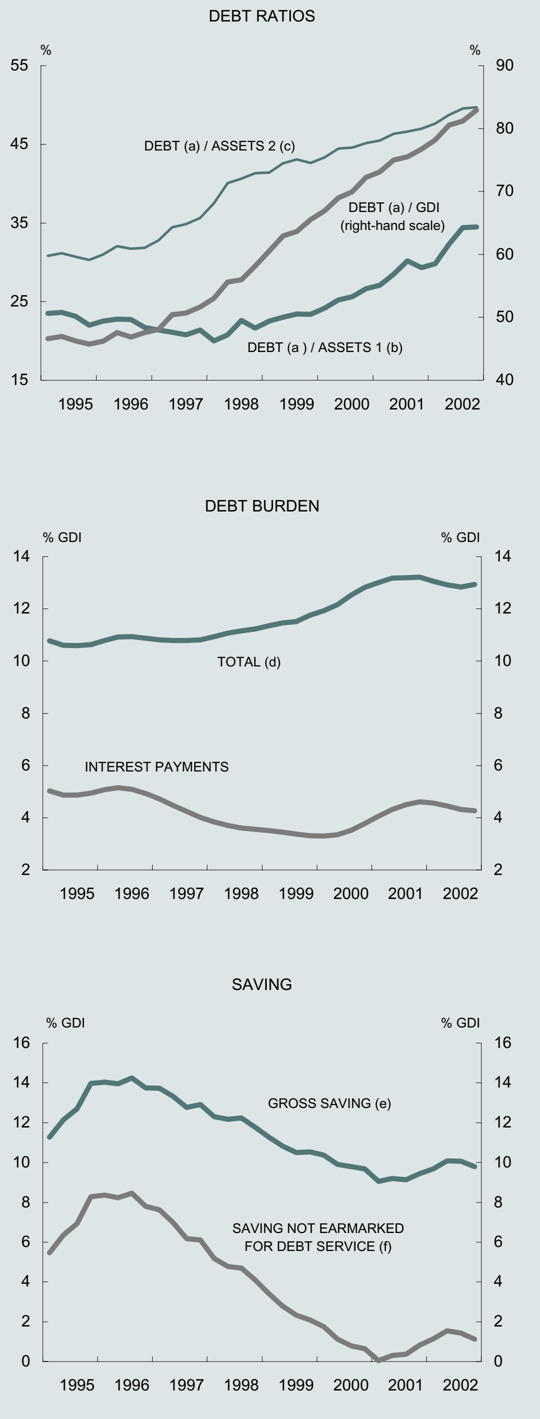


Source: Banco de España.

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

CHART 25

Indicators of the financial position of households and NPISHs



Source: Banco de España.

(a) Includes 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.

(d) Calculated on the basis of bank credit extended by resident credit institutions.

(e) Balance of households' use of disposable income account.

(f) Gross saving less estimated debt repayments.

TABLE 6

Financial assets and liabilities of households, NPISHs and non-financial corporations (Cumulative four-quarter data)

% GDP

	1999	2000	2001	2002 Q2	2002 Q3	2002 Q4
HOUSEHOLDS AND NPISHs:						
Financial transactions (assets)	**9.9**	**8.9**	**7.5**	**8.6**	**8.4**	**9.1**
Cash and cash equivalents	4.5	0.9	1.2	2.9	2.9	3.4
Other deposits and fixed-income securities (a)	3.0	6.4	3.1	2.0	1.4	1.7
Shares and other equity (b)	0.1	0.5	-0.4	0.3	0.5	0.7
Mutual funds	-2.2	-3.4	0.8	0.8	0.7	0.3
FIAMM	*-1.4*	*-1.4*	*1.3*	*1.2*	*1.0*	*0.8*
FIM	*-0.8*	*-2.0*	*-0.5*	*-0.4*	*-0.3*	*-0.5*
Insurance technical reserves	3.3	3.5	2.6	2.3	2.2	2.2
Of which:						
Life assurance	*2.0*	*1.9*	*1.4*	*1.2*	*1.2*	*1.3*
Pension funds	*1.0*	*1.4*	*0.9*	*0.9*	*0.8*	*0.7*
Other	1.1	0.9	0.4	0.3	0.7	0.7
Financial transactions (liabilities)	**7.9**	**7.7**	**6.5**	**7.6**	**7.9**	**7.9**
Resident credit institutions (c)	7.1	7.0	5.4	6.4	6.6	6.8
Other	0.8	0.8	1.1	1.2	1.3	1.0
NON-FINANCIAL TRANSACTIONS:						
Financial transactions (assets)	**17.6**	**27.5**	**17.7**	**14.9**	**14.6**	**13.4**
Cash and cash equivalents	0.7	0.9	1.7	1.6	1.4	1.4
Other deposits and fixed-income securities (a)	-0.2	1.2	0.9	0.8	0.9	1.2
Shares and other equity	8.1	14.5	4.6	4.1	3.7	3.5
Of which:						
Vis-à-vis the rest of the world	*6.5*	*10.9*	*3.7*	*3.0*	*2.6*	*2.4*
Other	9.0	10.9	10.6	8.3	8.6	7.2
Financial transactions (liabilities)	**19.9**	**31.1**	**22.2**	**19.1**	**18.7**	**17.4**
Credit from resident credit institutions (c)	5.3	7.6	6.9	6.8	6.7	6.6
Foreign loans	3.0	3.5	3.6	2.9	2.7	3.2
Fixed-income securities (a)	0.5	-0.7	0.1	0.0	-0.1	-0.3
Shares and other equity	4.9	12.5	4.1	3.1	2.8	2.8
Other	6.2	8.2	7.4	6.3	6.5	5.2
MEMORANDUM ITEM: YEAR-ON-YEAR GROWTH RATES (%):						
Financing (d)	**19.5**	**18.8**	**15.3**	**14.5**	**14.3**	**14.3**
Households and NPISHs	19.6	17.3	12.4	14.0	14.4	14.8
Non-financial corporations	19.4	19.9	17.4	14.9	14.2	13.9

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

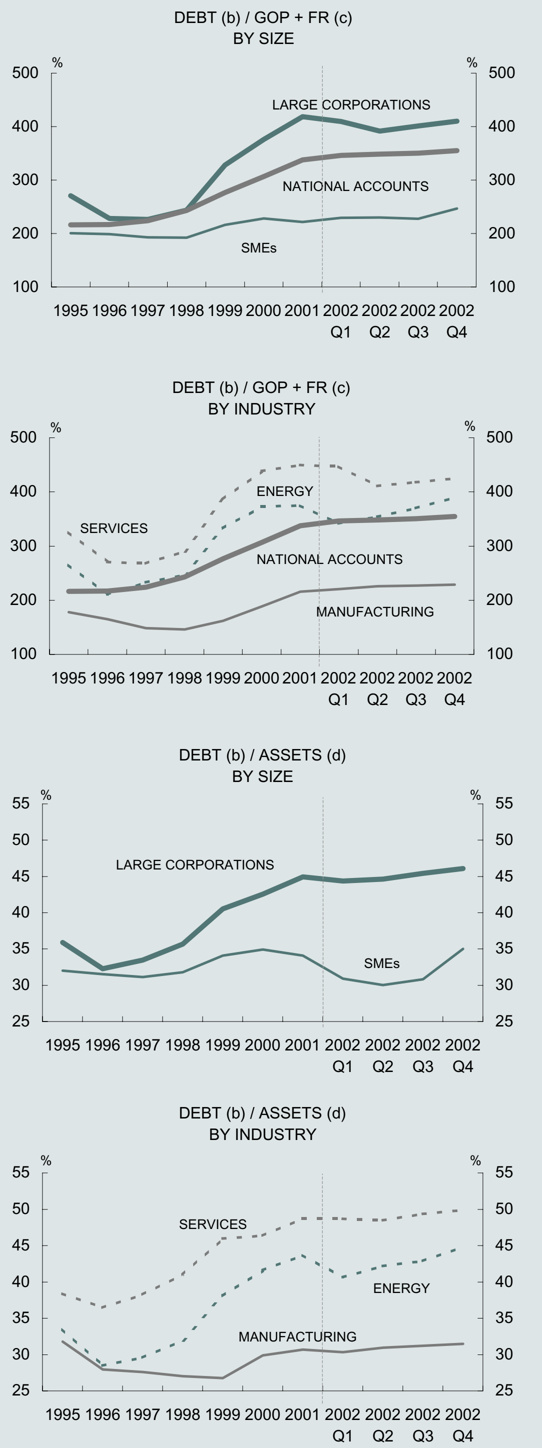
year growth rate of 10.2% to 6.4%. This was despite the fact that there was a slight rise at the end of last year in this latter spending component which, however, does not appear to have extended into the opening months of 2003.

5.3. Non-financial corporations

The net balance of non-financial corporations' financial transactions stood in 2002 Q4 at –0.4% of GDP, signifying a debit balance of 4.1% of GDP in cumulative four-quarter terms (see Table 5). The financing gap (the difference between the sector's real and permanent financial investment and its gross saving) reached similar levels to those of the previous quarter (see Chart 26), which was reflected in the fact that the growth rate of external financing of the sector held at around 14%. This high rate of increase in the resort to borrowed funds, combined with the moderate trend of the sector's

CHART 27

Debt ratios of non-financial corporations (a)



Source: Banco de España.

(a) All the series, except "National Accounts", are calculated with CBSO information. Up to 2001, the information is from the CBSO annual survey (CBA). Thereafter, the indicators have been estimated drawing on the CBSO quarterly survey (CBQ).

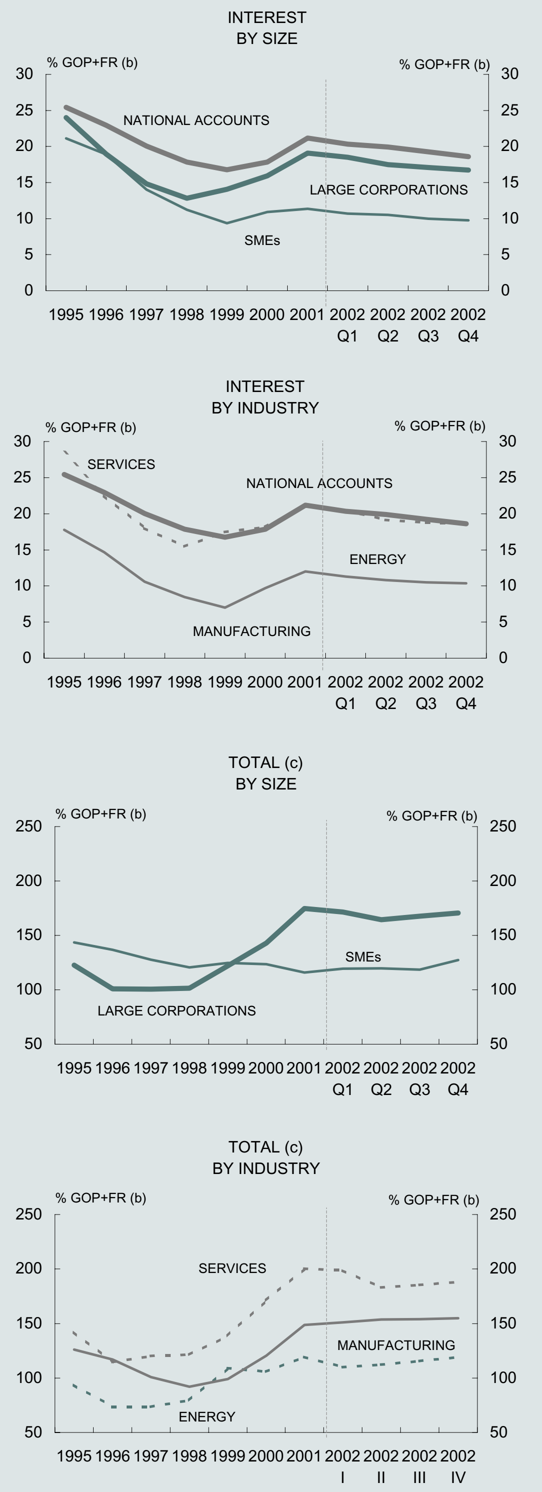
(b) Interest-bearing borrowed funds.

(c) Gross operating profit plus financial revenue.

(d) Defined as total inflation-adjusted assets less non-interest-bearing liabilities.

CHART 28

Debt burden of non-financial corporations (a)



Source: Banco de España.

(a) All the series, except "National Accounts", are calculated with CBSO information. Up to 2001 the information is from the CBSO annual survey (CBA). Thereafter, the information is from the CBSO quarterly survey (CBQ).

(b) Gross operating profit plus financial revenue.

(c) Includes interest plus interest-bearing short-term debt.

operating profit (proxied by the gross operating surplus plus financial revenue) and its assets, prompted a fresh increase in its debt ratios (see Chart 27). Drawing on CBSO data, the distribution of these ratios by size and by sector of activity is fairly heterogeneous. In particular, large, energy and market services corporations show higher relative debt levels than manufacturing firms and SMEs.

This increase in debt levels has not, however, translated into increases in the interest payment burden of corporations, owing to the favourable trend of the cost of financing. Indeed, this burden fell by 0.63 p.p. in the quarter in relation to the sector's operating profit. Nonetheless, on also including short-term debt, the resulting financial burden showed a slight increase during the quarter. According to this indicator, the large and market-services corporations are supporting a heavier relative financial burden.

As regards non-financial corporations' profits, the net profit of corporations reporting to the CBSO Quarterly Survey stood at a negative rate (–31.2%), owing basically to the increase in provisioning for unprofitable investment. However, net ordinary profit, which excludes extraordinary profit, grew at a similar rate (7.6%) to 2001. As a result, the ordinary return on assets, which is the ratio of net ordinary profit to net assets, was 9%, a rate more than four points above the average cost of financing for these corporations.

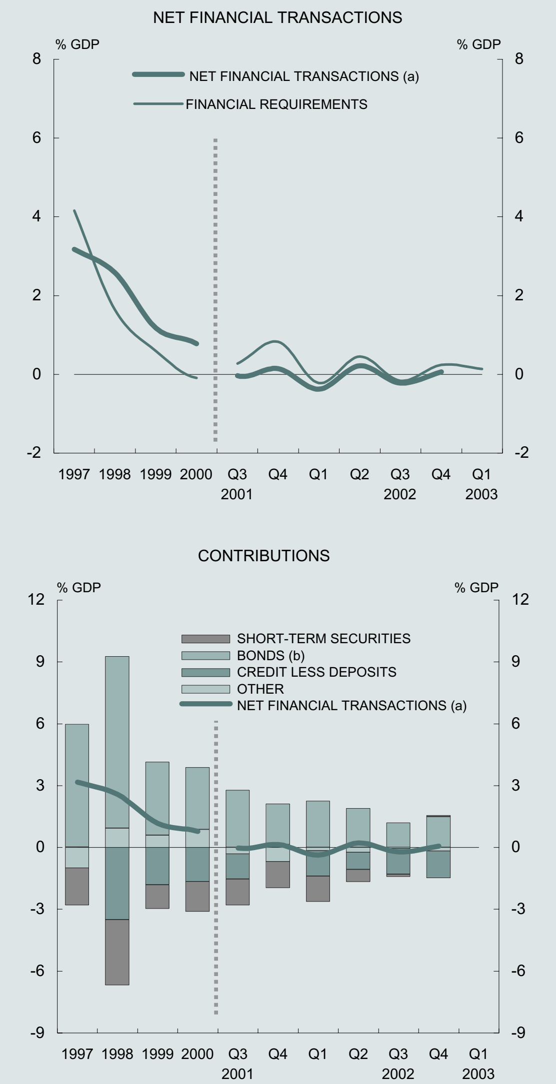
The volume of financial assets acquired by non-financial corporations continued to slow in 2002 Q4 to 13.4% of GDP (see Table 6). This was the outcome of a fresh reduction in the acquisition of shares and other equity and of assets under the heading "other", which accounted for 7.2% of GDP as opposed to 8.3% the previous quarter. Cash and cash equivalents held at the same level as in Q3.

In connection with liabilities transactions, and in cumulative four-quarter terms, funds obtained amounted to 17.4% of GDP, compared with 18.7% the previous quarter. Interest-bearing borrowed funds grew, as indicated, at a slightly lower rate than the previous quarter (13.9%), with a perceptible reduction in the weight of financing obtained via fixed-income securities, while that raised through bank and foreign loans became weightier. Trade credit, included under the heading "other", declined, while financing obtained via shares and other equity held at the level of the previous quarter (2.8% of GDP).

Significantly, however, across the different sectors, the pattern of external financing was uneven. Credit extended to the property sector (construction plus real estate services) once more grew at a year-on-year rate of over 20% (24.8%), in line with the buoyancy of activity in this sector over the year as a whole. Conversely, credit to manufacturing industry (excluding construction) continued to increase at a moderate rate, albeit up on the preceding quarter (3.2% against 1.1%), apparently confirming the signs of a pick-up in this sector. The pace of loans obtained by the services industry (excluding those relating to real estate activity) slowed by almost four percentage points to 5.7%. An analysis by size shows that large corporations, whose debt ratio is

CHART 29

General government
(cumulative four-quarter data)



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

TABLE 7

Financial transactions of the nation (cumulative four-quarter data)

% GDP

	1999	2000	2001	2002 Q2	2002 Q3	2002 Q4
Net financial transactions	**-1.0**	**-2.4**	**-2.1**	**-1.9**	**-1.7**	**-1.6**
Financial transactions (assets)	**14.8**	**24.6**	**10.5**	**9.7**	**10.4**	**10.7**
Gold and SDRs	**-0.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Cash and deposits	**1.7**	**2.8**	**-2.8**	**-0.2**	**1.2**	**3.7**
Credit system	3.7	2.5	-2.7	-0.6	0.2	2.0
Other resident sectors	-2.1	0.4	0.0	0.4	1.1	1.7
Securities other than shares	**2.8**	**3.8**	**7.1**	**5.8**	**5.5**	**4.4**
Credit system	-0.9	-0.3	2.0	1.0	1.3	0.7
Other resident sectors	3.7	4.1	5.1	4.9	4.3	3.7
Shares and other equity	**9.8**	**15.1**	**3.7**	**3.2**	**2.9**	**2.4**
Credit system	0.7	1.7	-0.1	0.1	0.1	-0.1
Other resident sectors	9.1	13.4	3.8	3.1	2.9	2.5
Of which:						
Non-financial corporations	6.5	10.9	3.7	3.0	2.6	2.4
Loans	**0.7**	**2.8**	**2.5**	**0.9**	**0.6**	**0.1**
Credit system	-0.2	0.5	0.8	0.6	0.5	0.0
Other resident sectors	0.9	2.3	1.7	0.3	0.1	0.1
Financial transactions (liabilities)	**15.8**	**27.1**	**12.6**	**11.6**	**12.0**	**12.2**
Deposits	**4.1**	**6.8**	**2.8**	**4.5**	**4.7**	**4.3**
Of which:						
Credit system	4.1	6.8	2.8	4.5	4.7	4.3
Securities other than shares	**5.4**	**6.9**	**3.1**	**3.0**	**3.8**	**4.1**
Credit system	0.9	0.7	0.6	0.2	0.7	1.2
General government	4.3	5.7	1.6	1.5	1.5	1.2
Other resident sectors	0.2	0.4	0.9	1.4	1.6	1.7
Shares and other equity	**3.9**	**9.1**	**3.5**	**2.1**	**1.9**	**1.5**
Credit system	0.3	1.7	0.5	0.3	0.2	0.1
Other resident sectors	3.6	7.3	2.9	1.8	1.8	1.4
Loans	**3.8**	**4.5**	**4.3**	**3.5**	**3.3**	**3.5**
General government	0.1	0.1	0.1	0.1	0.2	0.0
Other resident sectors	3.7	4.4	4.2	3.4	3.1	3.5
Other, net (a)	**-1.5**	**-0.1**	**-1.0**	**-1.6**	**-1.7**	**-1.2**

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

higher than that of non-financial corporations as a whole, increased their resort to borrowed funds more moderately (2.16%), testifying to the restructuring undertaken by some of these companies.

5.4. General government

The net balance of the financial transactions of general government in 2002 Q4 was negative and, in cumulative four-quarter terms, stood at –0.1% of GDP (see Chart 29).

To meet its requirements for funds, this sector stepped up the issuance of long-term securities. Thus, in terms of GDP, it raised the contribution of medium- and long-term government bonds. And although the financing received via short-term securities was slightly negative in 2002 Q4, it was positive in cumulative four-quarter terms, an unprecedented occurrence since 1997 Q3.

TABLE 8

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

% GDP

	1997	1998	1999	2000	2001	2002
National economy	**-20,9**	**-21,6**	**-22,2**	**-20,6**	**-22,2**	**-23,3**
Non-financial corporations and households and NPISHs	**-10,9**	**-8,6**	**-8,6**	**-0,8**	**-1,8**	**0,3**
Non-financial corporations	-17,2	-14,8	-16,2	-8,4	-9,6	-8,6
Households and NPISHs	6,3	6,2	7,6	7,6	7,8	9,0
Financial institutions	**6,9**	**4,8**	**6,9**	**5,1**	**4,7**	**1,8**
Credit institutions (b)	2,4	-5,4	-7,5	-12,5	-14,5	-15,7
Institutional investors (c)	4,6	10,7	15,0	18,3	20,8	20,5
Other financial institutions	-0,1	-0,4	-0,6	-0,8	-1,6	-3,0
General government	**-17,0**	**-17,9**	**-20,6**	**-24,8**	**-25,1**	**-25,4**

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

Provisional information for 2003 Q1 points to a reduction in net financing obtained by general government. The financial requirements indicator stood at 0.09% of GDP, against 0.24% the previous quarter.

5.5. The rest of the world

At the close of 2002, the debit balance of the nation's financial transactions stood at 1.6% of GDP, half a percentage point down on the related end-2001 balance. This recovery was basically due to the lower debit balance of non-financial corporations, and was achieved in a context in which asset and liabilities transactions were on a similar scale to those recorded in 2001.

The net acquisition of foreign assets increased to 10.7% of GDP, against 10.4% the previous quarter (see Table 7). This was once again the result of a substantial increase in liquid assets, which offset the decline seen under the other headings. On Balance of Payments information, foreign direct (permanent) investment rose compared with the same quarter a year earlier, while there was a significant decline in portfolio investment in relation to 2001 Q4.

On the liabilities side, net flows amounted to 12.2% of GDP, against 12% three months earlier, despite the decline in deposits and in shares and other equity, which accounted respectively for 4.3% and 1.5% of GDP. According to Balance of Payments information, inward foreign direct investment in Spain grew substantially in relation to 2001 Q4, while portfolio investment dipped slightly compared with the same quarter a year earlier.

Finally, the debit position of the Spanish economy vis-à-vis the rest of the world stood at 23.3% of GDP (see Table 8) at the end of last year, 1.1 p.p. up on end-2001.

29.4.2003.