

BANCO DE ESPAÑA

annual report

2000

annual report

2000

BANCO DE ESPAÑA

Madrid 2001

The Banco de España disseminates its main reports and most
of its publications via the INTERNET at the following website:
<http://www.bde.es>

ISSN: 1137-5124
ISBN: 84-7793-750-8
Depósito legal: M. 24760-2001
Imprenta del Banco de España

Abbreviations

| | | | |
|----------|--|---------|---|
| AIAF | Association of Securities Dealers | ICT | Information and communications technology |
| BE | Banco de España | IMF | International Monetary Fund |
| BIS | Bank for International Settlements | INE | National Institute of Statistics |
| CNE | Spanish National Accounts | INVERCO | Association of Collective Investment Institutions and Pension Funds |
| CNMV | National Securities Market Commission | LFA | Liquid financial assets |
| CPI | Consumer price index | LIFFE | London International Financial Futures Exchange |
| EAGGF | European Agricultural Guidance and Guarantee Fund | MEFF | Financial Futures and Options Market |
| ECB | European Central Bank | MEFF RF | Fixed-income derivatives market |
| ECOFIN | Council of the European Communities (Economic and Financial Affairs) | MEFF RV | Equity derivatives market |
| EDP | Excessive Deficit Procedure | MFIs | Monetary financial institutions |
| EMU | Economic and Monetary Union | MMFs | Money-market funds |
| EONIA | Euro overnight index average | MROs | Main refinancing operations |
| EPA | Official Spanish Labour Force Survey | NCBs | National Central Banks |
| ERDF | European Regional Development Fund | NPIs | Non-profit institutions |
| ESA 79 | European System of Integrated Economic Accounts | OECD | Organisation for Economic Co-operation and Development |
| ESA 95 | European System of National and Regional Accounts | PPP | Purchasing power parity |
| ESCB | European System of Central Banks | QNA | Quarterly National Accounts |
| EU | European Union | R+D | Research and development |
| EU15 | The fifteen current European Union Member States | SCLV | Securities Clearing and Settlement Service |
| EUROSTAT | Statistical Office of the European Communities | SDRs | Special Drawing Rights |
| FIAMMs | Money-market funds | TARGET | Trans-European Automated Real-Time Gross Settlement Express Transfer system |
| FIMs | Securities funds | TFP | Total factor productivity |
| GDP | Gross domestic product | ULCs | Unit labour costs |
| GNP | Gross national product | VAT | Value Added Tax |
| GVA | Gross value added | | |
| HICP | Harmonised index of consumer prices | | |

| <i>Countries</i> | | <i>Currencies</i> | |
|------------------|----------------|-------------------|----------------------|
| BE | Belgium | ESP | Peseta |
| DK | Denmark | EUR | Euro |
| DE | Germany | JPY | Japanese yen |
| GR | Greece | USD | United States dollar |
| ES | Spain | | |
| FR | France | | |
| IE | Ireland | | |
| IT | Italy | | |
| LU | Luxembourg | | |
| NL | Netherlands | | |
| AT | Austria | | |
| PT | Portugal | | |
| FI | Finland | | |
| SE | Sweden | | |
| UK | United Kingdom | | |
| US | United States | | |

Conventions used

- M1 Notes and coins held by the public + sight deposits.
- M2 M1 + deposits redeemable at notice of up to three months + deposits with an agreed maturity of up to two years.
- M3 M2 + repos + shares in money market funds and money market instruments + debt securities issued with an agreed maturity of up to two years.
- bn Billions (10^9).
- m Millions.
- pp Percentage points.
- ... Not available.
- Nil, non-existence of the event considered or insignificance of changes when expressed as rates of growth.
- » Less than half the final digit shown in the series.

The cut-off date for the information included in this report was 30 May 2001

Contents

| | <i>Page</i> |
|---|-------------|
| CHAPTER I | |
| OVERVIEW | |
| I.1. The changes in the internal situation | 11 |
| I.2. The slowdown in the US economy | 12 |
| I.3. Economic growth in the euro area in the new international situation..... | 14 |
| I.4. The cyclical upturn in the Spanish economy within the euro area | 16 |
| I.5. The correction of incipient imbalances and the sustainability of growth and real convergence.. | 24 |
| CHAPTER II | |
| THE EXTERNAL ENVIRONMENT OF THE EURO AREA | |
| II.1. Overview | 31 |
| II.2. The main industrialised economies | 34 |
| II.2.1. United States | 34 |
| II.2.2. Japan | 38 |
| II.2.3. Other developed economies | 39 |
| II.3. The emerging economies | 39 |
| II.3.1. EU candidate countries | 39 |
| II.3.2. Latin America | 40 |
| II.3.3. South-east Asia and other emerging regions | 44 |
| CHAPTER III | |
| THE EURO AREA AND THE COMMON MONETARY POLICY | |
| III.1. Economic conditions in the euro area | 51 |
| III.1.1. Activity and employment | 51 |
| III.1.2. Prices and costs | 54 |
| III.1.3. Macroeconomic divergence within the euro area | 56 |
| III.2. Economic policies in the euro area | 58 |
| III.2.1. Fiscal policy | 58 |
| III.2.2. Structural policies | 59 |
| III.3. The common monetary policy and monetary and financial conditions in the euro area | 60 |
| III.3.1. Monetary policy decisions | 60 |
| III.3.2. Monetary and financial conditions in the euro area | 62 |

CHAPTER IV

THE SPANISH ECONOMY

| | |
|--|----|
| IV.1. Economic policies | 65 |
| IV.1.1. Monetary and financial conditions in Spain | 65 |
| IV.1.2. Domestic macroeconomic policies | 66 |
| IV.2. Demand | 68 |
| IV.3. Activity | 75 |
| IV.4. The labour market | 77 |
| IV.5. Costs and prices | 81 |
| IV.5.1. Costs and prices: the productive branches | 83 |
| IV.6. Competitiveness | 84 |
| IV.7. General government activity | 87 |
| IV.8. Balance of payments | 91 |

CHAPTER V

SPANISH FINANCIAL FLOWS, MARKETS AND INTERMEDIARIES

| | |
|---|-----|
| V.1. Net borrowing and financial flows in the Spanish economy | 96 |
| V.1.1. The capital account of the institutional sectors | 96 |
| V.1.2. Financial flows in the Spanish economy | 96 |
| V.1.3. The financial flows of households and non-financial corporations | 98 |
| V.1.4. General government financial flows | 101 |
| V.1.5. Foreign investment and financing of the Spanish economy | 102 |
| V.2. Spanish financial markets | 104 |
| V.2.1. The primary markets | 105 |
| V.2.2. Secondary market activity | 107 |
| V.2.3. Secondary market prices | 109 |
| V.3. Spanish financial intermediaries | 110 |
| V.3.1. Deposit money institutions | 112 |
| V.3.2. Institutional investors | 116 |
| V.4. The net worth position of the sectors of the economy | 120 |

| | |
|---|------------|
| ANNUAL ACCOUNTS OF THE BANCO DE ESPAÑA. 2000 | 123 |
|---|------------|

INDEXES

| | |
|-----------------------|-----|
| INDEX OF TABLES | 149 |
| INDEX OF CHARTS | 151 |
| INDEX OF BOXES | 153 |

COMPOSITION OF THE GOVERNING BODIES OF THE BANCO DE ESPAÑA

| | |
|----------------------------------|-----|
| GOVERNING COUNCIL | 157 |
| EXECUTIVE COMMISSION | 158 |
| GENERAL ORGANISATION CHART | 159 |

CHAPTER 1

OVERVIEW

In Spain during 2000 and in 2001 to date, the economic upswing of the preceding years has continued. However, amid a more uncertain international setting, stemming initially from the rise in oil prices and, more recently, from the pronounced economic slowdown in the United States, the economy has been losing momentum.

I.1. THE CHANGES IN THE INTERNATIONAL SITUATION

The year 2000 was one of the most prosperous for the world economy since the crisis of the 1970s. The world economy grew by 4.8 %, well above the 3.4 % rate recorded in 1999. This expansion in activity, reflected in the growth of international trade flows which were 12.4 % higher than in the previous year, affected most geographical areas, being particularly pronounced in the United States and in south-east Asia. Economic growth was accompanied by moderate or low inflation rates in most of the industrialised economies, although the upward trend in oil prices that began in 1999 Q2 firmed during 2000.

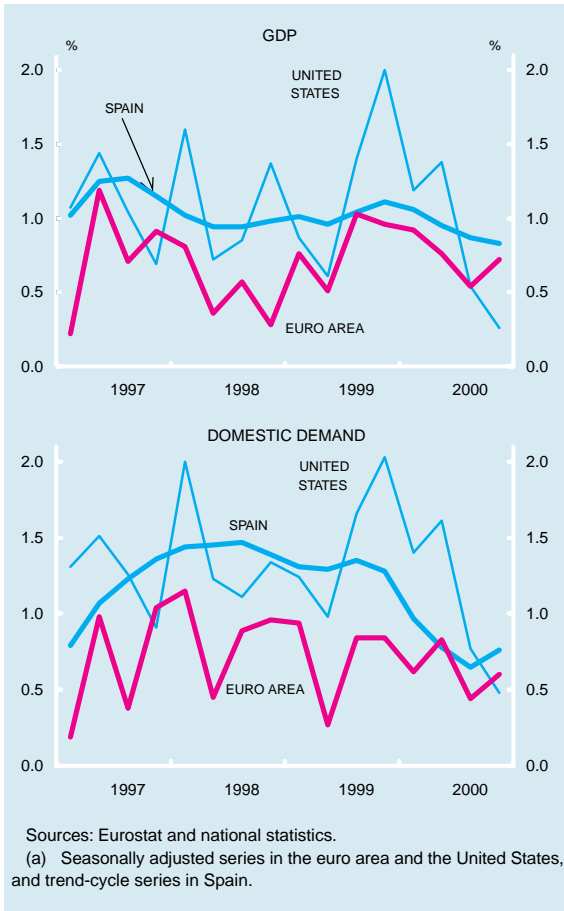
However, during the second half of the year, and especially from Q3, the international economic situation began to show signs of deterioration. In particular, the US economy saw a notable reduction in the high rate of growth that it had sustained for almost a decade. And in Japan, following signs of recovery in activity during the first half of 2000, which were especially linked to investment developments the weakness of private spending became increasingly apparent amid persistent deflation.

The slowdown of activity in the United States was accompanied by severe turbulence in stock markets. In particular, there were sharp corrections in the indices covering internet companies and the information and communication technology sector, which were affected by the decline in their profits and by the concurrent upward correction in the risk assigned by investors to technology stocks. This revision of the riskiness of financial assets also affected debt instruments and the risk premiums on corporate bonds have been rising since the last few months of 2000. These developments in US financial markets have been speedily transmitted to the rest of the world, where an increase in the volatility of stock prices and a widening of the rate spread between private and public debt in the developing economies have been apparent. And all this against a background in which the price of a barrel of oil, having stood at over USD 30 at end-2000, seems to have started an ill-defined and highly variable downward trend.

The slowdown in the US economy, the climate of greater instability on international financial markets and the fluctuating oil price are creating considerable uncertainty which hampers assessment of the medium- and the long-term outlook for the world economy. Over a shorter time horizon these factors have already led to a deterioration in activity in the south-east Asian economies, as a consequence of their close trade links with the United States (particularly in technology sectors), their heavy requirements for external financing and their pronounced dependence on oil. In Latin America, the loss of momentum in the US economy will have uneven effects on the different countries through the contractionary impact on trade with the area, which will be softened by the lowering of dollar interest

CHART I.1

Gross domestic product and domestic demand Quarter-on-quarter percentage change (a)



rates. In general, given the varied cyclical position of the Latin American economies, the aforementioned effects may lead to greater convergence of their growth rates in 2001.

The euro area economy grew at a high rate in 2000. However, in recent months this rate has moderated, as a consequence of the greater weakness in activity in the external environment and of the unfavourable developments in international financial and energy markets.

I.2. THE SLOWDOWN IN THE US ECONOMY

In 2000, the US economy completed a long cyclical expansion of almost ten years, with growth of 5 %, the highest rate since 1984. In the last four years, the increases in GDP have exceeded 4 %, while inflation has held at relatively low levels, al-

though last year it stood at 3.4 %, as a consequence of the direct impact on consumer prices of higher energy prices.

There is now no doubt that this prolonged phase of strong non-inflationary growth is largely linked to technological progress in the IT and telecommunications industries. This technological innovation, when it has spread to all sectors, leads to very pronounced and persistent increases in employment and productivity. New technologies thus appear to have altered the pattern of growth and expanded the overall potential output, so that the US economy is now capable of sustaining, without serious price pressures, increases in domestic demand that in the past would have prompted significant rises in inflation.

That said, in the second half of 2000, after growth rates of more than 5.5 %, increasingly clear symptoms emerged of the end of the expansionary phase, with the quarter-on-quarter growth rate falling drastically. This pronounced slowdown in the economy, although not accompanied by signs that call into question the increase in potential growth, does confirm that the «new economy» has not eliminated - and possibly not even smoothed - the business cycle.

On the other hand, changes in the usual patterns of cyclical fluctuations do seem discernible. Unlike at the end of previous expansions, when the accumulated macroeconomic imbalances were manifested primarily in a rise in inflation that announced the end of the boom, on this occasion, despite the pressure of demand, the cyclical slowdown has not been preceded by excessive increases in consumer prices. The latter have been contained by substantial increases in productivity, which have offset the rise in labour costs, by the flexibility of product and labour markets and by a monetary policy that has combined flexibility, in response to the rise in potential growth, with the maintenance of a firmly credible anti-inflationary stance.

The moderation of inflation rates has not however prevented the appearance of macroeconomic and financial imbalances during the boom years, largely linked to the transformation of the productive structure itself. The numerous significant innovations in the IT and telecommunications industries rapidly roused very optimistic expectations regarding the potential profitability of projects incorporat-

ing the new technologies into productive processes. This led to a considerable rise in private gross fixed capital formation (which grew at an average annual rate of close to 10 % over the period 1997-2000), and especially in the component of investment in technological capital (which increased in the same period at annual rates of over 20 %). Although this rapid increase in capital explains, as recent studies indicate, a large part of the observed increase in aggregate productivity, the speed of the process was too great, giving rise in some cases to excess capacity and in others to inappropriate selection of investment projects.

Also, the favourable business prospects for technology companies, driven by the expansion of domestic and international demand for the new equipment and applications, led to a spectacular increase in share prices, with the NASDAQ index rising fourfold between January 1996 and March 2000. The revaluation of technology shares arose, in principle, as a logical consequence of the expansion of the industry. That said, the markets have on occasions overvalued the shares of these companies, whose potential profits depend not only on the expected demand for their products, but also on the uncertain degree of competition that they will face once the industry has matured sufficiently.

In any event, the increase in the prices of technology firms, in an expansionary setting, pushed up the stock market indices (the Dow Jones practically doubled between 1996 and 2000), generating considerable increases in the value of corporate and household portfolios. In the case of households, the rise in financial wealth led to a strong expansion in consumption, well beyond what could be explained by the gradual rise in disposable income. This progressively reduced the saving ratio, which fell to negative levels, and took household debt to 92 % of household income in 2000 Q3. The vigorous growth of investment and the progressive reduction in the household saving ratio led, despite the saving by the public sector, to a considerable increase in the nation's borrowing requirement, which was manifested in 2000 in a current-account deficit of 4.4 % of GDP.

Clearly, neither the increase in the capital stock at rates like those seen in recent years, nor the progressive deterioration in private saving and the external balance are sustainable in the

medium term, especially if, as seems to be the case, the climate of euphoria has in some instances generated excess capacity and an increase in the financial vulnerability of firms and households. In fact, the data for 2000 Q4 and 2001 Q1 show first a sharp deceleration and then stagnation in investment, which is consistent with the culmination of the investment cycle, and which has prompted a sharp slowdown in productivity. This behaviour by gross fixed capital formation has occurred in tandem with a substantial moderation in the profits of technology companies, which has precipitated a significant reduction in their stock market values, with the NASDAQ index falling by more than 60 % over the year to March 2001. The stock-market correction has led to an incipient moderation in consumption, although it continued to grow in Q1 this year at an annualised rate of somewhat over 3 %.

Thus, as in previous cycles, the tailing off of the investment process seems to be the basis of the change in the stage of the cycle. However, unlike in the past, the transmission of the decline in investment to consumption is not occurring through the usual channels, linked to employment, wages and, therefore, current disposable income. The moderation in household spending seems to be based this time on a downward revision of expectations of future income, on the increase in uncertainty as to the foreseeable trend in financial and wage income and on the fall in value of household wealth. These factors may prompt households to restore their financial situation in the near future by increasing their low saving ratios.

Against this background, the implementation of monetary policy by the Federal Reserve has had to respond to a very complex setting. In a situation like the present one, characterised by profound structural change, associated with technical change, it is difficult to estimate the economy's potential growth rate and, therefore, to assess to what extent the pressure of demand poses a danger to price stability. Moreover, the greater vulnerability of the financial position of households requires careful modulation of monetary policy measures in order to avoid bouts of generalised instability. Over the last few quarters of the expansionary phase, the Federal Reserve graduated moderate rises in interest rates with the twofold objective of curbing excess spending, induced by

the stock-market euphoria, and of underpinning confidence in the economy's higher growth potential under conditions of macroeconomic stability. When the effects of the slowdown became apparent, interest rates were cut sharply and rapidly (by 2.5 percentage points to May 2001), in an attempt to help lay the foundations for a swift recovery, in the absence of inflationary risks, and to offset the effect on corporate and household confidence of the substantial fall in financial wealth.

The cyclical correction should, in any event, enable the internal and external imbalances of the US economy to be reduced and the productive structure to be purged of those business projects whose success was excessively linked to the expansionary climate. If these processes take place in an orderly manner, without excessive adjustment of spending decisions, the economy may soon embark upon a fresh expansion with simultaneous increases in output, employment and factor productivity, like in the last upturn. However, the biggest risk undoubtedly lies in the possibility of overreaction by financial and foreign exchange markets to the continuation and possibly even aggravation of the signs of slowdown in activity, which may be accentuated if there is a rapid rise in unemployment. A steep fall in share prices could have contractionary effects, which would extend, to a greater or lesser extent, to the whole world economy.

I.3. ECONOMIC GROWTH IN THE EURO AREA IN THE NEW INTERNATIONAL SITUATION

In recent years the euro area has not matched the growth rates recorded in the United States, and the signs of Europe undergoing, in the near future, a similar structural change to that seen in the US economy are still very faint. Although the new IT and telecommunications equipment and applications have been progressively incorporated into productive processes and distribution channels, the European economy has, until now, had difficulty competing internationally in the sectors that produce the new technologies. These sectors are precisely the ones that, in the case of the United States, explain a large part of the increase in aggregate productivity. In fact, euro-area productivity growth has remained below 1.5 % over the last three years.

Partly as a consequence of this muted productivity growth, in comparison with other geographical areas, companies in the euro area have attempted to raise their profit rates by investing, mainly directly, in more dynamic external markets. These capital exports, in many cases intended by the firms to give them sufficient size, through mergers and acquisitions, to compete in a more globalised environment, helped to strengthen the dollar during 1999 and a large part of 2000, and increased the demand for financing (on very favourable terms), both from the capital markets and the banking system. This behaviour explains a significant part of the acceleration in lending to firms during 2000, which reached a year-on-year growth rate of almost 11 %, as against less than 6 % in 1999.

In this context, one of the main challenges for the European economic authorities is to establish the foundations that would enable the rate of return on capital invested to reach levels comparable with those in the United States, through the full harnessing of the opportunities provided by the new economy. In the light of the US experience, this requires, on one hand, greater flexibility in the workings of product and labour markets, so that the absence of rigidity in price adjustment and greater competition generate the necessary incentives for investment and the adoption of more efficient productive systems. Also, steps must be taken to nurture a culture more conducive to risk-taking and to develop capital markets, favouring the financing of venture capital initiatives. At the same time, the increase in the efficiency and competitiveness of the European economy requires far-reaching changes to educational and training systems to enable labour, through the accumulation of human capital, to become more versatile and adaptable to the new technological environment.

At the Lisbon European Council in March last year, a number of actions to facilitate progress in the production and dissemination of the new technologies were highlighted. These included reducing the administrative obstacles to the starting up of innovative firms, integrating IT developments into school teaching programmes, greater use of the Internet and fully integrating telecommunications markets by the end of the current year. Whether Europe can aspire to increase significantly its potential growth rate will largely hinge on the success of the initiatives taken by the European authorities in these areas. These initiatives are particularly impor-

tant in those countries that have hitherto shown less urgency in adopting structural reforms.

The challenges that lie ahead for the European economy are very significant, but its current macroeconomic situation is relatively solid. Conditions are therefore propitious for the adoption of the agreed structural reforms. Last year GDP increased by 3.4 % (on provisional data), almost one percentage point more than in 1999. This acceleration in the aggregate output of the economy was a consequence of the sustained buoyancy of domestic demand, which has grown at similar rates since 1998, and of the progressive recovery of the external sector (from the second half of 1999, after the emerging markets crisis had been overcome), partly assisted by the depreciation of the euro.

Continued growth of domestic demand at relatively high rates has not entailed an appreciable deterioration in the financial position of the private sector. In fact, it is notable that, despite the increase in consumption, the gross saving ratio of households declined by barely 1.4 percentage points during the expansion of 1997-2000, as compared with a reduction of 5.6 percentage points in the United States (see Box I.1). This has meant that the level of household indebtedness, in terms of disposable income, has held at moderate levels, well below those prevailing in the US economy, even before the stock market boom.

A further factor that has been effective in helping to maintain macroeconomic stability in Europe is wage moderation. Even though there has been a rise in consumer prices as a consequence of oil price increases and the depreciation of the euro, the moderation of labour costs has generally avoided the re-stoking of the inflationary process that would have resulted from mechanical incorporation of temporary increases in the general price level to wage demands. Thus, the absence in most countries of automatic wage indexing mechanisms, has enabled inflation rates to remain moderate, despite the modest productivity gains. Also, this labour cost moderation, in conjunction with the labour market reforms implemented in some countries, has helped create numerous jobs. In this respect, it is significant that employment grew in the euro area in 2000 by 2 %, a similar rate to 1999, and well above average historical rates.

Budgetary policy, by continuing the process of fiscal consolidation, with the overall budget deficit of the area standing at 0.7 % of GDP (excluding receipts from the sale of (UMTS) mobile telephony licences), has helped to keep the macroeconomic environment favourable for economic activity. In the coming years however, the drive to contain spending should be stepped up in order to reduce the still high levels of public debt, given that the ageing population is going to pose significant medium-term challenges for public finances.

Accordingly, although the European economy has structural deficiencies, which are holding down its growth potential, the healthy private sector financial position, the prevailing wage moderation and the reduction in fiscal imbalances constitute a relatively solid set of internal foundations that will help sustain satisfactory growth in the euro area economy in the near future. At the same time, despite the growing importance of the external sector, the direct exposure of the area to the US economic slowdown is still limited. Exports to the United States currently account for 17 % of all external sales, equivalent to barely 2 % of euro area GDP. Potentially more important are the indirect links between the two economies, through the connection of their capital markets and the possible effects on the confidence of European consumers and investors of the greater uncertainty in the international economic scene. A sharp and lasting slowdown in the US economy, especially if accompanied by a drastic stock market correction and turbulence on the foreign exchange markets, would significantly affect the euro area. But, the fact that the euro area is at an earlier stage in the business cycle and the absence of significant macroeconomic and financial imbalances are a sufficient basis for some economic buoyancy, despite the deceleration in the rate of growth discernible since the second half of 2000.

The implementation of monetary policy by the ECB has not encountered the difficulties that the Federal Reserve has had to face in the United States, given the absence of significant changes in potential output, the limited importance of stock markets in the monetary policy transmission mechanism in the euro area and the healthy financial position of the private sector. However, with the inflationary pressures arising from the rise in international energy prices and from the depreciation of the euro, the ECB had to adapt its mone-

tary policy stance, reducing its initial looseness, in a setting in which economic growth was clearly outstripping the growth in potential output and the monetary aggregates were expanding above their reference level. Following a total rise of 1.75 percentage points in the Eurosystem's main refinancing rate during 2000 and a certain recovery in the euro exchange rate from November, the monetary conditions of the euro area were less accommodating. However, in recent months, although the growth outlook for the near future is still relatively favourable and prices are showing year-on-year rates of change of over 2 %, the slowdown in economic activity - as a consequence of the unfavourable external environment - has facilitated the moderation of inflationary risks. This, along with the deceleration of the monetary and credit aggregates led the ECB to lower official rates slightly in May, to 4.5 %.

I.4. THE CYCLICAL UPTURN IN THE SPANISH ECONOMY WITHIN THE EURO AREA

The Spanish economy has been influenced by the changes in the international situation and, especially, by developments in the euro area and the ECB's single monetary policy. However, it has essentially followed the path set by the maturing of its own cyclical pattern, which has specific features compared with what is happening in Europe and the United States.

Real GDP grew at a rate of 4.1 % in 2000, similar to the average rate for the period 1997-2000, so that the cyclical upturn of this period continued (see Table I.1). During these years, the Spanish economy has maintained a significant growth differential with the euro area countries, not only due to the smaller repercussions of the crisis in Asian markets on exporting activity, but basically, due to the expansionary effects stemming from the adoption of the single currency and the progress made in liberalising markets and the improvement in its competitive environment.

The degree of macroeconomic stability and the levels of credibility and confidence achieved by the Spanish economy made possible a particularly fruitful upswing, both in terms of output growth and job creation, which has enabled progress to be made in real convergence with the EU countries.

Comparison of the upswing of these years (1997-2000) with previous ones is shaped by the different starting points, in terms of equipment, liberalisation of markets, degree of openness and integration in the international environment. However, recent developments clearly show the advantages deriving from the stability inherent in the adoption of the euro and from the drive to increase competition. Thus, although the average annual rate of change of real GDP in the period 1997-2000 (4.1 %) was lower than in other upswings, the growth was more balanced and gave rise to a particularly strong fall in the rate of unemployment (more than nine percentage points in the last four years, to 13.6 % of the labour force in 2000 Q4, according to the EPA), which shows the benefits for job creation of the moderation in the growth of labour costs and the progress made in making the labour market more flexible. The change in expectations regarding employment growth and the stability of the economy were a further stimulus in the spending decisions of consumers, whose confidence reached very high levels, while firms recorded notable increases in their rates of return. In a setting in which external borrowing was relatively cheap, this created favourable conditions for the expansion of activity and productive capacity.

Another factor contributing to this favourable environment was the moderation of international prices. This was interrupted, however, by the increases that began to be seen in the price of crude oil at the beginning of 1999, which reached peak intensity in 2000, when the growth rate of the Spanish economy and world trade attained particularly high levels. The inflationary impact and moderating effects of the growth and of the increase in energy prices were transmitted with varying intensity across countries, affecting to a greater extent those, like Spain, with a higher degree of dependence on imported energy and at a more advanced stage of the cyclical upswing. The effects of the slowdown in the US economy in the second half of 2000 and the uncertainty over stock market developments, which extended into the first few months of 2001, have also affected expectations regarding the buoyancy of the Spanish economy in the short term.

In the case of Spain, these events took place at a time when the common monetary conditions established for the euro area as a whole were

The wealth position of households in the United States, the euro area and Spain

The wealth position of households can be analysed on the basis of flow variables (such as the saving ratio and net financial saving) or stock variables (such as the stock of financial assets net of liabilities and the debt ratio). It reflects the economic situation and, at the same time, represents a very important constraint on future economic developments.

As seen in the top panel of the adjoining chart, over the last two decades there has been a trend decline in the household saving ratio, both in the United States and in the euro area. The reasons for this behaviour might include: the large increase in household financial wealth, associated with the stock market boom of recent years, which has enabled households to be more optimistic about their solvency; the development of the financial system, which facilitates borrowing by households by more flexible and less costly means; and a more stable macroeconomic environment, with lower interest rates, which tend to discourage saving and encourage borrowing. These phenomena have led households to increase their average propensity to consume significantly.

Over the last five years, the downward trend in household saving has been particularly marked in the United States. This reduced household net lending (net financial saving) to negative levels, as from 1997 (see the second panel of the chart), coinciding with the beginning of the stock market boom. Thus, households have resorted to borrowing to finance more expansionary spending and investment decisions, underpinned by the revaluation of their wealth (see the third panel of the chart). During the same period, the decline in household net lending was much more moderate in the euro area, and it held at levels of more than 7 % of disposable income up until 1999 (the latest year for which aggregate data is available). Accordingly, the wealth position of European households (see the bottom panel of the chart) is less vulnerable than that of US households, as it is subject to a considerably lower level of debt in terms of disposable income (more than 20 % lower). Nonetheless, in the United States and in Europe, accumulated debt accounted for a similar proportion of the financial assets held by households (around 20 %). This moderate debt ratio (relative to financial wealth) is largely a consequence of the significant revaluation of portfolios and is therefore subject to market fluctuations.

Developments in the wealth position of Spanish households represent, in some aspects, an intermediate case. The decline in the saving rate since 1995 has been less than in the United States and significantly greater than in the euro area. This, together with the strong growth in residential investment has led to a significant decline in household net lending, to virtually zero in 2000. This process is basically a response to the increase (higher than in the euro area) in the value of portfolios when the cyclical position was very favourable, although it also seems to be the result of the successive adaptation of agents' investment and financing decisions to an environment of greater macroeconomic stability. Thus, despite the sharp increase in bank lending to households in recent years, debt ratios in terms of disposable income are still below those in the United States and in the euro area as a whole, although the distance from the latter has fallen significantly in recent years. In proportion to the stock of financial assets, the situation of Spanish households is on a par with that in the United States and the euro area. However, the proportion of total household assets represented by financial assets is significantly lower in Spain than in the United States and, to a lesser extent, than in the euro area. Accordingly, the vulnerability of the wealth position of Spanish households to stock market changes is less, although their exposure to house prices is greater.

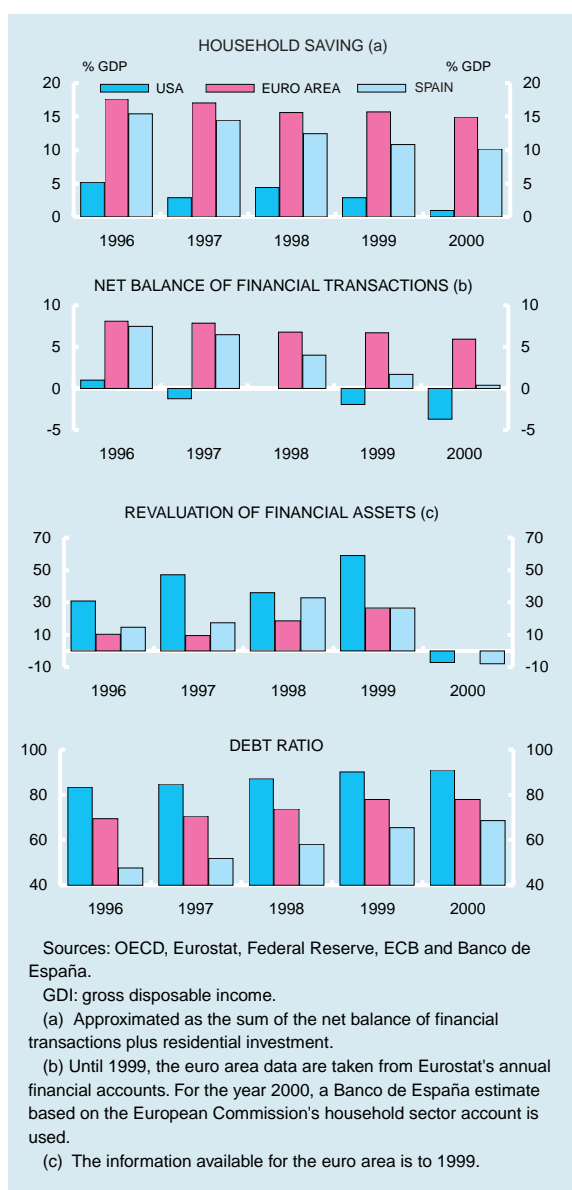


TABLE I.1

Main indicators of the Spanish economy

| | 1996 | 1997 | 1998 | 1999 | 2000 |
|--|-------|-------|-------|-------|-------|
| DEMAND AND OUTPUT AT CONSTANT PRICES (a): | | | | | |
| Private consumption | 2.2 | 3.1 | 4.5 | 4.7 | 4.0 |
| Government consumption | 1.3 | 2.9 | 3.7 | 2.9 | 2.6 |
| Gross capital formation | 1.8 | 4.7 | 10.1 | 9.5 | 5.3 |
| Exports of goods and services | 10.4 | 15.3 | 8.3 | 6.6 | 10.8 |
| Imports of goods and services | 8.0 | 13.3 | 13.4 | 11.9 | 10.4 |
| Gross domestic product | 2.4 | 3.9 | 4.3 | 4.0 | 4.1 |
| EMPLOYMENT, WAGES, COSTS AND PRICES (a): | | | | | |
| Total employment | 1.2 | 3.2 | 3.8 | 3.6 | 3.3 |
| Compensation per employee | 4.5 | 2.1 | 2.8 | 2.8 | 4.0 |
| Unit labour costs | 3.3 | 1.4 | 2.2 | 2.3 | 3.2 |
| GDP deflator | 3.5 | 2.2 | 2.3 | 2.9 | 3.5 |
| Consumer price index (annual average) | 3.6 | 2.0 | 1.8 | 2.3 | 3.4 |
| Consumer price index (12-month % change) | 3.2 | 2.0 | 1.4 | 2.9 | 4.0 |
| SAVING, INVESTMENT AND FINANCIAL BALANCE (b): | | | | | |
| Resident sectors: saving (c) | 23.1 | 23.8 | 23.7 | 23.5 | 23.6 |
| <i>General government (c)</i> | -1.8 | 0.0 | 0.8 | 2.2 | 3.0 |
| Resident sectors: investment | 21.9 | 22.2 | 23.2 | 24.7 | 25.9 |
| <i>General government (c)</i> | 3.2 | 3.2 | 3.4 | 3.4 | 3.3 |
| Resident sectors: domestic net lending (+) or net borrowing (-) | 1.2 | 1.6 | 0.5 | -1.1 | -2.2 |
| <i>General government</i> | -4.9 | -3.2 | -2.6 | -1.2 | -0.3 |
| General government gross debt | 68.1 | 66.7 | 64.7 | 63.4 | 60.6 |
| MONETARY AND FINANCIAL INDICATORS (d): | | | | | |
| ECB weekly intervention rate | — | — | — | 2.7 | 4.1 |
| Banco de España intervention rate | 7.5 | 5.4 | 4.2 | — | — |
| Ten-year government bond yield | 8.7 | 6.4 | 4.8 | 4.7 | 5.5 |
| Synthetic bank lending rate | 9.7 | 7.2 | 5.9 | 4.9 | 5.9 |
| Madrid Stock Exchange General Index (DEC 1985 = 100) | 367.3 | 556.1 | 817.7 | 894.4 | 994.8 |
| Dollar/euro exchange rate (e) | 1.3 | 1.1 | 1.1 | 1.1 | 0.9 |
| Spain's competitiveness index vis-à-vis developed countries (nominal) (1999 H1=100) (f) | 105.2 | 100.7 | 100.4 | 98.7 | 95.8 |
| Spain's competitiveness index vis-à-vis developed countries (real) (1999 H1=100) (f) | 103.5 | 99.3 | 99.6 | 99.0 | 97.4 |
| Liquid financial assets (g) | 9.7 | 7.9 | 3.7 | 1.4 | 2.6 |
| Broad liquid assets (g) | 10.2 | 10.4 | 8.1 | 6.8 | 2.7 |
| Households: total financing | 10.8 | 14.6 | 19.3 | 19.6 | 17.4 |
| Non-financial corporations: total financing | 5.0 | 9.2 | 14.7 | 19.3 | 20.1 |

Sources: Instituto Nacional de Estadística, Intervención General del Estado and Banco de España.

(a) Rates of change.

(b) Levels as percentages of GDP. The saving and investment figures for 2000 are Banco de España estimates.

(c) Includes net capital transfers received.

(d) Annual average levels for interest rates and exchange rates and rates of change for financial assets and liabilities.

(e) Prior to 1999, dollar/ecu exchange rate.

(f) Measured using consumer prices.

(g) Of non-financial corporations and households.

particularly generous. Their effect on prices could only be partly offset by the restrictive fiscal stance and by the progress made in liberalising markets in order to increase the growth potential of the economy. The persistence, for the fourth year running, of strong growth in demand (domestic and external) was a factor that had the potential to generate imbalances. And these began to appear in the form of some upward pressure on prices, a notable widening of the trade deficit, and the decline in the private saving ratio, which has led households to increase considerably their indebtedness. The joint effect of higher prices for imported energy on costs of production and the external accounts and of the deterioration in international markets magnified these incipient imbalances. The result was a decline during 2000 in household and corporate confidence, and the spending of these sectors began to weaken moderately in the second half of the year. Accordingly, the Spanish economy entered 2001 having passed the peak of the current upswing, and at a more advanced stage of the cycle than the euro area. However, the symptoms of financial imbalance in the private sector (which normally accompany long periods of growth) had not reached the same intensity as in the US economy.

In 2000, the Spanish economy sustained a high rate of real GDP growth, which only partially abated, in year-on-year terms, in Q4, continuing to do so moderately in the first few months of 2001. However, there was a significant change in the pattern of growth last year; national demand lost momentum, while the contribution of net external demand to output growth turned positive. Between 2000 Q1 and 2001 Q1 the year-on-year growth rate of real GDP fell by 0.7 percentage points (from 4.2 % to approximately 3.5 %), while the slowdown in national demand was of the order of two points (from 5 % to 3 %). The difference is explained by the change in the contribution of external demand; it reduced output growth by almost one point in 2000 Q1, while in the first three months of the current year it raised it by several tenths of a percentage point.

The reasons for the decline in strength of domestic demand in the Spanish economy are diverse. They range from the cyclical fading of certain items of household expenditure to the impact of the energy crisis. Added to them, as the year elapsed, was the fall in stock market prices, the de-

cline in agents' confidence owing to the changes occurring in the international environment and, to a lesser extent, the increasingly easy stance of Eurosystem monetary policy. Growth in consumer spending decelerated by some 2.5 percentage points between 2000 Q1 and the same period of 2001. The decline in the rate of change of gross fixed capital formation was somewhat larger, owing to the notable loss of steam in capital investment, while investment in construction, within its tendency to decelerate, was more sustained. It is not easy to find an explanation for this phenomenon, which goes further than the possible statistical problems in the provisional Quarterly National Accounts (QNA) estimates of this aggregate, but its real growth may be distorted downward by the underestimation of quality improvements in the calculation of the relevant deflators (see Box I.2). However, the uncertainty over the future international economic environment has probably affected the execution of some projects, in a sector that is very sensitive to changes in expectations, and it is also possible that the high returns on some foreign investments and their strategic nature in the growing internationalisation of the Spanish economy have affected investment at home.

Notwithstanding, the high levels of capacity utilisation, the moderate behaviour of the user cost of capital, the high corporate profit rates and the favourable financing conditions prevailing suggest that some temporary factor is responsible for the sharp slowdown in capital goods investment, which would mean that recovery of this variable in the coming quarters is possible. In any event, the course of this phenomenon is of great significance, since the maintenance of a growth differential between Spain and the euro area, to complete the process of real convergence, must be accompanied by strong investment, to increase factor productivity and permit high rates of employment growth to be sustained.

The strength of goods and services exports throughout 2000 is basically explained by the extraordinary buoyancy of external markets, as well as by the competitiveness gains recorded in certain areas as a consequence of the weakness of the euro vis-à-vis the US dollar during most of 2000. The slowdown in external markets and the change in the course of the euro were reflected in the figures released for the first few months of

2001, in which a slight downturn in the buoyancy of exports is apparent. That said, the change that has taken place in the contribution of external demand to output growth is largely attributable to the slowdown in imports, in line with the slowdown in domestic demand.

Job creation proceeded apace for the fourth consecutive quarter, employment having increased by 3.3 % on average during the year, in terms of homogenous QNA estimates. The strength of employment generation is one of the most notable characteristics (shared to a lesser extent by other European economies) of the current economic upswing in the Spanish economy and, as a result, the growth of apparent labour productivity has been very low. During 2000, employment growth began to slow, as the economy slowed and wage growth began to rise, and these trends continued in the first few months of 2001.

The increase in wages (of 4 % on average in 2000, on QNA estimates) combined with the low productivity growth (as a result of the vigorous employment generation during the upswing) to push up unit labour costs, doubling their growth differential vis-à-vis the euro area countries. The larger increase in labour costs in Spain can partly be attributed to its relatively advanced cyclical position, but it also reflects the existence of mechanisms in the wage determination process that establish a closer link between wage growth and actual inflation. At times of rising inflation, these mechanisms give rise to second-round effects that tend to prolong the inertia of inflationary pressures, even if the initial increase in prices is temporary in nature.

The price pressures that began to become apparent in some markets less exposed to competition in which the pressure of demand was particularly strong, intensified notably as the oil price increases were passed through to the different sectors of the economy. The Harmonised Index of Consumer Prices (HICP) ended the year with a rate of increase of 4 %, well above the 2.8 % rate recorded at end-1999. Part of this increase was attributable to the direct impact of energy prices, but other components, such as services and non-energy industrial goods, less exposed to temporary movements and transient changes in the workings of markets (such as the current distortions in the markets for some food products), also accelerated notably. The prices of non-energy

industrial goods rose by one percentage point during 2000 and the index of services by almost 1.5 percentage points. In 2001 to date, the decline in the prices of energy products has been less than expected and no significant changes are discerned in the dynamics of the other two components mentioned, so that the annual rate of change remained at around 4 %.

Comparing the above-mentioned values with those of the euro area reveals a widening of the inflation differential to 1.4 percentage points by end-2000 (see Chart I.2). This deterioration in consumer prices in the Spanish economy in relation to the euro area as a whole was attributable, in the first instance, to its greater dependence on imported energy, which makes it more sensitive to oil price increases and, above all, to the strong dynamism of domestic demand, a consequence of its advanced cyclical position, which has led to constant increases in the differentials between the rates of increase of unit labour costs and has been conducive to the passing through of cost increases to final prices. The insufficiency of competition still apparent in some goods and service markets, in which the widening of trade margins has been particularly sharp, should not be forgotten either.

The price of imported oil in US dollars rose on average in 2000 by 71 %, and in euro by 97 %, owing to the depreciation of the euro during this period. In the Spanish economy, this increase was passed through to the energy component of the CPI to a similar extent to that in most of the euro area countries (with certain time lags and leaving aside the problems arising from tax differences), the direct impact on the total index being 0.7 percentage points. Available estimates for the overall effect, including the repercussions on the rest of the sectors of the economy, exceed 1.5 %. This impact (which does not take into account the indirect effects that might have taken place through the process of determination of wages and business margins, if economic agents do not accept the loss of real income implicit in the rise in the world price) has been greater in the Spanish economy than in the European economies as a consequence of its greater energy dependence. In fact, if the growth in net oil imports per unit of GDP (in real terms) in Spain and in the euro area is compared, a parallel adjustment can be seen to have taken place since the energy crises of the

Inflation and product quality changes: the use of hedonic regressions to adjust for quality biases

The rapid technological progress taking place in the information and communication technology industries means that products marketed by these sectors undergo continuous changes in their characteristics and significant improvements in their quality. Consequently, a significant portion of the changes seen in their prices reflects, in fact, changes in quality, and this should not be included in the indices used to deflate the value of output. Ignoring or at best underestimating the effects on prices of quality changes will generally lead the change in volume of output to be underestimated. The methods traditionally used to adjust for quality biases in price indices have proven inadequate when technical progress is very rapid. In such cases, an alternative methodology based on the estimation of hedonic regressions is often used.

Hedonic price indices are based on the existence of a relationship between the price of a good and a set of relevant characteristics defining its quality. The estimation of this relationship via econometric procedures enables that part of the price variation attributable to the change in these characteristics to be assessed. Generally, the use of hedonic methods in high-technology goods-producing industries gives rise to adjustments to the price changes observed that are far greater than those obtained using traditional techniques, with the subsequent reduction in the estimated growth for the deflator and the upward revision of the magnitude in real terms. As these goods account for a significant and growing proportion of expenditure in an economy, the ensuing revisions may prove to be substantial, in particular in certain relevant variables such as investment.

Table 1 plots the course of the US deflator of investment in computers and peripherals (estimated with hedonic techniques), along with the successive aggregate deflators until arriving at that of total investment⁽¹⁾. As can be seen, the annual average rate of change of the deflator of these products was negative and above 18 %, in absolute values, during the nineties, the rate of decline of prices having intensified between 1995 and 1999. The magnitude of this revision means that the aggregate investment deflator has also posted negative rates of change in recent years. Although these results cannot be attributed entirely to the use of hedonic indices, there is no doubt that the scale of the estimated fall in prices applying this methodology is far greater than that obtained with more traditional adjustment techniques. Consequently, the upward revisions of the real growth rates of the economy's productive investment are also notable.

The OECD⁽²⁾ conducted a simulation exercise enabling the scale of these effects on investment growth rates to be approximated in several countries of the area. The exercise was performed under the assumption that the downward adjustment to the rates of change of deflators, derived from the use of hedonic techniques, is 10 %, in annual terms, for the case of computers, and 2 % for another set of goods related to the new technologies. The results of this exercise are given in Table 2. It can be seen that the use of this approach for the correction of quality biases would significantly increase (by between 0.4 % and 0.9 % per annum, depending on the country) the growth rates of investment in real terms. The inaccurate measurement of investment has consequences, in turn, for the measurement of the economy's capital stock and for total factor productivity. Nonetheless, the same OECD study concludes that the effects on the aggregate figures of economic growth are on a lesser scale since part of the direct impact is offset by the upward revision in the real growth of imports (via the adjustment of their deflator). The amount by which the impact is offset will depend on the extent to which access to the technological advances incorporated into these types of products is via imports.

(1) Although hedonic techniques are not used solely in the computers and peripherals sector, it is here that they have most impacted price developments. Currently, they are used in the United States to deflate items accounting for 18 % of US GDP. See S. Landefeld and B.T.Grimm «A Note on the Impact of Hedonics and Computers on Real GDP», *Survey of Current Business*, 17, December 2000.

(2) See P. Schreyer «Information and Communication Technology and the Measurement of Real Output, Final Demand and Productivity», STI Working Papers 1998/ 2 OECD.

TABLE 1

Annual average rate of change (%) of the US investment deflator

| | 1980-99 | 1980-90 | 1990-99 | 1995-99 |
|--|---------|---------|---------|---------|
| Total investment | 1.71 | 2.80 | 0.51 | -0.26 |
| Capital goods and software | 0.30 | 1.75 | -1.29 | -2.69 |
| Data processing equipment and software | -3.31 | -1.59 | 5.19 | -7.25 |
| Computers and peripherals | -15.42 | -12.59 | -18.4 | -24.17 |

Sources: Bureau of Economic Analysis. National Income and Product Accounts.

TABLE 2

Effect of hedonic price indices on the annual average growth rate of real investment

| | |
|------------------------|------|
| Canada, 1986-92 | 0.41 |
| France, 1985-96 | 0.68 |
| Japan, 1985-94 | 0.44 |
| Netherlands, 1986-93 | 0.71 |
| United States, 1987-93 | 0.91 |

Source: Schreyer (1998).

1970s, which was interrupted at the end of the 1980s, when the weight of net oil imports in GDP began to fall less strongly in the euro area countries while beginning to rise modestly in Spain. The same results are obtained if dependence is measured in terms of net energy imports as a percentage of final demand. This percentage was almost 1 % in Spain in 1999, while it was 0.8 % in Germany and Italy, 0.7 % in France and less than 0.5 % in the Netherlands.

The impact on the Spanish economy of the crisis in the market for oil products was also channelled through the notable increase in the trade deficit over the last two years to 6.2 % of GDP, on QNA data. As seen in Chart I.3, the growth of the nominal external deficit, last year, was closely related to the increase in the import prices of energy products and the related deterioration in the terms of trade. However, when the analysis is carried out in real terms, it can be seen that the widening of the trade deficit was also particularly strong and persistent and only abated in the second half of 2000. This behaviour is largely explained, therefore, by the differential between the rate of growth of the Spanish economy and that of most of Spain's main trading partners, but it could also be indicative of the incubation of competitiveness losses in certain markets, in particular those of the euro area, for which there is no exchange rate to offset price and cost differentials.

Chart I.4 depicts certain indicators of the Spanish economy's competitiveness in recent years (specifically those based on unit labour costs). Gains in competitiveness were recorded outside the euro area, largely determined by the depreciation of the European currency, and these entailed an additional stimulus to the strong growth in Spanish exports in non-EU markets, which were notably buoyant. In fact, in the last two years, Spanish exports have increased their market shares in these areas. By contrast, the persistence of price and cost differentials with euro area countries seems to have affected the results achieved by Spanish exports to the area. During 2000, real Spanish exports to the euro area countries grew at a slower rate than their imports, with the consequent loss of market share, after many years of uninterrupted gains.

The expansionary influence exerted by the common monetary policy on the conditions under

which Spanish economic activity has been carried on in recent years and the risks that involved, by further stimulating spending in the presence of latent cost pressures, which became manifest with the rise in the price of oil, has already been discussed. As has also been mentioned, the change in inflationary expectations in the euro area countries as a whole, against a background of a firming economic recovery, opened the way for a shift in Eurosystem monetary policy, which partially relieved the misalignment with purely domestic needs. However, although short-term nominal interest rates increased last year (in step with the increases made by the ECB), these movements were not passed through to the same extent to the real interest rates of the area due to the upturn in inflation rates. Moreover, long-term rates declined and the downward path of the euro only turned upward well into the year. Liquidity measured by liquid financial assets, increased at a very moderate rate (of around 3%), owing above all to the big fall in the mutual funds shares included in this variable (bond and hybrid funds), which means that it cannot be considered representative of the liquidity conditions in the economy. In fact, the heavy shifts taking place between the various types of asset and cross-border movements within the euro area are making it very difficult, during the first few years of monetary union, to know how much liquidity the agents resident in the Spanish economy have available for spending.

In any event, the financing obtained by firms and households again grew at a very high rate (close to 20 %), which only began to show signs of slowing somewhat at the beginning of 2001. This strong expansion of financing to the private sector, which has led to historic high levels of corporate and household indebtedness (albeit still below those recorded in the euro area countries and, therefore, even further below those of the US economy) is the clearest indicator of how easy monetary and financial conditions have been these years. It is possible that the strong growth in credit is, in part, the result of structural adjustment to conditions of macroeconomic stability in which the optimal level of indebtedness is higher. However, the very speed and intensity of the process involve risks for the maintenance of macroeconomic and financial stability.

In this situation, household spending expanded by more than disposable income in 2000, so that

there was a further drop in the saving ratio. The wealth gains accumulated in previous years and the favourable financing conditions (against a background characterised by favourable expectations regarding their future income) accounted for the dynamism of consumer spending, as well as for the demand for housing. Household net lending continued to fall to historically low levels, standing at 1.3 % of GDP at end-2000. The slowdown in household spending in the second half of the year tended, to some extent, to relieve these imbalances, and the initial results for the current year point to the possibility of a recovery in household net lending. The increase in corporate net borrowing in recent years has also been significant, but less intense than in other upswings partly, as mentioned already, due to the rapid slowdown in equipment investment. Only the increase in public saving therefore helped to lessen the decline in the nation's net saving.

Fiscal policy continued along the line of recent years of reducing the budget deficit. The results exceeded the targets set and policy became moderately restrictive (although less so than in the preceding years), which helped to counter the expansionary monetary conditions prevailing. In any event, the ECB's interest-rate increases and the slowdown in domestic demand had relieved the excessive looseness - from Spain's point of view - of the single monetary policy. The general government deficit was 0.3 % of GDP, as against an initial target of 0.8 %. This progress has enabled the time horizon set for balancing the budget to be shortened, and the State budget for 2001 proposes the achievement of balanced finances for general government as a whole, which seems to be a feasible objective judging by the data available to date. Contributing notably to the favourable developments in public finances last year was the dynamism of tax receipts, while spending growth exceeded, albeit to a lesser extent than in the preceding years (especially in the case of the State), the levels budgeted. A fresh drive is planned to bring public spending under control and to keep it within set limits, by means of the Budget Stability Law, which is currently before parliament. This is particularly timely to ensure that fiscal policy contributes effectively, in the medium and long term, to macroeconomic stability and that economic growth is sustainable within the constraints of the euro area stability requirements.

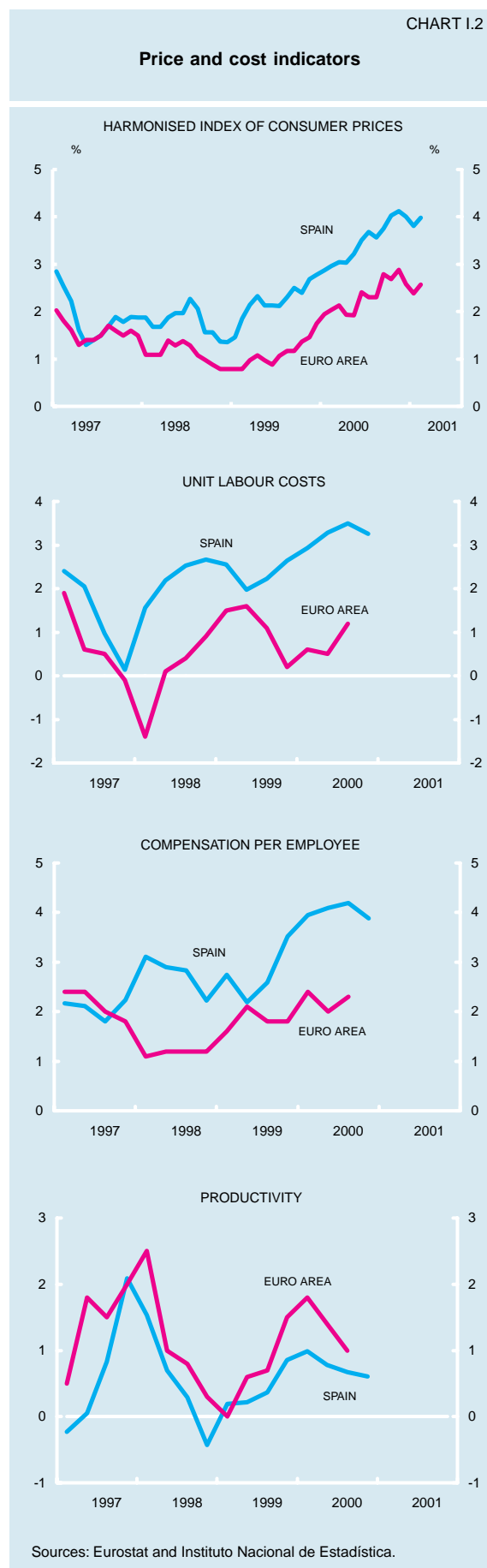
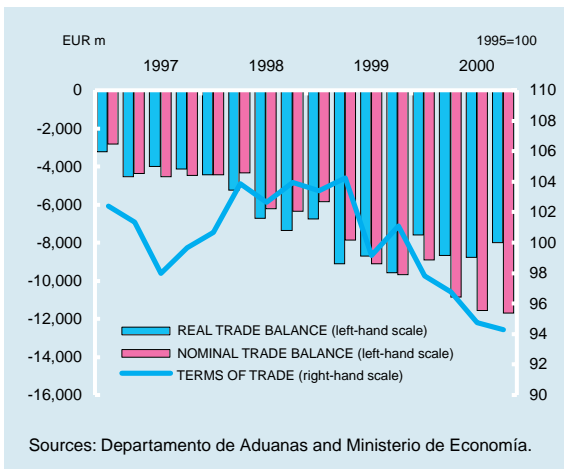


CHART I.3

Trade balance and terms of trade

I.5. THE CORRECTION OF INCIPENT IMBALANCES AND THE SUSTAINABILITY OF GROWTH AND REAL CONVERGENCE

Over the last four years, the Spanish economy has experienced rapid intensive job creating economic growth, which has taken its relative income levels close to the EU average. The macroeconomic stability achieved in terms of discipline in wage and income formation processes, reduction of the rate of inflation and fiscal consolidation, in a more flexible and competitive economic setting, has been decisive for the progress in real convergence.

As made clear in the review of the current situation of the Spanish economy, the long upswing has not been free from signs of imbalances in the form of price and cost differentials, declining saving and a growing trade deficit. These incipient imbalances, which surfaced last year just when the oil market crisis was at its height, need to be corrected in order to avoid a significant loss of economic and job creating dynamism. Otherwise, the persistence of inflation differentials (although small in magnitude) with euro area countries will end up affecting its competitive position and, therefore, its growth capacity. Moreover, the Spanish economy requires a boost to productive investment to increase the stock of capital and to incorporate the new technologies that currently determine competitiveness in the international environment.

The growth of the Spanish economy in the latest cyclical upturn has been especially intense in terms of job creation, which has enabled the rate of unemployment to be reduced significantly. The wage moderation of recent years and the progress on labour market reform helped considerably to relieve one of the most serious problems of the Spanish economy. This pattern of growth needs to continue, because otherwise the forces for deceleration which would be transmitted through the increase in unemployment (in the form of declining household income and a worsening of consumer and corporate expectations) would also limit the growth of demand, aggravating the risks of a deceleration. It must, therefore, be ensured that the increase in productivity necessary to maintain the process of real convergence with the EU countries is not the result of a decline in the rate of growth of employment, but rather of an increase in investment, through increasing the stock of productive capital and incorporating technological advances. Box I.3 shows that the increase in the employed proportion of the population has been the main factor driving the reduction in the gap between Spain's GDP per capita and the EU average in recent years. While the rate of unemployment in Spain remains significantly higher than in the rest of the area, it is important that the convergence process continues to be based on intensive employment creating growth. To make all these factors compatible, it is especially important that labour market reforms should proceed apace and that the rest of economic policies should help to make the economic system more competitive and efficient. This would allow the recent upturn in inflation to be overcome promptly and the inflation differential vis-à-vis the euro area countries to be closed rapidly, taking advantage of the smaller cyclical discrepancies.

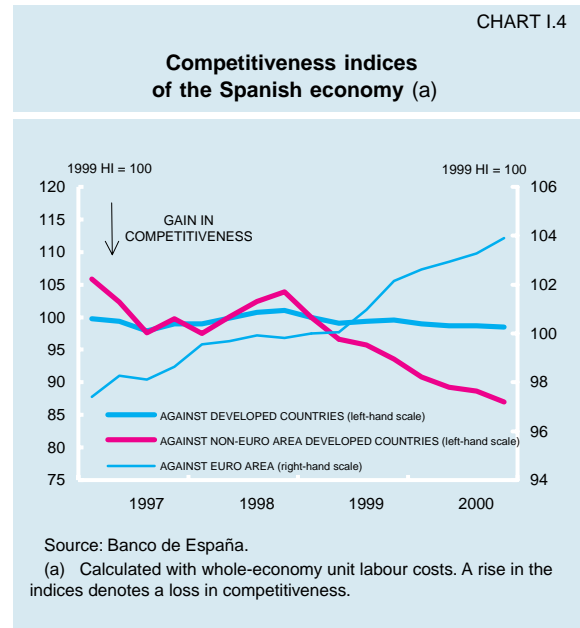
Fiscal policy also has a significant role to play here. Not only should it provide the discipline necessary to comply with the Stability and Growth Pact but also, via the development of public spending strategies consistent with the requirements for budgetary balance, it should aim to promote public investment, education and R&D, those spending components that can most assist in increasing productivity and potential growth. This requires careful revision of all spending components, in view of the smaller room for manoeuvre available through reductions in interest payments and government consumption and the growing pressure on social securi-

ty and health spending stemming from the ageing of the population. It is equally important that the reductions in the fiscal burden are designed so as to be conducive to the efficient allocation of resources and the competitiveness of firms and that they are based on a successful selection of the preferred lines of spending.

In the Spanish economy's current situation of ongoing structural adjustment to the requirements of monetary union and the challenges of a more competitive environment, two questions are particularly significant: first, to ensure on a sustainable basis that price, cost and income formation take place within limits compatible with the area's price stability objectives; and second, to eliminate those factors obstructing the competitive working of markets through the existence of barriers to entry, regulated prices or excessive administrative formalities, which may result in higher prices, slower adjustment to shocks and lower productivity gains (owing to the absence of incentives to incorporate technological innovations).

Of great importance here is the shaping of a more transparent and stable regulatory environment, enabling the administrative steps necessary to commence diverse activities (e.g. those relating to land use, the opening of large retail outlets, the construction of power stations, etc.) and to start up businesses to be simplified and speeded up. This requires progress in co-ordinating the actions of the various branches of general government in relation to these activities and revision of the requirements for obtaining licences or authorisations to supply certain public services and the term thereof, which in certain cases, such as regular-service transport, may be excessive.

To obtain a more competitive environment it is necessary to strengthen the bodies for the protection of competition and to extend their functions. A constantly dynamic liberalisation policy requires close monitoring of the effectiveness of the measures adopted last June to correct the distortions which, despite the progress made in liberalisation in recent years, continue to be displayed by certain strategic sectors. These distortions are principally manifest in the maintenance of high degrees of concentration in production and distribution. In this line of action it would be desirable to continue increasing the number of agents authorised to oper-



ate in certain activities (road transport, cable telecommunications) and to continue abolishing regulated prices in markets in which there are sufficient operators (chemists, book distribution, tobacconists etc.).

As regards the workings of the labour market, the recent reforms introduced by the government have tended to consolidate and expand the channels for creating employment through the standard contracts agreed by the social partners in 1997. Specifically, the permanent employment-creating contract has been extended, broadening the group of workers eligible for such contracts, and the conditions for part-time hiring have been made more flexible, as this type of employment is relatively much less important in Spain than in Europe. At the same time moderate severance pay has been introduced in the case of fixed-term contracts. These measures amount to progress in the right direction to ensure that job-creation remains dynamic. However, there are other aspects of the current labour market that require particular attention. Chart I.2, mentioned above, shows that the acceleration of final prices in recent years has been passed through to wages more quickly and completely than in other countries of the euro area. This behaviour signals the end of a period of moderate growth of labour costs in Spain, which was fundamental in facilitating the transition to the euro and which has driven the strong growth of employment during the latest upswing.

From this viewpoint, the presence of two special features that reinforce the role played by inflation in the process of income formation in Spain, in comparison with many European countries, should be taken into account. These are the deficient structure of collective bargaining, which leads to very uniform wage increases across productive branches (linked, moreover, to the rate of inflation), and the existence of ex-post indexation mechanisms which guarantee the purchasing power of a very high percentage of the wages subject to agreements (more than 75 % last year). Inflation-adjustment clauses, which became widespread in the past in response to a high-inflation environment, have been disappearing in almost all euro area countries, so that their continued existence in Spain has direct consequences for the competitiveness of Spanish firms when inflation temporarily deviates from its target.

Against this backdrop, it is essential to abandon the indexation of incomes and to establish patterns of behaviour appropriate for an economy with price stability. This means that productivity increases should be the main element in wage reviews and that collective bargaining should be sufficiently flexible as to enable the constraints and possibilities of each firm to be taken into account, such as demand and the productivity gains generated by technological development.

Progress in this direction requires revision of those features of the Spanish collective bargaining system that - despite the existence of a large number of agreements - prevent wages from behaving differently in response to different economic and sectoral conditions. It would seem desirable to reconsider those aspects that extend uniformly the terms agreed at the upper levels of bargaining to all the firms potentially affected, irrespective of their size, financial situation and location, and to make more use of the possibilities for firms to decide upon the most suitable wage terms. Those aspects that discourage the adoption of new agreements (and which therefore make it difficult to vary rights acquired under different circumstances from the present ones), should also be eliminated, and regulations relating to the wage structure should be revised in order to give more weight to the variable component of wages.

Revision of the collective bargaining system should be accompanied by a parallel reform of

those institutional elements that limit geographical mobility between regions. Notable among these are the workings of the markets for land and rented housing (which are responsible for the existence of large differences between house prices across areas with varying degrees of economic development) and certain characteristics of the system for protecting the unemployed, which reduce the mobility of those receiving benefits. Such reforms would enable the large differences in regional unemployment rates to be corrected. They would also be conducive to a more rapid adjustment of the supply of labour to the demand existing, irrespective of its geographical location, so avoiding the emergence of bottlenecks like those that have begun to be seen in certain activities and regions, and thereby helping to moderate wages.

Hitherto, the characteristics of collective bargaining in Spain and, in particular, the lack of wage flexibility have meant that, at times of lower economic growth, the adjustment of the labour market falls excessively on employment, and especially temporary employment. Accordingly, making the system more flexible and securing wage moderation are important factors in ensuring that the economic slowdown does not result in a significant deceleration of job creation.

The need for such measures has intensified in recent years, both in Spain and in the European Union, owing to growing globalisation, which requires increasingly competitive and open national markets to enable those technological innovations that generate productivity gains and growth (information and communication technologies in recent years) to be incorporated rapidly. Against this background, delay in implementing structural reforms to secure a more competitive environment may have significant costs in terms of potential growth and competitiveness.

In Europe, the move towards the single European market has served as a catalyst for structural reforms. Directives have been adopted to promote the liberalisation of factor and product markets, processes have been launched - such as the Cardiff and Luxembourg ones - to assess the progress made in this area, and initiatives adopted in Lisbon, a year ago now, to develop the information and knowledge-based society have been implemented.

Spain-EU convergence: 1960-2000. The contributions of the employment rate and labour productivity

Since 1960, the Spanish economy has reduced the gap between its GDP per capita (GDP pc) and that of the EU by around 25 percentage points. This process of convergence with the levels of economic welfare in the EU as a whole has not been smooth, either in terms of its pace or of identification of the factors responsible, with three distinct periods being discerned: 1960-1974, 1975-1985 and 1986-2000. In order to examine this process, the adjoining chart shows the relative level of Spanish GDP pc, that of the three variables into which it can be broken down - percentage of the population of working age, the rate of employment and labour productivity - and the differentials between the related growth rates. In order to explain the growth of labour productivity, the capital/labour ratio and total factor productivity (TFP)³ - which approximates the gains in productive efficiency stemming from technical progress, organisational improvements, etc. - are depicted in the same chart.

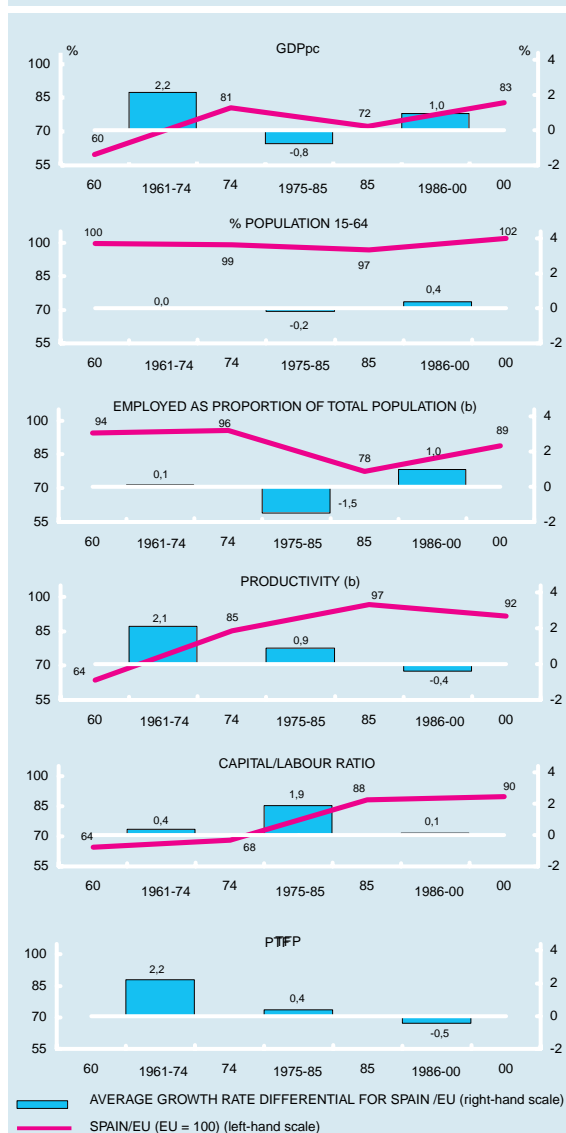
In 1960, Spanish GDP pc was scarcely 60 % of EU GDP pc. This difference is basically explained by labour productivity, which stood at 64 % of the Community level. During the period 1960-1974 the Spanish economy made substantial progress, with its GDP pc increasing by substantially more than that of the EU. This progress was almost entirely attributable to a wide productivity growth differential, which stemmed from the larger increases in the capital/labour ratio and, above all, in TFP. In the period 1975-1985, the economy lost some of its previous gains, the rate of employment falling by more than in the EU, although labour productivity grew at a higher rate than in the EU, with positive contributions from the capital/labour ratio (which rose considerably with the reduction in employment) and from TFP.

Between 1986 and 2000 the path of convergence towards European levels of welfare was regained, with annual growth of GDP pc one percentage point higher than in the EU. However, unlike in the previous convergence phase, the reduction in the gap was largely a consequence of the intensity of employment creation, which resulted in a differential in the rate of growth of the rate of employment of one percentage point per annum. Conversely, the increases in labour productivity were comparatively small, as a consequence of the relatively modest TFP growth, which contrasts with the behaviour of this variable in previous phases.

In short, as implied by the preceding paragraphs, the process of real convergence of the Spanish economy has not been uniform, either in terms of its continuity or of its determinants. In the initial years, it was led by very significant increases in labour productivity and, in the latter years, by strong job creation. The intervening phase, when relative welfare declined, saw a drastic cut in the employment rate, for which the increases in labour productivity were unable to fully compensate.

In 2000, Spanish GDP per capita reached a level which, in terms of purchasing power parity, represented 83 % of the EU level, with lags in the level of the employment rate (89 % of the EU rate) and in that of labour productivity (92 % of the Community level). These lags suggest that, more rapid, solid and sustained progress in real convergence requires a pattern of growth based, unlike in previous phases, on positive contributions both from the rate of employment and from labour productivity, with the latter stemming from significant increases in the stocks of physical, technological and human capital. Indeed, if productivity growth were not accompanied by significant job creation, the positive differential in the unemployment rate would be perpetuated. This would be unacceptable, both from the economic and social viewpoints. But also, in future, employment increases may be insufficient to support convergence, because, once the EU employment rates have been reached, unless productivity reduces the gap, GDP pc will cease to converge with EU welfare levels, remaining some distance below.

GDPpc, components and determinants of labour productivity Levels in relation to the EU and growth rate differentials (a)



Sources: AMECO and Banco de España.

- (a) The EU aggregate excludes Sain. The monetary variables are measured in euro constant prices, PPP-based, for the base year (2000).
 (b) Using the National Accounts employment series.

(1) The growth rate of labour productivity depends on the rate of change of the capital-labour relationship and of TFP, which captures the increases in productive capacity not attributable to changes in the amounts of capital and labour employed.

In recent years, numerous measures have been taken in Spain to improve the competitive environment. Reforms have been introduced into the labour market, significant steps have been taken to implement the liberalisation strategy and to strengthen competition, mainly affecting the network industries, and measures have been

adopted to promote investment in new technologies, personnel training and R&D. Nonetheless, the behaviour of inflation over the last two years shows that significant rigidities still persist in the workings of certain markets for factors, goods and services, which call for further action under this strategy.

CHAPTER II

THE EXTERNAL ENVIRONMENT
OF THE EURO AREA

II.1. OVERVIEW

The world economy posted exceptional results in the year 2000, although the figures for the year as a whole mask the clearly declining course of activity (see Table II.1 and Chart II.1). Overall output is estimated to have grown by almost 5 %, against a background of high macroeconomic stability. Most of the industrialised and emerging economies benefited from this boom climate, with the notable exception of Japan, which is still struggling to overcome stagnation and deflation in a fiscal and financial environment which continues to worsen.

While the average growth of output in the United States held at a firm pace of 5 %, with the related figure in the United Kingdom rising to 3 %, expansion in the emerging countries as a whole resumed a rate similar to that prior to the 1997 Asian crisis (see Chart II.1). The south-east Asian economies were particularly buoyant, with output expanding by almost 7 %. The pace of activity also quickened in the candidate countries for EU membership to 3.7 %, while GDP in Latin America is estimated to have grown by 4.2 %. Over the year as a whole, however, the economic growth profile was a changing one, whose turning point may be placed towards the start of the second quarter. Thereafter, activity in the United States slowed sharply, and this influenced to varying degrees the outlook for other countries, according to their linkage with the US economy.

Sustained high oil prices were in contrast to the prolonged depression marking the prices of other commodities (see Chart II.2). Combined with the buoyancy of global demand, this prompted some upward pressure on final prices. Nonetheless, the rise in inflation rates was limited and in certain

countries, such as the United Kingdom and the emerging economies as a whole, decreases were even recorded. In step with the latent inflationary pressures and with the expansionary phase of the cycle, the monetary authorities implemented gradual – but moderate – interest rate rises during the year. In some cases, these were more than corrected in the first quarter of the current year as the slower pace of economic activity became discernible. In turn, fiscal consolidation made further headway, boosted by robust demand, enabling a virtually balanced budget to be achieved across the developed economies.

The widening of current-account deficits in certain countries is a counterpoint to the general environment of economic stability. In the United States and the United Kingdom in particular, the current-account deficit widened notably to 4.4 % and 1.7 %, respectively, of GDP, whereas the euro area figure was almost in balance following a moderate surplus a year earlier and Japan maintained a surplus of around 2.5 % of GDP. Set against the deterioration in the external position of the developed countries as a whole was a substantial improvement in the external position of the oil exporting countries, including Russia. Overall, their current-account surplus increased fourfold.

International financial developments during the year were consistent with the gradual deterioration of the overall economic outlook, preceded to some extent by corrections on the financial markets. After strong rises in previous years, the equity markets were considerably volatile and prices fell from March onwards, in keeping with tighter monetary policy stances and the first signs of a downturn in corporate expectations in the United States. Moreover, into the second half of the year, stock market

TABLE II.1

Main macroeconomic indicators of the United States, Japan and the United Kingdom

| | 1997 | 1998 | 1999 | 2000 | 2000 | | | |
|--|------|------|------|---------|------|------|------|------|
| | | | | | Q1 | Q2 | Q3 | Q4 |
| UNITED STATES: | | | | | | | | |
| GDP (a) | 4.4 | 4.4 | 4.2 | 5.0 | 5.3 | 6.1 | 5.2 | 3.4 |
| Private consumption (a) | 3.6 | 4.7 | 5.3 | 5.3 | 6.0 | 5.4 | 5.3 | 4.5 |
| Private investment (a) | 9.6 | 11.8 | 9.2 | 9.3 | 10.0 | 10.6 | 9.4 | 7.2 |
| External demand (b) | -0.3 | -1.3 | -1.2 | -1.0 | -1.1 | -1.0 | -1.0 | -1.0 |
| General government financial balance (c) | -1.3 | 0.0 | 0.7 | 1.5 | ... | ... | ... | ... |
| CPI (a) | 2.3 | 1.6 | 2.2 | 3.4 | 3.2 | 3.3 | 3.5 | 3.4 |
| Current-account balance (c) | -1.7 | -2.5 | -3.6 | -4.4 | -4.2 | -4.2 | -4.5 | -4.6 |
| Unemployment rate (d) | 5.0 | 4.5 | 4.2 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 |
| JAPAN: | | | | | | | | |
| GDP (a) | 1.9 | -1.1 | 0.8 | 1.7 | 2.4 | 1.1 | 0.5 | 2.8 |
| Consumption (a) | 1.1 | 0.6 | 1.8 | 1.2 | 2.3 | 0.9 | -0.3 | 2.0 |
| Capital formation (a) | 0.7 | -4.2 | -0.8 | 1.1 | 0.8 | -0.9 | 0.6 | 3.9 |
| External demand (b) | 1.0 | 0.3 | -0.1 | 0.4 | 0.5 | 0.6 | 0.4 | 0.1 |
| General government financial balance (c) | -3.2 | -4.5 | -7.0 | -8.3 | ... | ... | ... | ... |
| CPI (a) | 1.7 | 0.6 | -0.3 | -0.6 | -0.7 | -0.7 | -0.7 | -0.5 |
| Current-account balance (c) | 2.2 | 3.0 | 2.4 | 2.5 | 2.7 | 2.5 | 2.5 | 2.2 |
| Unemployment rate (d) | 3.4 | 4.1 | 4.7 | 4.7 | 4.9 | 4.9 | 4.6 | 4.5 |
| UNITED KINGDOM: | | | | | | | | |
| GDP (a) | 3.5 | 2.6 | 2.3 | 3.0 | 3.2 | 3.4 | 3.0 | 2.6 |
| Consumption (a) | 2.7 | 3.3 | 4.4 | 3.5 | 3.3 | 3.4 | 4.0 | 3.3 |
| Capital formation (a) | 7.5 | 10.1 | 5.4 | 2.6 | 1.8 | 1.9 | 3.4 | 3.2 |
| External demand (b) | -0.3 | -2.0 | -1.5 | -0.8 | 0.0 | -1.3 | -1.5 | -0.5 |
| General government financial balance (c) | -1.5 | 0.3 | 1.5 | 1.4 (e) | ... | ... | ... | ... |
| CPI (a) | 3.1 | 3.4 | 1.6 | 2.9 | 2.3 | 3.1 | 3.2 | 3.1 |
| Current-account balance (c) | 0.8 | 0.0 | -1.1 | -1.7 | -1.5 | -2.1 | -1.7 | -1.6 |
| Unemployment rate (d) | 6.5 | 5.9 | 6.0 | 5.5 | 5.8 | 5.5 | 5.4 | 5.3 |

Sources: IMF, OECD, national statistics.

(a) The quarterly rates are on the same quarter a year earlier.

(b) Contribution to the increase in GDP.

(c) Percentage of GDP.

(d) Percentage of the labour force.

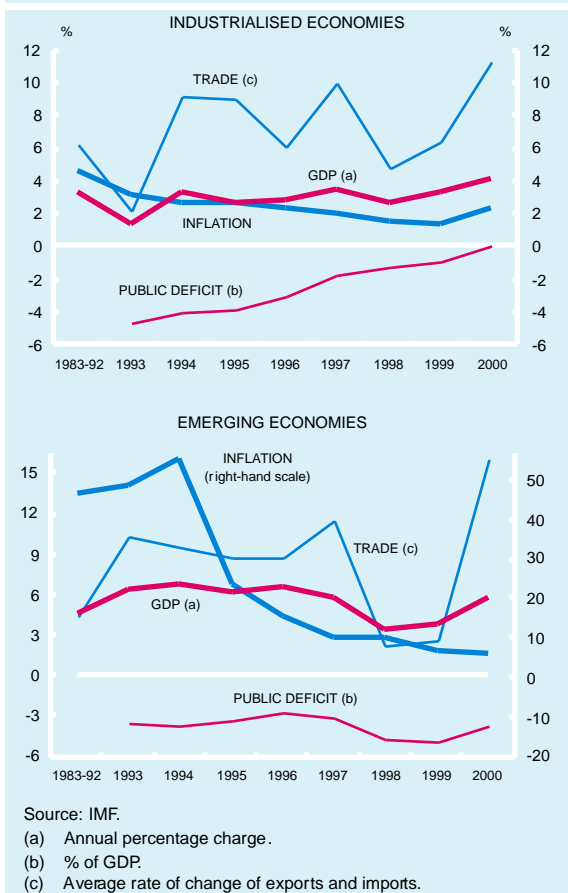
(e) Includes proceeds from award of UMTS licences (2.4 points of GDP).

public offerings or capital increases fell back as did the number of mergers and acquisitions conducted through share exchanges. The decline on stock markets was particularly severe in the technological indices. After having risen more than threefold since 1998 Q4, Nasdaq index prices peaked in March 2000, whereafter they lost 60 % of their value in the following 12 months. The correction of the European technological indices was even more acute. Compared with the technological indices, the de-

cline in general indices in the advanced economies was more moderate in the year 2000, though it stepped up in the opening months of 2001. In March 2001, the Dow Jones and the Euro Stoxx indices had fallen 10 % and 21 % from their level 12 months earlier, and in the case of the Nikkei index the decline was 36 %. The behaviour of the stock markets in the emerging economies exhibited a greater correlation with technology stocks, and they also fell substantially.

CHART II.1

Macroeconomic indicators of the industrialised and emerging economies

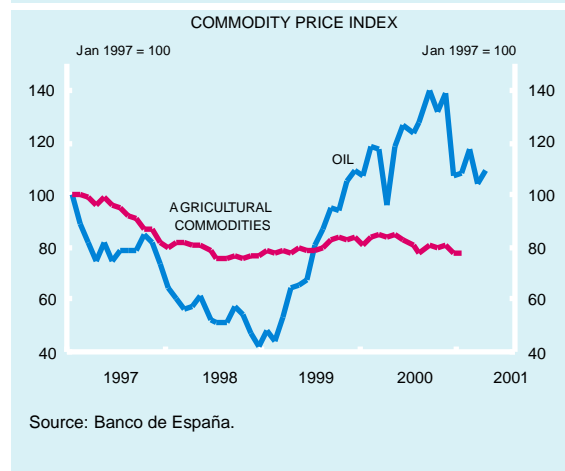


On the developed countries' public debt markets, medium- and long-term yields generally fell (more markedly so in the United States) during the year, and the trend has continued into the opening months of 2001. These developments appear to be due to moderate inflation expectations, to the greater safety of government bonds at times of stock market and financial turbulence and, in the United States, to the relative shortage of government paper derived from the ample budget surplus and the early repayment programmes for public debt.

On the private fixed-income markets in the developed countries, credit risk premia increased, especially for the lowest-rated securities. In the United States, the economic upturn, against a background of high liquidity on the stock and capital markets, had prompted a decline in these premia to levels similar to those prior to the Russian crisis. However, the new climate of uncertainty, worsening earnings expectations and the tightening of mon-

CHART II.2

Commodity prices



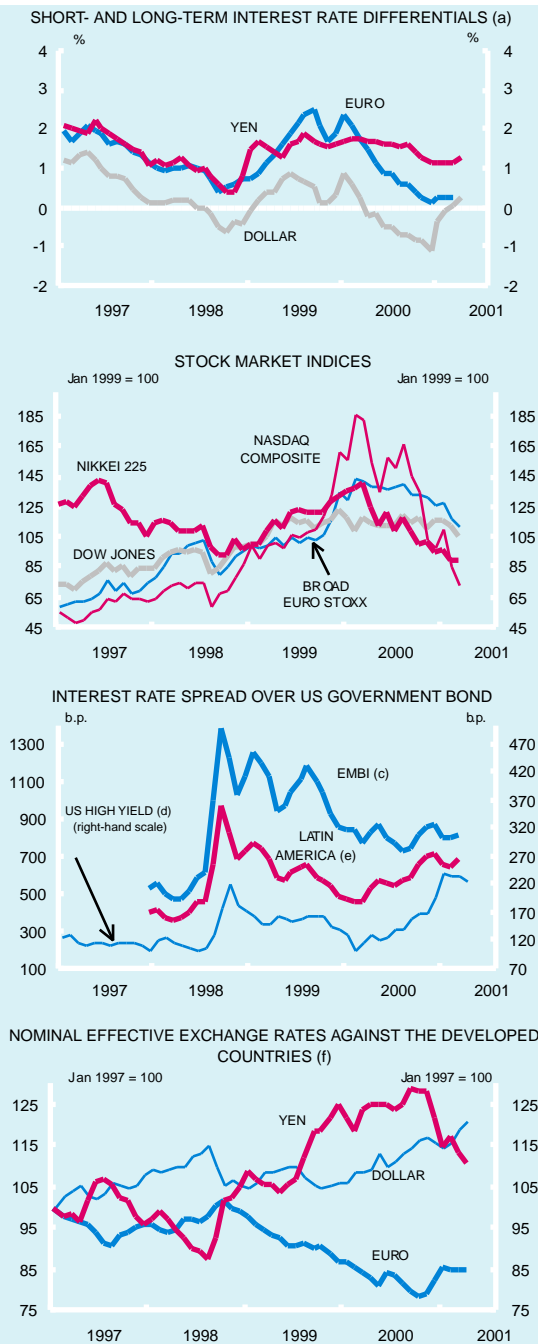
etary conditions ultimately increased the vulnerability of corporate balance sheets, which translated into a widening of the yield spread between government and private bonds. The change in sentiment was particularly marked in the new technology sectors. These trends have, in any event, been more pronounced in the United States than in Europe, while in Japan the situation on financial markets has been mainly influenced by the fragility of the national financial system, which continued to worsen during the year.

The increase in perceived risk also affected, in certain periods, the emerging countries' sovereign debt yield spreads. These were considerably volatile, which hampered the external financing of these countries. Nonetheless, for the year as a whole – and in contrast to private-sector debt in the developed countries – yields did not, on average, vary significantly (see Chart II.3). The international financial markets were increasingly selective with the emerging countries' debt, tending to focus more closely on each country's specific conditions. There were, however, certain bouts of contagion in the second half of 2000 and in the opening months of the current year, further to the Argentine and Turkish crises. The International Monetary Fund launched two packages aimed at helping the two countries overcome their difficulties, which did not prevent Turkey from devaluing its currency in February.

On the currency markets, the rising trend of the dollar was a constant for most of the year, in particular against the euro, which reached a low of 0.8272

CHART II.3

Short- and long-term interest rates, stock markets, and private and government bond yield spreads



Sources: Banco de España, Federal Reserve, Bloomberg, BIS and JP Morgan.

- (a) Three-month interbank rate.
- (b) Ten-year government bond.
- (c) Emerging market bond index compiled by JP Morgan.
- (d) Baa private bond and government bond.
- (e) JP Morgan EMBI for the region.
- (f) A fall denotes a depreciation of the currency.

dollars per euro in October, triggering a co-ordinated intervention by the G7 in favour of the European currency. In the closing months of the year, in step with the growing signs of economic cooling in the United States, the euro began to appreciate and, at the same time, the yen resumed a steeper downward path, with this continuing into 2001 Q1. Conversely, the appreciating trend of the euro has not firmed in the opening months of this year (see Box II.1 and Chart II.3).

As a result of the sound economic climate, world trade increased by more than 12 % in a year in which processes of economic and monetary integration made substantial headway, especially in Europe. From January this year, Greece became the twelfth member of the Monetary Union and, at the Nice summit in December, the EU set the framework and a tentative timetable for the accession of up to 12 candidate countries in the present decade. Outside Europe, the Free Trade Agreement in the Americas is expected to be strongly boosted, despite the misgivings of certain Latin American countries. And China, which already accounts for more than 10 % and 20 % of world GDP and population, respectively, will feasibly join the World Trade Organisation shortly, after having aligned its economic and trade practices more closely with those of the other member states.

II.2. THE MAIN INDUSTRIALISED ECONOMIES

II.2.1. United States

Overall, the year 2000 saw the culmination for the United States of a long period of intense growth with low inflation. In the three preceding years GDP grew at an annual rate of over 4 %, and the year 2000 closed with a rate of 5 %. US consumer prices accelerated from 1.6 % in 1998 to 3.4 % in 2000, although the rise in underlying inflation was only from 2.4 % to 2.6 %. The pace of GDP growth has been underpinned, among other factors, by the favourable effects of technological innovation. For 1995, such innovation translated into appreciably higher labour productivity gains than in the past (see Chart II.4). Between 1972 and 1995, hourly productivity in the non-farm economy increased at an average rate of 1.6 % per annum, but between 1996 and 1999 the related rate was 2.8 %, and this quickened to 4.3 % in 2000. However, during these

Productivity, the external imbalance and the exchange rate of the dollar

The strength of the dollar over the past five years, in which it has appreciated by more than 30 % in real terms against the developed countries, despite the growing external imbalance of the US economy, has aroused the issue of its possible overvaluation.

To test this hypothesis properly, some notion, albeit approximate, is needed of what the equilibrium value of the dollar is. This is a complex task since the exchange rate is a variable determined in a market marked by its high volatility, which tends to over-react to a myriad of highly differing determining factors, and which moreover anticipates the expected future course of such determinants. In any event, a more rigorous approach can be taken selecting what are considered to be commonly fundamental determinants (or fundamentals) of the real exchange rate and applying econometric methods that enable its long-run interrelatedness to be estimated.

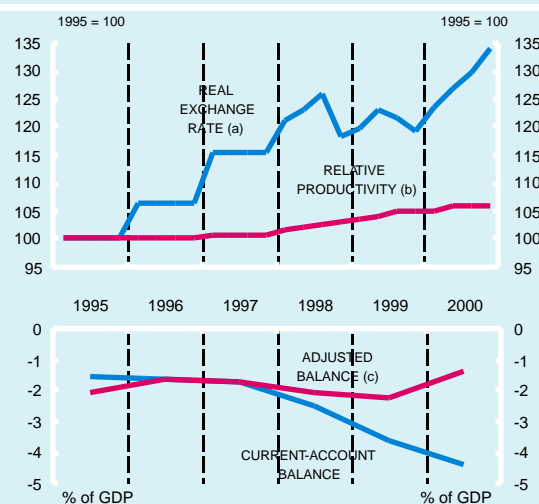
The first determinant for consideration is the net external liabilities position, derived from the current-account deficit build-up. To avoid an unsustainable current account, the growing interest payments arising from the accumulation of external liabilities will tend to be countered by a depreciation of the real exchange rate, facilitating an improvement in the trade balance and easing the external imbalance. In the past five years, the cumulative US current-account deficit has increased the stock of net financial liabilities by 15 % of GDP which, under the foregoing reasoning, would have entailed a depreciation of the long-term exchange rate.

The second fundamental factor arises from the growth differential of productivity, which affects exchange rate expectations via two channels. The first channel is included in the hypothesis known as the Balassa-Samuelson effect and implies that the increase in productivity (which rose in the United States by 6.6 % during the last five years relative to the other main economies) will be reflected in an appreciation of the real long-term exchange rate. Productivity gains tend to concentrate in the tradeable goods sector (mainly manufacturing and commodities). Consequently, to attain an equilibrium situation in which factors are paid in each industry according to their marginal productivity, services prices will tend to grow more than manufacturing prices. If, as tends to be accepted, tradeable goods prices move similarly across countries owing to competition, this adjustment in domestic prices will be reflected in an upward trend of relative prices vis-à-vis the external sector or, what amounts to the same, in an appreciation of the real long-term exchange rate. The second channel underscores the effects of greater productivity on the sustainability of financial flows. Thus, a bigger increase in productivity than in the rest of the world entails higher rates of return for investment in the United States, allowing long-term capital to be attracted and, in this way, future gains in competitiveness to be obtained. In order to consider – albeit roughly – the effects of these stable capital flows on the external position, net direct investment flows should be subtracted from the current-account deficit. Flows relating to this item between 1995 and 2000 accounted for more than 4 % of US GDP, owing largely to the greater expected return on investment. As can be seen in the accompanying chart, this adjusted current-account balance means that the future sustainability of the external position might not require such a substantial depreciation of the real exchange rate as the current-account deficit would suggest; moreover, any future improvement in the trade balance could be generated via gains in competitiveness derived from improved productivity and from foreign capital investment.

As a result, direct observation of how the above-mentioned fundamentals have moved in recent years does not suffice to determine whether the equilibrium exchange rate of the dollar has appreciated or by how much it may have done so. Accordingly, a model-based quantitative analysis must be used. This calculates the impact of relative productivity and of the build-up in external liabilities on the long-term exchange rate, allowing the appreciation of the dollar that would be warranted by the movements in the aforementioned fundamentals (1) to be quantified.

The results of this calculation are that the improvement in productivity relative to the rest of the world would account for 9.7 of the 30 percentage points appreciation observed, but developments in the external sector, even if only the current-account balance adjusted for direct investment flows were considered, would subtract 5.4 points from the equilibrium exchange rate; thus, overall, the fundamentals would, under this model, only enable 4.2 points of the appreciation observed to be accounted for, which is scarcely 14 % of the total. In any event, these results, which should be interpreted with caution, and whose insufficiency to explain the appreciation of the dollar is shared by other alternative models, appear to confirm the overvaluation of the dollar.

United States: real exchange rate of the dollar and its determinants



Source: Banco de España.

(a) Against the developed countries. An increase in the index denotes an appreciation of the real exchange rate of the dollar.

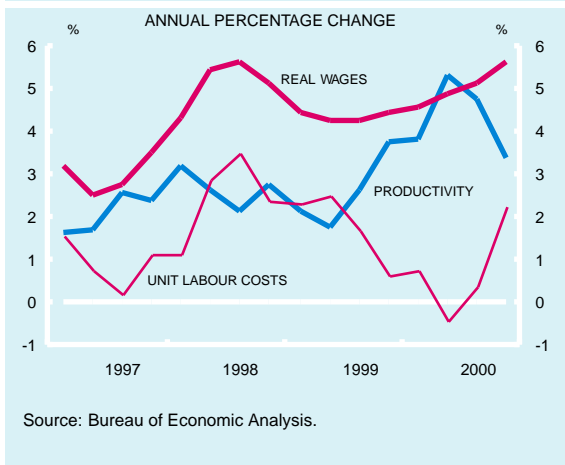
(b) Against the developed countries. An increase in the index denotes a relative productivity gain in the US.

(c) Current-account balance plus direct investment flows.

(1) See E. Alberola and H.López, *Internal and external exchange rate equilibrium in a cointegration framework*, Working Paper 9916, Research Department, Banco de España. The model, which develops the methodology applied in the Box, uses a cointegration analysis with unobserved components, in which the equilibrium real effective exchange rate is determined by the permanent components of US productivity and of the US net external position.

CHART II.4

United States: unit labour costs and breakdown thereof



years of higher growth certain imbalances have also been accentuated. This highlights the fact that, although there has undoubtedly been a substantial increase in potential output, this has been accompanied by excessive growth in demand.

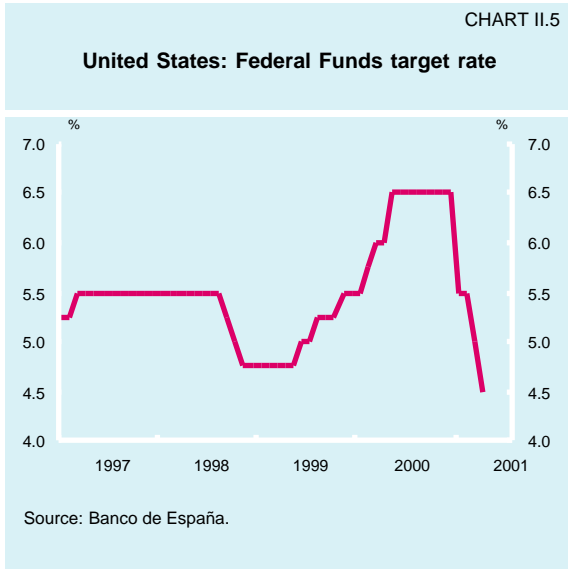
Underlying the notable buoyancy of consumption in recent years has been the strong growth of the value of household assets as a proportion of disposable income. This proportion has risen by 23 % since 1996 owing to the increase in and revaluation of all categories of real and financial assets, and of shares in particular. The impetus of private investment has been linked to growing earnings expectations and to favourable financial conditions, reflected in the sharp stock market rises in recent years and in heavy foreign capital inflows. The counterpart of this has been the growing current-account deficit, which climbed to 4.4 % of GDP in 2000.

Nonetheless, there was a turnaround in the trend of the US economy in 2000. The first half of the year saw the extension of the upswing. GDP continued to grow at a rate of close to 6 %, compared with a year earlier, far above the rate of 3.5-4 % estimated as the economy's potential. The driving force was the strong buoyancy of the main domestic demand components: private consumption, which grew at an annualised rate of 5.9 % in the first half of the year, and private fixed capital investment, whose rate of increase over this same period was 12.4 %. The resilience of demand prompted high growth in employment, placing the unemployment rate below 4 % in October and November. The tightness of the labour market entailed an accelera-

tion in wages, although thanks to productivity gains, unit labour costs did not increase significantly until the final quarter. In the second half of 2000, by contrast, domestic demand began to slow sharply, in particular as a result of private investment falling back. That brought about a notable reduction in the growth rate of GDP, which slipped from a year-on-year rate of 6.1 % in Q2 to 5.2 % and 3.4 %, respectively, in Q3 and Q4.

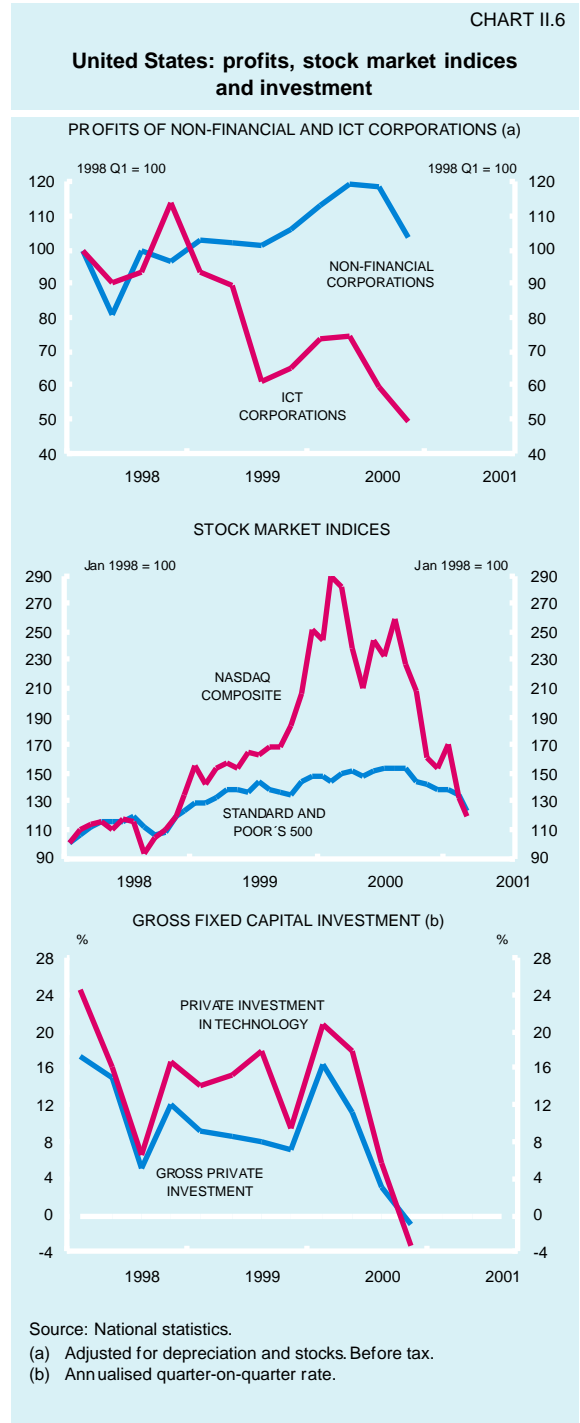
It is an inherently complex task to determine accurately the factors behind this turnaround and its intensity; but any assessment must, moreover, bear in mind that the recent US economic cycle differs significantly from past patterns. The most noticeable difference is, perhaps, that while upswings habitually entailed inflationary pressures that prompted a tightening of monetary policy, resulting in turn in the curtailing of GDP growth, on this occasion productivity gains have allowed relatively controlled price pressures to be sustained, despite dearer oil prices. The rise in energy prices nevertheless had a certain upward effect on final prices (although underlying inflation held fairly stable) and exerted something of a squeeze on margins and wage income. The slowdown in output also contributed to some extent to the gradual tightening of monetary policy by the Federal Reserve from August 1999, which was stepped up in the first half of 2000. This was in response to its perception that the rise in energy prices, the resilience of demand and low unemployment were fuelling serious inflation risks. Official interest rates were raised as a result from 5 % to 6.5 %, at which level they held from May 2000 to January 2001 (see Chart II.5). Moreover, towards mid-year a slow trickle of announcements of a deterioration in earnings began, continuing into the opening months of 2001. This was particularly intense in the manufacturing and in the high technology-producing industries, which adversely affected stock markets and induced a rise in credit risk premia on the fixed-income markets, as described earlier. Default indices also worsened, although they are still far from the 1990-91 recession levels, when there was a serious banking crisis. All these factors dampened investment plans, exacerbating the effect that a fall in earnings alone would have had, and they help explain the heavy decline in productive investment, especially that in high-technology goods (see Chart II.6).

Until the end of the year, the Federal Reserve authorities gave the impression that the biggest risks remained on the inflation side. At the begin-



ning of 2001, however, the worsening economic outlook, in the form of the strong deterioration in consumer and business confidence indices, prompted a change in the Federal Reserve's attitude. It now viewed the risks of recession as more significant, judging inflation to be contained. That led it between 3rd January and 15th May 2001 to cut the federal funds rate by 2.5 points, leaving it at 4 %. The swift and forceful reaction by the US monetary authority has prompted a climate of confidence in which, after a rapid adjustment in inventories and excess capacity, it is trusted that activity in the second half of 2001 will pick up, underpinned by the structural changes that have taken place in the United States in recent years and their favourable effects on the trend growth of productivity.

There is, however, a considerable degree of uncertainty about the future course of the US economy. First, although the National Accounts figures for 2001 Q1 have been better than expected, there are quite substantial risks that the sluggishness of activity will be accentuated and prolonged, owing to a possible sharper adjustment in private consumption and plant capacity. This possibility is related to a series of private-sector financial imbalances, which have been exacerbated during the prolonged expansion in the preceding years and are reflected in the high current-account deficit (4.4 %), a negative net household saving ratio (-4 % of disposable income) and high indebtedness in certain business sectors, in particular those associated with information technology. These disequilibria may be partly attributable to the excessive rise in stock market prices, which contributed during the upturn to accentuating the pace of con-



sumption and investment, and was a lure to foreign capital. In any event, this overvaluation has, as indicated, largely been corrected in the past year.

The deterioration in companies' financial position has already had palpable effects on investment and job creation. But so far, and despite the downturn in confidence indices, consumption has sustained a higher rate of increase than that of disposable income, perhaps because the stock market de-

cline has had a diminished impact on the wealth of households since the latter have, in recent years, reduced their riskiest share portfolios, partly assisted by the buy-back offers of the issuing companies. However, if the correction of households' financial position were too abrupt (induced, for instance, by a deterioration in employment conditions), a drastic decline in consumption might ensue, heightening the probability of a recession. A further risk relates to the current-account deficit and to a possible overly brisk downward adjustment of the dollar, owing to a loss of confidence by international investors. Admittedly, however, the stock market decline and the deterioration in expectations have not, up to 2001 Q1, adversely influenced the dollar.

Part of the negative differential between private saving and investment has been covered by the growing general government surplus, which amounted to 1.5 % of GDP in 2000. This was due mainly to the sharp growth in revenue, since expenditure was on an expansionary course. The ongoing upward revision of surplus forecasts for the coming ten years has been propitious to the new administration's tax cutting plan. This plan, which was originally of a marked structural and long-term nature, and whose soundest justification was the prospect of a redemption of public debt in about six years, has progressively been altered as the slowdown took hold. The strategy now adopted is one combining the aforementioned long-term objectives with a clear counter-cyclical intention in the shorter term, via a tax cut for this year with back-dated effects. In any event, although the programme's legislative passage is under way, its implementation will not be feasible until the second half of the year.

II.2.2. Japan

Real output grew by 1.7 % in Japan in the year 2000, meaning the average rate for the decade stands at only 1.5 % compared with 4.2 % for the previous decade. The signs of economic recovery apparent in the opening months faded as the year elapsed, leading to a fresh decline in output in Q3, in quarter-on-quarter terms, which was offset in Q4. This slackness has run into the opening months of the current year, in which the main indicators of activity available show a situation of stagnation. Moreover, still in place are deflationary pressures, the strong downtrend of stock market

prices, worsening public finances and the fragility of the financial sector, arising from the high volume of low- or zero-quality loans accumulated by credit institutions, from the scant headway in bank restructuring and from the decline in stock markets.

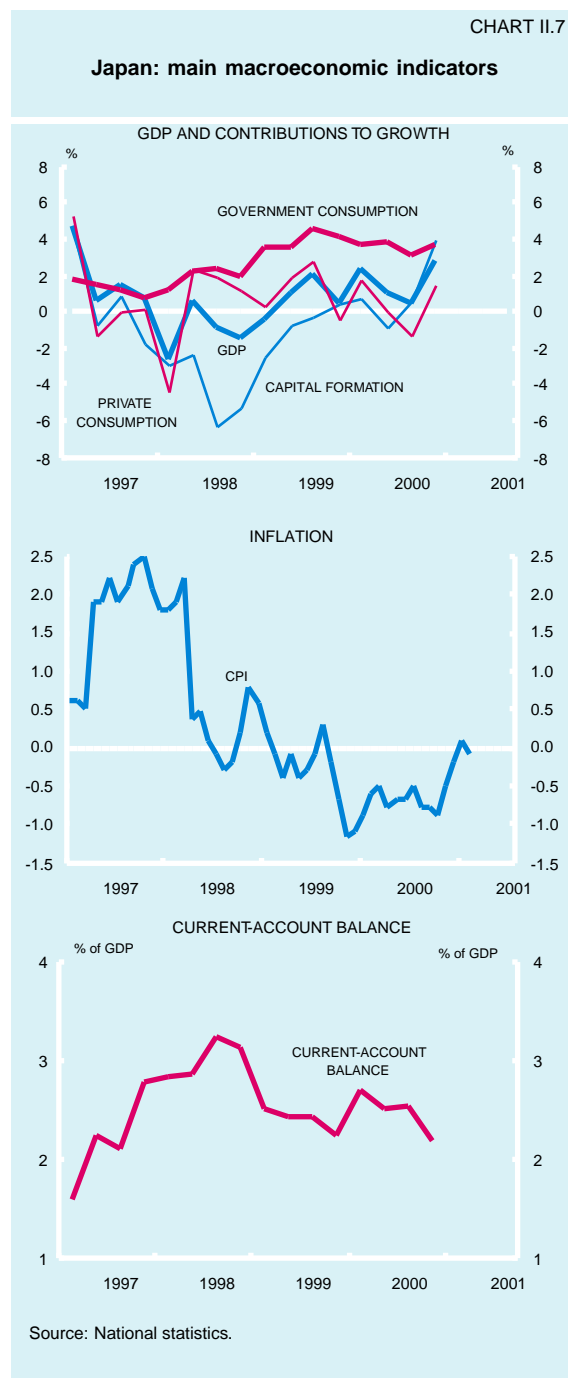
Private consumption increased by only 0.5 % in 2000, held down by stagnant employment. External demand lost momentum (a trend which shows signs of worsening in the coming months) further to the slowdown in the US economy. The only variables retaining any buoyancy were private investment and government consumption, with increases exceeding 3 % (see Chart II.7). Nonetheless, the possibilities of the latter variable increasing further are highly constrained by the levels of the budget deficit and public debt, namely 8.3 % and 130 % of GDP, respectively. The fall in industrial orders and the deterioration in business confidence in 2001 Q1 indicate that private investment also appears to have begun petering out.

Slack private spending has contributed to maintaining the downtrend of consumer prices, which posted a fall of 0.6 % in 2000 as a whole. Against this overall deflationary backdrop, monetary policy underwent significant changes in stance in the period in question. After sustaining a zero interest-rate policy in the first half of the year, the Bank of Japan decided to raise its daily intervention rate slightly in August. This decision aroused debate on the advisability of changing the strategy pursued until then, which resulted in a fresh reduction in the official discount rate from 0.5 % to 0.35 % in February 2001 and in the setting, in March, of a quantitative target. That involves an increase in the liquidity of the system and the placing once again of daily interest rates virtually at a level of zero, at the same time as it has been announced that these policies will be pursued until the 12-month inflation rate turns positive. After stabilising in the first half of last year, when the US currency was notably strong against the euro, the exchange rate of the yen against the dollar was on a declining course in the final quarter of the year. This fall became accentuated in the opening months of 2001, with an exchange rate of 125 yen per dollar, a level not witnessed since 1998, being reached in March and April. The current-account surplus stood at 2.5 % of GDP in 2000, practically unchanged on the previous year.

II.2.3. Other developed economies

Among the EU countries not belonging to the euro area, the UK economy posted growth of 3 % last year, above the 2.3 % rate for 1999. Developments during the year were in two considerably differentiated phases: during the first six months, growth was 3.3 % and demand pressures appeared to be threatening price stability, prompting a rise in interest rates of 50 basis points (to 6 %) in January and February. After the summer, the economy slowed mildly and the focal points of latent inflationary pressures (essentially strong wage increases and property prices) moderated notably. As a result, the harmonised index of consumer prices exhibited a rate of increase of 0.8 % at the end of the year, down from 1.3 % in 1999. Private consumption was the driving force of growth, advancing at an average rate of 3.7 %, which was nevertheless slower than in 1999. In the closing months of 2000, the stock market slump and the sharp slowdown in property prices (from rates of 14 % to around 4 %) dampened consumption. Gross capital formation rose by only 2.6 % during the year, compared with 5.4 % in 1999, while the negative contribution of external demand to GDP growth moderated notably compared with the previous year thanks to the higher growth of exports. Employment grew in the first half of the year and then stabilised, and the unemployment rate fell from 6 % to 5.5 %. The public sector recorded a very similar surplus to that of 1999 (1.4 % of GDP). In the opening months of the current year, the Bank of England cut its interest rates to 5.25 % in the face of signs of an economic slowdown and the decline in inflation, more than offsetting the rise in rates a year earlier.

In Denmark and Sweden, the other two EU countries that are not members of the euro area, growth (2.3 % and 3.9 %, respectively) was balanced, running in step with sustained low inflation and unemployment rates, although the Danish budget surplus was higher than 2.5 % of GDP and the Swedish surplus exceeded 3.5 %. Outside the European Union, growth slowed in Canada, whose annualised quarterly rate stood at 2.7 % in 2000 Q4 compared with 4.8 % in Q1. The brake applied by the US economy could step up this process of deceleration in view of the high degree of Canadian integration with the US economy, to which it exports 37 % of its output.



II.3. THE EMERGING ECONOMIES

II.3.1. EU candidate countries

The aspirations of the 12 EU accession candidates (ten of them from central and eastern Europe) were given strong backing at the Nice summit in December 2000, where the timetable and institutional arrangements for their membership during the present decade were laid down. Economic developments in these countries last year saw the path of recovery initiated the preceding year take

hold. That enabled the region as a whole to grow at a rate of close to 4 %, virtually double that in 1999 and the highest recorded since 1996. As a result of the economic pick-up, regional inflation rose by almost two percentage points to 12.9 %. Against this background, the challenge for these countries is to see through reform and achieve an appropriate economic policy mix capable of smoothing progress in real convergence without prejudice to the necessary consolidation of nominal convergence.

With regard to their recent cyclical position, two types of country can be distinguished in the area: those where recovery began in 1999 (Hungary, Poland and Slovenia) sustained high growth rates during 2000 of between 4 % and 5.5 %; the countries most behind in the cycle (Bulgaria, Slovakia and Latvia) and even those experiencing economic recession in 1999 (Czech Republic, Romania, Lithuania and Estonia) gradually moved on to the growth path, albeit with widely differing rates ranging from 2 % for Romania and 6.3 % for Estonia. The buoyancy of external demand, especially from the EU (which accounts for more than 50 % of the area's trade) and also, for the Baltic states, from Russia, was one of the main engines of growth. This has further provided for a slight correction (of below one percentage point) in the area's high current-account deficits which, for the region as a whole, stand slightly below 5 % of GDP. Likewise, the slowdown in activity in the main industrialised countries is translating into a loss of steam in the region in the opening months of 2001.

Turkey, which was accorded pre-candidate status in respect of its EU membership application at the Helsinki summit, underwent serious difficulties last year, despite economic growth of 6.6 %. These were due to the fragility of its financial system and to the widening of its current-account deficit, which exceeded 5 % of GDP. Turkey was beset by a financial crisis in November, further to which its IMF aid package was revised in January 2001. However, the obstacles blocking the structural reforms envisaged were exacerbated by political instability. This triggered a fresh bout of crisis, which ended in February with the abandonment of the crawling peg adopted the previous month and the depreciation of the Turkish lira by more than 40 %. Nonetheless, the effects of the crisis on the other economies in the region have been limited.

II.3.2. Latin America

Following the foreign exchange and financial crises affecting Latin America in recent years, the year 2000 saw a return to high growth rates which were consistent with a greater degree of macroeconomic stability. In the area as a whole, GDP increased by 4.2 % (compared with virtually zero growth in 1999), driven by buoyant exports and the take-off of domestic demand. Nonetheless, notable differences have been observed across the countries, attributable to the asymmetrical effects of external constraints, to the room for manoeuvre of the respective economic policy regimes and to specific domestic circumstances (see Table II.2).

The circumstances of the region have been essentially governed by the effects of economic developments in the United States, not forgetting that the diversity of economic results in the area has also been influenced by the course of commodities prices. This has benefited the oil exporting countries (mainly Venezuela, Mexico and Ecuador) given the buoyant situation of the oil market throughout last year.

The influence of US economic developments on Latin America has been exerted through two channels: the first, via US demand for exports from the region, and the second, via monetary conditions (interest rates and the exchange rate of the dollar). In the countries with the tightest trade links to the United States, in particular in Mexico, the first channel has prevailed over the second. That explains both the robustness of the Mexican economy in the first three quarters of the year and its notable slowdown from the fourth quarter. For the year 2000 as a whole, the performance of the Mexican economy was among the best of the major Latin American countries, with GDP growth of close to 7 %. Argentina was at the other extreme: the strength of the dollar and the rise in US interest rates to May represented an obstacle, given the fixed parity between the peso and the dollar, to economic recovery for most of the year. And exacerbating this were its continuing high sovereign debt differentials and the need to implement successive fiscal adjustment plans aimed at redressing the delicate situation of its public finances. The upshot of this combination of adverse circumstances has been a negative growth rate for the second year running. However, if regard is had to the recent change in the US economy, Argentina is the least sensitive of the

Emerging markets: main macroeconomic indicators

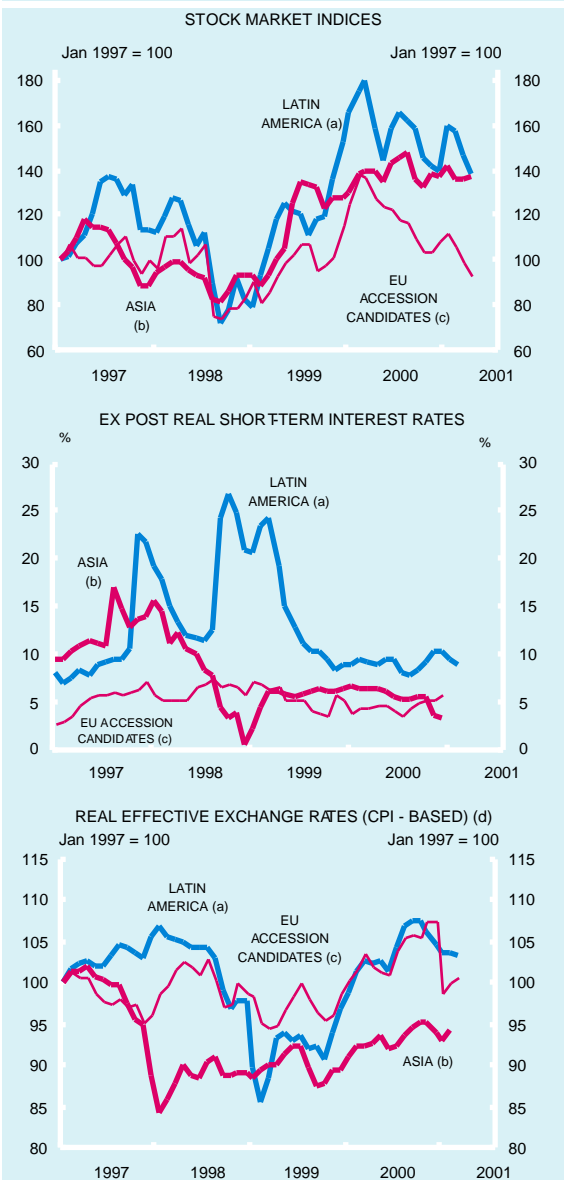
| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|--------------|-------------|-------------|-------------|-------------|-------------|
| GDP (a): | | | | | | |
| Asia | | | | | | |
| South Korea | 8.9 | 6.8 | 5.0 | -6.7 | 10.9 | 8.8 |
| China | 10.5 | 9.6 | 8.8 | 7.8 | 7.1 | 8.0 |
| Thailand | 9.3 | 5.9 | -1.4 | -10.8 | 4.2 | 4.3 |
| Indonesia | 8.2 | 8.0 | 4.5 | -13.1 | 0.8 | 4.8 |
| Malaysia | 9.8 | 10.0 | 7.3 | -7.4 | 5.8 | 8.5 |
| EU accession candidates | | | | | | |
| Hungary | 1.5 | 1.3 | 4.6 | 4.9 | 4.5 | 5.3 |
| Poland | 6.8 | 6.0 | 6.8 | 4.8 | 4.1 | 4.1 |
| Czech Republic | 5.9 | 4.8 | -1.0 | -2.2 | -0.8 | 2.8 |
| Romania | 7.1 | 3.9 | -6.1 | -5.4 | -3.2 | 2.0 |
| Russia | -4.2 | -3.4 | 0.9 | -4.9 | 3.2 | 7.5 |
| Latin America | | | | | | |
| Argentina | -2.8 | 5.5 | 8.1 | 3.8 | -3.4 | -0.5 |
| Brazil | 4.2 | 2.7 | 3.3 | 0.2 | 0.8 | 4.5 |
| Mexico | -6.2 | 5.2 | 6.8 | 4.9 | 3.8 | 6.9 |
| INFLATION: | | | | | | |
| Asia | | | | | | |
| South Korea | 4.5 | 4.9 | 4.4 | 7.5 | 0.8 | 2.3 |
| China | 17.1 | 8.3 | 2.8 | -0.8 | -1.4 | 0.4 |
| Thailand | 5.8 | 5.9 | 5.6 | 8.1 | 0.3 | 1.5 |
| Indonesia | 9.4 | 7.9 | 6.2 | 58.0 | 20.7 | 3.8 |
| Malaysia | 3.4 | 3.5 | 2.7 | 5.3 | 2.8 | 1.5 |
| EU accession candidates | | | | | | |
| Hungary | 28.3 | 23.5 | 18.3 | 14.3 | 10.0 | 9.8 |
| Poland | 27.9 | 19.9 | 14.9 | 11.8 | 7.3 | 10.1 |
| Czech Republic | 9.1 | 8.8 | 8.5 | 10.7 | 2.1 | 3.9 |
| Romania | 32.3 | 38.8 | 154.8 | 59.1 | 45.8 | 45.7 |
| Russia | 197.4 | 47.6 | 14.7 | 27.7 | 85.7 | 20.8 |
| Latin America | | | | | | |
| Argentina | 3.4 | 0.2 | 0.5 | 0.9 | -1.2 | -0.7 |
| Brazil | 66.0 | 15.8 | 6.9 | 3.2 | 4.9 | 7.0 |
| Mexico | 35.0 | 34.4 | 20.6 | 15.9 | 16.6 | 9.5 |
| GENERAL GOVERNMENT FINANCIAL BALANCE (b): | | | | | | |
| Asia | | | | | | |
| South Korea | 1.3 | 1.0 | -0.9 | -3.8 | -2.7 | 2.5 |
| China | -1.0 | -0.8 | -0.8 | -1.1 | -2.9 | ... |
| Thailand | 3.0 | 2.5 | -0.9 | -2.5 | -3.0 | ... |
| Indonesia | 0.8 | 1.2 | -0.7 | -1.9 | -2.3 | ... |
| Malaysia | 2.2 | 2.1 | 4.0 | -1.0 | -4.1 | ... |
| EU accession candidates | | | | | | |
| Hungary | -6.3 | -3.1 | -4.5 | -6.3 | -3.7 | ... |
| Poland | -2.6 | -2.5 | -1.3 | -2.4 | -2.0 | ... |
| Czech Republic | 0.5 | 0.9 | -1.9 | 6.6 | -1.6 | ... |
| Romania | -4.1 | -4.9 | -3.6 | -2.8 | -2.6 | ... |
| Russia | -5.2 | -7.9 | -7.0 | -5.0 | -1.7 | ... |
| Latin America | | | | | | |
| Argentina | -0.9 | -2.5 | -1.5 | -1.4 | -2.6 | -2.5 |
| Brazil | -7.1 | -5.9 | -6.3 | -7.9 | -10.0 | -4.6 |
| Mexico | -0.9 | -0.3 | -1.4 | -1.2 | -1.3 | -1.1 |
| CURRENT-ACCOUNT BALANCE (b): | | | | | | |
| Asia | | | | | | |
| South Korea | -1.7 | -4.4 | -1.7 | 12.7 | 6.1 | 2.2 |
| China | 0.2 | 0.9 | 4.1 | 3.3 | 1.6 | 1.2 |
| Thailand | -8.1 | -8.1 | -0.9 | 12.7 | 10.2 | 7.5 |
| Indonesia | -3.2 | -3.4 | -2.3 | 4.2 | 4.1 | 4.2 |
| Malaysia | -9.5 | -4.6 | -4.8 | 12.9 | 15.9 | 11.4 |
| EU accession candidates | | | | | | |
| Hungary | -5.6 | -3.7 | -2.1 | -4.8 | -4.4 | -4.5 |
| Poland | 4.5 | -1.0 | -3.0 | -4.3 | -7.5 | -6.8 |
| Czech Republic | -2.6 | -8.1 | -6.3 | -2.3 | -2.0 | -3.4 |
| Romania | -5.0 | -7.3 | -6.3 | -7.3 | -3.8 | -3.8 |
| Russia | 2.2 | 2.9 | 0.8 | 0.8 | 12.4 | 18.4 |
| Latin America | | | | | | |
| Argentina | -1.9 | -2.4 | -4.1 | -4.9 | -4.3 | -2.5 |
| Brazil | -2.6 | -3.0 | -4.2 | -4.3 | -4.7 | -4.1 |
| Mexico | -0.6 | -0.7 | -1.9 | -3.8 | -3.0 | -3.1 |

Sources: IMF, Russian and European Centre for Economic Policy, Deutsche Bank.

(a) Rate of change.

(b) Percentage of GDP.

CHART II.8

Emerging economies: financial indicators

Sources: Banco de España, JP Morgan and Bloomberg.

(a) Argentina, Brazil, Chile and Mexico.

(b) China, Malaysia, S. Korea, Indonesia, Thailand and Hong Kong.

(c) Czech Republic, Hungary and Poland.

(d) An increase in the index denotes a loss in competitiveness.

Latin American countries to a slowdown in US imports and a potential beneficiary of easier monetary conditions in the United States. Growth in the Brazilian economy was 4.5 % last year, compared with 0.8 % the previous year. Although up in terms of annual averages, its inflation rate fell over the course of 2000, and its current-account deficit narrowed slightly while nevertheless remaining at over 4 % of GDP.

A salient feature of the Latin American economies last year was the consolidation of the environment of macroeconomic stability. Results were particularly favourable on the prices front: inflation in the area firmed at below double figures (8 % compared with 8.8 % in 1999), despite the buoyancy of the economy and the upward pressures derived from the rise in oil prices. The fall in inflation was generalised, although specific mention may be made of those countries (such as Brazil, Mexico and Chile) which adopted direct inflation targeting monetary strategies. These arrangements have demonstrated their viability, which has reinforced their credibility.

Progress has also been made in the consolidation of public finances, which has placed the budget deficit for the area at 2.6 % of GDP, compared with 4.3 % in 1999. However, these apparently satisfactory results are more in response to a favourable cyclical position than to a genuine structural adjustment of the deficits.

Developments in the external sector were favourable, though much of the strength of exports – which grew by around 20 % – was due to the continuing high price of oil, of which the area as a whole is a net exporter, and to the overall buoyancy of demand. As a consequence, the region's trade deficit narrowed from 0.8 % of GDP in 1999 to 0.1 % in 2000, moving practically into balance. Also, the current-account deficit dropped from 3.2 % to 2.5 %, although virtually all this decline is attributable to the exceptional behaviour of the Venezuelan current-account surplus, which exceeded 12 % of GDP.

Despite the slight correction of the current-account imbalance, the financing of the deficit had to be conducted under relatively unfavourable conditions, marked by high interest rate spreads and recurring difficulties of access to global capital markets by the emerging countries (see Charts II.3 and II.8). Nonetheless, continuing direct investment flows have largely enabled borrowing requirements to be covered.

The general strengthening of the area's economic position should not, however, mask the recurrent emergence of bouts of instability. Thus, against a recessionary background lasting almost three years, the Argentine economy had to face a liquidity crisis in November triggered by a fresh episode of politi-

Recent trends in capital flows towards Latin America

Borrowing requirements in the Latin American region have been marked by increasingly higher debt servicing, which rose from 39 % of exports in 1993 to 51 % in 2000. This debt burden is at the root of the region's persistent current-account deficit and is a considerable brake on its growth capacity. Indeed, if the interest payment component were eliminated, the result would be an approximately balanced external position, as can be seen in the top panel of the accompanying chart. This situation is in contrast to the external position of the Asian economies, whose current-account balance has run an increasingly firm surplus since 1997, as these economies are strongly export-gearred and their debt servicing has held at low and stable levels (see middle panel of chart). In Asia, capital inflows in recent years have made for a strong build-up of reserves.

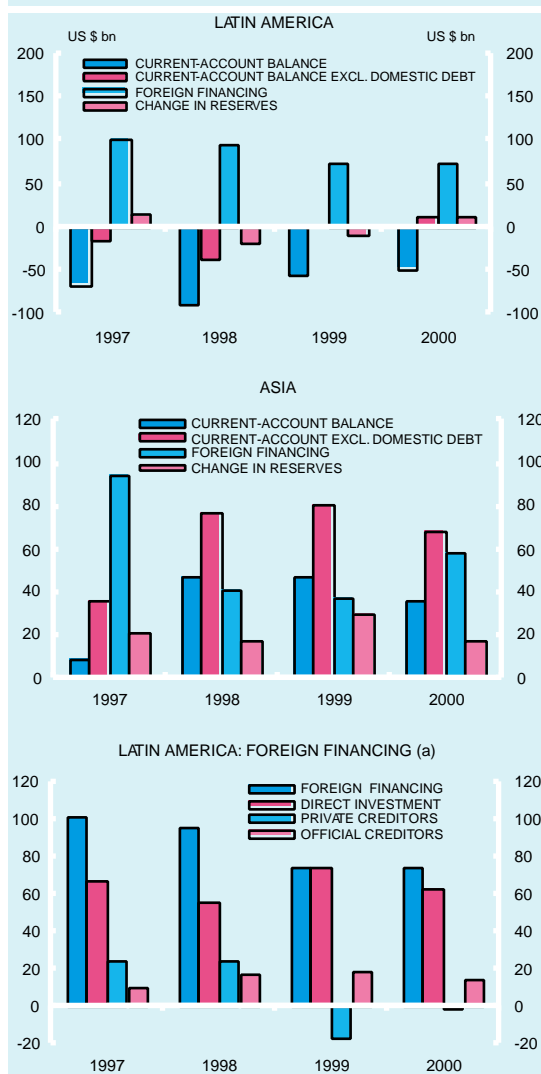
The Latin American current-account deficit has eased in recent years, as reflected in the slight fall in net external financing (see lower panel of chart). The improvement in the external position in 2000 was essentially due to the equilibrium achieved on the trade account, boosted by high crude oil prices and by the global expansion, since the external debt increased slightly during the year and the average interest rate thereon held stable.

High direct investment flows have largely enabled borrowing requirements to be covered and have offset the drastic reduction in private creditors' net flows. These have been negative in the past two years owing partly to the high volatility and periods of thin activity characterising the emerging financial markets. Net official aid flows accounted in the period 1997-2000 for around 20 % of Latin American borrowing needs. These flows have acted as a compensatory mechanism in periods of high instability in the emerging economies, when private financing has proved insufficient, though they obviously can not replace private capital.

The high, persistent external financing needs brought on by the financial burden of debt have, in combination with the volatility of the emerging capital markets, placed the Latin American economies in a persistently vulnerable position. In recent years, foreign direct investment flows have admittedly covered a good portion of external financing. But in the future the pace of such inflows is unlikely to be maintained owing to the slowdown in the privatisation process as a result of the exhaustion of readily privatisable assets. In this respect, private creditors' flows in recent years have proven highly variable and intermittent (subject to financial droughts), posing a permanent risk to the growth process in these countries.

To reduce the area's external vulnerability and its dependence on official aid, the following measures are pivotal: the implementation of stability-gearred macroeconomic policies and structural reforms aimed at fomenting balanced growth; the generation of public and private domestic saving through the development of the financial system; and the promotion of other less onerous financing channels that are less volatile in the short term. Among the latter, there has been a substantial increase in debt swaps to restructure these economies' debts and to promote long-term financing, and greater resort to the syndicated loans market, which has recently proven an important source of financing and whose financial cost in 2000 was lower than that of debt.

Emerging economies: foreign financing requirements



Source: IMF.

(a) Equivalent to the sum of flows of direct investment, and private and official creditors in net terms.

cal instability. The crisis was finally overcome this year thanks to an aid package implemented via the IMF, to which Spain contributed and which involved sizeable private sector participation, and to the easing of global monetary conditions. In the opening months of the current year, the heightening of the Turkish crisis and the continuing unstable political climate caused fresh difficulties for the Argentine economy and prompted a change in tack in economic policy, in the quest for a firmer boost towards recovery.

The data available for this year show that, in general, the trends present last year remain in place in the region, while national growth rates can be seen to be drawing somewhat closer together. The slowdown in global growth means, however, that the Latin American economies will have to base their growth to a greater extent on domestic demand. This is a challenge for those countries, like Brazil or Mexico, with a bigger external deficit. Finally, a cause for concern is the persistent volatility on the emerging capital markets, spurred by the adverse trend of stock market indices and by the recent crises. These have confounded any improvement in financing conditions and entail a risk for the consolidation of growth in economies which continue to be highly dependent on foreign flows to finance domestic investment (see Box II.2).

II.3.3. South-east Asia and other emerging regions

The recovery initiated in 1999 continued in the south-east Asian economies for most of the year 2000 against a backdrop of price and exchange rate

stability, with the exception of certain countries affected by political or institutional crises (Indonesia in particular). Generally, the driving force of economic growth was, as in the previous year, the growth of exports, which ran at over 20 % in most of the countries. Momentum was progressively lost, however, in the final months of the year as the US economy slowed and the outlook clouded for the technology goods industries, of which the region is a notable exporter. The growth of domestic demand was limited in most countries owing to the still discernible effects of the adjustment and industrial and financial restructuring policies applied in the wake of the 1997-98 crisis. Overall, these processes have unfolded favourably, albeit somewhat slowly in certain countries. Where far-reaching structural reforms have been made is in China, which is immersed in a complex and extensive process of change across the economy. The reforms should smooth their access in a relatively short time to the World Trade Organisation.

The pace of economic growth was most forceful in 2000 in South Korea, Malaysia and China, which achieved rates of between 8 % and slightly over 10 %. However, the indicators available for the opening months of 2001 confirm the deceleration in economic growth in most countries in the area in the wake of the slowdown in exports. To counter this, demand policies are adopting a more expansionary stance than in the past two years in both their monetary and fiscal facets.

Finally, Russia grew strongly in 2000 (by around 7.5 %), driven by high crude oil prices and the competitive position of the rouble, which also made for an ample current-account surplus.

CHAPTER III

THE EURO AREA
AND THE COMMON MONETARY POLICY

III.1. ECONOMIC CONDITIONS IN THE EURO AREA

In terms of growth, the euro area economy posted very positive results in 2000. GDP grew by 3.4 %, almost one percentage point more than in the previous year and the highest rate since 1989. This vigorous output growth was a consequence of the sustained buoyancy of domestic demand, which grew at a slightly lower rate than in the previous two years, and of the recovery in net external demand, which was assisted by the notable expansion in the world economy and by the depreciation of the euro (see Table III.1). There was also a considerable amount of job creation, which translated into a reduction in the rate of unemployment. Concurrently, the sharp rise in energy prices, intensified by the weakness of the euro, led to an acceleration in consumer prices, although the indicators of underlying inflation, which do not reflect the prices of the goods most exposed to temporary changes, displayed more moderate growth.

III.1.1. Activity and employment

Underlying the figures for annual growth was a trend decline in economic activity over the year. In the second half, all the components of domestic demand slowed and the positive contribution from net external demand fell somewhat. The loss of momentum in activity in the second half of the year affected almost all the member countries, but in some of them

(such as Italy and Spain) it was due to the smaller contribution from domestic demand, while in others (like Germany and France) the slowdown in net external demand was more significant (see Chart III.1).

The modest loss of vigour in domestic demand in 2000 was a consequence of somewhat lower growth than in 1999 of both private consumption and gross fixed capital formation. Consumption had the benefit of the notable increase in employment, the tax cuts made in some countries, the high level of household confidence and the healthy household wealth position, against a background in which financial conditions remained relatively generous. However, the deterioration in real household income, arising from the rise in price of imported products, and the less and less relaxed monetary policy stance led to a certain moderation in spending decisions, which became more apparent as the year elapsed. Meanwhile, fixed capital investment was stimulated by the expansion of final demand and by the increase in the rate of return on capital. The mild slowdown in this component stemmed from the loss of momentum in investment in construction, since investment in capital equipment was more sustained, with a rate of increase of close to 8 %, in line with the cyclical nature of this variable. It has been normal in recent years for these two items to display variant behaviour, closely governed by events in the Germany economy where, since 1995, investment in construction has grown at negative or nil rates, basically due to a surplus stock of existing housing.

**Euro area: main macroeconomic indicators
(annual percentage change, unless otherwise indicated)**

| | DEMAND AND OUTPUT: | | | | | | | | | |
|------------------------------------|---------------------------------|------|------|------|------|----------|------|------|------|------|
| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2000 | | | |
| | | | | | | | Q 1 | Q 2 | Q 3 | Q 4 |
| Gross domestic product | 2.2 | 1.4 | 2.3 | 2.8 | 2.5 | 3.4 | 3.5 | 3.7 | 3.2 | 3.0 |
| Domestic demand | 2.0 | 1.0 | 1.7 | 3.4 | 3.1 | 2.8 | 2.6 | 3.2 | 2.8 | 2.5 |
| Private consumption | 1.8 | 1.6 | 1.6 | 3.1 | 2.8 | 2.6 | 2.6 | 3.1 | 2.4 | 2.1 |
| Government consumption | 0.7 | 1.7 | 0.8 | 1.0 | 1.6 | 1.6 | 1.7 | 1.8 | 1.4 | 1.6 |
| Gross fixed capital formation | 2.3 | 1.2 | 2.4 | 4.8 | 5.3 | 4.6 | 5.7 | 4.9 | 4.0 | 3.9 |
| Exports | 7.9 | 4.3 | 10.4 | 7.0 | 4.7 | 11.7 | 12.8 | 11.4 | 11.2 | 11.6 |
| Final demand | 3.3 | 1.8 | 3.8 | 4.3 | 3.5 | 5.1 | 5.2 | 5.4 | 5.0 | 4.9 |
| Imports | 7.5 | 3.1 | 9.0 | 9.5 | 6.7 | 10.4 | 10.5 | 10.1 | 10.2 | 10.7 |
| Contributions to GDP growth (a): | | | | | | | | | | |
| Domestic demand | 2.0 | 1.0 | 1.7 | 3.3 | 3.0 | 2.7 | 2.6 | 3.1 | 2.7 | 2.5 |
| <i>Change in stocks</i> | 0.3 | -0.5 | 0.1 | 0.4 | 0.0 | 0.0 | -0.5 | 0.0 | 0.2 | 0.1 |
| External demand | 0.2 | 0.4 | 0.6 | -0.5 | -0.5 | 0.6 | 0.9 | 0.6 | 0.5 | 0.5 |
| | PRICES AND COSTS: | | | | | | | | | |
| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2000 | | | |
| | | | | | | | Q 1 | Q 2 | Q 3 | Q 4 |
| Consumer prices (annual average) | 2.5 | 2.3 | 1.7 | 1.2 | 1.1 | 2.4 | 2.1 | 2.1 | 2.5 | 2.7 |
| Consumer prices (Dec. annual rate) | 2.5 | 2.1 | 1.5 | 0.9 | 1.7 | 2.6 | ... | ... | ... | ... |
| Unit labour costs | 1.5 | 2.0 | 0.7 | -0.1 | 1.2 | 1.1 | 0.6 | 0.6 | 1.4 | 1.6 |
| Compensation per employee | 3.3 | 3.0 | 2.1 | 1.2 | 2.0 | 2.3 | 2.5 | 2.1 | 2.4 | 2.1 |
| Labour productivity | 1.7 | 1.0 | 1.5 | 1.3 | 0.9 | 1.3 | 2.0 | 1.5 | 1.0 | 0.5 |
| | GENERAL GOVERNMENT ACCOUNTS (b) | | | | | | | | | |
| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 (c) | | | | |
| Total expenditure | 51.5 | 51.5 | 50.2 | 49.3 | 48.9 | 48.1 | | | | |
| Current expenditure | 46.5 | 47.0 | 46.0 | 44.9 | 44.4 | 43.7 | | | | |
| <i>Interest payments</i> | 5.6 | 5.7 | 5.1 | 4.7 | 4.3 | 4.1 | | | | |
| Public investment | 2.7 | 2.6 | 2.4 | 2.5 | 2.5 | 2.5 | | | | |
| Total receipts | 46.5 | 47.2 | 47.6 | 47.1 | 47.7 | 47.3 | | | | |
| Primary deficit (-)/surplus (+) | 0.5 | 1.4 | 2.5 | 2.6 | 3.1 | 3.3 | | | | |
| Deficit (-)/surplus (+) | -5.0 | -4.3 | -2.6 | -2.1 | -1.2 | -0.7 | | | | |
| | LABOUR MARKET | | | | | | | | | |
| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2000 | | | |
| | | | | | | | Q 1 | Q 2 | Q 3 | Q 4 |
| Total employment | 0.5 | 0.3 | 0.6 | 1.5 | 1.7 | 2.0 | 1.8 | 2.0 | 2.0 | 2.1 |
| Unemployment (d) | 11.3 | 11.5 | 11.5 | 10.9 | 10.0 | 9.1 | 9.5 | 9.2 | 9.0 | 8.8 |
| | BALANCE OF PAYMENTS (b) | | | | | | | | | |
| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2000 | | | |
| | | | | | | | Q 1 | Q 2 | Q 3 | Q 4 |
| Current account | ... | ... | 1.1 | 0.5 | -0.1 | -0.4 | -0.5 | -0.4 | -0.4 | -0.5 |
| Capital account | ... | ... | 0.2 | 0.2 | 0.2 | 0.1 | 0.2 | 0.2 | 0.1 | 0.1 |

Sources: ECB and European Commission.

(a) Rate of change of GDP in percentage points.

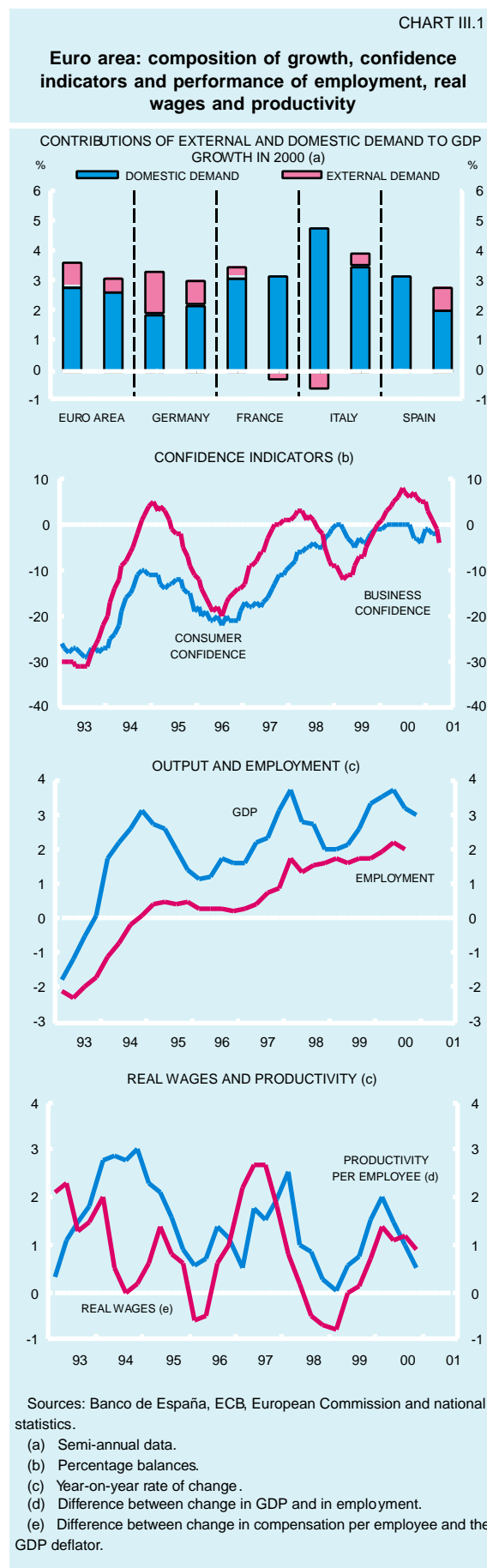
(b) As a percentage of GDP.

(c) Excluding receipts from the sale of third generation mobile telephony (UMTS) licences.

(d) As a percentage of the labour force.

The strength of goods and services exports in 2000 is explained primarily by the extraordinary vigour of external markets, as well as by the gains in competitiveness arising from the depreciation of the euro against the currencies of the main economies. However, although the real effective exchange rate of the euro fell by almost 10 % in 2000 and by somewhat more than 5 % in 1999, gains of market share on international markets were modest last year and only partially made up for the weakness of external sales in the previous two years. This may be related to factors of various kinds: productive-capacity constraints in the industrial sector of some euro area countries; losses of competitiveness through channels other than relative price changes; and difficulties in recovering markets lost in the wake of the devaluation of the currencies of competitor countries, prompted by the Asian crisis. Imports accelerated notably from the previous year, in line with the robustness of final demand, despite the strength of import prices. The growth in the latter, well above that of export prices, led to a significant deterioration in the terms of trade, which helped the nominal rate of change of imports of goods and services to exceed that of exports. This led to a reduction in the surplus on the goods and services account, so that it was insufficient to offset the deficit on income and current transfers, and consequently the current account deficit reached 0.4 % of GDP, while the overall balance on current and capital account moved from slight surplus in 1999 to a deficit of 0.3 % of GDP in 2000.

In line up with the buoyancy of activity, the rate of job creation remained highly vigorous in 2000, with an average annual increase of 2 %, three tenths of a percentage point up on 1999. The favourable trend in employment did not prevent a slight recovery from the previous year in the growth of apparent labour productivity, to 1.4 %, although this was still somewhat less than the average level during the 1990s. This pattern of growth, more employment intensive than normal in Europe, may be due to the moderation of real wage costs seen in recent years and to the introduction, in some



countries, of structural labour market reforms, which has stimulated less replacement of labour by capital (see Box III.1). The growth in employment led to a significant reduction in total numbers unemployed, despite the large increase in the working population. The rate of unemployment stood on average during the year at 9.1 %, almost one percentage point down on 1999. The dispersion of unemployment rates across countries narrowed again in 2000, although there is some evidence that, in certain sectors and in the case of highly qualified workers, the supply of labour was insufficient to satisfy the increase in demand.

The deterioration in the international environment, the extent of which is still uncertain - since the depth and duration of the US economic slowdown and its impact on other geographical areas are still not clear - will foreseeably reduce the contribution of external demand to output in the near future. Nonetheless, it seems likely that domestic demand will remain relatively dynamic (as the indicators available for the first few months of 2001 signal), bolstered by the reduction in the tax burden and by the maintenance of generous monetary conditions, provided that the slowdown in the international environment does not worsen and prompt additional corrections in asset prices and further falls in the confidence of economic agents.

III.1.2 Prices and costs

On most price indicators, in the euro area in 2000 there was a relative worsening of the inflation situation, basically owing to the rise in the price of oil and the depreciation of the euro. All the components of the final demand deflator (except government consumption) displayed an accelerating profile, which was much more pronounced in the case of the prices of imported goods than in that of domestic costs. Among the latter, unit labour costs and net indirect taxes recorded moderate growth, so that the increase in the gross operating surplus per unit of output was somewhat greater than

that in the GDP deflator, and unit margins widened.

In 2000, wage developments contributed to the maintenance of a stable macroeconomic environment, the increase in real compensation per employee being slightly lower than the change in apparent labour productivity (see the lower panel of Chart III.1). Also, if the trend in wages is compared with the increase in consumer prices, it can be seen that, in many countries, employees suffered losses of purchasing power. Given the almost complete absence of indexation mechanisms in euro area countries, it is likely that these losses will not be recovered in the current year, which would help to reduce the persistence of the effects of the oil price shock on inflation rates. However, it cannot be ruled out that the reduction in real income received will prompt workers to raise their wage demands in future collective bargaining, which would lead to a deterioration in the inflation outlook.

Since the beginning of last year the rate of change of the harmonised index of consumer prices (HICP) has stood above the upper limit of the ECB's definition of price stability. In December 2000 the rate of change was 2.6 %, nearly one percentage point up on the rate in the same month a year earlier. As seen in Chart III.2, the acceleration in the HICP was almost entirely due to the energy component, which accounted for more than two-thirds of the 1.4 percentage point rise in the average annual rate of increase of the total index on the previous year. The other components posted moderate growth, although it accelerated at the end of the year, reflecting the increase in import prices. Thus, the index which excludes energy goods and unprocessed food rose by 0.1 percentage points in the first half of 2000 and by 0.3 in the second half. The moderation of wage costs in recent years and the deregulation of certain markets - particularly telecommunications - contributed to the favourable trend in this measure of core inflation. Also, there is some evidence that the passing through of higher oil prices and of the depreciation of the exchange rate to the more stable

Output per employed person in the euro area: recent trends and national divergences

In recent years there has been a deceleration in the rate of growth of **output per employed person** in the euro area, as well as a notable divergence in its behaviour across the countries of the area. On certain assumptions, changes in output per employed person are positively determined by changes in the factor endowment (physical and human capital) and changes in their total productivity. The **capital-labour** ratio changes in accordance with investment in physical capital and with changes in employment, while total factor productivity captures gains in productivity not attributable to greater use of labour and capital, and therefore approximates technical change.

Between 1998 and 2000 **output per employed person** in the euro area grew at an average annual rate of 1.2 %, 0.5 percentage points down on the rate for the previous years of the decade. The slowdown stemmed from the large amount of job creation, which was proportionately higher than the increase in output between the two periods. While average GDP growth between 1998 and 2000 was 1.4 percentage points higher than between 1991 and 1997, the difference in the average increase in employment between the two sub-periods was 1.9 percentage points. In addition, there was a notable slowdown of the upward trend in the **capital-labour** ratio, despite the relatively high growth of investment in fixed capital. This adjustment of the proportions of labour and capital employed is consistent with the behaviour of their relative costs in the period and with the policies implemented in some countries to modernise labour markets and increase their flexibility.

In the more recent years, total factor productivity contributed to the change in **output per employed person** to a greater extent than in the earlier years, although its growth was modest and, in any case, well below that seen in the US economy. In fact, the incorporation of technological improvements into the productive stock of the economies of the area appears to be proceeding at an unsatisfactory rate, with spending on research and development having remained stuck at around 1.9 % of GDP since the mid-nineties. At the same time, the moderate growth of total factor productivity also indicates that the new jobs have a less productive composition. This reflects, among other factors, the strong increase in hiring by the services sector.

The aggregate euro area data are the sum of very diverse behaviour at the national level. As seen in the chart below, the rate of change of output per employed person has moderated in the more recent period in some countries, while in others it has accelerated. These divergences are also reflected in the distribution of the changes in the rate of growth of total factor productivity. Moreover, the average rate of substitution of labour by capital has, in all cases, been lower in the latter years of the decade than in the earlier years, although to a greater or lesser extent according to the country in question.

The forgoing analysis implies that the deterioration in the rate of change of output per employed person in the euro area in the more recent period largely stemmed from more intensive use of labour, which was not offset by the incorporation of more productive physical and human capital. The strong demand for labour in the tertiary sector and, possibly, insufficient research and development may have been responsible for the scant growth of total factor productivity in the more recent years in comparison with the first part of the last decade. These facts illustrate the favourable effects on the demand for labour of wage moderation and greater labour market flexibility and call for the application of selective policies to increase the quality of the stock of physical capital and the training of the labour force.

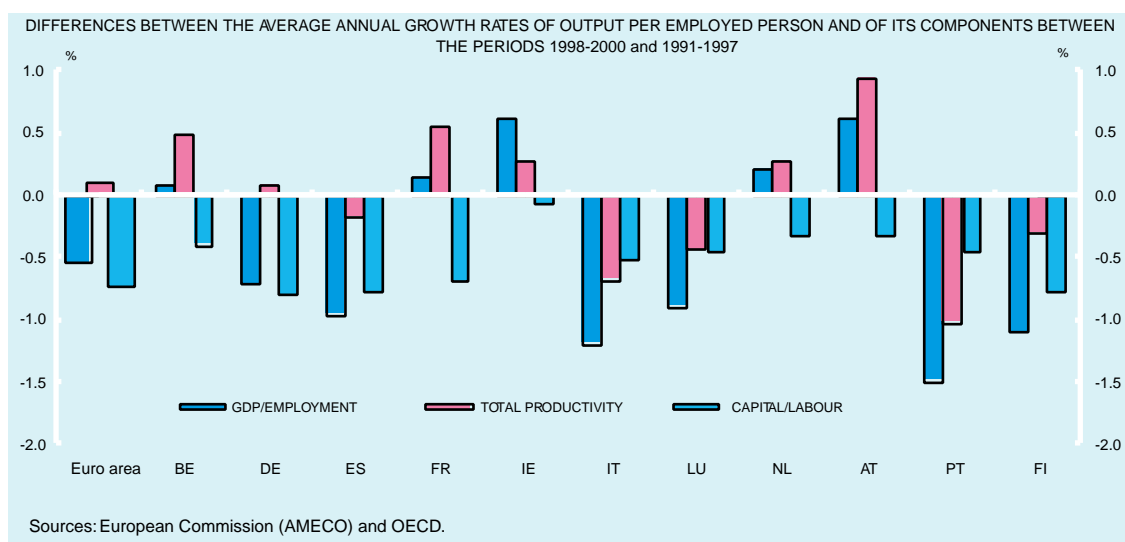
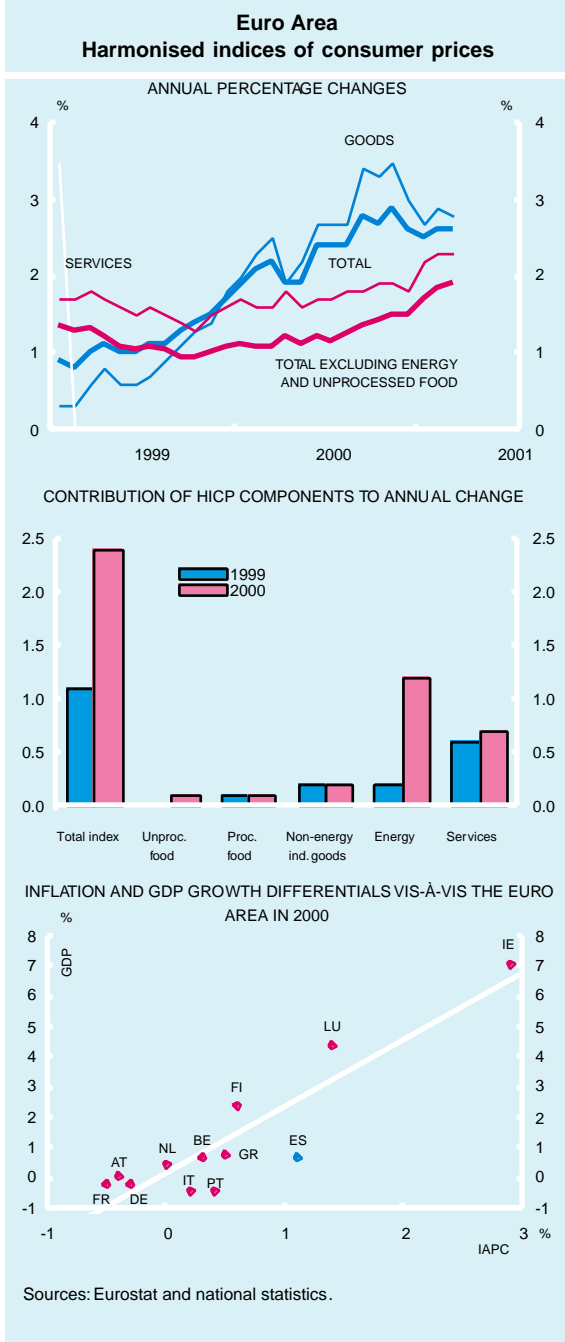


GRÁFICO III.2



components and, in particular, to the prices of non-energy industrial goods, has been less complete than on previous occasions. Although the reasons for this phenomenon are not clear, it is possible that the higher degree of competition on foreign and domestic markets has led both the suppliers of goods produced abroad and national producers to accept a smaller increase in net margins in order to maintain market shares.

In 2000 Q1, inflation remained above 2.5 % as a consequence of the rise in certain indirect taxes and administered prices and, above all, of the repercussions of the crisis in the meat sector. The latter factor may continue to affect the total index in the coming months, although if the expectations of oil prices remaining at around their current levels are confirmed and the euro behaves more in line with its fundamentals, the year-on-year growth of the HICP will foreseeably gradually draw close to 2 % as the year unfolds. However, as already mentioned, its medium term course will be closely governed by the results of current wage bargaining.

III.1.3. Macroeconomic divergence within the euro area

During 2000, the economies of the area displayed relatively significant divergences in their rates of economic growth and inflation, although these were somewhat less than in the previous year (see Table III.2 and the lower panel of Chart III.2). In the three largest countries of the area GDP growth stood at around 3 %, while the other countries recorded rates that were slightly lower or else above 4 %. Generally, the countries with larger increases in GDP also displayed higher rates of inflation.

The observed differences in growth rates across countries are primarily due to the discrepancies in their potential GDP growth rates. The area includes mature economies, with a relatively firmly established productive structure, and other less developed economies immersed in processes of real convergence (associated, depending on the case, with an expansion in the productive resources available or with more intensive use thereof) helped by the stable macroeconomic environment.

However, a significant part at least of the macroeconomic divergences observed appears to stem from cyclical factors. The more dynamic economies generally sustained particularly intense growth in domestic demand, with the benefit of more relaxed domestic monetary

TABLE III.2

Euro-area countries: annual GDP growth

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|--------------------|------|------|------|------|------|------|
| Belgium | 2.6 | 1.2 | 3.4 | 2.4 | 2.7 | 4.0 |
| Germany | 1.8 | 0.8 | 1.5 | 1.8 | 1.4 | 3.1 |
| Greece | ... | 2.4 | 3.5 | 3.1 | 3.4 | 4.1 |
| Spain | 2.8 | 2.4 | 3.9 | 4.3 | 4.0 | 4.1 |
| France | 1.9 | 1.0 | 1.9 | 3.3 | 3.2 | 3.2 |
| Ireland | 9.7 | 7.7 | 10.7 | 8.6 | 9.8 | 10.5 |
| Italy | 2.9 | 1.1 | 2.0 | 1.8 | 1.6 | 2.9 |
| Luxembourg | 3.8 | 2.9 | 7.3 | 5.0 | 7.5 | 7.8 |
| Netherlands | 2.3 | 3.0 | 3.8 | 4.1 | 3.9 | 3.9 |
| Austria | 1.6 | 2.0 | 1.3 | 3.3 | 2.8 | 3.3 |
| Portugal | 2.9 | 3.7 | 3.8 | 3.8 | 3.0 | 3.3 |
| Finland | 3.8 | 4.0 | 6.3 | 5.3 | 4.2 | 5.7 |
| Euro area | 2.2 | 1.4 | 2.3 | 2.8 | 2.5 | 3.4 |
| Memorandum item: | | | | | | |
| Standard deviation | ... | 1.8 | 2.6 | 1.8 | 2.3 | 2.2 |

Sources: Eurostat and national statistics.

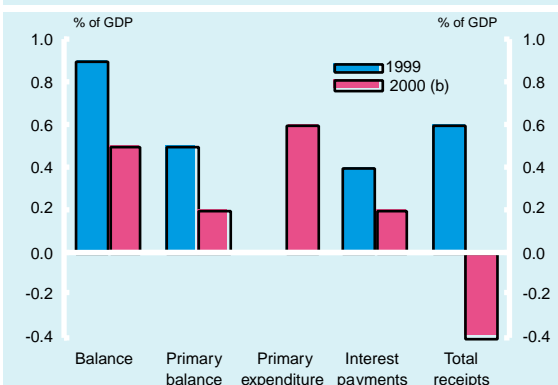
conditions than in the other member countries. Insofar as these countries have had positive inflation differentials, the single monetary policy has meant that their real interest rates have been below the area average and, in most cases, below those observed at similar stages of the cycle prior to the adoption of the euro. The response of the various economies to common shocks has, however, mitigated the divergences. In particular, the countries furthest behind in the cycle (especially Germany) have benefited to a greater extent from the growth of external markets and the depreciation of the exchange rate. The different effects of the rise in the oil price are more difficult to pinpoint, since the repercussions on growth depend, among other factors, on how intensively oil is used and, insofar as they permit more or less real-wage adjustment, on the institutional characteristics of the labour market.

Accordingly, taking into account the importance of cyclical differences, it is generally inappropriate to attribute differences in actual inflation to real convergence processes alone. On the contrary, in most cases the expansion of demand beyond sustainable GDP growth ex-

plains the rise in national prices to an extent that varies in accordance with the cyclical position and the flexibility of each economy. Note that, in those cases in which the buoyancy of activity is based on domestic demand, although the maintenance of a positive inflation differential involves appreciation of the real exchange rate, this does not generate a sufficient stabilising effect, and it also leads to losses in competitiveness, with potentially damaging effects on medium-term growth capacity. Given the existence of a common monetary policy for the area as a whole, containment of these effects requires, at the national level, market reforms to make supply more responsive, as well as a fiscal policy that helps moderate excessive demand pressures. Such actions are beneficial not only for the economies concerned, but also for the area as a whole, since the emergence of large discrepancies in the macroeconomic situation of the members states may hamper the proper functioning of the Monetary Union. In any case, the macroeconomic divergences mentioned are likely to tend to diminish in future, as the countries become more integrated economically and as progress is made with the current structural reforms.

CHART III.3

Euro area: composition of the budgetary adjustment in 1999 and 2000 in relation to the previous year (a)



Source: European Commission.

(a) A plus sign denotes a positive contribution to the adjustment, and vice versa.

(b) Receipts obtained in 2000 from the sale of third generation mobile telephony (UMTS) licences are not taken into account.

III.2. ECONOMIC POLICIES IN THE EURO AREA

Monetary union has involved the application of a common monetary policy to all the countries that have adopted the euro as their currency. At the same time, the process of European economic integration has given rise to greater co-ordination of the other strands of economic policy which remain under the sovereignty of each country. This co-ordination has taken the form of public adoption of fiscal policy and structural reform objectives by each Member State and of the supervision of their fulfilment through joint monitoring of the progress made. The main instrument of co-ordination is the so-called «Broad Economic Policy Guidelines» established annually and supplemented, in the fiscal sphere, by the provisions of the Stability and Growth Pact, and by the Progress Reports on reforms in goods and labour and capital markets.

III.2.1. Fiscal policy

Last year, headway in budgetary consolidation was modest, although the area as a whole achieved a budget surplus of 0.4 % of GDP. This figure is distorted by the extraordinary receipts

from the sale of third generation mobile telephony (UMTS) licences. In some countries these funds were very considerable and for the area as a whole they amounted to 1.1 % of GDP. After deducting these revenues, there was thus a deficit of -0.7 % of GDP, only 0.5 percentage points less than in the previous year. Moreover, 0.2 percentage points of this improvement were attributable to the reduction in interest payments. On European Commission estimates, the cyclically adjusted primary balance worsened by 0.1 percentage points, which implies that the favourable effects of the cycle on the budget balance totalled 0.4 percentage points of GDP. The decision to use all the extraordinary revenues mentioned to reduce public debt enabled the latter variable to be reduced as a proportion of GDP by more than in preceding years, to stand below 70 %.

In terms of headway in improving the quality and efficiency of public spending, the assessment of fiscal policy in 2000 is somewhat more positive in that the tax burden and the weight of current expenditure were reduced. Total revenue fell by 0.4 percentage points of GDP, as against the increase of 0.6 percentage points of GDP in 2000, while primary spending declined by 0.6 percentage points of GDP in 2000, whereas in 1999 it had stayed the same as in the preceding year (see Chart III.3). Although public investment remained unchanged at 2.5 % of GDP, it rose as a proportion of total spending. The fiscal reforms introduced to date have generally concentrated on reducing social contributions and the taxation of earned income (especially at the lower end of the pay scale), while the revision of spending programmes and, in particular, social benefits has received less attention. It would be desirable if, in future, tax reforms were to form part of a broad strategy encompassing, in addition, changes in protection systems and in the institutional and regulatory features of labour markets. Moreover, despite their positive medium and long-term effects, reductions in the tax burden, insofar as they may give rise to a deterioration of budgetary positions, should be implemented with great caution, particularly in

countries with significant inflationary pressures, ongoing budget deficits or high debt ratios.

One aspect that is attracting growing attention from the European authorities is the public policy implications of the ageing population. According to the projections currently available, the budgetary consequences of this process, in terms of increased pension and health expenditure, will take time to emerge. However, the medium and long-term challenge is of such a magnitude that it needs to be faced up to as soon as possible. In the area of pensions, the solutions envisaged generally include measures to stimulate an increase in the activity rate and employment, reform of the present pay-as-you-go systems, the development of supplementary funded systems and the strengthening of budget balances, to ensure that the problem is tackled from a general government financial position that is as solid as possible. The reforms of the pay-as-you-go systems undertaken in some countries have tended to be aimed, to a greater extent, at limiting the amount of the benefits rather than at raising contributions, in order to avoid a contraction in labour supply. Moreover, some countries (such as Spain, France, Belgium and Ireland) have set aside, or are on the point of setting aside, reserves to help pay for the future increase in spending. However, the introduction of the reforms is being inordinately delayed. Although this is usually due to the difficulty of ensuring that the reforms have the support, as is desirable, of a broad consensus among social agents, these delays may significantly increase the costs of reform.

III.2.2. Structural policies

Along with fiscal policy, structural reforms play a fundamental role in shaping a more flexible and competitive economic environment, since blatant deficiencies persist in EU product and factor markets, which limit the economy's growth potential. These reforms received a very significant initial political boost at the Lisbon European Council in March 2000, which

drew up an overall medium-term strategy (subsequently watered down) consisting of four basic points: preparation for the transition to a knowledge-based economy; the achievement of higher levels of competitiveness and innovation; renewal of the European social model, on the basis of investment in human capital and social cohesion; and a macroeconomic policy mix consistent with sustainable growth.

According to various indicators, the overall functioning of European product markets improved in 2000, albeit not across-the-board. Notable were the increased levels, in some countries, of transposition of Community directives for the development of the internal market, the strengthening of national competition authorities and progress in the liberalisation of telecommunications. However, the possibilities for reform and modernisation of public tendering systems and mechanisms and of the structure of state aids do not seem to have been exploited to the full. Also, the administrative burden on corporations, in particular that which increases start-up costs has not fallen at a sufficient rate. Moreover, the creation of an integrated European market for corporate services, the opening up of the transport sector to competition and liberalisation of postal services continue to be delayed. Finally, as confirmed by the recent Stockholm Council, progress in liberalising the energy sector has been insufficient.

With regard to the labour market, progress continued to be made in 2000 in the implementation of active employment policies. Some countries have adopted measures to increase the (still-very-low) female employment rate and others have improved those aspects of their tax systems which penalised job creation and increases in the supply of labour. However, as already mentioned, these measures have not been accompanied by effective reform of protection systems.

In the area of the financial sector, market integration continued, within the framework of

the European Commission Action Plans for Financial Services and Risk Capital. In July 2000, the so-called Committee of Wise Men was set up, under the presidency of Alexandre Lamfalussy, to facilitate the first of these action plans. Its basic purpose was to analyse how securities markets operate in the EU and to identify the mechanisms necessary for their rapid and smooth integration. The suggestions of this Committee - published in February this year and endorsed by the Stockholm European Council in March - include both the drawing up of a list of priorities and the adoption of a tight schedule for their achievement. The most important proposal of the report is the adoption of a new system for the approval of European legislation on securities markets. This new system is swifter than the present one (involving the European Parliament, the European Council and the European Commission) and requires the setting up of two new committees (on securities and on regulators), which will begin to function before the end of this year.

III.3. THE COMMON MONETARY POLICY AND MONETARY AND FINANCIAL CONDITIONS IN THE EURO AREA

III.3.1. Monetary policy decisions

During 2000 the monetary policy of the Eurosystem became gradually more restrictive in response to mounting inflationary pressures, stemming mainly from the sharp rises in energy prices and the depreciation of the exchange rate, against a background of highly buoyant domestic demand. The growth of M3, which was persistently higher than the reference value set by the ECB (of 4.5 % per annum), and the strong expansion of credit reflected relatively easy monetary conditions. In the most recent period, the fall in oil prices and, especially, the US economic slowdown and its incipient impact on euro area activity have helped reduce inflation risks, leading the ECB to re-

duce its rates by 0.25 basis points in May this year.

Reviewing monetary policy measures in chronological order, it can be seen that the cycle of rising official interest rates began in November 1999 following confirmation that the effects of the emerging markets crisis had been overcome. At the beginning of 2000, the economic outlook was very favourable, while the prolonged depreciation of the euro was making imported goods significantly more expensive and exacerbating the impact of the increase in oil prices which, having risen sharply during 1999, accelerated further. In the first few months of 2000, as a consequence of these factors, the HICP exceeded, for the first time since the start of Stage Three of EMU, the 2 % upper bound in the ECB's definition of price stability. These elements had still not translated into a significant increase in underlying inflation, which stood at around 1 %, but a risk was perceived of the rise in the prices of imported goods being passed through to domestic prices, via production costs, and of agents taking the higher actual inflation rate as the reference for their wage demands. These circumstances, along with the fact that monetary and credit aggregates were expanding at very high rates, called for a gradual tightening of the monetary policy stance. The Governing Council of the ECB decided at its meetings on 3 February, 16 March and 27 April to raise official interest rates on each occasion by 25 basis points. At the end of April 2000 the interest rate on the main refinancing operations of the Eurosystem thus stood at 3.75 %.

In the following months, economic activity in the euro area remained clearly buoyant, with GDP growth in Q2 reaching a year-on-the-year rate of 3.7 % (the highest rate of the current upswing), while no signs of weakness were discerned among the aforementioned factors feeding inflation risks. This prompted the Governing Council of the ECB to raise its official interest rates again on 8 June and 31 August, by 50 and 25 basis points respectively.

The change in the conduct of the main refinancing operations of the Eurosystem

The Governing Council of the ECB decided in June 2000 that the so-called «main refinancing operations» (MROs) (1) should no longer be carried out using the system of fixed rate tenders, but using instead a system of variable rate tenders with pre-announcement of the minimum interest rate at which the institutions may place their bids. This decision was the Council's response to the phenomenon of overbidding, whereby the liquidity demanded by the institutions through MROs reached more than 100 times their true requirements.

The signalling capacity of variable rate tenders

| Period | Type of tender | Signal | Variability of EONIA (a) | EONIA-signal deviation (b) |
|--|-------------------|--------------|--------------------------|----------------------------|
| 13/10/99 – 03/11/99 | Fixed rate | Fixed rate | 0.118 | 0.032 % |
| 12/01/00 – 02/02/00 | Fixed rate | Fixed rate | 0.041 | 0.030 % |
| 23/02/00 – 15/03/00 | Fixed rate | Fixed rate | 0.027 | 0.048 % |
| 05/04/00 – 26/04/00 | Fixed rate | Fixed rate | 0.039 | 0.051 % |
| 17/05/00 – 07/06/00 | Fixed rate | Fixed rate | 0.044 | 0.075 % |
| <i>Average of the periods with fixed rate tenders</i> | | | <i>0.054</i> | <i>0.047 %</i> |
| 09/08/00 – 30/08/00 | Variable rate (c) | Minimum rate | 0.041 | 0.046 % |
| 13/09/00 – 04/10/00 | Variable rate (c) | Minimum rate | 0.026 | 0.028 % |
| <i>Average of the periods with variable rate tenders</i> | | | <i>0.034</i> | <i>0.037 %</i> |

(a) The ratio of the standard deviation to the mean of EONIA. To avoid distortions, days on which reserve maintenance periods end are excluded from the sample.

(b) Ratio between the differential between EONIA and the signal, on the one hand, and the signal itself, on the other. To avoid distortions, days on which reserve maintenance periods end are excluded from the sample.

(c) With the announcement of a minimum rate.

The chart shows the total bids of the institutions and the amounts actually provided through the Eurosystem MROs between the start of Stage Three of EMU and end-2000. Before the change in tender method, the rising trend in bids contrasts with the stability of the liquidity actually provided by the Eurosystem. Thereafter, however, there has been a significant change in the behaviour of the institutions, which have drastically reduced the amounts requested (2). The pro-rata ratio (between the amount provided and the amount requested) has risen on average from 8 % to 58 %.

It is sometimes stated that a possible weakness of the variable rate tender system is its relatively low capacity to signal adequately the desired monetary policy stance. To analyse the functioning of the new system in this respect and, in particular, to compare it with the fixed rate tender system, it would be best to concentrate on periods in which expectations of rises in interest rates have predominated since, in principle, these are the ones during which it is most difficult for the central bank to signal its intentions. These periods of tension are defined as the three weeks preceding each decision to raise rates (3).

The signalling capacity actually displayed by each type of tender can be assessed, first, on the basis of the stability of the overnight market interest rate, EONIA, the origin of the term structure in the euro area. Another important indicator is the differential which, in periods of tension, arises between the interest rate through which the Eurosystem indicates its policy stance (the fixed rate or the minimum bid rate, depending on the type of tender used) and a very short-term interest rate, such as EONIA, through which, in the first instance, the actions of the ECB are transmitted. The table includes both indicators and shows that during the period of variable rate tenders, both the variability of the market rate and the differential between the monetary policy signal and EONIA have been similar, if not lower, than when fixed rate tenders were used.

In short, the evidence set out in this box (with the obvious caveats relating to the shortness of the period of analysis) enables the decision to replace fixed rate tenders with variable rate tenders, supplemented by the announcement of a minimum bid rate for the conduct of Eurosystem MROs, to be assessed positively. Not only has the phenomenon of overbidding, the main reason for the decision, abated significantly, but also the correction of this problem does not seem to have weakened the ability of the Eurosystem to signal adequately its desired monetary policy stance.

(1) Liquidity-providing open market operations, through which the Eurosystem satisfies the bulk of the requirement of the credit institutions of the area.

(2) For a more detailed analysis of the problem of overbidding and its relationship to the type of tender, see Ayuso and Repullo (2000), *A model of the Open Market Operations of the ECB*, Banco de España, Working Paper no. 0016.

(3) Likewise, periods of calm may be defined (the three weeks following each rate rise). The analysis of these periods leads to the same conclusions as an analysis based on periods of tension. For further details see Ayuso (2000), "El funcionamiento de las subastas a tipo variable en las operaciones principales de financiación del Eurosystema", Banco de España, *Boletín económica*, December.

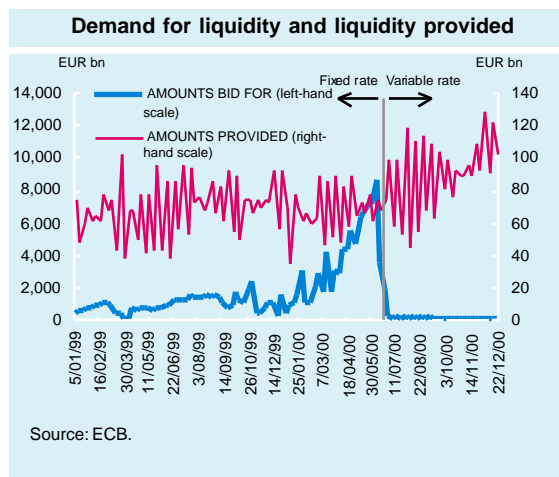
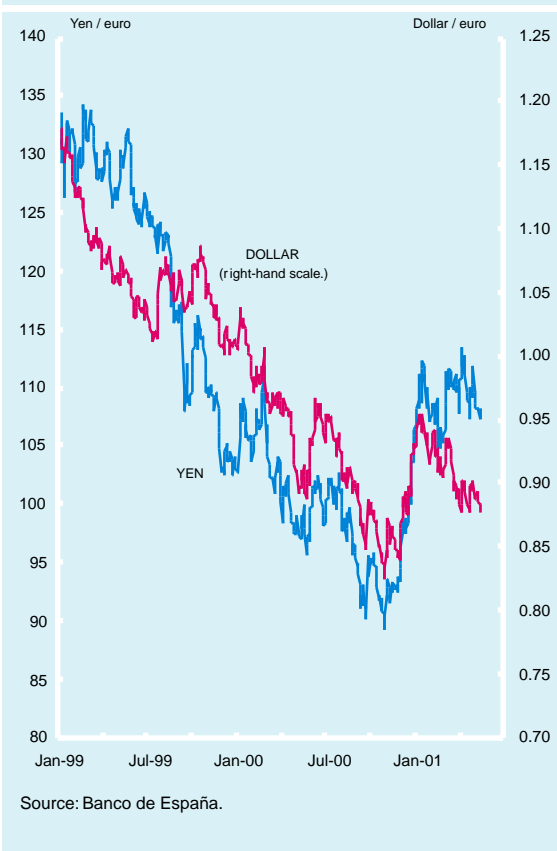


CHART III.4

Nominal euro exchange rate vis-à-vis the US dollar and the yen



Despite the increases in interest rates, the euro continued to slide against the US dollar (see Chart III.4), feeding inflationary pressures and moving further and further from the levels warranted by the euro area's economic situation and outlook. As a result, the ECB considered it necessary to send a clear signal to market participants of its dissatisfaction with the level of the euro exchange rate, to strengthen the perception of the risk incurred by those agents betting on the inability of the European currency to return to levels compatible with the economic fundamentals. To this end, in the second half of September concerted interventions to purchase euro were carried out with other central banks, including the US Federal Reserve and the Bank of Japan, which led to a temporary recovery in the euro/US dollar exchange rate. This measure was accompanied on 5 October by a 25 basis-point increase in interest rates, which placed the rate on the main refinancing operations at 4.75 %. These interven-

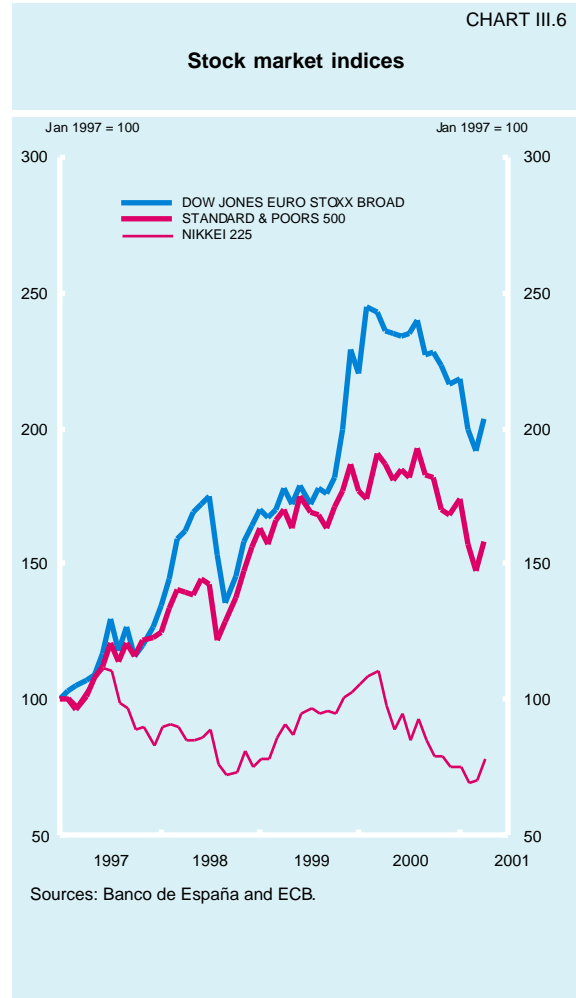
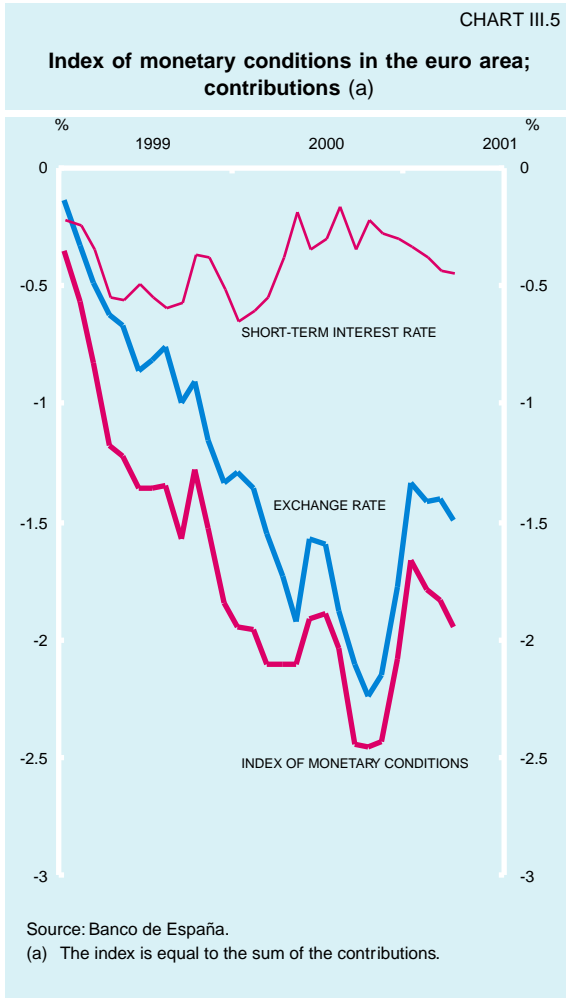
tions in defence of the euro were repeated in November, when the European Central Bank acted unilaterally. At the same time the first news was emerging of a significant deterioration in the US growth outlook and the upward trajectory of the price of oil came to a halt. All of this enabled the euro to appreciate moderately against the US dollar in the latter part of 2000, although during 2001 to date this upward movement has been partially reversed.

In recent months, the deterioration in the world economic outlook, as a consequence of the abrupt change in the US economic outlook, together with the fall in the price of crude oil, have reduced inflation risks, while economic activity shows signs of slowing. These factors, together with the effect of the monetary restriction applied since November 1999 (involving a total increase in official interest rates of 225 basis points), have reduced the generosity of the prevailing monetary conditions. Against this background, the Governing Council of the ECB decided on 10 May 2001 to reduce its interest rates by 25 basis points.

As regards the implementation of the monetary policy, perhaps the most important change in 2000 was the switch in the method used to allocate liquidity in the main refinancing operations to one based on variable rate tenders (see Box III.2). The changes in the interest rates on the main refinancing operations were always accompanied by equal changes in the interest rates on the credit and deposit facilities, so that the corridor between these rates remained unchanged at two percentage points.

III.3.2. Monetary and financial conditions in the euro area

As already mentioned, the ECB tightened the monetary policy stance considerably during 2000. However, the rise in inflation and the cumulative depreciation of the euro significantly offset the restrictive effects of the central bank's actions, as reflected by the indices of monetary conditions (see Chart III.5). Stock



market developments worked in the other direction, with falls in 2000 (of 6 % in the case of the Dow Jones Euro Stoxx Broad index), following a prolonged rise (see Chart III.6). In all, the change in the stance of the monetary policy has enabled monetary and financial conditions to adjust to the situation in the euro area, although such conditions have remained conducive to continued buoyancy of activity.

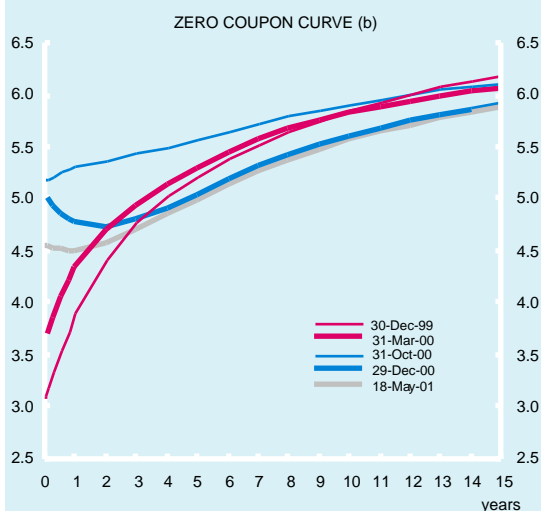
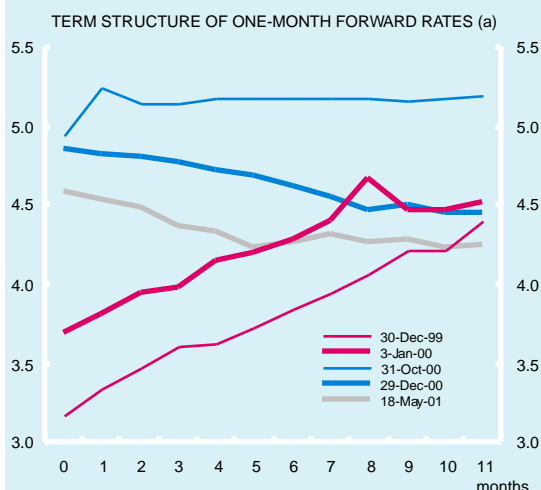
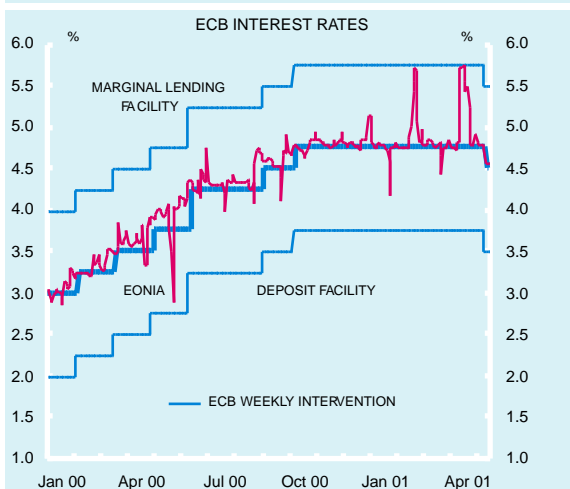
Developments in the money and short-term debt markets were closely governed by the monetary policy measures taken. In fact, the decisions of the ECB were largely discounted by the markets, as shown by a comparison of the forward rates observed at the beginning of 2000 with the trend over the year in the short-term spot rates (see Chart III.7).

Meanwhile, on the long-term debt markets, interest rates reflected the high credibility of

the ECB's price stability objective. As seen in the zero-coupon curve depicted in the lower panel of Chart III.7, the increases in official interest rates have tended to be accompanied by downward shifts in the curve at the longer maturities. Ten-year bond yields in the area as a whole fell by around 0.5 percentage points during 2000 and by a further 15 basis points in 2001 Q1. Accordingly, the slope of the yield curve, understood as the difference between the rate of return on 10-year debt and three-month EURIBOR, flattened during 2000 from 250 basis points in January to almost zero in December. The long-term interest rate spreads between the European countries have varied somewhat, tending to respond more than in the past to the credit rating of the issuer and to the liquidity of the market on which the securities are traded (see Box III.3).

CHART III.7

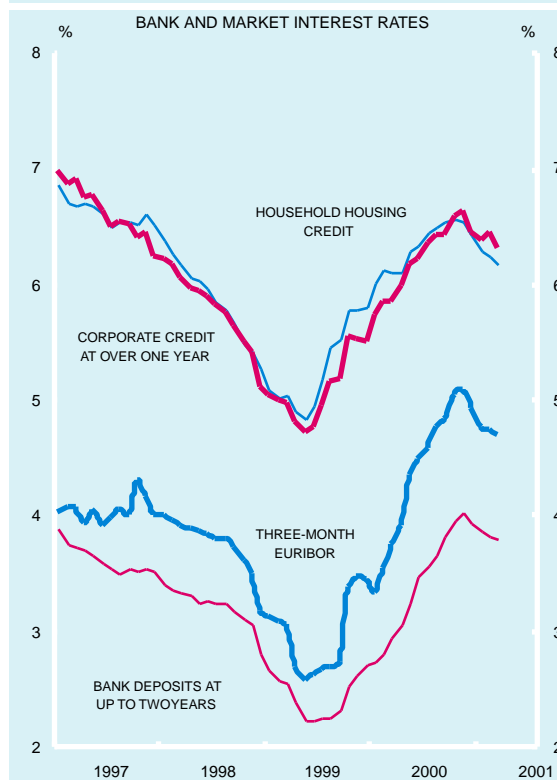
Eurosystem interest rates



Sources: Banco de España and ECB.
 (a) Estimated with Euribor rates data.
 (b) Estimated with money market and data.

CHART III.8

Euro area interest rates



Sources: Banco de España and ECB.

In the transmission to the interest rates set by credit institutions in their lending and deposit transactions, the effect of the increase in interest rates on the interbank market predominated over that arising from the stability of long-term bond yields, as is clearly seen in Chart III.8. In general, the transmission to lending rates was swift. For example, between mid-1999 (when lending rates reached a low) and December 2000, the costs of loans for house purchase and to enterprises with a maturity of more than one year rose by around 170 basis points, or around 75 % of the cumulative increase in official rates during this period. The movements in bank rates tended, therefore, to stimulate saving and penalise borrowing, although, as mentioned above, the level reached by bank rates is still very low in comparison with those prevailing in many countries prior to the start of Stage Three of EMU.

Have the determinants of the yield differentials between the sovereign bonds of the euro area countries changed since the advent of Monetary Union?

The sovereign bonds of the member countries have, since the start of Stage Three of EMU, been denominated in a common currency, which has eliminated one of the main elements distinguishing those of one country from those of another. With the disappearance of this element, the main characteristics distinguishing issues and which should, in principle, determine yield differentials are the issuers' creditworthiness and liquidity differences.

In the past, the yield differentials between the long-term sovereign bonds of the countries which, in January 1999, joined the euro area were, in some cases, very wide and volatile. During the months leading up to Stage Three of EMU they narrowed considerably in response to expectations that the various countries would join the euro area. In January 1999, the spreads on 10-year sovereign bonds over Germany were between 7 basis points (bp) and 22 bp, with an average of 18 bp. Since then, these spreads have tended to widen and, as at end-2000, had increased by an average of 11 bp. It cannot be ruled out that the general increase in spreads has been at least partly a consequence of specific changes in the German market, such as the improvement in its liquidity as a consequence of this being the market underlying the most-traded bond derivatives contracts in the euro area. However, the significant widening in the dispersion of these spreads (from 14 bp to 41 bp), almost twice the range existing in January 1999, suggests that other factors must have also played an important part in these developments. How far these developments reflect changes in the relative ratings of the creditworthiness of the issuers and in the degree of liquidity of the benchmarks will now be discussed.

The charts depict the spreads over 10-year German bonds of bonds with the same maturity of the other 10 member countries of the euro area in terms of the debt/GDP ratio in January 1999 and in December 2000 respectively. Since the creditworthiness of the various issuers should fall as the debt/GDP ratio rises, a positive relationship may be expected between the two variables considered. As the charts show, in January 1999 the correlation was positive but very low. At end-2000, by contrast, it had increased considerably which, in principle, suggests that spreads were at that time more in line with the differences in the creditworthiness of the various issuers.

The message gleaned from comparing these two charts may be distorted by the omission of other relevant variables that influence differentials in bond yields. Indeed, the increased dispersion of the differentials around the line of best fit suggests that other factors not reflected in the debt/GDP ratio must also have contributed to the changes. Notable among such factors are the relative differences in the degree of market liquidity (along with others, such as the reputation of the issuers).

However, the results of a simple exercise in which the role of liquidity is also considered (approximated, in this case, by the outstanding amount of benchmark bonds of each country) do not alter the conclusions drawn from the charts. Also, evidence is found of an inverse relationship between differentials and the outstanding amount of benchmark bonds, which is stronger at the later date, suggesting that liquidity differences are now more strongly reflected in the relative valuations of sovereign bonds.

In conclusion, the evidence presented in this box suggests that, at the start of Stage Three of EMU, the markets' valuations of the sovereign bonds of the member countries hardly reflected the differences in the creditworthiness of the issuers or the degree of liquidity of the benchmark bonds. However, since then the changes in the spreads seem to indicate that the markets are now discriminating to a greater extent between the different issuers in accordance with these two factors.

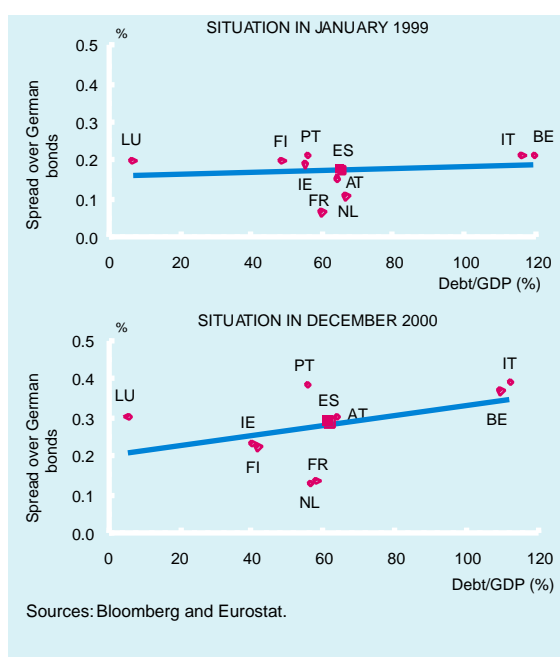
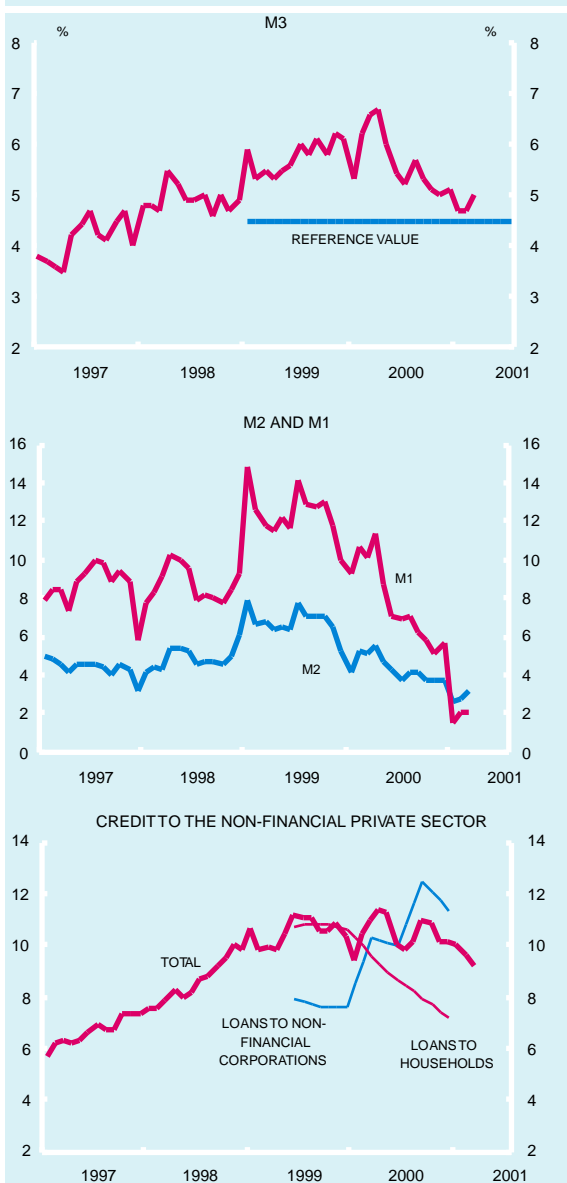


CHART III.9

**Monetary and credit aggregates
in the euro area
Year-on-year rates of change**



Sources: Banco de España and ECB.

Developments on the financial markets and the path of economic growth of the euro area naturally affected agents' demand for liquid assets during 2000. The main monetary aggregate, M3, held at an annual rate of growth above its reference value (see Chart III.9). This behaviour was largely attributable to economic growth in the euro area running at above the potential rate and inflation at levels above 2 %. The narrowest aggregates, that had been displaying high growth rates, as a consequence of the lower

opportunity cost of holding the most liquid assets, decelerated during 2000, as interest rates rose. A preference became apparent for assets offering less liquidity and a higher yield. Within M3, the components that grew most were time deposits and marketable assets, which rose by between 10 % and 15 %. By contrast, the rate of growth of sight deposits has fallen from above 10 % at the beginning of 2000 to the present very low rates (of around 2.5 %). In recent months the rate of change of M3 has moderated significantly, drawing close to the reference value set. This reflects, among other factors, the cumulative rise in interest rates and the slight slowdown in economic growth.

Despite the rise in the cost of credit, the financing extended by monetary financial institutions (MFIs) to the private sector displayed relatively high and stable rates of growth, of around 10 %, throughout 2000. However, the composition of the aggregate changed significantly, with credit to households slowing and that supplied to firms accelerating. The scant sensitivity of corporate borrowing to the rise in the cost of credit was partly due to the certain extraordinary financial transactions (like the auctions of UMTS licences in Europe and mergers and acquisitions in the industrialised countries), as well as to the seizing of opportunities for direct investment abroad, which have required sizeable financial resources. As in the case of M3, a moderate turning point has been detected in recent months in the expansion of credit, although, according to March balance sheet data, the latter continued to grow at rates of close to 9 %.

The difference between the strong rate of growth of credit and the more moderate rate of growth of banking liabilities was covered by the credit institutions primarily through foreign financing. Consequently, the euro area MFIs borrowed a net amount of EUR 100 billion last year. From the viewpoint of the financial account of the balance of payments, these funds were needed to finance the net capital outflow in the form of direct and portfolio investment abroad, against a background of deficit on current and capital account.

CHAPTER IV

THE SPANISH ECONOMY

IV.1. ECONOMIC POLICIES

IV.1.1. Monetary and financial conditions in Spain

In the year 2000, monetary and financial conditions in the Spanish economy were once again more generous than in the rest of the euro area. In Spain, the Eurosystem's tighter monetary policy stance during the year, and the consequent rise in short-term nominal interest rates, was offset not only by the course of the euro exchange rate and of long-term interest rates, but also by higher price rises than in the rest of the area, against the background of the Spanish economy's higher growth. Reflecting these relatively easier conditions, the Spanish monetary aggregates grew at higher rates than their euro-area counterparts and, in particular, financing conditions were again markedly expansionary.

The Spanish component of the M3 monetary aggregate (the benchmark aggregate for the euro area) grew by 7.4 % during 2000, almost two percentage points up on the related annual rate as at December 1999 (5.6 %). Liquid Financial Assets (LFA), a broader monetary aggregate including deposits and bank securities with a maturity of over two years and shares in domestic fixed-income mutual funds, grew at more moderate rates. They were nonetheless on a rising course, showing an increase in December 2000 of 2.7 % on a year earlier, when the related rate was 0.5 % (see Chart IV.1). The moderate growth of LFA was largely determined by intensified disposals of shares in mutual funds. These were not offset by the increase in term deposits and were induced, in turn, by certain changes in the taxation on these instruments and by the fall in and greater volatility of asset prices on se-

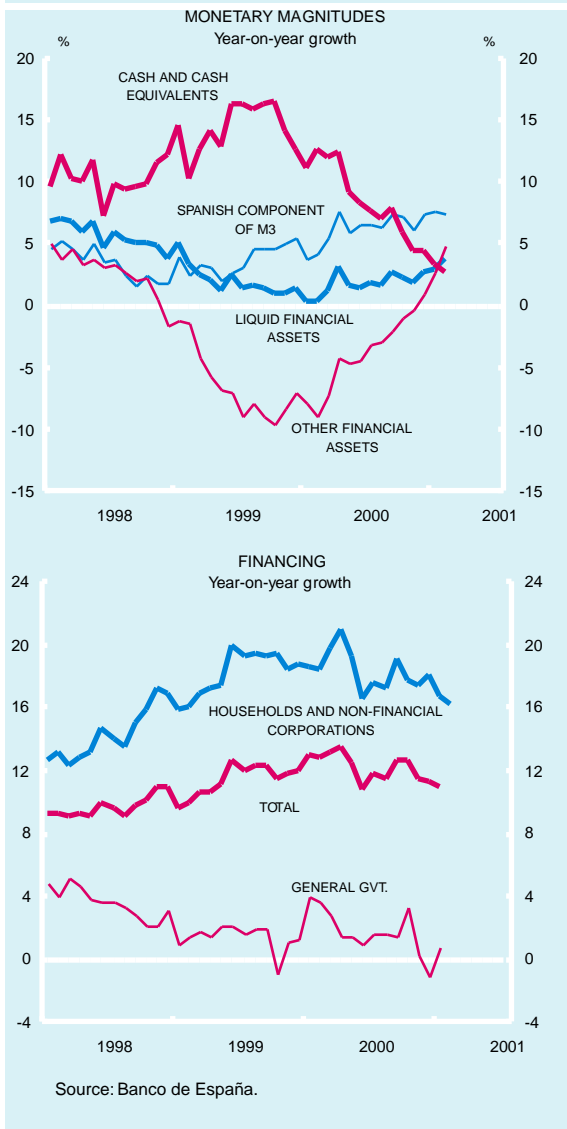
curities markets. Notably, too, the growth rate of the most liquid aggregate – cash and cash equivalents – fell from 12.7 % in December 1999 to 2 % in March 2001. This slowdown, which fed through to all the associated components (cash, sight deposits and savings deposits), was essentially due to the increased opportunity cost of holding these assets induced by the rise in short-term interest rates, the result of the change in the single monetary policy stance.

Once again in 2000, lending to the non-financial resident sectors ran at significantly higher growth rates than those recorded in the rest of the euro area, with no clear signs of slowing until the opening months of 2001. In December 2000, the year-on-year growth rate of financing to the non-financial sector was 12 %, virtually unchanged on a year earlier. The contribution of lending to general government to this expansion was scant (see Chart IV.1). However, financing to households and non-financial corporations held at very high growth rates. In particular, loans from resident credit institutions to the sector were running at a growth rate of close to 19 % at end-2000. Admittedly, the decline in real long-term interest rates, the greater macroeconomic stability deriving from Monetary Union membership and the fact the Spanish economy is ahead in cycle might warrant a higher level of debt for Spanish households and firms. But these factors alone do not appear able to explain the speed and intensity of the expansion of credit in recent years.

In the early months of 2001 signs have emerged of an incipient shift in monetary and financial conditions in Spain to levels more in keeping with the requirements of the economy's present juncture. Nonetheless, it is still too soon to attempt to draw firm conclusions in this respect.

CHART IV.1

Monetary and financial magnitudes of the Spanish economy



IV.1.2. Domestic macroeconomic policies

Fiscal policy in 2000 was geared to attaining a fresh decline in general government net borrowing; as stipulated in the State Budget for the year, this variable was scheduled to stand at 0.8 % of GDP, six-tenths of a point below the estimated deficit for 1999. As in previous years, this target was integrated into a medium-term budgetary consolidation strategy which took specific form in the Updated Stability Programme for the period 1999-2003, approved in January. This programme proposed attaining a balanced budget and placing the public debt/GDP ratio at below 60 % in the year 2002.

The State Budget envisaged all sub-sectors of general government making a joint fiscal consolidation effort. The State was thus expected to cut its deficit by three-tenths of a point to 0.8 % of GDP, the Territorial Governments to reduce their debit balance to 0.1 % of GDP and Social Security Funds to run a surplus of 0.1 % of GDP, after achieving a position close to balance in 1999. The decline forecast in general government net borrowing was based on moderate growth in public spending (below the nominal growth of the economy) and on the renewed vigour of revenue. Both factors were expected to be favoured by continuing expansionary cyclical conditions whose positive effect on public finances would be bolstered, on the expenditure side, by the scheduled reductions in interest payments and by a fresh cut in final consumption expenditure. As in previous years, the cut in consumption would be underpinned by restrictions on public-sector employment creation and by growth in civil servants' compensation in line with the inflation target (2 %).

Under these co-ordinates, the general government deficit-cutting target was considered compatible with the pursuit of specific public spending and revenue strategies entailing an increase in net borrowing that would be offset, in turn, by the moderate growth of other budgetary items. Notable among the spending strategies are the budgetary increase in productive and investment activities, the upward revision of social spending (following the rise in minimum pensions and the setting of an income allowance for the integration of the long-term unemployed) and the ongoing professionalisation of the armed services. And among the revenue strategies, the freeze on excise duties, the cut in withholdings on dividends and on income from fee-earning activities, and the reduction in social security unemployment charges in connection with permanent contracts. Lastly, the segregation of the sources of financing of Social Security Funds was completed and the creation of a reserve fund for pensions was scheduled.

The budget outturn during the year showed revenue to be more buoyant than expected. This allowed the envisaged general government deficit to be successively revised first to 0.4 % of GDP, and then to 0.3 % of GDP during the summer, the latter figure being finally attained. In turn, certain expenditure items were increased, including financial charges relating to debt conversion. The debt/GDP

Information and communications technologies (ICT) branches in the Spanish economy

In recent decades the branches producing goods and services relating to information and communications technologies (ICT) have made considerable technological advances. This has provided for notable reductions in the prices of the goods and services they produce, along with improved quality. Such advances may have a substantial effect on the economy as a whole through two channels: through the very growth of the ICT branches and through their use as intermediate goods. This box explores the first channel in the context of the Spanish economy, considering three groups of activities: the manufacture of computer and communications products (ICT manufacturing), telecommunications services (ICT communications) and computer-related services (ICT computer services) (1). Two sources of information are used: the Spanish National Statistics Institute's DIRCE (Central Directory of Corporations), which contains information on numbers of corporations and employment, and the Banco de España Central Balance Sheet Office (CBE) (2).

Table 1 offers information drawn from DIRCE for the period 1996-1999. Employment in the ICT branches as a whole accounts for a small proportion (around 3 %) of total employment in the market economy. That said, its rate of increase has been two percentage points higher than that for the whole economy, with the rise in employment in ICT computer services, at over 25 % per year, proving particularly significant. Conversely, ICT communications has seen a reduction in employment, reflecting the ongoing restructuring of the former monopoly. As regards the number of companies, the ICT branches have grown by 13 % per year, against 6.3 % for the market economy as a whole.

The performance of the ICT branches is summarised in Table 2. As regards value-added, companies in these branches have proven more dynamic than the market economy as a whole. Their productivity, which is at a relatively high level, has also performed more favourably, except for the ICT computer services branch. However, the increases in value-added and productivity may be biased downwards, since the deflators used do not take quality changes, which are particularly relevant in these branches, sufficiently into account. Table 2 likewise shows companies in the ICT branches have sustained significant investment momentum in recent years along with an especially favourable market value; however, in the period analysed profits, measured by net operating result (3), have not exceeded those of companies in other productive branches.

It may be concluded that, in Spain, the ICT branches have been more dynamic than the economy as a whole, especially in IT-related activities. However, their weight in the whole economy remains small, so their contribution to overall growth has been modest. Compared with other European countries, the data available indicate that the ICT branches in the Spanish economy are of lesser relative significance (4). As regards employment in and value added by ICT manufacturing, countries such as France, Ireland, Finland, United Kingdom, Netherlands and Sweden account for a proportion of total manufacturing that is almost twice that of Spain. As regards ICT computer services, the weight of this branch in terms of employment is also less, although it is experiencing greater growth than in most of these economies. Lastly, imports of ICT goods throughout the period 1996-1999, which account for almost 9 % of the total, have grown at a rate exceeding 18 % per year. This notable increase, along with the buoyancy of economic activity in these branches, indicates that their use by the economy as a whole may be increasing with considerable momentum.

(1) The OECD definition has been used.

(2) For the ICT branches, the CBE offers coverage, in terms of employment, of close to 55 % (45 % for ICT manufacturing, 94 % for ICT communications and 22 % for ICT computer services).

(3) The result for the year without taking into consideration atypical operations, capital losses and capital gains.

(4) According to the Eurostat SBS database.

TABLE 1

Dependent employment in the ICT branches: 1996-1999

| | % of total in 1999 | Rate of change 1996-1999 |
|-----------------------------|--------------------|--------------------------|
| ICT manufacturing | 0.88 | 3.8 |
| ICT communications | 1.03 | -1.5 |
| ICT computer services | 1.38 | 25.3 |
| Total ICT | 3.28 | 8.7 |
| Industry | 30.50 | 3.4 |
| Sales services | 53.36 | 7.5 |
| Whole market economy | 100.00 | 6.5 |

Source: INE companies directory.

TABLE 2

Economic performance of the ICT branches 1995-1999 (a)

| | Level in 1999 | Rate of change 1995-1999 (b) |
|--|---------------|------------------------------|
| VALUE ADDED (bn) | | |
| ICT manufacturing | 582 | 7.2 |
| ICT communications | 2,022 | 9.2 |
| ICT computer services | 901 | 11.1 |
| Whole market economy (c) | 65,594 | 3.5 |
| PRODUCTIVITY (m/employee) | | |
| ICT manufacturing | 9.3 | 6.1 |
| ICT communications | 29.5 | 13.0 |
| ICT computer services | 7.7 | -6.7 |
| Whole market economy (c) | 5.6 | 0.6 |
| GFCF (TANGIBLE) (% GVA) | | |
| ICT manufacturing | 8.7 | 31.7 |
| ICT communications | 25.1 | 3.0 |
| ICT computer services | 16.8 | 47.0 |
| Total market-economy corporations (d) | 23.4 | 8.8 |
| NOR/VA (%) | | |
| ICT manufacturing | 18.2 | 138.6 |
| ICT communications | 24.1 | 24.0 |
| ICT computer services | 1.3 | 29.9 |
| Total market-economy corporations (d) | 26.8 | 2.5 |
| MARKET VALUE (bn) (e) | | |
| ICT manufacturing | 718 | 51.4 |
| ICT communications | 22,009 | 93.7 |
| ICT computer services | 2,906 | 128.8 |
| Total market-economy corporations | 80,184 | 36.0 |

Sources: Instituto Nacional de Estadística and Central Balance Sheet Office Banco de España.

(a) The monetary variables are expressed in constant pesetas.

(b) Average of annual rates. Annual rates calculated with the common sample for each two consecutive years.

(c) Annual National Accounts data.

(d) Total of corporations analysed by the CBE.

(e) CBE estimate.

ratio stood at 60.6 %, almost three percentage points down on the previous year. The performance of the various sub-sectors differed however. The results for the State and Social Security Funds were better than expected, but were worse for the Territorial Governments. Against this background, it was also announced that the balanced budget would be brought forward to 2001, in line with the recommendations for Spain of the Broad Economic Policy Guidelines approved by the European Council in June. The submission to Parliament at the end of the year of the draft legislation on budgetary stability, which proposed amending certain budgetary procedures and extending the balanced budget commitment to all general government sub-sectors, considerably strengthened the extent of this commitment.

Employment policies in the year 2000 were designed, as in previous years, with the aim of promoting stable employment and raising employment rates among the groups with the highest unemployment levels (youths, women and the over-45s). In this connection, the employment-promoting permanent contract established in 1997 was retained, the unemployment contributions coupled to permanent contracts were cut slightly, and the allowances relating to the social security contributions applied to permanent contracts entered into with specific groups were extended, albeit with some changes from the previous year. This strategy has been confirmed following the adoption in March this year of Royal Decree-Law 5/2001 on urgent labour market reform measures. These extend the groups qualifying for employment-promotion permanent contracts and the allowances on social contributions, they marginally penalise temporary hiring through the introduction of firing costs and they institute measures promoting part-time work. Nonetheless, neither the measures undertaken last year nor those more recently approved have a bearing on other labour market aspects which will need revising in the future, in line with the suggestions of the Broad Economic Policy Guidelines: to improve collective bargaining arrangements, to enhance the co-ordination and effectiveness of active and passive employment policies and to review unemployment benefits.

Further steps were taken during the year 2000 in the strategy of liberalising and heightening competition in the markets for products. These were mainly structured around a broad set of measures

approved by the government in June (1), affecting different industries. The liberalising content of these measures was greater in respect of specific strategic sectors (electricity, gas, hydrocarbons and telephony), where the actions undertaken were designed to correct the distortions still shown by certain facets of their workings, despite the liberalising headway made in recent years. To this end, specific aspects of the Law on the Protection of Competition were amended. In particular, merger notification and authorisation procedures were regulated, limits to concentration in the production of electricity and the distribution of liquid hydrocarbons were introduced, and production activities and the provision of storage and transport activities were unbundled in the gas and hydrocarbons industries. In addition, procedures were adopted to make the setting of prices, rates and tolls more transparent, the timetable for the liberalisation of electricity and gas industries was brought forward to the year 2003, and effective competition is being increased in significant production segments, especially in fixed telephony, with the liberalisation of the local loop.

Measures were also introduced to promote the new technologies and the development of business activities for small and medium-sized enterprises. These were essentially channeled through tax incentives for investment in the Internet, personnel training in new technologies and R+D investment (Box IV.1 analyses the importance of these activities for the Spanish economy). Lastly, some of the obstacles to engaging in certain economic activities (road transport, land use, retailing hours, pharmaceutical products, books, notary and property registrar fees) were eliminated, bearing solely, in most cases, on partial aspects of the institutional arrangements regulating these activities.

IV.2. DEMAND

Various factors bore on consumer and corporate decisions in the Spanish economy during 2000. On one hand, the international setting (described in the preceding chapters), where the pick-up in the euro-area economy, the turnaround in the US economy towards the end of the year and higher oil prices were to the fore. On the other, domestic monetary and financial conditions and policies, dis-

(1) Fiscal and liberalisation measures approved by the government on 23rd June 2000.

cussed in the previous section, and the maturing of the economic upswing. All these factors shaped a pattern of behaviour characterised by high growth in both domestic and external demand, albeit with clearly differentiated profiles for both these variables (see Table I.1 and Chart IV.2). National demand slowed notably during the year, with the deceleration extending to all its components, especially investment in capital goods. Exports, however, benefited from the recovery in world trade in 1999 and 2000, and remained expansionary throughout the year. This helped sustain final demand growth at an average rate of over 5.5 % for the fourth year running.

Household final consumption spending continued to post high growth rates in real terms in the year 2000, although it tended to slow, mainly in the second half of the year. The increase in annual average terms was 4 %, compared with 4.7 % in 1999. The rise in consumption was supported by the growth of real household income (slightly down on that of 1999 owing to higher price rises in 2000) and by financial conditions which remained favourable to spending. Nonetheless, consumption was negatively affected as the year unfolded by the progressive disappearance of the effects of the rise in financial wealth. These effects were accompanied by significant volatility on the securities markets and turned negative in the second half of the year. The fact that the reduction in real income derived from higher prices was sharper in the final six months of the year may also have had a bearing on the consumption profile. These events, and the emerging uncertainty as to the international economic outlook, saw consumers' view of the general economic situation worsen from the outset of the year. That said, this deterioration took time to pass through to the confidence indicator, which remained firm until well into the summer, holding thereafter, too, at high levels.

In terms of the composition of consumption, the slowdown during 2000 was particularly severe in durable goods, reflecting the petering out of the consumption cycle for these goods (cars among them) and the impact of dearer energy on the associated user cost. Under non-durables consumption, spending on food fell back strongly, while the demand for services (particularly in respect of the strong growth in transport and the hotel and catering trade) remained substantially buoyant, slipping only in the final quarter.

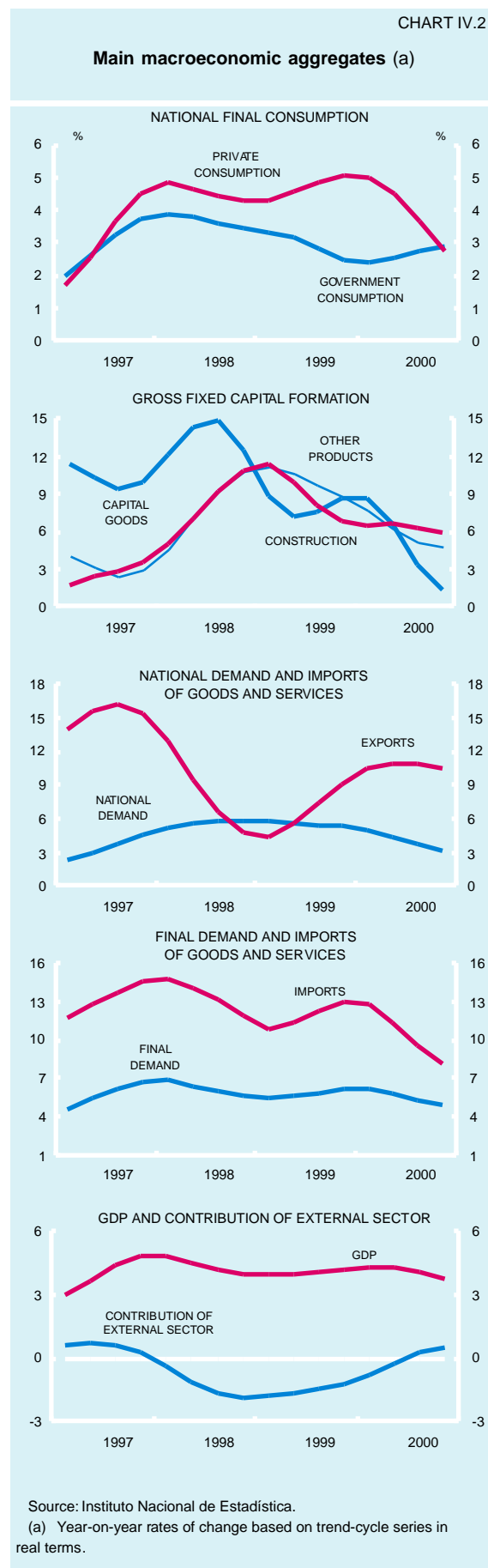
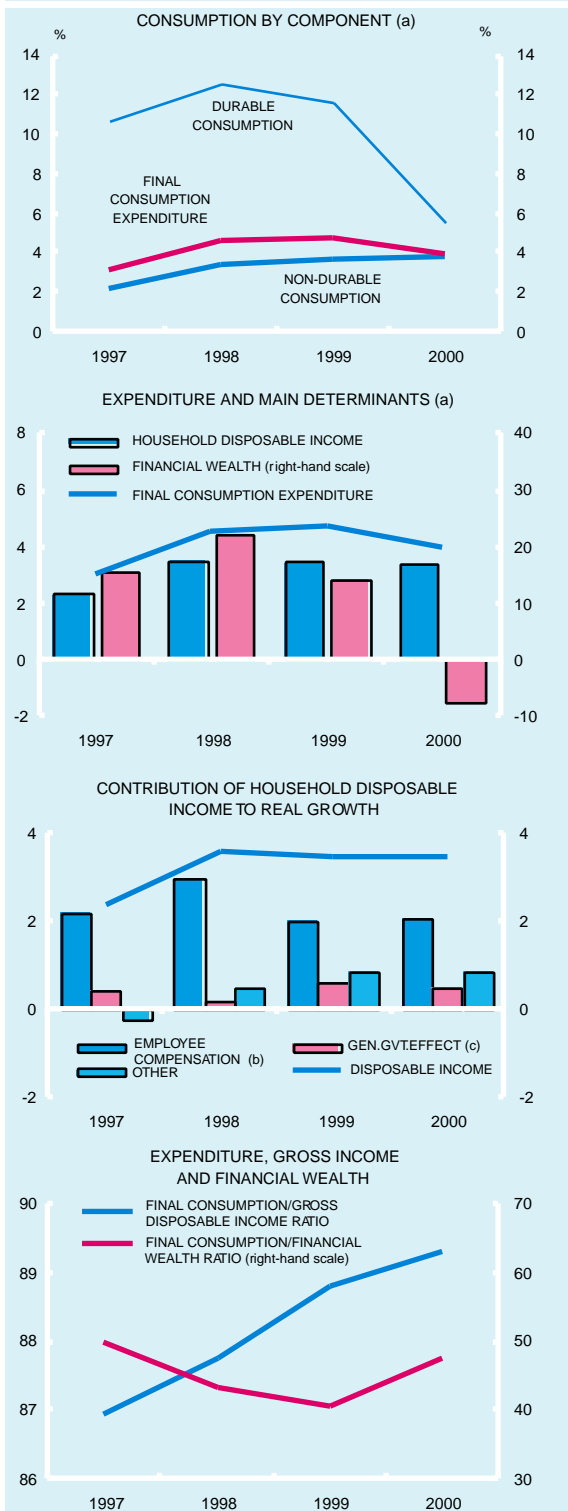


CHART IV.3

Household final consumption



Sources: Instituto Nacional de Estadística and Banco de España.
 (a) Real rates of change.
 (b) Employee compensation is net of social contributions.
 (c) Includes social benefits and taxes on income and wealth.

According to estimates, household disposable income in nominal terms grew at a higher rate than in previous years. However, the rise in the rate of inflation largely eroded purchasing power, which grew by only 3.4 % in real terms against 3.5 % in 1999 (see Chart V.3). Considering the contributions to real income growth, that of net general government transfers (benefits less direct taxes) was similar to the previous year, as a result of the disappearance of the expansionary effects of the 1999 tax reform and of the greater growth of social benefits. The contribution of employee compensation (net of social security contributions) was also similar to that of 1999 owing to the lesser vigour of dependent employment and to the greater growth of compensation per employee. The contribution of income relating to returns on saving (net interest flows and dividends) remained negative. But it did so to a lesser extent than in previous years owing to the pick-up in traditional financial assets (bank deposits) and to the increased return thereon. This partly countered the higher interest payments arising from dearer financing and from the strong expansion of lending.

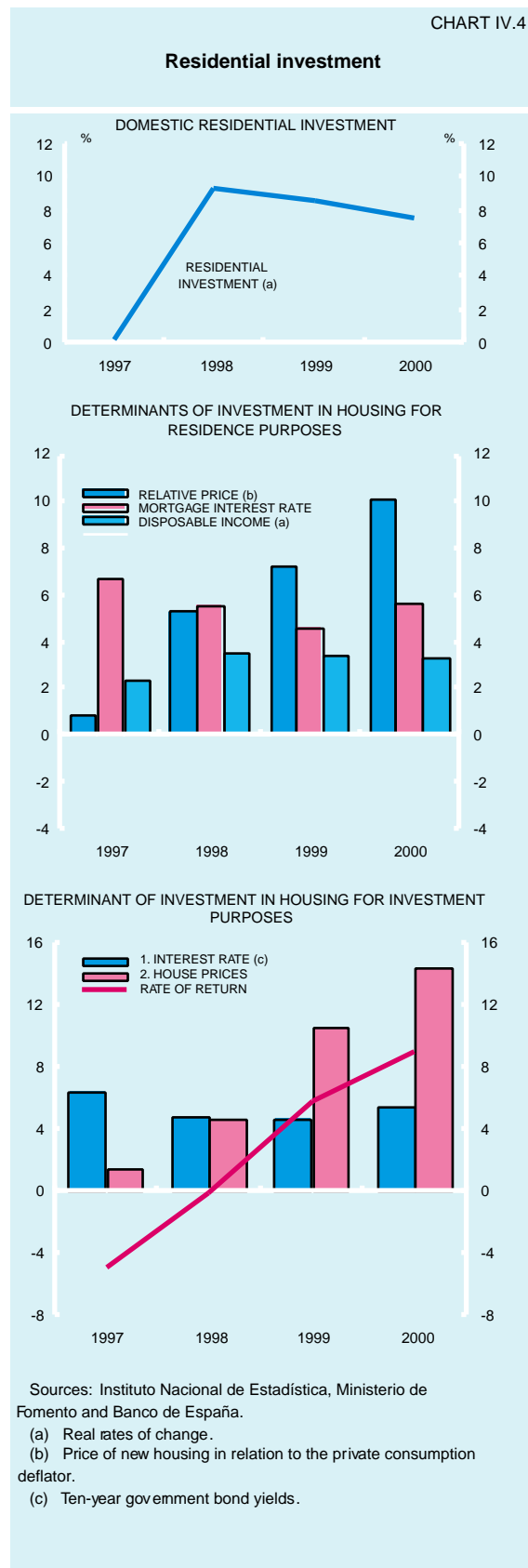
The growth rate of consumption outpaced that of real income in 2000, giving rise to a further reduction in the saving ratio to 11.4 %, down from 14.5 % in 1995. The related rise in the consumption/disposable income ratio is depicted in the lower panel of Chart IV.3. The decline in the household saving ratio reflects the expansionary influence exerted on spending by consumption determinants other than real income. Lower interest rates in the second half of the nineties translated into a significant decline in real interest rates, despite the notable reduction in the inflation rate during that period. That may have driven household demand towards levels in step with a more stable nominal and financial situation. As earlier mentioned, in the years prior to 2000 household financial asset values rose significantly, contributing considerably to the expansion of consumption in this period. Adding to these factors is the increase in real estate wealth, associated not only with the growth of investment in housing but also with the increase in property prices, which may have encouraged the propensity to consume in the past two years.

Despite the saving ratio having declined once again in annual average terms during 2000, many of the above-mentioned effects have diminished (or have even changed sign, a case in point being the turnaround in the consumption/net financial wealth

ratio, which is depicted in Chart IV.3). As a result, the declining course of the saving ratio has been significantly checked. Indeed, in the year 2001 to date, the information available points to real growth in consumption running at slightly lower rates than at the end of the previous year, and to lower real income growth. That should enable the household saving ratio to stabilise.

For the third year running domestic residential investment expanded notably, growing by 7.5 % after posting a figure of 8.6 % in 1999, although it exhibited a slightly slowing profile during the year. The buoyancy of recent years has come about against a clearly favourable background marked by the high growth rates of household real income and by financial conditions most conducive to investment. The reason is that interest rates, despite rising in 2000, remain at historically low levels (see Chart IV.4). The notable increase in movable wealth between 1995 and 1999 has no doubt given a further boost to house purchases, which have proven an attractive alternative asset in which to invest. Likewise, demographic factors have played a relevant role. The creation of new homes recovered in this period, expanding relatively strongly in 1999. In 2000, however, the pace of this expansion diminished. Nonetheless, the use of housing as a store of value and for obtaining potential capital gains (taking advantage of the scope for tax anonymity) has stepped up in recent years, as the robustness of the second-residence market and the stock of unoccupied dwellings testify.

The buoyancy of house purchases by Spanish households and the demand exerted by non-residents (which is still limited but liable to expand forcefully) have generated notable pressures on the property market. These have led to a substantial rise in house prices. In the year 2000, prices climbed 14.5 %, after having risen 10.6 % the previous year. And this despite the notable expansion in supply (on the information available, housing starts in 2000 may have even exceeded 1999 levels, when the related figure stood at 500,000). Nonetheless, determining the overall impact of the relative rise in house prices on the demand for housing is a complex task. First, such rises check the demand for housing for residential motives. And further, they generate revaluation expectations that encourage house purchases, especially given significant reductions in the return on alternative investments (see lower panel of Chart IV.4).



The leading indicators of residential investment – such as permits extended by municipal authorities and project approvals – point to the prolongation,

TABLE IV.1

Consumption and gross fixed capital formation by institutional sector (a)

| | % PIB | | Rate of change | | | | |
|--|-------|------|----------------|------|------|------|------|
| | 1995 | 2000 | 1996 | 1997 | 1998 | 1999 | 2000 |
| Households and NPISH | | | | | | | |
| Final consumption expenditure | 59.8 | 59.6 | 2.2 | 3.1 | 4.5 | 4.7 | 4.0 |
| Gross fixed capital formation (b) | 5.7 | 6.6 | 9.0 | 0.1 | 9.4 | 8.6 | 7.5 |
| Corporations | | | | | | | |
| Gross fixed capital formation (c) | 12.6 | 15.0 | 3.5 | 8.0 | 8.9 | 10.6 | 6.5 |
| <i>Construction and other products</i> | 6.7 | 7.2 | -3.0 | 4.8 | 5.0 | 12.1 | 7.8 |
| <i>Equipment and other products</i> | 5.9 | 7.8 | 10.8 | 11.2 | 12.6 | 9.4 | 5.4 |
| General government | | | | | | | |
| Final consumption expenditure | 18.1 | 17.1 | 1.3 | 2.9 | 3.7 | 2.9 | 2.6 |
| Gross fixed capital formation | 3.7 | 3.2 | -13.1 | 2.3 | 13.8 | 2.5 | 0.0 |
| <i>Of which:</i> | | | | | | | |
| <i>Construction and other products</i> | 2.5 | 1.9 | -19.5 | 2.9 | 14.5 | 0.8 | -2.0 |
| MEMORANDUM ITEM: | | | | | | | |
| Gross fixed capital formation | 22.0 | 24.8 | 2.1 | 5.0 | 9.7 | 8.9 | 5.9 |
| <i>Equipment</i> | 6.1 | 7.8 | 8.1 | 10.3 | 13.4 | 8.1 | 5.0 |
| <i>Construction</i> | 12.6 | 13.2 | -1.9 | 2.7 | 8.1 | 9.0 | 6.4 |
| <i>Other products</i> | 3.3 | 3.8 | 6.1 | 3.2 | 8.1 | 10.1 | 6.0 |

Sources: Instituto Nacional de Estadística and Banco de España.

(a) Data in real terms.

(b) Residential domestic investment.

(c) Private productive investment; includes investment by self-employed entrepreneurs.

in the opening months of the current year, of the slowdown apparent in the year 2000. These trends are consistent with the lesser incidence of demographic factors and with the high levels of house prices, which should affect demand for residential motives. In 2000 Q4, prices grew less than in the preceding quarters, testifying to the lesser pressure of demand.

Corporate gross fixed capital formation is estimated to have slowed substantially in 2000, growing by 6.6 % compared with 10.6 % the previous year (see Table IV.1). This affected both construction spending and investment in equipment. That said, the slowdown in this latter component, which extended the declining trajectory initiated in 1999, was more acute and it ended the year 2000 growing at very low rates. The gradual loss of momentum of investment over the course of 2000 partly reflects the influence of developments in the economy's external setting and its foreseeable influence on corporate expectations. Nonetheless, the scale of this slowdown contrasts with the relatively favourable background shaped by the main investment deter-

minants last year; moreover, the growth rate of capital investment in the current upswing can be seen to be significantly less than that observed in the second half of the eighties.

Chart IV.5 plots the course of some of the main determinants of productive investment. As remarked at the start of the section, final demand remained notably buoyant in 2000 despite its slowing profile. Sales abroad were particularly robust. Such demand pressure translated into a slight increase in capacity utilisation. Indeed, according to the Spanish Ministry of Science and Technology's half-yearly investment survey, demand in 2000 was once again the factor with the most positive influence on investment decisions in industry, with capital increases the essential end of these investments. Financing conditions remained very favourable, despite the moderate rise in interest rates, and corporate profitability in the non-financial sector (according to data from the quarterly Central Balance Sheet Office survey) increased considerably in 2000 from the already high levels of the previous year. This greater profitability gave rise to a fresh increase in the

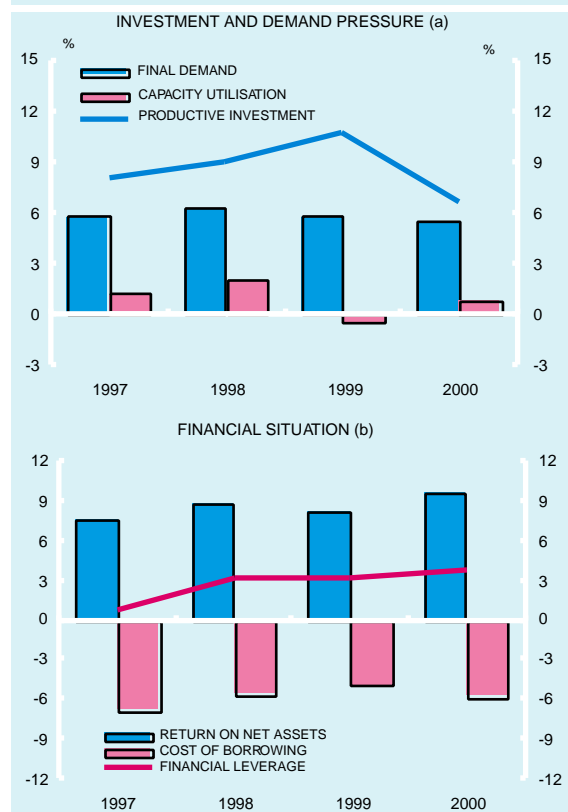
leverage ratio, which is standing at historical highs despite the rise in financial charges derived from dearer credit and from greater resort to borrowed funds.

In connection with the estimated low growth for capital investment in 2000, the existence of measurement problems arising from the calculation of the deflator cannot be ruled out. Such calculations combine information from sources that use different methodologies, such as the producer price indices and the foreign trade unit value indices. The strong increase in the latter, partly as a result of the euro exchange rate, might in turn have checked certain investment projects. Nonetheless, there is no conclusive evidence that these types of problems (or others such as those analysed in Box I.2) have particularly affected last year's data. Moreover, there are further factors which might help explain, at least in part, such sluggish investment. Mention has already been made of the possible deterioration in demand expectations associated with the uncertainty as to the scope and duration of dearer oil prices and the impact of the US slowdown. The strong expansion of foreign direct investment, which has been on a most substantial scale over the past two years, might also have withdrawn resources from investment in the domestic market. This behaviour would have been concentrated in large corporations in sectors linked to the network industries which, owing to their size, dominate the economy's total investment figures. In contrast, on the as yet very partial information available, capital investment might have grown at higher rates than the previous year in other domestic industries (cars, IT, furniture).

To conclude, the excellent financial position of the corporate sector provides a sound basis for achieving more vigorous private productive investment, if a context of favourable production expectations is resumed and profit generation is sustained. The recovery in investment is particularly necessary for maintaining a positive growth differential with the EU countries and for furthering real convergence with the area. The data available for the opening months of the year 2001 do not yet show a recovery in investment in capital goods, which is holding at a similar level to the end of last year.

In the year 2000, the contribution of the change in stockbuilding to GDP growth was negative of the order of one-tenth of a point. Nonetheless, in quar-

CHART IV.5
Private productive investment



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

(a) Real rates of change and differences for the degree of plant capacity utilisation.

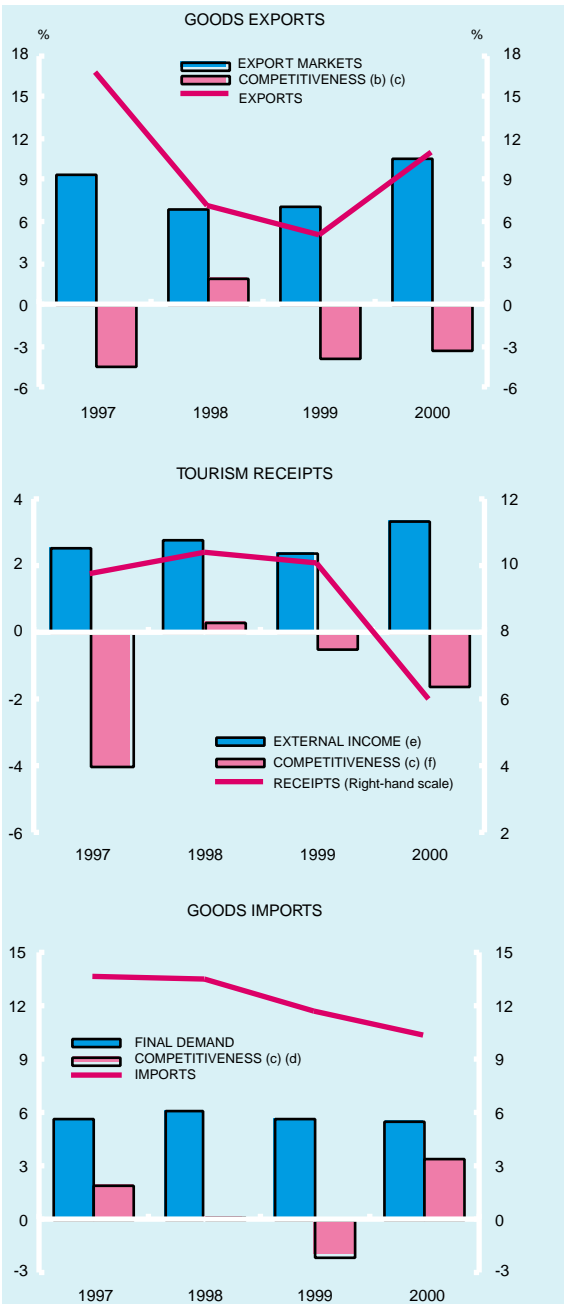
(b) Data obtained from the CBA annual survey until 1999 and from the CBQ quarterly survey for 2000.

ter-on-quarter terms, a negative contribution was only apparent in Q1, the contribution standing at zero in Q2 and rising to positive values in the second half of the year. Given the upward trend of the proportion of businesses reporting higher-than-desired stock levels, the involuntary component of stocks no doubt increased last year; in addition, the replenishment of stocks of oil products also contributed positively to the trend of this aggregate.

Final general government demand held on a moderate course last year, similar to that observed in previous years. In real terms, the growth of final consumption was 2.6 % compared with 2.9 % in 1999. In nominal terms, however, the rate of change was 6 % on QNA estimates. Under consumption, total compensation of general government employees grew by 5.9 % in nominal terms, a

CHART IV.6

External demand (a)



Sources: IMF, OECD, Instituto Nacional de Estadística and Banco de España.

- (a) Real rates of change.
 (b) Measured by relative export prices.
 (c) Negative values denote a gain in competitiveness, positive values a loss.
 (d) Prices of Spanish non-energy imports in relation to the non-energy producer price index.
 (e) Average of GDP of countries of origin of tourists to Spain, weighted according to the relative significance of the number of visitors.
 (f) Index of competitiveness vis-à-vis developed countries, measured with consumer prices.

rise attributable in the main to the increase in compensation per employee.

Public investment is estimated to have run at a rate of virtually zero in real terms in the year 2000. This decline in the rate largely reflects the falls in public works in the first half of the year, while in the final months this expenditure component appears to have resumed a growth path. The course followed gives something of a counter-cyclical profile to public investment in construction in the recent period. However, a significant portion of infrastructure investment, channelled through management entities, is recorded as private-sector construction investment, which probably accounts for the fact that this private productive investment component has run at a more sustained growth rate than capital investment.

Overall, household, corporate and general government consumption and investment spending gave rise to high growth in national demand in the year 2000, albeit on a markedly slowing profile which has eased appreciably in the opening months of the current year. The related growth rate averaged 4.1 % in the year 2000, almost 1.5 percentage points down on the 1999 figure (see Chart IV.2). Against this, merchandise exports were notably robust, especially in the first half of the year which saw the extension of the upward trend of the second half of 1999. The growth of exports of goods and services averaged 10.8 %, about four percentage points up on the previous year. The pick-up came about as a result of the performance of exports of goods and other services, since tourism results, as will later be seen, were down on 1999.

The strong increase in world trade and the gains in competitiveness arising from the depreciation of the euro (relative export prices in national currency nonetheless increased against the developed countries by 1.2 %) led to a 11 % rise in goods exports (see Chart IV.6). They sustained their buoyancy throughout the year, although there was a slight slowdown in Q4 in tune with the lesser momentum of global activity, which does not appear to have stepped up in the opening months of the current year. Despite this favourable performance, Spanish exports in 2000 expanded less than had been expected in the light of the past pattern of response of exports to world growth. The fact that the international economic recovery was led by the United States and Asia, regions which account for a

small proportion of Spanish sales, only partly explains this.

The expansion of exports in the year 2000 was both inside and outside the European Union, more intensely so in non-Community regions. Sales to the euro area, which account for almost 60 % of the total, rose 15.6 % in nominal terms against 6.3 % in 1999, propelled by the economic recovery in these countries. Nonetheless, real growth was somewhat lower than the expansion recorded by the area's markets. There was a notable increase in sales to France (18.4 %), Germany (11.5 %) and Italy (15.1 %), which had exhibited great slackness the previous year. Exports to the rest of the world were most robust throughout the year 2000, growing by 26.3 % in nominal terms, compared with 2.9 % the previous year. Of note here was the rise in sales to central and eastern European countries, to the United States and to the newly industrialised south-east Asian countries, while exports to Japan decelerated. In these markets, where the depreciation of the euro provided price competitiveness gains for Spanish products, there was indeed an improvement in export shares.

After expanding strongly for several years, tourism receipts increased more moderately in the year 2000, by 6 % in real terms. This was in contrast to the growth of worldwide tourism activity (7.4 %). Consequently, despite being supported by the depreciation of the euro, the Spanish share in international tourism flows fell (see Chart IV.6). Among the potential factors behind this result are, among others, the strong growth of tourist service and hotel prices in Spain, which has no doubt prompted visitors (especially those from the euro area, who do not see these rises offset by movements in the exchange rate) to switch to other Mediterranean countries that compete with Spain for worldwide tourism and which have progressively overcome the political instability that detracted from their attractiveness in the past.

As a result of high export growth, final demand was once more most vigorous in 2000. It grew by 5.6 %, a very similar rate to that posted in 1999 (5.8 %), although its profile over the course of the year was impacted by the slowdown in domestic spending (see, once again, Chart IV.2). Underpinned by the growth in final demand, both domestic output and imports also posted high growth rates (4.1 % and 10.4 %, respectively). Imports of

goods and services continued to rise as a proportion of final demand, albeit to a lesser extent than in previous years; the strong increase in non-energy import prices, set against domestic prices, no doubt contributed to this lesser import penetration. The joint performance of exports and imports gave rise to a substantial improvement in the contribution of external demand to GDP growth, from -1.5 percentage points in 1999 to -0.1 points in 2000, moving into positive figures at the end of the year. This pattern has continued into 2001 Q1, despite the fact that imports have regained some buoyancy.

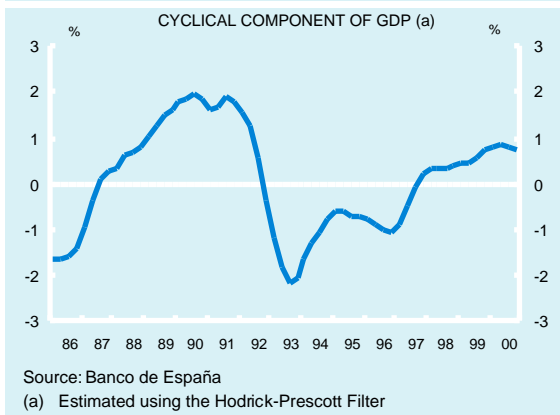
Merchandise imports were most robust last year, although their growth was down on 1999 (10.4 % against 11.7 %). They moved on a slowing trend in step with final demand developments and with the loss of momentum of industrial activity. The rising course of import prices, in particular of non-energy goods, far outpaced the related increase in equivalent domestic goods, and this also helped contract the demand for imports. Noteworthy in this respect was the slowdown in capital goods imports in real terms, markedly so in Q4. Conversely, the real rate of increase of energy imports increased – despite forceful oil price rises – owing to the replenishment of refinery stocks, which had been heavily depleted in the initial stages of the hike in energy prices in 1999. Lastly, tourism expenditure grew by 8.4 % in real terms compared with 14.3 % the previous year. The slowdown in consumer spending, accentuated by the depreciation of the euro, had a negative bearing on tourist outflows, especially to outside the euro area, although non-euro-area destinations account for a very small percentage of the total.

IV.3. ACTIVITY

Final demand growth in the year 2000 rose to 5.6 %, as mentioned above, and provided an appropriate setting for the expansion of domestic output. Gross domestic product grew by 4.1 %, one-tenth of a point up on 1999. And although it continued to diminish as a proportion of final demand, it did so at a lesser rate than in the past. In year-on-year terms the GDP rate was high for most of the year. It slipped back only in the final quarter when the slowdown already apparent in domestic expenditure combined with the loss of momentum of exports, against a more adverse international background,

CHART IV.7

Economic cycle

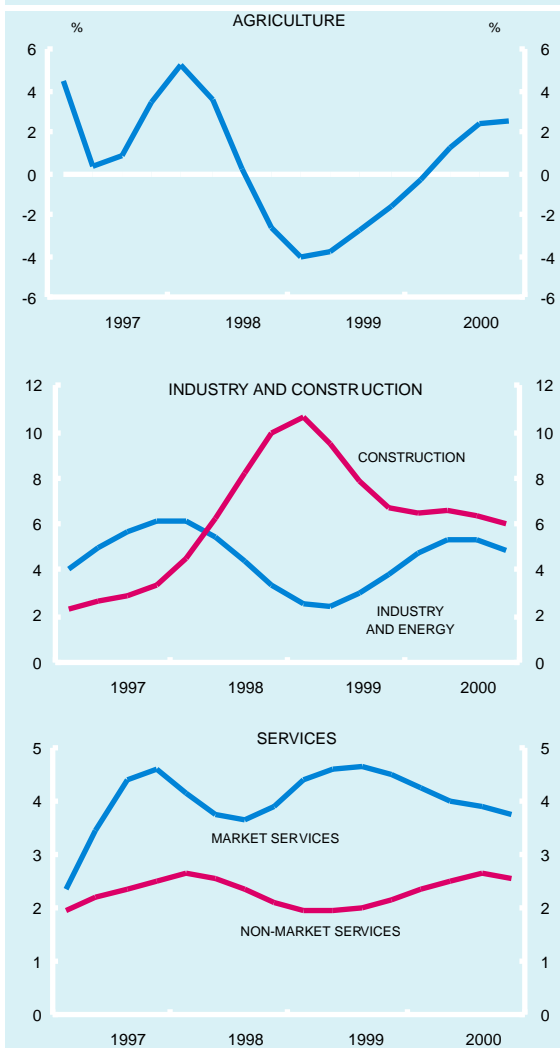


checking the rate of improvement of net external demand (see Chart IV.2).

From a somewhat broader perspective, the buoyancy of domestic output in the year 2000 has meant the prolongation of the expansionary cycle on which the Spanish economy embarked following the 1992-93 crisis, and which peaked in late 1997 and early 1998. GDP has since been running at annual rates of close to 4 %, above its medium-term trend growth. These rates have only eased slightly since the final months of 2000 when, on provisional QNA estimates, GDP grew by 3.8 %, posting 3.5 % in 2001 Q1 according to Banco de España estimates. Comparing the GDP levels reached in this expansionary phase with those that would have been recorded had the trend growth rate been maintained, the resulting, so-called output gap was positive from 1998 onwards and widened slightly up to the first half of the year 2000 (see Chart IV.7). Nonetheless, at end-2000 the gap began to close, and the available estimates appear to point to a further closing in the first half of 2001, thus culminating an upturn marked by less intensity than that witnessed in the second half of the eighties. The narrowing of the output gap would denote an easing of the significant pressures exerted in the course of 2000 on prices (and on the external imbalance) by high demand growth. Nonetheless, this episode, compared with other similar ones, has proven more balanced, which has translated into notably greater macroeconomic stability.

CHART IV.8

GVA by branch of activity



From the standpoint of the various productive branches, the slight increase in the average growth rate of GDP in 2000 was attributable to the sound performance of the agricultural and industrial branches, since both construction (which remains, nevertheless, the most buoyant activity) and services saw their rates of advance cut (see Chart IV.8). Activity in the primary branches was favoured by better weather and, in particular, by greater rainfall in most of Spain, which enabled the recession besetting this productive activity the previous year to be overcome. The expansion in agricultural output countered the loss of momentum in livestock output as the year unfolded, which was exacerbated at the end of the year and in the opening months of 2001 by the health and hygiene-related problems affecting certain species.

Industry and energy were notably vigorous in the year 2000, with growth rising to a rate of 5.1 %,

up on the 1999 figure (3 %). This expansion was more intense in the energy branches, particularly affecting electricity and gas production by raising the domestic consumption of these productive inputs. Manufacturing, for its part, continued on the expansionary course it began in 1999, driven by the resilience of domestic expenditure and the robustness of exports. Nonetheless, the second half of the year saw this recovering profile begin to turn down as a result of the slowdown in domestic demand and the less favourable export performance. The pick-up in manufacturing for the year as a whole was underpinned especially by the higher-technology industries, with the manufacture of machinery and of electrical and electronic equipment to the fore. Car assembly also grew at a high rate, despite the weakness of domestic demand for these products, since over 80 % of national car production is for the export market. Lastly, the more traditional labour-intensive industries (textiles, clothing and footwear) remained depressed.

Construction remained the most dynamic branch in the year 2000 as a whole, although its growth rate, at 6.3 %, was lower than in 1999 (8.7 %). The slowdown in residential construction during the year took place against a background of lower growth in the demand for housing and strong house price rises (fuelled by the shortage of land for building in the major cities and by construction-material and labour cost pressures). In conjunction with the sluggishness of civil engineering works during the first half of the year, this translated into a gradual weakening of this activity. However, the pick-up in civil engineering works in the second half of 2000 cushioned the loss of momentum in construction. And this may continue to be the case into 2001 in the light of the existing plans to extend railway and hydrological infrastructure.

Finally, output in the tertiary branches decelerated slightly in 2000 (from 4 % to 3.6 %), as the pick-up in non-market services did not offset the lower growth of market services. Among the latter, the distributive trade and repair activities were constrained by the loss of steam in domestic consumption, while the hotel and catering trade was impacted by fewer foreign tourist arrivals. Conversely, the pace of transport and communications services and, to a lesser extent, real estate and corporate services, stepped up in 2000. Most buoyant among corporate services were those relating to IT and R+D.

IV.4. THE LABOUR MARKET

Job creation continued apace in 2000, in step with the expansionary behaviour of activity. On QNA estimates, employment (2) grew by 3.3 %, moving on a slowing profile in the second half of the year consistent with that of GDP and with something of a recovery in apparent labour productivity. In annual average terms, apparent productivity increased by 0.8 %, four-tenths of a point up on 1999, drawing close to the average growth of the past decade. Both the rate of participation and that of employment posted substantial increases, and the unemployment rate fell once more. Nonetheless, wages, which had trended very moderately in recent years, showed a tendency to accelerate in 2000 which, should it continue, would hamper employment growth in the future. The lesser buoyancy of employment in the second half of the year might be beginning to reflect the acceleration in real labour costs observed last year, as well as the slowdown in activity.

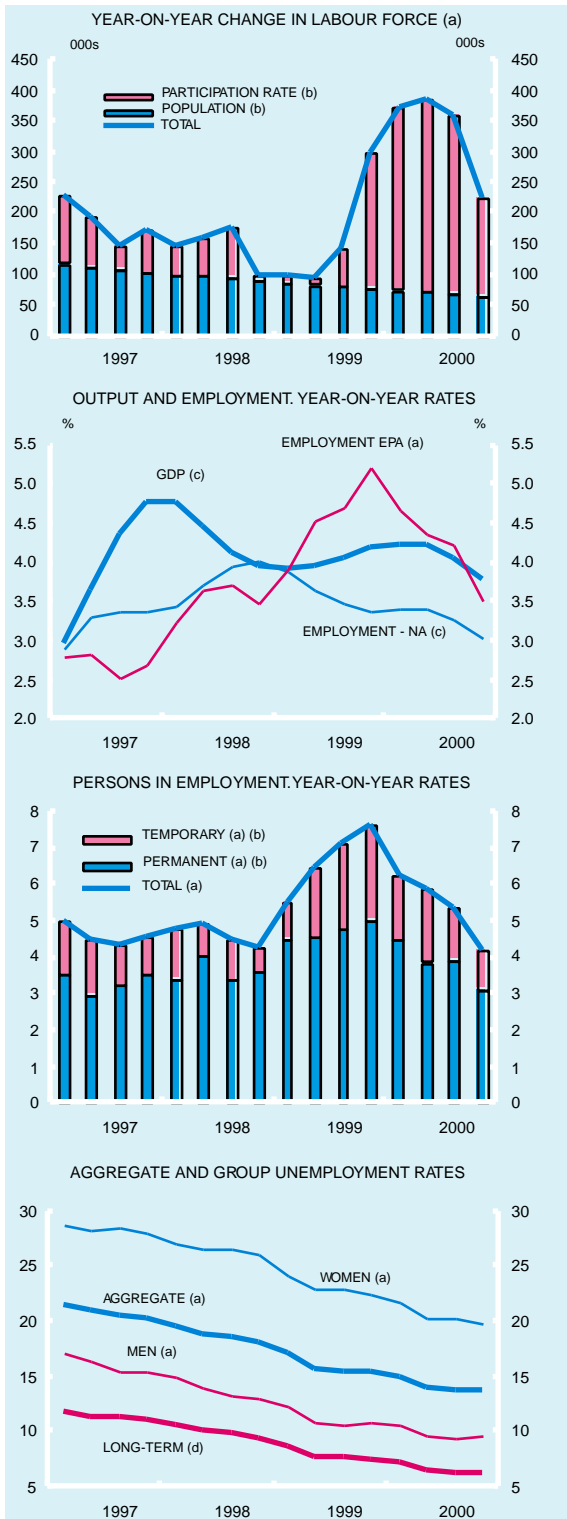
Owing to methodological and coverage issues, the growth in employment estimated by the Spanish labour force survey (EPA) does not, as is known, usually coincide with that of the QNA. These differences have become more marked in recent years (in the year 2000, the growth in numbers employed according to the EPA was 4.2 % (3), compared with 3.3 % according to QNA). But both indicators provide a similar slowing profile (see Chart IV.9). According to the EPA, all net jobs created last year were in dependent employment, giving rise to growth of 5.6 % in this item, since the numbers of self-employed fell by 1.1 % (in QNA terms, the related rates were 4 % and 0 %). The numbers of both wage-earners with a permanent contract and those with a temporary contract were less buoyant, with the latter losing most momentum. The related rates of change were 6.6 % for permanent employees and 3.7 % for temporary workers. The growth differential between both groups duly widened and the proportion of temporary to total employees dipped to 32 %, down 0.6 percentage points. The approval in

(2) Measured by the number of equivalent jobs.

(3) In the year 2000, the EPA was subject to a sample updating process so as to reflect more reliably the current population structure. This has provided for a more accurate measurement of the variables under investigation, but it has also distorted comparison with the preceding years. Therefore, in 2000 Q1, INE estimated the impact of this sample renewal. The rates of change analysed in this section are the results of the adjustment.

CHART IV.9

Labour market: participation, employment and unemployment



Source: Instituto Nacional de Estadística (QNA and EPA).
 (a) EPA (Labour Force Survey). Homogeneous sample in the year 2000.
 (b) Contribution.
 (c) QNA. Trend-cycle. Full-time equivalent jobs.
 (d) EPA. Over one year unemployed. Official series.

March this year of new legislation to promote stable employment, giving a permanent stamp to the related law introduced in 1997 and extending its coverage to new groups, should lead to fresh reductions in the proportion of temporary employment. The 1997 measures (amended or extended annually in subsequent years' budgets) have been relatively successful. Indeed, according to the figures for contracts registered with INEM (the Spanish Employment Office), the employment-promoting permanent contract came to account for 6 % of all contracts in 1999, but this percentage had fallen to 4.7 % in the year 2000, when the allowances for the conversion of certain types of temporary contracts into permanent ones were eliminated. Moreover, the employment-promoting contract has provided the cohorts most exposed to unstable employment (youths and women) with readier access to more stable conditions, encouraging their participation in the labour market, and it has also enabled the more mature groups to take up employment again.

In respect of types of working day, the slowdown in employment affected both full- and part-time employees. Although there was a more marked deceleration in the part-time segment, its growth (4.8 %) remained higher than the full-time segment (4.1 %). However, as a proportion of the total, part-time employment remained at 8.1 %. Occasionally, the low presence of part-time employment has been attributed to the rigidities introduced by the legislation approved in late 1998. In this respect, the reform measures of March 2001 have corrected most of these rigidities, whereby part-time hiring may be expected to grow more strongly in the future.

In the year 2000 as a whole, employment increased in all branches of activity except in agriculture, where the reduction in jobs was, nonetheless, less intense than in 1999. On QNA data, job creation was particularly high in construction, where it grew by 7.5 %, and in market services (4.8 %), the sole activity where employment quickened compared with 1999. The pick-up in industrial activity in the first half of 2000 fed through with something of a lag to employment, which grew less than the previous year (2.9 %, including energy). Lastly, in non-market services, job creation remained on the moderate trend begun in 1997, and employment grew by 0.3 %.

Turning to labour supply and resorting once more to the EPA figures, the labour force grew by

Aspects of collective bargaining in Spain

A significant characteristic of collective bargaining arrangements in Spain is their wide – virtually total – coverage of wage-earners. Although trade union membership is very low, binding statutory extensions ensure that wage agreements of a specific territorial scope (national or provincial level, for instance) are extensive to non-unionised companies across the whole territory. In this way, small firms with no trade union representativeness must avail themselves of an agreement reached at a broader level than corresponds to them. Generally, such agreements will rarely be attuned to their particularities. Statutory extensions, together with the high degree of centralisation of trade unions, mean that the aim of maintaining or increasing the purchasing power of wages is most prominent, and they lead to the negotiation of wage increases that are very uniform across branches of activity and closely tied to overall price indices (a link that is reinforced by the existence of inflation-adjustment clauses). Centralisation of wage increases closely related to the CPI has been reinforced by the scant use made of opt-out clauses. These were introduced in 1994 to allow ailing firms to opt out of the wage regime resulting from collective bargaining agreements. In fact, collective bargaining has been governed by a pattern of conduct that restricts the legal possibilities of opting out. As can be seen in the accompanying chart, this translates into a very low dispersion of wage growth across productive sectors, notably lower than that of labour productivity gains.

The scant differentiation of agreed wage rises combines with the difficulties of individualising wage levels through variable supplements. The solidification via collective bargaining of rigid wage structures inherited from the seventies has meant that the starting levels for wages are, generally, high (clearly higher than the minimum wage), even for the less-skilled categories, and that it is very difficult to change these structures without encroaching on workers' vested interests. In these circumstances, the scope for wages to be tailored to companies' and workers' specific conditions, beyond what is established in the collective agreement, is very limited. This is unlike the case in other countries, where the variable component of wages is much more significant. The scant room for wage differentiation gives rise to considerable distortions affecting the efficient functioning of companies.

The rigidity of wage structures and the limited weight of variable components are factors that help explain too the lack of cyclical sensitivity of wages in Spain. Wage drift (calculated as the difference between the actual increase in wages and that agreed under collective bargaining) is dominated by payments relating to years-of-service bonuses (which were obligatory until 1994), by promotions and, above all, since provisions were made for temporary hiring in 1984, by changes in the composition of employment. The accompanying chart shows that, since the mid-eighties, wage drift has tended to diminish, due partly to the progressive loss of weight of years-of-service bonus payments. But, moreover, it has also behaved counter-cyclically, essentially as a result of new workers joining the labour market, mostly with temporary contracts and with relatively low wages, during economic upturns. In contrast, in other countries where variable wage supplements are of greater importance, they tend to increase during expansions and to fall in recessions, giving a pro-cyclical character to wage drift and to wage increases.

The limited room for manoeuvre companies have to adjust wage levels to employee productivity and to synchronise wage increases with the buoyancy of the demand for their products generates market distortions at microeconomic level, as discussed. But it also means that aggregate wages adjust with a great delay to the economy's cyclical phase; employment is then, perforce, first to be adjusted and the absorption of unemployment is permanently hampered.

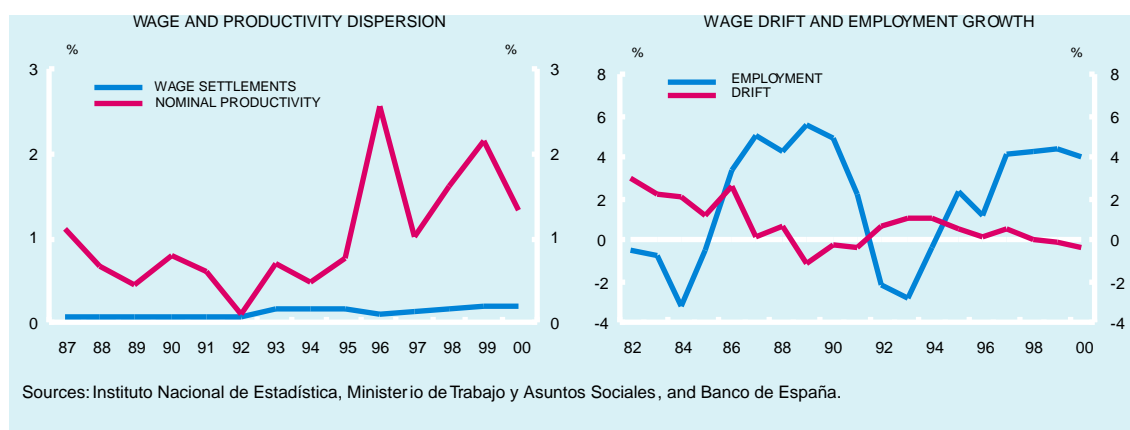
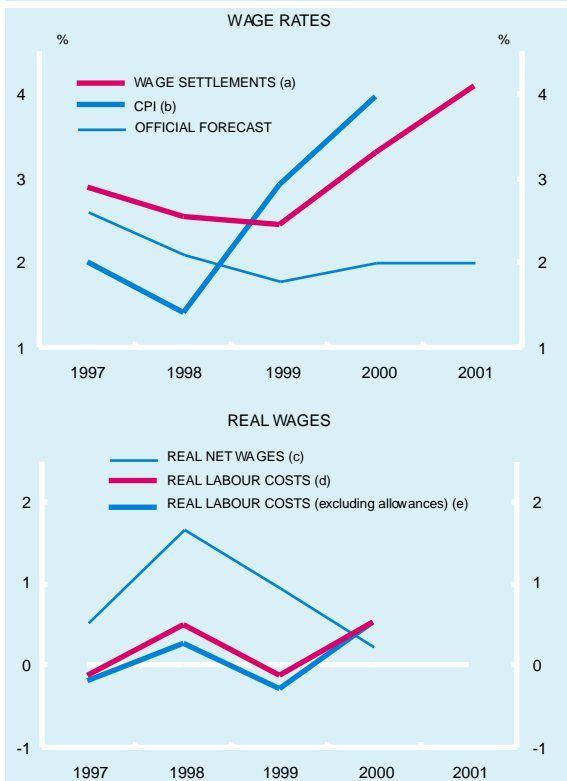


CHART IV.10

Wage determinants



Sources: Instituto Nacional de Estadística, Ministerio de Trabajo y Asuntos Sociales, and Banco de España.

(a) Including prior-year inflation-adjustment clause. The figure for 2001 is on information to March.

(b) Year-on-year rate as at December.

(c) Gross wages discounting employee contributions and direct taxes, deflated by the consumption deflator.

(d) Compensation per employee deflated by the GDP deflator.

(e) Real labour costs discounting employment-promoting allowances.

2 % during 2000, doubling the rate recorded for the past three years. As can be seen in the top panel of Chart IV.9, the greater momentum of labour supply was provided by the participation rate, since the increase in the working age population was less than in previous years. Specifically, the participation rate among 16-64 year-olds climbed to 65 %, more than one percentage point up on 1999. This much sharper than usual increase enabled the gap still separating the Spanish participation rate from the EU average to be narrowed substantially. The largest increase in this rate was among women (particularly in the intermediate age groups), although at 51.8 % it is still almost 27 percentage points lower than the rate for men. The biggest increase among the male population was for the youngest cohort. The gener-

alised rise in the participation rate in 2000 suggests a favourable impact of the Spanish economy's cyclical position on labour supply (since the likelihood of finding employment is greater). In addition, the fact that the groups trending most favourably in this respect are those on which the latest labour market reforms have been mainly targeted (youths, the over-45s and women) also shows that the non-cyclical component of this change is significant.

The strong growth in employment described above enabled new labour market entrants to be absorbed without difficulty. As a result, unemployment fell again (down 9.3 %) albeit at a lesser rate than in 1999 (-14.9 %). The unemployment rate declined by almost two percentage points to 14.1 % (13.6 % in Q4). Moreover, the reduction was sharper among the groups most affected by unemployment, although the female unemployment rate (20.5 %) is notably still more than double the related male rate (9.7 %), and that of the jobless aged 16-24 accounts significantly for 26.1 % of employable youths. In any event, the Spanish unemployment rate is still six points above the EU average. Another notable feature of the ongoing reduction in unemployment is its effect on those who have been longest outside the job market, especially youths. Consequently, in 2000 as a whole, long-term unemployment was 46.1 % of total unemployment, almost four percentage points less than in 1999. For the first time since 1986, this percentage was less than the EU average. The considerable reduction in the unemployment rate in recent years, and the particular intensity with which this has been manifest in certain groups, can only be explained by a comparable reduction in the more permanent component of unemployment, to which the successive labour market reforms enacted in Spain have contributed.

Despite the increase in the supply of labour and the strong structural component to which the reduction in unemployment is attributable, signs emerged during the year 2000 of pressures and bottlenecks in some labour market segments (in certain provinces, professions and industries). The feed-through of such pressures to wages was still limited, although the impact may be more significant in 2001.

Wage developments in recent years have been against the backdrop of a slowing inflation rate, changes in the taxation of salaried income, lower social contributions for certain groups and higher

subsidies aimed at bolstering employment growth. Until 1999, wage deceleration ran parallel to slowing consumer prices (see the top panel of Chart IV.10), with modest increases in compensation per employee in real terms (lower panel of the chart). Actually, the increase in real wages received by workers during these years, in net terms, was of a greater amount, mainly as a result of improvements in the taxation of income from work associated with personal income tax reform (a substantial portion of the so-called tax wedge). In turn, the favourable effect of labour costs on employment was accentuated by the subsidies received to promote the hiring of specific groups, as can be seen in the course of wage costs in real terms once employment allowances are deducted (lower panel of the aforementioned chart). The absorption of the effects of these naturally temporary tax factors on wage growth rates and the enactment of inflation-adjustment safeguard clauses (as a result of the growth rate of prices from 1999 outpacing that of official forecasts) have curtailed this process, there having been a surge in the growth rate of the real labour costs faced by firms last year. The data available on collective bargaining this year point to the continuity of this tendency.

In fact, wage settlements pursuant to collective bargaining agreements during the year 2000 stood at 3 %, with this rate rising to 3.3 % on inclusion of the impact of the safeguard clauses in 1999, in which year actual inflation was almost one percentage point above the official forecast. In terms of compensation per employee (a measure of the labour costs borne by companies which, as has been seen, is more appropriate than wage rates, since it includes all types of contributions and wage drift), the increase was greater: 3.5 % in the market economy and 4 % in the economy as a whole, the result of the substantial wage drift estimated in the general government sector. The data on the results of wage bargaining to March 2001 are equally worrying, since the average agreed wage increase (3.5 %) rises to 4.1 % if the impact of the inflation-adjustment clauses for the year 2000 is taken into account. This figure is the outcome of the end-year inflation rate outpacing the official forecast taken as a reference for collective bargaining by two percentage points (Box IV.2 analyses specific collective bargaining aspects).

The enactment of the safeguard clauses as a result of the surge in consumer prices (largely the

outcome of temporary factors) has thus entailed a departure from the pattern of wage restraint marking developments in the Spanish economy in recent years. This may not only hamper and delay the slowdown in the inflation rate forecast for this year, but may also jeopardise employment growth and the correction of the unemployment rate and slow the Spanish economy's real convergence with the core EU countries.

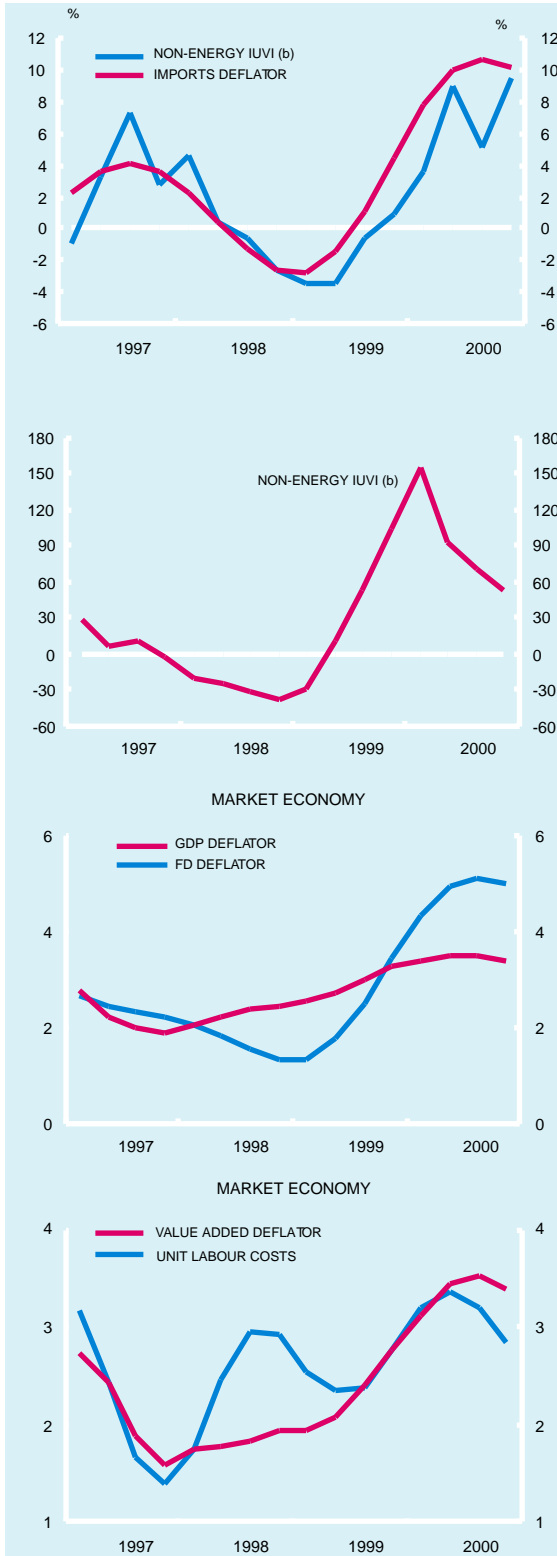
IV.5. COSTS AND PRICES

The main indicators of prices in the Spanish economy exhibited higher average growth rates in the year 2000 than in previous years. The CPI increased by 3.4 % in annual average terms, compared with 2.3 % a year earlier, and the harmonised index of consumer prices (HICP) climbed by a slightly higher amount. The rise in the consumer-price inflation rate in 2000 was largely due to exogenous and temporary factors, including most notably higher oil (and other commodity) prices on international markets and the depreciation of the euro against the dollar. In any event, the various measures of core inflation indicated a rising trend throughout the year. Among the more stable components of the CPI, services prices posted a notable average growth rate (3.8 %), and its upward profile was particularly salient, taking its 12-month growth rate to 4.4 % in December. Lower inflation rates are expected gradually to be resumed during 2001, against a more favourable macroeconomic background and once some of the temporary factors bearing on the year 2000 have been overcome. Nonetheless, the emergence of fresh, unexpected factors (such as those arising from the food crisis), the pass-through to prices of a portion of the past increases in costs and the inertia beginning to be discernible in wage formation might make this process slower than envisaged.

The growth of the final demand deflator in the year 2000 averaged 4.8 %, 2.5 percentage points up on the previous year. The momentum gained by export prices was notable, increasing by 6.4 % compared with 0.3 % a year earlier. From another perspective, the acceleration of the final demand deflator reflects the upward trajectory of the imports deflator, adding to which – much more moderately – are domestic prices, proxied by the GDP deflator (see the top panel of Chart IV.11).

CHART IV.11

Composition of the final demand and GDP deflators (a)



Sources: Instituto Nacional de Estadística and Banco de España.
 (a) Year-on-year rates of change.
 (b) Merchandise imports unit value index.

The imports deflator accelerated more sharply in the opening quarters of the year 2000, running thereafter at year-on-year rates of slightly over 10 %. Behind this notable thrust is not only the behaviour of the energy component but also that of prices of other imported goods and services. The upward course of oil on international markets (North Sea Brent was trading at \$30.1 per barrel on average in 2000 Q4, more than \$6 up on the same period a year earlier) and the depreciation of the euro on the currency markets (13.4 % on average during the year) propelled the unit value index for energy products upwards. This index increased by 84 % for the year on average, considerably up on the related rate the previous year (29.6 %). The non-energy imports deflator also accelerated, though less sharply. This result would be in keeping with the pass-through to import prices of the depreciation of the euro and with the more expansionary course of our main trading partners' export prices in their respective currencies.

Domestic prices, proxied by the GDP deflator, averaged 3.5 % in 2000, six-tenths of a point up on 1999. As has been the case in recent years, the rise in this deflator, which includes the taxes net of subsidies borne by products, outstripped the economy's value-added deflator, which rose by 3.4 %. It should be stressed that the growth differential between both deflators narrowed substantially last year, denoting more moderate behaviour in unit taxes net of subsidies than in previous years. The absence of relevant changes in tax rates would account for this result.

The acceleration in the GVA deflator in 2000 came about due to sharper growth in both the gross operating surplus per unit of output and in labour costs per unit of value added, the growth rate of which rose by six-tenths of a point to 3.2 %. Overall, the share of income from work in value added fell slightly compared with a year earlier. The source of the acceleration in labour costs lay in compensation per employee, which edged up from growth of 2.8 % in 1999 to 4 % in 2000. This acceleration was partly offset by productivity, which increased by 0.8 % in 2000, a rate more in keeping with its historical average than the abnormally low figures in the immediately preceding years.

The foregoing results are similar to those that arose in the market economy, which are depicted in Chart IV.11. The growth of productivity in this ag-

gregate was somewhat lower, reflecting the high job-creation intensity of the current growth pattern and the considerable pick-up in margins. That said, as will be seen there were notable differences between the various branches of the economy.

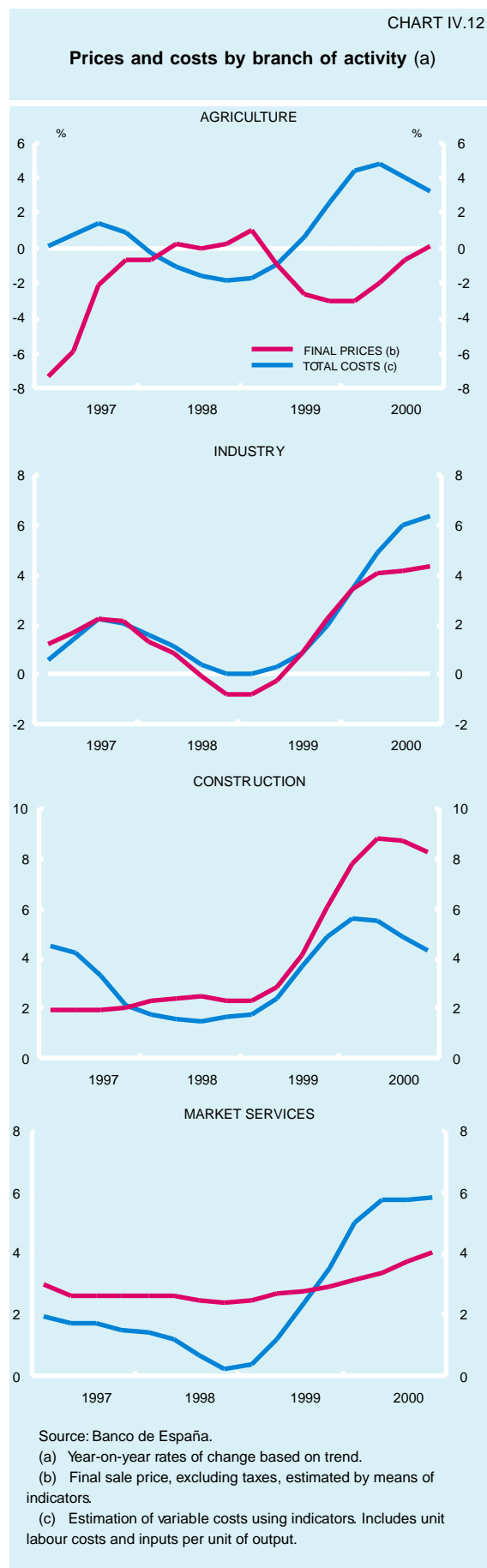
IV.5.1. Costs and prices: the productive branches

This section briefly reviews the price formation process in the various branches of the market economy. It draws on QNA data and on the information provided by a broader set of indicators, which also allows analysis of the costs arising from the use of imports, including energy, and of final production prices (see Chart IV.12). Disaggregated analysis shows that costs and prices in the various productive activities had significant differentiating features in 2000. One factor common to them all, albeit with a quantitatively different impact in each case, was the rise in intermediate costs and, in particular, in energy costs.

Starting with agriculture, the value-added deflator in this sector posted a negative rate of change in the year 2000 which progressively lessened as the year unfolded. Unit labour costs slowed sharply, despite the considerable acceleration in compensation per employee, owing to passive productivity gains arising from job destruction. As a result, the operating margin shrank.

On QNA figures, there was a combination in the energy branch of a strong acceleration in the value-added deflator and a sharp fall in unit labour costs (-6.8 %), which gave rise to a widening of unit margins. The notable growth of value-added in this branch, along with moderate headway in employment, prompted an 8.8 % increase in apparent productivity, thereby accounting for the favourable course of unit labour costs. The information provided by the price and cost indicators, which enables intermediate costs to be considered explicitly, qualifies the foregoing results somewhat by showing the impact on margins of the rise in the cost of imported inputs (essentially crude oil).

During the year 2000, the value-added deflator in industry fell by 3.1 % on a year earlier. Meanwhile, unit labour costs rose by 2 %, having slowed in relation to 1999 since the bigger increase in compensation per employee was offset by a slight recov-



ery in apparent productivity. Consequently, according to these data, the unit surplus would have worsened acutely in the year 2000. Analysis of other price and cost indicators tends to confirm the qualitative results provided by the QNA figures, likewise showing a deterioration in the gross unit operating margin in industry, albeit of a different intensity (see Chart IV.12). According to these indicators, final manufacturing prices accelerated significantly in 2000, but costs (intermediate and labour alike) also grew strongly. Imported input costs climbed strongly, propelled by the rising price of oil on international markets and by the trajectory of the euro. It should be stressed that the squeeze on margins was not common to all manufacturing branches; specifically, in metallurgy, minerals, transport equipment, food and paper, margins held firm or even improved slightly.

The value-added deflator in construction accelerated most significantly in 2000 to a rate of 8.8 %. The previously strong growth rate of unit labour costs tended to moderate, as apparent productivity, though still running at negative rates of change, performed somewhat more favourably than in 1999. The behaviour of both variables provided for a widening of margins, as has also been reflected in the indicators of final prices and total costs.

The value-added deflator in market services grew more sharply than in 1999. Notwithstanding, the gross operating margin shrank. The reason behind this result lies in the rise in unit labour costs, owing to the combination of a greater increase in compensation per employee (3.9 %) and a deterioration in productivity (-0.8 %), against a backdrop of strong employment growth. The information provided by the price and cost indicators is similar, since it estimates that the increase in unit labour costs was accompanied by strong growth in intermediate costs, which intensified the squeeze on margins. Nonetheless, prices were on a clearly rising trend throughout the year while the upward course of costs was checked. And that would point to a resumption of a situation in which margins may widen in the year 2001.

Developments were very mixed in services, as a result of the differing intensity in the use of energy by the various activities, the differing degree of demand pressure and the actual level of competition. In the hotel and restaurant trade and in education, margins widened; however, other branches such as

transport, communications, health and other services saw their margins shrink. Nonetheless, in all these branches except for communications, which was subject to a wide-ranging process of opening up to competition, margins increased in the second half of 2000. This was due either to a strong increase in prices, as in transport, or to a mild easing of costs accompanied by an upturn in prices. In services as a whole, the sharpest decline in any surplus was in the distributive trade. Here, despite the substantial acceleration in final prices, dearer purchasing prices combined with a bigger increase in variable costs, prompting a strong correction in the operating margin.

IV.6. COMPETITIVENESS

As discussed in the analysis of external demand, Spanish exports were notably resilient in the year 2000. They were favoured by the pick-up in external markets and by the gains in competitiveness against the rest of the world, which were reflected in the related indices. The pace of import penetration in the domestic market also slowed owing to the higher price of imports compared with domestically produced goods. Nonetheless, given that the improved competitiveness of Spanish products was due to the gradual depreciation of the nominal exchange rate of the euro against other currencies (especially against the dollar), the competitiveness indices revealed highly uneven behaviour depending on the geographical region involved. Thus, as can be seen in Chart I.4 in the first chapter of this Annual Report, competitiveness vis-à-vis the euro area countries (measured in this case by the index based on unit labour costs) worsened considerably, while it improved progressively against the developed countries throughout the year.

From this perspective, price and cost developments in Spain during the year 2000 provide the key for interpreting both the adverse performance of competitiveness against the euro area and the improvements recorded against other countries. Chart IV.13 depicts a set of indices of relative prices and costs for Spain against the euro area and against other developed countries, all of them calculated in their own currencies and without taking into account the exchange rate, changes in which have been depicted separately. As can be seen, unlike the competitiveness indicators that include the exchange rate, the relative prices and costs indices did

Foreign trade by productive branch: consequences for the competitiveness of the Spanish economy

In the year 2000, there was an improvement in the competitiveness of the Spanish economy, proxied by relative price and cost indices expressed in a single currency, owing to the depreciation of the euro. However, another series of relevant factors enter into play in the determination of competitiveness. Sectoral analysis of foreign trade flows allows implications to be elicited from a broader perspective of competitiveness since, in certain cases, price or labour costs are the fundamental determinants of competitiveness in certain sectors, while factors associated with technology or product characteristics are fundamental in others.

The adjoining table gives a breakdown of manufacturing exports and imports by productive branch, following the OECD classification, which groups the different sectors according to their technological intensity and the so-called revealed comparative advantage indices (which show a sector's deficit or surplus as a percentage of its total trade).

Although there has been a shift in recent years in the structure of exports towards the more technological capital-intensive industries, Spanish sales continue to be concentrated in the more traditional unskilled labour-intensive industries, and in the physical capital-intensive transport equipment industry. The most technologically advanced industries still have a limited share in total exports (lower than that of our most advanced EU partners). The situation highlights some of the weaknesses of the Spanish industrial apparatus. The high specialisation in industries with lower technological requirements makes Spanish exports somewhat vulnerable, since in these industries competitiveness via relative prices and costs is of particular importance, whereby competitive pressures from recently industrialised countries are intense. It should be borne in mind that these countries have substantial comparative advantages in the production of unskilled labour-intensive goods because of their lower labour costs. Conversely, the technologically more developed industries are characterised by greater expansion potential and fewer competitive pressures from these countries. There is also a concentration of sales in the transport equipment industry (specifically, the car industry), which generates high dependence on its results. Notable in the case of imports is the sizeable share of technology-intensive industries and the transport equipment industry. The proportion accounted for by this latter industry's imports is the result of the gradual shift in automobile demand towards more powerful mid- to upper-range cars, where Spanish supply specialisation is limited.

One way of jointly analysing export and import flows involves using the revealed comparative advantage indices. In the year 2000, Spain had a comparative disadvantage in most sectors. In addition, this disadvantage was particularly significant in the more technological capital-intensive industries which, despite their situation improving in recent years, continued to evidence a lack of competitiveness.

Other structural indicators that seek to show relevant aspects of companies' productive efficiency and, therefore, their competitive capacity include the following: technological intensity, physical capital abundance, human capital skills and infrastructure endowment. In particular, these indicators reveal that, although substantial headway has been made in these areas in Spain (notably in terms of the increase in public infrastructure endowment), differences with the EU average remain considerable.

TABLE 1

Foreign trade by productive branch

| | YEAR 1990 | | |
|-------------------------------------|-------------|-------------|--------------|
| | Structure | | RCAI |
| | Expor. | Impor. | |
| HIGH-TECHNOLOGY INDUSTRIES | 19.1 | 31.8 | -42.8 |
| Electrical and electronic equipment | 6.6 | 11.5 | -44.7 |
| IT and precision instruments | 2.9 | 8.2 | -62.1 |
| Chemicals and pharmaceuticals | 9.6 | 12.1 | -30.7 |
| MEDIUM-TECHNOLOGY INDUSTRIES | 42.3 | 36.2 | -12.6 |
| Rubber and plastics | 3.6 | 2.8 | -8.0 |
| Means of transport | 27.5 | 17.3 | 2.8 |
| Industrial machinery | 8.1 | 13.1 | -41.5 |
| Miscellaneous products | 3.0 | 3.0 | -20.5 |
| LOW-TECHNOLOGY INDUSTRIES | 38.6 | 32.0 | -10.9 |
| Textiles, leather and clothing | 8.7 | 6.1 | -3.1 |
| Metallic minerals, iron and steel | 7.9 | 7.5 | -17.9 |
| Metal products | 4.5 | 3.5 | -8.7 |
| Non-metallic minerals | 4.3 | 2.3 | 11.1 |
| Paper and printing | 3.3 | 3.7 | -24.8 |
| Food, beverages and tobacco | 9.9 | 8.8 | -14.4 |
| TOTAL MANUFACTURING | 100 | 100 | -20.1 |
| | | | |
| | YEAR 2000 | | |
| | Structure | | RCAI |
| | Expor. | Impor. | |
| HIGH-TECHNOLOGY INDUSTRIES | 22.4 | 31.7 | -28.6 |
| Electrical and electronic equipment | 8.8 | 12.2 | -27.7 |
| IT and precision instruments | 3.3 | 7.0 | -46.5 |
| Chemicals and pharmaceuticals | 10.4 | 12.5 | -21.2 |
| MEDIUM-TECHNOLOGY INDUSTRIES | 43.5 | 38.5 | -6.0 |
| Rubber and plastics | 4.0 | 3.5 | -4.7 |
| Means of transport | 30.2 | 23.0 | 1.4 |
| Industrial machinery | 6.5 | 9.0 | -27.9 |
| Miscellaneous products | 2.8 | 3.0 | -15.0 |
| LOW-TECHNOLOGY INDUSTRIES | 34.0 | 29.8 | -5.5 |
| Textiles, leather and clothing | 7.4 | 6.6 | -6.6 |
| Metallic minerals, iron and steel | 5.7 | 7.1 | -22.9 |
| Metal products | 4.1 | 3.4 | -2.0 |
| Non-metallic minerals | 4.1 | 1.7 | 31.8 |
| Paper and printing | 3.4 | 3.1 | -7.8 |
| Food, beverages and tobacco | 9.3 | 7.9 | -3.8 |
| TOTAL MANUFACTURING | 100 | 100 | -12.1 |

TABLE 2

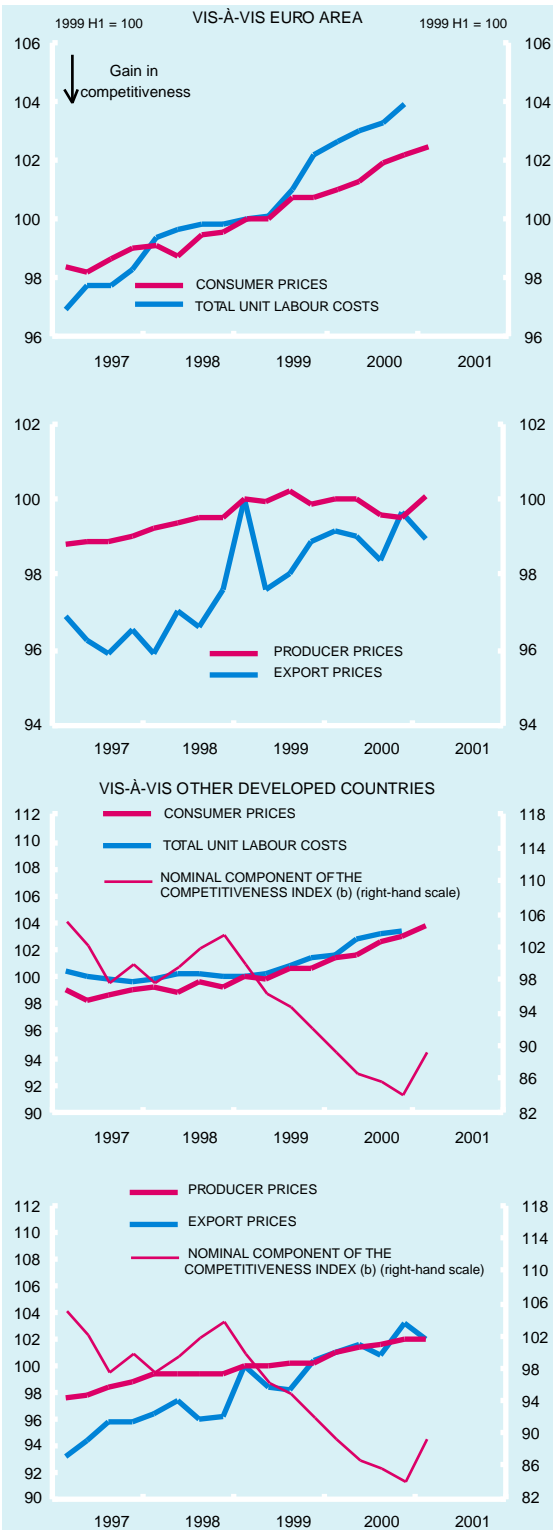
Structural competitiveness indicators

| | Spain/EU Levels (%) | | Spain Δ |
|---|---------------------|------|----------------|
| | 1990 | 1999 | |
| | 1999-90 | | |
| Physical capital | | | |
| <i>Total capital stock/employment</i> | 85.4 | 89.6 | 2.2 |
| <i>Private capital stock/employment</i> | 77.6 | 80.8 | 2.5 |
| Technological capital/GDP | 33.3 | 40.8 | 4.1 |
| Human capital/population 16-64 year-olds | 62.9 | 71.7 | 2.9 |
| Public capital/population | 52.8 | 70.5 | 4.5 |

Sources: Departamento de Aduanas, FUNCAS (Programa de Estudios Europeos) and Banco de España.

CHART IV.13

Relative cost and price indices (a)



Source: Banco de España.

(a) An increase in the index denotes a loss in competitiveness, and vice versa .

(b) Shows the bilateral exchange rate of the peseta against the non-euro area developed countries.

not behave differently vis-à-vis the different geographical regions, but generally tended to reflect higher Spanish cost and price growth rates than those for the other countries (Box IV.3 analyses other structural aspects of competitiveness).

Analysis of competitiveness vis-à-vis the euro area (which is currently determined exclusively by cost and price differentials over this area) reveals that the deterioration in relative prices was particularly significant in the case of consumer prices. This denotes the existence of positive inflation differentials in almost all the major consumer product categories, most notably so in services, where the differential has widened to 2.5 percentage points in the opening months of 2001. This might be warranted, at least in part, by a greater impact of higher oil prices on services prices in the Spanish economy, given the greater energy dependence of the Spanish productive apparatus compared with other developed countries. But it also reveals the persistence of inflationary inertia in certain more sheltered sectors of the economy.

Prices in the industries most exposed to foreign competition (producer and export prices) followed a pattern of behaviour similar to that of the euro area countries. Moreover, mention should be made of the rise in relative unit labour costs both in the economy as a whole and in the manufacturing sector, owing to the higher growth of employee compensation in the Spanish economy and to the lesser pick-up in apparent labour productivity (see Chart I.2). Overall, in comparison with what is happening in the euro area, these indicators would appear to be pointing to a squeeze on the operating margins of activities exposed to foreign competition.

Changes in price and cost differentials vis-à-vis non-euro area countries followed very similar patterns to those vis-à-vis the euro area. However, the increase in both relative export prices and, to a lesser extent, producer prices might indicate that the squeeze on margins is proving less in companies exporting to these countries as they have been favoured by the depreciation of the euro. The widening of price and cost differentials vis-à-vis these areas highlights the vulnerability of the gains in competitiveness achieved; as they have come about owing to the weakness of the euro, they might be reversed once the single European currency reverts to values closer to those deemed consistent with its fundamentals. Indeed, the strengthening trend of the

euro in the opening months of 2001 and its subsequent stability led to a deterioration in competitiveness against these markets, adding to that observed vis-à-vis the euro area.

This is an especially important point because, although the export performance in 2000 was very favourable and raised the share of Spanish products in world markets, the increase in said share was concentrated in non-euro area countries and was undoubtedly favoured by the competitiveness gains associated with the depreciation of the euro. Conversely, in the euro area markets, export shares fell back. Compounding this is the fact that the share of imports in supplying national demand continues to increase. There are thus potential signs that cost and price pressures could be presaging losses in competitiveness that would emerge in full once the euro were to settle firmly on a stronger footing.

IV.7. GENERAL GOVERNMENT ACTIVITY

The consolidation of public finances continued in the year 2000, and a deficit of 0.3 % of GDP was recorded compared with 1.2 % of GDP in 1999 (see Table IV.2 and Box IV.4). The overall general government primary balance ran a surplus of 3 % of GDP in 2000, six-tenths of a point up on the previous year.

The performance across the general government sectors was, however, uneven. The State and its agencies ran a deficit of 0.6 % of GDP, below the figure of 0.8 % forecast in the Updated Stability Programme. Social Security Funds (for which a surplus of 0.1 % of GDP was forecast) posted a surplus of 0.5 % of GDP. Territorial governments, however, for which a deficit of 0.1 % of GDP was forecast, recorded a bigger deficit (0.3 % of GDP). In the absence of greater information, and without prejudice to the discrete incidence of specific items on the budgetary outturn, this performance brings to the fore the need for greater control of territorial government spending [particularly by the regional (autonomous) governments] and for the reform of financing arrangements.

In National Accounts terms, total revenue grew by 7.1 %, slightly below nominal GDP. Tax receipts, however, increased as a proportion of GDP; conse-

TABLE IV.2
Main general government non-financial transactions
(ESA/95)

| | Percentage of GDP | | | |
|--|-------------------|-------------|-------------|-------------|
| | 1997 | 1998 | 1999 | 2000 |
| Total revenue | 39.6 | 39.5 | 40.0 | 39.8 |
| Current revenue | 38.2 | 38.2 | 38.6 | 38.6 |
| <i>Taxes on production and imports</i> | 10.5 | 11.1 | 11.6 | 11.6 |
| <i>Taxes on income and wealth</i> | 10.5 | 10.2 | 10.3 | 10.5 |
| <i>Social contributions</i> | 13.2 | 13.1 | 13.1 | 13.4 |
| <i>Other revenue (a)</i> | 4.0 | 3.7 | 3.6 | 3.1 |
| Capital revenue | 1.3 | 1.4 | 1.4 | 1.2 |
| Total expenditure | 42.7 | 42.1 | 41.1 | 40.1 |
| Current expenditure | 37.8 | 37.0 | 35.8 | 35.2 |
| <i>Final consumption expenditure</i> | 17.6 | 17.5 | 17.3 | 17.1 |
| <i>Social benefits in cash</i> | 13.4 | 12.8 | 12.4 | 12.4 |
| <i>Actual interest payments</i> | 4.8 | 4.3 | 3.6 | 3.3 |
| <i>Subsidies</i> | 0.9 | 1.1 | 1.2 | 1.1 |
| <i>Other transfers</i> | 1.1 | 1.2 | 1.3 | 1.3 |
| Capital spending | 5.0 | 5.1 | 5.3 | 5.0 |
| <i>Gross capital formation (b)</i> | 3.2 | 3.4 | 3.4 | 3.3 |
| <i>Other expenditure</i> | 1.8 | 1.8 | 1.9 | 1.7 |
| Net lending (+)/borrowing (-) | -3.2 | -2.6 | -1.2 | -0.3 |
| MEMORANDUM ITEM: | | | | |
| Primary balance | 1.6 | 1.7 | 2.4 | 3.0 |
| Gross debt | 66.7 | 64.7 | 63.4 | 60.6 |

Sources: Instituto Nacional de Estadística, Ministerio de Hacienda and Banco de España.

(a) Includes fixed-capital consumption.

(b) Includes acquisitions of non-produced, non-financial assets.

quently, the loss of relative weight of total revenue is due to the fall in dividends and other ownership income and the decline in capital transfers (essentially those from the European Union) received by general government.

Notable under tax receipts was the high growth (10.3 %) of income and wealth tax, the weight of which in GDP increased by two-tenths of a percentage point. On the data available, this result may be attributed to the substantial growth of corporate income tax, although personal income tax also trended better than expected. In terms of revenue raised, and exclusively within the scope of the State, income and wealth tax receipts exceeded the budgeted amount by more than ESP 500 billion. The residual effect of the personal income tax reform was limited and reflected above all in the reduction in the net tax paid in connection with returns filed for the 1999 fiscal year.

Indirect tax grew more moderately (7.5 %), slowing appreciably on 1999 (11.9 %). In terms of revenue raised, VAT on domestic transactions grew

far less than budgeted, this being largely offset by the greater growth of VAT on imported products. Excise duties grew above budget, owing essentially to the more robust performance of taxes on tobacco products. Hydrocarbons duties, however, grew very modestly; as a flat rate is applied, they were not affected by price rises but were impacted by the slowdown in the consumption of these products.

Revenue relating to social contributions increased by 9.7 %, exceeding the figure of 7.4 % for 1999. Numbers registered with the Social Security remained on a favourable trend, rising by 5 % over the year as a whole. The Social Security revenue results explain its positive balance of 0.5 % of GDP in 2000, which enabled a provision of ESP 100 billion to be set aside for the pension reserve fund created last year.

Total general government expenditure grew at a moderate rate of 5 %, meaning public spending as a proportion of GDP diminished once again in 2000 to 40.1 %, one percentage point down on 1999. This decline in the weight of public spending was distributed equally among primary current expenditure, public debt interest payments and capital expenses.

Under primary current expenditure, general government final consumption spending grew by 6 % in nominal terms, slightly up on 1999. General government employee compensation grew by 5.9 %, with 5.7 points relating to compensation per employee if this variable is approximated by the behaviour in the non-market services branch. Also notable under government consumption was the 10.3 % rise in social transfers in kind acquired on the market (basically associated with health spending) and goods and services, which grew by 7.2 % in nominal terms. Even so, the weight of general government final consumption in GDP declined by 0.2 percentage points in 2000.

Social benefits in cash rose by 7.1 % in 2000, a considerable acceleration on 1999 (4 %). This meant they held unchanged relative to GDP. Given the moderate growth in the number of contributory pensions recorded since 1998, the growth of payments in this connection is essentially due to the increase in the average pension, including upward deviations attributable to the CPI in 2000. In turn, the payment adjusting pensions for the CPI having

outpaced the official inflation target for 1999 (paid in early 2000) has been recorded in the year in which it accrued, i.e. in 1999. Spending on unemployment benefits increased in 2000 (for the first time since 1993) by 3.3 %, compared with a reduction of 2.9 % in 1999. That said, the number of beneficiaries decreased again in 2000, albeit at a much lower rate than in 1999 (a fall of 2.7 % in 2000 against a decline of 9.5 % in 1999), evidencing the slowdown in the rate of decline of unemployment. In any event, the fall in the number of beneficiaries was less than that in unemployment, whereby the eligibility ratio rose once again in 2000 to 64.7 % against 63.5 % in 1999. In the absence of specific measures aimed at increasing this eligibility ratio, this rise might be reflecting greater access to the labour market by those groups that did not previously receive unemployment benefits.

Actual interest paid by general government ran at a slightly negative rate in 2000, diminishing relative to GDP by 0.3 percentage points. This testifies to the favourable effects of the public debt conversions carried out in recent years (and undertaken again in 2000), which have brought about a lesser interest burden for the future. However, the rate of decline of interest payments has diminished considerably in relation to 1999.

Capital expenses increased by only 0.9 % in 2000, compared with 10.1 % the previous year, signifying a reduction in the weight of this variable in GDP of 0.3 percentage points. Public investment posted growth of 5.2 % in nominal terms (against 7.7 % in 1999). However, this rate would rise to 7.4 % were it to not include net acquisitions of non-produced, non-financial assets, among which are (with a negative sign) the proceeds obtained in 2000 from the award of the UMTS mobile telephony licences (4). It should be added here that much of the infrastructure policy pursued by central government is being channelled increasingly through corporate public entities and state-owned companies that are in the National Accounts under the companies sector, not under general government.

(4) Note that, in National Accounts terms, proceeds from the sale of the mobile telephony licence rights appear as a reduction of expenses, and specifically of capital expenses. The heading under which they appear, with a negative sign, is that of net acquisitions of non-produced, non-financial assets, along with, for example, net acquisitions of land. This means that, by considering these net acquisitions of non-produced, non-financial assets as part of the total for public investment, the increase in the latter is less.

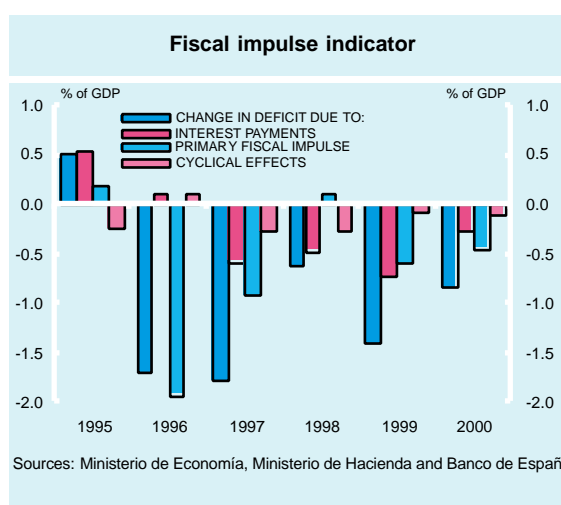
The Spanish fiscal policy stance

Changes in the public financial balance are not a good indicator of the fiscal policy stance since the latter depends not only on discretionary decisions on public revenue and expenditure but also on the economy's cyclical position. During expansions (recessions), revenue tends to grow (diminish) and expenditure to fall (increase) as a result of the action of the automatic stabilisers, thereby affecting the budgetary balance regardless of the discretionary measures adopted. To evaluate fiscal policy, then, a distinction must be drawn between the cyclical and discretionary components of the changes in public financial balances, given that only the latter component proxies the degree of fiscal consolidation.

The indicators available quantify the discretionary change in fiscal policy subtracting from the change in the budgetary balance the portion thereof attributable to cyclical factors. All the indicators have as their reference a framework given by potential or trend GDP, and they estimate the cyclical component of the budgetary balance through the application of public revenue and expenditure elasticities in respect of the difference between actual and potential GDP (the output gap).

Despite their usefulness, these indicators should be interpreted with caution, given that they are very sensitive to alternative measures of the output gap and are based on elasticities of public revenue and expenditure, the calculation of which is not free from difficulty. In addition, the budgetary balance is affected by other factors – apart from the economy's cyclical position – which are not the consequence of the government's discretionary action. Such factors include demographic variables, inflation or interest rates. However, the foregoing indicators only isolate the changes in the public balance due to the cycle, which should be borne in mind when it comes to interpreting them. Moreover, the indicators do not measure the impact of fiscal policy on activity, as they do not reflect – inter alia – its incidence on supply, income distribution, interest rates or inflation, the differentiating effect of public revenue and spending on demand and the interaction between expectations and fiscal policy.

One method of calculating the cyclical and discretionary components of changes in public balances is provided by the IMF-proposed fiscal impulse. To calculate this indicator, unit elasticities of expenditure and revenue to trend and nominal GDP are respectively assumed. In this way, expenditure growth that exceeds (is less than) estimated trend GDP growth will be attributed to an expansionary (restrictive) action. Likewise, any growth in revenue above (below) nominal GDP will be considered to be the outcome of a restrictive (expansionary) action. The estimation of the fiscal impulse for the Spanish economy in the period 1995-2000 (see accompanying table and chart) shows that the reduction in the deficit is essentially due to non-cyclical factors. If the portion relating to the debt burden is stripped out, the primary fiscal impulse shows a significant reduction (of 3.7 points). That is indicative – with the aforementioned caveats – of a restrictive discretionary action, exerted more through a reduction of primary public spending than by an increase in revenue. In 2000, one-tenth of a point of the fall in the deficit is due to the effect of the cycle, three-tenths of a point to the decline in the interest burden, and four-tenths of a point to the effect of the primary fiscal impulse. The breakdown of the latter shows that the adjustment bore exclusively on primary spending. This result would denote a slightly restrictive fiscal policy stance in 2000.



Fiscal impulse indicator

| | % of GDP | | | | | |
|----------------------------|----------|------|------|------|------|------|
| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
| Change in deficit | 0.5 | -1.7 | -1.8 | -0.6 | -1.4 | -0.8 |
| Due to: | | | | | | |
| Interest payments | 0.5 | 0.1 | -0.6 | -0.5 | -0.7 | -0.3 |
| Primary fiscal impulse (a) | 0.2 | -1.9 | -0.9 | 0.1 | -0.6 | -0.4 |
| Revenue | 0.0 | -0.5 | -0.2 | -0.1 | -0.4 | 0.2 |
| Primary expenditure | 0.2 | -1.4 | -0.7 | 0.2 | -0.2 | -0.6 |
| Cyclical effects | -0.2 | 0.1 | -0.3 | -0.3 | -0.1 | -0.1 |
| MEMORANDUM ITEM: | | | | | | |
| Gen. gvt. balance | -6.6 | -4.9 | -3.2 | -2.6 | -1.2 | -0.3 |
| Primary balance | -1.4 | 0.4 | 1.6 | 1.7 | 2.4 | 3.0 |
| Interest payments | 5.2 | 5.3 | 4.8 | 4.3 | 3.6 | 3.3 |
| Real GDP growth | 2.8 | 2.4 | 3.9 | 4.3 | 4.0 | 4.1 |
| Output gap (b) | -0.7 | -0.9 | -0.3 | 0.3 | 0.5 | 0.8 |

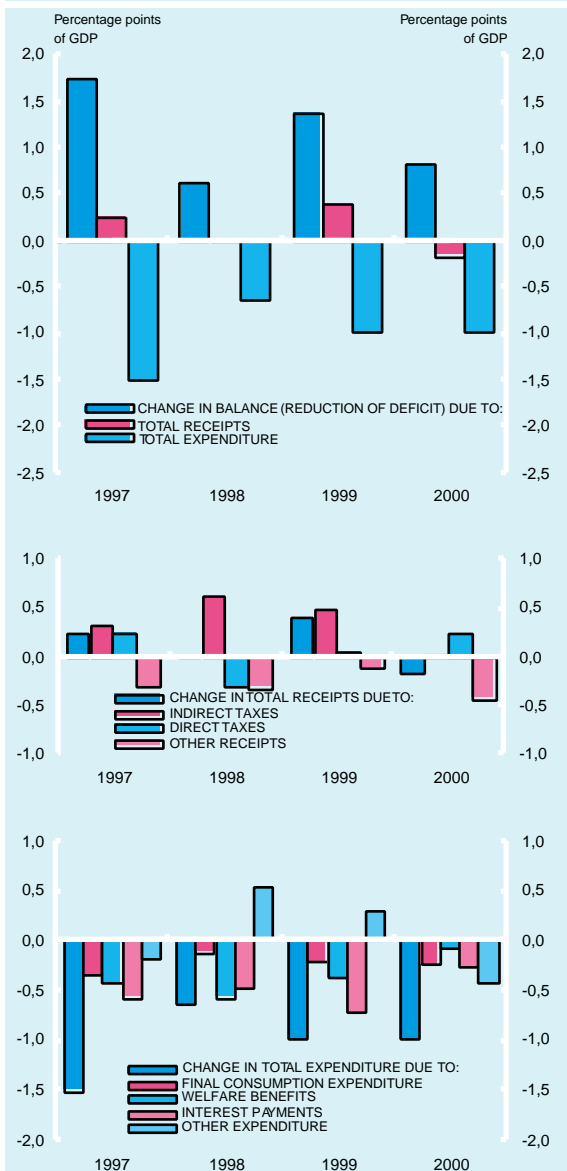
Sources: Ministerio de Economía, Ministerio de Hacienda and Banco de España.

(a) A positive sign denotes an expansionary discretionary fiscal policy stance.

(b) Output gap = (GDP - trend GDP)/Trend GDP (%). A Hodrick-Prescott filter with a lambda value equal to 10 has been applied to calculate trend GDP.

CHART IV.14

Breakdown of the change in the general government deficit (ESA 95)



Sources: Instituto Nacional de Estadística, Ministerio de Hacienda and Banco de España.

Regarding this latter point, some of the major central government programmes in the field of infrastructure policy, or as part of the National Plan for Scientific Research, Development and Technological Innovation, have been financed in recent years via the heading of acquisitions of financial assets, i.e. outside the scope of the State non-financial expenditure budget. For the year 2000 mention may be made, for example, of the capital contributions to the Ente Gestor de Infraestructuras Ferroviarias - GIF (Railway Infrastructure Managing En-

tity) for ESP 123 billion in 2000, the purchase of shares in the water utilities *Sociedades de Aguas* and *Sociedades Estatales para la Consolidación y Modernización de Regadíos* (ESP 56 billion in total) or loans extended to business enterprises for technological development activities, essentially in aeronautical and shipbuilding projects (ESP 103 billion). Such projects, which have been under way since 1997, entail a higher level of public debt (or a smaller reduction in such debt), despite not affecting the budget deficit immediately. However, the bolstering of the Spanish economy through such policies aimed at increasing its physical or technological capital endowment and, in sum, at achieving real convergence with the core EU countries, is to be positively viewed. Some of the foregoing measures will smooth adaptation to European guidelines in areas such as rail transport, for instance, where the creation of GIF is part of the unbundling of railway infrastructure management and transport service provision, which may be the first step towards introducing a competitive environment in this industry. Moreover, the routing of certain infrastructure projects through business enterprises facilitates the pass-through of part of the cost of such infrastructure to end-users, which is likewise in keeping with Community policy in this area. In this connection, efforts should be made in the future to develop concession formulas further, involving the private sector more closely in the management of such infrastructure.

The favourable budget outcome in 2000 has enabled an overall general government balanced budget target to be considered for the general government sector for the year 2001, bringing forward by one year what had been envisaged under the Stability Programme. In the new Updated Programme unveiled early this year, it is planned to achieve this target with a reduction in the State budget to 0.3 % of GDP, a Social Security surplus of 0.3 % of GDP and the territorial government position in equilibrium. The data available to date suggest there is enough scope to attain this goal, even if a slowdown in economic growth from the figure of 3.6 % initially forecast were to be confirmed. This achievement will be of particular importance not only for sustaining a general climate of economic stability, but also for enabling a restructuring of public spending such as that foreseen in the Updated Stability Programme, which envisages a sizeable increase in public investment in the coming years.

The successful passage through Parliament of the legislation on budgetary stability will entail reinforcing public spending control mechanisms, in both the public sector and territorial government. The white paper for this legislation establishes the principle of budgetary stability (defined in relation to general government) as an equilibrium or surplus position in terms of lending capacity. For the correction of deficit positions, a mechanism is established based on the submission by the corresponding agent (central government, regional governments or local governments) of an economic and financial plan that shall define the revenue and spending policies to be applied to correct the situation in the medium term. Moreover, in the case of regional governments, the role of the Fiscal and Financial Policy Council in setting and monitoring budgetary stability targets is strengthened. As a result of the foregoing, this legislative reform will be far-reaching and will contribute to projecting forward the budgetary consolidation attained in recent years.

IV.8. BALANCE OF PAYMENTS

There was a cumulative current- and capital-account deficit of EUR 13,741 million in 2000, equivalent to -2.3 % of nominal GDP, compared with -1.2 % in 1999. This performance was essentially due to the rise in the trade balance deficit, which was 24.7 % up on the previous year and amounted to 5.9 % of GDP. Moreover, there was an appreciable reduction in the positive balances of the current transfers and capital account, which fell by 46.6 % and 20.4 %, respectively, owing to fewer funds from the EU. The other services and income sub-balances remained virtually stable, as can be seen in Table IV.3 and Chart IV.15.

Both receipts and payments in the merchandise balance grew at high nominal growth rates: 18.2 % and 19.6 %, respectively. The increase in payments came about largely due to the surge in international oil prices. These passed through to import prices, with the subsequent deterioration in the terms of trade. Moreover, as analysed in the preceding sections, the fact the Spanish economy is at an advanced stage of maturity in the cycle (its growth rate slowed moderately as the year unfolded) combined with the exceptional buoyancy of foreign markets throughout the year meant that the growth rate of exports, in real terms, attained

TABLE IV.3

Balance of payments: summary table

% of GDP

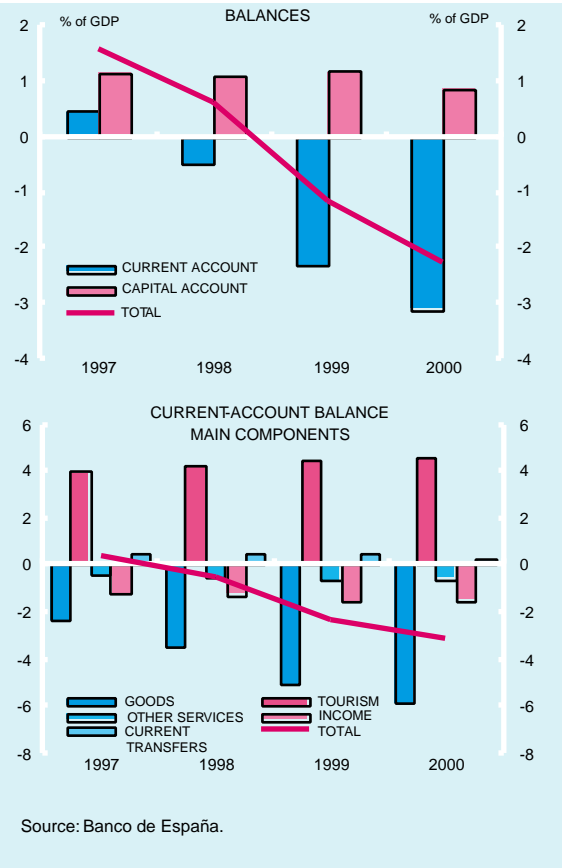
| | 1997 | 1998 | 1999 | 2000 |
|--|-------------|-------------|-------------|-------------|
| Receipts | | | | |
| Current account | 31.4 | 32.2 | 32.0 | 34.9 |
| Goods | 19.1 | 19.1 | 18.8 | 20.6 |
| Services | 7.9 | 8.4 | 8.9 | 9.6 |
| <i>Tourism</i> | 4.8 | 5.1 | 5.4 | 5.6 |
| <i>Other services</i> | 3.1 | 3.3 | 3.5 | 4.0 |
| Income | 2.3 | 2.5 | 2.1 | 2.7 |
| Current transfers | 2.1 | 2.2 | 2.2 | 2.0 |
| Capital account | 1.3 | 1.2 | 1.3 | 1.0 |
| Payments | | | | |
| Current account | 30.9 | 32.7 | 34.4 | 38.1 |
| Goods | 21.5 | 22.6 | 23.9 | 26.5 |
| Services | 4.3 | 4.7 | 5.1 | 5.6 |
| <i>Tourism</i> | 0.8 | 0.9 | 0.9 | 1.0 |
| <i>Other services</i> | 3.5 | 3.8 | 4.2 | 4.6 |
| Income | 3.6 | 3.8 | 3.7 | 4.2 |
| Current transfers | 1.6 | 1.6 | 1.7 | 1.8 |
| Capital account | 0.1 | 0.1 | 0.2 | 0.2 |
| Balance | | | | |
| Current account | 0.5 | -0.5 | -2.3 | -3.1 |
| Goods | -2.4 | -3.5 | -5.1 | -5.9 |
| Services | 3.6 | 3.7 | 3.8 | 4.0 |
| <i>Tourism</i> | 4.0 | 4.2 | 4.5 | 4.6 |
| <i>Other services</i> | -0.4 | -0.5 | -0.7 | -0.6 |
| Income | -1.2 | -1.3 | -1.6 | -1.5 |
| Current transfers | 0.5 | 0.6 | 0.5 | 0.3 |
| Capital account | 1.1 | 1.1 | 1.2 | 0.9 |
| MEMORANDUM ITEM: | | | | |
| Overall balance on current and capital account | 1.6 | 0.6 | -1.2 | -2.3 |
| Source: Banco de España. | | | | |

and exceeded that of imports, which showed signs of tapering off in the closing months of the year. Finally, the Spanish economy's gains in competitiveness against the non-euro area countries resulted in particularly high export growth rates to these areas.

The surplus on services increased once again relative to GDP, up to a percentage of 4 %. The services balance continue to be dominated by the surplus on tourism, where receipts grew at a rate of 10.8 % (against 15.5 % for payments); however, this figure did not reflect the relative stagnation shown by the real indicators. The forceful increase in prices in the tourism sector last year no doubt affected the competitiveness of this sector. This was especially the case in the euro area, although a series of international events in various points in Europe may also have affected results for the year. The heading of other services, other than tourism, saw the high growth rates recorded in recent years step up in the year 2000. Here the related receipts and payments grew by 22.9 % and 18.5 %, respectively (compared with 14.7 % and 17.9 % in 1999),

CHART IV.15

Balance of payments: summary table



and, once again, it was the information, communications and business services sectors which proved particularly buoyant.

The balance on income account held practically at the levels reached the previous year, namely -1.5 % of GDP. In the year 2000 there was a reduction in the deficit in the credit sector and in that of other resident sectors (owing to the momentum of receipts in both sectors, reflecting the recent acquisition of assets abroad). Nonetheless, this reduction was offset by substantial growth in the deficit relating to general government transactions. Likewise, there was a change in the structure of net income receipts where, as was the case in previous years, the proportion accounted for by net returns on direct and portfolio investment increased to the detriment of returns on other investment.

Lastly, as earlier stated, the considerable reduction in the balance of current and capital transfers is attributable to the fall in EU funds. Note that the year 2000 was the first in the new EU planning period (2000-2006) and, as occurred in the first two years of the previous period, there are usually lags in devising the programmes financed by these funds, delaying their availability to subsequent years.

For the second year running, therefore, the Spanish economy saw its current- and capital-account deficit widen substantially. This result is the consequence, in turn, of the imbalance between domestic saving and investment flows, and highlights the need to resort to foreign funds to finance the deficit. The following chapter analyses in detail the way this deficit position has been financed.

CHAPTER V

SPANISH FINANCIAL FLOWS,
MARKETS AND INTERMEDIARIES

For the second year running, national saving, which held practically unchanged relative to GDP at the level of the preceding five years, was insufficient to finance the growth of investment in Spain. Savings generated in the rest of the world were therefore required to cover the shortfall. However behind the nation's moderate net borrowing of 2.2 % of GDP, there is a notably higher level of gross external financing, as a result of the significant increase in the demand for financial assets issued in the rest of the world. Both households and, above all, corporations contributed to the expansion of Spanish financial interests beyond Spanish frontiers, the former primarily through the growing weight of foreign assets in the portfolios of institutional investors in which they have holdings, while the latter increased their direct and portfolio investment abroad. This process of internationalisation was one of the most notable features of Spanish financial flows, markets and intermediaries in 2000.

A significant part of the financing required by the expansion of national demand and for the acquisition of foreign assets was channelled through the Spanish financial markets, where the participation of international investors increased. Stock markets were notable here, with increases in their size and activity, although they continue to play a limited role in the intermediation of the financial flows of the Spanish economy. Fixed-income markets, however, were slacker, and derivatives markets declined somewhat in comparison with previous years. Accordingly, the deposit-money institutions strengthened their leading role in attracting the savings necessary to finance domestic consumption and investment and to facilitate the international expansion of corporations. As a result, bank lending to the private sector grew at very high rates (of around 20 %), which only in the first few months of 2001

seemed to show signs of moderating. Given the relative shortage of domestic funds, a further increase in the external liabilities of the banking system was necessary. Despite the increase last year in securities issuance on international markets, these liabilities continue to take the form mainly of borrowing from non-resident financial institutions.

The expansion of the Spanish economy and its internationalisation have thus stimulated not only a simultaneous increase in the external assets and liabilities of resident sectors, but also a significant increase, in terms of national income, in the indebtedness of corporations and households. This took place last year amid falling stock markets and a general increase in uncertainty on international financial markets, following a long boom on the securities markets and rising house prices, which had increased wealth significantly.

The implications of the internationalisation of financial flows and of the growing indebtedness of Spanish corporations and households are complex. The former process is enabling national agents to achieve a more efficient geographical diversification of their portfolios, business and sources of financing, and should therefore result in an improved allocation of financial resources. Moreover, Spain's membership of the euro area, by helping to entrench a more stable macroeconomic environment, is a structural change in the evolution of the Spanish economy which will foreseeably enable national agents to service higher levels of debt than in the past. However, the implications of internationalisation for the exposure of national agents to new sources of risk and the problems caused by the velocity and intensity of the process of credit expansion should not be underestimated. Maintenance of the economy's key variables in balance, which is

necessary if satisfactory growth rates are to be sustained in the medium term, could be jeopardised and the vulnerability of the net-worth position of the various institutional sectors increased.

V.1. NET BORROWING AND FINANCIAL FLOWS IN THE SPANISH ECONOMY

V.1.1. The capital account of the institutional sectors

Net borrowing was recorded for the first time during the Spanish economy's long upswing of the second half of the last decade in 1999. This was a consequence of the significant growth in gross capital formation (up by 4 percentage points of GDP) and the stability of national saving as a percentage of GDP. In 2000 this trend accentuated, since gross saving (including net capital transfers) was 23.6 % of GDP (only 0.1 percentage points more than in 1999) and investment rose to 25.9 % of GDP (1.2 points higher than in the previous year) making the economy's net borrowing 2.2 % of GDP.

By sector, general government and the private sector again behaved differently (see Chart V.1 and Table V.1). General government continued to move towards financial balance, more than fulfilling its commitments under the Stability Programme for 2000, with a decline in net borrowing of 0.9 percentage points of GDP, to 0.3 %. The sector's saving improved by a similar percentage, as a result of the buoyancy of tax receipts and of the restraint of government consumption. General government gross fixed capital formation, as a percentage of GDP, remained unchanged.

Meanwhile, the net lending of households and NPIs fell by one percentage point of GDP to 1.4 %. This was the result of a decline in their saving and of an increase in housing investment. As described in the previous chapter, the ratio of saving to gross disposable income continued to exhibit a downward trend, despite the fall in net financial wealth caused by the reductions in the value of investments.

Spanish corporations increased their total net borrowing by one percentage point, to 3.3 % of GDP, as a result of the reduction in their saving and

the increase in their investment. However, it is necessary to distinguish between the behaviour of financial institutions and that of non-financial corporations. The net lending of the former increased in 2000 to 0.7 % of nominal GDP. By contrast, non-financial corporations recorded net borrowing equal to 3.9 % of GDP (up one point on 1999); gross fixed capital formation rose to 14.1 % of nominal GDP, although in real terms it slowed in comparison with the previous year.

V.1.2. Financial flows in the Spanish economy

The financial accounts of the Spanish economy provide the information necessary to analyse the trends in the financial assets and liabilities of the economy and of its main constituent sectors and also the trends in the financial flows between these sectors. Table V.2 shows the balance of the financial transactions of the various sectors (i.e. the counterpart of the net lending or net borrowing according to the non-financial accounts (1)) and the main inter-sectoral flows. Before analysing these flows in detail, it is worth commenting briefly on the most significant processes that, in the light of this table, have recently been taking place in the Spanish economy.

The main trend revealed by the inter-sectoral analysis is the increasing internationalisation of financial flows in the Spanish economy. First, general government has, since 1999, been obtaining an increasing volume of financing from the rest of the world, basically through the sale of government securities to non-residents by credit institutions and domestic institutional investors. Second, the latter have increased their net creditor position vis-à-vis the rest of the world. Finally, the balances vis-à-vis non-residents of credit institutions and of non-financial corporations are the result, as mentioned below, of increasing gross flows of funds to and from abroad.

(1) The balance of the financial transactions account is called *net financial saving*, in accordance with the terminology used in ESA 79. In the financial accounts compiled in accordance with ESA 95 methodology, this balance is now known as *net financial transactions*. Both names are used in this report interchangeably. The name *non-financial firms and households*, which has been used in previous editions, and its ESA 95 equivalent, *non-financial corporations and households and private non-profit institutions (NPIs)*, are also used interchangeably.

TABLE V.1

Use of income, capital and financial accounts. National economy
Breakdown by sector

% of GDP

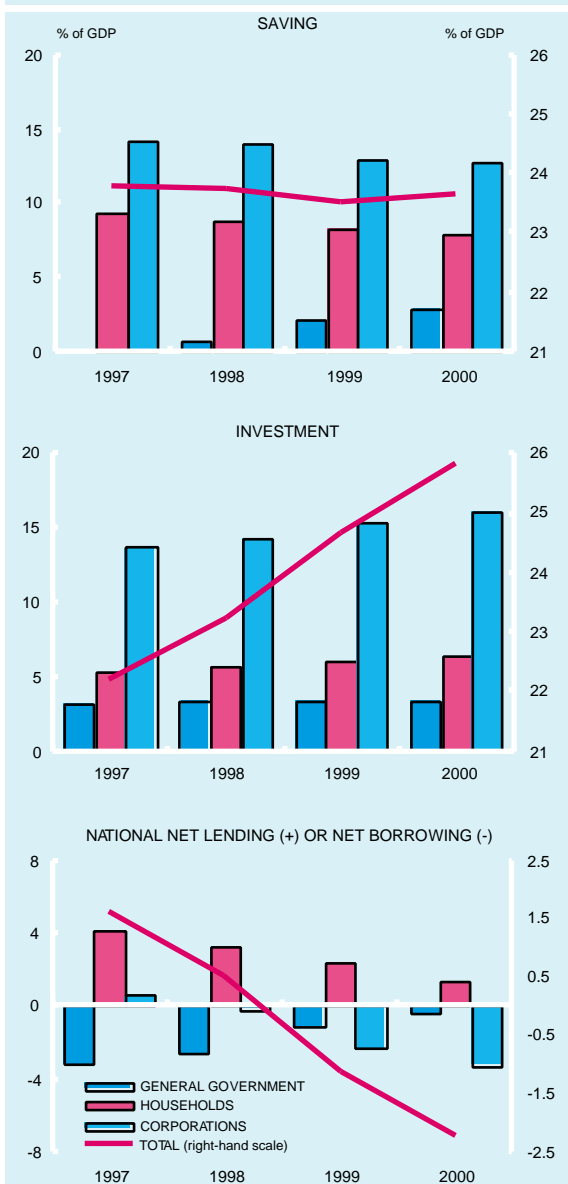
| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|--|--------------|-------------|-------------|-------------|-------------|-------------|
| 1. Gross disposable income | 100.2 | 99.6 | 99.5 | 99.3 | 99.0 | 98.9 |
| General government | 16.2 | 16.7 | 18.0 | 18.7 | 20.1 | 20.5 |
| Financial institutions | 2.1 | 2.0 | 1.6 | 1.8 | 1.5 | 1.7 |
| Non-financial corporations and households and NPIs | 81.8 | 81.0 | 79.8 | 78.8 | 77.3 | 76.7 |
| <i>Households and NPIs</i> | 69.5 | 69.1 | 68.2 | 67.5 | 66.8 | 66.5 |
| <i>Non-financial corporations</i> | 12.3 | 11.9 | 11.7 | 11.4 | 10.5 | 10.2 |
| 2. Consumption | 77.9 | 77.6 | 76.8 | 76.7 | 76.7 | 76.4 |
| General government | 18.1 | 17.9 | 17.6 | 17.5 | 17.3 | 17.1 |
| Households and NPIs | 59.8 | 59.6 | 59.3 | 59.2 | 59.3 | 59.4 |
| 3. Gross national saving (1 - 2) | 22.3 | 22.1 | 22.6 | 22.6 | 22.3 | 22.4 |
| General government | -1.8 | -1.2 | 0.4 | 1.2 | 2.8 | 3.4 |
| Financial institutions | 1.8 | 1.6 | 1.3 | 1.5 | 1.0 | 1.3 |
| Non-financial corporations and households and NPIs | 22.4 | 21.7 | 20.9 | 19.9 | 18.5 | 17.7 |
| <i>Households and NPIs</i> | 10.1 | 9.9 | 9.2 | 8.5 | 8.0 | 7.6 |
| <i>Non-financial corporations</i> | 12.3 | 11.9 | 11.7 | 11.4 | 10.5 | 10.2 |
| 4. Gross capital formation (a) | 21.3 | 20.8 | 21.0 | 22.1 | 23.5 | 24.7 |
| General government | 4.8 | 3.7 | 3.6 | 3.8 | 3.9 | 3.8 |
| Financial institutions | 0.8 | 0.6 | 0.6 | 0.4 | 0.5 | 0.6 |
| Non-financial corporations and households and NPIs | 15.7 | 16.6 | 16.8 | 17.9 | 19.0 | 20.3 |
| <i>Households and NPIs</i> | 4.8 | 5.1 | 5.0 | 5.3 | 5.6 | 6.2 |
| <i>Non-financial corporations</i> | 10.9 | 11.5 | 11.8 | 12.6 | 13.4 | 14.1 |
| 5. Net lending (+) or borrowing (-) of the nation (3 - 4) | 1.0 | 1.2 | 1.6 | 0.5 | -1.1 | -2.2 |
| General government | -6.6 | -4.9 | -3.2 | -2.6 | -1.2 | -0.3 |
| Financial institutions | 1.0 | 1.0 | 0.7 | 1.1 | 0.5 | 0.7 |
| Non-financial corporations and households and NPIs | 6.7 | 5.1 | 4.0 | 2.0 | -0.5 | -2.5 |
| <i>Households and NPIs</i> | 5.3 | 4.8 | 4.2 | 3.2 | 2.4 | 1.4 |
| <i>Non-financial corporations</i> | 1.4 | 0.4 | -0.2 | -1.3 | -2.9 | -3.9 |
| 6. Net financial transactions (7 - 8) | 1.0 | 1.2 | 1.6 | 0.5 | -1.1 | -2.2 |
| General government | -6.6 | -4.9 | -3.2 | -2.6 | -1.2 | -0.3 |
| Financial institutions | 1.0 | 1.0 | 0.7 | 1.1 | 0.5 | 0.7 |
| Non-financial corporations and households and NPIs | 6.7 | 5.1 | 4.0 | 2.0 | -0.5 | -2.5 |
| <i>Households and NPIs</i> | 6.2 | 5.3 | 4.6 | 3.3 | 1.8 | 0.5 |
| <i>Non-financial corporations</i> | 0.5 | -0.1 | -0.5 | -1.3 | -2.3 | -3.1 |
| 7. Financial transactions (assets) | 35.7 | 43.1 | 43.3 | 50.1 | 52.4 | 48.7 |
| General government | 1.5 | 3.7 | 0.5 | 1.4 | 1.7 | 1.6 |
| Financial institutions | 17.1 | 20.2 | 21.4 | 24.2 | 22.3 | 20.7 |
| Non-financial corporations and households and NPIs | 17.2 | 19.2 | 21.4 | 24.5 | 28.4 | 26.4 |
| <i>Households and NPIs</i> | 9.4 | 9.2 | 9.9 | 10.2 | 9.8 | 9.1 |
| <i>Non financial corporations</i> | 7.8 | 10.0 | 11.4 | 14.3 | 18.5 | 17.2 |
| 8. Financial transactions (liabilities) | 34.7 | 41.9 | 41.6 | 49.6 | 53.6 | 49.8 |
| General government | 8.1 | 8.6 | 3.7 | 4.0 | 2.9 | 2.7 |
| Financial institutions | 16.1 | 19.2 | 20.7 | 23.1 | 21.8 | 20.3 |
| Non-financial corporations and households and NPIs | 10.5 | 14.1 | 17.3 | 22.5 | 28.9 | 26.8 |
| <i>Households and NPIs</i> | 3.3 | 3.9 | 5.4 | 6.9 | 8.1 | 7.5 |
| <i>Non-financial corporations</i> | 7.3 | 10.2 | 12.0 | 15.6 | 20.8 | 19.3 |

Sources: Instituto Nacional de Estadística and Banco de España.

(a) Includes the change in stocks and net acquisitions of valuables and of non-financial non-produced assets (added) and net capital transfers (subtracted).

CHART V.1

National saving, investment and net lending (+) or net borrowing (-)



Sources: Instituto Nacional de Estadística and Banco de España.

Also notable are the downward trend in household net financial saving and the reintermediation, over the last two years, of household financial flows through credit institutions, following a period in which households preferred to channel their savings through institutional investors. However, as will be discussed below, some of the instruments issued by the latter (such as international mutual funds, unit-linked life assurance and pension funds) have continued to capture a very significant portion of household savings in the last two years.

V.1.3. Financial flows of households and non-financial corporations

In 2000, the net financial saving of households and private non-profit institutions (NPIs) fell again to 0.5 % of GDP (see Table V.2), the lowest level in recent decades. The downward trend seen since the mid-1990s has been a consequence of the relative stability of gross saving, in terms of GDP, and of the vigorous accumulation of liabilities (see Chart V.2), associated with the growth in housing investment. Until 1999, this behaviour stemmed from an intensive process of asset revaluation, as well as from the Spanish economic upswing and monetary and financial conditions conducive to rising spending and indebtedness. The increase in the value of financial wealth, together with the rise in the price of housing, has led to growth in the net wealth of the sector in recent years, which has improved its expectations regarding its future spending capacity, and thus discouraged saving. Furthermore, the environment of greater macroeconomic stability which has accompanied Spain's membership of the Monetary Union and the growth of employment have also helped to strengthen the confidence of households, thus reducing the precautionary motive for saving.

However, this situation began to change somewhat during 2000, owing to a number of factors that could give rise to a change of trend in household financial saving. Among these is the moderation in the rate of economic growth, and the rise in interest rates that accompanied the change in monetary policy stance during the year and, above all, the fall in the value of wealth, as a consequence of the behaviour of financial-asset prices.

By component, the net acquisition of financial assets fell during 2000 (see Table V.3 and Chart V.2), probably to the benefit of investment in real assets, whose profitability, measured in terms of the annual growth of the price of appraised housing, has displayed an upward trend over the last three years (see Chart V.3). Among financial assets, time deposits and repos were the most dynamic in 2000, to the detriment of shares in mutual funds and cash and cash equivalents. Time deposits were boosted by the rapid response of the interest rates on time deposits to changes in the Eurosystem monetary policy, the more equal tax treatment of traditional bank liabilities and other financial assets and, in particular, the reduction in 1999 in the tax charged on deposits with a maturity of more than two years.

TABLE V.2

Net financial transactions and inter-sectoral flows

% of GDP

| | NET FINANCIAL TRANSACTIONS | | | | | |
|---|----------------------------|-------------|-------------|-------------|-------------|-------------|
| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
| National economy | 1.0 | 1.2 | 1.6 | 0.5 | -1.1 | -2.2 |
| Non-financial corporations and households and NPIs | 6.7 | 5.1 | 4.0 | 2.0 | -0.5 | -2.5 |
| Non-financial corporations | 0.5 | -0.1 | -0.5 | -1.3 | -2.3 | -3.1 |
| Households and NPIs | 6.2 | 5.3 | 4.6 | 3.3 | 1.8 | 0.5 |
| Financial corporations | 1.0 | 1.0 | 0.7 | 1.1 | 0.5 | 0.7 |
| General government | -6.6 | -4.9 | -3.2 | -2.6 | -1.2 | -0.3 |
| | INTER-SECTORAL FLOWS (a) | | | | | |
| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
| Households and NPIs | 6.2 | 5.3 | 4.6 | 3.3 | 1.8 | 0.5 |
| Vis-à-vis: | | | | | | |
| Credit institutions (b) | 2.0 | -2.7 | -6.7 | -4.5 | 0.3 | -0.6 |
| Institutional investors (c) | 3.1 | 8.8 | 10.9 | 7.7 | 1.1 | 0.3 |
| Non-financial corporations | 0.5 | -0.1 | -0.5 | -1.3 | -2.3 | -3.1 |
| Vis-à-vis: | | | | | | |
| Credit institutions (b) | -1.3 | -0.3 | -3.2 | -4.3 | -3.7 | -6.2 |
| Rest of the world | -0.3 | 0.4 | 1.7 | 0.5 | -0.5 | 0.7 |
| General government | -6.6 | -4.9 | -3.2 | -2.6 | -1.2 | -0.3 |
| Vis-à-vis: | | | | | | |
| Credit institutions (b) | -3.1 | -0.4 | 1.4 | 1.4 | 1.4 | 2.2 |
| Institutional investors (c) | 0.5 | -5.9 | -3.9 | -2.6 | 1.7 | 3.5 |
| Rest of the world | -3.4 | -0.2 | -2.0 | -1.1 | -4.3 | -6.0 |
| Rest of the world | -1.0 | -1.2 | -1.6 | -0.5 | 1.1 | 2.2 |
| Vis-à-vis: | | | | | | |
| Credit institutions (b) | -2.8 | 0.9 | 2.8 | 7.2 | 2.2 | 5.2 |
| Institutional investors (c) | -0.5 | -0.9 | -2.6 | -6.3 | -3.5 | -5.7 |
| Non-financial corporations | 0.3 | -0.4 | -1.7 | -0.5 | 0.5 | -0.7 |
| General government | 3.4 | 0.2 | 2.0 | 1.1 | 4.3 | 6.0 |

Source: Banco de España.

(a) A positive sign denotes the extension of financing to the counterpart sector. A negative sign denotes the receipt of financing from the counterpart sector.

(b) As defined by the First Banking directive.

(c) Insurance corporations and collective investment undertakings.

Conversely, purchases of shares in domestic fixed-income mutual funds fell significantly, but this did not affect equity and international funds. Finally, contributions to pension schemes and insurance (included under the heading *other*) were significant during the year as a whole, although their amount diminished in the last two quarters as a result of a certain tailing-off of the demand for *unit-linked* life assurance.

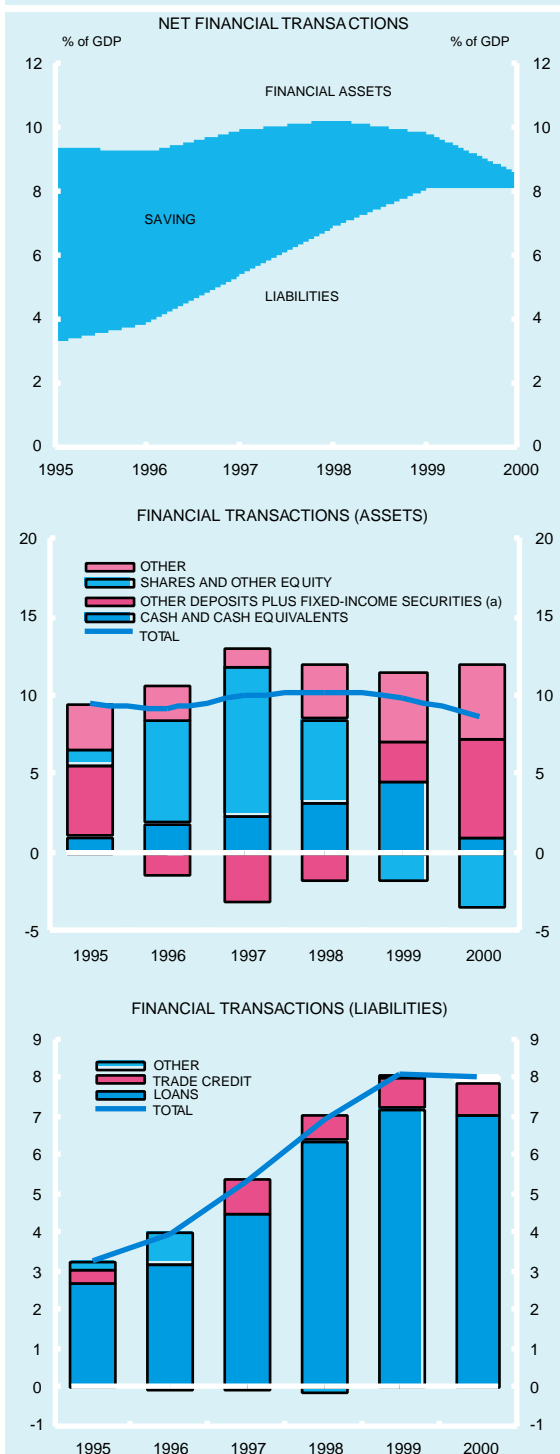
The financing obtained by the household and NPI sector continued to increase at high rates during 2000 (see Table V.3 and Chart V.2). However, the

increase in the cost of bank credit and the loss of momentum in the economic upswing have helped to moderate the demand for financing in the latest period, although loans for house purchase have continued to grow at a high rate. A contributing factor here may be the fact that the interest rates on housing loans are the ones that have risen least, as a consequence of the high degree of competition existing between banks in this segment of the market.

Turning to non-financial corporations, their net financial saving continued to decline during 2000, to

CHART V.2

Financial transactions of households and NPIs



Source: Banco de España.

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

stand at -3.1 % of GDP (see Table V.2), as the gap between the gross capital formation and gross saving of the sector widened. This net borrowing was

increased by acquisitions of foreign enterprises, which led to a considerable increase in the portfolio of shares and other equity. If the portfolio of foreign shares (which, in most cases, represents a permanent investment in capital equipment already installed) is added to gross capital formation, the difference between the gross saving and the real and permanent financial investment increases to 13 % of GDP, four percentage points higher than in 1999 (see Chart V.4). However, the figures for last year were affected by reorganisations of multinational groups, which involved movements of a purely accounting nature in their Spanish subsidiaries.

In terms of components, there was a very pronounced increase in the acquisition of financial assets by this sector (see Table V.3 and Chart V.4), owing to various transactions involving large Spanish firms. A significant part of this increase is explained by the acquisition of foreign enterprises and the financing of foreign subsidiaries (included under the headings *shares and other equity* and *other*, in Chart V.4), a smaller portion corresponding to trade credit and a very small part to cash and cash equivalents, other deposits and fixed-income securities.

The financing of the acquisitions of foreign enterprises, of gross capital formation and of other financial investment involved significant growth in the liabilities of non-financial corporations during 2000 (see Table V.3 and Chart V.4), which took the form of an increase in their equity and borrowing. The volume of funds raised through increases in capital and, to a lesser extent, through loans from the rest of the world increased significantly (see Table V.3). Meanwhile, although the issuance of fixed-term securities was negative in net terms, it should be taken into account that a large part of such issuance was channelled through the foreign subsidiaries of Spanish enterprises (see Box V.1) and is therefore not reflected in the information relating to the issues of the resident parent company.

Funds obtained from resident credit institutions also increased notably last year. This variable was affected by the need to finance the acquisition of UMTS licences in Europe. During 2000, the business sectors that resorted most intensively to bank finance were services and construction, whose demand for credit grew at a rate of around 20 %. By contrast, loans to industry, excluding construction, grew at a much more moderate rate.

**Non-financial corporations and households and NPIs
Financial transactions**

TABLE V.3

% of GDP

| | Non-financial corporations | | | Households and NPIs | | |
|---|----------------------------|-------------|-------------|---------------------|------------|------------|
| | 1998 | 1999 | 2000 | 1998 | 1999 | 2000 |
| Net financial transactions | -1.3 | -2.3 | -3.1 | 3.3 | 1.8 | 0.5 |
| Financial transactions (Assets) | 14.3 | 18.5 | 28.2 | 10.2 | 9.8 | 8.6 |
| Cash and transferable deposits | 1.5 | 0.7 | 0.9 | 1.3 | 2.3 | 0.6 |
| Other deposits | 0.2 | -1.3 | 1.0 | 0.6 | 4.4 | 6.5 |
| Of which: | | | | | | |
| <i>Rest of the world</i> | 1.6 | -1.4 | -0.2 | 0.8 | 0.6 | 0.6 |
| Securities other than shares | 0.2 | 1.1 | 0.2 | -0.4 | 0.5 | 0.2 |
| Shares and other equity | 3.0 | 8.6 | 14.3 | 5.3 | -1.8 | -3.4 |
| Of which: | | | | | | |
| <i>Shares in mutual funds</i> | 0.6 | 0.2 | -0.1 | 5.1 | -1.8 | -3.7 |
| Insurance technical reserves | 0.2 | 0.3 | 0.3 | 2.5 | 3.3 | 3.7 |
| Credit and other | 9.2 | 9.1 | 11.5 | 0.9 | 1.2 | 1.1 |
| Financial transactions (Liabilities) | 15.6 | 20.8 | 31.3 | 6.9 | 8.1 | 8.0 |
| Securities other than shares | -0.1 | 0.5 | -0.4 | | | |
| Shares and other equity | 2.7 | 5.3 | 12.4 | | | |
| Loans | 6.5 | 8.4 | 11.1 | 6.4 | 7.2 | 7.1 |
| Of which: | | | | | | |
| <i>Credit institutions</i> | 4.7 | 4.9 | 6.8 | 5.9 | 6.5 | 6.9 |
| <i>Rest of the world</i> | 1.7 | 3.0 | 3.3 | 0.0 | 0.0 | 0.0 |
| Trade credit | 6.6 | 6.3 | 8.2 | 0.7 | 0.8 | 0.9 |
| Insurance technical reserves and other | -0.1 | 0.3 | 0.0 | -0.2 | 0.1 | 0.1 |

Source: Banco de España.

V.1.4. General government financial flows

General government net financial saving, which was still negative last year, continued to decline in absolute terms to stand at -0.3 % of GDP (see Chart V.5). The fall in general government net borrowing was reflected in its liabilities, which increased by a smaller amount than in previous years, while the rate of increase of assets remained the same. The reduction in the general government deficit in recent years has been the result of a reduction in financing needs at all levels of the public sector (see Chart V.5). However, in 2000 only central government and the social security system contributed to the improvement in the financial position of the sector.

The downward trend of the last five years in securities issuance was extended in 2000. Net issuance continued to fall, being negative again in the case of short-term instruments. Also, State securities issued in the past at higher rates of interest were exchanged for recent issues with a

lower yield. As a result of this strategy of restructuring the maturity profile, the share of long-term debt in total general government liabilities has increased by almost 20 percentage points over the last five years to stand at 85 % at end-2000. The average term to maturity of State debt was, as at the same date, more than five and a half years.

Analysis of the sources of general government financing during 2000 shows an intensification of the process of replacement of funds from resident sectors with contributions from the rest of the world. Both institutional investors and credit institutions, which absorbed the larger part of issues of public securities until 1998, have in the last two years significantly reduced, and even changed the sign of, the net balance of their financial transactions with general government (see Chart V.5), while non-resident investors increased their net acquisitions of Spanish public debt. These changes took place against a background of increasing international di-

CHART V.3

Yields

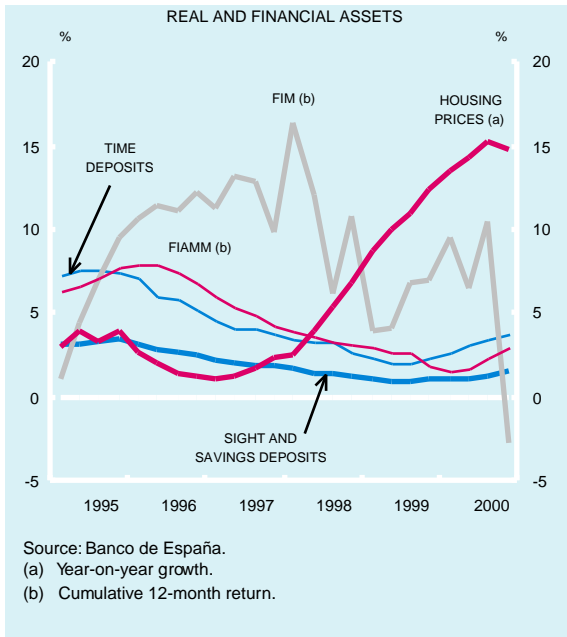
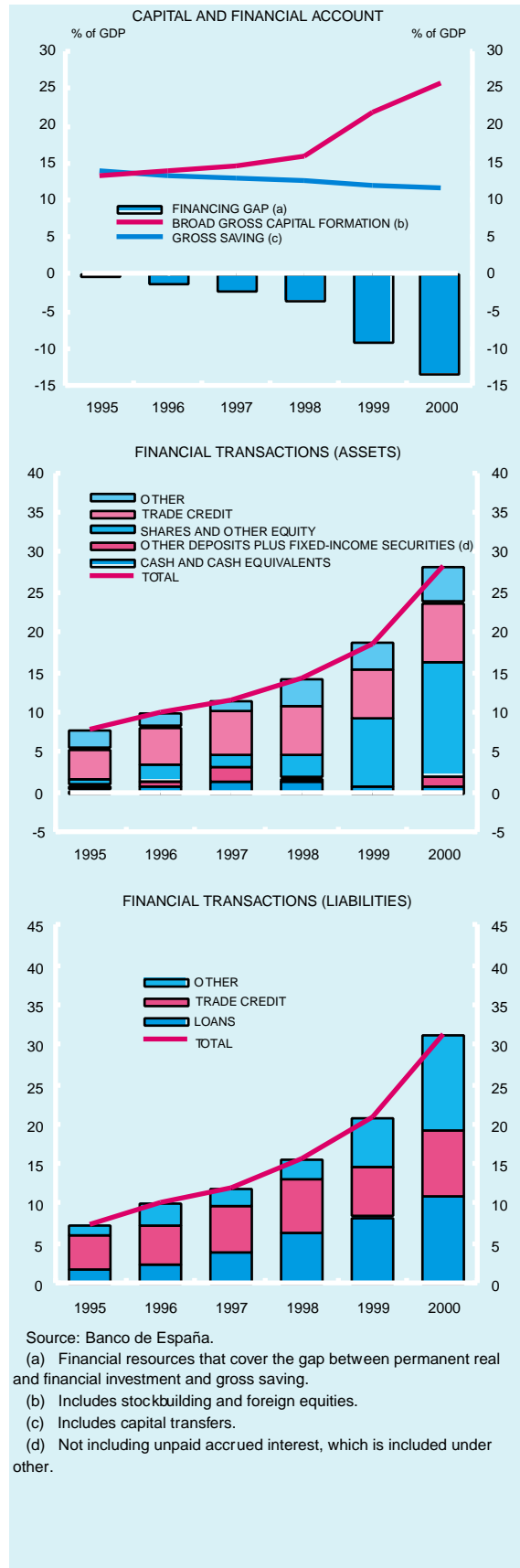


CHART V.4

Financial transactions of non-financial corporations



verification of portfolios following the start of Stage Three of EMU.

V.1.5. Foreign investment and financing of the Spanish economy

As already mentioned, the net balance of financial transactions of the Spanish economy with the rest of the world was negative in 2000 for the second year running, with the net borrowing of the nation increasing from 1.1 % of GDP in 1999 to 2.2 %.

The information contained in the financial accounts indicates that this negative net balance was the result of a significant increase in the accumulation of both external assets and liabilities (see Chart V.4). This shows the increasing internationalisation of the investment and financing decisions of resident sectors, prompted by the liberalisation of capital movements and participation in Stage Three of EMU.

Investment in external assets displayed an exceptional rise in 2000, following three consecutive years of increases. The rise primarily took the form of shares and other equity acquired by non-financial corporations (especially Spanish multinationals) and institutional investors. In the last four years, the volume of such acquisitions (which includes most of the direct investment and that part of portfolio in-

Recent developments in the financing of Spanish non-financial firms through the issuance of debt securities

Spanish non-financial firms have traditionally covered the bulk of their external financing requirements through bank borrowing, while the issuance of debt securities has been residual. For example, as at end-1998 credit financing was nine times greater than the outstanding balance of debt issued by such firms and by their subsidiaries abroad. Against this background, certain changes have occurred since 1999, which have created a more favourable climate for the issuance of private debt, presaging a higher degree of development of these markets in Spain. First, the tax treatment for private debt securities was put on an equal footing with that of the debt issued by the State and, within the operational framework of the single monetary policy, private debt securities were included in the list of eligible assets for Eurosystem operations. Moreover, the reduction in net issuance by the Treasury, owing to the smaller budget deficit to be financed, opened up new opportunities for issuance by other sectors. At the same time, the greater stability of the Spanish economy and a lower nominal return on low-risk assets helped shift the interest of investors towards assets with higher expected returns, such as private debt securities. Finally, regulatory changes were made to simplify the process and reduce the cost of issuing corporate debt securities.

This background makes an analysis of recent developments in the financing of Spanish non-financial firms through the issuance of debt securities and an evaluation of the extent to which debt in the form of such securities helps to increase disintermediation by replacing bank loans highly relevant.

For this purpose, it is appropriate to distinguish between resident firms and their foreign subsidiaries. In fact, some large Spanish firms have subsidiaries that issue debt on international markets and then distribute the funds obtained among the group firms. According to the information in the adjoining table such issuance grew considerably in importance during 1999 and 2000, to the extent that the outstanding balance is estimated to have risen almost fivefold in just two years and, as at end-2000, exceeded that of fixed-income securities issued directly by the parent companies (1). The large increase in such issuance has been concentrated among the subsidiaries of a small number of firms. In fact, the net volume of funds obtained by the subsidiaries of just three firms accounts for more than 90 % of net foreign issuance during the last two years (2).

As regards the issuance of resident firms, it has grown much more moderately (see adjoining table), with positive net values in the last two years, following negative values in the preceding years. However, the aggregate analysis fails to reveal that there were two groups of company with very different behaviour. On one hand, there is a small group (13 to be precise) which obtained positive net financing from debt markets over the period 1999 to 2000. Of these, the four main ones account for more than 75 % of the total volume. On the other hand, the large majority of the firms that had securities in issue as at end-1998 (seventy) did not obtain fresh financing from the fixed-income markets and the net issuance of many of these (forty-one) was actually negative. Neither was there a significant number of new issuers.

In conclusion, the information available suggests that the strong increase in the issuance of debt securities has been concentrated among a small number of large firms which have in the short term required large volumes of financing. This suggests that, despite the various factors which have given rise to an environment more conducive to the issuance of such securities during the last two years, other factors of a structural nature that change only gradually, such as the structure of domestic industry, asymmetric-information problems and the investment policy of Spanish banks, are limiting the development of this market.

Issuance of debt securities by Spanish non-financial firms

| | EUR millions and units | | |
|---|------------------------|---------------|---------------|
| | 1998 | 1999 | 2000 |
| Net issuance (EUR m) | | | |
| Resident firms | -31 | 3,480 | 25 |
| Short-term (a) | 547 | 1,671 | -1,196 |
| Medium and long-term | -578 | 1,809 | 1,221 |
| Subsidiaries abroad | 854 | 9,487 | 11,134 |
| Outstanding securities (EUR m) | 19,837 | 33,709 | 44,855 |
| Resident firms | 14,327 | 18,032 | 18,105 |
| Short-term (a) | 3,070 | 4,741 | 3,545 |
| Medium and long-term | 11,257 | 13,291 | 14,560 |
| Subsidiaries abroad | 5,510 | 15,677 | 26,750 |
| Number of active issuers (b) (c) | 9 | 11 | 12 |
| Resident firms | 9 | 10 | 7 |
| Short-term (a) | 6 | 5 | 4 |
| Medium and long-term | 5 | 8 | 6 |
| Subsidiaries abroad (c) | 2 | 4 | 6 |

Sources: CNMV and Banco de España.

(a) Issues of commercial paper registered with the CNMV.

(b) Active issuers are those whose net issuance is positive.

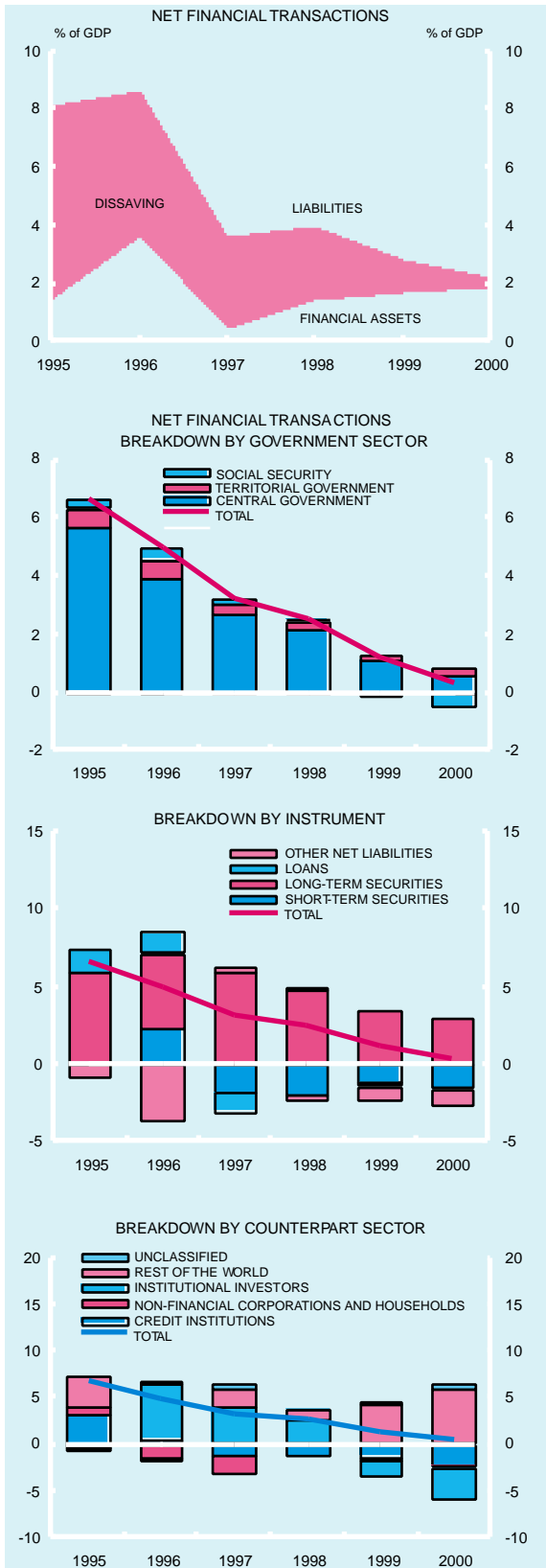
(c) All the subsidiaries of a resident firm plus the parent firm itself are counted as one single issuer.

(1) The information on the issuance of subsidiaries is based on a provisional estimate subject to revision. The figures in the table probably understate the actual outstanding balances of securities issued by subsidiaries.

(2) The firms in question have had high borrowing requirements owing to the processes of international expansion in which they are immersed and the costs of acquiring UMTS licences.

CHART V.5

General government financial transactions



Source: Banco de España.

vestment in the form of shares and other equity) represents 30 % of GDP. In 1998 and 1999 the main geographical destination of investment abroad was Latin America. By contrast, during 2000 the flow of investment to Latin America fell while that to the European Union increased, and the latter area became the main recipient of such funds.

Last year the Spanish economy also accumulated a very significant volume of liabilities vis-à-vis the rest of the world, which were recorded under various headings. There was a significant flow of capital to Spain in the form of acquisitions of shares in Spanish companies, partly as a result of the exchange transactions arising from the acquisition of foreign enterprises (and of reorganisations of groups of transnational enterprises). The non-financial private sector also obtained a significant volume of loans from the rest of the world, basically to finance the real and financial investment of non-financial firms. The acquisition by non-residents of securities issued by general government gained further momentum during 2000, as already mentioned, continuing the trend that began in 1999. Finally, as explained in section V.3, credit institutions further increased their liabilities vis-à-vis non-residents in the form of deposits and loans. Some of these funds were endowments and transfers from institutions belonging to the same financial group, which thereby exploit the possibilities offered by the existence of a Europe-wide inter-bank market.

V.2. SPANISH FINANCIAL MARKETS

Spanish financial markets are currently in the throes of a transformation prompted by the increasing internationalisation of financial activity and competition between trading centres. Their activity during 2000, carried out against a background of high price volatility, particularly on the stock exchanges, was governed by the trends in the net borrowing of the resident sectors discussed in the previous section. Broadly, their role in directly channelling funds from final savers to final investors diminished, to the benefit of financial intermediaries (see Section V. 3). However, this outcome was the result of differing performances by the equity and fixed-income markets, with the former recording significant growth both in terms of issuance and secondary market trading.

TABLE V.4

Financial transactions of the nation

% of GDP

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|-------------|------------|------------|-------------|-------------|-------------|
| Net financial transactions | 1.0 | 1.2 | 1.6 | 0.5 | -1.1 | -2.2 |
| Financial transactions (assets) | 6.5 | 6.5 | 9.6 | 12.8 | 15.2 | 24.9 |
| Gold and SDRs | 0.0 | 0.0 | 0.0 | 0.0 | -0.2 | 0.0 |
| Cash and deposits | 5.2 | 1.3 | 1.3 | 3.2 | 1.8 | 2.9 |
| Credit system | 3.6 | 0.0 | -1.5 | 0.0 | 3.7 | 2.6 |
| Other resident sectors | 1.6 | 1.3 | 2.7 | 3.2 | -1.9 | 0.3 |
| Securities other their shares | -0.9 | 3.3 | 3.6 | 3.4 | 2.8 | 3.8 |
| Credit system | -1.0 | 2.8 | 1.9 | -1.4 | -0.9 | -0.3 |
| Other resident sectors | 0.1 | 0.5 | 1.6 | 4.8 | 3.7 | 4.1 |
| Shares and other equity | 0.7 | 1.0 | 2.9 | 4.4 | 9.8 | 15.1 |
| Credit system | 0.2 | 0.0 | 0.5 | 0.4 | 0.5 | 2.0 |
| Other resident sectors | 0.5 | 1.0 | 2.4 | 4.0 | 9.4 | 13.1 |
| Of which: | | | | | | |
| Non-financial corporations | 0.4 | 0.9 | 1.6 | 2.2 | 6.9 | 10.2 |
| Loans | 1.5 | 0.9 | 1.9 | 1.9 | 0.9 | 3.1 |
| Credit system | 0.5 | 0.0 | 0.8 | 0.2 | -0.1 | 0.5 |
| Other resident sectors | 1.0 | 0.9 | 1.1 | 1.7 | 1.0 | 2.5 |
| Financial transactions (liabilities) | 5.5 | 5.3 | 8.0 | 12.3 | 16.3 | 27.1 |
| Deposits | 0.4 | 3.4 | 4.4 | 6.0 | 4.2 | 7.4 |
| Of which: | | | | | | |
| Credit system | 0.4 | 3.4 | 4.4 | 5.9 | 4.1 | 7.3 |
| Securities other their shares | 3.0 | 0.5 | 2.2 | 1.0 | 5.5 | 7.0 |
| Credit system | -0.1 | 0.1 | 0.2 | 0.2 | 0.9 | 0.8 |
| General government | 3.1 | 0.4 | 2.1 | 1.0 | 4.3 | 5.7 |
| Other resident sectors | 0.0 | 0.0 | 0.0 | -0.2 | 0.2 | 0.5 |
| Shares and other equity | 1.5 | 1.0 | 1.0 | 2.9 | 3.9 | 9.0 |
| Credit system | 0.2 | 0.1 | -0.2 | 0.1 | 0.3 | 1.6 |
| Other resident sectors | 1.3 | 0.9 | 1.2 | 2.8 | 3.6 | 7.4 |
| Loans | 1.2 | 1.0 | 1.1 | 3.0 | 4.1 | 4.9 |
| General government | 0.2 | 0.0 | -0.1 | 0.1 | 0.0 | 0.1 |
| Other resident sectors | 1.0 | 1.0 | 1.2 | 2.9 | 4.1 | 4.9 |
| Other, net (a) | | | | | | |

Source: Banco de España.

(a) Includes the asset item which covers insurance technical reserves.

V.2.1. The primary markets

The heavy net borrowing by the various sectors of the Spanish economy had an uneven impact on the primary securities markets. Net issuance on equity markets was EUR 28.4 billion, an all-time high and almost three times the volume of the previous year. Meanwhile, net fixed-income issuance was EUR 15.9 billion, a relatively low figure that contrasts with the vigorous growth seen in 1999. As a result, the total financing obtained in the domestic

markets by the resident sectors fell to EUR 44.2 billion from EUR 58.1 billion in 1999 (see Table V.5).

In equity markets, the capital increases were concentrated among a small number of listed firms with large financing requirements deriving, in many cases, from their international expansion and mergers and acquisitions, and in others, from the costs of acquiring UMTS licences. The issues of four non-financial firms and two credit institutions account for almost 90 % of the total volume of equity is-

TABLE V.5

Issuance and public offerings of marketable securities

EUR millions

| | 1997 | 1998 | 1999 | 2000 |
|---|---------------|---------------|---------------|---------------|
| Net issuance by residents (a) | 22,893 | 28,009 | 58,112 | 44,244 |
| Fixed income | 22,972 | 20,884 | 48,796 | 15,875 |
| <i>State</i> | 18,254 | 12,342 | 13,626 | 10,714 |
| <i>Territorial government</i> | 2,419 | 1,387 | 1,655 | 1,174 |
| <i>Credit institutions</i> | 3,110 | 3,975 | 24,755 | -1,727 |
| <i>Other financial firms</i> | 77 | 3,211 | 5,280 | 5,689 |
| <i>Non-financial corporations (b)</i> | -888 | -31 | 3,480 | 25 |
| Equities | -79 | 7,125 | 9,316 | 28,369 |
| <i>Credit institutions</i> | -147 | 4,034 | 812 | 9,979 |
| <i>Other financial firms</i> | -99 | 24 | 399 | 732 |
| <i>Non-financial corporations</i> | 167 | 3,067 | 8,105 | 17,658 |
| Public offerings | 10,652 | 11,072 | 5,042 | 2,695 |
| Privatisations | 9,852 | 10,857 | 772 | 0 |
| Other | 800 | 215 | 4,270 | 2,695 |
| MEMORANDUM ITEMS: | | | | |
| Net issuance by foreign subsidiaries | 3,839 | 12,589 | 21,102 | 33,060 |
| Financial institutions | 2,748 | 11,735 | 11,616 | 21,926 |
| Non-financial corporations | 1,091 | 854 | 9,487 | 11,134 |

Sources: CNMV and Banco de España.

(a) Includes issuance by residents, in both domestic and foreign currency.

(b) Short-term issuance is commercial paper registered with the CNMV.

suance. It should be noted however that the number of capital increase operations also rose significantly from previous years. This may be explained, at least partly, by the still low relative cost of capital implied by the level of the stock market.

The large volume of placements on equity markets helped to increase significantly the size of Spanish stock markets. Moreover, they also had the benefit of EUR 2,700 million of initial public offerings during 2000, albeit a lower figure than in previous years.

The decline of net issuance on domestic private fixed-income markets was fairly generalised, as shown by the fact that only one of the sectors considered in Table V.5 (*other financial firms*) recorded growth. The most significant decline was concentrated in the credit-institutions sector where, having obtained net financing through the issuance of fixed-income securities of EUR 24.8 billion in 1999, there was a net redemption of EUR 1.7 billion in 2000. Recourse to the fixed-income market by non-financial firms showed a similar trend, although the fall in

volumes was less pronounced so that the net volume was slightly positive, but very much smaller than in 1999. In any case, the high and growing concentration of new issuance among a small number of large firms (see Box V.1) is notable. This, together with the fall in issuance in 2000 and the increase in credit extended to firms by credit institutions, suggests that at least for the moment there are no signs in Spain of further growth in financial disintermediation, through a shift towards financing with fixed income securities at the expense of bank borrowing.

It should be pointed out, in any case, that an analysis of issuance on domestic markets provides only a partial view of the financing obtained by means of debt instruments. In fact, in recent years, issuance on international markets by the subsidiaries of Spanish firms, both financial and non-financial, has been growing in importance, so that the outstanding amount of such operations currently exceeds that of the domestic issues made by the parent firms. It cannot be ruled out that part of the issuance by subsidiaries goes to help finance the ac-

TABLE V.6

Turnover on secondary and derivatives markets

EUR millions

| | 1997 | 1998 | 1999 | 2000 |
|---|-------------------|-------------------|-------------------|-------------------|
| Public-debt book-entry market(a) | 12,352,112 | 14,478,979 | 13,109,675 | 13,788,917 |
| Spot (b) | 1,700,197 | 1,747,709 | 1,817,465 | 1,585,460 |
| Repos | 10,577,350 | 12,676,285 | 11,254,309 | 12,186,364 |
| Forward (b) | 74,565 | 54,985 | 37,901 | 17,093 |
| AIAF fixed-income market (b) | 21,173 | 43,120 | 86,269 | 99,826 |
| Commercial paper | 4,447 | 7,935 | 25,284 | 46,425 |
| Ordinary and asset-backed bonds and mortgage certificates | 10,950 | 28,761 | 58,572 | 52,189 |
| Matador bonds | 5,776 | 6,424 | 2,413 | 1,212 |
| Stock exchange: fixed-income (b) | 54,217 | 53,148 | 44,718 | 39,692 |
| State debt | 21,890 | 603 | 160 | 73 |
| Territorial government debt | 30,043 | 51,791 | 42,858 | 38,723 |
| Other | 2,284 | 754 | 1,700 | 896 |
| Stock exchange: equities | 163,261 | 261,276 | 291,975 | 492,980 |
| MEFF derivatives markets (c) | 3,286,810 | 2,668,336 | 966,975 | 689,214 |
| Fixed-income | 3,012,658 | 2,111,985 | 378,065 | 109,655 |
| Short-term | 1,631,754 | 1,125,442 | 20,262 | 205 |
| Medium and long-term | 1,380,904 | 986,543 | 357,803 | 109,450 |
| Equities | 274,152 | 556,351 | 588,910 | 579,559 |
| Ibex 35 | 270,719 | 549,329 | 574,109 | 549,132 |
| Stock options | 3,433 | 7,022 | 14,801 | 30,426 |

Sources: AIAF, MEFF, Spanish stock exchanges, CNMV, Federación Europea de Bolsas and Banco de España.

(a) Only includes transactions with State securities.

(b) Nominal turnover.

(c) Turnover is expressed in monetary units and has been obtained by multiplying the number of contracts traded by their size.

tivities pursued by these firms abroad. However, it is also possible that some of the funds go to the parent company. If so, the question would arise as to whether this practice is a cause or a consequence of the scant development of these markets in Spain.

Finally, general government reduced its net issuance of securities as a consequence of the lower net borrowing implied by the reduction in the budget deficit. By maturity, net short-term issuance (both by the State and territorial government) was negative, which, as already mentioned, helped to lengthen the average term to maturity of the instruments issued by the sector. The stock of securities issued will foreseeably continue to decelerate in the coming years, insofar as the general government budget balance continues to improve.

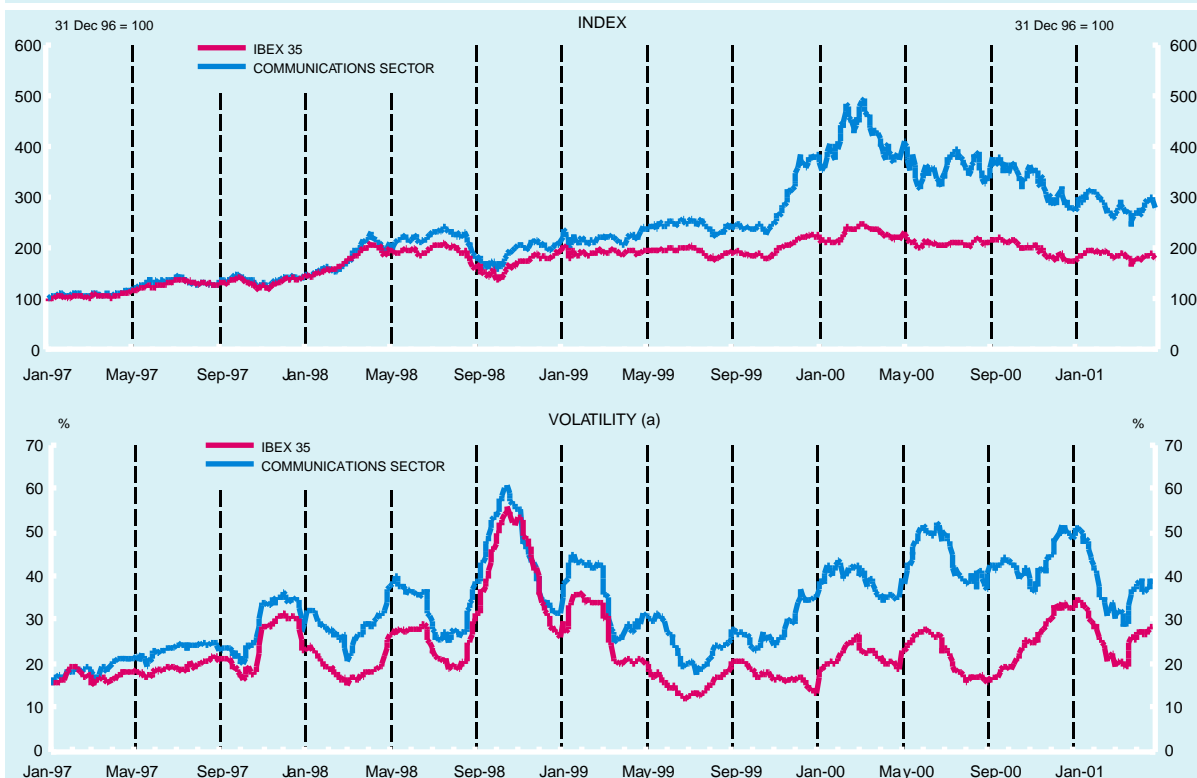
The information available on the first few months of 2001 suggests that the funds raised on the domestic securities markets have continued to decline. Moreover, unlike in 2000, the relative importance of equity markets has diminished, possibly

as a consequence of the greater uncertainty over the future direction of share prices.

V.2.2. Secondary market activity

Activity on the Spanish secondary markets during 2000 was characterised by the increasing internationalisation and integration of the various settlement and trading platforms. The share of non-resident investors in trading on Spanish stock markets rose by seven percentage points (from 47 % in 1999 to 54 %). At the same time non-resident investors continued to increase their positions in the government debt market, their outright holdings rising from 26 % at end-1999, to 36 % at end-2000. Meanwhile, the merger between the Book-Entry System and the SCLV (securities clearing and settlement system) has meant that the clearing and settlement systems for most of the securities traded on the Spanish fixed-income and equity markets can begin to be integrated. With regard to trading, the private AIAF fixed-income market acquired a holding of 60 % in the Senaf public fixed-income trading plat-

Stock price indices



Source: Madrid Stock Exchange.

(a) Annualised standard deviation of the logarithmic difference of the last 40 observations.

form at the end of 2000. It is planned that certain private debt benchmarks and MEFF futures and options will soon be traded on this platform. On the derivatives markets the management of MEFF Renta Fija and MEFF Renta Variable was integrated. All this helped reduce the operating costs and increase the liquidity of the instruments traded, thereby increasing the attractiveness of Spanish markets for investors and issuers of securities. Also, the increased integration of domestic markets helped improve their position to confront greater international competition with better chances of success.

Last year, trends in trading figures varied across Spanish markets (see Table V.6). In equity markets, the volume of trading grew at an annual rate of 69 % (higher than the rates for the main international stock markets), boosted by the volatility of prices and by the significant increase in the stock of tradeable securities referred to above. By segment, the Nuevo Mercado (in which high growth stocks are traded), set up at the beginning of the year, has

not so far involved the entry of new firms into the stock market, although during 2000 there was a large amount of activity, which represented 12 % of total trading volume. By contrast, the relative importance of the Latibex segment on which securities issued by Latin American firms are traded remained small, given the limited number of firms listed.

Volume traded on the book-entry government debt market grew slightly (5.2 %). And this was solely due to the growth of repo transactions, since the amounts traded under outright transactions fell by 13 %. Activity in this segment seems to have been affected by various kinds of factor. In particular, the relative stability of prices and the shift, from 1999, in activity in derivatives towards contracts on German bonds may have contributed to the slackness of outright trading in Spanish government debt. In the AIAF fixed-income market, the volume of trading also showed positive growth (15.7 %), which varied greatly by instrument. While the volume of

transactions in commercial paper almost doubled in comparison with the previous year, as a consequence of the growth in gross issuance since late 1999, that in the other instruments declined.

Finally, volumes traded on the derivatives markets continued to decline for the third year running (by 29 % in 2000). However, on this occasion the decline was not limited to the fixed-income segment, but also affected instruments that have the Ibex 35 as their underlying. These falls reflected the strength of contracts traded in other European centres, especially in the Swiss-German Eurex market, in the case of contracts on medium and long-term rates and on stock-market indices, and in the British LIFFE market, in the case of contracts on short-term rates. The shift in activity in relation to fixed-income instruments is largely a consequence of the increase in the degree of substitutability between the contracts traded in Spain and on other European markets following the introduction of the euro. In the case of derivatives on stock market indices, the shift is a result of the decline in importance of the Ibex 35 in the strategies of national fund managers, against a background of international diversification of investments. It is therefore no surprise that the only segment of the derivatives market which continued to record growth in amounts traded in 2000 was that of derivatives on individual securities. This sector benefited from the launch of new options contracts and, from the beginning of 2001, from the commencement of trading in futures contracts, although its importance, in quantitative terms, is still small.

During the first few months of 2000 there were some changes in the trends in activity in comparison with the previous year. On the equity market the upward trend in trading figures came to a halt. Meanwhile, in the government debt market outright transactions recovered from the falls recorded during 2000. In the other markets, the amounts traded continued to display the same patterns as seen last year, namely growth in the AIAF market and contraction of the derivatives markets.

V.2.3. Secondary market prices

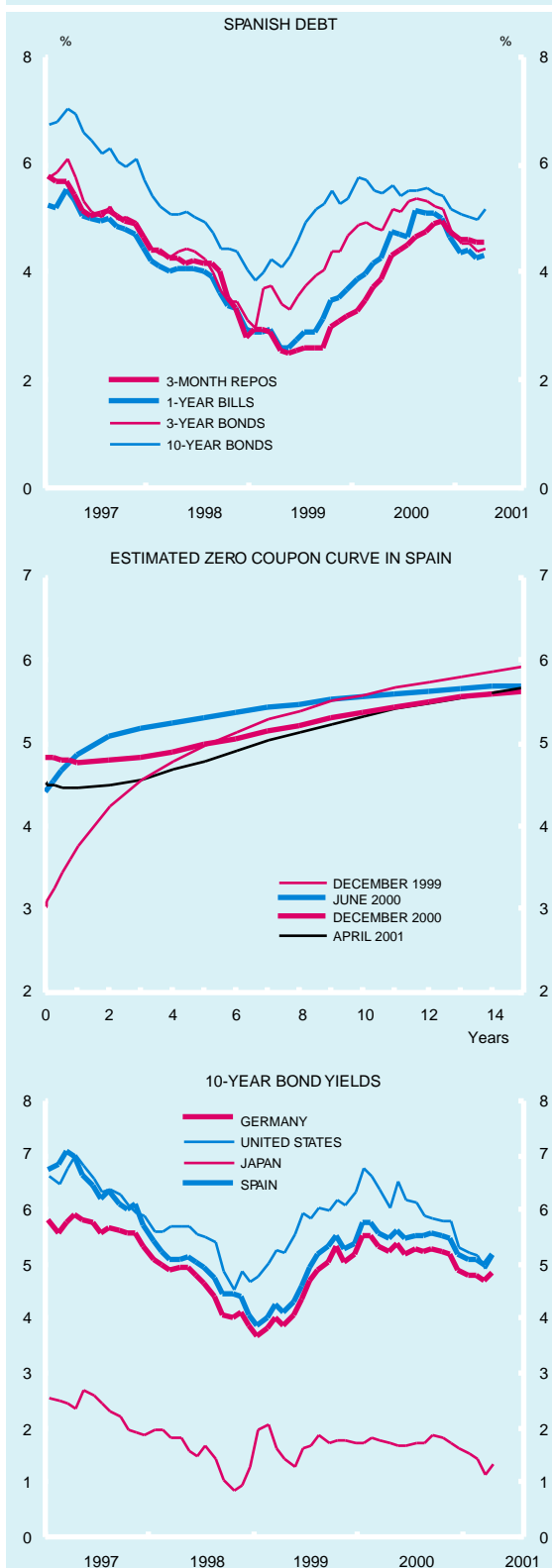
As in the case of most international equity markets, the upward trend in share prices dating back to 1995 came to a halt in the Spanish market in 2000. The Ibex 35 index fell by 21.7 %,

while the general Madrid Stock Exchange index fell by 12.7 % (see Chart V.6). This performance was more unfavourable than that of other international indices (such as the S&P 500 of American stock markets, which fell by 10.1 %, and the Dow Jones EURO STOXX Broad of euro area stock markets, which fell by 5.9 %), basically due to the relatively high weight of the worst performing sectors, namely technology and communications. The technology index of the Madrid Stock Exchange fell by 57.1 %, while the communications index slid by 27.1 %. Revision of the earnings prospects of the firms in these sectors and the more pessimistic expectations for world economic growth over the coming years prompted the price correction, despite most of the firms listed recording very healthy results during the year. The general level of prices, as measured by the Ibex 35 index, rose during January 2001, but fell again over the following months to close to the end-2000 levels. During this period, however, Spanish indices performed better than other international indices.

Another notable aspect of stock market developments in 2000 was the rise in volatility, which was particularly strong in the telecommunications and new technology sector. There was some reduction in volatility at the beginning of 2001, but it remains high, reflecting the increase in uncertainty over the performance of the economy in general and of the IT and telecommunications industries in particular.

Interest rates on the Spanish government debt market displayed a similar trend to that seen on other euro area debt markets (see Chart V.7). Short-term rates rose gradually, in line with the path of the Eurosystem's policy interest rate. Medium and long-term interest rates hardly changed during the year; moderate increases at the beginning of the year and falls during the last two months made for a reduction of some 20 basis points in 10-year yields over the year as a whole. As a consequence of these movements, the yield curve flattened considerably during the year. As in 1999 the yield spread of the Spanish over the German long-term benchmarks was small and stable during 2000. During the second half of the year however there was a slight increase in the spread (from 22 to 29 basis points), which is partly explained by a change in the German market benchmark.

CHART V.7

Government debt yields (a)

Source: Banco de España.

(a) Monthly averages.

In the early months of 2001, short-term interest rates began to fall as a consequence of expectations of reductions in the Eurosystem's policy interest rates, while medium and long-term rates held almost unchanged.

Finally, a significant increase (of some 40 basis points) was seen on private debt markets in the long-term yield spread over government debt (see Chart V.8). This trend, similar to that seen on other international markets, may reflect the higher credit risk perceived by the market for most issuers, as a consequence of the deterioration in expected future earnings and of the relatively high levels of indebtedness. The spread on short-term operations, however, remained stable at a lower level, possibly as a consequence of the lower credit risk on these instruments, although it is also possible that this segment of the market has a greater concentration of issuers with high credit standing.

V.3. SPANISH FINANCIAL INTERMEDIARIES

For another year, financial intermediaries and, especially, deposit-money institutions were the main parties responsible for channelling the financial flows of the Spanish economy, contributing significantly to their internationalisation. The sum of asset and liability transactions of resident financial institutions with the external sector rose from 12.4 % of GDP in 1999 to 20.9 % in 2000, to account for practically half of the total flows of the sector (excluding inter-sectoral flows). This notable volume of transactions with the external sector affected both the assets and the liabilities of the institutions. Acquisitions of assets issued in the rest of the world reached 10.6 % of GDP, reflecting the international expansion of the major Spanish banking groups and the geographical diversification of the portfolios of the credit institutions themselves and, especially, of collective investment undertakings, pension funds and insurance companies. On the liabilities side, deposit-money institutions resorted to the external sector for a volume equal to 10.3 % of GDP, mainly through the placement of shares by the major commercial banks and the issuance of securities on international markets. Unlike in previous years, the weight of net interbank loans was lower, although its distribution across groups of institutions was uneven and the total net interbank financing of Spanish institutions remained high (see Box V.2). The funds raised in the rest of the world by deposit-money in-

The financing of bank lending in Spain

In recent years, basically as a consequence of competition from mutual funds, the growth of customer deposits and other typical bank liabilities has been insufficient to finance the strong growth in lending (1). As a result there has been a significant change in the composition of banks' financing: resident creditors (deposits and repos), which in 1996 represented 86 % of total lending, only covered 44 % of the change in lending over the period 1997-2000.

Between 1997 and 1999, a large part of growth in lending was financed through the European interbank market. The growth in interbank debt came to a halt in 2000 thanks to a certain recovery in customer deposits and an increase in securities issuance on domestic and international markets. Even so, Spanish deposit-money institutions still have net outstanding interbank debt of close to 5 % of their total assets, which is an all-time high.

The aggregate developments described in the previous paragraph are the result of diverse situations at the level of the individual institutions. Chart 1 shows how the various groups of institution have financed the growth of credit in recent years. For these purposes, the counterparts of credit have been grouped into four categories (2): permanent financing, resident creditors, foreign creditors and debt securities, and recourse to the interbank market (3). Permanent financing and resident creditors are the most stable forms of financing. Debt securities involve a higher cost and less stability as they must be periodically renewed upon maturity. Finally, interbank financing is, in principle, the least stable, as it involves very short-term instruments, such as potentially reviewable lines of credit.

As can be seen, the gap between the growth of credit and that of traditional resources (permanent financing and resident creditors) has been clearly wider in the case of foreign banks (for whom this is a traditional characteristic) and the large commercial banks than in that of other Spanish deposit-money institutions. All banks have, to a greater or lesser extent, made use of the interbank market. However, the net positions of the various groups of institution are markedly different. Chart 2 shows how a deterioration in the net interbank position is recorded in all cases over the period in question. However, the net position is still a credit one except in the case of the large commercial banks and foreign banks.

Stage Three of EMU has had important effects on the interbank financing of institutions. Foreign banks in Spain have replaced their traditional debit position in the domestic interbank market with foreign financing, probably from their parent institutions. This would be the logical result of the greater facilities that EMU has entailed for the centralisation of the liquidity operations of euro area institutions. Furthermore, the total net borrowing of banks resident in Spain has been channelled (besides through foreign banks) through the large commercial banks, which could mean that the euro area interbank market has two tiers. The first level would involve net flows of liquidity between countries channelled through operations between the large banks of each country. At the second level, such banks would redistribute the financing obtained from abroad among the country's institutions.

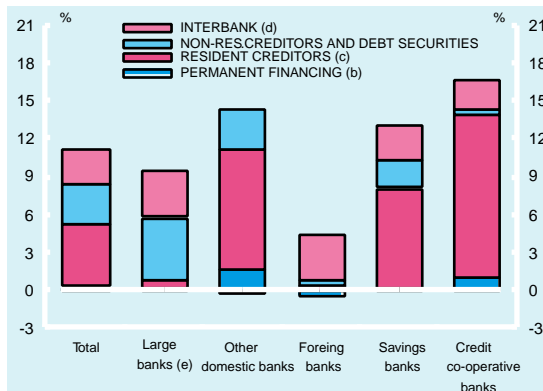
(1) Broadly defined, i.e. including loans and the debt securities held by institutions.

(2) See the footnotes to the chart.

(3) The reason for grouping together non-resident creditors and debt securities is that a large part of the strong growth in the former in recent years is due to the channelling to the parent institution, via deposits, of funds obtained through the issuance of securities by their non-bank subsidiaries in international markets.

CHART 1

Credit growth and its financing (a)



Source: Banco de España.

(a) Contributions to the average annual growth rate of lending plus holdings of fixed-income securities (1997-2000).

(b) Own funds, special funds and subordinated financing, less holdings of equities, fixed assets and cash.

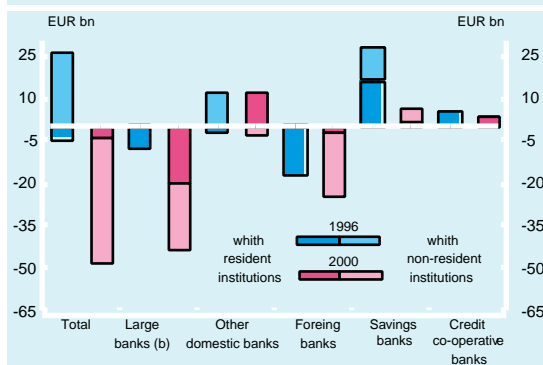
(c) Includes the net balance of various accounts.

(d) Includes Banco de España.

(e) Spanish banks belonging to the BBVA and BSCH groups.

CHART 2

Net interbank position by type of bank (a)

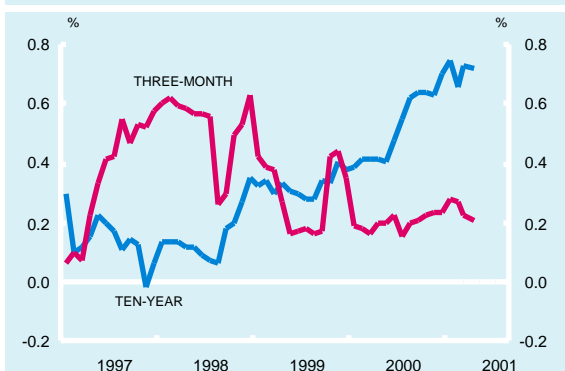


Source: Banco de España.

(a) Assets less liabilities. Not including Banco de España. Net debit position of all banks with resident credit institutions that are not deposit-money institutions (Official Credit Institute and specialised credit institutions).

(b) Spanish banks belonging to the BBVA and BSCH groups.

CHART V.8

Yield differential between private and public debt (a)

Sources: Reuters, AIAF and Banco de España.

(a) Monthly averages.

stitutions enabled the growth of credit to resident sectors to be financed and, ultimately, for the gap between domestic saving and investment to be filled.

V.3.1. Deposit money institutions

For deposit-money institutions, 2000 was a year of vigorous growth with an increase in their degree of exposure, owing to the high volume of credit extended to non-financial corporations and households and to their expansion abroad. According to the unconsolidated data on the business of individual institutions in Spain, their average total assets increased by 10 %, primarily reflecting the increases in credit extended to the resident private sector and in the equity portfolio (see Table V.7). The consolidated data for the groups of institutions show still higher growth, of 13 % (18 % in the loan portfolio and 20 % in creditors' funds and debt securities), as a consequence of the expansion of foreign business, which grew at rates of close to 50 %. For the commercial banks as a whole, foreign business now accounts for 36 % of all their business and provides 32 % of total profits before tax. Roughly half of the foreign assets relate to business in Latin America, the positions held in Mexico, Brazil and Argentina being particularly significant.

Both the commercial banks and the savings banks increased their average lending rates by similar amounts to the rises in interbank rates, although with some delay in the case of the savings banks. It should be pointed out, however, that the cost of

credit is still well below its historical average in the Spanish economy. In particular, the synthetic interest rate applied to new lending transactions rose on average by one percentage point during the year (to around two percentage points above the lows reached in July 1999), stabilising at around 6.2 % in the first few months of 2001. This compares with an average level of 9 % during the 1990s.

Including both loans in the strict sense and the portfolio of private fixed-income held by Spanish deposit-money institutions, total credit to the resident private sector grew by 16.5 % on average during the year, compared with 17.6 % in the previous year. This slight slowdown, concentrated in the second half of 2000, and continuing during the first few months of 2001, is exclusively attributable to the large commercial banks, which were immersed in merger and international expansion processes. The other domestic institutions continued to display high rates of credit growth during the first few months of 2001.

As regards the composition of credit by purpose (see Table V.8) housing credit in the broad sense (including credit to construction and real-estate activities) accounts for the sustained high rates of growth in 2000, since the expansion of the other components moderated significantly. The buoyancy of construction activity (albeit on a downtrend) and the increases in house prices (by around 15 % year-on-year) were the factors that stimulated the demand for this type of credit.

Over the last five years bank credit to the resident non-bank private sector has increased by 70 % in real terms, 20 percentage points more than during the previous upswing (1987-1991). This forceful expansion can be explained, in principle, by the low level of interest rates and the macroeconomic stability associated with Spain's participation in Stage Three of EMU, factors which help make sustainable higher levels of debt than the Spanish economy has seen historically. In fact, current debt-income ratios are not far from the average for other euro area countries (see Table V.9). However, against a background of economic boom (2), strong demand for credit and fierce

(2) The volume of doubtful assets continued to fall during 2000, although it tended to stabilise in the second half of the year. As a result, the ratio of doubtful assets to lending again reached historical lows (1 % for deposit-money institutions as a whole).

TABLE V.7

Deposit money institutions
Structure of balance sheet and profit and loss account

% of average total assets

| | Total (a) | | Banks | | Savings banks | |
|---|-------------|-------------|-------------|-------------|---------------|-------------|
| | 1999 | 2000 | 1999 | 2000 | 1999 | 2000 |
| ASSETS: | | | | | | |
| Cash and central banks (b) | 1.8 | 1.5 | 1.4 | 1.4 | 2.3 | 1.7 |
| Interbank market assets (c) | 20.0 | 17.3 | 24.1 | 20.7 | 14.2 | 12.7 |
| Lending | 50.4 | 52.7 | 46.1 | 48.2 | 56.9 | 58.8 |
| <i>General government</i> | 3.0 | 2.8 | 3.0 | 2.7 | 3.2 | 3.0 |
| <i>Other resident sectors</i> | 44.1 | 46.5 | 38.2 | 40.6 | 52.7 | 54.6 |
| <i>Non-residents</i> | 3.4 | 3.4 | 4.9 | 4.9 | 1.0 | 1.2 |
| Securities portfolio | 19.9 | 20.5 | 20.2 | 20.9 | 19.9 | 20.5 |
| <i>Of which:</i> | | | | | | |
| <i>Government debt</i> | 10.1 | 8.8 | 9.6 | 7.9 | 11.0 | 10.4 |
| <i>Equities</i> | 4.6 | 6.0 | 4.8 | 6.6 | 4.5 | 5.4 |
| Other assets (d) | 7.9 | 7.9 | 8.3 | 8.8 | 6.7 | 6.1 |
| LIABILITIES: | | | | | | |
| Banco de España | 1.5 | 1.5 | 2.0 | 1.7 | 0.8 | 1.2 |
| Interbank market liabilities (e) | 25.6 | 22.2 | 34.8 | 29.9 | 11.5 | 11.2 |
| Customer funds | 56.5 | 58.8 | 45.7 | 49.1 | 73.3 | 72.6 |
| <i>Asset repo sales to customers</i> | 8.9 | 7.6 | 7.8 | 6.8 | 11.3 | 9.2 |
| <i>Creditors: general government</i> | 1.8 | 1.9 | 1.7 | 1.8 | 1.9 | 2.0 |
| <i>Creditors: other resident sectors</i> | 37.5 | 38.3 | 26.6 | 27.3 | 55.5 | 55.0 |
| <i>Creditors: non-residents</i> | 5.9 | 8.0 | 8.2 | 11.1 | 2.3 | 3.6 |
| <i>Debt securities</i> | 2.5 | 3.0 | 2.2 | 2.8 | 3.1 | 3.6 |
| Own funds, special reserves and subordinated financing | 10.1 | 11.3 | 9.9 | 11.5 | 10.5 | 10.8 |
| <i>Of which:</i> | | | | | | |
| <i>Subordinated financing</i> | 1.9 | 2.7 | 2.5 | 3.2 | 1.2 | 2.1 |
| Other liabilities (f) | 6.3 | 6.3 | 7.7 | 7.8 | 4.0 | 4.2 |
| PROFIT AND LOSS ACCOUNT: | | | | | | |
| (+) Interest income | | | | | | |
| (-) Interest expenses | | | | | | |
| Net interest income | 2.20 | 2.17 | 1.80 | 1.81 | 2.78 | 2.65 |
| (+) Commissions | 0.70 | 0.71 | 0.74 | 0.77 | 0.65 | 0.63 |
| (+) Profits on financial operations | 0.09 | 0.11 | 0.09 | 0.15 | 0.09 | 0.06 |
| Gross income | 2.99 | 2.99 | 2.62 | 2.72 | 3.52 | 3.34 |
| (-) Operating expenses | 1.96 | 1.91 | 1.76 | 1.72 | 2.26 | 2.19 |
| Net income | 1.03 | 1.08 | 0.86 | 1.01 | 1.26 | 1.15 |
| (-) Write-downs and provisions | 0.24 | 0.34 | 0.20 | 0.28 | 0.30 | 0.44 |
| (+) Other income | 0.15 | 0.23 | 0.12 | 0.15 | 0.21 | 0.37 |
| Pre-tax profit | 0.94 | 0.96 | 0.78 | 0.88 | 1.17 | 1.07 |
| MEMORANDUM ITEM: | | | | | | |
| Pre-tax profit (as a % of own funds) | 16.7 | 16.0 | 15.7 | 15.5 | 18.3 | 17.2 |
| Average total assets (EUR m) | 948.2 | 1,041.9 | 584.5 | 627.7 | 331.3 | 377.5 |
| Year-on-year growth rate (%) | 5.3 | 9.9 | 1.9 | 7.4 | 11.5 | 13.9 |

Source: Banco de España.

(a) Banks, savings banks, and credit co-operatives. Total turnover figures, including banks' foreign branches but not subsidiaries, refer to all the institutions existing in each period.

(b) Cash, central banks (except BE repos) and ECB.

(c) Credit and savings institutions (forward accounts, repos and securities lending) and repo purchases from the BE.

(d) Premises and equipment, sundry accounts and other assets with credit and savings institutions.

(e) Credit and savings institutions (forward accounts, repos and creditors on short sales).

(f) Sundry accounts and other liabilities with credit and savings institutions.

TABLE V.8

Credit by purpose

%

| | Rates of growth | | | Contribution to growth |
|---------------------------------------|-----------------|------|------|------------------------|
| | 1998 | 1999 | 2000 | 2000 |
| Broad housing credit | 18.4 | 18.5 | 21.4 | 9.2 |
| House purchases | 21.7 | 18.2 | 19.0 | 5.8 |
| Construction and real-estate services | 11.2 | 22.7 | 27.7 | 3.4 |
| Other credit to individuals | 23.5 | 16.8 | 13.6 | 1.6 |
| Credit to service activities | 15.4 | 14.0 | 13.1 | 3.2 |
| Credit to other productive activities | 10.5 | 15.9 | 8.2 | 1.5 |
| Other (NPIs and unclassified) | -4.0 | 9.7 | 17.6 | 0.5 |
| TOTAL | 16.0 | 16.5 | 16.0 | 16.0 |

Source: Banco de España.

competition between banks, it is also possible that part of the growth in credit is attributable to the expansionary strategies of certain institutions. In any event, the intensity and speed of the process involve a certain risk for the maintenance of macroeconomic and financial balances.

The financing of the growth of assets in 2000 was facilitated by the recovery of banks' traditional liabilities. Time deposits were especially expansionary, boosted by the rise in ECB interest rates and the increasing competition between banks to attract this kind of liability, their remuneration increasing by even more than interbank market rates (3). Particularly important here was the impact of banks which market products exclusively through the new distribution channels (telephone and Internet) which, thanks to the offers they made, managed to attract 5 % of the total increase in resident private creditors during 2000. However, these institutions have a very low market share (less than 1 %) and their growth prospects, albeit favourable, have moderated following the euphoria of early 2000.

The increase in deposits and repos to non-banks was, however, insufficient to finance the growth of credit. Unlike in previous years, this gap did not translate into a further increase in foreign interbank indebtedness, although this remains

high, but into the issuance of securities on domestic and, above all, international markets (see Chart V.9). This issuance was carried out mainly by subsidiary institutions without credit-institution status, which then channel the funds obtained to the parent institution in Spain via deposits. This accounts for the large increase in foreign creditors, which in 2000 made up 40 % of the total increase in creditors. In any case, foreign interbank indebtedness remains close to 5 % of the total assets of Spanish deposit-money institutions, although it is not evenly distributed across groups of institutions (see Box V.2).

The expansion of business, the favourable economic developments and the upward trend in interest rates led to pronounced growth in the aggregate profit of deposit-money institutions in 2000, albeit with clear differences between groups. According to the unconsolidated data, the profits after tax of the commercial banks increased by 31 %, while those of the savings banks and credit co-operatives increased to a much lesser extent (10 % and 2 % respectively). Relative to total assets, all commercial bank margins were up on the previous year, while they fell in the case of savings banks and credit co-operatives (see Table V.7). These differences were basically attributable to the different behaviour of bank lending rates. The commercial banks passed the rises in market interest rates through to their lending rates more quickly than savings banks did. Also, certain transactions were recorded that generated a very high income due to exchange differences and futures positions.

(3) That said, the synthetic rate on new liabilities transactions increased on average in 2000 by only 0.7 percentage points, to stabilise at around 3 % in the latter months of 2000 and the early months of 2001, which enabled the liabilities margin to recover somewhat.

Recent changes in the tax treatment of financial instruments

The tax regulations enacted in mid and late 2000 have again transformed the tax treatment and withholding system for financial instruments. These changes, together with those made over the previous two years have shaped a new tax environment, which has influenced household portfolio decisions.

The publication in June of Royal Legislative Decree 3/2000 (subsequently ratified in December 2000 by means of Law 6/2000) made changes to the system of withholdings and to the tax treatment for various financial products. The main changes that affect the financial savings of households may be summarised as follows: first, the period of investment necessary for capital gains and losses to be included in the special tax base of the personal income tax was cut from two years to just one year, while the rate at which tax is charged on this base was reduced from 20 % to 18 %, which made it equal to the minimum rate for the general tax base of the personal income tax; second, the withholding rate was reduced from 20 % to 18 % for capital gains and losses arising from the sale of equities and shares in collective investments undertakings and rules were specified for setting off capital losses generated over periods of one to two years, something that was not previously envisaged.

Also, the percentage reductions applicable to investment income generated by life, retirement and disability insurance (and indirectly by unit-linked insurance, also known as mutual fund insurance) were increased as follows: for returns generated over periods of more than five years, the reduction was increased from 60 % to 65 %; while for periods of over eight years, the increase was from 70 % to 75 %. Also the ceilings on deductions from the tax base for contributions to pension schemes were raised to 25 % of earned income (previously 20 %) subject to a maximum amount of ESP 1,200,000 per annum (up from ESP 1,100,000), and new higher limits were introduced for persons over the age of 52 (40 % and ESP 2,500,000 per annum).

The interest paid on debt issued by regional (autonomous) governments and local authorities was made exempt from withholdings or payments on account (so that its tax treatment was brought into line with that of book-entry government debt), provided that the issue is registered with the Book-Entry System and that the issuer of the debt has entered into an agreement with the Banco de España establishing the repayment procedure.

Finally, it should be pointed out with regard to non-residents that the accompanying law reduced the general rate of tax on most of their capital income to 18 %. Previously, the rate was 25 % on dividends, interest and other investment income and 35 % on capital gains and losses arising from the sale of equities and shares in collective investment undertakings. This reduction would also apply to the withholding rate, according to the provisions of the law on the taxation of the income of non-residents.

Clearly the legislator has, with this set of changes, attempted to boost medium and long-term saving by households and to establish greater neutrality in the withholding system for investment income, which even extends to investment income paid to non-resident investors. The adjoining table shows, in summary form, the tax incentives (resulting from a simple simulation exercise) for the various financial instruments introduced by the tax regulation of June 2000. It can be seen that the financial instruments whose tax treatment has improved are shares in collective investment undertakings, insurance contracts (and indirectly, therefore, unit linked insurance or fund insurance) and, above all, pension schemes.

Changes in simulated net returns after tax following the tax changes in 2000. In basis points (a)

| FINANCIAL INSTRUMENT | Years held | | | | | |
|---------------------------------|------------|----|-----|----|----|----|
| | 1 | 2 | 3 | 6 | 9 | 15 |
| Income levels (euro) (b) | | | | | | |
| Short-term deposit (c) | — | — | — | — | — | — |
| Housing account deposit | — | — | — | — | — | — |
| Long-term deposit (d) | — | — | — | — | — | — |
| Mutual fund (e) | — | 10 | 10 | 9 | 9 | 8 |
| Life insurance | | | | | | |
| 12,000 | — | — | — | 5 | 5 | 5 |
| 27,000 | — | — | — | 9 | 8 | 7 |
| 42,000 | — | — | — | 10 | 10 | 9 |
| 72,000 | — | — | — | 11 | 10 | 9 |
| Share dividends | — | — | — | — | — | — |
| Pension funds | | | | | | |
| 12,000 | 78 | 37 | 124 | 71 | 52 | 37 |
| 27,000 | 47 | 47 | 122 | 64 | 45 | 30 |
| 42,000 | — | — | — | — | — | — |
| 72,000 | — | — | — | — | — | — |

Source: Banco de España.

(a) The basic assumptions of the simulation are: single investment of EUR 6,000; a common fixed financial return on all the assets of 5%; the returns are received at the end of each period; withholding tax is not taken into account and marginal tax rates are used.

(b) Only for those assets where the incentives depend on the income level.

(c) Similar to the tax treatment for full-coupon bonds.

(d) Similar to the tax treatment for zero-coupon bonds.

(e) Similar to the capital gains on shares.

TABLE V.9

Bank credit to the private sector as a percentage of GDP in the euro area countries (a)

% of GDP

| | In 2000 | | | | | Change since 1997 |
|-----------------------------|----------------------------|---------------------|-------------|-------------|-------------------------------------|-------------------|
| | Non-financial corporations | Households and NPIs | Of which: | | Total non-fin. corps and households | |
| | | | Housing | Consumption | | |
| Germany | 38.3 | 67.6 | 42.7 | 10.9 | 105.9 | 4.4 |
| Austria | 58.8 | 28.0 | 12.7 | 11.7 | 86.9 | 7.0 |
| Belgium | 36.5 | 34.1 | 23.0 | 3.6 | 70.6 | 2.8 |
| Spain | 43.5 | 46.1 | 29.1 | 8.0 | 89.6 | 19.7 |
| Finland | 18.5 | 27.3 | 18.5 | 2.4 | 45.7 | 5.0 |
| France | 36.2 | 34.4 | 21.2 | 7.8 | 70.7 | 3.4 |
| Netherlands | 49.7 | 67.0 | 57.9 | 3.4 | 116.7 | 26.8 |
| Ireland | 34.3 | 39.9 | 29.8 | 9.1 | 74.2 | ... |
| Italy | 41.7 | 21.2 | 8.4 | 1.8 | 62.9 | 8.6 |
| Luxembourg | 30.1 | 38.0 | 27.4 | 3.0 | 68.1 | -2.4 |
| Portugal | 55.4 | 61.5 | 45.3 | 7.5 | 116.9 | 45.6 |
| Euro area | | | | | | |
| Simple average | 40.3 | 42.3 | 28.7 | 6.3 | 82.6 | 12.1 |
| GDP-weighted average | 40.1 | 45.9 | 29.1 | 7.3 | 86.0 | 10.9 |

Source: ECB.

(a) Based on comparable information compiled by the ECB for purposes of monetary policy. It therefore includes credit extended by all MFIs resident in the country concerned to residents of the country. Holdings of fixed-income securities are not included.

The growth of the branch network and the strong expansion of lending by savings banks led to a decline in their efficiency ratio (gross income to operating costs), so that for the first time in recent years it was lower than that of the commercial banks. Likewise, their profit and loss account was more affected by the new statistical provision for bad debts, although they were able to offset its impact with capital gains arising from the sale of securities. The commercial banks, meanwhile, had to make significant extraordinary transfers to their employee pension funds.

The profits of the commercial banks in 2000 were also very favourable when their consolidated accounts are considered. Owing to the Latin American expansion of the two major groups, the consolidated net interest margin was considerably higher than the unconsolidated one (2.59 % of average total assets, as against 1.81 %), extending the upward trend of recent years. Although operating costs were also higher, the efficiency ratio has improved

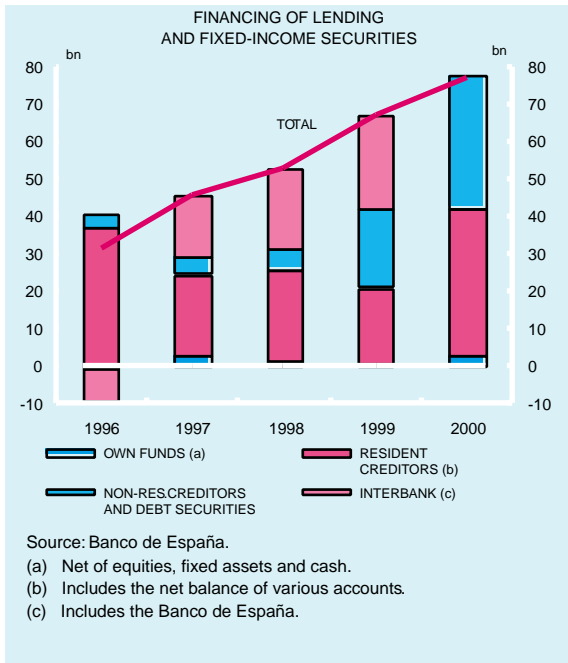
by 12 percentage points during the last two years and was higher than that corresponding to the unconsolidated accounts (1.64, as against 1.59). During 2000, foreign business made a positive contribution to the net profit of the groups, for the first time since 1997, which explains the significant growth of the latter (33 %, as against 18 % the previous year). In the savings bank sector, the consolidated results are not significantly different from the unconsolidated ones.

V.3.2. Institutional investors

As in previous reports, institutional investors include financial institutions other than credit institutions (collective investment undertakings, insurance companies and pension funds) which obtain funds from the public and invest them in assets. Developments in this group were very uneven during 2000, generally involving an accentuation of the trends seen in 1999.

CHART V.9

Deposit-money institutions



The net asset value of mutual funds fell by 9.8 % (EUR 20.2 billion) (4), while that of pension funds rose by 19 % and, according to ICEA (Investigación Cooperativa de Entidades Aseguradoras) estimates, funds managed by life insurance companies (mathematical provisions) rose by more than 20 %.

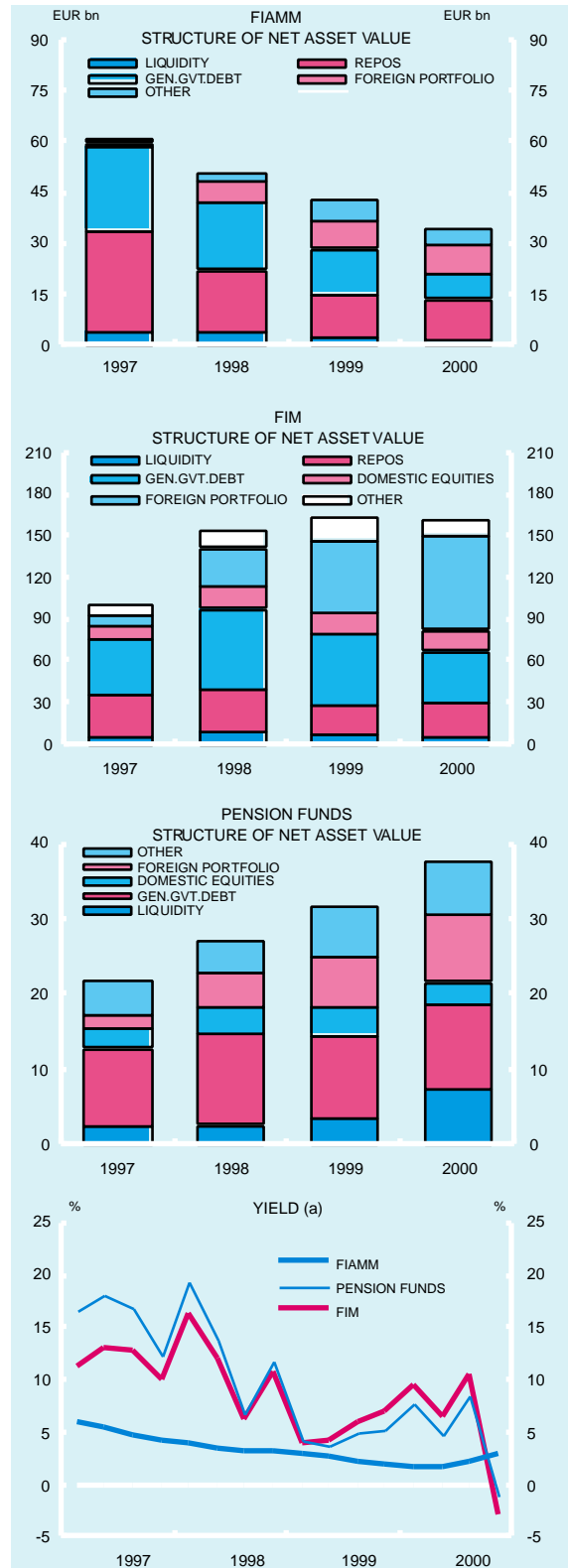
As can be seen in Chart V.10, the year-on-year yield on securities funds (FIM) and pension funds fell sharply last year, turning negative at the end of 2000, and becoming more strongly negative in the first few months of 2001. This performance was governed by the increases in interest rates and above all by the sharp falls in share prices.

As regards subscriptions or net contributions, Table V.10 shows how in 2000 they doubled in the case of pension funds and grew significantly in that of life insurance companies, while they were negative both for FIM and for FIAMM, reflecting the

(4) The net asset value of all collective investment undertakings (which also include closed-end investment companies (SIM), open-end investment companies (SIMCAV), real-estate mutual funds and foreign collective investment undertakings marketed in Spain) also fell by 7 %. This was due to the high weight of mutual funds in the total (88 % in 2000), since both SIMCAV and real-estate mutual funds and foreign undertakings marketed in Spain displayed high rates of growth.

CHART V.10

Institutional investors



Sources: CNMV, Banco de España and INVERCO.
 (a) Cumulative yield over last 12 months.

TABLE V.10

Funds raised by other financial intermediaries

EUR millions

| | 1997 | 1998 | 1999 | 2000 | 2000 Balances (a) |
|---|---------------|---------------|---------------|---------|----------------------|
| Total (b) | 48,104 | 35,510 | 10,693 | | |
| Pension funds | | | | | |
| <i>Net contributions (c)</i> | 2,322 | 2,692 | 3,015 | 6,454 | |
| <i>Change in net asset value</i> | 4,469 | 5,251 | 4,439 | 6,109 | 37,709 |
| Life assurance | | | | | |
| <i>Premiums net of claims</i> | 5,494 | 4,653 | 8,127 | | |
| <i>Change in mathematical provisions (d)</i> | 7,905 | 6,775 | 11,768 | 13,486 | 75,755 |
| Mutual funds | | | | | |
| <i>Net share purchases</i> | 40,287 | 28,166 | -449 | -14,317 | 186,068 |
| <i>FIAMM</i> | 1,532 | -12,267 | -7,229 | -10,156 | 33,368 |
| <i>FIM</i> | 38,755 | 40,433 | 6,780 | -4,161 | 152,700 |
| MEMORANDUM ITEM: | | | | | |
| Deposit money institutions: change | | | | | |
| in accounts payable: other resident sectors | 24,111 | 14,969 | 21,282 | 52,424 | 505,329 |
| Sources: Banco de España, CNMV, INVERCO, Dirección General de Seguros and ICEA. | | | | | |
| (a) Balances to December. Net asset value in the case of funds, and mathematical provisions in the case of insurance. | | | | | |
| (b) Sum of contributions, premiums and net share purchases. | | | | | |
| (c) BE estimate based on the change in the net asset value and annual yield of the funds. | | | | | |
| (d) The 2000 figure is provisional (based on ICEA estimates). | | | | | |

continuity of the process of substitution of time deposits for shares in mutual funds that began the previous year. During 2000, however, this process did not seem to be driven by a reduced demand for higher-risk products. On the contrary, net subscriptions for domestic and international equity funds remained positive, while net redemptions of shares in fixed-income funds were very significant. However, it should be pointed out that in 2001 Q1 net subscriptions to FIAMM turned positive again.

The demand for pension funds and life insurance, stimulated by regulatory and fiscal changes, continued to rise. In 2000, the compulsory externalisation of firms' pension commitments (whereby they are required to transfer in-house provisions to an external pension fund or insurance company) became particularly significant. Although the deadline for complying with this requirement was eventually extended from December 2000 to November 2002, and although firms have 10 years to make the necessary contributions to cover their commitments, externalisation has already

had a significant impact on the growth of these products. For example, funds corresponding to employment pension schemes accounted for 58 % of the total change in the net asset value of pension funds, as against 39 % in 1999. However, other factors have also contributed to the growth of insurance products. Unit-linked insurance has grown with the support of a favourable tax treatment that has contributed to their expansion over the last two years (see Box 3). On ICEA estimates, between 35 % and 40 % of all life insurance premiums in the last two years correspond to unit-linked insurance (some EUR 6 billion in 1999 and EUR 9.3 billion in 2000).

Finally, as regards the distribution of the portfolio of assets held by institutional investors, the stock market situation helped to moderate the growth in the weight of domestic and international equities. The process of internationalisation of portfolios has not stopped, however. As at end-2000, external assets represented 44 % of the total net asset value of FIM, 30 % in the case of FIAMM and 24 % in that of pension funds. The intense ac-

The main changes in the composition of household financial wealth

Over the last six years the financial wealth of Spanish households, i.e. the value at market prices of their portfolio of financial assets has grown considerably, while its composition has changed (see table). As at end-2000, 43 % of the financial wealth of households was held in equities and shares in securities funds (FIM) (compared to 24 % in 1994), 13 % in insurance products (10 % in 1994), and 40 % in more liquid components, i.e. cash, deposits and money-market funds (FIAMM) (60 % as at end-1994). The change in the composition of household portfolios has been the result, on one hand, of a process of disintermediation that has shifted investment from traditional savings instruments (basically deposits) towards shares in mutual funds and insurance products and, on the other, of the sharp revaluation of equity holdings.

Over the period 1995-2000, only 50 % of the increase in wealth stemmed from the net acquisition of financial assets. The fact that only 40 % of this net investment (see Chart 1) was in low-risk assets (cash and deposits) and that these were hardly revalued explains the reduction in their weight in household portfolios. Insurance products, especially retirement and life insurance (which includes unit linked insurance), attracted 30 % of net investment, while mutual funds (FIM and FIAMM) received 25 %. Finally, the acquisition of equities was practically zero. These flows of investment were linked to the development of the Spanish financial system itself, in which institutional investors have acquired a high profile and facilitated greater diversification of household portfolios, and also to the changes in the tax treatment of assets.

In relation to the revaluation component, between 1995 and 2000, around 50 % of the increase in household financial wealth arose from that corresponding to equities (see chart), in a period in which the Madrid Stock Exchange General Index tripled. The revaluation of listed and unlisted shares was very similar, although, in absolute terms, the higher weight of unlisted shares meant that the latter contributed to a greater extent to the increase in household wealth (see table). At end-2000 equities made up 31 % of the financial portfolio of Spanish households (as against 15 % in 1994), a proportion that falls well below those of households in the United States and other European countries.

The changes in the composition of household portfolios in recent years have basically two types of implication. First, the financial position of Spanish households is now more vulnerable to changes in the prices of more volatile financial assets, although the growing role of institutional investors has also been conducive to an increase in the degree of diversification of agents' portfolios. Second, the new composition may increase the impact of equity-price movements, via the wealth effect, on household consumption and saving decisions, either directly or through their effects on consumer confidence.

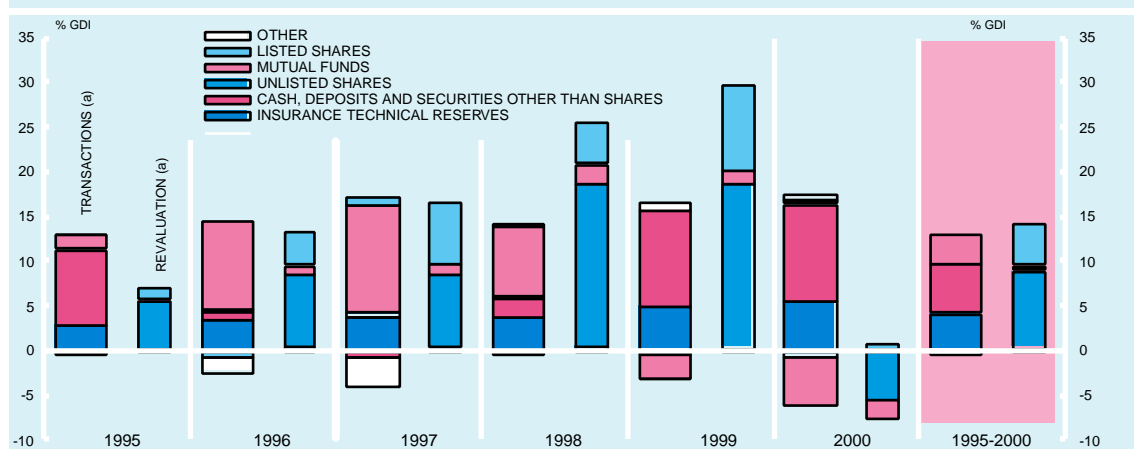
Composition of the portfolio of financial assets of households and NPIs

| | As % of total | | | 2000 Q 4 |
|--|---------------|--|-------------|--------------|
| | 1994 Q 4 | Transactions and revaluation (1995-2000) (a) | 2000 Q 4 | |
| TOTAL (EUR bn) | 567 | 294 | 302 | 1,157 |
| Cash, deposits and securities other than shares | 56.5 | 40.0 | 0.7 | 38.0 |
| Shares and other equity | 17.4 | 2.4 | 93.2 | 33.5 |
| Of which: | | | | |
| Listed shares | 4.9 | -0.1 | 31.6 | 10.6 |
| Unlisted shares | 10.6 | -0.5 | 60.5 | 20.9 |
| Mutual funds | 10.5 | 24.2 | 4.2 | 12.4 |
| FIAMM | 3.7 | -2.5 | 0.5 | 2.5 |
| FIM | 6.8 | 26.7 | 3.6 | 9.9 |
| Insurance technical reserves | 9.8 | 29.7 | 1.8 | 13.1 |
| Retirement | 4.4 | 9.7 | 1.8 | 5.4 |
| Life | 4.3 | 17.5 | 0.0 | 6.5 |
| Other | 1.1 | 2.4 | 0.0 | 1.2 |
| Others | 5.8 | 3.6 | 0.0 | 3.0 |

Source: Banco de España.

(a) Cumulative data. Financial transactions are in the left-hand column and revaluations in the right-hand one.

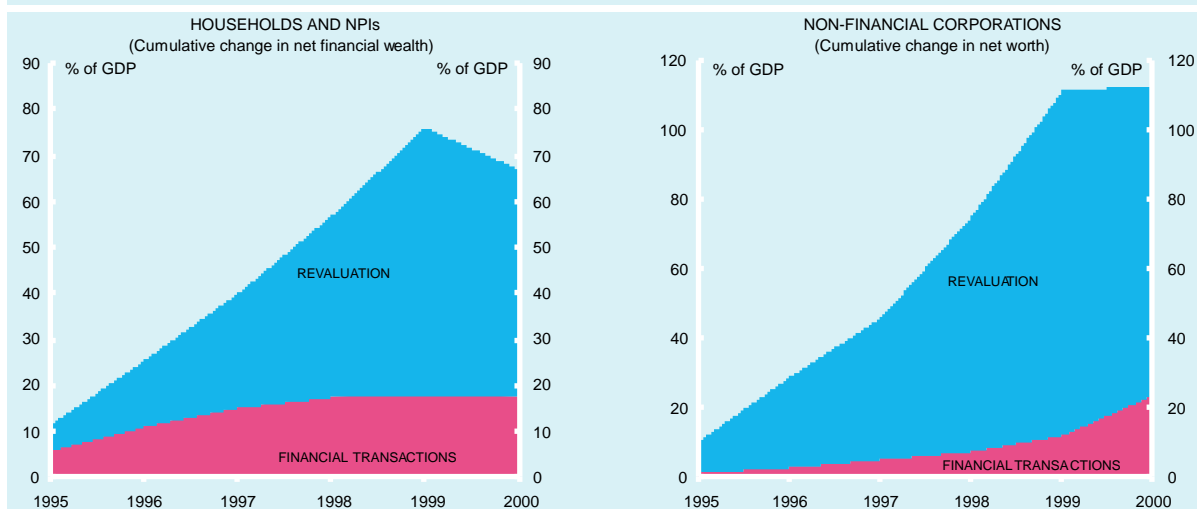
Net acquisition and revaluation of financial assets of households and NPIs



Source: Banco de España.

(a) For each year the first column shows financial transactions by instrument and the second revaluations.

Net-worth position of households and NPIs and non-financial corporations



Source: Banco de España.

quisition of external assets has limited the volume of financing extended by Spanish institutional investors to domestic non-financial corporations. According to estimates of the *Financial accounts of the Spanish economy*, on average over the period 1995-2000, such financing amounted to only 0.1 % of GDP (0.4 % of the total financing of non-financial corporations). A search for fresh opportunities for returns and risk diversification undoubtedly lie behind the internationalisation of these portfolios. Even so, the inadequate development of private securities markets in Spain probably also helps explain the greater propensity of Spanish institutional investors to acquire instruments issued and traded abroad.

V.4. THE NET WORTH POSITION OF THE SECTORS OF THE ECONOMY

The financial transactions carried out last year and the developments in the prices of financial assets (both described in previous sections) changed the net-worth position of the main institutional sectors of the Spanish economy and their exposure to different sources of risk.

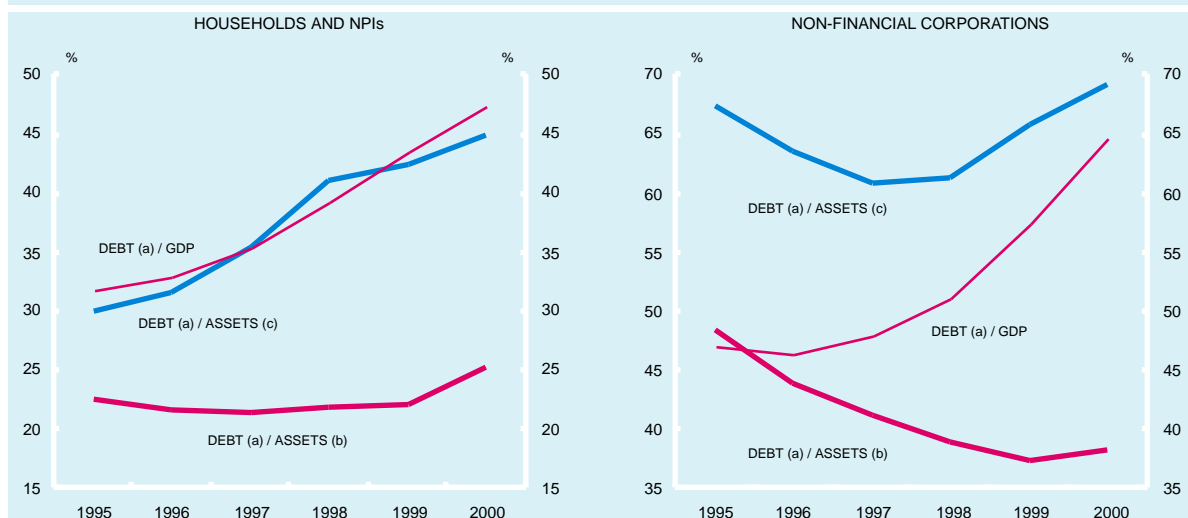
The fall in stock markets and decline in the net asset value of mutual funds during 2000 reduced the value of the financial wealth of households and NPIs,

breaking the trend of previous years (see Chart V.11). However, the value of real household wealth increased significantly last year, as a consequence of the rise in the price of housing and the growth in residential investment, which outweighed the fall in the value of financial assets and its impact on household net-worth. At the same time, the growth in household debt during 2000 (which includes bank credit, external loans and financing through securitisation funds) led to a further rise in debt ratios, both in terms of GDP and total financial assets (see Chart V.12). Overall, 2000 saw a certain deterioration in the financial position of households which may prompt a moderation in the demand for financing in comparison with previous years. The figures available for the first few months of 2001 appear to show that this moderation has already begun.

This deterioration in the financial position of households arose against a background in which the relative weights of real assets and equities in the net worth of the sector have increased (see Box V.4). This has increased the degree of exposure of the sector to changes in house prices and in the prices of more volatile financial assets. Even so, the share of equities in household net worth is still well below the levels in the United States and, to a lesser extent, in other more advanced European countries.

In 2000, the market value of the assets of non-financial corporations held relatively stable, in con-

Debt ratios



Source: Banco de España.

- (a) Includes bank credit extended by resident credit institutions, foreign loans, fixed-income securities and financing through securitisation funds.
 (b) Total assets, excluding other.
 (c) Total assets, excluding other, less shares and other equity (not including FIAMM).

trast to the rising trend of previous years (see Chart V.11). The strong growth in the net worth of the corporate sector up until 1999 had a number of effects. First, it helped to reduce the cost of financing for companies, by increasing the value of their collateral. Second, it may have increased the confidence of employers and their readiness to borrow. The consequent growth in the financing obtained by non-financial corporations in 2000 continued to increase the sector's debt ratios (see Chart V.12), both in terms of GDP and of the most liquid assets. The current levels of debt are not significantly different from those in previous upswings. Moreover, the lower interest rates have reduced the relative weight of the interest burden and the profitability of Spanish firms, as mentioned in Chapter IV, remains high. However, it should not be forgotten that their international expansion and growing participation in relatively new areas of business mean that Spanish firms are exposed to a higher degree of risk.

As for general government, the level of its debt and its exposure continued to decline in 2000 as a

result of the reduction in its net borrowing and of the debt restructuring referred to in section V.1.4. According to the latest data released under the excessive deficit procedure in March 2001, general government nominal gross consolidated debt at nominal value was 60.6 % of GDP.

Finally, the growth during 2000 in the net external debt position of credit institutions and in the weight of their interbank liabilities vis-a-vis non-resident institutions should again be highlighted. Institutional investors also continued to increase their net external assets. In short, these developments, which have their parallels and obvious links with developments in the other sectors of the Spanish economy, reflect a process of internationalisation that is facilitating greater international diversification of portfolios and of agents' sources of financing. This process is undoubtedly also helping to ensure a more efficient allocation of financial resources. However, the importance of the fact that the degree of exposure of these sectors to a wider range of risk factors is increasing should not be underestimated.

ANNUAL ACCOUNTS OF THE BANCO DE ESPAÑA

2000

INTRODUCTION

The annual accounts of the Banco de España ("the Bank"), as established by Article 29.1 of its internal rules, comprise the balance sheet, the profit and loss account and the notes on the accounts. The accounts, pursuant to the provisions of the same article, have been prepared in accordance with the Bank's internal accounting rules. These rules follow generally accepted accounting principles, adapted to the special characteristics of the operations and functions of a central bank. They also comply, in all applicable aspects, with the accounting criteria and valuation rules established for the European System of Central Banks (ESCB), as required by Article 26.4 of the Statute of the ESCB, relating to standardisation of accounting principles and practices in the Eurosystem.

The annual accounts of the Banco de España have been subject, in accordance with the provisions of Articles 29 and 32 of its internal rules, to internal audit by the Internal Audit Department and to review by the Accounts Review Committee, appointed for the purpose by a resolution of the Governing Council of the Banco de España of 22 December 2000. The accounts have also been audited by independent external auditors, as stipulated by Article 27 of the Statute of the ESCB.

Under the provisions of Article 4.2 of Law 13/1994 of 1 June 1994 of Autonomy of the Banco de España, it is for the government, upon proposal by the Economy and Finance Minister, to approve the balance sheet and accounts of the Bank, which will be sent to Parliament (Cortes Generales) for

informational purposes. The Governing Council of the Bank, under the provisions of Article 21.1 (g) of the aforementioned Law, is responsible for formulating the Bank's accounts.

Unless otherwise indicated, the figures refer to millions of euro. For ease of comparability, 1999 figures are also given on the basis of the new structure of the balance sheet, profit and loss account and accounting standards applied in 2000, as described in the relevant explanatory notes. It should be pointed out that the discrepancies that may, on occasions, be observed between the breakdowns in the notes and the figures in the balance sheet and profit and loss account arise from the rounding of the former.

This document presents the accounts for the year 2000. Section I includes the balance sheet and profit and loss account; Section II, the notes on the accounts, with the valuation criteria used and explanatory notes on the most important aspects of the balance sheet and profit and loss account; and Section III, in compliance with Article 4.2 of the Law of Autonomy, details the contributions made to the Deposit Insurance Funds and the loans and transactions not conducted on a market basis or which in any other way entail a loss of profit or losses for the Bank, giving estimates of the amount of such loss of profit or losses.

Finally, the reports of the external auditors and of the Banco de España Accounts Review Committee on the annual accounts presented in Sections I-III are included in Annexes 1 and 2.

I. BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

Balance sheet of the Banco de España as at 31 December 2000

(EUR millions)

| | Note Number | 2000 | 1999 |
|--|----------------|-------------------|-------------------|
| ASSETS | | | |
| 1. Gold and gold receivables | 1 | 4,931.16 | 4,872.62 |
| 2. Claims on non-euro area residents denominated in foreign currency | | 32,757.26 | 32,655.83 |
| 2.1. Receivables from the IMF | 2 | 1,727.80 | 1,933.49 |
| 2.2. Balances with banks and security investments, external loans and other external assets | 3 | 31,029.46 | 30,722.34 |
| 3. Claims on euro area residents denominated in foreign currency | | 0.06 | 0.03 |
| 4. Claims on non-euro area residents denominated in euro | 4 | 0.00 | 4,118.98 |
| 4.1. Balances with banks security investments and loans | | 0.00 | 4,118.98 |
| 4.2. Claims arising from the credit facility under ERM II | | 0.00 | 0.00 |
| 5. Lending to euro area credit institutions related to monetary policy operations denominated in euro | 5 | 16,142.87 | 24,181.55 |
| 5.1. Main refinancing operations | | 14,309.62 | 20,347.70 |
| 5.2. Longer-term refinancing operations | | 1,821.47 | 3,379.30 |
| 5.3. Fine-tuning reverse operations | | 0.00 | 0.00 |
| 5.4. Structural reverse operations | | 0.00 | 0.00 |
| 5.5. Marginal lending facility | | 0.00 | 453.00 |
| 5.6. Credits related to margin calls | | 11.78 | 1.55 |
| 6. Other claims on euro area credit institutions denominated in euro | 6 | 1.97 | 2.75 |
| 7. Securities of euro area residents denominated in euro | | 0.00 | 0.00 |
| 8. General government debt denominated in euro | 7 | 11,006.79 | 11,632.68 |
| 9. Intra-Eurosystem claims | 8 | 45,724.81 | 32,823.98 |
| 9.1. Participating interest in ECB | | 444.68 | 444.68 |
| 9.2. Claims equivalent to the transfer of foreign reserves | | 4,446.75 | 4,446.75 |
| 9.4. Other claims within the Eurosystem (net) | | 40,833.38 | 27,932.55 |
| 10. Items in course of settlement | 9 | 7.45 | 4.81 |
| 11. Other assets | | 7,837.63 | 6,562.50 |
| 11.2. Tangible and intangible fixed assets | 10 | 225.64 | 223.50 |
| 11.3. Other financial assets | 11 | 3,443.84 | 3,534.83 |
| 11.4. Off-balance-sheet instruments revaluation differences | 12 | 188.18 | 0.00 |
| 11.5. Accruals and deferred expenditure | 13 | 929.90 | 738.97 |
| 11.6. Sundry | 14 | 3,050.07 | 2,065.20 |
| TOTAL ASSETS | | 118,410.00 | 116,855.73 |

Balance sheet of the Banco de España as at 31 December 2000 (contd)

(EUR millions)

| | Note Number | 2000 | 1999 |
|--|----------------|-------------------|-------------------|
| LIABILITIES | | | |
| 1. Banknotes in circulation | 15 | 57,198.32 | 58,911.16 |
| 2. Liabilities to euro area credit institutions related to monetary policy operations denominated in euro | 16 | 8,391.21 | 12,490.92 |
| 2.1. Current accounts (covering the minimum reserve system) | | 8,385.21 | 12,462.00 |
| 2.2. Deposit facility | | 6.00 | 28.00 |
| 2.3. Fixed-term deposits | | 0.00 | 0.00 |
| 2.4. Fine-tuning reverse operations | | 0.00 | 0.00 |
| 2.5. Deposits related to margin calls | | 0.00 | 0.92 |
| 3. Other liabilities to euro area credit institutions denominated in euro | | 0.00 | 0.00 |
| 4. Debt certificates issued | 17 | 0.00 | 3,301.82 |
| 5. Liabilities to other euro area residents denominated in euro | | 30,238.29 | 22,082.66 |
| 5.1. General government | 18 | 29,298.24 | 20,947.66 |
| 5.2. Other liabilities | 19 | 940.05 | 1,135.00 |
| 6. Liabilities to non-euro area residents denominated in euro | 20 | 24.63 | 451.07 |
| 7. Liabilities to euro area residents denominated in foreign currency | | 3.72 | 2.66 |
| 8. Liabilities to non-euro area residents denominated in foreign currency | | 453.67 | 548.38 |
| 8.1. Deposits, balances and other liabilities | 21 | 453.67 | 548.38 |
| 8.2. Liabilities arising from the credit facility under ERM II | | 0.00 | 0.00 |
| 9. Counterpart of special drawing rights allocated by the IMF | 22 | 418.35 | 407.86 |
| 10. Intra-Eurosystem liabilities | | 0.00 | 0.00 |
| 10.2. Liabilities related to promissory notes backing the issuance of ECB debt certificates | | 0.00 | 0.00 |
| 10.3. Other liabilities within the Eurosystem (net) | | 0.00 | 0.00 |
| 11. Items in course of settlement | 23 | 385.32 | 274.70 |
| 12. Other liabilities | | 1,599.84 | 877.95 |
| 12.1. Off-balance-sheet instruments revaluation differences | 24 | 0.00 | 1.22 |
| 12.2. Accruals and deferred income | 25 | 917.53 | 125.25 |
| 12.3. Sundry | 26 | 682.31 | 751.48 |
| 13. Provisions | 27 | 3,864.79 | 3,796.81 |
| 14. Revaluation accounts | 28 | 10,068.62 | 9,641.37 |
| 15. Capital and reserves | | 4.54 | 4.54 |
| 15.1. Capital | 29 | 1.37 | 1.37 |
| 15.2. Reserves | 30 | 3.17 | 3.17 |
| 16. Profit for the year | 31 | 5,758.70 | 4,063.83 |
| TOTAL LIABILITIES | | 118,410.00 | 116,855.73 |

Profit and loss account of the Banco de España for the year ending 31 December 2000

(EUR millions)

| | Note Number | 2000 | 1999 |
|--|----------------|-----------------|-----------------|
| Interest income | 1 | 4,540.61 | 3,091.84 |
| Interest expense | 2 | -919.57 | -699.74 |
| Net interest income | | 3,621.04 | 2,392.10 |
| Realised gains/losses arising from financial operations | 3 | 2,494.67 | 2,304.78 |
| Write-downs on financial assets and positions | 4 | -7.00 | -398.21 |
| Transfer to/from provisions for foreign exchange rate and price risks | | 0.00 | 0.00 |
| Net result of financial operations, write-downs and risk provisions | | 2,487.67 | 1,906.57 |
| Fees and commissions income | | 16.03 | 35.94 |
| Fees and commissions expense | | -1.46 | -1.33 |
| Net income from fees and commissions | 5 | 14.57 | 34.61 |
| Income from equity shares and participating interests | 6 | 1.75 | 1.60 |
| Net result of pooling of monetary income | 7 | 1.85 | -22.61 |
| Other income | 8 | 41.23 | 139.17 |
| TOTAL NET INCOME | | 6,168.11 | 4,451.44 |
| Staff costs | 9 | -174.76 | -170.35 |
| Administrative expenses | 10 | -51.97 | -54.08 |
| Depreciation of tangible and intangible fixed assets | 11 | -16.60 | -16.22 |
| Banknote production services | 12 | -68.13 | -56.41 |
| Other expenses | 13 | -1.39 | -0.85 |
| TOTAL OPERATING EXPENSES | | -312.85 | -297.91 |
| Transfers and additions to other funds and provisions | 14 | -96.56 | -89.70 |
| PROFIT FOR THE YEAR | 15 | 5,758.70 | 4,063.83 |

Countersigned by
The Governor,



JAIME CARUANA

The Comptroller,



ANTONIO ROSAS

II. NOTES ON THE ACCOUNTS

II.1. VALUATION CRITERIA

1. Basic principles

The following accounting principles have been applied:

- economic reality and transparency;
- prudence;
- recognition of post-balance-sheet events;
- materiality;
- the accruals principle;
- consistency and comparability.

2. Basis of accounting

The accounts have been prepared on a historical cost basis, except in the case of marketable securities, gold and the foreign currency position, which are valued at market prices. Transactions in assets and liabilities are reflected in the accounts on the date on which they are settled.

As an exception to the application of the general historical cost criterion it should be pointed out that, on 31 December 1998, at the time the ESCB was established and in application of the harmonised accounting standards established for the European System of Central Banks, gold, domestic and foreign securities and foreign currencies were valued at the prices and exchange rates then prevailing, without recognising profits, in the event of unrealised gains, and with a charge to the profit and loss account in the case of unrealised losses. These unrealised gains are subsequently credited to the profit and loss account, when the sale of the asset in question takes place or, under certain conditions, when unrealised losses arising at a later date can be netted against them.

The specific valuation criteria applied to each of the assets and liabilities specified were the following:

Gold

Gold is recorded at its purchase price, which is determined by the cash amount paid, including all the expenses inherent in the transaction.

The cost of sales is obtained by applying the daily LIFO method. In the event that the cash to be paid or received is specified in a foreign currency, it is translated into euro at the mid-market exchange rate two business days before the settlement date.

On the last day of each calendar quarter stocks are valued at the market price of a troy ounce of fine gold supplied by the European Central Bank, with the appropriate accounting adjustments, without changing the average book price

Unrealised losses existing at the end of the year are taken to the profit and loss account and the average book price is modified. Such losses are considered irreversible.

Sales of gold against foreign currency under repurchase agreements are recorded as off-balance-sheet items, with no effect on the balance sheet. The foreign currency received by way of consideration is recorded on the assets side, with the obligation to repay it being recorded simultaneously on the liabilities side. Possible differences arising between gold delivered spot and that received forward are recorded as if there had been an independent outright sale or purchase, at the time of maturity of the transaction.

Special drawing rights

SDRs and the net IMF position are valued at the year-end SDR market exchange rate.

Foreign securities

Foreign securities are recorded at the purchase price, which is determined by the cash amount paid, after deducting any accrued gross coupon.

The cost of foreign securities sold or redeemed is determined by the average book price of the security in question.

Foreign securities are revalued quarterly, in line with market price. This revaluation is carried out

without any netting of unrealised gains and losses on different security codes. Gains and losses (with the exception of losses at year-end) are reflected in adjustment accounts and credited or debited, respectively, to revaluation and expense accounts, with both cancelled at the end of the following quarter.

Losses existing at the end of the year are taken to the profit and loss account. Their amount is credited directly to the securities account, and the average book price – and therefore the internal rate of return – of the security code concerned is modified. Such losses are considered irreversible, not being cancelled at the end of the following quarter.

Any premiums, discounts and coupons that have accrued but are not due are recorded in accruals accounts, using the internal rate of return of each security code for their calculation.

The above references to purchase and market prices shall, in relation to securities denominated in foreign currency, be understood to refer to the currency concerned, these amounts being translated into euro, as stipulated below.

Convertible currencies

Purchases are recorded at the purchase price in euro. Purchases and sales of foreign currencies against euro are valued at the exchange rate agreed in the transaction. Where foreign currencies are bought and sold against other foreign currencies the euro valuation is at the mid-market exchange rate of the currency sold on the contract date.

The cost in euro of foreign currency sold is calculated using the daily LIFO method.

On the last day of each calendar quarter stocks are valued at the mid-market exchange rate, with the relevant adjustments, without changing the average book price. Losses existing at the end of the year, for each currency, are taken to the profit and loss account, and the average book exchange rate changed. Such losses are considered irreversible.

Foreign banknotes

The same criteria are applied as indicated above for convertible currencies.

Repurchase agreements involving securities

Reverse repurchase agreements involving securities are recorded on the assets side of the balance sheet as collateralised outward loans for the amount of the loan. Securities acquired under reverse repurchase agreements are not revalued or included in the securities portfolio.

Repurchase agreements involving securities are recorded on the liabilities side of the balance sheet as an inward deposit collateralised by securities. The balance sheet shows the deposits and the value of the items given as collateral. Securities sold under this type of agreement remain on the balance sheet of the Banco de España and are treated as if they remained part of the portfolio from which they were sold. Repurchase agreements involving securities denominated in foreign currencies have no effect on the average cost of the currency position.

Doubtful debtors

Where there is any reasonable doubt over the recovery of an asset it is recorded in a separate account and the relevant provision set aside.

Loans to financial institutions and balances with EU central banks

These are valued at their nominal amount.

Special loans to the State and the Social Security System

Special loans granted to the State that are referred to in transitional provision seven of Law 21/1993 on the State budget for 1994, and those granted to the Social Security System that are envisaged in transitional provision six of Law 41/1994 on the State budget for 1995, are valued at their nominal amount, in accordance with the ESCB's harmonised rules.

Book-entry domestic securities

The criteria used to record and value book-entry domestic securities are the same as those indicated above for foreign securities.

Participating interests in institutions and other entities

Participating interests in national and/or international institutions, including the participating interest in the ECB, are valued at their purchase price.

Tangible and intangible fixed assets

In general, fixed assets are valued at the purchase price, which includes any non-deductible VAT paid and all additional expenses that may arise until they are in operation. Fixed assets whose cost is less than EUR 120 are recorded as expenses in the year in which they are acquired.

Annual charges for depreciation are calculated on the basis of the estimated economic life of the various assets using the straight-line method. Land and items forming part of the Bank's art collection are not considered to be depreciable assets. Depreciation is carried out on a monthly basis, starting from the month following that of the date the asset is recorded in the accounts or put into operation. Assets paid for out of the Beneficent-Social Fund (Fondo de Atenciones Benéfico Sociales) are considered automatically depreciated.

Relevant expenses relating to projects due to be in effect for several years may be capitalised and depreciated over a maximum period of four years.

In 2000, the depreciation percentages applied to the various fixed assets were the same as those applied in 1999, and were as follows:

| | % |
|---|----|
| • Land and buildings | 2 |
| • Facilities | 6 |
| • Furniture and office equipment | |
| — Libraries | 10 |
| — Furniture | 10 |
| — Office machines other than computer equipment | 20 |
| — Machines for the treatment of banknotes and coins | 20 |
| — Computer equipment | 25 |
| — Other machines and equipment | 20 |
| • Transport equipment | 20 |
| • Computer applications | 33 |
| • Art collection | 0 |

Purchases of silver are recorded at the purchase price. At year-end the stocks are revalued at the London market US dollar price of a troy ounce on that date, translated into euro at the prevailing exchange rate. This revaluation is carried out only in the event that the amount so obtained is less than the book value.

Banknotes

Banknotes in circulation are recorded on the liabilities side of the balance sheet at their face value, and their purchase cost is recorded as an expense in the relevant year.

Recognition of income and expenses

Income and expenses are recognised in the period in which they accrue.

Realised gains and realised and unrealised losses are taken to the profit and loss account. The average cost method is used to calculate the purchase price of individual items sold. In the case of unrealised losses on any item at year-end, its average cost is reduced in line with the end-of-year market price and/or exchange rate.

Unrealised gains are not recognised as income, but are transferred to a revaluation account.

Unrealised losses are taken to the profit and loss account if they exceed previous revaluation gains recorded in the corresponding revaluation account, and are not reversed in subsequent years against new unrealised gains. Unrealised losses in any one security or currency or in gold are not netted against unrealised gains in other securities or currencies.

Premiums or discounts arising on issued and purchased securities are calculated and shown as interest income or expenses and amortised over the remaining life of the securities concerned, according to the internal rate of return method.

Pension scheme

Contributions to an external pension fund by employees who, having joined the Bank after 31.1.1986, are eligible to and do participate in the Pension Scheme, are established at 6.5 % of the so-called "regulating salary", consisting of the salary items determined in the Scheme Rules. The amounts contributed by the Bank are recognised as a current expense in the year to which they relate.

Off-balance-sheet positions (1)

Foreign exchange forward transactions, forward legs of foreign exchange swaps and other currency instruments involving an exchange of one currency for another at a future date, are included in the net foreign currency positions in order to calculate foreign exchange gains and losses.

Interest rate futures are revalued on an item-by-item basis and treated in a similar manner to securities.

Profits and losses arising from off-balance-sheet instruments are recognised and treated in a similar manner to on-balance-sheet instruments.

Post-balance-sheet events

Assets and liabilities are adjusted to reflect events that occur between the annual balance sheet date and the date on which the Governing Council formulates the financial statements if such events materially affect the condition of assets and liabilities.

II.2. NOTES ON THE BALANCE SHEET

1. Gold and gold receivables

The Banco de España's gold holdings amount to EUR 4,931.16 million, consisting of 16,829 million troy ounces of fine gold, valued at EUR 293.01 per ounce (2). As a consequence of the rise in the market price of gold during the year, the value of the Bank's holdings is EUR 58.54 million higher than at end-1999. Meanwhile, the number of ounces remained almost unchanged during the year (the end-1999 stock amounted to 16,830 million ounces).

2. Receivables from the IMF

These include: a) drawing rights within the reserve tranche (EUR 1,270.64 million) which include the net IMF position (EUR 1,270.64 million) and the

(1) The net position under foreign exchange forward transactions and swaps, and the foreign-exchange gains and losses generated by such position are shown in the balance sheet under items 11.4 on the assets side and 12.1 on the liabilities side, depending on their sign.

(2) One troy ounce is equal to 31.1035 grams.

euro tranche position and its balancing account (EUR 3,089.54 million, with a positive and negative sign); b) special drawing rights (EUR 311.71 million), and c) other claims (EUR 145.46 million). In total, receivables from the IMF fell by EUR 205.69 million, with respect to end-1999, due to various factors. Notable among them were operations carried out through the IMF, basically aid to other countries and loan repayments, which have involved a net reduction of EUR 196.94 million, to which must be added another EUR 8.83 million arising from the revaluation of stocks of SDRs. There was no change in Spain's IMF quota during 2000.

3. Balances with banks and security investments, external loans and other external assets

This item includes balances with banks, loans and other claims on non-euro area residents denominated in foreign currency. Their total amount is EUR 31,029.46 million, with the following breakdown:

| Type of asset | 2000 | 1999 |
|--|------------------|------------------|
| Balances with banks | 446.07 | 253.60 |
| Security investments | 30,353.62 | 30,238.30 |
| External loans and other external assets | 239.70 | 243.24 |
| <i>Loan provisions</i> | -14.57 | -4.86 |
| Non-euro area banknotes | 4.64 | 2.06 |
| TOTAL | 31,029.46 | 30,722.34 |

At end-2000, 97 % of the balances with foreign banks, loans denominated in foreign currency and security investments were denominated in US dollars.

The increase in this item (EUR 307.12 million) was basically due to the net effect of the factors listed in the following table:

| Breakdown of the change | (EUR millions) |
|--|----------------|
| Net sales of foreign currency | -1,184.78 |
| Decline in the outstanding gold swaps position at year-end | -94.64 |
| Increase in the market price of foreign securities | 570.41 |
| Increase in the market exchange rate | 754.62 |
| Increase in accrued implicit interest on securities | 264.24 |
| Other | -2.73 |
| TOTAL | 307.12 |

Under "external loans and other external assets" are included, inter alia, certain assets, to the

value of EUR 24.84 million, considered to be of doubtful recovery. Country-risk provisions of EUR 14.57 million have been established in respect of these assets.

4. Claims on non-euro area residents denominated in euro

This item, with a zero balance, includes the net amount of bilateral agreements denominated in euro, and the balance on correspondent accounts in euro held with non-participating NCBs. Last year it also included the debtor position of these central banks arising from cross-border payments through TARGET (3). The latter balances, together with balances arising from TARGET payments vis-à-vis the euro area NCBs, have from December 2000 been netted daily, being replaced by a net position vis-à-vis the ECB reflected in item 9.4 of the assets side of the balance sheet "Other claims within the Eurosystem (net)". Accordingly, at year-end, the balances included in this item had a zero balance, this being the main reason for the reduction from end-1999 of EUR 4,118.98 million.

5. Lending to euro area credit institutions related to monetary policy operations denominated in euro

This includes euro-denominated lending to euro area financial institutions, for the conduct of monetary policy. The bulk of this lending is in the form of main refinancing operations.

Although the end-2000 data are 33.24 % down on those for 1999 [EUR 16,142.87 million in 2000, against EUR 24,181.55 million in 1999 (4)], it should be pointed out that the average daily flow of financing extended during the year was up 6.94 %, from EUR 13,644.20 million in 1999 to EUR 14,591.41 million in 2000. This increase was basically connected with the need to offset part of the liquidity withdrawn through sales of external assets.

(3) Trans-European Automated Real-time Gross settlement Express Transfer system.

(4) The 1999 figures have been adjusted to make them comparable to those for 2000, since item 5.7 ("Other claims"), in the 1999 Annual Accounts is shown separately in these accounts as item 6 ("Other claims on euro area credit institutions denominated in euro").

In compliance with the provisions of Article 4.2 of the Law of Autonomy of the Banco de España of 1 June 1994, it is hereby stated that in 2000 no loans were granted to financial institutions other than under market conditions.

6 Other claims on euro area credit institutions denominated in euro

This includes the balance of the current accounts held with the credit institutions of other euro area countries. In 1999, these accounting entries were included under item 5 of the assets side of the balance sheet, "lending to euro area financial sector counterparties denominated in euro"

The outstanding year-end balance of EUR 1.97 million is down 28.36 % on the previous year, owing to the decline in the balance on the correspondent accounts held with euro area financial institutions.

7. General government debt denominated in euro.

a) State

Loans which, by virtue of their respective laws of creation, were granted to the State prior to the entry into force of Law 21/1993 of 29 December 1993 on the State budget for 1994. Transitional provision seven of this Law states that the terms and maturities originally established in such loans shall be maintained and, in the absence thereof, they shall be repaid on a straight-line basis within twenty-five years, by means of annual payments as from 1999.

The outstanding balance as at 31 December 2000 of the loans granted to the State amounted to EUR 9,343.80 million, broken down as follows:

| Type of asset | (EUR millions) | | |
|---|-----------------|---------------|-----------------|
| | 31.12.2000 | Repayment | 31.12.1999 |
| Treasury. Law 3/1983 special account | 2,343.02 | 97.62 | 2,440.64 |
| Treasury. Law 4/1990 special account | 6,253.18 | 347.40 | 6,600.58 |
| Subrogation under loans to Tabacalera. S.A. (Law 31/1991) | 12.90 | 12.90 | 25.80 |
| Credits arising from subscription for participating interests. contributions and quotas in international agencies | 734.70 | 40.82 | 775.52 |
| TOTAL | 9,343.80 | 498.74 | 9,842.54 |

The change was solely due to repayments made during the year, as specified in the above table.

b) Social Security System

This item (EUR 1,662.99 million) corresponds to the outstanding amount of two loans granted to the Social Security System under Law 41/1994 of 30 December on the State budget for 1995. The first includes the principal of another loan granted to this institution, which was not paid on its maturity, of EUR 1,539.19 million, and the second includes the interest due but not paid on the previous loan to 31.12.1994, amounting to EUR 501.90 million. The repayment of the first loan, by means of twenty annual instalments starting in 2000, is treated in the same way as established for the repayment of special loans granted to the State, referred to above. The loan for interest due to 31 December 1994 is being repaid on a straight-line basis over ten years, the first instalment having been made on 31 December 1995.

EUR 50.19 million of the reduction in the balance of this item (EUR 127.15 million) corresponds to receipt of the sixth repayment instalment on the loan of EUR 501.90 million. The amount of this instalment was recovered by means of set-off against some of the amounts due to the Social Security System in respect of interest payable on its interest-bearing accounts with the Banco de España. The remaining EUR 76.96 million corresponds to receipt of the first repayment instalment on the loan of EUR 1,539.19 million.

8. Intra-Eurosystem claims

a) Participating interest in ECB

The fully paid-up subscription of the Banco de España to the capital of the ECB amounts to EUR 444.68 million, which is equal to a share of 8.8935 % in such capital. This percentage, which remained unchanged during the year, corresponds to the Banco de España, in accordance with the capital key established by the European Commission on the basis of Spain's population and GNP.

b) Claims equivalent to the transfer of foreign reserves

Pursuant to Article 30 of the Statute of the ESCB/ECB, the Banco de España transferred foreign reserve assets to the value of EUR 4,446.75 million to the ECB at the beginning of 1999. These claims are equivalent to this transfer. They are subject to a possible reduction of up to 20 % in their initial value, in the event that the European Central Bank incurs unrealised losses caused by exchange rate differences relating to the reserve assets and which it is unable to cover either with its reserves or through appropriation of the monetary income for the year pooled by the participating NCBs. In 2000, it was not necessary to use this means of covering unrealised losses, as the ECB made a profit.

c) Other claims within the Eurosystem (net)

The balance of EUR 40,833.38 million reflects the position of the Banco de España vis-à-vis the ECB, in respect of the transfers issued and received through TARGET, both with the banks of the Eurosystem and with the non-participating NCBs. It also includes the balances held with the Eurosystem NCBs through correspondent accounts, the latter constituting an insignificant part of the total.

In relation to the transfers made through TARGET, it should be pointed out, as already mentioned in Note 4 above that, from 30 November 2000, the balances arising from such transfers vis-à-vis the Eurosystem banks, as well as the rest of the European Union banks, are netted and replaced by a single balance vis-à-vis the ECB, the latter (EUR 40,831.53 million) being the most significant part of the amount of this item of the balance sheet.

As from 2000, this item also shows any claims on the ECB that may arise from the process of pooling and redistribution of monetary income between the Eurosystem central banks (5), in accordance with the revision made by the Governing Council of the ECB of the Guideline regulating the rules for drawing up harmonised balance sheets. As at 31 December 2000, these claims totalled EUR

(5) Until 1999, these assets were included under item 11.6 of the balance sheet ("Other assets. Sundry"). The 1999 figures have been adjusted to reflect the current structure of the accounts.

1.85 million, this amount being the result of a contribution of monetary income of EUR 1.91 million and a reallocation to the Banco de España of EUR 3.76 million.

9. Items in course of settlement

Totalling EUR 7.45 million, they correspond basically to bills and documents in the process of being cleared (EUR 6.25 million)

10. Tangible and intangible fixed assets

Their balance totalled EUR 225.64 million at end-2000, of which EUR 402.26 million corresponded to their cost and EUR 176.62 to accumulated depreciation.

The two tables below show this item broken down into its components, together with their accumulated depreciation.

(EUR millions)

| Cost or valuation | Property and facilities | Furniture and equipment | Fixed assets under construction | Other fixed assets | Total |
|-------------------|-------------------------|-------------------------|---------------------------------|--------------------|--------|
| 1 January 2000 | 231.67 | 73.17 | 4.44 | 78.78 | 388.06 |
| Acquisitions | 2.24 | 5.69 | 11.66 | 3.00 | 22.59 |
| Disposals | -0.49 | -4.15 | -3.43 | -0.32 | -8.39 |
| 31 December 2000 | 233.42 | 74.71 | 12.67 | 81.46 | 402.26 |

(EUR millions)

| Accumulated depreciation | Property and facilities | Furniture and equipment | Fixed assets under construction | Other fixed assets | Total |
|--------------------------|-------------------------|-------------------------|---------------------------------|--------------------|--------|
| 1 January 2000 | 90.83 | 59.75 | — | 13.97 | 164.55 |
| Change during the year | 8.71 | 1.63 | — | 1.73 | 12.07 |
| 31 December 2000 | 99.54 | 61.38 | — | 15.70 | 176.62 |

The Bank's holdings of silver, valued at EUR 28.48 million, are included under "Other fixed assets". They rose by EUR 0.2 million with respect to the previous year as a consequence of the capitalisation of expenses arising from the polishing and re-sealing of stocks to meet London Good Delivery condition.

11. Other financial assets

Of the total amount of this item, 99 % corresponds to the portfolio of book-entry debt, in which the Banco de España has EUR 3,443.23 million invested, EUR 91.26 million less than a year

earlier. This decline is basically due to the redemption of securities upon maturity, as well as the reduction in implicit interest accrued, partly offset by recorded gains.

12. Off-balance-sheet instruments revaluation differences

Included here is the amount of the net debtor position under foreign-exchange forward transactions and swaps valued at the market exchange rates prevailing at year-end. When this position is a creditor one, as in 1999, it is included in item 12.1 of the liabilities side of the balance sheet. The end-2000 balance, EUR 188.18 million, is the net value of the forward transactions then outstanding, as well as of a currency swap.

13. Accruals and deferred expenditure

Of the total balance of this group of accounts (EUR 929.90 million), the main components are interest accrued but not yet received on securities denominated in foreign currency (EUR 358.73 million), interest accrued but not yet received on State book-entry debt (EUR 161.78 million), interest accrued on the claims equivalent to the transfer of foreign reserves (EUR 154.93 million) and interest accrued and not received as at year-end on the net balance of claims within the Eurosystem arising from transfers made through TARGET (EUR 176.29 million).

14. Sundry

The most significant component of this item, representing 94.4 % of the total, is the transfer made to the Treasury on 2.11.2000, in respect of 70 % of the Bank's recorded profits accrued to 30 September 2000, which totalled EUR 2,878.92 million.

The difference (EUR 1.42 million) between the amount recorded for this item in 1999 and the amount shown for the same year in the column included in these Annual Accounts for the purposes of comparison with the balance in 2000, is explained by the reason mentioned in footnote 5 on page 142 and by the reclassification under this item of "Unpaid authorised documentary credits" (EUR 0.74 million) which, in 1999, was reflected on the liabili-

ties side of the balance sheet, being deducted from "Amounts payable under documentary credits".

15. Banknotes in circulation

The breakdown of banknotes in circulation by denomination at 31.12.2000 is as follows:

| Denomination | (EUR millions) | |
|--------------------------|------------------|------------------|
| | 2000 | 1999 |
| ESP 1,000 | 1,514.74 | 1,574.21 |
| ESP 2,000 | 2,994.34 | 3,164.23 |
| ESP 5,000 | 18,837.69 | 20,734.52 |
| ESP 10,000 | 33,887.42 | 33,471.71 |
| Held by other ESCB banks | -35.87 | -33.51 |
| TOTAL | 57,198.32 | 58,911.16 |

The stock of banknotes in circulation was down 2.9 % on end-1999, owing to the temporary increase in banknotes in circulation at the end of 1999 as a consequence of the so-called "year-2000 effect".

16. Liabilities to euro area credit institutions related to monetary policy operations

The overall balance of the different types of deposit held by credit institutions with the Banco de España totalled EUR 8,391.21 million at end-2000. The reduction with respect to the previous year was concentrated in current accounts (covering the minimum reserve system), which fell from EUR 12,462.00 million at 31.12.1999 to 3,385.21 million at 31.12.2000. This reduction was basically related to the decision taken by the credit institutions at the end of 1999 to cover themselves for possible risks arising from so-called "year-2000 problems". Despite the large increase in the balance of this item at end-1999, the average balance during 2000, which totalled EUR 9,009.71 million, was 10.2 % higher than in 1999 (EUR 8,174.54 million).

17. Debt certificates issued

This item includes fixed-term certificates issued by the Banco de España to absorb liquidity from the financial system, pursuant to the Ministerial Order of 21 February 1990, whereby the reserve requirements for financial intermediaries were altered. As the repayment of these certificates was completed

in September 2000, the balance of this item at end-2000 is zero.

18. Liabilities to other euro area residents denominated in euro. General government

This item includes the deposits held by general government with the Banco de España. The outstanding balance at year-end was EUR 29,298.24 million, which breaks down as follows:

| | (EUR millions) | |
|--|------------------|------------------|
| | 2000 | 1999 |
| Central government (State) | 22,907.41 | 16,866.33 |
| <i>Treasury current account</i> | 20,536.27 | 14,846.40 |
| <i>Other central government agencies and similar bodies</i> | 2,371.14 | 2,019.93 |
| Territorial government | 149.79 | 165.82 |
| <i>Regional (autonomous) governments, administrative agencies and similar bodies</i> | 140.89 | 162.54 |
| <i>Local government</i> | 8.90 | 3.28 |
| Social security funds | 6,241.04 | 3,915.51 |
| TOTAL | 29,298.24 | 20,947.66 |

The large increase in the balance of this item (EUR 29,298.24 million at end-2000, compared with EUR 20,947.66 million at end-1999) was basically due to the increase in the current account of the Treasury, which rose from EUR 14,846.40 million to EUR 20,536.27 million, and to the increase in the balance of the Social Security System accounts, which rose from EUR 3,915.51 million to EUR 6,241.04 million.

19. Liabilities to other euro area residents denominated in euro. Other liabilities

Included here are the current accounts of financial institutions other than credit institutions, such as the Deposit Insurance Funds, other financial intermediaries associated with securities markets settlement, other intermediaries in the debt book-entry market, etc., as well as the current accounts of employees and pensioners and other accounts of legal entities classified in the other resident non-financial sectors. The balance at end-2000 was EUR 940.05 million, a reduction of EUR 194.95 million on end-1999, basically due to the decrease in the balances of the current accounts of State bodies (both autonomous agencies and business entities).

20. Liabilities to non-euro area residents denominated in euro

The balance of this item is EUR 24.65 million, 426.44 million lower than at end-1999, basically owing to the daily netting referred to in Notes 4 and 8 c) above.

21. Liabilities to non-euro area residents denominated in foreign currency. Deposits, balances and other liabilities

Of the total of these liabilities (EUR 453.67 million at end-2000), 99.87 % corresponds to debts arising under repurchase agreements relating to the management of the foreign-currency reserves of the Banco de España. The amount of this item fell by EUR 94.71 million.

22. Counterpart of special drawing rights allocated by the IMF

This item, totalling EUR 418.35 million, includes the counterpart of the special drawing rights allocated to Spain in proportion to its IMF quota.

23. Items in course of settlement

Of the total balance of this group of accounts (EUR 385.32 million), EUR 333.67 corresponds to transfers ordered by credit institutions pending payment at year-end. These transfers also account for most of the increase with respect to 1999 (EUR 74.75 million out of a total of EUR 110.62 million).

The difference between the amount published for this item in 1999 and the amount given for that year in these Annual Accounts (EUR 13.89 million) is basically due to the reclassification under this item of certain accounts relating to transfers pending (EUR 13.15 million) which, in 1999, were included in the item ("Other liabilities. Sundry"). A small amount (EUR 0.74 million) is explained by the reclassification referred to in Note 14 above.

24. Other liabilities. Off-balance-sheet instruments revaluation differences

See Note 12.

25. Other liabilities. Accruals and deferred income

The most significant item of this sub-group of accounts totalling EUR 917.53 million, corresponds to (ordinary and pre-system) profits, attributable to the foreign exchange forward transactions outstanding at year-end (EUR 620.65 million), such profits being considered unrealised until the transactions mature. The rest corresponds mainly to interest accrued on remunerated current accounts, of which those of the Social Security System (EUR 232.81 million) and the Treasury (EUR 30.69 million) are notable.

26. Other liabilities. Sundry

The most important components of this sub-group of accounts are those relating to contributions payable to the Banco de España employee social welfare scheme (Mutualidad de empleados), which amounted to EUR 379.49 million, representing the current value of the debt recognised by the Banco de España in favour of the scheme arising from commitments made thereto, this amount being reduced by EUR 16.54 million during the year, and "settled credit interest pending allocation – suspense accounts" (corresponding to a loan to the Social Security System, referred to in Note 7), the balance of which at year-end amounted to EUR 200.76 million, down 50.19 million on the previous year.

Also appearing in this subgroup are the taxes pending payment, to the value of EUR 7.81 million, of which EUR 4.81 correspond to withholdings on the wages and salaries paid to employees, and EUR 2.79 to insurance and social benefits payable.

The difference between the amount included for this group of accounts in 1999 and the amount shown for the same year in the column included in these Annual Accounts for purposes of comparison (EUR 13.15 million) is explained by the reason indicated in Note 23 above.

27. Provisions

With the exception of country-risk provisions, which are presented in the balance sheet in the form of adjustments to the values of the assets con-

cerned, provisions are recorded under this item, with the following breakdown:

| | (En millones de euros) | |
|---|------------------------|-----------------|
| | 2000 | 1999 |
| For liabilities and charges | 96.92 | 4.18 |
| For exchange rate risks - Pre-system account | 3,767.58 | 3,767.58 |
| For ECB losses covered by monetary income | — | 3.94 |
| For ECB losses covered by additional contributions | — | 20.81 |
| For other risks | 0.29 | 0.30 |
| TOTAL | 3,864.79 | 3,796.81 |

The most important provision, unchanged during the year, relates to pre-system exchange rate risks. It was created by a resolution of the Executive Commission of 26 January 1999 to cover future exchange rate risks affecting the external reserves of the Banco de España and possible contingencies in respect of unrealised losses on reserves transferred to the European Central Bank.

The increase in the provision for liabilities and charges was basically due to the creation of a provision to cover assistance for death and retirement established in Article 190 of the Bank's Employment Rules (EUR 88.24 million), as indicated in Note 8 to the profit and loss account.

Unlike in 1999, the ECB posted a profit in 2000. Accordingly there was no need to set aside any amount to cover its losses.

28. Revaluation accounts

These accounts represent revaluation reserves arising from unrealised gains on financial assets and liabilities. Their breakdown is as follows:

| Type of account | (EUR millions) | |
|---|------------------|-----------------|
| | 2000 | 1999 |
| Pre-system revaluation accounts | 4,137.23 | 4,763.33 |
| Due to exchange rate differences | 1,177.74 | 1,729.83 |
| Due to price differences | 2,959.49 | 3,033.50 |
| Gold | 2,565.67 | 2,565.79 |
| Securities denominated in foreign currency | 41.48 | 96.09 |
| Book-entry public debt | 352.34 | 371.62 |
| Ordinary revaluation accounts | 5,931.39 | 4,878.04 |
| Due to exchange rate differences | 4,536.43 | 4,151.58 |
| Due to price differences | 1,394.96 | 726.46 |
| Gold | 784.95 | 726.22 |
| Securities denominated in foreign currencies | 570.76 | 0.24 |
| Book-entry public debt | 39.25 | 0.00 |
| TOTAL | 10,068.62 | 9,641.37 |

The difference between the pre-system and ordinary revaluation accounts is that the former record the unrealised gains existing at end-1998 (immediately before the start of Stage Three of EMU) and the latter, those arising since that date.

The decline of EUR 626.10 million in the balance of the pre-system revaluation accounts in 2000 has the following breakdown:

| Pre-system revaluation accounts | Breakdown of the change in 2000 | | Total |
|---|---|---|---------------|
| | Realisation of capital gains in sales and redemptions | Netting against unrealised capital losses | |
| Due to exchange rate differences | 552.09 | - | 552.09 |
| Due to price differences | 72.42 | 1.59 | 74.01 |
| Gold | 0.12 | - | 0.12 |
| Securities denominated in foreign currencies | 54.61 | - | 54.61 |
| Book-entry public debt | 17.69 | 1.59 | 19.28 |
| TOTAL | 624.51 | 1.59 | 626.10 |

The balance of the ordinary revaluation accounts increased by EUR 1,053.35 million, with the following breakdown:

| Breakdown of change | EUR millions |
|--|-----------------|
| Due to exchange rate differences | 384.85 |
| Due to price differences | 668.50 |
| Gold | 58.73 |
| Securities denominated in foreign currencies | 570.52 |
| Book-entry public debt | 39.25 |
| TOTAL | 1,053.35 |

29. Capital

The capital of the Banco de España, constituted in accordance with the provisions of Royal Legislative Decree 18/1962 of 7 June 1962, totalled EUR 1.37 million and remained unchanged during the year.

30. Reserves

Included in this item, which remained unchanged during the year, is the amount of capital, reserves and profits arising from membership in 1973 of the former Spanish Foreign Currency Institute in the Banco de España.

31. Profit for the year

The net profit for the year, having deducted the transfer to the Beneficent-Social Fund (EUR 11.54

million), totalled EUR 5,758.70 million, 41.7 % up on 1999. Of this amount, EUR 2,878.92 million, as indicated in Note 14 above, was paid to the Treasury on 2.11.2000, in accordance with Royal Decree 1746/1999 of 19 November 1999.

The following amounts corresponding to 1999 profits were also paid to the Treasury during the year.

- a) On 1.2.2000, EUR 1,751.60 million, in order to reach 90 % of the profit for 1999 (EUR 4,063.83 million).
- b) On 31.8.2000, the Balance Sheet and Profit and Loss account for the year 1999 having been approved by the Council of Ministers, EUR 406.38 million, representing the rest of the profit for 1999.

The details of the various components of the profit for 2000 are given in Section II.3 below, relating to the profit and loss account.

II.3. NOTES ON THE PROFIT AND LOSS ACCOUNT

1. Interest income

This item includes income from interest accrued on the main assets of the Banco de España. It was made up, in 2000 and 1999, as follows:

| | Foreign currency | | Euro | | Total | |
|--------------|------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | 2000 | 1999 | 2000 | 1999 | 2000 | 1999 |
| Securities | 1,999.66 | 1,737.74 | 170.74 | 138.19 | 2,170.40 | 1,875.93 |
| Other assets | 216.31 | 65.76 | 2,153.90 | 1,150.15 | 2,370.21 | 1,215.91 |
| TOTAL | 2,215.97 | 1,803.50 | 2,324.64 | 1,288.34 | 4,540.61 | 3,091.84 |

Of the total of EUR 2,215.97 million, corresponding to interest on foreign-currency denominated investments in 2000, the interest on US-dollar-denominated fixed-income security investments totalled EUR 1,946.01 million (87.8 %), with much lower amounts corresponding to the interest on SDRs, Canadian dollars, gold, etc. The average level of such US-dollar investments was EUR 27,452 million, with an average yield of 6.3 %.

The interest on euro-denominated investments (EUR 2,324.64 million) arose, in short, from the following assets:

| Assets | Average investment | Amount | Average yield in 2000 |
|---|--------------------|-----------------|-----------------------|
| Loans to institutions related to monetary policy operations | 14,591 | 596.41 | 4.0% |
| Net position with European Union central banks | 33,465 | 1,396.86 | 4.1% |
| Claims equivalent to the transfer of foreign reserves | 4,447 | 154.93 | 3.4%(1) |
| Book-entry debt portfolio and other | 3,551 | 176.44 | 4.9% |
| TOTAL | 56,054 | 2,324.64 | 4.1% |

(a) The claims equivalent to the transfer of foreign reserves are remunerated at 85% of the marginal rate in main refinancing operations.

Comparison with the previous year shows a notable net increase in total interest obtained (EUR 1,448.77 million), basically as a result of the following:

- The increase in the average yield on the main assets (the yield on US dollar investments rose from 4.8 % to 6.3 %, while that on euro investments rose from 2.8 % to 4.1 %).
- The appreciation of the US dollar against the euro during 2000 (the average US dollar/euro exchange rate at which interest was recorded was 1.02 in 1999 and 0.91 in 2000).
- The increase in the average balance of euro-denominated investments, which was almost EUR 10,000 million higher than in 1999.

The increase in total interest arose despite the divestment of US dollar-denominated assets, the average balance of which fell by USD 8,099 million.

2. Interest expense

This item includes expenditure on the interest accruing on liabilities, which breaks down as follows:

| | Average financing | Interest expense | | Average cost in 2000 |
|---|-------------------|------------------|----------------|----------------------|
| | | 2000 | 1999 | |
| Certificates issued by the Banco de España | 1,653 | -99.44 | -289.05 | -6.0 |
| Remuneration of minimum reserves | 9,010 | -369.55 | -223.24 | -4.0 |
| General government deposits | 9,652 | -407.91 | -149.15 | -4.2 (1) |
| Other euro-denominated liabilities | 49 | -1.48 | -7.74 | -3.0 |
| Liabilities denominated in foreign currency | 734 | -41.19 | -30.56 | -5.5 |
| TOTAL | 21,098 | -919.57 | -699.74 | -4.3 |

(a) Only the amount of the balances in favour of the Treasury that exceeds the amount of the special loans extended thereto is remunerated.

The increase in the expense compared with the previous year (EUR 219.83 million) was primarily due to increase in the average cost of financing received which, in line with the general trend in interest rates during the period, rose from 3.6 % in 1999 to 4.3 % in 2000, and also to the increase in the balances of the accounts held by the Treasury and by the Social Security System with the Banco de España. This increase was partly offset by the repayment on schedule of debt certificates issued by the Banco de España that were outstanding at the beginning of the year, the final instalment being paid in September 2000.

3. Realised gains/losses arising from financial operations

This item includes the profits and losses arising from dealing in financial assets. In 2000, there was a net realised gain of EUR 2,494.67 million, basically arising from the following sources:

- Foreign exchange gains upon the sale of foreign currency totalling EUR 2,406.99 million, of which EUR 421.26 million corresponded to the realisation of unrealised gains already existing at 31.12.1998 and the rest, EUR 1,945.73 million, to the realisation of those arising in 2000.

Of the total of EUR 2,406.99 million, EUR 2,315.22 million (96.2 %) arose from the net daily sale (daily LIFO) of US dollars which, including the transfer of reserves to the ECB, totalled USD 11,092 million in 1999. The other gains related to the net sale of Japanese yen (EUR 2.24 million), SDRs (EUR 89.19 million) and other foreign currencies.

- The net gains arising from price movements, on the sale of foreign securities, amounted to EUR 93.57 million, basically corresponding to the sale of US dollar-denominated securities.

Of the total of EUR 93.57 million, EUR 54.62 million corresponds to the realisation of unrealised gains existing as at 31.12.1998, and the rest, EUR 38.95 million, to gains arising and realised during 2000 owing to changes in market prices.

Compared with the previous year, the net profit on these transactions has increased by EUR 189.89 million, owing basically to the increase in foreign exchange gains, even though there has been a reduction in gains arising from price movements.

- The increase in foreign exchange gains (EUR 678.31 million) arose basically as a result of:

- The appreciation of the US dollar against the euro (the gain on each USD100 sold rose from EUR 6.37 in 1999 to EUR 16.99 in 2000) and the reduction in the volume of daily net sales of US dollars, which totalled USD 12,800 million during the whole of 1999, as against USD 11,092 million in 2000, entailed an increase in gains of EUR 1,068.76 million.
- The reduction in realised pre-system gains (EUR 861.69 million in 1999, as against EUR 461.26 million in 2000) entailed a decline in gains of EUR 400.43 million.

- The reduction in gains arising from price movements on securities and gold (EUR 479.88 million) is basically due to the smaller amount of realised gains on sales of securities (EUR 67.02 million), and to the fact that in 1999 gains were also realised on the transfer of gold to the ECB (EUR 412.86 million).

4. Write-downs on financial assets and positions

This item includes that part of the loss arising from exchange rate depreciation in the foreign currency position, as well as from the fall in the price of gold and of securities denominated in foreign currency, that cannot be netted against unrealised gains arising from previous years.

The loss recorded in 2000 (EUR 7 million), basically corresponds to the depreciation of the position in Pounds Sterling. The loss in 1999 was EUR 398.21 million, primarily attributable to the losses arising from price movements existing in the portfolio of US dollar-denominated securities.

5. Net income from fees and commissions

This basically includes income and expenses arising from fees for banking services and the like (transfers, negotiation of cheques, custody and administration of securities, telephone service for securities transactions, etc.). It may be broken down as follows:

| | (EUR millions) | | | |
|---------------------|----------------|--------------|--------------|--------------|
| | Income | | Expenses | |
| | 2000 | 1999 | 2000 | 1999 |
| Foreign operations | 4.07 | 23.93 | -1.15 | -1.15 |
| Domestic operations | 11.96 | 12.01 | -0.31 | -0.17 |
| TOTAL | 16.03 | 35.94 | -1.46 | -1.32 |

The sharp decline in income from commissions on external operations is attributable to the exceptional nature of the income recorded in 1999 as a consequence of the guarantee given by the Banco de España that year on a loan granted by the Bank for International Settlements to Brazil. Other commission income and expense was virtually unchanged on the previous year.

6. Income from equity shares and participating interests

This includes the dividends paid on the participating interest of the Banco de España in the capital of the Bank for International Settlements.

7. Net result of pooling of monetary income

According to Article 32.5 of the Statute of the ESCB/ECB, the monetary income of the national central banks, accruing in the performance of the ESCB's monetary policy function, shall be allocated to such banks in proportion to their paid-up shares in the capital of the ECB. The Governing Council of the ECB, in its meeting of 3 November 1998, decided to calculate monetary income by the application of a reference rate to the liability base, defined for this purpose as all the central bank's deposit liabilities to credit institutions, without including banknotes. The reference rate used is the marginal rate of the latest main refinancing operation and is applied on a daily basis to the liability base of each national central bank.

The table below shows the breakdown of the net result for the Banco de España of the pooling of monetary income in 2000.

| (EUR millions) | |
|--|---------------|
| Items | December 2000 |
| Monetary income contributions to the Eurosystem | -1.91 |
| Reallocation of monetary income to the Banco de España | 3.76 |
| Net result of monetary income pooled | 1.85 |

As the ECB made a profit in 2000, it was not necessary to use the amount of reallocated monetary income to cover ECB losses. By contrast, in 1999, pursuant to the terms of Article 33.2 of the Statute of the ESCB/ECB, and to the decision of the

Governing Council of the ECB of 15.12.1999, the whole amount of monetary income reallocated to the Banco de España in 1999 (EUR 3.94 million) had to be contributed to cover the ECB's losses, along with an additional contribution of EUR 20.81 million.

8. Other income

This includes the profits arising on book-entry public debt, as well as other diverse income of an exceptional nature. It may be broken down as follows:

| (EUR millions) | | |
|--|--------------|---------------|
| Description | 2000 | 1999 |
| Profit on the sale of book-entry public debt | — | -0.95 |
| Pre-system profit on book-entry public debt | 17.69 | 14.58 |
| Extraordinary profit | 22.45 | 124.66 |
| Sundry | 1.09 | 0.88 |
| TOTAL | 41.23 | 139.17 |

Under the extraordinary profit (EUR 22.45 million), the following items are notable:

- Extraordinary profits of EUR 85.03 million, arising basically from the receipt from the Social Security System of interest accrued in previous years (EUR 50.19 million) and from the distribution of IMF reserves generated in previous years (EUR 34.78 million).
- A profit arising from the withdrawal from circulation of the 2000 peseta banknote issue of 22.07.80, which ceased to be legal tender in 2000 (EUR 37.67 million) (6).
- Extraordinary losses, totalling EUR 101.45 million, basically arising from the extraordinary contribution to the Bank's employee pension scheme in respect of past services (EUR 13.04 million) and from the establishment of a provision to cover the assistance for death and retirement established in Article 190 of the Bank's employment rules (EUR 88.24 million).

In 1999, the most important items under extraordinary profits were the receipt from the Social Security System of interest accrued in previous years (EUR 50.19 million); the tax rebate (47.57 mil-

(6) A provision has been established to cover the loss arising from future presentation of some of these banknotes, as explained in Note 14 below.

lion) and the recovery of part of the country-risk provision as a result of the State's assumption of debts of the Dominican Republic and Equatorial Guinea (EUR 25.71 million).

9. Staff costs

This item, which amounts to EUR 174.76 million, includes the salaries and other emoluments of the Bank's staff (EUR 127.87 million), which were 3.1 % higher than in 1999; Social Security contributions (EUR 30.38 million), 3 % higher; expenses of a social nature (EUR 14.28 million), down 3.1 %; and contributions to the pension scheme (EUR 2.23 million), which increased by 5.7 %.

10. Administrative expenses (7)

This item includes expenditure arising from the purchase of current assets, as well as diverse services received during the year. The most important were office expenses (including IT costs), which amounted to EUR 20.63 million, and costs relating to premises (especially maintenance), which amounted to EUR 12.66 million.

It breaks down as follows:

| Description | (EUR millions) | |
|------------------------------|----------------|---------------|
| | 2000 | 1999 |
| Office expenses | -20.63 | -24.72 |
| Property expenses | -12.66 | -12.00 |
| Transport and communications | -4.65 | -4.42 |
| Security | -5.18 | -4.83 |
| Training and grants | -1.32 | -1.14 |
| Sundry operating expenses | -6.73 | -6.22 |
| Taxes | -0.80 | -0.75 |
| TOTAL | -51.97 | -54.08 |

11. Depreciation of fixed assets

Included here is the cost of the estimated depreciation of the Bank's fixed assets, which breaks down as follows:

| Description | (EUR millions) | |
|--|----------------|---------------|
| | 2000 | 1999 |
| Depreciation of property | -8.85 | -9.05 |
| Depreciation of transport equipment | -0.09 | -0.08 |
| Depreciation of furniture and office equipment | -5.69 | -5.88 |
| Depreciation of computer applications | -1.78 | -0.98 |
| Other depreciable expenses | -0.19 | -0.23 |
| TOTAL | -16.60 | -16.22 |

(7) Given that there is no explicit provision for taxes in the harmonised ESCB profit and loss account format, these are included in this item.

12. Banknote production costs

This amount (EUR 68.13 million) corresponds to payments made by the Banco de España to purchase banknotes from the National Mint. The increase (EUR 11.72 million; 20.8 %) was basically attributable to the higher unit cost of euro-denominated banknotes, that began to be received in 2000.

13. Other expenses

These were as follows:

| Description | (EUR millions) | |
|---|----------------|--------------|
| | 2000 | 1999 |
| Fund conveyance expenses | -0.57 | -0.63 |
| Coin and banknote packaging material expenses | -0.65 | -0.22 |
| Other | -0.17 | — |
| TOTAL | -1.39 | -0.85 |

14. Transfers and additions to other funds and provisions

These totalled EUR 96.56 million and basically included expenses arising from payment commitments to the Banco de España Employee Social Welfare Scheme (EUR 43.56 million), the increase in the country-risk provision to cover 100 % of the loans extended under the bilateral agreement with Cuba (EUR 36.24 million), the contribution to the Beneficent-Social Fund (EUR 11.54 million) and the establishment of a provision of EUR 5.11 million to cover the possible exchange of 2000-peseta banknotes of the issue of 22.07.80, which were withdrawn from circulation in 2000.

In 1999, the most significant items in the total of EUR 89.70 million were the expenses arising from payment commitments to the Employee Social Welfare Scheme (EUR 45.20 million) and the net losses in the book-entry public debt portfolio (EUR 39.48 million).

15. Profit for the year

As detailed and explained in the preceding notes, the net profit for 2000 amounted to EUR 5,758.70 million, 41.7 % up on the previous year.

As detailed in the table below, of this amount, pursuant to Royal Decree 1746/99, EUR 2,303.91

million was paid to the Treasury on 1.02.2001. This was the amount necessary, taking into account the advance payment made on 2.11.2000 of EUR 2,878.92 million, to make a total payment of 90 % of the Bank's profit for the period ending 31.12.2000.

| | | (EUR millions) | |
|---|----------|----------------|-----------------|
| 1. Profit for the year 2000 | | | 5,758.70 |
| 2. Payments to the Treasury: | | | |
| — on 2.11.2000, 70% of profit as at 30.09.2000 | 2,878.92 | | |
| — on 1.2.2001, the additional, necessary amount to reach 90% of the profit for the year ending 31.12.2000 | 2,303.91 | 5,182.83 | |
| 3. Profit pending payment to the Treasury (a) | | | 575.87 |
| TOTAL (2+3) | | | 5,758.70 |

(a) The remaining amount due shall be paid to the Treasury when the annual accounts for 2000 have been approved by the Government.

III. SPECIFIC INFORMATION REQUIRED BY ARTICLE 4 OF THE LAW OF AUTONOMY OF THE BANCO DE ESPAÑA

1. Contributions made by the Bank to the Deposit Insurance Funds (Article 4.2 of the Law of Autonomy of the Banco de España of 1 June 1994)

The contribution of the Banco de España to the Deposit Insurance Funds is regulated by Article 3 of Royal Decree 18/1982, according to the wording established by additional provision seven of Royal Legislative Decree 12/1995 of 28 December 1995 and Royal Decree 2606/1996 of 20 December 1996, which implemented the legal regime for such funds.

The latter Royal Decree established that the Deposit Insurance Funds may only exceptionally be supplemented by contributions from the Banco de España, the amount of which shall be fixed by Law. In 2000 the Banco de España made no contributions whatsoever to the Deposit Insurance Funds.

2. Loss of profit

The table below shows the loans outstanding in 2000 with interest rates below the reference rates used, in order to estimate the loss of profit for the year pursuant to the provisions of Article 4.2 of Law 13/1994 of 1 June 1994 of autonomy of the Banco de España.

| Average balances on loans outstanding in 2000 with interest rates below the reference rates | | | | |
|---|-----------------------------------|------------------------|-------------------------|--------------------------|
| Title | Estimated average balance in 2000 | Interest rate received | Reference interest rate | Estimated loss of profit |
| Net State debt | 854.53 | 0 | 4.05 | 34.61 |
| Loans to the Social Security System | 1,789.10 | 0 | 4.05 | 72.46 |
| Home loans and repayable advances to employees | 128.40 | 1.97 | 4.05 | 2.67 |
| Home loans | 110.52 | 2.29 | 4.05 | 1.95 |
| Repayable advances | 17.88 | 0 | 4.05 | 0.72 |
| TOTALS | 2,772.03 | 0.09 | 4.05 | 109.74 |

Included under the heading "net State debt" is the average balance during the year, on a daily basis, of the special loans granted to the State before 1994 and the deposits held by the Treasury with the Banco de España, when there is a net balance in favour of the latter.

As regards the loans to the Social Security System, transitional provision six of Law 41/1994 of 30 December 1994 on the 1995 State budget, when establishing the conditions for repayment of certain loans to the Social Security System, provided that no interest shall accrue on such loans as from 1 January 1995.

Finally, home loans and advances to employees correspond to those granted under the collective agreements with them signed by the Banco de España.

The reference rate used to estimate the loss of profit is the monthly average of the interest rate on main refinancing operations during the year.

I. REPORT OF THE EXTERNAL AUDITORS

The Governor and Governing Council of the Banco de España

We have audited the annual accounts of the Banco de España, comprising the balance sheet as at 31 December 2000, the profit and loss account and the notes on the accounts for the year then ended. The Governing Council is responsible for the preparation of the accounts. It is our responsibility to express an opinion on the annual accounts taken as a whole based on our audit.

We conducted our audit in accordance with International Standards of Auditing, which require us to plan and conduct the audit in such a way that we can be reasonably certain that the annual accounts do not contain any material errors. An audit includes examination, by means of selective tests, of the documentation supporting the annual accounts and evaluation of their presentation. It also includes an evaluation of the estimates made and of whether the accounting principles applied are appropriate to the Banco de España's circumstances and adequately disclosed. We consider that our work provides an adequate basis for our opinion.

For purposes of comparison, the attached annual accounts present, in addition to the 2000 figures, those for the previous year for each balance sheet and profit and loss account item. Our opinion refers solely to the 2000 annual accounts. Our unqualified audit report on the 1999 annual accounts was issued on 1 June 2000.

In our opinion, the annual accounts referred to above present a true and fair view, in all material respects, of the net worth and financial position of the Banco de España as at 31 December 2000, and of the net profit from its operations in the year then ended, and contain the sufficient necessary information for their proper interpretation and comprehension, in conformity with the accounting principles and standards referred to in Section II.1 of the notes on the accounts, based on the accounting rules established for the member central banks of the European System of Central Banks, which are consistent with those applied the previous year.

Pricewaterhouse Coopers Auditores, S.L.

[signed]

Juan José Hierro
Partner – Auditor

31 May 2001

2. REPORT OF THE ACCOUNTS REVIEW COMMITTEE

We the undersigned, José Manuel González-Páramo Martínez-Murillo, Eduardo Bueno Campos and Jaime Requeijo González, members of the Governing Council of the Banco de España and of the Accounts Review Committee appointed by the Governing Council, were given the task of reviewing the accounts of the institution for the year 2000.

By virtue of this mandate, the Accounts Review Committee has analysed the operations of the Banco de España. This examination basically involved: 1) studying the Annual Accounts of the Banco de España for the year 2000, prepared by the Control and Accounting Department of the Banco de España; 2) studying the internal audit of the balance sheet and profit and loss account of the Banco de España for 2000, conducted by the Internal Audit

Department; 3) studying the documentation requested by the members of this Committee from the independent external auditors; 4) interviewing the senior managers of the independent external audit firm; and 5) making proposals for the modification, correction or clarification of various matters, all of which have been satisfactorily incorporated in the Annual Accounts by the Control and Accounting Department.

The basic conclusion of our report is that from the analysis carried out of the examination and accounting procedures, of the accounting records and of the internal controls carried out, it can be inferred that the Annual Accounts for the year 2000 give a true and fair view of the net worth and financial position of the Banco de España.

30 May 2001.

[signed]

D. JOSÉ MANUEL GONZÁLEZ-PÁRAMO
MARTÍNEZ-MURILLO

[signed]

D. EDUARDO BUENO CAMPOS

[signed]

D. JAIME REQUEIJO GONZÁLEZ

INDEXES

Index of tables

| | <i>Page</i> |
|--|-------------|
| Table I.1. Main indicators of the Spanish economy | 18 |
| Table II.1. Main macroeconomic indicators of the United States, Japan and the United Kingdom. . | 32 |
| Table II.2. Emerging markets: main macroeconomic indicators | 41 |
| Table III.1. Euro area: main macroeconomic indicators | 48 |
| Table III.2. Euro area countries: annual GDP growth | 53 |
| Table IV.1. Consumption and gross fixed capital formation by institutional sector | 72 |
| Table IV.2. Main general government non-financial transactions (ESA 95)..... | 87 |
| Table IV.3. Balance of payments: summary table..... | 91 |
| Table V.1. Use of income, capital and financial accounts. National economy. Breakdown by sector . . | 97 |
| Table V.2. Net financial transactions and inter-sectoral flows..... | 99 |
| Table V.3. Non-financial corporations and households and NPIs. Financial transactions..... | 101 |
| Table V.4. Financial transactions of the nation | 105 |
| Table V.5. Issuance and public offerings of marketable securities | 106 |
| Table V.6. Turnover on secondary and derivatives markets | 107 |
| Table V.7. Deposit money institutions. Structure of balance sheet and profit and loss account. . . . | 113 |
| Table V.8. Credit by purpose | 114 |
| Table V.9. Bank credit to the private sector as a percentage of GDP in the euro area countries. . | 116 |
| Table V.10. Funds raised by other financial intermediaries..... | 118 |

Index of charts

| | <i>Page</i> |
|---|-------------|
| Chart I.1. GDP and domestic demand | 12 |
| Chart I.2. Price and cost indicators | 23 |
| Chart I.3. Trade balance and terms of trade | 24 |
| Chart I.4. Competitiveness indices of the Spanish economy..... | 25 |
| Chart II.1. Macroeconomic indicators of the industrialised and emerging economies | 33 |
| Chart II.2. Commodity prices | 33 |
| Chart II.3. Short- and long-term interest rates, stock markets, and private and government bond yield spreads. | 34 |
| Chart II.4. United States: unit labour costs and breakdown thereof..... | 36 |
| Chart II.5. United States: Federal Funds target rate | 37 |
| Chart II.6. United States: profits, stock market indices and investment..... | 37 |
| Chart II.7. Japan: main macroeconomic indicators | 39 |
| Chart II.8. Emerging economies: financial indicators | 42 |
| Chart III.1. Euro area: composition of growth, confidence indicators and performance of employment, real wages and productivity | 49 |
| Chart III.2. Euro area. Harmonised indices of consumer prices..... | 52 |
| Chart III.3. Euro area: composition of the budgetary adjustment in 1999 and 2000 in relation to previous years | 54 |
| Chart III.4. Nominal euro exchange rate vis-à-vis the US dollar and the yen | 58 |
| Chart III.5. Index of monetary conditions in the euro area: contributions..... | 59 |
| Chart III.6. Stock market indices | 59 |
| Chart III.7. Eurosystem interest rates | 60 |
| Chart III.8. Euro area interest rates | 60 |
| Chart III.9. Monetary and credit aggregates in the euro area. Year-on-year rates of change | 62 |
| Chart IV.1. Monetary and financial magnitudes of the Spanish economy..... | 66 |
| Chart IV.2. Main macroeconomic aggregates | 69 |
| Chart IV.3. Household final consumption | 70 |
| Chart IV.4. Residential investment | 71 |
| Chart IV.5. Private productive investment | 73 |
| Chart IV.6. External demand..... | 74 |
| Chart IV.7. Economic cycle | 76 |
| Chart IV.8. GVA by branch of activity..... | 76 |
| Chart IV.9. Labour market: participation, employment and unemployment..... | 78 |

| | <i>Page</i> |
|--|-------------|
| Chart IV.10. Wage determinants | 80 |
| Chart IV.11. Composition of the final demand and GDP deflators | 82 |
| Chart IV.12. Prices and costs by branch of activity | 83 |
| Chart IV.13. Relative cost and price indices | 86 |
| Chart IV.14. Breakdown of the change in the general government deficit (ESA 95) | 90 |
| Chart IV.15. Balance of payments: summary table | 92 |
| Chart V.1. National saving, investment and net lending (+) or net borrowing (-) | 98 |
| Chart V.2. Financial transactions of households and NPIs | 100 |
| Chart V.3. Yields | 102 |
| Chart V.4. Financial transactions of non-financial corporations | 102 |
| Chart V.5. General government financial transactions | 104 |
| Chart V.6. Stock market price indices | 108 |
| Chart V.7. Government debt yields | 110 |
| Chart V.8. Yield differential between private and public debt | 112 |
| Chart V.9. Deposit money institutions | 117 |
| Chart V.10. Institutional investors | 117 |
| Chart V.11. Net worth position of households and NPIs and non-financial corporations | 120 |
| Chart V.12. Debt ratios | 121 |

Index of boxes

| | <i>Page</i> |
|---|-------------|
| Box I.1. The wealth position of households in the United States, the euro area and Spain..... | 17 |
| Box I.2. Inflation and product quality changes: the use of hedonic regressions to adjust for quality biases | 21 |
| Box I.3. Spain-EU convergence: 1960-2000. The contributions of the employment rate and labour productivity | 27 |
| Box II.1. Productivity, the external imbalance and the exchange rate of the dollar | 35 |
| Box II.2. Recent trends in capital flows towards Latin America | 43 |
| Box III.1. Output per employed person in the euro area: recent trends and national divergences.. | 51 |
| Box III.2. The change in the conduct of the main refinancing operations of the Eurosystem..... | 57 |
| Box III.3. Have the determinants of the yield differentials between the sovereign bonds of the euro area countries changed since the advent of Monetary Union?..... | 61 |
| Box IV.1. Information and communications technologies (ICT) branches in the Spanish economy.. | 67 |
| Box IV.2. Aspects of collective bargaining in Spain | 79 |
| Box IV.3. Foreign trade by productive branch: consequences for the competitiveness of the Spanish economy | 85 |
| Box IV.4. The Spanish fiscal policy stance..... | 89 |
| Box V.1. Recent developments in the financing of Spanish non-financial firms through the issuance of debt securities | 103 |
| Box V.2. The financing of bank lending in Spain..... | 111 |
| Box V.3. Recent changes in the tax treatment of financial instruments | 115 |
| Box V.4. The main changes in the composition of household financial wealth..... | 119 |

COMPOSITION OF THE GOVERNING BODIES
OF THE BANCO DE ESPAÑA

Governing Council

| | |
|---|--|
| GOVERNOR | Jaime Caruana |
| DEPUTY-GOVERNOR | Gonzalo Gil |
| COUNCIL MEMBERS | Eduardo Bueno José M. González-Páramo Jesús Leguina Joaquín Muns Jaime Requeijo Julio Segura |
| DIRECTOR-GENERAL OF THE TREASURY AND FINANCIAL POLICY (No vote on monetary policy issues) | Gloria Hernández |
| VICE-PRESIDENT OF THE NATIONAL SECURITIES MARKET COMMISSION (No vote on monetary policy issues) | Juan Jesús Roldán |
| DIRECTORS-GENERAL OF THE BANK (Without a right to vote) | José L. Malo de Molina Francisco J. Aríztegui Pedro Pablo Villasante José M. ^a Roldán José M. ^a Viñals |
| SECRETARY (Without a right to vote) | José R. del Caño |
| REPRESENTATIVE OF THE BANK'S PERSONNEL (Without a right to vote) | Isabel Gutiérrez |

Executive Commission

GOVERNOR

Jaime Caruana

DEPUTY-GOVERNOR

Gonzalo Gil

COUNCIL MEMBERS

José M. González-Páramo
Julio Segura

DIRECTORS-GENERAL

(Without a right to vote)

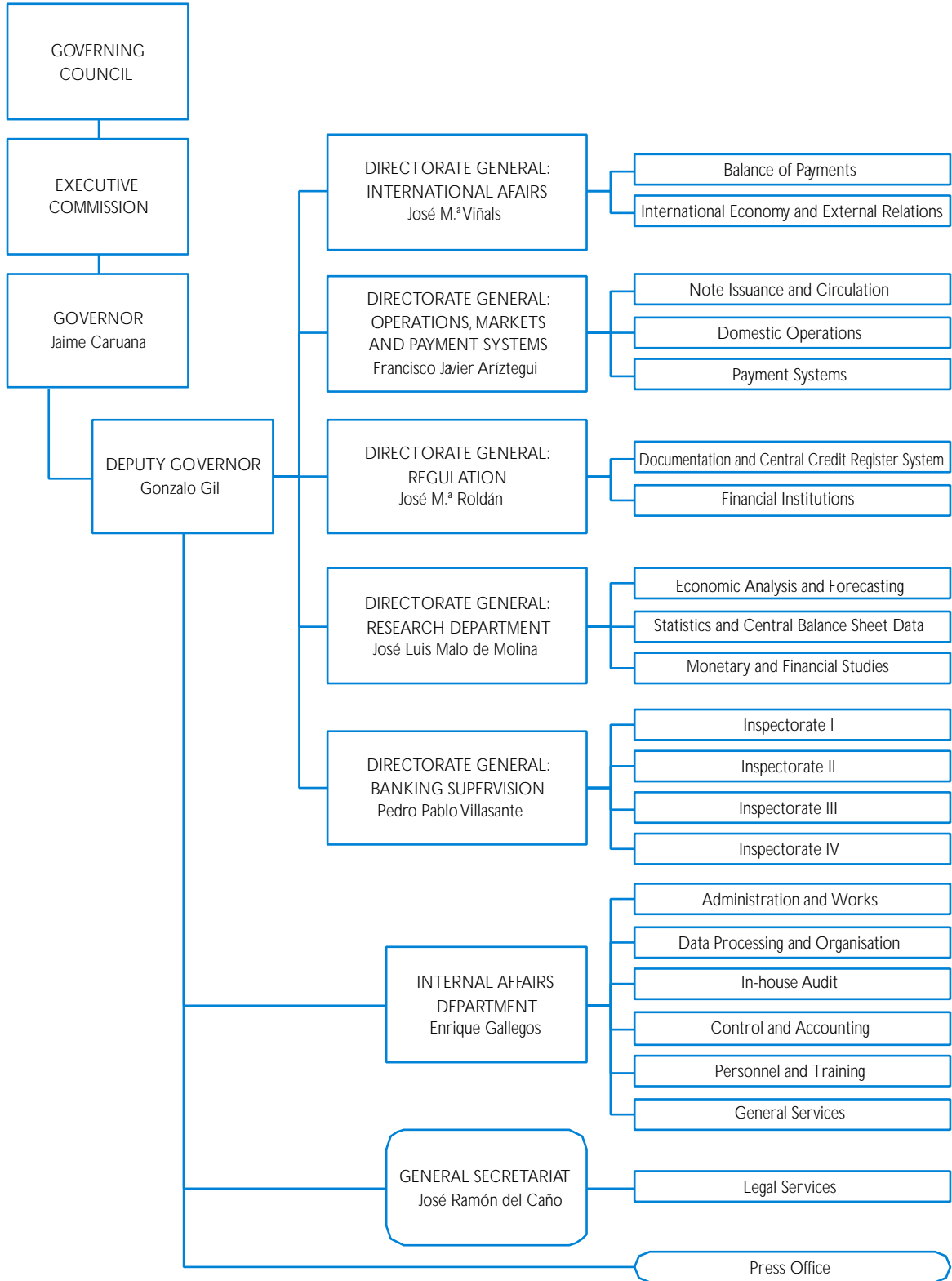
José L. Malo de Molina
Francisco J. Aríztegui
Pedro Pablo Villasante
José M.^a Roldán
José M.^a Viñals

SECRETARY

(Without a right to vote)

José R. del Caño

GENERAL ORGANISATION CHART



BANCO DE ESPAÑA
PUBLICATIONS

REGULAR PUBLICATIONS

ANNUAL REPORT (in Spanish and English)
FINANCIAL ACCOUNTS OF THE SPANISH ECONOMY (in Spanish and English) (annual)
THE SPANISH BALANCE OF PAYMENTS (in Spanish and English) (annual)
CENTRAL DE ANOTACIONES EN CUENTA (annual)
BOLETÍN ECONÓMICO (monthly)
ECONOMIC BULLETIN (quarterly)
BOLETÍN ESTADÍSTICO (monthly)
BOLETÍN DE ANOTACIONES EN CUENTA (daily)
CENTRAL DE BALANCES. RESULTADOS ANUALES DE LAS EMPRESAS NO FINANCIERAS (annual)
CIRCULARES A ENTIDADES DE CRÉDITO
CIRCULARES DEL BANCO DE ESPAÑA. RECOPIACIÓN (four-monthly)
REGISTROS DE ENTIDADES (annual)

ECONOMIC STUDIES (BLUE SERIES)

63. GABRIEL QUIRÓS (coordinador): Mercado español de deuda pública. Tomos I y II (1998).
64. FERNANDO C. BALLABRIGA, LUIS JULIÁN ÁLVAREZ GONZÁLEZ AND JAVIER JAREÑO MORAGO: A BVAR macroeconomic model for the Spanish economy: methodology and results (1998). (The Spanish original of this publication has the same number.)
65. ÁNGEL ESTRADA Y ANA BUISÁN: El gasto de las familias en España (1999).
66. ROBERTO BLANCO ESCOLAR: El mercado español de renta variable. Análisis de la liquidez e influencia del mercado de derivados (1999).
67. JUAN AYUSO, IGNACIO FUENTES, JUAN PEÑALOSA Y FERNANDO RESTOY: El mercado monetario español en la Unión Monetaria (1999).
68. ISABEL ARGIMÓN, ÁNGEL LUIS GÓMEZ, PABLO HERNÁNDEZ DE COS Y FRANCISCO MARTÍ: El sector de las Administraciones Públicas en España (1999).
69. JAVIER ANDRÉS, IGNACIO HERNANDO AND J. DAVID LÓPEZ-SALIDO: Assessing the benefits of price stability: the international experience (2000).
70. OLYMPIA BOVER AND MARIO IZQUIERDO: Quality-adjusted prices: hedonic methods and implications for National Accounts (2001). (The Spanish original of this publication has the same number.)
71. MARIO IZQUIERDO AND M^a DE LOS LLANOS MATEA: An approximation to biases in the measurement of Spanish macroeconomic variables derived from product quality changes (2001). (The Spanish original of this publication has the same number.)
72. MARIO IZQUIERDO, OMAR LICANDRO AND ALBERTO MAYDEU: Car quality improvements and price indices in Spain (2001). (The Spanish original of this publication has the same number.)

ECONOMIC HISTORY STUDIES (RED SERIES)

16. ESTEBAN HERNÁNDEZ ESTEVE: Contribución al estudio de las ordenanzas de los Reyes Católicos sobre la Contaduría Mayor de Hacienda y sus oficinas (vol. extra) (1988).
17. ALONSO DE OJEDA EISELEY: Índice de precios en España en el periodo 1913-1987 (1988).
18. ALEJANDRO ARIZCUN: Series navarras de precios de cereales, 1589-1841 (1989).
19. FRANCISCO COMÍN: Las cuentas de la hacienda preliberal en España (1800-1855) (1990).
20. CARLOS ALBERTO GONZÁLEZ SÁNCHEZ: Repatriación de capitales del virreinato del Perú en el siglo XVI (1991).
21. GASPAR FELIU: Precios y salarios en la Cataluña moderna. Vol. I: Alimentos (1991).
22. GASPAR FELIU: Precios y salarios en la Cataluña moderna. Vol. II: Combustibles, productos manufacturados y salarios (1991).
23. ESTEBAN HERNÁNDEZ ESTEVE: Noticia del abastecimiento de carne en la ciudad de Burgos (1536-1537) (1992).
24. ANTONIO TENA JUNGUITO: Las estadísticas históricas del comercio internacional: fiabilidad y comparabilidad (1992).
25. MARÍA JESÚS FUENTE: Finanzas y ciudades. El tránsito del siglo XV al XVI (1992).
26. HERNÁN ASDRÚBAL SILVA: El Comercio entre España y el Río de la Plata (1778-1810) (1993).
27. JOHN ROBERT FISHER: El Comercio entre España e Hispanoamérica (1797-1820) (1993).
28. BEATRIZ CÁRCELES DE GEA: Fraude y administración fiscal en Castilla. La Comisión de Millones (1632-1658): Poder fiscal y privilegio jurídico-político (1994).
29. PEDRO TEDDE Y CARLOS MARICHAL (coords.): La formación de los bancos centrales en España y América Latina (siglos XIX y XX). Vol. I: España y México (1994).
30. PEDRO TEDDE Y CARLOS MARICHAL (coords.): La formación de los bancos centrales en España y América Latina (siglos XIX y XX). Vol. II: Suramérica y el Caribe (1994).
31. BEATRIZ CÁRCELES DE GEA: Reforma y fraude fiscal en el reinado de Carlos II. La Sala de Millones (1658-1700) (1995).
32. SEBASTIÁN COLL Y JOSÉ IGNACIO FORTEA: Guía de fuentes cuantitativas para la historia económica de España. Vol. I: Recursos y sectores productivos (1995).
33. FERNANDO SERRANO MANGAS: Vellón y metales preciosos en la Corte del Rey de España (1618-1668) (1996).
34. ALBERTO SABIO ALCUTÉN: Los mercados informales de crédito y tierra en una comunidad rural aragonesa (1850-1930) (1996).
35. M^a GUADALUPE CARRASCO GONZÁLEZ: Los instrumentos del comercio colonial en el Cádiz del siglo XVII (1650-1700) (1996).
36. CARLOS ÁLVAREZ NOGAL: Los banqueros de Felipe IV y los metales preciosos americanos (1621-1665) (1997).
37. EVA PARDOS MARTÍNEZ: La incidencia de la protección arancelaria en los mercados españoles (1870-1913) (1998).
38. ELENA MARÍA GARCÍA GUERRA: Las acuñaciones de moneda de vellón durante el reinado de Felipe III (1999).
39. MIGUEL ÁNGEL BRINGAS GUTIÉRREZ: La productividad de los factores en la agricultura española (1752-1935) (2000).
40. ANA CRESPO SOLANA: El comercio marítimo entre Amsterdam y Cádiz (1713-1778) (2000).

Note: The full list of each series is given in the Publications Catalogue.

WORKING PAPERS

- 9903 OLYMPIA BOVER AND RAMÓN GÓMEZ: Another look at unemployment duration: long-term unemployment and exit to a permanent job. (The Spanish original of this publication has the same number.)
- 9904 IGNACIO HERNANDO Y JOSEP A. TRIBÓ: Relación entre contratos laborales y financieros: Un estudio teórico para el caso español.
- 9905 CRISTINA MAZÓN AND SOLEDAD NÚÑEZ: On the optimality of treasury bond auctions: the Spanish case.
- 9906 NADINE WATSON: Bank Lending Channel Evidence at the Firm Level.
- 9907 JOSÉ VIÑALS: El marco general de la política monetaria única: racionalidad, consecuencias y cuestiones pendientes.
- 9908 OLYMPIA BOVER AND MANUEL ARELLANO: Learning about migration decisions from the migrants.
- 9909 OLYMPIA BOVER AND PILAR VELILLA: Migrations in Spain: historical background and current trends.
- 9910 FERNANDO RESTOY: Los mercados financieros españoles ante la Unión Monetaria.
- 9911 LUIS J. ÁLVAREZ AND M^a DE LOS LLANOS MATEA: Underlying inflation measures in Spain.
- 9912 REGINA KAISER AND AGUSTÍN MARAVALL: Estimation of the business cycle: a modified Hodrick-Prescott filter.
- 9913 ENRIQUE ALBEROLA AND JOSÉ MANUEL MARQUÉS: On the relevance and nature of regional inflation differentials: The case of Spain.
- 9914 AGUSTÍN MARAVALL: An application of tramo and SEATS. Report for the «Seasonal Adjustment Research Appraisal» project.
- 9915 REGINA KAISER AND AGUSTÍN MARAVALL: Seasonal outliers in time series.
- 9916 ENRIQUE ALBEROLA AND HUMBERTO LÓPEZ: Internal and external exchange rate equilibrium in a cointegration framework. An application to the Spanish Peseta.
- 9917 JOSÉ VIÑALS AND JAVIER VALLÉS: On the real effects of monetary policy: A central banker's view.
- 9918 REGINA KAISER AND AGUSTÍN MARAVALL: Short-term and long-term trends, seasonal adjustment, and the business cycle.
- 9919 J. ANDRÉS, J. D. LÓPEZ-SALIDO AND J. VALLÉS: Intertemporal substitution and the liquidity effect in a sticky price model.
- 9920 J. ANDRÉS, I. HERNANDO AND J. D. LÓPEZ-SALIDO: The role of the financial system in the growth-inflation link: The OECD experience.
- 9921 ÁNGEL ESTRADA AND IGNACIO HERNANDO: Microeconomic price adjustments and inflation: Evidence from Spanish sectoral data.
- 9922 CONCHA ARTOLA AND UNA-LOUISE BELL: Identifying Labour Market Dynamics using Labour Force Survey Data.
- 9923 JUAN AYUSO AND ROBERTO BLANCO: Has financial market integration increased during the nineties?
- 9924 IGNACIO FUENTES AND TERESA SASTRE: Mergers and acquisitions in the Spanish Banking industry: some empirical evidence.
- 0001 GEORGES SIOTIS: Market power, total factor productivity growth, and structural change. An illustration for Spain, 1983-1996.
- 0002 ALBERTO CABRERO: Seasonal adjustment in economic time series: The experience of the Banco de España (with the model-based method).
- 0003 LUIS GORDO AND PABLO HERNÁNDEZ DE COS: The financing arrangements for the regional (autonomous) governments for the period 1997-2001. (The Spanish original of this publication has the same number.)
- 0004 J. ANDRÉS, F. BALLABRIGA AND J. VALLÉS: Monetary Policy and Exchange Rate Behavior in the Fiscal Theory of the Price Level.
- 0005 MICHAEL BINDER, CHENG HSIAO AND M. HASHEM PESARAN: Estimation and Inference in Short Panel Vector Autoregressions with Unit Roots and Cointegration.
- 0006 ENRIQUE ALBEROLA AND LUIS MOLINA: Fiscal discipline & Exchange Rate Regimes. A case for currency Boards?
- 0007 SOLEDAD NÚÑEZ Y MIGUEL PÉREZ: La rama de servicios en España: un análisis comparado.
- 0008 OLYMPIA BOVER AND NADINE WATSON: Are There Economies of Scale in the Demand for Money by Firms? Some Panel Data Estimates.
- 0009 ÁNGEL ESTRADA, IGNACIO HERNANDO AND J. DAVID LÓPEZ-SALIDO: Measuring the NAIRU in the Spanish Economy.
- 0010 EVA ORTEGA AND ENRIQUE ALBEROLA: Transmission of shocks and monetary policy in the euro area. An exercise with NIGEM. (The Spanish original of this publication has the same number.)
- 0011 REGINA KAISER AND AGUSTÍN MARAVALL: An Application of TRAMO-SEATS: Changes in Seasonality and Current Trend-Cycle Assessment. The German Retail Trade Turnover Series.
- 0012 REGINA KAISER AND AGUSTÍN MARAVALL: Notes on Times Analysis, ARIMA Models and Signal Extraction.
- 0013 JORDI GALÍ, J. DAVID LÓPEZ-SALIDO AND JAVIER VALLÉS: Technology Shocks and Monetary Policy: Assessing the Fed's Performance.
- 0014 AGUSTÍN MARAVALL AND FERNANDO J. SÁNCHEZ: An Application of TRAMO-SEATS: Model Selection and Out-of-sample Performance. The Swiss CPI series.
- 0015 OLYMPIA BOVER, SAMUEL BENTOLILA AND MANUEL ARELLANO: The Distribution of Earnings in Spain during the 1980s: The Effects of skill, Unemployment, and Union Power.
- 0016 JUAN AYUSO AND RAFAEL REPULLO: A Model of the Open Market Operations of the European Central Bank.
- 0017 FRANCISCO ALONSO, ROBERTO BLANCO, ANA DEL RÍO AND ALICIA SANCHÍS: Estimating liquidity premia in the Spanish government securities market.
- 0018 SANTIAGO FERNÁNDEZ DE LIS, JORGE MARTÍNEZ PAGES AND JESÚS SAURINA: Credit growth, problem loans and credit risk provisioning in Spain.
- 0019 PABLO HERNÁNDEZ DE COS, ISABEL ARGIMÓN AND JOSÉ MANUEL GONZÁLEZ-PÁRAMO: Does public ownership affect business performance? Empirical evidence with panel data from the Spanish manufacturing sector. (The Spanish original of this publication has the same number.)
- 0020 JORDI GALÍ, MARK GERTLER AND J. DAVID LÓPEZ-SALIDO: European inflation dynamics.
- 0101 SILVIO RENDÓN: Job Creation under Liquidity Constraints: The Spanish Case.
- 0102 RAVI BALAKRISHNAN: The interaction of firing costs and on-the-job search: an application of a search theoretic model to the Spanish labour market.
- 0103 FRANCISCO DE CASTRO, JOSÉ MANUEL GONZÁLEZ-PÁRAMO AND PABLO HERNÁNDEZ DE COS: Evaluating the dynamics of fiscal policy in Spain: patterns of interdependence and consistency of public expenditure and revenues.
- 0104 CARSTEN KRABBE NIELSEN: Three Exchange Rate Regimes and a Monetary Union: Determinacy, Currency Crises, and Welfare.
- 0105 JUAN AYUSO AND RAFAEL REPULLO: Why Did the Banks Overbid? An Empirical Model of the Fixed Rate Tenders of the European Central Bank.

- 0106 FRANCISCO J. RUGE-MURCIA: Inflation targeting under asymmetric preferences.
- 0107 JOSÉ VIÑALS: Monetary policy issues in a low inflation environment.
- 0108 AGUSTÍN MARAVALL AND ANA DEL RÍO: Time aggregation and the Hodrick-Prescott filter.
- 0109 JORDI GALÍ AND J. DAVID LÓPEZ-SALIDO: A new Phillips curve for Spain.
- 0110 ÁNGEL ESTRADA AND DAVID LÓPEZ-SALIDO: Accounting for Spanish productivity growth using sectoral data: New evidence.
- 0111 FRANCISCO ALONSO, ROBERTO BLANCO AND ANA DEL RÍO: Estimating inflation expectations using French government inflation-indexed bonds.
- 0112 GIANLUCA CAPORELLO, AGUSTÍN MARAVALL AND FERNANDO J. SÁNCHEZ: Program TSW reference manual.

MISCELLANEOUS PUBLICATIONS (1)

- FELIPE RUIZ MARTÍN (Y OTROS): El Banco de España. Una historia económica (1970). Edición normal: 2,392 PTA / e 14.38; edición de lujo: 2,990 PTA / € 17.97 (*).
- GABRIEL TORTELLA CASARES: La banca española en la Restauración (2 vols.) (1974). 1,040 PTA / € 6.25 (*).
- NICOLÁS SÁNCHEZ ALBORNOZ: Los precios agrícolas durante la segunda mitad del siglo XIX. Vol. I: Trigo y cebada (1975). 520 PTA / € 3.13 (*).
- EDUARDO MARTÍNEZ DE SALINAS Y MENDOZA: Legislación bancaria y crediticia española (1978). 1,872 PTA / € 11.25 (*).
- MIGUEL ARTOLA: Los ferrocarriles en España, 1844-1943 (2 vols.) (1978). 2,080 PTA / € 12.50 (*).
- LA ECONOMÍA ESPAÑOLA AL FINAL DEL ANTIGUO RÉGIMEN (4 vols.): I. Agricultura: Edición e introducción de Gonzalo Anes. II. Manufacturas: Edición e introducción de Pedro Tedde. III. Comercio y Colonias: Edición e introducción de Josep Fontana. IV. Instituciones: Edición e introducción de Miguel Artola (1982) (**).
- MIGUEL ARTOLA: La Hacienda del Antiguo Régimen (1982) (**).
- RAMÓN SANTILLÁN: Memoria Histórica sobre los Bancos Nacionales de San Carlos, Español de San Fernando, Isabel II, Nuevo de San Fernando y de España (1982). 520 PTA / € 3.13 (*).
- CONGRESO SOBRE ARCHIVOS ECONÓMICOS DE ENTIDADES PRIVADAS. I. 1982. MADRID: Actas del primer congreso sobre archivos económicos de entidades privadas (1983). 520 PTA / € 3.13 (*).
- GONZALO ANES, LUIS ÁNGEL ROJO, PEDRO TEDDE (Y OTROS): Historia económica y pensamiento social. Estudios en homenaje a Diego Mateo del Peral (1983) (**).
- INTRODUCCIÓN A LA CONTABILIDAD. Nociones elementales para principiantes (1985). Centro de Formación del Banco de España. 520 PTA / € 3.13 (*).
- JOAQUÍN MUNS: Historia de las relaciones entre España y el Fondo Monetario Internacional, 1958-1982: Veinticinco años de economía española (1986) (**).
- MIGUEL ARTOLA: La Hacienda del siglo XIX: progresistas y moderados (1986) (**).
- TERESA TORTELLA CASARES: Índice de los primitivos accionistas del Banco Nacional de San Carlos (1986). 1,560 PTA / € 9.38 (*).
- GONZALO ANES ÁLVAREZ: Monedas hispánicas, 1475-1598 (1987). 4,160 PTA / € 25 (*).
- JUAN SARDÁ DEXEUS: Escritos (1948-1980) (1987). 2,080 PTA / € 12.50 (*).
- CENTRO DE ESTUDIOS JUDICIALES Y BANCO DE ESPAÑA: Aspectos jurídicos de las crisis bancarias (respuesta del ordenamiento jurídico). Ciclo de conferencias (1988). 1,560 PTA / € 9.38 (*).

- CONGRESO SOBRE ARCHIVOS ECONÓMICOS DE ENTIDADES PRIVADAS. II. 1986. MADRID: Actas del segundo congreso sobre archivos económicos de entidades privadas (1988). 1,040 PTA / € 6.25 (*).
- PEDRO TEDDE DE LORCA: El Banco de San Carlos (1782-1829) (1988) (**).
- SERVICIOS JURÍDICOS DEL BANCO DE ESPAÑA: Comentarios a las sentencias del Tribunal Constitucional de 22 de marzo de 1988 (1988). 1,040 PTA / € 6.25 (*).
- SERVICIOS JURÍDICOS DEL BANCO DE ESPAÑA: Mercado de valores. Ley 24/1988, de 28 de julio (1988). 1,560 PTA / € 9.38 (*).
- FERNANDO SERRANO MANGAS: Armadas y flotas de la plata (1620-1648) (1989). 2,080 PTA / € 12.50 (*).
- MARÍA TERESA OLAZ NAVARRO: Inventario de los fondos del Banco de San Carlos en archivos del Estado (1989) 1,560 PTA / € 9.38 (*).
- BANCO DE ESPAÑA: Registros especiales a cargo del Banco de España. Resumen histórico de variaciones. (Años 1970 a 1989) (1990). 1,040 PTA / € 6.25 (*).
- SERVICIOS JURÍDICOS DEL BANCO DE ESPAÑA: Legislación de entidades de depósito y otros intermediarios financieros: normativa *autonómica* (1990). Segunda edición. 6,000 PTA / € 36.06 (*).
- BANCO DE ESPAÑA: Monedas de Oro de la Colección del Banco de España (1991). 8,000 PTA / € 48.08 (*).
- PEDRO MARTÍNEZ MÉNDEZ: Los beneficios de la banca (1970-1989) (1991). 2,080 PTA / € 12.50 (*).
- SERVICIOS JURÍDICOS DEL BANCO DE ESPAÑA: Legislación de Entidades de Crédito: normativa general. 3ª ed. (1994). 6,000 PTA / € 36.06 (*).
- MARÍA JOSÉ TRUJILLO MUÑOZ: La potestad normativa del Banco de España: el régimen dual establecido en la Ley de Autonomía (1995). 520 PTA / € 3.13 (*).
- BANCO DE ESPAÑA: Tauromaquia. Catálogo comentado sobre la Tauromaquia, de Francisco de Goya, referido a una primera tirada de esta serie, propiedad del Banco de España (1996). 832 PTA / € 5 (*).
- JUAN LUIS SÁNCHEZ-MORENO GÓMEZ: Circular 8/1990, de 7 de septiembre. Concordancias legales (1996). 1,040 PTA / € 6.25 (*).
- RAMÓN SANTILLÁN: Memorias (1808-1856) (1996) (***)).
- BANCO DE ESPAÑA. SERVICIO DE ESTUDIOS (Ed.): La política monetaria y la inflación en España (1997) (**).
- BANCO DE ESPAÑA: La Unión Monetaria Europea: cuestiones fundamentales (1997). 500 PTA / € 3.01 (*).
- TERESA TORTELLA: Los primeros billetes españoles: las «Cédulas» del Banco de San Carlos (1782-1829) (1997). 4,680 PTA / € 28.13 (*).
- JOSÉ LUIS MALO DE MOLINA, JOSÉ VIÑALS AND FERNANDO GUTIÉRREZ (Ed.): Monetary policy and inflation in Spain (1998) (****).
- SERVICIO JURÍDICO DEL BANCO DE ESPAÑA: Legislación de Entidades de Crédito. 4ª ed. (1999). 6,000 PTA / € 36.06 (*).
- VICTORIA PATXOT: Medio siglo del Registro de Bancos y Banqueros (1947-1997) (1999). Libro y disquete: 884 PTA / € 5.31 (*).
- PEDRO TEDDE DE LORCA: El Banco de San Fernando (1829-1856)(1999)(**).
- BANCO DE ESPAÑA (Ed.): Arquitectura y pintura del Consejo de la Reserva Federal (2000). 2,000 PTA / € 12.02 (*).
- PABLO MARTÍN ACEÑA: El Servicio de Estudios del Banco de España (1930-2000)(2000). 1,500 PTA / € 9.02 (*).
- TERESA TORTELLA: Una guía de fuentes sobre inversiones extranjeras en España (1780-1914) (2000). 1,560 PTA / € 9.38 (*).

(1) Publications marked with an asterisk (*) are distributed by the Banco de España, Sección de Publicaciones. Prices include 4 % VAT. Publications with two asterisks (**) are distributed by Alianza Editorial. Publications with three asterisks (***) are distributed by Editorial Tecnos. Publications with four asterisks (****) are distributed by Macmillan (London).

DISTRIBUTION, PRICES AND SUBSCRIPTION (1) (2001)

All publications may be obtained from the Banco de España Publications Department (Negociado de Distribución y Gestión —Sección de Publicaciones—), except books for which a different distributor is indicated.

Annual report (in Spanish and English):

- Spain: ESP 2,080 / € 12.50
- Abroad: ESP 3,000 / € 18.03

Financial accounts of the Spanish economy (bilingual edition in Spanish and English):

- Spain: ESP 2,080 / € 12.50
- Abroad: ESP 3,000 / € 18.03

The Spanish Balance of Payments (in Spanish and English):

- Spain: ESP 2,080 / € 12.50
- Abroad: ESP 3,000 / € 18.03

Central de Anotaciones en Cuenta:

- Spain: ESP 1,040 / € 6.25
- Abroad: ESP 2,000 / € 12.02

Boletín económico and Boletín estadístico (2):

- Spain:
Subscription to *Boletín económico* or *Boletín estadístico*:
ESP 20,800 / € 125.01
Subscription to both: ESP 28,600 / € 171.89
Single copy: ESP 2,080 / € 12.50
- Abroad:
Subscription to *Boletín económico* or *Boletín estadístico*:
ESP 31,000 / € 186.31
Subscription to both: ESP 48,000 / € 288.49
Single copy: ESP 3,000 / € 18.03

Economic bulletin (2):

- Spain:
Annual subscription: ESP 7,488 / € 45.00
Single copy: ESP 2,080 / € 12.50
- Abroad:
Annual subscription: ESP 14,250 / € 85.64
Single copy: ESP 3,000 / € 18.03

Boletín de anotaciones en cuenta (3):

- Spain:
Annual subscription by mail: ESP 33,280 / € 200.02
Annual subscription by fax: ESP 33,280 / € 200.02
Single issues: ESP 208 / € 1.25
- Abroad (air mail): Annual subscription: ESP 95,000 / € 570.96

Manual de la Central de Anotaciones:

- Single copy: ESP 5,200 / € 31.25

Registros de entidades (annual):

- Spain: ESP 2,522 / € 15.16

Circulares a entidades de crédito:

- Spain: Annual subscription: ESP 14,560 / € 87.51
- Abroad: Annual subscription: ESP 28,000 / € 168.28

Circulares del Banco de España. Recopilación:

- Spain:
Compilation: ESP 7,280 / € 43.75
Annual update: ESP 3,120 / € 18.75
- Abroad:
Compilation: ESP 14,000 / € 84.14
Annual update: ESP 6,000 / € 36.06

Central de Balances (Spanish Central Balance Sheet Office):

- Monografía anual*:
— Spain: Book or CD-ROM ESP 2,000 / € 12.02
- Commissioned studies*:
— Price per quote given for each study (4).
- BACH Project (Bank for the Accounts of Companies Harmonised)*:
— Spain: enquiries to Central Balance Sheet Office.

Economic studies (blue series) and Economic history studies (red series):

- Spain: ESP 884 / € 5.31
- Abroad: ESP 1,800 / € 10.82

Working papers:

- Spain:
Annual subscription: ESP 7,280 / € 43.75
Single copy: ESP 312 / € 1.88
- Abroad:
Annual subscription: ESP 10,000 / € 60.10
Single copy: ESP 430 / € 2.58

Memoria del Servicio de Reclamaciones:

- Spain: ESP 1,040 / € 6.25
- Abroad: ESP 2,000 / € 12.02

Miscellaneous publications (6).

(1) Prices for Spain include 4% VAT. The Canary Islands, Ceuta and Melilla, and abroad are exempt from VAT, as are EU residents who communicate their tax identification number. 16% VAT included for disks and CD-ROM.
(2) Subscription to the *Boletín económico* and/or the *Boletín estadístico* includes a free copy of the *Informe anual*, the *Cuentas financieras de la economía española* and the *Balanza de pagos de España*. Subscription to the *Economic bulletin* includes a free copy of the *Annual report*, the *Financial accounts of the Spanish economy*, and English copies of Working papers. Distribution abroad will be by airmail.
(3) Includes free delivery of the Annual Report of the Central Book-Entry Office (in Spanish).
(4) Requests should be addressed to: Servicio de Difusión de la Central de Balances (tel. 91 3386931, 91 3386929 and 91 3386930; fax 91 3386880; postal address calle de Alcalá, 50, 28014 Madrid). No work will be undertaken without prior acceptance of quote. Requests by firms that have refused to join reporting list will not be considered.
(5) Prices of books distributed by Banco de España are given after each title. Such prices include 4% VAT for sales to the Spanish mainland and the Balearic Islands. Consult prices for other destinations.

Enquiries: Banco de España. Sección de Publicaciones. Negociado de Distribución y Gestión.
Alcalá, 50. 28014 Madrid - Tel. 91 338 5180 - Fax: 91 338 5320 - e-mail: publicaciones@bde.es