1 Overview

The Spanish economy underwent a marked contraction in 2009. This was at its worst in Q1 and eased thereafter, posting a quarter-on-quarter rate of decline in GDP of 0.1% at the close of the year. For the year as a whole, output fell by 3.6%, in response to the annual decline of more than 6% in national demand, whereas net external demand, with a positive contribution of 2.8 pp, helped soften the adverse impact of demand on GDP.

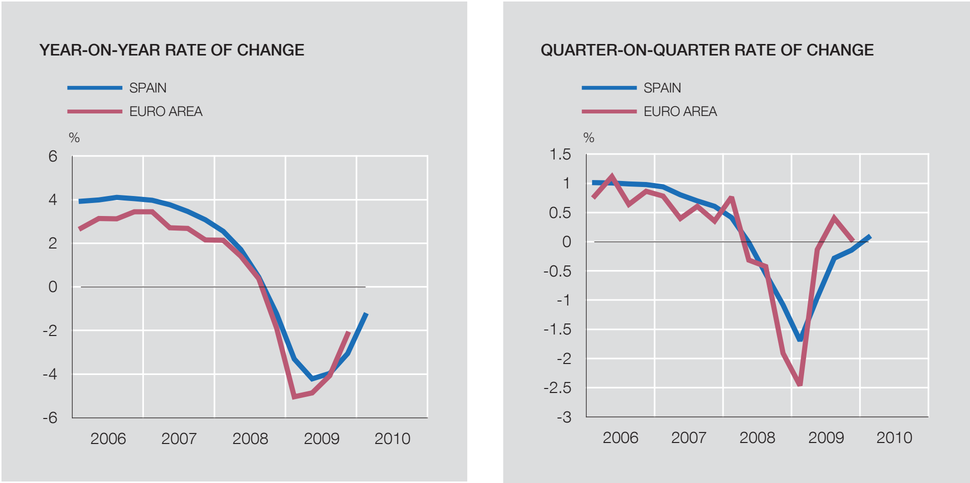
The gradual improvement in the Spanish economy continued in the opening months of 2010, in an environment marked by the progressive recovery of the world economy, the continuation of the effects of the public measures supporting demand and the increase in agents' confidence. Estimates based on the conjunctural information available suggest that, in Q1, GDP grew at a quarter-on-quarter rate of 0.1%, following six consecutive quarters of declines. Nonetheless, in terms of the year-on-year rate, which measures the conjunctural situation with some lag, output is estimated to have declined by 1.3%. On the expenditure side, the rate of decline of national demand slackened to -2.6% (-5% in 2009 Q4) and the positive contribution of net external demand lessened to 1.4 pp (2.2 pp in the three previous months), with a pick-up both in exports and in imports. The plans to support the private sector were influential in rekindling certain spending components, in particular household consumption, although their impact has progressively diminished, while the outcome of the completion of projects linked to the State Local Investment Fund was reflected in something of a fall-off in investment in non-residential construction. In step with this all the productive branches were somewhat less depressed than in previous quarters, and the pace of decline in employment slackened, with this variable posting a year-on-year fall of 3.6% on EPA figures. However, the unemployment rate rose again in Q1, up to 20%, owing to the slowdown in the rate of decline of the labour force. Against this backdrop of low growth and sluggish recovery, inflation continued to moderate. The rate of change of the CPI rose in the opening months of 2010 (1.4% in March) as a result of dearer energy, while the CPI excluding unprocessed food and energy held at a rate of virtually zero. The leading indicator of the HICP showed an increase in its year-on-year rate to 1.6% in April.

Turning to the international economic outlook, the recovery in train - as has been the case since it began - showed different rates across countries and regions. The recovery in the emerging Asian and Latin American economies was prominent, although the United States also contributed decisively to the growth of world GDP. Nonetheless, certain factors persist in the developed economies that weigh on and pose risks to the recovery, including most notably the weakness of the labour market and the generalised deterioration in fiscal positions. Global inflation rose in the opening months as a result of the increase in oil and commodities prices, although expectations about its future course remain moderate. Finally, the ongoing stabilisation of international financial markets, though taking root in numerous segments, was interrupted from February as a result of the fiscal crisis in Greece. This gave rise to various episodes of instability, which were particularly severe in the second half of April, especially in the euro area. Initially, the focal point of these episodes was the sovereign debt markets, but they subsequently spread to stock and foreign exchange markets. Against this background, the exchange rate of the euro depreciated from the start of the year against the dollar by around 7.6%.

In the absence of inflationary pressures, monetary policies retained an expansionary stance, while the central banks of the main developed countries began to implement the plans an-

GROSS DOMESTIC PRODUCT (a)

CHART 1



SOURCES: ECB, INE and Banco de España.

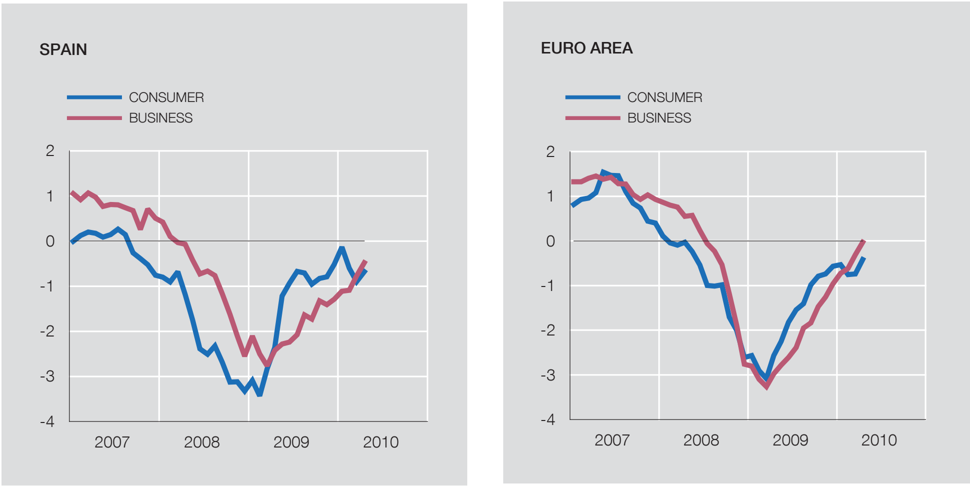
a. Seasonally adjusted series.

nounced for the withdrawal of the non-conventional liquidity-support measures. In the United States, the Federal Reserve held its official interest rate in a range of 0% to 0.25% and ended its asset purchase programme in March. The Bank of England left Bank Rate unchanged at 0.5% and, from February, interrupted its asset purchase programme. Finally, the Bank of Japan held its official interest rates at 0.1%, although it extended the fixed-term open market operations running since December.

The general trend of recovery was also discernible in the euro area, albeit at a somewhat more muted rate, as was already the case in late 2009. The impulse of the external sector has not yet translated into greater strength in internal demand, in a setting in which some of the temporary factors that boosted the recovery, such as the fiscal stimulus and the change in the inventory cycle, are beginning to lose momentum, and in which bad weather may have adversely affected activity in certain productive branches. Inflation rose somewhat in the opening months of the year, although this was due mainly to temporary factors as a result of transitory increases in the more volatile components (energy and unprocessed food). The foreseeable scenario of mild recovery, wage moderation and slack capacity means risks to price stability are not envisaged in the medium term. Against this backdrop, the ECB Governing Council decided at its meetings in the year to date (to May) to keep its official rate unchanged at 1% for the main refinancing operations, at which level they have held for a year, while the rates for its marginal lending and deposit facilities stand at 1.75% and 0.25%, respectively.

The ECB took further steps in defining the strategy of gradual withdrawal from the extraordinary measures introduced during the financial crisis, although it retained its policy of abundant liquidity provision. In March, the ECB Council confirmed that the conditions under which its weekly and special one-month tenders are made will remain in place at least until 12 October. It also agreed that its regular three-month refinancing operations would resume their habitual variable-rate tender procedure, as from 28 April, although allotment would take into account market conditions. Finally, the ECB decided to keep its collateral requirements relatively unchanged, beyond the end of 2010. However, on 3 May, after issuing a favourable opinion on the ambitious fiscal adjustment programme sanctioned by the Greek government under the aid plan approved by the Eurogroup and the IMF, the ECB Governing Council decided to suspend application of the minimum credit rating threshold to Greek government debt.

CONFIDENCE INDICATORS (a) CHART 2



SOURCE: European Commission.

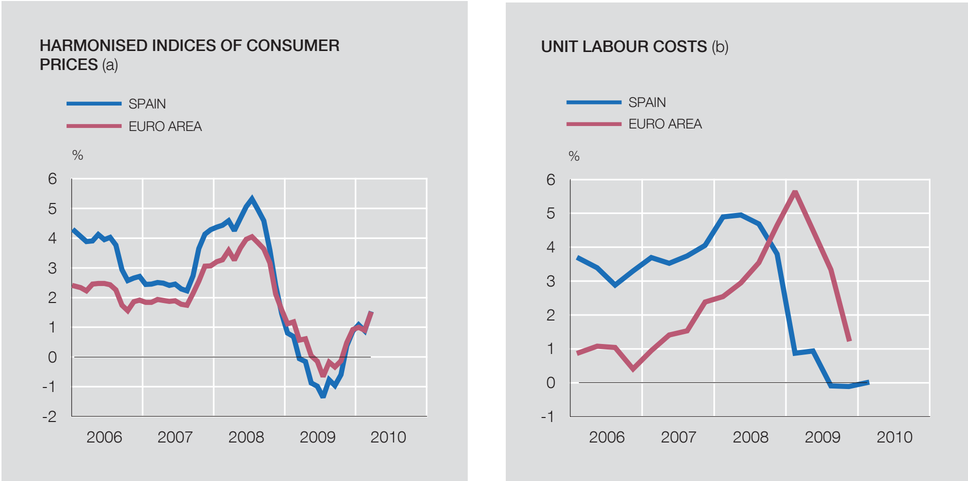
a. Normalised confidence indicators (difference between the indicator and its mean value, divided by the standard deviation).

Following the fiscal disaster in 2009, a slight deterioration is expected in the public finances for the euro area as a whole in 2010 further to the various fiscal consolidation strategies adopted nationally. In the countries with the biggest deficits, these strategies envisage the application in 2010 of adjustment programmes, while in the remaining countries they will be put back to 2011. Nonetheless, the doubts raised by the budgetary adjustment initially presented by Greece ultimately gave rise to an acute fiscal crisis which has required the adoption of a series of unprecedented measures, both by the Greek government and by the European authorities, as detailed in Box 2. The Greek government formally requested on 23 April that the exceptional financial support mechanism defined by the Eurogroup at its meeting on 11 April be activated. This request was dealt with by the euro area ministers of finance on 2 May. They unanimously approved an unprecedented programme envisaging bilateral loans of up to €110 billion over three years, €80 billion (€30 billion the first year) of which would correspond to the euro area Member States, and the remaining €30 billion to the IMF. The first payments will take place prior to 19 May, when a sizeable amount of instruments issued by the Greek Treasury mature. It should be stressed that this aid package which has now been approved entails strict conditionality terms. Indeed, on 2 May the Greek government approved, as a prior step to the activation of the aid, an ambitious and stringent program of fiscal consolidation and far-reaching structural reforms, negotiated beforehand with the European Commission, the IMF and the ECB. The progress made by the Greek authorities in complying with these demanding commitments will be evaluated each quarter. What is involved, therefore, is a not only a great effort by Greece but also an innovative institutional drive to restore confidence, curtailing the serious risks that the potential insolvency of one of its Member States would entail for the stability of the area.

The Greek crisis has in fact highlighted the need to strengthen governance of the euro area and to set in place multilateral mechanisms that ensure greater coordination of domestic economic policies. Heeding these demands, the Commission has announced its intention in May to unveil initiatives in three areas considered essential: first, the reinforcement of multilateral procedures for monitoring competitiveness and for the early detection of external imbalances; second, the reform of the Stability and Growth Pact, and third, the formalisation of a crisis resolution mechanism and a permanent framework that ensures financial support to member countries in difficulties, under the appropriate terms of conditionality. In parallel, progress was

PRICES AND COSTS

CHART 3



SOURCES: Eurostat, ECB and INE.

a. Year-on-year rate of change.
b. Per unit of output. Year-on-year rate of change calculated on the basis of seasonally adjusted series.

made during the quarter in defining the most suitable strategies for withdrawing the economic policy impulses exceptionally applied during the economic crisis.

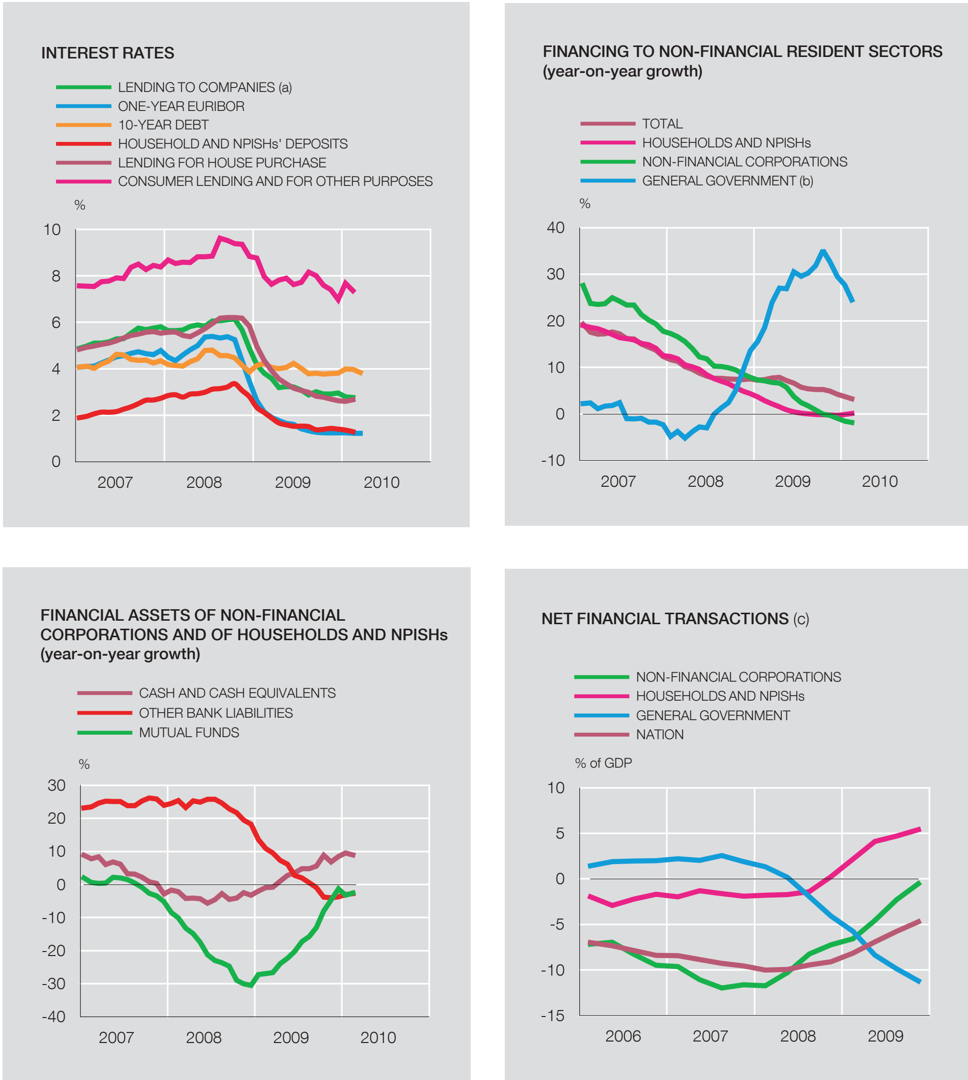
Despite the bouts of instability on the government debt markets from February, interbank market interest rates held stable at low levels, both globally and in the euro area, and risk premia on private fixed-income markets remained relatively stable. However, the main stock market indices posted losses in Europe and sovereign risk premia held at very high levels in Greece and Portugal. The Spanish economy was affected by this episode of instability; in the four months to end-April, the IBEX registered a loss of 12.1%, a more unfavourable performance than that of the Eurostoxx 50 index of the euro area stock markets (which had fallen by 5% as at the same date). In Spain, the 10-year government debt yield spread over the German *Bund* widened by almost 40 bp to around 100 bp. Lastly, on 28 April a credit rating agency downgraded Spain's long-term rating from AA+ to AA, to a much lesser extent than was the case for sovereign debt issued by Greece and Portugal.

Household and business financing costs held at similar levels to those of the previous quarter, as did the degree of tightness of lending standards, which are in any event stricter than those applied at the start of the financial crisis. In the real estate market, and on Spanish Ministry of Housing figures, the pace of the fall in open-market housing prices slowed, posting a year-on-year rate of decline of 4.7% in Q1 (-6.3% in December 2009).

There was confirmation of the incipient signs of improvement in household spending seen in the past two quarters, while business investment remained relatively depressed. Specifically, the quarter-on-quarter growth rate of household consumption is expected to have risen for the second quarter running, slowing the year-on-year rate of decline in this demand component to -0.7% (-3.4% in the previous quarter). Unlike in the second half of 2009, the consumption of services and, to a lesser extent, of durable goods other than cars is estimated to have played a pivotal role in this recovery, while the effects of the government plan providing direct aid for car purchases are expected to have lost steam. Yet the presence of exceptional factors, also of a temporary nature, cannot be fully ruled out in the rise in specific spending items, which might slacken later (the digital switchover and the bringing forward of purchases before the

FINANCIAL INDICATORS OF THE SPANISH ECONOMY

CHART 4



SOURCE: Banco de España.

a. Weighted average of interest rates on various transactions grouped according to their volume. For loans exceeding €1 million, the interest rate is obtained by adding to the NDER (Narrowly Defined Effective Rate), which does not include commission and other expenses, a moving average of such expenses.
b. Consolidated financing: net of securities and loans that are general government assets.
c. Four-quarter cumulated data.

VAT rise in July). Over the rest of the year, a continuation of the modest pick-up in consumption may be expected. It will, however, be conditioned by the unfavourable behaviour of disposable income (as a result, above all, of the lower growth in wage income and of the lower contribution of other sources of income, in particular those arising from general government measures), the reduction in household wealth, the need for households to reduce their level of debt and uncertainty over labour market developments. However, the saving rate would begin to turn downwards during 2010 from its peak in 2009 Q4 (18.8% in four-quarter terms).

Residential investment remained firmly set on its path of adjustment, although its rate of decline slowed once more, and a year-on-year rate of around -20% (-25% in 2009 Q4) is estimated for this demand component. This figure was compatible with some stabilising of certain indicators of the demand for housing (such as the number of transactions or of mortgage approvals). In the opening months of the year, levels of affordability continued to improve. These developments might take the form of some recovery in the demand for housing in the coming months and, alongside this, a somewhat more rapid absorption of the overhang of unsold houses, after this variable peaked in the opening months of this year, although the estimated excess capacity in the sector is subject to great uncertainty. Over the rest of the year the fall in residential investment is expected to slacken, although the behaviour of this variable will continue to weigh on output growth during 2010. In this setting of lesser slackness of household spending, the outstanding balance of household credit stabilised (its year-on-year rate edged up slightly to 0.1% in February) as a result of a slight increase in credit for house purchases (0.5%) and a small fall-off in credit for consumption and other purposes.

Business investment plans showed no signs of picking up. Compounding the factors that have held back non-financial corporations' investment decisions in the past two years (weak prospects of demand recovering, especially domestic demand, a contraction in business profits, high debt levels and a build-up of excess capacity) has been the lesser effect of the stimulus plans on this demand component (the plans mainly affect transport equipment purchases and participation in civil engineering projects). Indeed, investment in equipment might have resumed a negative quarter-on-quarter growth rate after having risen in the second half of 2009, precisely in those investment components. Nonetheless, a most significant correction is foreseen in the year-on-year rate of decline of investment in equipment, which is estimated to be around -3.5%, compared with -15.3% the previous quarter.

The component of investment in other construction, which also includes public investment in this item, showed signs of sluggishness as a result of the completion of infrastructure projects linked to the State Local Investment Fund and of the potential lag that the start of the projects to be financed by the State Fund for Employment and Local Sustainability (which will, in any event, be for a lesser amount) will most probably entail. As to the financing of non-financial corporations, credit continued to contract (its year-on-year rate turned even more negative, to -4.3% in February), which had a relatively generalised effect on all the productive branches.

The expansionary nature of general government conduct is expected to have begun to moderate as a result of the implementation of the 2010-2013 fiscal consolidation plan, bearing on both government consumption and public investment. Subsequent to the publication of the January quarterly report on the Spanish economy, details were released on this consolidation plan, which the government approved in late January. Specifically, it proposes cutting the deficit by 1.6 pp of GDP in 2010 and by 2.3 pp of GDP annually between 2011 and 2013. It would essentially target the structural deficit, as it is based above all on public spending cuts to 2013 - distributed among employee compensation, inputs, transfers, public investment and subsidies - although also on the tax increases approved under the 2010 budget. Given the scale of the budgetary imbalance resort will inevitably have to be made to increasing resources by means of the taxes offering the greatest revenue-raising capacity and those which generate least distortions. The aims of the programme are ambitious, but based on an optimistic macroeconomic scenario. Accordingly, strict compliance with the programme may require the adoption of complementary measures that prevent deviations from the established targets.

As regards trade with the rest of the world, the as yet incomplete information available indicates that the contribution of net external demand to annual GDP growth was positive (1.4 pp) in 2010 Q1, with substantial increases in both exports and imports. The take-off of exports is connected to the recovery in economic activity globally - although the reactivation of our export markets was more moderate - in a setting in which the favourable performance of price-competitiveness in recent months continued. However, the contribution of the external sector was smaller than in the previous quarters, as goods imports began to rise in response to the slight recovery in certain domestic spending components. To date, however, this rise is weak, and its trajectory is not free from oscillations. Trade in services, of which tourism is a part, also picked up in Q1. The outcome of these developments was a further improvement in the nation's net borrowing, which continued to decline in January and February.

On the supply side, the year-on-year rate of decline in value added in the market economy eased, as was the case with employment, since there was a significant slowdown in job destruction (-3.6% on EPA figures, against -6.1% in 2009 Q4). Nonetheless, compared with the previous quarter, only value added and employment in market services showed positive rates of growth. The remaining non-farm productive branches posted declines, which were more acute in the construction industry, in light of the completion of some of the projects linked to the State Local Investment Fund and, perhaps, relatively bad weather.

The latest information on collective bargaining indicates that the start of the year is being marked by greater wage moderation. Wage agreements reached in the period to March show average settlements of 1.4%, 1 pp down on 2009. The influence of the agreement on employment and collective bargaining entered into by the social partners last February, which sets 1% as the ceiling for wage increases in 2010, is proving limited so far owing to the majority presence of revised agreements in collective bargaining. However, in the immediate future the agreement should allow wage growth to be adjusted to a greater extent to the economic situation and to provide for a downturn in compensation per employee and a slowdown in unit labour costs.

The government has put a labour reform proposal to the social partners which, though specific details have yet to be ironed out, suggests setting limits on temporary hiring, promoting permanent contracts and boosting part-time contracts and the youth employment plan. All these aspects, depending on how they finally materialise, may prove very relevant for the functioning of the Spanish labour market. Nonetheless, the proposal diverts the amendment of collective bargaining arrangements to the agreement between the social partners, which may unfortunately delay the necessary reform of this key labour market aspect.

Finally, the growth rate of the CPI has risen at the start of this year to 1.4% in March, as a result of the increase in oil prices. But core inflation held on the declining trend of recent quarters, and the year-on-year rate of change of the CPI excluding unprocessed food and energy (the two most volatile variables) stood at 0.1% in Q1. That meant the core inflation differential vis-à-vis the euro area remained favourable to Spain, by 0.6 pp. With a view to the future this inflation performance should desirably become entrenched, as it may make a decisive contribution to improving competitiveness and the recovery in growth.

2 The external environment of the euro area

During the opening months of 2010 the recovery on international financial markets and in global economic activity has continued. These processes have been mutually reinforcing, despite the fact that there have been bouts of growing instability related chiefly to the situation of public finances in certain European countries. During the quarter a gradual and bigger-than-expected improvement in world economic activity was perceptible, albeit at different rates across countries and regions, with a prominent firming of the recovery in the emerging Asian and Latin American economies. China and the other emerging Asian countries, on one hand, and the United States, on the other, were the main contributors to world GDP growth. In any event, in the developed economies output remains below its pre-crisis levels, and there are still factors weighing on and posing risks to the recovery, such as the weakness of the labour market (despite the first signs of improvement being observed), the fragility of the recovery in the housing market (especially in the United States and the United Kingdom), the slackness of bank credit and, above all, the public finances position (see Box 1).

On the international financial markets the recovery has been taking root in many segments. Following a correction in February and, also, in late April, the main stock market indices showed gains of between 2% and 7% in the first four months of the year, and both volatility and credit spreads on corporate bonds and emerging market sovereign spreads have diminished. Nonetheless, market developments have been very closely linked to news relating to the fragility of the Greek fiscal position, and the possible contagion to other European countries, which has given rise to various bouts of instability during the period. The improved economic outlook prompted an increase in private-sector bond issues in 2010 Q1, which were up 25% on 2009 Q4. At the same time, a very high volume of government bond issues - especially medium and long-term issues - is forecast for 2010, which has contributed to the slope of the US yield curve reaching a high. On the foreign exchange markets, the dollar has since the start of the year strengthened against the euro (although it has only partly corrected the depreciation recorded in 2009), sterling and the yen, while it has depreciated against most of the main emerging economies' currencies, which have been boosted by the return of capital flows to these countries. On the commodities markets, the pick-up in demand in many emerging and in some developed economies has led to a notable increase in prices, which have reached highs not seen since autumn 2008. The price of Brent oil is currently at around $85 per barrel, and oil futures do not anticipate significant increases in this price.

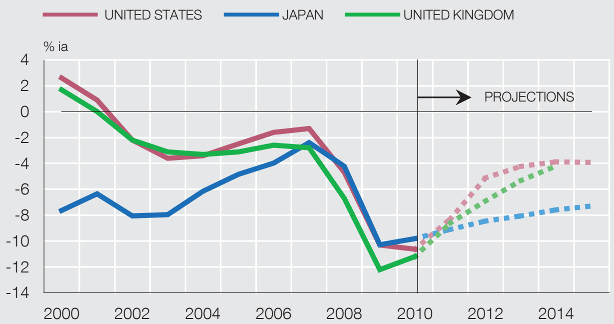
In the United States, the GDP estimate for Q1 was for quarterly growth of 0.8% (3.2% in annualised terms), down on the figure of 1.4% for 2009 Q4. This was due above all to the momentum of private consumption and stockbuilding. This initial estimate confirmed the increases reflected in the supply-side and employment indicators, although doubts persist about the recovery in consumption. Net employment was created in the labour market in Q1 for the first time since end-2007, and the unemployment rate dipped to 9.7%, 0.3 pp down on Q4. Conversely, the housing market continues to show signs of weakness, as reflected in the stabilisation of prices and in the flatness of constructors' confidence, although both housing starts and sales rose in March, moving ahead of the phasing out of government aid. The CPI measure of inflation eased during the quarter to a year-on-year rate of 2.3% in March, while core inflation fell to 1.1%. Against this background, the Federal Reserve held its official interest rate unchanged in a range between 0% and 0.25% at its April meeting, reiterating that the rate would remain at a low level over a prolonged period, in step with developments in the economy. Furthermore, its asset purchase programme ended in March. On the fiscal front, the reform of

The deep recession experienced by the advanced economies against the background of the global economic and financial crisis, the forceful fiscal activism pursued (essential for averting the collapse of aggregate demand), and, to a lesser extent, the support to the financial system have resulted in a drastic increase in these economies' budget deficits and debt, to levels unprecedented in the post-Second Word War period. This poses major policy challenges and risks to the economic and financial outlook.

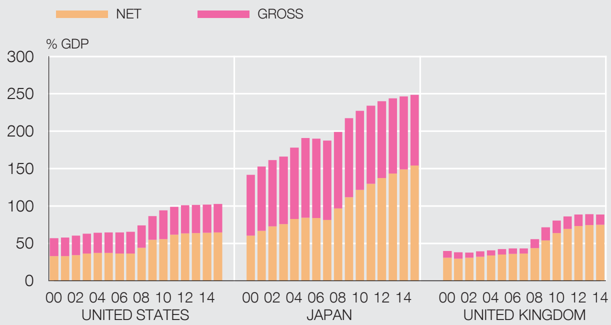
The three main developed economies outside the euro area (the United States, the United Kingdom and Japan) faced the effects of the crisis from relatively similar starting points as far as general government financial balances were concerned, but markedly different ones in terms of their public debt. The three countries showed deficits of between 1% and 3% of GDP in 2007 (see Panel 1), although their structural deficits - which take into consideration the cyclical position of the economy - were concentrated in a range of 2.5%-3%. Nonetheless, Japan reached these levels following a fiscal consolidation process which enabled it to reduce its budget deficit by more than 5 pp from 8% of GDP in 2002, while in the United Kingdom and the United States the structural deficit remained relatively unchanged over this period, although the expansionary phase of the business cycle prompted an improvement in their general government balance. As regards debt, the legacy of the banking crisis in the 1990s in Japan and its unfavourable economic performance since then, which has been accompanied by persistent deflation, were reflected in public debt that amounted to 188% of GDP - in gross terms - in 2007, compared with 62% in the United States and 44% in the United Kingdom. However, as Panel 2 shows, the differences in terms of net debt, i.e. taking into account State assets and the debt holdings of other public-sector entities, were substantially less. In the United States and the United Kingdom, the net debt ratio was similar, at around 40% of GDP, while it stood at 82% in Japan.

In the wake of the crisis, treasuries contributed very actively to sustaining aggregate demand and implemented financial sector support plans. The support for aggregate demand was both through discretionary measures and stimulus plans, and through the operation of the automatic stabilisers. Among the discretionary measures adopted from 2008 were the increase in public investment (or the bringing forward of that scheduled for 2010 and 2011), support for employment (including training and placement programmes), direct transfers, tax cuts and, in some cases, aid to specific industries, such as the automobile and real estate sectors.

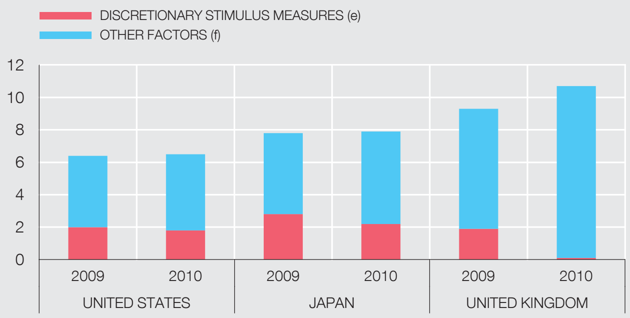
1 BUDGET DEFICIT (a) (b)



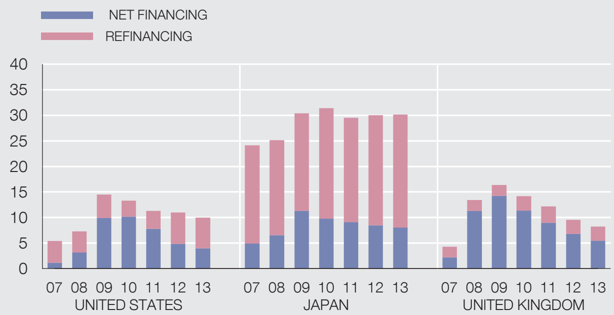
2 GROSS AND NET PUBLIC DEBT (a) (b) (c)



3 FISCAL SUPPORT TO AGGREGATE DEMAND (d)



4 GROSS ISSUE OF PUBLIC DEBT SECURITIES (a) (c) (g)



SOURCES: IMF, US Treasury, Congresional Budget Office, UK Treasury, Cabinet Office and Japanese Ministry of Finance.

a. The UK and Japanese debt and defecit figures refer to fiscal years.
b. The US, Japanese and UK projections are from the CBO, the IMF and the UK Treasury, respectively.
c. UK gross debt refers to the general government sector (central and local government), while net debt refers to the overall public sector (including public corporations).
d. Excludes financial-sector support measures, in order to analyse the fiscal measures with a direct effect on demand.
e. Budgetary cost of discretionary measures related to the crisis, compared with 2007.
f. Includes the impact of the automatic stabilisers and the impact on revenue of factors other than the cyclical change (e.g. the fall in house prices or in financial sector profits).
g. The US, Japanese and UK projections are from the CBO, Japanese Ministry of Finance and the UK Treasury, respectively.

The scale of the discretionary fiscal stimulus differs across the three countries analysed (see Panel 3). In Japan it exceeded two percentage points of GDP in 2009 (2.8%) and it is projected to be reduced by only half a point this year; in the United States it stood at around this figure in 2009 and is expected to hold at a similar level this year; finally, in the United Kingdom the fiscal impulse was on a similar scale to that of the other two countries in 2009, although it will be practically zero in 2010. This difference is due to the lesser room for manoeuvre offered by the strong deterioration in the UK's fiscal balance and the additional increase in debt arising from support to the financial sector. Regarding the first point, Panel 3 shows that the greater deterioration in the UK fiscal balance - by almost 10 pp in the past two years - came about due both to the greater weight of its automatic stabilisers and to the strong decline in tax receipts from the real estate and the financial sector; the latter has a greater relative weight in the United Kingdom than in the other two economies.

Turning to support for the financial system, the main developed economies implemented a series of measures which included, inter alia, capital injections, asset purchases and guarantees of assets or liabilities, and whose direct cost accounted for around 3.5% of the GDP of these economies. However, there were substantial differences among the countries, in accordance with the relative size of their financial systems, the degree of exposure to impaired assets and funding needs on wholesale markets. Thus, in the United Kingdom and in the United States, the amount of earmarked resources exceeded 80% of GDP overall as at mid-2009, while in Japan this figure was scarcely over 30% (a similar ratio to that of the euro area). Nonetheless, the differential characteristics of the types of support meant that the impact of these measures on public finances was notably greater in the United Kingdom (8.2% of GDP) than in the United States, while in Japan the impact was relatively insignificant.

As a result, the crisis has caused a very marked increase in budget deficits and in public debt. Deficits exceeded 10% of GDP in the three aforementioned countries in 2009, while public debt increased between 2007 and 2009 by 20 pp of GDP in the United States, by 28 pp in the United Kingdom and by 30 pp in Japan. These high deficits and public debt levels pose a difficult fiscal policy challenge. On one hand, the recovery of private-sector demand is still fragile, whereby fiscal stimuli would need to be maintained during 2010. On the other, the swift increase in debt, in a setting in which concerns over its sustainability in other developed economies have increased, points to the need to diligently design and communicate credible fiscal consolidation plans for the medium term. In this respect, both the United States and the United Kingdom have unveiled budgetary projects that provide for a very gradual reduction in their deficits (reaching around 4% of GDP in the United States and 5% in the United Kingdom by 2013), based both on spending restraint and an increase in the tax burden (through higher taxes in the United Kingdom and through the phasing out of prior tax cuts in the United States). In both cases, these fiscal plans are based on revenue-raising forecasts on what are deemed optimistic assumptions. Although Japan has not presented deficit projections for the coming years (a medium-term fiscal plan is expected to be announced in June 2010), the IMF estimates that the Japanese deficit will fall slightly to 8% of GDP in 2013. Despite the envisaged pick-up in activity, the still-high deficits in the next four years mean the gross debt of the three countries will move on a rising path, which in 2013 would amount to 244% of GDP in Japan, to 100% in the United States and to 90% in the United Kingdom. Furthermore, there has been little specific headway in these three countries as regards reducing the fiscal burden stemming from population ageing.

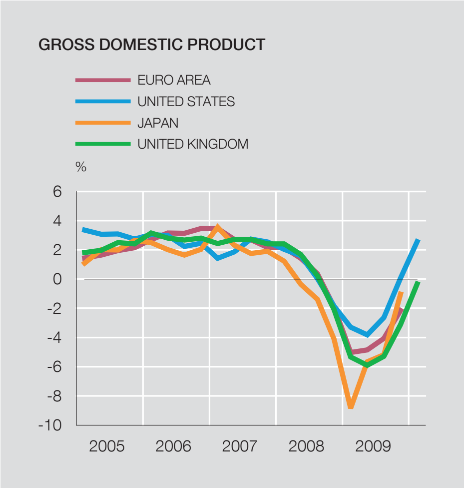
This fragile public finances situation harbours factors of risk for the economic recovery and for financial stability. Firstly, an increase in agents' uncertainty over debt sustainability may force through a faster-than-expected fiscal adjustment. At the same time, the still-high deficits in the coming years in these three economies, combined with the need to refinance growing volumes of debt (see Panel 4), may give rise to upward pressures on long-term interest rates, as the economic and financial situation normalises. And such pressures might compromise the incipient recovery in private-sector demand. Also, it is important to generate further fiscal policy headroom so as to be able to tackle any demand shocks arising in the future. All these factors point to the need to present credible fiscal consolidation strategies, along with a reform programme that promotes an increase in potential growth and which contributes to the sustainability of public finances in the long run.

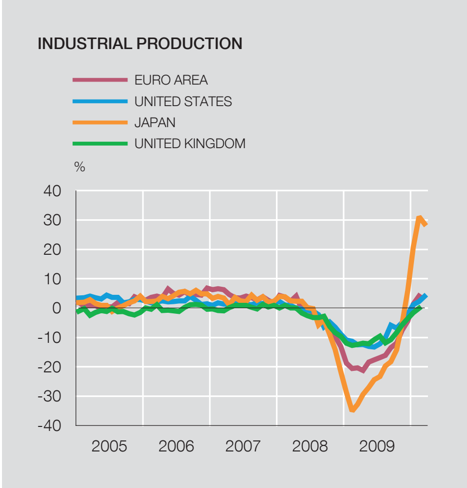
the US health care system was approved, and in February the executive branch unveiled the draft budget bill for fiscal year 2010-2011, which proposes a gradual reduction in the deficits over the period to 2013.

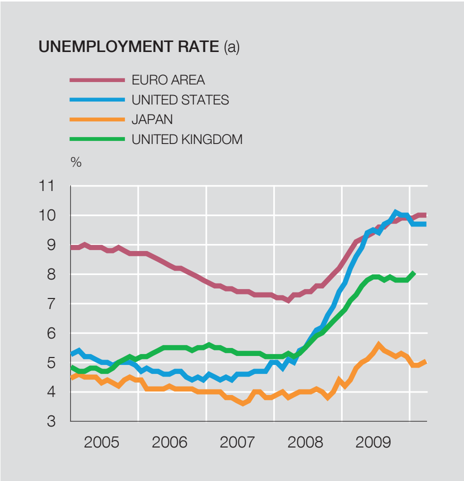
In Japan, GDP in 2009 Q4 grew at a quarterly rate of 0.9% (-1% year-on-year), reversing the decline of 0.1% the previous quarter. The expansion was essentially underpinned by the strength of external demand, and by the improvement in domestic demand, boosted by various fiscal support measures. In 2010 Q1, the economy continued to show signs of recovery. Industrial production continued to grow and the Tankan business confidence index regained its highest level since the crisis began, reflecting signs of improvement both in the services

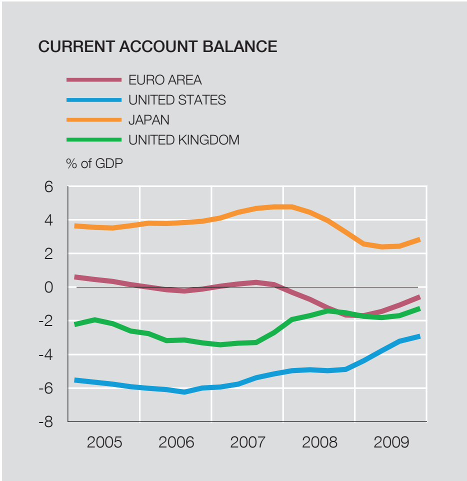
MAIN MACROECONOMIC INDICATORS
Year-on-year rate of change

CHART 5









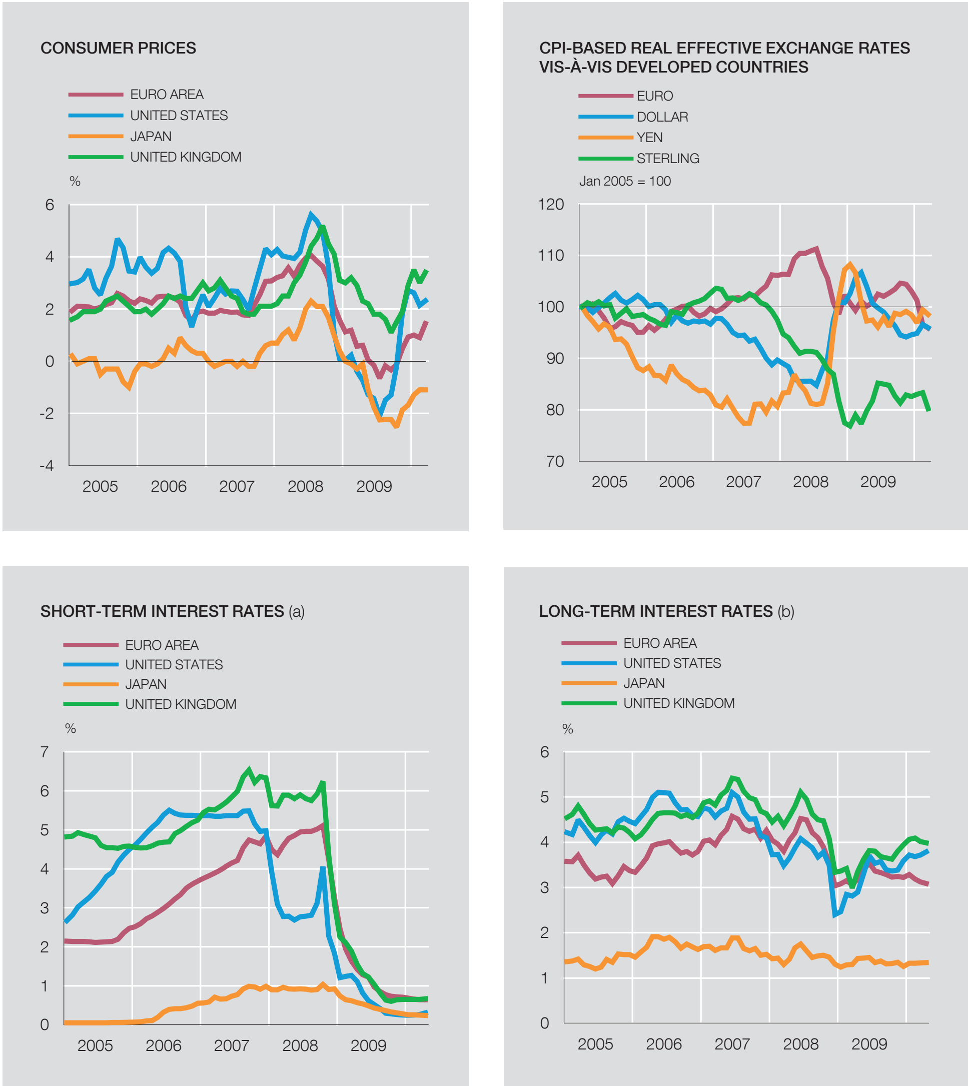
SOURCES: Banco de España, national statistics and Eurostat.

a. Percentage of labour force.

sector and in SMEs. Despite the sluggishness of disposable income, consumption benefited from the government incentives for goods purchases. In the labour market, the unemployment rate stood at 5% in March (0.2 pp down on the December figure), due to the pick-up in employment in Q1. Consumer and wholesale prices continued to fall in year-on-year terms, albeit with less intensity, owing to oil price rises. Against this backdrop, the Bank of Japan kept its official interest rate on hold at 0.1%, but decided to extend the fixed-rate money market operations approved in December, up to an amount equivalent to 4.2% of GDP. Further, in late April it revised its growth forecasts for fiscal year 2010-2011 upwards from 1.3% to 1.8%.

The gradual recovery in the UK economy continued in Q1, with a preliminary estimate for quarterly GDP growth of 0.2% (-0.3% year-on-year), compared with 0.4% in 2009 Q4. The Q1 industrial production and business sentiment indicators had already anticipated this development, offering a positive outlook for external demand and a somewhat gloomier picture for domestic demand (especially for investment spending). Retail sales remained sluggish in March, still under the effects of the January rise in VAT and persistent credit restrictions. The labour market, while fragile, continues to show signs of some stability, although the unemployment rate edged up in February to 8%. Diminished activity was observed in the real estate

PRICES, REAL EXCHANGE RATE AND INTEREST RATES CHART 6



SOURCE: Banco de España.

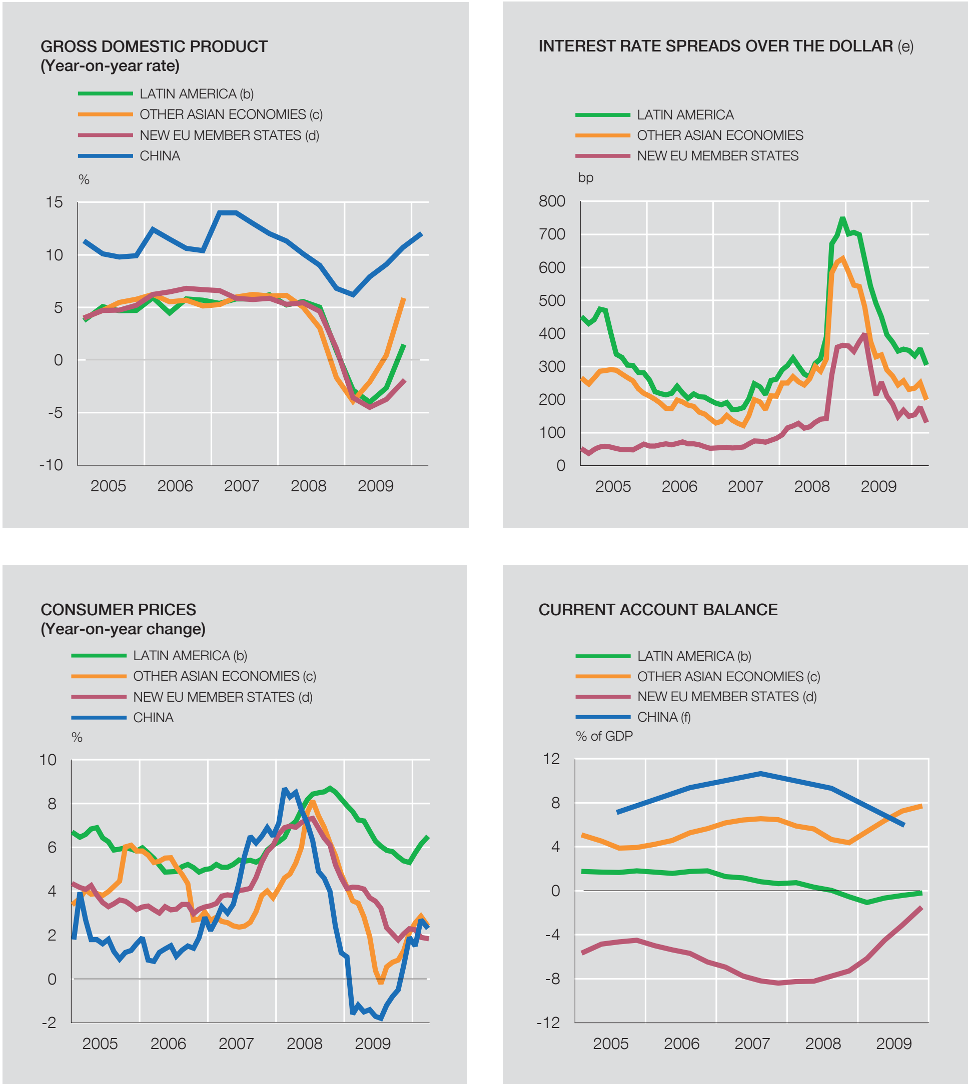
a. Three-month interbank market interest rates.
b. Ten-year government debt yields.

market, a development partly attributable to the fact that the tax exemption for house purchases ended in December. Inflation increased notably in Q1, rising to 3.4% year-on-year in March, owing to the temporary effects derived from the increase in oil prices and the rise in VAT at the start of the year. Against this background, the Bank of England held its official interest rate unchanged at 0.5% and, from February, it halted its asset purchase programme. Finally, the government presented the budget for 2010, which includes measures to continue supporting the recovery, while drawing up medium-term fiscal consolidation plans.

In the new EU Member States outside the euro area, the decline in GDP in Q4 eased to -2.2% year-on-year on average, compared with -3.6% in Q3. There were, however, marked differences across countries; while there was a decline of around 18% in Latvia, Poland posted growth of 3.1%, the only country with a positive year-on-year rate. In 2009 as a whole, aggregate GDP fell by 3.6% on 2008. The gradual economic recovery continued to be underpinned by the pick-up in exports, while domestic demand – both consumer and investment demand – remains flat. Nonetheless, industrial production continued to improve in Q1, thanks

EMERGING ECONOMIES:
MAIN MACROECONOMIC INDICATORS (a)

CHART 7



SOURCES: National statistics and JP Morgan.

a. The aggregate of the different areas has been calculated using the weight of the countries that make up these areas in the world economy, drawing on IMF information.
b. Argentina, Brazil, Chile, Mexico, Colombia, Venezuela and Peru.
c. Malaysia, Korea, Indonesia, Thailand, Hong Kong, Singapore, Philippines and Taiwan.
d. Poland, Hungary, Czech Republic, Slovak Republic, Estonia, Latvia, Lithuania, Bulgaria and Romania.
e. JP Morgan EMBI spreads. The data on the new EU Member States relate to Hungary and Poland. The aggregate for Asia does not include China.
f. Annual data.

to the expansion in the export sector, while there are still no signs of recovery in private consumption. During the quarter, inflation remained moderate and declined by 0.1 pp in March to 2.7% year-on-year. In this situation, Latvia, Romania and Hungary lowered their official interest rates. On the fiscal front, there was a notable deterioration across the board in budget balances and in gross debt in 2009 (with the exception of Estonia). On average, the budget deficit amounted to 6.6% of GDP and gross debt rose to 43%. At the second plenary meeting under the so-called "Vienna initiative" (with the participation, inter alia, of national authorities, of the main international organisations and of the banking groups with interests in the region) it was proposed to boost the development of local-currency-denominated capital markets and to lay down an appropriate prudential policy regulating the extension of foreign-currency-denominated loans. Indeed, some countries, such as Hungary and Poland, had already moved in this connection and set limits on granting loans.

In China, GDP quickened in Q1 to a year-on-year growth rate of 11.9%, up on 10.7% in Q4. This strong expansion confirmed the momentum indicated by industrial production, investment in fixed assets and retail sales. Conversely, regarding the external sector, the trade surplus fell significantly in Q1 (posting in March its first deficit since 2004), owing to the strong growth of imports (65% year-on-year), while exports rose by around 24%. However, reserves continued to build up, amounting at the end of March to $2.4 trillion. Set against the gradual slowdown in the money supply and in bank loans (owing to the effect of the restrictive measures), inflation dipped by 0.3 pp in March to a year-on-year rate of 2.4%. In the rest of Asia, economic activity and the external sector continued to show notable dynamism in Q1, and in some countries there were signs of overheating. Inflation tended to fall in most countries, with the notable exception of India, where it rose to a year-on-year rate of 9.9% in March. These price developments led India (on two occasions) and Malaysia to raise their official interest rates during the quarter. The strong acceleration in activity in Singapore prompted it, along with inflationary pressures, to revalue its exchange rate in mid-April and to announce the gradual widening of its intervention bands in the future.

In Latin America, GDP grew at a year-on-year rate of 1.3% in Q4, following three consecutive quarters of declines. This meant that in 2009 as a whole activity contracted by 2.1%, having grown by 4.2% in 2008. Underpinning the recovery was the positive contribution of external demand and the reactivation of domestic demand, particularly private consumption. The indicators for Q1 would suggest an acceleration in the recovery, more markedly so in Brazil and less vigorously so in Mexico. During the quarter, inflation moved on a rising path, owing to the increases in food and fuel prices, and it stood in March at a year-on-year rate of 6.5% for the region as a whole, while the core inflation rate held at 6.6%. In Brazil, price developments, combined with the buoyancy of activity, prompted the central bank to raise its official interest rate by 75 bp. Conversely, Colombia surprisingly cut its rate by 50 bp, while in the other countries rates remained unchanged. The aggregate current account deficit declined in 2009 (from 0.7% to 0.1% of GDP), thanks to the improvement in trade balances. Portfolio investment flows increased most notably, as both governments and companies raised their bond issues on international markets, especially in Q4, whereas direct investment inflows fell to their minimum 2006 levels. On the fiscal front, primary balances improved across the board late in the year, owing to the pick-up in receipts. Argentina offered a further debt swap for holders who did not avail themselves of it in 2005.

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

The information available on the first quarter of the year indicates that the recovery in the euro area continued, albeit at a subdued pace. The momentum of the external sector has still not fed through into stronger domestic demand, against a background in which some of the temporary factors fuelling recovery, such as the tax stimulus and the change in the inventory cycle, are petering out, and the poor weather seems to have had a highly negative impact on the activity of the construction sector in that period. In the medium term, the forecasts published recently by international agencies continue to affirm that the end of the crisis will arrive only very gradually over the coming months, underpinned primarily by the buoyancy of external demand and by the progressive normalisation of the financial situation.

Inflation rose more than expected in 2010 Q1, as a result of increases in the more volatile components, namely energy and unprocessed food, which seem to have been affected by the harsh winter weather. However, the hesitant nature of the recovery in activity projected for the coming months, along with the under-utilisation of installed capacity and the foreseeable wage moderation owing to the sluggish labour market, seem to rule out significant inflationary pressures within the time horizon relevant to monetary policy. Against this backdrop, the latest ECB Governing Council meetings decided to hold official interest rates unchanged at 1% for main refinancing operations, and to push ahead (in view of the progressive normalisation of financial markets) with the gradual withdrawal of the extraordinary measures adopted at the height of the crisis. Through these decisions, the Eurosystem has maintained its policy of providing liquidity on favourable terms, while avoiding the market distortions which would result if these measures were held in place for longer than required.

In the fiscal arena, the latest data furnished by the euro area Member States evidence the sharp deterioration of public finances in 2009, since the budget deficit for the area as a whole is 6.3% of GDP, up 4.3 pp on 2008. For 2010, the aggregation of the stability plans points to a slight worsening of budget balances, mainly as a consequence of the maintenance of fiscal stimuli by France and Germany, which will postpone correction of their deficits to 2011-2013. By contrast, the countries with the highest negative balances (Ireland, Greece, Portugal and Spain) have submitted stability plans proposing ambitious fiscal consolidation for the current year. At present,13 of the 16 euro area countries are subject to the excessive deficit procedure, the most important case being that of Greece, whose deficit and volume of debt stood, respectively, at 13.6% and 115% of GDP in 2009.

Indeed, the deterioration of the fiscal situation in Greece and the resulting financial tensions were the principal factors shaping economic developments in the euro area in the early months of the year (see Box 2). The action of the Greek authorities to strengthen the credibility of the fiscal consolidation programme and the measures agreed by the Eurogroup to ensure the financial stability of the euro area were initially unable to stabilise the situation and on 23 April the Greek government formally requested financial support, the basic terms of which had been defined in the meeting of euro area finance ministers on 11 April. This request was met by the Eurogroup on 2 May through the unanimous approval of a programme of bilateral loans of up to €110 billion in three years (€80 billion from the euro area Member States and the remainder from the IMF). This plan imposes strict conditionality and quarterly assessment of the progress made under the severe programme of fiscal adjustment and structural reforms negotiated by the Greek authorities with the European Commission, the IMF and the ECB and approved by the Greek government on 2 May as a prior step to the activation of the assistance plan. As this

In early 2010 the fiscal crisis of the Greek economy caused an increase in the level and volatility of government debt spreads in the euro area countries. These tensions also spread to the debt markets of other euro area countries, particularly those with the highest budget deficits; to the stock markets, which fell sharply, particularly in the banking sector due to its exposure to sovereign debt; and to the foreign-exchange markets.

The origin of this turmoil dates back to autumn 2009, when the Greek authorities revealed the serious condition of their public finances, which had been concealed by severe statistical deficiencies. This precipitated an institutional crisis of confidence in Greece which is making it harder to remedy its imbalances. At the end of October 2009 the Greek government revealed that the estimated deficit for that year amounted to 12.7% of GDP, nearly eight percentage points more than announced previously and the prelude to a subsequent upward revision to 13.6%. Greece's debt exceeds 115% of GDP and is the highest in the euro area after Italy. This debt burden led the main agencies to progressively downgrade the credit rating of Greek sovereign debt. Simultaneously, its yield moved substantially higher, raising the financing costs of the Greek economy (see Chart 1).

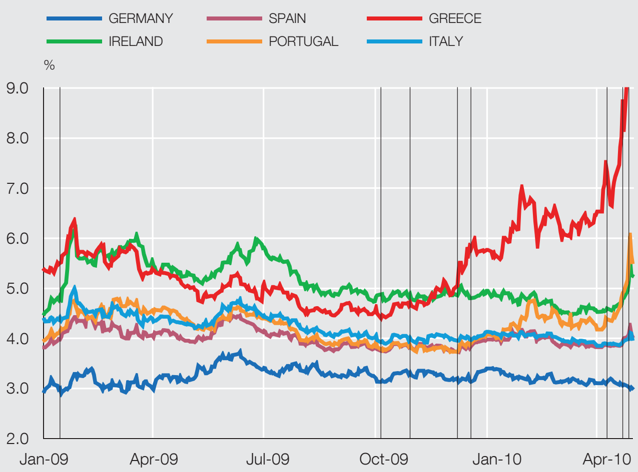
In January 2010 the Greek government presented its stability programme with a 2010 deficit-reduction target which is relatively ambitious (4 pp), but based mainly on measures to increase revenue. On 11 February the euro area heads of government issued a political declaration of support to the Greek economy. Subsequently, the ECOFIN of 16 February established the correction path to be followed by Greece's deficit, and, at the same time, pressed for more precise details of the measures needed to achieve the 2010 deficit target and the introduction of additional reforms in subsequent years. Furthermore, the mechanisms for monitoring Greek public finances were strengthened by requiring the Greek government to submit successive reports on the status of approval and execution of the initiatives adopted.

At the beginning of March the Greek government adopted supplementary fiscal measures, including most notably wage cuts for civil servants and higher VAT rates. However, the deterioration in Greek public finances had been so sharp that it was difficult to overcome the uncertainty about their sustainability in the medium and long term. In this climate, doubts arose as to whether the Greek economy would be able to refinance the high debt repayments it will have to make in the next three years.

In view of the seriousness of the situation and the attendant risks to euro area stability, the European institutions had to set in place an emergency mechanism at the end of March to forestall the possible financing difficulties of the Greek government. On 11 April the Eurogroup mapped out the details of this mechanism. However, in late April the yield on Greek bonds rose to a new all-time high and CDSs, which approximate the cost of insuring against the risk of default on sovereign debt, increased at all maturities, particularly shorter ones. This showed that the markets still assigned a not-insignificant probability to the prospect of debt restructuring by this economy (see Chart 2).

On Friday 23 April, Greece formally requested the activation of this support mechanism. Its request was met at the Eurogroup's extraordinary meeting on 2 May, where an agreement of historic proportions in terms of its ambitiousness and degree of consensus was reached to support the Greek government. The mechanism approved envisages a joint programme of loans by the euro area countries and the IMF over three years. The euro area countries will grant bilateral loans for €80 billion (€30 billion in the first year), which will be increased by an IMF contribution of €30 billion. Hence the total amount of the loans is 45% of Greece's GDP. The interest rate on this support facility will be, for the variable-rate loans, 3-month EURIBOR, and for the fixed-rate loans, that of the related EURIBOR swap, plus an additional cost of 300 bp (plus another 100 bp if the loan maturity is longer than three years). Additionally, operating costs will be covered by a fee of 50 bp.

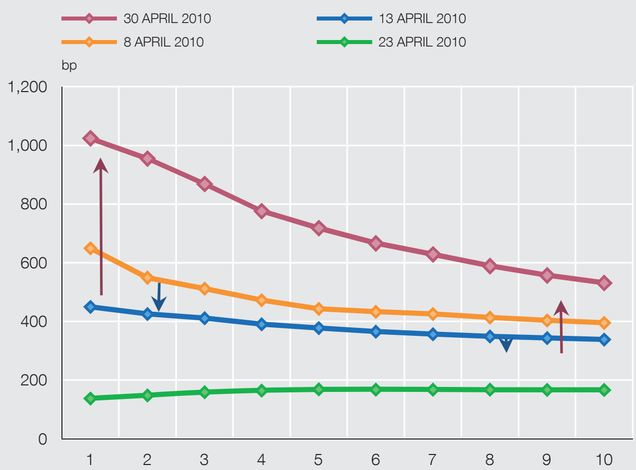
1 10-YEAR TREASURY BOND RATE (a)



SOURCES: ECB and Datastream.

a. Vertical lines indicate the dates when Greek debt was downgraded.

2 CDS TERM STRUCTURE (YEARS)



For example, in mid-April a three-year fixed-rate loan would accrue interest of nearly 5%, mid-way between the IMF's usual soft terms for these loans and market rates. The first disbursements will take place before 19 May, the date when the Greek government has to refinance a significant volume of debt.

The granting of this loan is subject to strict conditionality in that it depends on compliance with a reform programme which the IMF, the European Commission and the ECB have agreed with the Greek authorities. In fact, on 2 May the Greek Council of Ministers approved a new package of wide-ranging fiscal measures which establish, among other things, an additional increase in VAT rates (the average rate is up by a further two percentage points to 23%), larger cuts in civil servants' wages and the freezing of pensions for the next three years. The final purpose of this new package is to reduce Greece's deficit by 5 pp of GDP in 2010 and to bring it below 3% in 2014. The application of this set of measures is subject to strict quarterly monitoring by the IMF, the ECB and the European Commission. The package also contains structural reforms designed to restore confidence in the institutions of the Greek economy.

bulletin went to press, the interest rates on Greek debt remained high and there had been some outbreaks of contagion to other euro area economies, particularly Portugal, although also Ireland, Italy and Spain.

The Greek crisis has increased the realisation that there is a need to strengthen euro area governance and to establish multilateral mechanisms to ensure that domestic economic policies are more closely coordinated. In this respect, the Commission announced that in May it will present initiatives in three key areas: first, the strengthening of multilateral procedures for monitoring competitiveness and for early detection of external imbalances; second, the reform of the Stability and Growth Pact, strengthening both the mechanisms for detecting fiscal imbalances and the instruments for ensuring stricter compliance with commitments given; and, third, the establishment of a crisis resolution mechanism and a permanent framework to ensure, subject to the appropriate conditionality, that member countries in difficulty will receive financial support.

3.1 ECONOMIC DEVELOPMENTS

According to the second National Accounts estimate, euro area GDP showed zero growth in 2009 Q4, down 0.4 pp on the period July-September (see Table1). This slowdown came about because the most buoyant components in the previous quarter (government consumption and stockbuilding) made a markedly smaller contribution, while private sector spending continued to hold back the momentum of activity. Despite further improvement in confidence, private consumption held unchanged and investment fell sharply due to the worsening of all of its components (see Chart 8). As a result, the contribution of domestic demand to GDP growth (excluding inventories) was negative, while that of net external demand was positive thanks to the higher growth of exports compared with imports. In year-on-year terms, GDP fell by 2.1%. The sectoral breakdown of GDP reveals an across-the-board decline, except in intermediation services and in government.

The slowdown in growth of activity in the last quarter of the year and its composition were uneven across the member countries of the euro area. The GDP of Germany remained steady, since the positive contribution from the external sector fully offset the fall in domestic demand and the negative contribution from inventories. In France, however, the marked pick-up in private consumption and, to a lesser extent, in government consumption raised the quarter-on-quarter growth rate of GDP to 0.6%. However, the external sector detracted from the buoyancy of activity. Finally, the GDP of Italy decreased by 0.3% with respect to Q3, due to the decline in consumption, investment and net external demand, partly offset by a positive contribution from inventories.

EURO AREA ECONOMIC INDICATORS (a) TABLE 1

	2008		2009				2010	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
NATIONAL ACCOUNTS (q-o-q rates of change, unless otherwise indicated)								
GDP	-0.4	-1.9	-2.5	-0.1	0.4	0.0		
Private consumption	0.0	-0.6	-0.5	0.1	-0.1	0.0		
Public consumption	0.5	0.6	0.6	0.6	0.7	-0.1		
GFCF	-1.3	-4.1	-5.2	-1.6	-0.9	-1.3		
Imports	0.1	-4.8	-7.6	-2.8	2.9	1.3		
Exports	-1.1	-7.3	-8.0	-1.1	2.9	1.9		
Contributions to quarter-on-quarter GDP growth (pp)								
Domestic demand (exc. stocks)	*-0.2*	*-1.1*	*-1.2*	*-0.1*	*-0.1*	*-0.3*		
Change in stocks	*0.3*	*0.3*	*-1.0*	*-0.7*	*0.5*	*0.1*		
Net foreign demand	*-0.5*	*-1.1*	*-0.2*	*0.6*	*-0.1*	*0.2*		
GDP (year-on-year rate of change)	*0.4*	-1.9	-5.0	-4.9	-4.1	-2.2		
ACTIVITY INDICATORS (quarterly average)								
IPI seasonally and working-day adjusted	-3.4	-5.9	-7.7	-2.7	0.9	2.0	3.0	
Economic sentiment	92.4	80.0	71.5	75.6	84.1	91.9	96.6	100.6
Composite PMI	47.6	40.2	37.6	43.2	49.5	53.6	54.4	57.3
Employment	-0.3	-0.4	-0.8	-0.5	-0.5	-0.3		
Unemployment rate	7.6	8.0	8.8	9.3	9.7	9.8	10.0	
PRICE INDICATORS (y-o-y change in end-period data)								
HICP	3.6	1.6	0.6	-0.1	-0.3	0.9	1.4	
PPI	7.8	1.2	-3.2	-6.5	-7.6	-2.9	-0.4	
Oil price (USD value)	98.1	40.5	46.8	68.8	67.7	74.4	78.8	84.5
FINANCIAL INDICATORS (end-period data)								
Euro area ten-year bond yield	4.5	3.8	4.1	4.2	3.8	4.0	4.0	4.6
US-euro area ten-year bond spread	-0.88	-1.76	-1.31	-0.63	-0.47	-0.17	-0.08	3.78
Dollar/euro exchange rate	1.430	1.392	1.331	1.413	1.464	1.441	1.348	1.332
Appreciation/ depreciation of the NEER-21 (b)	-1.0	2.5	-0.6	-0.9	0.2	-1.0	-4.5	-5.5
Dow Jones EUROSTOXX 50 index (b)	-30.9	-44.3	-15.5	-2.0	17.2	21.0	-1.2	-5.0

SOURCES: European Commission, Eurostat, Markit Economics, ECB and Banco de España.

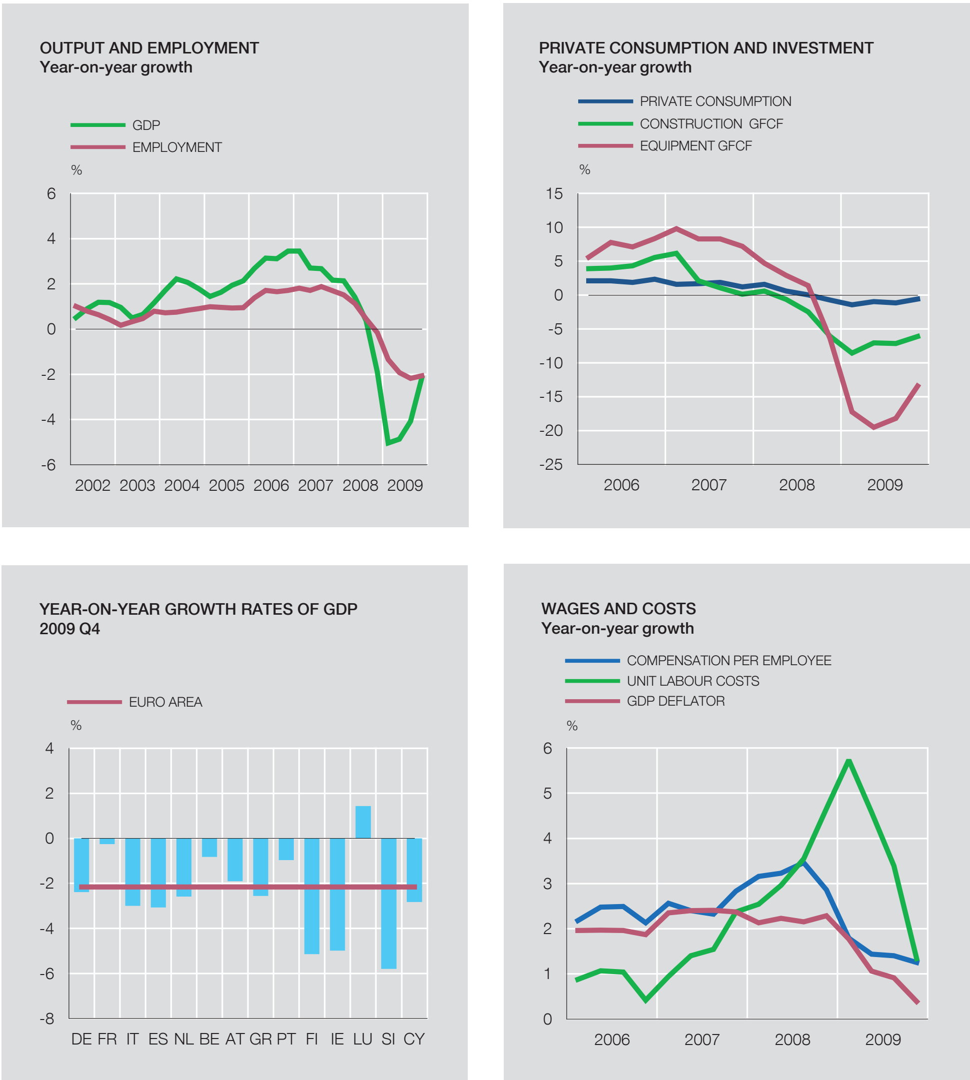
a. Information available up to 30 April 2010.
b. Percentage change over the year.

The fall in employment moderated in 2009 Q4 to a contraction of 0.2%, with a year-on-year fall of 2%. Although all economic sectors posted job losses, these were sharper in industry (-1.1% with respect to the previous quarter). The rates of slowdown of employment and GDP were similar, and this substantially eased the year-on-year fall in apparent labour productivity, leaving it at -0.3% (see Box 3). These developments, along with the wage moderation, brought a significant slowdown in unit labour costs, the year-on-year growth rate of which declined to 1.6%. Nevertheless, they rose more quickly than the GDP deflator, so business margins narrowed further (see Chart 8).

The latest conjunctural information suggests that euro area real activity grew at a positive, albeit subdued, rate in the first quarter of the year (see Chart 9). On the supply side, with data to February, industrial orders and, in particular, industrial production increased with respect to the previous quarter. However, construction sector production contracted strongly, largely because of the harsh winter weather. Confidence indicators held on their upward path and stood above the long-term average in European Commission surveys and, in particular, in purchasing manager surveys, such behaviour continuing in April. Meanwhile, the unemployment rate increased to 10% in February, while the qualitative indicators of the labour market improved, although they still remain below their historical averages.

EURO AREA NATIONAL ACCOUNTS

CHART 8



Sources: Eurostat and national statistics.

On the demand side, the indicators reflect continuing sluggish domestic expenditure and a certain buoyancy in foreign sector demand. Thus, on data to February, retail sales and car registrations fell, the latter affected by the phasing-out of car purchase incentive plans, and consumer confidence scarcely advanced in the opening months of the year. As to investment in capital goods, the level of capacity utilisation increased in the early months of the year, while the assessment of industrial order books by the European Commission increased notably in Q1 and in April, although both remained well below their long-term averages. In addition, the information for January and February reflects, on average, a moderate increase in sales abroad, while the outlook for exports and the assessment of foreign orders continue to improve. Lastly, the European Commission's stock level assessment indicator suggests that, in the first quarter of the year, the contribution of inventories to GDP may be zero or slightly positive.

In short, the latest available data point to a moderate expansion of GDP in the opening months of the year, against a background of weak domestic demand and a gradual petering-out of the temporary factors that were underpinning the recovery, such as the contribution from economic policies and from inventories. In the medium term, the latest forecasts of international agencies point to a slow and gradual economic recovery over the next two years, shaped by diverse fac-

SENSITIVITY OF EURO AREA EMPLOYMENT TO THE DETERIORATION IN ACTIVITY

The unprecedented economic and financial crisis which has swept through the euro area has brought a sharp contraction in activity, which, however, has not been accompanied in the euro area as a whole by a significant adjustment in employment (see Table 1). Thus, during the cyclical downturn between 2008 Q1 and spring 2009, the fall of 5.2% in GDP far exceeded the decline of 1.7% in the number of employed.

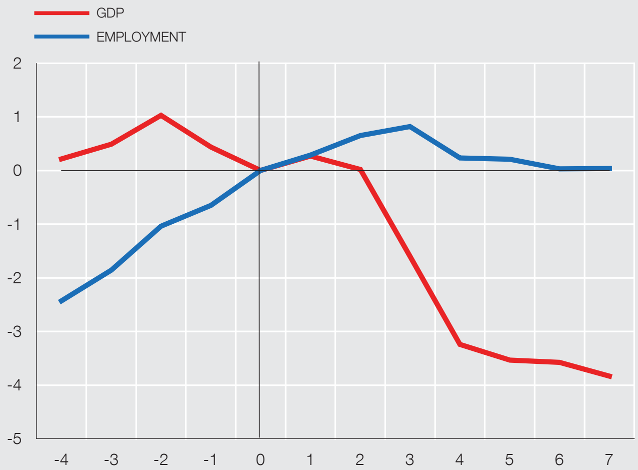
The scant response of the labour market in this period contrasts with that seen in the recession of the early 1990s, when employment was more responsive to the deterioration in activity (see Chart 2). Indeed, the elasticity of employment with respect to GDP in the latest crisis is approximately 4 times less than in the period 1992-1993. This is even more surprising if it is taken into account that, in the latest crisis, real compensation per employee has increased despite the sharp fall in productivity (unlike in the 1990s), which should have led to greater job destruction. Furthermore, the increase in contract flexibility in recent years, should have also heightened the sensitivity of employment to the cycle (see Chart 3).

In this context, the information on the total number of hours worked suggests that the low elasticity of employment with respect to the economic situation is partly due to the fact that, at the level of the overall euro area, firms and workers have opted to reduce working hours while preserving jobs (see Table 1). This strategy has drawn basically on the short-time work programmes introduced, or expanded, in most European countries, Germany being the archetype. Thus, the German Kurzarbeit allows all workers, including those hired through a temporary employment agency, to avail themselves of short-time work programmes for a maximum period of 24 months, the government undertaking to finance up to 67% of the wage reduction and 50% of social security contributions for the hours not worked.

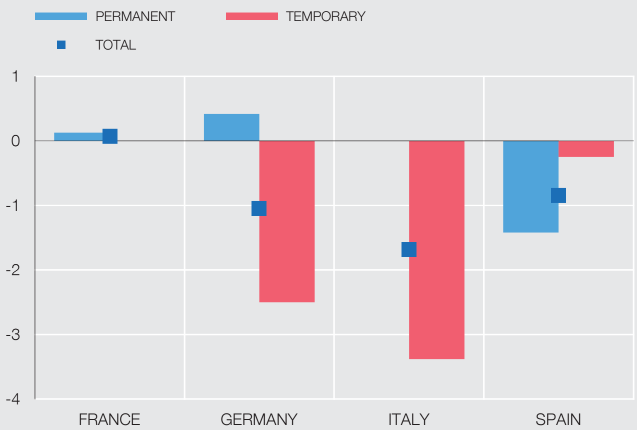
1 CUMULATIVE GROWTH IN RECESSIONS (a) (b)

	1992 Q1 - 1993 Q2	2008 Q1 - 2009 Q2	2009 Q2 - 2009 Q4
GDP	-1.6	-5.2	0.4
EMPLOYMENT			
Total employees	-1.9	-1.7	-0.8
Total hours worked	-2.8	-3.3	-0.1
Hours per employee	-0.9	-1.5	0.7
Elasticity of employment to GDP	*1.2*	*0.3*	*-1.7*
Elasticity of hours worked to GDP	*1.8*	*0.6*	*-0.1*
NOMINAL AND REAL COMPENSATION			
Total nominal compensation	2.7	0.5	0.0
Nominal compensation per employee	4.7	2.2	0.8
Nominal compensation per hour worked	3.6	2.1	-0.7
GDP deflator	4.6	1.8	0.2
Total real compensation	-2.9	-1.3	-0.2
Real compensation per employee	-0.9	0.5	0.6
Real compensation per hour worked	0.0	2.0	-0.2
PRODUCTIVITY			
Productivity per employee	0.3	-3.4	1.2
Productivity per hour worked	1.2	-1.9	0.5

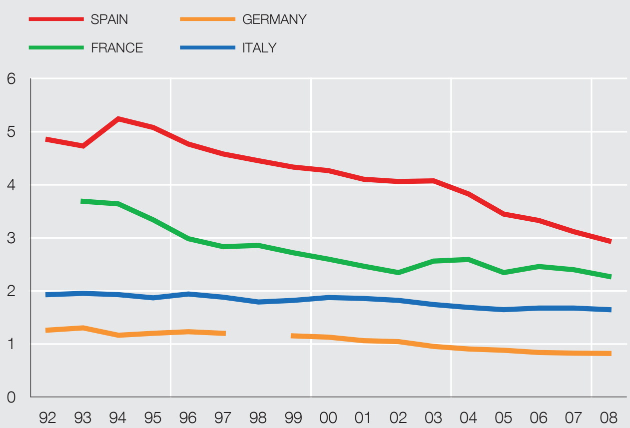
2 GDP AND EMPLOYMENT. DIFFERENCE BETWEEN THE 2008 AND 1992 RECESSIONS (a)
INDICES NORMALISED TO 100 AT THE CYCLICAL PEAK



3 CHANGE IN THE LEVEL OF EMPLOYMENT PROTECTION BETWEEN 1990 AND 2008



4 RATIO BETWEEN 25-34 AND 50-59 COHORTS. WORKFORCE WITH UNIVERSITY STUDIES.



SOURCES: Eurostat and OECD.

a. Contractionary phases are defined as the period between the last quarter of positive quarter-on-quarter growth and the last quarter of quarter-on-quarter decline.
b. The last column shows the two latest figures available. These two quarters are not considered to be a recession.

The programmes of other countries are fairly similar, although there are some differences in duration and, to a lesser extent, in the amounts provided. Most notable regarding duration is the extreme case of Italy, where certain firms can make a subsidised reduction of hours worked under programmes lasting for up to four years, while in the Netherlands the maximum time is 15 months. With regard to the percentage of pay that is subsidised, nearly all governments guarantee between 70% and 80% of pay. An exception is Austria, where, if the reduction in hours worked is not linked to training, the government subsidy may not exceed 55% of net pay.

Additionally, the relative containment of employment may have been driven not only by government support programmes, but also by the response of firms themselves, which, faced with a demand shock which they judge to be temporary, opt to retain their workers in an environment in which the number of skilled workers is declining. The data on the education of the labour force show how the proportion of skilled workers has increased significantly in the last two decades. Thus, for example, in countries like France or Spain, the relative weight of young people with university studies within their age cohort (25-34 years) increased from 25% and 28%, respectively, to more than 40% at the end of 2009. However, as the inversion of the population pyramid proceeds, the new cohorts entering the labour force are narrowing and the greater investment in the human capital of young people may not be sufficient to replace the outgoing cohorts. This seems to be the situation in Germany, where the rate of replacement of employees with university studies shown in Chart 4 has moved below the critical value of unity in the last few years.

In both cases, however, it should be kept in mind that the medium- and long-term effectiveness of these actions will depend crucially on the persistence of the demand shocks. In particular, if in certain firms or sectors the economic contraction is due to factors of a more structural nature (for example, oversized sectors), the decisions taken might end up being counter-productive. In fact, the receipt of subsidies is currently subject to the employee remaining in the same firm, disincentivating the adjustments in productive structure needed to correct sectoral imbalances, which could make it more difficult to exit the crisis.

tors (see Table 2). In particular, the unfavourable outlook for the labour market and the lacklustre consumer confidence will foreseeably limit the strength of private consumption, while the excess plant capacity and the depressed earnings expectations will hinder the resumption of investment. The expected world growth will foreseeably not feed through in full to demand for euro area exports because of the euro area's specialisation in trade in areas undergoing a less buoyant recovery, such as eastern Europe. Finally, the need for the private sector of the economy to rebuild its balance sheets following the crisis, along with the fiscal consolidation initiated in some countries, will tend to moderate the rate of recovery of domestic demand.

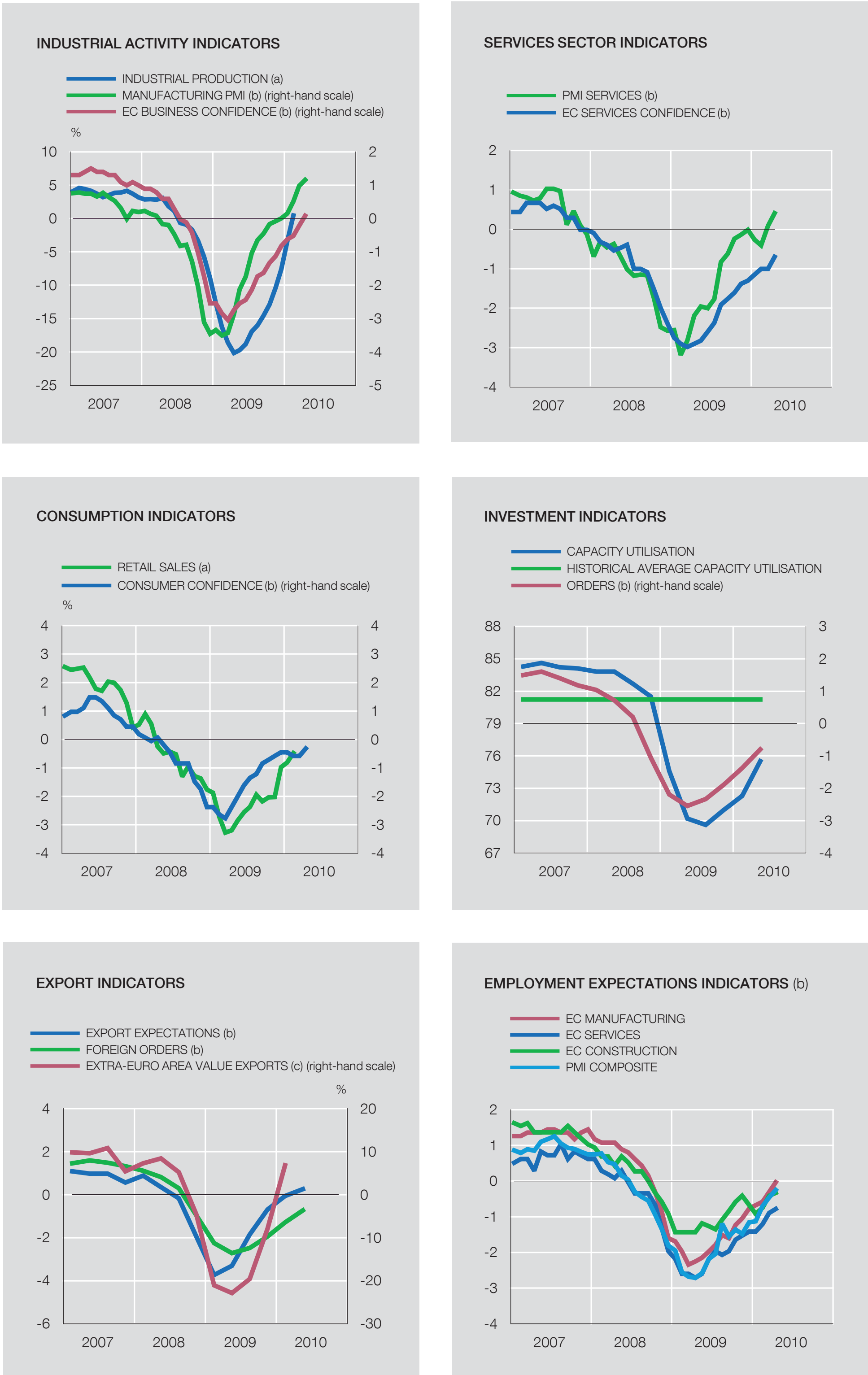
According to the Eurostat preliminary estimate, in 2010 Q1 euro area inflation rose to 1.5% in April (see Chart 10). This unexpected rise was due to temporary factors which will foreseeably peter out in the coming months. In particular, the especially adverse winter weather may explain a part of the increase in energy prices and the reversal of the falling trend in unprocessed food prices, while the effect of the unusually early Easter week may have pushed up the prices of some services, such as tourism packages, somewhat more than expected. Underlying inflation, as measured by the CPI excluding unprocessed food and energy, fell by 0.1 pp between December and March to 0.9%. Meanwhile, the year-on-year fall in industrial prices slackened to -0.5% in November, after recording -1.1% in January, basically as a result of movements in the energy component.

Foreseeably, inflation will continue to be subdued in the coming months due to the weak demand, reflected in the sizeable slack in productive capacity. Thus the latest IMF forecasts, published in late April, estimate that inflation will stand at 1.1% and 1.3% in 2010 and 2011, respectively. Possible upside risks to this scenario may derive from sharper commodity price rises and from possible increases in indirect taxes and administered prices to meet the fiscal consolidation targets contained in the stability plans recently approved by the European Commission.

On estimates published by the ECB, the euro area current account deficit amounted to €20 billion (1.3% of GDP) between January and February 2010, down from €29 billion (2% of GDP)

EURO AREA. ACTIVITY, DEMAND AND EMPLOYMENT INDICATORS

CHART 9



SOURCES: European Commission, Eurostat and Markit Economics.

a. Non-centred year-on-year rates, based on the quarterly moving average of the seasonally adjusted series.
b. Normalised data.
c. Original series year-on-year rates. Quarterly average.

GDP AND HICP PROJECTIONS FOR THE EURO AREA (a)

TABLE 2

	2010		2011	
	GDP	HICP	GDP	HICP
ECB (March 2010)	0.4-1.2	0.8-1.6	0.5-2.5	0.9-2.1
European Commission (February 2010)	0.7	—	1.1	—
IMF (April 2010)	1.0	1.1	1.5	1.3
OECD (November 2009)	0.9	0.9	1.7	0.7
Consensus Forecast (April 2010)	1.2	1.2	1.5	1.4
Eurobarometer (March 2010)	1.2	1.1	1.6	1.4

SOURCES: European Commission, Consensus Forecast, Eurosystem, IMF, MJ Economics and OECD.

a. Annual growth rates.

in the same period of the previous year. This improvement was because, except for the current transfers balance, on which the deficit increased slightly, the other components performed more favourably. Thus the goods balance remained negative, albeit smaller in magnitude, as a result of exports increasing by more than imports, while the surplus on the services balance increased and the deficit on the income balance became zero. As regards the financial account during the same period, the net outflows of capital in the form of direct investment amounted to €3 billion, one-tenth of the €37 billion in the same period of 2009, while net inflows of portfolio investment amounted to €10 billion, down on the €53 billion in the same period of 2009. As a result, the basic balance, which is the sum of these two types of investment and the current account balance, scarcely changed, showing a deficit of €12.8 billion (see Chart 11).

According to the latest data notified by the euro area Member States to the European Commission in spring, the budget deficit of the euro area as a whole in 2009 increased by 4.7 pp to 6.3% of GDP (see Table 3). This figure will, based on the aggregated data of the stability plans submitted in recent months, increase by 0.4 pp in 2010, and then it will gradually be corrected over the following years, reaching in 2013 the target of 3% set in the Stability and Growth Pact. At present,13 of the 16 euro area countries (Cyprus, Finland and Luxembourg are exceptions) are subject to the excessive deficit procedure, the most important case being that of Greece, whose deficit and volume of debt stood, respectively, at 13.6% and 115% of GDP in 2009 (see Box 2).

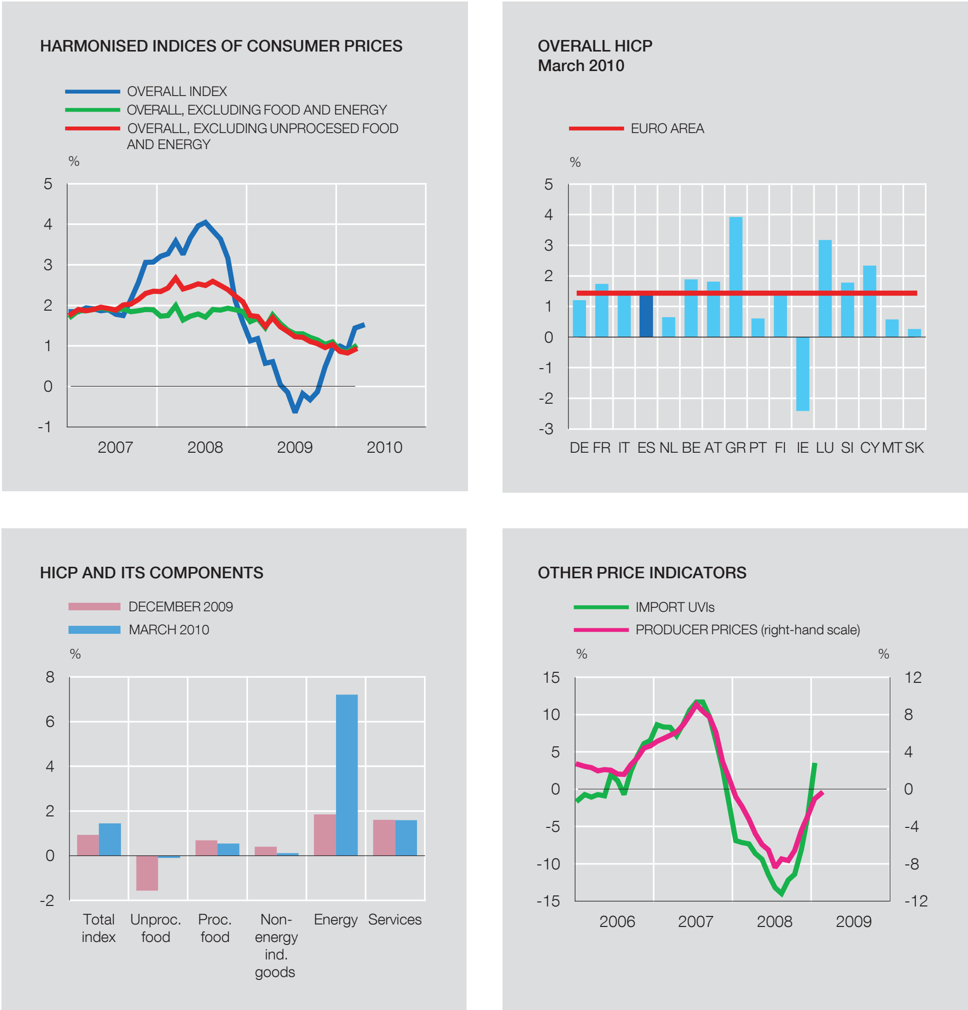
The slight worsening of public finances expected in 2010 for the euro area as a whole is a result of the different fiscal consolidation strategies adopted at national level. Thus the countries with the highest deficits (Greece, Ireland and Spain) have established adjustment programmes for 2010, while France and Germany will maintain the fiscal stimulus this year, concentrating their consolidation in the period 2011-2013. Finally, according to these plans, public debt will reach 83.8% of GDP in 2010, up from the 78.6% estimated for 2009 and the 69.3% in 2008.

At the end of March the European Commission assessed positively the stability plans submitted by the Member States, since they will allow the government balances of those subject to excessive deficit procedures to be corrected within the proposed time frame. However, it expressed certain reservations as to the relative optimism of the macroeconomic scenarios on which these projections are based, requested more specific details of the measures to be adopted and stressed the need for strict compliance with the measures set out in the stability plans.

3.2 MONETARY AND FINANCIAL DEVELOPMENTS

The deterioration of the fiscal situation in Greece gave way in early 2010 to a financial crisis which pushed the yields on Greek debt up to unprecedented levels since the inception of the euro area. The euro area financial markets were severely affected by the crisis, which through-

EURO AREA. PRICE INDICATORS CHART 10
Year-on-year percentage changes



SOURCES: Eurostat and ECB.

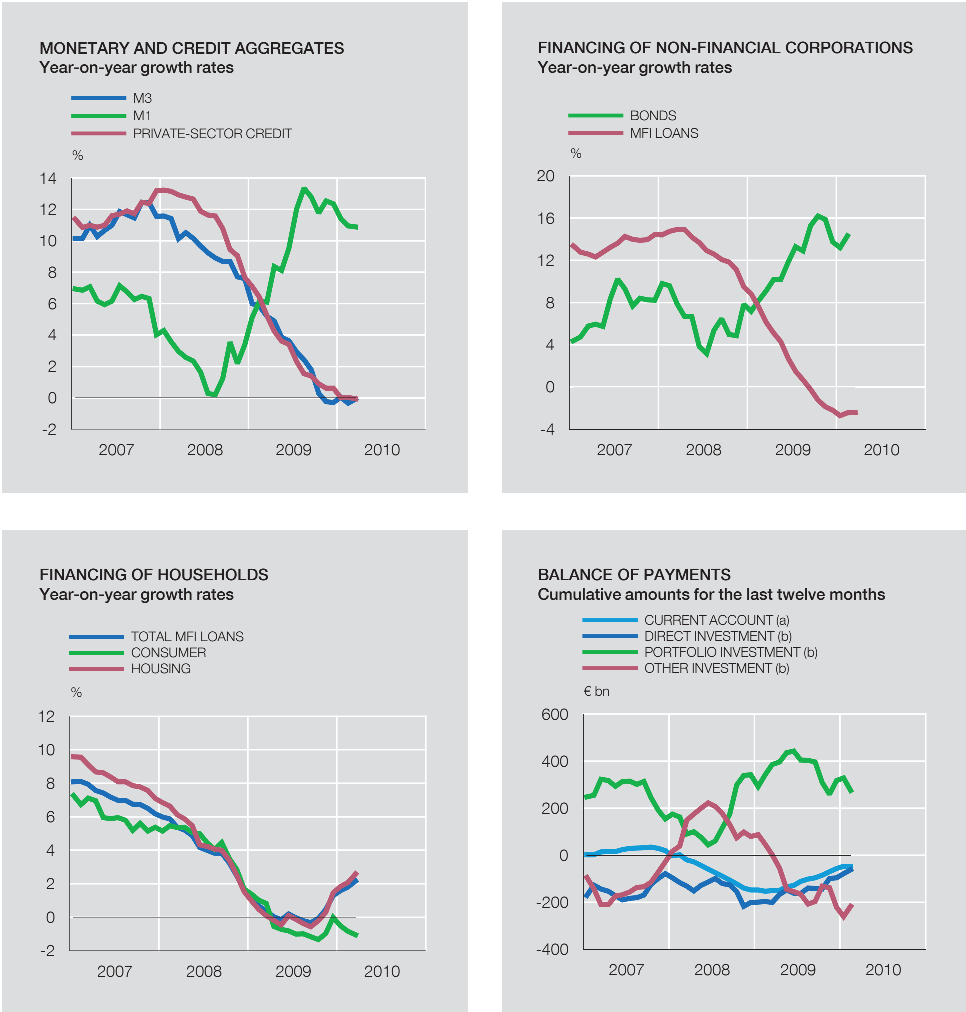
out Q1 brought repeated bouts of instability in the government debt, foreign exchange and stock markets of the euro area. The diverse measures adopted by Greece and the governments of the other euro area countries (see Box 2) were unable to contain the situation and on 23 April the Greek government formally requested financial support from the other euro area countries and the IMF, as previously provided for by the Eurogroup. The support was finally granted on 2 May, subject to strict conditionality (see Box 2).

Regarding developments in support schemes for the euro area banking system, it should be mentioned that in April, after obtaining the consent of the European Commission, the Irish agency NAMA, entrusted with the restructuring of impaired assets on the balance sheets of financial institutions, carried out the first acquisition of real estate loans, with a value of €16 billion on the institutions' balance sheets, to which it applied an average haircut of 47%. This is the first tranche of a programme which will have a cost of €54 billion, more than 30% of Ireland's GDP, and is conducted by five institutions constituting the bulk of the Irish banking sector.

The absence of significant inflationary pressures in the medium term, against a background in which recovery is expected to be slow, meant that, in its meetings up to April, the ECB Gov-

MONETARY AND CREDIT AGGREGATES AND BALANCE OF PAYMENTS

CHART 11



SOURCES: ECB and Banco de España.

a. A positive (negative) sign denotes a current account surplus (deficit).
b. Capital inflows less capital outflows. A positive (negative) sign denotes a net capital inflow (outflow).

erning Council held official interest rates unchanged. Hence the rate on main refinancing operations has stood at 1% since May 2009, while those on marginal lending and deposit facilities were 1.7% and 0.25%, respectively (see Chart 12).

in Q1 the ECB continued its policy of providing ample liquidity while at the same time gradually withdrawing some extraordinary measures. Specifically, the Governing Council meeting in March decided that the weekly tenders would continue to be fixed rate with full allotment as long as necessary and at least until 12 October. By contrast, from 28 April the regular three-month refinancing operations will return to the usual variable-rate tender procedure, although the amounts allotted will be determined with the aim of easing market conditions and avoiding significant spreads with respect to the rate on main refinancing operations. Also, with regard to collateral requirements, the April Governing Council meeting decided to hold the minimum credit quality threshold at the BBB–/Baa3 investment grade level beyond the end of 2010, except in the case of asset-backed securities. It also introduced stepwise valuation haircut schedules for lower quality assets, although it maintained the additional uniform haircut of 5% currently applied to general government debt instruments rated at BBB+/BBB/BBB– by Fitch or Standard & Poor's or at Baa1/Baa2/Baa3 by Moody's. However, on 3 May the ECB Governing Council decided to suspend application of the minimum credit quality threshold to Greek

EURO AREA GENERAL GOVERNMENT.
BUDGET BALANCES AND PUBLIC DEBT

TABLE 3

% of GDP

	BUDGET BALANCE (a)					
	2007	2008	2009		2010	
			EDP (b)	SP (c)	IMF (d)	SP (c)
Belgium	-0.2	-1.2	-6.0	-5.9	-5.1	-4.8
Germany	0.2	0.0	-3.3	-3.2	-5.7	-5.5
Greece	-3.7	-7.7	-13.6	-12.7	-8.7	-8.7
Spain	1.9	-4.1	-11.2	-11.4	-10.3	-9.8
France	-2.7	-3.4	-7.5	-7.9	-8.3	-8.2
Ireland	0.3	-7.2	-14.3	-11.7	-12.1	-11.6
Italy	-1.5	-2.7	-5.3	-5.3	-5.3	-5.0
Luxembourg	3.7	2.5	-0.7	-1.1	-3.8	-3.9
Netherlands	0.2	0.7	-5.3	-4.9	-5.9	-6.1
Austria	-0.6	-0.4	-3.4	-3.5	-4.8	-4.7
Portugal	-2.6	-2.7	-9.4	-9.3	-8.7	-8.3
Finland	5.2	4.5	-2.2	-2.2	-3.6	-3.6
Slovenia	0.0	-1.8	-5.5	-5.7	-6.1	-5.7
Cyprus	3.4	0.9	-6.1		-7.6	
Malta	-2.2	-4.7	-3.8	-3.8	-5.0	-3.9
Slovakia	-1.9	-2.3	-6.8	-6.3	-8.0	-5.5
MEMORANDUM ITEMS: Euro area (including Cyprus, Slovakia and Malta)						
Primary balance	2.4	1.0				
Total balance	-0.6	-2.0	-6.3	-6.3	-6.9	-6.7
Public debt	66.0	69.3	78.7	78.6		83.8

SOURCES: European Commission, Eurostat and IMF.

a. Deficit (-) / surplus (+). The deficits that exceed 3% of GDP have been shaded.
b. Spring 2010 Excessive Deficit Procedure notification.
c. Stability and Convergence Programmes presented in early 2010.
d. April 2010 IMF projections.

debt, following the approval of an assistance plan by the Eurogroup and the IMF and of an ambitious fiscal adjustment programme by the Greek government.

Against this background, interbank interest rates held steady at low levels in 2010 Q1. The average levels of three-month and one-year EURIBOR remained at 0.66% and 1.2%, respectively. The long-term yield for the euro area 10-year government bond index rose at the end of April to 4.6%, while demand increased for German government bonds, the interest rate on which fell slightly to around 3% (see Chart 13). Sovereign risk premia held at high levels in the first four months and a ratings agency downgraded the sovereign debt of Greece, Portugal and Spain to varying extents. Following a temporary improvement achieved by the agreement to lend financial assistance to Greece, the yield on Greek debt again rose to all-time highs a few days ago, with the 10-year bond yield exceeding 10%.

The risk premia in private fixed-income markets held relatively steady. Meanwhile, the cost of bank loans tended to steady around the low levels reached at the end of summer, with slight falls in the case of household credit. However, financing conditions remained tight. According to the latest bank lending survey, which relates to 2010 Q1, the lending standards for new loans to households and firms tightened very slightly and institutions do not foresee significant changes in Q2. Moreover, the demand for loans seems to have fallen, although institutions expect a certain recovery in Q2. Against this background, the balance of bank loans to the private sector fell

EURO AREA INTEREST RATES

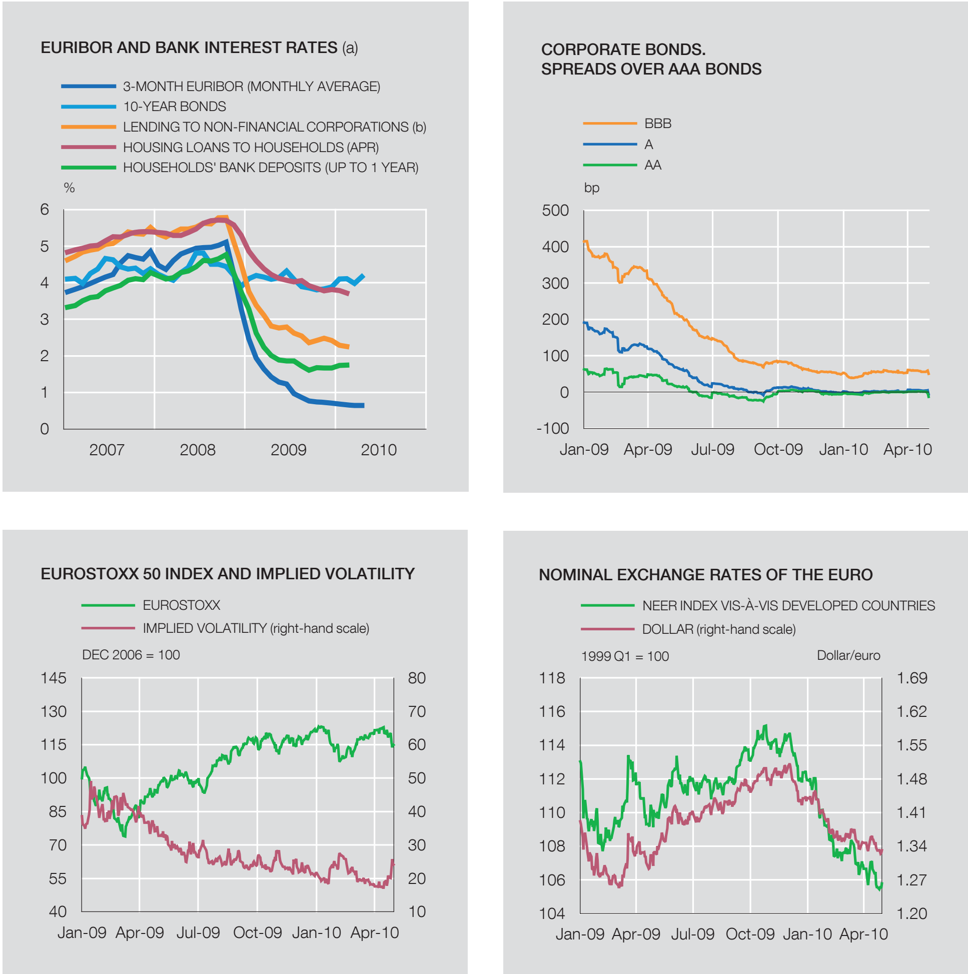
CHART 12

SOURCES: ECB and Banco de España.

a. ECB estimate using swap market data.

EURO AREA INTEREST RATES, EXCHANGE RATE AND STOCK MARKET INDEX

CHART 13



SOURCES: ECB and Banco de España.

a. On new operations.
b. Floating interest rates and up to 1 year initial rate fixation.

slightly in year-on-year terms in March, behaviour differing by type of borrower. Lending to non-financial corporations fell off somewhat more markedly than it did at end-2009, while lending to households recovered a little thanks to the greater buoyancy of credit for house purchases.

Equity markets were affected by the tensions and news relating to the Greek fiscal crisis. Thus the EURO STOXX 50 index has fallen by more than 5% since end-2009. The banking sub-index was hardest hit because of its exposure to sovereign debt markets, falling more than 12% in the year.

In the foreign-exchange markets, the euro exchange rate depreciated in 2010 Q1, trading at below $1.33 per euro at the end of April. In the year to date, the euro has depreciated by 7.6% against the dollar and by around 5.5% in nominal effective terms against the main currencies.

Finally, the M3 monetary aggregate showed scant dynamism in Q1, posting a year-on-year fall of 0.1% in March, similar to that at end-2009. This performance of the aggregate contrasts with the high buoyancy of its most liquid component (M1 - cash and sight deposits), against a background in which low interest rates drive the shift of M3 assets towards M1.

On QNA estimates, the pace at which GDP had been contracting in year-on-year terms moderated in 2009 Q4, posting a decline of 3.1% which was 0.9 pp lower than in the previous period. The quarter-on-quarter rate remained negative (-0.1%), although the decline was less steep than in Q3. The smaller year-on-year decrease in GDP was due to the slower decline in national demand, while the external sector's contribution to GDP growth remained high. The lower drop in activity fed through into employment which posted a year-on-year fall of 6.1%.

On the available information, in 2010 Q1 the quarter-on-quarter rate of change in GDP turned marginally positive (0.1%) against a background marked by the gradual recovery of the world economy, a slight improvement in agents' confidence and the ongoing effects of certain government measures to support demand. It is estimated that the year-on-year fall in GDP in the early months of 2010 continued to slacken to -1.3%, 1.8 pp down on the decline seen in the closing months of 2009 (see Chart 14). These developments would testify that national demand was gradually performing less unfavourably, although it still fell considerably (-2.6% in year-on-year terms) but less markedly than at end-2009, especially since private consumption progressively picked up. The external sector's contribution to year-on-year GDP growth remained relatively high at 1.4 pp, due to buoyant exports boosted by the improvement in the international climate and the depreciation of the euro.

On the supply side, the year-on-year rate of decline in the market-economy value added moderated substantially in Q1, while available labour market indicators point to an easing of the process of job destruction with a year-on-year fall in employment of approximately 3.7% in comparison with the same period in 2009. Thus, productivity growth is estimated to have weakened, following the strong rises seen throughout 2009. In turn, the growth rate of compensation per employee continued to be restrained which, given productivity developments, allowed corporations' unit labour costs to remain stable. Finally, the year-on-year rate of change in the CPI climbed in the early months of 2010 to reach 1.4% in March as a result of higher energy prices, whereas the rate of change in the CPI excluding energy and unprocessed food prices held close to zero.

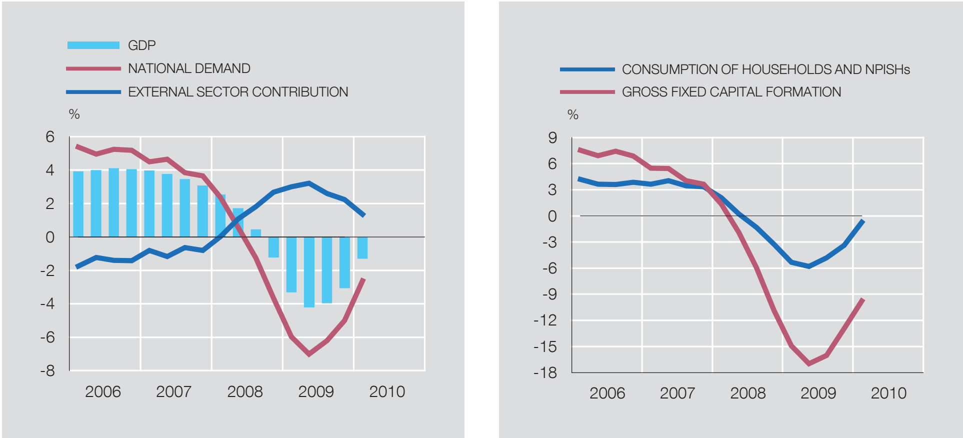
4.1 Demand

In 2010 Q1 the year-on-year rate of decline in household consumption continued to lose momentum after posting, as at end-2009, a positive quarter-on-quarter rate of change. The various available indicators show widespread lower rates of contraction with respect to the same quarter last year (see Chart 15). Confidence indicators rose in quarterly average terms, especially retail trade confidence, while the improvement in consumer confidence centred on January and decreased in the following two months. Among the quantitative indicators, once again worth noting was the sharp year-on-year growth in new car registrations (up 44% in Q1), although, in quarter-on-quarter terms, they were less buoyant than at end-2009. The retail trade index also improved substantially in the quarter, posting its first positive year-on-year growth rate since end-2007.

Although there are still a few months before VAT is increased, it cannot be ruled out that some consumer decisions in the early months of the year (especially decisions to buy durable goods) involved households bringing forward their spending, meaning that the more buoyant consumption seen could be transitory.

In any event, household spending decisions continue to be affected by the labour market deterioration, in terms of current wage income and uncertainty about its future perform-

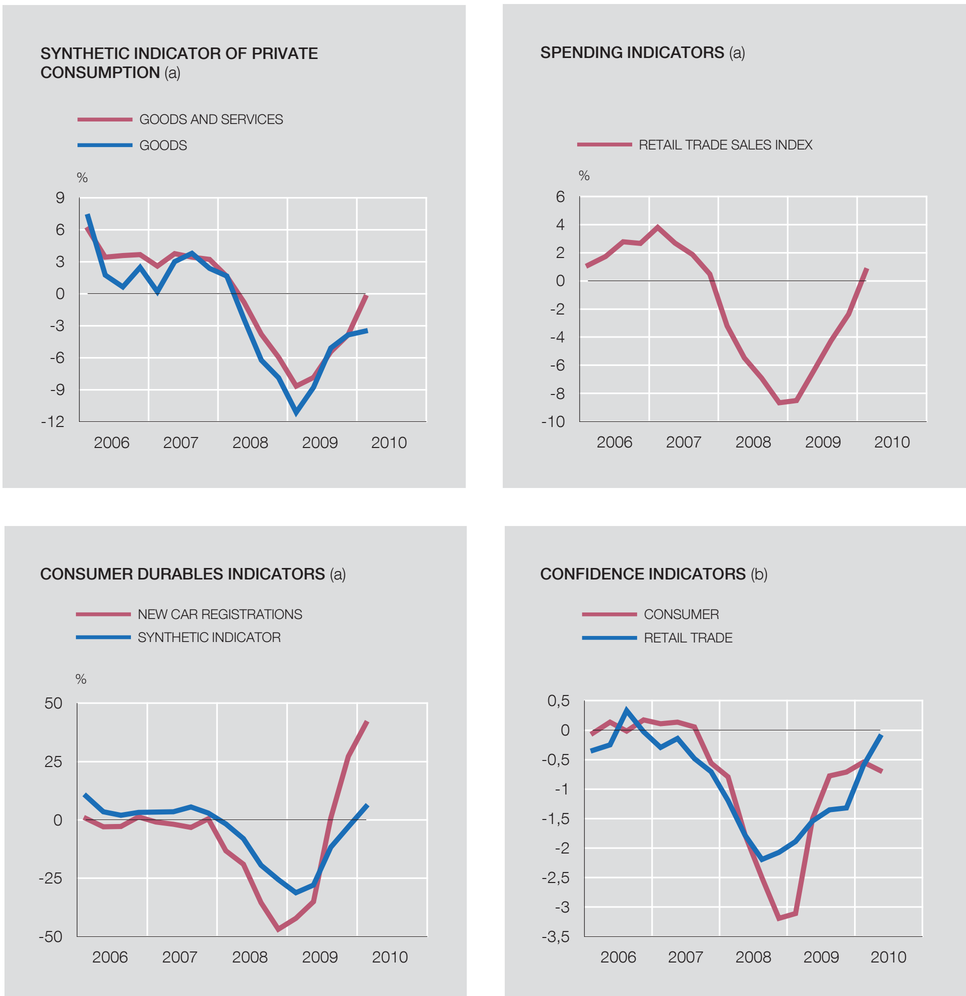
MAIN DEMAND AGGREGATES (a) CHART 14



SOURCES: INE and Banco de España.

a. Year-on-year percentage change based on seasonally adjusted series.

PRIVATE CONSUMPTION INDICATORS CHART 15



SOURCES: INE, European Commission, ANFAC and Banco de España.

a. Year-on-year percentage change based on the seasonally adjusted series.
b. Normalised confidence indicators (difference between the indicator and its mean value, divided by the standard deviation).

ance, in addition to ongoing relatively tight credit standards and the fall in wealth associated with the drop in house prices. Accordingly, on the information of the non-financial accounts of institutional sectors to 2009 Q4, weak consumption triggered a significant rise in the household saving rate in 2009 to 18.8% of gross disposable income, nearly 6 pp higher than in the previous year and very notably above the figures for recent decades. While household spending has seemingly been stronger into 2010, it is expected that the upward path in household saving will be reversed, taking into account, furthermore, that in the context of the fiscal consolidation plan, general government will have to reduce its contribution to sustaining household disposable income. The improvement in consumer and retail trade confidence indicators in April suggests that more buoyant consumption could continue into 2010 Q2.

It is estimated that the year-on-year increase of final general government consumption remained relatively low in 2010 Q1 and was similar to that at end-2009. Based on State budget outturn data, net purchases of goods and services and expenditure on wages and salaries would have contributed to these developments.

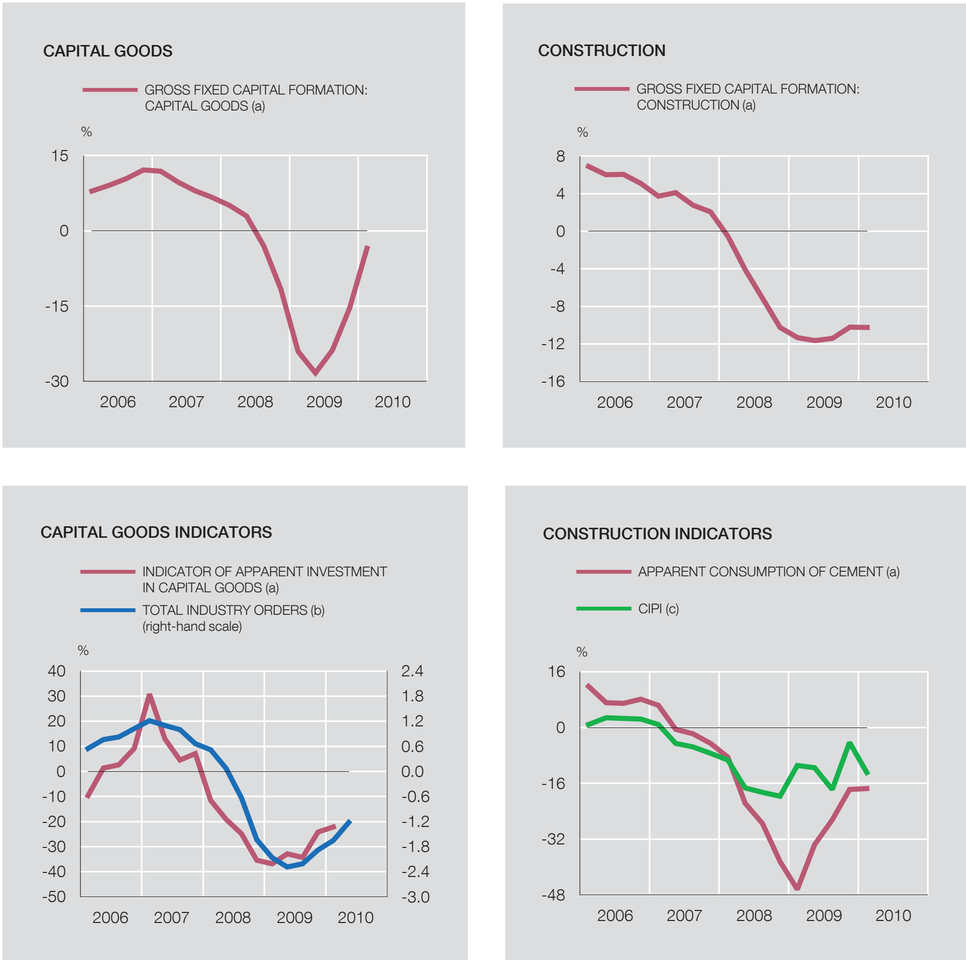
Following the quarter-on-quarter rise seen in investment in capital goods in 2009 H2, the available information suggests that this type of investment fell off slightly in 2010 Q1. Among the quantitative indicators, new commercial vehicle registrations (boosted by the Plan 2000E) once again posted positive rates in the early months of 2010, although they were more moderate than at end-2009. Similarly, the indicator of apparent investment in capital goods, albeit based on incomplete information for the quarter as a whole, points to a year-on-year decline in this spending component. In any event, these developments are consistent with a substantial improvement in year-on-year rates in 2010 Q1 (see Chart 16). Business confidence in this segment of industry rose slightly in Q1, the clearest increase was seen in opinions about the forecast order book. Lastly, capacity utilisation in manufacturing still remained below its long-term average, although in Q2 it rose to 70.9%, 2 pp higher than in Q1.

As in the case of private consumption, some of the investment in capital goods might be indicative of purchase decisions being brought forward, as a result of the public stimulus plans, which would tend to moderate the rise in investment in future quarters. Likewise, it is estimated that uncertainty about the strength of the recovery and continuing tight credit conditions might further check the implementation of new investment projects by non-financial corporations. At the same time, corporations seemed to have restructured their balance sheets slightly with the result that at end-2009 their net borrowing amounted to 2.2% of GDP, more than 5 pp lower than the previous year, and they had net lending capacity in Q4 for the first time in the last five years.

As for investment in construction as a whole, the coincident indicators of employment and inputs for the sector showed smoother rates of decline in year-on-year terms, except for cement consumption. However, in terms of quarter-on-quarter rates, there was a slight decline possibly linked to the completion of the projects related to the Local Investment Fund and pending the start of new projects which will be financed by the State Fund for Employment and Local Sustainability.

In the opening months of 2010, the adjustment of residential investment is expected to have continued intensively, with the stock of housing under construction falling further since the projects completed at the beginning of the year continued to outpace housing starts. These developments reflected, in particular, the performance of open-market housing starts, while the decrease in subsidised housing starts was much more moderate, giving rise to a further increase in the relative weight of this segment in the total. On the de-

GROSS FIXED CAPITAL FORMATION CHART 16



SOURCES: INE, European Commission, Eurostat, OFICEMEN and Banco de España.

a. Year-on-year percentage change based on the seasonally adjusted series.
b. Normalised indicator (difference between the indicator and its mean value, divided by the standard deviation).
c. Construction Industry Production Index (Eurostat). Year-on-year percentage change based on the seasonally adjusted series.

mand side, according to the data on transactions and new mortgages granted, there have been signs in recent months that sales and purchases have stabilised which has meant a return to positive year-on-year growth rates. This picture might be related to the improvement in the affordability indicators due to the cuts in interest rates and in house prices. It is estimated that the fiscal changes already approved (the VAT increase in July 2010) or announced (the partial abolition of house-purchase tax credits in January 2011) could also be encouraging households to bring forward certain spending decisions. According to the figures for new project approvals, both non-residential building and civil engineering works continued to contract in the quarter.

As mentioned above, the latest information available suggests that in 2010 Q1 the contribution of net external demand to year-on-year GDP growth is expected to have remained positive, albeit lower than at end-2009, as a result of progress in exports and imports (see Chart 17). Exports recovered further in Q1, in keeping with the rise in international trade and a slight improvement in price-competitiveness indices, driven by exchange rate depreciation. The quickening of imports is linked to the gradual pick-up seen in final demand, mainly for exports which have a relatively high import content.

FOREIGN TRADE
Percentage change on year ago

CHART 17

SOURCES: INE, Ministerio de Economía y Hacienda and Banco de España.

a. QNA data at constant prices.
b. Deflated seasonally adjusted series.
c. Seasonally adjusted series.

On Customs data, real goods exports were up 13.6% in the first two months of 2010 in comparison with 4.3% in 2009 Q4, with strong rises in sales of non-energy intermediate goods and consumer durables, especially cars, which possibly continued to benefit from the incentives for new car purchases in certain European countries. By geographical area, noteworthy was the rise in sales to non-EU countries which might reflect the greater vigour of certain emerging economies and the depreciation of the euro.

As regards exports of tourist services, available information suggests their year-on-year rate of decline slowed further based on the gradual pick-up in tourists inflows and overnight hotel stays which showed positive year-on-year rates of change in 2010 Q1 (amounting to 0.3% and 3.3%, respectively), although these figures might be biased upwards since this year the Easter holiday straddled March and April. Also, nominal tourist expenditure rose in Q1 to 2.1% according to EGATUR (the tourism spending survey). Similarly, the decline in exports of non-tourist services is estimated to have slackened in Q1 in line with the recovery of the goods trade and passenger traffic.

On the imports side, Customs data showed real growth of 2% in the first two months of the year compared with a decline of 1.7% posted in the closing months of 2009. By product group, imports of non-energy intermediate goods (in principle, those very closely linked to industrial activity and exports) were more vigorous, as were consumer durables other than cars, which could be related to purchases of electrical household appliances due to the digital switchover and ahead of future tax rises. In contrast, car imports fell off significantly. Finally, on balance of payments nominal figures for January and February, the rate of decline of real services imports eased in 2010 Q1, reflecting the less unfavourable trend of the travel heading and of purchases of non-tourist services.

4.2 Production and employment

During 2010 Q1, the gross value added of the total market economy was expected to remain stable with respect to 2009 Q4, after posting declines for seven consecutive quarters. These developments, which represent a significant easing of year-on-year rates of decline extended to most productive sectors (see Chart 18).

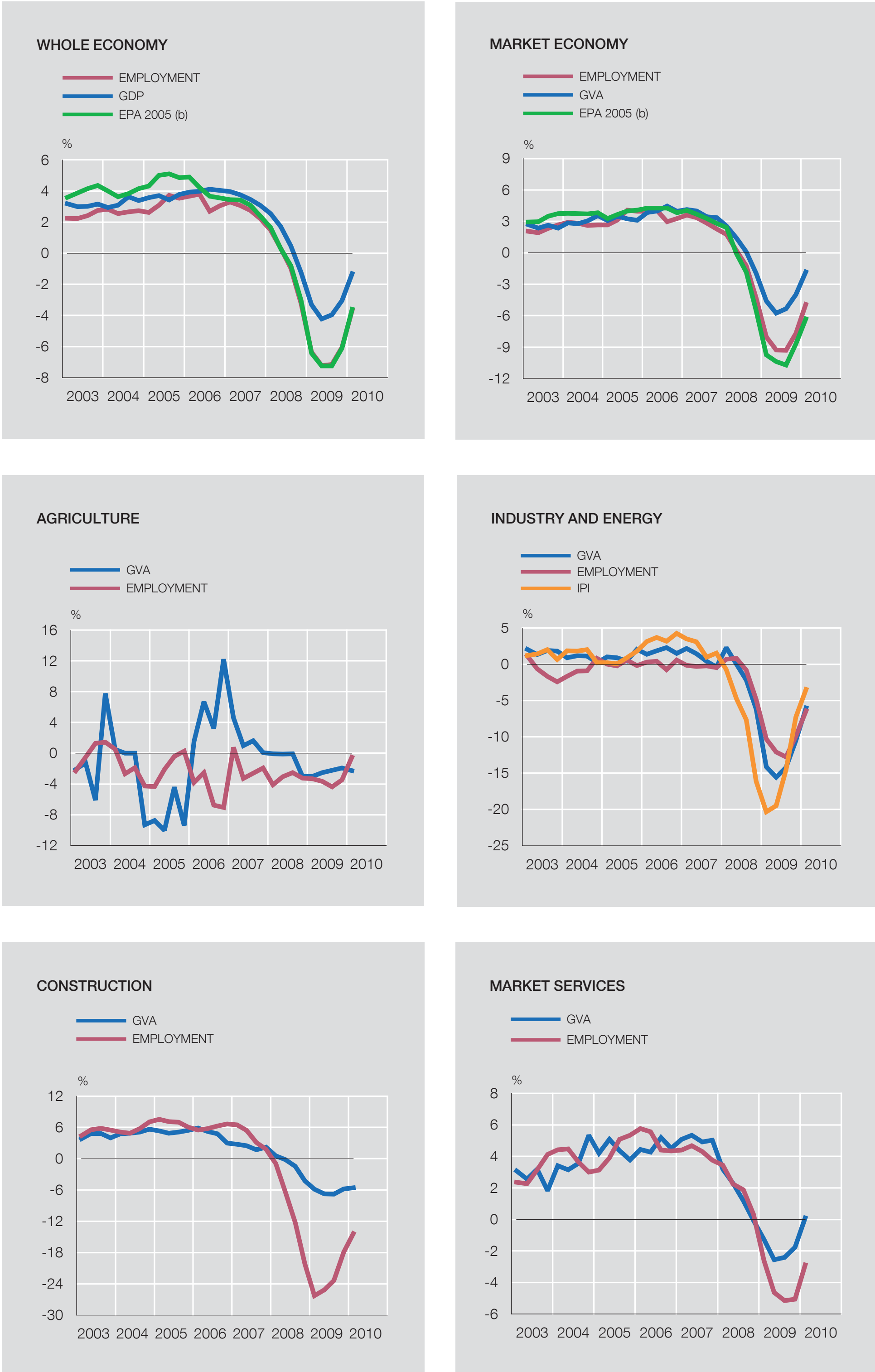
The contraction of value added in industry was expected to continue in year-on-year terms in the January-March period, albeit at a lower rate than that posted at end-2009. The industrial production index (IPI) had a mixed performance in the first two months of 2010, slowing down in January then gaining momentum in February. The year-on-year declines in the labour market indicators also eased throughout Q1. In the same vein, the sector's main opinion-based indicators continued to show signs of improvement: the European Commission's confidence indicator increased four points on average in Q1 with respect to 2009 Q4, while the Purchasing Managers' Index (PMI) also picked up and breached the 50-point level for the first time since November 2007, this level is interpreted as the threshold between expansion and contraction in the sector. In April, the European Commission's survey showed again an increase in industrial confidence of four points with respect to March.

The year-on-year decline in the value added of construction is expected to be very similar to that seen at end-2009, as a result of sluggish residential investment and the completion of projects related to the Local Investment Fund.

Conjunctural information shows a rise in the quarter in market services' activity which is expected to lead to a flat year-on-year rate of change in the value added of this sector in comparison with the declines of previous quarters. Qualitative indicators improved across the board with a two-point increase in average confidence in services in Q1 according to the European Commission's survey and the PMI indicator also rose notably and, as in the case of industry, breached the 50-point level in March. The quantitative indicators such as the turnover index fell less in year-on-year terms in January and February. According to large firms' sales data, the improvement was particularly pronounced in some sectors such as transport and communications, wholesale and retail trade, and accommodation and food service activities, where there were year-on-year increases in activity on data to February. Lastly, employment indicators also showed more moderate year-on-year decreases in average Social Security registrations and the quarter-on-quarter rate of change turned slightly positive in Q1. As for Q2, the services confidence indicator for April is already available and it dropped three points with respect to March.

The various conjunctural labour market indicators suggest that the rate of deterioration of employment was lower in 2010 Q1. Specifically, the average number of Social Security registrations fell by 3% in year-on-year terms, compared with the 4.6% decline in October-December 2009, although in quarter-on-quarter terms employment continued to fall. Following the steep declines in 2009, INEM-registered hires posted a 2% rise in Q1 which was centred on temporary employment.

GROSS VALUE ADDED AND EMPLOYMENT BY BRANCH OF ACTIVITY (a) CHART 18



SOURCES: INE, Ministerio de Fomento and Banco de España.

a. Year-on-year rates based on seasonally adjusted series, except for the EPA which is based on crude series. Employment in terms of full-time equivalent jobs. For incomplete quarters, the year-on-year rate for the period available within the quarter is taken.
b. Series linked by the Banco de España's DG Economics, Statistics and Research on the basis of the control survey conducted using the methodology applied up to 2004 Q4.

EPA figures for Q1 show a 3.6% decline in employment compared with the same period a year earlier, 2.5 pp down on the previous quarter, although in quarter-on-quarter terms there was only a slight easing in the fall in the seasonally adjusted employment figures. This lesser year-on-year decline in employment affected all the market economy branches, especially services, while construction and industry continued to post highly considerable falls. The slowdown in the rate of decline of employment fed through to wage-earners, whose numbers decreased by 3.7% in year-on-year terms, compared with 5% the previous quarter, and to the numbers of self-employed which fell by 3.4%, following rates of decline of more than 10% in recent quarters. By nationality, although employment continued to decrease more among the foreign-nationality group (-4.6%), the differences narrowed with respect to Spanish workers, whose numbers decreased by 3.5%. With regard to contract duration, the year-on-year rate of decline of temporary workers eased again (-7.6%), though labour shedding continued to be higher in this group than among those with permanent contracts (which was down 2.4%, somewhat higher than the decline of 1.3% in the previous quarter). As a result, the proportion of temporary to total employees stood at 24.4%, 1 pp down on a year earlier. Lastly, part-time hires picked up slightly in 2010 Q1 (-1.2%), while full-time employees dropped by 4.4%. As a result of these developments, the part-time employment ratio stood at 13.3% compared with 12.7% a year earlier.

The year-on-year rate of decline in the labour force stabilised in 2010 Q1 at the figure of 0.4% seen at end-2009, checking the progressively slowing path observed throughout 2009. The population aged over 16 showed a slight further deceleration, which increased by 0.1% (against 0.2% the previous quarter) while the participation rate stabilised around the 59.8% mark seen in the two previous quarters. As regards the breakdown by sex, the female labour force grew by 1.4% in Q1 (1% in 2009 Q4), while the male labour force held on a downward path, falling by 1.8% which was slightly higher than the decline recorded three months earlier. In terms of nationality, there was a 1.4% reduction in foreign nationals, for the first time in recent years, as a result of a 0.4% decline in the foreign population in comparison with the same period the previous year. The participation rate of this group, however, rose to 77.3% in 2010 Q1, after posting successive declines in the last three quarters. Spanish nationals continued to show a similar year-on-year decline to that seen the previous quarter (-0.2%) and their participation rate remained stable at 57.4%.

Finally, numbers unemployed increased by around 286,000 in Q1 to 4.6 million. However, the year-on-year increase eased to around 700,000, with the year-on-year rate of change of 15%, below the figure of 35% in the previous quarter. The unemployment rate rose by 1.2 pp during the quarter to 20% of the labour force, although, once again, there was a moderation in its increase in year-on-year terms. Official registered unemployment also showed a slowdown in the increase in numbers unemployed in the opening months of 2010, with a year-on-year rise of 18.5%, following a figure of 29.8% in 2009 Q4.

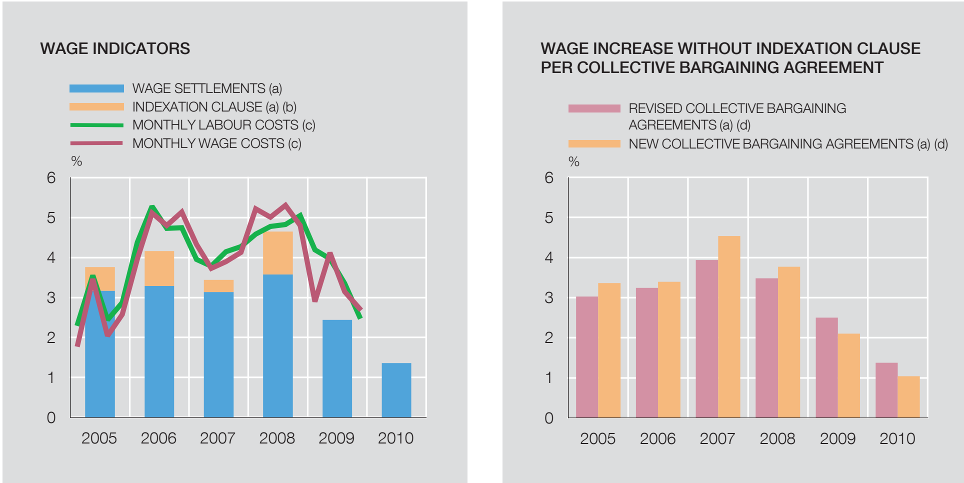
4.3 Costs and prices

There was greater wage restraint in collective bargaining in the early months of 2010 which was encouraged, in particular, by the fall in inflation in the final months of 2009, although the influence of the multi-year agreement signed by social agents last February has begun to be felt. The agreements signed so far this year are nearly all prior years' revised agreements and include a pay rise of 1.4% for 2010, 1 pp below the rise agreed in the previous year (see Chart 19). However, the still-few newly signed agreements include, on average, slightly lower wage rises for 2010 in line with the upper limit of 1% set in the wage agreement signed for 2010-2012.

In terms of compensation per employee, this deceleration in wage rates is expected to contribute to a further slowdown in the increase of firms' labour costs following growth of more

WAGE INDICATORS AND LABOUR COSTS

CHART 19

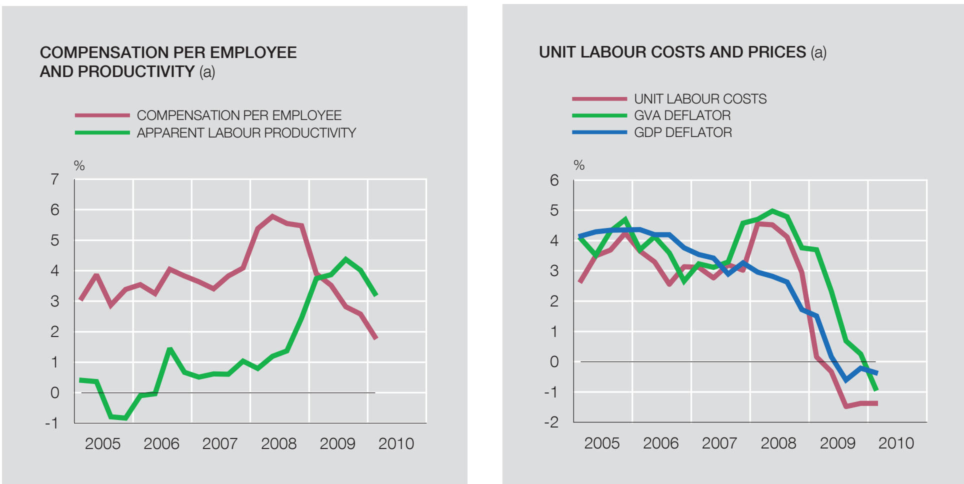


SOURCES: INE and Ministerio de Trabajo e Inmigración.

a. The last year, with information from collective bargaining agreements to March 2010.
b. Previous year's indexation clause.
c. ETCL (quarterly labour costs survey). Year-on-year rates of change.
d. Revised: collective bargaining agreements with economic effects in the year but which were signed in previous years and are in force for more than one year. New: collective bargaining agreements signed and with economic effects in the year, this being the first or only year they are in force.

PRICES AND LABOUR COSTS IN THE MARKET ECONOMY

CHART 20



SOURCES: INE and Banco de España.

a. Year-on-year percentage change based on QNA seasonally adjusted series.

than 3% in 2009 (see Chart 20). Furthermore, productivity growth is expected to keep unit labour costs stable.

Following the fall in the GDP deflator in 2009 H2, 2010 is also expected to have begun with a year-on-year decrease in the domestic component of inflation, with declines in the deflators of the main investment components. The private consumption deflator rose, although this is mainly explained by the increase in import prices.

The main consumer price indicators posted a rise in Q1, thus, in terms of CPI, growth is estimated to have been 1.1% in comparison with 0.1% recorded at end-2009 (see Chart 21).

PRICE INDICATORS (a)
Spain

CHART 21

SOURCE: INE.

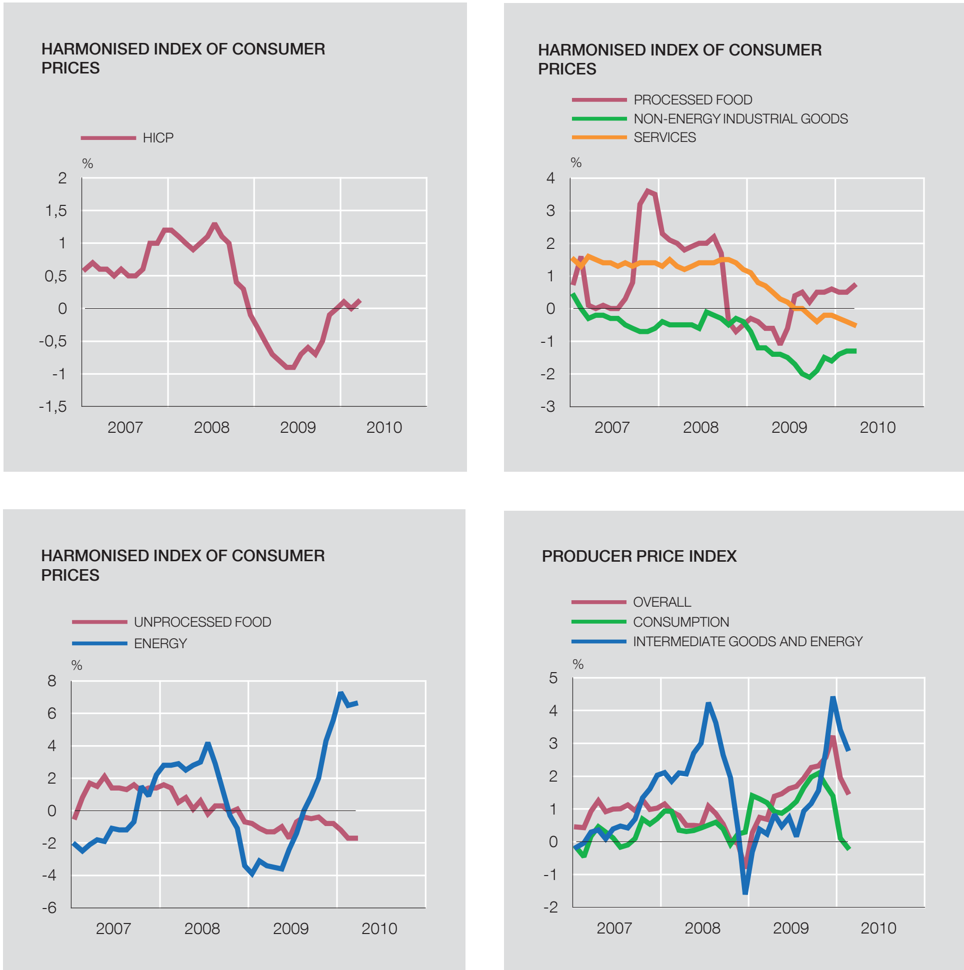
a. Year-on-year rate of change based on the original series.

These developments were mainly in response to the quickening of energy prices following the previous year's decline and the recent rise in oil prices. In general, the downward trends of recent quarters continued in the other components. In particular, the fall in food prices continued to steepen slightly and the year-on-year growth rate of services prices decreased for the sixth consecutive quarter. The rate of decline of non-energy industrial goods prices eased slightly. As a result of the trend of its different components, the CPI excluding unprocessed food and energy posted a year-on-year rate of 0.1% in Q1, 0.1 pp less than in the closing months of 2009).

The rise in HICP inflation was slightly higher in Spain than in the euro area, which meant that the differential was no longer negative (see Chart 22). This was the result of the trend in the energy component, whose differential widened notably in 2010 Q1. By contrast, the growth rates of the prices of services, non-energy industrial goods and unprocessed food were lower in Spain. As a result, the core inflation differential remained favourable for Spain, shedding 0.1 pp to 0.6 pp. The year-on-year rate of the leading indicator of the HICP climbed to 1.6% in April, 0.1 pp higher than in March, while in the euro area inflation also rose to 1.5% with the result that the differential is expected to have remained at around 0.1 pp.

PRICE INDICATORS
Differentials vis-à-vis the euro area (a)

CHART 22



SOURCES: Eurostat and Banco de España.

a. Year-on-year rates based on the original series.

Lastly, the producer price index remained on the rising course begun at the end of 2009 and grew 1.5% in Q1, reflecting higher energy prices and the tailing off of the decline in input prices, while the growth rates for consumer goods prices remained slightly negative. On data to February, producer prices in the euro area grew at a slightly lower rate than those in Spain, except for consumer goods whose differential was close to zero.

Finally, the price indices for imports and exports of industrial products began to post positive rates of change, standing in February at respective rates of 4.7% and 1.7%, mainly due to the strong increase of energy prices.

4.4 *The State budget*

On a cash basis, the State budget outturn in 2010 Q1 showed a deficit of €15,546 million, in comparison with a deficit of €11,345 million for the same period in 2009 (see Table 4). State revenue increased 4.8% in year-on-year terms, which was lower than the rise of 13.5% in expenditure. Although the figures for the early months of the year are usually erratic, these data suggest a quickening of revenue and a slowdown of expenditure in 2010, which should intensify in the coming months due to certain measures approved for this year. These measures include, most notably, the partial abolition of the €400 personal income tax credit, the envisaged increase in VAT rates as from July, the spending cuts in the Immediate Action Plan and the

STATE BUDGET OUTTURN

TABLE 4

€m and %

	Outturn 2009	Percentage change 2009/2008	Initial budget 2010	Percentage change 2010/2009	Outturn 2009 Jan-Mar	Outturn 2010 Jan-Mar	Outturn Percentage change
	1	2	3	4 = 3 / 1	5	6	7 = 6 / 5
1 REVENUE	102,038	-21.1	121,206	18.8	31,269	32,759	4.8
Direct taxes	54,096	-27.0	66,393	22.7	13,594	14,516	6.8
Personal income tax	*30,432*	*-29.9*	*42,633*	*40.1*	*11,678*	*12,924*	*10.7*
Corporate income tax	*20,188*	*-26.1*	*20,184*	*-0.0*	*1,023*	*693*	*-32.2*
Other (a)	*3,476*	*2.8*	*3,576*	*2.9*	*894*	*899*	*0.5*
Indirect taxes	28,664	-26.9	40,736	42.1	12,567	14,314	13.9
VAT	*15,784*	*-36.7*	*26,111*	*65.4*	*9,559*	*11,311*	*18.3*
Excise duties	*10,141*	*-9.6*	*11,964*	*18.0*	*2,304*	*2,292*	*-0.5*
Other (b)	*2,739*	*-11.2*	*2,661*	*-2.9*	*703*	*712*	*1.2*
Other net revenue	19,277	20.4	14,076	-27.0	5,108	3,929	-23.1
2 EXPENDITURE	189,319	27.8	184,542	-2.5	42,614	48,305	13.4
Wages and salaries	26,570	5.3	27,572	3.8	5,635	6,017	6.8
Goods and services	4,860	7.2	3,515	-27.7	903	954	5.7
Interest payments	17,650	10.8	23,224	31.6	6,151	7,579	23.2
Current transfers	112,412	35.8	103,137	-8.3	22,144	26,348	19.0
Investment	10,468	-1.6	9,390	-10.3	2,785	2,883	3.5
Capital transfers	17,360	94.1	14,452	-16.7	4,997	4,522	-9.5
3 CASH-BASIS BALANCE (3 = 1 – 2)	-87,281	—	-63,336	—	-11,345	-15,546	—
MEMORANDUM ITEM: TOTAL TAXES (State plus share of regional and local governments)							
Personal income tax	63,857	-10.5	65,734	2.9	19,002	19,212	1.1
VAT	33,573	-30.1	29,281	-12.8	14,274	14,584	2.2
Excise duties	19,349	-1.1	20,450	5.7	4,546	4,655	2.4

SOURCE: Ministerio de Economía y Hacienda.

a. Includes revenue from the tax on the income of non-residents.
b. Includes taxes on insurance premiums and tariffs.

lower amount of the State Fund for Employment and Local Sustainability in 2010 compared with the Local Investment Fund approved in 2009.

For a more detailed analysis of changes in revenue, information is available on total takings from the main taxes, both in the portion assigned to the State and in that relating to the ordinary-regime regional governments. According to this information, receipts had still not posted positive rates and fell 1.9% in Q1 as a result of weak non-tax revenue, while the main taxes began to show year-on-year increases. Thus, direct taxes began to feel the impact of the partial abolition of the €400 tax credit under personal income tax, although this revenue was weighed down by sluggish withholdings from movable capital and investment fund gains. As for indirect taxes, noteworthy was the recovery of VAT revenue which posted positive rates of 2.2% following eight consecutive months of declines. Excise duties posted an increase of 2.4% due to the impact of the rate rise that was implemented in June 2009.

State cash-basis expenditure climbed 13.4% in Q1, also in this case because some of the measures approved have not had time to affect expenditure. Interest payments posted a strong rise, reflecting the high volume of debt issued last year.

BALANCE OF PAYMENTS: MAIN COMPONENTS (a) TABLE 5

€m

		January-February		% change 2010/2009 (b)
		2009	2010	
CREDITS	Current account	45,487	46,020	1.2
	Goods	*23,858*	*26,444*	*10.8*
	Services	*12,920*	*12,399*	*-4.0*
	— Tourism	4,589	4,520	-1.5
	— Other services	8,331	7,879	-5.4
	Income	*6,129*	*5,058*	*-17.5*
	Current transfers	*2,579*	*2,118*	*-17.9*
	Capital account	799	1,688	111.2
	Current + capital accounts	46,286	47,708	3.1
DEBITS	Current account	60,916	59,125	-2.9
	Goods	*33,303*	*33,631*	*1.0*
	Services	*10,256*	*9,710*	*-5.3*
	— Tourism	1,799	1,765	-1.9
	— Other services	8,457	7,946	-6.0
	Income	*12,424*	*9,650*	*-22.3*
	Current transfers	*4,933*	*6,133*	*24.3*
	Capital account	210	222	5.8
	Current + capital accounts	61,125	59,347	-2.9
BALANCES	Current account	-15,429	-13,105	2,324
	Goods	*-9,445*	*-7,188*	*2,257*
	Services	*2,664*	*2,689*	*25*
	— Tourism	2,790	2,755	-35
	— Other services	-126	-66	59
	Income	*-6,295*	*-4,592*	*1,704*
	Current transfers	*-2,353*	*-4,015*	*-1,661*
	Capital account	590	1,466	877
	Current + capital accounts	-14,839	-11,639	3,201

SOURCE: Banco de España.

a. Provisional data.
b. Absolute changes for balances.

As for the Social Security budget outturn, complete data are only available until February 2010. On the latest information released by the Social Security Treasury for February, revenue is estimated to have fallen by 0.9% and expenditure is estimated to have increased by 5.1%. The decrease in revenue was due to the fall in transfers from the State and in transfers of other revenue since revenue relating to Social Security contributions, the largest item, is estimated to have risen 0.9%. The drop in the number of social security contributors gradually slowed down during 2010 Q1, posting a decline of 2.6% at end-March, compared with a fall of approximately 4% in December 2009. Spending on contributory pensions increased 5.6% to February, somewhat lower than the increases seen throughout 2009, while the number of contributory pensions grew 1.7% in the same month of 2010 in line with the rises recorded in the last twelve months. On data of the National Public Employment Service (SPEE, by its Spanish abbreviation), expenditure on unemployment benefits slowed notably during 2010 Q1, posting an increase of 16% to March, in contrast with increases of more than 50% in the closing months of 2009. This slowdown reflects the changes in registered unemployment and the numbers drawing unemployment benefit. In particular, the rate of change in beneficiaries stood at 26.8% in February, compared with an average increase of

55.6% in 2009, the eligibility ratio remained slightly higher than 80% during the first two months of the year.

4.5 Balance of payments

In the first two months of 2010, the combined current and capital account balance was a deficit of €11,639 million, 22% lower than in the same period a year earlier (see Table 5). Most of this correction is explained by the 15% decrease in the current account deficit. This adjustment is accounted for by the decrease in the goods and, to a lesser degree, income deficits, which offset the widening of the negative current transfers balance. The surplus on the services balance remained practically stable.

In the first two months of 2010 the trade deficit fell by 24% due to the improvement in the non-energy balance which offset the increase in the energy bill against a background of sharp rises in oil prices. The services balance showed a surplus of €2,689 million in January and February, hardly 1% up on the same period in 2009. This modest improvement is explained by the correction of the non-tourism services deficit which offset the slight decrease in the tourism surplus. The deficit on the income balance narrowed notably in the first two months of 2010 to €4,592 million. The current transfers deficit amounted to €4,015 million in the first two months of 2010, as a result of the 18% decline in revenue related to EU funds. By contrast, payments rose noticeably, although migrants' remittances decreased. Finally, in the first two months of 2010 the capital account surplus rose to €1,466 million owing to the increase in general government receipts from the Cohesion Funds.

5 Financial developments

5.1 Overview

In 2010 Q1 and Q2 to date, Spanish financial markets have been influenced by the episodes of tension linked to participants' concern about the sustainability of Greek government debt, which affected to a greater degree those euro area countries whose public finances had deteriorated most. This tension eased somewhat from mid-February, coinciding with the announcement of fiscal consolidation plans in Greece but it resurfaced at the end of April. Thus, on 30 April the IBEX 35 was 12.1% down on its level at the beginning of the year, performing more unfavourably than the EUROSTOXX 50 for the euro area (which slipped 5% on the same day) and than the S&P 500 which gained 6.4% (see Chart 23). The yield on Spanish ten-year government debt, whose long-term credit rating was downgraded on 28 April by S&P from AA+ to AA, scarcely rose by 3 bp over this period, nevertheless, its spread over the German bund at the same term widened by almost 40 bp (to nearly 100 bp) as a result of price developments in the latter. The credit risk premia of Spanish corporations traded on derivatives markets followed a similar trajectory but the cost of insuring the assets issued by financial institutions was higher. On the interbank market, interest rates showed little movement, with the 12-month EURIBOR averaging 2 bp less than the figure for December (1.24%).

On the real estate market, the price of unsubsidised housing continued to fall in 2010 Q1, according to the latest Ministry of Housing data, although once again at a slower year-on-year pace than three months earlier. Thus, the year-on-year rate of decline stood at 4.7% in March compared with the fall of 6.3% in December 2009.

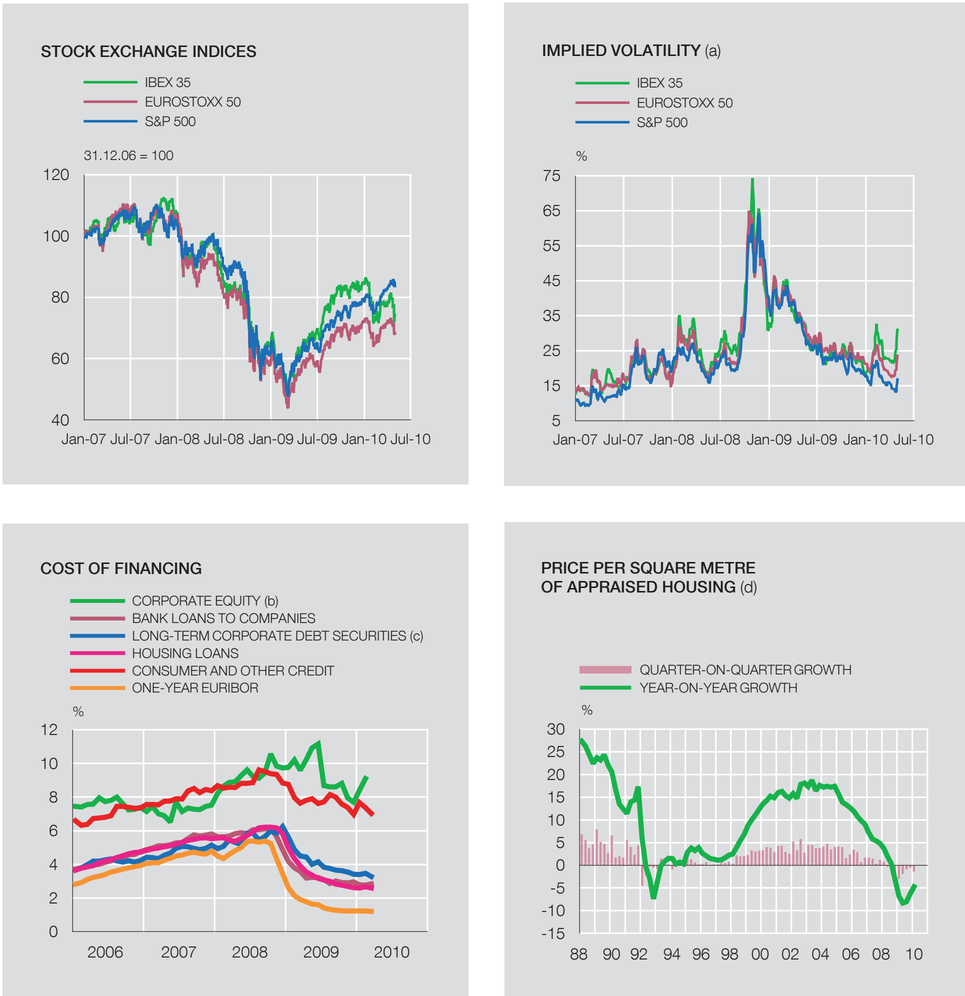
During the opening months of 2010 the cost of borrowing for households and firms did not show, in general, any substantial changes compared with the average for 2009 Q4 (see Chart 23). Conditions other than interest rates did not change significantly either. Thus, according to the April Bank Lending Survey (BLS) financial institutions were expected to have maintained (and even slightly relaxed) their lending standards for new loans between January and March, a trend that the intermediaries surveyed expected would continue into 2010 Q2.[1] Nevertheless, these standards are seemingly still more restrictive than at the onset of the financial crisis, as a result of the tightening accumulated in the preceding period.

The latest data available on credit to the private sector (relating to February) show stable household credit balances (the year-on-year rate rose slightly from -0.3% in December to 0.1%). By contrast, corporate debt continued to contract at an increasingly sharp rate in year-on-year terms (by 1.8% in February in comparison with the decline of 0.9% two months earlier). In annualised quarter-on-quarter terms, the differences in the rates of increase in these sectors' borrowed funds are even more pronounced. The breakdown of corporate borrowing shows that the various instruments, sectors and sizes of firm performed differently (see Box 4). In particular, the credit received from resident institutions has continued to fall in recent months (by -4.3% in year-on-year terms), while debt securities issued, access to which is essentially available only to large corporations, continued to expand notably (29%). The latest information, relating to end-2009, on the breakdown by type of lending by resident institutions, shows declines in all productive branches, except in real estate services where bank credit was still increasing at a positive, albeit very low rate of 1.7%. This is partly explained by the fact that, against a background of less buoyant house sales, funds remain on real estate service firms'

1. For more details, see the article entitled "Encuesta sobre Préstamos Bancarios en España: abril de 2010", by Jorge Martínez Pagés, in the Banco de España's *Boletín Económico,* April 2010.

FINANCING CONDITIONS AND ASSET PRICES

CHART 23



SOURCES: Bloomberg, Credit Trade, Datastream, MSCI Blue Book, Ministerio de Vivienda and Banco de España.

a. Five-day moving averages.
b. The cost of equity is based on the three-stage Gordon dividend discount model.
c. The cost of long-term debt is proxied as the sum of the 5-year euro swap rate and a weighted average of the 5-year CDS premia for Spanish non-financial corporations.
d. Base 2001 to December 2004; base 2005 thereafter.

balance sheets for a longer period. The provisional data for March do not show any significant changes in household and corporate debt in comparison with the preceding month.

Sluggish household credit combined with income stability, meant that in 2009 Q4 this sector's ratio of debt to gross disposable income (GDI) was virtually unchanged. However, the debt burden ratio continued to decline due to the lower average costs of financing the outstanding debt. These developments were accompanied by fresh increases in the sector's savings rate and net lending capacity. Lastly, household net wealth remained relatively stable, as the recovery in the financial component was offset by the drop in the real estate component. The preliminary estimates for the opening months of 2010 suggest that the debt burden ratio will continue to decline and the debt ratio will remain the same.

During 2009 Q4 the corporate debt/income ratio continued to increase despite the contraction of debt which is indicative of the unfavourable performance of corporate surpluses. However, the debt burden ratio fell again as a result of the decline in the average cost of outstanding

Since mid-2007, lending to Spanish non-financial corporations has slowed down very notably, posting negative year-on-year rates of change in the closing months of 2009 and the opening months of 2010. However, behind this general pattern there is great variety in terms of instruments, productive sectors and borrower size.

Thus, firstly, by instrument, while the credit extended by Spanish banks slowed down more sharply than overall lending to the sector, credit from the rest of the world decelerated to a much lower degree – and still posted positive year-on-year growth at end-2009. Additionally, issuance of fixed-income securities slowed initially until end-2008 and subsequently recovered high growth rates (see accompanying table). Higher recourse to securities markets – and, to a lesser degree, also to credit from abroad – is very closely related to the activity of a small number of large Spanish multinational groups which regularly use this type of financing. Just four entities were responsible for more than 70% of net issuance in the last three years. The international reach of these corporations means that their business performance is influenced less by the economic cycle in Spain. In fact, some of these groups expanded in 2009 which helps to explain the growth of security issuance. Similarly, the relatively favourable financing conditions on these markets – due to the fact that, although risk premia have not returned to pre-crisis levels, they did fall notably during the recent period and benchmark interest rates remained very low – contributed to an increase in the volume of funds raised by some of these groups, in anticipation of future funding requirements. In any event, it cannot be completely ruled out that corporations have also replaced bank credit by market financing to a certain degree.

For the other non-financial companies, the main source of funds is credit from resident institutions which has been less buoyant. This credit also varies significantly from one productive sector to another: in 2009 credit earmarked for real estate services increased slightly; in the construction and agriculture and fishing sectors there were high year-on-year rates of decline; meantime, other sectors recorded moderate falls (see accompanying table). Although the declines in credit and the drop in the volume of activity are slightly interconnected, this relationship is not uniform, as shown particularly by the case of property development companies. Sustained lending to this sector could be partly explained, in the current context of sharp adjustment in production, by the lower pace of property sales which means that the related financing has to be maintained for a longer period.

One final important dimension is borrower size. The information available (both from the Central Credit Register and statistics on new loans to firms) indicates that funds granted to small and medium-sized enterprises (SMEs) were less buoyant compared with new lending to large corporations. Nevertheless, as seen in Panel 1, this pattern is not found in the construction and real estate services sectors. If the category of firms with debt of less than €1 million is excluded (this category generally performs atypically since it includes most of the new debtors recorded in the Central Credit Register), there was a substantial cut in lending in construction, affecting all firm sizes (proxied by the outstanding balance of bank credit), while in real estate services credit fell, year-on-year, in terms of loans to companies with a higher volume of debt, and yet increased among other firms. Therefore, it is in the other productive sectors where the more contractionary performance of lending to SMEs can be clearly seen, at the same time as the positive growth of funds granted to companies with a higher level of bank liabilities has continued.

There are undoubtedly several factors behind this difference in terms of size. An important component is the borrowers' financial position. Panel 2 shows that the pre-crisis debt levels of SMEs in the other productive sectors were significantly higher than those of the large corporations, which is indicative of the former's greater financial vulnerability. Likewise, the impact of the crisis on small companies also seems to be stronger and, as shown in Panel 3, the fall in their profits in 2008 was higher. The information available for 2009 (for example, such as the results of Spanish firms in the ECB survey on access to finance) suggests that this situation continued throughout that year. In this setting, it should be no surprise that the doubtful assets ratio has risen more among SMEs in sectors other than construction and real estate services (see Chart 4) than among large firms. By contrast, in the two branches mentioned both the initial situation and the recent performance of profits suggest that the financial position of larger corporations is more delicate, which would help to explain the different behaviour of credit in these sectors.

The more negative profit performance by SMEs in sectors other than construction and real estate services and their more difficult financial situation is estimated to have contributed to depressing their demand for funds to a greater degree than for larger corporations, since SMEs' spending plans have been revised downwards, at the same time as their solvency, as seen by financial institutions, is expected to have deteriorated more in comparative terms. In fact, the findings of the ECB survey of SMEs (see Panel 5) show a high correlation between, on the one hand, the percentage of rejection of bank loan applications and the changes perceived by firms in loan availability and, on the other, their financial performance.

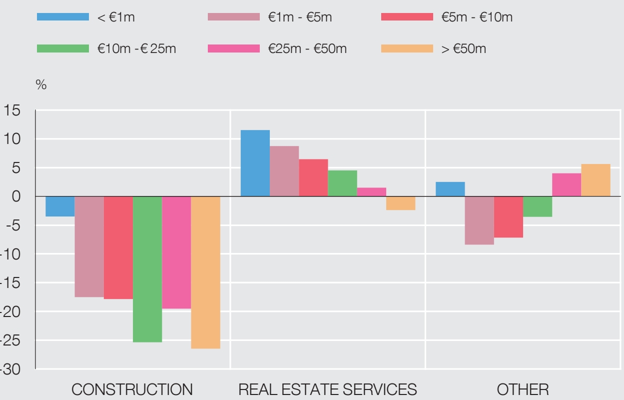
Furthermore, it is possible that, taking into account the generally riskier nature of bank loans to SMEs and the lower collateral usually provided by them, against a backdrop of a general repricing of risk worldwide following the financial crisis, institutions have tightened more than proportionally the lending standards for this type of companies, whose individual solvency is always more complicated to assess.

BREAKDOWN OF LENDING TO NON-FINANCIAL CORPORATIONS

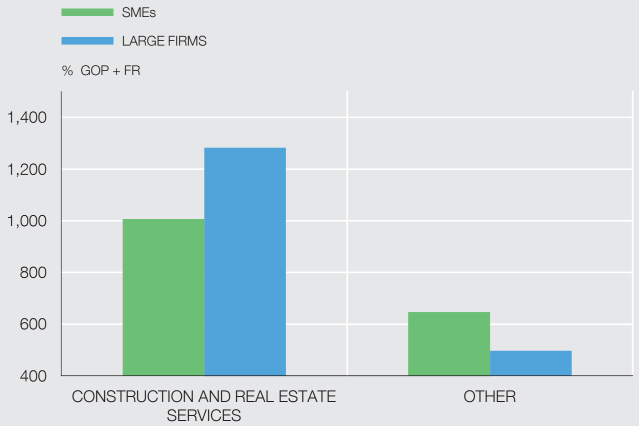
%

	YEAR-ON-YEAR RATE OF CHANGE	RELATIVE WEIGHT
TOTAL BORROWING	-1.0	100.0
Credit from resident banks	-3.5	70.1
Credit from rest of the world	1.9	25.6
Securities	37.0	4.3
BREAKDOWN OF CREDIT FROM RESIDENT BANKS BY SECTOR		100.0
Agriculture and fishing	-11.9	2.3
Construction	-14.1	13.2
Industry except for construction	-2.5	15.4
Real estate services	1.7	32.6
Other services	-0.7	36.5

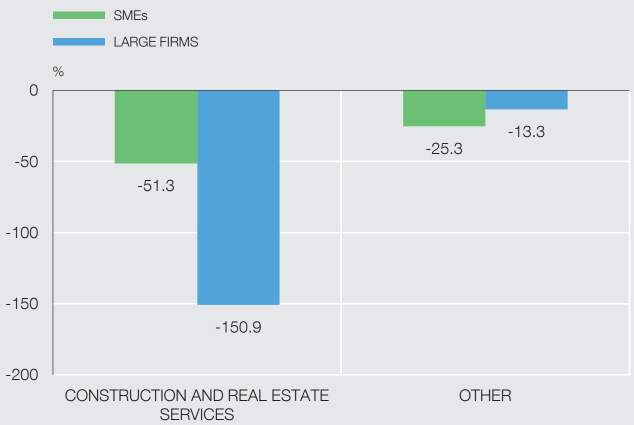
1 BREAKDOWN OF CREDIT BY BORROWER SIZE (a)
Year-on-year rate of change. December 2009



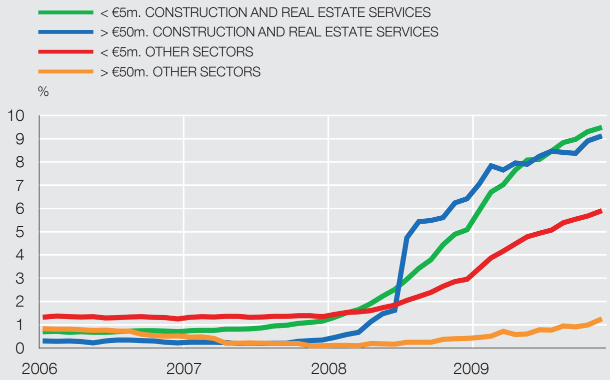
2 LEVEL OF DEBT BY SIZE AND SECTOR. 2007



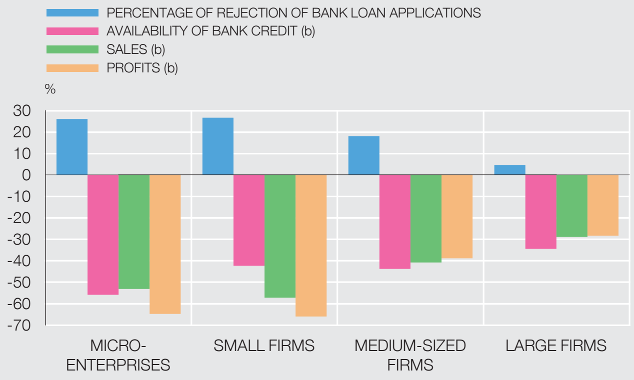
3 GROWTH OF ORDINARY NET PROFIT BY SIZE AND SECTOR



4 DOUBTFUL ASSETS RATIO BY SIZE AND SECTOR



5 RESULTS OF SPANISH FIRMS IN THE SURVEY ON SMEs' ACCESS TO FINANCING IN THE EURO AREA. 2009 H2



SOURCES: Banco de España and European Central Bank.

a. Proxied by data from the Central Credit Register. Firms are classified by size according to the total volume of their debt recorded in the Central Credit Register as of December 2008. The new debtors which appeared in 2009 are classified according to their total debt level at end-2009.
b. Percentage of respondents which indicates an increase less the percentage of those which indicated a decrease.

NET FINANCIAL TRANSACTIONS
Four-quarter data

TABLE 6

% GDP					2008	2009			
	2004	2005	2006	2007	Q4	Q1	Q2	Q3	Q4
National economy	-4.8	-6.5	-8.4	-9.6	-9.1	-8.1	-6.9	-5.8	-4.7
Non-financial corporations and households and NPISHs	-5.1	-8.4	-11.1	-13.5	-7.0	-4.4	-0.5	2.4	4.9
Non-financial corporations	*-4.5*	*-7.1*	*-9.5*	*-11.6*	*-7.2*	*-6.6*	*-4.6*	*-2.3*	*-0.5*
Households and NPISHs	*-0.6*	*-1.3*	*-1.7*	*-1.9*	*0.2*	*2.2*	*4.1*	*4.7*	*5.4*
Financial institutions	0.6	0.9	0.7	2.1	2.0	2.0	1.9	1.7	1.6
General government	-0.4	1.0	2.0	1.9	-4.1	-5.8	-8.4	-9.9	-11.2
MEMORANDUM ITEM:									
Financing gap of non-financial corporations (a)	-8.7	-11.4	-17.8	-15.9	-10.9	-9.6	-6.7	-3.5	-1.0

SOURCE: Banco de España.

a. Financial resources that cover the gap between expanded gross capital formation (real investment and permanent financial investment) and gross saving.

debt, which was accompanied by the sector's lower net borrowing. The provisional data relating to the early months of 2010 point to a stabilisation of the debt ratio and to fresh declines in the debt burden ratio.

The data, relating to 2009 Q4, on firms contributing to the Central Balance Sheet Data Office Quarterly Survey (CBQ) show that there was a slight recovery in the income generated by these firms, which are predominantly large corporations. Ordinary net profit fell in the year as a whole at a lower rate than in the previous year. The rate of decline in corporate surpluses also eased but to a lesser degree than the fall in borrowed funds and, consequently, both the debt ratio, particularly in the case of the large corporations, and the debt burden ratio decreased. As a result of all the above, the indicators of financial pressure on investment and employment fell somewhat, checking the upward trend in recent months, although they remain high from a historical perspective.

The volume of doubtful loans has also begun to show signs of lower growth in line with the trend towards a stabilisation of the degree of financial pressure. However, the doubtful assets ratio continued to climb. Specifically, this indicator for the whole of the other resident sectors (which include, in addition to households and firms, financial intermediaries other than credit institutions) stood at 5.4% in February, 0.3 pp higher than the December figure.

As for general government, the rate of expansion of debt remained very high, albeit more moderate than in previous months (24% in February 2010 compared with 35% in October 2009). This, together with the decline in GDP, has continued to be reflected in rises in the debt-to-GDP ratio (which reached 53% of GDP at end-2009), and in an increase, albeit more moderate, in the associated debt burden.

The latest Financial Accounts data, corresponding to end-2009, reflect a further decline in the nation's net borrowing, down to 4.7% of GDP in cumulative 12-month terms (1.1 pp below the September level; see Table 6). Once again, this was the result of the increased net lending capacity both of households and non-financial corporations, which was partially offset by the rise in the general government deficit (which stood at 11.2% of GDP) and the marginal decline in financial institutions' savings. In line with the rise in the government deficit, the bulk of the funds raised abroad was channelled through government debt securities bought by the rest of the world.

In short, the most recent information suggests that indicators of financial pressure on the private sector have stabilised slightly, it is estimated that this has been favoured by the lower cost of borrowing, flagging borrowed funds and the performance of GDP. However, household and corporate debt ratios remained high. As for general government, although the rise in liabilities eased, they continued to grow at a high rate.

5.2 Households

The most recent information on interest rates on new loans for households, relating to March, shows that they remained virtually unchanged in comparison with the December figures (down by hardly 2 bp in the case of home loans and up by only 6 bp in the case of consumer and other loans). Similarly, according to the BLS, financial institutions are estimated to have maintained (and even relaxed) lending standards, a trend which they projected would continue in Q2.

In this setting, household debt is estimated to have remained stable during the opening months of 2010, with a year-on-year growth rate of hardly 0.1% in February, in comparison with a rate of decline of 0.3% in December. The breakdown by type of loan shows that, while home loans grew in December by around 0.5% in comparison with the same period in 2009, funds earmarked for consumption and other purposes continued to contract by close to 1%. The quarter-on-quarter seasonally adjusted rates posted slightly higher values for home loans and similar values for loans for other purposes.

As for portfolio decisions, according to the latest Financial Accounts data for 2009 Q4, during the final stretch of the year household investment in financial assets continued to pick up (see Box 7). Thus, in cumulative year-on-year terms, the funds earmarked for these purposes accounted for 4.2% of GDP, up 0.7 pp on their level in September 2009. These flows were invested mainly in holdings of cash and cash equivalents (4% of GDP, up 0.7 pp on three months earlier), at the same time as the relative share of flows invested in shares and insurance technical reserves increased, respectively, to 1% and 0.9% of GDP. Likewise, net purchases of mutual fund shares turned positive again, while investment in time deposits (included in the heading "Other deposits and fixed-income securities") was negative.

Given the stability of credit and income, the household debt ratio remained in 2009 Q4 at around 125% of household gross disposable income - GDI - (see Chart 24). Conversely, the debt burden ratio declined once again to values close to 17% of GDI, due to the fall-off in the average cost of on-balance sheet liabilities. The sharp fall in consumer spending together with the downward stickiness of income (partly linked to the easing of debt servicing obligations) resulted in an increase in the sector's ability to save, net of the expenses associated with their liabilities. Meanwhile, household net wealth hardly changed since the decline in the real estate component, associated with the fall in house prices, was broadly offset by the recovery in the value of net financial assets.

On the latest data for 2009 Q4, the household doubtful assets ratio stabilised to some extent, due apparently to the moderation of the debt burden and the slowdown in the pace of job destruction. Thus, this indicator fell by 0.1 pp in the case of house purchase and refurbishment loans (from 3% in September to 2.9% in December) and by 0.2 pp in the case of consumer and other loans (from 7.1% to 6.9%).

FINANCIAL TRANSACTIONS OF HOUSEHOLDS, NPISHs AND NON-FINANCIAL CORPORATIONS
Four-quarter data

TABLE 7

% GDP	2006	2007	2008	2009		
				Q2	Q3	Q4
HOUSEHOLDS AND NPISHs:						
Financial transactions (assets)	10.9	7.1	2.8	2.9	3.5	4.2
Cash and cash equivalents	3.1	-1.0	-0.4	2.5	3.3	4.0
Other deposits and fixed-income securities (a)	5.9	7.5	6.8	1.8	0.3	-1.3
Shares and other equity (b)	-1.2	0.4	-0.1	0.5	0.7	1.0
Mutual funds	0.2	-1.1	-3.4	-1.9	-0.7	0.0
Insurance technical reserves	1.8	0.9	0.2	0.3	0.4	0.9
Of which:						
Life assurance	*0.6*	*0.2*	*-0.2*	*0.0*	*0.1*	*0.6*
Retirement	*1.0*	*0.4*	*0.3*	*0.3*	*0.3*	*0.3*
Other	1.0	0.4	-0.3	-0.3	-0.6	-0.4
Financial transactions (liabilities)	12.6	9.0	2.5	-1.2	-1.2	-1.2
Credit from resident financial institutions (c)	13.0	9.4	3.4	0.1	-0.3	-0.5
House purchase credit (c)	*10.0*	*7.1*	*2.7*	*0.7*	*0.2*	*0.1*
Consumer and other credit (c)	*3.0*	*2.1*	*0.8*	*-0.3*	*-0.2*	*-0.4*
Other	-0.4	-0.4	-0.9	-1.3	-0.9	-0.7
NON-FINANCIAL CORPORATIONS:						
Financial transactions (assets)	23.7	13.6	4.9	-2.1	-5.2	-6.5
Cash and cash equivalents	2.3	-0.4	-1.1	-0.9	-0.8	-0.1
Other deposits and fixed-income securities (a)	2.3	2.1	2.3	-0.1	0.1	-0.6
Shares and other equity	11.4	7.9	3.0	1.9	0.7	-0.5
Of which:						
Vis-à-vis the rest of the world	*8.3*	*6.6*	*3.3*	*1.6*	*1.2*	*0.1*
Trade and intercompany credit	6.9	2.5	0.1	-3.8	-5.3	-5.8
Other	0.9	1.5	0.6	0.8	0.0	0.6
Financial transactions (liabilities)	33.2	25.3	12.2	2.4	-2.9	-6.0
Credit from resident financial institutions (c)	17.6	13.9	5.5	1.2	-1.6	-3.0
Foreign loans	3.3	2.8	2.8	2.9	1.8	0.6
Fixed-income securities (d)	1.8	0.5	0.3	0.3	0.9	1.3
Shares and other equity	2.9	4.8	2.6	1.8	1.1	1.3
Trade and intercompany credit	7.0	3.6	-0.4	-4.2	-5.7	-6.2
Other	0.7	-0.4	1.3	0.4	0.5	0.0
MEMORANDUM ITEM: YEAR-ON-YEAR GROWTH RATES (%):						
Financing (e)	24.2	15.5	6.4	2.4	0.5	-0.7
Households and NPISHs	19.6	12.5	4.4	0.5	-0.1	-0.3
Non-financial corporations	27.9	17.7	7.9	3.7	0.8	-0.9

SOURCE: Banco de España.

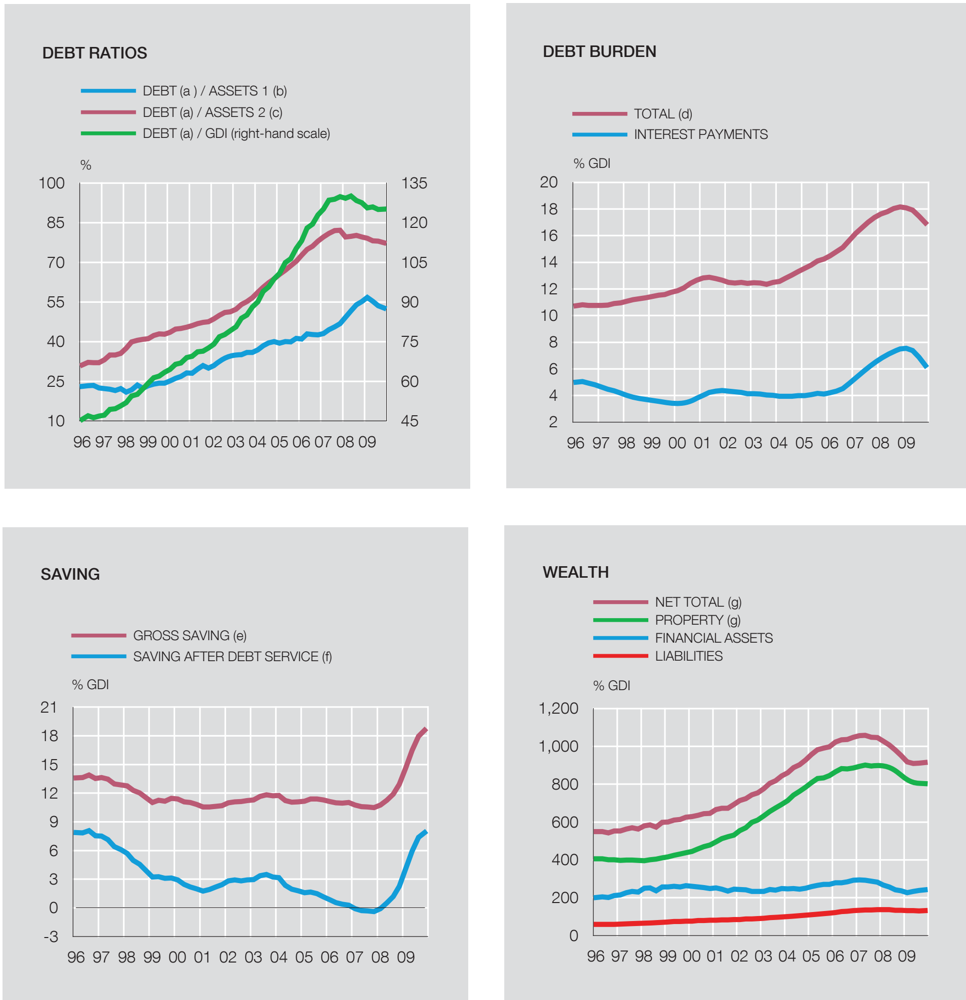
a. Not including unpaid accrued interest, which is included under "Other".
b. Excluding mutual funds.
c. Including off-balance sheet securitised loans.
d. Including issues of resident financial subsidiaries.
e. Defined as the sum of bank credit extended by resident credit institutions, foreign loans, fixed-income securities and financing through securitisation special purpose entities.

5.3 Non-financial corporations

In 2010 Q1, borrowing costs for firms varied according to the type of liability concerned. Therefore, interest rates on new loans of less than €1 million to corporations fell by hardly 4 bp to 4.21%, while those on loans of over €1 million declined by 23 bp to 2.24%. However, it should be taken into account that the latter is usually more volatile. In fact, if the data for interest rates on loans of over €1 million is compared with the average for 2009 Q4, the decline would amount to 7 pb. The returns demanded for fixed-income securities rose by 7 bp for short maturities and fell by 13 bp for longer maturities. On the latest data available relating to February, the issuance cost of shares rose 141 pb, reflecting an increase in the risk premium,

INDICATORS OF THE FINANCIAL POSITION OF HOUSEHOLDS AND NPISHs

CHART 24



SOURCES: Ministerio de Vivienda, INE and Banco de España.

a. Includes bank credit and off-balance sheet securitised loans.
b. Assets 1 = Total financial assets less "Other".
c. Assets 2 = Assets 1 less shares less holdings in mutual funds.
d. Estimated interest payments plus debt repayments.
e. Balance of households' use of disposable income account.
f. Gross saving less estimated debt repayments.
g. Calculated on the basis of the estimated changes in the stock of housing, in the average area per housing unit and in the price per square metre.

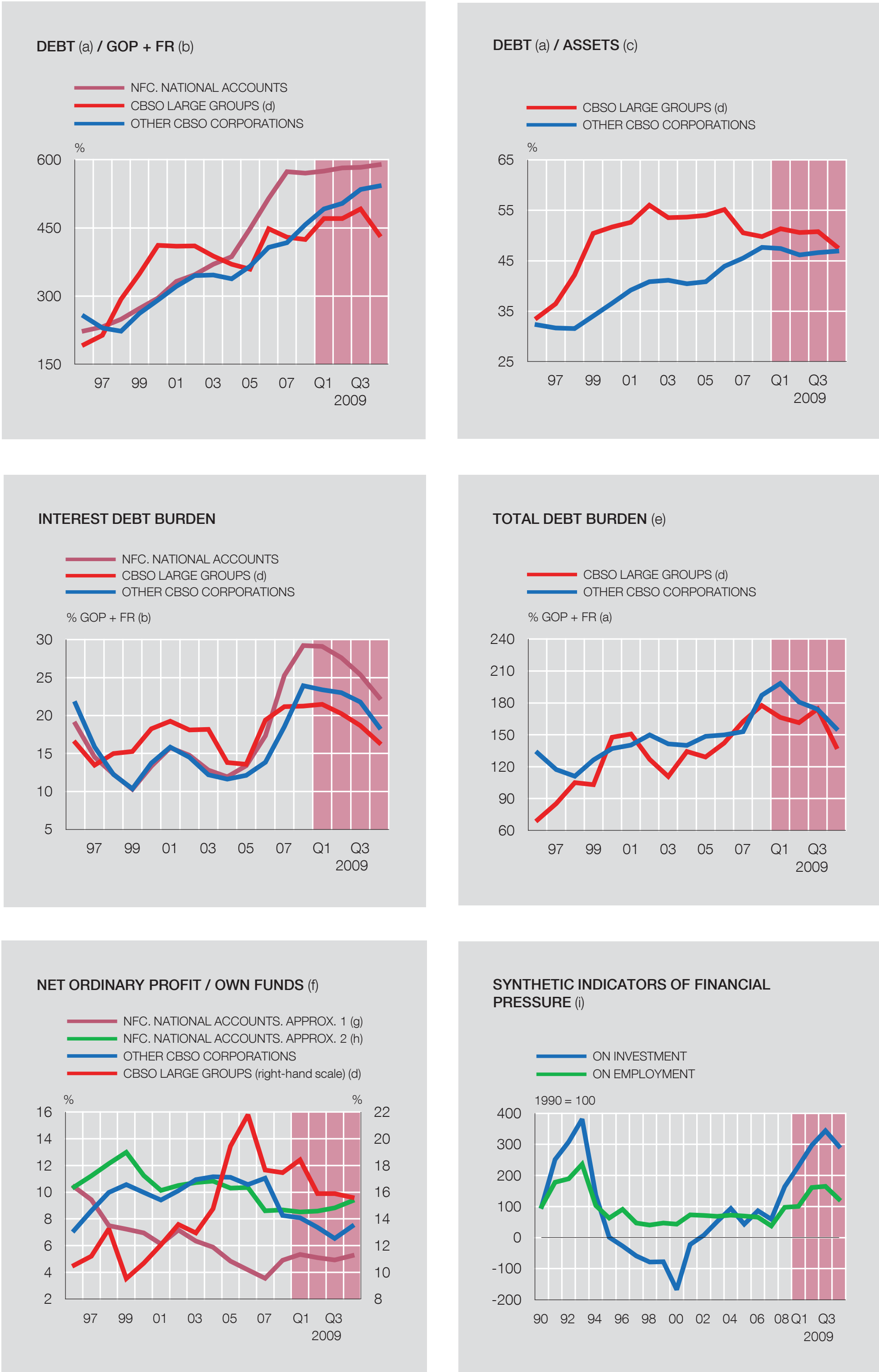
although this indicator is estimated more imprecisely. Lastly, according to the April BLS, institutions are estimated to have slightly relaxed lending standards for corporations during 2010 Q1, at the same time as they expected to leave them unchanged for the next three months.

Despite relatively stable credit conditions, corporate debt has continued to contract, in February its year-on-year growth rate stood at -1.8%, 0.9 pp less than in December 2009). The annualised quarter-on-quarter rates of growth (-3%) indicate that this decline has stepped up in recent months. By instrument, credit extended by resident institutions is seen to be decreasing more rapidly (by 4.3% in year-on-year terms), while the positive expansion of funds obtained from abroad and through fixed-income issuance (both vehicles being used mainly by large firms) has continued, albeit at a slightly lower pace than in the previous quarter.

The most recent information on the breakdown of lending by purpose, relating to December 2009, shows that negative growth was posted in all sectors, except for real estate activities,

INDICATORS OF THE FINANCIAL POSITION OF NON-FINANCIAL CORPORATIONS

CHART 25

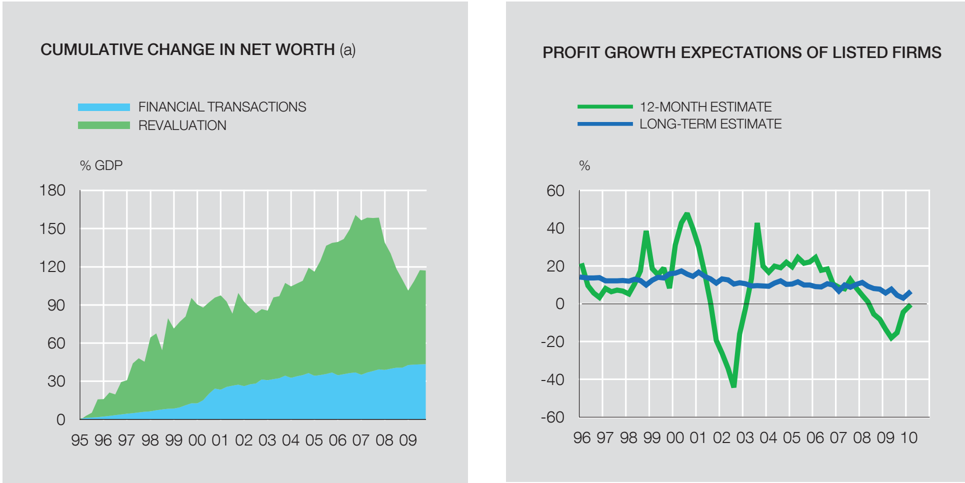


SOURCES: INE and Banco de España.

a. Interest-bearing borrowed funds.
b. Gross operating profit plus financial revenue.
c. Defined as total inflation-adjusted assets less non-interest-bearing liabilities.
d. Aggregate of all corporations reporting to the CBSO that belong to the Endesa, Iberdrola, Repsol and Telefónica groups. Adjusted for intra-group financing to avoid double counting.
e. Includes interest plus interest-bearing short-term debt.
f. NOP, using National Accounts data, is defined as GOS plus interest and dividends received less interest paid less fixed capital consumption.
g. Own funds valued at market price.
h. Own funds calculated by accumulating flows from the 1996 stock onwards.
i. Indicators estimated drawing on the CBA and CBQ surveys. A value above (below) 100 denotes more (less) financial pressure than in the base year.

OTHER FINANCIAL INDICATORS OF NON-FINANCIAL CORPORATIONS

CHART 26



SOURCES: I/B/E/S and Banco de España.

a. Net worth is proxied by the valuation at market price of shares and other equity issued by non-financial corporations.

which showed a growth rate of 1.7% (2.9% in the previous quarter). By contrast, construction is the sector where debt is falling fastest (14.1% in year-on-year terms), a considerably higher figure than the decline of 2.5% in industry (down 1 pp more than in September) and that of 0.7% in non-real estate services (compared with positive growth of 2.8% three months earlier).

In line with these developments, Financial Accounts data for 2009 Q4 show that borrowing by firms stood at 0.5% of GDP (in cumulative 12-month terms), which is lower than the September figure of 2.3%. Likewise, the financing gap, an indicator that approximates the funds needed to cover the difference between the firms' gross saving and gross capital formation plus foreign investment of a permanent nature, also declined by 2.5 pp to 1% of GDP.

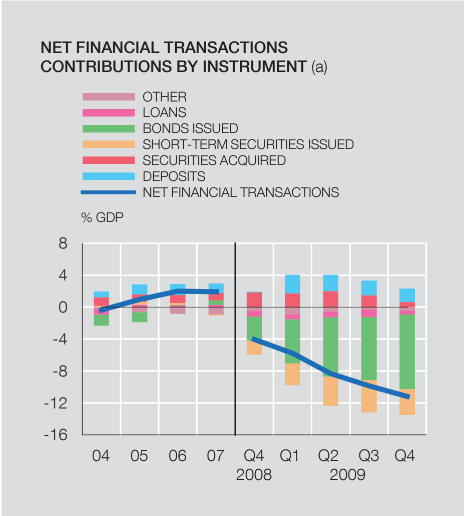
The latest National Accounts estimates of corporate surpluses (corresponding to December 2009) show that the latter continued to move on the declining path of recent months, in year-on-year terms. This decrease in revenue, despite the contraction of liabilities, drove the corporate debt ratio slightly higher (see Chart 25). However, the decline in the average cost of on-balance-sheet debt was reflected once again in the fall in the debt burden ratio.

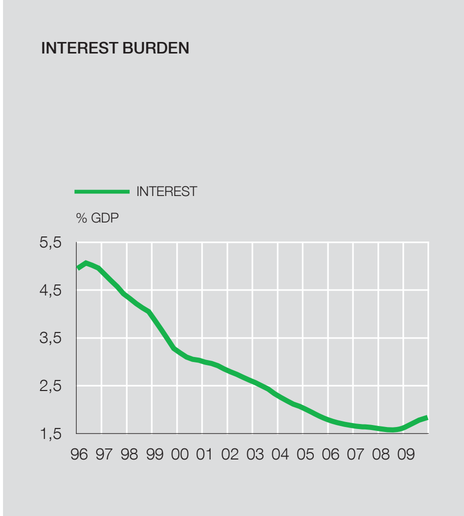
The data on firms contributing to the Central Balance Sheet Data Office Quarterly Survey (CBQ), which are predominantly large corporations, recorded during the closing months of 2009 a slight recovery in profits in comparison with the same period of the previous year, reflecting a moderate pick up in profit ratios and a decrease in debt and debt-burden ratios (also as a result of the decline in the cost of funds). This resulted in declines in the indicators of financial pressure on investment and employment, although they remain at historically high levels. In this same connection, analysts have refrained from projecting short-term declines in listed non-financial corporations' profits at the same time as they have upgraded the outlook for profits rising in a longer time frame (see Chart 26).

The non-financial corporations' doubtful loans ratio continued to rise during the closing months of 2009 and stood at 6.2% in December, 0.5 pp up on 2009 Q3. This increase is basically explained by the performance of lending to construction and real estate services firms whose ratio rose from 8.5% to 9.6%, while in the other sectors the ratio climbed by only 0.1 pp to 3.4%.

GENERAL GOVERNMENT
Four-quarter data

CHART 27





SOURCE: Banco de España.

a. A postive (negative) sign denotes an increase (decrease) in assets or a decrease (increase) in liabilities.

5.4 General government

Rising public spending and declining revenues led to continued growth in general government net borrowing in 2009 Q4 to 11.2% of GDP in cumulative annual terms, 1.3 pp above the September figure (see Table 6).

The main channel for financing the general government deficit continued to be the issuance of fixed-income securities, through which a net volume of funds equivalent to 12.6% of GDP was raised in 2009 (see Chart 27). The bulk of these placements took the form of securities maturing at over one year while the relative weight of those maturing at short-term decreased. By contrast, funds obtained through loans hardly accounted for the equivalent of 0.4% of GDP. On the assets side, financial flows stood at close to 2.3% of GDP, 1 pp down on three months earlier.

Although the growth rate of general government debt moderated, it remained high at 24%. This, together with the decline in GDP, has led to a further increase in the debt-to-GDP ratio which stood at more than 53% of GDP in December 2009, 3 pp above the September figure. However, the low level of the cost of debt contributed to curbing the rise in the interest burden associated with these liabilities which at the end of last year stood at approximately 1.8% of GDP.

5.5 The rest of the world

In 2009 Q4, the nation's net borrowing continued to fall to 4.7% of GDP in cumulative 12-month terms, 1 pp below the September level and 4.4 pp below the figure at end-2008. This was due to households' increased net lending capacity and to firms' lower debit balance, which were partially offset by the rise in the general government deficit and, to a lesser degree, by the decline in financial institutions' savings.

In line with the improvement in international financial markets throughout 2009 H2, financial flows of assets and liabilities vis-à-vis the rest of the world recovered during the final months of 2009 in comparison with the same period of the preceding year, which was reflected in an increase in the volume of transactions (see Table 8). Thus, in cumulative 12-month terms, capital inflows represented the equivalent of 5.7% of GDP, in comparison with 3.3% three

FINANCIAL TRANSACTIONS OF THE NATION
Four-quarter data

TABLE 8

% GDP	2006	2007	2008	2009		
				Q2	Q3	Q4
NET FINANCIAL TRANSACTIONS	-8.4	-9.6	-9.1	-6.9	-5.8	-4.7
FINANCIAL TRANSACTIONS (ASSETS)	18.0	14.7	2.5	-2.8	-2.5	1.1
Gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0
Cash and deposits	5.2	2.1	-0.3	-6.0	-5.9	-1.8
Of which:						
Interbank (a)	*3.4*	*4.2*	*-0.5*	*-5.6*	*-5.6*	-1.7
Securities other than shares	-1.2	1.6	1.3	0.5	0.5	0.0
Of which:						
Credit institutions	*-2.0*	*1.8*	*1.6*	*1.6*	*1.5*	1.3
Institutional investors (b)	*0.7*	*0.0*	*-1.3*	*-1.2*	*-1.3*	-0.5
Shares and other equity	10.8	8.8	1.9	2.0	2.1	1.5
Of which:						
Non-financial corporations	*8.3*	*6.6*	*3.3*	*1.6*	*1.2*	0.1
Institutional investors (b)	*1.2*	*-1.1*	*-1.6*	*-0.5*	*-0.1*	0.3
Loans	2.1	1.2	0.8	1.2	0.4	0.7
FINANCIAL TRANSACTIONS (LIABILITIES)	26.4	24.2	11.6	4.1	3.3	5.7
Deposits	0.3	7.3	9.0	1.9	1.5	0.9
Of which:						
Interbank (a)	*0.6*	*6.7*	*6.2*	*0.9*	*-0.2*	0.7
Securities other than shares	21.3	8.1	-2.6	-1.0	-1.2	3.8
Of which:						
General government	*1.0*	*-1.3*	*1.2*	*3.3*	*3.3*	5.1
Credit institutions	*8.0*	*3.6*	*-1.9*	*-1.2*	*-0.6*	1.1
Other non-monetary financial institutions	*12.3*	*5.8*	*-1.9*	*-3.0*	*-3.7*	-2.4
Shares and other equity	0.5	4.6	3.3	1.0	1.7	0.9
Of which:						
Non-financial corporations	*0.1*	*4.7*	*2.4*	*0.2*	*0.5*	0.1
Loans	3.5	3.1	2.7	3.1	2.1	1.0
Other, net (c)	-0.4	0.3	0.4	-0.3	-1.2	-1.5
MEMORANDUM ITEMS:						
Spanish direct investment abroad	8.4	9.5	4.7	3.5	2.4	1.1
Foreign direct investment in Spain	2.5	4.5	4.6	2.3	2.0	1.0

SOURCE: Banco de España.

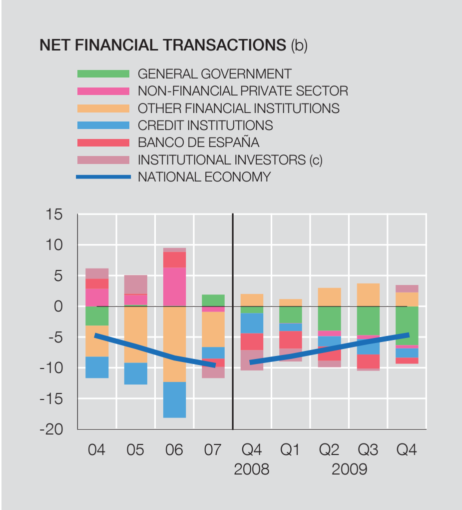
a. Correspond only to credit institutions and include repos.
b. Insurance corporations and collective investment institutions.
c. Includes, in addition to other items, the asset-side caption reflecting insurance technical reserves and the net flow of trade credit.

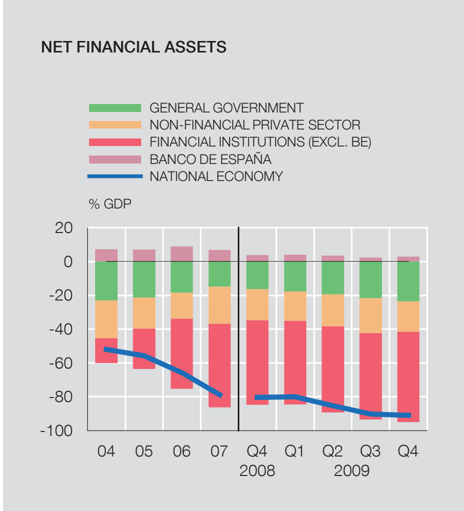
months earlier. By instrument, the bulk of these funds was channelled through non-residents' purchases of fixed-income securities which increased to 3.8% of GDP. This increase in activity centred in particular on securities issued by general government, the flow of which amounted to more than 5% of GDP. Noteworthy, however, were net non-resident purchases of credit institutions' debt, which posted positive figures again. By contrast, other assets were seen to be less buoyant. In particular, foreign direct investment in Spain fell to 1% of GDP, 1 pp less than in 2008.

In turn, capital outflows represented in cumulative 12-month terms 1.1% of GDP, compared with -2.5% in September 2009. By instrument, there was a notably smaller contraction in

NET FINANCIAL TRANSACTIONS AND NET FINANCIAL ASSETS VIS-À-VIS THE REST OF THE WORLD (a)

CHART 28





SOURCE: Banco de España.

a. Four-quarter data for transactions. End-period data for stocks. Unsectorised assets and liabilities not included.
b. A negative (positive) sign denotes that the rest of the world grants (receives) financing to (from) the counterpart sector.
c. Insurance companies and collective investment institutions.

loans extended on the interbank market to foreign institutions, which eased from a flow equivalent to -5.6% of GDP in 2009 Q3 (in cumulative 12-month terms) to -1.8% at year-end. Conversely, net purchases of fixed-income securities amounted to zero, while shares and other equity decreased by 0.6 pp (to 1.5% of GDP). In line with these developments, Spanish direct investment abroad fell by 1.3 pp to 1.1% of GDP.

As a consequence of changes in cross-border financial flows, asset prices and the exchange rate, the Spanish economy's accumulated net debt was equivalent to 91% of GDP in December 2009, nearly 1 pp more than the September figure (see Chart 28). By institutional sector, this rise was essentially due to the increase in debit positions vis-à-vis non-residents of financial institutions (excluding the Banco de España) and general government, which was partly offset by the 2.8 pp reduction in the non-financial private sector's net liabilities and by the moderate 0.6 pp increase in the Banco de España's credit balance.

3.5.2010.