1 Overview

In 2010 Q1 there was a slight increase of 0.1% in the Spanish economy's GDP in quarter-on-quarter terms, following six consecutive quarters of decline. The year-on-year rate of change, which measures the conjunctural situation with something of a lag, showed a 1.3% decline. This was due to the fall-off in national demand (2.4%), which was partly offset by a positive contribution of net external demand equivalent to 1.2 pp of GDP.

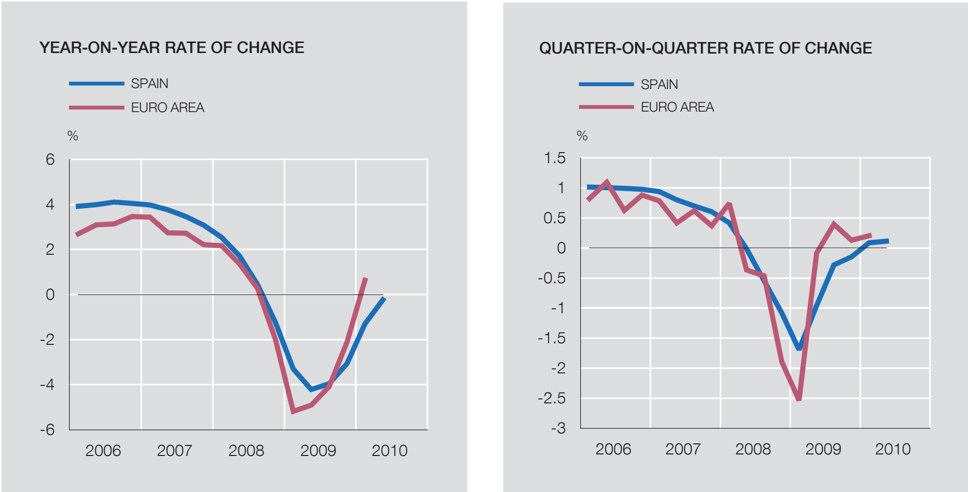
Economic activity in Q2 held on a path of recovery similar to that in Q1, against a background of markedly volatile financial markets and an acute crisis in confidence, following the spread of the effects of the Greek fiscal crisis to other European economies. On the domestic front, economic developments were further marked by temporary factors. These included most notably the imminent conclusion of certain public programmes supporting spending, the rise in VAT scheduled for 1 July, which contributed to bringing forward some private agents' spending decisions, and the volcanic eruption in Iceland, which significantly affected air traffic. Finally, over the course of the past few months, the government took important policy measures in the fiscal, labour and financial fields, the contents of which are detailed elsewhere in this report.[1]

Against this backdrop, the estimates made drawing on conjunctural data indicate that output is expected to have held at a moderate quarter-on-quarter growth rate of 0.2%, although in year-on-year terms, it is estimated to have declined by 0.2%. On the expenditure side, the fall in national demand slackened notably (-0.8% a year-on-year), chiefly as a result of the rise in private consumption, while the positive contribution of net external demand fell to 0.6 pp of GDP. On the supply side, the performance of all branches of activity was somewhat more favourable, albeit to differing degrees of intensity, as was the case with employment, the year-on-year rate of decline of which was cut. On EPA figures, employment fell by 2.5% and the unemployment rate rose slightly, to 20.1%, set against a pick-up in the labour force. The year-on-year rate of change of consumer prices rose during the quarter, up to 1.5% in June, mainly as a consequence of dearer energy, whereby core inflation stood at 0.4%. The leading indicator of the HICP for July showed a further rise, taking the year-on-year rate of the HICP up to 1.9%, due to the impact of the rise in VAT on final prices.

Turning to the international economic outlook, the worsening financial situation in Europe from end-April resulted in a serious confidence crisis that sharply affected several euro area economies, in particular those showing most vulnerability due to the rapid deterioration in their public finances or because of the scale of the imbalances they had built up. At the outset, tensions focused on the sovereign debt markets. But they subsequently spread to the stock, foreign exchange and banking system wholesale funding markets, where the loss of confidence gave rise to a severe problem of liquidity shortages. The intensity and complexity of this episode, which arose almost 3 years after the global financial crisis broke, has highlighted the presence of significant shortcomings in the economic governance of the euro area and the risks entailed by running up high fiscal deficits during prolonged phases of low growth, as has occurred in recent years.

1. Royal Decree-Law 8/2010 of 20 May 2010, adopting extraordinary budget-deficit-reduction measures; Royal Decree-Law 10/2010 of 16 June 2010 on urgent labour market reform measures; and Royal Decree-Law 11/2010 of 9 June 2010 on the governing bodies and other aspects of the legal regime for savings banks.

GROSS DOMESTIC PRODUCT (a) CHART 1



SOURCES: ECB, INE and Banco de España.

a. Seasonally adjusted series.

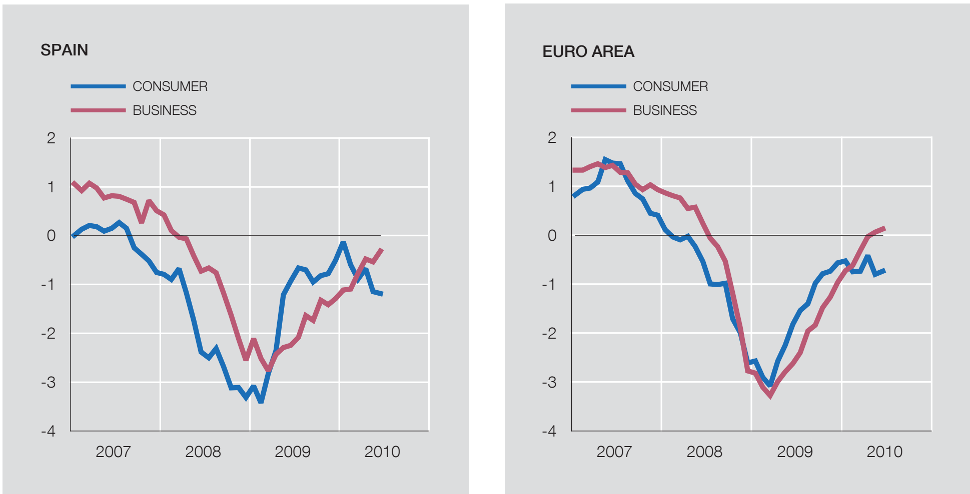
That said, the effect of this new bout of instability on international economic activity in Q2 was limited. The ongoing global economic recovery continued to be led by the emerging Asian countries, although the developed countries posted similar growth rates, on the whole, to those of the previous period. Inflation held at moderate levels. Inflationary pressures were greater in the emerging countries, giving rise to a progressive tightening of monetary policy in a growing number of them.

As a result of these events the world economy faces the coming quarters amid greater uncertainty, and the downside risks surrounding the outlook for recovery have been accentuated, especially in the euro area. Only the achievement of far-reaching headway in European governance, the success of the fiscal consolidation programmes undertaken and the implementation of ambitious reforms can provide any lasting relief to the tensions that have arisen, building on the improvement of recent weeks and preventing downside risks from materialising.

The European economic authorities reacted forcefully to the seriousness of the situation and deployed an array of unprecedented measures to safeguard the unity and financial integrity of the area. The European Council and the Ecofin resolved to set in place the European Financial Stabilisation Mechanism and the European Financial Stability Facility. Designed for crisis resolution in the euro area, the activation of these vehicles will be subject to strict terms of conditionality (see Box 3). In addition, new ways to strengthen EU and euro area governance were agreed upon, and the attendant three-pronged guiding principles will be developed in the coming months: stronger public finances commitments; the establishment of a new macroeconomic surveillance procedure to prevent the build-up of imbalances; and the development of crisis-resolution mechanisms. Lastly, measures were taken to shore up the European banking system through the extension of public support programmes, and it was agreed to conduct stress tests of European banks, the results of which were released on 23 July.

At the level of the Eurosystem, the Securities Markets Programme was temporarily adopted with a view to normalising the functioning of the public and private debt securities markets, the distortions in which were hampering the correct transmission of monetary policy. Further, support for liquidity was restored, through the reactivation of fixed-rate auctions for three-month liquidity injections and full allotment, the introduction of a new six-month auction and the re-

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).

opening of liquidity lines denominated in dollars. Lastly, fiscal consolidation plans were reinforced at the level of national governments, taking immediate effect in some countries such as Portugal and Spain, and deferred to some extent in Italy, Germany and other euro area countries, where austerity plans will begin to be applied in 2011 (see Box 4).

Set against this background are the measures approved by the Spanish government on 20 May this year, which came into force on 1 June. These bring forward to 2010 and 2011 a significant part of the budgetary drive envisaged in the Updated Stability Programme for the period 2010-2013, and they introduce additional expenditure-cutting measures, many of them structural, including most notably the cuts to investment and civil servants' wages from 1 June this year, and a freeze on public-sector wages and pensions in 2011. Overall, this fiscal package entails a reduction in spending of somewhat over €15 billion (around 1.5% of GDP) between 2010 and 2011 (see Box 1). The deficit-cutting path has thus been set at 9.3% of GDP in 2010, 6% in 2011, 4.4% in 2012 and 3% in 2013.

As regards the labour market, the government approved on 16 June a series of provisions - currently in passage through Parliament - aimed at encouraging permanent hires and at increasing the internal flexibility of companies. In the financial realm, the Banco de España deemed practically complete the bank restructuring undertaken over the past year through the FROB. And to dispel the doubts still surrounding certain banking segments, which were heightening to some extent mistrust over the Spanish economy, the central bank announced its intention to publish the stress tests of all Spanish banks and savings banks. This initiative was assumed at the European level by the European Council held under Spain's presidency, and the results of the exercise, harmonised by the Committee of European Banking Supervisors, were published on 23 July. In the case of Spanish banks, the stress tests covered virtually all the financial system and were conducted in greater detail and with a high degree of transparency. Finally, a far-reaching reform of the regulation of savings banks was set in train, completing the restructuring of the sector and helping entrench a sounder capital base for these institutions. The adoption of this set of measures and most particularly the publication of the stress tests of financial institutions has helped ease significantly in recent weeks the tensions on financial markets.

DESCRIPTION OF THE FISCAL CONSOLIDATION MEASURES INCORPORATED INTO THE IMMEDIATE ACTION PLAN AND THE 20 MAY 2010 PACKAGE

BOX 1

Since late 2009 fiscal policy has progressively adopted a restrictive stance. The State Budget for 2010 included tax rises and some restraint in public spending in relation to the trend of the previous years. The regional government budgets for 2010 also entailed considerable spending restraint. Along these same lines were the multi-year targets contained in the Updated Stability Programme (USP), published on 29 January 2010, which laid out a significant budgetary consolidation path to 2013. Since releasing the USP, the government has set in train two packages of measures that specify part of the fiscal adjustment announced for 2010 and 2011.

On one hand, the government approved in March 2010 the so-called "Immediate Action Plan". This cuts public spending by €5 billion (0.5% of GDP) in 2010, affecting capital transfers, public investment, goods and services, and subsidies (see accompanying table). Further, it was resolved to reduce, without exceptions, public-sector vacancies in 2010 to 10% of the replacement rate and to hire no new stand-in staff.

On the other, the government approved Royal Decree-Law 8/2010 of 20 May 2010, adopting extraordinary measures to reduce the budget deficit. What are involved here are a series of far-reaching measures which, moreover, were accompanied by the bringing forward of the consolidation plans initially included in the USP. As a result, part of the fiscal drive initially envisaged to be made in 2012 is brought forward to 2010 and 2011, and the commitment to the new budgetary targets is strengthened. Accordingly, the general government deficit targets will be set at 9.3% of GDP in 2010, 6% in 2011, 4.4% in 2012 and 3% in 2013 (compared with 9.8%, 7.5%, 5.3% and 3%, respectively). The May package contains a set of measures which, if applied in their entirety, would entail saving of somewhat more than €15 billion (around 1.5% of GDP) in cumulative terms between 2010 and 2011. The main spending items affected by the cuts are public-sector employee compensation, specific social benefits and public investment. A cut in current spending by the regional governments is likewise included.

In addition to the aforementioned measures with an impact in 2010 and 2011, on 28 May 2010 the government set a ceiling on State spending for 2011, in cash-basis terms, and which in homogeneous terms (excluding transfers from the Sufficiency Fund to the regional governments) would entail a decline of 7.7% in State expenditure in relation to the ceiling set in 2010. This limit could result in a further reduction in public spending of around 1% of GDP in 2011, according to European Commission estimates.

The measures taken are appropriate and a significant step towards attaining the budgetary targets set for 2010 and 2011. First, because they have been implemented as permanent cuts in public spending. In this connection, the composition of the adjustment, focusing chiefly on current expenditure, is appropriate. Second, because they are a step up from the fiscal targets initially set in the USP, meaning that two-thirds of the adjustment will be concentrated in the first two years of the consolidation path (2010 and 2011). Third, because the swift adoption of the measures has helped counter the financial markets' adverse expectations about the sustainability of public finances in Spain observed throughout May. Finally, the recently approved measures have made it possible to meet the requirements undertaken in the Stability and Growth

FISCAL CONSOLIDATION MEASURES
Immediate Action Plan and 20 May 2010 Measures

EUR m and % of GDP

	EUR m		% of GDP	
	2010	2011	2010	2011
	1	2	3	4
IMMEDIATE ACTION PLAN (spending cuts)	5,000		0.48	
Goods and services	1,540		0.15	
Subsidies	210		0.02	
Investment	850		0.08	
Capital transfers	2,400		0.23	
20 May 2010 PACKAGE OF MEASURES	5,250	10,000	0.50	0.94
Cuts in wages and salaries	2,300	2,200	0.22	0.21
Saving from pensions freeze		1,530		0.14
Saving on aid and pharmaceutical spending	825	2,200	0.08	0.21
Cuts in local and regional government spending		1,200		0.11
Additional cuts in investment	2,125	2,870	0.20	0.27
TOTAL FISCAL CONSOLIDATION MEASURES	**10,250**	**10,000**	**0.98**	**0.94**

SOURCES: Spanish government and Banco de España.

DESCRIPTION OF THE FISCAL CONSOLIDATION MEASURES INCORPORATED INTO THE IMMEDIATE ACTION PLAN AND THE 20 MAY 2010 PACKAGE (cont'd) BOX 1

Pact. As a result, the European Commission's assessment dated 15 June was positive in relation to the targets set for the horizon of 2013 and the fiscal drive envisaged to correct the current excessive deficit situation.

Nonetheless, the fiscal consolidation plan is subject to appreciable risks. For one thing, some of the measures announced have yet to be detailed, in particular those relating to the spending ceiling for 2011 and all those that affect the cuts to be made by the regional governments, especially for 2011. In this respect, the government should be prepared to apply further restrictive fiscal measures if the budget targets were in danger of not being met. Hence the monitoring of the budget outturn and the swift application of those measures already approved is crucial in the current circumstances so as to ensure the credibility of the adjustment path in the medium term.

The euro area participated in the general recovery, boosted by the strength of world trade and, temporarily, by unusually high growth in investment in construction. The absence of medium-term inflationary pressures in a setting of muted economic recovery led the ECB Governing Council, at its meetings to August, to keep official interest rates unchanged. As a result, the MRO rate held at 1%, at which level it has remained since May 2009, while the rates corresponding to the marginal lending and deposit facilities held at 1.75% and 0.25%, respectively.

Under these circumstances, the external environment of the Spanish economy continued to improve, although the aforementioned bout of instability affected private-sector financing conditions, which turned more restrictive during the quarter. While bank borrowing costs for households and firms generally continued falling during Q2, both the costs for companies of short-term securities issuance and Spanish firms' credit risk premia on derivatives markets rose. Bank lending standards are expected to have tightened further over this same period.

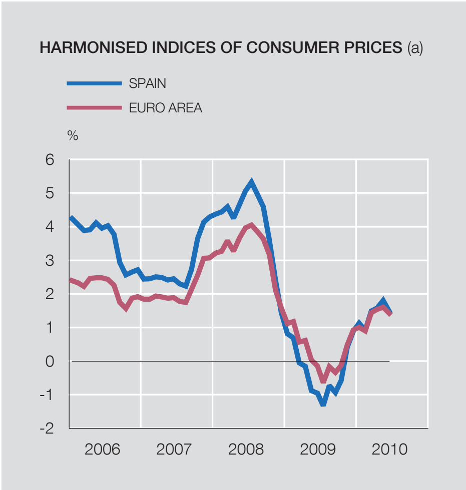
Nonetheless, some slackening of tensions was detected during July, with appreciable declines in credit risk premia and in bond market yields, meaning that the interest rate spread on Spanish 10-year government bonds over the German bund stood below 150 bp in late July (after having peaked at 220 bp in mid-June), and the IBEX 35 was 2.1% down on end-March. Spanish Treasury tenders were favourably adjudicated, and certain private issuers returned to the markets (see Box 7). That said, the financing conditions facing credit institutions, companies and general government remain substantially more restrictive than those in previous quarters.

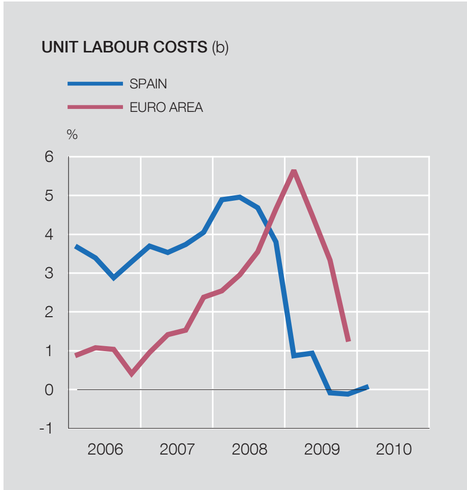
In these conditions, household consumer spending held on the recovering course of the previous months. A quarter-on-quarter rate of 0.7% has been estimated for Q2, which would place the year-on-year rate of change at 1.5%. This pick-up in household spending has prompted something of a turnaround in the trajectory of the saving ratio, which already fell slightly in Q1, following two years of successive rises, and wstands at 18.5% of disposable income on four-quarter cumulated data.

The effect of the direct-aid-for-car-purchase plan continued to boost this spending component, as did other temporary factors such as the digital switchover and the bringing forward of purchases ahead of the VAT rise, which boosted the acquisition of other consumer durables. As these effects peter out, the pace of consumption is expected to slacken, against a background of falling disposable income attributable to lower growth in wage earnings and to the lower contribution of other sources of income, in particular that stemming from general government, which is beginning to reflect the withdrawal of some of the stimuli applied during the recessionary phase. The restoring of confidence and a less uncertain outlook regarding labour

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.

market prospects, in step with the labour reform under way, would be essential ingredients of a sustained recovery in consumption.

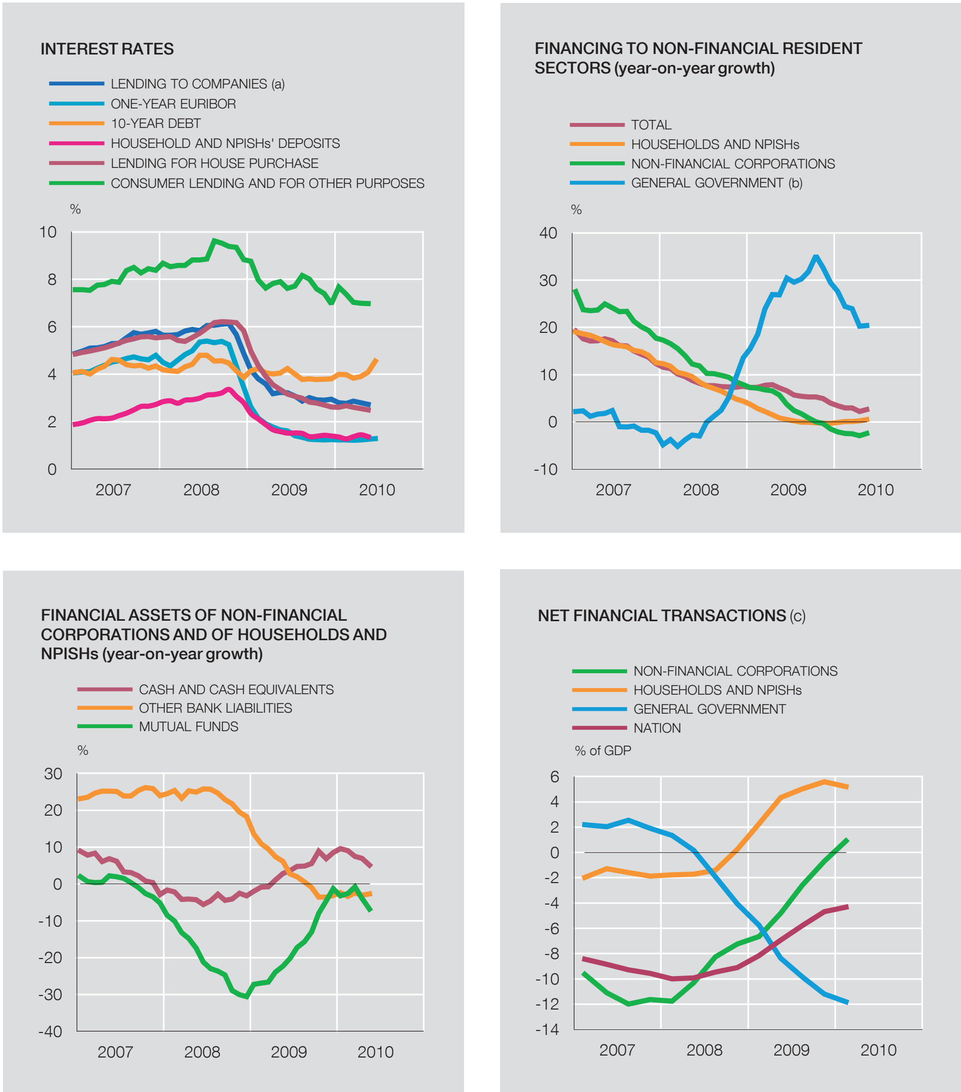
Residential investment remained immersed in adjustment, although its rate of decline eased slightly. It is expected to post a fall of 18% in terms of its year-on-year rate. As was the case in the opening months of the year, this development was consistent with some stabilisation of certain housing demand indicators, such as the number of transactions and that of mortgages. This may be linked to an improvement in the affordability indicators, and also to the bringing forward of property purchasing decisions given the foreseeable changes in indirect taxes and the elimination of tax deductions for habitual-dwelling purchases from January 2011. Possibly, these latter factors have borne on the recent slowing in the decline of house prices, the year-on-year rate of which stood in 2010 Q2 at -3.7%.

The containment of household spending continues to prompt an improvement in their lending capacity, which stood at a rate of 7.4% of GDP in Q1 on four-quarter cumulated data. That is consistent with a slight increase in the outstanding balance of credit to households, which grew at a year-on-year rate of 0.5% in May further to a moderate increase in lending for house purchases (0.9%) and a slight fall-off in credit for consumption and other purposes.

Despite the more expansionary behaviour of some domestic demand components and the pick-up in exports, business investment held on a contractionary course, albeit one somewhat slacker, amid marked uncertainty over accessibility to financing, surplus capacity and the need for some business sectors to deleverage. However, the year-on-year rate of investment in capital goods is expected to have turned positive once more, to around 2%, reflecting the expansionary impact of the plan to promote commercial vehicle purchases launched in June last year. The non-residential investment component performed somewhat more negatively, since it was also affected by the impact of the cuts to investment in infrastructure, the completion of the works executed under the State Fund for Local Investment and the potential delay in the start of the projects to be implemented under the (lesser funded) State Fund for Employment and Environmental Sustainability.

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.

The fall in non-financial corporations' investment and the improvement in their saving, via the sharp decline in interest payments, notably eased this sector's net borrowing, placing it at 1.2% of GDP in 2010 Q1 on four-quarter cumulated data. In parallel, on data for May, business-sector debt continued on a declining path at a year-on-year rate of 2%. In this setting, the return to a situation of normality on financial markets is vital for the recovery of this demand component.

Turning to general government conduct, the fiscal consolidation plans have begun to check the expansionary impulse provided by the public sector to aggregate demand, although the impact on public finances is still incipient. In the case of central government, the information available for Q2 offers some signs of an improvement in the State deficit owing to the reduction in wages and salaries and the rise in tax takings.

As regards foreign trade, the positive contribution of net external demand in Q2 (0.6 pp of GDP) continued to mitigate the fall-off in spending on activity, albeit to a lesser extent than in previous quarters. The pick-up in activity and in world trade, and the more favourable behaviour of competitiveness in terms of relative prices with our competitors, contributed to driving a sharp increase in exports. This development was accompanied by the more expansionary behaviour of goods imports, linked partly to the rise in exports but also to some improvement in industrial activity and to the recovery of certain domestic demand components, such as durable goods purchases, which might be as a result of the aforementioned temporary factors. When these factors have tailed off, imports may be expected to perform less dynamically, meaning that net external demand may play a greater role once again in terms of its contribution to growth, based on higher exports. To ensure this, perseverance is needed to entrench the improvements in cost- and price-competitiveness attained in recent quarters, and to underpin them with genuine productivity gains.

Trade in services continued on the recovering path seen in Q1. Tourism trended relatively favourably, despite the effects of the flights cancelled in April and May due to the volcanic eruption in Iceland (see Box 5). As a result, the ongoing correction of the nation's net borrowing continued in Q2, after having stood at 4.3% of GDP in Q1 on four-quarter cumulated data.

On the supply side, the year-on-year rate of decline of value added in the market economy eased once more, as did employment. This would have been consistent with a slight rise in productivity, estimated at 2.5% for the economy as a whole. Compared with the previous quarter, both value added in market services and industrial activity are expected to show positive growth, although in the latter case job destruction would have continued, unlike in services where, for the second quarter running, employment rose moderately. Construction performed similarly to the previous quarter, with sharper declines both in value added and in employment, as a result of the more contractionary behaviour of the non-residential building segment, for the reasons mentioned earlier.

The latest information on labour costs shows that the wage restraint observed early in the year is expected to have intensified in Q2. Wage agreements to June show average wage settlements of 1.3%. Overall, compensation per employee in the market economy is estimated to increase in Q2 by around 1%. And this, combined with the still relatively expansionary behaviour of productivity, is expected to prompt a decline in unit labour costs, markedly so in industry.

Wage moderation will foreseeably continue over the rest of the year, as collective bargaining outcomes are incorporated into newly signed agreements. These are still few in number, but include wage increases of around 1%, below those of multi-year agreements (1.4%). The measures taken to cut public-sector wages might exert something of a demonstration effect on private-sector wages. Using the means laid down by the labour market reform under way to provide for wage opt-outs by companies facing difficulties might also be of benefit in this connection.

Finally, inflation rose in Q2 to 1.6% on average for the quarter (1.2% in Q1). This is essentially due to the rise in energy product prices compared with a year earlier, when they posted markedly low increases. Core inflation held at a moderate level, with the CPI excluding energy and unprocessed food prices registering a rate of increase of 0.2% for the quarter as a whole, similar to that in Q1. The price differential with the euro area also held steady at 0.1 pp. Overall, price pressures remain contained in line with the relative weakness of the recovery in domestic spending. This factor will foreseeably lessen the extent to which the VAT rise passes through to final prices, especially in those cases where the impact of the changes in indirect tax in the past was greater (energy and services). This pattern is decisive for entrenching the gains in competitiveness that are beginning to arise.

In sum, for the recovery the Spanish economy has embarked upon to take root - with growth rates that will remain sluggish for some quarters yet - will require the prompt and firm implementation of the fiscal consolidation plans to which the government has committed and of the approved or announced structural reforms, which are of pivotal importance for restoring confidence and boosting long-term growth.

2 The external environment of the euro area

The recovery on international financial markets was interrupted in 2010 Q2 due to the impact of the fiscal problems in the euro area, which gave rise to a strong increase in volatility, greater global risk aversion and investor flight to safe assets. Despite this market instability, the economic indicators released point to continuing vigour in the pick-up in the world economy in this period, albeit probably at lower rates than in the previous quarter and with notable divergence between the developed economies - which are recovering at a slower pace - and the much more dynamic emerging economies. In any event, the potential impact on activity of Europe's fiscal and financial problems comes at a time when private demand in the developed economies should take up the baton from fiscal stimuli and from the increase in inventories as the motor of the recovery, which adds uncertainty to the strength of the economic upturn. The recent unfavourable performance of the labour and housing markets in the United States and the loss of momentum in business surveys in many countries suggests some easing off in the pace of growth in the second half of the year; in the case of the emerging economies, the slowdown might be induced by the tightening of the monetary policy stance in these countries. Recent events have, moreover, influenced policymakers' exit strategies. In particular, they have precipitated the start of fiscal consolidation process in some countries, especially in Europe, and they have put back expectations of official interest rate rises in the advanced economies. All these factors make for a more uncertain outlook and one with greater downside risks for the world economy in the coming quarters, which may also affect global disequilibria, as analysed in Box 2.

The behaviour of international financial markets during Q2 was characterised by a marked increase in instability, which has softened to some extent in July. At the start of the quarter the uncertainty over the euro area fiscal situation affected only the European market, but gradually took on a global dimension. Against this background, the government bonds of countries such as the United States and United Kingdom, but also of Germany, acted as safe-haven securities, showing declines in their long-term yields. This instability was exacerbated by the greater uncertainty over the strength of the recovery in economies such as the United States and China, and fed through to interbank markets, particularly to dollar-denominated operations, and to stock market indices, which fell clearly back, prompting an increase in volatility. Private-sector fixed income issues declined significantly (especially those of financial institutions), in contrast to their buoyancy at the beginning of the year. The economic authorities adopted various measures to address the financial instability, including most notably, outside the euro area, the reactivation of foreign currency swap lines. On the foreign exchange markets, the dollar appreciated over the quarter as a whole against the main currencies, in developed and emerging economies alike, the exception being the yen, which showed greater strength. In July, however, this trend has been partly reversed. Also of note was the greater flexibility announced for the Chinese foreign exchange regime, which abandoned parity with the dollar in mid-June, although the appreciation of the renminbi against the US currency was less than 1%. Finally, the emerging economies' financial markets moved in line with the mature markets, which made for a widening of sovereign spreads; once again, however, the indicators have improved appreciably in recent weeks.

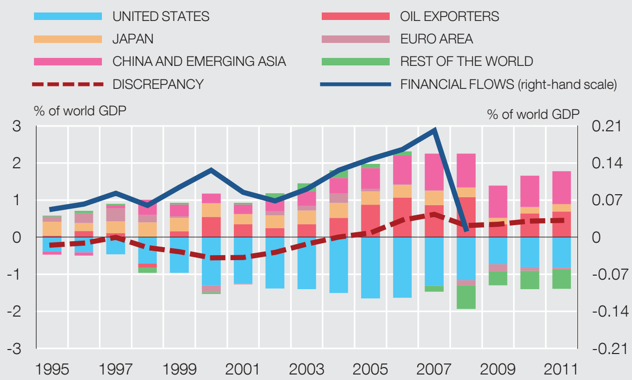
Commodities prices underwent a correction, as a result of the bout of financial turbulence in May and the greater uncertainty over world demand, although some of the decline has recently been recouped. Brent oil currently stands at around $75 per barrel, $10 less than in late April.

Global disequilibria were considered as one of the factors of greatest risk to the world economy in the years prior to the crisis. Generally, such disequilibria were believed to be unsustainable in the medium term and it was feared their correction might come about in a disorderly fashion, generating substantial financial instability. Global disequilibria are associated with the presence of high and persistent current account deficits in specific economies, in particular the United States, the counterpart of which are very sizeable surpluses in a diverse number of countries, in particular China, other emerging Asian economies and commodities exporters (see Panel 1). The absolute value of current account balances, which accounted for less than 1% of global GDP in the mid-1990s, rose to 5% in 2008. The contribution of global disequilibria to crises remains a controversial subject. While they were not a direct trigger, they were considered to have reinforced the financial excesses that resulted in the crisis. In any event, the post-crisis economic and financial adjustment has entailed the notable correction of these disequilibria, which may largely prove transitory. The main determinants of global disequilibria are set out below, along with a description of the impact of the economic crisis on their adjustment and an assessment of how they will behave in the medium term.

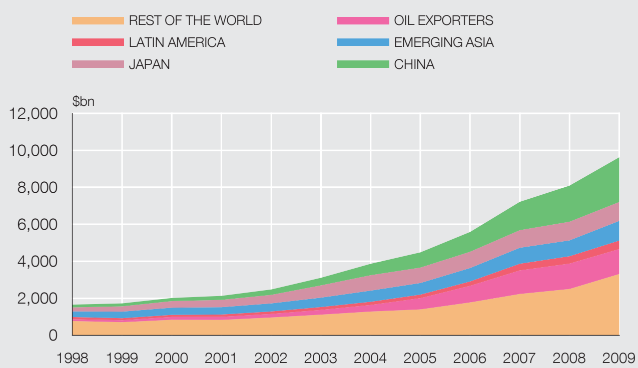
The build-up and persistence of global disequilibria before the crisis was the outcome of a broad set of real and financial factors, and of economic policy decisions, which combined over the course of these years in the world economy. Firstly, the growing dispersion of current account balances coincided with a strong increase in cross-border financial flows, as can be seen in Panel 1, in a phase of intense financial globalisation. The increase in foreign financing needs reflected the divergent movements in saving ratios and investment across the different countries. Thus, in the United States, whose current account deficit climbed to 6% of GDP - and 1.6% of world GDP - in 2006, the widening of the negative saving/investment gap in recent years was due to a gradual decline in private saving (associated with a growth pattern characterised by highly dynamic consumption), which was accompanied by a deterioration in the budget deficit (see Panel 3). The main counterpart of this was the substantial current-account surplus in China and the emerging Asian economies, which reached 1% of world GDP in 2007, the reflection of a very high and growing saving ratio that was not matched by the dynamism of investment (see Panel 4). More recently, in 2007 and 2008, the high prices of oil and other commodities contributed to widening notably the current-account surpluses of the exporting countries of these products. Such surpluses came to account for 1.1% of world GDP in 2008, giving rise to a parallel deterioration in the current account balances of importing countries.

Certain economic policies proved conducive to the persistence of global disequilibria. In the emerging economies, there was a build-up

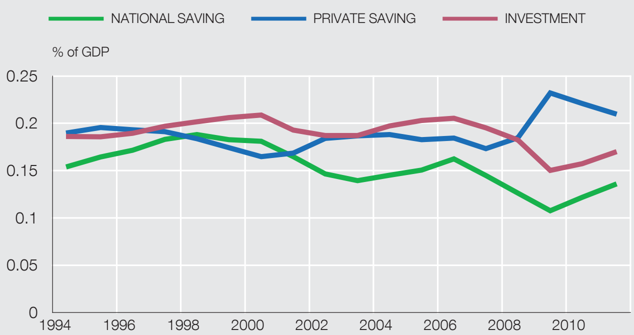
1 CURRENT ACCOUNTS AND GROSS FINANCIAL FLOWS (a)



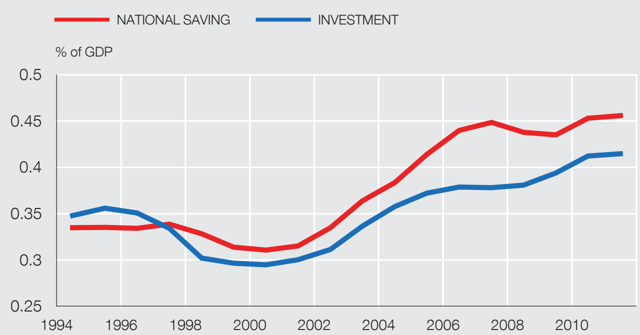
2 INTERNATIONAL RESERVES



3 US SAVING RATE AND INVESTMENT. PERCENTAGE OF GDP (a) (b)



4 SAVING RATE AND INVESTMENT IN EMERGING ASIA. PERCENTAGE OF GDP (a) (b)



SOURCES: World Economic Outlook (April 2010) and International Financial Statistics.

a. 2010 and 2011. WEO projection.
b. National saving is the sum of public saving and private saving.

of reserves (see Panel 2), arising partly from a precautionary motive, but also - and most especially so in the case of China - from the wish to maintain exchange-rate stability and to preserve an export-led growth model. Many oil exporting countries also adopted fixed exchange-rate policies, although the accumulation of external assets in these cases materialised through sovereign wealth funds. Consequently, a notable set of emerging economies routed their external financing to deficit-running countries, in particular the United States, investing in publicly owned assets.

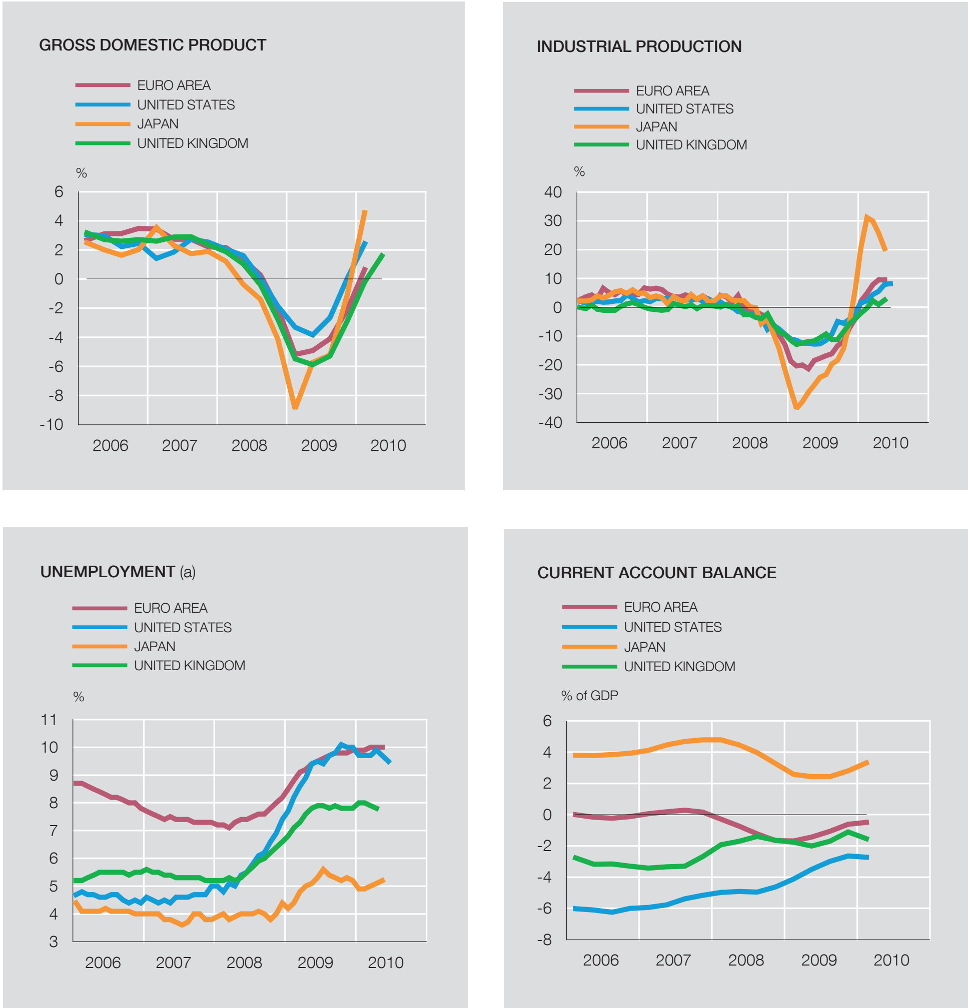
The economic and financial crisis has prompted a partial correction of global disequilibria, which edged down to account for somewhat more than 3% of world GDP in 2009, 2 pp less than the previous year, but still 2 pp more than in the mid-1990s. The collapse in world demand and in trade flows, and also in commodities prices, were the main factors of adjustment. In the United States, where the correction had begun before the crisis, the external deficit narrowed to 2.6% of GDP in 2009 (0.65% of world GDP), while in the oil exporting countries the surplus narrowed by 70%, coming to account for only 0.3% of world GDP; in China, the reduction was smaller, at 30%, whereby its surplus accounted for 0.5% of world GDP. From a more financial perspective, during the crisis there was a fall-off in international capital flows (a trait of financial crises), a decline in investment and a significant increase in private saving in the developed economies, which was more than offset by the strong rise in public dissaving in most of these countries.

Some of the factors behind the reduction in global disequilibria are associated with the strong economic and trade contraction; accordingly, some increase in disequilibria is expected with the recovery and the foreseeable reactivation of capital flows. In any event, they are not likely to recover their high pre-crisis levels. And domestic private demand in the developed economies is thus not expected to be as buoyant as it was before the crisis. Indeed, there has been a notable increase in the private saving ratio in the United States (see Panel 3) and in other countries, as a response to the heavy prior indebtedness, and the high budget deficits that have built up during the crisis will impose a restrictive bias in the medium term on the developed economies. Nor is it likely that oil and other commodities prices will regain their pre-crisis levels. On the other hand, however, the financial crisis may have reinforced the precautionary motive-led reserves-accumulation strategy, a factor that might lead disequilibria to widen. The potential impact of the recent fiscal problems in the euro area is difficult to gauge. Were they significantly to impact external and commodities demand in the area, that would slow the widening of surpluses in the countries running them, while the depreciation of the euro against the dollar may adversely affect the US current account deficit. Lastly, there are doubts as to whether the limited added flexibility of the exchange rate in China will substantially change exchange-rate policy and support the correction of China's extensive external surplus.

In sum, global disequilibria will foreseeably widen in the recovery phase, albeit on a lesser scale than before the crisis. Significantly, moreover, the disequilibria are now of a substantially different nature: countries with a surplus have shifted from financing heavy private debt in deficit countries to covering the high borrowing needs of their public sectors, which will absorb a notable amount of financial resources over a prolonged period of time.

In the *United States*, the rise in GDP in Q2 showed quarterly growth of 0.6% (3.2% year-on-year), thanks to the positive contribution of investment (including its residential component), private consumption and public spending, and despite the smaller contribution of inventories and the strongly negative contribution of external demand. The figure entails a slowdown in growth of 0.3 pp on Q1. The latest indicators revive doubts about the strength of the recovery, given the sluggishness of the figures for private consumption, employment and the residential real estate market. Retail sales fell in May and June, while consumer confidence plummeted in early July. The employment figures for May and June, once new hires to conduct the census were stripped out, were very disappointing, despite the 0.2 pp fall in the unemployment rate to 9.5%, derived from a reduction in the labour force owing to a discouragement effect. The residential real estate market fell once again in Q2 once tax relief for house purchases was removed at the end of April, and there were further reductions in housing starts and house sales. Turning to consumer prices, the inflation rate declined by 0.9 pp in June to a year-on-year rate of 1.1%, while core inflation held at 0.9%. Against this backdrop, the Federal Reserve left its official interest rate unchanged - between 0% and 0.25% - at its June meeting, and reiterated that it would hold it at a lower level for a prolonged period, depending on developments in the economy. FOMC projections revised down expected growth in 2010 and raised the forecast for the unemployment rate for 2011 and 2012. Lastly, the Financial Reform was finally approved. This legislation substantially amends regulatory and supervisory arrange-

MAIN MACROECONOMIC INDICATORS CHART 5
Year-on-year rate of change



SOURCES: Banco de España, national statistics and Eurostat.

a. Percentage of labour force.

ments governing financial institutions and the capital markets, although much of its content is still pending implementation.

In *Japan*, GDP in Q1 grew at a quarterly rate of 1.2%, slightly down on 0.9% the previous quarter and raising year-on-year growth to 4.6%. Underpinning the expansion was the momentum of exports and stockbuilding, while consumption moderated. The economic indicators point to a slowdown in Q2, owing to the diminished thrust of exports and the progressive phasing out of fiscal stimuli, despite the fact that the confidence indicators continue emitting positive signs. Turning to the external sector, the trade surplus narrowed in May as a result of the appreciation of the yen. The labour market worsened during the quarter and the unemployment rate rose by 0.3 pp to 5.3% in June. Consumer prices continued falling year-on-year to a negative rate of -0.7% in June, 0.4 pp less than at the end of Q1. In this context the Bank of Japan held its official interest rate at 0.1%, and approved a new temporary facility to stimulate the granting of bank credit to projects aimed at increasing the economy's potential growth. Finally, the new government announced a fiscal consolidation programme with the aim of restricting the issuance of public debt and achieving a balanced budget in 10 years, although the details have not been specified.

PRICES, REAL EXCHANGE RATE AND INTEREST RATES

CHART 6

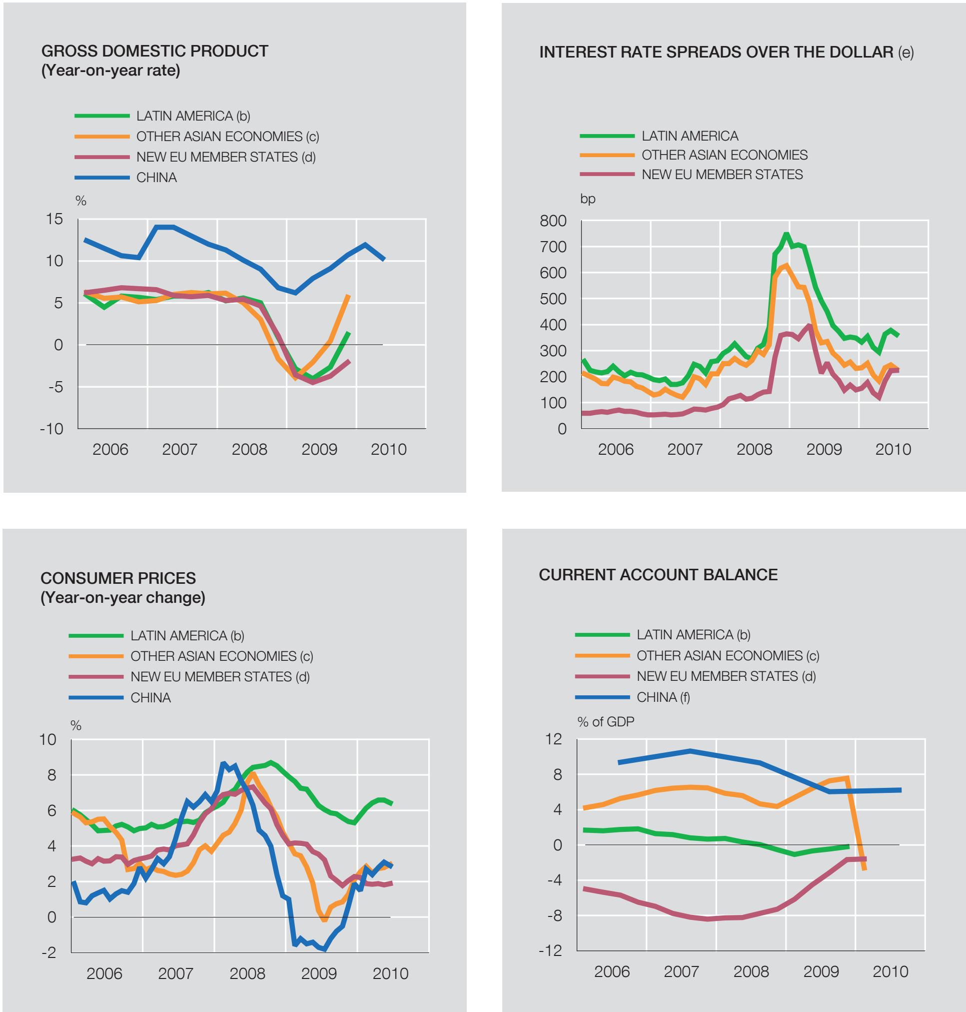
SOURCE: Banco de España.

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

In the *United Kingdom*, the final estimate of GDP for 2010 Q1 placed growth at a quarterly rate of 0.3% (-0.2% year-on-year), although the increase in GDP in Q2 points to a significant acceleration, with quarterly growth of 1.1%. This figure is higher than expected, given that the recent indicators of output, business sentiment and consumption have been somewhat slack, while the external sector showed signs of sluggishness. There were no significant changes in the labour market, although the unemployment rate fell slightly to 7.8% in June. There was an easing of prices in June in the real estate market, probably induced by the slowdown in demand and the sound growth of supply. Inflation was down 0.2 pp in June to 3.2%, following the rise in the opening months of the year, due in part to temporary factors such as the rise in VAT rates. Against this background, the Bank of England held its official interest rate unchanged at 0.5%, and did not make any further extensions to its asset purchase programme. Finally, the new government unveiled a budget envisaging a fiscal adjustment of 8 pp of GDP over the next five years, and plans for financial reform in which the central bank is given more powers in macroprudential regulation and the Financial Services Authority (FSA) is phased out.

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.

In the *new EU Member States* not belonging to the euro area, GDP grew at a year-on-year rate of 0.5% in Q1, following four consecutive quarters of declines. Activity was boosted by exports, except in Poland, where growth was underpinned by private consumption. Nonetheless, there are notable differences from country to country, with GDP growth in Poland, Hungary and the Czech Republic, and declines - albeit more moderate - in the remaining countries. The indicators for Q2 suggest a gradual recovery in industrial output, while signs are emerging of a pick-up in private consumption in some countries. As to the external sector, most countries posted current account surpluses, thanks to the sound behaviour of the trade balance. Over the course of the quarter, inflation held at a moderate rate and, in June, stood at 2.7% year-on-year for the region on average. Official interest rates held stable, except in the Czech Republic, where they were surprisingly cut in early May to 0.75%. Finally, in the institutional realm, on 13 July Ecofin approved the adoption of the euro by Estonia. Entry is scheduled for

1 January 2011, with a conversion rate of 15.6466 kroons per euro, its current Exchange Rate Mechanism II currency board rate.

In *China*, GDP grew at a year-on-year rate of 10.3% in Q2, easing from 11.9% in Q1. This slowdown came about partly due to the measures aimed at moderating the excessive dynamism of the real estate market and local government investment. On the external front, exports grew notably during the quarter after slowing in Q1, while the growth rate of imports eased, contributing to an increase in the trade surplus. Inflationary pressures moderated at the end of the quarter and inflation dipped by 0.2 pp in June to 2.9%. The central bank further increased banking reserve requirements, which may have contributed to the slight slowdown in bank lending. Moreover, as indicated, greater flexibility was provided to the exchange rate against the dollar, resuming the regime prior to the 2008 crisis, with a daily fluctuation band of + 0.5% against a basket of currencies. In the *other main Asian economies*, economic activity was very buoyant with India, South Korea and Singapore posting notable GDP growth in Q1. Economic indicators suggest the pace of growth will be maintained in Q2. Inflation rose moderately in the main countries of the region and remained very high in India. That led to the first rises in official interest rates in Taiwan, South Korea, Thailand and India, where reserve requirements were also increased.

In *Latin America*, GDP grew at a year-on-year rate of 5.5% in Q1 (1.4% in the previous quarter), driven by domestic demand and despite the fact that the contribution of external demand turned negative. In quarter-on-quarter terms, growth eased, due partly to the contraction in Mexico and despite the acceleration in Brazil and Argentina. The indicators for Q2 generally point to continuing buoyant activity, with the exception of Brazil, where some signs of slowing - from very high rates - are perceptible, and of Venezuela, which is expected to continue to post negative rates. Inflation across the region as a whole held stable, at around 6.6% year-on-year, with a generalised rise in most countries, except in Brazil and, especially, Mexico. Many central banks tightened their monetary policy stance; interest rates were raised in Peru, Chile and Brazil (which had already begun to tighten the previous quarter) and there were increases in reserve requirements in Peru, where sizeable exchange-rate interventions were made to restrain the appreciation of the exchange rate. In Argentina, the new unpaid debt swap was concluded, after which over 90% of the 2001 default has been restructured. Following this operation, the credit rating agency Fitch deemed that Argentine sovereign debt is no longer in a position of partial default. Finally, Colombia introduced a fiscal rule whose aim is to pursue a countercyclical policy and stabilise the effects on the budget of changes in oil prices.

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

During the second quarter of the year, there was a marked increase in the severity of the financial market turbulence in the euro area. Delays in addressing fiscal sustainability issues in Greece led to strong tensions in government bond markets, which initially spread to the more vulnerable economies owing to the rapid deterioration of their public finances and/or the size of their accumulated imbalances. However, the contagion was not confined to these countries, but spread to stock and foreign exchange markets and the financial system of the entire euro area on account of the exposure of a large number of European financial institutions to sovereign bonds issued in these countries. Moreover, the loss of confidence among international investors limited access to the wholesale funding markets, whereby the financial system, which channels the necessary external resources to households and firms, faced a serious liquidity problem.

Given the seriousness of the situation, the European authorities decided at a meeting on 7 May to adopt unprecedented emergency measures to safeguard the financial unity and integrity of the euro area. First, the Ecofin Council of 9-10 May established two new financing arrangements – the European Financial Stabilisation Mechanism and the European Financial Stability Facility – to assist Member States if they encounter difficulties in accessing the capital market. The arrangements are subject to strong conditionality. To date, it has not been necessary to activate these arrangements, which if warranted could be topped up with an additional contribution from the IMF (see Box 3). Second, the ECB, which kept the official interest rate at 1% on its main refinancing operations, again boosted the supply of liquidity and launched, as a temporary measure, the Securities Markets Programme to restore the correct functioning of public and private debt securities markets, whose distortions were hampering the monetary policy transmission mechanism. Significant progress was also made in the fiscal area and in structural reform. In particular, Greece, Portugal and Spain brought forward and considerably stepped up their fiscal consolidation plans, introducing some structural reforms, while Italy, Germany and other euro area economies started setting out their own austerity programmes, scheduled for introduction from 2011 onwards (see Box 4). Similarly, as explained in Box 3, important steps were taken in the reform of European governance to improve the mechanisms for the detection and correction of macroeconomic and fiscal imbalances. Last, the publication on 23 July of the bank-by-bank results of the stress tests on 91 EU financial institutions confirmed the overall resilience of the banking system to negative macroeconomic and financial shocks and was an important step towards restoring confidence to the markets.

The gradual introduction of all of these measures ultimately marked a turning point in the course of the financial tensions. In July sovereign debt spreads started to narrow, although they remain at high levels, and the euro appreciated against other currencies from its low mid-June levels. Similarly, more precise details of fiscal consolidation commitments eased investor concerns, as reflected in the success of all government debt issues.

Against this background, euro area growth is expected to be stronger in Q2 than during the winter months and to slow somewhat in the second half of the year, as a consequence of fiscal consolidation efforts being brought forward in some countries and a forecast loss of momentum in world trade due to the gradual withdrawal of the non-standard measures introduced in response to the crisis. The euro area rate of inflation stabilised during Q2 and inflation expectations remain firmly anchored below 2%. The weakness of domestic demand and continuing

The sovereign debt crisis has highlighted deep-seated weaknesses in the supervisory mechanisms designed to safeguard euro area macroeconomic and financial stability. It has also necessitated the introduction of new instruments to address the exceptional events of recent months.

In late April and early May, the expansive wave from the Greek crisis began to take on unexpected proportions. As it spread to other euro area economies, far-reaching emergency measures, listed in the table below, became necessary. Initially, efforts targeted the Greek liquidity crisis. On 2 May, the countries of the euro area set up a three-year financial assistance programme for Greece, with the commitment of extending bilateral loans for up to €80 billion. This amount can be increased by an additional contribution of €30 billion from the IMF. The first payment was made in mid-May, once the Greek authorities had adopted an ambitious and credible fiscal consolidation programme approved by the IMF, European Commission (EC) and European Central Bank (ECB).

Nevertheless, given the heightening and spreading of tensions in sovereign bond markets, the Ecofin Council meeting of 9-10 May decided to establish a more effective mechanism to provide financial assistance to any euro area member country in need, capable of mobilising up to €750 billion (over 8% of euro area GDP). This instrument comprises three elements. First, the European Financial Stabilisation Mechanism (EFSM), on which any euro area member country in need can call, has a fund of €60 billion which the EC will raise on the capital markets. Second, a company under the name of the European Financial Stability Facility (EFSF) was set up with the aim of granting loans to euro area countries in financial difficulty, up to a maximum of €440 billion, which the EFSF will obtain through bond issues. These loans will be guaranteed by those euro area member countries not benefiting from the assistance in proportion to their share in the capital of the ECB. To ensure the maximum credit rating for bonds issued by the EFSF, each euro area country will guarantee 120% of its share in each of the company's securities issues and, additionally, will set up a liquidity reserve. The EFSF has been functioning since the end of July, since over 90% of the member countries have already officially approved their participation in this facility, and it is expected to remain in place for three years. Finally, the IMF made a commitment to contribute additional funds to this assistance mechanism, amounting to at least half of the total contributions of the EU Member States (up to a maximum of €250 billion). Recourse to these funds is subject to strict conditionality hinging on the introduction of fiscal adjustment and structural reform measures.

These financial solidarity measures among euro area member countries were accompanied by a very active response from the ECB (discussed in detail in the main text of this Report) and a major commitment to fiscal consolidation by European countries (see Box 4), thus containing the spread of the tensions. However, the critical situation over recent months highlighted the need to fully overhaul governance in the euro area in order to prevent the emergence of situations that jeopardise euro area financial stability and, were they to materialise, to offer a more rapid and structured response.

European institutions are making considerable progress in this area, with the creation of a working group within the European Council in April (Van Rompuy Task Force), with the support of the EC, ECB and all EU Member States, in an attempt to establish a more robust political architecture for the euro area and the EU. This group will present its final conclusions in October. In the meantime, its work is already very advanced, as indicated by the Commission's communication of 30 June, which sets out a series of specific reform proposals and a road map for their introduction.

The reforms proposed thus far focus on the review of the supervisory mechanisms and are likely to involve, specifically, a strengthening of the Stability and Growth Pact (SGP) and a widening of surveillance to macroeconomic imbalances and competitiveness divergences of Member States. In the fiscal area, it is proposed that government debt should again have the relevance it was originally given by the Pact, on account of its close relationship to the sustainability of public finances. Consequently, countries with levels of debt above 60% of

RECENT EURO AREA AND EU ECONOMIC POLICY DECISIONS

DATE	INSTITUTION	DECISION
11 February	Heads of State or Government	Commitment to take measures necessary to safeguard euro area financial stability
25 March	Heads of State or Government	Establishment of principles of future financing mechanism for Greece. Bilateral loans between member countries and IMF
11 April	Eurogroup	Agreement on specific terms of possible financial support to Greece
2 May	Eurogroup	Approval of Greek support programme
3 May	ECB	Suspension of application of minimum credit rating threshold applicable to Greek marketable debt
7 May	Heads of State or Government	Euro area governance and structural reform drive
9-10 May	ECOFIN	European Financial Stabilisation Mechansim
10 May	ECB	Securities Markets Programme
12 May	European Commission	Presentation of first proposal for governance reform
7 June	Eurogroup	European Financial Stability Facility
10 June	ECB	Publication of contribution to governance reform
30 June	European Commission	Announcement with more specific proposals for governance reform

SOURCE: Banco de España.

GDP will be subject to the Excessive Deficit Procedure (EDP), unless the variable is declining at a satisfactory pace (as measured against a yet to be set numerical target). Furthermore, an extension of the system of sanctions and incentives is proposed, whereby they will kick in more automatically, even in a pre-emptive capacity, when progress towards compliance with medium-term objectives is not satisfactory. In the case of countries subject to the EDP, the Commission upholds the suspension and subsequent cancellation of financial commitments associated with structural, agricultural and fishing funds, which make up most of the EU's budget, for those countries that fail to comply with the recommendations. Finally, to provide an incentive for compliance with the SGP while respecting the national sovereignty of fiscal policies, the Commission will make a proposal in September establishing the minimum requirements to be met by national fiscal frameworks (fiscal rules, multiannual budgetary programmes), with the recommendation that they apply to all tiers of government.

For the surveillance and correction of macroeconomic imbalances, a scoreboard of economic and financial indicators will be created. These indicators will include the current account balance, real effective exchange rates measured using unit labour costs and the GDP deflator, net external assets, house prices, government debt and the private sector credit/GDP ratio. Nevertheless, given the complexity in establishing the target or reference values for these indicators, the situations of those countries with larger imbalances will be analysed in greater depth, incorporating other relevant criteria, and on this basis the necessary recommendations will be made. In the most extreme cases, the country will be placed in an "excessive imbalances position", triggering a procedure of closer supervision by the Eurogroup and the European Council and leading to the issuance of more detailed economic policy recommendations. Meanwhile, the country will be required to report regularly to Ecofin and the Eurogroup on its progress in implementing reforms. The functioning of this mechanism will be consistent with the outcome of the surveillance of structural reform in the Member States conducted by the Commission within the framework of the Europe 2020 strategy, using as a basis the National Reform Programmes (NRPs).

All these changes will be integrated into the "European semester", which will be launched in 2011 and will foster the ex ante coordination of national policies with European objectives. The Semester will start in January each year with the publication by the European Commission of a report entitled "Annual Growth Survey", in which economic issues of relevance to the EU and euro area are reviewed, and will continue in April when the Member States submit their Stability and Convergence Programmes and NRPs to the European Council. The Council's response will be given in July, with the publication of country-specific economic policy guidelines which should be taken into account in the national government budgets for the following year.

In addition to strengthening the surveillance mechanisms, consideration is being given to the possibility of establishing a permanent crisis management mechanism to tackle a possible restructuring of debt by a Member State. The design of this permanent mechanism is still pending discussion by the Working Group, but there is a broad consensus that the financial assistance provided through it will necessarily be subject to a strict conditionality to ensure that the correction of imbalances is addressed with sufficient resolve and to minimise situations of moral hazard.

tight credit standards point to a slow, uneven economic recovery, with growth rates of less than 1.5% forecast for 2011. Furthermore, the downside risks to this scenario have increased owing to the possible effect that a new crisis episode may have both on the confidence of households and firms, although for the moment no noticeable impact has been observed, and on financing conditions in the economy. Progress in the areas of fiscal consolidation, structural reform and euro area governance – details of which will be provided in October – is key to restoring the correct functioning of financial markets, to reducing to a minimum the probability that the downside risks eventually materialise and to laying the foundations for more robust growth.

3.1 Economic developments

According to the second National Accounts estimate for 2010 Q1, euro area GDP rose by 0.2% over the previous quarter (see Table 1). This increase was chiefly attributable to the positive contribution from stockbuilding and, to a lesser extent, to favourable developments in government consumption, exports and investment in capital goods. Conversely, private consumption declined slightly, while construction investment fell sharply owing to the bad weather. Imports quickened, causing net external demand to subtract 0.5 pp from the GDP growth rate, despite the vigour of exports (see Chart 8). The sectoral breakdown of value added also reflects the delays in activity in construction, the only sector to experience a negative quarter-

The severe tensions in the sovereign bond markets during April and May have substantially upset the pace of the design and implementation of fiscal consolidation plans in some euro area countries.

Greece was the first to step up its efforts, amid a crisis of confidence that took its economy to the brink of economic collapse. The situation was such that it required the activation of a financial assistance package under very stringent conditions, including the requirement to draw up a credible and ambitious fiscal consolidation plan. Thus, having already submitted three successive packages of measures in the course of 2010 Q1, on 2 May – immediately after the Eurogroup meeting approving the terms of the assistance mechanism – the Greek government presented an aggressive consolidation plan, this time with realistic targets and more specific measures. The implementation of the plan will be reviewed quarterly by the EC, ECB and IMF. The government's new budgetary targets envisage a deficit reduction of 11 pp of GDP between 2010 and 2014 (see accompanying table), one of the biggest such reductions in the developed economies in recent decades. To achieve this goal, the Greek government plans to introduce important discretional measures which create sufficient leeway to counter the impact that the contraction in GDP is having on tax revenue. Almost half of the consolidation drive is planned for 2010, when the deficit is expected to drop by more than 5 pp of GDP. The measures introduced rely heavily on expenditure cuts in the form of a pension and public sector wage freeze for the next three years, restrictions on public sector recruitment and a sizeable adjustment in public investment expenditure. Additionally, revenue increases are expected as a result of hikes in VAT, excise duties and income tax.

Following the extraordinary meeting of Ecofin on 9-10 May, Spain and Portugal, two economies severely affected by the tensions in government bond markets, were urged to step up their fiscal austerity efforts in 2010 and 2011. Accordingly, they announced additional initiatives on 12 and 13 May, respectively. Spain's consolidations measures, which are explained in greater detail in Section 4 of this Report, include a deficit reduction of 0.5 pp of GDP in 2010 and a further 1 pp in 2011, which would mean reducing the deficit from the 11.2% reached in 2009 to 9.3% in 2010, and to 6% in 2011 (compared with the 7.5% previously planned). Meanwhile, in mid-May the Portuguese government announced new adjustment measures amounting to 1.2% of GDP in 2010 and an additional 1% in 2011. Furthermore, the introduction of some of the measures set out in the Stability Programme submitted in March, initially planned for 2011, was brought forward to 2010. As a result, new deficit targets of 7.3% for 2010 and 4.6% for 2011 (instead of the previous 6.6%) were set. The decisions having the greatest budgetary impact include, on the revenue side, a VAT increase (of 1 pp to 21%) and the increases in personal income tax and corporate income tax. On the expenditure side, the measures with most impact are the reduction in government investment, public sector wage restraint and restrictions on recruitment. Overall, more than 60% of the fiscal consolidation agreed within the framework of the Stability and Growth Pact (SGP) for the period 2009-2013 will be carried out in 2010 and 2011. In both cases, austerity measures have been introduced on the income and expenditure sides, although in Spain's case expenditure will bear the brunt.

Meanwhile, Italy and Germany have not altered their targets from those set in their initial stability programmes, but both countries have drawn up austerity programmes for the coming years that will take effect from 2011. The programmes specify measures which, under other circumstances, would have been included in the scope of budgetary discussions for that year. Italy issued a legislative decree on 25 May, targeting an overall consolidation of 1.6% of GDP to be spread equally between 2011 and 2012. Almost two-thirds of the adjustment comes from government expenditure restraints in the form of wage cuts, a freeze on public sector recruitment, cuts in pensions and expenditure on medicines and, most of all, a reduction in transfers to local government. Revenue from the fight against tax evasion also makes a considerable contribution (almost one-third of the total from all measures). In Germany, the government presented a consolidation plan on 7 June for the period 2011-2014, aimed at achieving compliance with the provisions of the EDP and a structural deficit in 2016 close to the Constitution's target of 0.35% of GDP. The

BUDGET TARGETS IN THE EURO AREA (2009-2012)

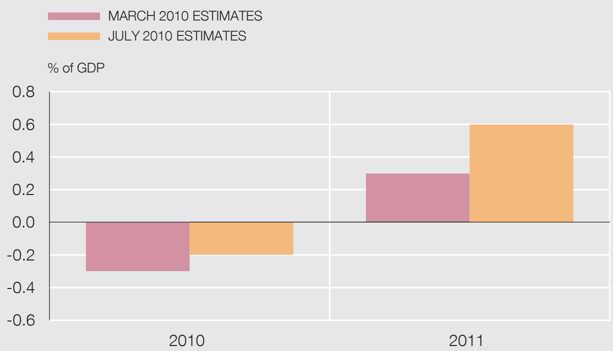
% of GDP

	BUDGET BALANCES (a)			
	2009	2010	2011	2012
Germany	-3.3	-5.5	-4.5	-3.5
Greece	-13.6	-8.1	-7.6	-6.5
Spain	-11.2	-9.3	-6.0	-4.4
France	-7.5	-8.2	-6.0	-4.6
Italy	-5.3	-5.0	-3.9	-2.7
Portugal	-9.4	-7.3	-4.6	-3.0
Euro area	-6.3	-6.6	-5.1	-3.9

SOURCES: Stability and Convergence Programmes and additional measures introduced in 2010.

a. Deficit (-) / surplus (+). The deficits that exceed 3% of GDP have been shaded.

FISCAL ADJUSTMENT. CHANGES IN THE STRUCTURAL BALANCE



SOURCES: European Commisison and Banco de España.

plan envisages a deficit reduction of 1.1% of GDP over the four years (0.5% in 2011) and also relies heavily on government expenditure restraints, particularly welfare and armed forces expenditure. However, also being planned are increases in energy taxation and the introduction of a new banking sector charge from 2012.

Finally, on 30 June the French government presented a preparatory report outlining the budgetary programme for the next three years (2011-2013), which is to be approved in the autumn. On the basis of what has been announced so far, which is still very tentative, France intends to contain its budget deficit by freezing central government expenditure over the three-year period, reducing transfers to local government, eliminating tax deductions and implementing restraints on health expenditure. The forthcoming pension reform will also have a significant impact on the country's public finances.

With these budgetary plans, the euro area as a whole looks set to maintain a moderately loose or neutral fiscal policy stance in 2010, with considerable differences between the group formed by Greece, Portugal and Spain, which, together with Ireland, have already started to introduce ambitious fiscal plans, and France and Germany, which support a loose fiscal policy (see accompanying table). In 2011, fiscal consolidation will probably be more generalised, although the degree is still likely to differ across countries. The adjustment for this year, measured as changes in the structural balance, will foreseeably amount to almost 0.6% of euro area GDP (see accompanying chart), an additional effort of 0.3 pp compared with the Commission's spring estimates, which do not take into account the additional consolidation measures presented in May and June.

The effects of these austerity measures on economic growth are very uncertain, although the lack of corrective measures in those economies with sizeable imbalances would undermine confidence and hamper economic growth. Empirical evidence on the macroeconomic effects of fiscal consolidation indicates that they are due to multiple factors. However, the possible short-term negative impact on growth tends to be less when the adjustment is based on restraining primary government expenditure, as planned in almost all of the countries discussed. Furthermore, given the current tensions in the euro area sovereign debt markets, medium-term budget plans based on credible measures may be especially beneficial owing to their effect on consumer and investor confidence, particularly if they are accompanied by institutional and structural reforms that enhance the credibility of these commitments.

on-quarter change, whereas in industry and services the pace of activity was brisker than in previous quarters. In year-on-year terms, GDP rose by 0.6%, leaving behind the negative growth rates recorded since 2008 Q4.

The GDP of the main euro area economies expanded in the first quarter of the year, although the composition varied in some respects. In Germany the 0.2% increase in GDP was attributable mainly to the high positive contribution from stockbuilding and, to a lesser extent, to growth in government consumption, while the contribution to GDP from net external demand was negative due to the rise in imports. By contrast, GDP growth in France and Italy – up by 0.1% and 0.4%, respectively – was supported by favourable external developments, strongly driven by exports and a moderate rise in imports, while government consumption and stockbuilding recorded a zero or slightly negative contribution to GDP. In all three countries private consumption was markedly weak and investment in capital goods picked up.

Based on National Account figures, the quarter-on-quarter rate of change in employment in 2010 Q1 was zero, after declining for six consecutive quarters. In year-on-year terms, employment fell by 1.3%, more so than the number of hours worked, most likely reflecting the movement towards the re-storing standard work hours. The year-on-year increase in GDP, however, meant that apparent labour productivity recorded a positive rate of change – the first since 2008 Q2 – that translated into a considerable reduction in unit labour costs, which in turn gave rise to an increase in business margins (see Chart 8).

The latest conjunctural information, which refers to developments in 2010 Q2, suggests that euro area activity grew more than in Q1 (see Chart 9). On the supply side, based on data to May, both industrial orders and industrial and construction sector production grew with re-

EURO AREA ECONOMIC INDICATORS (a) TABLE 1

	2008	2009				2010		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
NATIONAL ACCOUNTS (quarter-on-quarter rates, unless otherwise indicated)								
GDP	-1.9	-2.5	-0.1	0.4	0.1	0.2		
Private consumption	-0.7	-0.6	0.1	-0.2	0.2	-0.1		
Government consumption	0.8	0.8	0.7	0.7	-0.2	0.2		
GFCF	-4.0	-5.3	-1.5	-1.1	-1.2	-1.2		
Imports	-4.7	-8.0	-2.8	2.8	1.2	3.8		
Exports	-7.3	-8.4	-1.1	2.9	1.8	2.1		
Contributions to quarter-on-quarter GDP growth (pp)								
Domestic demand (excl. stocks)	*-1.1*	*-1.3*	*-0.1*	*-0.2*	*-0.1*	*-0.3*		
Change in stocks	*0.3*	*-1.1*	*-0.6*	*0.5*	*0.0*	*1.0*		
Net external demand	*-1.1*	*-0.2*	*0.5*	*-0.1*	*0.1*	*-0.5*		
GDP (year-on-year rate)	*-2.0*	-5.2	-4.9	-4.1	-2.1	0.6		
ECONOMIC INDICATORS (average data for the quarter)								
IPI seasonally and working day-adjusted	-6.8	-9.3	-1.7	2.6	1.3	2.5	*2.3*	
Economic sentiment	80.0	71.5	75.6	84.1	91.9	96.6	99.3	*101.3*
Composite PMI	40.2	37.6	43.2	49.5	53.6	54.4	56.6	*56.7*
Employment	-0.4	-0.8	-0.5	-0.5	-0.2	0.0		
Unemployment rate	8.0	8.8	9.3	9.7	9.8	9.9	10.0	
PRICE INDICATORS (year-on-year change in end-of-period data)								
HICP	1.6	0.6	-0.1	-0.3	0.9	1.4	1.4	
PPI	1.2	-3.2	-6.5	-7.7	-2.9	0.9	*3.1*	
Oil price (USD value)	40.5	46.8	68.8	67.7	74.4	78.8	75.0	*76.1*
FINANCIAL INDICATORS (end-of-period data)								
Euro area ten-year bond yield	3.8	4.1	4.2	3.8	4.0	4.0	3.7	*3.6*
US-euro area ten-year bond spread	-1.76	-1.31	-0.63	-0.47	-0.17	-0.08	-0.72	*-0.55*
Dollar/euro exchange rate	1.392	1.331	1.413	1.464	1.441	1.348	1.227	*1.299*
Appreciation/ depreciation of the EER-21 (b)	2.5	-0.6	-0.9	0.2	-1.0	-4.5	-10.3	*-7.8*
Dow Jones EURO STOXX 50 index (b)	-44.3	-15.5	-2.0	17.2	21.0	-1.2	-13.2	*-6.7*

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

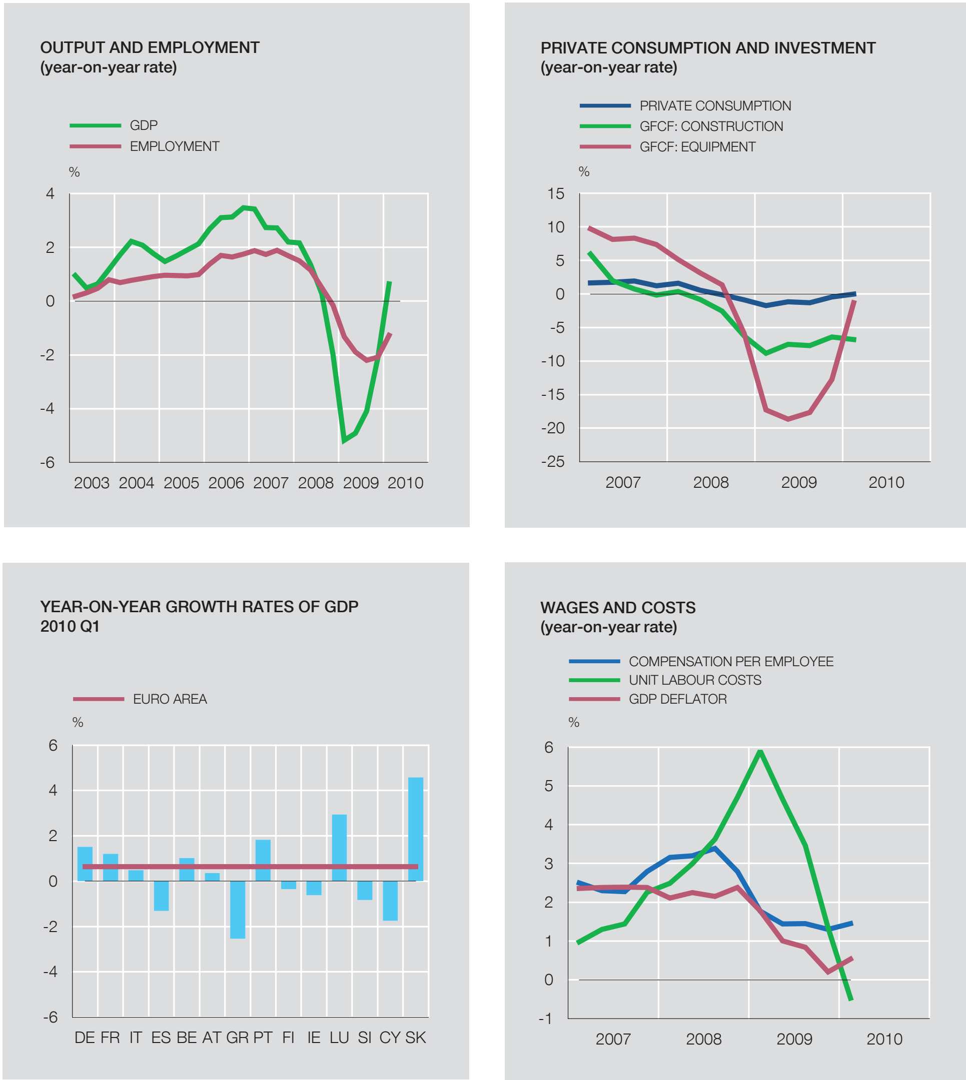
a. Information available to 28 July 2010.
b. Percentage change in the year to date.

spect to the previous quarter. The industry and services confidence indicators published by the European Commission and those associated with purchasing manager surveys indicated an improvement in the quarterly average, although in May and June they fell back somewhat due to expectations of weaker demand, while optimism regarding order books rose. The latest information from the qualitative indicators, for developments in July, points to a large increase. Meanwhile, the unemployment rate remained flat at 10% and the qualitative indicators for the labour market continued to strengthen.

On the demand side, retail sales were weak in April and May, and car registrations were still affected by the phasing-out of car purchase incentive plans in the average for the quarter, although there are signs that the contractionary effect may be coming to an end. Consumer confidence fell in May, possibly associated with the increase in uncertainty caused by the sovereign debt crisis, before improving in June and July. As to investment in capital goods, both the level of capacity utilisation and the European Commission's assessment of industrial order books increased notably during Q2 and Q3, although both still remain below their long-term averages. In addition, goods exports grew at a firm pace in April and May, while the improvement in the outlook for exports and in the assessment of foreign orders continued through to July. Lastly, the European Commission's industrial stock level assessment indica-

EURO AREA NATIONAL ACCOUNTS

CHART 8



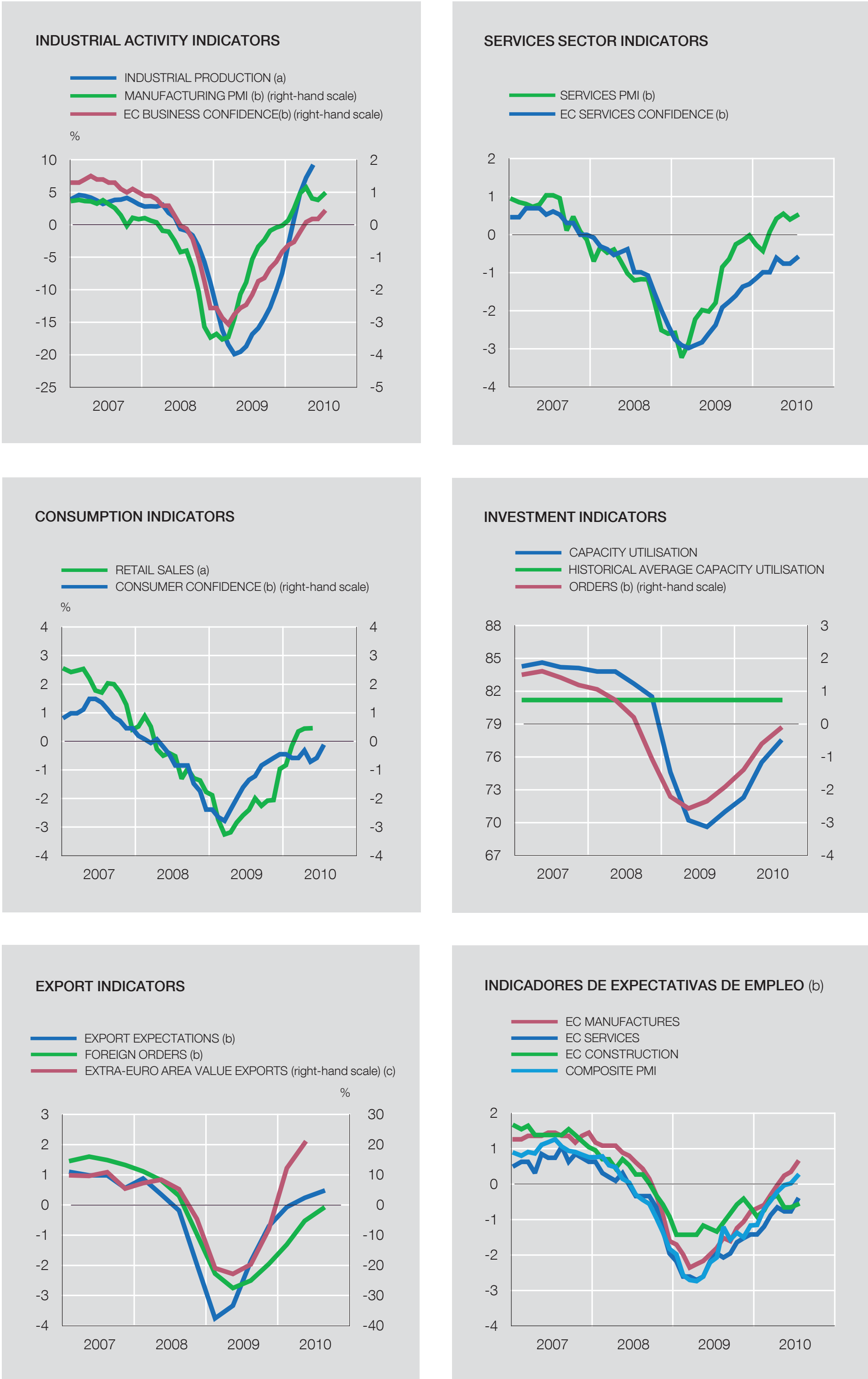
Sources: Eurostat and national statistics.

tor suggests that, during the spring, the contribution of stockbuilding to GDP growth may have fallen.

In short, available indicators, mostly for Q2, point to growth in euro area GDP of around 0.5%, driven by the strength of world trade and, temporarily, by investment in construction, which is likely to counter the sharp decline in the previous quarter associated with the adverse weather conditions. The sovereign debt crisis does not seem to have had a noticeable impact on confidence indicators in view of their trend over recent months. The accommodative stance of monetary policy and the introduction of a raft of non-standard measures, which were adopted to restore the correct functioning of the financial system and to bolster confidence in the euro area, would seem to have provided support to the ongoing recovery. Looking ahead to the second half of the year, the pace of growth is expected to slow somewhat owing to the impact, in the short term, of the early implementation of fiscal consolidation measures in some countries and to the persistent weakness of consumption and investment. In particular, unfavourable labour market conditions and low growth in wage income constrain the expansion of private consumption, while excess plant capacity and the still very tight credit standards faced by some countries and sectors hinder the resumption of investment. The pace of world growth

EURO AREA. REAL INDICATORS

CHART 9



SOURCES: Eurostat and European Commission.

a. Non-centred annual percentage changes, based on the quarterly moving average of the seasonally adjusted series.
b. Normalised data.
c. Quarter-on-quarter rates of the original series. Quarterly average.

GDP AND HICP FORECASTS FOR THE EURO AREA (a) TABLE 2

	2010		2011	
	GDP	HICP	GDP	HICP
ECB (June 2010)	0.7-1.3	1.4-1.6	0.2-2.2	1.0-2.2
European Commission (May 2010)	0.9	1.5	1.5	1.7
IMF (July 2010)	1.0	1.2	1.3	1.3
OECD (May 2010)	1.2	1.4	1.8	1.0
Consensus Forecast (July 2010)	1.1	1.5	1.4	1.5
Eurobarometer (July 2010)	1.1	1.4	1.3	1.5

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

a. Annual rate of change.

is expected to moderate in the second half of the year, as the non-standard measures adopted in response to the crisis run their course.

The latest forecasts for 2011 published by international agencies point to a subdued recovery, with GDP growth rates in the euro area of between 1.2% and 1.5% (see Table 2). The moderate and gradual pace of the recovery is consistent with the usual pattern of developments following a financial crisis, characterised by high levels of excess capacity and tight credit standards, which hinder a more robust pick-up in domestic demand. As a result of the sovereign debt crisis, the downside risks to this baseline scenario have increased. Such risks may stem, inter alia, from greater financial tension and the weakening of business and consumer confidence. Furthermore, the recovery hinges closely on the success of the fiscal consolidation drive and structural reforms in driving potential growth and in curbing any lasting increase in unemployment. The unprecedented measures that are being adopted and the ongoing progress in improving European governance should contribute to preventing these risks from materialising.

Euro area inflation levelled off during Q2, after picking up in the first few months of the year as a result of the increase in energy prices. In June the HICP stood at 1.4%, while core inflation, as measured by the CPI excluding unprocessed food and energy, was 0.9%, both rates unchanged from March. Producer prices rose by 3.1% in May, compared with -1% in January, with a particularly sharp rebound in the prices of energy and non-energy intermediate goods. Thus, weak demand, reflected in the sizable slack in capacity, could well be associated with the difficulties encountered by firms to pass on some of the increases in their costs to consumers and helps to explain the favourable developments in the prices of the most stable components of the HICP. In this context, long-term inflation expectations remain anchored below 2% and there is a consensus among international agencies that inflation with remain at moderate levels over the coming quarters (see Table 2).

According to estimates published by the ECB, the euro area current account balance ran a deficit of €44 billion (1.2% of GDP) between January and May 2010, down from the level recorded for the same period of the previous year (1.6% of GDP). This improvement was the result of the more favourable behaviour observed in all of its components, particularly the goods balance, which recorded a surplus. As regards the financial account for the same period, net capital outflows in the form of direct investment amounted to €55 billion, compared with €40 billion in the same period of the previous year, while portfolio investment recorded net inflows of €87 billion, down on the €135 billion for the period January-May 2009. As a result, the basic balance, which is the sum of these two types of investment and the

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

CHART 10

SOURCES: Eurostat and ECB.

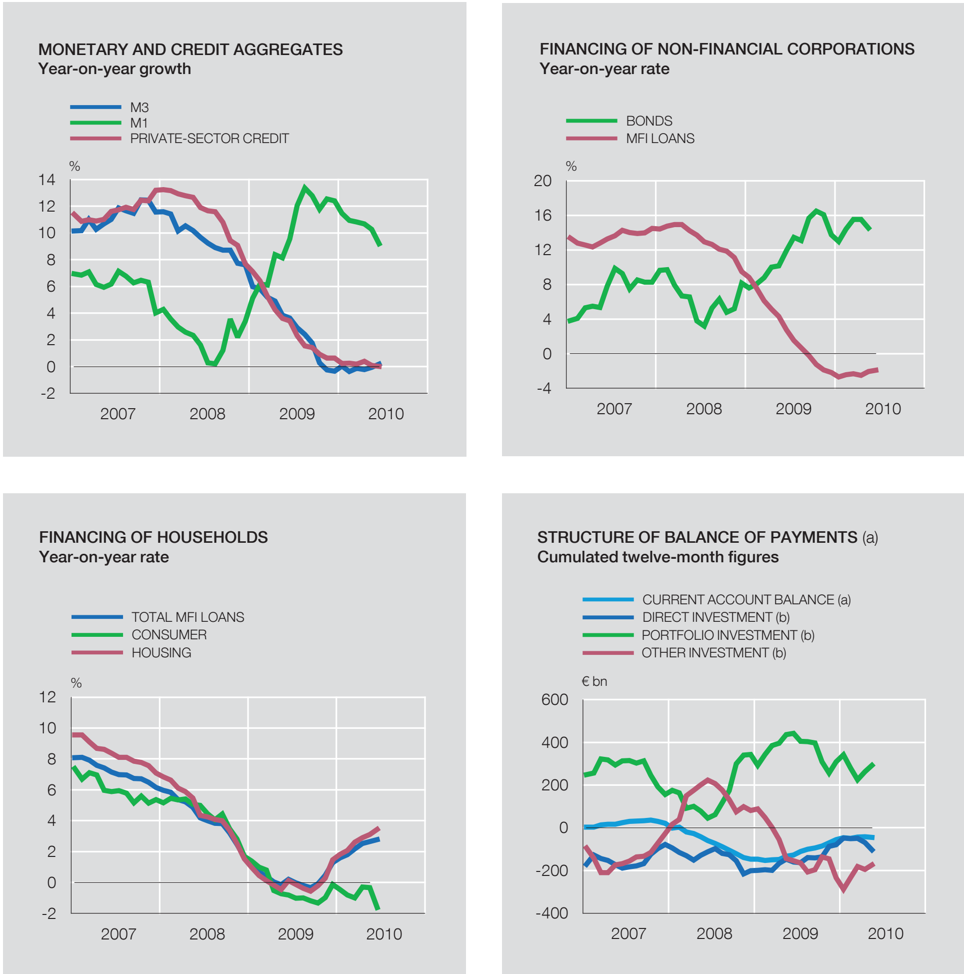
current account balance, scarcely changed, showing a deficit of €12.5 billion (see Chart 11).

According to the European Commission's spring forecasts, the euro area's general government budget deficit will stand at 6.6% of GDP in 2010, its highest level since the creation of the monetary union (see Table 3). The fiscal policy stance this year will foreseeably be slightly expansive, with considerable differences across countries. More specifically, Greece and, subsequently, Spain and Portugal had to accelerate their plans for fiscal consolidation, in compliance with the recommendations of the Ecofin Council meeting of 9-10 May, while France and Germany still maintain sizeable stimulus measures. For 2011 the Commission expects a deficit correction of up to 6.1% of GDP, as a result both of the economic recovery and of the planned fiscal consolidation measures, which next year will be more generalised, in accordance with the programmes submitted and/or approved recently by the countries concerned (see Box 2). Furthermore, government debt in the euro area could well stand at around 85% of GDP in 2010, a 7 pp increase on the previous year.

By country, there has been a notable improvement in Greek public finances during the first half of 2010, with a deficit reduction of 45% over the previous year. This exceeds the 40% target

MONETARY AND CREDIT AGGREGATES AND BALANCE OF PAYMENTS

CHART 11



SOURCES: ECB and Banco de España.

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

of the economic programme announced by the government in May and required under the conditionality of the financial assistance programme. In the cases of Spain and Portugal, the Commission gave a very positive assessment of the new targets approved in May, although for 2011 both economies will have to specify additional measures to reduce their deficits. Lastly, the Ecofin Council of 13 July decided to initiate an excessive deficit procedure against Cyprus, whose fiscal deficit exceeded the 3% of GDP reference value of the Stability and Growth Pact, and against Finland, whose deficit, in line with forecasts, will exceed the reference value in 2010. Consequently, 15 euro area countries are currently subject to excessive deficit procedures – the exception being Luxembourg.

3.2 Monetary and financial developments

Over recent months financial developments in the euro area have been characterised by the escalation of tensions in government bond markets. Investor concerns over the sustainability of public finances in a number of countries, particularly Greece, led to sovereign spreads widening considerably. The financial support package for Greece was not enough to reverse this trend and the tensions spread to the interbank and bank funding markets, and also to share prices and the exchange rate of the euro, which fell sharply. As Box 3 describes, the situation called for an urgent, unprecedented response from the governments of the EU Member States, which led to the creation on 9 and 10 May of a mechanism to provide financial assistance to

EURO AREA: GENERAL GOVERNMENT BUDGET BALANCES AND PUBLIC DEBT OF EURO AREA COUNTRIES (a)

TABLE 3

% del PIB

	2008	2009	2010		2011	
		EDP (b)	EC (c)	IMF (d)	EC (c)	IMF (d)
Belgium	-1.2	-6.0	-5.0	-5.1	-5.0	-4.4
Germany	0.0	-3.3	-5.0	-5.7	-4.7	-5.1
Greece	-7.7	-13.6	-9.3	-8.7	-9.9	-8.8
Spain	-4.1	-11.2	-9.8	-10.3	-8.8	-9.6
France	-3.3	-7.5	-8.0	-8.3	-7.4	-7.1
Ireland	-7.3	-14.3	-11.7	-12.1	-12.1	-11.5
Italy	-2.7	-5.3	-5.3	-5.3	-5.0	-5.3
Luxembourg	2.9	-0.7	-3.5	-3.8	-3.9	-5.0
Netherlands	0.7	-5.3	-6.3	-5.9	-5.1	-5.1
Austria	-0.5	-3.4	-4.7	-4.8	-4.6	-4.5
Portugal	-2.9	-9.4	-8.5	-8.7	-7.9	-7.5
Finland	4.2	-2.2	-3.8	-3.6	-2.9	-3.2
Slovenia	-1.7	-5.5	-6.1	-6.1	-5.2	-4.9
Cyprus	0.9	-6.1	-7.1	-7.6	-7.7	-8.8
Malta	-4.5	-3.8	-4.3	-5.0	-3.6	-4.8
Slovak Republic	-2.3	-6.8	-6.0	-8.0	-5.4	-7.4
MEMORANDUM ITEM: Euro area (including Malta and Cyprus)						
Primary balance	1.0		-3.6		-2.9	
Total balance	-2.0	-6.3	-6.6	-6.9	-6.1	-6.3
Public debt	69.4	78.7	84.7	83.7	88.5	87.7

SOURCES:European Commission, Eurostat and IMF.

a. Deficit (-) / surplus (+). The deficits that exceed 3% of GDP have been shaded.
b. Spring 2010 notification of Excessive Deficit Procedure.
c. European Commission forecasts (spring 2010).
d. IMF forecasts (April 2010).

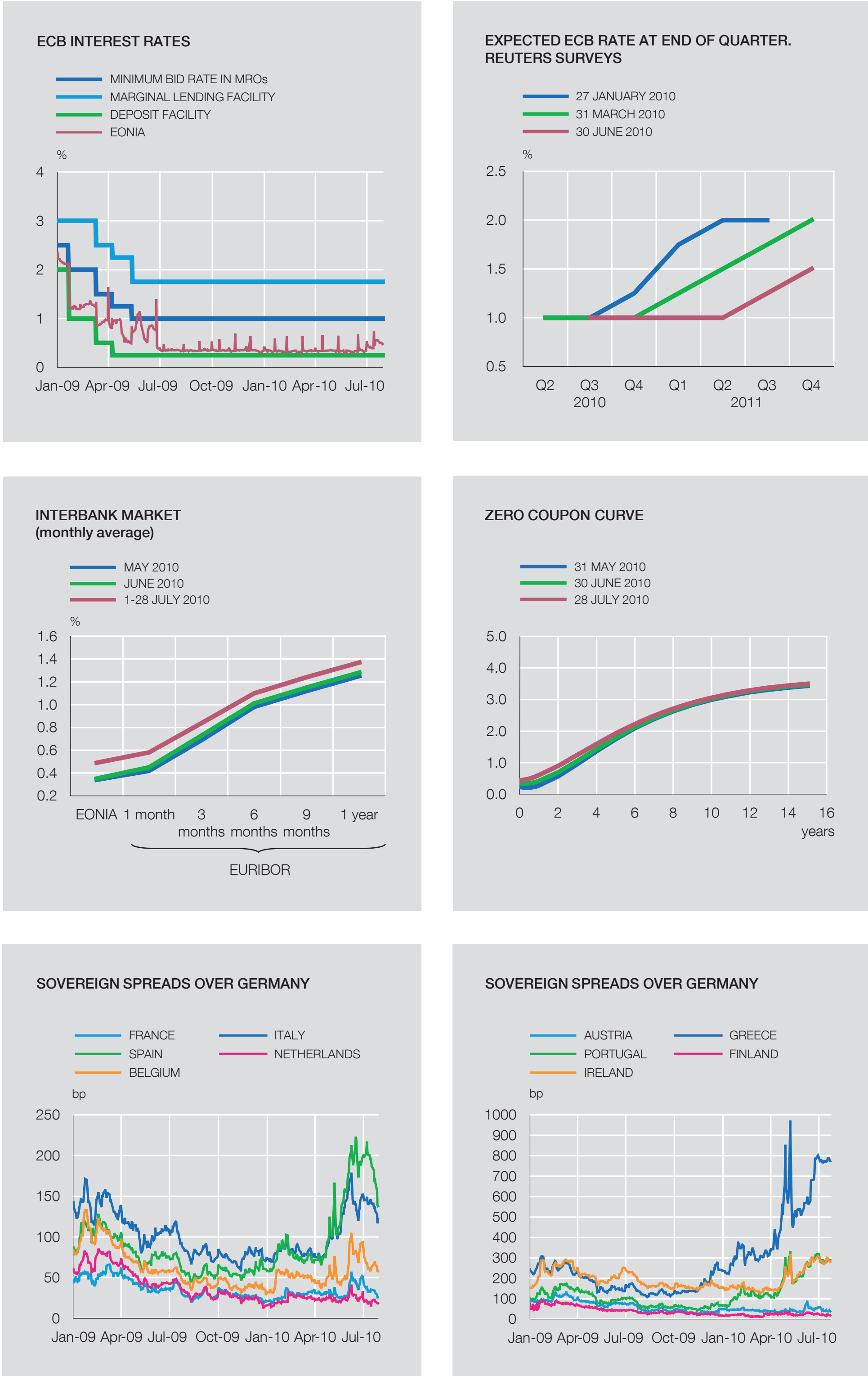
any euro area member country, subject to strong conditionality. For its part, the ECB introduced – as described below – a number of measures, including a Securities Markets Programme aimed at helping restore the appropriate functioning of certain debt securities markets. The phasing-in of these initiatives, together with the success of a series of government bonds issues and the stress-testing of a large number of EU banks, inter alia, led to a gradual easing of the volatility and tensions in the financial markets from mid-June, and more especially in July, with the publication of the results of the stress tests.

The absence of inflationary pressures in the medium term, in the context of slow economic recovery, meant that, in its meetings to August, the ECB's Governing Council left official interest rates unchanged. Hence the rate on main refinancing operations has stood at 1% since May 2009, while those on the marginal lending and deposit facilities were 1.75% and 0.25%, respectively (see Chart 12).

In response to the resurgence of tensions in government bond markets and their pass-through to the banking system, the ECB, which had already started to withdraw some of the enhanced credit support measures, embarked on new courses of action. Thus, in early May, the ECB decided to suspend the application of the minimum credit rating threshold to marketable debt instruments issued or guaranteed by the Greek government, to bolster longer-term liquidity provision by returning to three-month refinancing operations based on a fixed-rate tender procedure with full allotment and by conducting a new six-month longer-term refinancing op-

EURO AREA INTEREST RATES

CHART 12



SOURCES:ECB and Banco de España.

a. ECB estimate drawing on swap market data.

eration, and to resume US dollar liquidity-providing operations. Furthermore, to counter the tensions in the debt securities markets and ensure the transmission of monetary policy, it introduced, as a temporary measure, the Securities Markets Programme, through which it conducts sterilised purchases of public and private debt in the secondary market. The amount purchased weekly has fallen gradually since May, declining to negligible levels in recent weeks, and totals some €60 billion. The interventions are sterilised through weekly tenders to re-absorb the liquidity injected. Additionally, in the framework of non-standard measures and enhanced credit support, the Covered Bond Purchase Programme, which was launched one year ago, concluded as foreseen at the end of June, with €60 billion worth of bonds purchased (in the Spanish market covered bonds are referred to as *cédulas hipotecarias).*

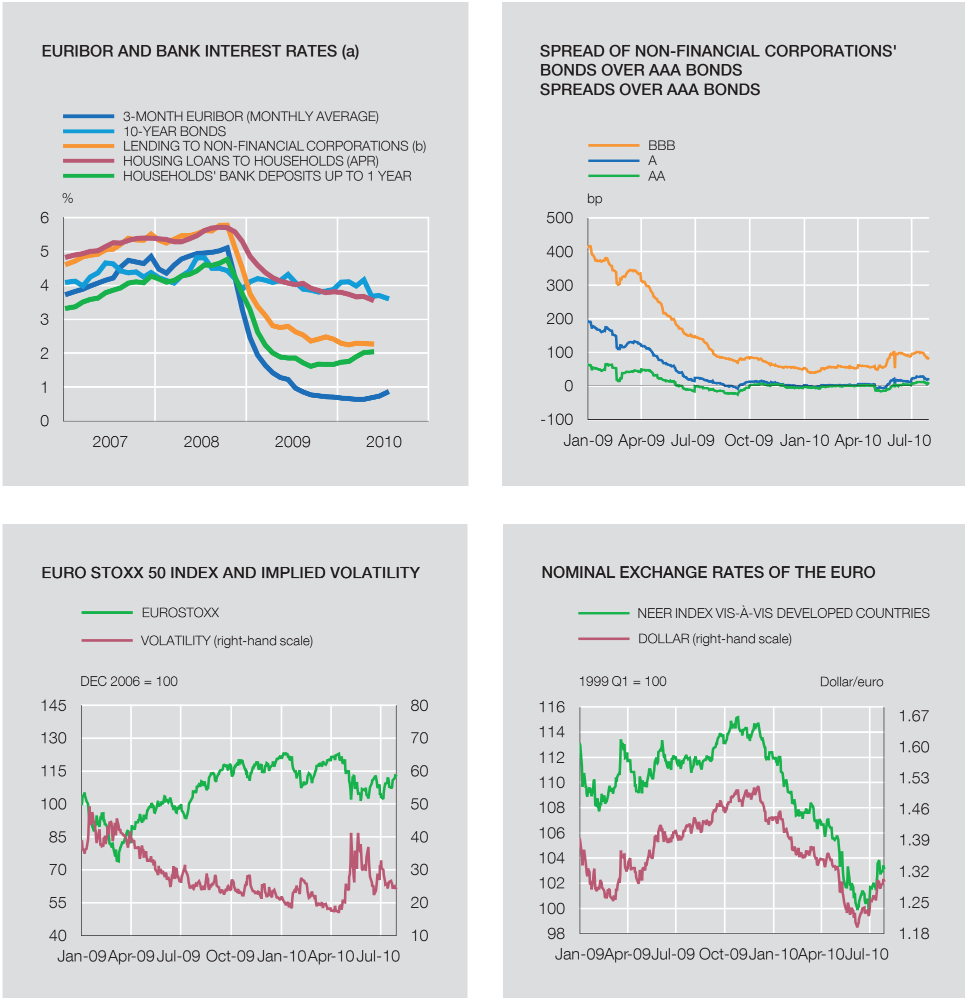
The European Commission authorised the extension of the government programmes to provide support to the banking system for those countries which had so requested, both in the form of guarantees for new debt issuance – subject to stricter conditions – and capital injections. Consequently, the stress tests conducted within the common framework designed by the Committee of European Banking Supervisors on 91 EU banks, representing 65% of the sector, revealed a relatively small overall capital shortfall of €3.5 billion, attributable to seven institutions whose Tier 1 capital ratio would fall below 6% in some of the adverse scenarios considered.

Interbank interest rates rose moderately during Q2 and in July. The average levels of three-month and one-year EURIBOR reached 0.9% and 1.4%, respectively, in July. The financial turmoil led to increased demand for German government bonds, with yields on the ten-year bund falling to 2.76% in July. This decline was more moderate than for US ten-year government bonds, and as a result the spread between German and US bonds fell to around 40 bp. In the euro area, sovereign bond spreads vis-à-vis Germany widened generally to reach record highs in some countries on 7 May, climbing above 900 bp in the case of Greece for the ten-year benchmark bond and 300 bp in Ireland and Portugal (see Chart 12). The introduction of financial assistance mechanisms and the support of the ECB achieved a substantial short-term adjustment, although it failed to take hold, since the upward pressure on sovereign bond yields continued, particularly in the peripheral countries. These developments started to unwind after 10 June, after the success of government bond issues and more particularly in certain countries with the publication of the stress tests on domestic banks. Nevertheless, Greek bond spreads remained extremely high following the further downgrading of Greece's sovereign debt rating to speculative grade by Moody's, as S&P had already done in April. In addition to Greek debt, Moody's also downgraded the sovereign rating of Portugal to A1 and of Ireland to Aa2.

The risk premia in private fixed-income markets have also rebounded since March, albeit relatively moderately. Meanwhile, the cost of bank loans to the private sector held steady, with the exception of home loans, which fell to 3.58% in new business in May, compared with 3.66% in March. Nevertheless, financing conditions remained tight. According to the bank lending survey for Q2, the lending standards for new loans to households and firms again tightened slightly, a trend which is expected to continue over the next three months. Moreover, the demand for loans remained weak with no variation, except in loans for house purchase, which rose slightly. Against this background, bank loans to the private sector recovered slightly in year-on-year terms (see Chart 11). The pace of the decline in lending to non-financial corporations eased in year-on-year terms to -1.9% in June, after -2.4% in March. Lending to households grew 2.8% year-on-year in June, 0.8 pp more than in March, on account of the greater buoyancy of credit for house purchases. However, the year-on-year decline in consumer lending increased further to -1.6% at the end of Q2.

EURO AREA INTEREST RATES, EXCHANGE RATE AND STOCK MARKET INDEX

CHART 13



SOURCES: ECB and Banco de España.

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

Movements in equities markets also reflected the climate of uncertainty, with indices posting sharp falls (see Chart 13). Influenced by the lifting of some uncertainties, exchanges resumed an upward trend in July. Overall, the EURO STOXX 50 index has fallen by around 7% since the end of 2009. Along the same lines, the euro slid sharply against the dollar until the beginning of June, before appreciating more than 8% since, making for a depreciation of around 8% in nominal effective terms so far this year. Finally, the M3 monetary aggregate has remained lacklustre, with a slightly positive year-on-year growth rate in June.