NOVEMBER 2006

THE SPANISH ECONOMY

Monthly Report

NUMBER 296

RESEARCH DEPARTMENT

"la Caixa"

Forecast

% change over same period year before unless otherwise noted

	2005	2006	2007	2005		2006			
				3Q	4Q	1Q	2Q	3Q	4Q
INTERNATIONAL ECONOMY		Forecast						Forecast	
Gross domestic product									
United States	3.2	3.2	2.7	3.4	3.1	3.7	3.5	2.9	2.9
Japan	2.6	2.6	1.9	2.8	4.0	3.4	2.5	2.6	2.1
United Kingdom	1.9	2.5	2.4	1.8	1.9	2.3	2.6	2.7	2.7
Euro area	1.5	2.5	1.8	1.7	1.8	2.2	2.7	2.4	2.6
Germany	*1.1*	*2.1*	*1.3*	*1.5*	*1.7*	*1.7*	*2.4*	*2.0*	*2.1*
France	*1.2*	*2.2*	*1.9*	*1.4*	*1.0*	*1.4*	*2.6*	*2.5*	*2.4*
Consumer prices									
United States	3.4	3.4	2.4	3.8	3.7	3.7	4.0	3.3	2.7
Japan	–0.3	0.3	0.4	–0.3	–0.7	–0.1	0.2	0.6	0.7
United Kingdom	2.3	2.8	2.6	2.4	2.2	2.2	2.8	3.2	3.1
Euro area	2.2	2.2	2.0	2.3	2.3	2.3	2.5	2.1	1.9
Germany	*2.0*	*1.7*	*2.4*	*2.1*	*2.3*	*2.0*	*1.9*	*1.6*	*1.4*
France	*1.7*	*1.7*	*1.8*	*1.9*	*1.6*	*1.8*	*1.5*	*1.8*	*1.8*
SPANISH ECONOMY		Forecast						Forecast	
Macroeconomic figures									
Household consumption	4.2	3.5	3.0	4.1	3.8	3.8	3.6	3.4	3.2
Government consumption	4.8	4.4	4.4	4.5	4.9	4.4	4.4	4.5	4.4
Gross fixed capital formation	7.0	6.1	5.2	7.1	6.6	6.3	6.1	6.1	6.0
Capital goods	*9.0*	*8.9*	*7.6*	*8.3*	*8.6*	*8.6*	*9.1*	*9.1*	*8.8*
Construction	*6.0*	*5.6*	*4.0*	*6.3*	*5.6*	*5.8*	*5.7*	*5.6*	*5.4*
Domestic demand (contribution to GDP growth)	5.2	4.7	4.1	5.2	5.0	5.0	4.8	4.6	4.5
Exports of goods and services	1.5	6.4	5.2	2.5	2.3	9.5	5.3	5.5	5.5
Imports of goods and services	7.0	8.8	6.5	7.7	6.6	12.4	7.9	7.5	7.4
Gross domestic product	**3.5**	**3.7**	**3.3**	**3.6**	**3.6**	**3.6**	**3.7**	**3.7**	**3.6**
Other variables									
Employment	3.1	3.0	2.6	3.3	3.2	3.2	3.1	3.0	2.9
Unemployment (% labour force)	9.2	8.5	8.2	8.4	8.7	9.1	8.5	8.1	8.2
Consumer price index	3.4	3.6	2.5	3.4	3.6	4.0	3.9	3.5	2.8
Unit labour costs	2.2	2.5	2.2	1.9	2.3	2.4	2.6		
Current account balance (% GDP)	–7.5	–8.8	–8.3	–6.8	–7.0	–10.6	–8.1		
Not lending or net borrowing rest of the world (% GDP)	–6.5	–8.0	–7.5	–6.0	–5.9	–10.3	–7.6		
Government balance (% GDP)	1.1	1.0	0.6						
FINANCIAL MARKETS		Forecast							Forecast
Interest rates									
Federal Funds	3.2	5.0	5.1	3.4	4.0	4.4	4.9	5.3	5.3
ECB repo	2.0	2.8	3.7	2.0	2.1	2.3	2.6	2.9	3.3
10-year US bonds	4.3	4.8	4.9	4.2	4.5	4.6	5.1	4.9	4.7
10-year German bonds	3.4	3.8	4.2	3.2	3.4	3.5	4.0	3.9	3.8
10-year Spanish bonds	3.4	3.8	4.2	3.2	3.4	3.5	4.0	3.9	3.8
Exchange rate									
$/Euro	1.25	1.25	1.33	1.22	1.19	1.20	1.26	1.27	1.28

THE SPANISH ECONOMY
MONTHLY REPORT
November 2006

**CAJA DE AHORROS
Y PENSIONES
DE BARCELONA**

Research Department

Av. Diagonal, 629,
planta 6, torre I
08028 BARCELONA
Tel. 34 93 404 76 82
Telefax 34 93 404 68 92
www.research.lacaixa.com
e-mail:
informemensual@lacaixa.com

"la Caixa" GROUP: KEY FIGURES

As of December 31, 2005

FINANCIAL ACTIVITY	Million euros
Total customer funds	169,470
Receivable from customers	113,857
Profit attributable to Group	1,495

STAFF, BRANCHES AND MEANS OF PAYMENT	
Staff	25,254
Branches	5,053
Self-service terminals	7,208
Cards	8,408,956

COMMUNITY PROJECTS: BUDGET FOR ACTIVITIES IN 2006	Million euros
Social	160
Cultural	70
Science and environmental	54
Educational	19
TOTAL BUDGET	**303**

Design and page make-up: www.cege.es - Ciutat d'Asunción, 42 - 08030 Barcelona D. L.: B. 21063-1980 ISSN: 1134-1920
Internet edition: www.comunicacions.com - Travessera de Dalt, 30 - 08024 Barcelona

Contents

China and India: players in globalization process

They are the world's most populous countries each with more than 1,000 million population. They are two of the oldest human civilizations although, in contrast to those of Egypt and Babylonia, they still survive today. With a rich, complex and very different history in terms of politics, economy, culture and religion, their relative importance in the world economy was far above that of all of Western Europe right up until the 18th century, according to recognized figures drawn up by Angus Maddison. Since then, they gradually became picturesque and little- developed countries, one subject to unviable rule and the other enveloped in government intervention and corruption. Their old days of splendour were far off in the past.

In just a few years, however, scarcely without being aware of it, the world has seen the emergence of two new economic powers. In the Eighties, the leader of the People's Republic of China, Deng Xiaoping, opted for adjusting Marxism to the methods of the capitalist system in a peculiar practical combination that sought to restore growth and prosperity without renouncing the principles or the political regime defined by Communism. Since then, China's take-off has turned it into the world's fourth largest economy, or the second largest following the United States if measured by purchasing power parity, that is to say, adjusted by local purchasing power of the currency. When China was admitted to the World Trade Organization in 2001 it was the world's ninth largest exporter. Today, it is the world's leading exporting country.

India's story is quite different. In fact, it remained far behind in the economic growth race until quite recently if we compare it with China. But it is now the world's fourth largest economy (in terms of purchasing power parity) and since the government chose to liberalize, remove controls and open the country up to the outside world in the Nineties, India's potential has gradually begun to come into its own. While China is the bright star of globalization because of its export potential, India has shown that globalization is also possible in services, as demonstrated by the proliferation of companies in the information technology sector in Bangalore and it provides a development alternative for the medium and long term based on political institutions that demand a broad social consensus.

From this part of the world, the transformation of the Far East seems a long way away. The opening up of Spain's economy to abroad is relatively recent and its main horizon has been Europe as well as the inclusion of Latin America in recent years. Spain's business foothold in China and India, while meritorious and heroic, is not in keeping with the current position of Spain's economy in terms of world classification. Chinese products have obtained an important market share in Spain generating the second biggest bilateral deficit in foreign trade statistics, only behind that recorded with Germany. Meanwhile, Spain's exports continue to be directed to «Old Europe», wealthy but showing very low growth, while its exports to China and India, two huge burgeoning economies, are quite minimal. That is to say, Spain is missing out on the best of the party of world globalization. There are relevant moves aimed at remedying the situation although it is clear that the road will not be an easy one. As Confucius, the famous Chinese sage, once said, the important thing is not how slowly we go along the road but that there not be any stopping. Globalization does not wait.

OVERALL SUMMARY

Housing in United States: a threat to world economy?

Uncertainty about extent of drop in US real estate sector creates anxiety because of possible repercussions on rest of economic activity and even effects on world economy.

Is housing collapsing in the United States? Will the bursting of the real estate bubble drag the rest of the US economy into a recession? If the US growth cycle wears out, will it halt growth of world economy? Many of the analyses by economists at this moment are aimed at answering these questions, especially after seeing the figures for the gross domestic product (GDP) for the US economy for the third quarter, which was even surprisingly below the low growth forecast. That growth was only 1.6% quarter-to-quarter annualized or 2.9% if compared with the level for the same period in 2005.

Situation in rest of US economy, apart from housing, leaves room to expect a limited drop...

The answer to the first question is that, indeed, the slowdown in housing construction is quite sharp. In the macroeconomic table for the third quarter, the residential construction component was down by nearly 8% year-to-year, the biggest drop since 1991. The number of housing starts and building permits are more than 20% lower than one year ago. Prices have begun to drop although the cushion accumulated through the rises in recent years is very high.

...but growth will probably show effects in coming months.

As to whether the collapse in housing is a prelude to recession in the United States, our own main scenario does not point in that direction. We believe that private consumption and investment have sufficient support to partly compensate the negative effect of housing. The strength of the labour market and population growth suggest only a limited drop. The practical stability of long-term interest rates at low levels, the halt to rate increases by the Federal Reserve System and the drop in oil prices are key factors in the makeup of expectations of companies and households. The stock market does not seem to be anticipating any dark clouds but rather, to the contrary, it has climbed to new all-time records.

In the United Kingdom, Australia and the Netherlands, the drop in housing demand following a notable boom did not bring about a general decline in economic activity although international comparison must be handled with caution. What it certainly has meant in those countries is some cooling down in the growth rate of the economy, something which will likely happen in the United States. In this respect, our forecasts indicate a slowdown in the high increases of the GDP after three years of growth between 3% and 4%.

We believe that any possible collapse of US growth would have devastating effects on the world economy, given that the nearly 800 billion dollars in trade deficit generated by the United States in one year constitutes a decisive support for economic activity in Europe and the Far East. But, as we stated earlier, we do not feel this will happen. In any case, the expected slowdown will cool off the extraordinary growth cycle of the international economy now undergoing its third year of progress.

China, the other engine of world growth, is not slackening. In the third quarter, growth was 10.4% compared with the same period last year, an impressive figure, although it involved something of a drop from the 11.3% in the previous period. On the demand side, the bases of growth continue to rest on exports and investment on machinery and equipment. On the supply side, industry is the leading sector showing growth of 13% year-to-year.

China's exports have become a real *bête noire* for manufacturers in the West, given that the Chinese trade surplus with the United States and the European Union keeps on increasing. Nevertheless, the Chinese trade balance shows major deficits with Taiwan, South Korea and Japan, which clearly shows the drag effect of China's economy on that part of the planet.

The Chinese influence has had a clearly positive effect on the Japanese economy which is gradually consolidating its recovery. Growth continues to rely on domestic demand but dependence on the foreign sector is more and more important. Whereas private consumption is tending to weaken and public spending is being contained, the main engine of growth has become investment with the large exporting companies more and more dominant.

The Euro Area is also going through a very good moment with growth of 2.7% year-to-year in the second quarter, the highest since the beginning of 2001. Europe would suffer in the case of a recession in the US economy given that the present growth stage, with all its brilliance, remains excessively based on the foreign sector and private consumption is still reluctant to join the party. The recent drop in oil prices should contribute to revive consumer spending and give support to the present level of private investment. It is to be hoped that this momentum holds up until the beginning of next year but in 2007 the European economy will have to overcome the difficulties resulting from somewhat less strength in foreign demand, less favourable monetary conditions (in interest rates and foreign exchange rates) and not very attractive tax policies.

In this respect, we should point out the tighter policies being adopted by the European Central Bank (ECB) over the past year. While the Federal Reserve System decided to make an extended pause after two years of continuous rate increases, the ECB seems committed to continue raising its reference rates. In view of the recovery of economic activity and inflation risks, the body headed by Jean-Claude Trichet still seems uncomfortable with the present level of interest rates. It probably wants to raise them from the current 3.25% to a more neutral level, that is, to one that neither stimulates nor slows down the economy and is coherent with stable inflation, which we estimate at close to 3.50%-4%. Therefore, the prospect continues to be a time of increases, although very moderate ones, so long as there are no signs of premature weakness in the growth cycle of the Euro Area.

Spain's economy grows more than expected

A limited additional rise in official interest rates would not likely on its own manage to appreciably slowdown the vigorous drive in the growth of Spain's economy. Early impressions about the third quarter suggest growth very similar, or even higher, than the 3.7% seen in the previous quarter. As a result, expectations of a gradual moderation of growth, based on a slowdown in domestic demand, that we were dealing

China, engine of world economy, continues to enjoy strong growth that is spreading to neighbouring countries...

...such as Japan, which is consolidating recovery.

Euro Area going through most favourable moment since beginning of present decade although whether this will continue into 2007 not certain.

Spain's economy continues to show excellent growth results with very gradual slowdown in domestic demand and foreign sector better than a few quarters back.

Labour market benefitting from current growth situation, with unemployment down to low levels and activity rate at all-time highs.

with at the beginning of the year are not going to be fulfilled.

In fact, consumer demand and investment have indeed moderated but much less than forecast. While some indicators of household consumption, such as car sales, seem to be slackening off, production investment remains very strong and construction is maintaining a very firm level. Meanwhile, the balance for imports and exports with abroad is contributing to improve the growth figure by taking away a lesser part of demand.

The truth is that the worsening of the foreign sector continues to be notable, although it is tending to run at a somewhat slower rate. The drop in imported oil prices should strengthen this trend but it should be remembered that the latest figures for foreign trade are still showing that imports are growing by 9% in real terms, more than the 6.8% real for exports. In services, there continues to be a rapid drop in the traditional tourist surplus due to the growing spending of Spaniards on foreign travel and to the fact that the growth in the number of tourists coming to Spain is accompanied by a drop in average spending per visitor.

High percentage of temporary jobs and low wage levels fail to stop households from borrowing spree while stock market continues to add record price levels.

The labour market is also showing a gradual containment of growth within the strong expansionist situation already well-known. This is the conclusion to be taken from the Labour Force Survey for the third quarter. It should be pointed out, however, that the number of persons employed has now gone up to nearly 20 million (700,000 more in one year) while the unemployment rate has fallen to 8.1%, the lowest level in recent decades, and the activity rate (calculated as the relation between the labour force and the population 16 years of age or older) has reached an all-time high.

In contrast to the good figures for the labour market, we should mention the fact that job creation is still concentrated in low value added sectors, such as construction and certain areas of services. It is also noted that the temporary nature of jobs continues to show an increase in spite of the measures adopted in May aimed at slowing the growth of temporary contracts. In addition, figures from the Tax Agency indicate that new employment created provides wage levels that stand in the lower part of the wage scale. This is a trend very much connected to the rise in the hiring of foreign workers as a result of the high level of immigration still being seen in Spain.

The population boost coming from immigration thus continues to set the path for the growth cycle of Spain's economy. In spite of the existing macroeconomic imbalances (especially in the foreign sector and inflation), household and corporate confidence about the future of the economy both seem to rest on solid bases, in view of the growing indebtedness of households (backed by real estate assets with prices still rising) and the recent vigour shown by the stock market. Without losing sight of existing threats, we may conclude that for the moment 2006 is well on the way to being one of the best years in the past decade.

October 27, 2006

CHRONOLOGY

2005

October	4	IBEX 35 index for **Spanish stock exchange** marks up annual high (10,919.2) with cumulative gains of 20.2%.
	13	Government approves **National Reform Programme for Spain**.
November	1	**Federal Reserve** raises reference rate to 4%.
	28	**Slovak crown** joins Exchange Rate Mechanism.
December	1	**European Central Bank** raises official interest rate to 2.25%.
	13	**Federal Reserve** raises reference rate to 4.25%.
	17	European Council approves **2007-2013 Budget**.
	18	Hong Kong Summit of **World Trade Organization** agrees to removal of all aids to agricultural exports of developed countries in 2013.

2006

January	20	Government presents bills for reform of **personal income tax** and **corporate tax.**
	31	**Federal Reserve** raises reference rate to 4.50%.
March	2	**European Central Bank** raises official interest rate to 2.50%.
	28	**Federal Reserve** raises reference interest rates to 4.75%.
	31	Government approves **economic policy package** including budgetary measures and others on mortgage market, energy sector and rail transport.
May	4	Agreement between government, business organizations and trade unions on **labour reform** aimed at reducing extent of temporary work.
	10	**Federal Reserve** raises reference rate to 5%.
June	8	**European Central Bank** raises official interest rate to 2.75%.
	29	**Federal Reserve Board** increases reference rate to 5.25%.
July	11	European Council authorizes **Slovenia** to adopt euro as currency as of January 1, 2007.
	24	Multilateral negotiations in **Doha Round** of World Trade Organization, aimed at greater liberalization of international trade, indefinitely suspended.
August	3	**European Central Bank** raises official interest rate to 3.00%.
	8	One-month forward price of Brent quality **oil** goes up to all-time high of 78.49 dollars a barrel.
	12	UN Security Council approves resolution for **cease-fire in Lebanon** in conflict between Israel and Hezbollah.
September	26	European Commission gives go-ahead to entry of **Romania and Bulgaria** into European Union on January 1, 2007.
October	5	**European Central Bank** raises official interest rate to 3.25%.
	26	Dow Jones index for **New York stock exchange** records all-time high (12,163.7), a rise of 13.5% compared with end of 2005.
	27	IBEX 35 index for **Spanish stock exchange** marks up all-time high (13,725.8), a cumulative gain of 27.9% compared with end of December 2005.

AGENDA

November

2 Governing Council Meeting, European Central Bank.
3 Registrations with Social Security and registered unemployment (October).
6 Industrial production index (September).
14 Early Spanish GDP (3rd Qtr.) Euro Area GDP (3rd Qtr.).
15 CPI (October). Balance of payments (August).
16 Harmonized CPI for EU (October).
21 Central government revenue and spending (October).
22 Quarterly national accounts (3rd Qtr.).
23 Foreign trade (September).
27 Producer price index (October).
30 Early CPI (November).

December

4 Registrations with Social Security and registered unemployment (November).
5 Industrial production index (October).
7 Meeting Governing Council, European Central Bank.
12 Meeting Open Market Committee, Federal Reserve System.
15 CPI (November). Balance of payments (September). Harmonized CPI for EU (November).
19 Central government revenue and spending (November).
20 Labour cost (3rd Quarter).
26 Producer prices (November). Foreign trade (October).
29 Early CPI (December).

US slowdown finds a support base and a risk

US economy slows down because of housing construction and foreign sector...

The latest figures for the US economy show a drop in growth expectations while increasing fears of inflation. Earlier, energy prices and the high level of utilization of production capacity brought fears of inflationary pressures. Later, the sharp drop in the housing market has focussed attention on a slowdown that could be less gradual than expected or desirable. The poor gross domestic product (GDP) figure for the third quarter clearly leans the balance of risks toward lower growth, apparently without putting inflationary fears fully to rest. In spite of all this, things are somewhat better than they seem, both in growth and inflation. There is, however, a major risk based on real estate prices.

...but consumption and investment holding strong.

The economy grew by 2.9% year-to-year in the third quarter, 1.6% annualized compared with the previous quarter. Nevertheless, this sharper than expected slowdown has two positive aspects, one in terms of growth and the other in terms of prices. In the first place, with regard to the risk of a landing less gentle than desirable, the slowdown has been very much located in the housing sector, which was down 7.7% year-to-year, the biggest drop since 1991 and, to a lesser extent, in foreign trade. Without both of these negative contributions, growth of the economy would have been well above 3%, whether compared with the same period last year or with the previous quarter. The key factor is that private consumption and non-residential investment kept up a strong pace with increases of 2.8% and 7.9% respectively, showing some increase

UNITED STATES: MAIN ECONOMIC INDICATORS

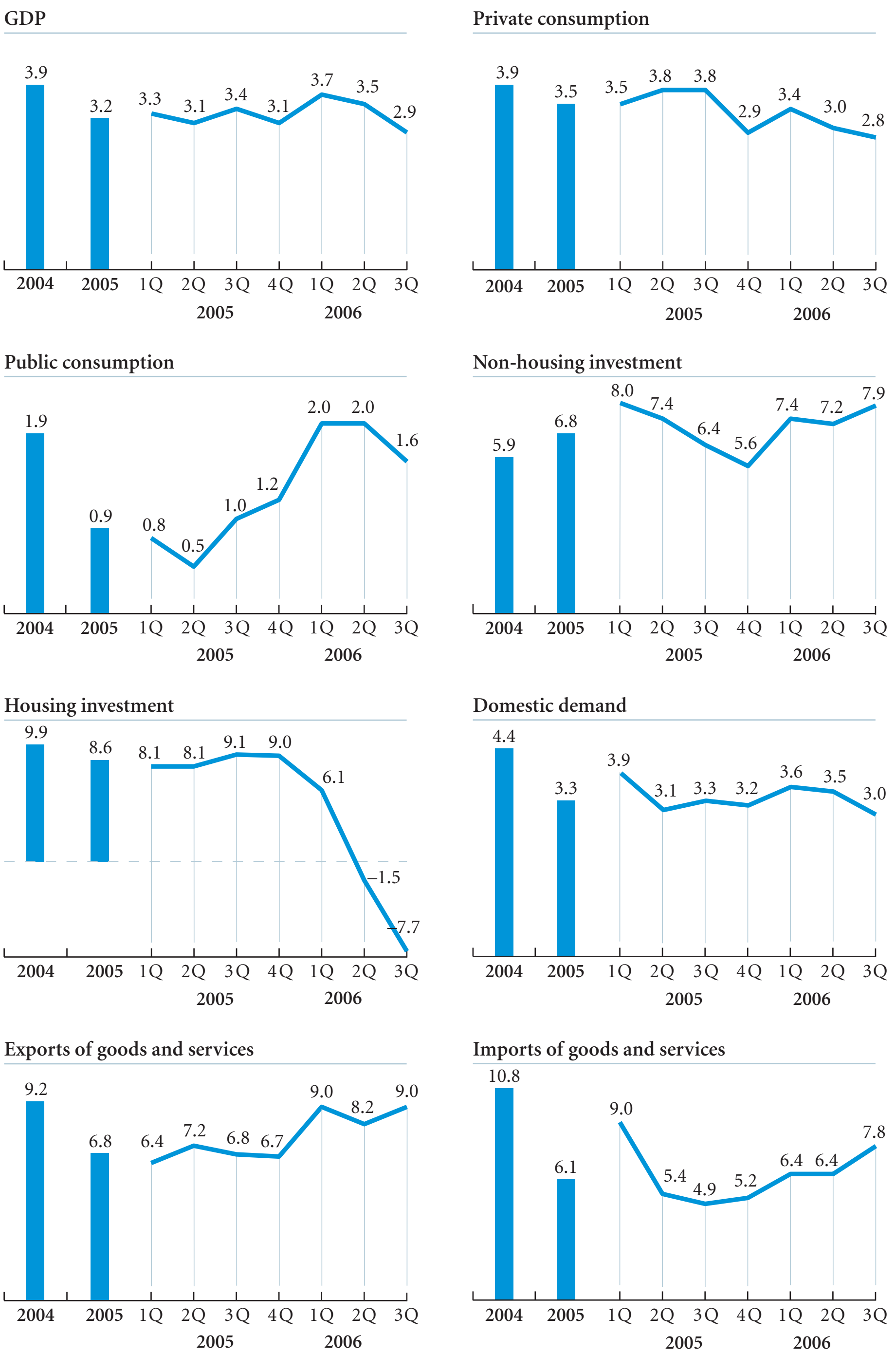
Percentage change over same period year before unless otherwise indicated

	2004	2005	2005		2006				
			3Q	4Q	1Q	2Q	July	August	September
Real GDP	3.9	3.2	3.4	3.1	3.7	3.5	–	2.9	–
Retail sales	6.2	7.2	8.2	6.2	8.3	6.6	4.8	6.4	5.5
Consumer confidence (*)	96.1	100.3	98.9	95.8	105.7	106.6	107.0	100.2	104.5
Industrial production	4.1	3.2	2.7	3.0	3.3	4.6	5.1	4.8	5.6
Industrial activity index (ISM) (*)	60.5	55.5	56.0	57.0	55.6	55.2	54.7	54.5	52.9
Sales of single-family homes	10.1	6.6	11.9	3.1	–11.6	–14.4	–28.0	–19.7	–14.2
Unemployment rate (**)	5.5	5.1	5.0	4.9	4.7	4.6	4.8	4.7	4.6
Consumer prices	2.7	3.4	3.8	3.7	3.7	4.0	4.2	3.8	2.1
Trade balance (***)	–611	–717	–689	–717	–740	–762	–771	–783	...

NOTES: (*) Value.
(**) Percentage of labour force.
(***) Cumulative balance for 12 months. Billion dollars.
SOURCE: OECD, national statistical bodies and internal figures.

TREND IN UNITED STATES GDP BY COMPONENT

Percentage year-to-year change in real terms



SOURCE: Bureau of Economic Analysis and internal figures.

following the slight drop in the previous period. If on top of that we add the foreseeable improvement in the foreign sector because of the lower cost of energy imports, we may conclude that growth still has a fund of strength.

UNITED STATES: CONSUMERS KEEP ON BUYING

Year-to-year change in retail sales excluding cars and petrol

SOURCE: Department of Commerce and internal figures.

Consumers still optimistic while business executives somewhat more cautious.

The latest demand indicators are consistent with this fund of strength. Retail sales in September (excluding cars and petrol) continued to show a strong trend with growth of 7.2% year-to-year. In terms of volume, latest figures put the more up-to-date trend at around a quite respectable growth of 3.6% year-to-year. In line with the strength of consumption, consumer confidence in September rose to a level of 104.5 points, with increases in both expectations and the perception of the current situation. While consumers maintained a positive attitude, business executives this time were somewhat more cautious as shown in the Institute of Supply Management index, where both, manufactures and services, drop to 52.9 points in September, close to the 50 level where optimists and pessimists are equal in number. Nevertheless, these decreases were largely brought about by the decrease in the price component of the index, which gives an optimistic touch to the current situation. Industrial production, which grew by 5.6% year-to-year in September, also added to this sustained growth profile.

Biggest risk lies in sharper drop in real estate prices which could hurt consumer spending.

In spite of this substantial support base, the biggest risks lie in growth. Up to now, the slowdown in the housing market has shown up in lower economic activity with decreases of close to 20%, restricted to a sector that accounts for 6% of the total economy. Nevertheless, the key lies in real estate prices seeing that a drop in these prices would depress the willingness of consumers whose spending in the United States makes up more than two-thirds of the GDP. In September, the price of existing housing, deflated by core inflation, dropped by 5.3% year-to-year while new housing (which is more volatile) went down by 12.3%. Up to now, the situation is better than in previous downward cycles, given that in recent years there has been a cumulative cushion built up with a 30% appreciation in real estate values. Even so, if this downward trend should continue, it would become the biggest risk floating over the US economy.

The situation in prices is much better than a few months back. This is the other good news on the GDP for the third quarter. The private consumption deflator grew by 2.9% year-to-year, well below the 3.3% in the previous period. Along the same lines, the drop in oil prices and base effects meant a downward correction of the rise in the consumer price index (CPI) which in September grew by 2.1% year-to-year as against the previous 3.8%. Nevertheless, what matters here is the core component, which is less volatile because it excludes energy and foods. The underlying CPI for September rose by one decimal to grow by 2.9% year-to-year. The deflator for the consumer GDP excluding energy components rose by a very reasonable 2.4% annualized compared with the previous quarter.

Consumer prices up 2.1% while prospects improve.

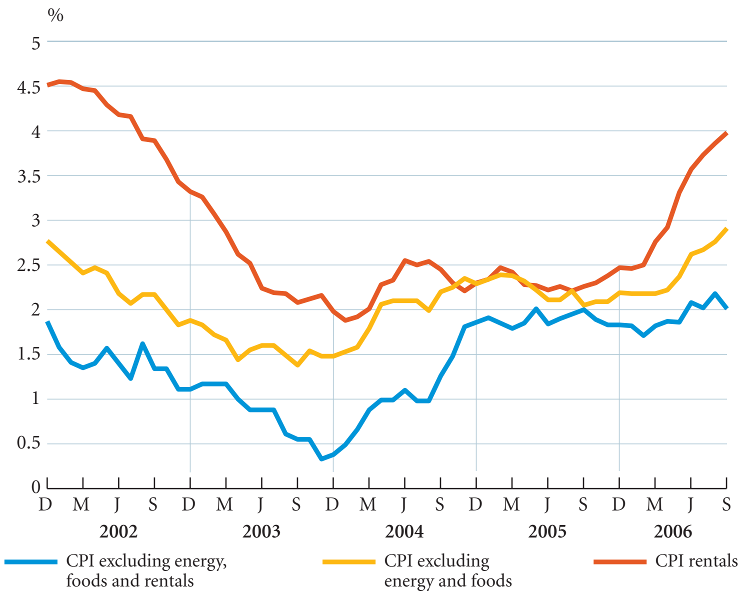
While taking note of the relative improvement on the inflation front, we should consider that one third of the core index consists of the prices which in the United States are accounted for by the use an owner makes of his/her own residence. This important component of the CPI has been especially on the rise in 2006, given that the slowdown in the housing market has brought about a swing from home buying to home rental, thus raising prices of the latter which are precisely those forming the calculation base for the price applicable for use of one's own home. Given the volatility existing as a result of swings in the market and even though they may not in fact be paid, the increases in the prices index arising from this component must have limited effects on the basic trend in the price index. Excluding energy, food and imputed rentals, the consumer price index rose by 2.0% year-to-year in September to show a relatively stable trend that should be more representative of what we can expect in coming months.

The labour market continued to give off ambiguous signals. While the new job creation seems to have become blurred with lower increases than forecast and

Labour market could be stronger than expected...

UNITED STATES: EXCLUDING RENTALS, INFLATION PRESSURES EASE

Year-to-year change in CPI by component



SOURCE: Department of Work and internal figures.

...but trade deficit fails to go down.

wages continued to show no gain in purchasing power, the unemployment rate is low at 4.6% of the labour force, upward revision is foreseen in the figures for job creation and unit labour costs are increasing more than predicted. Confirmation of the strength of the labour market at this time would be more of a support for the level of economic activity than an inflationary threat.

The foreign sector, in turn, has not started yet the road of. The trade deficit for the past 12 months ending in August went to a new record although with slower growth if we discount the effects of oil. Cheaper oil and the trend in the US economy in recent months should end up cutting down part of this imbalance but doubts may arise about the speed of the adjustment and its effects on the dollar exchange rate.

Japan: growth with eye to foreign trade

Japan's economy showing more and more sustained growth based on investment and exports.

Japan's growth continues to be based on domestic demand although there is more and more dependence on the foreign sector in spite of the fact that in recent months the increased cost of oil has distorted indicators. The dependence on foreign trade is reinforced by the level of spending in the Japanese economy. With private consumption that is holding up but losing ground bit by bit and with a restrictive public sector because of debts piled up in previous years, the main engine of growth is investment, although the exporting companies are more and more dominating the scene.

The Tankan industrial activity index for September covering large manufacturing companies rose to the level of 24 points, showing signs of the good state of the sector and representing strong support for maintenance of the current growth cycle. Increases on the stock market in recent months and the recovery in exports to China confirm that the usual big companies are in very good shape. At the same time, these big companies are more and more casting their eye abroad. Machinery orders, which are an early indication of the performance of investment, are moving up but the

JAPAN: MAIN ECONOMIC INDICATORS

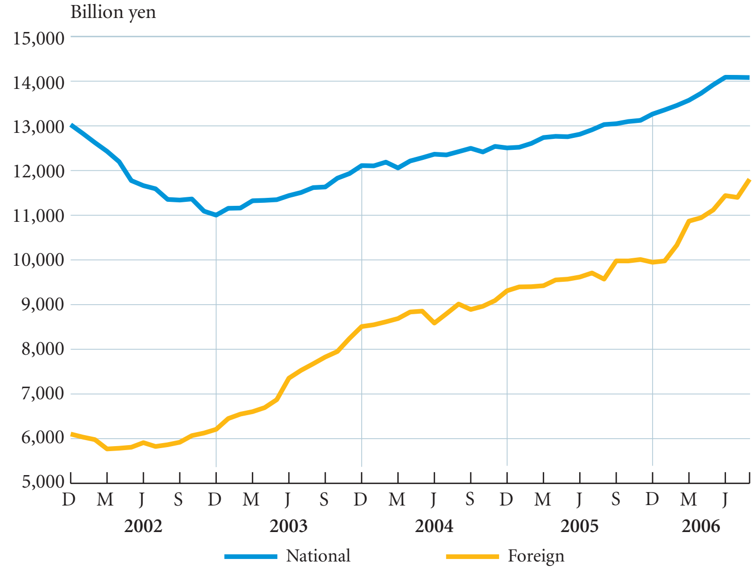
Percentage change over same period year before unless otherwise indicated

	2004	2005	2005		2006				
			3Q	4Q	1Q	2Q	July	August	September
Real GDP	2.3	2.6	2.8	4.0	3.4	2.5	–	...	–
Retail sales	–0.9	1.4	1.1	0.7	0.6	–0.2	0.0	1.1	0.3
Industrial production	5.3	1.5	–0.1	3.6	2.8	3.7	5.0	5.8	4.8
Tankan company index (*)	20.5	18.0	19.0	21.0	20.0	21.0	–	24.0	–
Housing construction	2.6	3.8	4.9	6.9	4.9	8.8	–7.7	1.9	4.0
Unemployment rate (**)	4.7	4.4	4.3	4.5	4.2	4.1	4.1	4.1	4.2
Consumer prices	0.0	–0.3	–0.3	–0.7	–0.1	0.2	0.3	0.9	0.6
Trade balance (***)	13.9	10.2	10.9	10.2	9.5	9.1	9.2	9.2	...

NOTES: (*) Value.
(**) Percentage of labour force.
(***) Cumulative balance for 12 months. Billion yen.
SOURCE: OECD, national statistical bodies and internal figures.

JAPAN: MACHINERY ORDERS GOING STRONG BOTH NATIONAL AND FOREIGN

Machinery orders in last 12 months



SOURCE: Japanese Ministry of Communications and internal figures.

proportion represented by international orders in the past 12 months ending in August went to 45.0% of the total whereas in the Nineties the norm was around 30%.

While investment is moving up, latest indicators for consumer demand continue to slacken off. Recent sales in September grew by 0.3% year-to-year thus maintaining the discreet level seen in recent months. Car sales continued languid and in spite of the seasonal boost in September sales were down 8.9% compared with the same period last year. At the same time, in spite of wage increases and the fact that consumer confidence held at the 45.6 points level in September, still relatively high, the monthly savings rate of workers in August continued the upward trend that has predominated all through 2006.

Confirming the lead shown by producers over consumers, supply indicators are in a better state with industrial production in September growing by 4.8% year-to-year, somewhat below August when it reached the highest rate in the past two years. Housing starts in August also continued a strong upward trend in contrast to the performance on the Tokyo stock market where prices recovered in September, although selling did not move up but continued to drop following a major correction in August.

The labour market continued strong with the unemployment rate holding at 4.2% of the labour force in September, well within the low band for recent years. The strength of the labour market helped to bolster prices. While prices slowed their advance under the effect of lower cost oil, they kept to a background that would indicate that the period of deflation is continuing to fade into the past. Prices excluding fresh foods rose by 0.2% year-to-year in September and the general Tokyo index for October was up

Manufacturing companies running strong with orientation toward international markets.

Despite robust labour market, consumers taking things calmly.

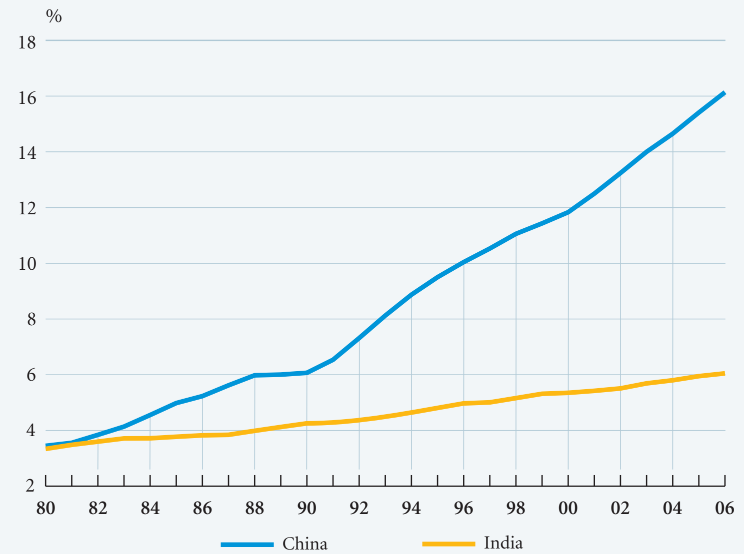
Industry showing growth while prices hold to positive ground.

India following in China's footsteps

It is increasingly difficult to find a reference to China without India being added to it. It is true that both countries have some important characteristics in common (that economic growth is making it possible to reduce the poverty of millions of people is perhaps the most notable) but there is still a big gap between the two economies that is often overlooked. In this section, we point out some of the differences and note the main challenges facing India in order to boost its growth rate and bring it closer to that of China.

CHINA BEATS INDIA IN GROWTH

National GDP over world GDP (*)

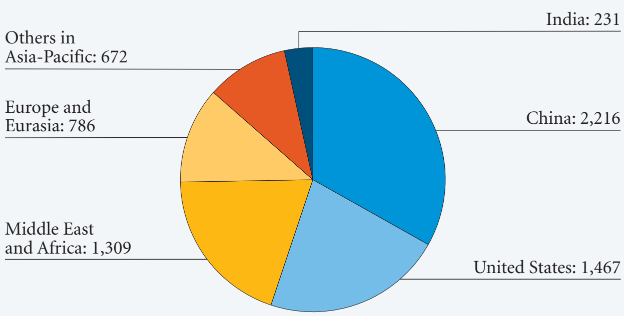


NOTES: (*) GDP measured at purchasing power parity.
SOURCE: International Monetary Fund and internal figures.

China's economy is still much bigger than that of India and contributes much more to global growth. This year, China's GDP will represent approximately 16% of world GDP while that of India will be 6% (measured at purchasing power parity exchange rates). However, this has not always been the case. In 1980, at the beginning of the Chinese miracle, the size of both economies was similar. In the following 25 years, China grew at an average rate of 10% a year but India (where the process of reform did not begin until 1990) grew at 6%. More recently, India's growth rate (8% a year) has moved somewhat closer to that of China but this convergence has not been complete. Because of its size and dynamism, China's impact on the world economy has been much more notable as, for example, on demand for raw materials.

CHINA'S THIRST FOR OIL

Increase in oil consumption (2000-2005) in thousand barrels

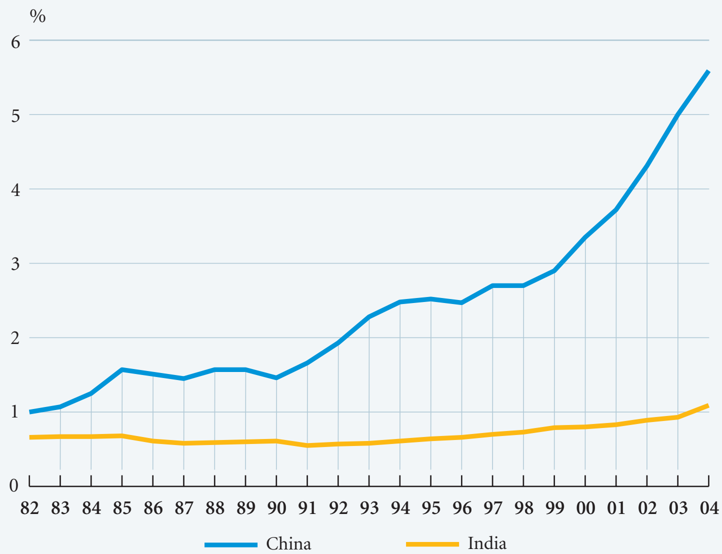


SOURCE: BP Statistical Review of World Energy, June 2006.

Despite India's significant opening to the world since 1990, it remains far less open than China. China's international trade in goods and services was more than 80% of its GDP in 2005, more than twice that of India. This year, China's exports of goods will reach 900 billion dollars, seven times those of India (the difference is somewhat less in imports). Customs duties on imports continue to be higher in India despite an

INDIA LAGS BEHIND IN OPENING UP TO THE WORLD

Foreign trade in goods and services in relation to world trade



SOURCE: World Trade Organization and internal figures.

impressive drop from an average of more than 100% at the beginning of the Nineties to 15% at present, some 5 percentage points higher than those of China where, furthermore, a considerable proportion of imports benefit from exemptions. The differences in exports of services (25% higher in China) are much lower, partly thanks to the growth of the software sector in India. But we should put the importance of this leading export sector in perspective. It represents 3% of the GDP and employs less than 0.5% of the labour force. And 2006 will be the first year in which software exports receipts will exceed immigrant remittances.

Direct foreign investment in India has yet to take off. China and India appear in various rankings (for instance by AT Kearney) as the two most attractive countries for direct international investment. But interest in India so far has not yet translated into a notable level of incoming investment. In 2005 it amounted to 8 billion dollars, one-tenth of investment in China and half that going to Brazil. Given that the legal framework is not unusually restrictive for foreign investment, this result may largely be accounted for by the general difficulties of doing business in India. The financial sector (banks and insurance) and the distribution sector (supermarkets) do encounter major restrictions on the entry of foreign investment and liberalization of these constraints (probably in the next few years) could also result in major capital inflows.

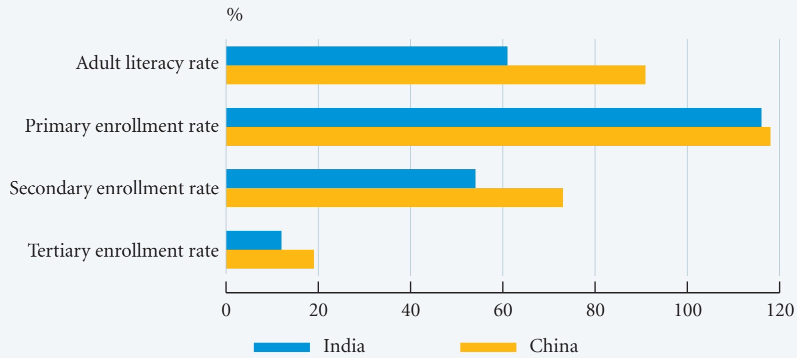
IS IT EASY TO DO BUSINESS IN INDIA AND CHINA IN 2006?

	India	China
Place in a ranking of 175 countries (best place is 1)		
Global position	134	93
Investor protection	33	83
Obtaining credit	65	101
Setting up a business	88	128
Registering property	110	21
Employing workers	112	78
Closing down a company	133	75
International trading	139	38
Obtaining permits	155	153
Paying taxes	158	168
Having contracts fulfilled	173	63
Relevant indicators for international trade		
Documents needed for exports	10	6
Days required for exports	27	18
Cost of exports (US dollars per container)	864	335
Documents needed for imports	15	12
Days required for imports	41	22
Cost of imports (US dollars per container)	1,244	375

SOURCE: World Bank (Doing Business Indicators 2006).

LEVEL OF EDUCATION IN CHINA HIGHER THAN THAT OF INDIA

Number enrolled over corresponding population age group (2004)



SOURCE: World Bank.

India's biggest challenge is the development of its labour-intensive industry. This will be necessary to maintain or increase its growth rate closer to the levels achieved by China. Up to now, growth has been based on services and manufactures intensive in knowledge and capital (for example, in the petrochemical and pharmaceutical industries) but the creation of employment in these industries has been limited and more than 500 million people continued to be involved in agriculture of very low productivity. Neither they nor the majority of the 100 million young people who will move into the labour force in the next decade have the qualifications needed to obtain a job in today's more dynamic sectors. Unfortunately, the stereotype of an Indian society where everyone speaks English and the general level of education is quite good is far from reality.

Although there is some consensus about the reforms needed to accelerate growth, progress in implementing these has been slow. There is wide agreement that there are three factors that limit India's potential, namely the rigidity of the labour market, infrastructures (transport and electricity) and a web of taxes, regulations and bureaucracies at various levels of government. In the case of the labour market, where reforms face the opposition of parties of the far-left which support the government in parliament, there has been no progress. With regard to infrastructures, a fiscal deficit of close to 8% of the GDP and a government debt of 85% of the GDP make higher public investment difficult. As an alternative, the government has fostered the creation of public-private partnerships (an excellent opportunity for European companies involved in construction or infrastructures management) but uncertainty about the regulatory framework continues to be a problem. A large part of the investment effort in infrastructures is being focused in the recently created special economic zones, where bureaucracy and taxes are also being streamlined. The success of these areas should facilitate application of these reforms to the economy as a whole. Whether India grows as much or more than China hinges on the outcome.

JAPAN: INDUSTRIAL PRODUCTION MOVING UP

Year-to-year change in industrial production

SOURCE: Ministry of Communications, National Statistics Office and internal figures.

0.5% and continues to show an upward trend. The trade deficit for the past 12 months ending in August was 9,200 billion yen, some 17.5% lower than in the same period last year. Nevertheless, this drop, marked by energy prices, is easing and exports continue to be showing signs of increasing strength with growth in August recording 14.9%.

China's drive shows very little letup

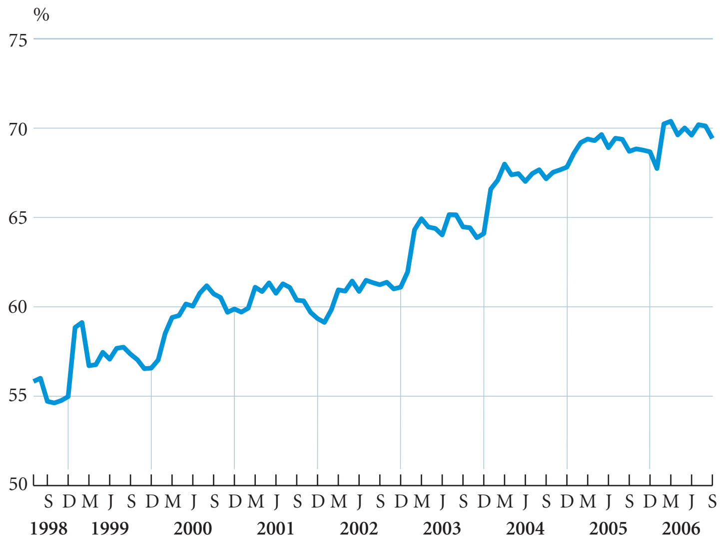
China: growth slowing down but rate still 10.4%.

The Chinese economy has recently had some mystery about it with much higher growth than some economic indicators would suggest. In the third quarter, the economy grew by 10.4% year-to-year which, while a respectable figure, meant something of a slowdown over the previous period when the economy had raised its growth rate to 11.3%. This is a slowdown that is somewhat more coherent with the efforts of the monetary authorities, with the relative weakness in imports of raw materials in recent months and with energy production indicators. Even so, China continues strong growth thanks to investment, exports and industry. By sector, industry continues in a dominant position with growth at 13.0% year-to-year as against services with a rise of 9.5%. Agriculture, that still accounts for 12.6% of economic activity, continues at a low profile with a meagre increase of 4.9% year-to-year. On the spending side, investment (its biggest component) showed something of a slowdown because of restrictions on credit in the urban areas but the foreign sector was the leader in growth. Exports took over from investment with growth of 28.7% year-to-year in the third quarter making the respectable 22.1% for imports look rather small.

Industrial production grew by 16.1% year-to-year in September, a rate that has held very constant since the beginning of 2005. Heavy industry (70% of the total) was again the most vigorous component

CHINA: HEAVY INDUSTRY HOLDS REINS

Participation of heavy industry in total industrial production



SOURCE: Chinese National Statistics Office and internal figures.

with an increase of 17.6%. If we look at the nature of company ownership, the state conglomerates moved up by a respectable 12.4%. Their share of the total continues to shrink because their growth is slower than the average but, contrary to what might be expected, their profits have significantly increased in recent months, which means some relief for the risk floating over the banking system which has financed them so heavily. This fact is coherent with the successful privatizations of commercial banks. The third of the four largest banks to be privatized was the Industrial and Commercial Bank of China (ICBC) which, at 19.1 billion dollars marked the biggest transaction of this type so far. Following the increases in recent days, the ICBC is now the fifth in the world in terms of stock market capitalization following on JP Morgan Chase.

Energy production grew by 13.9% year-to-year in September, a rate of increase considerably lower than what had been the norm up until the end of 2005. Among demand indicators, retail sales in September were up 13.9% year-to-year, with rural consumption losing pace compared with the cities. Prices continued under control with a rise of 1.5% in September compared with the same period the year before. This was unusual containment considering the strength of economic activity. Always keeping within this low range, there is generally greater pressure on price levels in the rural areas, which is some slight proof of the undeniable bottlenecks affecting economic activity once we move away from the fast-growing coastal provinces.

The trade surplus continues to set the pace of the Chinese economy with the export of manufactured goods going far above imports of raw materials. Exports in the past 12 months, measured in current dollars, reached 34.0% of the GDP, a share constantly on the rise since

Industry and foreign sector leading growth...

...and financiers, the banks, finding good response from investors.

Trade surplus based on manufactured goods and exports to United States and Europe.

CHINA: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005		2006				
			3Q	4Q	1Q	2Q	July	August	September
Real GDP	9.5	9.9	9.8	9.9	10.3	11.3	–	10.4	–
Industrial production	16.3	15.9	16.2	16.4	16.8	18.0	16.7	15.7	16.1
Electrical power production	15.0	13.4	13.6	11.8	13.4	13.2	15.5	18.9	15.2
Consumer prices	3.9	1.8	1.3	1.4	1.2	1.4	1.0	1.3	1.5
Trade balance (*)	32.1	102.1	96.6	102.1	108.9	123.7	127.7	135.9	143.6

NOTES: (*) Cumulative balance for 12 months. Billion dollars.
SOURCE: National Statistics Office of China, Thomson Financial Datastream and internal figures.

CHINA: RAW MATERIALS IMPORTS NOT RECOVERING

Monthly imports by volume

SOURCE: Chinese National Statistics Office, London Market and internal figures.

mid-2002. Imports are also following this upward trend but, since the end of 2004, the increase has lost some strength. As a result, the trade surplus for the last 12 months as of September was close to 5.4% of the total economy at 143.6 billion dollars. This balance is being sustained by the special bilateral relation with the United States given that, according to Chinese statistics, if this were excluded, China would have had a trade deficit with the rest of the world until August, when the total for the last 12 months amounted to 3.57 billion dollars.

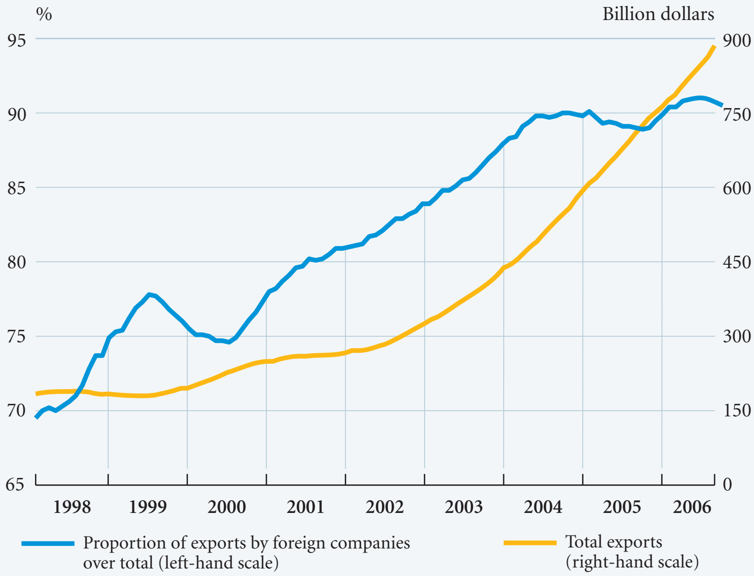
Imports of raw materials and energy production showing lower profile.

In the face of China's growing surplus with Europe, at the opposite end of the scale, China's biggest deficit is with Taiwan, at 65 billion dollars, followed by South Korea with 45 billion dollars and a now recovering Japan with a deficit of

China: where are its entrepreneurs?

In the 17th century, Portugal and Holland were rivals for the command of maritime trade. The interiors of Portugal's powerful ships exuded luxury and good taste compared with the stern simplicity of their opponents from the Low Countries. Nevertheless, appearances can lead astray and Portugal's dominance, in fact, was in decline while Holland was on the threshold of its era of command of the seas.

CHINA: FOREIGNERS RUN TRADE NOT THE LOCALS



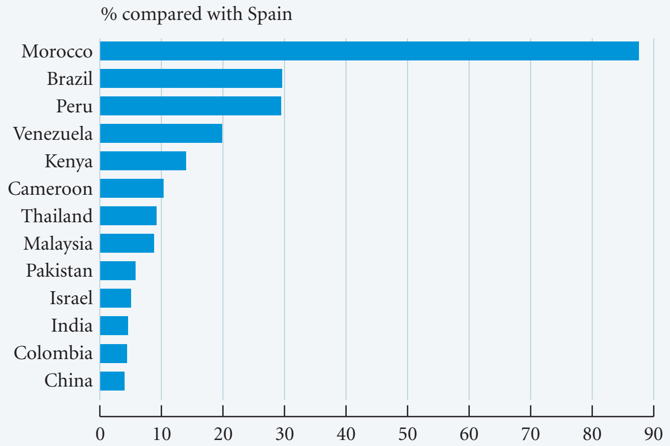
SOURCE: Chinese National Statistics Office and internal figures.

The Chinese figures are even more impressive than the Portuguese ships, especially if compared with other emerging areas such as India, Russia and Latin America. Its economy is now the second largest in the world in terms of volume and each year its growth is consistently close to 10%. Furthermore, it invests 42% of its gross domestic product (GDP), a share that continues to increase because the Chinese are serious savers. As if national savings were not enough, in 2005 some 72.4 billion dollars came in the form of direct foreign investment, a figure equal to what ended up in Central America, South America, India, Pakistan and Bangladesh combined. China's influence is also being felt in raw materials markets as it takes up a quarter of world steel production and, in absolute terms, contributes to the growth of world oil demand as much as the United States. On top of this, in 2005 China became the world's leading exporter ahead of Germany. As if all this were not sufficient, keeping true to the sage Confucius, China is now the world leader in the number of students enrolled in technical faculties. Who is doing better?

However, the giant has feet of clay. In the first place, the impressive rise in Chinese exports is more than 90% due to foreign companies, while exports by local Chinese companies held stagnant up until 2004. China treats foreign entrepreneurs much better than its own companies. It is logical that the abundance of cheap labour attracts foreign capital but what is surprising is the strong desire of Chinese companies to obtain foreign financing in spite of the substantial national savings available. Since 1982, the Chinese Constitution has guaranteed foreign companies property rights which their Chinese counterparts did not enjoy until 1999. Furthermore, the managers of national savings are still the large state banks, institutions that are not very efficient and either lend money to the big industrial conglomerates, also of state origin and often running in deficit, or paradoxically to foreign companies that obtain four times more credit from them than local Chinese companies. For local entrepreneurs, wherever they exist, there is little left. The question is: are there any local entrepreneurs?

CHINA: THERE ARE A LOT OF FARMERS AND THEY HAVE IT VERY BAD

Fertile land available per farmer

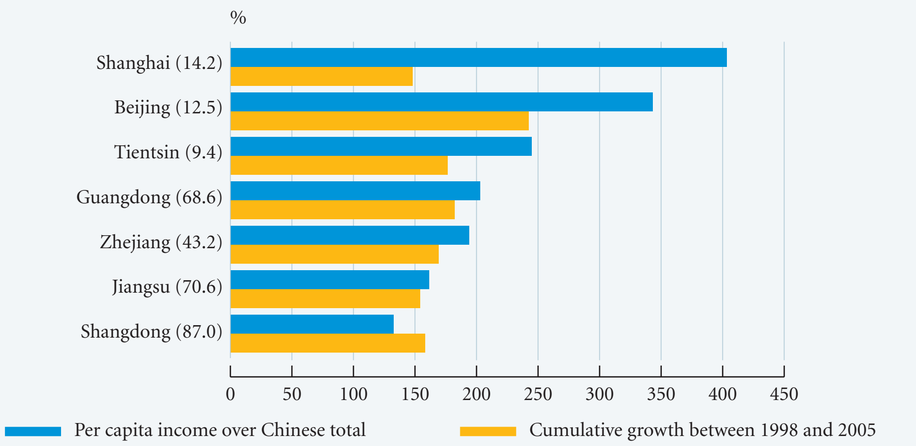


SOURCE: Economist Intelligence Unit and internal figures.

In second place, the composition of China's production fabric is peculiar. Some 37% of industry is of state origin and heavy industry has a growing share of the total, now well above two-thirds. Most investment projects go into infrastructures but, in contrast to the rise in exports, domestic distribution of goods has dropped and the domestic market is fragmented. Much «hardware» and cement but a lot less «software», that is to say, entrepreneurial initiative. In the list of the 50 best Asian companies published by *Forbes* magazine, in 2006 there were five Chinese names as against 12 names from India which receives only a tenth of the direct investment going to China. Furthermore, from the Chinese list we should take off the name Lenovo, the technological leader which has set up in Hong Kong in order to obtain advantageous treatment as a foreign company. In the *Forbes* list of the 200 best companies with sales of less than one billion dollars, China partially regains ground with 30 names as against 23 in the case of India. This is, however, a Pyrrhic victory seeing that the combined sales of Chinese companies are 20% less than those of the Indian companies. This is poor baggage if we take into account that the Chinese economy is nearly three times that of India.

The third question is rural China which involves approximately 800 million people. Levels of consumption and income of this majority are around 30% of those enjoyed in urban China and they are dropping. The government is trying to subsidize farmers but the real challenge is to reduce their numbers. Some 50% of the labour force is engaged in agriculture but the cultivable land per person in China is 35% less than in India and less than a third of that in the case of a Brazilian. A Chinese farmer has available seven times less fertile land than a farmer in Brazil. As a result, farm productivity is extremely low. It would be better for farmers to go somewhere else. Finally, in education, a well-established traditional value in the Asian giant, rural China gets a very low mark. In spite of the savings generated, investment in education is not adequate and the fact is the legal system means that the farmers end up subsidizing the cities. According to figures from UNCTAD, between 1995 and 2001 the index for human capital, valued according to the level of education of the population in China dropped from 0.318 to 0.298, losing a place in world ranking. While some are worse off, this is poor baggage for the world star performer in investment and growth.

CHINA: THE SEVEN RICHEST PROVINCES



NOTES: Population in millions shown in brackets.
SOURCE: Chinese National Statistics Office and internal figures.

Where are the Chinese entrepreneurs? Where shall we find the inventive capacity of those who discovered gunpowder and ice-cream? Hank Paulson, US Secretary of the Treasury, was recently in China negotiating the trade terms between the two countries. After the compulsory visits to Beijing and Shanghai, he went off to the coastal province of Zhejiang. Compared with imposing Shanghai, Zhejiang is sparse and rural, something like the Dutch ships at the end of the 17th century. What was the US dignitary looking for?

Paulson was looking for entrepreneurs. In the Seventies, Zhejiang had a per capita income similar to the Chinese average. Today, it is the fifth richest province after Beijing, Shanghai, Tientsin and Guangdong but the difference lies in that these four regions are highly urban while rough Zhejiang has a huge rural population. The investment in infrastructures that puffs up the figures have been much lower in Zhejiang than in its city counterparts and it has been free of abusive expropriations to make way for huge civil works. Nevertheless, this could be the stern Dutch ship that sails strongly ahead. Its cumulative growth since 2000 is higher than that of Shanghai and, much more important, it has companies that are working. Out of the 30 companies listed by *Forbes*, with 12.7% of all sales, four of them are located in Zhejiang. They are in sectors such as retail sales, chemical industry, pharmaceuticals and electrical equipment, far from the piles of steel and concrete. Furthermore, the banking system of the province is one of the most orderly in the country. Hank Paulson must be a very well-informed person to go off looking in places like Zhejiang given that the best Chinese entrepreneurs are not to be found in the skyscrapers of the big cities. The Dutch ships of promise are hiding away in parts of the badly-treated sector of rural China.

22 billion dollars. In spite of representing less than 10% of all exports, it is significant that exports of Chinese home-based companies have come out of a long lethargy and have been gaining strength all through 2006. In turn, imports of aluminium and copper by volume stabilized after showing decreases in previous months but this was not the case with steel which in the 12 months ending in August continued to drop to the point where it showed a loss of close to 40% compared with the same period last year.

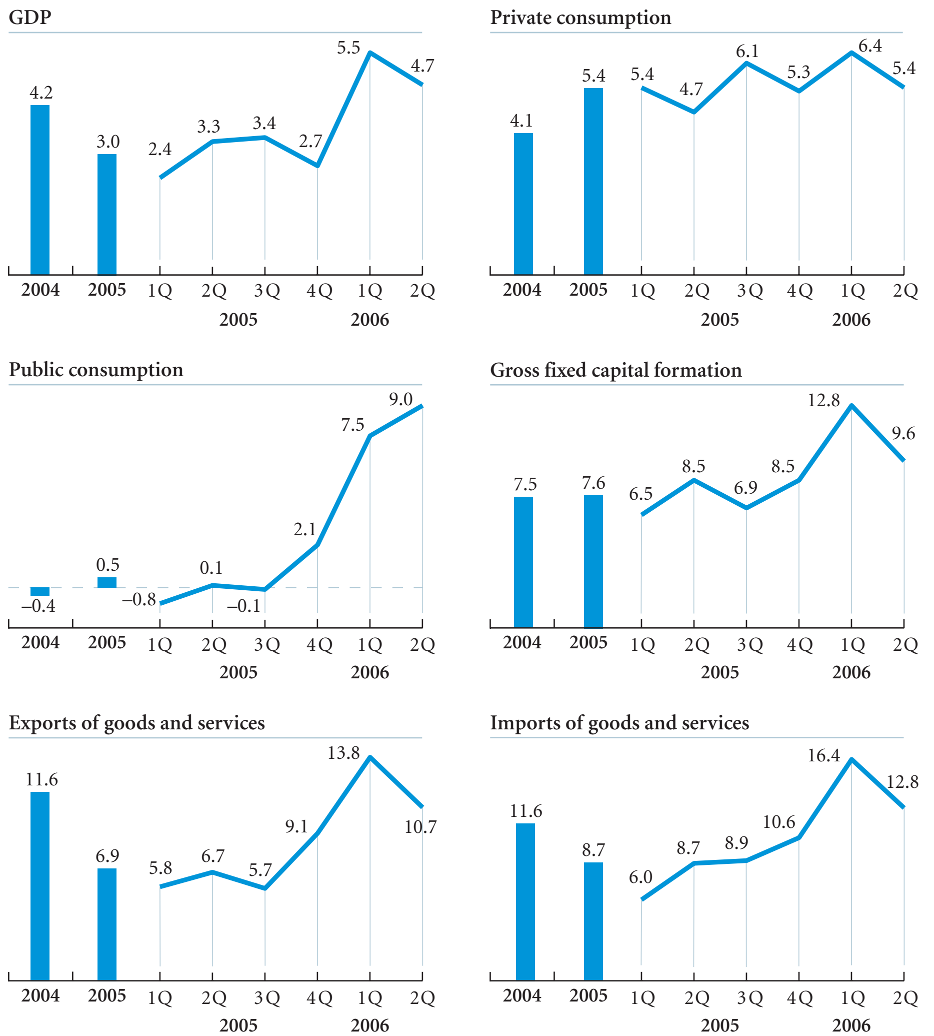
Mexico: good growth, prices permitting

Mexico grows by 4.7% with private investment in lead...

The Mexican economy showed commendable strength in the second quarter holding to the high profile begun

TREND IN MEXICO'S GDP BY COMPONENT

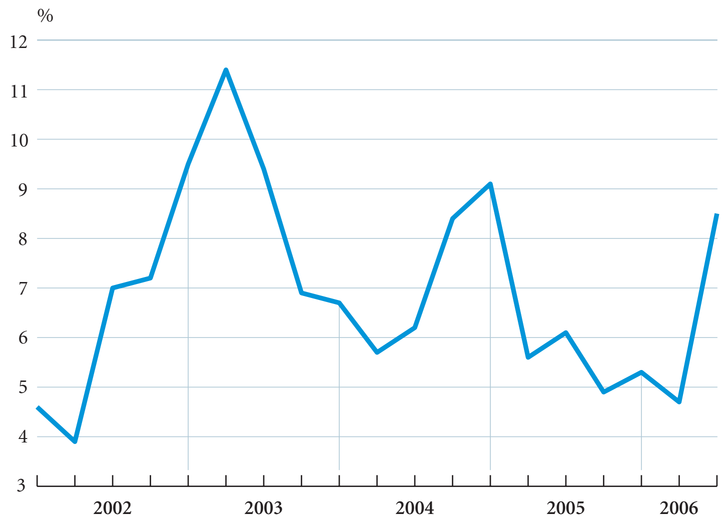
Percentage year-to-year change in real terms



SOURCE: Central Bank of Mexico and internal figures.

MEXICO: PRICES GIVE OUT WARNING

Year-to-year change in GDP deflator



SOURCE: Central Bank of Mexico and internal figures.

at the end of 2005. Growth of 4.7% year-to-year in the GDP was soon backed by private consumption which moved up by 5.4%, while public consumption rose to 9.0%. Nevertheless, the biggest advance continued to show up in investment which recorded an increase of 9.6% year-to-year. While there was a slight slowdown in capital formation compared with the rate early in the year, we first have to consider the rate of increase and, secondly, its nature, given that in the previous period public investment had risen by 22.0% year-to-year, only to drop by 1.6% in the second quarter with the lead going to the private sector. The foreign sector continued to take strength away from growth, approximately a fifth of the total, with exports growing strongly but not matching the rate of imports.

Among most recent demand indicators, industrial production grew by 5.8% year-to-year in August and continues to make a good showing with the

...but GDP deflator shoots up to 8.5%...

MEXICO: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005		2006				
			3Q	4Q	1Q	2Q	July	August	September
Real GDP	4.2	3.0	3.4	2.7	5.5	4.7	–	...	–
Industrial production	4.2	1.6	0.8	2.7	7.0	3.9	6.1	5.8	...
General unemployment rate (*)	3.9	3.6	3.8	3.1	3.5	3.2	4.0	4.0	4.0
Consumer prices	4.7	4.0	4.0	3.1	3.7	3.1	3.1	3.5	4.1
Trade balance (**)	–8.8	–7.6	–9.5	–7.6	–5.0	–4.5	–4.1	–4.2	–5.3

NOTES: (*) Percentage of labour force.
(**) Cumulative balance for 12 months. Billion dollars.
SOURCE: Central Bank of Mexico.

...while foreign sector continues to worsen.

construction sector partly taking over from manufactured goods although these are still holding up well. Production by «maquiladoras» (foreign companies, that is, US firms operating in Mexico to take advantage of low labour costs) move up to 8.9% year-to-year following a long period that was somewhat slack.

The question of price stability is not as clear as it was a few months back. Inflation in September rose to 4.1% year-to-year. This figure may even be considered reasonable, especially taking into account the stability of the underlying component (less energy and food) which stood at an increase of 3.4%. But the latest GDP deflator, which in the second quarter rose from 4.7% to 8.5% year-to-year, is showing reasonable signs that the strong rate of economic activity is generating some price increases.

The foreign sector continued to grow worse, brought about by the lack of competitiveness due to the foreign exchange rate of the peso and the strength of domestic demand which has shown five years of continuous increase. The trade balance for the 12 months ending in September showed a deficit of 5.26 billion dollars. If we exclude oil exports, a cushion that in view of the trend in prices could begin to shrink, the deficit goes up to 44.9 billion dollars, a growing figure which keeps getting bigger.

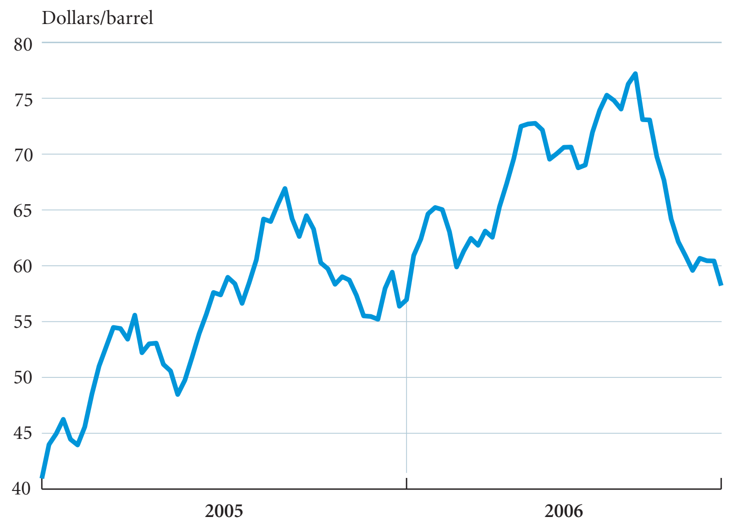
OPEC tries to halt drop in crude oil prices

Drop in oil prices forces cut in OPEC production...

At the beginning of October the per barrel price of Brent quality oil (one-month forward) stood at annual lows, scarcely above 58 dollars. The all-time high of 78.49 dollars reached on August 8 lay far behind. Behind this sharp shift, among other factors, there were prospects of a notable easing of demand in coming months. The Organization of Petroleum Exporting Countries (OPEC)

DROP IN OIL PRICES ENDS

1-month forward price of Brent oil as weekly average



SOURCE: Thomsom Financial Datastream.

has revised downward expected demand for oil for 2006 and 2007 as many as five times so far this year. The International Energy Agency has made a similar correction.

The sharp drop in oil prices has led the oil cartel to consider its first cut in production since 2004. Finally, following a series of preliminary announcements, at its meeting in Doha on October 19-20, OPEC decided to reduce production by 1.2 million barrels a day as of November 1, a figure that is approximately equivalent to 4.3% of current official production. At the same time, OPEC reserves to itself the possibility of further cuts at its meeting on December 14.

...a decision putting no major pressures on oil prices.

All through October, the price of oil has tended to run at around 60 dollars without showing any very clear trend. The International Energy Agency has put on record that demand has moderated slightly due to seasonal maintenance work carried out by refineries during this period of the year.

Metals continue to pile up big annual rise.

The course followed by other raw materials has been different to that of oil. The Economist index in dollars rose by 7% in October, to stand at levels 33% higher than one year ago. The rise was largely due to metals. The upward move in metal raw materials recorded in October was headed by the increase in lead, silver, nickel and zinc. On the other hand, there was a contrasting correction in gold which showed two consecutive months (September and October) with decreases. On monthly average, gold stood at the level of 586 dollars an ounce in October, nearly 140 dollars below the annual high recorded last May.

Euro Area: economic climate improving

In Euro Area, drop in inflation to 1.7% may strengthen growth...

The card game was already decided when someone unexpectedly threw out a joker. Economic growth was strong, with a rise of 2.7% year-to-year in the second quarter, the best result since the beginning of 2001. But private consumer demand had not yet come to the party. Suddenly, there was the joker. Inflation had fallen more than expected. This meant added support for recovery that no one had been counting on, thus making it possible to extend the stage of economic growth. That is, of course, so long as oil prices, the cause of the change mentioned, does not come up with other surprises.

...thanks to role in boosting consumer demand.

While it is expected that inflation will slow the upward trend followed in recent months, the figure for September came as a surprise to everyone. After standing at 2.3% year-to-year in August, the September figure for the harmonized consumer price index (HCPI) rose by a moderate 1.7% year-to-year. This was the first time since March 2004 that inflation stood below the 2% year-to-year reference rate of the European Central Bank (ECB). This good performance was largely due to the lower year-to-year growth in the energy component (it barely moved up by 1.5% year-to-year, as against 8.1% in August), a correction that looks like continuing in coming months if oil prices remain moderate. At the same time, the containment of

SHARP DROP IN INFLATION IN EURO AREA

Year-to-year change in Harmonized CPI

SOURCE: Eurostat and internal figures.

EURO AREA: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005		2006				
			3Q	4Q	1Q	2Q	July	August	September
GDP	1.7	1.5	1.7	1.8	2.2	2.7	–	...	–
Retail sales	1.5	1.2	1.5	1.2	0.9	1.8	1.9	2.4	...
Consumer confidence (*)	–14	–14	–15	–12	–11	–10	–8	–9	–8
Industrial production	2.0	1.2	1.4	2.1	3.4	3.8	3.0	5.4	...
Economic sentiment indicator (*)	99.7	98.4	97.9	100.6	103.1	107.2	108.6	108.3	109.3
Unemployment rate (**)	8.9	8.6	8.5	8.4	8.1	7.9	7.8	7.9	...
Consumer prices	2.1	2.2	2.3	2.3	2.3	2.5	2.4	2.3	1.7
Trade balance (***)	80.4	43.5	36.4	25.1	6.9	–6.2	–17.0	–20.0	...

NOTES: (*) Value.
(**) Percentage of labour force.
(***) Cumulative balance for 12 months. Billion euros.
SOURCE: Eurostat, European Central Bank, European Commission and internal figures.

inflationary pressures is confirmed by the low growth rate to be seen in core inflation (excluding energy and food), which was stable at 1.5% in August and September.

We must ask up to what point this containment of prices may extend the current growth stage. Over the short term, its most notable effects are an improvement in the real purchasing power of households with less pressure on the ECB regarding its current tighter money policy. The first of these factors may contribute substantially to help consumption (still in something of a slack stage) to move into a somewhat clearer upward path. The second factor would directly affect one of the determinants of corporate investment, namely, financing costs. In addition, a less restrictive monetary policy than that expected would provide additional support to domestic demand by lowering the cost of borrowing. To sum up, the most immediate impact would be to generate stronger drive that that forecast in domestic demand and therefore somewhat more solid economic growth.

Retail sales and industrial production going well.

While inflation has been the big news of the month, other indicators have also added further evidence that the Euro Area is moving into its best economic situation in the past decade. On the demand side, we should point out the good figure for retail sales which grew by 2.4% year-to-year in August, a half-point more than in July, and the gradual recovery in consumer confidence. On the supply side, the positive performance in industry (industrial production was up 5.4% year-to-year in August as against 3.0% in July) and some improvement in construction (sector confidence rose by more than three points in the third quarter) underline the spread of economic recovery over various sectors.

Surprising minor rise in unemployment disappointing but should be corrected shortly.

Finally, as a less positive counterpoint, it should be borne in mind that the unemployment rate rose by one decimal in August putting it at 7.9% of the labour force. In any case, the immediate prospects are far from negative given that further decreases in the unemployment rate are expected in coming months.

India and China: are they global partners or competitors of the European Union?

There is concern in Europe about China and India. They are seen as fierce global competitors in industry (China) and services (in the case of India). Furthermore, it is felt that the two are playing the game of world competition with marked cards. In a recent survey of business executives carried out by the European Commission, it was felt that in their relations with China the main problems were control of technology transfer, the copying of products, the protection of intellectual property, Chinese domestic regulations, the existence of unfair competition and lack of a predictable investment climate that is transparent and stable. It is not surprising that there are currently 35 anti-dumping or similar complaints being heard in which the European Commission has established safeguard measures against Chinese products. Complaints against India are not far behind with a total of 14 cases involving the application of specific measures by the European Commission. Nevertheless, a less anecdotal analysis of trade and investment relations between the European Union (EU) and China and India will serve to largely remove the above clichés.

More than their current extent, what is of concern is the rapidity with which both economies have emerged as global players. With regard to trade in goods, China is the leading player given that in just a few years it has become a trading partner of reference for Europe. Between 2001 and 2005, China went from supplying 8% of EU-25 imports to a figure of 13.4%. Given that its importance as a destination market rose to a lesser extent (from 3.4% of the total in 2001 to 4.9% in 2005, in the period 2001-2005 the bilateral trade deficit doubled. In the case of India, the situation is diametrically opposed. The EU maintains a gradually increasing trade flow but this amounts only to 1.6% of Europe's imports of goods and 2% of goods exports. Furthermore, there is a slight trade surplus in favour of the EU. Therefore, here we are faced with relations with Europe's second largest trading partner (China), far behind the EU's first trading partner which continues to be the United States, and not so much with its tenth trading partner (India).

We may ask if the emergence of China is taking place at the cost of the EU. A first approach to this matter is to compare the shares of each country in world exports (see accompanying graph). From this we discover that the emergence of China as a trading power has largely taken place at the expense of other economies outside the EU. China has practically doubled its share of exports going from 3.9% to 7.6% in little more than five years, whereas the European Union, with some swings up and down, holds at 38% of total world exports. The progress of India is also notable although its global position is limited (in this period it went from 0.7% to 1%). Significantly, the drop in the case of the United States (down four percentage points) turns out to be equivalent to the increase by China.

Are China and the EU struggling for the same markets? A recent study by the European Commission makes a very illustrative double comparison.[1] European Commission economists wonder if China-Europe trade may fall into the respective patterns of specialization of both economies. For this purpose, they classified international trade in manufactured goods in five categories (high technology, information and communications technology, high-medium technology, low-medium technology and low technology) and analyzed those cases in which the EU is more competitive and in which cases this falls to China. The complementary nature is complete in the categories of low technology, low-medium technology and high-medium technology. Europe is clearly more competitive in the two latter categories while China wins out in the first case. In the segment of greatest value added (high technology and ICT) the EU remains more competitive, although here the distance between them is less and, therefore, they could be in a less complementary situation.

(1) Denis, C., McMorrow, K. and Roger ,W. (2000): «Globalisation: Trends, Issues and Macro Implications for the EU». Economic Paper No. 254. DG of Economic and Monetary Affairs, European Commission.

TRADE IN GOODS WITH EUROPEAN UNION

In million euros (2005)

	China			
	Chinese exports to EU		EU imports from China	
	Value	% of EU imports	Value	% of EU exports
Machinery and transportation equipment	73,135	19.5	30,983	6.5
Various manufactured goods (footwear, furniture, clothing)	53,997	32.3	3,220	2.7
Manufactured goods (paper, textiles, metal manufactures)	17,403	15.0	6,138	4.6
Chemical products and allied goods	4,966	5.3	5,059	3.1
Raw materials (not including fuels and other)	2,281	5.0	3,103	16.0
Food products and live animals	2,076	3.8	590	1.7
Fuels and lubricants	750	0.3	63	0.1
Other products	377	1.5	572	1.7
Drink and tobacco	68	1.4	198	1.2
Oils, fats and waxes	34	0.8	20	0.8
TOTAL	**158,098**	**13.4**	**51,796**	**4.9**

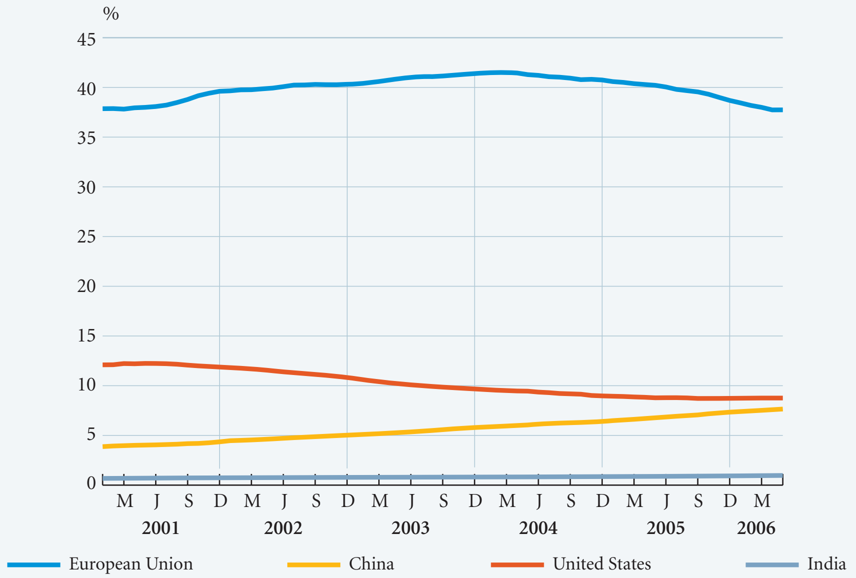
	India			
	India's exports to EU		EU imports from India	
	Value	% of EU imports	Value	% of EU exports
Various manufactured goods (footwear, furniture, clothing)	5,631	3.4	1,432	1.2
Manufactured goods (paper, textiles, metal manufactures)	4,988	4.3	8,165	6.1
Machinery and transportation equipment	2,368	0.6	7,177	1.5
Chemical products and allied goods	1,892	2.0	1,894	1.2
Food products and live animals	1,133	2.1	56	0.2
Fuels and lubricants	885	0.4	98	0.3
Raw materials (not including fuels and other)	518	1.1	937	4.8
Oils, fats and waxes	142	3.5	11	0.5
Other products	125	0.5	392	1.4
Drink and tobacco	56	1.2	54	0.3
TOTAL	**18,911**	**1.6**	**21,110**	**2.0**

SOURCE: European Commission.

In addition, an analysis of all goods was carried out last year making a distinction between the following five groups: goods combining a major research and development effort which are difficult to copy; capital-intensive goods; labour-intensive goods and goods intensive in raw materials. Once more, the complementary nature of China-EU trade is notable. Europe is competitive in those goods difficult to copy and capital-intensive, whereas China is competitive in those that are labour-intensive (and to a lesser extent in those that are intensive in raw materials and goods easy to copy). Finally, in spite of the logical conflicts that arise in trade relations, those between Europe and China may be termed as of growing importance with a predominance of complementary trade factors.

CHINA STEALS GROUND FROM UNITED STATES BUT STILL FAR FROM EU

Share of world exports of goods as movable average for 12 months
in US dollars



SOURCE: International Monetary Fund and internal figures.

And what about services? If we look at trade in services, the balance is still positive for the European Union. China shows a modest deficit with the EU while India enjoys a surplus, although still small. Both countries are relatively minor trading partners, given that China represents 2.6% of total EU imports and exports in services while India shows 1.1%. To put the size of these figures in perspective, the United States, the leading partner of the EU in trade in services, accounts for a total of 35% of EU imports and exports.

Certainly, the trade figures represent no more than part of the story. It is possible that, in spite of the fact that Europe holds up as a trading giant, its companies may be clearly opting to position themselves in the new Asian markets. The trend in direct foreign investment (DFI) should provide some information in this respect. On average for the period 2001-2004, China and India represented the destination of 1.6% and 0.4% of all DFI going abroad from the EU, which was far from the United States, a country to which 31% of all DFI funds was directed. Therefore, it does not seem that the EU is faced with a phenomenon of alarming size.

Finally, in China the EU has encountered an increasingly important trading rival, but one with substantial complementary factors, while India is playing a lesser role. At the same time, the figures allow us to conclude that the bulk of trade relations is concentrated in goods, while trade in services is of significantly lesser extent. Nor does it seem that the amount of direct foreign investment is indicative of an increase in the process of deindustrialization of Europe.

Germany: party continues but future unclear

Germany continues to enjoy a stage of economic growth. Its growth of 2.4% year-to-year in the second quarter was the best since the third quarter of 2000. The recovery in retail sales indicates a slightly stronger growth stage in consumption. The sharp growth in industrial production of capital goods confirms that corporate investment is still very strong.

While domestic demand is recovering the strength lost in previous years, the foreign sector is also showing an excellent performance. From the beginning of the year growth in exports has tended to stand above 10% year-to-year and, if the foreign surplus has not improved, this is due to the fact that recovery of domestic demand is also boosting imports.

The supply side is running along similar lines. Industrial production grew by an

Germany continues stage of strong economic activity...

GERMAN INDUSTRY IN EXCELLENT SHAPE

Year-to-year change in industrial production index

SOURCE: Federal Statistics Office and internal figures.

GERMANY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005		2006				
			3Q	4Q	1Q	2Q	July	August	September
GDP	0.8	1.1	1.5	1.7	1.7	2.4	–	...	–
Retail sales	2.1	1.2	1.4	0.1	0.7	0.3	–0.3	1.0	...
Industrial production	2.4	2.9	3.1	4.7	4.6	4.9	4.3	7.3	...
Industrial activity index (IFO) (*)	95.5	95.5	95.4	98.7	103.6	106.1	105.6	105.0	104.9
Unemployment rate (**)	10.5	11.7	11.7	11.4	11.3	11.0	10.6	10.6	10.6
Consumer prices	1.7	2.0	2.2	2.3	2.0	1.9	2.0	1.7	1.0
Trade balance (***)	149	157.2	157.2	160.3	157.5	154.1	150.7	150.4	...

NOTES: (*) Value.
(**) Percentage of labour force.
(***) Cumulative balance for 12 months. Billion euros.
SOURCE: OECD, national statistical bodies and internal figures.

...with key role falling to industrial production at highest levels in past 15 years.

excellent 7.3% year-to-year in August, the highest in 15 years. Indicators for construction and services also reflect the improved economy. Finally, we should complete this positive review of the situation mentioning the big drop in inflation (the CPI grew by a mere 1.2% in October, far from the 2% last July) and some stabilization of the unemployment rate which stood at 10.6% of the labour force in September (with no change over July and August). Putting a gold cap on this good state of affairs, the German government announced it was revising its growth forecasts upward for 2006 from 1.6% to a level between 2.0%-2.5%.

Uncertainty about 2007 causes drop in corporate and consumer confidence.

Nevertheless, if the situation is so positive, why are consumer and corporate confidence indices being eroded? Germany's ZEW index, which closely monitors expectations of the main economic players, stood at –27 points in October, continuing nine consecutive months of downward moves. While shortly afterwards the IFO industrial activity index showed marginal growth in October, the overall feeling is that prospects for the German economy are not too clear. The factors underlying this loss of confidence are the uncertainty raised by the rise in the value added tax (VAT) in 2007, the growing difficulties for exports and the ECB's tighter monetary policy. Economic players indeed are expecting that growth next year will be less than this year.

France: boom helps put public accounts in order

French consumption continues to drive economy.

The economic boom in France continued strong in the third quarter due to the fact that private consumption, the engine behind growth, continued to show notable strength. The improvement in consumer confidence, which rose by two points in the third quarter, and maintenance of private consumption at levels scarcely any lower than those in the brilliant second quarter, confirm that this economic support is continuing. The strength of domestic demand is bringing about greater recourse to imports, something that also explains the worsening of the trade balance as of August.

FRENCH ECONOMY GAINS STRENGTH

Figure for economic sentiment index

SOURCE: European Commission.

FRANCE: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005		2006				
			3Q	4Q	1Q	2Q	July	August	September
GDP	2.0	1.2	1.4	1.0	1.4	2.6	–	...	–
Domestic consumption	3.8	2.9	4.1	2.3	2.9	4.7	3.7	6.4	2.9
Industrial production	2.0	0.0	0.3	–0.7	0.4	1.7	1.2	1.0	...
Unemployment rate (*)	10.0	9.9	9.9	9.7	9.6	9.1	8.9	9.0	...
Consumer prices	2.1	1.7	1.9	1.6	1.8	1.9	1.9	1.9	1.2
Trade balance (**)	0.1	–1.3	–1.5	–1.8	–2.0	–2.1	–2.2	–2.4	...

NOTES: (*) Percentage of labour force.
(**) Cumulative balance for 12 months. Billion euros.
SOURCE: OECD, national statistical bodies and internal figures.

Slowdown in industry in contrast to recovery in services and construction.

Supply indicators also reflect the drive in the French economy with the exception of industrial activity, as usual. While industrial production slowed down in August to 1.0% year-to-year (1.2% in July), construction indicators (housing starts and building permits) and confidence in the secondary sector showed a good performance. In addition, the trends in both the CPI and the unemployment rate are a repeat of what is happening in the Euro Area as a whole: a notable slowdown in prices and a momentary rise in unemployment. Specifically, inflation stood at 1.2% year-to-year in September dropping by seven decimals compared with August while the unemployment rate rose to 9.0% that same month (8.9% in July).

The French government is taking advantage of the positive economic situation to put the imbalances in the public accounts in order. The increase in

Improvement in tax collections to go into reducing government debt.

tax collections, mainly from higher figures for VAT due to the rise in consumption, is to be used entirely for reducing the cumulative government debt, as indicated by the 2007 budget estimates. In addition, there has been a certain policy of containment of spending which shows up in the elimination of 15,000 public service jobs.

Italy: reform difficult

In Italy, economic situation tending to improve.

Things are going awry for Romano Prodi, Italy's prime minister. The slight improvement in the economy during the summer may not be enough to restore the honeymoon between the centre-left coalition and the electorate which continued until a start was made to spelling out the tougher budgetary measures for 2007. As a result, with regard to the economic situation, the final months of the third quarter clearly show a slight increase in economic activity, although not enough to decisively boost growth. The recovery in retail sales and the improvement in consumer confidence would indicate that the weak level of consumption may be coming to an end.

Recovery in both industry and retail sales make significant news.

The unexpected rise in industrial production, which in August was practically twice the figure for July, and the recovery in the economic sentiment index as of September confirm the view of an economy making progress in its recovery. The improvement in the secondary sector was due largely to the growth of exports (up 12% year-to-year in August). Finally, we should mention some containment of inflation although relatively less than that recorded in other economies of the EU. As a result, the CPI grew by 2.1% year-to-year in September compared with 2.2% in August.

In this situation, confronted with undoubtedly negative budget figures, Prodi has tackled the problem of the 2007 budget estimates through a moderate increase in the tax load. The public response has been largely negative. Industry spokesmen and economists have tended to point out that the absence of any containment in public spending is erroneous, a position followed by the rating agencies Standard & Poor's and Fitch with a lowering of the rating applied to Italian government bonds. Another criticism, also well founded, is that the Italian budget does not face up to the problem seen as the

ITALY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005		2006				
			3Q	4Q	1Q	2Q	July	August	September
GDP	0.9	0.1	0.1	0.5	1.6	1.5	–	...	–
Retail sales	–0.4	0.4	0.3	1.9	0.5	1.9	1.1	2.0	...
Industrial production	–0.5	–0.9	–0.1	0.4	2.7	1.6	1.3	2.0	...
Unemployment rate (*)	8.0	7.7	7.6	7.5	7.3	7.0	–	...	–
Consumer prices	2.2	1.9	2.0	2.2	2.1	2.2	2.2	2.2	2.1
Trade balance (**)	–1.2	–9.9	–7.0	–9.3	–13.2	–16.3	–19.8	–20.9	...

NOTES: (*) Percentage of labour force.
(**) Cumulative balance for 12 months. Billion euros.
SOURCE: OECD, national statistical bodies and internal figures.

most acute in that country's economy, namely the progressive worsening of Italy's productivity. The reaction of the Italian government has been to propose an easing of the tax adjustment so far as it affects small proprietors. Indeed, introducing reform in Italy is not easy.

United Kingdom: better than expected growth

Economic activity indicators were anticipating that in the third quarter the economy would record a good growth rate. The initial estimate ended up showing growth of 2.7% year-to-year, even better than expected and one decimal above the figure for the second quarter.

In addition, inflation indicators suggest that something of a bottleneck is taking place in recovery. In September, for example, inflation stood at 3.2% year-to-year, exactly the same figure as the average for the third quarter. This was a rise of four decimals over the second quarter.

Other indicators, such as retail sales for the third quarter and industrial production as of August confirm that the improvement in the economy is broad-based and looks like continuing during the final stretch of the year. All of this has raised expectations of a further increase in reference rates by the Bank of England, perhaps in November. Now, the government budget is coming under pressure. The more orthodox voices are demanding that the government face up to the need to revise public spending.

Attempt to slightly increase tax load in Italy comes up against resistance of all kinds.

United Kingdom grows by 2.7% in third quarter...

...which, along with price increases, opens door to more restrictive monetary and fiscal policies.

UNITED KINGDOM: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005		2006				
			3Q	4Q	1Q	2Q	July	August	September
GDP	3.3	1.9	1.8	1.9	2.3	2.6	–	2.7	–
Retail sales	6.0	1.9	0.8	2.7	1.8	3.5	4.1	4.4	3.2
Industrial production	0.8	–1.8	–1.6	–2.6	–1.0	–0.7	–0.5	0.7	...
Unemployment rate (*)	2.7	2.7	2.7	2.8	2.9	3.0	3.0	3.0	3.0
Consumer prices	2.2	2.2	2.4	2.3	2.2	2.8	3.1	3.3	3.2
Trade balance (**)	–56.1	–64.6	–65.1	–67.3	–72.1	–76.0	–78.9	–79.1	...

NOTES: (*) Percentage of labour force.
(**) Cumulative balance for 12 months. Billion pounds.
SOURCE: OECD, national statistical bodies and internal figures.

Monetary and capital markets

Federal Reserve remains cautious

Fed makes no change in official interest rate, now at 5.25%...

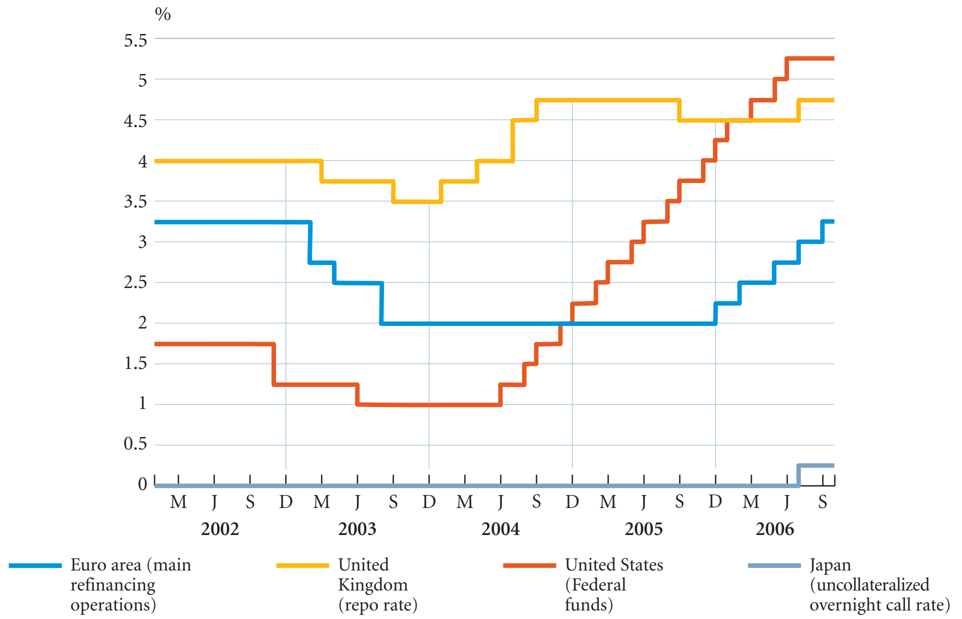
The meeting of the Federal Open Market Committee of the Federal Reserve System held in the second last week of October ended with a press release that meant scarcely any change from the previous meeting in September. As a result, it maintained the objective level for Federal Funds (interbank overnight deposits) at 5.25% for the third consecutive time. The US central bank continues to see upward risks for inflation and is leaving the door open for a further tightening of monetary policy should this be needed. This confirms that the Fed is ruling out any cut in official interest rate over the short term.

...and likely will hold this level in coming months.

The expectations in this regard held in the market up to the end of September vanished following a series of statements by heads of the Fed which showed their concern about inflation. While the sharp slowdown in the real estate market would have helped a downward move, the Fed considered that other segments of the economy continued to show a drive that could put price stability in jeopardy. The core component of inflation stands above the level considered desirable by the Fed. Furthermore, the drop in long-term interest rates in recent months has taken pressure off the Fed with regard to signs of economic weakness over the short term. Because of this, it is likely that it

EUROPEAN CENTRAL BANK RAISES INTEREST RATES

Monetary policy reference interest rates



SOURCE: National central banks.

SHORT-TERM INTEREST RATES IN NATIONAL MARKETS

Monthly averages as annual percentage

	Euro area			United States		Japan	United Kingdom		Switzerland
	ECB auctions (2)	Euríbor (5) 3-month	Euríbor (5) 1-year	Federal Reserve Board target level (3)	3-month (5)	3-month (5)	Bank of England repo rate (4)	3-month (5)	3-month (5)
2005									
September	2.06	2.14	2.22	3.60	3.91	0.09	4.50	4.60	0.76
October	2.06	2.20	2.41	3.75	4.17	0.09	4.50	4.59	0.81
November	2.06	2.36	2.68	4.00	4.35	0.09	4.50	4.62	0.95
December	2.28	2.47	2.78	4.16	4.49	0.09	4.50	4.64	1.02
2006									
January	2.30	2.51	2.83	4.26	4.60	0.10	4.50	4.60	1.01
February	2.31	2.60	2.91	4.50	4.76	0.11	4.50	4.58	1.09
March	2.56	2.72	3.11	4.54	4.92	0.12	4.50	4.59	1.21
April	2.58	2.79	3.22	4.75	5.07	0.13	4.50	4.63	1.28
May	2.58	2.89	3.31	5.00	5.18	0.19	4.50	4.70	1.40
June	2.76	2.99	3.40	5.03	5.38	0.31	4.50	4.73	1.48
July	2.80	3.10	3.54	5.25	5.50	0.40	4.50	4.73	1.53
August	2.98	3.23	3.62	5.25	5.42	0.44	4.75	4.94	1.61
September (*)	3.03	3.34	3.72	5.25	5.38	0.44	4.75	5.03	1.74
October (1)	3.30	3.55	3.87	5.25	5.38	0.45	4.75	5.18	1.86

NOTES: (*) Provisional figures.
(1) October 27.
(2) Marginal interest rate. Latest dates showing change in minimum rate: 5-6-03 (2,00%), 1-12-05 (2,25%), 2-3-06 (2,50%), 8-6-06 (2,75%), 3-8-06 (3,00%), 5-10-06 (3,25%).
(3) Latest dates showing change: 9-8-05 (3,50%), 20-9-05 (3,75%), 1-11-05 (4,00%), 13-12-05 (4,25%), 31-1-06 (4,50%), 28-3-06 (4,75%), 10-5-06 (5,00%), 29-6-06 (5,25%).
(4) Latest dates showing change: 10-7-03 (3,50%), 6-11-03 (3,75%), 5-2-04 (4,00%), 6-5-04 (4,25%), 10-6-04 (4,50%), 5-8-04 (4,75%), 4-8-05 (4,50%), 3-8-06 (4,75%).
(5) Interbank offer rate.
SOURCE: National central banks, Thomson Financial Datastream and internal figures.

will maintain its cautious stand over coming months.

On the other hand, as expected, the European Central Bank (ECB) raised its reference rates by 25 basis points on October 5. As a result, the Eurosystem reference rate stood at 3.25%, some 125 basis points above the level prevailing before December 2005. The ECB justified its decision in order to maintain inflation prospects moderate over the medium term. President Trichet stated that ECB interest rates continued to be relatively low in a context of sharp growth in the money supply and lending figures in the Euro area. Furthermore, he indicated another rise sometime during the rest of the year which likely will take place in December.

With regard to prospects for 2007, the official ECB interest rate will likely rise somewhat more. Although the harmonized inflation rate for the euro area dropped to 1.7% in September, it is expected that it will go above 2% at the beginning of next year. The ECB itself maintains that there are upward inflation risks because of oil prices and the trend in wages.

The Bank of England did not alter its repo rate at its meeting early in October.

Eurosystem interest rate may keep rising in early months of 2007.

Early interest rate increase by Bank of England expected.

Nevertheless, from the minutes of the meeting published afterwards it would seem that another rise in the official interest rate could come soon. Recovery of the economy and subsequent inflation risks would be behind that decision.

On the other hand, the same day as the ECB raised its interest rates, the Bank of Denmark also announced a rise in its rates by the same amount, namely a quarter-point. The rate for 14-day loans thus went to 3.50% while the discount rate was set at 3.25%. As is well-known, the inclusion of the Danish crown in the Exchange Rate Mechanism (ERM-2) with a narrow fluctuation band of ±2.25% has an effect on the monetary policy of that Baltic country.

Yen rebounds from low levels

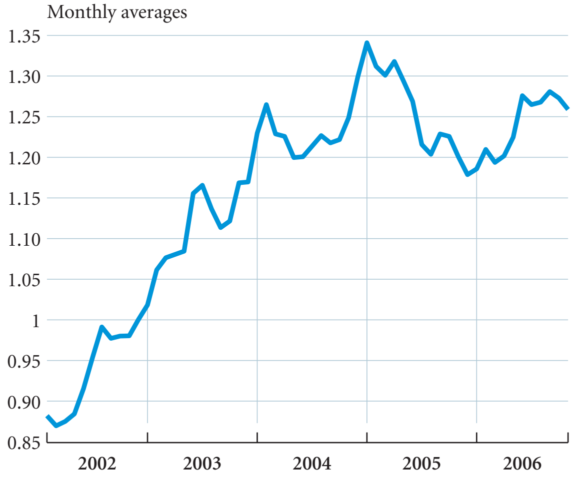
Disappearance of expectations of rise in Fed interest rates weakens dollar.

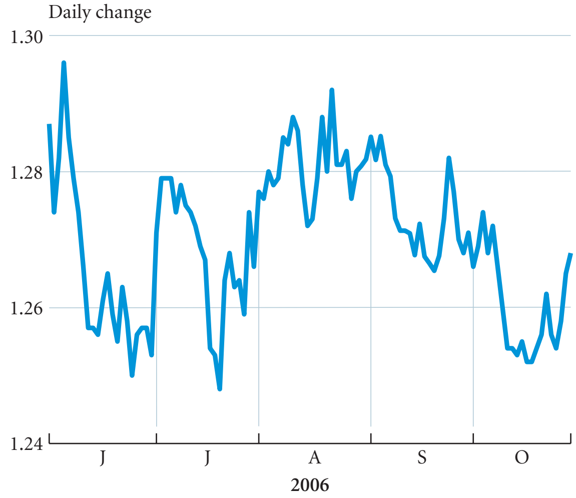
With the disappearance of any prospect of an early cut in the Federal Reserve System interest rate, the dollar tended to strengthen as of the end of September. Nevertheless, following the meeting of the Fed, the greenback weakened with the disappearance of expectations held by some investors that there was going to be an early rise in the Fed's official interest rate. As a result, at the end of the second last week in October the US currency showed a depreciation of 4% in terms of the group of currencies compared with the end of 2005 and it is possible that in coming months it will continue on a downward path, something needed in order to correct the foreign imbalance.

With the easing of expectations of increases in European Central Bank interest rates in 2007, the euro was adversely affected in the early weeks of October. This, however, must have been to the relief of European political leaders who previously had expressed concern that the strengthening of the European currency, especially against the yen, might hurt Euro area exports. In any case, toward the end of October, the

UPS AND DOWNS OF EURO AGAINST DOLLAR

US dollars to euro





NOTES: Figures go up to October 27.
SOURCE: OCDE, Thomson Financial Datastream and internal figures.

EXCHANGE RATES OF MAIN CURRENCIES

September 2006

	Final session of month		Monthly figures				Exchange rate October 27, 2006
	Exchange rate	% monthly change (2)	Average exchange rate	% change (2) Monthly	Over December 2005	Annual	
Against US dollar							
Japanese yen	118.0	0.6	117.2	1.0	–1.1	5.4	*117.6*
Pound sterling (1)	1.872	–1.7	1.886	–0.4	8.0	4.3	*1.899*
Swiss franc	1.250	1.5	1.244	1.0	–4.7	–1.7	*1.251*
Canadian dollar	1.118	1.3	1.116	–0.3	–3.9	–5.3	*1.119*
Mexican peso	10.98	0.6	10.98	1.0	3.3	1.9	*10.71*
Nominal effective index (4)	*108.2*	*0.4*	*108.1*	*0.3*	*–3.3*	*–2.3*	*107.5*
Against euro							
US dollar	1.266	–1.5	1.273	–0.7	7.3	3.8	*1.268*
Japanese yen	149.3	–0.8	149.0	0.3	6.1	9.5	*150.3*
Swiss franc	1.588	0.8	1.584	0.4	2.3	2.2	*1.591*
Pound sterling	0.678	0.5	0.675	–0.2	–0.6	–0.4	*0.671*
Swedish krona	9.280	0.1	9.266	0.6	–1.8	–0.7	*9.222*
Danish krone (3)	7.458	0.0	7.460	0.0	0.1	0.0	*7.455*
Polish zloty	3.971	0.9	3.965	1.5	3.0	1.2	*3.878*
Czech crown	28.33	0.4	28.38	0.7	–2.0	–3.2	*28.41*
Hungarian forint	273.0	–0.6	274.4	0.0	8.6	11.6	*261.7*
Nominal effective index (5)	*104.1*	*–0.6*	*104.2*	*–0.2*	*3.5*	*2.4*	*103.7*

NOTES: (1) Units to pound sterling.
(2) Percentages of change refer to rates as shown in table.
(3) Danish krone has central parity of 7.46038 against euro with fluctuation band of ±2.25%.
(4) Broad nominal effective index of US Federal Reserve Board. Calculated as a weighted average of the foreign exchange value of the US dollar against the 26 currencies of those countries with greatest volume of trade with the United States. Base: 1-1997 = 100.
(5) European Central Bank nominal effective exchange rate index for the euro. Calculated as a weighted average of the bilateral value of the euro against the currencies of the 23 main trading partners of the euro area. Base: I-1999 = 100.
SOURCE: Thomson Financial Datastream and internal figures.

euro showed an appreciation of around 3% in terms of the currencies of the main trading partners of the Euro area.

The pound sterling has tended to appreciate in recent weeks with consolidation of the forecast of a further increase in official rates by the Bank of England this year following the inflation figure for September and going by the minutes of that bank's monetary meeting. As a result, the British currency showed a cumulative rise of 10% against the dollar and 2% against the euro.

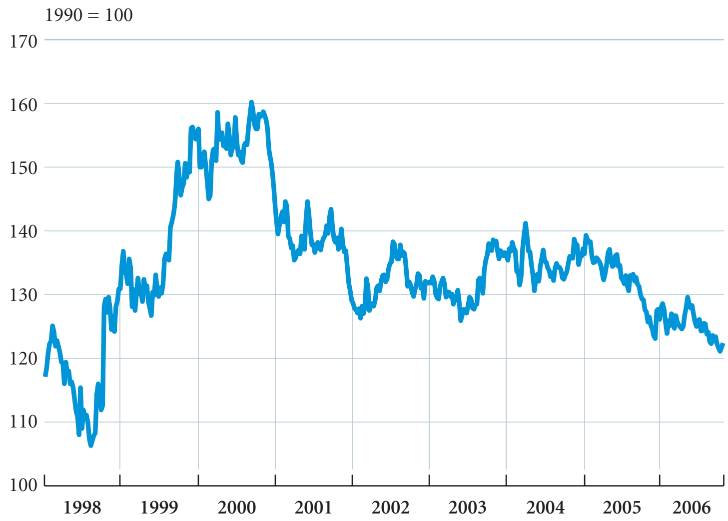
Pound sterling appreciates with firmer prospects of further rise in UK interest rates.

The Japanese yen marked up its lowest level in the past eight years compared with a broad group of currencies on October 13. The widening of the interest rate differential unfavourable to the yen depressed the Japanese currency. The drop in the yen in October brought rumours of a possible intervention by the Japanese authorities in foreign exchange markets which would be the first time they had done so since March 2004. The yen bounced back slightly around the middle of the month which was contributed to by the announcement by Russia's central bank, one of the

Adverse differential in interest rates pushes down yen.

YEN MARKS UP LOW FOR PAST EIGHT YEARS IN OCTOBER

Exchange rate of Japanese yen against basket of currencies



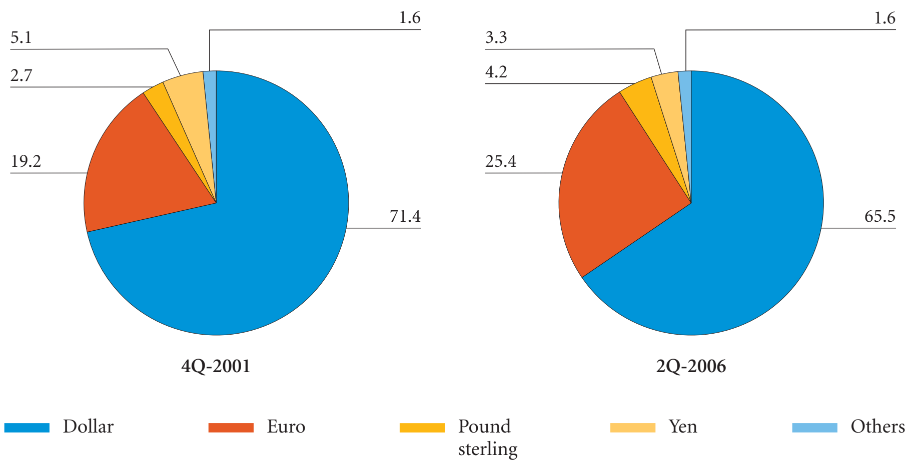
NOTES: Figures go up to October 27.
SOURCE: Bank of England.

world's leaders in foreign currency holdings, that it had decided to maintain part of its reserves in yen. Up until then the composition of its foreign currency reserves was mainly in dollars and euros as well as in pounds sterling.

On the other hand, the quarterly report by the International Monetary Fund on the make-up of foreign currency reserves in terms of the end of the first half-year shows that the participation of the yen in the total continues to drop. As a result,

DOLLAR AND YEN LOSE GROUND AMONG WORLD FOREIGN CURRENCY RESERVES

Composition of official foreign currency reserves as percentage (*)



NOTES: (*) Does not include certain countries.
SOURCE: International Monetary Fund and internal figures.

the share of the total stood at 3% whereas at the end of 1995 the yen held 7%. In turn, after having risen to 71% in 2001, the share held by the dollar fell to 65% in June this year.

Slight rise in government bond yields

The downward trend in yields on US Treasury bonds since the end of June was halted in the early weeks of October with the postponing of a possible cut in the Federal Reserve System interest rate, whereas inflation prospects were contained. Nevertheless, the yield on 10-year bonds dropped again later in view of a definite economic slowdown.

In Europe, the yield on long-term government bonds followed in the wake of the other side of the Atlantic although the 10-year differential was down slightly. It should be pointed out that in the third week of October the rating agencies Standard & Poor's and Fitch each lowered the sovereign debt rating for Italy to A+ and AA– respectively. The reason was the big increase in the government debt.

In addition, in the early weeks of October there was a narrowing of risk premiums, both on sovereign bonds of emerging countries and on low-rating corporate bonds. The risk premium on emerging country bonds was down notably coming close to the all-time low level recorded in May. The risk premium on high-yield corporate bonds was also down substantially in recent weeks although it is holding above the low in March 2005. It is unlikely, however, that there is much room for risk premiums on «junk bonds» to go lower, given an increase in default rates is expected.

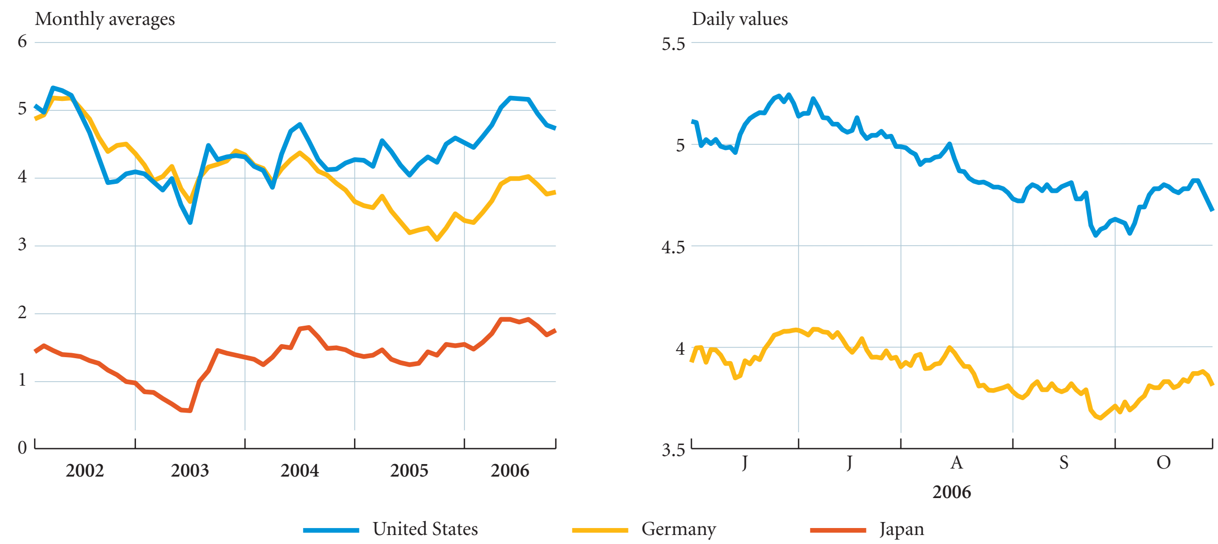
In another sphere, in the third week of October a plan was announced for the merger of the CME and CBOT derivatives markets, both located in Chicago, in order to form the world's biggest platform in this field. As a result, the Eurex derivatives market, connected

Inflation expectations contained.

Drop in Italy's sovereign bond rating.

UPS AND DOWNS IN LONG-TERM INTEREST RATES

Yield on 10-year government bonds as annual percentage



NOTES: Figures go up to October 27.
SOURCE: Bank of Spain and Thomson Financial Datastream.

LONG-TERM INTEREST RATES IN NATIONAL MARKETS

10-year government bonds: average for period as annual percentage

	2004	2005	2006					
			1Q	2Q	July	August	September	October 27
United States	4.31	4.33	4.61	5.13	5.16	4.95	4.78	4.67
Japan	1.50	1.39	1.58	1.90	1.91	1.81	1.68	1.73
Germany	4.07	3.38	3.50	3.96	4.02	3.90	3.76	3.81
France	4.10	3.41	3.51	3.99	4.03	3.90	3.77	3.82
Italy	4.24	3.56	3.71	4.27	4.31	4.18	4.04	4.08
Spain	4.10	3.39	3.49	3.97	4.02	3.89	3.76	3.82
United Kingdom	4.93	4.47	4.23	4.65	4.70	4.71	4.60	4.59
Switzerland	2.57	2.04	2.18	2.67	2.79	2.61	2.43	2.50

SOURCE: Bank of Spain, Thomson Financial Datastream and internal figures.

Plan to set up first world derivatives market.

to the Deutsche Börse, will be relegated to second place. The US markets calculate that this merger will generate significant annual synergies. There is the risk, however, that with the increase in market strength those benefits will not shift to their customers, something that has raised fears of an increase in tariffs applied. In any case, this is another step in the consolidation of international financial markets.

Many stock exchange indices breaking all-time records

Optimism about moderate interest rates and low oil prices boosts stock markets.

October 2006 brought good news to stock market investors to the point where many indices marked up all-time highs or at least highs for recent years. As a result, most stock exchanges recovered from the dip in May when some came to stand below the levels at the beginning of the year in a situation of increased uncertainty. On the other hand, the autumn began on a rather optimistic note. Interest rates at moderate levels and the drop in oil prices aided the good state of corporate profits. Furthermore, the lively activity in corporate operations also pushed up the market. Nevertheless, uncertainty about the trend in the US economy raised some risks.

Dow Jones Industrial index marks up all-time record...

In the United States, the lead falls to the traditional Dow Jones Industrial Average which includes 30 big corporations. This index went above the 12,000 points level in the third week of October and in the fourth week marked up a new all-time high leaving behind the record in January 2000 before the bursting of the hi-tech bubble. The rise of the Dow Jones index show the preference of investors for large companies which in periods of moderate growth tend to perform better than small ones. In turn, the Standard & Poor's 500 index marked up its highest levels since 2000 although it did not go above the highs for that year. The Nasdaq index, which is representative of hi-tech shares, recovered noticeably and topped the annual high seen in mid-April.

In the Euro Area, the DJ Eurostoxx 50, which includes the main companies in the area, recorded its highest level since the summer of 2001. Forecasts that interest rates in the Eurosystem were close to the ceiling for this upward stage aided stock markets in the area. What also helped them was that increases in value were generally more in line than those for US shares. At the beginning of the fourth quarter, the main Euro Area indices thus showed enviable cumulative balances with two-digit rises.

The star role, however, was taken by Spain's selective IBEX 35 index which, after calmly going above 13,000 points, reached an increase of more than 25% over December. In this case, apart from reflecting the drive in the economy, a series of take-over bids and share acquisitions aimed at consolidation of positions in the energy, real estate and banking sectors, among others, pushed the IBEX 35 way above what might have been expected at the beginning of the year.

Outside the Euro Area, euphoria also gripped the London market and the Footsie 100 index recorded a high for the past five and a half years. In turn, the Swiss stock exchange continued to mark up new all-time records in October. On the other hand, the Japanese stock market, in spite of some recovery, failed to reach the levels seen in April.

Markets in emerging countries also showed an upturn in recent weeks and generally present a notable cumulative balance in line with the boom in those countries. Nevertheless, as a whole they still stand below the all-time highs at the

...as happens on Spanish stock market...

INDICES OF MAIN WORLD STOCK EXCHANGES

September 29, 2006

	Index (*)	% monthly change	% cumulative change	% annual change	*Figures on October 27, 2006* % cumulative change	*Figures on October 27, 2006* *% change over same date in 2003*
New York						
Dow Jones	*11,679.1*	*2.6*	*9.0*	*10.5*	*12.8*	*25.8*
Standard & Poor's	*1,335.9*	*2.5*	*7.0*	*8.7*	*10.3*	*33.6*
Nasdaq	*2,258.4*	*3.4*	*2.4*	*5.0*	*6.6*	*24.8*
Tokyo	16,127.6	–0.1	0.1	18.8	3.5	*59.4*
London	5,960.8	0.9	6.1	8.8	9.6	*44.9*
Euro area	3,899.4	2.4	9.0	13.7	12.2	*59.9*
Frankfurt	*6,004.3*	*2.5*	*11.0*	*19.0*	*15.8*	*78.1*
Paris	*5,250.0*	*1.6*	*11.3*	*14.1*	*14.4*	*63.2*
Amsterdam	*483.6*	*3.1*	*10.7*	*20.0*	*12.2*	*53.0*
Milan	*29,414.0*	*1.3*	*9.8*	*9.6*	*12.8*	*58.8*
Madrid	*12,934.7*	*6.5*	*20.5*	*19.6*	*27.9*	*97.5*
Zurich	8,425.9	3.2	11.1	22.1	14.7	*68.6*
Hong Kong	17,543.1	0.9	17.9	13.7	23.0	*55.7*
Buenos Aires	1,637.3	–1.5	6.1	–3.4	15.6	*94.4*
São Paulo	36,449.0	0.6	8.9	15.4	17.6	*121.6*

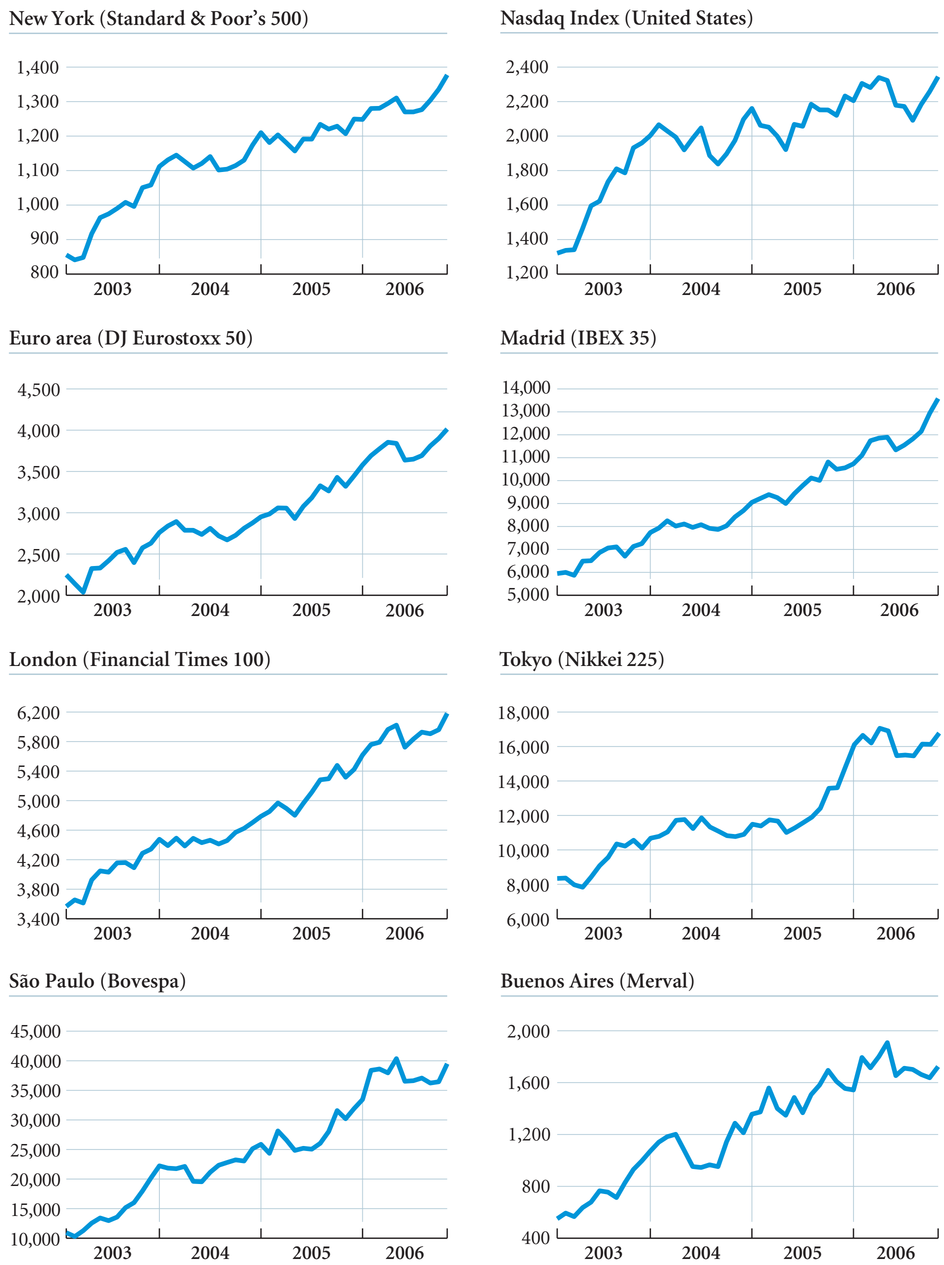
NOTES: (*) New York: Dow Jones Industrials, Standard & Poor's Composite, Nasdaq Composite; Tokyo: Nikkei 225; Euro area: DJ Eurostoxx 50; London: Financial Times 100; Frankfurt: DAX; Paris: CAC 40; Amsterdam: AEX; Milan: MIBTEL; Madrid: IBEX 35 for Spanish stock exchanges; Zurich: Swiss Market Index; Hong Kong: Hang Seng; Buenos Aires: Merval; São Paulo: Bovespa.
SOURCE: National stock exchanges and internal figures.

...and in many emerging markets.

beginning of May. Some indices, however, such as those of Poland, India, Indonesia, Oman, South Africa, Mexico and Venezuela marked up new all-time highs.

INTERNATIONAL STOCK EXCHANGES

Indices at month-end



NOTES: October 27, 2006.
SOURCE: National stock exchanges.

SPAIN: OVERALL ANALYSIS

Economic activity

Spanish companies enjoying excellent times

The Central Balance Sheet Data Office Quarterly Survey prepared by the Bank of Spain provides a good yardstick for taking the pulse of Spanish companies. The results for the first half of 2006 show that the corporate situation continues to be excellent. As these figures underline, non-financial companies included in the sample raised their rate of production in the period mentioned giving rise to growth of gross value added (GVA) of the order of 6.5% year-to-year, as against 4.2% in the first half of 2005.

All sectors represented in the sample reported significant increases in GVA although what stood out was the sharp in the retail sector (8.8%) and energy (9.8%), which were well above the figures seen one year earlier, especially in the former case. The increases obtained by industry and the transportation and communications sector were more moderate (4.0% and 4.5% respectively) but still show a profile of very strong growth. The renewed strength of domestic demand (which in this recent period has been the real engine of growth) along with the revival of sales abroad (something more recent) were the main factors behind the strength of economic activity reflected in the Bank of Spain quarterly figures.

Spanish companies doing well...

In the period under consideration, employment in the sample companies grew by 1.9% while at the same time

PROFIT AND LOSS ACCOUNT OF NON-FINANCIAL COMPANIES

Annual change rates

	2005	First half-year 2005	First half-year 2006
Value of production	12.5	12.0	14.3
Intermediate consumption	17.1	16.4	18.4
Gross value added (GVA)	**4.4**	**4.2**	**6.5**
Wage costs	3.9	3.6	5.1
Gross operating profit	**4.7**	**4.7**	**7.6**
Financial income	32.6	26.4	9.4
Financial costs	8.9	8.0	25.3
Depreciation and provisions	–0.1	–0.4	3.0
Net ordinary profit	**14.3**	**13.0**	**6.3**
Capital gains and extraordinary income	58.7	65.9	29.5
Capital losses and extraordinary costs	68.0	85.0	–15.3
Provisions and tax	–31.7	–37.3	89.3
Net profit	**35.3**	**31.5**	**3.3**

SOURCE: Bank of Spain (Central Balance Sheet Data Office Quarterly Survey).

...with significant increase in economic activity rate and profits.

average wages rose by 3.1%. As a result, wage costs rose by 5.1%, some 1.5 points more than in the same period the year before. It turns out that the sum of the companies that increased or maintained their workforce showed more moderate averages than that group of companies that cut jobs, largely due to the costs the latter group had to bear because of early retirements, especially in the energy sector.

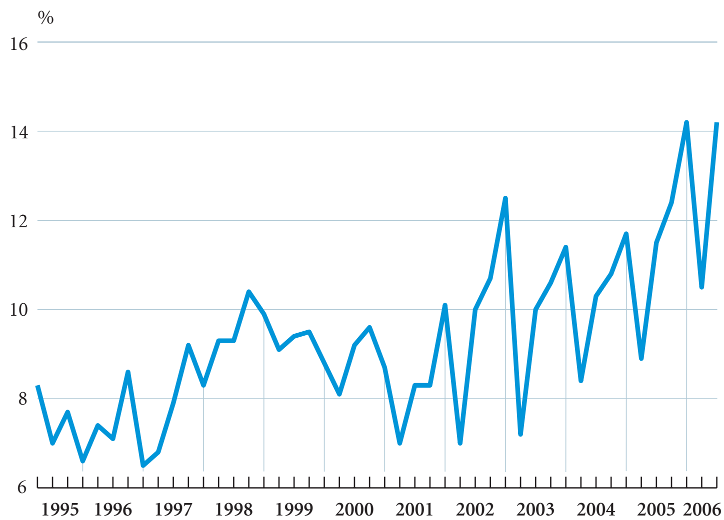
In any case, the increase in economic activity mentioned allowed companies to comfortably handle the increase in wage costs while marking up overall growth in gross operating profit of 7.6%, nearly three percentage points higher than that recorded one year earlier. Nevertheless, due mainly to the fact that financial costs showed a notable rise (up 25.3% year-to-year) and that, on the other hand, growth of financial income (9.4%) was well below the figure for 2005, growth of net ordinary profit was limited to 6.3%. What is significant from an economic point of view, however, is that from the sum of ordinary net profit and financial costs we obtain a net return on assets of 8.6%, well above that for the previous year. Along the same lines, return on equity for that six-month period stood at 13.7% on average, one of the highest in the whole statistical series.

It should be mentioned that the sharp growth in financial costs was almost entirely due to the increase in borrowing (largely brought about by debt acquired by one large telecommunications company in taking over control of another European company in the same sector) given that the change due to costs resulting from interest rate increases was very limited.

Finally, movements under the headings of capital gains and extraordinary income (very volatile because of their nature) account for the fact that growth of final net profit was down to 3.3%, which does not in any way put in question the high level of corporate

RETURN ON EQUITY AT ALL-TIME HIGHS

Ordinary net return on equity before tax



SOURCE: Bank of Spain and internal figures.

DEMAND INDICATORS

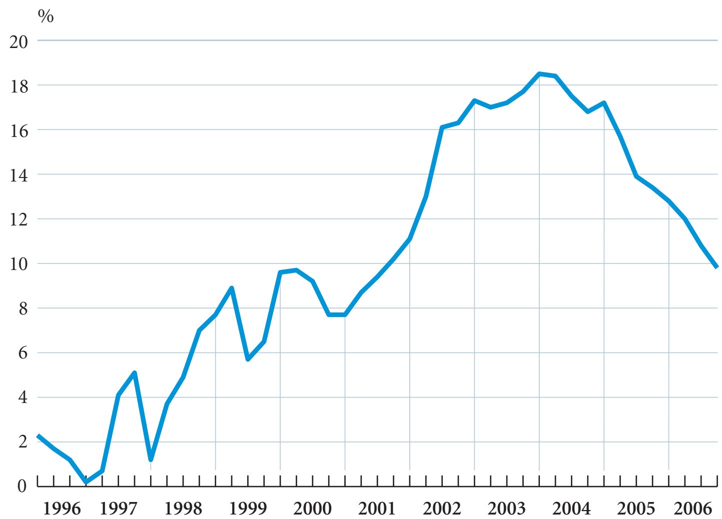
Percentage change over same period year before

	2004	2005	2005		2006				
			III	IV	I	II	July	August	September
Consumption									
Production of consumer goods (*)	–0.1	0.9	1.4	0.9	0.6	2.1	0.8	2.3	...
Imports of consumer goods (**)	13.4	7.9	7.8	8.6	20.5	5.9	3.4	4.9	...
Car registrations	9.8	0.8	2.3	–4.5	2.4	–4.3	–5.1	–3.8	–7.2
Credit for consumer durables	5.5	15.0	17.3	19.7	17.6	...	–	–	–
Consumer confidence index (***)	–10.5	–10.8	–11.4	–11.2	–12.5	–12.7	–14.0	–13.0	–14.0
Investment									
Capital goods production (*)	1.9	–0.1	–1.3	0.8	6.7	7.6	6.7	12.2	...
Imports of capital goods (**)	14.9	20.4	13.5	8.2	10.0	–5.0	12.3	5.2	...
Commercial vehicle registrations	11.7	13.2	13.9	11.5	7.4	–0.1	1.8	1.9	–2.2
Foreign trade (**)									
Non-energy imports	9.8	6.0	4.7	4.5	13.7	4.7	8.9	12.0	...
Exports	5.2	0.2	1.2	0.1	12.7	3.7	0.1	7.5	...

NOTES: (*) Adjusted for difference in number of working days.
(**) By volume.
(***) European Commission survey: difference between percentage of positive and negative replies.
SOURCE: ANFAC, National Institute of Statistics, Bank of Spain, Ministry of Economy and Finance, European Commission and internal figures.

GROWTH OF HOUSING PRICES MODERATING

Year-to-year change in non-subsidized housing prices per m²



SOURCE: Ministry of Housing and internal figures.

profits in that period, as shown by the rates of return indicated above.

Following an excellent first half-year, Spain's economy is maintaining great strength in the second half. Everything

Spain's economy continues strong growth.

would indicate that the third quarter would have ended at a growth rate very similar to that the previous quarter, or perhaps slightly higher. From a demand perspective, the moderate slowdown in private consumption in recent months was more than compensated by the rise in investment and the recovery of foreign demand.

The moderation of private consumption is quite uneven depending on the type of goods. Passenger car registrations, for example, recorded a drop of 5.3% year-to-year in the third quarter but even so the figure for sales in that period was the third highest in history. On the other hand, the retail trade survey has been reflecting something of an upward trend in sales in recent months, especially in the non-food area. There have been no significant changes in the level of consumer confidence, still stuck at very negative figures, which suggests that in the immediate future we shall see a continuation of the trend to gradual moderation in household consumer spending.

Investment in capital goods continues to show very strong, if we are to go by the trend in some significant indicators such

SUPPLY INDICATORS

Percentage change over same period year before

	2004	2005	2005		2006				
			III	IV	I	II	July	August	September
Industry									
Electricity consumption (1)	4.2	3.4	2.9	2.7	2.4	4.0	6.1	5.0	6.5
Industrial production index (2)	1.6	0.7	0.7	1.6	2.6	4.0	3.9	4.9	...
Confidence indicator for industry (3)	–2.5	–4.9	–4.8	–4.0	–5.4	–2.7	–2.0	–5.0	0.0
Utilization of production capacity (4)	79.8	80.2	81.1	80.7	79.7	80.5	–	–	–
Imports of non-energy intermediate goods (5)	6.6	1.6	0.6	1.1	10.3	6.4	11.6	19.0	...
Construction									
Cement consumption	3.9	7.3	7.8	6.1	17.1	2.4	7.8	4.0	0.2
Confidence indicator for construction (3)	13.6	22.4	22.7	28.3	15.3	11.7	20.0	8.0	16.0
Housing (new construction approvals)	8.0	6.2	2.8	10.6	18.5	6.3	19.4	...	...
Government tendering	18.3	18.5	3.1	36.9	14.9	34.8	1.6	...	...
Services									
Retail sales	5.5	4.4	4.4	3.8	5.2	3.8	5.4	7.2	...
Foreign tourists	3.1	6.5	7.8	4.9	0.6	9.5	3.0	3.3	5.8
Tourist revenue inflows	3.8	5.8	13.9	4.9	–7.6	3.0	1.0	...	...
Goods carried by rail (km-tonnes)	–3.5	–3.2	–2.3	11.0	8.1	–2.7	–4.0	6.7	...
Air passenger traffic	8.0	9.2	10.3	9.1	5.2	10.1	3.9	3.8	5.9
Motor vehicle diesel fuel consumption	6.7	5.0	5.1	4.3	8.7	4.5	3.0	...	...

NOTES: (1) Adjusted for number of working days and temperature.
(2) Adjusted for difference in number of working days.
(3) European Commission survey: difference between percentage of positive and negative replies.
(4) Business survey: percentage of utilization inferred from replies.
(5) By volume.
SOURCE: Red Eléctrica Española, OFICEMEN, AENA, National Institute of Statistics, Bank of Spain, European Commission, Ministry of Public Works, Ministry of Industry, Commerce and Tourism, Ministry of Economy and Finances and internal figures.

as domestic production itself and imports of such goods, with the odd exception as in imports of transportation equipment, which have shown a drop. Investment in construction is also holding at a firm level although everything would suggest that the long growth cycle has now reached a ceiling. The first signs come from the real estate market. The rise in housing prices is tending to ease and, according to figures from the Ministry of Housing, the price of land is now stagnant with growth below the CPI.

On the supply side, the overall situation is positive in nearly all production sectors. In construction, confidence sentiment continues to hold at a very high level in keeping with the strength of sector activity. In turn, industry is holding to a path of recovery with growth in the production index of close to 5%. Finally, services also reflect good times, if we are to go by the trend in sector indices for business volume. Specifically, the retail trade, transportation and company services are maintaining a considerable growth rate. On the other hand, information technology, which some months back had been showing great strength, has notably moderated its growth rate.

To complete the picture, we should point out that results for tourism in the first nine months of the year have been moderately positive. Overnight hotel stays rose by 6.4% (7.3% for foreigners and 5.3% for domestic tourism) but the result would have been better had it not been for the tendency of foreign tourists to cut their average spending (from January to August average spending per tourist fell by 1.4%).

Increased investment and improvement in exports more than compensate for moderation in consumption.

Economic boom spread generally over all production sectors.

Labour market

Construction and services maintain strength of labour market

Number of persons employed up 3.7% year-to-year.

The number of those employed reached nearly 20 million in the third quarter of 2006, according to the Labour Force Survey. Job creation in the 12 months was somewhat more than 700,000, down substantially in annual growth rate. In fact, the number of persons employed rose by 3.7% compared with the same period the year before, that is to say, a half-point less than in the previous quarter. This sharp drop does not show up as clearly in the figures for registrations with Social Security when corrected for the effect of giving normal status to foreign workers carried out last year. In any case, the increase in employment was more than 3.5%, a rate still very high and in line with the growth rate of the economy.

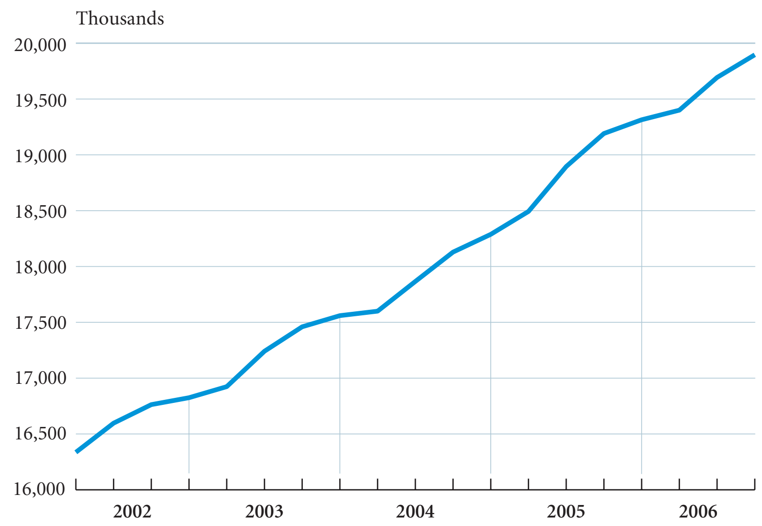
Construction continues to create employment at high rate.

Construction continued in its stellar role. According to the Labour Force Survey, estimated employment in this sector grew at the rate of 8.1% thus going above levels for previous quarters. In services, the increase in employment stood at 4.9% practically stabilizing in terms of the previous month. The picture in the industrial sector was very different with employment down slightly reflecting the difficulties showing up in some manufacturing branches. In general, those same trends can be seen in figures for registrations with Social Security.

The decline in industrial employment was concentrated in certain consumer

NUMBER OF PERSONS EMPLOYED CLOSE TO 20 MILLION

Estimated number of persons employed



SOURCE: National Institute of Statistics.

ESTIMATED EMPLOYMENT

Third quarter 2006

	No. of employees (thousands)	Quarterly change		Cumulative change		Annual change		% share
		Absolute	%	Absolute	%	Absolute	%	
By sector								
Agriculture	913.1	–44.4	–4.6	–93.7	–9.3	–79.1	–8.0	4.6
Non-farm	18,982.6	246.9	1.3	675.2	3.7	783.6	4.3	95.4
Industry	*3,288.1*	*1.2*	*0.0*	*–0.4*	*0.0*	*–22.9*	*–0.7*	*16.5*
Construction	*2,590.1*	*68.4*	*2.7*	*167.3*	*6.9*	*193.8*	*8.1*	*13.0*
Services	*13,104.4*	*177.3*	*1.4*	*508.3*	*4.0*	*612.7*	*4.9*	*65.9*
By type of employer								
Private sector	16,992.0	152.7	0.9	545.7	3.3	940.6	5.9	85.4
Public sector	2,903.6	49.8	1.7	35.6	1.2	–10.0	–0.3	14.6
By work situation								
Wage-earners	16,365.9	254.4	1.6	524.2	3.3	616.3	3.9	82.3
Permanent contract	*10,704.5*	*133.8*	*1.3*	*213.2*	*2.0*	*371.3*	*3.6*	*53.8*
Temporary contract	*5,661.4*	*120.6*	*2.2*	*311.0*	*5.8*	*245.0*	*4.5*	*28.5*
Non-wage-earners	3,516.9	–49.0	–1.4	70.7	2.1	95.5	2.8	17.7
Entrepreneurs with employees	*1,094.4*	*6.4*	*0.6*	*64.9*	*6.3*	*117.4*	*12.0*	*5.5*
Entrepreneurs without employees	*2,167.3*	*–26.8*	*–1.2*	*15.7*	*0.7*	*10.8*	*0.5*	*10.9*
Family help	*255.2*	*–28.6*	*–10.1*	*–9.9*	*–3.7*	*–32.7*	*–11.4*	*1.3*
Other	12.9	–2.8	–18.1	–13.5	–51.1	–7.3	–36.3	0.1
By time worked								
Full-time	17,642.4	353.6	2.0	643.4	3.8	679.1	4.0	88.7
Part-time	2,253.2	–151.0	–6.3	–62.1	–2.7	25.5	1.1	11.3
By sex								
Males	11,859.4	155.5	1.3	309.8	2.7	334.6	2.9	59.6
Females	8,036.2	47.1	0.6	271.5	3.5	370.0	4.8	40.4
TOTAL	**19,895.6**	**202.5**	**1.0**	**581.4**	**3.0**	**704.6**	**3.7**	**100.0**

SOURCE: National Institute of Statistics and internal figures.

manufactures of low-medium value added, activities affected by growing foreign competition and relocation moves. This is the situation in furniture and wood, textiles, clothing, leather and footwear and consumer electronics, among others. On the other hand, some sectors less accessible to foreign suppliers, such as construction materials, continue full-steam-ahead driven by strong domestic demand. Finally, some branches of activity in metallurgy, machine building and other capital goods are showing a favourable result in terms of job creation, most likely thanks to the drive coming from the foreign sector.

In the area of services, the strongest drive in employment, with rates of more than 20%, is showing up in real estate activities and air transport, both sectors that are really booming. Other sectors, such as wholesale trade, company services, research and development activities, computer services, hotel and restaurant trade and domestic service show increases in employment of more than 10%, reflecting the basic trends of

Accounting for half jobs created, immigration remains key factor in defining labour scene.

Public service employment stagnant while permanent job situation improves in context of stronger business climate.

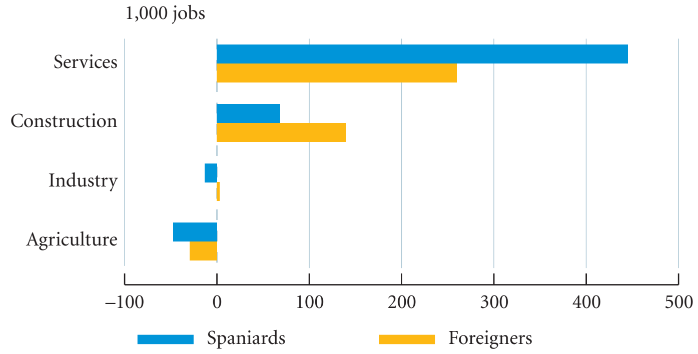
the economy in these areas. At the other end of the scale, insurance, sea transport and some public health services show substantial job reductions.

Under services, in contrast to what has been the norm in recent years, the stagnation of public service employment deserves special mention. This held practically at the same levels as the year before (down 0.3%). As a result, public service employment has been losing ground in total employment so that in the third quarter of 2006 those persons with direct employment in the public service or public companies represented 14.6% of all employees, six decimals less than in the same period last year.

The moderation in the increase in employment is somewhat more noticeable among those self-employed than among those on wages. In the former case, however, this slowdown is significant under the heading of the independent worker but not so under the

FOREIGN WORKERS ACCOUNT FOR KEY PART OF NEW JOBS IN CONSTRUCTION AND SERVICES

Year-to-year change in estimated employment in third quarter



SOURCE: INE and internal figures.

ESTIMATED UNEMPLOYMENT

Third quarter 2006

	No. of unem-ployed	Quarterly change		Cumulative change		Annual change		Share %	Unemployment rate over labour force %
		Absolute	%	Absolute	%	Absolute	%		
By sex									
Males	760.3	–35.3	–4.4	–60.9	–7.4	–39.0	–4.9	43.1	6.0
Females	1,004.8	–36.7	–3.5	–15.3	–1.5	39.0	4.0	56.9	11.1
By age									
Under 25 years	433.2	–18.6	–4.1	–23.1	–5.1	–32.6	–7.0	24.5	16.9
Other	1,331.8	–53.4	–3.9	–53.2	–3.8	32.6	2.5	75.5	7.0
By personal situation									
Long-term unemployment	520.9	–4.4	–0.8	–36.2	–6.5	–1.4	–0.3	29.5	–
Seeking first job	210.7	0.2	0.1	–9.6	–4.4	–39.9	–15.9	11.9	–
Other	1,033.4	–67.8	–6.2	–30.5	–2.9	41.3	4.2	58.5	–
TOTAL	**1,765.0**	**–72.0**	**–3.9**	**–76.3**	**–4.1**	**0.0**	**0.0**	**100.0**	**8.1**

SOURCE: National Institute of Statistics and internal figures.

heading of employer. In this respect, the figures for the Labour Force Survey reflect some increase under the heading of entrepreneurs recent quarters. In addition, the moderation under wage employment is concentrated in those contractual headings of a temporary nature, which may reflect the incipient efficacy of policies aimed at the reduction of temporary jobs. Of the 704,600 jobs created in the past year, some 52.7% were for permanent posts, 34.8% for temporary jobs while the rest were self-employed workers.

In addition, the incorporation of foreigners continues to be the most notable factor of Spain's labour market. Some 52.9% of jobs created in the past year was for non-Spaniards. This percentage goes up to 67% in the case of construction, which reflects the heavy dependence of that sector on this source of labour that, in the third quarter of 2006, represented more than 22% of employment in the sector (in 1998 this proportion was around 1%). In addition, in the case of industry the adjustment has been concentrated exclusively on Spanish workers.

The lower drive in employment did not bring about any appreciable improvement in the unemployment situation as the sharp growth in the labour force continued. In fact, the activity rate, measured as the relation between the labour force and the population 16 years of age or older, came to 58.4%, the highest level seen in recent

Unemployment drops to 8.1% with sharp differences between male and female population.

LABOUR FORCE, EMPLOYMENT AND UNEMPLOYMENT BY AUTONOMOUS COMMUNITY

Third quarter 2006

	In work force			Employed			Unemployed			Unemployment rate (%)
	Total (thousands)	Annual change	% annual change	Total (thousands)	Annual change	% annual change	Total (thousands)	Annual change	% annual change	
Andalusia	3,562.5	124.3	3.6	3,116.4	143.6	4.8	446.1	–19.3	–4.1	12.5
Aragon	615.3	5.5	0.9	583.6	5.8	1.0	31.7	–0.3	–1.0	5.2
Asturias	470.5	18.7	4.1	424.6	14.9	3.6	45.9	3.8	9.0	9.8
Balearic Islands	555.3	29.1	5.5	528.9	29.0	5.8	26.5	0.1	0.4	4.8
Canary Islands	1,007.1	61.2	6.5	887.5	46.1	5.5	119.6	15.1	14.4	11.9
Cantabria	269.4	4.5	1.7	252.2	6.3	2.5	17.2	–1.8	–9.3	6.4
Castile-Leon	1,149.8	14.4	1.3	1,063.5	14.9	1.4	86.3	–0.5	–0.5	7.5
Castile-La Mancha	882.5	30.0	3.5	805.1	23.8	3.0	77.4	6.2	8.7	8.8
Catalonia	3,672.6	131.5	3.7	3,443.2	119.4	3.6	229.4	12.1	5.6	6.2
Valencian Community	2,348.2	102.8	4.6	2,153.4	84.8	4.1	194.8	17.9	10.2	8.3
Extremadura	456.5	–8.5	–1.8	404.7	10.5	2.7	51.8	–19.1	–26.9	11.3
Galicia	1,284.6	17.9	1.4	1,191.1	34.0	2.9	93.5	–16.1	–14.7	7.3
Madrid Community	3,164.2	98.2	3.2	2,971.5	94.6	3.3	192.7	3.6	1.9	6.1
Murcia	645.7	23.5	3.8	594.8	19.6	3.4	50.9	3.9	8.4	7.9
Navarre	303.9	13.8	4.8	289.3	14.3	5.2	14.6	–0.5	–3.6	4.8
Basque Country	1,063.2	36.1	3.5	994.1	43.5	4.6	69.1	–7.5	–9.7	6.5
La Rioja	153.0	2.6	1.7	144.2	0.6	0.4	8.8	2.1	29.4	5.8
Ceuta and Melilla	56.4	–1.0	–1.7	47.6	–1.2	–2.5	8.8	0.2	2.3	15.6
TOTAL	**21,660.7**	**704.6**	**3.4**	**19,895.6**	**704.6**	**3.7**	**1,765.0**	**0.0**	**0.0**	**8.1**

SOURCE: National Institute of Statistics and internal figures.

Geographical differences major factor in creating jobs.

statistics. The male rate held at more than 20 points above the female rate (47.8%) in spite of the sustained growth of the latter.

Estimated unemployment returned to the level in the third quarter of 2005, that is to say, 1,765,000 persons. The unemployment rate, however, was down slightly going to 8.1% while maintaining the differences between male and female rates at 6.0% and 11.1% respectively. The level of unemployment among those under 25 years of age dropped to 16.9%, with the drop in the activity rate in that population segment.

From a geographical perspective, the tendency to more moderate growth was not across the board. The Balearic Islands, the Basque Country, Navarre, Madrid and, to a lesser extent, Extremadura showed more favourable figures than in previous quarters. In addition, there were notable differences in employment growth rates by autonomous community.

Registered unemployment sharpens gradual drop.

Registered employment sharpens drop in September

The good state of the labour market shown by the various employment indicators is also evident from the figures for registered unemployment. In fact, the drop in the number of persons registered at Public Employment Service offices in September was well above that for the same month last year and, therefore, the rate of decrease in registered unemployment sharpened its drop to 2.3% year-to-year.

The good performance in unemployment in recent months has made it possible for the overall figure for the year so far to be much more favourable than in the January-September period in 2005 and, furthermore, puts it at the best level for the present decade.

REGISTERED UNEMPLOYMENT BY SECTOR, SEX AND AGE

September 2006

	No. of unemployed	Change over December 2005		Change over same period year before		% share
		Absolute	%	Absolute	%	
By sector						
Agriculture	61,520	–3,707	–5.7	776	1.3	3.1
Industry	277,276	–24,043	–8.0	–13,363	–4.6	14.1
Construction	215,645	–29,455	–12.0	–3,000	–1.4	11.0
Services	1,193,302	–73,087	–5.8	–14,561	–1.2	60.7
First job	218,423	–6,479	–2.9	–16,972	–7.2	11.1
By sex						
Males	752,747	–99,216	–11.6	–31,513	–4.0	38.3
Females	1,213,419	–37,555	–3.0	–15,607	–1.3	61.7
By age						
Under 25 years	238,710	–37,185	–13.5	–24,518	–9.3	12.1
All other ages	1,727,456	–99,586	–5.5	–22,602	–1.3	87.9
TOTAL	**1,966,166**	**–136,771**	**–6.5**	**–47,120**	**–2.3**	**100.0**

SOURCE: INEM and internal figures.

Prices

CPI down sharply going below 3% in September

The annual rate for the consumer price index (CPI) was sharply down in September to stand at 2.9%, eight decimals below the previous month. This sharp decrease may largely be attributed to the drop in fuel and fuel-oil prices and, to a lesser extent, to the moderation in non-energy industrial goods. Food and services, on the other hand, held stable at a high sustained growth level.

The sharp drop in fuel prices came as a result of the easing of conditions in international oil and oil-derivative markets. The impact on the energy component of the CPI was not greater because of the continuing rise in the price of gas (more than 17% annual) and electricity (above 5%).

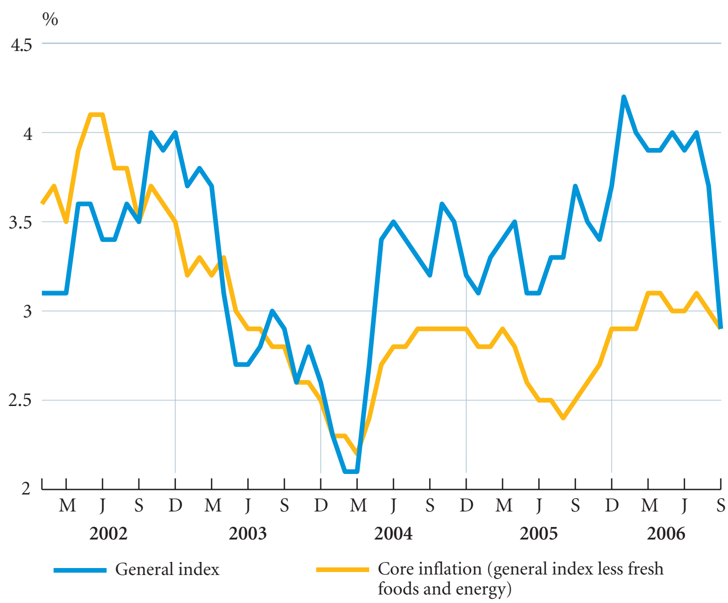
Sharp drop in fuels behind much of containment in general CPI in September.

Apart from energy, non-energy industrial goods also showed a slight easing off in its modest growth levels, particularly in the areas of textiles, footwear and cars, perhaps in an attempt to tempt demand which had slackened following the summer. This containment, at 1.3% annual, had a positive impact on underlying inflation which again stood below 3.0%, the same as the general index.

Prices of industrial goods also contribute to easing in CPI.

GENERAL PRICE INDEX AND CORE INFLATION INDEX MEET

Year-to-year change in CPI



SOURCE: National Institute of Statistics and internal figures.

CONSUMER PRICE INDEX

	2005			2006		
	% monthly change	% change over December 2004	% annual change	% monthly change	% change over December 2005	% annual change
January	–0.8	–0.8	3.1	–0.4	–0.4	4.2
February	0.3	–0.6	3.3	0.0	–0.4	4.0
March	0.8	0.2	3.4	0.7	0.3	3.9
April	1.4	1.6	3.5	1.4	1.8	3.9
May	0.2	1.8	3.1	0.4	2.1	4.0
June	0.2	2.1	3.1	0.2	2.3	3.9
July	–0.6	1.5	3.3	–0.6	1.7	4.0
August	0.4	1.9	3.3	0.2	1.9	3.7
September	0.6	2.5	3.7	–0.2	1.7	2.9
October	0.8	3.4	3.5			
November	0.2	3.5	3.4			
December	0.2	3.7	3.7			

SOURCE: National Institute of Statistics.

SHARP DROP IN FUELS IN SEPTEMBER

Year-to-year change in fuels and fuel-oils group in CPI

SOURCE: National Institute of Statistics and internal figures.

Price increases in foods because of demand pressure.

In the food sphere, prices in the food and beverages group continued their sustained advance maintaining their growth rate at the 4.6% seen the month before. This performance was the result of some increase in fresh foods which was compensated by the containment in tobacco. Pressures on food prices, apart from some weakness in supply (cooking oil), seem to be due mainly to the effect of demand boosted by tourism and, especially, by population growth.

As usual, the second negative aspect came as a result of services prices. Personal services, repairs (to both homes and cars) and education showed very high increases which made it impossible for any positive effect to show up from the relative containment seen in prices in much more competitive markets such as banking and insurance. Also worth mentioning are tourism and the hotel and restaurant trade which continue to be a drag on the general CPI with price increases of more than 4.5%, which may be accounted for by heavy demand.

From this perspective, the CPI continued to face very disparate performances in its various components. Energy may still play a containment role in October but it will be difficult to maintain this in coming months, at least until the second quarter of 2007. Industrial goods have little margin to go down and there do not seem to be any alternative scenarios which could decisively help bring about moderation of food prices or in non-competitive market services. Therefore, there will be short-term improvements in the CPI although it does seem plausible that the year 2006 will end at levels close to 3% which, after all, is well below the levels recorded last year.

Containment of prices in Spain was somewhat sharper than in the Euro Area if we are to go by the harmonized consumer price index. The inflation differential compared with the the group of countries making up the Euro Area thus moderated to 1.2 percentage points, three decimals less than in the month before. This performance may largely be accounted for by the sharper drop in energy prices in Spain and by the price of foods which rose moderately in the Euro Area.

Less competitive services clearly hurting CPI.

SERVICES NOT MODERATING PRICES

Year-to-year change in services group of CPI

SOURCE: National Institute of Statistics and internal figures.

CONSUMER PRICE INDEX BY COMPONENT GROUP

September

	Indices (*)	% monthly change		% change over previous December		% annual change	
		2005	2006	2005	2006	2005	2006
By type of spending							
Food and non-alcoholic beverages	122.5	0.2	0.3	2.1	2.5	2.8	4.6
Alcoholic beverages and tobacco	122.7	0.7	0.1	4.8	0.7	4.7	1.1
Clothing and footwear	109.7	3.4	3.5	–8.7	–8.9	1.2	1.2
Housing	123.1	0.4	–0.1	5.3	5.1	6.1	5.8
Furnishings and household equipment	111.0	0.4	0.3	1.1	1.6	2.3	2.7
Health	107.9	0.1	0.0	0.7	1.4	0.9	1.4
Transport	121.0	2.2	–2.3	9.9	3.7	9.1	0.2
Communications	90.7	–0.1	0.0	–1.4	–0.8	–1.9	–1.1
Recreation and culture	103.8	–1.3	–1.6	0.3	–0.1	–0.6	0.3
Education	122.6	0.7	0.8	1.3	1.2	4.1	4.0
Restaurants and hotels	125.9	–0.7	–0.7	4.0	4.1	4.3	4.4
Other goods and services	119.0	0.2	0.2	2.9	3.4	3.1	4.0
By group							
Processed food, beverages and tobacco	119.5	0.2	0.1	2.3	2.0	2.8	3.5
Unprocessed food	128.6	0.5	0.6	2.5	2.8	3.4	5.6
Non-food products	116.3	0.7	–0.3	2.6	1.5	4.0	2.5
Industrial goods	111.3	1.8	–0.2	1.9	–0.1	4.2	1.2
Energy products	*126.0*	*3.1*	*–3.8*	*16.2*	*6.7*	*15.0*	*0.9*
Fuels and oils	*132.1*	*4.2*	*–5.0*	*21.5*	*7.2*	*19.8*	*–0.4*
Industrial goods excluding energy products	*106.9*	*1.3*	*1.1*	*–2.4*	*–2.3*	*0.9*	*1.3*
Services	122.1	–0.4	–0.4	3.3	3.3	3.7	3.9
Underlying inflation (**)	115.9	0.3	0.2	1.0	1.0	2.5	2.9
GENERAL INDEX	**117.9**	**0.6**	**–0.2**	**2.5**	**1.7**	**3.7**	**2.9**

NOTES: (*) Base 2001 = 100.
(**) General index excluding energy products and unprocessed food.
SOURCE: National Institute of Statistics.

Energy, food and intermediate goods help contain general industrial price index.

Containment of wholesale prices continues

For the second month in a row, industrial prices showed strong containment which put year-to-year growth of the general index at 4.2% in September, more than two points below the relative highs reached in May. The sharp drop in energy prices, a modest easing in intermediate goods and moderation in food goods account for the improvement in the general situation.

On the other hand, this situation of containment does not show up in prices of non-food consumer manufactured goods which to some degree partly incorporate the impact of the notable increases in production costs in recent months. In any case, the increase in prices of manufactured goods (2.4% year-to-year) is lower than it might have been if we take into account the trend in production costs.

In this respect, the performance of prices of non-food consumer manufactures

INFLATION INDICATORS

Percentage change over same period year before

	Farm prices	Producer price index					Import prices				GDP deflator (*)
		General index	Consumer goods	Capital goods	Intermediate goods	Energy goods	Total	Consumer goods	Capital goods	Intermediate goods	
2005											
July	–5.1	4.6	2.1	1.9	3.0	15.7	8.2	0.6	10.4	11.7	–
August	9.2	4.9	2.5	1.8	2.9	16.4	6.1	–0.2	–0.4	11.0	4.2
September	6.7	5.4	2.6	1.9	3.2	17.9	4.3	–0.6	4.2	7.0	–
October	–0.8	5.0	3.0	1.9	3.1	15.2	4.8	0.8	14.0	5.3	–
November	2.0	4.9	3.1	2.0	3.2	14.7	3.8	3.3	–0.8	5.6	4.1
December	2.1	5.2	3.2	2.0	3.2	15.6	7.1	0.9	10.2	8.9	–
2006											
January	4.1	6.3	3.5	2.1	3.6	20.6	5.7	–6.5	–5.2	15.2	–
February	0.7	6.3	3.6	2.1	3.9	20.1	6.5	2.5	3.2	9.2	4.1
March	–10.2	5.8	3.3	2.0	4.6	16.4	5.9	2.7	7.5	7.2	–
April	–8.1	5.7	2.9	2.2	5.1	15.4	7.4	3.2	–4.2	11.7	–
May	–3.6	6.6	3.2	2.3	6.1	17.8	6.1	4.2	–0.6	8.2	4.0
June	6.0	6.3	3.5	2.3	6.8	14.6	1.7	–1.6	–3.2	4.2	–
July	0.7	6.4	3.6	2.4	7.0	13.9	1.1	0.5	–7.3	3.1	–
August	...	5.7	3.2	2.5	7.2	10.2	2.3	–0.6	–0.5	4.0	...
September	...	4.2	2.7	2.5	6.7	4.1	...	...	...	...	–

NOTES : (*) Figures adjusted for seasonal and calendar effects.

SOURCE: National Institute of Statistics, Ministry of Economy and internal figures.

coming from abroad is significant. In the January-August period the increase in prices stood at 0.9%, well below the increase in domestic producer prices. Similarly, imported food consumer goods showed a drop of 1.3% in prices in the same period.

Manufactures stabilize price increases at 2.5%, well below cost increases.

Farm prices, on the other hand, also eased in July, mainly because of agricultural prices. As a result, in the first seven months of the year, prices obtained by crop farmers showed a drop of 2.6%, a turnaround from the positive figure and thus more favourable than the increase of 2.3% reported in 2005.

Farm prices down slightly.

Foreign sector

Rise in trade deficit eases slightly in August

Increase in trade deficit as result of imbalance in energy heading.

The trade deficit showed a slight easing in growth rate in August when exports were slightly stronger than imports. In any case, the cumulative deficit for the first eight months of the year amounted to 58.47 billion euros, some 17.9% more than in the same period in 2005. This increase in the deficit was mainly due to the increase in the imbalance in the energy heading (37.6%), which was well above the 8.3% recorded for the non-energy balance. The sharp increase in the price of imported oil in euros (39.2% in the first eight months of the year) was decisive in this respect.

The strength of exports in August helped to consolidate a cumulative balance for foreign sales that was better than that for last year. In fact, these were up by 12.1% nominal thanks to the relative boost in sales to markets outside the Euro Area which, in some cases, such as in Latin

FOREIGN TRADE

January-August 2006

	Imports			Exports			Balance	
	Million euros	% annual change in value	% share	Million euros	% annual change in value	% share	Million euros	Export/ Import ratio (%)
By product group								
Energy products	27,804	37.3	16.4	5,209	35.9	4.7	–22,595	18.7
Consumer goods	47,067	11.1	27.8	40,826	8.3	36.8	–6,241	86.7
Food	*9,175*	*3.7*	*5.4*	*13,117*	*7.9*	*11.8*	*3,942*	*143.0*
Non-foods	*37,892*	*12.8*	*22.4*	*27,709*	*6.2*	*25.0*	*–10,183*	*73.1*
Capital goods	17,429	2.0	10.3	11,070	22.3	10.0	–6,360	63.5
Non-energy intermediate goods	77,048	11.9	45.5	53,777	11.2	48.5	–23,271	69.8
By geographical area								
European Union (EU-25)	98,997	9.4	58.5	77,819	8.1	70.2	–21,178	78.6
Euro area	*82,772*	*8.6*	*48.9*	*61,943*	*7.4*	*55.9*	*–20,829*	*74.8*
Other countries	70,352	21.2	41.5	33,062	22.6	29.8	–37,289	47.0
Russia	*5,042*	*52.0*	*3.0*	*907*	*36.2*	*0.8*	*–4,135*	*18.0*
United States	*5,659*	*4.1*	*3.3*	*4,984*	*30.4*	*4.5*	*–676*	*88.1*
Japan	*3,786*	*–1.1*	*2.2*	*855*	*14.7*	*0.8*	*–2,931*	*22.6*
Latin America	*9,333*	*38.0*	*5.5*	*6,809*	*43.4*	*6.1*	*–2,523*	*73.0*
OPEC	*14,782*	*38.4*	*8.7*	*2,822*	*6.4*	*2.5*	*–11,960*	*19.1*
Rest	*31,750*	*13.3*	*18.7*	*16,685*	*16.4*	*15.0*	*–15,065*	*52.6*
TOTAL	**169,349**	**14.0**	**100.0**	**110,882**	**12.1**	**100.0**	**–58,467**	**65.5**

SOURCE: Department of Customs and Special Taxes and internal figures.

America, United States and countries of the former Soviet Union, showed nominal increases of more than 30%. Altogether, the market in third countries recorded growth of the volume of 14.8% real, more than 10 points above that of the European Union, an area that was dragged down by the relatively low drive in such important markets as Germany and the United Kingdom. Overall, real average growth of exports stood at 6.8%.

The strongest export headings were capital goods, with growth of 16.8% by volume, some 10 points above that shown by foreign sales of consumer goods. Of these exports, foods showed a somewhat higher figure than non-food consumer goods. Among the latter, we should point out the drop in car exports which tarnished the good results in other industrial spheres, such as consumer electronics (increase of 63.8% nominal), pharmaceuticals (35.8%), clothing (21.1%) and motor-vehicle parts (13.1%).

The continued strength of imports in August put cumulative growth of foreign purchases at 14.0% nominal, equivalent to 9.0% real. The most dynamic component was non-food consumer goods, particularly clothing, footwear, appliances and consumer electronics which are progressively moving into the domestic market thanks to their competitiveness and the strength of domestic demand. Overall, imports of this type of goods rose by 12.2% but we note some tendency to an easing off compared with previous months. The increase in foreign purchases of intermediate goods, although still high, was somewhat down, which supports the idea of a certain level of activity in industry and mainly that in construction. Purchases of iron, steel, minerals, metals and construction materials are showing major increases.

On the other hand, imports of capital goods are growing very modestly, perhaps suggesting an easing off in the investment cycle.

Markets outside European Union supporting exports that show favourable balance as of August.

Current account deficit again out of hand in July

The balance of payments showed a much worse result in July, which ended with a cumulative deficit for the year at 52.50 billion euros, some 32.3% more than in the same period last year. The decrease in the services surplus and the bigger deficit in all other headings, particularly in trade, lay behind the increase in the negative balance in the first seven months of 2006.

Flood of non-food consumer products from abroad continues.

The drop in the services balance came both from the tourist sector and for trade in other services. In the case of tourism, the surplus was down by 7.8% mainly because of the notable impact of payments for travel abroad by Spaniards which was up by more than 20%. On the other hand, revenue inflows were down by 1.9% because of the drop in average spending per tourist, given that the number of visitors rose by around 5%.

Current account deficit up 32% as of July.

The worsening of the incomes deficit may be attributed to companies and households which, because of increased borrowing, increased their payments abroad. The imbalance was not greater because it was compensated by containment of the deficit in the general government sector and that of financial and monetary institutions. Income from work also showed a negative balance, higher than last year but not very relevant compared with the figure for income on capital.

Travel abroad by Spaniards pulls down tourist balance also affected by lower spending per foreign tourist.

The bigger deficit in the transfers balance was boosted by the sharp increase in remittances by foreign workers to their

Remittances by foreign workers make up 25% of foreign transfer payments of Spain's economy.

BALANCE OF PAYMENTS

12-month rolling sum in million euros

	July 2005	July 2006	% change
Current account balance			
Trade balance	–62,811	–76,662	22.1
Services			
Tourism	*25,724*	*25,350*	*–1.5*
Other services	*–3,602*	*–6,054*	*68.1*
Total	22,122	19,296	–12.8
Income	–15,427	–18,632	20.8
Transfers	–1,774	–3,452	94.6
Total	**–57,890**	**–79,449**	**37.2**
Capital account	**8,146**	**6,068**	**–25.5**
Financial balance			
Direct investment	–32,294	–38,182	18.2
Portfolio investment	93,275	158,629	70.1
Other investment	–16,147	–18,049	11.8
Total	**44,834**	**102,398**	**128.4**
Errors and omissions	–268	–4,755	–
Change in assets of Bank of Spain	5,178	–24,262	–

NOTES: The figure resulting from the sum of current account balance, capital account balance and financial balance is compensated by the change in assets of Bank of Spain plus errors and omissions.
SOURCE: Bank of Spain and internal figures.

countries of origin in a context of stable figures for transfers by general government, mainly within the sphere of the European Union. Payments for remittances made up somewhat more than a quarter of all transfer payments abroad.

Foreign corporate investment recovers strength with real estate investment down, while Spanish investment abroad showing notable drive.

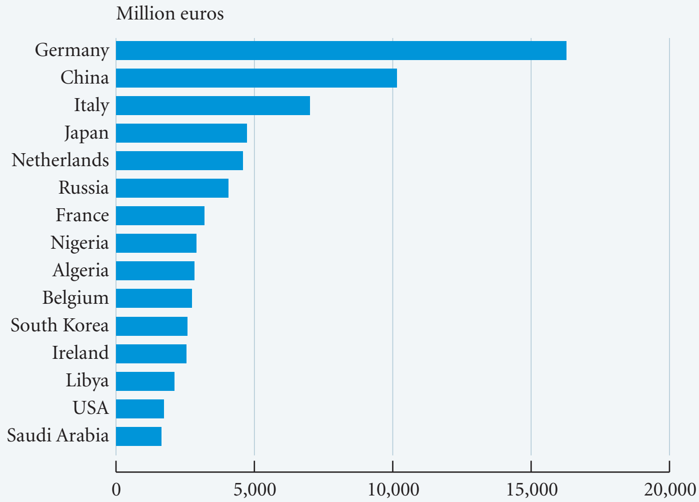
In the financial sphere, direct foreign investment of a corporate nature rose sharply thanks to certain transaction carried out in July. In the first seven months of the year as a whole, the cumulative increase amounted to 49.3%. Portfolio investment rose spectacularly (78%) in contrast to that going into real estate which was down appreciably (by 17.7%). Direct Spanish investment grew sharply in the corporate sphere and also in real estate. In this case, the total amount (1.21 billion euros in the first seven months of the year) accounted for 2.7% of all direct investment.

Chinese dragon raises its head in Spain

In 2005, Spain's trade deficit with China amounted to more than 10.1 billion euros, the second in amount after Germany. But with an important difference. Whereas the export-import ratio for Spain's exports compared with imports from Germany stood at around 52%, in the case of trade with China it failed to reach 13%. Put another way, Spain buys a lot from China but sells little. At present, Spain's imports from the Asian giant make up more than 5% of all foreign purchases whereas its exports are limited to a mere 1% of total sales.

CHINA SECOND BIGGEST SOURCE OF MASSIVE MANUFACTURED GOODS DEFICIT

Countries with which Spain showed biggest trade deficit in 2005



SOURCE: Secretary of State for Trade and Tourism and internal figures.

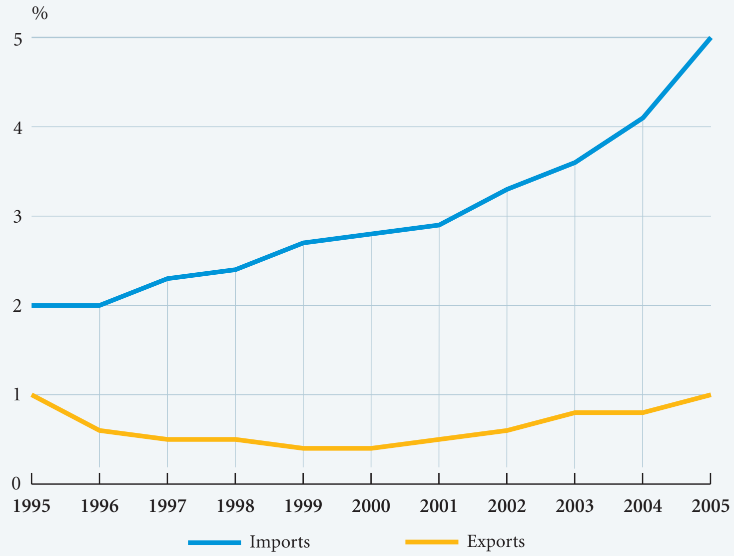
China's trade penetration in the Spanish market in recent years has been stunning. The figures speak for themselves. In 1995, Spain's purchases from that country amounted to 1.8 billion euros and by 2005 had reached close to 12 billion euros. That is to say, Spanish purchases had gone up nearly seven times in ten years whereas in the same period Spain's sales to China (nearly 1.5 billion euros in 2005) had merely doubled. The final result is that Spain's trade deficit with the People's Republic is now nearly ten times higher than ten years ago. A noteworthy point is that imports are not entirely restricted to labour-intensive products of technological content. Contrary to what is often believed, products of high value added are gaining more and more significance in Spain's purchases from the Chinese market. Imports of capital goods, which in 1995 represented 17% of all purchases from China, now make up 32%.

Specifically, there have been significant increases in certain segments such as those related to office equipment and telecommunications (with participation in total purchases now amounting to 16%, twice that 10 years ago) and some specialized goods (electrical equipment, specific machinery for industry, etc.). This is far from the Western stereotype which for centuries put out an image of China as a country of silk and spices. Clearly, the weight of imports of consumer manufactures (very labour-intensive and usually low in price) continues to be very high but this is now limited to less than half of total purchases. Under this heading, the strength of imports of textile manufactures, clothing and footwear (in 2005 these goods together made up nearly a quarter of all imports) was in contrast to the more gradual increase in other goods, such as those related to consumer electronics and toys.

With regard to trade in services, the pattern on a smaller scale is the same as that noted in trade in goods. Leaving aside tourism, still of little importance, the balance of payments deficit for other services amounted to 540 million euros in 2005, equivalent to somewhat more than 14% of Spain's total deficit under this heading. As in the trade deficit, the figure for payments (mainly related to those services, such as transportation, connected to trade in goods) was well above incoming amounts.

CHINESE PRODUCTS INCREASE MARKET SHARE IN SPAIN

China's share of all Spanish imports and exports of goods



SOURCE: Secretary of State for Trade and Tourism and internal figures.

In conclusion, the balance of trade relations with the People's Republic of China is very poor from a Spanish point of view. While Chinese products have obtained an important share in penetration of the Spanish market, on the other hand, Spain's presence in the Chinese market is little more than merely representational. There is no doubt that the difficulties in moving into that market are significant, ranging from the language barrier itself to the peculiarities of that huge country where, among other matters, the rhythm of events and the organization of time factors prove to be quite different from those of the Western mentality. Whether true or false, the story about Chou en Lai, Mao's lieutenant, is quite illustrative. In replying to a question about the French Revolution, he stated that there was still a lack of historical perspective to make a definitive judgement.

The steady pace of the Indian elephant in Spain holds little similarity to that of the highly active Chinese dragon. In fact, the balance of Spain's trade with India is very limited and has no real relation to the economic importance of the two countries. In 2005, imports from the Indian market represented a mere 0.7% of all Spanish imports abroad while exports to India stood at around 0.4% of all foreign sales. Overall, Spain's trade deficit with India was close to 992 million euros, holding 22nd place in order of importance in the classification headed, as noted earlier, by Germany and China. Nearly 40% of the value of all imports was taken up by consumer manufactures (textiles and clothing, leather, etc.), 11% was for durable goods and 29% for capital goods. The bulk of Spain's exports was concentrated in semi-manufactured goods (mainly chemical products) and capital goods.

The Democratic Federal Republic of India, with more than 1,000 population, is the second most populous country on Earth. It is estimated that nearly 300 million people have significant purchasing power and around 90 million people have a consumption capacity comparable with that of European countries. In this case, how is it that bilateral relations with Spain are so little developed? Some key factors, of course, are the distances involved and a mutual lack of knowledge. It should also be borne in mind that before the drive coming from the liberalization of trade and elimination of quantitative restrictions on imports in 2000 and 2001, the effective penetration of the Indian market was very limited. Even today, the difficulties continue to be appreciable, mainly arising from the broad mix of the Indian market (in fact, we cannot speak of just one Indian market but of various markets, each with a very big degree of difference), the continuation of custom duties that are still high compared with Western standards and the existence of other more subtle barriers to entry. For example, the frequent investigations begun to prevent dumping initiated at the request of local industry that put considerable obstacles in the way of foreign imports.

With regard to investment flows, there is no doubt that China and India have a high potential to attract direct investment because of the size of their markets and the existence of abundant cheap labour. In spite of this, Spanish investment in these countries is of no relevance. That going to China in the period 2000-2005 barely amounted to 0.1% of Spain's total investment abroad and that going to India was still lower. Aware of the poor market penetration of Spain's trade with these two Asian giants, the Spanish government has put forward overall plans for developing markets in China and India, following agreements with the Spanish Confederation of Business Organizations (CEOE). For the period 2005-2007 a series of measures are planned for institutional and financial support, training and information, as well as trade and tourist promotion, with a budget of 20.7 billion euros for the plan covering India and 690 million euros for the plan related to China. This represents a first step in what should be a continuing succession of moves aimed at taking advantage of the enormous possibilities these markets not offer, which furthermore are expected to show rapid development in the future.

Public sector

Direct taxes growing at good rate, especially corporate tax.

Tax collections growing above domestic demand

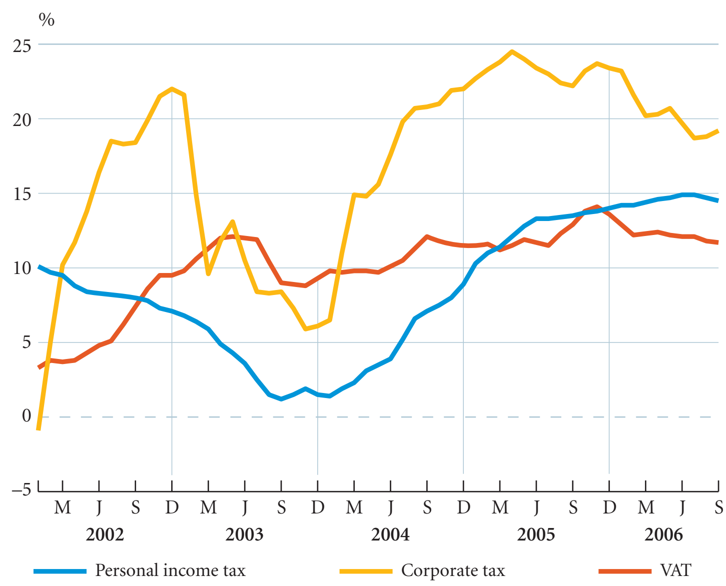
Tax collections continue to grow well above the nominal growth rate of domestic demand.

In fact, Spain's central government tax revenues were up by 11.2% as of September and amounted to 126.68 billion euros. This growth would amount to 12.7% if it were calculated according to homogeneous figures, that is, mainly eliminating the bias arising from changes in the interest maturity dates for government bonds and the rate of tax rebates.

The progressive strengthening of tax collections is across the board although the size of the increase differs substantially depending on the tax heading. The sharpest increases showed up in direct taxation, particularly, in corporate taxes and personal income tax, which show increases of 17.2% and 15.2% respectively in homogeneous terms. This trend was due to the good state of corporate profits and the increase in employment. In addition, the upward trend on the stock market also is favouring the increase in tax collections arising from hold-backs related to investment funds. At the same time, the growing importance of corporate dividends favoured an increase in withholding-tax on capital earnings, both in personal and corporate incomes. In any case, the bulk of tax collections

CORPORATE TAX, PERSONAL INCOME TAX AND VAT MOST ACTIVE TAX HEADINGS

Year-to-year change in homogeneous tax revenues by tax heading (*)



NOTES: (*) 12-month rolling sums.
SOURCE: Ministry of Economy and Finance and internal figures.

came from hold-backs on salaries and wages which were up by more than 10%, boosted by the strength of employment and wage increases.

In the case of indirect taxes, collections for value added tax (VAT) recovered slightly going to 12.2% in homogeneous terms, a much higher increase than that seen in special taxes at 2.1%. In the latter case, the moderation of the increase of special tax collections on fuels and of the general impact on tobacco were behind this situation. Collections for tax on electric power consumption, on the other hand, was up 12.3%, due to an increase in consumption and in power supply prices.

Sharp increase in VAT collections while special taxes show weak returns under two main headings – fuels and tobacco.

The boom in the situation from a tax collections point of view, along with relative moderation in central government spending (mainly attributable to lower interest payments on borrowing arising from the change in the calendar for maturities) helped to bring about a substantial improvement in the government's financial balance. In Treasury terms, the cumulative budget balance for the first nine months of the year showed a surplus of 6.91 billion euros, practically twice that for the same period in 2005. In terms of National Accounting, that is to say, with amounts stated in accrual terms, the surplus held at 11.81 billion euros, equivalent to 1.2% of the gross domestic product.

High budget surplus in first nine months of year.

Savings and financing

Rise in interest rates fails to stop demand for funds.

Big boost in credit granted to companies

The upturn in European Central Bank rates which began in December 2005 has been moving to interest rates applied by financial institutions on loans to customers. On average, the interest rate on loans and credits granted to companies and households in August stood at 4.8%, thus returning to the level at the beginning of 2003 after having recorded a low in the middle of last year. Nevertheless, in real terms, that is to say discounting inflation, loan interest rates stand at relatively low rates.

If we add to this a good economic situation, it is not surprising that demand for credit is running strong. What is even more surprising is that in August funding to the private sector grew at 23.6%, the highest annual rate for at least the past decade. Both corporate borrowing and that of households was growing at year-to-year change rates of above 20%. While households showed a stable growth profile, funding granted to companies shot up to annual growth of 26.0%, the highest in recent years. Corporate borrowing was growing even more at around 28%.

Where is this new credit to companies going? Commercial credit, used to finance working capital of companies, rose by 10.6% in the past 12 months ending in August but failed to reach half the figure

LOAN INTEREST RATES ON RISE

Interest rates on loans and credits granted to private sector by credit institutions (*)

NOTES: (*) Equivalent annual rate for new transactions.
SOURCE: Bank of Spain.

CREDIT GRANTED TO COMPANIES AND HOUSEHOLDS

August 2006

	Total	Change this year		Change over 12 months		% share
	Million euros	Million euros	%	Million euros	%	
Commercial credit	76,901	1,540	2.0	7,347	10.6	5.5
Secured loans (*)	852,761	123,474	16.9	184,989	27.7	61.5
Other term loans	379,372	54,076	16.6	74,488	24.4	27.4
Demand loans	28,043	–15	–0.1	4,029	16.8	2.0
Leasing	38,736	3,742	10.7	6,152	18.9	2.8
Doubtful loans	10,914	1,283	13.3	1,460	15.4	0.8
TOTAL	**1,386,727**	**184,099**	**15.3**	**278,465**	**25.1**	**100.0**

NOTES : (*) Greater part made up of loans with mortgage security.
SOURCE: Bank of Spain and internal figures.

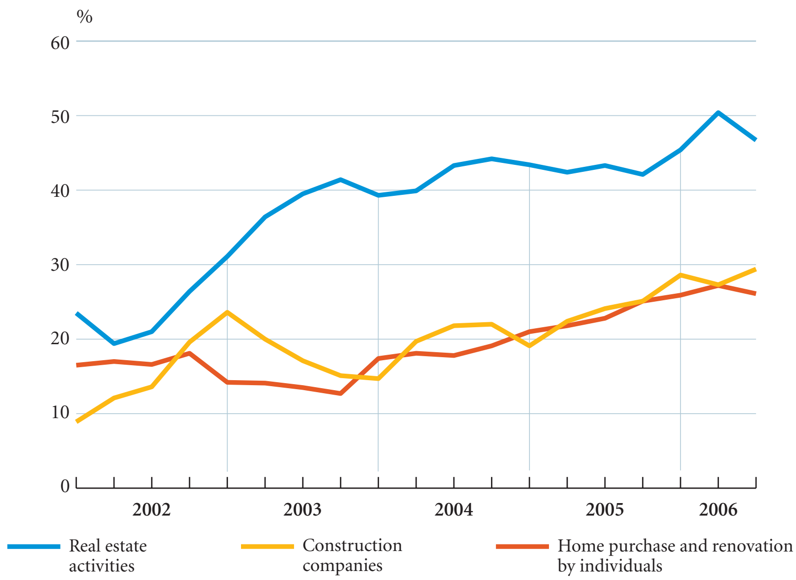
for total average growth. Doubtful loans rose by 15.4% in the past year, less than the volume of loans so that the default rate continued to drop over the past year, although in the past two months the rate has moved up slightly. The biggest annual increase was recorded by those borrowing against security, mainly mortgage loans, which were up 27.7%.

From another point of view, figures put out by the Bank of Spain for loans broken down by purpose make possible an analysis by economic sector, although the figures go up only to the end of the first half-year. By major sector, the figures confirm that construction is showing the biggest growth in credit, with a rise of 29.4% in the past 12

Bank credit for construction and real estate development up 40% in last 12 months ending June...

CREDIT FOR CONSTRUCTION CONTINUES TO RISE

Year-to-year change in credit to private sector



SOURCE: Bank of Spain.

months ended in June, followed by services, for which credit rose by 29.2% in the same period. In turn, the primary sector (agriculture, livestock raising and fishing) and industry recorded notable growth (above 10%) but substantially lower than construction. In fact, the services sub-sector to show most growth in recent times was real estate activities with an extraordinary annual increase of 46.7%. The figure for bank loans going into construction and real estate development showed a spectacular rise of 39.9%.

...but housing loans to households down slightly.

With regard to funding going to households, we should mention that housing loans continued to slow down slightly although they still showed an annual increase of 22.5% in August. On the other hand, the rest of credit to households reported an upward move with annual growth of 16.2% in August.

Under this heading, funding to buy durable consumer goods, such as cars, motorcycles, furniture, appliances, etc., rose by 15.6% in the past 12 months ending in June. This trend came about in spite of a slight drop in consumption by individuals. We should keep in mind, however, that the financial institutions have intensified their marketing campaigns in order to push consumer credit and thus compensate for the slowdown in mortgage loans.

In addition, in the period August 2005-August 2006, the savings banks were more active than banks in granting credit to the private sector, to show a year-to-year increase of 28.2% as compared with 23.0% for banks. As a result, the savings banks continued to increase their share of this market segment.

CREDIT TO PRIVATE SECTOR BY PURPOSE

Second quarter 2006

	Total (*)	Change this year		Change over 12 months	
	Million euros	Million euros	%	Million euros	%
Financing of production activities					
Agriculture, livestock raising and fishing	21,946	1,208	5.8	2,445	12.5
Industry	109,855	5,160	4.9	10,463	10.5
Construction	116,195	15,434	15.3	26,389	29.4
Services	433,311	55,444	14.7	97,962	29.2
Total	**681,307**	**77,247**	**12.8**	**137,259**	**25.2**
Financing for individuals					
Home purchase and renovation	498,248	52,277	11.7	103,259	26.1
Purchase of consumer durables	49,161	3,233	7.0	6,629	15.6
Other financing	95,289	10,935	13.0	16,425	20.8
Total	**642,698**	**66,445**	**11.5**	**126,314**	**24.5**
Financing of private non-profit institutions	**5,109**	**443**	**9.5**	**908**	**21.6**
Other unclassified	**21,077**	**3,429**	**19.4**	**390**	**1.9**
Total	**1,350,191**	**147,562**	**12.3**	**264,871**	**24.4**

NOTES: (*) Made up of all credit institutions: banking system, lending institutions and Official Credit.
SOURCE: Bank of Spain and internal figures.

Bank deposits showing strong growth

On the liabilities side of the financial institutions, deposits continue to rise sharply, at rates twice those in the Euro Area. Nevertheless, deposits are growing slightly less than loans which forces the financial institutions to have recourse to other sources of funding such as bond issues or going to the foreign interbank market.

By type of deposit, there was a spectacular rise in those set up in foreign currency, a contributing factor being the interest rate differential in favour of currencies other than the euro. Deposits for more than two years also showed sharp growth over the past 12 months (43.6% in August) thanks to a tax benefit of 40% on interest. As is well-known, there is to be a substantial change in taxes on savings with the final passage of reforms to the law on personal income tax, expected to come into force at the beginning of 2007. This expected reform would mean the end to the tax benefit mentioned and the general introduction of a single tax rate of 18%. In turn, on-demand accounts and savings accounts are increasing at a notable annual rate of 11.5%.

Bank deposits grow more than twice rate in Euro Area.

In contrast to the situation in loans, banks are showing more strongly in the deposits segment than the savings banks in recent times. In the past year ending in August, for example, deposits at banks rose by 29.1% as against 19.2% for the savings banks. As a result, the banks are regaining ground in this market segment.

Mutual fund assets up 6% in September 2005-September 2006 period.

Participations in securities mutual funds are another favourite investment for savers. At the end of September total assets of mutual funds amounted to 255.51 billion euros, an increase of 5.6% over the same month last year.

The average return on mutual funds over the past 12 months ended in September was 3.4%, going above inflation by a half-point.

Average annual yield on mutual funds half-point above inflation.

DEPOSITS OF COMPANIES AND HOUSEHOLDS AT CREDIT INSTITUTIONS

August 2006

	Total	Change this year		Change over 12 months		% share
	Million euros	Million euros	%	Million euros	%	
On-demand savings (*)	409,012	12,822	3.2	42,125	11.5	39.7
Up to 2 years	226,084	35,564	18.7	44,661	24.6	22.0
More than 2-year term	295,430	55,948	23.4	89,722	43.6	28.7
Repos	70,595	–2,451	–3.4	–140	–0.2	6.9
Total	**1,001,123**	**101,885**	**11.3**	**176,370**	**21.4**	**97.2**
Deposits in currencies other than euro	**28,855**	**13,216**	**84.5**	**21,079**	**271.1**	**2.8**
TOTAL	**1,029,979**	**115,102**	**12.6**	**197,450**	**23.7**	**100.0**

NOTES: (*) Includes deposits redeemable at notice, according to ECB definition.
SOURCE: Bank of Spain and internal figures.

Research Department Publications

All publications are available on Internet:
www.estudios.lacaixa.es
E-mail:
publicacionesestudios@lacaixa.es

■ **THE SPANISH ECONOMY MONTHLY REPORT**
Report on the economic situation

■ **INFORME MENSUAL**
Report on the economic situation. Spanish version

■ **ANUARIO ECONÓMICO DE ESPAÑA 2006. Selección de indicadores**
Complete edition available on Internet

■ **ECONOMIC STUDIES SERIES**

18. **La economía del arte** (Out of stock) Bruno Frey
19. **La reforma de las pensiones ante la revisión del pacto de Toledo** José A. Herce and Javier Alonso Meseguer
20. **La ampliación de la Unión Europea al Este de Europa**
21. **Del real al euro. Una historia de la peseta** (Out of stock) José Luis García Delgado and José María Serrano Sanz (editors)
22. **Cómo tratar con Bruselas. El lobby en la Unión Europea** Robin Pedler
23. **Crecimiento y empleo en las empresas industriales** Ángel Hermosilla and Natalia Ortega
24. **La regulación del comercio internacional: del GATT a la OMC** (Out of stock) Montserrat Millet
25. **Quiebras y suspensiones de pagos: claves para la reforma concursal** Fernando Cerdá and Ignacio Sancho
26. **El euro: balance de los tres primeros años** Joan Elias (editor), Pere Miret, Àlex Ruiz and Valentí Sabaté
27. **European Union enlargement. Effects on the Spanish economy** (Out of stock) Carmela Martín, José Antonio Herce, Simón Sosvilla-Rivero and Francisco J. Velázquez
28. **Internet: situación actual y perspectivas** Fèlix Badia
29. **El gobierno de la empresa** Vicente Salas Fumás
30. **La banca en Latinoamérica. Reformas recientes y perspectivas** Josep M. Liso, Montserrat Soler, Montserrat Manero and Maria Pilar Buil
31. **Los nuevos instrumentos de la gestión pública** Guillem López Casasnovas (editor), Jaume Puig-Junoy, Juan José Ganuza and Ivan Planas Miret
32. **La competitividad de la economía española: inflación, productividad y especialización** Francisco Pérez (editor), Pilar Chorén, Francisco J. Goerlich, Matilde Mas, Juliette Milgram, Juan Carlos Robledo, Ángel Soler, Lorenzo Serrano, Deniz Ünal-Kesenci and Ezequiel Uriel
33. **La creación de empresas. Un enfoque gerencial** José María Veciana
34. **Política agraria común: balance y perspectivas** José Luis García Delgado and M. Josefa García Grande (editors)

■ **SERIES: DOCUMENTOS DE ECONOMÍA ”la Caixa”**

1. **El problema de la productividad en España: ¿Cuál es el papel de la regulación?** Jordi Gual, Sandra Jódar and Àlex Ruiz Posino June 2006

■ **”la Caixa” ECONOMIC PAPERS SERIES**

1. **Vertical industrial policy in the EU: An empirical analysis of the effectiveness of state aid** Jordi Gual and Sandra Jódar June 2006

Research Department Advisory Council

The Advisory Council guides the Research Department in its work of analyzing economic and social policy that may be most effective for the progress of Spanish and European society. The Council is made up as follows:

- Carles Boix
  University of Chicago
- Josep M. Carrau
  ”la Caixa”
- Antón Costas
  Universidad de Barcelona
- Juan José Dolado
  Universidad Carlos III
- Jordi Galí
  CREI and Universitat Pompeu Fabra
- José Luis García Delgado
  Universidad Complutense
- Teresa Garcia-Milà
  Universitat Pompeu Fabra
- Andreu Mas Colell
  Universitat Pompeu Fabra
- Víctor Pérez Díaz
  Universidad Complutense
- Xavier Vives
  IESE and ICREA-UPF