

Monthly Report



NUMBER 301

American and European universities: a matter of public interest [Page 10](#)

United States has the best universities and wins nearly all Nobel prizes. Why is this?

European talent moving to America [Page 27](#)

400,000 scientists and engineers from EU working in USA

Education of parents: a lasting benefit [Page 46](#)

The higher the parents' educational level, the more time they spend with their children

Knowledge is power... purchasing power? [Page 52](#)

Wage difference decreasing between university-trained workers and others

Forecast

% change over same period year before unless otherwise noted

	2005	2006	2007	2006				2007	
				1 Q	2 Q	3 Q	4 Q	1 Q	2 Q
INTERNATIONAL ECONOMY				Forecast				Forecast	
Gross domestic product									
United States	3.2	3.3	2.5	3.7	3.5	3.0	3.1	2.6	2.5
Japan	1.9	2.2	1.9	2.7	2.1	1.5	2.5	2.3	2.0
United Kingdom	1.9	2.8	2.5	2.4	2.7	2.9	3.0	2.7	2.6
Euro area	1.5	2.8	2.5	2.2	2.8	2.7	3.3	2.9	2.5
Germany	1.1	2.9	2.3	1.9	2.8	3.1	3.7	3.3	2.5
France	1.2	2.0	2.1	1.3	2.5	1.8	2.2	2.3	1.9
Consumer prices									
United States	3.4	3.2	2.0	3.7	4.0	3.4	2.0	2.3	1.7
Japan	-0.3	0.2	0.4	-0.1	0.2	0.6	0.3	0.2	0.4
United Kingdom	2.0	2.3	2.1	2.0	2.2	2.4	2.7	2.7	2.1
Euro area	2.2	2.2	1.8	2.3	2.5	2.1	1.8	1.8	1.6
Germany	2.0	1.7	1.7	2.0	1.9	1.6	1.3	1.7	1.6
France	1.7	1.7	1.4	1.8	1.9	1.7	1.3	1.1	1.1
SPANISH ECONOMY				Forecast				Forecast	
Macroeconomic figures									
Household consumption	4.2	3.7	3.5	3.7	3.6	3.6	3.7	3.7	3.6
Government consumption	4.8	4.4	4.4	4.3	4.4	4.2	4.9	4.2	4.3
Gross fixed capital formation	7.0	6.3	4.8	6.3	6.2	6.4	6.4	5.9	5.4
Capital goods	9.0	9.7	5.6	8.6	9.1	9.6	11.4	9.5	8.0
Construction	6.0	5.9	4.8	5.8	5.8	6.2	5.7	5.4	4.8
Domestic demand (contribution to GDP growth)	5.2	4.9	4.3	4.8	4.8	4.8	4.9	4.6	4.4
Exports of goods and services	1.5	6.2	4.2	9.5	4.9	3.4	7.3	2.6	4.8
Imports of goods and services	7.0	8.4	5.4	11.6	7.3	6.0	8.8	4.5	6.4
Gross domestic product	3.5	3.9	3.6	3.7	3.8	3.8	4.0	3.9	3.8
Other variables									
Employment	3.1	3.1	2.8	3.2	3.1	3.0	3.0	2.9	2.8
Unemployment (% labour force)	9.2	8.5	8.0	9.1	8.5	8.1	8.3	8.2	8.0
Consumer price index	3.4	3.5	2.5	4.0	3.9	3.5	2.6	2.4	2.3
Unit labour costs	2.2	2.6	2.2	2.3	2.7	2.7	2.8		
Current account balance (% GDP)	-7.5	-8.5	-9.3	-10.0	-7.8	-8.4	-7.9		
Not lending or net borrowing rest of the world (% GDP)	-6.5	-7.8	-8.8	-9.7	-7.4	-7.8	-6.7		
Government balance (% GDP)	1.1	1.8	1.2						
FINANCIAL MARKETS				Forecast				Forecast	
Interest rates									
Federal Funds	3.2	5.0	5.2	4.4	4.9	5.3	5.3	5.3	5.3
ECB repo	2.0	2.8	3.8	2.3	2.6	2.9	3.3	3.6	3.8
10-year US bonds	4.3	4.8	5.0	4.6	5.1	4.9	4.6	4.7	4.9
10-year German bonds	3.4	3.8	4.3	3.5	4.0	3.9	3.8	4.0	4.2
10-year Spanish bonds	3.4	3.8	4.4	3.5	4.0	3.9	3.8	4.1	4.3
Exchange rate									
\$/Euro	1.25	1.26	1.34	1.20	1.26	1.27	1.29	1.31	1.35

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"la Caixa" GROUP: KEY FIGURES

As of December 31, 2006

FINANCIAL ACTIVITY	Million euros
Total customer funds	197,495
Receivable from customers	139,765
Profit attributable to Group	3,025

STAFF, BRANCHES AND MEANS OF PAYMENT	
Staff	25,241
Branches	5,186
Self-service terminals	7,493
Cards	9,007,335

COMMUNITY PROJECTS: BUDGET FOR ACTIVITIES IN 2007	Million euros
Social	256
Science and environmental	64
Cultural	54
Educational	26
TOTAL BUDGET	400

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Quality education: an investment for the future

Gary Becker, a US Nobel prize-winner in 1992, was a pioneer in using concepts of economic theory to rationalize matters which until then had been considered more in the sphere of sociology. Among these, was education understood as human capital. To construct a reserve of human capital, according to the Chicago economist, first called for savings, which meant refraining from spending now in the hope that the possible gains from future spending would be greater. People and societies will act in this way if they perceive that what they gain from such restraint will be greater than the satisfaction obtained from immediate consumption. These gains might be higher wages, more agreeable work, more recreation and greater well-being in general. A higher educational level also brings general improvements in terms of public health, less crime and greater social cohesion. It also brings increased capacity to be competitive in the economic sphere. Human capital and social capital are more and more becoming the most important assets in economies, much more than possessing natural resources, for example.

This is what economic rationality teaches us. In practice, investment in education is a complex matter. Often, education systems have been built starting out from immediate priorities with limited resources and with a biased focus having little eye on the future. In the developed economies, illiteracy has been eradicated and about half of the young population has access to higher studies. But, is the present educational level satisfactory? Until very recently it was very difficult to give an objective response to this question. Since 2000, when the Organization for Economic Cooperation and Development began the PISA programme (Programme for International Student Assessment), we have figures for comparing educational levels in different countries. The results are quite significant. In Europe, the differences in matters such as mathematics and reading proficiency are notable. Such differences cannot be attributed to genetic or cultural factors. In the Nordic countries, Finland is the country with the best proficiency level, well above Sweden and especially above Norway. Nor is there any clear relation between the per capita income level and the achievement of 15-year-old students, at least in the European scene. Still more surprising, we do not find any direct link between the level of educational spending (public or private) and the student achievement. How then do we explain all this? The most plausible explanation to be taken from the PISA report is that the differences in achievements across countries are due to differences in the way their school system is organized and managed.

We must, of course, invest in education but it is very important to invest well. The education and training system must be adapted to the realities of the knowledge and innovation economy, something that is not simple to do. We are not investing well when we find that there exists a surplus of persons with university degrees and a high proportion of over-educated workers. It could be for this reason that the wage differences between workers with a university degree and others has dropped rapidly in recent years. Nor are we investing well when highly talented young people go off to the United States where they find the best universities and top-level research centres. In this Monthly Report we look at many of these and other aspects of the educational system. Obtaining an efficient training and educational system well adapted to a labour market undergoing constant change is one of the most important challenges of our society.

OVERALL SUMMARY

Concern about unstable stock markets, US real estate market and oil prices but emerging countries, Japan and Europe showing favourable prospects.

Just when stock exchanges reach highest levels since high-tech bubble, markets hit by major correction.

A major concern is whether worsening of US mortgage market could affect general economy, engine of world economic growth.

International economy: clouds on the horizon

In recent weeks, the world economy has been subjected to some blows that have raised questions about whether the current growth stage of the economic cycle can continue. The most important was the drop on world stock exchanges on February 27 and the subsequent volatility of financial markets. At the same time, fears of a major slowdown in the US economy from a spill-over from the real estate crisis have not gone away. Nor did the recent rise in oil prices help calm down nerves. Nevertheless, prospects remain relatively optimistic. Outside the United States, both Japan and the euro area are consolidating recovery. Among the emerging countries, China and India continue to show strong growth. In the words of Jean-Philippe Cotis, chief economist at the Organization for Economic Cooperation and Development, in mid-March, «we see no immediate reason to describe a more pessimistic scenario for the G-7 economies».

A few weeks earlier, however, there was quite a scare. It all began following a drop on the Shanghai stock exchange on February 27 in the midst of rumours about measures being taken by the Chinese government to cool off stock market fever. At the same time, Alan Greenspan, former chairman of the Federal Reserve, was speculating about the possibility that the US economy could go into a recession as a result of the real estate crisis. These were two events of little importance but, just as the flapping of a butterfly's wings in one part of the world may cause a tempest on the other side of the globe, they set off a severe

drop on the stock markets. It should be remembered that, after the highs reached in 2000, the bursting of the high-tech bubble pushed prices down considerably until 2003 when a new upward cycle began that especially benefited the emerging countries. In fact, some international stock exchanges were marking up all-time highs at the beginning of the fourth week in February.

The upsets were not limited to the stock markets. The price of gold also dropped while government bond prices rose. Currencies subject to the carry trade (transactions to take advantage of interest rate differences) were also revalued. Investors chose to make a complete revision of risks at a moment of splendour in most markets with an eye on possibly less optimistic scenarios for the world economy. Risk premiums moved up slightly in the case of low-rated bonds and those of emerging countries while the volatility of prices increased considerably. However, it does not seem that the correction will go farther. The global money supply situation is rather easy, company profits are still high and corporate operations are moving ahead. Investors have become more cautious but the game goes on.

Of course, it goes on with the United States permitting. The main focus of interest at this moment is the crisis in the subprime mortgage market, loans granted to borrowers with poor credit rating. The fear that loan default could spread to other segments of the mortgage market or that the subprime crisis might push down prices and sales in the real estate sector, thus depressing the economy as a whole, has again raised the spectre of

recession. Furthermore, company investment in equipment does not seem to be going through its best moment so that growth prospects for 2007 are tending to stand below potential. The good news is that the services sector is continuing to create jobs, the unemployment rate is holding low and wages have risen in recent months.

The key question is whether further weakening of the US economy could drag down the world economy as a whole. Or whether, on the other hand, the sum of the dynamic emerging economies plus the recovery of Japan and Europe could compensate for the possible slump in the United States. There are many and varied opinions on this point but the fact is that for now the dynamic is still there. In fact, the concern of the Chinese authorities is the possible overheating of their economy and it was for this reason they decided to raise reference rates on loans and deposits. In Japan, the most recent economic activity indicators confirm the good state of the economy although the spectre of deflation has not yet been banished. In January, the consumer price index showed no change over January 2006.

In Europe, the figures suggest that in the first quarter the economy is maintaining the vigour shown at the end of last year. This was a good way to celebrate the 50th anniversary of the Treaty of Rome which set up the Common Market composed of six members. Since then, the European Communities have evolved and now the European Union is made up of 27 member states. Public opinion, however, seems to be disenchanted with a European Union that suffered a blow in 2005 when the proposed Constitution was rejected in referendums held in France and the Netherlands. The EU is seen as a bureaucratic monster, far removed from the ordinary citizen and very complex to administer. However, the European integration has managed to

create something close to a single market, with mechanisms for correcting regional imbalances and a single currency for part of its members, among other achievements. Accusations of a lack of economic drive, which have also been very common, will have to be revised, given that latest studies draw attention to an increase in productivity that is compatible with a labour market growing more than expected (partly due to immigration) and that is notably cutting the unemployment rate.

Is the growth potential of the European economy increasing? In any case, with regard to the 13 countries of the euro area, their prospects this year are relatively high. Taking into account the good state of the gross domestic product, the strong demand for credit and inflation risks, the European Central Bank keeps raising its interest rates. At its meeting on the second Thursday in March, the ECB Governing Council decided to again raise its reference rate by a quarter-point putting it at 3.75%. This was its seventh increase since the start of its upward course in December 2005. A further increase is now expected in June setting the rate at 4% and this may not be the last.

Spanish economy: they come and they produce

Within the euro area, Spain's economy stands as an example of economic success in terms of growth and employment. The main factor behind this recent economic trend, both because of its importance and because it was not expected, has been the immigration boom. The National Institute of Statistics recently published figures on population registration as at January 1, 2006. With the inclusion of more than 400,000 immigrants per year, the total population reached a figure of nearly 45 million (3.5 million more than in 2001), a level presumably higher at this

Could world economy keep growing without United States? Japan confirming recovery and China not faltering...

...while European Union celebrates 50th anniversary with unaccustomed economic strength.

Spain has become country of immigrants with population now above 45 million...

...displaying very dynamic labour market with construction and services main job providers for immigrants.

Industry recovering from dip over past year while public sector obtains second surplus since Seventies.

Inflation that refuses to go down, a cost differential not being cut and an increasing current account deficit are main problems in a generally favourable economic situation.

moment because the population explosion is unlikely to slow down over the short term. In six years, foreign workers registered in civil rolls went from 750,000 persons to more than 4 million, more than 9% of the total population.

The labour market has been able to absorb this flood of immigrants, mainly in construction and in certain branches of the services sector, such as the hotel trade. These are activities with traditionally low value added which, as a result, have pushed down total productivity figures. For the moment, there is no sign of fatigue in the growth of the labour market. The total number of persons registered with Social Security was growing at a year-to-year rate of 3.5% in February, a rate somewhat higher than in the fourth quarter of 2006. Services, which give employment to 66% of those working continues as the sector generating the most jobs but we should also note the recovery in industry, which in 2006 maintained the number of new Social Security registrations for new jobs with practically no change. In fact, the industrial production index grew at a 5% rate in January thus consolidating the improvement seen all through the past year.

Construction is also maintaining a high rate of economic activity, as seen in cement consumption which was up 13.4% in January compared with the same month the year before. Registrations with Social Security were up by more than 6% in the first two months of the year. Early indicators open up favourable perspectives in public works with a spectacular increase in the volume of government tendering. On the other hand, in housing construction we note signs of a slackening off, with an easing of prices or stagnation in sales of existing housing. In any case, it should be remembered that in 2006 the number of housing units given the green light hit an all-time record of 864,000, some 18% more than in 2005.

One of the effects of the strong growth of the economy, and more specifically of domestic demand, is the increase in tax collections. Together with containment of spending, this has made it possible for the various levels of government to end the year 2006 in surplus for the second year in a row since the establishment of democracy in the Seventies. The surplus of nearly 18 billion euros represents 1.8% of gross domestic product, a figure twice the initial forecast and the highest surplus in the euro area after Finland. The most «virtuous» segment of government is still Social Security, thanks to the increase in contributions arising from the increasingly strong labour market which made it possible to raise its reserve fund to more than 40 billion euros. Figures for central government budget implementation for January and February suggest a continuation of this situation.

This excellent state of affairs has two weak spots which must be followed carefully, namely inflation and the foreign deficit. While the consumer price index has moderated considerably in recent months, with year-to-year rates below 2.5% in January and February, as against 4.0% reached in some months of 2006, the core component of the index (excluding fresh foods and energy) shows serious downward resistance which indicates the persistence of inflationary pressures. In addition, the growth of labour costs in Spain in 2006 widened the gap with the European Union average. In the past five years, the hourly labour cost in Spain rose by an annual average of 4.4%, as against 2.8% reported in the euro area. The relative loss of competitiveness arising from higher inflation would have had an influence on the further worsening of the current account deficit which last year rose to 8.8% of gross domestic product. This is a very high level both in nominal and real terms and it will likely worsen in 2007 given the current growth trend in domestic demand.

March 28, 2007

CHRONOLOGY

2006

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%.
November	29	Publication in BOE Official Bulletin of Law 35/2006 on reforms to Personal Income Tax and partial modification of laws on Corporate Tax, Non-resident tax and Property Tax.
December	7	European Central Bank raises official interest rate to 3.50%.

2007

January	1	European Union enlarged to 27 member states following inclusion of Romania and Bulgaria; and euro area numbers 13 members following adoption of European single currency by Slovenia. Reforms to Personal Income Tax and Corporate Tax go into force.
February	19	IBEX 35 index for Spanish stock market marks up all-time high (14,915.8) with cumulative gains of 5.4% compared with end of December 2006.
	20	Dow Jones index for New York stock exchange reports all-time record (12,786.6), an increase of 2.6% over end of 2006.
March	8	European Central Bank raises official interest rate to 3.75%.

AGENDA

April

- 3 Registrations with Social Security and registered unemployment (March).
- 4 Industrial production index (February).
- 12 Governing Council of European Central Bank.
- 13 CPI (March).
GDP for EU (4th Quarter).
- 16 Balance of payments (January).
Harmonized CPI for EU (March).
- 24 Central government revenue and spending (March).
- 25 Producer prices (March). Foreign trade (February).
- 27 Labour Force Survey (1st quarter).
Preview Harmonized CPI (April).
US GDP.

May

- 4 Registrations with Social Security and registered unemployment (April).
Industrial production index (March).
- 9 Open Market Committee of the Fed.
- 10 Governing Council of European Central Bank.
- 11 CPI (April).
- 14 Preview GDP (1st Quarter).
- 16 Balance of payments (February).
Harmonized CPI for EU (April).
- 22 Central government revenue and spending (April).
Foreign trade (March).
- 23 GDP (1st Quarter).
- 25 Producer prices (April).
- 27 Municipal and Autonomous Community elections.
- 30 Preview Harmonized CPI (May).

INTERNATIONAL REVIEW

United States grows 3.3% in 2006 and still on slowdown course.

Growth based on private consumption...

United States: a calm descent with the risk of a storm

Once you have climbed the mountain you can start the descent but this is often more complicated than the climb. Then it is a matter of applying the brakes so that no member of the team stays behind or drops into the abyss. Following the downward revision of the national accounts for the fourth quarter, the US gross domestic product (GDP) grew by 3.3% in 2006 but in the second half of the year growth was below 2.5% (at quarter-to-quarter rates) which confirms that it is now going through a slowdown. The drop is generally orderly with corporate profits and the labour market giving strength and confidence. However, one of the players, household consumption, seems to be holding up and, if something unforeseen should

happen here, this could make things difficult for the whole group.

The first factor giving support to the economy is the relative prudence on the corporate side. Company profits have built up to a high at year-end. The descent has not yet begun but everything would indicate that from now on profits will take a downward course. The corporate caution that has been a dominant note in recent times would suggest a downturn without difficulties. This caution shows up in the moderate investment levels in terms of profits and in the real estate market. The reduction of investment in construction has been drastic (12.6% year-to-year), taking place even before the slowdown in demand, thus indicating a faster adjustment than on other occasions. Just when home buyers have begun to show

UNITED STATES: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006				2007	
			1 Q	2 Q	3 Q	4 Q	January	February
Real GDP	3.2	3.3	3.7	3.5	3.0	3.1	—	...
Retail sales	7.2	6.3	8.3	6.6	5.5	4.9	2.2	3.2
Consumer confidence (*)	100.3	105.9	105.7	106.6	104.4	106.8	110.2	112.5
Industrial production	3.2	4.0	3.3	4.2	5.1	3.5	2.7	3.4
Industrial activity index (ISM) (*)	55.5	53.9	55.6	55.2	53.8	50.9	49.3	52.3
Sales of single-family homes	6.6	-16.8	-11.6	-14.4	-22.3	-18.8	-20.1	...
Unemployment rate (**)	5.1	4.6	4.7	4.6	4.7	4.5	4.6	4.5
Consumer prices	3.4	3.2	3.7	4.0	3.4	1.9	2.1	2.4
Trade balance (***)	-717	-765	-740	-762	-781	-765	-758	...

NOTES: (*) Value.

(**) Percentage of labour force.

(***) Cumulative balance for 12 months. Billion dollars.

SOURCE: OECD, national statistical bodies and own calculations.

signs of less solvency, the banks have exercised more prudence and tightened up loan terms to an extent not seen since the beginning of the Nineties. The surprise factor is a characteristic of drastic corrections but, if there was correction this time, many would have been forewarned.

The second factor lies in the labour market. In the 12 months ending in February, some 2 million new jobs were created, less than the 2.7 million one year ago. The drop is sustained and the figures have just been revised upward by 800,000 jobs. In this respect, the unemployment rate stands at 4.5% of the labour force, the lowest level since 2001, which shows that the losses in the construction sector are being compensated by new hiring in the services sector. Backing this support for the economy, wages are now moving up after a weak performance during most of the present growth stage and the high level of corporate profits leaves room

for this process to continue for some time.

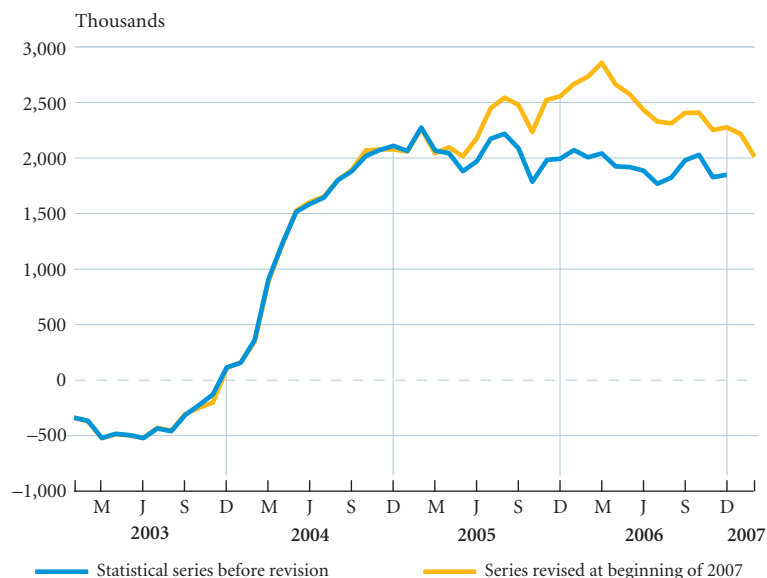
Latest supply and demand indicators are consistent with this scenario of lower growth without sharp slowdowns. Retail sales were up by 3.8% year-to-year in February, excluding the always erratic sales of cars and petrol. This indicates a clear downturn that, according to latest figures, began in mid-summer. In real terms, growth is holding below 2% year-to-year, with consumer electronics, furniture and home goods as the weakest sectors in recent months. Nevertheless, the Conference Board consumer confidence index rose to its highest level since 2001 although the increases were in the «current situation» component and not in «future prospects». Corporate perception remains along the same lines with the activity index published by the Institute for Supply Management again going above the 50 level in February (although just above). This means that those perceiving improvement are

...but corporate profits and labour market provide strong background.

Consumers and business executives relatively optimistic...

UNITED STATES: EMPLOYMENT STILL SHOWING STRONG

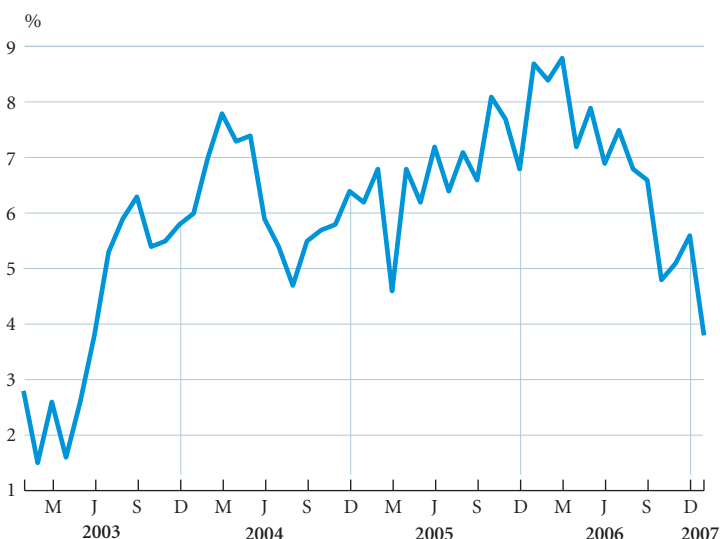
Job creation in past 12 months



SOURCE: Department of Labour and own calculations.

UNITED STATES: CONSUMERS HOLDING BACK

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



SOURCE: Department of Commerce and own calculations.

...but biggest risk lies in housing which still shows drop in activity while price decreases halt.

slightly higher than those seeing no improvement.

It is the housing market that now shows the greatest weakness with the end of the tunnel seeming farther and farther away each month, although there are slight signs of some stabilization. Housing starts in February unexpectedly showed improved figures in January but were still down 28.5% compared with the same period the year before and no substantial improvements are expected before the end of summer. It is in housing sales where we can see a more stable situation. In the existing housing market, which represents 80% of the total, sales were down 3.6% year-to-year in February whereas in September they had dropped by 13.6%. February prices were up compared with January so that, in year-to-year terms, they fell by a contained 1.3%. Price maintenance is more crucial than the level of construction activity, seeing that the increase in real estate prices is one of the factors stimulating

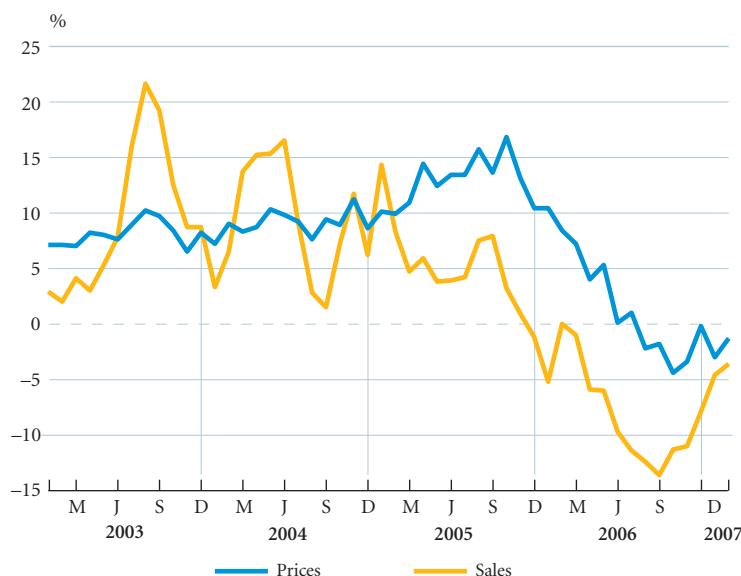
consumption in a situation of lack of savings.

It is here, however, that one member of the team is slacking. With the drop in construction and investment in equipment, both in industry and in information technology, and with a foreign sector also failing to contribute strongly to growth, the main engine of growth is private household consumption. This represents 71% of the economy and in the fourth quarter it contributed to almost all GDP growth. The problem is that consumers may not be acting as cautiously as corporations. Many of these consumers have not had real increases in their incomes during the latest growth period and some of these have got on the housing bandwagon taking on mortgage loans at higher interest rates because of their lower solvency (these are termed junk or *sub prime* mortgage loans). The increase in loan default represents a risk for banks and for housing prices.

Threat of default on low-credit-rating mortgages could increase perception of risk.

UNITED STATES: HOUSING CONSTRUCTION TAKES A PAUSE

Year-to-year change in price and sales of existing housing



SOURCE: Federal Housing Board, National Association of Realtors and own calculations.

The weight of this factor is difficult to quantify as it is not clear how many households may be at risk of default. More default and a higher perception of risk on the part of banks reduces the volume of mortgage loans granted, raises the number of houses unsold and ends up affecting real estate prices. At this time, default has shown a major increase but is still at historically low levels. New mortgage loans have dropped coming close to the bottom at the beginning of the Nineties and the stock of unsold housing stands at high levels. Nevertheless, so far the effect on prices has been limited. From now on, not only the real extent of the problem comes into the picture but also possible changes in the perception of risk as it affects the confidence of the players.

In this situation, inflation in February was no help. The general index showed a slight rise to 2.4% year-to-year, above the previous 2.1%. The increase in the core component (excluding energy and food) held at 2.7% while core inflation, excluding home rentals, which more directly reflects labour market pressures, and utilization of production capacity rose slightly to 1.6%.

The drop in the trade deficit in January was entirely due to the improvement in the oil balance leaving any real correction for later. In spite of continuing at rates of increase somewhat higher than expected, prices remain at moderate levels and the attention of monetary policy is swinging more toward preventing the risk of lower growth.

Inflation up slightly but prices continue to rise at moderate rate.

American and European universities: a matter of public interest

Thales of Miletus, one of the Seven Sages of Greece, wanted to show that philosophy also had some use, including helping to make one wealthy. He foresaw that there was going to be a bumper olive harvest and discreetly cornered all the oil-presses he could find. As he expected, since the harvest was good there was a big demand for presses and he rented his out at high prices thus obtaining abundant profits. Some 2,500 years later, in the context of the university, the question of the utility of knowledge remains crucial. In this respect, few universities show up like the University of Stanford, California, from which emerged the brains that founded Google, Sun Microsystems, Yahoo and Cisco whose market capitalization together reached the equivalent of a quarter of Spain's GDP in 2006. Beyond the strictly economic sphere, universities contribute to moulding the moral values of the society and, as centres for training teachers, they have a major influence on primary and secondary education.

THE WORLD'S BEST UNIVERSITIES

Classification of the 20 leading universities in 2006 in order

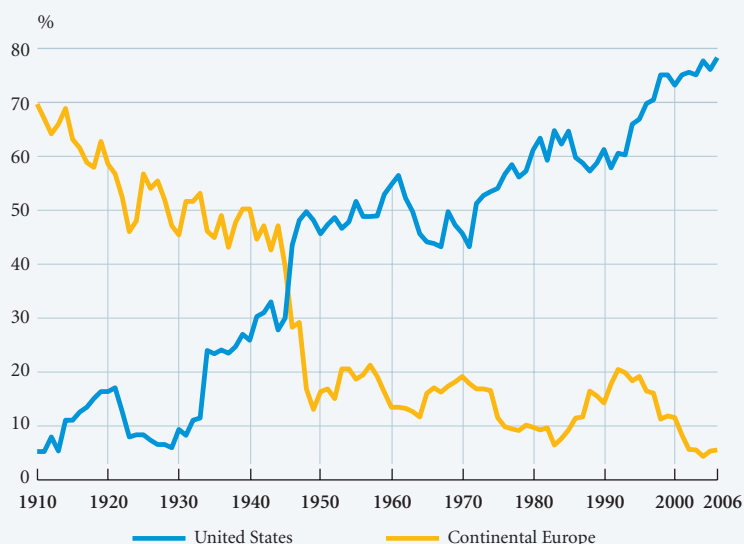
Harvard	United States
Cambridge	United Kingdom
Stanford	United States
California - Berkeley	United States
Massachusetts Institute of Technology (MIT)	United States
California Institute of Technology	United States
Columbia	United States
Princeton	United States
Chicago	United States
Oxford	United Kingdom
Yale	United States
Cornell	United States
California - San Diego	United States
California - Los Angeles	United States
Pennsylvania	United States
Wisconsin - Madison	United States
Washington - Seattle	United States
California - San Francisco	United States
Tokyo	Japan
Johns Hopkins	United States

SOURCE: University of Jiao Tong, Shanghai, China.

To properly meet its task, the university must combine excellence and access. That is to say, it must achieve the highest quality while at the same time be open to the society without elitist exclusions. These are two potentially contradictory objectives but they should not be so. Furthermore, adaptation to a more and more globalized environment and to the revolution in information technology involves an added challenge. For many years, US universities have taken the lead while those in Europe have fallen behind.

US NOBEL PRIZE-WINNERS OUT IN FRONT

Proportion of Nobel prize-winners according to university of origin at moment of award (*)



NOTES: (*) Moveable 10-year average. Nobel prize-winners for Literature and Peace excluded.
SOURCE: Nobelprize.org and own calculations.

US dominance in higher education becomes apparent, for example, when we review statistics for Nobel prize-winners. The proportion of those winners coming out of US universities has not stopped increasing in the past 100 years, in clear contrast with Germany, the leader in Continental Europe. From the accompanying graph we can see the flight of brains during World War II but this does not change the background trend. In the first decade of the 20th century some 5% of prize-winners were from the United States and 70% from Europe, of which 39% were German. In 2006, the United States took 78% and Europe 5%. The US success in terms of excellence does not seem to be in conflict with access seeing that more than 50% of young people go to university (a figure comparable with that of Spain). Furthermore, 36% of doctoral students in US universities come from abroad.

The role of the State and models of internal management and financing are factors that help to explain the lack of competitiveness of the European model. There are good reasons for the university's being able to count on public funding. For example, because research and education present major positive external factors (beneficial effects on third parties), or the need to provide support to students with talent who lack financial resources. Nevertheless, all governments suffer from budgetary restraints which oblige them to be miserly in their spending. In this context, providing the universities with the flexibility to generate alternative sources of income is key to ensuring their financial soundness. Competition between universities in this area would also bring about a greater effort to achieve excellence and to strengthen relations with companies.

Probably a matter of greater importance is the degree of government intervention in the operation of universities. The more intervention and the less autonomy institutions have, the more difficult it is for centres of excellence to flourish and thus become examples to follow. In the United States, universities have managing rectors who wield broad decision-making powers, something not too common in Europe. Autonomy thus

generates a more competitive environment. Under these conditions, the diversity of supply is increased (because supplier institutions have an incentive to differentiate their product) and adaptation to a changing environment is speeded up because any university that rests on its laurels is left behind.

In Ancient Greece there was a diversity of opinions to be found in the search each sage pursued to discover the basis of all matter –water, air, ether, fire and many other things. The US universities seem to be paying attention to this heritage and are winning the race, thanks to a State that leaves them alone, to that very diversity and, remembering Thales of Miletus, to a sense of utility that involves the private sector. Meanwhile, Europe stays in its ivory tower and continues to lose talented people. Given the importance of higher education, this is a luxury Europe cannot afford.

Japan recovers with growth of 2.5% but still depends on foreign demand.

Japan: progress resumed

The Japanese economy has recovered strength with a GDP revised slightly upward in the fourth quarter (showing growth of 2.5% year-to-year) which put 2006 growth at 2.2%. Recovery of private consumption was confirmed although in this case it was starting out from a very low point. Recovery was also reported in capital goods investment. Also gaining strength is the public sector, in consumption and especially in investment, with the fourth quarter turning out to be an exceptional period.

Growth over the previous quarter was 15% higher in annualized terms. As a whole, the make-up of growth continues to pose some doubt about a continuation of growth in view of the dependence on the foreign sector and low returns on investment.

The most recent economic indicators show that private consumption continues to languish with retail sales in January down 0.8% year-to-year, going deeper into this trend for the third consecutive month. Car sales in the past 12 months ending in February

JAPAN: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006				2007
			1 Q	2 Q	3 Q	4 Q	January
Real GDP	1.9	2.2	2.7	2.1	1.5	2.5	–
Retail sales	1.4	0.2	0.6	–0.2	0.4	–0.1	–0.8
Industrial production	1.5	4.2	2.8	3.7	5.3	5.2	2.9
Tankan company index (*)	18.0	22.5	20.0	21.0	24.0	25.0	–
Housing construction	3.9	4.5	4.9	8.9	–0.8	5.4	–0.8
Unemployment rate (**)	4.4	4.1	4.2	4.1	4.1	4.0	4.0
Consumer prices	–0.3	0.2	–0.1	0.2	0.6	0.3	0.0
Trade balance (***)	10.2	9.4	9.5	9.1	8.9	9.4	9.9

NOTES: (*) Value.

(**) Percentage of labour force.

(***) Cumulative balance for 12 months. Billion yen.

SOURCE: OECD, national statistical bodies and own calculations.

continued along a similar trend dropping by 7.7% compared with the same period the year before. Industry, which had been showing a more robust aspect in recent months, this time was not keeping up the pace and industrial production in January showed a gain of 2.9% year-to-year after growth of 4.6% the month before.

In the Tokyo real estate market, prices continued to rise in February with a major rise of 15.7% year-to-year. Sales, however, are down, a situation that has been growing worse in recent months with a loss of 23.0%. Machinery orders, an early indicator of capital goods investment, again recovered although they followed the rule seen in recent times when growth of domestic demand orders (9.6% year-to-year) was well overshadowed by export orders which were up 17.6% to come close to 47% of the total.

The spectres of deflation have not all been put to rest given that the January consumer price index showed no change over the same period last year after having come through several months on positive ground. The trend in the index excluding fresh foods, which indicates more of a trend, was the same just as in the case of Tokyo prices in February. The inclusion of energy in these indices could cause some bias but the trend in the private consumption deflator, which following revision confirms a slight drop, also fails to indicate substantial changes in coming months although the background trend is still toward positive advances in prices. The January rate held at a low 4.0% but wages were down 1.0% year-to-year, which does not help consumption. The trade balance continued to grow in January following the end of swings in oil.

Retail sales down nearly 1% and car sales fail to improve.

Industrial sector slowing down.

Prices not increasing and low unemployment level not turning into higher wages.

JAPAN: RETAIL SALES GOING NOWHERE

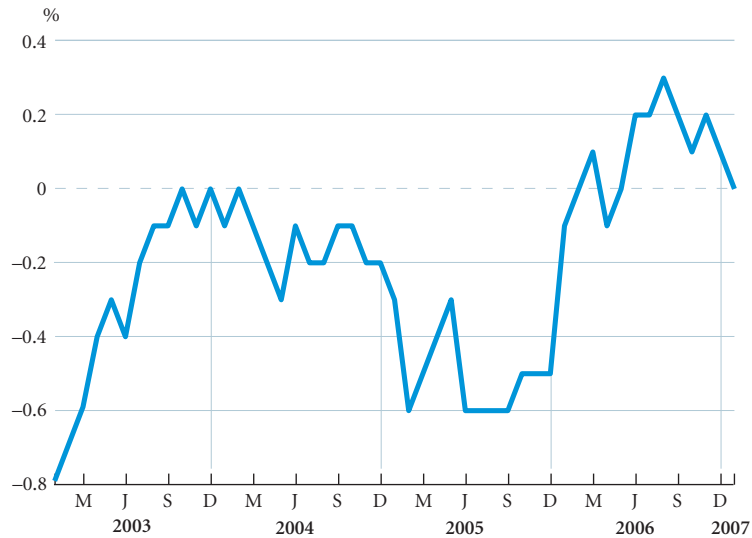
Year-to-year change in retail sales



SOURCE: Japanese Ministry of Economy, Trade and Industry and own calculations.

JAPAN: DEFLATION HARD TO DISPEL

Year-to-year change in consumer price index, excluding fresh foods



SOURCE: Japanese Ministry of Communications, National Statistics Office and own calculations.

Brazil firms up recovery with growth at 3.8%.

Strength of private consumption and investment should up growth to desired 5%.

Industrial investment again growing at 18%.

Brazil: taking the high road

In the fourth quarter, the Brazilian economy consolidated its growth and kept recovery going through a combination of price stability and a major trade surplus in spite of the renewed strength of domestic demand. The economy moved up slightly with GDP increase of 3.8% year-to-year. Private consumption and investment rose by 4.1% and 7.1% respectively. While the increase in economic activity has still not reached the government objective of 5% and there remains a considerable deficit in infrastructures, the upward trend in consumption and investment suggests a continuation of the growth cycle.

Public consumption continues to grow well below the private sector but it is in the foreign sector that exports (now slowing down) are growing well below imports which showed a very notable increase of 24.3% year-to-year. With regard to the deficit in fixed capital

formation, things seem to be going well with industrial production recovering in January (with 4.6% year-to-year growth). It is significant that the biggest efforts in this sphere are going into capital goods which, with growth at a rate of 18.0%, recovered the strength they had been displaying at the beginning of 2004.

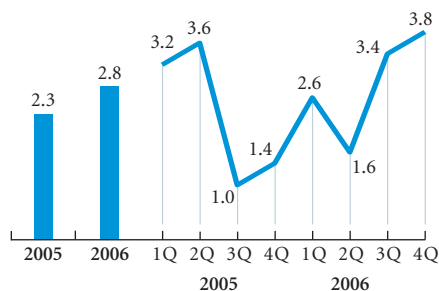
On the demand side, things went much along the same lines with retail sales growing by 8.5% year-to-year in January thus recovering the good situation recorded at the beginning of the Autumn, something that had slightly slackened off at year-end.

Inflation continued to moderate with the CPI up 3.0% year-to-year in February. Consumer prices have been undergoing upward pressure from raw materials prices which, after dropping in the first half of 2006, turned this trend around to an increase and in January managed to show a rise of 6.8% year-to-year. Wholesale prices moved up 4.1% in

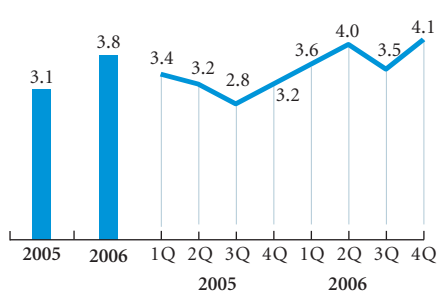
TREND IN BRAZIL'S GDP BY COMPONENT

Percentage year-to-year change in real terms

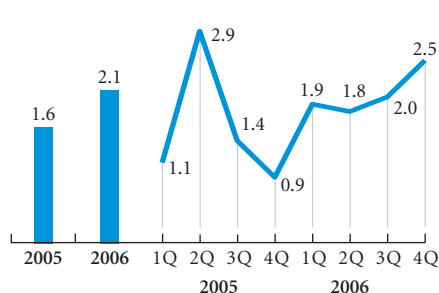
GDP



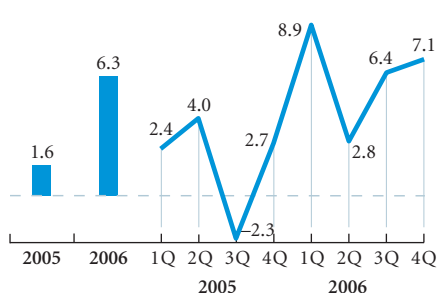
Private consumption



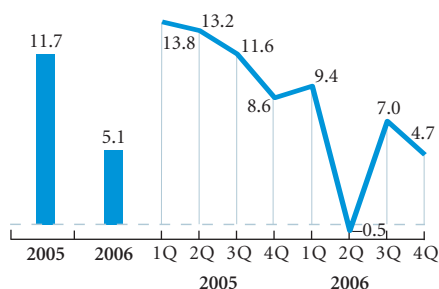
Public consumption



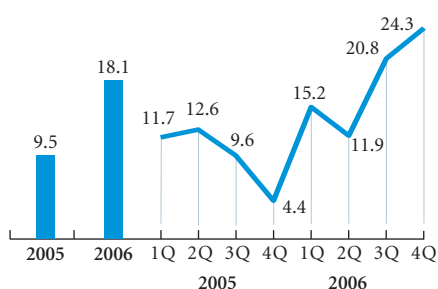
Gross fixed capital formation



Exports of goods and services



Imports of goods and services



SOURCE: Brazilian Institute of Geography and Statistics, Central Bank of Brazil and own calculations.

February compared with the same period last year. In spite of the recovery in economic activity, the unemployment rate in the São Paulo district in January rose slightly to 14.2% of the labour force, breaking with the positive

downward trend that predominated in the Autumn. The foreign sector maintained a trade surplus of 45.8 billion dollars for the past 12 months ending in January, largely helped by maintenance of raw materials prices.

Inflation holds at 3% but unemployment fails to drop below 14%.

BRAZIL: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006				2007	
			1 Q	2 Q	3 Q	4 Q	January	February
Real GDP	2.3	2.8	2.6	1.6	3.4	3.8	—	...
Industrial production	3.1	2.8	4.6	0.9	2.8	3.2	4.5	...
Unemployment rate São Paulo (*)	17.0	15.9	16.3	16.9	16.0	14.3	14.4	...
Consumer prices	6.9	4.2	5.5	4.3	3.8	3.1	3.0	3.0
Trade balance (**)	44.8	46.1	45.7	44.5	46.1	46.1	45.8	...

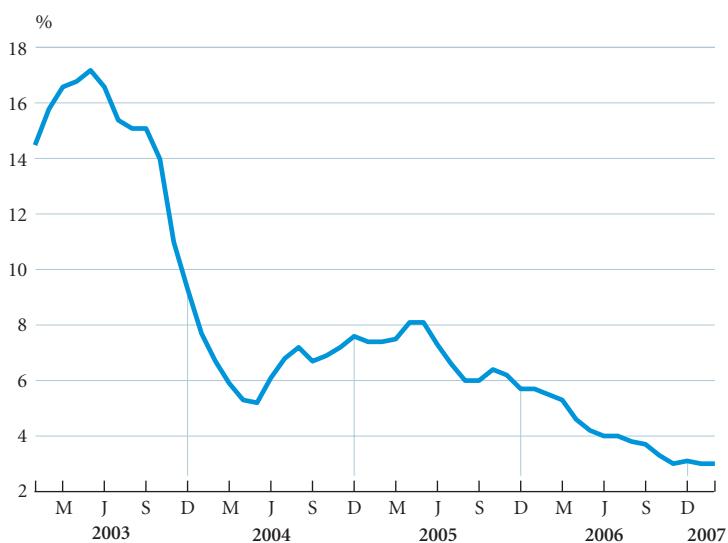
NOTES: (*) Percentage of labour force.

(**) Cumulative balance for 12 months. Billion dollars.

SOURCE: Brazilian Institute of Geography and Statistics, Central Bank of Brazil and own calculations.

BRAZIL: NOTABLE REDUCTION IN INFLATION

Year-to-year change in CPI



SOURCE: IPEA and own calculations.

Argentina growing at 8.6% thanks to private consumption and investment.

Recovery in exports boosts foreign sector that had lost some drive.

Argentina: growth becomes more solid

The Argentine economy completed its fourth growth year with GDP more than 20% above the level before the 2002 recession. Recovery was based on growth of domestic demand but included two new factors that make it firmer than on other occasions. These factors are a greater strength of investment, which

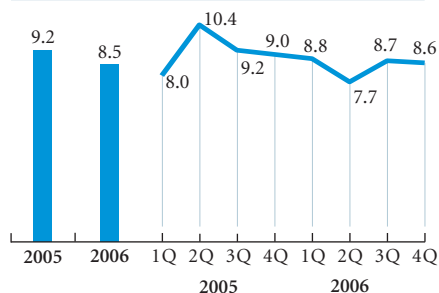
amounted to 23% of the economy whereas in the Nineties it failed to reach 20%, and a bigger opening up of trade.

The fourth-quarter GDP was up 8.6% year-to-year, aided by strong private consumption and investment that moved up by 14.0%. The contribution to growth from the foreign sector had been moving down in 2006 but there was a strong recovery in exports in the

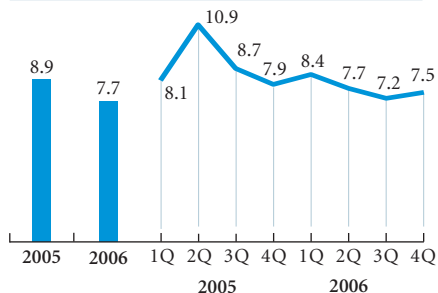
TREND IN ARGENTINA'S GDP BY COMPONENT

Percentage year-to-year change in real terms

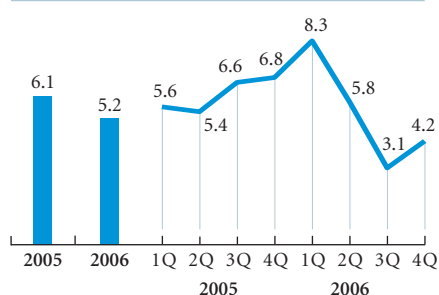
GDP



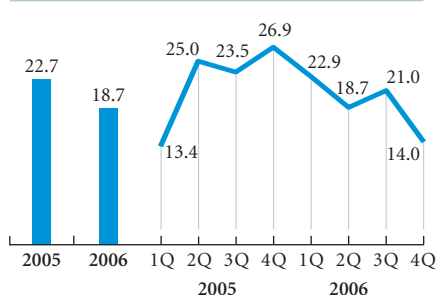
Private consumption



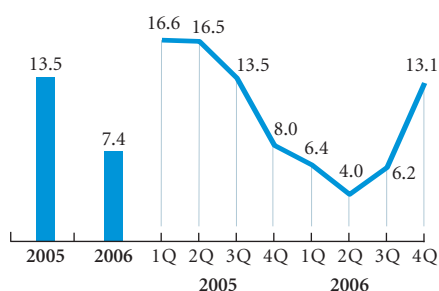
Public consumption



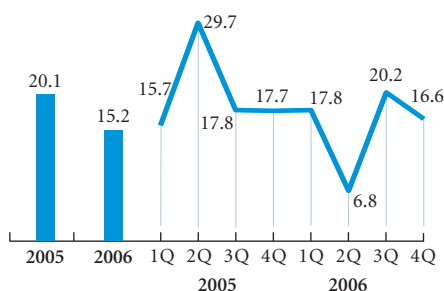
Gross fixed capital formation



Exports of goods and services



Imports of goods and services



SOURCE: National Institute of Statistics and Census of Argentine Republic (INDEC) and own calculations.

fourth quarter that indicates maintenance of the current surplus.

The most recent demand indicators confirm the strength of the growth cycle. Retail sales grew by 19.8% year-to-year in January and in the past 12 months ending in January Argentines bought 36% more cars than in the same period the year before, going above 70% of the level before the recession.

On the supply side, industrial production continued to lose strength because of decreases in the steel sector. Growth in January slowed to 4.0% year-to-year. In addition, industrial activity indicators, especially for construction, held at high levels.

Inflation is holding at relatively high levels compared with the rest of the region and stands as the biggest risk for

Renewed strength of retail sales continuing...

...but weakness in steel means drop in industrial production.

ARGENTINA: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006				2007	
			1 Q	2 Q	3 Q	4 Q	January	February
Real GDP	9.2	8.5	8.8	7.7	8.7	8.6	—	...
Industrial production	7.3	7.5	6.1	8.4	9.1	6.3	4.0	...
Unemployment rate (*)	11.6	10.2	11.4	10.4	10.2	8.7	...	...
Consumer prices	9.6	10.9	11.6	11.4	10.6	10.1	9.7	9.6
Trade balance (**)	11.7	12.4	11.7	12.3	11.7	12.4	12.0	...

NOTES: (*) Percentage of labour force.

(**) Cumulative balance for 12 months, Billion dollars.

SOURCE: National Institute of Statistics and Census, Republic of Argentina (INDEC) and own calculations.

Inflation down but still above 9.5% while unemployment shows improvement.

continued growth. In recent months there has been some improvement but it is slow and prices rose by 9.6% year-to-year in January, only one decimal below the month before. Where we see substantial improvement is in employment with an unemployment

rate that dropped from 10.2% to 8.7% of the labour force in the fourth quarter. The trade surplus continued to benefit from the winter increase in exports so that for the 12 months ending in January this held at 12 billion dollars.

ARGENTINA: INFLATION RISK PUTS UP RESISTANCE

Year-to-year change in CPI



SOURCE: INDEC and own calculations.

Raw materials: prices again move up

Gradually oil prices are breaking away from earlier positions and again showing a moderately upward trend. After a surprise drop in January putting the per barrel price at 55 dollars (one-month forward *Brent*), seven dollars below the December average, prices in February went into the range of 59 dollars, only to jump to 62 dollars as the March average, even going above 66 dollars at some sessions.

There are three factors behind the new rise in oil. First, January surprised the Western Hemisphere with unusually mild temperatures which eased demand for refined heating oil products. When temperatures returned to levels more in keeping with the calendar, oil demand again rose. This affected the second factor pushing up prices, namely available refining capacity. Especially in the United States, this capacity is

maintained at a very high level of utilization which increases the difficulties in following a growing rate of demand. The drop in petrol inventories for six weeks in a row was the result of refining capacity with little possibility of increasing output and demand leaping ahead. Finally, after some months of relative calm, tension between Iran and the Western powers has recently again increased.

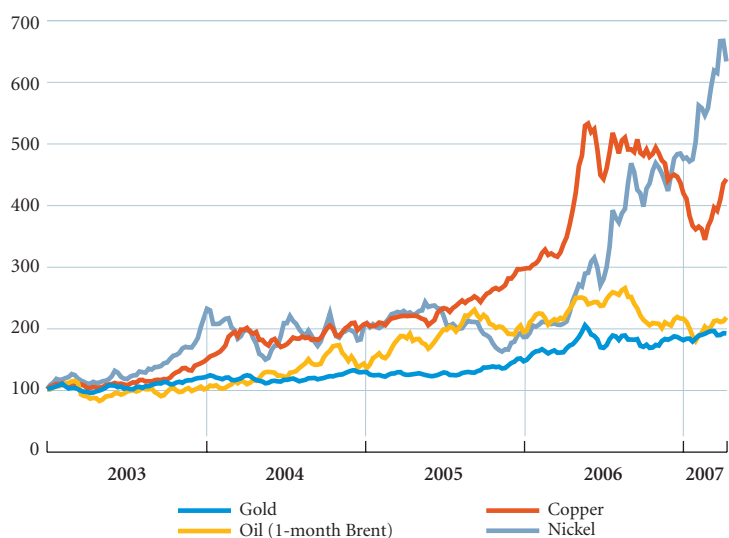
Other raw materials are also on a growth path. In March, «The Economist» raw materials index stood at a level 24% higher than one year earlier. While all the components of this indicator are on the rise, metals have led the sharpest rise. Among industrial metals, we should especially mention the increases in nickel (rise of 33% since the beginning of the year) and copper (9%) and, in precious metals, platinum (10%) and gold (4%).

In another sphere, March saw a busy round of contacts between natural gas

Oil price again moving up under effect of more seasonable weather conditions and increased geopolitical uncertainty.

INDUSTRIAL METALS AND OIL AGAIN ON THE CHARGE

January 2003 = 100 (weekly averages in US dollars)



SOURCE: Thomson Financial Datastream and own calculations.

RAW MATERIALS PRICES

	2005	2006	2006				2007		
			1 Q	2 Q	3 Q	4 Q	January	February	March
«The Economist» index in dollars (*)									
General	3.4	27.5	18.2	27.9	30.5	33.3	22.9	18.8	23.7
Food	−1.7	11.0	9.7	5.7	8.5	20.2	17.2	15.0	17.3
Industrials	10.0	46.1	28.0	54.1	55.5	46.9	28.7	22.5	29.7
Non-food agricultural	−2.4	12.5	15.6	19.9	12.6	2.0	5.3	4.3	3.8
Metals	17.4	62.0	33.8	70.8	76.4	66.8	38.5	30.0	40.5
«The Economist» index in euros (*)									
	3.2	26.3	28.9	28.3	24.9	22.9	13.9	8.9	12.2
Oil (**)									
Dollars/barrel	53.9	66.3	62.9	70.6	70.9	61.0	54.9	58.7	62.5
Change rate	44.8	21.5	32.6	33.3	14.7	5.7	−13.5	−5.1	−1.1
Gold									
Dollars/ounce	446.0	604.1	554.2	626.4	621.3	614.4	631.4	664.6	653.7
Change rate	8.5	36.1	29.7	46.5	41.5	26.6	15.0	19.6	17.2

NOTES: (*) Year-to-year change rate.

(**) Brent quality; one-month forward price.

SOURCE: «The Economist», Thomson Financial Datastream and own calculations.

Metals continue on upturn, both industrial and precious.

Attempt to form a «Gas OPEC» although its ability to influence market would be lower than that of oil cartel.

producing countries with the idea of setting up a cartel similar to the Organization of Petroleum Exporting Countries (OPEC). It was rumoured that this «Gas OPEC» might be formed on April 9 at the ordinary meeting of an informal group of gas producers known as the Forum of Gas Producing Countries. This Forum is now made up of 16 countries that together control 73% of world natural gas reserves and 41% of gas production.

In spite of the fear this proposal has raised among importing countries, it should be mentioned that, as opposed

to what happens with oil, three-quarters of gas imports/exports using gas pipelines are negotiated bilaterally between producer and consumer countries under long-term contracts quite outside financial markets. Only the remaining quarter, that involving liquid natural gas exported in LNG tankers, operates within a global financial market. To the extent that liquid natural gas does not significantly increase its importance in the gas sector, the strength of this hypothetical gas cartel would be substantially lower than the existing oil cartel.

EUROPEAN UNION

Euro area: growth goes above 3%

In the fourth quarter of 2006, the euro area grew by 3.3% year-to-year, the best figure since 2000 when the European economy was enjoying its last boom stage in the second half of the Nineties. This is a positive figure not only because of the level reached but because of its make-up. Together with the strength of investment and the foreign sector which goes back several quarters, the new factor is the improved strength of private consumption.

Specifically, in the fourth quarter household consumption grew by 2.1% year-to-year, four decimals more than in the third quarter while public consumption reported the same increase. Investment went from 3.9% year-to-year in the third quarter to 4.8% in the fourth quarter. Only the bigger

drain from the change in inventories stood in the way of higher levels of investment and consumption bringing about a rise in domestic demand. With regard to foreign demand, its contribution to the change in gross domestic product (GDP) was 1.1 percentage points, the highest for the decade.

If this was the year-end fireworks, the start of 2007 has not deviated very much from this growth rate. While retail sales slackened off in January as a result of the poor performance of the indicator in Germany, the recovery of consumer confidence as of February would indicate that consumption will continue its recovery in coming months.

On the supply side, the growth of industrial production in January (3.8% year-to-year) represents a slight increase

Final stages of 2006 expansionist in euro area with growth at 3.3%.

EURO AREA: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006				2007	
			1Q	2Q	3Q	4Q	January	February
GDP	1.5	2.8	2.2	2.8	2.7	3.3	—	...
Retail sales	1.3	1.5	0.8	1.7	1.8	1.5	0.0	...
Consumer confidence (*)	-14	-9.0	-11	-10	-8	-7	-7	-5
Industrial production	1.3	3.8	3.4	4.2	4.0	3.6	3.8	...
Economic sentiment indicator (*)	97.9	106.9	102.6	106.8	108.2	109.9	109.2	109.7
Unemployment rate (**)	8.6	7.8	8.2	7.8	7.7	7.5	7.4	...
Consumer prices	2.2	2.2	2.3	2.5	2.1	1.8	1.8	1.8
Trade balance (***)	42.1	-10.4	3.0	-10.0	-21.6	-13.1	-5.7	...

NOTES: (*) Value.

(**) Percentage of labour force.

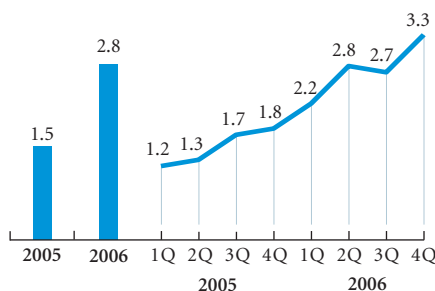
(***) Cumulative balance for 12 months. Billion euros.

SOURCE: Eurostat, European Central Bank, European Commission and own calculations.

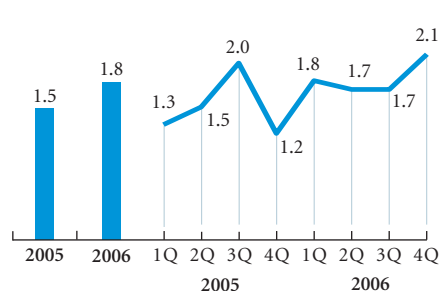
TREND IN EURO AREA GDP BY COMPONENT

Percentage year-to-year change

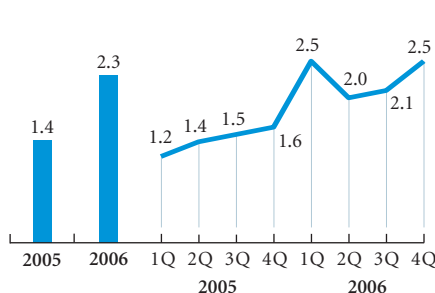
GDP



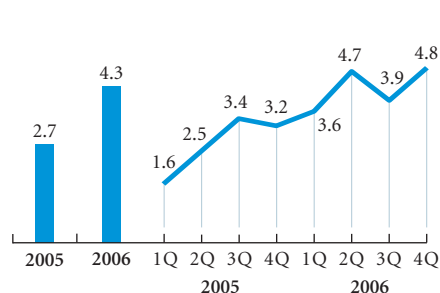
Private consumption



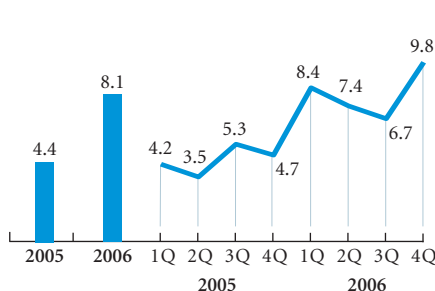
Public consumption



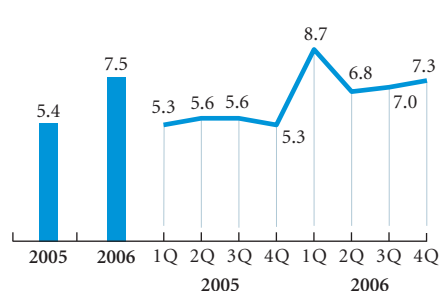
Gross fixed capital formation



Exports of goods and services



Imports of goods and services



SOURCE: Eurostat and own calculations.

Year begins on good footing with industry consolidating recovery and consumers openly optimistic.

over the fourth-quarter average of 3.6%. The stability seen in industrial confidence as of February and the positive trend in industrial orders confirm the good prospects for the secondary sector. The trend in the confidence indicators for services and construction also suggest that the early months of the year will be positive.

With regard to prices, these are moving into a stage of increased containment. The harmonized consumer price index

(HCPI) in February held at 1.8% year-to-year with no change from January. Consolidation of this figure below the European Central Bank reference rate was largely due to the small add-on from energy. In February, the energy component stood at levels a mere 0.8% higher than one year earlier. On a less positive note, we should mention that, once the more volatile headings (energy and unprocessed foods) were taken off, the result for February moved up to 1.9%, two decimals higher than the

January figure. So long as there is no sharp upward episode in oil, prospects for coming months are favourable and we should see further reductions in the inflation rate up until the summer months. As of the Autumn, however, much of what remains of the year will run in the opposite direction.

One of the most positive results of economic recovery is the gradual reduction of the unemployment rate. In January, this stood at 7.4% of the labour force. This figure was nine decimals lower than that recorded one year earlier. Job creation rose in the third quarter (the latest figure available) to 1.5% year-to-year (1.4% in the second quarter). Both headings help to explain the recovery in consumption.

Germany: Get thee behind me, Pessimism!

Scarcely two months ago, economic analysts were predicting a rather shaky start for the German economy in 2007. Of special concern was that the three-point increase in value added tax (VAT)

as of January might bring about an advance of consumption into the fourth quarter and create an untimely drop-off in the early months of 2007. As figures for the beginning of the year become known, these fears have been disappearing, to the point where the prestigious DIW Institute of the University of Kiel has forecast growth of 2.8% in 2007, nothing less than seven decimals higher than the forecast put out toward the end of 2006.

Certainly, the indicators offer a picture of economic activity in good shape in the first quarter. In spite of the fact that a key consumption indicator, retail sales, worsened in January, this must be off-set by the stability of the capital goods component in industrial production as of January and the recovery of consumer confidence as of February. Furthermore, we should mention the drop in the unemployment rate in January and February, equivalent to a half-point of the labour force, which represents additional support for consumption.

On the demand side, we should also mention that investment is still

Inflation at 1.8% since year start may be close to further decreases.

Germany's 2007 growth forecasts get notable upward revision.

First quarter indicators support better prospects.

GERMANY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006				2007	
			1Q	2Q	3Q	4Q	January	February
GDP	1.1	2.9	1.9	2.8	3.1	3.7	—	...
Retail sales	1.3	0.1	0.6	0.2	0.0	-0.3	-1.2	...
Industrial production	2.7	5.7	4.5	6.0	6.6	5.3	7.9	...
Industrial activity index (IFO) (*)	95.5	105.5	103.6	106.1	105.2	107.0	107.9	107.0
Unemployment rate (**)	11.7	10.8	11.4	11.1	10.6	10.1	9.5	9.3
Consumer prices	2.0	1.7	2.0	1.9	1.6	1.3	1.7	1.6
Trade balance (***)	156.3	153.0	154.7	151.2	148.3	157.9	165.9	...

NOTES: (*) Value.

(**) Percentage of labour force.

(***) Cumulative balance for 12 months. Billion euros.

SOURCE: OECD, national statistical bodies and internal figures.

Moderate cut in company taxes and retirement age changes.

In France, economic programmes of Royal and Sarkozy not proffering major reforms.

French economy consolidating recovery with consumption playing key role.

increasing (the capital goods component of industrial production went above a 10% increase in January) and that the foreign surplus, as cumulative figure for 12 months, rose by 4 billion euros in the first month of 2007.

These positive figures underline the excellent state of German industry. In January, industrial production rose to 7.9% year-to-year, a little less than two points above the December figure. This trend should not weaken in coming months seeing that industrial orders have marked up four consecutive months (from October to January) with growth above 8% year-to-year. This good situation allows us to take calmly the drop in the IFO industrial activity index that took place between January and March (one point in total). This was mainly a correction of the high levels reached at the end of 2006, the best since reunification. At the same time, this adjustment is concentrated mainly in sectors most affected by the increase in indirect taxes.

Another area that is troubling, namely inflation, is performing better than expected, a situation that is contributing to dispel uncertainty about the first quarter even more. The increase in January (up to 1.7% year-to-year) was a long way from forecasts predicting figures above 2%. A continuation of this moderation in February, a month when inflation stood at 1.6%, ended up calming down the economic analysts.

The year 2007 has thus begun better than expected and this reinforces a more expansionist growth scenario than foreseen earlier. This made it possible for the gradual introduction of structural adjustments by the coalition government led by Angela Merkel to continue in March. That month saw a slight

reduction in corporate tax equivalent to 5 billion euros (the reduction in itself came to 30 billion euros but this is compensated by a reduction of 25 billion euros in subsidies). At the same time, in March the federal parliament approved the progressive extension of the retirement age, a process that will be fully implemented in 2029, when the retirement age will be 67 years.

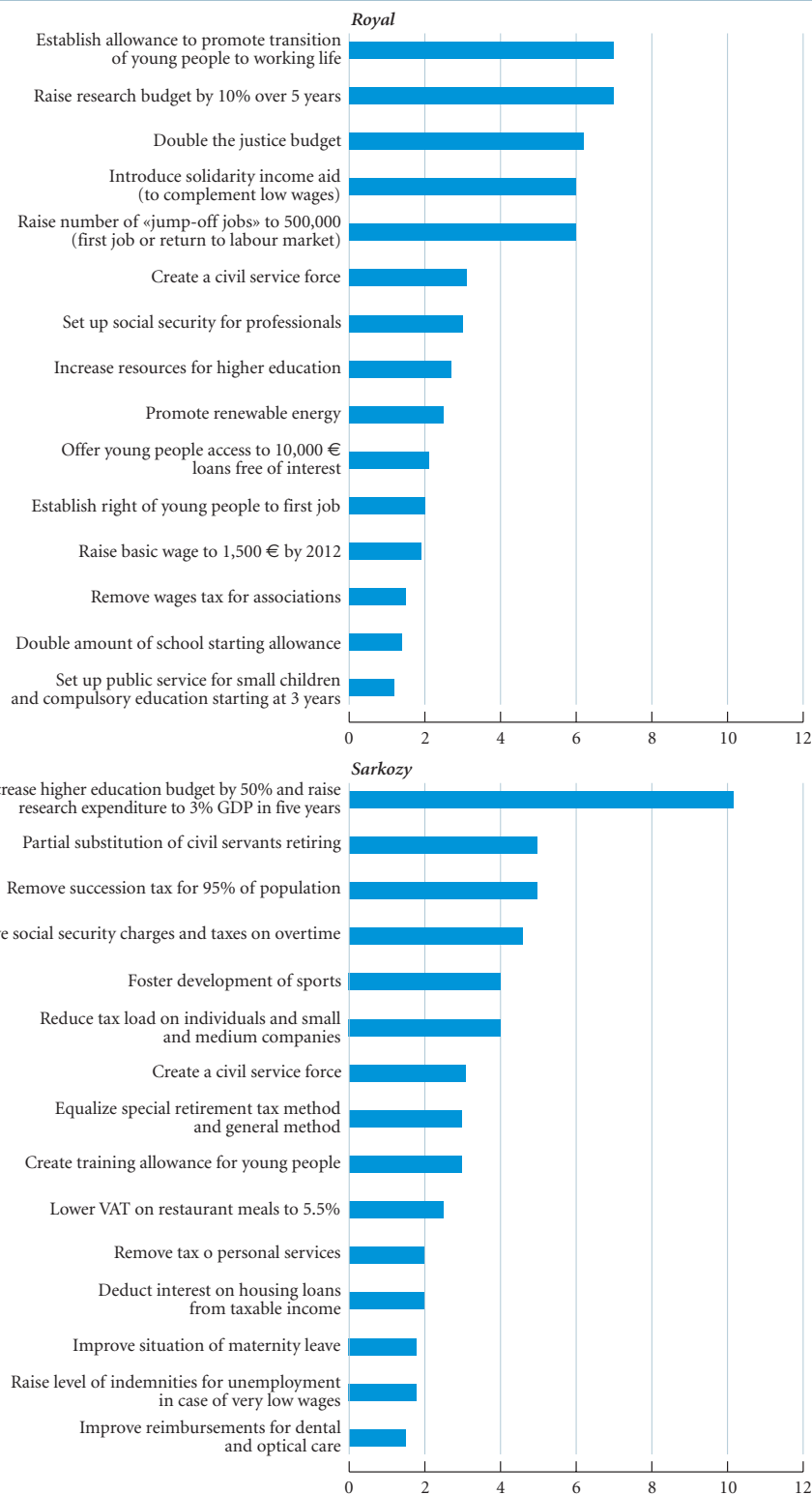
France: new faces, old politics

What will be changed in French economic policy after the presidential elections in April and the legislative elections in June? If we look over the economic programmes of Nicolas Sarkozy and Ségolène Royal (we are not of the opinion that François Bayrou has any real possibility of reaching the presidency), the positions taken make it difficult to reach any clear conclusions. Because of this, in an effort to be specific about the plans of these two candidates, we have chosen 15 measures having the biggest direct impact on the budget. While this is only a partial economic estimate, at least it gives a somewhat more precise idea of where Sarkozy and Royal are planning to place their attention.

Looking at the figures, we can reach at least two main conclusions. The first is that both candidates are certainly trying to show the difference between their proposals. Royal's platform has many elements traditionally linked to social-democrat positions while Sarkozy is opting for a line based on liberal ideas. The second conclusion is that, in spite of specific positions taken, the truth is that both candidates will have difficulty in dealing with basic economic problems through an ambitious programme of reforms.

ROYAL AND SARKOZY FACE TO FACE: MAIN MEASURES PROPOSED

Cost of 15 measures with biggest budgetary impact (in billion euros)



SOURCE: Débat 2007 Opinion Group and own calculations.

FRANCE: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006				2007	
			1Q	2Q	3Q	4Q	January	February
GDP	1.2	2.0	1.3	2.5	1.8	2.2	—	...
Domestic consumption	2.9	4.2	2.9	4.8	4.3	4.9	7.1	...
Industrial production	0.2	0.8	0.6	1.7	0.5	0.4	−0.6	...
Unemployment rate (*)	9.8	9.0	9.5	9.1	8.8	8.6	8.5	...
Consumer prices	1.7	1.7	1.8	1.9	1.7	1.3	1.2	1.0
Trade balance (**)	−1.3	−2.2	−2.0	−2.1	−2.4	−2.4	−2.4	...

NOTES: (*) Percentage of labour force.

(**) Cumulative balance for 12 months. Billion euros.

SOURCE: OECD, national statistical bodies and internal figures.

Italian political crisis ends but uncertainty remains.

As things are, the figures continue to show an economy undergoing progressive recovery. On the demand side, the most notable development is the improved situation in consumption. The improvement in household consumption in January was accompanied by recovery of consumer confidence in January and February. On the supply side, if we look at the trend in confidence in services, the tertiary sector is showing signs of recovery. Industrial activity, which continues to be outside the improvement in the economy (industrial production fell by 0.6% year-to-year in January), could be moving into a stage of better results, seeing that industrial orders and industrial confidence swung upward in February. Finally, as a tail-piece to a macroeconomic scenario on the mend, it should be pointed out that inflation remains well contained (the CPI was up 1.0% year-to-year in February) and the unemployment rate went down to 8.5% in January.

Italy: good news on economy

The fall of Romano Prodi's first government has opened the door to a

stage of increasing political uncertainty. While it seems that the crisis that started in February has been smoothed out, the fact is that Prodi's government has only a slim majority of one seat in the senate and that the coalition of nine parties continues to be very fragile.

The economy, on the other hand, is turning around and it likely will be the main focus of positive news in the early months of 2007. The starting point is the excellent GDP growth in the fourth quarter at 2.8% year-to-year. While over the current year this rate will tend to moderate, consumption and exports (two supports of the recovery) will continue to operate in coming quarters.

At least, this is indicated by the trend in consumer confidence (which up to February has been holding at levels similar to those for the fourth quarter) and the recent sharp growth in exports.

To be specific, exports rose by as much as 15% year-to-year in January which, combined with the smaller increase in imports (up 11% year-to-year), meant that the cumulative trade balance for 12 months ending in January was down for the second month in a row.

Good situation at end of 2006 continues into early months of 2007.

European talent moving to America

How would it be possible to work out if a country is going to substantially improve its prosperity in a decade? The answer: just count the «white coats». In other words, the possibilities open for a country's economic progress largely depend on its capacity for innovation. This, in turn, is closely related to the availability of the human resources that make it possible. Thus the number of persons devoted to creative tasks and those related to the application of knowledge (the «white coats») is a key indicator of the economic future of a country. For this reason, concern about the flight of young European scientists to the United States is fully justified. The loss of talent (the so-called «brain-drain») is a threat to our future prosperity. Two questions immediately arise. One, up to what point is the brain-drain of quantitative importance? Two, if indeed it is a phenomenon of considerable size, what are the factors lying behind the flight of our scientists and technicians?

This is no simple question given that available statistics are not especially designed to measure a matter fraught with such intangible factors, such as talent, ideas and the organizational practices involved in innovation. To begin with, an analysis demands a precise definition of the scientists and technicians. In an attempt to homogenize the varying national conceptions, the European Union, along with such international bodies as the Organization for Economic Cooperation and Development (OECD), has established a category called «human resources in science and technology» (HRST). Belonging to HRST are those persons who either because of their qualifications (graduates and post-graduates in science and technology in a broad sense) or because of their occupations, are considered closest to creative activities related to scientific and technological knowledge. In the case of the European Union (EU-15), some 36 million persons (approximately 12% of total employment) have scientific or technical training and at the same time are employed in work in this sphere.

The HRST figures make a quantitative approach to the phenomenon of the brain-drain possible. If we take a more restrictive definition that includes only those human resources with tertiary education in science and engineering, the increase in the «stock» in any given year may be obtained by taking the stock for the previous year and adding the total of new persons coming in (basically new national graduates and immigrants with equivalent qualifications) less those leaving (deaths and emigration). In order to better adjust the flow under consideration, we have opted to limit the analysis to the trend in the group aged 25-34 years, a group in which deaths are minimal and where most decisions to emigrate for career reasons are made. At the same time, figures have been corrected for those individuals who leave the group on reaching 35 years of age based on census data.

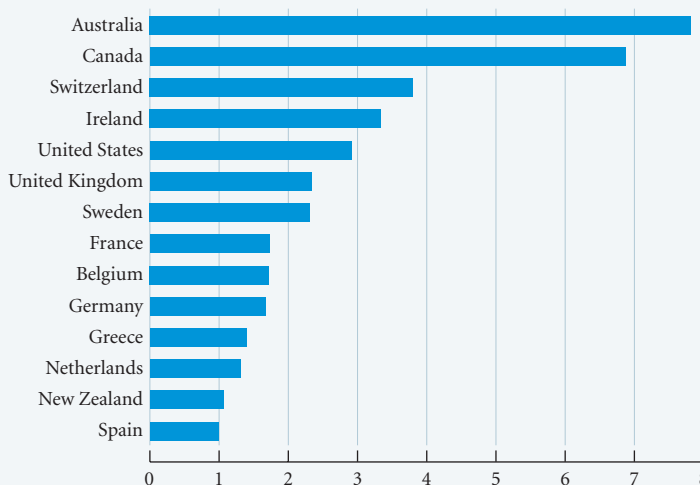
If we make these calculations for the few countries where complete data exist, we obtain relatively important figures for the movement of scientists and engineers at the national level. In 2004, these figures showed a net outflow of HRST equivalent to 20% of the national «stock» in Germany, Italy and the Netherlands. In the case of Spain, the net outflow of HRST was approximately 3% of the national stock. These figures, however, allow only a partial interpretation of the phenomenon. This is due to the fact that we do not have a breakdown of intra-European and extra-European movements of scientists and technicians, and that a good part of these flows likely takes place within the European Union. In order to have a broader international comparative view we must have recourse to another battery of statistics, namely those of the OECD.

The OECD recently analyzed the mobility of what it terms highly skilled immigrants. The international body defines this group as that made up of persons who immigrate and whose level of education is equivalent to

tertiary education in Spain. According to the OECD figures, a majority of highly qualified immigrants settles in the United States, followed at some distance by Canada and Australia. The United States, Canada and Australia are also among the five countries with the biggest proportion of highly skilled immigrants in terms of total population. While a relevant part of those highly qualified immigrants may well be Europeans, the OECD does not provide a breakdown by nationality.

ANGLO-SAXON COUNTRIES GET LION'S SHARE IN INTERNATIONAL TALENT RACE

Highly skilled immigrants as percentage of total population (2001) (*)



NOTES: (*) Immigrants with educational level equivalent to tertiary education in Spain. Figures for United States are for 2000, those for France are for 1999 and those for Ireland apply to 2002.

SOURCE: OECD.

In order to construct a profile of this aspect of the phenomenon, a resource is to be found in the figures of the US National Science Foundation (NSF), which provides information about foreign-nationality human resources in science and technology. The NSF definition is different from and more restrictive than that prepared by the EU and the OECD. Because of this, its figures are not strictly comparable with the figures given earlier. According to the NSF, there are approximately 3.1 million scientists and technicians resident and working in the United States who were foreign-born. Of these, some 295,000 come from Germany, United Kingdom, France, Italy and Ireland (details of other EU states are not available). According to our calculations, the total number of persons from the EU could stand at 370,000 persons. This figure, which surely is a conservative estimate, stands at a similar order of magnitude to that sometimes cited by the European Commission at 400,000 scientists and technicians from the EU working in the United States. This means that Europe has «exported» to the United States the entire output of one year's science and engineering graduates from the whole European university system. This is just a numerical approximation without reference to the quality of the human resources that have emigrated. In all likelihood, many of the best brains are those that leave for the United States.

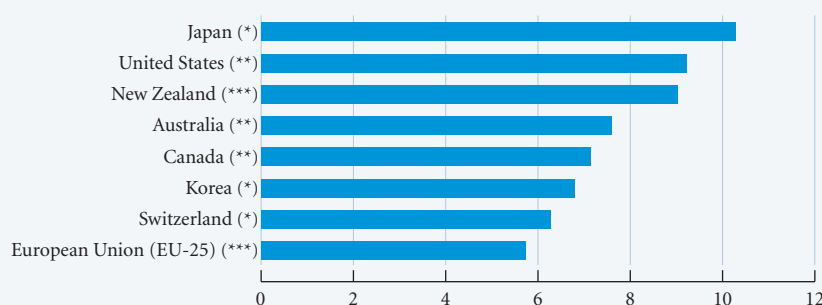
What are the reasons for this brain-drain to the United States? While studies dealing with this matter put forward various explanations, they may be gathered together in two large groups of factors, under supply and

demand, each being non-exclusive. One group of explanations concentrates on emphasizing the quality of the higher education system in the United States. While this matter is specifically dealt with in a box in this Monthly Report, it serves as an illustration to mention that, according to one key report, among the first 20 leading world universities in terms of quality, 17 were in the United States and only 2 in Europe. In addition, we should point out that the United States devotes approximately 3% of gross national product (GDP) to tertiary education while the EU applies a mere 1.3% of GDP.

The better level of higher education in the United States brings about the attraction of a large number of post-graduates, many of whom end up staying in the United States (60% of German post-graduate students studying there in 1998 stated their plans to remain in the United States), and the attraction of a large number of researchers. In turn, explanations of demand (that is to say, those related to employment expectations) certainly have an even clearer and more direct incidence. The difference between Europe and the United States in this sphere is to be seen both in the quantitative importance of the HRST segment and in matters of a less tangible nature such as the organization of research work, the incentives system, etc. If we deal only with the first of these matters, purely the numbers, in the European Union on average approximately 27% of total employment involves personnel from the HRST group, five percentage points less than in the United States. Along the same lines, the researcher segment, a sub-group of HRST, reaches 8 per thousand of those employed in the United States whereas in the European Union it fails to reach 6 per thousand.

EUROPE NEEDS TO INTENSIFY ITS DEMAND FOR RESEARCHERS

Proportion of researchers per thousand of total number of persons employed



NOTES: (*) Figure for 2004.

(**) Figure for 2002.

(***) Figure for 2003.

SOURCE: OECD.

To sum up, if Europe really wants to ensure its future prosperity, it must realize that the number of «white coats» shows that the question of talent is relevant. It needs to take action in the matter of supply (that is, improving the level of resources and probably the organization of the university system) as well as demand by means of a clearer commitment to developing the European system of research, development and innovation.

ITALY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006				2007	
			1Q	2Q	3Q	4Q	January	February
GDP	0.2	1.9	1.7	1.7	1.6	2.8	–	...
Retail sales	0.4	1.2	0.5	1.8	1.6	1.0	...	...
Industrial production	–0.9	2.3	2.8	1.6	1.4	3.5	1.7	...
Unemployment rate (*)	7.7	6.8	7.2	6.9	6.7	6.5	–	...
Consumer prices	1.9	2.1	2.1	2.2	2.2	1.8	1.7	1.8
Trade balance (**)	–9.4	–18.2	–12.9	–16.5	–21.3	–22.0	–20.9	...

NOTES: (*) Percentage of labour force.

(**) Cumulative balance for 12 months. Billion euros.

SOURCE: OECD, national statistical bodies and internal figures.

The better state of foreign trade, however, did not fully pass through to industry which in January slowed down to a surprising 1.7% year-to-year. Inflation rose by one decimal in February going to 1.8% year-to-year, a rate in line with figures reported since the Autumn of 2006.

United Kingdom: signs of correction?

The British economy is going through some complicated moments. In contrast to other European economies, growth in the United Kingdom continues to be surprisingly strong. However, with an unemployment rate at all-time lows, inflation at a menacing level and a rising foreign deficit, the signs of overheating are quite clear. Because of this, from the recent figures it is a matter of trying to decide whether a gradual economic correction is beginning to take place that might make it possible to readjust the most pressing imbalances.

Following this criteria, the latest indicators make it possible for the optimists to see the light without setting right those who are more prudent. Thus, to the question whether private consumption is slowing down (a key

movement in correcting the foreign deficit), the slowdown in retail sales in January seems to point in that direction, although the upward trend in February would discount this. To the question whether the drive in economic activity is less expansionist, a review of supply indicators (more sensitive to cyclical dips) gives us contradictory signals. While industrial production is stabilizing, with growth at a contained 0.4% year-to-year in January and confidence in services dropping up to February, economic sentiment rose by 5.3 points in February.

Finally, when we look at the most pressing imbalance, namely prices, the picture of the glass half full or half empty makes even more sense. The CPI grew by 2.8% year-to-year in February, a rate similar to the 2.7% in January. This undoubtedly is a correction related to the December figure (3.0% year-to-year) that caused much concern. It cannot be denied that this is a long way from the official 2% the Bank of England must try to reach. To complicate the analysis even more, the forecasts of most analysts point to even tenser months followed by a major slowdown. As always, time will tell but in the meantime the Bank of England has work to do.

Economic imbalances still troubling in United Kingdom.

Trends in inflation, consumption and sector activity may be seen as sign of slowdown or maintenance of pressures.

UNITED KINGDOM: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006				2007	
			1Q	2Q	3Q	4Q	January	February
GDP	1.9	2.8	2.4	2.7	2.9	3.0	—	...
Retail sales	1.9	3.2	1.7	3.4	3.8	3.8	3.5	4.9
Industrial production	−1.9	0.1	−0.7	−0.4	0.6	1.0	0.4	...
Unemployment rate (*)	2.7	3.0	2.9	3.0	3.0	3.0	2.9	2.9
Consumer prices	2.0	2.3	1.9	2.2	2.4	2.7	2.7	2.8
Trade balance (**)	−64.9	−78.5	−72.0	−77.5	−81.4	−83.2	−83.0	...

NOTES: (*) Percentage of labour force.

(**) Cumulative balance for 12 months. Billion pounds.

SOURCE: OECD, national statistical bodies and internal figures.

FINANCIAL MARKETS

Monetary and capital markets

European Central Bank reference rate goes up to 3.75%...

...with another rise expected in June.

European Central Bank suggests further rises ahead

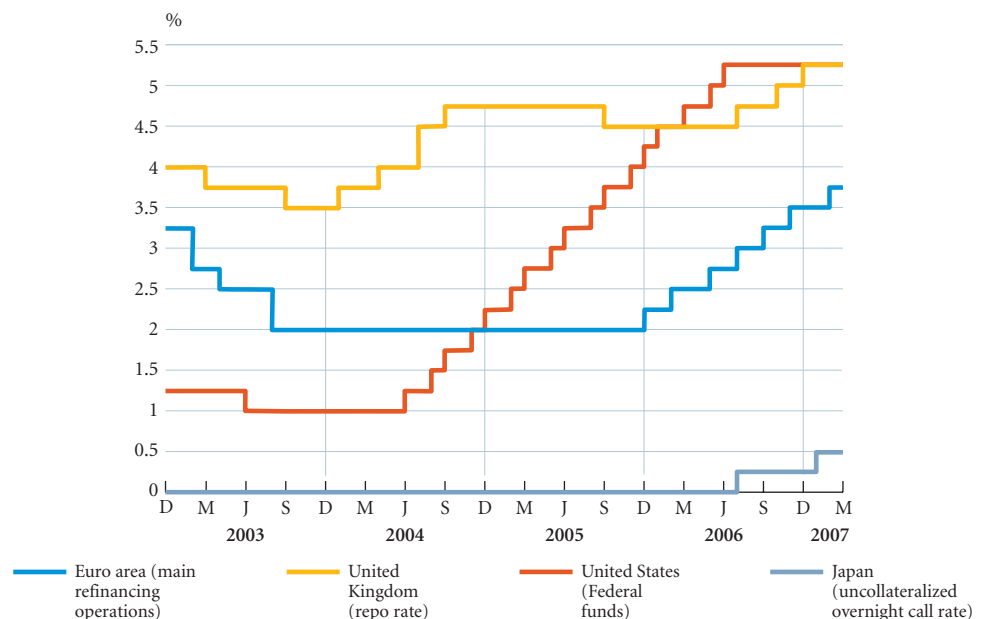
As expected, the Governing Council of the European Central Bank (ECB) raised its reference rates by 25 basis points at its meeting on March 8. The Eurosystem interest rate thus went to 3.75% following seven increases since the upturn began in December 2005. This decision was justified by the persistence of upward inflationary risks. Following the trend, underlying inflation in February rose to 1.9%, the highest level since the end of 2004. At the same time, the broad M3 money supply figure continued to rise at a sharp rate, namely 9.8% year-to-year in January.

The new macroeconomic projections of the ECB experts have put growth of the euro area gross domestic product at 2.5% in 2007 and 2.4% in 2008, which is an upward revision compared with December. For inflation, the projections stand at around 1.8% in 2007 and 2.0% in 2008. This scenario suggests some inflationary risks.

Jean-Claude Trichet, chairman of the ECB, termed the current level of interest rates as moderate, leaving out the term «low». Nevertheless, he left the impression that the level was still not adequate. It is thus likely there will be a further rise in the official ECB rate putting it closer to the neutral level. It is

EUROPEAN CENTRAL BANK RAISES ITS OFFICIAL RATE

Monetary policy reference rates



SOURCE: National central banks.

probable that the rate for main financing transactions of the ECB will go up to 4% in June.

Nor has the US Federal Reserve substantially changed its position. At its meeting on March 21 it made no change in the objective level of Federal Funds, the overnight interbank rate, which has stood at 5.25% since June. The press release issued after the meeting indicated some easing of the upward bias. Indeed, the markets are rather betting on decreases. In fact, the recent instability in financial markets, linked to doubts about the trend in the US economy, suggests a sharpening of these

expectations. The repeated pessimistic comments of the former Fed chairman Alan Greenspan has strengthened this view. (Greenspan has estimated the chances that the US economy would go into recession this year at one out of three.) Nevertheless, Ben Bernanke, the current president, has taken a more optimistic position and made some statements designed to calm down the market.

Other central banks have raised their official interest rates, including New Zealand, Denmark, Norway and Switzerland. At the end of the third week of March, the Bank of China raised its

Federal Reserve eases upturn bias.

SHORT-TERM INTEREST RATES IN NATIONAL MARKETS

Monthly averages as annual percentage

	Euro area			United States		Japan	United Kingdom		Switzerland
	ECB auctions (2)	Euribor (5) 3-month	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)
2006									
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	4.73	4.94	1.61
September	3.03	3.34	3.72	5.25	5.38	0.44	4.75	5.03	1.74
October	3.23	3.50	3.80	5.25	5.37	0.44	4.75	5.13	1.85
November	3.31	3.60	3.86	5.25	5.37	0.48	4.93	5.23	1.90
December	3.50	3.68	3.92	5.25	5.36	0.53	5.00	5.29	2.02
2007									
January	3.56	3.75	4.06	5.25	5.36	0.55	5.16	5.49	2.15
February (*)	3.55	3.82	4.09	5.25	5.36	0.57	5.25	5.57	2.21
March (1)	3.82	3.91	4.15	5.25	5.35	0.68	5.25	5.58	2.29

NOTES: (*) Provisional figures.

(1) March 27.

(2) Marginal interest rate. Latest dates showing change in minimum rate: 2-3-06 (2,50%), 8-6-06 (2,75%), 3-8-06 (3,00%), 5-10-06 (3,25%), 7-12-06 (3,50%), 8-3-07 (3,75%).

(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: 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%), 9-11-06 (5,00%), 11-1-07 (5,25%).

(5) Interbank offer rate.

SOURCE: National central banks, Thomson Financial Datastream and own calculations.

Bank of China again raises reference rate on loans and deposits.

rate on 1-year loans and deposits by 27 basis points to 6.39% and 2.79% respectively in view of inflationary pressures. The Bank of Brazil continued to ease monetary conditions with a further cut of 25 basis points in the second week of March putting the reference rate at 12.75%.

Yen in eye of the storm

In recent weeks, the yen has undergone major swings in foreign exchange markets as a result of carry trade operations. The yen went to 121.9 units to the dollar in mid-February, its lowest level since December 2002, under the effect of the wide interest rate differential working against it. Later on, it tended to recover to some extent because of the weakening of the dollar and publication of better than expected figures for economic growth in the fourth quarter of 2006. As of February 27, it moved into a stage of increasing volatility. That day the Japanese currency suddenly

appreciated by 2.1% against the dollar with the unwinding of speculative transactions involving interest rates as a hedge against sharp drops on the stock market.

In fact, carry trade operators had been borrowing yen (and Swiss francs) in large volumes due to the low interest rate while at the same time buying currencies with high interest rates, such as the US dollar, the pound sterling, the Australian dollar and the New Zealand dollar. In conditions of low volatility on the stock markets, the interest rate risk is broadly compensated by the substantial difference in interest rates and if the speculative transaction is big this may induce a depreciation of the currency with low interest rate, bringing a gain from the exchange rate as well.

There is always the risk of a sudden switch in foreign exchange markets which could result in major losses. On this occasion, the increased aversion to risk brought the unwinding of some

Increased aversion to risk brings about closing of positions against yen causing it to appreciate.

YEN DROPS AFTER MARKING UP HIGHEST LEVEL AGAINST DOLLAR SINCE DECEMBER

Yen to US dollar



NOTES: Figures go up to March 27.

SOURCE: Thomson Financial Datastream and own calculations.

EXCHANGE RATES OF MAIN CURRENCIES

February 2007

	Final session of month		Monthly figures				Exchange rate on March 27, 2007
	Exchange rate	% monthly change (2)	Average exchange rate	% change (2)			
				Monthly	Over December 2006	Annual	
Against US dollar							
Japanese yen	118.5	−1.9	120.4	0.0	2.6	2.2	117.8
Pound sterling (1)	1.963	−0.1	1.960	0.1	−0.1	12.1	1.966
Swiss franc	1.219	−2.0	1.239	−0.3	2.3	−5.1	1.212
Canadian dollar	1.170	−0.6	1.171	−0.4	1.5	1.9	1.157
Mexican peso	11.16	1.1	10.99	0.4	1.3	4.9	11.05
Nominal effective index (4)	107.0	−0.7	107.2	−0.3	0.5	−3.0	106.1
Against euro							
US dollar	1.321	2.0	1.307	0.5	−1.0	9.5	1.335
Japanese yen	156.5	−0.5	157.6	0.7	1.7	12.0	157.9
Swiss franc	1.614	−0.5	1.621	0.4	1.5	4.1	1.621
Pound sterling	0.674	1.6	0.668	0.6	−0.7	−2.2	0.679
Swedish krona	9.276	2.5	9.190	1.2	1.7	−1.6	9.318
Danish krone (3)	7.453	0.0	7.454	0.0	0.0	−0.1	7.450
Polish zloty	3.918	−0.2	3.894	0.4	2.1	2.6	3.871
Czech crown	28.30	0.5	28.23	1.5	1.7	−0.6	27.99
Hungarian forint	254.7	−1.0	253.3	−0.2	−0.2	0.7	247.6
Nominal effective index (5)	106.0	1.0	105.4	0.5	−0.1	4.2	106.5

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 $\pm 2.25\%$.

(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 24 main trading partners of the euro area. Base: 1-1999 = 100.

SOURCE: Thomson Financial Datastream and own calculations.

positions and the yen regained ground going close to the 115 level against the dollar in the second week of March. Nevertheless, the ample interest-rate differential again tempted operators so that the Japanese currency again weakened to some extent. In any case, the yen is still undervalued.

In recent weeks the dollar has tended to depreciate with growing expectations that the next move by the Federal Reserve will be downward as a result of doubts about the impact of the high-risk

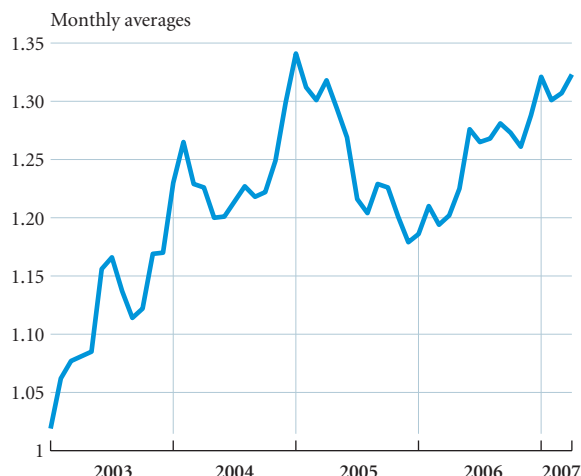
mortgage crisis on the US economic cycle. Nevertheless, in overall terms, in the last week of March the greenback stood at a level only slightly below that at the beginning of the year.

The euro in recent weeks has begun to take an upward course spurred on by the improved economic prospects of the euro area, especially in Germany. The European single currency went above the level of 1.33 dollars in the fourth week of March, marking up its highest level since March 2005.

Sharper downward expectations on US interest rates push down dollar.

EURO MARKS UP HIGHEST LEVEL AGAINST DOLLAR IN PAST TWO YEARS

US dollars to euro



NOTES: Figures go up to March 27.

SOURCE: Thomson Financial Datastream and own calculations.

Improved economic prospects in euro area benefiting euro.

Revaluation of Slovak crown within Exchange Rate Mechanism II (ERM II).

It should be noted that the end of the third week of March brought revaluation of the central parity of the Slovak crown in terms of the euro within the Exchange Rate Mechanism II (ERM II), a move which resulted in the appreciation of various Central European currencies. Slovakia may be able to meet the requirements for joining the euro as of 2009. One of the conditions is the absence of serious pressures on the currency within the ERM II over a period of two years. Other currencies participating in the ERM II are the Danish crown, the Estonian crown, the Cypriot pound, the Latvian lats, the Lithuanian litas and the Maltese lira.

Government bonds take on role of safe haven

Since the end of February, the yield on US Treasury bonds has tended to drop as a result of demand for these instruments by investors abandoning

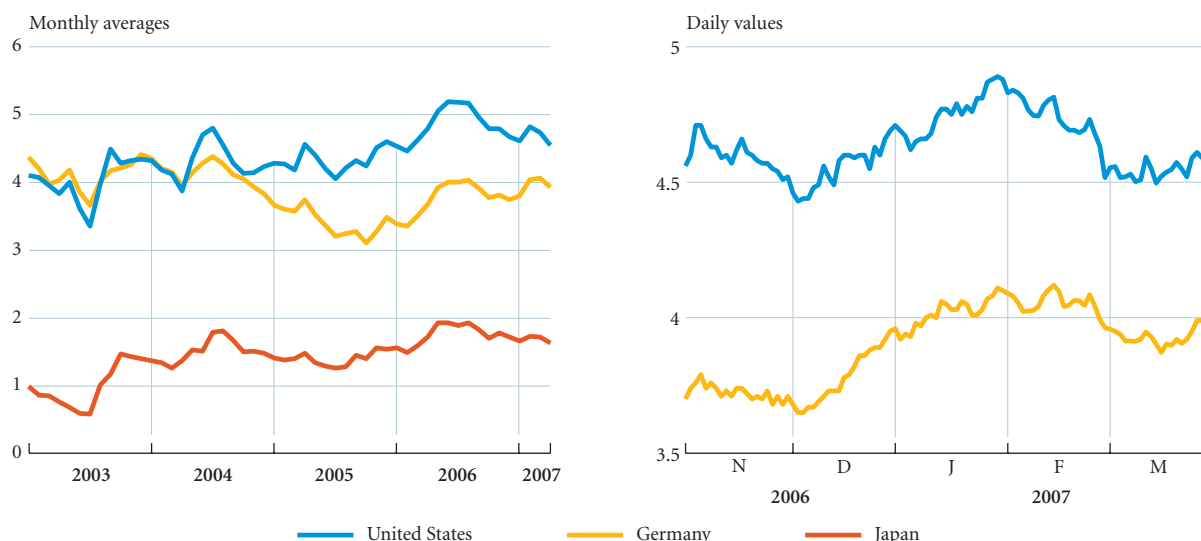
other markets, such as shares or junk bonds, with the increased aversion to risk. With the increase in demand for bonds the price has gone up with a subsequent drop in implicit interest rate (which bears an inverse relation to price). As a result, in mid-March the yield on US 10-year government bonds went down to its lowest level since December 2006. At the same time, the interest rate on German 10-year government bonds showed the lowest level since the end of 2006 in the third week of March. Once the storm has passed, however, it is likely that bond yields will again tend to move up.

In fact, risk aversion stands at historically very low levels. The risk premium on emerging country sovereign bonds, measured by the differential with the yield on US long-term Treasury bonds, marked up an all-time low on February 22 at 164 basis points. Later on, it rose as a result of a series of factors, such as the sharp drop on the Chinese stock market, political

Yield on US and German bonds at lowest levels since December 2006.

INTEREST RATES ON GOVERNMENT BONDS MOVING DOWN

Yield on 10-year government bonds as annual percentage



NOTES: Rates go up to March 27.

SOURCE: Bank of Spain and Thomson Financial Datastream.

tension over Iran's nuclear programme and uncertainty about the performance of the US economy. Over the broader spectrum, as may be seen from the accompanying graph, aversion to risk continues to be relatively low.

The risk premium on low credit rating bonds has also risen since the end of February. However, the risk premium on

these instruments also stands at moderate levels. One factor in favour of this containment of risk is the present low default rate. According to Moody's rating agency, the doubtful rate on global low credit rating bonds dropped to 1.6% in the past 12 months ending in February, a level not reported since May 1997. Nevertheless, it is most likely that default will soon begin to rise.

Default rate on global junk bonds down but upward trend likely.

LONG-TERM INTEREST RATES IN NATIONAL MARKETS

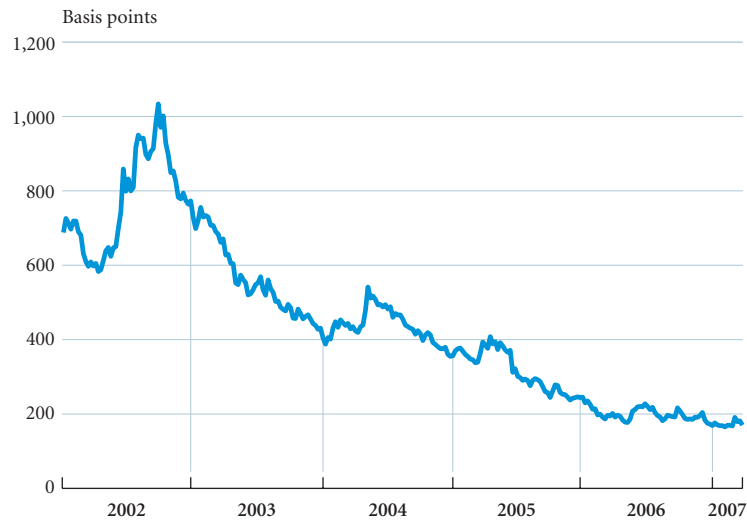
10-year government bonds: average for period as annual percentage

	2004	2005	2006				2007		
			1 Q	2 Q	3 Q	4 Q	January	February	March 27
United States	4.31	4.33	4.61	5.13	4.96	4.68	4.81	4.79	4.61
Japan	1.50	1.39	1.58	1.90	1.80	1.70	1.71	1.71	1.64
Germany	4.07	3.38	3.50	3.96	3.89	3.77	4.03	4.05	4.02
France	4.10	3.41	3.51	3.99	3.90	3.78	4.06	4.10	4.07
Italy	4.24	3.56	3.71	4.27	4.18	4.03	4.24	4.27	4.22
Spain	4.10	3.39	3.49	3.97	3.89	3.79	4.07	4.11	4.08
United Kingdom	4.93	4.47	4.23	4.65	4.67	4.65	4.93	4.98	4.93
Switzerland	2.57	2.04	2.18	2.67	2.61	2.38	2.55	2.57	2.63

SOURCE: Bank of Spain, Thomson Financial Datastream and own calculations.

RISK PREMIUM FOR EMERGING COUNTRIES REMAINS LOW

Differential in sovereign bonds of emerging countries compared with US Treasury bonds measured by JP Morgan EMBI+ index



NOTES: Figures go up to March 23.

SOURCE: JP Morgan and Thomson Financial Datastream.

Stock markets move into turbulent period at end of February following sharp drop in Chinese market...

Excessive optimism of markets corrected

World stock markets marked up new all-time highs at the beginning of the last week of February. Abundant global money supply and the good state of the world economy was pushing up indices. However, as of February 27, a series of factors threw world stock markets into a period of instability that caused a revaluation of risks that had gone down to very low levels.

As of the end of February, the VIX volatility index for the Chicago CBOE derivatives market based on Standard & Poor's 500 showed it had gone into a stage of higher risk, although not comparable with that existing following the high-tech bubble at the beginning of the decade.

...but international indices gradually recovering par for year.

With the increased aversion to risk following the sharp drop of nearly 9% on the Shanghai market on February 27

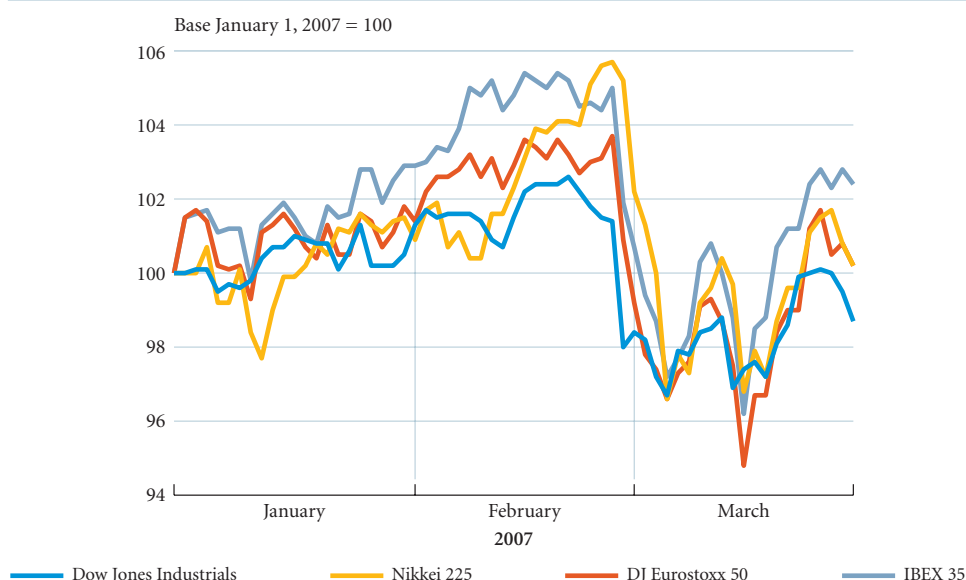
in an environment of rumours of government measures to cool down the stock market fever and concern about the high-risk mortgage crisis in the United States, world stock markets underwent a sharp correction after the preceding upward course in certain cases had led to some overvaluation. As a matter of fact, the outlook for corporate profits is favourable, but will slow down somewhat.

After a few anxious days that put most stock market indices onto the red side for the year, thanks to the publication of favourable macroeconomic indicators for the main economies and various corporate moves, calm of some sort was gradually restored. As a result, many markets came back onto positive ground in mid-March.

The IBEX 35 index for the Spanish stock market recovered par for the year in the third week of March. On the other hand, we should mention that the big listed

STOCK MARKET CORRECTION AT END OF FEBRUARY

Stock exchange indices



SOURCE: Thomson Financial Datastream and own calculations.

INDICES OF MAIN WORLD STOCK EXCHANGES

February 28, 2007

	Index (*)	% monthly change	% cumulative change	% annual change	Quotation on March 27, 2007	
					% cumulative change	% change over same date in 2004
New York						
Dow Jones	12,268.6	-2.8	-1.6	11.6	-0.5	21.4
Standard & Poor's	1,406.8	-2.2	-0.8	9.9	0.7	28.9
Nasdaq	2,416.2	-1.9	0.0	5.9	0.9	24.4
Tokyo	17,604.1	1.3	2.2	8.6	0.8	47.5
London	6,171.5	-0.5	-0.8	6.6	1.2	44.4
Euro area	4,087.1	-2.2	-0.8	8.3	0.8	50.3
Frankfurt	6,715.4	-1.1	1.8	15.9	4.0	79.4
Paris	5,516.3	-1.6	-0.5	10.3	0.8	55.5
Amsterdam	490.2	-1.9	-1.0	6.9	2.6	51.6
Milan	31,868.0	-1.9	-0.1	10.7	0.8	59.9
Madrid	14,248.4	-2.1	0.7	21.4	2.8	82.8
Zurich	8,789.7	-3.8	0.0	11.4	2.1	60.5
Hong Kong	19,651.5	-2.3	-1.6	23.5	-1.3	57.9
Buenos Aires	2,067.6	-0.1	-1.1	20.6	-1.4	70.1
São Paulo	43,892.0	-1.7	-1.3	13.7	1.6	109.9

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: Thomson Financial Datastream and own calculations.

Emerging stock markets with biggest previous rise meted out sharpest punishment.

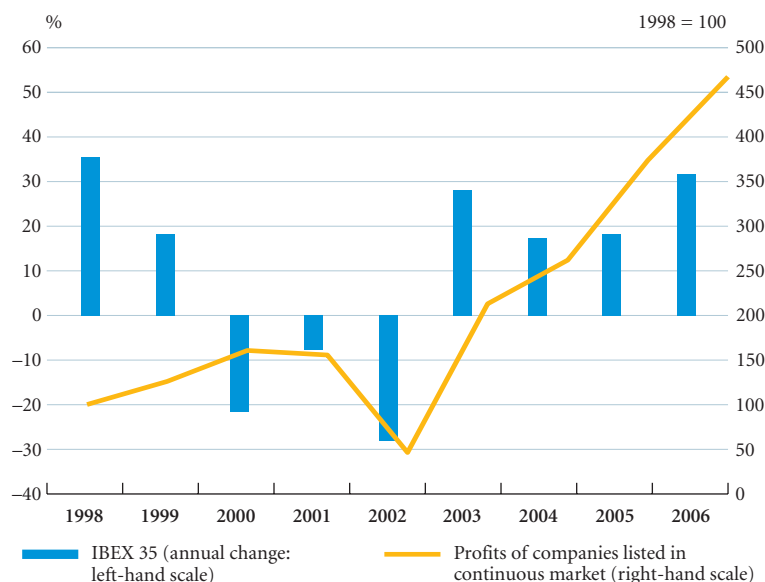
companies included in the IBEX 35 index obtained record net profits of close to 43 billion euros in 2006, an increase of 31% compared with the year before. This result represents a decrease compared with the annual rise of 44% recorded in 2005 and is comparable with the increase of 31.8% recorded by the selective Spanish index in 2006. The major increase in profits of the largest Spanish companies reflects the good state of the economy and the contribution of extraordinary profits. Other companies listed in the continuous market also

increased their profits in 2006 but to a much lesser degree.

With the increased aversion to risk, instruments that had previously risen and showed a higher risk profile were given the harshest punishment. In recent weeks, emerging country stock exchanges dropped more sharply and generally took longer to climb above the level at which they had begun 2007. Nevertheless, by the fourth week of March the Shanghai stock market had again marked up an all-time high.

PROFITS OF SPANISH LISTED COMPANIES SHOW SHARP GROWTH IN 2006

Quotations and profits of listed companies



SOURCE: Sociedad de Bolsas and own calculations.

SPAIN: OVERALL ANALYSIS

Economic activity

Spain's economy remains buoyant

From information available at this moment, we may deduce that the growth rate of economic activity at the beginning of 2007 is very similar to that noted during the final stages of 2006.

Both private consumption and investment are maintaining considerable strength and it is expected that the foreign sector will confirm the improvement shown in recent months.

Industry has fully consolidated its recovery, if we go by the trend in the industrial production index. Adjusted for calendar differences, this index grew by 5.1% year-to-year in January while showing a clearly upward background trend. During that month, nearly all

branches of industry were clearly expansionist, especially in motor vehicles and other transportation equipment, machinery, electrical equipment, furniture and medical equipment, with increases of 10%. The textile sector (apart from clothing), with a drop of 1.4% year-to-year and manufacture of data-processing equipment (with a drop of 7.6%) were the only exceptions, although in both cases the decreases were more modest than a few months ago.

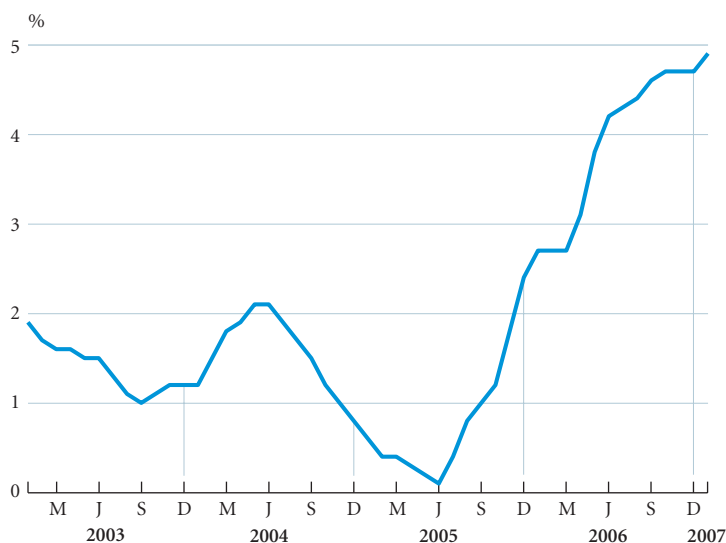
Construction is also maintaining a high rate of economic activity, as shown by cement consumption which was up 13.4% year-to-year in January. Looking into the future, the trend in some early indicators opens up fairly favourable

Spain's economy keeps up strong drive.

Recovery of industrial sector consolidating.

GROWTH OF INDUSTRIAL PRODUCTION ON RISE

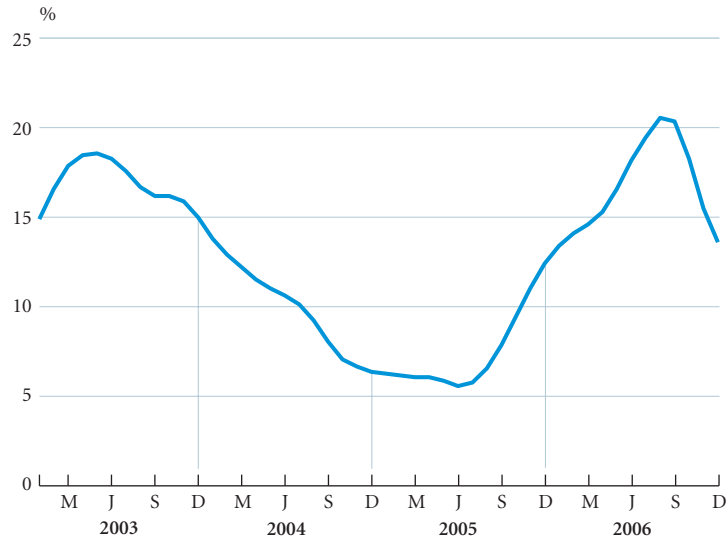
Year-to-year change in industrial production index



NOTES: Cycle-trend series adjusted for calendar differences.
SOURCE: INE and own calculations.

GROWTH OF TOTAL HOUSING UNITS GIVEN GREEN LIGHT EASING OFF

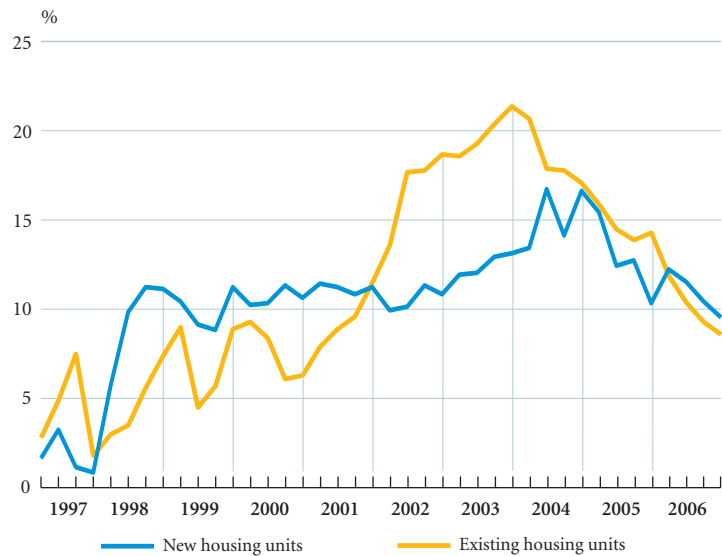
Year-to-year change in number of new housing units given green light



NOTES: Cycle-trend series.
SOURCE: INE and own calculations.

SIGNIFICANT SLOWDOWN IN HOUSING PRICE INCREASES

Year-to-year change in price per M² for non-subsidized housing



NOTES: Since the first quarter of 2005, new housing refers to that less than two years old while existing housing refers to that more than two years old. Previously, the difference was one year.
SOURCE: Ministry of Housing and own calculations.

Construction still showing strong drive.

prospects for public works (the amount of government tendering was up 54.6%

year-to-year in the fourth quarter of 2006 and 31.2% for the year as a whole).

On the other hand, it is expected that housing construction will significantly moderate growth, keeping in mind the slowdown in the growth rate of go-aheads for new construction and signs of some loss of drive coming from the real estate market, such as the easing up of growth in prices and the stagnation in the total number of transactions, mainly in existing housing.

With regard to services, the growth rate continues to be relatively sustained, according to the trend in the main indicators and indices of sales volume for the sector. With regard to tourism, 2006 ended with a fairly satisfactory result. Some 58.5 million foreign tourists visited Spain (4.5% more than in 2005) and spent nearly 48.3 million euros (4.8% more), according to the survey on tourist spending drawn up by the Institute of Tourist Studies (IET). These figures again put Spain in second world place both for number of tourists and monetary inflows.

We should point out, however, that the calculation of monetary inflows from tourism carried out by the Bank of Spain in the balance of payments shows much less brilliant results. According to that source, the growth of monetary inflows in 2006 was practically nil. The discrepancy arises from the different methodologies used. Among these differences, the Bank of Spain figures do not include costs of transportation provided by foreign companies that do not come back to Spain which do, in fact, show up in the IET survey.

In 2006, nearly 90% of foreign tourists chose the six following autonomous communities as their main destination: Catalonia, Balearic Islands, Canary Islands, Andalusia, Valencian Community and Madrid Community. The first three accounted for nearly 60%

of total spending by foreign tourists. The United Kingdom was Spain's main source market, with a share of close to 28%. Following in order of importance were Germany, France, Italy and the Netherlands. These five countries accounted for 71% of tourist entries.

On the demand side, we should point out the good state of consumption, according to the trend shown by the most representative indicators. The production index for consumer goods grew by 4.9% year-to-year in January (adjusted for calendar differences), a bigger increase than that recorded in the fourth quarter of the year before. Along the same lines, the availabilities index for consumer goods prepared by the Ministry of Economy showed a growth profile up to the end of 2006.

Another figure illustrating the strength of consumption at the beginning of the current year comes from the retail sales index. In real terms (discounting inflation), this was up 5.0% year-to-year in January. These figures are in contrast to the containment shown in the European Union survey of consumer confidence sentiment which at the beginning of 2007 was holding at negative levels, similar to preceding months.

Standing apart from the general picture, consumption of certain durable goods is showing some wearing out of its growth margin. This is the case in car sales (passenger cars and four-wheel-drive vehicles) which in January and February were down 1% on average compared with the same period the year before, mainly due to the drop in demand from car-rental companies. On the other hand, acquisitions by companies and individuals showed only a slight drop.

With regard to demand for capital goods, we should mention the expansionist

Prospects for public works somewhat favourable but some easing off in housing construction expected.

Services maintaining sustained growth.

Tourism obtains fairly satisfactory results in 2006.

Consumption holds quite firm...

SUPPLY INDICATORS

Percentage change over same period year before

	2005	2006	2006				2007	
			1Q	2Q	3Q	4Q	January	February
Industry								
Electricity consumption (1)	3.4	3.5	2.0	3.1	5.8	3.5	6.6	4.9
Industrial production index (2)	0.7	3.9	2.6	4.0	4.2	4.6	5.1	...
Confidence indicator for industry (3)	-4.8	-2.7	-5.3	-2.7	-2.3	-0.3	3.0	1.0
Utilization of production capacity (4)	80.2	80.5	79.7	80.5	80.3	81.6	—	80.6
Imports of non-energy intermediate goods (5)	1.6	10.5	10.3	6.4	13.8	12.1	21.6	...
Construction								
Cement consumption	7.3	8.2	17.1	4.0	4.5	8.4	13.4	...
Confidence indicator for construction (3)	22.4	14.2	15.3	11.7	14.7	15.0	10.0	11.0
Housing (new construction approvals)	6.2	18.4	18.5	6.3	50.5	0.2	...	...
Government tendering	18.5	31.2	15.1	34.8	19.2	54.6	....	...
Services								
Retail sales	4.4	5.0	5.2	3.8	5.9	5.2	6.6	...
Foreign tourists	6.6	4.5	1.1	9.6	3.7	2.5	4.0	4.5
Tourist revenue inflows	5.8	0.7	-7.6	3.0	3.9	-0.3	...	...
Goods carried by rail (km-tonnes)	-3.2	-1.2	8.1	-2.7	-3.3	-6.4	1.6	...
Air passenger traffic	9.2	6.7	5.2	10.1	4.5	7.1	6.7	9.1
Motor vehicle diesel fuel consumption	5.1	5.4	8.7	4.5	3.9	4.9	...	...

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 own calculations.

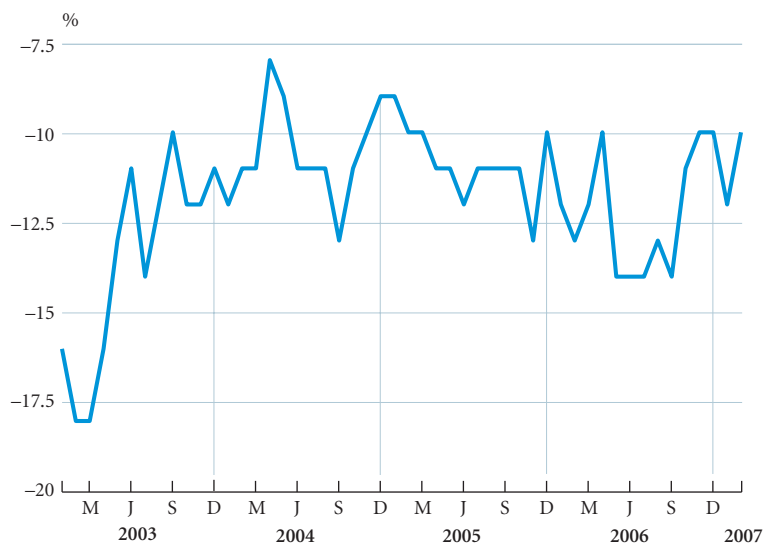
...but consumer confidence not responding.

nature of most indicators. Among others, the industrial production index for goods of that nature was up by 12.6% year-to-year in January, above the average for previous months and in the

same period domestic sales of equipment and software in large stores rose by 8.6%. The increase in commercial vehicle registrations in the January-February period stood at 8.1% year-to-year.

CONSUMER CONFIDENCE REMAINS STUCK AT NEGATIVE LEVELS

Difference between positive and negatives responses, as percentage



SOURCE: European Commission.

DEMAND INDICATORS

Percentage change over same period year before

	2005	2006	2006				2007	
			1 Q	2 Q	3 Q	4 Q	January	February
Consumption								
Production of consumer goods (*)	0.9	2.3	0.5	2.2	1.9	4.3	4.9	...
Imports of consumer goods (**)	7.9	8.9	20.5	5.9	2.4	7.6	7.9	...
Car registrations	2.1	-3.2	2.7	-3.6	-4.1	-8.1	2.7	-4.4
Credit for consumer durables	15.0	15.4	17.6	15.6	13.2	...	-	...
Consumer confidence index (***)	-10.8	-12.3	-12.3	-12.7	-13.7	-10.3	-12.0	-10.0
Investment								
Capital goods production (*)	-0.1	8.4	6.7	7.6	7.9	11.1	12.6	...
Imports of capital goods (**)	20.4	3.2	10.0	-5.0	6.5	3.4	32.2	...
Commercial vehicle registrations	13.2	1.5	7.4	-0.2	0.5	-1.0	20.3	-6.2
Foreign trade (**)								
Non-energy imports	6.0	9.0	13.7	4.7	8.9	9.3	11.7	...
Exports	0.2	5.6	12.7	3.7	1.7	4.7	6.0	...

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 own calculations.

Education of parents: a lasting benefit

There is a broad consensus about the beneficial effects of a higher level of education both for the individual and for the population in general. A number of empirical studies have tried to quantify the individual (or private) return on investing in education, calculating what an extra year of schooling contributes to individual income. A review of these studies suggests that each additional year of education tends to increase wages between 5% and 15%. However, these estimates do not take into account the benefits that investment in education may generate in general terms beyond the strictly private sphere.

Some examples of additional benefits, or positive external effects, brought about by education are a reduction in crime, improved health of the population, the increase in child well-being and the inter-generational pass-through of human capital. These are some examples of the positive consequences of education that affect not only the person acquiring a higher level of education but also the family or social environment.

Identifying all the external effects is not easy and it is even more complicated to quantify them. Some recent studies have tried to calculate the social return of investment in education including the aggregate level of education in calculating private returns. If an individual, under the same conditions, is earning more when the educational level of his/her neighbours is higher, this suggests the existence of additional positive benefits. In general, these empirical studies show that an increase of one percent in the proportion of graduates increases private returns by 1-2%. Nevertheless, these studies do not take into account the positive external effects which may come from the inter-generational pass-through of human capital so that they probably undervalue the social return from investing in education.

This inter-generational pass-through means that the education of the parents generates a lasting positive external effect in the children. In fact, the empirical evidence indicates a positive correlation between the time, and especially the quality of that time, that parents devote to their children and their intellectual development. If, under similar conditions, parents with higher educational levels devote more time to looking after their children than those with little education, the investment in education will have lasting positive effects as it will show up in the human capital of the next generation.

Statistical analysis of a Spanish Use of Time Survey confirms that the amount of time parents spend with their children increases with their educational level. The accompanying table shows the average number of minutes a day a father or mother devotes to primary care of each child under 17, according to their level of education and labour force status. «Primary care» is the time an individual considers that his/her main activity is looking after the children. The table distinguishes between two types of primary care, basic care (feeding, dressing, etc.) and quality care (telling stories, helping with homework, etc.). A father or mother is classified as having a «high» education if their maximum level of studies is university degree while all other levels are classified as «low».

We note from the table that mothers with «low» education who work devote nearly half the quality primary time to their children than better-educated working mothers. Among non-working mothers, those of «low» education spend approximately three-fifths of the time than do mothers of «high» education. In the case of males, the ratios are fairly similar, although the difference by educational level is higher in the case of non-working fathers.

TIME DEVOTED TO CHILDCARE

Time per child under 17 years old in minutes per day

Time	Educational level of fathers		Educational level of mothers	
	Low	High	Low	High
Working				
Basic	13.29	25.02	37.93	59.63
Quality	8.90	12.48	8.30	16.97
Total	22.18	37.5	46.23	76.60
Non-working				
Basic	14.78	38.53	51.53	75.18
Quality	9.16	20.98	11.04	21.00
Total	23.96	59.61	62.57	96.18

SOURCE: Own calculations based on the Spanish Use of Time Survey, INE (2002).

It should be noted that these figures may be overstating the association between the education of fathers and the time devoted to their children if, for example, those individuals with a «high» educational level enjoy higher income or have more domestic help. This would mean that the fact they devote more time to their children is not entirely due to a better education but also to the fact they have higher income or more domestic help which relieves more time for childcare. An econometric analysis of the figures, that takes into account these overall circumstances, confirms the positive association between the educational level of the fathers/ mothers and the time spent on primary care of their children. The results also reveal that a father whose spouse is better educated tends to spend more time with the children.⁽¹⁾

The evidence thus corroborates that there exists a positive association between the educational level of the parents and the time they devote to the primary care of their children. Given that more time spent with the children, especially quality time, implies better cognitive development of the child, investment in education has clearly positive external effects over the long term. While such lasting effects are difficult to quantify, we should not leave them out of a discussion of the calculation of the social returns of investment in education. Failing to take these positive external effects into account could lead to the erroneous conclusion that investment in education is less beneficial than it is in fact.

(1) Additional details on estimates of the econometric model are available in Gutiérrez-Domènech, M. (2007), «Parental employment and time with children in Spain», "la Caixa" Working Papers No. 01/2007.

Labour market

Employment continues to grow at strong rate...

...thanks to drive in construction and services and full recovery of industry.

Positive trend in employment

Employment is maintaining great strength, according to the trend in main indicators. For example, the total number of persons registered with Social Security was up 3.5% year-to-year in February, the same as in January and two decimals more than in the final quarter of 2006.

By economic sector, construction and services continue to hold the trophy although we should also mention the performance in industry which is consolidating its recovery. In the past twelve months, manufacturing industry

has brought in close to 72,000 more Social Security registrations, which represents an increase of 3.2%. Construction is also keeping up a strong drive with close to 101,000 new registrations in the period mentioned, 5.5% more than in February 2006.

In services, the most dynamic branches are those related to education, health and social services, with increases of more than 14% in the 12 months under consideration. Also notable were the hotel and restaurant trade, transport, warehousing and communications, real estate activities and company services, with increases of close to 6%.

EMPLOYMENT INDICATORS

Percentage change over same period year before

	2005	2006	2006				2007	
			1 Q	2 Q	3 Q	4 Q	January	February
Persons registered with Social Security								
Wage-earners	4.8	4.7	6.3	5.3	3.9	3.5	3.7	3.7
<i>Industry</i>	−0.5	0.0	−0.3	0.0	0.0	0.2	1.3	...
<i>Construction</i>	8.6	8.7	11.0	9.5	7.5	6.8	6.5	...
<i>Services</i>	5.7	5.2	6.6	5.8	4.6	4.0	4.0	...
Non-wage-earners	2.6	2.2	2.3	2.2	2.1	2.2	2.3	2.5
Total	4.4	4.3	5.5	4.8	3.6	3.3	3.5	3.5
Persons employed (*)	5.6	4.1	4.9	4.2	3.7	3.6	–	–
Jobs (**)	3.1	3.1	3.2	3.1	3.0	3.0	–	–
Hiring contracts registered (***)								
Permanent	8.7	41.1	25.6	16.1	46.6	76.8	59.9	9.5
Temporary	4.6	4.7	13.7	5.5	0.5	0.5	6.5	2.2
Total	5.0	7.9	15.0	6.4	4.1	7.3	12.3	3.0

NOTES: (*) Estimate from Labour Force Survey (changes for 2005 adjusted for impact of methodological changes).

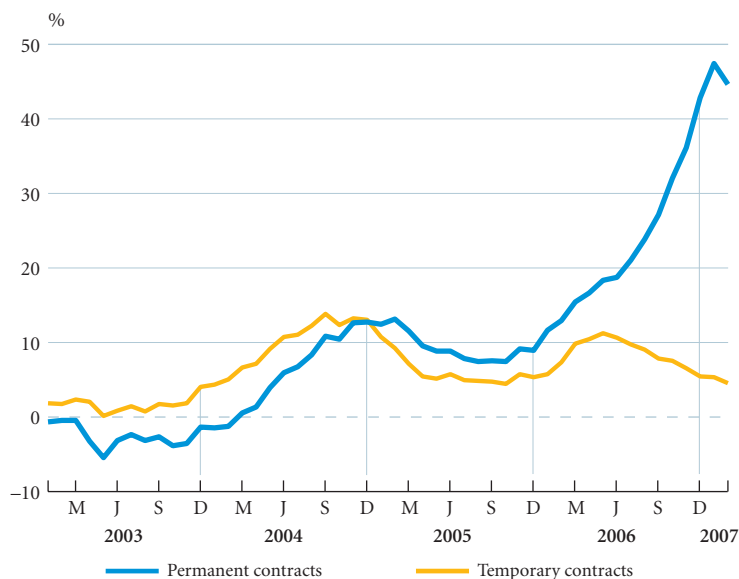
(**) Equivalent to full-time work. National Accounting estimate; figures adjusted for seasonal effects and number of working days.

(***) At INEM.

SOURCE: National Institute of Statistics, Ministry of Labour and Social Services, Employment Institute and own calculations.

PERMANENT JOB CONTRACTS UP SHARPLY

Hiring contracts registered with INEM in past 12 months compared with same period year before



SOURCE: Employment Institute and own calculations.

By sex, the number of females registered with Social Security on February 28, 2007 amounted to 7.8 million (41% of the overall total), representing year-to-year growth of 4.7%, well above the figure for the male group (2.7%). By nationality, the registration rate for foreign workers rose slightly in February to 8.9% year-to-year, whereas the figure for Spanish nationals held stable at 2.9%. Nearly 70% of foreign workers registered (1.9 million at the end of February) were from countries outside the European Union, although in recent months foreign workers from the EU have been increasing sharply following inclusion of Bulgaria and Romania in the European Union.

According to figures from the Employment Institute, more than 431,000 permanent job contracts were signed in the January-February period, 34.7% above those signed in the same period in 2006, the highest figure

recorded in the entire statistical series. In addition, in those two months, temporary work contracts, which still make up the great majority, showed a drop in the rate of increase to 4.4%.

Registered unemployment continues to drop

Registered unemployment rose to 2,075,275 persons in February, 4.3% less than one year earlier, thus showing an increased rate of drop. The decrease was much sharper among the male group (6.8%) than for females (2.7%) and for young people (12.1%) compared with those over 25 year of age (3.1%). By sector, also from this point of view, we note a recovery in industry with a year-to-year decrease in registered unemployment of 7.4%, proportionally higher than that recorded in construction (4.4%) and all services (3.8%).

Sharp increase in permanent job contracts.

Downward trend in registered unemployment sharpens.

REGISTERED UNEMPLOYMENT BY SECTOR, SEX AND AGE

February 2007

	No. of unemployed	Change over December 2006		Change over same period year before		% share
		Absolute	%	Absolute	%	
By sector						
Agriculture	63,102	1,608	2.6	-4,804	-7.1	3.0
Industry	280,838	-1,310	-0.5	-22,315	-7.4	13.5
Construction	224,256	-12,515	-5.3	-10,250	-4.4	10.8
Services	1,279,232	54,363	4.4	-50,471	-3.8	61.6
First job	227,847	10,256	4.7	-6,162	-2.6	11.0
By sex						
Males	794,202	-10,072	-1.3	-58,299	-6.8	38.3
Females	1,281,073	62,474	5.1	-35,703	-2.7	61.7
By age						
Under 25 years	255,337	13,325	5.5	-35,027	-12.1	12.3
All other ages	1,819,938	39,077	2.2	-58,975	-3.1	87.7
TOTAL	2,075,275	52,402	2.6	-94,002	-4.3	100.0

SOURCE: INEM and own calculations.

Labour costs rise in 2006...

Rise in labour costs

Wage costs per person per month tended to increase in 2006, if we go by figures from the quarterly survey of labour costs prepared by the National Institute of Statistics. In the year as a whole, wage costs rose by 3.4%, close to 0.8 points more than in 2005. These figures agree with information from National Accounting, which shows very similar figures.

By sector, there were no great differences, although the increases reported in construction and services were somewhat higher. Other non-wage labour costs were up by 3.6% overall in 2006, the same as in the two previous years, so that total labour cost rose by 3.5%, the same as the average inflation rate that year.

The fact that growth of labour costs in Spain is much higher than that of most member states of the European Union should be considered as negative. In the past five years, the hourly labour cost has grown by 4.4% on annual average, as against 2.8% reported in the euro area and 3.2% in the European Union as a whole.

This situation, together with the fact that the increase in Spanish productivity is relatively lower, explains why labour costs in Spain are growing at a much higher rate than that seen in EU countries. This gap has tended to widen in recent years, as may be seen in the following graph, making the foreign competitiveness of the Spanish economy even worse.

...widening gap with euro area.

WAGE INDICATORS

Percentage change over same period year before

	2005	2006	2006				2007
			1 Q	2 Q	3 Q	4 Q	1 Q
Increase under general wage agreements (*)	3.2	3.2	3.1	3.2	3.2	3.2	2.8
Wage per job equivalent to full-time work (**)	2.6	3.4	3.4	3.4	3.6	3.9	...
Quarterly labour cost survey							
Wage costs							
Total	2.6	3.4	3.0	3.1	4.0	3.6	...
Industry	2.7	3.6	3.8	3.1	4.1	3.6	...
Construction	2.3	3.7	3.8	3.1	4.2	3.9	...
Services	2.9	3.7	3.0	3.4	4.3	4.0	...
Average wages per hour worked	3.2	4.2	0.0	7.1	4.4	5.0	...
Other labour costs	3.6	3.6	4.4	4.9	2.6	2.6	...
Work day (***)	-0.6	-0.6	3.0	-3.8	-0.3	-1.3	...
Farm wages	3.1	2.8	2.9	2.6	3.2	2.4	...
Labour cost in construction	4.3	4.4	4.2	4.5	4.5	4.5	...

NOTES: (*) Does not include wage revision clauses.

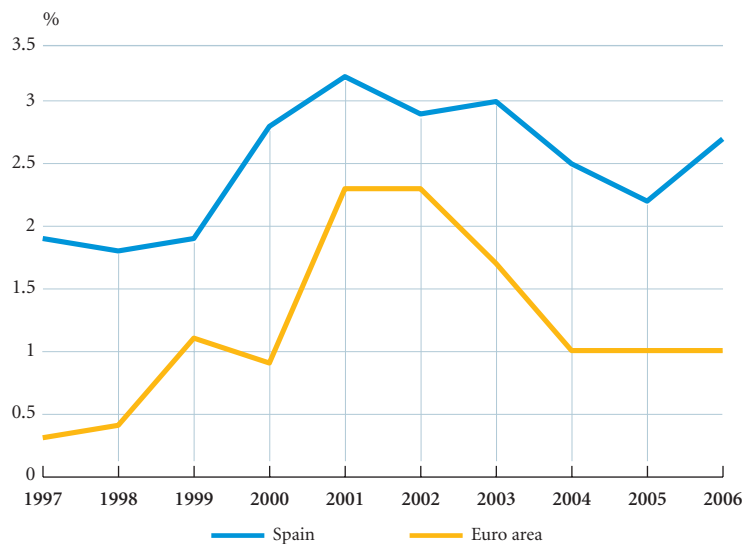
(**) Quarterly National Accounts: figures adjusted for seasonal and calendar differences.

(***) Effective hours worked per worker per month.

SOURCE: National Institute of Statistics, Ministry of Labour and Social Affairs, Ministry of Agriculture, Fishing and Food, Ministry of Public Works and own calculations.

SPAIN'S LABOUR COSTS SHOWING HIGHER GROWTH

Change in labour costs per gross domestic product unit



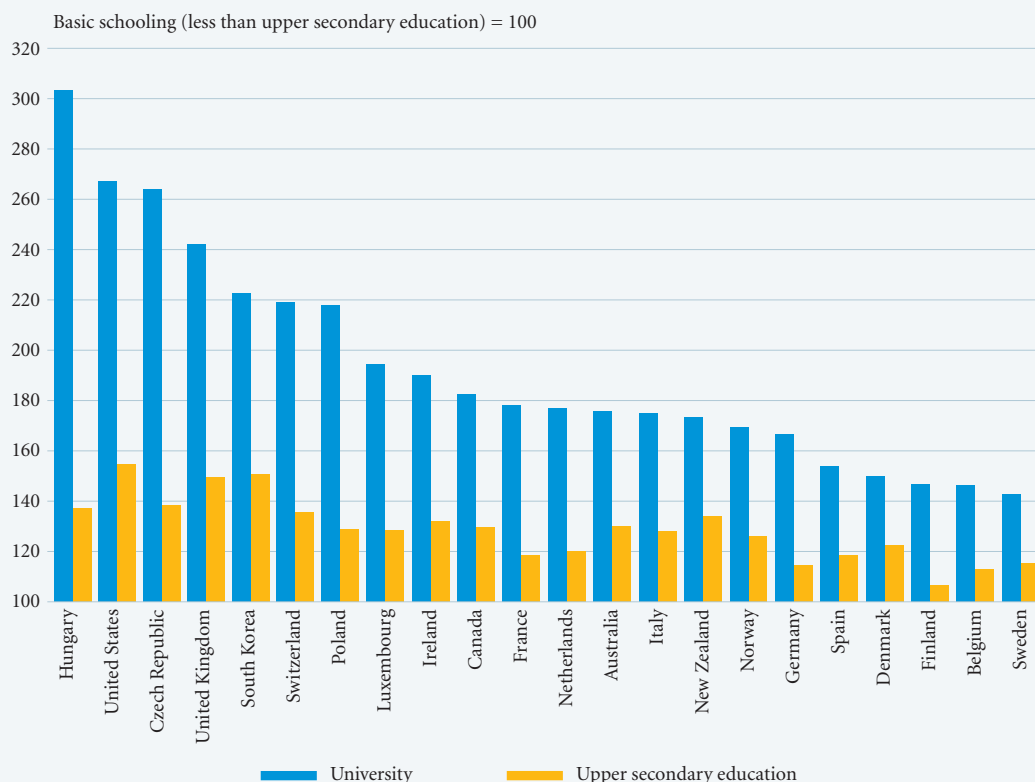
SOURCE: Eurostat, National Institute of Statistics and own calculations.

Knowledge is power... purchasing power?

It was the wish of Sir Francis Bacon, the seventeenth-century English philosopher, to live in order to study and not to study in order to live. Not everyone, however, shares his philosophy. For many people, the prospect of better pay is one of the key factors when it comes to deciding to keep on studying or otherwise. The available evidence supports this belief but recent figures indicate that economic incentives for higher education in Spain are no longer what they used to be.

THE MORE YOU STUDY, THE MORE YOU EARN

Average earnings by education level relative to earnings of those with basic schooling (*)



NOTES: (*) 2004 or latest figure available.

SOURCE: OECD *Education at a Glance* (2006) and own calculations.

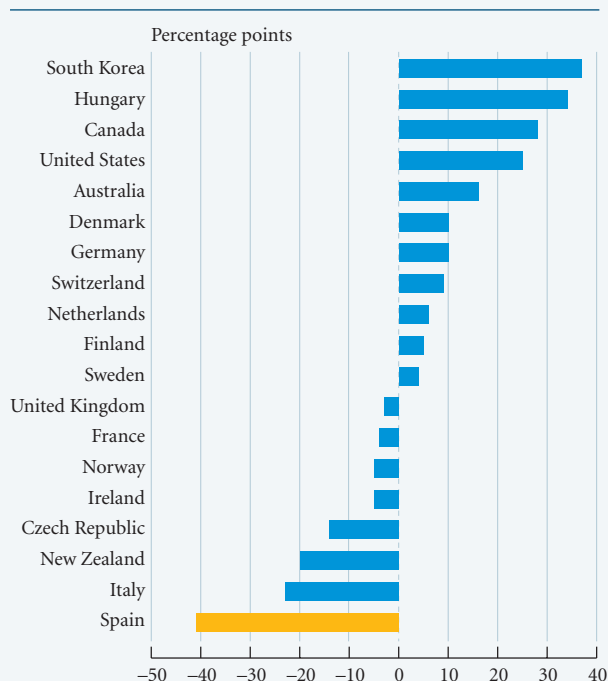
In 2002, reference year for the latest wage structure survey published in Spain, those who had not finished primary school earned an annual average of 12,903 euros whereas the average income of a person with a university degree was 32,997 euros, or 2.6 times more. Studying, therefore, does have its reward, and not only in Spain but in other countries as well, according to figures from the Organization for Economic Cooperation and Development (OECD). The graph above shows average earnings by education level, taking as reference a worker who did not finish secondary school. We note how the earnings differential with respect to the reference worker increases with the level of education. We also observe that the education premium varies across countries and that Spain stands in the low segment of the table.

A few years ago, Spain stood in the high segment of this classification but between 1997 and 2004 the earnings premium for university studies dropped notably. As illustrated by the following graph, not only did this premium drop in Spain while rising in other countries but in none of the countries in the sample did it drop as much as it did in Spain. Moreover, we observe that not only the incentive to get a university degree has gone down but the incentive to keep studying beyond lower secondary school has decreased as well. The question is: why, in countries like South Korea and the United States, is a university degree valued more today than a few years ago while the opposite holds true in Spain?

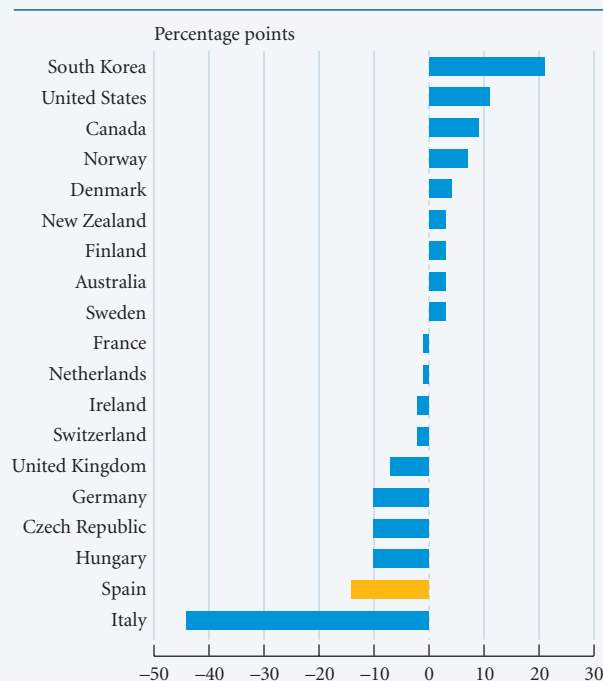
The earnings differential in favour of workers with higher educational levels can be interpreted as the value markets give to a university degree. As such, this differential is indicative of the relative scarcity of skilled workers' supply with respect to the market demand for that type of worker. Hence, there are, in principle, two obvious factors that may explain the decrease in relative wages of those workers with university studies in Spain, namely, an increase in the supply and a reduction in the relative demand of this type of worker. We should not forget that the labour market is characterized by certain rigidities and peculiarities that have an influence too on that market's equilibrium. For example, an increase in the minimum wage that affects the average wage of workers with lower studies could also contribute to reducing wage differentials. This reduction of the premium for university studies can be seen as more or less negative depending on which its main determinant is. In the best of cases, the relative wage reduction for more educated workers would have been

DECREASING INCENTIVES TO CONTINUE STUDIES BEYOND LOWER SECONDARY EDUCATION IN SPAIN (*)

Change in wage differential for university studies relative to average wage of workers with studies below upper level of secondary education



Change in wage differential for upper level of secondary education and non-university post-secondary studies relative to average wage of workers with studies below upper level of secondary education



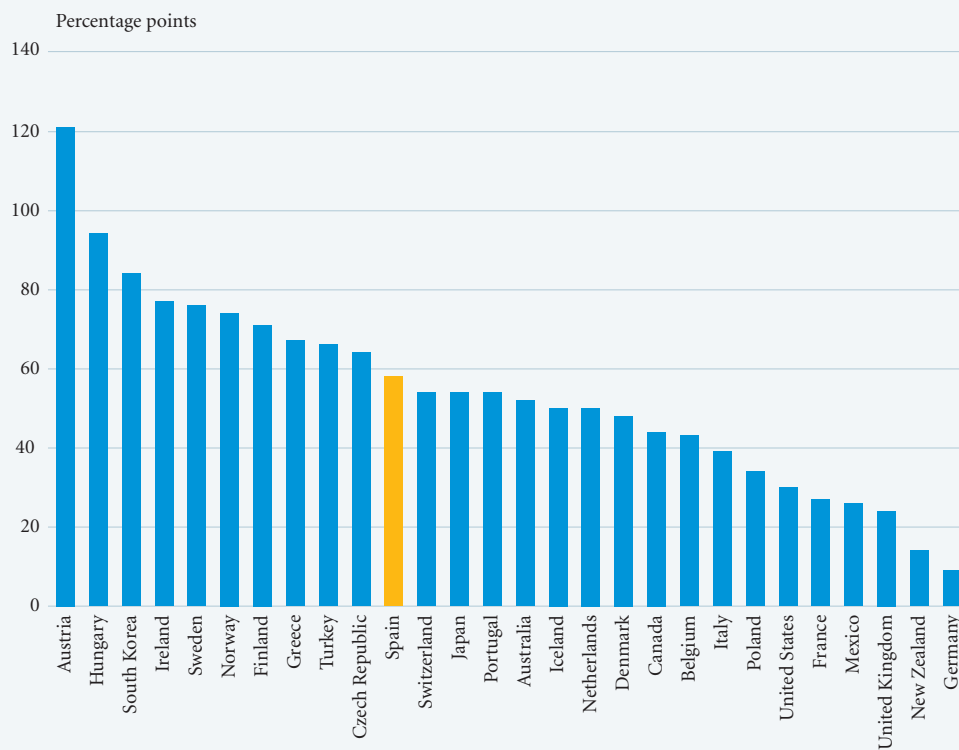
NOTES: (*) Figures for period 1997-2004 or closest interval.

SOURCE: OECD *Education at a Glance* (2006) and own calculations.

driven by a big increase, from relatively low levels, in the proportion of workers with higher qualifications. In the worst of cases, the relative wage would have dropped as a result of: a reduction in relative demand for those workers; the low quality of the education they received; or their employment in jobs for which they are over-qualified.

INCREASING SUPPLY OF WORKERS WITH A UNIVERSITY DEGREE

Change in the relative supply of persons with a university degrees relative to population with lower secondary education or less (*)



NOTES: (*) Period 1998-2004 or closest interval.

SOURCE: OECD *Education at a Glance* (2000) and (2006) and own calculations.

The supply of those with a university degree has indeed increased. In 1997, the proportion of Spain's population between 25 and 64 with university studies was 19%, one point below the OECD average, whereas in 2004 this proportion stood at 26%, one point above the OECD average. This increase in the relative supply of persons with a university degree in Spain could be part of the explanation of the lower earnings differential between those workers with a university degree and those with lower education. In any case, in countries such as United States, Hungary and South Korea, where the supply of workers with university studies rose even more than in Spain (as may be seen in the previous graph), the wage differential has not dropped but quite the opposite.

In contrast to supply, changes in demand are harder to calculate given that we do not directly observe who the companies would like to hire but who they hire, which is also determined by the available supply. Even so,

many studies show that in recent decades there has been an increase in relative demand for qualified workers which may explain the increase in the education premium observed in most countries. Experts attribute this increase in demand for qualified workers to a technological change biased in favour of this type of worker and to the competition and specialization brought about by globalization. The idea is simple enough. New technologies require technicians and workers with some training and this raises the demand for more educated workers. At the same time, globalization has contributed to a process in which the most advanced countries tend to specialize in the production of more sophisticated goods and this has increased relative demand for, and the wages of better educated workers. We must reach the conclusion that in Spain the increase in demand (if it ever occurred) has not been sufficient to compensate for the increase in supply, either because the application of new technologies has been limited or because we have specialized in sectors intensive in less-educated labour, such as construction and tourism.

Finally, we should raise the possibility that the quality of university education in Spain is worse than in other countries or that the specialization of those with university degrees in Spain is not what the market demands. Both these factors could also explain the lower retribution to education in the Spanish labour market.

In a nutshell, either because demand did not increase sufficiently to absorb the increase in supply or because the quality of education is not good enough, the end result is that education today pays off less than it did before. This is not positive because it works against investment in education, key to the future well-being of the country. It is a matter of urgency to bring incentives to education back to balance, otherwise, our young people will neither live to study nor study to live better.

Prices

CPI stands at lowest level since March 2004.

Fresh foods up but energy cools off index.

CPI stabilizes at 2.4%

In February, the year-to-year change in the consumer price index (CPI) held at the level recorded the month before (2.4 %), the lowest level since March 2004. This trend was the result of opposing movements in various components and was along the lines expected.

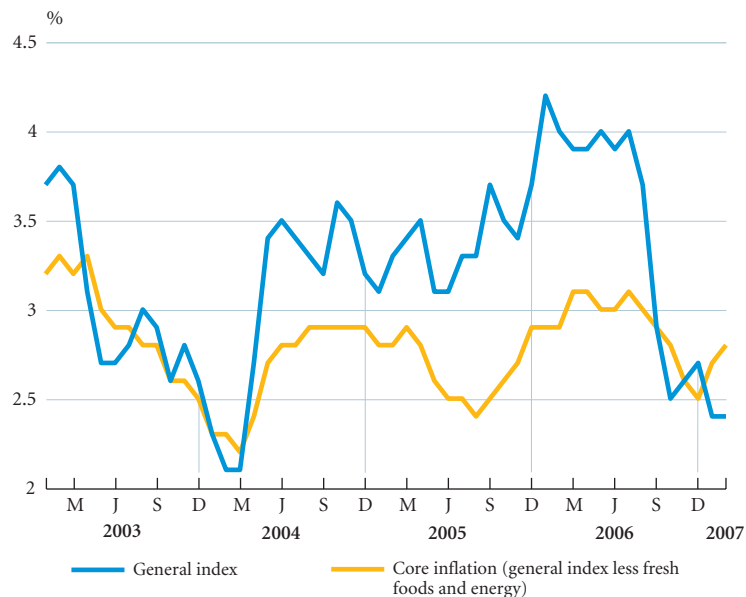
For another month, fuels and lubricants contributed to moderating the CPI with a year-to-year drop of 4.6%. On the other hand, fresh foods rose by 3.7% compared with February 2006. Potatoes continued their notable rise.

The most stable segment of inflation, core inflation, which excludes the most volatile elements of the CPI (energy products and unprocessed foods), showed a slight rise compared with the same month last year at 2.8%. This rate was one decimal above January but may be explained by the rise in tobacco prices which showed a year-to-year increase of 16.6%. The rise in core inflation from the 2.5% figure with which it ended 2006 shows the persistence of inflationary pressures.

Generally protected from foreign competition, services continue to show an annual change of 3.8%. On the

SLIGHT RISE IN CORE INFLATION

Year-to-year change in CPI



SOURCE: National Institute of Statistics.

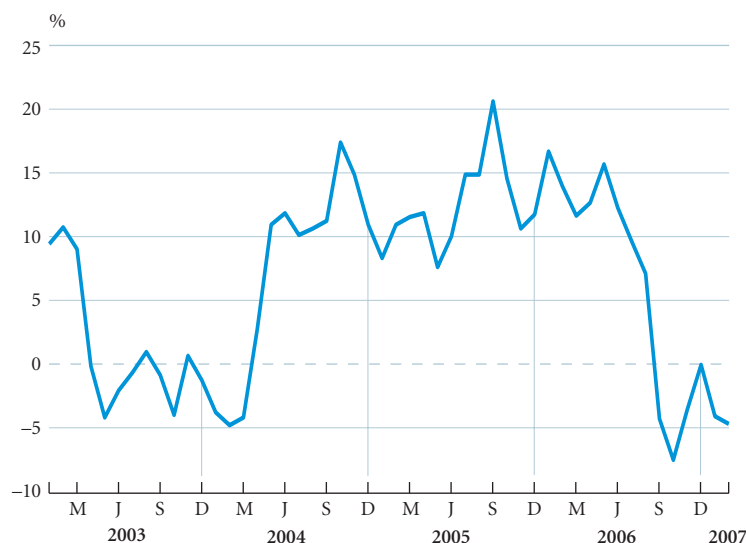
CONSUMER PRICE INDEX

	2006			2007		
	% monthly change	% change over December 2005	% annual change	% monthly change	% change over December 2006	% annual change
January	-0.4	-0.4	4.2	-0.7	-0.7	2.4
February	0.0	-0.4	4.0	0.1	-0.6	2.4
March	0.7	0.3	3.9			
April	1.4	1.8	3.9			
May	0.4	2.1	4.0			
June	0.2	2.3	3.9			
July	-0.6	1.7	4.0			
August	0.2	1.9	3.7			
September	-0.2	1.7	2.9			
October	0.4	2.1	2.5			
November	0.2	2.4	2.6			
December	0.3	2.7	2.7			

SOURCE: National Institute of Statistics.

DROP IN FUEL PRICES...

Year-to-year change in fuels and lubricants



SOURCE: National Institute of Statistics.

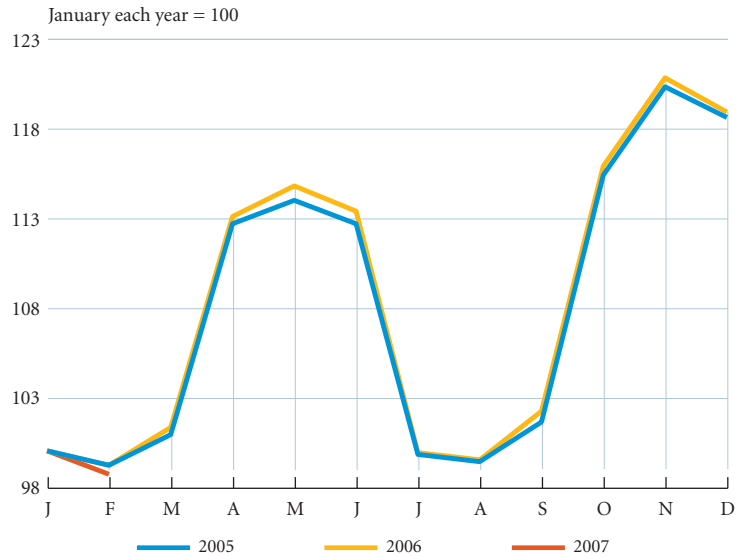
contrary, industrial goods excluding energy products moderated in February reducing the annual increase to 1.0% (1.2% in January). The small increase in these products was due to strong pressure

from international markets. Nevertheless, sharper cuts in women's outer-garment clothing prices in February (probably because of the balmy climate which likely decreased demand) also had an influence.

Rise in core inflation shows persistence of inflationary pressures.

...AND BIGGER CUTS IN FEBRUARY SALES...

Price of women's outer-garment clothing



SOURCE: National Institute of Statistics and own calculations.

Inflation prospects for coming months favourable if oil not a problem.

If oil prices do not bring any unpleasant surprises, inflation will tend to drop in coming months taking it close to 2%

toward mid-year. Nevertheless, what is most likely is that there will be a rise in the second half of the year because of the

...COUNTERACT RISE IN TOBACCO

Year-to-year change in tobacco



SOURCE: National Institute of Statistics.

CONSUMER PRICE INDEX BY COMPONENT GROUP

February

	Indices (*)	% monthly change		% change over previous December		% annual change	
		2006	2007	2006	2007	2006	2007
By type of spending							
Food and non-alcoholic beverages	101.4	−0.3	−0.2	0.7	0.0	4.3	2.5
Alcoholic beverages and tobacco	106.7	−2.9	0.2	−5.0	5.2	−0.5	12.4
Clothing and footwear	93.4	−0.9	−1.2	−12.5	−12.7	1.1	1.0
Housing	102.1	0.4	0.3	2.6	1.5	7.8	3.8
Furnishings and household equipment	101.1	0.3	0.0	−0.1	−0.2	2.4	2.6
Health	101.1	0.4	0.3	0.7	0.5	1.0	1.5
Transport	98.6	0.7	0.4	2.2	0.3	7.2	−0.1
Communications	99.3	−0.2	−0.3	0.1	0.2	−1.6	−1.4
Recreation and culture	98.8	0.3	0.4	−1.4	−1.4	0.2	−0.7
Education	103.5	0.1	0.1	0.2	0.4	3.9	4.6
Restaurants and hotels	102.6	0.6	0.6	1.1	1.4	4.5	4.6
Other goods and services	102.5	0.2	0.2	1.8	1.6	3.1	3.7
By group							
Processed food, beverages and tobacco	101.9	−0.1	0.4	0.2	1.5	3.4	3.5
Unprocessed food	102.0	−1.5	−1.3	−0.5	−1.2	4.5	3.7
Non-food products	100.0	0.3	0.1	−0.5	−1.0	4.1	2.0
Industrial goods	98.0	0.1	−0.2	−1.8	−2.9	4.3	0.3
Energy products	96.4	0.7	0.2	4.2	−0.2	13.3	−1.8
Fuels and oils	94.1	0.9	0.2	4.2	−1.1	16.6	−3.5
Industrial goods excluding energy products	98.5	−0.1	−0.3	−3.7	−3.8	1.5	1.0
Services	102.2	0.5	0.4	0.9	1.0	3.8	3.8
Underlying inflation (**)	100.9	0.1	0.2	−0.9	−0.6	2.9	2.8
GENERAL INDEX	100.5	0.0	0.1	−0.4	−0.6	4.0	2.4

NOTES: (*) Base 2001 = 100.

(**) General index excluding energy products and unprocessed food.

SOURCE: National Institute of Statistics.

effect of the drop in oil prices in the same months of last year.

The inflation rate for consumer prices in harmonized terms with the European Union stood at 2.5% in February, one decimal more than in the month before. As a result, the inflation differential with the euro area held at 0.6 points.

Producer prices and import prices moderating

Thanks particularly to the oil price levels lower than one year before that were recorded in the early months of this year, wholesale prices slowed down in the early stages of 2007. As a result, the annual change in producer prices in February stood at the same level as harmonized consumer prices, something that had not happened since April 2004.

Slight increase in inflation differential with euro area.

Annual inflation rate of producer prices stands at same level as harmonized consumer prices, something not seen since April 2004.

In fact, the general producer price index was up 2.5% in February compared with the same month the year before, 2 decimals less than in January, and marked up the lowest level since March 2004. This slowdown came about thanks to the 2.5% year-to-year drop in energy goods prices, 1.3 points less than in January and a slight annual drop in capital goods prices to 2.8%. On the other hand, consumer goods rose by 1.5% in the past 12 months ending in February, one decimal more than in the first month of the year. Intermediate goods rose to 6.6%

reflecting the rise in raw materials prices.

By industrial sector, February saw a notably sharp year-to-year rise in tobacco industry prices at 19.3%. Metallurgical prices also showed a high annual rise of 13.1%, mainly a result of the extraordinary increase in metal prices. This also brought about a 12.4% rise in prices in the machine building sector and in electrical material. On the other hand, coke production and oil refining reported a drop of 11.9% because of the drop in oil prices.

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											
December	2.1	5.2	3.2	2.0	3.2	15.6	7.1	0.9	10.2	8.9	—
2006											
January	4.0	6.3	3.5	2.1	3.6	20.6	5.6	−6.5	−5.1	15.2	—
February	0.8	6.3	3.6	2.1	3.9	20.1	6.6	2.5	3.2	9.2	3.9
March	−10.2	5.8	3.3	2.0	4.6	16.4	6.0	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	−1.5	−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	0.4	5.7	3.2	2.5	7.2	10.2	2.3	−0.6	−0.5	4.0	3.8
September	1.1	4.2	2.7	2.5	6.7	4.1	0.8	2.4	−5.0	1.0	—
October	2.3	3.4	2.3	2.4	6.9	0.5	1.7	0.1	−8.2	4.5	—
November	0.8	3.6	2.4	2.5	6.8	1.0	0.2	−5.4	−0.7	2.8	3.6
December	−5.8	3.6	2.0	2.6	6.8	2.3	1.2	−2.2	4.1	2.1	—
2007											
January	...	2.7	1.4	2.9	6.3	−1.2	0.8	8.6	0.8	−3.2	...
February	...	2.5	1.5	2.8	6.6	−2.5	...	...	...	...	...

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

SOURCE: National Institute of Statistics, Ministry of Economy and own calculations.

Foreign sector

Foreign imbalance worsens in 2006

The current account balance showed a cumulative deficit of 86.03 billion euros in 2006. This figure meant an annual increase of 29.1%. While this is a very high growth rate, it represents a drop compared with the last two years when it rose at rates of more than 50%. The foreign current account deficit continues to increase in terms of the gross domestic product (GDP). In 2006, it stood at 8.8% of GDP although this ratio is likely to reduce slightly as a result of the methodological revision in relation to tourist inflows. In any case, the current account deficit in terms of GDP stands among the highest of the developed countries, going above the figure for the United States.

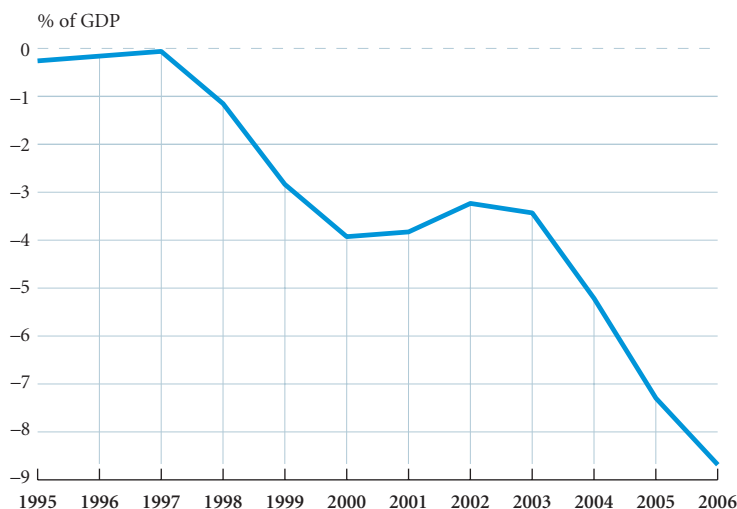
While the worsening of the current account deficit began at the end of the Nineties, in recent years it has grown substantially worse. This may partly be explained by the expansionist cycle of Spain's economy with growth higher than most developed countries but it also reveals problems of competitiveness.

This is most visible in the increase in the trade deficit to 8.3% of GDP. The deficit in the trade balance accounts for 94% of the current account deficit and lies behind 60% of the increase. The 16.8% increase in the trade deficit was brought about by the rise in exports lower than in imports in spite of the recovery in the former.

Foreign current account deficit goes up to 8.8% of GDP, among highest of developed countries.

CURRENT ACCOUNT DEFICIT CONTINUES TO GROW

Current account balance



SOURCE: Bank of Spain, National Institute of Statistics and own calculations.

BALANCE OF PAYMENTS

Cumulative figure for last 12 months in million euros

	December 2006	Annual change	
		Absolute	%
Current account balance			
Trade balance	-80,544	-11,575	16.8
Services			
<i>Tourism</i>	25,480	-890	-3.4
<i>Other services</i>	-5,365	-1,630	43.6
Total	20,115	-2,519	-11.1
Income	-20,429	-3,221	18.7
Transfers	-5,168	-2,084	67.6
Total	-86,026	-19,399	29.1
Capital account	6,158	-1,814	-22.8
Financial balance			
Direct investment	-47,847	-35,154	277.0
Portfolio investment	185,847	127,957	221.0
Other investment	-28,974	-45,589	-
Total	109,026	47,214	76.4
Errors and omissions	-3,343	-2,447	272.9
Change in assets of Bank of Spain	-25,815	-23,554	-

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 own calculations.

Bigger interest payments due to heavy borrowing adversely affect incomes balance.

After the trade balance, the biggest deficit among current accounts is in the incomes balance, which amounted to 20.43 billion euros. This figure meant a big annual increase of 18.7% although this was a drop compared with the year before. The worsening of this sub-heading contributed 17% of the current account total. The increased deficit in the incomes balance was largely due to higher interest payments as a result of the growth of borrowing abroad because of the prolonged period of negative domestic savings.

Tourist surplus continues to drop as result of increased payments for travel abroad.

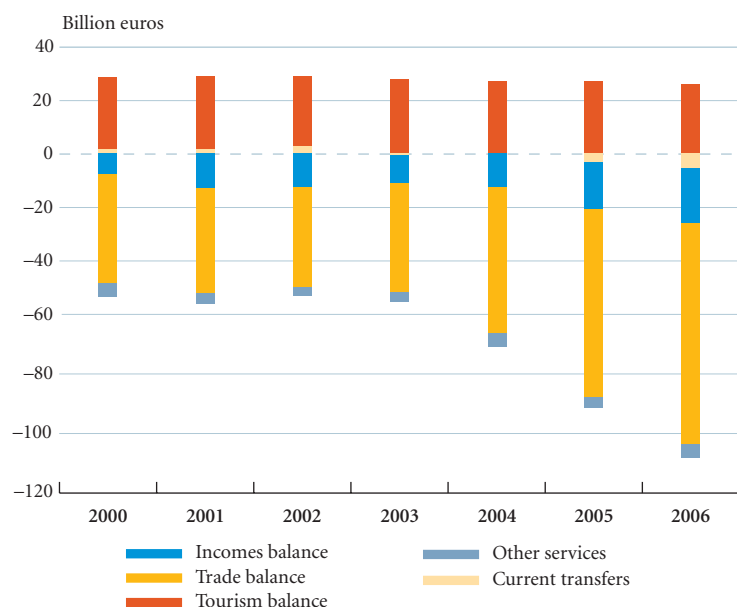
The deficit in the account for services apart from tourism (transport, company services, communications, construction, insurance, financial services, data-processing services, royalties, cultural

and recreational services, etc.) shows a major worsening (43.6%) due to a bigger increase in payments than in receipts. The tourism balance, with a surplus of 25.48 billion euros, counteracts the deficit in other current account sub-headings but the positive figure continues to drop. This trend has taken place in spite of the increase in the number of tourist entries seeing that payments for Spaniards travelling abroad have increased to a much greater extent. This is logical in view of the higher level of development. Gone are the days at the beginning of the Nineties when tourism fully compensated the trade deficit.

The transfers sub-heading showed a sharp increase in deficit with a rise of

ALL ACCOUNTS IN CURRENT ACCOUNT PAYMENTS BALANCE GROWING WORSE

Balances of various accounts in current account balance



SOURCE: Bank of Spain and own calculations.

67.6% to 5.17 billion euros. The drop in the transfers balance with the European Union in view of the increase in Spain's gross national income within the European Union and the growth of foreign remittances by immigrants to their countries of origin lay behind this result. This account showed a deficit for the third consecutive time whereas it had previously reported a surplus. The days when Spain was a net source of immigrants have long passed.

With net entries of 6.16 billion euros, capital account somewhat eased the current account deficit. Nevertheless, here again things got worse with a drop of 22.8% in the positive balance due to lower receipts for transfers from the European Union.

What are the future prospects for the current account balance? In the previous Monthly Report, we noted that

the trade deficit could likely continue to increase in 2007 due to the growth of domestic demand and possible lowering of foreign competitiveness. If, on top of this, we add the lower funds coming from the European Union and an increase in immigrant remittances, the most likely result is that the foreign imbalance will increase during the current year.

In any case, there seem to be no problems in financing this imbalance. In 2006, the total financial balance (109.03 billion euros) easily covered the current account deficit, thanks to net entries of portfolio investment of 185.85 billion euros, more than three times that in 2005. On the other hand, the net balance for direct investment continued to drop going to -47.85 billion euros. This was mainly a result of large investments abroad under expansion plans of Spanish companies. In any case,

Foreign current account deficit likely to continue increasing in 2007.

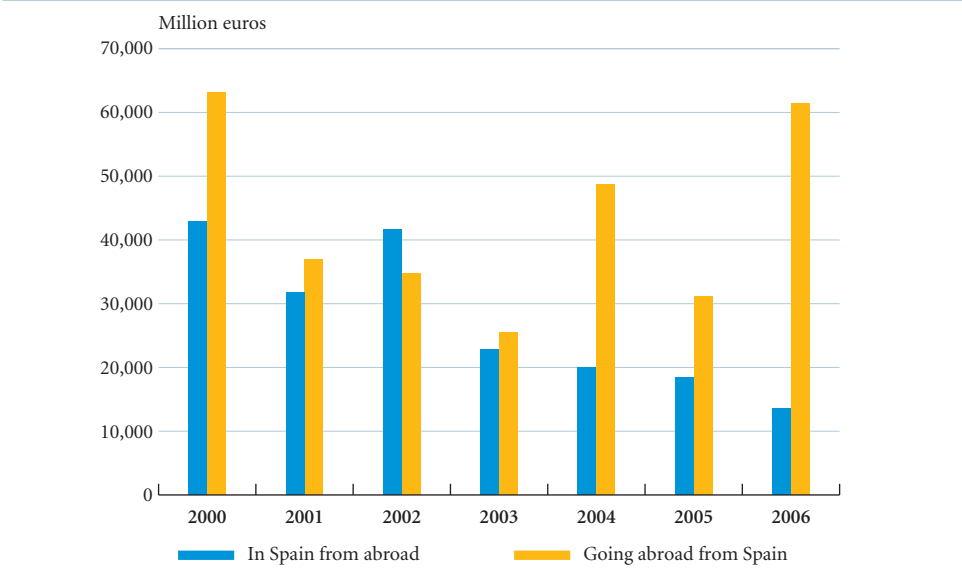
Foreign imbalance obtaining ample funding from portfolio investment.

foreign investment in Spain was down in line with the trend in recent

years. Real estate investment was also lower.

SPANISH DIRECT INVESTMENT ABROAD ON INCREASE

Direct foreign investment



SOURCE: Bank of Spain and own calculations.

Public Sector

Excellent results in government accounts in 2006

The favourable trend in Spain's economy in recent years is clearly reflected in government accounts. The year 2006 ended with a surplus of 17.9 billion euros, which represents 1.8% of gross domestic product (GDP), according to provisional figures supplied by the Ministry of Economy and Finance. This is twice the amount initially forecast, given that in the Stability Programme presented in Brussels one year ago, Spanish economic authorities forecast a surplus of «only» 0.9% of GDP. This difference largely arose because GDP growth in 2006 was 3.9% as against 3.3% forecast one year ago.

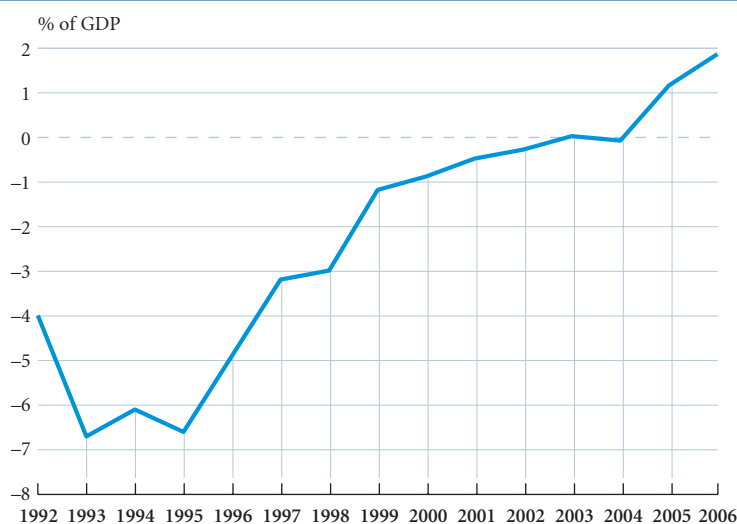
The surplus was even higher than that estimated in the latest up-date of the Stability Programme 2006-2009, which put GDP surplus at 1.4%. The 2006 results consolidate the improvement in government accounts with a budget surplus for the second year in a row following a long stage of deficit financing begun in the Seventies. Spain now stands among leaders under this heading in the euro area with a government surplus beaten only by Finland.

Most government levels improved their accounts. The best results came in Social Security with its traditional surplus moving up to 1.2% of GDP, thanks to the strength of the labour market, with an increase of 3.4% in registrations. This

Finland only country in euro area to show higher budget surplus than Spain.

BUDGET SURPLUS FOR SECOND YEAR IN A ROW

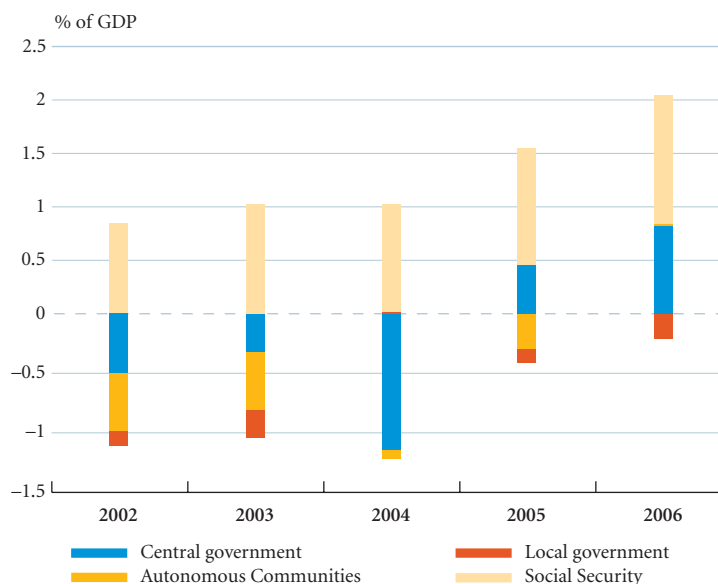
Balance of general government



SOURCE: Ministry of Economy and Finance and Bank of Spain.

MOST LEVELS OF GOVERNMENT SHOW IMPROVED BALANCES

Budgetary balance by level of government



SOURCE: Ministry of Economy and Finance.

surplus will partly go to increase allocations to the Social Security reserve fund, raising the balance to 40.33 billion euros, a fund aimed at meeting future needs in benefits. The central government surplus was also up notably to 0.8% of GDP. The autonomous communities managed to leave red figures behind but only just. Local government, which in 2004 moved onto positive ground, showed a deficit.

The favourable trend in government finances was largely due to strong growth of tax collections, with central government tax revenues up 11.6% compared with those the year before. The increase in Treasury revenues was 3 percentage points higher than national demand.

Personal income tax collections showed an increase of 14.8%, thanks to high job creation and a positive trend in earnings on capital. The good state of the stock

markets, along with extraordinary dividends and the rise in interest on bank deposits, meant a substantial contribution. Another key direct tax, corporate tax, brought an increase of 14.5% in collections, thanks to the good state of corporate profits.

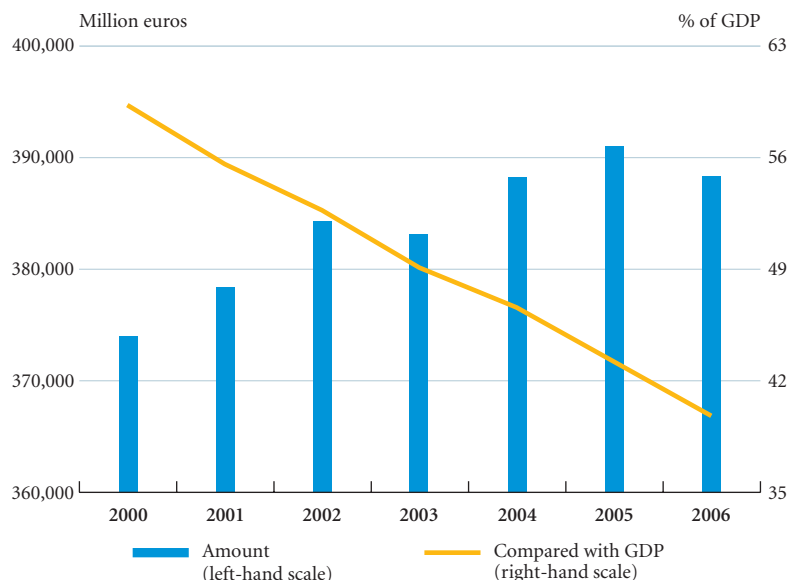
Value added tax rose by 9.6%, in keeping with the trend in final consumption spending. Collections for special taxes rose at a much lower rate (3.2%) due to the slack in two key headings (oil and tobacco) while taxes on beer and electricity were firmer. Capital transfers were down because of lower funds coming from the European Union. Government earnings were up strongly due to profits of the Bank of Spain.

Central government non-financial spending rose by a moderate 6.2%, lower than nominal GDP, thanks to the drop in financial spending and containment of real investment and

Economic boom and subsequent growth of collections makes for improvement in public accounts.

PUBLIC DEBT ALSO DOWN IN NOMINAL TERMS

Borrowing by general government



SOURCE: Ministry of Economy and Finance and own calculations.

capital transfers. Central government public servant labour costs were up 7.4%. Current spending on goods and services rose by a notable 12.1%.

The budgetary surplus of all government levels made it possible to reduce the government debt in nominal terms. The drop in terms of GDP was even sharper (3.4 points) putting it at 39.8%, the lowest level in 20 years. Most of this applied to the central government (31.0% of GDP), followed by the autonomous communities (5.9%). The level of Spain's government debt thus stood substantially below the euro area average.

These favourable results will likely continue in coming years if existing macroeconomic forecasts are fulfilled. The Stability Programme indicates a government surplus of the order of 1% of GDP in the next three years. If this scenario is fulfilled, the relative volume of government debt will drop considerably going to 32% of GDP in 2009 and the financial situation will consolidate the «virtuous circle» into which (according to finance minister Pedro Solbes) Spain's economy has now moved.

Level of public debt stands substantially below euro area average.

Savings and financing

One-year Euribor moves up to 4.09% in February, highest level since August 2001.

Corporate transactions take up major financing in contrast to drop in loans to households...

Funding granted to private sector barely decreasing

Interest rates on bank loans continued to rise in the early months of 2006, with a gradual pass-through of increases in the Eurosystem interest rate begun in December 2005. Average interest rate on loans and credits to the private sector rose to 5.22% in January, 111 basis points above the level 12 months earlier. The 1-year Euribor, widely used as a reference rate, rose to 4.09% in February, the highest level since August 2001. The monthly increase in February (3 basis points) was the lowest since September 2005, indicating that the market feels the current upward stage is now close to a ceiling.

In spite of the rise in loan interest rates, the total volume of funding obtained by the private sector continued to show strong growth with an annual rate of 24.1% in January, scarcely one decimal less than the highest rate for the last decade reported in December. The sharp growth of credit is largely due to increased demand by companies while that going to households continues to slow down. Funding granted to non-financial companies rose by 28.4% in January compared with the same month the year before, the highest rate for at least the last ten years.

On the other hand, funding to households was up 18.9% in January compared with the same month in 2005.

FUNDING GRANTED TO COMPANIES CONTINUES TO RISE SHARPLY

Year-to-year change in funding granted to companies



SOURCE: Bank of Spain.

CREDIT GRANTED TO COMPANIES AND HOUSEHOLDS

January 2007

	Total	Change this year		Change over 12 months		% share
	Million euros	Million euros	%	Million euros	%	
Commercial credit	82,149	-3,217	-3.8	8,571	11.6	5.4
Secured loans (*)	934,110	11,119	1.2	192,058	25.9	61.3
Other term loans	422,996	8,407	2.0	93,294	28.3	27.7
Demand loans	33,679	-443	-1.3	5,542	19.7	2.2
Leasing	40,273	-440	-1.1	5,580	16.1	2.6
Doubtful loans	11,397	562	5.2	1,485	15.0	0.7
TOTAL	1,524,605	15,989	1.1	306,532	25.2	100.0

NOTES : (*) Greater part made up of loans with mortgage security.

SOURCE: Bank of Spain and own calculations.

While this meant a high borrowing rate, this rate was 2.4 percentual points below March 2006, which shows a clear slowdown. This easing off was due to a drop in demand for home purchase as a result of the increase in interest rates and the rise in housing prices. Housing loans rose by 19.3% in the past year ending in January, 5.3 points less than in November 2005. On the other hand, loans for other purposes, largely consumer buying, have practically not decreased although they are growing at a somewhat lower rate, 17.7% in January.

After recording an all-time low in December, the default rate for all lending institutions rose slightly (by 3 hundredths of a point) in January to stand at 0.75%. In greater detail (although figures go only to December), we note that the rate for doubtful loans for home purchase with mortgage stood at 0.41% at the end of 2006. While substantially below that for loans as a whole, this level meant a slight increase in 2006. The default rate on loans for buying durable goods (cars, motorcycles, furniture, etc.) rose more going to 2.18% in December. This indicates that the bottom default level

for this cycle has probably now been reached, with a possible rise ahead in 2007.

A total of 1,863,846 mortgages on rural and urban properties were signed in 2006, according to figures from the National Institute of Statistics, 6.3% more than the year before. The average amount per mortgage in 2006 was 156,876 euros, 13.9% more than in 2005. The average home mortgage was 140,275 euros, an annual rise of 12.6%. Savings banks were the entities granting most mortgage loans in 2006 (55.7% of the total) followed by banks with 33.5%. The average term for mortgages was 25 years, one more than in 2005. Most mortgages were for variable rate and only 2.2% were at fixed rate. Among those at variable rate, 84% of new mortgages were set at the Euribor rate.

With regard to geographical distribution of mortgages, there was generally more activity in the Mediterranean littoral and the Canary Islands, with demand for holiday homes contributing to this. Those areas with fewer mortgages in relative terms were Galicia, Extremadura and the Basque Country.

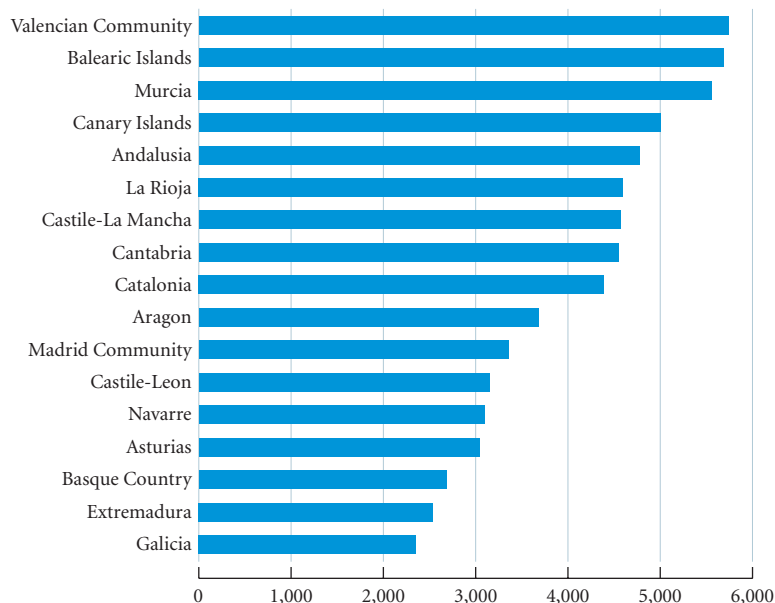
...because of lower demand for mortgage loans to buy homes.

Default rate up slightly in January and likely to rise in 2007.

Only 2% of mortgages at fixed rate in 2006.

MEDITERRANEAN LITTORAL SHOWS HIGHEST DEMAND FOR MORTGAGE LOANS

Number of properties with mortgage signed in 2006 per 100,000 population



SOURCE: National Institute of Statistics and own calculations.

Bigger increase in deposit accounts up to 2 years than for longer terms following equal tax treatment set in January.

Average annual return on securities mutual funds at 3.9% in February, well above inflation.

Total life insurance premiums up 10% in 2006.

Bank deposits running full-steam-ahead

Bank deposits of companies and households in credit institutions were up 24.1% in the 12 months ending in January, a rate similar to that reported the month before. In order to maintain this high growth rate, financial entities had recourse to broadening the existing range of financial products by adding new ones. It is worth noting that in January there was a bigger rise in accounts with terms of up to two years than for longer terms following disappearance of tax advantages for longer terms at the start of 2007.

With regard to another preferred savings instrument, securities mutual funds, assets rose by 73 million euros in February to 255.15 billion euros. This increase was due to net acquisition of shares for a value of 581 million euros

given that capital losses took place during the month as a result of the negative turn taken by most share markets. Nevertheless, annual average return stood at 3.9%, somewhat above inflation. Return was greatly varied depending on type and ran between 22.9% for national share-based funds to a drop of 4.3% on Japanese share-based funds.

In the insurance field, life premiums rose by 9.8% in 2006 going to 22.54 billion euros. Other branches of direct insurance amounted to 30.15 billion euros, an increase of 6.5%. The branch to show the biggest growth was health with an increase of 9.8% in premiums, followed by all-risk type which was up by 8.8%. The most important branch by volume (car insurance) rose by only 4.9% as a result of sharper competition in this field which put pressure on premium levels.

DEPOSITS OF COMPANIES AND HOUSEHOLDS AT CREDIT INSTITUTIONS

January 2007

	Total	Change this year		Change over 12 months		% share
	Million euros	Million euros	%	Million euros	%	
On-demand savings (*)	425,946	-22,001	-4.9	38,659	10.0	37.5
Up to 2 years	257,611	11,362	4.6	65,014	33.8	22.7
More than 2-year term	339,290	6,441	1.9	95,015	38.9	29.9
Repos	78,317	-2,138	-2.7	4,107	5.5	6.9
Total	1,101,164	-6,335	-0.6	202,795	22.6	96.9
Deposits in currencies other than euro	34,772	2,055	6.3	18,123	108.9	3.1
TOTAL	1,135,936	-4,280	-0.4	220,919	24.1	100.0

NOTES: (*) Includes deposits redeemable at notice, according to ECB definition.

SOURCE: Bank of Spain and own calculations.

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