THE SPANISH ECONOMY: MONTHLY REPORT

SEPTEMBER 2004

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Research Department

"la Caixa"

Forecast

% change over same period year-before unless otherwise noted

	2002	2003	2004	2003				2004		
				1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.	3rd Qtr.
INTERNATIONAL ECONOMY			Forecast						Forecast	
Gross domestic product										
United States	1.9	3.0	4.4	1.9	2.3	3.5	4.4	5.0	4.7	3.9
Japan	–0.3	2.5	4.2	2.4	2.2	1.8	3.5	5.2	4.5	3.9
United Kingdom	1.8	2.2	3.2	1.8	2.1	2.2	2.9	3.4	3.7	3.1
Euro area	0.9	0.5	1.7	0.7	0.1	0.4	0.7	1.3	2.0	1.8
Germany	*0.1*	*–0.1*	*1.6*	*0.1*	*–0.3*	*–0.3*	*0.0*	*0.8*	*1.5*	*1.9*
France	*1.1*	*0.5*	*2.3*	*0.8*	*–0.1*	*0.4*	*1.0*	*1.7*	*3.0*	*2.4*
Consumer prices										
United States	1.6	2.3	2.6	2.9	2.1	2.2	1.9	1.8	2.9	2.8
Japan	–0.9	–0.3	–0.1	–0.2	–0.2	–0.2	–0.3	–0.1	–0.3	–0.1
United Kingdom	2.2	2.8	2.3	2.9	2.9	2.9	2.6	2.3	2.2	2.3
Euro area	2.3	2.2	2.0	2.3	1.9	2.0	2.0	1.7	2.3	2.4
Germany	*1.4*	*1.1*	*1.6*	*1.2*	*0.8*	*1.0*	*1.2*	*1.1*	*1.8*	*1.9*
France	*1.9*	*2.1*	*2.2*	*2.4*	*1.9*	*1.9*	*2.2*	*1.8*	*2.4*	*2.3*
SPANISH ECONOMY										
Macroeconomic figures										
Household consumption	2.6	3.0	2.9	3.0	2.8	3.1	3.0	3.2	3.0	2.9
Government consumption	4.4	4.6	4.4	4.3	4.5	4.8	4.8	4.7	4.5	4.3
Gross fixed capital formation	1.0	3.0	3.2	3.2	3.4	3.0	2.5	3.0	3.1	3.3
Capital goods and other	*–2.7*	*2.2*	*3.0*	*2.8*	*2.9*	*1.9*	*1.2*	*2.4*	*2.7*	*3.4*
Construction	*4.2*	*3.7*	*3.4*	*3.5*	*3.8*	*3.8*	*3.6*	*3.6*	*3.4*	*3.3*
Domestic demand	2.6	3.3	3.3	3.6	3.2	3.6	2.9	3.7	3.5	3.1
Exports of goods and services	0.0	4.0	4.9	4.4	7.8	2.2	1.8	4.1	4.6	5.4
Imports of goods and services	1.8	6.7	6.8	8.5	10.1	5.9	2.7	6.7	6.9	6.8
Gross domestic product	2.0	2.4	2.6	2.2	2.3	2.4	2.7	2.8	2.6	2.5
Other variables										
Employment	1.5	1.8	1.8	1.6	1.7	1.9	2.1	2.1	1.9	1.7
Unemployment (% labour force)	11.4	11.3	11.2	11.7	11.1	11.2	11.2	11.4	10.9	11.2
Consumer price index	3.5	3.0	3.0	3.7	2.8	2.9	2.7	2.2	3.2	3.4
Unit labour costs	3.3	3.6	3.4	3.9	3.6	3.5	3.5	3.5		
Current account balance (% GDP)	–2.7	–3.2	–3.0	–5.0	–2.5	–3.3	–2.0	–5.1		
Net lending or net borrowing rest of the world (% GDP)	–1.6	–2.0	–1.8	–4.0	–1.3	–2.5	–0.3	–4.4		
Government balance (% GDP)	0.1	0.3	–0.9							
FINANCIAL MARKETS										
Interest rates										
Federal Funds	1.7	1.1	1.3	1.3	1.2	1.0	1.0	1.0	1.0	1.4
ECB repo	3.2	2.3	2.0	2.7	2.4	2.0	2.0	2.0	2.0	2.0
10-year U.S. bonds	4.6	4.0	4.5	3.9	3.6	4.2	4.3	4.0	4.6	4.4
10-year German bonds	4.8	4.1	4.3	4.1	3.9	4.1	4.3	4.1	4.2	4.3
10-year Spanish bonds	5.0	4.1	4.3	4.1	3.9	4.1	4.3	4.1	4.2	4.3
Exchange rate										
$/Euro	0.95	1.13	1.22	1.07	1.14	1.12	1.19	1.25	1.20	1.23

"la Caixa" GROUP: KEY FIGURES

As of December 31, 2003

FINANCIAL ACTIVITY	Million euros
Total customer funds	126,281
Receivable from customers (including securitizations)	79,130
Group income	840

STAFF, BRANCHES AND MEANS OF PAYMENT	
Staff	24,338
Branches	4,735
Self-service terminals	6,939

"la Caixa" FOUNDATION	
Budget for 2004 (million euros)	183.5
Science Museum (number of visitors)	194,893
«CosmoCaixa» (number of visitors)	807,545
Exhibitions	295
Concerts and musical events	384
Recreation Clubs for elderly	544
Fellowships for study abroad (1982-2003)	1,688

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September 2004

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CAJA DE AHORROS Y PENSIONES DE BARCELONA ("la Caixa") is a non-profit financial institution which channels its operating surplus back to the community through educational, cultural and social projects. It is one of Spain's leading financial institutions. (See Chapter on Spanish Banking System)

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ECONOMIC OUTLOOK FOR 2004

During the summer months, **the prospects for the world economy were somewhat darkened by the rise in oil prices and loss of economic drive in the** United States. The difficulty in making any forecast about the trend in oil prices adds to uncertainty about its possible effects on the economic cycle. Given a balanced scenario, the high prices seen in August should be corrected in coming months given that we can see no factors to justify high price levels being sustained over an extended period of time. With regard to U.S. growth, earlier forecasts were already anticipating a slowdown in the second half of the year due to the progressive weakening of the monetary and fiscal incentives applied to get over the dip in 2001. The other centre of world growth, the Chinese economy, is going through a slight slowdown, although still within high growth levels, but it will continue to outpace Japan where growth in 2004 will go above 4%, the highest in 14 years.

The euro area has now left behind the stagnation shown in 2003 and in the second quarter of 2004 year-to-year growth increased in Germany, France and Italy. In any case, current and early indicators show little sign of recovery in domestic demand, so that the **growth forecast remains very moderate** at 1.7% for the area as a whole. Inflation, measured by consumer prices, will not drop below 2% over the remainder of the year.

Within this framework, the U.S. Federal Reserve Board **will continue to raise its reference rate** although at a gradual pace. The Bank of England likely will further restrict monetary policy in coming months. The European Central Bank, in turn, for the moment is making no change in its position although it could begin a more restrictive phase toward the end of the year. Long-term interest rates will likely resume an upward path due to inflationary pressures. Over the short term, the euro will keep to around its present levels.

With regard to Spain's economy, growth is based on domestic demand which is showing growth of around 3%. While growth of private consumption and construction is tending to stabilize or decrease slightly, this factor is being compensated by the strength recently being shown by capital goods investment. On the other hand, the weakness in exports of goods and services is taking away from growth of the gross domestic product so that **overall growth in 2004 is expected to be 2.6%**.

For the moment, the performance in the labour market is proving relatively satisfactory if we are to go by the trend in figures for registrations with Social Security and registered unemployment. With regard to inflation, if current pressures on oil prices let up, the year-to-year rate for the consumer price index will go only a few decimals above 3% at the end of 2004 although there are risks it may go higher. Finally, we should point out that the current account deficit is tending to increase with no foreseeable correction to any appreciable degree coming before year-end.

August 26, 2004

Oil price rise clouds prospects

Second half of 2004 begins with high-cost energy, less buoyant economic situation and financial markets on defensive.

July and August were marked by the spectacular rise in the per barrel price of oil which has caused notable concern and brought fears of a new energy crisis. Following the early months of 2004 when the economy and world trade were growing to a notable extent (more than expected in the most optimistic forecasts), the second half-year is being faced with concern. Not only because of the effects of increasing fuel costs by also because of signs of some containment of growth which are showing up in the main engines of the world economy, namely United States, Japan and China. Financial markets have reacted negatively in the face of this change of scene.

Oil prices go up to nearly 50 dollars in August…

The per barrel price of oil began 2004 swinging around 30 dollars for Brent quality product. Very soon the price settled clearly above that level going up to 39 dollars at the beginning of June. As of that moment, the market eased but in July prices resumed an upward trend. In August, prices held above 40 dollars practically all month long and in the case of West Texas, this product went to nearly 50 dollars a barrel.

…due to heavy demand, some supply problems and speculation factor.

There is no basic reason to justify an increase in oil prices by more than 40% over one year ago. It is true that recovery in Asia, particularly in China, has given a strong boost to demand. It is also true that production in exporting countries stands at maximum levels partly because of a lack of investment in extraction and prospecting. Furthermore, a succession of bad news accounts has affected the market pushing up prices, including sabotage in Iraq, the bankruptcy of Yukos, the Russian oil company, lower inventories of refined product, the referendum in Venezuela, etc. Not to overlook the activity of speculators in raw materials markets.

Rise in oil price coincides with some loss in strength of recovery in United States.

In any case, the rise in oil has unleashed much uncertainty. In the United States, the rise in energy costs comes at a bad moment. The extraordinary stimulus measures applied to lift the economy out of the dip in 2001 (easier monetary policy, tax cuts, public deficit) are seeing their effects wear out. The macroeconomic results for the second quarter were disappointing due to the weakness of consumption although at year-to-year rate growth of the gross domestic product still stood at a high 4.7%. Nor did job creation increase as would be expected in a stage of economic recovery. The 32,000 jobs created in July represented a shower of cold water at a moment when the campaign for the presidential elections on November 2 was just starting off.

Consumption and exports continue to drive Japan's economy while China slowing down slightly.

The results for Japan's economy in the second quarter also were seen as disappointing. At year-to-year rate, the increase in Japan's economy dropped from 5.2% in the first quarter to 4.5% in the second. But the fact that at quarter-to-quarter rate annualized growth was only 1.7% raised doubts about the immediate future course of economic activity. In any case, it should be emphasized that both consumption and exports are pointing in a good direction and most recent indicators present no change in the general perception of the strength of Japan's economy. In China, too, we note a situation of gradual moderation in industrial production which, in any case, stands at extraordinarily high levels.

Euro area tending to improve growth figures which still depend too much on foreign sector.

In the euro area, on the other hand, figures for the second quarter of 2004 were positive, going from 1.3% in the first three months to 2.0%. No breakdown of demand by component is yet available but figures indicate that recovery is continuing to respond to the drive in exports while domestic demand remains weak. This is the case in Germany, for example, where sluggishness of consumption is the rule but, in spite of this, growth in the second quarter was 1.5% as against 0.8% in the first three months of the year. Something similar is taking place in Italy whereas in France, on the other hand, all demand components have shown substantial recovery marking up year-to-year growth of 3.0%.

Rise in oil prices shifts to consumer prices…

While the effects of the rise in oil prices still cannot be noted in economic activity indicators, the increase in oil has already left its mark on inflation figures. In the United States, the rise in consumer prices went from less than 2% year-to-year at the beginning of the year to 3.3% in June, only to ease slightly in July. In the euro area, the increase was much more contained (the single currency eased the rise in the oil price quoted in dollars and higher taxes acted as a cushion) putting it at 2.5% in May and easing off to 2.3% in July. In Japan, consumer prices were practically stagnant thus giving some slight indication that the long stage of deflation was coming to an end.

…while stock markets lose gains obtained at beginning of year and the Fed begins to leave its easy money policy behind.

Where the impact of the rise in oil was notable was in financial markets, coming as it did at the same time as other unfavourable figures and the current world political situation. Following a hopeful start to the year, the main world stock markets underwent notable drops during the summer months. At the end of August a good many stock market indices stood below the starting figure for the year, with the notable exception of Tokyo, or they were holding at very similar levels. Money has shifted to the bond market in the search for more security thus pushing up bond prices while at the same time reducing yields. The yield on U.S. 10-year Treasury bonds moved down as of mid-June while also dragging down European bonds. On the other hand, short-term interest rates in the United States have tended to rise in keeping with the two increases in the Federal Reserve target level on June 30 and August 10.

Spain's economy showing stable growth

In Spain, domestic demand remains strong but exports down.

In Spain, the growth rate of the economy remains more or less stable. For the second quarter, the Bank of Spain has estimated a year-to-year growth rate pf 2.6% as against 2.8% in the first quarter, although in quarter-to-quarter rate growth in April-June was very similar to the first three months of 2004. The most notable change is a continuation of growth in domestic demand (private consumption and investment) while, on the other hand, foreign demand is tending to weaken due to the smaller increase in exports of goods.

Consumption remains strong, investment making progress and construction continuing its drive.

The few available indicators for the third quarter point in this direction. The level of consumption continues to be positive. Passenger car registrations in July, for example, were the highest recorded in any single month in history. Nevertheless, it is true that other indicators show a less solid trend which may be connected to the loss of purchasing power arising from the increase in inflation and somewhat less job creation in recent months. In turn, capital goods investment continues to present satisfactory results and construction remains strong with some slight indication of an easing off.

Industrial production amends disappointing course when it started year…

Other indicators also point to a stable growth profile, such as electrical power consumption and demand for credit by individuals and companies. We should especially mention the better state being shown by the industrial production index in recent months following a rather negative start to the year,

…but exports of goods dropping and foreign tourism not making progress.

The main doubts come from the foreign sector. The trade deficit continues to increase month after month as exports weaken while purchases of consumer goods and capital goods from abroad remain buoyant. It does not appear that this year tourism, the key element in the balance of payments, will solve the figures. The number of tourists is up but not tourist spending.

Increase in cost of oil products affecting consumer prices and also producer prices.

Another source of uncertainty is inflation. The rise in fuel prices has finally broken all hope of meeting the official objective of 2% at the end of the year and the consumer price index in the first seven months has piled up a rise of 1.4%, more than twice that for last year. Producer prices, in turn, rose more than 4% in July compared with last year, a rate which has not been seen since 2000.

Number of those employed goes above 17 million for first time in history.

Finally, both job creation and the financial situation of companies are holding at a positive level which is helping to maintain the rate of economic activity. As mentioned earlier, employment is growing somewhat less than before but both registrations with Social Security and the estimated number of persons employed according to the Labour Force Survey have now gone above 17 million for the first time in history.

CHRONOLOGY

2003

January	**1**	*Coming into force of* ***Law on Personal Income Tax Reform*** *which involves decrease in individual tax load (BOE 19-12-02).*
		Culmination of ***liberalization of energy markets*** *offering possibility for households and small businesses to choose electricity and gas supplier.*
March	**20**	*United States and its allies begin* ***war against Iraq*** *to depose Saddam Hussein regime.*
April	**27**	*Coming into force of group of* ***economic reform measures*** *aimed at reducing cost of mortgage loans, fostering female employment, improving scheme for self-employed persons under Social Security and access of young people to rental housing, as well as improving tax treatment of small and medium-size companies (BOE 26-4-03).*
May	**25**	***Elections*** *for local government and autonomous communities.*
June	**5**	***European Central Bank*** *cuts official interest rate by 50 basis points to 2.00%, the second reduction this year.*
September	**14**	*Sweden rejects adoption of* ***euro*** *in referendum.*
		World Trade Organization *summit in Cancun (Mexico) ends without agreement.*
November	**1**	*Jean-Claude Trichet, former governor of French central bank, takes over from Willem F. Duisenberg as* ***chairman of European Central Bank****.*

2004

January	**1**	***Central government budget for 2004*** *comes into force (BOE 31-12-03).*
February	**11**	*Dow Jones index for* ***New York stock exchange*** *records annual high (10,737.7), rise of 2.7% compared with end of 2003.*
	17	***Euro*** *running at 1,286 dollars, highest figure since launching of single currency at beginning of 1999.*
March	**11**	*Tragic* ***terrorist attacks*** *on commuter trains in Madrid.*
	14	*Victory of Spanish Socialist Workers Party (PSOE) in Spanish* ***general elections****.*
April	**13**	*IBEX 35 index for* ***Spanish stock market*** *records annual high (8,444.3), a cumulative gain of 9.1% over end of December 2003.*
May	**1**	*Enlargement of the* ***European Union*** *by ten new member states making a total of 25.*
June	**18**	*Summit meeting of European Council in Brussels approves* ***European Constitution*** *which must be ratified by member states of European Union.*
August	**10**	***Federal Reserve*** *raises reference rate a quarter-point for second time this year putting it at 1.50%.*
	19	*One-month Brent quality* ***oil*** *price goes up to record level of 44.49 dollars a barrel.*

AGENDA

September

- **1** *Quarterly National Accounts (2nd Quarter).*
- **2** *Meeting of Governing Council of European Central Bank.*
- **9** *Industrial production index (July).*
- **10** *Consumer price index (August).*
- **16** *Harmonized consumer price index for European Union (August).*
- **21** *Meeting of Open Market Committee of U.S. Federal Reserve Board.*
- **22** *Quarterly survey of labour costs (2nd Quarter).*
- **27** *Producer price index (August).*
- **30** *Early HCPI index (September).*

October

- **5** *Industrial production index (August).*
- **7** *Meeting of Governing Council of European Central Bank.*
- **14** *Consumer price index (September).*
- **15** *Ongoing survey of household budgets (2nd Quarter).*
- **18** *Harmonized consumer price index for European Union (September).*
- **25** *Producer price index (September).*
- **26** *Labour Force Survey (September).*

United States: slight economic slowdown because of less drive in consumption

U.S. economy grows 4.7% in second quarter...

The U.S. economy saw a drop in its strong expansionist rate in the second quarter when it grew by 4.7% year-to-year as against 5.0% in the previous quarter. The sharpness of the slowdown shows up more clearly in the quarter-to-quarter rate annualized which was 2.8% in the second quarter, some 1.7 points less than in the first three months of the year.

...showing some slowdown in economic activity mainly due to easing of consumption.

The main culprit in the loss of pace in the U.S. gross domestic product (GDP) was private consumption which went from 4.2% year-to-year in the first quarter to 3.6% in the next. Also contributing to the lower growth rate was the slack in public consumption. On the other hand, investment held practically stable, mainly because of the strength of housing investment which rose by 11.4% compared with the same quarter in 2003. In turn, the contribution to the increase in the GDP coming from the change in inventories rose from 0.3% in the first quarter to 0.7% in the second.

UNITED STATES: MAIN ECONOMIC INDICATORS

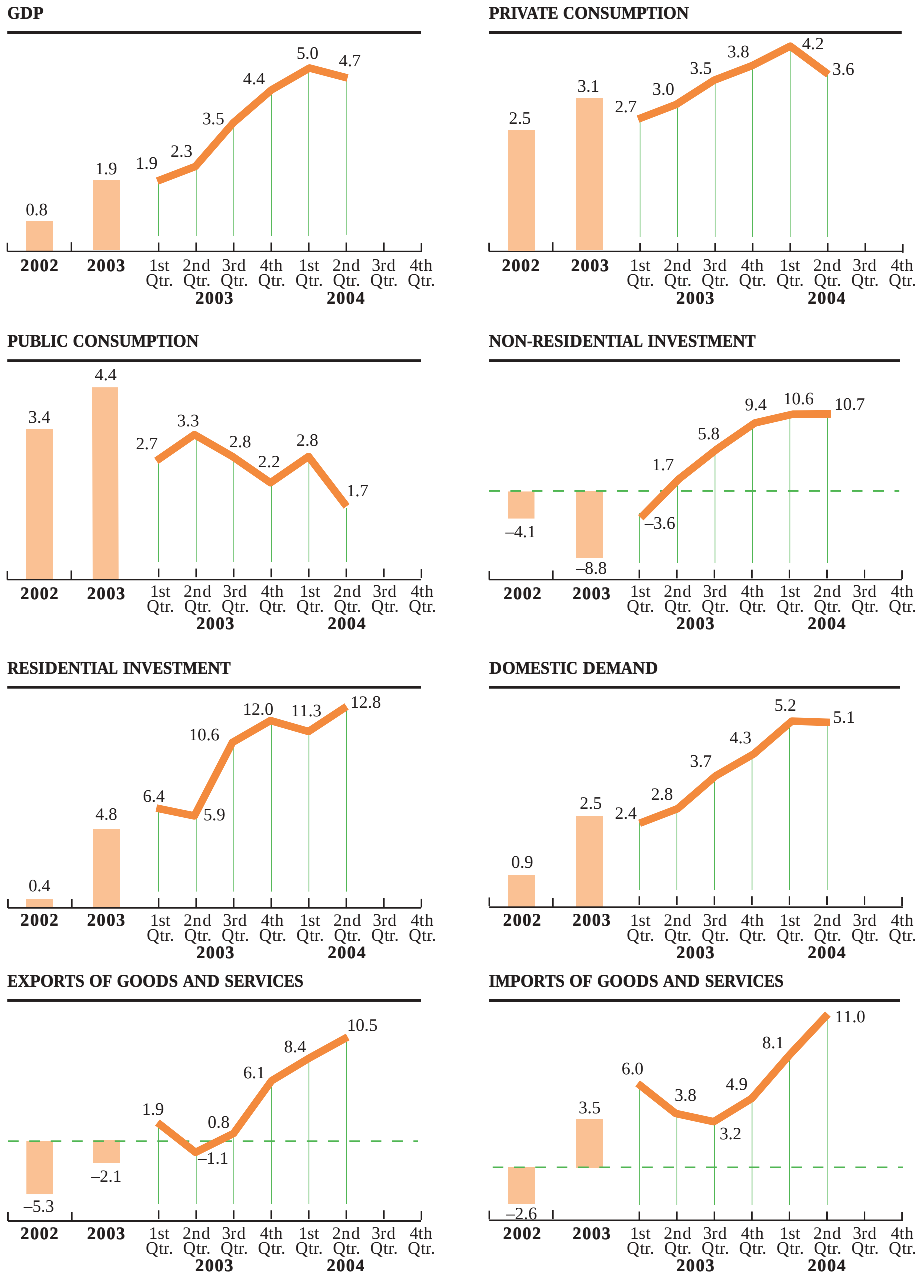
Percentage change over same period year before unless otherwise indicated

	2002	2003	2003			2004				
			2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
GDP	1.9	3.0	2.3	3.5	4.4	5.0	–	4.7	–	–
Retail sales	2.5	5.4	4.5	6.2	6.7	7.8	7.5	9.3	7.0	6.5
Sales of single-family homes	7.6	11.6	15.5	15.1	8.8	22.1	16.6	22.3	11.1	...
Consumer confidence (*)	96.6	79.8	82.7	78.6	89.7	91.6	93.0	93.1	102.8	106.1
Industrial production	–0.6	0.3	–1.0	–0.4	1.5	2.9	4.7	5.7	5.2	4.9
Industrial activity index (ISM) (*)	52.4	53.3	48.9	54.1	60.6	62.5	62.4	62.8	61.1	62.0
Unemployment rate (**)	5.8	6.0	6.1	6.1	5.9	5.6	5.6	5.6	5.6	5.5
Consumer prices	1.6	2.3	2.2	2.2	1.9	1.8	2.3	3.1	3.3	3.0
Trade balance (***)	–35.5	–42.7	–42.4	–43.5	–44.3	–45.0	–46.0	–46.5	–47.9	...

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

TREND IN UNITED STATES' GDP BY COMPONENT

Percentage year-to-year change rate



SOURCE: Bureau of Economic Analysis and internal figures.

Contribution by foreign sector worsens in second quarter.

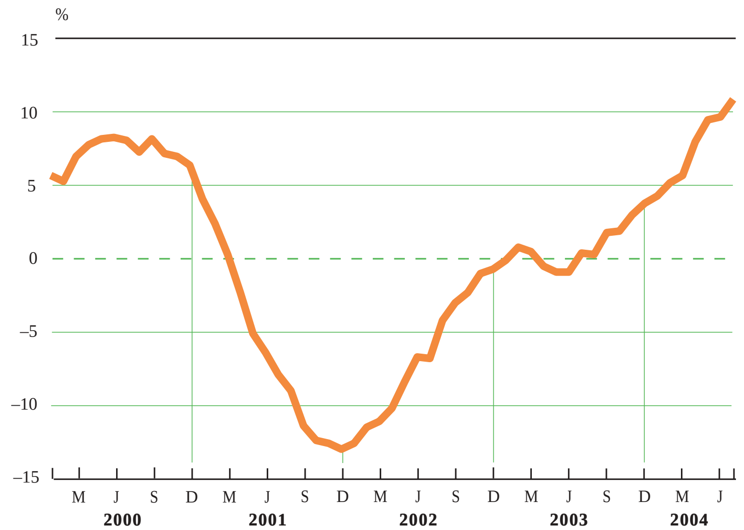
With regard to foreign demand, exports continued to maintain the positive situation begun in the third quarter of 2003. In the three months from April to June it rose to 10.5% year-to-year, more than two percentage points above the first quarter. The drive in imports was still greater and these went from year-to-year growth of 8.1% in the first quarter to 11.0% in the second quarter. Overall, the foreign sector took six decimals off the increase in the GDP, two decimals more than in the first quarter.

Slowdown in retail sales in July qualified by recovery in consumer confidence.

The latest available indicators confirm previous trends. The slowdown in private consumption continues to worsen although it would be surprising if the dip were to be serious. Retail sales, which indicate the current state of household spending, grew by 6.5% year-to-year in July compared with 7.0% in June. In any case, the notable rise in consumer confidence in June and July (13 points) puts a qualifier on the previous trend and makes it possible to be confident that this represents a contained process of moderation in household spending. On the other hand, the investment cycle points to continued growth.

U.S. INVESTMENT CONSOLIDATING RECOVERY

Year-to-year change in capital goods component of industrial production index



SOURCE: Federal Reserve Board.

Industry shows reduced growth rate as of July…

On the supply side, the indicators most sensitive to cyclical change are reflecting the relative loss of economic pace. Specifically, industry is having difficulty in consolidating the sharp growth rate of earlier months. After marking up a high since June 2000 in year-to-year rate in May (5.7%), industrial production slowed to 4.9% year-to-year in July. This figure, along with the stabilization of the industrial activity index published by the Institute of Supply Management (ISM) at levels around 62 points in the second quarter and in July, would suggest some stagnation of the advance in industry, although at relatively high levels.

…and similar course may be expected in construction in coming months.

With regard to construction, the other major pillar of the current recovery, after a period of strong growth the sector may be moving into a stage of lower activity. While current indicators continue strong (sales of single-family houses grew by 16.5% year-to-year on average in the second quarter), both housing starts and building permits lost strength as the second quarter advanced. In turn, services maintained a performance in July in line with that seen in the second quarter.

Poor employment figure in July with only 32,000 jobs created in month.

The labour market brought a surprise in July with low growth in non-farm employment of only 32,000 persons compared with the month before. As a result, employment in July stood at levels 1.1% higher than one year earlier with no change over June. The unemployment rate, in turn, dropped to 5.5% of the labour force in July, one decimal less than in June.

Drop in consumer prices puts CPI at 3.0% in July.

The figure for inflation in July may be considered somewhat more positive. In spite of the sharp rise in oil prices, which pushed the energy component above 14% year-to-year, the consumer price index (CPI) dropped to 3.0% year-to-year, three decimals below the figure for June. If we discount the more volatile components (energy and food) the resulting rate stood at 1.8% year-to-year (1.9% year-to-year in June).

Domestic demand still very strong and huge trade deficit goes up again in June.

The strong U.S. buying boom continues to be reflected in the further worsening of the trade balance. The sharp rise in imports (increase of 19.3% year-to-year in June) as against a weaker boost in exports (growth of 9.7% year-to-year) meant that in June the cumulative trade deficit for 12 months on monthly average amounted to 47.9 billion dollars, compared with 46.5 billion dollars in May.

Brazil: good signs give way to growth

Brazil grows 2.7% in first quarter confirming signposted recovery.

Brazil's GDP grew by 2.7% year-to-year in real terms in the first quarter, confirming the signs which had been given out by industrial production and car sales. This growth is significant in so far as it puts an end to a period of three consecutive quarters of negative growth and also eases political tension.

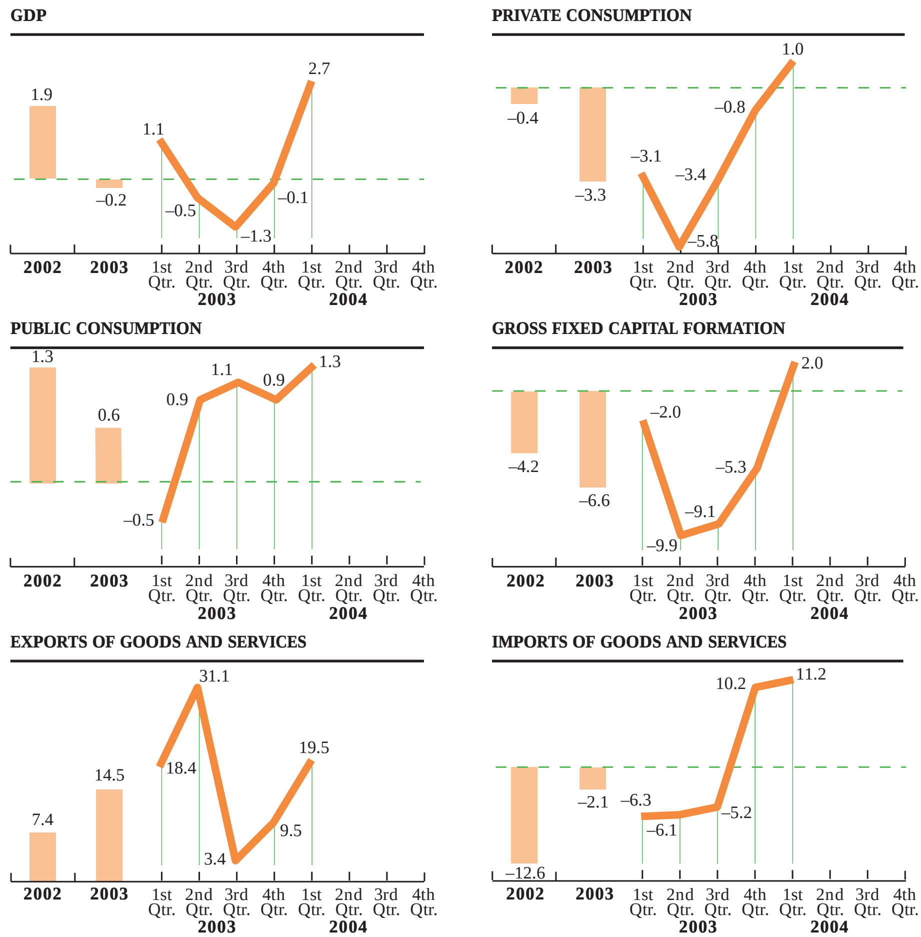
Investment still has long way to go.

By component, private consumption grew by 1.0% year-to-year. While the figure is modest it should be put in context with preceding quarters when it showed decreases of close to 6%. Public consumption grew by 1.3% but in this case, in contrast to the private component, the trend is much flatter, something which meshes with the fiscal austerity Brazil is now undergoing. As a possible risk we should mention that in nominal terms public consumption grew by 12.1%, a figure higher than the 11.2% and 6.7% recorded for the GDP and private consumption respectively. Gross capital formation grew by 2.0% which represents a clear improvement compared with the drop of 5.3% in the final quarter of 2003. Nevertheless, this component still has a long way to go.

Foreign sector holds its leading role.

The foreign sector continued to keep its leading role with exports which in real terms grew by 19.5% year-to-year, thus recovering the sharp increases showing up in the first half of 2003. This increase more than compensated for imports which also followed a clear course of recovery with an increase of 11.2% year-to-year.

TREND IN BRAZIL'S GDP BY COMPONENT
Percentage year-to-year change rate



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

Industrial production and retail sales pointing to growth.

Monthly indicators for demand and supply continue to give out positive signals. Industrial production in June continued on an upward trend with growth of 13.0% year-to-year which put growth in the second quarter at 9.2%. Following the course already indicated, industrial production of capital goods in the same periods grew by 32.9% and 27.0% respectively. Retail sales in June rose by 12.8% while car sales were up 35.9%.

July inflation halts moderate course.

Consumer prices rose by 6.3% in July compared with the same period the year before. This meant a halt to the definite trend to moderation seen up until May when the year-to-year increase stood at 5.0%. Registered unemployment in the São Paulo region in June was 19.1% which represented a decrease from the 20.7% in April and the 19.7% in May, although levels are still high.

BRAZIL: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2002	2003	2003			2004				
			2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
Real GDP	1.9	–0.2	–0.5	–1.3	–0.1	2.7	–	...	–	–
Industrial production	2.7	–0.1	–2.6	–0.5	1.8	5.9	6.7	7.9	13.0	...
Unemployment rate São Paulo (*)	19.0	19.9	20.5	20.1	19.8	19.8	20.7	19.7	19.1	...
Consumer prices	10.2	17.0	19.8	17.8	13.0	7.6	5.6	5.0	5.6	6.3
Trade balance (**)	13.1	24.8	20.9	23.1	24.8	27.2	27.4	28.0	29.5	30.9

NOTES: (*) Percentage of labour force.
(**) Cumulative balance for 12 months. Billion dollars.
SOURCE: Brazilian Institute of Geography and Statistics and Central Bank of Brazil.

Trade surplus continues to mark up new highs.

The trade surplus continued its basic positive trend and in the 12 months up to July amounted to 30.9 billion dollars, thus making it the most hopeful feature of recovery in Brazil. Direct investment for the 12 months ending June was 10.3 billion dollars, showing a continuation of the same but still at low levels.

Argentina: economy continues to recover

Argentina continues to show robust growth starting out from very low levels.

The Argentine economy continues to grow at a spectacular rate. In the first quarter, the GDP grew by 11.2% year-to-year in real terms and this growth showed a slight rise in the final quarter of 2003 going from 11.3% to 11.7%. Private consumption in the first quarter showed a rise of 11.7% while public consumption was up by 1.4% year-to-year. Gross fixed capital formation, the big unsolved challenge for the Argentine economy, rose by 51.0%.

Modest growth of exports raises doubts about foreign sector.

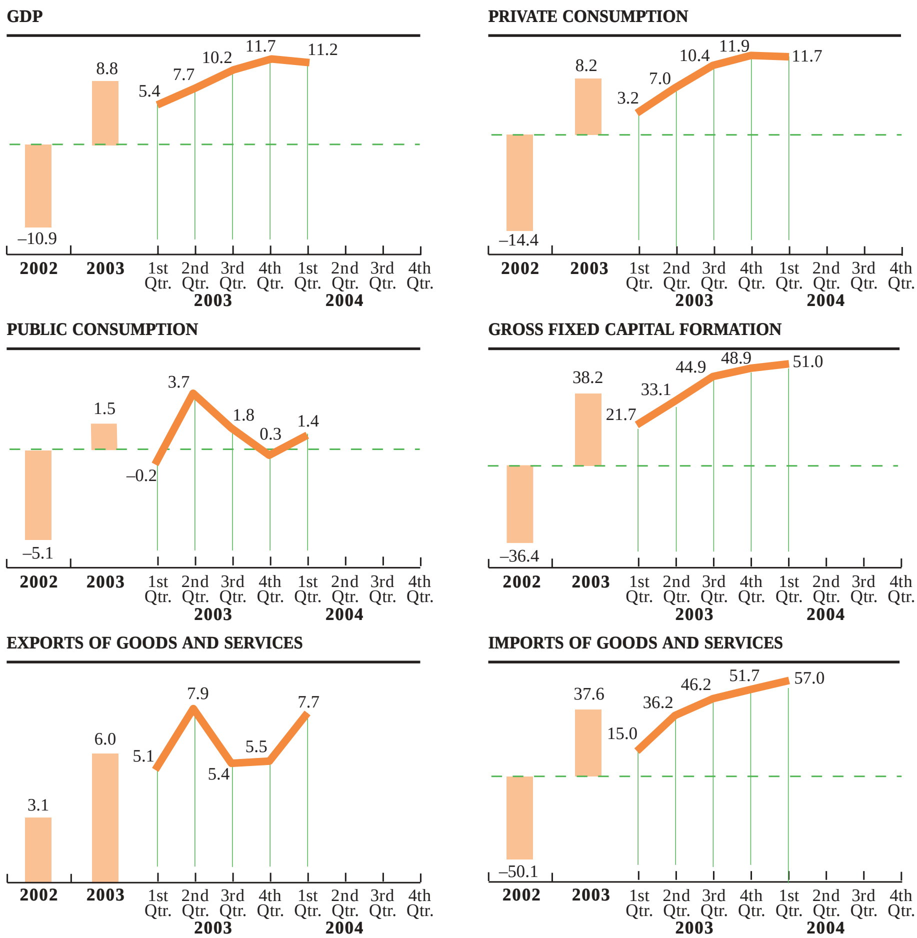
In this context of a strong recovery of domestic demand imports grew by 57.0% year-to-year while exports showed a modest increase of 7.7%. Although still showing a surplus, the contribution to GDP growth in the foreign sector was negative at –3.1%, thus cutting GDP growth by a quarter. While this process is normal in the present stage of the cycle, what is more troubling is the modest growth of exports compared with Brazil.

Demand indicators showing massive growth in keeping with stage of Argentina's economic cycle.

Industrial production in July showed a year-to-year increase of 9.2%. This represented an improvement of the temporary slowdown in April with increases of the order of 6%. Retail sales in the Buenos Aires area rose by 42.1% in June compared with the same period last year while car sales were up 77.8% in July. All of these increases must be put into the context of recovery from the deep recession in the country in 2002. In the case of car sales, however, the levels are at all-time highs.

TREND IN ARGENTINA'S GDP BY COMPONENT

Percentage year-to-year change rate



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

ARGENTINA: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2002	2003	2003			2004				
			2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
GDP	–10.9	8.8	7.7	10.2	11.7	11.2	–	...	–	–
Industrial production	–7.5	12.7	13.9	13.0	10.9	8.5	5.4	7.9	8.2	9.2
Unemployment rate (*)	20.6	...	...	...	...	...	...	...	...	...
Consumer prices	25.9	13.4	14.5	5.2	3.7	2.4	3.1	4.3	4.9	4.9
Trade balance (**)	16.7	15.7	17.3	16.7	15.7	14.3	14.4	14.2	13.4	...

NOTES: (*) Percentage of labour force.
(**) Cumulative balance for 12 months. Billion dollars.
SOURCE: National Institute of Statistics and Census, Republic of Argentina (INDEC).

Slight rise in inflation not immediately troubling.

Consumer prices have been undergoing a slight rise in recent months and in July showed growth of 4.9% over the same period last year, which is in contrast to the increase of 2.4% in the first quarter. While Argentina has a history of ups and downs in this matter, in the current situation when the Argentine economy is growing at a stunning pace what becomes most important is to note the moderate level of inflation, slightly below that for Brazil.

Worsening of trade balance could bring more pressure on debt payment.

The trade balance, which shows a surplus, has gradually been getting worse and in the past 12 months as of June reported a balance of 13.4 billion dollars. Doubts about this come from whether this drop may be the result of growing domestic demand or a relative lack of competitiveness putting Argentina behind its neighbours at a time especially propitious for Latin American exports. These doubts are of special significance at this time in view of pressure from the International Monetary Fund regarding the country's ability to pay its debt and the increase in the tax load in order to balance the public accounts. Any worsening of the foreign sector would make things much more difficult.

Exports and consumption driving growth in Japan

Japan grows 4.5% in second quarter and revises first-quarter growth upward to 5.2%.

In the second quarter, the Japanese economy grew by 4.5% year-to-year and the Economic and Social Research Institute (ESRI) revised year-to-year growth in the first quarter upward from 5.0% to 5.2%. The slight moderation in year-to-year growth, along with the revision for the first quarter, put quarter-to-quarter growth at a less vigorous 1.7% annualized. While this figure would suggest some caution, examination of the various components of the GDP continue to confirm Japan's recovery.

Private consumption showing strength with rise of 3.4%...

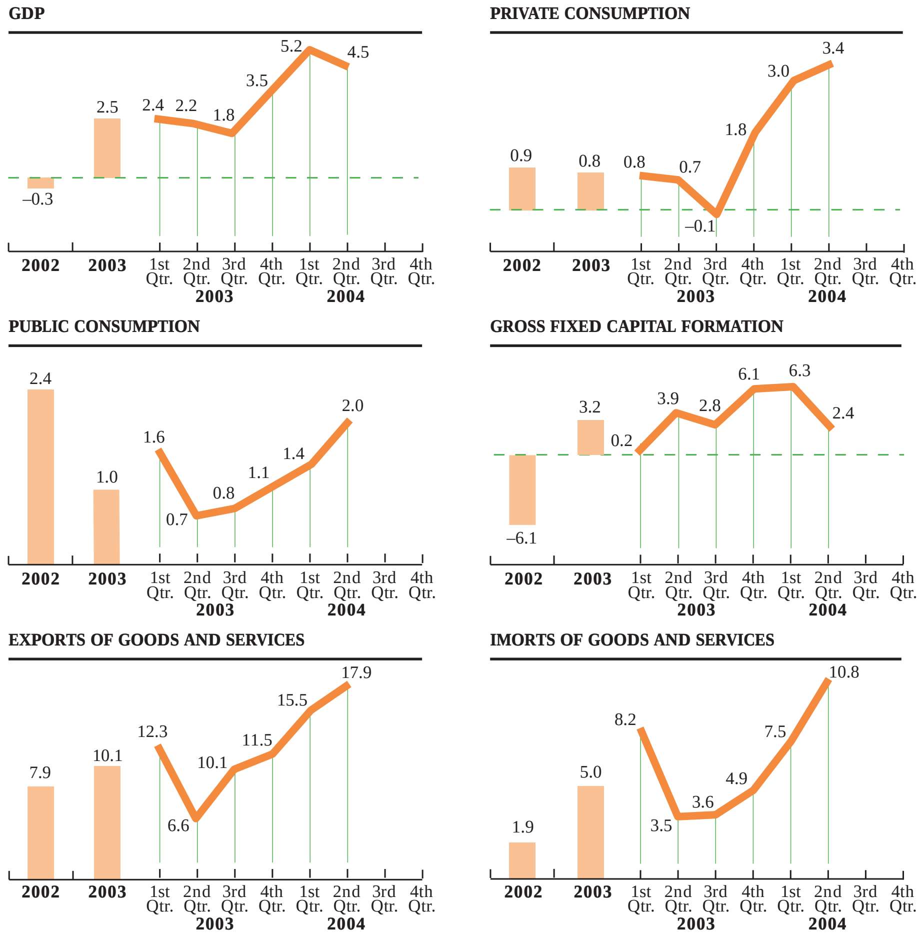
...although investment slackens for the moment.

Private consumption, which represents more than half the Japanese economy, grew by 3.4% year-to-year in the second quarter compared with 3.0% in the first quarter and continues to show a significant upward trend. Public consumption in this period grew by 2.0% year-to-year which, while higher than increases in recent quarters, will likely moderate as growth continues to be confirmed. Gross fixed capital formation in the second quarter showed a drop in year-to-year growth to 2.4% compared with the 6.3% recorded in the preceding quarter. Given the importance of the investment component in the cycle, this drop in growth rate is the factor raising most doubts about the strength of Japan's recovery.

The foreign sector continued its upward course with exports growing by 17.9% year-to-year which more than compensated for the increase of 10.8% in imports, this in turn being consistent with the strength of domestic demand. Such growth in exports has not taken place for many years. Nevertheless, as opposed to the case with imports, in nominal terms the figure comes to 13.8%, certainly very strong but lower, which gives an idea of the gains in competitiveness of Japan's economy, mainly in the manufacturing sector.

TREND IN JAPAN'S GDP BY COMPONENT

Percentage year-to-year change rate



SOURCE: Economic and Social Research Institute and internal figures.

Industrial production, car and housing sales reduce impact of slowdown in investment.

Among monthly indicators of economic activity what stands out is industrial production in June which grew by 7.7% compared with the same period last year. Housing starts in June were down by 7.7% year-to-year, although the basic trend of this indicator is moderately upward which puts a limit on downward prospects for gross fixed capital formation. In this respect, the number of housing units sold and prices in July continue to confirm this gradual upward trend. The number of bankruptcies in July (1,123) is following a positive trend compared with the monthly average of 1,355 in 2003. Retail sales were down by 2.5% year-to-year in June but car sales in July showed an increase of 9.1%.

Productivity and competitiveness continue to increase.

The unemployment rate in June stood at 4.6%. The number of those employed showed no significant change but the number of unemployed did change and in the second quarter was down 14% in year-to-year terms. Productivity in the same period rose by 8% which is quite positive in this situation of reduction of unemployment and in keeping with the performance in the export sector.

JAPAN: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2002	2003	2003			2004			
			2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June
GDP	–0.3	2.5	2.2	1.8	3.5	5.2	–	...	–
Retail sales	–3.9	–1.9	–2.6	–2.2	–1.2	0.2	–1.0	–2.2	–2.5
Industrial production	–1.3	3.3	1.9	1.1	4.7	5.0	8.7	8.4	7.7
Tankan company index (*)	–32.8	–21.0	–26.0	–21.0	–11.0	–5.0	–	...	–
Housing construction	–1.8	0.6	2.1	–0.5	3.3	5.3	–4.0	0.8	–7.2
Unemployment rate (**)	5.4	5.3	5.4	5.2	5.1	4.9	4.7	4.6	4.6
Consumer prices	–0.9	–0.3	–0.2	–0.2	–0.3	–0.1	–0.4	–0.5	0.0
Trade balance (***)	11.8	12.4	11.7	11.9	12.4	13.2	13.5	13.9	14.2

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

Deflation still persists but end seems close.

In June, the CPI repeated the figures for the same period last year thus giving some slight signs of the end of the period of deflation. Caution, however, is called for in this respect given that prices in Tokyo in July still recorded year-to-year decreases of 0.2%. Within the environment of competitiveness mentioned, the trade balance went above 14,000 billion yen in the 12 months ending in June.

Raw materials: oil price goes above 44 dollars a barrel

Series of bad signs on oil supply prospects push price above 44 dollars.

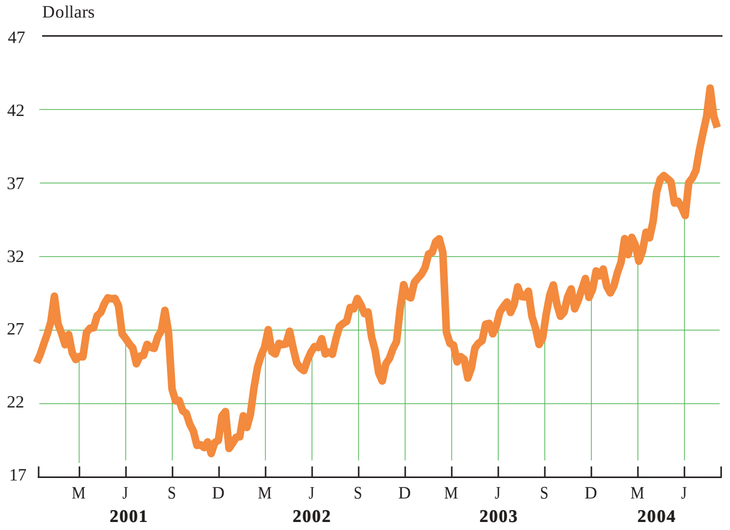
In July and August the price of oil underwent a notable climb which put a barrel of Brent quality oil with 1-month delivery at 44.5 dollars, the highest since 1985 when that quality was first quoted. The later adjustment to levels of around 40 dollars a barrel did not prevent oil from going to prices some 42% higher than in those months of 2003. This increase was due to the flow of bad news in the past couple of months, including the instability in Iraq, the problems of Yukos company in Russia and strikes in Norway and Nigeria, to mention the key events.

Basic factor in crude oil market is difficulty OPEC having to raise production in situation of growing demand.

Nevertheless, beyond these specific factors arising during the summer the general situation in the oil market may be summed up by the fact that, in a situation of growing energy demand due to the sharp growth of the world economy and with oil exporting countries having little margin to increase their production over the short term, any risk seen in guaranteeing future supply brings about upward pressure on prices. These pressures have sharpened because of the active intervention of investors on a speculative basis.

OIL PRICES SHOOT UP

One-month forward price of Brent oil per barrel



SOURCE: Thomson Financial Datastream.

World oil demand in second quarter doubles growth rate.

The figures support this view of the more structural nature of the market for black gold. With regard to the rise in world oil demand, according to figures from the International Energy Agency (IEA), in the second quarter of the year demand rose to 5.2% year-to-year, twice the rate in the first three months of the year. Supply, on the other hand, is running into serious difficulties to grow at similar levels. The IEA estimates that last July production by the Organization of Petroleum Exporting Countries (OPEC), excluding Iraq, was 27.1 million barrels a day. The additional supply that could be put on the market within a period of 30 days was only 670,000 barrels, practically half of which would come from Saudi Arabia.

On contrary, prices of other raw materials easing since May.

This trend is in contrast to the moderation now beginning to show up in other raw materials. «The Economist» index for raw materials in August stood at levels 15% higher than those for one year earlier (expressed in dollars) and 5% (expressed in euros), figures far from the annual highs in May (31% and 19% respectively). The biggest moderation in raw materials has been led by foods and non-food agricultural products.

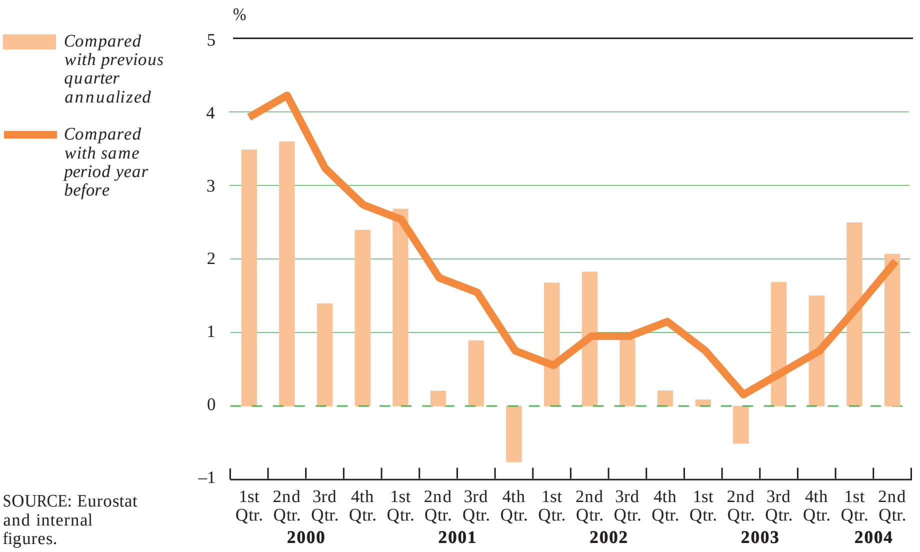
Euro area: foreign sector driving recovery

Euro area grows 2% in second quarter.

In the second quarter of 2004, the euro area economy grew by 2.0% year-to-year, somewhat stronger than the 1.3% year-to-year in the previous quarter. In spite of the fact that this figure represents a continuation of recovery, it should be pointed out that the year-to-year rate is partly biased upward because of the low level of growth recorded in the second quarter of 2003. This moderate rate of economic activity is reflected in the quarter-to-quarter increase annualized which came to 2.1%, lower than the 2.5% in the first quarter of 2004. In the absence of a breakdown by component, available indicators suggest that recovery in the euro area continues to largely depend on the strength of exports.

GRADUAL RECOVERY OF EURO AREA ECONOMY

Change in gross domestic product in real terms



SOURCE: Eurostat and internal figures.

Recovery still fragile and largely dependent on foreign sector given that private consumption scarcely advancing.

The main factor still missing in order to consolidate recovery is a more expansionist performance in private consumption. In this respect, the latest available indicators are mediocre. Retail sales fell by 0.1% year-to-year in the second quarter, worse than the poor result in the first three months of the year (increase of 0.6% year-to-year). Immediate prospects are not bright given that since the beginning of the year consumers in the euro area have been reporting a confidence level swinging around figures of the order of 14 points without showing more than a marginal tendency to improve. To some extent, this perception arises from the weakness shown by the labour market which is unable to offer any improvement, so far as can be seen from the weak growth of employment (increase of 0.2% year-to-year in the first quarter of 2004, with no change over the fourth quarter of 2003) and from the stable figure for the unemployment rate which in June repeated a figure of 9.0% of the labour force for the third consecutive month, the highest since October 1999.

EURO AREA: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2002	2003	2003			2004				
			2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
GDP	0.9	0.5	0.1	0.4	0.7	1.3	–	2.0	–	–
Retail sales	0.0	0.2	1.1	–0.4	–0.4	0.6	0.4	–1.8	1.2	...
Consumer confidence (*)	–11.0	–18.0	–19.0	–17.0	–16.0	–14.3	–14.0	–16.0	–14.0	–14.0
Industrial production	–0.5	0.3	–0.8	–0.3	1.4	1.1	1.6	3.7	2.7	...
Economic sentiment indicator (*)	94.4	93.5	91.4	94.2	97.7	98.7	100.2	100.3	99.7	100.1
Unemployment rate (**)	8.5	8.9	8.9	8.9	8.9	8.9	9.0	9.0	9.0	...
Consumer prices	2.2	2.1	1.9	2.0	2.0	1.7	2.0	2.5	2.4	2.3
Trade balance (***)	84.1	81.4	82.4	76.8	73.5	78.9	88.6	91.9	93.5	...

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

Industry down in June.

The more general supply indicator, that for economic sentiment, confirmed a diagnosis of an economy recovering something of its drive although at a very slow rate. This indicator went up to the level of 100.1 points in July, recovering from the relative dip in June but without going above the figures for April and May. By sector, we should point out that the state of industry is very uneven. Industrial production grew by 2.7% year-to-year in June compared with 3.7% year-to-year in May. While these rates are higher that those recorded in the first four months of the year, neither the level of industrial confidence nor that for the industrial climate (two indicators which have something of an anticipatory nature) make it possible to expect more than moderate growth in coming months.

Neither construction nor services show high rate of activity.

In turn, neither construction nor the tertiary sector are showing signs of any great strength. As a result, both indicators of sector confidence have put out signs of either stagnation (in the case of construction, where the confidence indicator has been stuck at levels of around –17 points since last April) or else backsliding (services recorded a drop in the confidence indicator in both June and July).

Inflation at 2.3% in July due to moderation in all price categories except energy.

In this situation of incipient recovery, inflationary pressures in recent months have special importance because they could possibly erode real incomes. Following a relatively contained start to the year, the harmonized consumer price index (HCPI) rose to 2.0% year-to-year in April and then rose again in May to 2.5%. As of that moment, consumer prices seem to have begun a gradual decrease. After growing by 2.4% year-to-year in June, the following month they dropped by one decimal to 2.3%. The reduced pressure on all components of the index with the exception of energy was behind this more moderate level of inflation.

Exports remain basic goal in present European situation.

In this situation, the most positive feature of the euro area situation continues to be its performance in exports. In June, exports grew by 15.4% year-to-year (increase of 4.8% year-to-year in the average for the first quarter) which, together with lower growth of imports (14.8% year-to-year in June) meant that the trade surplus rose once more. In June, the cumulative balance for 12 months stood at 93.5 billion euros, a clear recovery compared with the average for the months January-March when it stood at 78.9 billion euros.

Germany: private consumption delaying recovery

Germany's GDP grows 1.5% in second quarter.

Germany's economy grew by 1.5% year-to-year in the second quarter as against 0.8% year-to-year in the first three months of the year. With the quarter-to-quarter rate annualized the growth rate changes given that it goes from 1.7% in the first quarter to 1.9% in the second quarter. Even in a context of world economic recovery which runs in favour of exports (growth of 12.2%) the twin year-to-year drops in private consumption and investment (0.8% and 2.5% respectively) stand in the way of Germany's possibilities for growth.

GERMANY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2002	2003	2003			2004				
			2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
GDP	0.1	–0.1	–0.3	–0.3	0.0	0.8	–	1.5	–	–
Retail sales	–2.2	–0.6	0.8	–1.8	–1.2	–0.5	–1.6	–6.1	1.0	...
Industrial production	–1.2	0.1	–0.5	–1.3	1.4	1.1	1.9	3.5	2.7	...
Industrial activity index (IFO) (*)	89.4	91.7	89.5	92.5	96.2	96.4	96.3	96.1	94.6	95.6
Unemployment rate (**)	10.2	10.5	10.6	10.5	10.5	10.4	10.5	10.5	10.5	10.6
Consumer prices	1.4	1.1	0.9	1.1	1.2	1.1	1.7	2.1	1.6	1.8
Trade balance (***)	118.6	130.9	128.8	131.1	132.3	139.7	148.5	152.7	155.9	...

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

Consumption indicators confirm weakness of household spending in contrast to investment which is more dynamic.

As a result, the economic situation in Germany continues to be ruled by the slack in household spending, so far as can be deduced from consumer indicators for the second quarter. In that period, retail sales fell by 2.3% year-to-year, industrial production of consumer goods rose by only 0.9% year-to-year and, finally, consumer confidence was down by two points to the –17 points level. The only positive aspect of domestic demand came in capital goods investment, as shown by the notable rise in industrial production of those goods, close to 6% year-to-year in the second quarter of the year.

Exports stand at levels 10% higher than one year ago.

Foreign demand, in turn, continues to act as the main engine of the economy. In exports, June was the third consecutive month with growth above 10% year-to-year, which meant an increase in Germany's trade surplus to 155.9 billion euros as cumulative balance for 12 months (139.7 billion euros in the first quarter). Imports, on the other hand, in keeping with the poor level of domestic demand, dropped to 5.3% year-to-year in June (8.9% year-to-year in May).

Industrial production up 2.7% in June, relatively slower than in May.

On the supply side, what stands out is the drop in growth rate of industrial production in June, with an increase of 2.7% year-to-year, which for the moment halts the incipient recovery begun in April. The scenario for coming months is uncertain if we are to go by the swings shown in the IFO industrial activity index since the beginning of the year which, in spite of being erratic, shows an underlying downward trend. In this respect, the moderate rise in June to the 95.6 points level and the slight drop in August (95.3 points) may be taken as partial compensation for the drop in June.

Unemployment rate up to 10.6% in July while inflation goes to 1.8%.

Finally, indicators for prices and the labour market show many of the same trends as in previous months. With regard to inflation, consumer prices were up by 1.8% year-to-year in July as a result of the impact of higher energy prices, a factor which has been pushing up Germany's CPI since last April. After being stable at 10.5% for three months, the unemployment rate rose by one decimal in July to stand at 10.6% of the labour force.

France: growth moves up to 3%

In France, drive in domestic demand brings growth of 3.0% in second quarter.

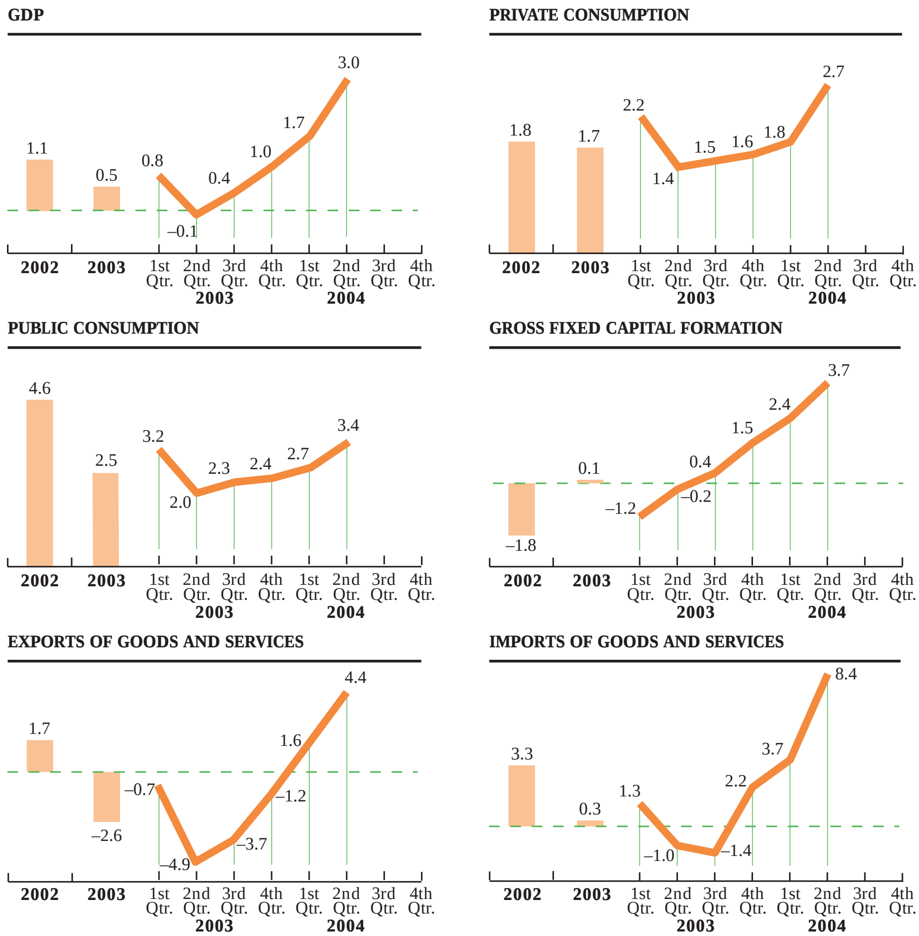
The French economy underwent a notable rise in growth in the second quarter. In the three months from April to June the gross domestic product (GDP) rose by 3.0% year-to-year as against 1.7% in the first quarter. All demand components showed substantial recovery compared with previous quarters although what stood out was the major rise in private consumption (which increased to 2.7% year-to-year from the previous 1.8%) and gross fixed capital formation (3.7% year-to-year in the third quarter compared with the previous 2.4%). In turn, the foreign sector reduced its negative contribution to the change in GDP from 1% in the first quarter to 0.7% in the second quarter.

Industrial production slackens in June but immediate prospects not negative.

Latest available indicators offer no notable developments apart from showing a further increase in the strength of private consumption which reached a year-to-year increase of 8.6% in June, four points higher than in May. On the supply side, we should point out that industrial activity slackened in June dropping to 2.7% year-to-year (3.5% year-to-year in May). In any case, the relatively better performance of exports in May and June, when foreign sales rose by the order of 10% year-to-year, along with a recovery in industrial orders and industrial confidence in June and July, suggest that the dip in industry will be short-lived.

TREND IN FRENCH GDP BY COMPONENT

Percentage year-to-year change rate



SOURCE: INSEE and internal figures.

Investment and consumption pushing up growth.

Unemployment worsens slightly in June going to 9.9% while inflation stalls at 2.3% in July.

The CPI, in turn, followed the trend already shown in other euro area economies and, after reaching an annual high in May (2.6% year-to-year) has since then been dropping. In July, inflation stood at levels 2.3% higher than one year earlier. Less satisfactory was the trend in the unemployment rate which, after four consecutive months at 9.8%, moved up to 9.9% in June.

FRANCE: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2002	2003	2003 2nd Qtr.	2003 3rd Qtr.	2003 4th Qtr.	2004 1st Qtr.	2004 April	2004 May	2004 June	2004 July
GDP	1.1	0.5	–0.1	0.4	1.0	1.7	–	3.0	–	–
Domestic consumption	0.9	0.9	–0.3	0.8	1.4	2.5	3.8	4.6	8.6	...
Industrial production	–1.4	–0.4	–1.7	–0.8	0.9	0.5	0.8	3.5	2.7	...
Unemployment rate (*)	9.3	9.9	9.8	9.9	9.9	9.8	9.8	9.8	9.9	...
Consumer prices	1.9	2.1	1.9	2.0	2.2	1.9	2.1	2.6	2.4	2.3
Trade balance (**)	0.4	0.3	0.3	0.2	0.1	0.3	0.3	0.3	0.3	...

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

Italy: slight recovery in second quarter

Italy's economy grows 1.1% in second quarter but early indicators suggest recovery could be limited.

In the second quarter of 2004, Italy's economy grew by 1.1% year-to-year, a moderate increase over the 0.7% in the first quarter. In spite of this slight rise in economic activity, early indicators hold out hope for no more than contained growth. The composite index of leading indicators published by the Organization for Economic Cooperation and Development would suggest a process of slowdown in the months of May and June, which all corresponds with the uneven course followed by the economic sentiment index as of July when it stood at the 100.6 points level, scarcely above the average for the second quarter.

ITALY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2002	2003	2003 2nd Qtr.	2003 3rd Qtr.	2003 4th Qtr.	2004 1st Qtr.	2004 April	2004 May	2004 June	2004 July
GDP	0.4	0.4	0.2	0.4	0.1	0.7	–	1.1	–	–
Retail sales	2.4	2.0	3.2	1.8	0.9	1.2	0.8	–3.2	...	...
Industrial production	–1.3	–0.5	–1.6	–0.2	0.1	0.0	0.7	1.7	0.0	...
Unemployment rate (*)	9.0	8.7	8.7	8.6	8.5	8.5	–	...	–	–
Consumer prices	2.5	2.7	2.7	2.8	2.5	2.2	2.3	2.3	2.4	2.3
Trade balance (**)	10.8	3.4	3.5	1.5	2.0	1.4	2.6	3.2	...	...

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

Lack of drive in consumption and limited improvement in industry twin stumbling blocks in Italy's economic situation.

These limited prospects arise from the lack of impetus in domestic demand (in May retail sales were down by 3.2% year-to-year) and the lack of drive in industrial activity. As a result, in spite of the recovery in exports reported between March and May, industrial production in June stood at the same level as one year earlier. In turn, consumer prices grew by 2.3% year-to-year in July as against 2.4% year-to-year the month before.

United Kingdom: notable rate of economic activity in second quarter

United Kingdom grows by close to 4% in April-June period thanks to strong domestic demand.

The British GDP grew by 3.7% year-to-year in the second quarter which meant two consecutive quarters above 3%. By component, we should mention the sharp increase in domestic demand (from 3.7% year-to-year in the first quarter to 4.4% in the second) due to renewed drive in private consumption (growth of 3.8% year-to-year) and the substantial recovery in investment (year-to-year increase of 7.5%). On the other hand, the foreign sector took off nine decimals from the change in the GDP, more than twice that in the first quarter. While the breakdown by component is not yet available, the good performance in retail sales (6.6% year-to-year in July) and other private consumption indicators would confirm that household spending continues to act as the main engine of the economy. The recovery of consumer confidence as of July points to a continuation of this positive trend in the near future.

UNITED KINGDOM: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2002	2003	2003			2004				
			2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
GDP	1.8	2.2	2.1	2.2	2.9	3.4	–	3.7	–	–
Retail sales	6.8	2.9	2.6	3.0	3.1	6.4	6.0	7.3	6.9	6.6
Industrial production	–2.5	–0.1	–0.5	–0.1	0.5	–0.2	1.0	1.1	0.5	...
Unemployment rate (*)	3.0	2.9	3.1	3.0	2.9	2.8	2.8	2.8	2.7	2.7
Consumer prices	2.2	2.8	2.9	2.8	2.6	2.3	2.0	2.3	2.3	2.2
Trade balance (**)	–43.5	–46.8	–46.5	–47.1	–47.3	–49.8	–52.3	–53.2	–53.6	...

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

Good situation in services in contrast to problems in industrial activity.

With regard to trends by sector, while in recent months services seem to have undergone something of a halt to growth, they are still showing a high level of activity. On the other hand, industrial production remains stuck in a state of weakness. The industrial production index for June stood at levels some 0.5% higher than in the same month in 2003, a very modest advance when compared with the general strength of the economy. The improvement in exports, which showed up as incipient in July, should go in favour of foreign sales of British manufactures.

Little pressure on consumer prices while unemployment at all-time lows.

Maintenance of the unemployment rate at low levels since 1975 (2.7% in July) and the absence of relevant inflationary pressures (the CPI in July, discounting mortgage interest costs was 2.2% year-to-year as against 2.3% in June) round out an economic situation among the best in Europe.

MONETARY AND CAPITAL MARKETS

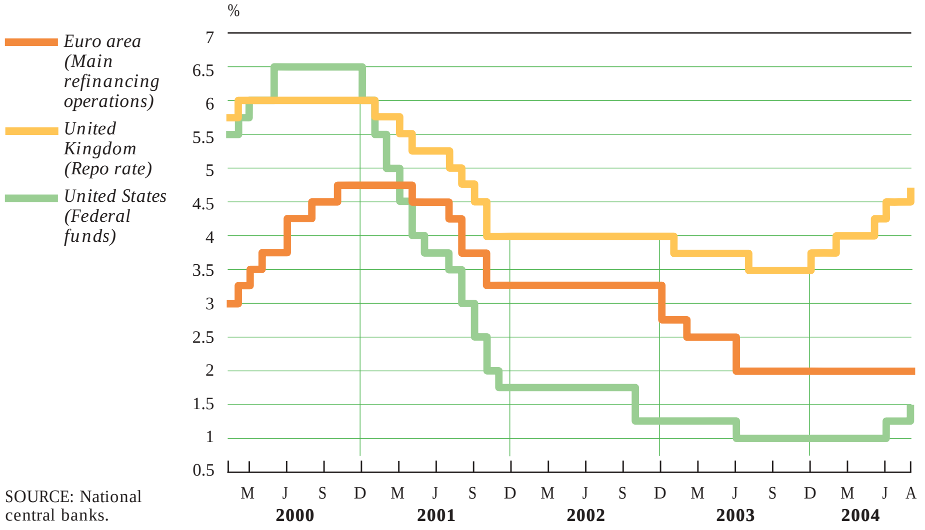
Federal Reserve Board again raises reference rate

Upturn in interest rates consolidating.

Recovery of the world economy and the subsequent rise in raw materials prices, particularly the increase in oil prices above 40 dollars, is putting pressure on prices. In this situation, the very easy monetary policies followed by many central banks no longer apply. As a result, some central banks, such as those in the United Kingdom and Switzerland and the U.S. Federal Reserve Bank have begun upward moves in interest rates. Nevertheless, it is likely that the European Central Bank and the Bank of Japan will wait some months still before beginning a restrictive monetary policy due to conditions in their areas. As a result, the period of interest rates at all-time low rates is coming to an end.

GRADUAL UPTURN IN OFFICIAL INTEREST RATES

Monetary policy reference rates



SOURCE: National central banks.

Federal Reserve Board again raises reference rate putting it at 1.50%.

In the United States, the appearance of Alan Greenspan, chairman of the Federal Reserve Board, before the U.S. Congress and Senate around mid-July confirmed that the process moving toward a less expansionist monetary policy had begun. As a result, at the meeting of the Federal Open Market Committee held on August 10, it was decided to increase 1-day interbank reference rate by 25 basis points to 1.50% with the same measure being taken on the discount rate putting it at 2.50%. This measure had been widely expected. In its press release, the Federal Open Market Committee felt that part of the increase in inflation was of a temporary nature. At the same time, it confirmed that the risks were in balance both for growth and inflation. In this situation, it announced that the turnaround in monetary policy would be gradual.

SHORT-TERM INTEREST RATES IN NATIONAL MARKETS

Monthly averages as annual percentage

	Euro area			United States		Japan	United Kingdom		Switzerland
	ECB auctions (2)	Euribor		Federal Reserve Board target level (3)	3-month	3-month	Bank of England intervention rate (4)	3-month	3-month
		3-month	1-year						
2003									
July	2.08	2.13	2.08	1.00	1.08	0.01	3.58	3.39	0.28
August	2.06	2.14	2.28	1.00	1.10	0.01	3.50	3.43	0.26
September	2.07	2.15	2.26	1.00	1.10	0.00	3.50	3.60	0.25
October	2.05	2.14	2.30	1.00	1.12	0.00	3.50	3.71	0.24
November	2.02	2.16	2.41	1.00	1.13	0.01	3.71	3.89	0.25
December	2.01	2.15	2.38	1.00	1.12	0.01	3.75	3.93	0.26
2004									
January	2.01	2.09	2.22	1.00	1.09	0.01	3.75	3.96	0.24
February	2.00	2.07	2.16	1.00	1.07	0.01	3.96	4.08	0.25
March	2.00	2.03	2.06	1.00	1.07	0.01	4.00	4.21	0.25
April	2.00	2.05	2.16	1.00	1.10	0.00	4.00	4.30	0.28
May	2.00	2.09	2.30	1.00	1.21	0.00	4.21	4.44	0.26
June	2.00	2.11	2.40	1.25	1.47	0.00	4.42	4.71	0.41
July (*)	2.01	2.12	2.36	1.25	1.59	0.00	4.50	4.77	0.50
August (1)	2.02	2.12	2.32	1.50	1.73	0.00	4.75	4.91	0.55

NOTES: (*) Provisional figures.
(1) August 24.
(2) Marginal interest rate. Latest dates showing change in minimum rate: 6-3-03 (2.50%), 5-6-03 (2.00%).
(3) Latest dates showing change: 25-6-03 (1.00%), 30-6-04 (1.25%), 10-8-04 (1.50%).
(4) Latest dates showing change: 6-2-03 (3.75%), 10-7-03 (3.50%), 6-11-03 (3.75%), 5-2-04 (4.00%), 6-5-04 (4.25%), 10-6-04 (4.50%), 5-8-04 (4.75%).
SOURCE: European Central Bank, Bank of Spain, Thomson Financial Datastream and internal figures.

Upward prospects on U.S. interest rates moderating.

As a result, the interest rate on 1-year U.S. interbank deposits swung according to the economic indicators published and the signals coming from the Federal Reserve Board. Toward the end of July it went to the same level as at the end of June to stand at 2.42% but again dipped following publication of a lower than expected figure on job creation in July and the rate went to 2.28% on August 25. The interest rate curve suggests that operators are discounting that the official Federal Reserve Board rate will stand at around 2% at the end of the year.

European Central Bank continues to make no move…

In the euro area, the Governing Council of the European Central Bank (ECB) made no change in its reference rates at its meeting on August 5. As a result, the Eurosystem reference rate has held at 2% since June 2003. The ECB has continued to resist pressure to cut the official interest rate. In its latest bulletin published in August, although it foresaw short-term inflationary pressures, it felt that over the medium term inflation would be in line with its objectives. Nevertheless, it pointed to risks such as the price of oil, future developments on indirect taxes and controlled prices, as well as wages.

…and no change likely before year-end...

In this framework, while the 3-month Euribor stood slightly above the Eurosystem reference rate, the 12-month Euribor stood at 2.36% on monthly average in July, although it was 5 basis points below the level in November 2003. At the beginning of the fourth week in August the 12-month Euribor stood at 2.32%. As a result, the market was not expecting any change during the rest of the year and was putting any upward change forward into the first quarter of 2005.

…in contrast to Bank of England which has again raised official rate putting it at 4.75%.

On the other hand, the Bank of England continued to raise its official interest rates putting it up 25 basis points to 4.75% on August 5, as had been expected. This was the fourth increase in reference rate during the year and the fifth since November. The British central bank took this decision to hold down inflationary pressures which could put in danger reaching the objective of price stability over the medium term, set at 2%. Following the August increase the market is expecting further increases of only 25 basis points in the Bank of England rate in coming months.

Bank of New Zealand also raises interest rate.

In addition, on July 29 the Bank of New Zealand again raised its official interest rate for the fourth time this year putting it up 25 basis points to 6.00%. The New Zealand central bank took this action to meet inflationary risks and warned that further increases were likely.

Swings in euro and dollar with no clear course

Economic slowdown and increase in trade deficit hurting dollar.

The dollar marked up its lowest level since 1997 against a broad group of currencies on January 9, 2004. Later on, confirmation of economic recovery in the United States, the moves by the Asian central banks to acquire U.S. currency and the expectation of a rise in the Federal Reserve Board official rate boosted the dollar. As a result, on May 13 the U.S. currency reached a high since September 2003 against a broad group of currencies. Later on, signs of some slowdown in economic growth, moderation in prospects regarding the programme of increases in U.S. reference rates and the rise in the trade deficit contributed to a weakening of the dollar. In overall terms, at the beginning of the fourth week in August the U.S. currency had dropped by 2.6% compared with the high in May although it showed an appreciation of 1.7% compared with the end of December.

Euro has difficulty going above level of 1.24 dollars.

The euro marked up an all-time high against the group of currencies of the 13 main trading partners of the euro area in the second week of January 2004. Nevertheless, it later dropped because the market was sensitive to statements by the European Central Bank expressing concern about its rapid appreciation, and because of the weakness of economic strength in the euro area and speculation about a further decrease in the Eurosystem reference rate. As a result, on April 13 it recorded the lowest level since November 2003. Nevertheless, the disappearance of prospects of a reduction in the ECB reference rate helped it to recover to some degree. In any case, at the beginning of the fourth week in August the single currency had depreciated by 3.3% in terms of its main trading partners compared with the end of 2003. Against the dollar, the euro recovered the 1.24 level on July 19 but then dropped again in the face of the rise in the dollar. On August 25 it was running at 1.214 dollars, a decrease of 3.9% since the beginning of the year.

EXCHANGE RATES OF MAIN CURRENCIES

July 2004

	Final session of month		Monthly figures				*Exchange rate August 24, 2004*
	Exchange rate	% monthly change (2)	Average exchange rate	% change (2)			
				Monthly	Over December 2003	Annual	
Against U.S. dollar							
Japanese yen	111.4	2.3	109.5	0.1	1.6	–7.7	*109.6*
Pound sterling (1)	1.820	0.0	1.843	0.8	5.1	13.5	*1.793*
Swiss franc	1.282	2.6	1.245	–0.4	–1.3	–8.4	*1.273*
Canadian dollar	1.332	–0.1	1.322	–2.6	0.8	–4.2	*1.308*
Mexican peso	11.41	–1.1	11.47	0.7	1.9	9.7	*11.38*
Nominal effective index (4)	*116.1*	*0.2*	*115.1*	*–0.7*	*0.5*	*–2.9*	115.3
Against euro							
U.S. dollar	1.204	–1.0	1.227	1.1	–0.2	7.9	*1.214*
Japanese yen	134.2	1.4	134.1	0.9	1.2	–0.7	*133.0*
Swiss franc	1.541	1.1	1.527	0.5	–1.8	–1.3	*1.541*
Pound sterling	0.663	–1.2	0.666	0.2	–5.2	–5.0	*0.673*
Swedish krona	9.236	1.0	9.196	0.6	1.9	0.1	*9.161*
Danish krone (3)	7.436	0.0	7.435	0.0	–0.1	0.0	*7.438*
Nominal effective index (5)	*101.8*	*–0.3*	*102.4*	*0.6*	*–1.6*	*1.0*	102.1

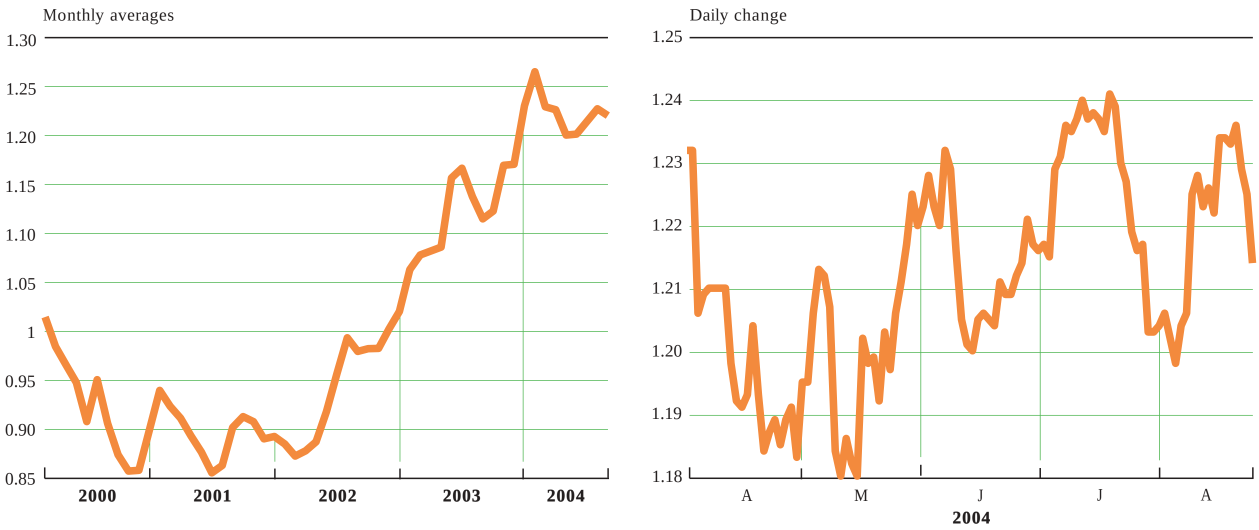
NOTES: (1) Units to pound sterling.
(2) Percentages of change refer to rates as shown in table.
(3) Danish krone has central parity of 7.46038 against euro with fluctuation band of ±2.25%.
(4) Broad nominal effective index of U.S. Federal Reserve Board. Calculated as a weighted average of the foreign exchange value of the U.S. 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 13 main trading partners of the euro area. Base: I-1999 = 100.
SOURCE: Thomson Financial Datastream and internal figures.

Decreased prospects of further interest rate rises hurts pound sterling.

On June 17, the pound sterling reached its highest level against a wide group of currencies since October 2002, helped out by the buoyant state of the economy and the interest rate differences in its favour. While it later tended to weaken at the end of July it came close to the annual high in June following the prospect of further increases in the Bank of England interest rate. Nevertheless, with the easing of prospects of British interest rate increases, the pound later lost ground. As a result, at the beginning of the fourth week in August it showed a drop of 2.6% compared with the high in June, although it still held an overall appreciation of 3.5% over the end of December. In the first 25 days of August, the pound depreciated by 1.5% against the euro and 1.5% against the dollar. Since the beginning of the year the British currency has shown an appreciation of 0.4% against the dollar and 4.8% against the euro.

EURO SWINGS AGAINST DOLLAR

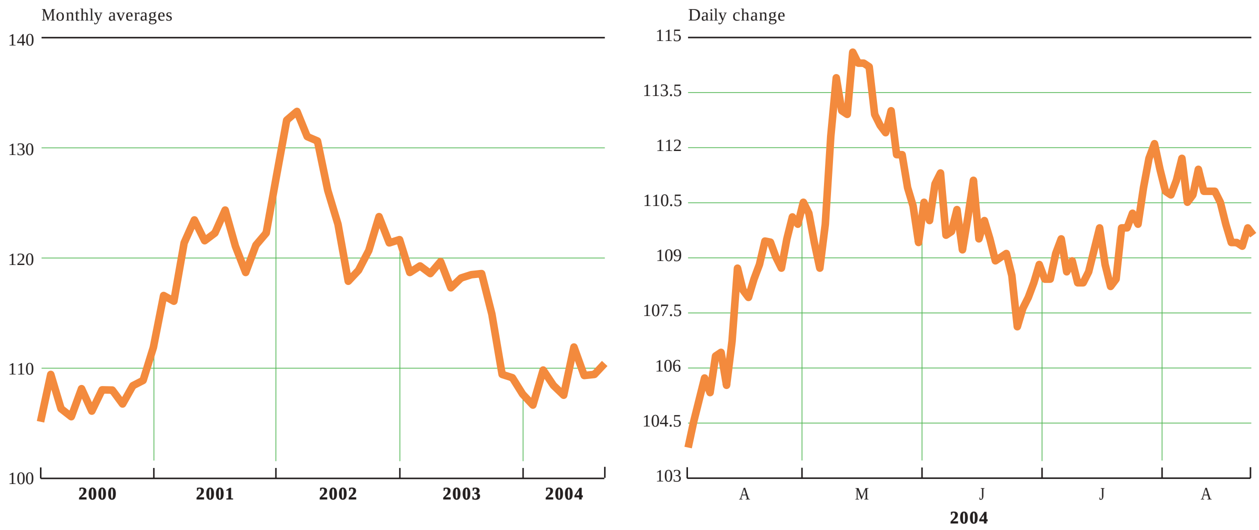
U.S. dollars to euro



NOTES: Figures go up to August 24. SOURCE: OECD, Thomson Financial Datastream and internal figures.

YEN DEPRECIATES SLIGHTLY AGAINST DOLLAR IN SUMMER

Yen to dollar



NOTES: Rates go up to August 24. SOURCE: OECD, Thomson Financial Datastream and internal figures.

Loss of drive in Japan's economy affecting yen.

The loss of drive in Japan's economy and the drop on the Tokyo stock exchange have hurt the yen in recent weeks. The Japanese currency has thus dropped by 0.7% against the dollar and 0.5% against the euro since the end of the first half-year. On the other hand, during the course of the year, while it fell 2.2% against the dollar, it showed a rise of 1.5% against the euro.

Yields on government bonds easing

Yield on U.S. Treasury bonds stands at level at start of year.

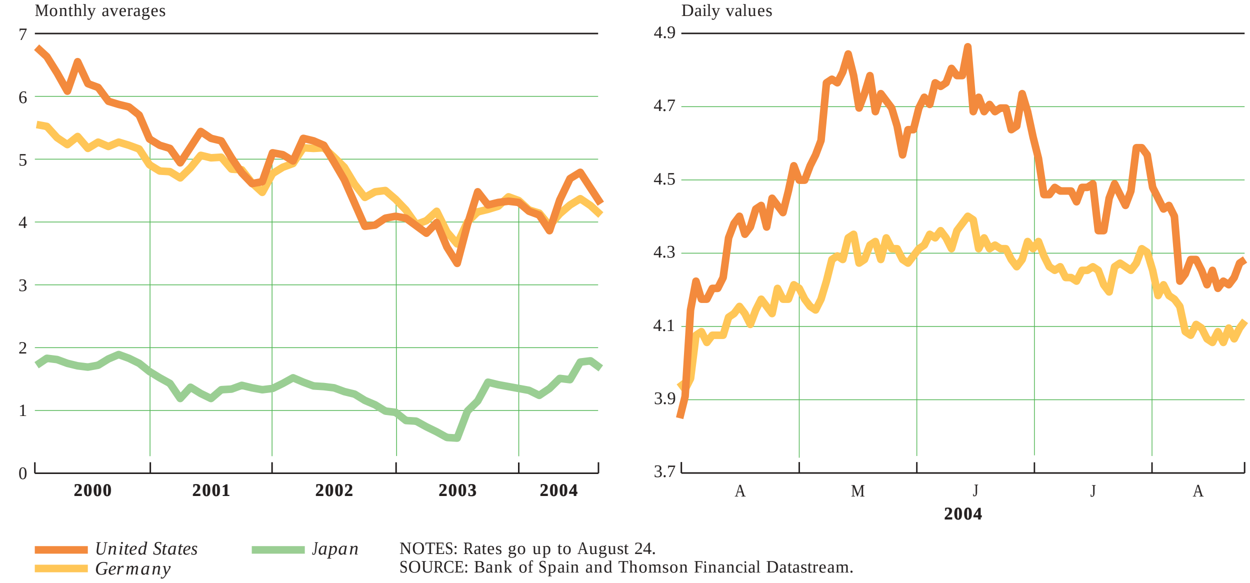
The yield on U.S. 10-year Treasury bonds marked up the highest for the past two years going to 4.87% on June 14. Later on, doubts about the sustainability of the economic growth rate, an easing off in upward prospects for Federal Reserve Board interest rates and shifts from the stock markets because of the safe haven effect in view of alarm caused by terrorist attacks meant that yields on government bonds tended downward. As a result, the interest rate on U.S. 10-year Treasury bonds stood at 4.28% on August 25, just 2 basis points above the level at the beginning of the year and 59 basis points above the low in mid-March.

Rating of Italian government bonds drops.

In recent weeks the yield on German 10-year government bonds has followed the course set by similar U.S. bonds although dropping to a lesser extent so that the differential between both these bonds was reduced. On August 25 the yield stood at 4.11%, some 15 basis points below the end of December. On the other hand, the reduction of the rating on Italian long-term government bonds to AA- by Standard & Poor's at the beginning of July due to the worsening of Italy's public finances had little effect on their risk premium. This was the first reduction in rating of sovereign bonds in the euro area since the launching of the single currency, although Moody's agency maintained the rating for Italian bonds at the Aa2 level.

REDUCTION IN INTEREST RATE DIFFERENTIAL ON U.S. AND GERMAN LONG-TERM BONDS

Yield on 10-year government bonds as annual percentage



NOTES: Rates go up to August 24.
SOURCE: Bank of Spain and Thomson Financial Datastream.

European companies get improved credit rating.

On the contrary, the upward revisions of the credit rating of companies in Western Europe in the second quarter were higher than reductions for the first time in four years, according to Moody's agency. In addition, issues of high-yield European bonds this year have already exceeded the total volume in 2003 and are running close to the all-time high in 1999.

Ups and downs in interest rate on Japanese government bonds.

The interest rate on Japanese government bonds went to 1.87% on June 24, the highest level since October 2000 as a result of the recovery of Japan's economy and the feeling among investors that an early finale to the stage of deflation would bring about an end to the period of 0% interest rates. Nevertheless, in the early weeks of August the yield on Japanese government bonds dropped substantially following the weakening of economic prospects and it went to 1.60% at the beginning of the fourth week of that month, although it stood 27 basis points above the end of 2003.

LONG-TERM INTEREST RATES IN NATIONAL MARKETS

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

	2002	2003	2004					
			1st Qtr.	April	May	June	July	August 24
United States	4.65	4.04	4.05	4.35	4.77	4.79	4.54	4.28
Japan	1.27	0.99	1.30	1.51	1.49	1.77	1.79	1.60
Germany	4.80	4.10	4.09	4.13	4.29	4.37	4.26	4.11
France	4.88	4.13	4.11	4.20	4.34	4.39	4.28	4.09
Italy	5.04	4.24	4.24	4.35	4.50	4.55	4.44	4.29
Spain	4.96	4.12	4.12	4.20	4.33	4.39	4.28	4.13
United Kingdom	4.93	4.53	4.83	5.00	5.16	5.25	5.15	5.00
Switzerland	3.02	2.47	2.46	2.64	2.72	2.87	2.83	2.71

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

Main stock markets show drops in summer months

Stock markets reflect worsening of economic climate…

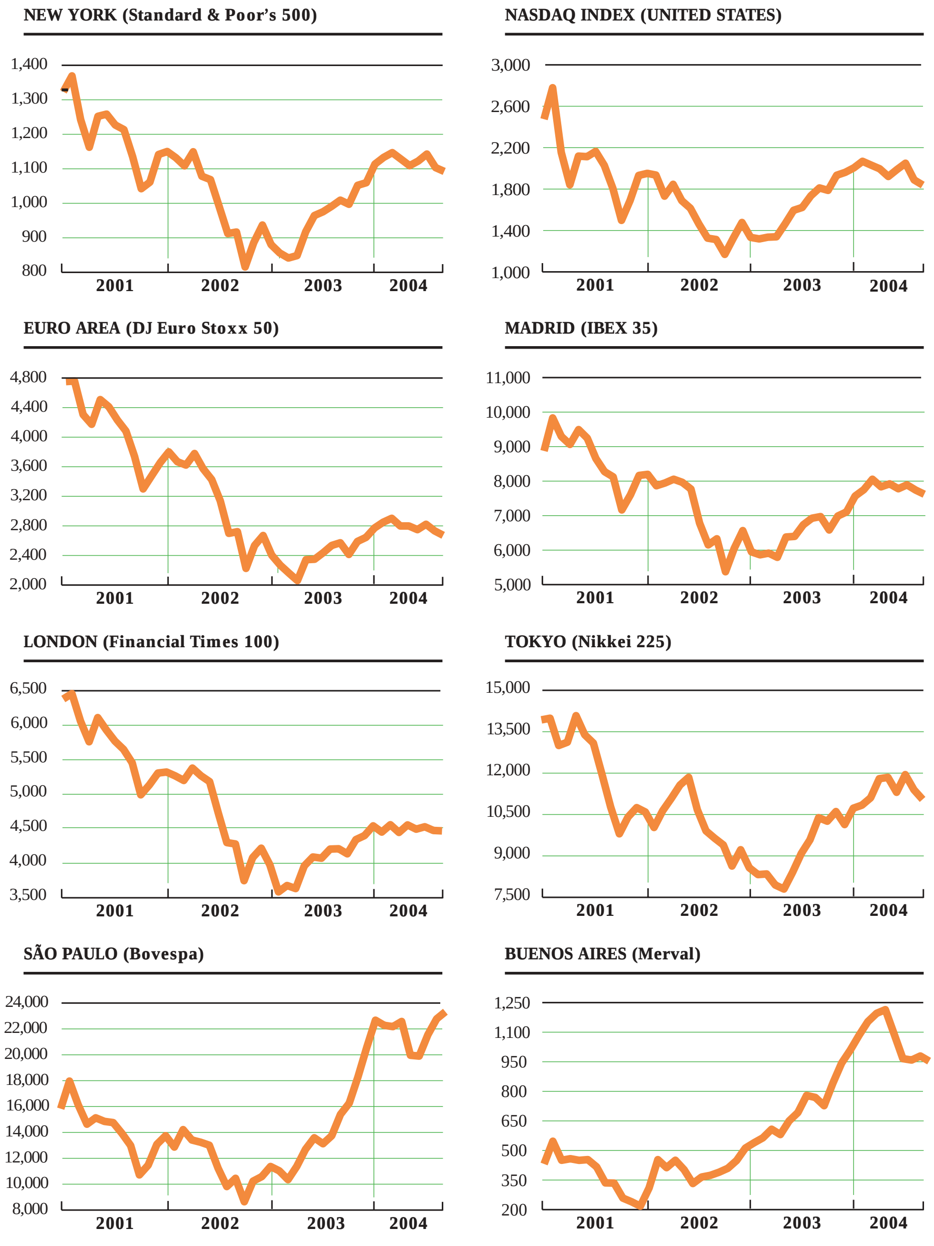
The stock markets began the year in positive fashion following the upward course set since the lows in March 2003. Recovery of the economy without inflation, good prospects for corporate profits and interest rates at all-time low levels enlivened the stock markets. Nevertheless, they later suffered a series of blows brought about by the terrorist attacks in Madrid on March 11, the worsening of the situation in the Middle East and Iraq, the rise in bond yields since mid-March in anticipation of an upturn in official interest rates as well as the continuing rise in oil prices.

...because of sharp rise in oil prices and other factors.

The concern about terrorism remained during the summer and the rise in oil prices has continued, thus putting it at record levels in August. This has brought a scenario of slowdown in corporate profits which meant many stock markets were marking up annual lows in August. As a result, on August 25 most indices of the main international stock markets stood below par for the year although they generally showed substantial gains over one year ago.

INTERNATIONAL STOCK EXCHANGES

Indices at month-end



NOTES: August 24, 2004. SOURCE: Thomson Financial Datastream.

Oil sector benefits from rise in price of crude.

By sector, one of the areas to show the best trend in the first seven and a half months of the year was the oil business due to the sharp rise in the price of crude. On the other hand, this factor has hurt sectors such as the airlines and the car industry.

U.S. stock market indices mark up annual lows in August going below par for year…

In the United States the upward trend which had brought major increases in stock market indices in 2003 began to show signs of wearing out at the end of January. Publication of disappointing figures for monthly job creation in July and August, along with other weak indicators increased doubts about the sustainability of the economic growth rate in the United States which had a negative effect on the stock markets. As a result, the main indices for the U.S. stock markets recorded annual lows in the first weeks of August. At the beginning of the fourth week of that month, the Standard & Poor's 500 index stood at 1.4% below the level at the beginning of the year but maintained gains of 10.4% in the past 12 months. The Nasdaq general index, which is representative of hi-tech shares, suffered a bigger blow in recent months going to 8.3% below par for the year although it was 4.1% above one year earlier.

INDICES OF MAIN WORLD STOCK EXCHANGES
July 30, 2004

	Index (*)	% monthly change	% cumulative change	% annual change	*Figures on August 24, 2004*	
					% cumulative change	*% change over same date in 2001*
New York						
Dow Jones	*10,139.7*	*–2.8*	*–3.0*	*9.8*	*–3.4*	*–3.1*
Standard & Poor's	*1,101.7*	*–3.4*	*–0.9*	*11.3*	*–1.4*	*–7.5*
Nasdaq	*1,887.4*	*–7.8*	*–5.8*	*8.8*	*–8.3*	*–4.2*
Tokyo	11,325.8	–4.5	6.1	18.4	2.9	*–1.6*
London	4,413.1	–1.1	–1.4	6.2	–1.6	*9.5*
Euro area	2,720.1	–3.2	–1.5	7.9	–3.7	*1.7*
Frankfurt	*3,895.6*	*–3.9*	*–1.8*	*11.7*	*–4.9*	*–30.0*
Paris	*3,647.1*	*–2.3*	*2.5*	*13.6*	*1.0*	*–26.9*
Amsterdam	*329.9*	*–4.4*	*–2.3*	*3.9*	*–4.8*	*–40.3*
Milan	*1,298.3*	*–2.1*	*3.3*	*11.3*	*1.1*	*–18.9*
Madrid	*7,919.3*	*–2.0*	*2.4*	*12.1*	*0.7*	*–8.8*
Zurich	5,547.2	–1.3	1.1	9.2	–2.0	*–19.9*
Hong Kong	12,238.0	–0.4	–2.7	20.8	0.6	*13.8*
Buenos Aires	966.1	2.2	–9.9	27.9	–12.3	*196.9*
São Paulo	22,336.0	5.6	0.4	64.6	2.9	*75.9*

NOTES: (*) New York: Dow Jones Industrials, Standard & Poor's Composite, Nasdaq Composite; Tokyo: Nikkei 225; Euro area: DJ Euro Stoxx 50; London: Financial Times 100; Frankfurt: DAX; Paris: CAC 40; Amsterdam: AEX; Milan: Banca Commerciale Italiana; 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 internal figures.

…as in case of DJ Eurostoxx 50 although show year-to-year gains.

The stock markets in the euro area have also shown substantial drops in recent months. The DJ Eurostoxx 50 index, which is representative of the larger companies in the euro area, at the beginning of the fourth week in August stood 3.7% below the level at the beginning of the year, although compared with 12 months earlier the balance showed an increase of 2.5%. It should be mentioned that on August 25 the Milan, Paris and Madrid stock exchanges showed a slightly positive cumulative balance.

Nikkei 225 index for Japanese stock market maintains capital gains over December in spite of recent drops.

Outside the euro area, toward the end of April the Nikkei 225 index for the Japanese stock market showed an increase of 13.9% over December, going above 12,100 points thanks to recovery of Japan's economy. Nevertheless, the rise in oil prices and the faltering of economic prospects reduced the cumulative gain to 2.9% at the beginning of the fourth week in August. On August 25, the Financial Times 100 index for the London stock exchange stood 1.6% below the end of the year. On the other hand, the SMI index for the Swiss stock exchange suffered a loss of 2.0% in the first seven and a half months of the year.

Following sharp swings, IBEX 35 stands close to level at start of year.

With regard to the Spanish stock market, the IBEX 35 went through sharp swings during the year going from an annual high of 8,444.3 points on April 13 (with cumulative gains of 9.1%) to an annual low below par just four months later. At the beginning of the fourth week in August it stood 0.7% above the starting level for the year. Eleven shares out of the 35 making up the selective index stood in the red compared with the end of 2003. Nevertheless, in the past 12 months this index obtained notable capital gains of 8.1%.

Favourable trend in Brazilian and Mexican stock markets in first seven and half months of year.

So far as emerging stock markets go, they have been fairly erratic in the course of the year. At the beginning of the fourth week in August the Hang Seng index in Hong Kong showed an increase of 0.6% over the end of December and, compared with 12 months earlier, presented an increase of 17.5%. In Latin American markets, the Merval index for the Buenos Aires market fell by 12.3% in the course of 2004 although it showed an annual rise of 37.5%. On the other hand, the Bovespa index for the Brazilian stock market marked up cumulative gains of 2.9% for the year and an annual rise of 56.5%. The Mexican stock market obtained a still better result this year with cumulative capital gains of 16.2%.

ECONOMIC ACTIVITY

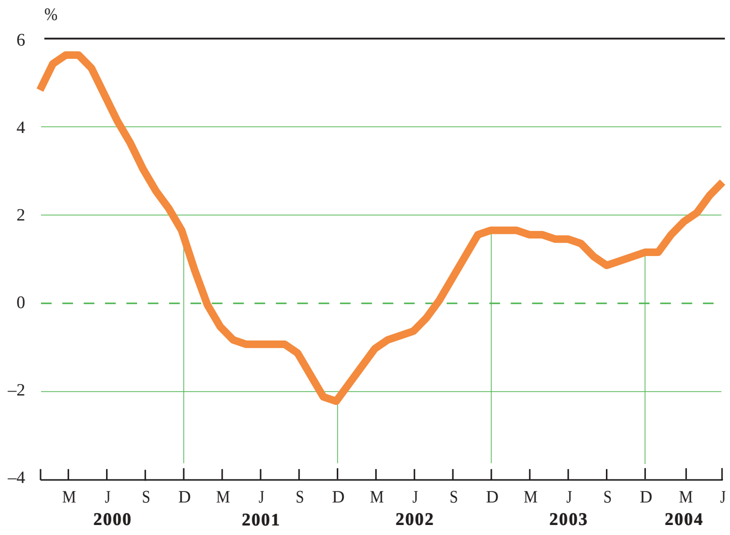
Domestic demand remains main support for growth

Weakness in exports halting growth of Spain's economy.

The few figures available for the third quarter show that growth of Spain's economy continues to be based on the strength of domestic demand, with investment in capital goods tending to take on a bigger role. Electrical power consumption, adjusted for number of working days and temperature, an indicator closely linked to the general rate of economic activity, grew by 3.3% year-to-year in July in terms of cycle trend, the same as in June, which suggests that the general trends in economic activity had not changed substantially at the beginning of the second half-year. While further figures to fully confirm this are lacking, it would seem that the weakness in exports of goods and services continues to be the weakest link in growth of Spain's economy.

INDUSTRIAL PRODUCTION RECOVERING

Year-to-year change in industrial production index



NOTES: Cycle-trend series corrected for number of working days.
SOURCE: National Institute of Statistics and internal figures.

Industrial production improving thanks to strength in capital goods, energy and intermediate goods.

The industrial production index has gone through an appreciable improvement in recent months, thanks to the strong growth of the energy branches and recovery of those branches related to intermediate goods and capital goods. On the other hand, production of consumer goods is maintaining a notable weakness in contrast to the drive shown in imports of goods of this type, which to some extent indicates a possible loss of competitiveness of Spanish industry.

Metallurgical industry and machine building and electrical equipment stand out as most dynamic branches.

With regard to the manufacturing industry as a whole, of special note is the positive situation in metallurgy and the manufacture of machinery and electrical equipment which showed average growth of 8.5% and 10.6% as of June respectively compared with the first half of 2003. Machine building, medical equipment, paper and publishing, with growth close to 5%, were also among the most expansionist branches. On the other hand, production of data-processing equipment was down by 30.1% while the leather industry dropped by 11.5%. Somewhat lower drops (between 3% and 5%) showed up in the textile industry, electronic equipment, clothing and furs and furniture manufacturing.

SUPPLY INDICATORS

Percentage change over same period year before

	2002	2003	2003		2004				
			3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
Industry									
Electricity consumption (1)	3.8	4.8	6.1	4.7	3.7	3.9	2.5	1.9	4.6
Industrial production index (2)	0.2	1.4	1.1	1.2	1.4	0.8	2.9	3.6	...
Confidence indicator for industry (3)	–5.7	–0.9	–1.3	–2.3	–3.0	–1.0	–1.0	–4.0	–3.0
Utilization of production capacity (4)	78.5	79.1	79.7	80.6	78.7	–	79.3	–	80.5
Imports of non-energy intermediate goods (5)	6.4	3.3	–0.1	–3.7	0.6	3.5	–1.6	...	...
Construction									
Cement consumption	4.7	4.8	4.5	5.7	5.6	–1.6	–1.2	7.0	...
Confidence indicator for construction (3)	5.3	10.5	10.3	7.7	6.3	10.0	7.0	7.0	5.0
Housing (new construction approvals)	4.3	21.4	14.1	26.0	8.0	1.2	9.3	...	...
Government tendering	13.1	–10.9	–31.6	–50.2	11.0	–17.6	–65.3	...	...
Services									
Retail sales	5.7	5.7	5.0	6.1	6.7	6.4	3.0	7.3	...
Foreign tourists	4.5	–0.3	–3.1	1.3	5.4	–0.2	4.6	–3.2	0.6
Tourist revenue inflows	–2.9	3.7	3.9	2.3	4.0	–1.9	–0.9	...	...
Goods carried by rail (km-tonnes)	–0.7	1.7	5.8	3.0	6.4	8.0	–3.4	15.2	...
Air passenger traffic	–1.1	7.4	7.7	8.5	11.0	6.9	7.2	6.0	7.9
Motor vehicle diesel fuel consumption	6.2	8.0	7.2	6.0	7.8	6.4	3.3	...	...

NOTES: (1) Corrected for number of working days and temperature.
(2) Corrected 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, SEOPAN, Civil Aviation, National Institute of Statistics, Bank of Spain, Ministry of Science and Technology, Ministry of Economy and internal figures.

Construction at good level although some early indicators suggest lower future growth.

With regard to construction, some early indicators suggest a more or less immediate slowdown in the growth rate of this sector. This shows up, for example, in the number of housing units to be built according to new work approvals which reported a drop in annual growth rate to 6.9% in the first five months of the year as against the 22.5% recorded in the same period in 2003. The drop in the amount of government tendering (12.0% from January to May) runs in the same direction. For the moment, however, the strength of the sector continues to be fairly high, if we are to go by the relatively sustained growth of cement consumption.

Modest tourist balance as of July…

The modest balance in tourism (necessarily still incomplete until the end of the summer season) sets out the situation in the services sector. While the number of foreign tourists has shown moderate growth (1.9% year-to-year as of July), overnight hotel stays by non-residents were down by 3.2% in the same period. In any case, the increase in domestic tourism has partly eased this effect putting total overnight stays finally up by a modest 1.3%.

…but situation generally favourable in other services.

In other services, the situation is generally positive with growth of 6% and 7% year-to-year in retail trade, transportation and information technology as of May and somewhat more modest results (4.2%) in services to companies, according to indices of economic activity drawn up by the National Institute of Statistics. In transportation, the rate of economic activity is generally satisfactory in goods traffic and more uneven in passenger lines. The strength of air traffic is being maintained and road transport is tending to recover. On the other hand, the total number of rail passengers fell by 2.4% in the first half of 2004.

DEMAND INDICATORS

Percentage change over same period year before

	2002	2003	2003		2004				
			3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
Consumption									
Production of consumer goods (*)	2.4	0.2	0.3	–1.7	–0.1	–2.7	0.6	0.1	...
Imports of consumer goods (**)	5.0	10.0	12.6	8.9	20.4	19.1	7.5	...	...
Car registrations	–6.6	3.8	7.4	10.3	20.8	4.0	8.9	15.0	3.8
Credit for consumer durables	12.6	1.6	4.0	1.1	3.7	–	...	–	–
Consumer confidence index (***)	–11.6	–13.7	–12.3	–11.7	–11.7	–8.0	–9.0	–11.0	–11.0
Investment									
Capital goods production (*)	–4.9	0.5	–2.2	3.2	1.3	–1.5	3.1	9.0	...
Imports of capital goods (**)	–5.8	16.8	26.2	9.9	18.7	11.0	6.5	...	...
Commercial vehicle registrations	–6.0	13.4	15.9	11.9	14.9	11.1	12.5	15.6	4.7
Foreign trade (**)									
Non-energy imports	3.7	7.4	7.6	2.1	8.9	9.1	2.3	...	...
Exports	1.4	6.2	4.6	3.3	7.3	–1.0	–0.8	...	...

NOTES: (*) Corrected 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, European Commission and internal figures.

Consumption remains strong...

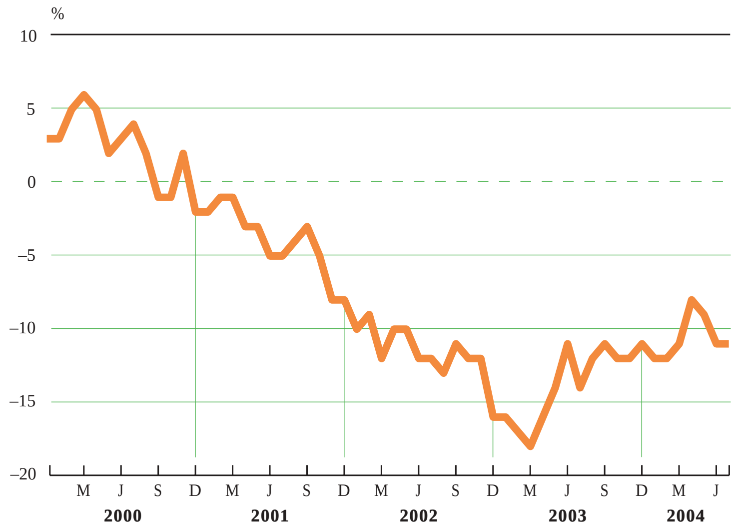
On the demand side, we note that the situation in consumption is still positive, if we look, for example, at the growing profile of supply in goods of this type. Confirming this, passenger car registrations in July (167,689 units) was the highest ever recorded in any one month. At the same time, registrations of motorcycles is undergoing very high growth (34.7% year-to-year in the first seven months of the year).

...although this could be affected in future by rise in fuel prices and increased inflation.

Nevertheless, other indicators show a less sure trend, as in the case of the index of retail trade sales which showed a drop of 2.5% in real year-to-year growth (discounting inflation) in the second quarter. The main source of uncertainty is the impact on household purchasing power which could come from the increased cost of fuel and the rise in inflation. For the moment, consumer confidence has shown no noticeable change although the tendency in recent months would point to a slight drop.

CONSUMER CONFIDENCE AGAIN STAGNANT AT NEGATIVE LEVELS

Difference between percentage of positive and negative replies



SOURCE: European Commission.

Investment in capital goods holds on expansionist path.

As mentioned earlier, indicators for capital goods investment are fairly satisfactory. If these are adjusted for number of working days, the index for production of goods of this type for June grew by 9.0% year-to-year. Along the same lines, imports of these goods are growing at a very lively rate (14.1% as of May). Finally, we should point out the high growth (12.4% as of July) of commercial vehicle registrations.

Madrid, Canary Islands and Valencia gain relative weight in Spain's economy

Murcia and Navarre are most dynamic regions thanks to construction and public services.

In a repetition of the situation in 2002, Murcia was the autonomous community to grow most in 2003, specifically 3.3%, according to regional figures prepared by the National Institute of Statistics (INE). In second place, again in a repeat of last year, came Navarre which showed a growth rate of 3.0%. In both cases, the strength of the construction sector and the notable increase in activity in public services were largely behind the growth differential with other autonomous communities. A similar pace in growth, with the only difference being less strength in market services, also gave rise to a favourable balance in Andalusia, which ended 2003 with growth of 2.9%.

GROSS DOMESTIC PRODUCT BY AUTONOMOUS COMMUNITY (*)
2003

	Million current euros	% of total	% real change		Current euros	Per capita GDP		
			2003	1998-2003		Spain = 100	EU-25 = 100	EU-15 = 100
Andalusia	101,136	13.6	2.9	3.6	13,709	75	72	66
Aragon	22,963	3.1	2.6	2.7	19,726	108	103	94
Asturias	16,227	2.2	2.2	1.8	15,521	85	81	74
Balearic Islands	18,552	2.5	1.0	2.2	21,965	121	115	105
Canary Islands	30,863	4.2	2.6	3.5	17,006	93	89	81
Cantabria	9,391	1.3	2.1	3.3	17,681	97	93	85
Castile-La Mancha	25,478	3.4	2.2	2.8	14,673	81	77	70
Castile-Leon	41,572	5.6	2.6	2.7	16,956	93	89	81
Catalonia	135,901	18.3	2.1	2.8	21,601	119	113	103
Valencian Community	72,332	9.7	1.9	3.3	17,314	95	91	83
Extremadura	12,795	1.7	2.4	3.5	11,812	65	62	57
Galicia	39,503	5.3	2.4	2.7	14,439	79	76	69
Madrid Community	129,702	17.5	2.7	3.5	24,392	134	128	117
Murcia	18,445	2.5	3.3	3.8	15,826	87	83	76
Navarre	12,608	1.7	3.0	3.5	23,098	127	121	111
Basque Country	47,045	6.3	2.4	3.2	22,719	125	119	109
La Rioja	5,563	0.7	2.7	2.9	20,584	113	108	99
Ceuta and Melilla	2,230	0.3	2.3	3.2	15,381	84	81	74
TOTAL	**742,308**	**100.0**	**2.4**	**3.1**	**18,208**	**100**	**95**	**87**

NOTES: (*) At market prices.
SOURCE: National Institute of Statistics, Eurostat and internal figures.

Madrid, Aragon, Canary Islands and La Rioja also grow above Spanish average...

At the next level down, with growth rates in gross domestic product (GDP) around two or three decimals above the Spanish average, came a group of autonomous communities of quite varied economic structure and showing substantially different growth levels. These were Madrid Community, Aragon, Canary Islands and La Rioja. In the case of Madrid Community, the major rise in the GDP for public services (4.8%, the highest in Spain) and in industry (more than one point above the average) makes up a situation which is also characterized by substantial activity in construction. In Canary Islands and La Rioja, in turn, construction played a key role and was joined by a performance in services (market services in the former case and public services in the latter) substantially higher than the Spanish average. Finally, the economy in Aragon stood out because of its relatively favourable balance in the industrial sector.

…while Basque Country, Galicia and Extremadura match average.

At a third level we find Galicia, Extremadura and the Basque Country with growth equal to the Spanish average. In these three cases, the annual balance might have been better but for an unfavourable year for agriculture. Furthermore, in Extremadura there was a notably weak level in construction which was compensated by the good result in the industrial sector, particularly in energy. In Galicia, the energy sector also had a notable year with construction and market services holding in line with Spain as a whole. Finally, in the Basque Country non-farm market sectors outpaced the Spanish average thus compensating for a somewhat weaker situation in public services.

Public services maintaining activity in Asturias and Cantabria while Catalonia and Valencia show poor levels in industry.

Growth of the economy in the Cantabrian Rim (Cantabria and Asturias) was lower at around 2% and this was maintained thanks to the sharp growth in public services at around 4.5%, the highest figure in Spain after Madrid. Growth in Castile-La Mancha also showed a figure of around 2% with a good farm year improving final results. Catalonia and Valencian Community stood among the latter group with both showing the weakest situation in the industrial sector. In addition, we should mention the poor growth in public services in Catalonia at 2.2%, the lowest in Spain as a whole.

Balearic Islands stands at tail-end in growth for second year running.

The year in the Balearic Islands was less favourable although not entirely negative. A moderate drop in the industrial sector, stagnation in market services (mainly tourism) and the contraction in construction activity (the only autonomous community where activity in this sector dropped) gave rise to real growth of 1.0% which meant that this autonomous community stood at the tail-end of Spain's autonomous communities.

Per capita GDP goes up to 87% of EU-15 average in 2003.

The notable growth of Spain's economy has made it possible to progressively reduce the relative level of development compared with the European Union (EU). According to latest figures from Eurostat, the per capita GDP adjusted for parity of purchasing power put Spain at 87% of the average for the EU-15 in 2003. This index would rise to 95% if we were to take into consideration the recent enlargement to EU-25.

Per capita GDP in Madrid double that of Extremadura.

From a regional perspective, there remain notable differences among the various autonomous communities. Madrid, with a per capita GDP of 24,392 euros in 2003, led the whole of Spain, more than doubling the figure for Extremadura which stood at 65% of the Spanish average. Navarre, Basque Country, Balearic Islands, Catalonia, La Rioja and Aragon came after Madrid Community while also showing above the Spanish average. At the opposite end of the scale, apart from Extremadura, the autonomous communities of Andalusia, Galicia and Castile-La Mancha made up the map of regions in Spain with a per capita GDP of around 80% of the figure for all of Spain.

GROSS VALUE ADDED BY AUTONOMOUS COMMUNITY AND SECTOR (*)

2003

Percentage annual change at constant prices

	Agriculture, livestock and fishing	Energy	Industry	Construction	Market services	Non-market services	Total
Andalusia	4.7	4.1	1.7	4.2	1.7	3.2	2.5
Aragon	2.4	0.0	2.6	3.0	2.0	2.8	2.2
Asturias	0.1	–7.0	0.6	4.2	2.8	4.3	1.7
Balearic Islands	–6.0	3.4	–1.7	–0.9	0.7	3.0	0.6
Canary Islands	–3.7	–4.3	2.5	3.9	2.3	2.6	2.2
Cantabria	–5.0	–6.1	1.0	2.0	2.3	4.5	1.7
Castile-Leon	2.1	4.6	1.3	3.6	1.4	3.9	2.2
Castile-La Mancha	3.0	0.0	–0.8	3.3	2.2	2.7	1.8
Catalonia	–5.4	1.4	1.1	3.7	2.0	2.2	1.7
Valencian Community	–2.5	–0.2	–1.1	3.2	2.3	3.0	1.5
Extremadura	–3.0	5.3	2.6	1.6	2.5	2.9	2.0
Galicia	–4.0	4.1	1.9	3.6	2.1	2.9	2.0
Madrid Community	2.6	2.9	2.4	3.5	1.6	4.8	2.3
Murcia	0.2	0.0	2.2	4.7	3.3	3.4	2.8
Navarre	1.2	–4.8	2.0	4.0	3.1	3.6	2.5
Basque Country	–7.0	–2.1	2.1	4.4	2.2	2.5	1.9
La Rioja	7.2	0.0	1.3	5.8	1.5	2.3	2.3
Ceuta and Melilla	12.6	1.3	1.3	4.8	0.4	3.1	1.8
Spain	**0.7**	**1.4**	**1.3**	**3.6**	**1.9**	**3.3**	**2.0**

NOTES: (*) At market prices.
SOURCE: National Institute of Statistics.

Madrid Community gains economic weight in Spain overall while Catalonia drops by practically same proportion.

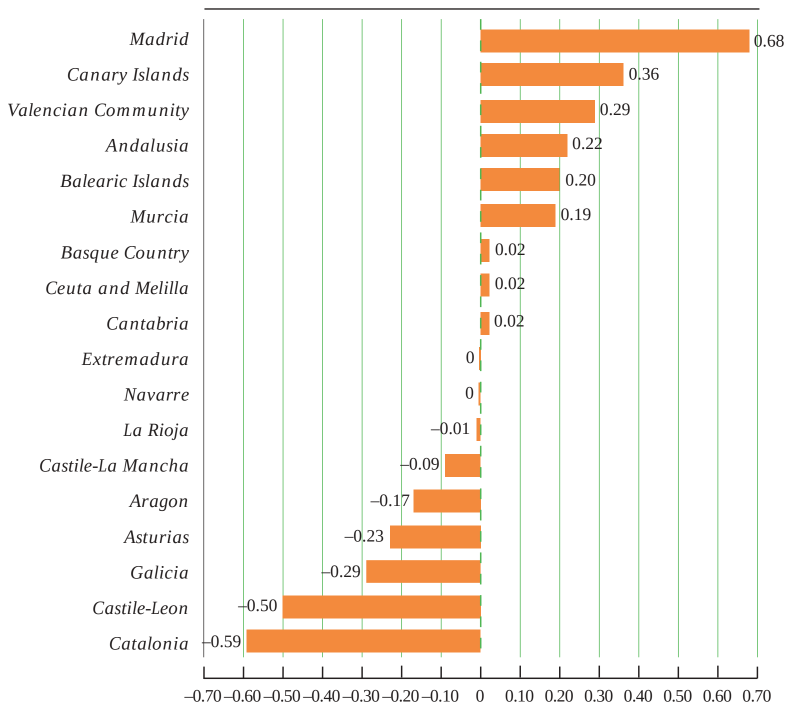
Over a longer time span, the model of regional growth in Spain shows some notable features. Undoubtedly the most outstanding is that Madrid Community has turned out to be the area to benefit most from the years of sharp growth enjoyed by Spain's economy. In fact, the contribution of this autonomous community to Spain's GDP in 2003 stood at 16.8%, seven decimals above the figure recorded in 1995. This sharp gain in share was almost entirely balanced by the loss of relative weight of Catalonia in the overall Spanish picture at 18.3% of the GDP in 2003 as against 18.9% in 1995. The notably tertiary nature of Madrid Community, as opposed to the heavy industrial specialization in Catalonia, was a decisive factor in this process due to the relative weakness of industry in recent years which gave an advantage to Madrid's tertiary sector, along with the added factors of its being the country's capital, privatizations carried out and the process of globalization of the economy.

Canary Islands, Valencia, Andalusia, Murcia and Balearic Islands gain relative weight in Spain's economy.

Furthermore, the balance in recent years seems to run clearly in favour of the autonomous communities of the Canary Islands, Valencian Community, Andalusia, Murcia and the Balearic Islands. In the case of the Balearic Islands, it so happens that in the last two years the results have not been very favourable. At the other end of the scale, Castile-Leon, Asturias, Galicia, Aragon and Castile-La Mancha are losing relative weight in Spain as a whole while the other regions are maintaining a relatively stable position.

MADRID COMMUNITY, CANARY ISLANDS AND VALENCIAN COMMUNITY GAIN RELATIVE WEIGHT IN SPAIN'S ECONOMY

Change in GDP share between 1995-2003 in percentage points



SOURCE: National Institute of Statistics and internal figures.

Farm production drops in 2003

Discounting price rise effect, farm production down 2.2% real in 2003…

The value of farm production grew by 3.7% in 2003, according to early figures from the Ministry of Agriculture, Fishing and Food. The rise in prices, which were up 6.0% overall, was the main cause of this increase given that, if this effect is discounted, real production dropped by 2.2%. The decrease in farm production, in turn, may be explained by the drop in agricultural production (4.9%) which was partially compensated by the increase in livestock production (2.7%).

…due to drop in production of some vegetables, such as potatoes, olive oil and cereals.

The overall decrease in production of vegetable products was due to the sharp drop in olive oil (39.8%) and to a lesser extent to that for potatoes (10.4%) and cereals (2.2%). Nevertheless, the sharp increase in prices (8.9% overall, and more than 30% in the case of olive oil and potatoes) meant that the nominal value of farm production rose by 3.5%. In addition, we should point out good results in wine and must with growth in value of 21.8% (12.6% in quantity and 8.2% in price) and in produce, with a nominal increase of 16.4%, in this case due entirely to the rise in prices. In a similar way, the growth in the value of fruit production (7.6%) was fully the result of price increases.

FARM MACROECONOMIC FIGURES

Million euros

	2002 (*)	2003 (**)	% annual change		
			Real	Prices	Value
Final production					
Agriculture	23,142	23,959	–4.9	8.9	3.5
Livestock	12,945	13,490	2.7	1.5	4.2
Production of services and other	1,546	1,560	–	–	0.9
Total	**37,633**	**39,009**	**–2.2**	**6.0**	**3.7**
Intermediate consumption	13,619	14,112	2.6	1.0	3.6
Gross value added (at market prices)	**24,014**	**24,897**	**–**	**–**	**3.7**
Repayments	3,025	3,078	–	–	1.7
Subsidies net of tax	1,961	1,994	–	–	1.7
Net farm income	**22,949**	**23,814**	**–**	**–**	**3.8**

NOTES: (*) Provisional.
(**) Second estimate on March 29, 2004.
SOURCE: Ministry of Agriculture, Fishing and Food.

On other hand, livestock reports real growth overall along with moderate increase in prices.

Overall growth in the value of livestock production came to 4.2%, thanks to the rise in real production (2.7%) and a moderate increase in prices (1.5%) although there were notable disparities in the various components. As a result, the increase in value of beef produced (5.0%) arose almost entirely from increased production. In pork, while the increase in real production was 5.8%, the drop in prices limited nominal growth to a mere 1.8%. On the other hand, the nominal increase in the value of poultry production (14.6%) was largely due to the increase in prices (13.2%), Finally, in animal products, the excellent result in egg production (increase of 17.9% in quantity and 25.7% in value) was in contrast to the poor performance in milk production (decrease of 1.9% in quantity and 3.1% in value).

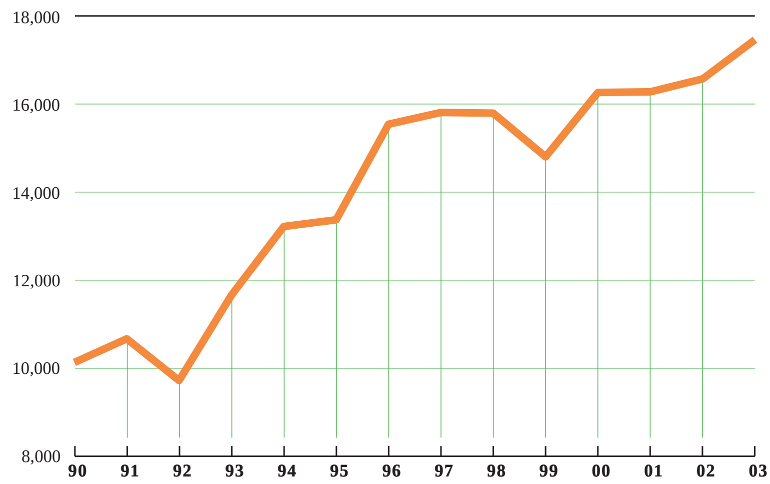
Gross value added in agriculture tending to reduce relative weight in total GDP…

As a whole, consumption of intermediate goods in the sector was up 3.6%, slightly below total production which made it possible for gross value added to go up to 24.9 billion euros, 3.7% more than in 2002. This figure is equal to 3.4% of the total gross domestic product generated by Spain's economy, the same as in 2002, although this proportion has done nothing but drop in recent years (5.0% in 1990, 4.3% in 1995 and 3.8% in 2000).

…although real income per person continues to grow, partly due to drop in total number employed in sector.

Finally, average employment in the sector in 2003 stood at around 841,500 persons, some 39,000 less than in 2002, following along the downward path seen in previous years. Nominal growth in total farm income (3.8%, after repayments and non-taxable subsidies), along with the reduction in employment mentioned, would explain why income per person grew by 8.6% in nominal terms, equivalent to 5.4% real, thus following an upward course practically uninterrupted since 1992.

FARM INCOME PER PERSON CONTINUES TO RISE
Constant 1990 euros



SOURCE: Ministry of Agriculture, Fishing and Food, National Institute of Statistics and internal figures.

Positive balance in food industry in 2003

Food industry production grows by 3% real in 2003…

The food industry grew by around 5.5% in nominal value in 2003 (2.8% real in physical terms). In constant euros (discounting the general inflation rate), the increase in value of production was close to 3.0%, an improvement on the poor results in the previous five years, according to estimates by the Spanish Federation of Food and Beverages Industries (FIAB). This increase may be explained by the positive trend shown both in domestic consumption and foreign demand. In addition, the situation would not have changed greatly in the first half of 2004, if we are to go by the trend in the industrial production index.

…due to good performance in both domestic consumption and foreign demand.

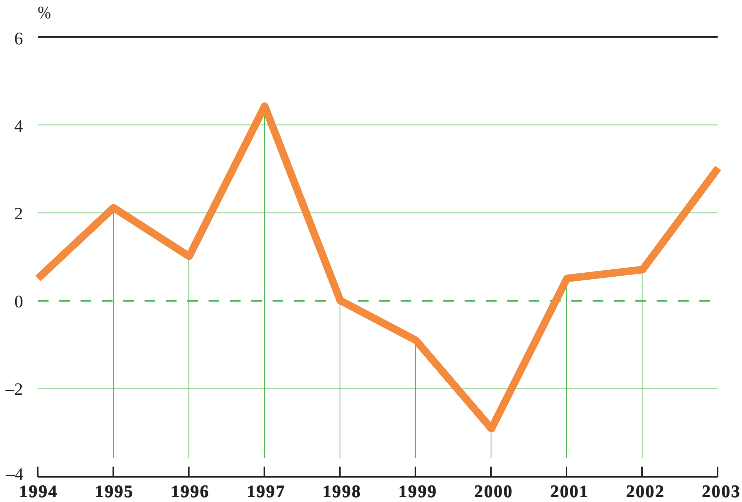
Total spending on food amounted to 69.4 billion euros in 2003, thus reporting moderate growth (4.8% nominal, equivalent to 2.1% in physical terms compared with the year before), according to figures from the table on food consumption drawn up by the Ministry of Agriculture, Fishing and Food. In nominal terms, household consumption rose to 50.7 billion euros (73.1% of the total) representing growth of 4.6%, somewhat below that for consumption outside the home (in hotels, restaurants and various institutions) which rose by 5.4%.

Consumption of fish, fruit, produce, cooking oil and prepared dishes shows rise, meat consumption holds steady while bread, milk and wine drop.

With regard to the more representative foods, consumption of meat held steady although in terms of value it grew by 2.1% due to the increase in prices. Per capita consumption of this food came to 67.6 kg. with a value equivalent to 21.6% of total food spending. Consumption of fish (the second in importance with 13.6% of total spending) rose by 0.8% in volume and 3.7% in value. With regard to other foods, there were notable decreases in consumption of bread (1.2% in volume and 1.7% in value), milk (1.9% and 2.4%) and table wine (3.8% and 4.6%) in contrast to the increases for milk products (3.5% in volume and 6.8% in value), cooking oil (1.3% and 4.6%), fruit (3.5% and 14.3%), produce (3.7% and 10.3%) and prepared dishes (9.0% and 12.3%).

SIGNIFICANT GROWTH IN VALUE OF FOOD INDUSTRY PRODUCTION IN 2003

Change in value of food and beverage industry production in constant euros



SOURCE: Federation of Food and Beverages Industries.

INDICATORS FOR FOOD AND BEVERAGES INDUSTRY

Percentage change over same period year before

	2002	2003	2003				2004	
			1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.
Production								
Industrial production index	3.7	2.6	4.6	0.8	3.8	1.3	3.8	2.8
Consumption								
Household consumption (constant prices) (*)	2.4	2.2	1.3	3.8	2.7	0.9	0.7	–
Food retail sales (deflated)	1.3	0.5	–1.3	0.5	1.7	0.9	1.7	–1.3
Foreign trade								
Exports of food consumer goods (volume) (**)	2.2	6.4	7.5	8.8	5.7	4.0	8.5	0.7
Imports of food consumer goods (volume) (**)	–0.7	9.8	6.7	11.6	9.6	11.0	14.3	7.8
Export/import ratio (%) (**)	143.3	139.3	170.3	145.1	108.7	140.0	158.5	140.2
Prices								
Producer prices	2.5	2.1	1.5	1.2	2.9	3.1	3.4	5.1
Processed foods (CPI)	4.2	2.8	3.5	2.8	2.4	2.6	2.6	3.6
Fresh foods (CPI)	5.8	6.0	6.2	4.6	6.6	6.6	6.4	6.7
Total food and beverages (CPI)	4.5	4.0	4.5	3.5	4.0	4.1	3.9	4.5
Exports food consumer goods (**)	1.6	–0.3	–4.4	1.5	1.4	0.7	–2.8	–2.2
Imports food consumer goods (**)	0.4	–0.7	0.6	1.0	–0.3	–3.5	–0.9	–1.1
Employment								
Persons employed	1.0	0.2	2.3	–1.1	0.2	–0.7	–2.6	–0.3

NOTES: (*) Food, beverages and tobacco.
(**) Figures for second quarter are for April.
SOURCE: National Institute of Statistics and Ministry of Economy and Finance.

Substantial price increases in fresh foods...

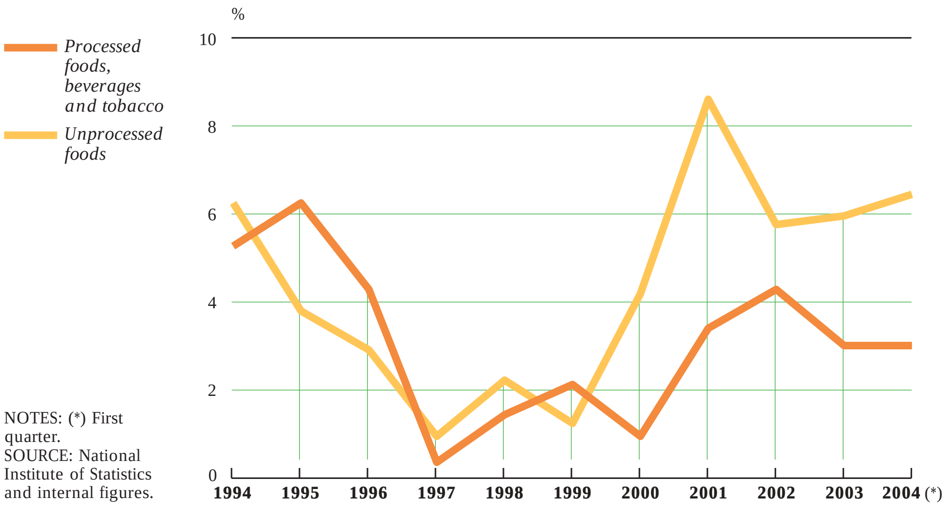
Figures from the food consumption table show a trend in prices generally in line with that seen in the consumer price index (CPI) of the National Institute of Statistics. In 2003, the CPI for the food and beverage group grew by 4.0% on average, a half-point less than in 2002. The main focus of inflation was in the fresh food group which was up 6.0%, with special mention merited by fresh fruit (11.6% increase in 2003 following the 9.8% recorded in 2002) along with vegetables and produce (5.1% in 2003 and 18.0% in 2002).

...while processed food prices more contained.

On the other hand, processed foods showed more contained increases with average overall growth of 2.8%. Notable in this group was the rise in the price of bread (5.4% in 2003 following a rise of 6.7% in 2002) and the moderate increase in cooking oil (3.5% as against 16.2% in 2002).

FRESH FOODS CONSTITUTE MAIN FOCUS OF INFLATION

Year-to-year change in consumer price index



NOTES: (*) First quarter.
SOURCE: National Institute of Statistics and internal figures.

Growth rate of exports higher than for imports...

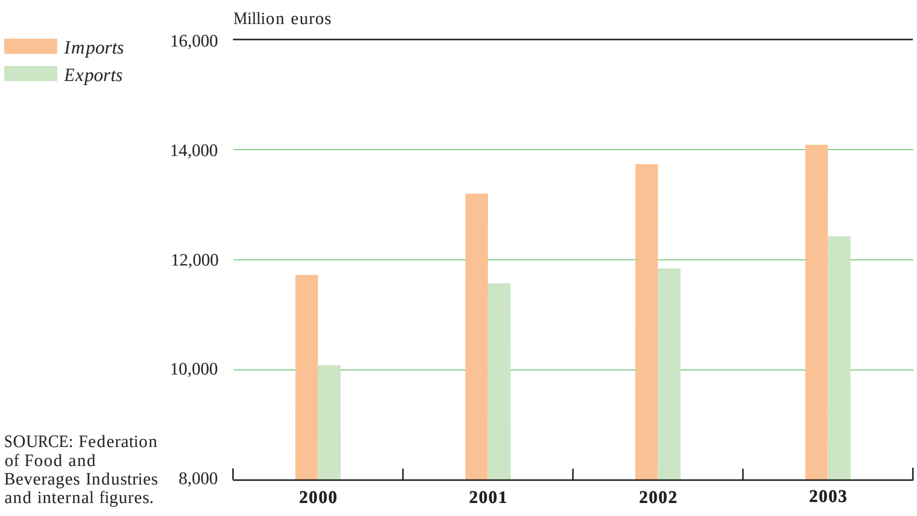
With regard to foreign trade, exports by the food and beverages industry, according to estimates by FIAB, amounted to 12.4 billion euros, representing growth of 4.7% over the year before, nearly twice the rise in 2002. On the other hand, growth of imports, which totalled 14.1 billion euros, was more moderate (2.7%) which put the sector export/import ratio (percentage value of exports over imports) at 88.3%, a gain of 1.7 percentage points.

...especially in case of meat products, green vegetable and fruit conserves and milk products.

Among the more representative products, green vegetable and fruit conserves, meat products and the group made up of milk, milk products and eggs showed major increases in sales abroad of the order of 9.7%, 14.7% and 11.4% respectively, figures higher than imports of those products. The increase in exports of all kinds of beverages (except juices) came to 6.0% which, however, was lower than the increase in respective imports (12.2%). On the other hand, foreign sales of oils and fats were down by 3.1% as against an increase of 22.6% in foreign purchases although the value of the former was three times that of the latter.

FOOD INDUSTRY TRADE DEFICIT DOWN IN 2003

Imports and exports of food and beverages industry



SOURCE: Federation of Food and Beverages Industries and internal figures.

Employment in sector holds stable in 2003.

Employment in the sector in 2003 held practically stable while recording a somewhat more negative trend in the first half of 2004. Finally, from a structural point of view, what stood out was the importance of the meat industries which contributed 19.7% of the total value of sector production in 2002. Next in order of importance came the sub-sector of alcoholic beverages (13.4%), the milk industries (10.9%) and animal foods (9.2%).

LABOUR MARKET

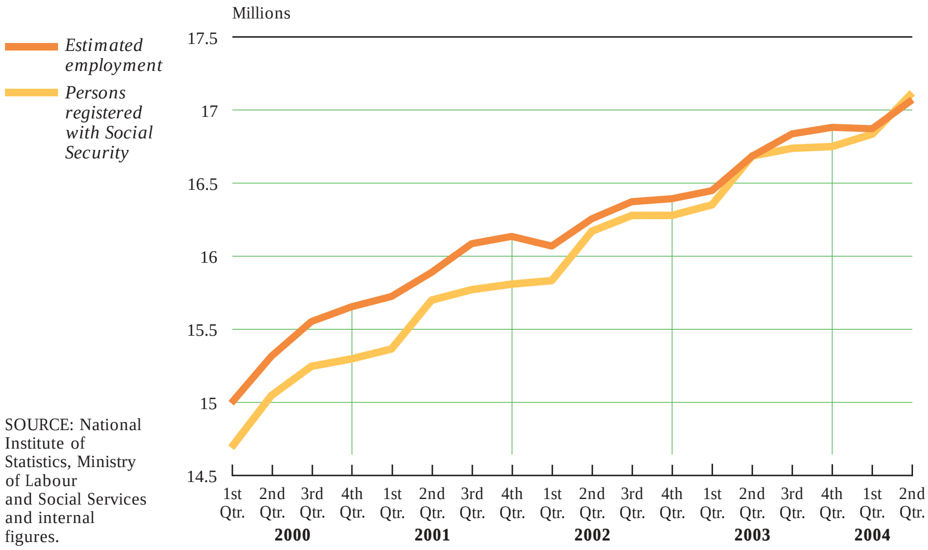
Job creation remains strong

Number of persons working grows more than 2% but easing off.

Spain's economy created 197,600 net new jobs in the second quarter of 2004, according to the Labour Force Survey, a figure somewhat lower than in the same period last year. As a result, the rate of job creation slowed to 2.3% year-to-year, three decimals lower than in the previous quarter, thus reflecting the somewhat weaker state of the labour market. In any case, the number of persons employed in Spain's economy went above 17 million for the first time in history with 384,100 new jobs having been created in the past 12 months. Of these, more than one third (134,800) were taken up by workers of foreign origin.

NUMBER EMPLOYED GOES ABOVE 17 MILLION

Estimated employment and persons registered with Social Security



SOURCE: National Institute of Statistics, Ministry of Labour and Social Services and internal figures.

Drop in employment mainly affecting workers of foreign origin.

The decrease in the rate of job creation last quarter was mainly due to the drop in employment of workers of foreign origin given that employment among Spaniards maintained stable growth, somewhat above 1.5% in recent quarters. From this perspective, a possible slowdown in employment should be taken with some caution to the extent that it may be concentrated in a group where employment conditions are not particularly clear. In this respect, the foreign worker population employed totalled 722,800 in the second quarter, 4.2% of the total according to the Labour Force Survey, a figure some 330,000 lower than that reflected in totals for registrations with Social Security.

Rise in registrations with Social Security in July following slight drop in previous quarter.

The slowdown trend in employment shown by the Labour Force Survey was also confirmed by registrations with Social Security, according to figures for the second quarter. Nevertheless, more recent figures for July point to a slight recovery in the growth rate of registrations with a figure of 2.8% year-to-year. This recovery was concentrated in the resident Spanish population as opposed to previous months when the relative strength of this indicator was being maintained by the foreign worker group.

ESTIMATED EMPLOYMENT

Second quarter 2004

	No. of employees (thousands)	Quarterly change		Cumulative change		Annual change		Share
		Absolute	%	Absolute	%	Absolute	%	%
By sector								
Agriculture	908.9	–55.5	–5.8	–42.9	–4.5	–25.5	–2.7	5.3
Non-farm	16,141.2	253.1	1.6	231.0	1.5	409.5	2.6	94.7
Industry	*3,091.1*	*18.3*	*0.6*	*15.6*	*0.5*	*–36.9*	*–1.2*	*18.1*
Construction	*2,059.9*	*51.2*	*2.5*	*68.0*	*3.4*	*49.9*	*2.5*	*12.1*
Services	*10,990.2*	*183.6*	*1.7*	*147.4*	*1.4*	*396.5*	*3.7*	*64.5*
By type of employer								
Private sector	14,275.9	174.5	1.2	161.2	1.1	326.1	2.3	83.7
Public sector	2,774.2	23.1	0.8	26.9	1.0	58.0	2.1	16.3
By work situation								
Wage-earners	13,877.0	170.1	1.2	124.4	0.9	302.8	2.2	81.4
Permanent contract	*9,664.0*	*82.4*	*0.9*	*130.3*	*1.4*	*243.7*	*2.6*	*56.7*
Temporary contract	*4,213.0*	*87.7*	*2.1*	*–5.9*	*–0.1*	*59.1*	*1.4*	*24.7*
Non-wage-earners	3,159.0	30.1	1.0	67.2	2.2	83.1	2.7	18.5
Entrepreneurs with employees	*951.9*	*4.5*	*0.5*	*19.7*	*2.1*	*37.1*	*4.1*	*5.6*
Entrepreneurs without employees	*1,960.7*	*31.0*	*1.6*	*62.5*	*3.3*	*71.8*	*3.8*	*11.5*
Family help	*246.3*	*–5.4*	*–2.1*	*–15.0*	*–5.7*	*–25.8*	*–9.5*	*1.4*
Other	14.2	–2.6	–15.5	–3.5	–19.8	–1.8	–11.3	0.1
By time worked								
Full-time	15,576.1	136.5	0.9	89.5	0.6	270.5	1.8	91.4
Part-time	1,474.0	61.0	4.3	98.6	7.2	113.6	8.4	8.6
By sex								
Males	10,378.0	87.4	0.8	54.9	0.5	99.4	1.0	60.9
Females	6,672.0	110.1	1.7	133.1	2.0	284.6	4.5	39.1
TOTAL	**17,050.1**	**197.6**	**1.2**	**188.1**	**1.1**	**384.0**	**2.3**	**100.0**

SOURCE: National Institute of Statistics and internal figures.

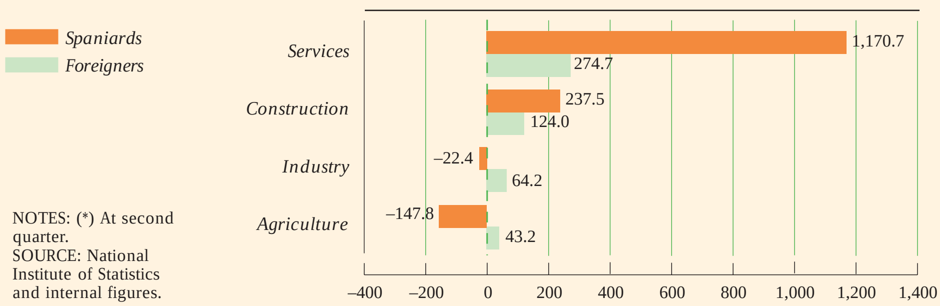
RECENT EMPLOYMENT OF FOREIGN WORKERS: LOW JOB QUALIFICATIONS PREDOMINANT FEATURE

The labour market picture in Spain has changed significantly in recent years as a result of the substantial addition of foreign workers. The Labour Force Survey indicates that in the past four years the foreign worker group has taken up somewhat more than a half million of the 1.7 million new jobs created by Spain's economy, that is to say, 29% of the total. In any case, we should point out the difficulties in making an estimate of the foreign worker group given the many situations where employment is not legal.

This recent employment largely concerns persons with relatively low job qualifications. Out of the 506,000 new jobs occupied by foreign workers since the second quarter of 2000 only 12.6% applied to managers, technicians and professionals while the rest were labourers or workers with little or no qualifications.

EMPLOYMENT OF FOREIGN WORKERS RELATIVELY LOWER IN SERVICES

Change in number of persons employed by sector and origin between 2000 and 2004 (*)
in thousands



NOTES: (*) At second quarter.
SOURCE: National Institute of Statistics and internal figures.

In addition, out of these new jobs occupied by foreign workers, some 43,200 were of an agricultural type and partly compensated figures for Spanish workers leaving rural jobs (147,800 less in the same period). This process of replacing Spanish labour with foreign workers was also noted in the industrial sector. In fact, in net terms, industrial employment dropped by 22,400 among Spaniards whereas there was an increase of 64,200 foreign workers in the same period.

The situation was somewhat different in construction where foreign labour has filled the lack of local workers arising from the exceptional boost in activity in that sector. As a result, foreign workers took up 124,000 of the 361,500 new jobs, that is to say, 34.3% of those created in the sector in the past four years.

On the other hand, the proportion of foreign workers employed in services was less significant although in absolute terms it made up the main sector employing foreign workers. To be specific, some 19.0% of new jobs created in the tertiary sector since the second quarter of 2000 were occupied by the immigrant group.

Slowdown in employment shows up mainly in construction and services while drop in industrial employment slackens.

The gradual slowdown in employment indicated by the Labour Force Survey in the second quarter was especially notable in construction and services. In the former case, employment went to a growth figure of 2.5% while in the latter case it held at the still quite notable level of 3.7%. On the other hand, the industrial sector showed a somewhat less unfavourable situation with a drop in the rate of decrease in employment. Agriculture, in turn, continued the trend to a decrease in the number of those employed.

INDUSTRIAL EMPLOYMENT HALTS DROP

Annual change in estimated employment by sector

SOURCE: National Institute of Statistics and internal figures.

Services to companies most dynamic segment in tertiary sector, according to Labour Force Survey.

In the area of services, personal services and those related to recreation (which include tourism and the hotel/restaurant trade) showed the weakest levels along with the financial and real estate sector. There was also some easing off in the growth of employment in retail trade, transportation and communications although the rate of increase held at high levels (3.7%). On the other hand, employment in social services, education and health services improved slightly although it failed to reach the levels seen last year. Employment in services to companies, on the other hand, showed spectacular growth at 11.6% year-to-year, making it the sector contributing most to job creation in absolute terms.

Increase in self-employment...

The weaker state of employment showed up only among wage-earners given that non-wage earners recorded a notable increase (2.7% year-to-year) which was higher than in preceding quarters. In any case, self-employed persons represented only one fifth of new jobs created in the past 12 months. Under self-employed work the most dynamic segments were employers and independent self-employed persons with growth rates of more than 4%. On the other hand, in this group we see a sharp reduction in members of cooperatives and family aid persons.

...with less strength in wage employment in both public and private sectors.

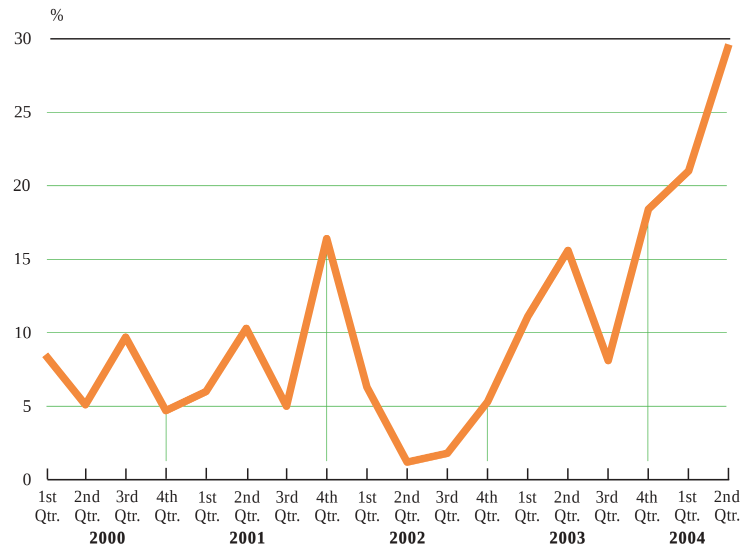
The drop in growth of employment was spread over both the private and public sectors with both segments showing a rate of increase slightly above 2%. New public employment (58,000 persons since the second quarter of 2003, represented only 15% of the total number of jobs created in the past year, a relatively low proportion compared with normal levels and lower than the 16.3% making up public service personnel in government and government-run companies out of total employment.

Level of employment of temporary nature dropping.

Figures for the second quarter also confirm a somewhat bigger drop in temporary hiring as compared with permanent jobs so that the level of temporary employment, measured against the total wage-earning population, dropped to 30.4%, two decimals lower than in the second quarter of 2003. By sector, rates differ considerably with 56.1% showing up in construction, 27.2% in services and 21.4% in industry.

SHARP RISE IN PART-TIME WORK

Part-time employment created in past year compared with total jobs created



SOURCE: National Institute of Statistics and internal figures.

Women take up three-quarters of new jobs created in past year.

The slight weakness in employment was somewhat more noticeable in the female segment. In spite of this, the rate of increase held at exceptional levels and was very much higher than in the male segment (4.5% as against 1.0%). This differential meant that in the past 12 months female employment has made up 74.1% of new jobs created. Youth employment, in turn, showed a further rise in rate of decrease going to 2.7% year-to-year, thus reflecting the effect of the demographic drop at the end of the Seventies and later years. The sharp drop in the labour force under 25 years of age (56,900 persons in the past year) in fact corresponds to the loss of youth jobs in the same period.

Part-time work becomes solid formula for women to enter labour market.

The rise in female employment is clearly linked to the increased application of a shorter working day. Some 54.6% of female employment created in the past 12 months was of a part-time nature so that this formula is gaining ground in the Spanish labour market. In any case, the proportion of total employment involving part-time work although growing is still modest at 8.6% of the total. Among the female group the figure reached 17.9% of total employment in the second quarter of 2004 as against 2.7% for males.

LABOUR FORCE, EMPLOYMENT AND UNEMPLOYMENT BY AUTONOMOUS COMMUNITY

Second quarter 2004

	Labour force			Employed			Unemployed			Unem-ployment rate %
	Total (1,000s)	Annual change	% annual change	Total (1,000s)	Annual change	% annual change	Total (1,000s)	Annual change	% annual change	
Andalusia	3,219.1	56.1	1.8	2,659.2	71.0	2.7	559.9	–14.9	–2.6	17.4
Aragon	526.3	6.5	1.3	498.9	12.8	2.6	27.4	–6.3	–18.7	5.2
Asturias	432.9	8.0	1.9	387.9	8.6	2.3	45.0	–0.6	–1.3	10.4
Balearic Islands	445.1	12.6	2.9	404.5	11.7	3.0	40.6	0.9	2.3	9.1
Canary Islands	893.0	27.8	3.2	779.8	14.6	1.9	113.2	13.2	13.2	12.7
Cantabria	244.3	4.3	1.8	219.4	4.5	2.1	24.9	–0.2	–0.8	10.2
Castile-Leon	1,061.4	5.0	0.5	947.3	9.1	1.0	114.1	–4.1	–3.5	10.7
Castile-La Mancha	731.5	1.2	0.2	668.3	9.1	1.4	63.2	–7.9	–11.1	8.6
Catalonia	3,200.6	59.8	1.9	2,906.0	59.4	2.1	294.6	0.4	0.1	9.2
Valencian Community	2,038.4	46.5	2.3	1,838.3	64.3	3.6	200.1	–17.8	–8.2	9.8
Extremadura	462.5	7.9	1.7	380.0	0.5	0.1	82.5	7.4	9.9	17.8
Galicia	1,290.7	35.7	2.8	1,110.2	3.9	0.4	180.5	31.8	21.4	14.0
Madrid Community	2,615.5	88.6	3.5	2,445.6	95.8	4.1	169.9	–7.2	–4.1	6.5
Murcia	544.4	17.9	3.4	486.7	10.6	2.2	57.7	7.3	14.5	10.6
Navarre	257.3	4.2	1.7	245.2	5.1	2.1	12.1	–0.9	–6.9	4.7
Basque Country	997.4	1.0	0.1	905.3	–1.4	–0.2	92.1	2.4	2.7	9.2
La Rioja	123.4	3.1	2.6	117.4	3.8	3.3	6.0	–0.7	–10.4	4.9
Ceuta and Melilla	58.9	5.6	10.5	50.1	0.8	1.6	8.8	4.8	120.0	14.9
TOTAL	**19,142.6**	**391.6**	**2.1**	**17,050.1**	**384.0**	**2.3**	**2,092.6**	**7.5**	**0.4**	**10.9**

SOURCE: National Institute of Statistics and internal figures.

Substantial disparities in growth of employment by autonomous community.

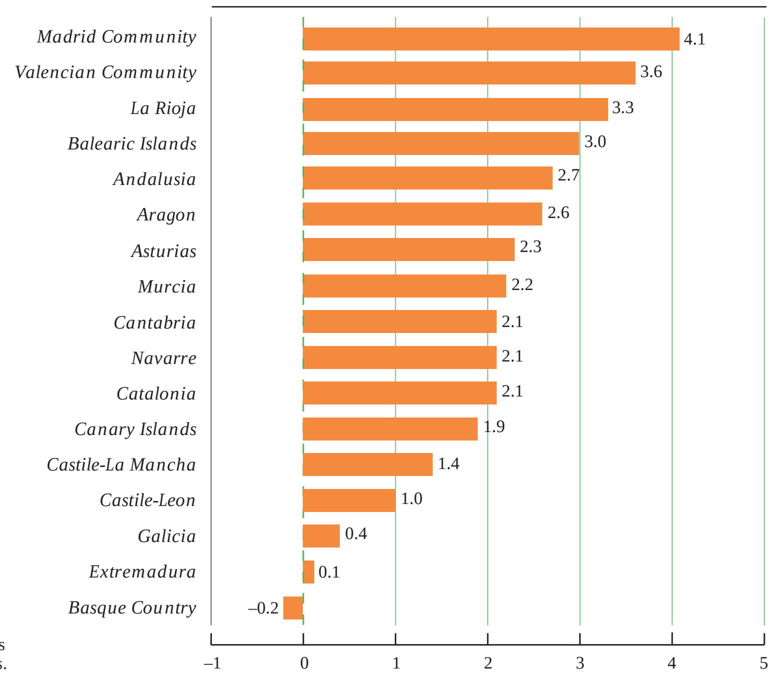
From a geographical perspective, the situation shows considerable disparity between autonomous communities. Madrid Community, Valencian Community, La Rioja, Catalonia and, to a lesser extent, Castile-Leon, show some recovery in the level of employment as against the general trend to slowdown although the rates of improvement are notably different. We should mention the growth of employment in Madrid Community with a year-to-year rate of more than 4%. At the opposite end of the scale was the Basque Country, where employment dropped slightly compared with the same quarter in 2003, and in Extremadura and Galicia which showed rates of increase of less than 0.5%.

Rise in labour force keeps unemployment above 2 million persons.

Estimated unemployment (2,092,600 persons in the second quarter) rose slightly compared with the same period in 2003 because of the increase in the labour force which continued to grow at a sharp rate, higher than that for the population 16 years of age and older. In the past 12 months, the increase in the labour force was 391,700 persons, practically double that for the population 16 years and older (206,800), a fact which is indicative of the increased inclination of persons to look for work. This is especially high in the case of females, given that new women entering the labour force (281,500) was well above the increase in the population (109,400). In the male segment, on the other hand, the imbalance was much less at 110,000 new persons in the labour force as against a population increase of 97,400.

MADRID COMMUNITY AND VALENCIAN COMMUNITY SHOW HIGHEST JOB CREATION

Second quarter 2004. Annual change in percentage of estimated employment



SOURCE: National Institute of Statistics and internal figures.

ESTIMATED UNEMPLOYMENT

Second quarter 2004

	No. of unemployed	Quarterly change		Cumulative change		Annual change		Share	Unemployment rate
		Absolute	%	Absolute	%	Absolute	%	%	% of labour force
By sex									
Males	898.2	–42.6	–4.5	–23.9	–2.6	10.6	1.2	42.9	8.0
Females	1,194.3	–29.0	–2.4	–10.6	–0.9	–3.1	–0.3	57.1	15.2
By age									
Under 25 years	487.9	–10.6	–2.1	–16.8	–3.3	–9.7	–1.9	23.3	22.4
Other	1,604.7	–60.9	–3.7	–17.6	–1.1	17.3	1.1	76.7	9.5
By personal situation									
Long-term unemployment	268.2	–16.5	–5.8	–5.0	–1.8	8.7	3.4	12.8	–
Seeking first job	302.9	–15.6	–4.9	–33.5	–10.0	–42.0	–12.2	14.5	–
Other	1,521.5	–39.4	–2.5	4.1	0.3	40.9	2.8	72.7	–
TOTAL	**2,092.6**	**–71.6**	**–3.3**	**–34.4**	**–1.6**	**7.5**	**0.4**	**100.0**	**10.9**

SOURCE: National Institute of Statistics and internal figures.

Unemployment rate down to 10.9% in second quarter.

The unemployment rate stood at 10.9%, two decimals below the same quarter last year, thus maintaining the sharp differences between the indices for the male and female groups at 8.0% and 15.2% respectively. The level of unemployment among those under 25 years, in turn, stood at 22.4%, one decimal above the same quarter last year.

Registered unemployment down sharply at beginning of summer

Better trend in registered unemployment…

The number of unemployed registered at offices of the National Employment Institute (INE) was down slightly in June and somewhat more so in July to stand at 1,585,175 persons at the end of that month, some 0.7% more than in July 2003. Because of their extent, these decreases, which are normal in the summer months, meant something of a turnaround in the trend recorded since last February when the rate of increase in unemployment was tending to rise slightly.

…with balance as of July most favourable in last five years.

This performance, which was in line with the upward move in employment shown by registrations with Social Security in the same period, put the balance for the January-July period at a decrease of 126,312 persons, the biggest since 1999. This improvement was mainly due to the bigger reduction in unemployment in construction and among those seeking a first job.

REGISTERED UNEMPLOYMENT BY SECTOR, SEX AND AGE

July 2004

	No. of unemployed	Change over December 2003		Change over same period year before		% share
		Absolute	%	Absolute	%	
By sector						
Agriculture	37,633	–291	–0.8	1,358	3.7	2.4
Industry	239,270	–25,023	–9.5	–5,851	–2.4	15.1
Construction	175,166	–36,722	–17.3	4,382	2.6	11.1
Services	915,099	–53,616	–5.5	24,865	2.8	57.7
First job	218,007	–10,660	–4.7	–13,074	–5.7	13.8
By sex						
Males	628,477	–96,785	–13.3	2,404	0.4	39.6
Females	956,698	–29,527	–3.0	9,276	1.0	60.4
By age						
Under 25 years	221,796	–35,954	–13.9	–17,006	–7.1	14.0
All other ages	1,363,379	–90,358	–6.2	28,686	2.1	86.0
TOTAL	**1,585,175**	**–126,312**	**–7.4**	**11,680**	**0.7**	**100.0**

SOURCE: National Employment Institute and internal figures.

PRICES

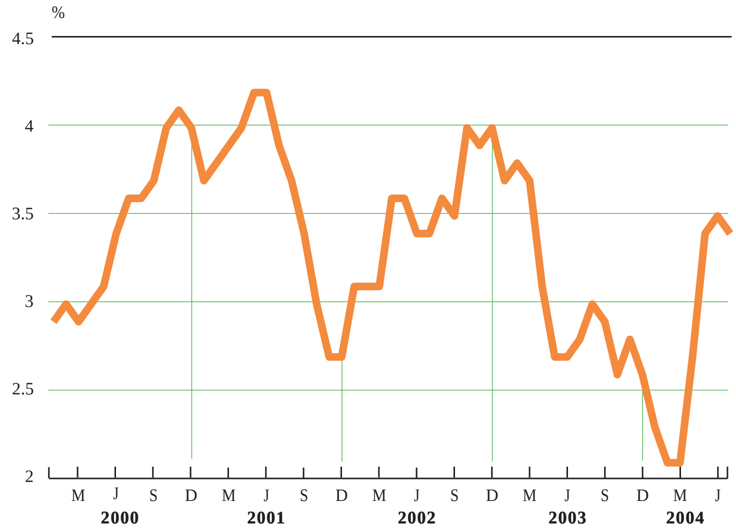
CPI suffers impact of oil price rise

Inflation rate stands at 3.4% in July.

The consumer price index (CPI) rose by 0.2% in June to later drop by 0.8% in July because of the notable impact of summer sales. The year-to-year inflation rate, however, remained relatively stable in this period seeing that, after moving up one decimal in June, the following month it went back to the 3.4% figure recorded in May, thus halting the rise in recent months. Underlying inflation ran along the same lines and stood at 2.8% in both June and July, seven decimals above the lows in March.

INFLATION HOLDING AT HIGH LEVELS

Year-to-year change in consumer price index



SOURCE: National Institute of Statistics.

Fresh food prices being contained.

The relative stability of the CPI in the summer months hides the improvement in unprocessed food prices which, following four months of consecutive increases, turned this trend around. In any case, growth of prices of this component still stood at a very high level (5.5% year-to-year) largely as a result of the sharp increases taking place in potatoes, eggs, certain fruit and vegetables and fresh produce, among other items.

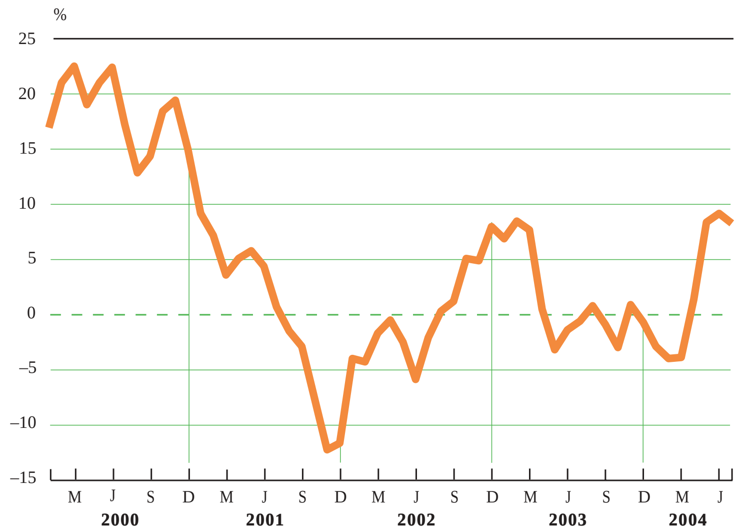
CONSUMER PRICE INDEX

	2003			2004		
	% monthly change	% change over Dec. 2002	% annual change	% monthly change	% change over Dec. 2003	% annual change
January	–0.4	–0.4	3.7	–0.7	–0.7	2.3
February	0.2	–0.2	3.8	0.0	–0.7	2.1
March	0.7	0.5	3.7	0.7	0.0	2.1
April	0.8	1.3	3.1	1.4	1.4	2.7
May	–0.1	1.2	2.7	0.6	2.0	3.4
June	0.1	1.3	2.7	0.2	2.2	3.5
July	–0.6	0.6	2.8	–0.8	1.4	3.4
August	0.5	1.1	3.0			
September	0.3	1.4	2.9			
October	0.7	2.1	2.6			
November	0.3	2.4	2.8			
December	0.2	2.6	2.6			

SOURCE: National Institute of Statistics.

NOTABLE RISE IN FUEL PRICES

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



SOURCE: National Institute of Statistics and internal figures.

Oil-based products moderate in July but make decisive contribution to high inflation level.

The biggest problem comes from the performance in energy prices seeing that, in spite of the relative moderation seen in July, these prices constitute the main reason for the sharp increase in the inflation rate in recent months. It is to be noted that between March and July the year-to-year growth rate in energy prices rose by nearly ten percentage points thus turning around a negative rate to the current 6.6%.

Services prices unchanged at around 3.7% while processed foods show moderate increase.

Notable among the less erratic components of the CPI, on the one hand, was a continuation of the trend to sustained but stable growth in services prices at around 3.7% year-to-year in the past 12 months and, on the other hand, the moderate rise in processed food prices (going to 4.2%) mainly because of the impact of cooking oil and tobacco.

CONSUMER PRICE INDEX BY COMPONENT

July

	Indices (*)	% monthly change		% change over previous December		% annual change	
		2003	2004	2003	2004	2003	2004
By type of spending							
Food and non-alcoholic beverages	113.5	0.6	0.4	1.6	2.0	3.6	4.5
Alcoholic beverages and tobacco	115.9	0.5	0.1	2.6	5.5	2.7	5.6
Clothing and footwear	104.4	–10.2	–10.7	–9.4	–10.2	3.9	1.5
Housing	109.0	0.1	0.3	1.9	2.7	2.6	3.7
Household equipment	105.6	–0.7	–0.6	0.6	0.5	2.0	1.7
Health	105.3	0.1	0.2	1.7	–0.1	2.2	0.2
Transport	109.4	0.7	0.1	1.2	5.5	1.6	5.3
Communications	93.7	–0.1	–0.2	0.7	0.1	–2.5	–0.8
Recreation and culture	103.8	1.0	0.7	0.3	0.4	0.1	0.2
Education	112.3	0.0	0.0	0.9	0.5	5.0	3.9
Hotels, cafés and restaurants	115.5	0.9	0.9	3.7	3.7	4.2	4.0
Other	110.9	–0.1	–0.1	2.5	2.4	3.3	3.0
By group							
Processed food	111.9	0.1	0.2	1.8	3.3	2.5	4.2
Unprocessed food	117.7	1.5	0.8	1.7	0.8	5.5	5.5
Non-food products	108.3	–1.0	–1.2	0.3	1.0	2.6	2.9
Industrial goods	104.3	–2.5	–2.7	–2.1	–0.9	1.7	2.2
Energy products	*106.6*	*0.9*	*0.3*	*0.1*	*6.7*	*0.0*	*6.6*
Fuels and oils	*108.0*	*1.3*	*0.4*	*–0.4*	*8.6*	*–0.5*	*8.4*
Industrial goods excluding energy products	*103.5*	*–3.5*	*–3.7*	*–2.7*	*–3.2*	*2.2*	*0.8*
Services	113.1	0.7	0.6	3.0	3.1	3.6	3.7
Underlying inflation (**)	109.3	–1.0	–1.0	0.6	0.9	2.9	2.8
GENERAL INDEX	**109.7**	**–0.6**	**–0.8**	**0.6**	**1.4**	**2.8**	**3.4**

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

Summer sales help cut prices of non-energy industrial goods in July.

Special mention should be made of non-energy industrial goods which reduced their already modest growth rate by a further two decimals in July putting the figure at 0.8% year-to-year. The notable price cuts at summer sales, greater than those last year mainly in textiles and footwear, helped lower some price levels which had already been affected by a situation of sharp competition. In this respect, the sharp reductions in prices of data-processing/audiovisual equipment are indicative, as shown by the corresponding headings of the CPI.

Energy could push up inflation toward year-end if no remedy comes from fresh foods.

Moderation of the CPI in July does not clear away the unfavourable prospects on energy. The notable increases in fuels in August represent a poor start. On the other hand, neither industrial goods or services seem in a situation to provide substantial reductions in the inflation rate if there is no real change in the general level of consumption. Finally, in the food area, the reductions in fresh foods are being compensated by increases in processed foods. In any case, the situation in farm prices opens the door to sharper decreases in fresh foods.

Price differential with euro area holds at one percentage point in July.

The inflation differential with the euro area in July stood at one percentage point, one decimal below the month before, thanks to the relatively greater moderation in the inflation rate in Spain, according to the harmonized consumer price index. Growth of prices in Spain was higher than in the euro area in practically all components of the index with the exception of alcoholic beverages and tobacco and medical services, both of which are rising sharply in Europe.

Producer prices at highest levels in past four years

Energy, intermediate goods and capital goods continue to put pressure on producer prices.

Producer prices continued their upward path in both June and July. The growth rate of these prices stood at 4.1% year-to-year in the latter month, which was the highest figure since December 2000. The continuation of price increases for energy, the sustained rise in non-energy intermediate goods and, for the first time in recent months, the increase in capital goods has helped raise the index. On the other hand, the notable containment of food prices has acted as a brake with a rate of increase moderating for the first time this year.

Rise in energy and intermediate goods could have negative effect on corporate costs.

Apart from the rise in energy (now 7.2% year-to-year) also troubling is the rise in non-energy intermediate goods which showed an increase of 5.3%, more than four points higher than at the end of last year. Metal prices are the main culprits in this increase and, together with increases in energy, could end up having a notable effect on corporate production costs and at the same time on final prices or business margins. In this respect, consumer durables showed a slight price rise in July going to 2.2% year-to-year, after four months of relative moderation.

Import prices move up slightly in May but still tending to weaken.

Import prices, in turn, showed some increase in May, particularly in the field of intermediate goods, especially energy products which reflected oil price rises (the average cost of imported oil in euros rose by 29.2% in May). This upward trend was also to be seen in manufactures, particularly in non-food consumer goods. Only imported foods continued to show a moderate decrease. In spite of the upward move in the past month, moderation and even decreases continue to mark the dominant trend in import prices in the first five months of the year. It should be pointed out that the average oil price in 2004 was 190 euros a ton, some 3.8% less than in the January-May period in 2003.

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	
2003											
March	–3.4	3.0	2.2	1.2	1.5	9.5	2.9	1.4	–3.0	5.3	–
April	1.0	1.4	1.6	1.0	1.3	1.3	–2.5	–0.1	–10.9	–0.9	–
May	11.2	0.7	1.8	1.2	1.0	–2.3	–2.0	–1.9	–10.0	0.4	4.1
June	7.8	0.9	2.0	1.2	0.4	–0.9	0.7	–0.6	–7.2	3.8	–
July	5.6	1.1	2.5	1.1	0.1	0.2	0.0	–3.4	–7.2	3.2	–
August	7.1	1.1	2.7	1.1	0.0	0.1	1.5	4.5	–9.1	2.9	4.0
September	13.5	0.8	2.7	1.2	0.3	–2.4	–2.8	–0.2	–17.7	0.9	–
October	10.0	0.6	2.5	1.2	0.7	–3.6	0.8	2.8	–0.6	–0.0	–
November	9.7	1.3	2.6	1.4	0.9	–0.4	–0.2	–0.4	–7.0	1.8	4.2
December	9.8	1.1	2.4	1.3	1.0	–1.1	–1.4	–1.4	–9.4	1.0	–
2004											
January	4.4	0.7	2.1	1.3	1.4	–3.6	–3.6	–1.0	–8.4	–3.5	–
February	–2.6	0.7	2.1	1.3	2.0	–5.4	1.8	–6.0	–6.2	7.5	4.0
March	1.3	0.8	2.3	1.3	2.6	–5.6	–2.3	–3.6	–7.0	–0.5	–
April	...	2.6	2.9	1.3	3.7	1.3	1.4	–3.9	2.6	3.4	–
May	...	3.8	3.1	1.2	4.4	7.2	5.3	2.9	–1.1	8.6	...
June	...	4.0	3.2	1.2	4.8	7.1	...	...	...	...	–
July	...	4.1	2.8	1.6	5.3	7.2	...	...	...	...	–

NOTES: (*) Gross figures corrected.
SOURCE: National Institute of Statistics, Ministry of Economy and internal figures.

FOREIGN SECTOR

Trade deficit continues to increase in May

Trade deficit up 26% as of May.

The trade deficit of Spain's economy continued to increase substantially in April and May so that the cumulative figure for the first five months of the year came to 21.2 billion euros, some 26.0% more than in the same period in 2003. The progressive slowdown in growth of exports along with the sustained increase in imports was behind this boost in the foreign imbalance.

FOREIGN TRADE
January-May 2004

	Imports			Exports			Balance	Export/ Import ratio (%)
	Million euros	% annual change in value	% share	Million euros	% annual change in value	% share	Million euros	
By product group								
Energy products	8,413	7.9	10.3	1,697	8.4	2.8	–6,716	20.2
Consumer goods	23,310	17.9	28.6	24,753	0.7	41.0	1,443	106.2
Food	*5,134*	*8.0*	*6.3*	*7,713*	*2.0*	*12.8*	*2,579*	*150.2*
Non-foods	*18,176*	*21.0*	*22.3*	*17,040*	*0.1*	*28.2*	*–1,136*	*93.8*
Capital goods	12,963	14.1	15.9	7,427	9.6	12.3	–5,536	57.3
Non-energy intermediate goods	36,857	11.2	45.2	26,490	4.0	43.9	–10,367	71.9
By geographical area								
European Union	53,443	7.9	65.5	45,457	2.2	75.3	–7,986	85.1
EU-15	*51,300*	*6.7*	*62.9*	*43,572*	*2.2*	*72.2*	*–7,728*	*84.9*
New member states	*2,143*	*45.8*	*2.6*	*1,885*	*0.8*	*3.1*	*–258*	*88.0*
Euro area	*44,779*	*7.4*	*54.9*	*36,370*	*1.9*	*60.2*	*–2,603*	*81.2*
Other countries	28,102	9.5	34.5	14,910	7.2	24.7	–5,971	53.1
Ex-USSR	*1,675*	*1.8*	*2.1*	*547*	*2.2*	*0.9*	*–251*	*32.7*
United States	*3,099*	*4.2*	*3.8*	*2,312*	*–0.8*	*3.8*	*–544*	*74.6*
Japan	*2,308*	*20.8*	*2.8*	*552*	*25.5*	*0.9*	*–727*	*23.9*
Latin America	*3,100*	*9.9*	*3.8*	*2,740*	*2.8*	*4.5*	*–93*	*88.4*
OPEC	*4,859*	*–2.6*	*6.0*	*1,303*	*–5.2*	*2.2*	*–1,839*	*26.8*
Rest	*13,061*	*15.3*	*16.0*	*7,459*	*13.5*	*12.4*	*–2,517*	*57.1*
TOTAL	**81,545**	**8.4**	**100.0**	**60,370**	**3.3**	**100.0**	**–21,175**	**74.0**

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

Rise in imports of non-food consumer goods...

Imports, at 81.5 billion euros as of May, recorded a nominal increase of 8.4%, higher than the average for last year. In real terms, the increase was lower (7.8%) due to the slight increase in import prices. The increase in imports was especially notable in the area of consumer goods, such as non-food products, consumer electronics, cars, furniture, footwear and clothing. Purchases of capital goods also were up sharply, mainly in railway equipment and in general-use machinery.

...coming from beyond borders of EU-15.

By geographical area, purchases from the European Union (EU) made up of 15 member states were up 2.9% real as against 16.4% for those from third countries. We should mention the sharp increase in purchases from the ten new member states of the EU at 45.8% nominal in the first five months of 2004. Outside the EU, the biggest increases were recorded in trade with China and Japan, slightly above 20% nominal.

Exports weaken because of poor state of European market.

Exports were stagnant in April and May although the cumulative figure for the first five months (60.4 billion euros) was still 3.3% above the same period in 2003. This increase was equal to 3.8% in volume if we take into account the slight decrease in foreign sale prices. The weakness of exports was fairly general in terms of markets and was especially notable in the euro area which showed decreases in April and May. In any case, the drive in the EU market was well below that for third countries among which Japan, the Middle East and China continued to show strong.

Drop in foreign sales of cars, furniture, footwear, toys and drinks.

The weaker level of exports was particularly notable in the area of food products, mainly drinks, and in other consumer goods such as cars, furniture, footwear and toys which all saw a drop in foreign sales. On the other hand, textiles and clothing maintained strong growth, as was the case in some capital goods, namely ships, office machinery and telecommunications equipment.

Current account deficit continues to rise

Current account deficit in May highest in recent years.

The current account deficit showed a deficit of 2.4 billion euros in April and 2.5 billion euros in May, figures which are much higher than the imbalances recorded in the same months in 2003. This worsening of the current account balance put the cumulative deficit for the past 12 months at 25.2 billion euros, the highest figure in recent years.

Various headings of current account balance grow worse, except for incomes.

The worse situation came largely as a result of the increase in the trade deficit, especially because of the turnaround in the transfers balance from positive to show a negative figure in cumulative terms for the past 12 months. In addition, the surplus in services also made a negative contribution to the overall balance by showing a slight reduction compared with last year. As a result, the only positive factor of note was the modest reduction in the incomes deficit.

Tourist balance surplus tending to stagnate.

The drop in the services surplus must be largely attributed to the figure for various services seeing that the tourist balance still showed a somewhat more positive figure than last year. In any case, we also note some weakness in this account as a result of the progressive slowing down of inflows from tourism along with the continuing sharp rise in payments. In fact, in the period between May 2003 and 2004 the tourist balance showed a positive balance of 29.3 billion euros, only 0.7% higher that the equivalent period one year earlier. On the other hand, inflows were 2.8% higher as against an increase of 11.3% in payments.

BALANCE OF PAYMENTS

Cumulative figure for last 12 months in million euros

	May 2003	May 2004	% change
Current account balance			
Trade balance	–35,418	–42,159	19.0
Services			
Tourism	*29,041*	*29,257*	*0.7*
Other services	*–2,045*	*–2,689*	*31.5*
Total	26,996	26,568	–1.6
Income	–10,887	–10,374	–4.7
Transfers	1,817	748	–58.8
Total	**–17,492**	**–25,217**	**44.2**
Capital account	**6,888**	**9,888**	**43.6**
Financial balance			
Direct investment	4,636	–4,555	–
Portfolio investment	–6,052	804	–
Other investment	20,679	25,606	23.8
Total	**19,263**	**21,855**	**13.5**
Errors and omissions	–5,135	–3,661	–28.7
Change in assets of Bank of Spain	–3,524	–2,865	–18.7

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

SOURCE: Bank of Spain and internal figures.

Recovery of positive figure in capital balance.

Capital account, in turn, showed a surplus of 560 million euros in April and 1.9 billion euros in May, respectively, thus improving considerably on the figure for the same months last year. Financial account, excluding Bank of Spain transactions, showed cumulative net inflows of 21.9 billion euros in the past 12 month ending of May 2004, some 13.5% more than in the same period last year. Spanish direct investment abroad recovered slightly while direct foreign investment in Spain maintained its sharp decline.

PUBLIC SECTOR

Modest increase in tax collections in first half-year

Central government revenues drop slightly but figure distorted by tax segments ceded to autonomous communities and local government.

In Treasury terms, central government non-financial revenues for the January-June period amounted to 47.7 billion euros to show a drop of 0.8% compared with the same period last year. As distinct from 2003, this figure did not include those segments of personal income tax collections and the greater part of indirect taxes ceded to the autonomous communities and local government, so that it is not directly comparable. If the revenues ceded are included, tax collections amount 66.7 billion euros, which means an increase of 2.7% compared with the first half of 2003.

CENTRAL GOVERNMENT BUDGET IMPLEMENTATION
June 2004

	Month		Cumulative for year	
	Million euros	% change over same month year before	Million euros	% change over same month year before
Non-financial revenue	**781**	**–61.6**	**47,670**	**–0.8**
Non-financial revenue adjusted (*)				
Personal income tax	710	–40.1	21,237	–5.3
Corporate tax	208	92.6	4,587	17.2
VAT	253	–71.1	22,794	3.3
Special taxes	1,635	16.7	8,773	8.5
Other	1,146	–10.9	9,301	9.8
Total	**3,952**	**–18.6**	**66,692**	**2.7**
Non-financial spending	**9,889**	**8.0**	**54,407**	**–0.9**
Treasury balance	**9,108**	**27.9**	**6,737**	**–2.2**
Surplus (+) or deficit (–) (**)	***–9,252***	***13.9***	***–5,167***	***85.3***

NOTES: (*) Includes tax segments ceded to autonomous communities under financing system in operation as of 2002.
(**) In terms of National Accounting.
SOURCE: Ministry of Finance and internal figures.

Indirect tax collections up 5% showing bigger boost than special taxes.

Tax collections rose somewhat less (2.5%) and were based on indirect taxes which accounted for 32.8 billion euros with a rise of 5.1% over the first half of 2003. Revenue from value added tax (VAT) was up 3.3% as of June and was affected by earlier rebates. Collections from special taxes rose by 8.5% with most taxes showing a good rate of increase with the exception of fuel tax which, being the highest in absolute figures, was up by 4.1%. As distinct from 2003, the figures for 2004 do not include tax on certain modes of transport which are now considered to be revenue proper to the autonomous communities.

Direct tax revenues down.

Revenue from direct taxes amounted to 27.1 billion euros overall, showing a drop of 0.5% compared with the first half of 2003. The decrease was centred on personal income tax and may largely be attributed to early tax rebates. Apart from tax revenues, fees and public service charges showed a decrease of little significance. On the other hand, capital transfers were twice the figure for the same period last year while funds coming from disposal of public investment property were of little importance.

Central government non-financial spending down slightly because of lower interest payments and decrease in real investments.

Central government non-financial Treasury spending, in turn, was down by 0.9% and amounted to 54.4 billion euros. This figure does not include the balancing entry for revenues corresponding to tax segments ceded to autonomous communities. The drop in spending showed up in current operations because of lower interest payments and real investments.

Treasury deficit down slightly in first half-year.

The central government Treasury balance as of June, that is to say, the difference between non-financial revenues and spending, was negative (–6.7 billion euros), standing 2.2% below the same period last year. The deficit, however, amounted to 8.9 billion euros seeing that, as well as the Treasury deficit, it was necessary to cover the sharp net increase in financial assets arising from increased deposits of the central government in financial institutions, repayment of loans and property contributions, mainly to Gestor de Infraestructuras Ferroviarias. In terns of National Accounting, the budgetary balance was also negative at a figure of –5.2 billion euros, an increase of 85.3% compared with the first half of 2003.

SAVINGS AND FINANCING

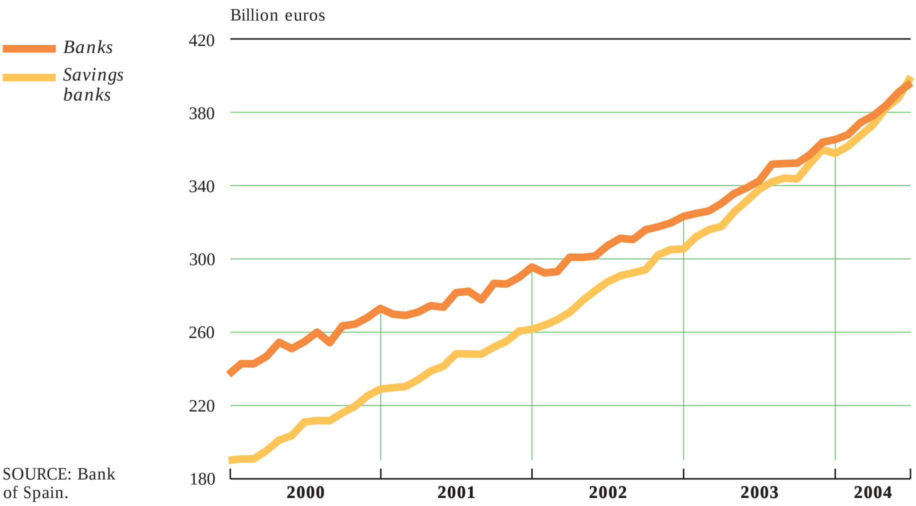
Bank credit to companies and households up

Bank credit to private sector up 16% in past 12 months ending June.

Bank credit to the private sector rose by 16.4% in the past twelve months ending June 2004. This rate was one point higher than that recorded the month before and the highest in the past three and a half years. At the same time, it represents a growth rate twice as high as that for the euro area as a whole. Bank loans to companies and households is being stimulated by the favourable economic climate and excellent financing terms, especially with regard to very low interest rates.

SAVINGS BANKS OUTSTRIP BANKS IN LOANS TO PRIVATE SECTOR FOR FIRST TIME

Loans to companies and households



SOURCE: Bank of Spain.

Savings banks increase loans to companies and households by 18% in past year…

In the past 12 months, total loans granted by savings banks to the private sector rose by 17.8%, six decimals more than the annual change in December 2003. In the period June 2003-June 2004 loans granted by banks to the private sector were up 15.4%, some 2.6 points more than in December. As a result, in June savings banks managed to outstrip banks in this market segment for the first time. As a result, at the end of June total loans granted by savings banks to the private sector stood at 396.9 billion euros, some 2.5 billion euros more than the banks. It should be pointed out that just 10 years earlier, at the end of June 1994, the figure for banks was 60.8% higher than that for the savings banks.

...but total mortgage loans at banks growing faster than at savings banks.

The growth in credit to companies and households is coming especially from mortgage loans. As a result, mortgage loans at banks and savings banks rose by 21.2% in June compared with that recorded in the same month in 2003 although this rate was 0.9 points lower than that recorded in April 2004. If we include securitizations, the change rate in mortgage loans for all institutions rose to 24.8% in May 2004, according to the Spanish Mortgage Association. Demand for mortgage loans continues to show great strength because of higher household incomes, very low real interest rates and favourable financing terms. In this respect, in recent times the financial institutions have reacted to the prospect of interest rate increases with more flexible mortgages. It should be noted that in recent months the growth rate of mortgage loans at banks has been higher than that recorded at saving banks. As a result, total mortgage loans at banks in June showed an annual change of 23.0% as against 20.0% in the case of savings banks.

Notable rise in leasing.

There was also considerable growth in leasing, which goes into financing the acquisition of equipment and premises by companies and self-employed professionals showing a year-to-year change of 14.5%. Commercial credit, used to financing working capital of companies, was up 10.6% in the past 12 months ending in June.

CREDIT TO COMPANIES AND HOUSEHOLDS

June 2004

	Total	Change this year		Change over 12 months		% share
	Million euros	Million euros	%	Million euros	%	
Trade credit	54,813	–718	–1.3	5,269	10.6	6.2
Secured loans (*)	491,233	49,108	11.1	86,676	21.4	55.9
Other term loans	270,594	19,695	7.8	26,713	11.0	30.8
On-demand loans	26,934	6,011	28.7	1,761	7.0	3.1
Leasing	27,527	2,458	9.8	3,493	14.5	3.1
Doubtful loans	7,408	–258	–3.4	–276	–3.6	0.8
TOTAL	**878,510**	**76,298**	**9.5**	**123,638**	**16.4**	**100.0**

NOTES: (*) For most part made up of mortgage security.
SOURCE: Bank of Spain and internal figures.

New all-time lows in default.

On the other hand, doubtful loans continued to drop in absolute figures to 7.4 billion euros in June, partly thanks to loan recoveries and to more efficient risk management systems. This figure meant a default rate of 0.84%, the lowest level in recent years. On the other hand, the default rate at banks and savings banks, excluding other lending institutions, dropped to 0.70%, a new all-time low level.

Bank loan interest rates mark up new low level in June.

Bank loan interest rates continued to drop in June to show a new all-time low. As a result, the composite interest rate for credits and loans at lending institutions fell to 3.85% in June 2004, some 5 basis points less than in the previous month and 43 basis points below 12 months earlier. In fact, the low level was due to the component of non-financial companies for which the composite interest rate dropped to 3.50%, a new low, while the composite rate for households rose slightly to 4.18%. This slight increase was due to the rise in the housing loan rate to 3.29% while the interest rate on consumer loans and other types of loan dropped to 6.04%.

Slight rise in housing loan rate for more than three years.

On the other hand, for lending institutions as a whole, the interest rate on mortgage loans for more than three years for acquisition of non-subsidized housing rose slightly to 3.32% in July. As a result, there was an increase of 7 basis points compared with the all-time low in May 2004.

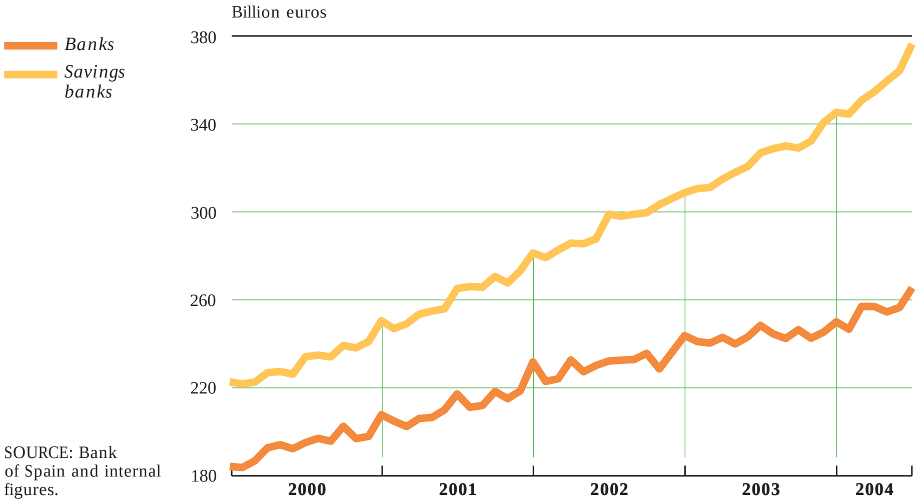
Boost in attraction of bank deposits

Total private sector deposits up 12%.

Total deposits of the resident private sector in euros and foreign currency rose by 12.3% in June 2004 compared with the same month last year, thus recording the highest change rate since December 2001. Nevertheless, in the course of the past 12 months deposits increased considerably less than total loans of the resident banking system. In order to compensate for this imbalance, the financial institutions carried out share issues and securitizations as well as having recourse to the foreign interbank market.

SAVINGS BANKS CONTINUE TO LEAD IN SEGMENT OF PRIVATE SECTOR DEPOSITS

Deposits by companies and households



SOURCE: Bank of Spain and internal figures.

Savings banks increase lead in this market segment.

In recent months both the savings banks and banks have increased levels in attracting deposits by companies and households. Nevertheless, the savings banks showed a bigger boost and recorded an annual increase of 15.2% as of June compared with 6.9% in the case of banks. As a result, they continued to increase their lead in this market segment. At the end of June the balance of private sector deposits at savings banks was 41.9% higher than that for banks.

DEPOSITS BY COMPANIES AND HOUSEHOLDS AT CREDIT INSTITUTIONS

June 2004

	Total	Change this year		Change over 12 months		% share
	Million euros	Million euros	%	Million euros	%	
On-demand	184,223	15,319	9.1	22,577	14.0	27.1
Savings (*)	154,018	8,809	6.1	15,833	11.5	22.7
2-year term	154,224	–2,002	–1.3	–3,428	–2.2	22.7
More than 2-year term	100,391	23,029	29.8	35,712	55.2	14.8
Repos	80,627	2,826	3.6	2,405	3.1	11.9
Total	**673,483**	**47,981**	**7.7**	**73,098**	**12.2**	**99.2**
Deposits in currencies other than euro	**5,268**	**1,117**	**26.9**	**1,211**	**29.8**	**0.8**
TOTAL	**678,751**	**49,098**	**7.8**	**74,309**	**12.3**	**100.0**

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

Spectacular rise in time deposits for more than two years.

By type of deposit, it is worth noting the spectacular 55.2% year-to-year rise in time deposits of more than two years. Deposits in currencies other than the euro also showed an extraordinary increase of 29.8%. On the other hand, time deposits for less than two years have dropped 2.2% since June 2003.

Yields on corporate deposits record new low.

The composite yield on deposits at credit institutions stood at 1.12% in June, at the same low level recorded the month before. The interest rate on funds deposited by households stood at 1.11%, three basis points above the October low while the yield on deposits by non-financial companies recorded a low of 1.14% in June.

Investment fund assets up 8% as of July.

The assets of investment funds stood at 211.3 billion euros in July, an increase of 7.7% over December, according to provisional information supplied by Inverco, the sector organization. In the first seven months of the year, net cumulative subscriptions amounted to 12.1 billion euros. Yields on investment funds in the December-July period were positive, running between 0.2% for national mixed funds and 7% for Japanese share-based funds.

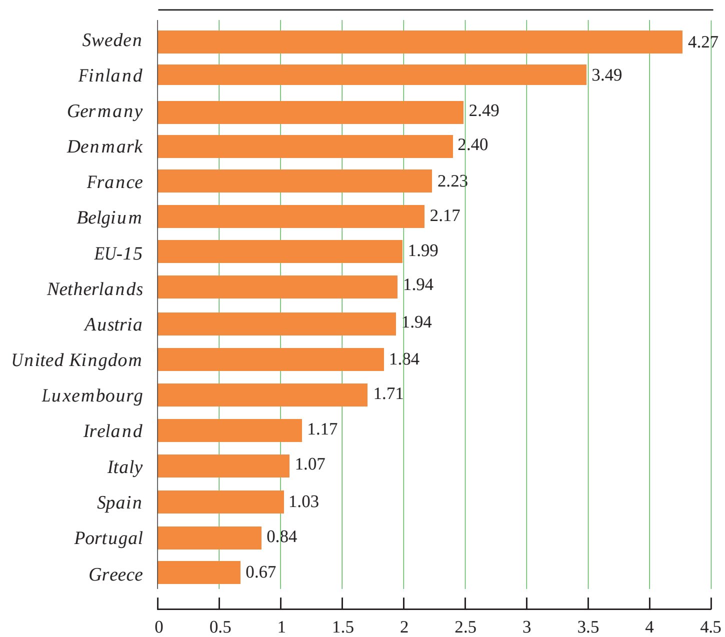
Spending on R&D: still a long way to go

Spain one of developed economies spending least on R&D…

Spain is one of the developed economies spending the least on research, development and innovation. Furthermore, Spain's trade balance in high-technology products shows a major deficit. In 2001, that deficit amounted to 10.3 billion euros, a figure which represents practically half the entire trade deficit in high-technology products for the European Union made up of 15 member states (EU-15).

SPAIN AT TAIL-END IN R&D SPENDING

Spending on R&D in EU as percentage of GDP (latest year available)



SOURCE: National Institute and Statistics, Eurostat and internal figures.

…mere 1% of GDP, half average for EU…

The countries of Northern Europe, Japan and United States are those investing most in this direction. Based on figures from Eurostat and the National Institute of Statistics (INE), overall spending on research and development (R&D) in Spain represented 1.03% of the gross domestic product (GDP) in 2002, whereas the EU-15 average was almost twice that percentage standing at 1.99% of the GDP, while the United States showed almost three times that figure (2.80% of the GDP). In other words, Europe presents a major deficit in R&D investment compared with the United States and Spain maintains a big deficit in terms of Europe.

…whereas Sweden stands above 4%.

Those countries investing most in terms of GDP are Sweden (4.27%), Finland (3.49%) and Japan (2.98%). Germany and France devote 2.49% and 2.23% of their GDP respectively to R&D while the new EU member states as a whole direct an average of 0.84% of their GDP into R&D spending, a low percentage but fairly close to that invested by Spain.

Another notable factor is high percentage of total R&D still government-funded in Spain.

A second key aspect is the breakdown of R&D spending between the public and private sectors. In the United States, the private sector accounts for more than 70% of total spending. The same applies in Europe's Nordic economies, Sweden (77.6%) and Finland (71.1%). On the other hand, the degree of private sector involvement in average R&D spending in the EU-15 drops to two-thirds (64.9%) while in economies like Spain and Italy the role of the private sector reaches only approximately half of total R&D spending (52.4% in Spain and 50.1% in Italy). These are qualitative differences in model which turn out to be significant because they indicate the different degrees of integration of R&D work in production activities.

SPENDING ON R&D BY TYPE OF INSTITUTION

Percentage breakdown

	Companies	Universities	Government	Other
Germany	69.1	17.1	13.8	–
France	62.2	19.5	16.9	1.4
Italy	50.1	31.0	18.9	–
United Kingdom	67.4	21.4	9.7	1.5
Sweden	77.6	19.4	2.8	0.2
Finland	71.1	18.1	10.2	0.6
Spain	52.4	30.9	15.9	0.8
European Union	**64.9**	**21.2**	**13.1**	**0.8**
United States	**70.2**	**15.9**	**8.8**	**5.1**
Japan	**73.7**	**14.5**	**9.5**	**2.3**
OECD	**69.0**	**17.4**	**10.8**	**2.8**

SOURCE: OECD and internal figures.

According to Lisbon objectives, EU to aim at sharp increase in R&D investment…

The importance of R&D activities for the growth and future development of the advanced economies was brought out at the European Council summit held in Lisbon in 2000 where strategic objectives were established for transforming the European Union into the most dynamic and competitive knowledge economy in the world and the setting up the European Research Area. Within this framework, the European Council meeting in Barcelona in March 2002 set two of the more important objectives in this field. First, to increase R&D investment in the EU from 1.9% of the GDP for 2002 to a goal of 3% of the GDP for the year 2010.

…while private sector to make bigger contribution…

The second objective referred to the breakdown in R&D spending between the public and private sectors. The aim is that the private sector contribute around 75% of all research activity in Europe within the period ending 2010, as is actually taking place in the more advanced countries in this field.

...both ambitious objectives for Europe and even more for Spain.

There are thus two objectives, one quantitative (devote 3% of the GDP to R&D) and the other qualitative (put three-quarters of the R&D effort onto companies and the remaining 25% onto the public sector) which set a course aimed at the real involvement of innovation in production activity and the improvement of productivity. Meeting both these objectives must be considered ambitious for Europe and even more so for Spain.

National R&D&I Plan for 2004-2007

National R&D&I Plan aims at improving Spain's position compared with EU...

The central government's research policy is in keeping with the directives of the National Plan for Scientific Research, Development and Technological Innovation for 2004-2007 which has as its priority objective to put the country into a position better than the current one in terms of the European Union and the OECD. The Plan covers research, development and innovation activities as a whole to be undertaken over the next four years. In broad terms, its quantitative objectives are aimed at the following:

...raising R&D spending to 1.4% of GDP in 2007.

- Put R&D spending at around 1.4% of GDP in 2007.
- Maintain annual increase in R&D spending close to 10%.
- Increase contribution of R&D spending from companies to 60%.
- Put number of research workers at more than 5 per thousand in labour force.
- Put spending on Innovation (I) at around 2.5% of GDP.
- Bring 6,500 new researchers and technologists into Plan programmes.

New government announces bigger effort than already programmed for public sector.

The initial aim of the Plan was to make an intermediate revision in 2005 in order to bring the quantitative indicators up to date for 2006 and 2007. Nevertheless, the recent change of government could mean some modification of the Plan. Specifically, during the debate at the opening of parliament, the new prime minister indicated that budget spending on R&D would go up by 25% a year during the four-year term of the legislature, a major quantitative leap which, if carried out, could speed up Spain's convergence with Europe in terms of R&D, at least so far as the public sector is concerned.

Plan establishes framework of support for private investment...

From the point of view of support for private sector investment, the Plan concentrates on four main areas:

- Sector agreements between the former Ministry of Science and Technology and corporate sector organizations.
- The fiscal framework for deductions for R&D&I activities now complemented with new legal guarantees provided by fiscal certification.

- Budgetary and financial support as well as initiatives linked to risk capital, technology centres, embryonic company support, etc.

- Improved protection for intellectual and industrial property.

…and methods of financing research activities.

Financing of research activities comes in various forms. The most significant are as follows:

- Budgeted subsidies by means of public competition, under agreement or by appointment.

- Financial support, either by means of conditional credits, through credits only partially repayable or through interest rate subsidies.

- Participation in capital, either directly or through participatory payments.

- Through provision of services.

Government R&D programmes

Public sector supports R&D by various means.

There are three main instruments of government support for R&D in Spain, namely the central government budget, the system of fiscal incentives for R&D&I activities and incentives for these activities provided by the autonomous communities.

In central government budget, funds for this purpose increasing more than most spending headings…

In the central government budget for 2004 investment in R&D was considered to be a priority which meant that it showed year-to-year increases greater than most spending headings. Nevertheless, the information which was incorporated in the budget indicated that existing restrictions also had to be taken into account. The accompanying graph thus shows that the budget increase in the period 1998-2001 was significantly greater than in 2001-2004. In the past three years, in spite of the European commitments made in Lisbon and Barcelona, the total amount set for R&D activities under the central government budget grew by an annual average of 7.3%, very little above the GDP in current terms.

…amounting to 4.4 billion euros in 2004, 10% more than the year before.

In overall terms, the total central government budget going into R&D spending in 2004 stood at 4.4 billion euros, an increase of 9.9%. These funds are grouped together by category in the budget under the heading of scientific, technical and applied research. Of these amounts, 2.1 billion euros represents current non-financial spending while the rest is for financial spending. It should be pointed out that in recent years a very large part of government support for R&D has been carried out by the granting of zero-interest loans which are accounted for as financial spending. In 1998, the central government provided 673 million euros whereas in the 2004 budget this figure was multiplied by almost four to reach 2.3 billion euros.

Among the programmes coming under the central government budget,

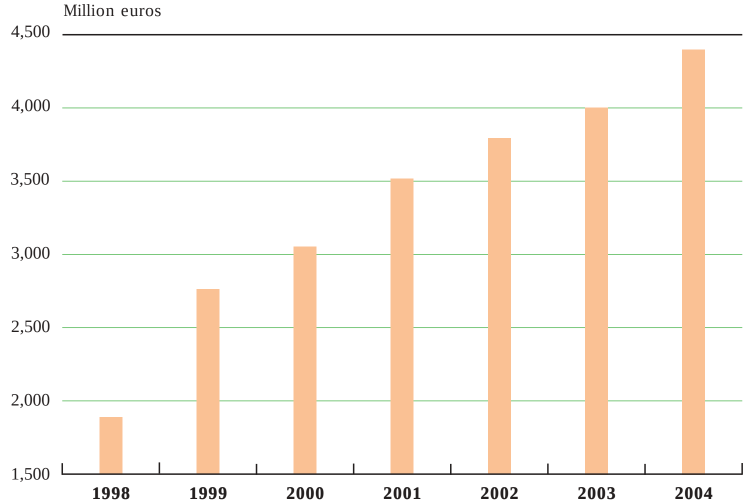
Certain headings make up bulk of current spending, such as that earmarked for scientific research…

five programmes have taken up more than 80% of non-financial spending by the central government on research in recent years. These include the scientific research programme which in 2004 was funded with 456.8 million euros, of which more than half went into personnel with one third going into investment for provision of equipment and transfers for financing fellowships for professors and researchers.

The research and study programme for the Armed Forces was funded

GOVERNMENT SPENDING ON R&D GROWING LESS THAN BEFORE

Spending on R&D included in central government budget



SOURCE: Ministry of Economy and Finance and internal figures.

…that for defence-related research…

at 302.7 million euros of which two-thirds went into paying research personnel on various Ministry of Defence projects while the remaining third went for projects conducted by INTA (Esteban Terradas National Institute of Aerospace Technology) which is developing projects such as MINISAT (small satellites) and test programmes for the Remote Pilot Aircraft.

…research and technological development…

The research and technological development programme, budgeted at 344.5 million euros, is aimed at promoting the application of knowledge and new ideas in the production process. This covers industrial research projects, initial studies of technical viability, development projects, infrastructure equipment projects for research and development in technology centres and measures aimed at fostering participation in international programmes such as EUREKA, IBEROEKA and projects under the European Union Programme for research and technological development.

…health research…

The health research programme, funded at 220.6 million euros, is concentrated on work at the Carlos III Health Institute, its institutions and associated centres, such as the Centres for Environmental Health, Epidemiology, Health Research Funds and the Centre for Research into the Toxic Syndrome, among others.

MAIN BUDGETARY SPENDING PROGRAMMES FOR R&D IN 2004

Million euros

	Non-financial spending	Financial spending	Total	% of total
Research and tecnological development	344	1,849	**2,193**	49.8
Scientific research	457	–	**457**	10.4
Promotion and coordination of scientific and technological research	397	55	**452**	10.3
Research and development of information society	–	304	**304**	6.9
Research and study for Armed Forces	303	–	**303**	6.9
Health research	221	–	**221**	5.0
Technological innovation in telecommunications	–	60	**60**	1.4

SOURCE: Ministry of Economy and Finance.

...and promotion and coordination of scientific and technological research.

The fifth of the priority programmes deals with the promotion and coordination of scientific and technological research, funded at 397.3 million euros, which is carried out along four streams of activity, namely the quantitative and qualitative increase in human resources in R&D&I activities; funding; provision of scientific and technical equipment and installations for setting up new research centres; and the coordination of R&D&I programmes of the central government and the autonomous communities.

Funds also go into agricultural research, information society, telecommunications, etc.

With less funding (between 2% and 3% of all funds in each case), come those programmes aimed at agricultural research, research on matters linked to the information society, energy research and environmental research and technological innovation in telecommunications.

Large part of spending goes into zero-interest loans aimed at R&D investment for defence and industrial innovation.

On the other hand, as mentioned earlier, we should point out the growing part of the budget being borne by financial spending. Out of the 4.4 billion euros allotted to R&D investment in the central government budget, 51.5% (2.3 billion euros) comes out of financial assets. These are zero-interest loans aimed at investment in R&D in the defence industry as well as programmes to promote industrial technology and innovation managed up until now by the Ministry of Science and Technology, now known as the Ministry of Industry, Trade and Tourism.

Financial resources concentrated on the research and technology development programme...

Notable among the government financial programmes aimed at supporting R&D activities is the 1.8 billion euros for the research and technological development programme concentrating on three types of activity. These include, first, the property contributions made to the Centre for Industrial Technology Development (CDTI), for R&D&I projects; second, the granting of loans to the public sector for technical research programmes and to foster technological research in depressed areas; and, third, the granting of loans outside the public sector, notable among which are repayable funds granted to companies for the development of qualified industrial technology projects.

…and on research and development of information society.

The second among the priority programmes supported by central government funding is for research and development of the information society, with aid amounting to 303.5 million euros and concentrating on fostering the development of information technology and telecommunications.

Tax incentives for R&D&I activities

Elaborate system of tax incentives for corporate R&D&I set in place in recent years…

Another major instrument to support R&D&I activities is made up of tax incentives. Over the past five years Spain's economy has been blessed with one of the strongest systems of tax incentives in the EU for supporting research, development and innovation activities by companies.

…although in practice this has not worked as well as might be wished…

While the theoretical fiscal framework is quite favourable, its actual application has not been so satisfactory. The main problem up to now has been the legal uncertainty surrounding R&D&I spending, given that the criteria applied by the Taxation Agency have often been significantly more restrictive than interpretations made by companies. In order to resolve this question, at the end of 2003, Royal Decree 1432/2003, dated November 21, 2003, regulated the issue of reports by the Ministry of Science and Technology (now the Ministry of Industry, Trade and Tourism) relating to the meeting of scientific and technological requirements for the application and interpretation of fiscal deductions for R&D&I activities.

…due to different criteria applied for spending to qualify as R&D&I.

Companies may apply to the Ministry of Industry or to an associated body for the issue of reports on whether they meet the requirements in order to benefit from tax incentives in any given project. These reports are binding on the Taxation Agency. The time transpiring since the approval of that Royal Decree and the change in government taking place in this period makes it impossible to evaluate the significance of this regulation although it would seem that it has not been used to any great extent. In any case, this is an instrument which could give a strong boost to corporate activities linked to research, development and innovation in coming years.

R&D spending by companies

Companies making qualitative leap to incorporate research and technological development in production activities.

This final section looks at R&D spending by companies which are responsible for slightly more than half of all R&D expenditure in Spain. In ten years the nominal spending of companies on R&D has risen from 1.6 billion euros to 3.9 billion euros, that is to say, it has gone up by 2.4 times. However, the trend has not been constant. In the first five years between 1992 and 1997, funds invested in R&D by companies grew by a modest 20.2% over that five-year period. On the other hand, between 1997 and 2000 R&D spending by companies practically doubled to grow by 99.2% in those five years. This is a good indication of a change of pace which suggests that companies are making a qualitative leap to incorporate research and technological development in their production activity, a performance which in the past five years has been much greater than that by the public sector.

TAX INCENTIVES FOR R&D&I ACTIVITIES

1. *Freedom in matters of write-off*

- *For fixed assets, both tangible and intangible, related to R&D activities (excluding buildings).*

2. *Deductions for R&D*

- *30% of spending on R&D. Where this is higher than the average for past two years, 50% of increase.*
- *20% additional on spending on research personnel exclusively devoted to R&D activities and on spending on projects with universities, public research bodies and innovation and technology centres.*
- *10% on investment in tangible and intangible fixed assets, excluding buildings and land, related exclusively to R&D activities.*

3. *Deductions for innovative activities*

- *15% of spending on technological innovation activities related to R&D projects under contract to universities, public research bodies or innovation and technology centres.*
- *10% of spending on technological innovation activities in:*
  - *Industrial design and production process engineering.*
  - *Acquisition of technology in form of patents, licences, know-how and design. The base figure for this heading cannot exceed one million euros.*
  - *Obtaining of certificate showing that ISO 9000, GMP and similar quality standards have been met.*

4. *Deduction limits*

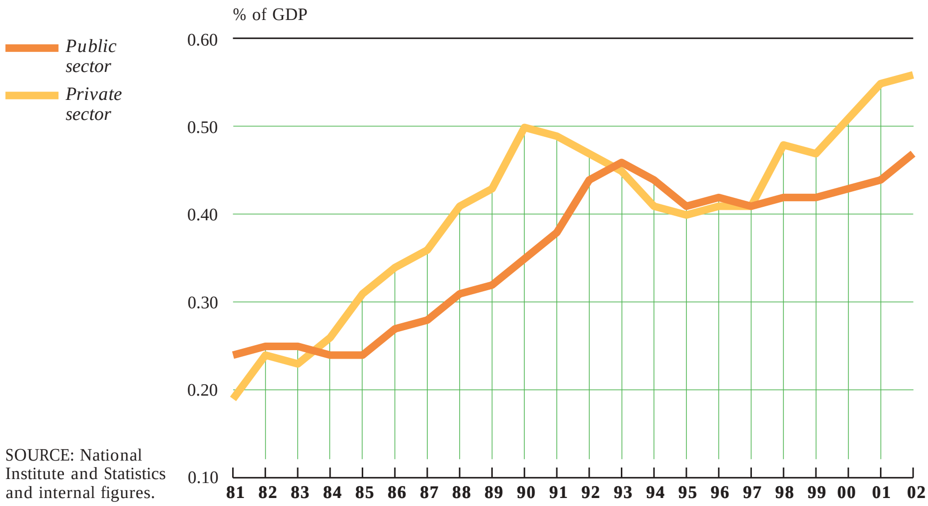
- *35% of taxable income less deductions in order to avoid double taxation, both domestic and international, and allowances.*
- *This percentage goes up to 45% where the amount of deduction for R&D&I and promotion of information technologies exceeds 10% of tax payable.*
- *In those cases where the tax base is insufficient, amounts not deductible may be carried forward over the next 15 years.*
- *Deduction base reduced by 65% of subsidies received for promoting these activities.*

5. *Small companies*

- *These may deduct 10% of investment and spending related to improved access to Internet and internal processes involving information and communications technology within the overall limits mentioned.*

COMPANIES DOING MORE RESEARCH THAN PUBLIC SECTOR

R&D spending by sector



SOURCE: National Institute and Statistics and internal figures.

In recent years increase in research effort has come in services sectors while industry has been less active.

Research activity has not been evenly spread among the various sectors. If we look at INE figures on trends in R&D spending by sector in the 1997-2002 period, we find that certain figures are somewhat surprising. In 1997, for example, some 85.4% of total spending on R&D was made by the industrial sector whereas the services sector accounted for 12.4%. Five years later in 2002, industry did not reach 60% of R&D spending and the services sector made up 38.7%. It is the services sector which by far is proving most dynamic when it comes to carrying out R&D activities. Whereas industry increased its annual spending on R&D by 40% in five years, the services sector showed a rise of 520%.

Some 30% of corporate R&D takes place in tertiary sector companies providing services to other companies.

In 1997 three industrial sectors stood out because of their investment in R&D. On the other hand, in 2002 the most important sector involved in R&D was that providing «services to companies» which includes sub-sectors such as data-processing services, R&D services and other services to companies. This sector made up 29.3% of all R&D spending in Spain, practically the same figure as that spent by the two industrial sectors which together devote most resources to R&D, namely the transportation equipment industry (15.2% of the total) and the chemical industry (14.8%).

Research effort in industry concentrated in sectors such as electrical equipment, electronics and optics, transportation equipment and chemicals.

With regard to R&D spending carried out by industry, the accompanying table shows spending by sector in 1997 and 2002. We see that three sub-sectors alone account for more than 10% of total R&D spending, namely electrical equipment, electronics and optics, transportation equipment and the chemical industry. Of the three, the sector to show the greatest activity in the five-year period was the chemical industry with an increase of 82.6% in R&D spending whereas the transportation equipment sub-sector raised its spending by 51.4%. Surprisingly, the sub-sector investing most in R&D in 1997, the electrical equipment, electronics and optical sector, showed a freeze on annual spending.

R&D SPENDING OF SPANISH COMPANIES BY BRANCH OF ECONOMIC ACTIVITY

	Million euros		% change	Percentage breakdown	
	1997	2002		1997	2002
Agriculture	**37.56**	**16.57**	**–55.9**	**1.9**	**0.4**
Industry					
Mining and oil industry	39.75	49.04	23.4	2.0	1.2
Food, drink and tobacco	61.81	98.23	58.9	3.1	2.5
Textiles, clothing, leather and footwear	27.23	60.88	123.6	1.4	1.6
Wood and cork	1.64	5.95	262.8	0.1	0.2
Paper and graphic arts	18.90	28.03	48.3	1.0	0.7
Chemical industry	319.14	582.89	82.6	16.2	14.8
Rubber and plastics	63.30	41.29	–34.8	3.2	1.1
Non-metallic mineral products	34.88	52.69	51.1	1.8	1.3
Metallurgy and metal product manufacturing	75.93	114.34	50.6	3.9	2.9
Machinery and mechanical equipment	139.83	231.18	65.3	7.1	5.9
Electrical equipment, electronics and optics	414.20	415.92	0.4	21.0	10.6
Transportation equipment	395.43	598.54	51.4	20.1	15.2
Various manufacturing industries	26.06	33.46	28.4	1.3	0.9
Energy and water	64.16	42.55	–33.7	3.3	1.1
Total	**1,682.26**	**2,354.99**	**40.0**	**85.4**	**60.0**
Construction	**6.31**	**36.55**	**479.2**	**0.3**	**0.9**
Services					
Retail trade and restaurant trade	2.64	84.39	3,096.6	0.1	2.1
Transportation and communications	80.90	145.21	79.5	4.1	3.7
Financial houses		100.31		0.0	2.6
Services to companies	146.47	1,151.41	686.1	7.4	29.3
Public services to companies and groups	14.69	36.93	151.4	0.7	0.9
Total	**244.70**	**1,518.25**	**520.5**	**12.4**	**38.7**
TOTAL	**1,970.83**	**3,926.36**	**99.2**	**100.0**	**100.0**

SOURCE: National Institute of Statistics and internal figures.

Food and metal product manufacturing show little investment in R&D.

In an overall analysis of industry, two sectors firmly established in Spain's economy showed surprisingly low participation in R&D activities. These were the food, drink and tobacco industry, which devoted only 2.5% of spending, and the metal industry and manufacture of metal products, which contributed 2.9%.

In any case, we must keep in mind phenomenon of outsourcing of services in industry which explains much of earlier growth.

An examination of the breakdown of R&D spending by sector would suggest the need to consider the interrelation between industry and services when carrying out R&D in Spain. In many industrial sectors, the size of companies makes it difficult to carry out R&D activities within the company itself and on the other hand makes it more convenient to outsource this through data-processing services or through specifically R&D service companies. This would explain the growth of 686% in R&D spending carried out in the sub-sector of services to companies, which made it possible to go from a figure of 7.4% of total R&D spending in 1997 to 29.3% of the total in 2002.

Retail trade and hotel trade making big effort in this area.

Finally, we should make mention of another services sub-sector, namely the retail trade and the hotel trade. In 1997, they devoted 2.6 million euros to R&D activities, an insignificant 0.13% of total corporate spending in this field. Five years later, the sector was spending 84.4 million euros, 40 times as much, and now makes up 2.15% of Spain's corporate spending on R&D.

To sum up, clear understanding of importance of R&D&I activities now exists although objectives set still remain far off.

To sum up, Spain's economy stands far from the objectives set for the European Union. Nevertheless, we note a number of positive signs which, if these are confirmed, could open the way to greater optimism. It comes down to the willingness of the economic authorities to raise government spending on R&D, increasing application of fiscal benefits under the tax system in order to encourage companies to carry out R&D projects and improvements in procedures to give legal guarantees in the application of fiscal incentives. Finally, the surest sign that things are changing in matters of research, development and innovation is the progressive increase in R&D investment and spending on the part of companies in the past five years. In coming years, the public sector and the private sector will have to move ahead in this area together in order to catch up in research and to improve the situation in terms of productivity.

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