THE SPANISH ECONOMY:

MONTHLY REPORT

SEPTEMBER 2005

No. 283 Contents

Oil prices reach new all-time highs

Price of Brent crude goes above 66 dollars a barrel at end of August. Page 17

Federal Reserve raises interest rates

By contrast, Bank of England cuts rates while European Central Bank rates remain unchanged. Page 29

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Strong domestic demand behind brilliant results in GDP. Page 42

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SPECIAL REPORTS

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Unemployment benefits vary greatly from country to country and may have notable effect on encouraging job search. Page 72

Research Department

"la Caixa"

Forecast

% change over same period year before unless otherwise noted

	2003	2004	2005	2004 1st Qtr.	2004 2nd Qtr.	2004 3rd Qtr.	2004 4th Qtr.	2005 1st Qtr.	2005 2nd Qtr.	2005 3rd Qtr.
INTERNATIONAL ECONOMY			Forecast						Forecast	
Gross domestic product										
United States	2.7	4.2	3.6	4.7	4.6	3.8	3.8	3.6	3.6	3.6
Japan	1.4	2.6	1.6	4.1	3.1	2.4	0.9	1.0	1.5	2.2
United Kingdom	2.5	3.2	2.0	3.4	3.7	3.1	2.7	2.1	1.8	1.9
Euro area	0.7	1.7	1.3	1.5	2.1	1.8	1.6	1.4	1.2	1.3
Germany	*–0.2*	*1.1*	*0.9*	*1.2*	*1.6*	*1.1*	*0.5*	*0.8*	*0.6*	*1.0*
France	*0.9*	*2.1*	*1.5*	*1.6*	*2.8*	*1.8*	*2.1*	*1.9*	*1.3*	*1.5*
Consumer prices										
United States	2.3	2.7	2.9	1.8	2.9	2.7	3.3	3.0	2.9	3.0
Japan	–0.3	0.0	0.0	–0.1	–0.3	–0.1	0.5	–0.2	–0.1	0.1
United Kingdom	2.8	2.2	2.2	2.3	2.2	2.1	2.3	2.2	2.2	2.3
Euro area	2.1	2.1	2.1	1.7	2.3	2.2	2.3	2.0	2.0	2.2
Germany	*1.0*	*1.7*	*1.8*	*1.0*	*1.9*	*1.9*	*1.9*	*1.7*	*1.7*	*1.9*
France	*2.1*	*2.1*	*1.7*	*1.8*	*2.4*	*2.3*	*2.1*	*1.7*	*1.7*	*1.8*
SPANISH ECONOMY										
Macroeconomic figures										
Household consumption	2.6	4.4	4.7	3.3	4.7	4.7	4.8	4.8	4.7	4.7
Government consumption	3.9	6.4	5.6	5.4	6.3	7.1	6.7	6.0	5.7	5.4
Gross fixed capital formation	5.3	4.4	7.5	3.4	3.1	4.9	5.9	7.5	7.7	7.5
Capital goods	*1.9*	*2.1*	*10.7*	*–2.5*	*–1.6*	*5.1*	*7.3*	*10.5*	*10.6*	*10.9*
Construction	*6.2*	*5.5*	*6.2*	*6.0*	*5.4*	*5.2*	*5.3*	*6.1*	*6.2*	*6.3*
Domestic demand (contribution to GDP growth)	3.8	4.8	5.8	3.8	4.6	5.2	5.5	5.8	5.8	5.8
Exports of goods and services	3.6	2.8	0.3	3.5	2.8	3.2	1.8	–1.7	–0.3	1.2
Imports of goods and services	6.3	8.1	7.1	6.2	8.0	9.2	8.8	6.0	5.8	7.5
Gross domestic product	2.9	3.1	3.3	3.0	3.1	3.1	3.2	3.3	3.4	3.4
Other variables										
Employment	2.5	2.7	3.0	2.6	2.5	2.7	2.9	3.0	3.0	3.1
Unemployment (% labour force)	11.5	11.0	9.4	11.5	11.1	10.7	10.6	10.2	9.3	9.1
Consumer price index	3.0	3.0	3.2	2.2	3.2	3.3	3.4	3.3	3.2	3.3
Unit labour costs	2.7	2.7	2.7	2.7	2.6	2.7	2.8	2.6		
Current account balance (% GDP)	–4.3	–5.1	–6.1	–3.4	–5.5	–5.1	–6.5	–6.8		
Net lending or net borrowing rest of the world (% GDP)	–3.1	–4.1	–5.1	–2.8	–4.2	–3.9	–5.4	–6.3		
Government balance (% GDP)	0.3	–0.1	0.0							
FINANCIAL MARKETS										
Interest rates										
Federal Funds	1.1	1.3	3.2	1.0	1.0	1.4	1.9	2.4	2.9	3.4
ECB repo	2.3	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
10-year US bonds	4.0	4.3	4.3	4.0	4.6	4.3	4.2	4.3	4.2	4.2
10-year German bonds	4.1	4.1	3.4	4.1	4.2	4.1	3.8	3.6	3.3	3.2
10-year Spanish bonds	4.1	4.1	3.4	4.1	4.2	4.2	3.8	3.6	3.3	3.2
Exchange rate										
$/Euro	1.13	1.24	1.25	1.25	1.20	1.22	1.30	1.31	1.26	1.22

"la Caixa" GROUP: KEY FIGURES
As of December 31, 2004

FINANCIAL ACTIVITY	Million euros
Total customer funds	143,912
Receivable from customers	93,242
Profit attributable to Group	1,020

STAFF, BRANCHES AND MEANS OF PAYMENT	
Staff	24,827
Branches	4,841
Self-service terminals	6,988
Cards	7,805,561

COMMUNITY PROJECTS: 2005 BUDGET

Activities	Million euros	%
Social	114	62
Cultural	29	16
Science and environmental	23	13
Educational	17	9
Total activities	**183**	**100**
Investment and other costs	67	
TOTAL BUDGET	**250**	

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September 2005

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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

The world economy faces the last months of 2005 with **moderate optimism**. Latest figures on growth from the United States and China, the main vectors of international growth, point to a continuation of present trends. The situation in Japan is improving and we are beginning to see signs of recovery in the euro area. The very drive in the world economy largely explains the rise in oil prices which have continued to climb to all-time highs. Pressures on raw material markets (those of industrial origin have also undergone major increases) scarcely seem to be affecting growth up to now while inflation rates in the developed countries are showing stable, apart from the energy component. In any case, **the rise in oil prices continues to represent a threat to growth**, as may be seen in the trend in international stock markets in the latter part of August.

To be more specific, the United States is showing **growth of 3.6%** in 2005, thanks to private consumption, which appears to be slowing down slightly, being compensated by strong corporate investment and a real estate sector that is benefiting from low interest rates. Japan is showing a more modest trend with growth of 1.6% but is reporting a **significant recovery in domestic consumption** and a better situation in exports. The euro area, in turn, after hitting bottom in the second quarter, has begun to show the **first signs of moving into a stage of increased economic activity**, according to early indicators for the third quarter. In any case, growth for the year as a whole will be 1.3% (1.8% in 2004).

The Federal Reserve will continue to raise its reference rate in coming months until it stands at a more neutral level at above 4%. On the other hand, the European Central Bank **will maintain its official rate at 2% until well into next year** in that hope that the recovery of the euro area will consolidate and that inflationary risks from high-cost oil will disappear. With regard to foreign exchange markets, it is generally expected that over the mid-term the dollar will depreciate against the Asian currencies now that the yuan has broken its exchange rate link with the dollar. It will continue to oscillate against the euro within a range around current levels while being subjected to various pressures resulting from the foreign imbalance and the differential in interest rates.

Spain's economy continues to enjoy **robust growth** at 3.4% in the second quarter (3.1% in 2004 as a whole). The favourable performance in consumption, the growth of capital goods investment and the continuation of construction demand (housing and public works) ensures maintenance of GDP results for the rest of the year. **Job creation** is also showing a strong trend with 900,000 more persons employed in one year (a large part of these, however, in temporary or part-time jobs) and a substantial reduction in unemployment. The negative counterpoint of Spain's economic situation shows up in the constant **worsening of the trade balance** and the current account balance with abroad. On the other hand, **inflation is showing a favourable** trend except with regard to the oil-based component. Energy has put the year-to-year CPI rate above 3%, a level that unlikely will drop this year unless there is a substantial change in oil prices.

August 26, 2005

Favourable winds for world economy

Optimistic outlook for world economy although somewhat clouded by oil prices.

Growth of economic activity and world trade seem to be well established as we pass the mid-point in the year. The US economy is maintaining its growth, Japan is improving domestic demand and even the euro area is showing tentative sparks of recovery. China has decided to remove the link between the yuan and the dollar bringing about a slight appreciation of the Chinese currency, something which should contribute to ease world imbalances in trade and savings. In this context, demand for oil and other industrial raw materials has remained firm. Crude oil has jumped to new all-time highs in August going above the level of 66 dollars in the case of Brent quality oil (40 dollars at the beginning of the year). Nevertheless, after discounting the energy component, inflation rates continued to show very moderate behaviour.

Economic activity remains strong in United States...

The United States continues to show notable growth levels. The first half-year brought an increase of 3.6% year-to-year in the gross domestic product (GDP) and in the summer months the leading world economy scarcely showed any signs of weakening. Consumers continue to spend, housing sales are strong and investment is maintaining a vigorous level. The good rate of job creation, which made it possible to go over 2.2 million jobs created in the past year, represents an important support for maintaining the current state of the economy.

...while not showing inflationary trends apart from direct effect of oil.

Under current risks, the rise in oil prices has begun to leave its mark on trends in consumer prices but the good performance in other components of the index has made it possible to largely absorb that impact. Underlying inflation, that is to say, that which does not include the trend in the more volatile components of the index, is showing stability at relatively contained levels of the order of 2% year-to-year in recent months.

Massive government deficit and foreign deficit remain basic threats.

This means that the main source of concern lies in the chronic fiscal and foreign deficits, two imbalances which could have an effect over the medium and long term. This is so especially in the case of the foreign deficit where the trend is disturbing. To be specific, the moderate recent reductions in the trade imbalance were wiped out in June so that figures in the red are again close to the all-time highs recorded at the beginning of the year.

China continues dynamic growth without increase in inflation.

Along with the United States, China is the second centre of recovery for the world economy. While some slowdown is expected as the year advances, figures for the first half do not point in this direction. The GDP grew by 9.5% year-to-year in the second quarter and the most recent indicators support the strength of the economic situation. Apart from the growth rate in itself, the most positive factor is the absence of notable inflationary pressures.

Japan overcomes dip at end of 2004 with increasingly strong contribution of domestic demand.

At another level, the Japanese economy is also showing encouraging signs in terms of its cyclical trend. Following the notable recovery in 2004, at the end of that year and the beginning of 2005, it seemed that Japan had again lost its growth rate. Exports showed some slowing down, the recovery in consumption slackened and investment contracted. Nevertheless, figures for the national accounts in the second quarter removed the threat of a new slack stage. Domestic demand show a positive upward trend while exports appear to be beginning to regain ground. In this context, the persistence of deflation stands as the main block holding back the Japanese economy.

In spite of positive international scene, low growth stage in European Union prolonged by domestic slack...

In sharp contrast, the European economies are scarcely benefiting from world trends. The notable level of international trade naturally runs in favour of such open economies as the European Union which explains the positive export situation in overall terms. Nevertheless, the lack of domestic drive is counteracting the contribution to growth coming from abroad. As a result, in the second quarter, the large European economies slowed down so that the euro area as a whole grew by a mere 1.2% while the European Union (EU-25) grew by only one decimal more.

...although prospects begin to improve in summer months.

In any case, prospects may also be changing in Europe. Between the end of the second quarter and the beginning of the third quarter, prospects have improved rapidly even in the weak situation in Germany. The economic sentiment indicator rose in the euro area in June and July and, if we are to go by the positive trend in other similar German surveys, it would seem that this trend will continue. Other more tangible indicators, such as industrial production and industrial orders, are showing signs of recovery in secondary industry which is very sensitive to the cycle. The containment of inflation adds another positive element.

Monetary reference rates rise in United States but are maintained in euro area while long-term interest rates hold at low levels.

Disparities in the cyclical stage of the various economies are reflected in the actions of the main central banks. In August, the Bank of England reduced its official interest rate, the US Federal Reserve announced a new increase in its reference rates (the tenth since the middle of last year), while the European Central Bank and the Bank of Japan maintained their monetary policies unchanged. On the other hand, long-term interest rates made moves which were more in unison while generally holding at very moderate levels.

Chinese authorities decide to remove yuan's link with dollar and apply modest revaluation.

Not even the announcement of the revaluation of the Chinese yuan managed to appreciably change the yield on US bonds. The Chinese authorities decided to remove the link between their currency and the dollar on July 21. As of that moment the exchange rate of the yuan is being established in relation to a basket of currencies made up largely of the currencies of those countries with which the Asian giant carries on trade, although the weight given to each of those currencies is still unknown. In any case, it should be pointed out that the revaluation was much lower than expected, given that the value of the dollar against the yuan went from 8.28 to 8.11 yuan and from that moment changes have been very slight.

Signs that rise on stock markets wearing out.

In turn, the stock markets performed better than expected in the early stages of the summer, especially the European and emerging markets, thus overcoming some anxious moments brought about by the terrorist attacks in London and Egypt and the increase in oil prices. Nevertheless, in the final stages of August there were signs of wearing out which cut down a part of the earlier gains.

Spain maintaining high growth rate

Spain's GDP growth rate moves up in second quarter...

With regard to Spain's economy, in the second quarter of 2005 the GDP grew by 3.4% year-to-year in real terms, one decimal more than in the preceding quarter, according to early estimates by the National Institute of Statistics. The strength of domestic demand, which is showing a fairly stable growth rate, and the slightly less negative contribution from the foreign sector have been key factors behind GDP growth in the first half of the year. According to all indices, this situation has scarcely changed with the start of the second half-year.

...with clear growth signs showing up in all sectors of economic activity except manufacturing industry.

Industry remains the only exception to the general growth situation and is showing a particularly negative performance in textile manufactures, clothing, furs, leather and footwear, under the effect of growing imports from Asia. On the other hand, prospects in construction remain optimistic. Available indicators point to a slight increase in housing construction, aided by strong growth in housing loans while the strong situation in government tendering in recent months would appear to indicate a high level of public works in the immediate future. The situation in services is also generally positive with the tourist balance for the first seven months of the year more favourable than at first predicted.

Employment continues to grow strongly and unemployment rate drops to lowest level in last 25 years.

The growth stage of Spain's economy is fostering strength in the labour market. In the second quarter of 2005, more than 400,000 new jobs were created to show a year-to-year growth rate of 5.0%, according to figures from the Labour Force Survey. Growth of the labour supply is directed to part-time work and temporary work. The latter hiring formula now represents one-third of total wage employment. Furthermore, females and immigrants are the groups showing highest growth in employment. In addition, the good state of the labour market made it possible to bring down the unemployment rate to 9.3% in the period under consideration, the lowest level in the past 25 years.

Increase in fuel prices seen in rise in inflation rate...

With regard to inflation, the annual change rate in the CPI rose to 3.3% in July, due entirely to the rise in energy prices which have put fuel prices at all-time highs. On the other hand, underlying inflation held stable especially due to the containment of non-energy industrial goods.

...and growth of trade deficit.

The increase in fuel prices also had a direct effect on increasing the foreign imbalance. In the first half-year, the trade deficit, as measured by the Customs Branch, went above 36 billion euros with a third of this attributable to the negative balance shown under the energy heading. Finally, it should be pointed out that the National Accounts showed a slight cumulative deficit at the end of the first quarter although lower than the figure recorded one year earlier.

CHRONOLOGY

2004

March	**11**	*Tragic* ***terrorist attacks*** *on commuter trains in Madrid.*
	14	*Victory of Spanish Socialist Workers Party (PSOE) in Spanish* ***general elections****.*
May	**1**	*Enlargement of the* ***European Union*** *by ten new member states making a total of 25.*
October	**29**	*Signing in Rome of first* ***European Constitution*** *by heads of State and government of 25 member states of European Union.*
November	**2**	*George W. Bush re-elected* ***President of the United States.***
December	**28**	***Euro*** *running at 1.363 dollars, highest figure since launching of single currency at beginning of 1999.*

2005

February	**25**	*Government approves* ***Economic Potential Plan****, broad programme of economic reforms aimed at increasing productivity and employment (BOE 14-3-05).*
March	**4**	*Dow Jones index for* ***New York stock exchange*** *marks up annual high (10,940.55), a rise of 1.5% over end of 2004.*
	23	*Heads of state and government of European Union member states approve reform of* ***Stability and Growth Pact*** *introducing more flexibility.*
April	**20**	*Dow Jones index for* ***New York stock exchange*** *marks up annual low (10,012.36) with 7.1% drop compared with end of 2004.*
May	**2**	***Cypriot pound****,* ***Latvian lat*** *and* ***Maltese lira*** *join Exchange Rate Mechanism.*
August	**9**	***Federal Reserve*** *raises reference rate by quarter-point to 3.50%.*
	10	*IBEX 35 index for* ***Spanish stock market*** *marks up annual high (10,229.2), cumulative gain of 12.6%.*
	26	*One-month forward price of Brent quality* ***oil*** *moves up to all-time high of 66.56 dollars a barrel.*

AGENDA

September

1 *Meeting of Governing Council of European Central Bank.*

8 *Industrial production index (July).*

13 *Consumer price index (August).*

16 *Harmonized consumer price index for European Union (August).*

20 *Central government revenue and spending (August).*
Meeting of Open Market Committee of Federal Reserve Board.

21 *Quarterly Survey of Labour Costs (2nd Quarter).*

26 *Producer price index (August).*

29 *Early HCPI index (September).*

October

5 *Industrial production index (August).*

6 *Meeting of Governing Council of European Central Bank.*

14 *Consumer price index (September).*

18 *Harmonized consumer price index for European Union (September).*

25 *Producer price index (September).*
Central government revenue and spending (September).

28 *Labour force survey (3rd Quarter).*
Early HCPI index (October).
US GDP (3rd Quarter).

United States maintaining stable growth

United States grows by 3.6% while improving foreign sector.

The US gross domestic product (GDP) grew by 3.6% year-to-year in the second quarter of 2005, thus maintaining the rate obtained in the previous quarter. In quarter-to-quarter terms annualized, growth was 3.4% as against 3.8% in the first quarter. The strength shown in housing and the notable improvement in the foreign sector were compensated by a sharp reduction in inventories. In its July review, the Bureau of Economic Analysis put growth for 2004 at 4.2% as against the previous estimate of 4.4%.

Private consumption up 3.9% with recovery in car purchases.

Private consumption rose by 3.9% year-to-year in the second quarter although in quarter-to-quarter terms annualized it stood at a more moderate 3.3%. The recovery in car sales was compensated by lower consumption of non-durables, especially those linked to oil-based products. Public consumption and investment continued to show a moderate trend moving up by 1.6% year-to-year.

Investment grows by 8%, transportation equipment recovers while inventories make adjustment.

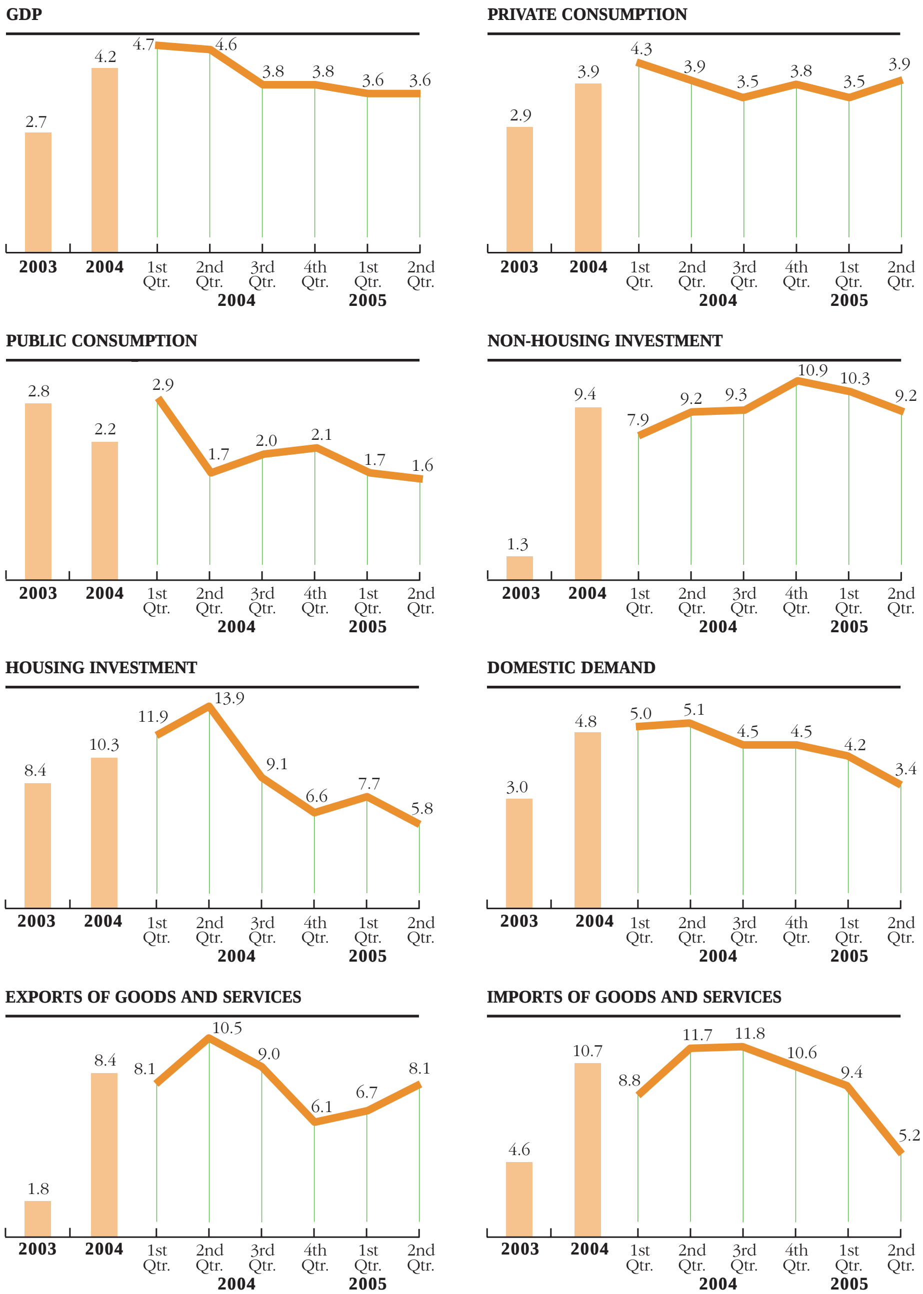
Investment grew by 8.0% year-to-year in the second quarter of 2005, somewhat below rates in the first quarter but still maintaining a vigorous trend. The non-housing component recovered from the slowdown in the first quarter especially helped along by heavy investment in transportation equipment which had been the weakest component in the previous period. Housing investment grew by 5.8% year-to-year, somewhat below the sharp increases in the previous quarter, for which the growth rate had been revised upward to 7.7% but still far from showing signs of a slowdown. In the second quarter, the level of inventories was adjusted downward taking off 40% from quarter-to-quarter growth annualized.

Foreign sector improves because of drop in imports and higher exports.

The foreign sector showed a clear recovery mainly brought about by a reduction in imports due to the above-mentioned adjustment in inventory levels. As a result, imports in the second quarter were up by 5.2% year-to-year, whereas in the previous period they had risen by 9.4%. The replacing of inventories could reduce this improvement in coming quarters. Nevertheless, exports showed a good performance with growth of 8.1% year-to-year, higher than the figures at the beginning of the year. As a result, the foreign sector brought a notable positive contribution to quarter-to-quarter growth after six quarters in a row showing negative contributions.

TREND IN UNITED STATES GDP BY COMPONENT

Percentage year-to-year change in real terms



SOURCE: Bureau of Economic Analysis and internal figures.

Retail sales now growing by more than 10% although consumer confidence down.

Among the most recent demand indicators, retail sales moved up by a strong 10.3% in July, thus reflecting the recovery in car sales as well as following the upward trend which began in the middle of 2003. As counterpoint, consumer confidence that month was down slightly to levels seen in May going to the level of 103.2 points. In keeping with the pattern of recent months, the perception of the present situation is better than that for future prospects.

UNITED STATES: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2003	2004	2004			2005				
			2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
Real GDP	2.7	4.2	4.6	3.8	3.8	3.6	–	3.6	–	–
Retail sales	4.3	7.2	7.4	6.3	8.3	7.3	9.1	6.3	9.7	10.3
Consumer confidence (*)	79.8	96.1	96.3	100.4	96.1	104.2	97.5	103.1	106.2	103.2
Industrial production	0.0	4.1	4.9	4.6	4.3	3.8	2.9	2.5	3.7	3.0
Industrial activity index (ISM) (*)	53.3	60.5	62.0	60.1	57.5	55.6	53.3	51.4	53.8	56.6
Sales of single-family homes	11.8	10.0	10.0	–0.3	10.8	5.0	9.2	4.4	9.9	27.7
Unemployment rate (**)	6.0	5.5	5.6	5.4	5.4	5.3	5.2	5.1	5.0	5.0
Consumer prices	2.3	2.7	2.8	2.7	3.4	3.0	3.5	2.8	2.5	3.1
Trade balance (***)	–532	–651	–575	–608	–651	–686	–696	–704	–709	...

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

RETAIL CONSUMPTION SHOWING STRONG GROWTH

Year-to-year change in index for retail sales (*)

NOTES: (*) Cycle-trend series.
SOURCE: Department of Commerce and internal figures.

Manufacturing activity indicator recovers but industrial production remains weak.

On the supply side, business executives reported clearly better prospects following a number of months without any definite consensus. The manufacturing activity index of the Institute of Supply Management for July recovered to the 56.6 points level, the highest for the year. The new orders component especially reflects this improvement in the business climate going up in two months from the level of 51.7, which indicated doubts about the state of the economy, to a definitely more optimistic level at 60.2. In spite of this improvement in the business climate, industrial production in July rose by 3.0% year-to-year making it clear that manufacturing still remains in a state of weakness.

Housing remains strong with price rises above 14%.

The housing sector continued to show a vigorous situation. While housing starts in July grew by 2.8% year-to-year showing some signs of a slowdown, new housing sales in July were up by a strong 27.7% year-to-year while existing housing showed a 4.6% increase. Along these same upward lines, the average price of existing housing rose by 14.5% year-to-year in June, a rate which, together with the 14.7% seen in April, is the highest in recent years.

Recovery of employment now a fact with 207,000 new jobs in July...

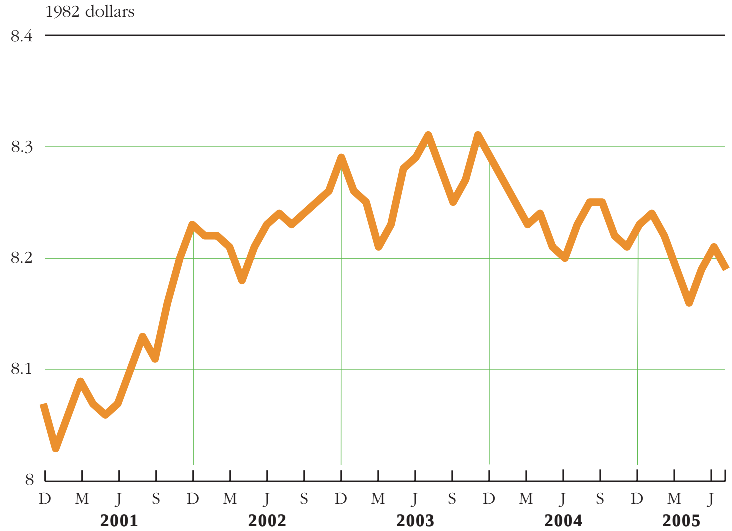
The labour market continued to recover in July with 207,000 new non-farm jobs so that in the last 12 months some 2,224,000 new jobs have been created. The unemployment rate continued at 5.0% of the labour force, the lowest level since September 2001. The manufacturing sector still failed to join the general picture with a loss of 4,000 jobs.

...but purchasing capacity of wages continues to drop while labour productivity slows.

While job creation, which was a concern at the beginning of the current recovery, is no longer a problem, the matter which is still raising doubts at this moment is wages. Real hourly wages (discounting inflation) dropped by 0.5% year-to-year in July, a downturn going on for the last 15 months which, on top of the increases in oil prices, is significantly reducing the purchasing power of many households. As a result, the sustainability of retail sales and private consumption is only possible with lower and lower levels of saving in household economies. In a similar context, labour productivity slowed in the second quarter with growth of only 2.3% year-to-year while unit labour costs rose by 4.3% year-to-year.

WAGES CONTINUE TO LOSE PURCHASING POWER

Real hourly earnings (*)



NOTES: (*) Discounting inflation.
SOURCE: Department of Commerce and internal figures.

Energy prices put inflation above 3%.

Consumer prices in July rose to 3.1% year-to-year. The increase, however, was concentrated in energy prices so that the underlying component (not including food or energy) remained stable at 2.1%. Producer prices rose rather strongly in July with a year-to-year rate going up to 4.6%, thus rejoining the upward path seen in the early months of 2005 and giving the economy a more inflationary bias than the month before.

Trade deficit continues to worsen.

The foreign sector still failed to hit bottom. The trade deficit in June was 62.75 billion dollars, a level close to the record in February which put the cumulative deficit for the past twelve months at a new high of 709.06 billion dollars, thus wiping out the tentative improvements in previous months.

Consumption boosts Japan's recovery

Japan grows by 1.5% in second quarter based on private consumption and recovery in exports.

Japan's economy grew by 1.5% in the second quarter of 2005 and has begun to consolidate recovery based on private consumption and the recent upturn in exports. The quarter-to-quarter increase annualized remained slightly below 1.1% although the change in inventories in the second quarter had a negative effect on growth of the economy. The cycle of inventories and export recovery could support a continuation of growth.

Private consumption consolidating with increase of 1.7% while investment rests on capital goods.

Private consumption in the second quarter grew by 1.7% year-to-year confirming an upward trend with a contribution of 1.7% to economic growth in quarter-to-quarter terms annualized. Public consumption grew by 1.4% although its contribution to quarter-to-quarter growth is negative. Investment, in turn, grew by 2.3% year-to-year. Private investment in capital goods, with an increase of 5.3% year-to-year, showed a much better performance than the construction component which dropped by 2.4%.

Exports recovering and foreign sector again contributing to growth.

Exports grew by 4.9% year-to-year, somewhat below the rate in the first quarter. Nevertheless, if we take away base effects, the quarter-to-quarter change annualized was 11.3% as against a drop of 0.3% in the first quarter. Imports grew by 6.9% year-to-year, which was above that for exports, although the foreign sector showed a quarter-to-quarter contribution to growth annualized of 1.5%, thus recovering figures at the beginning of 2004 and breaking away from the state of weakness seen in the three previous quarters.

Retail sales consolidate growth at 3%...

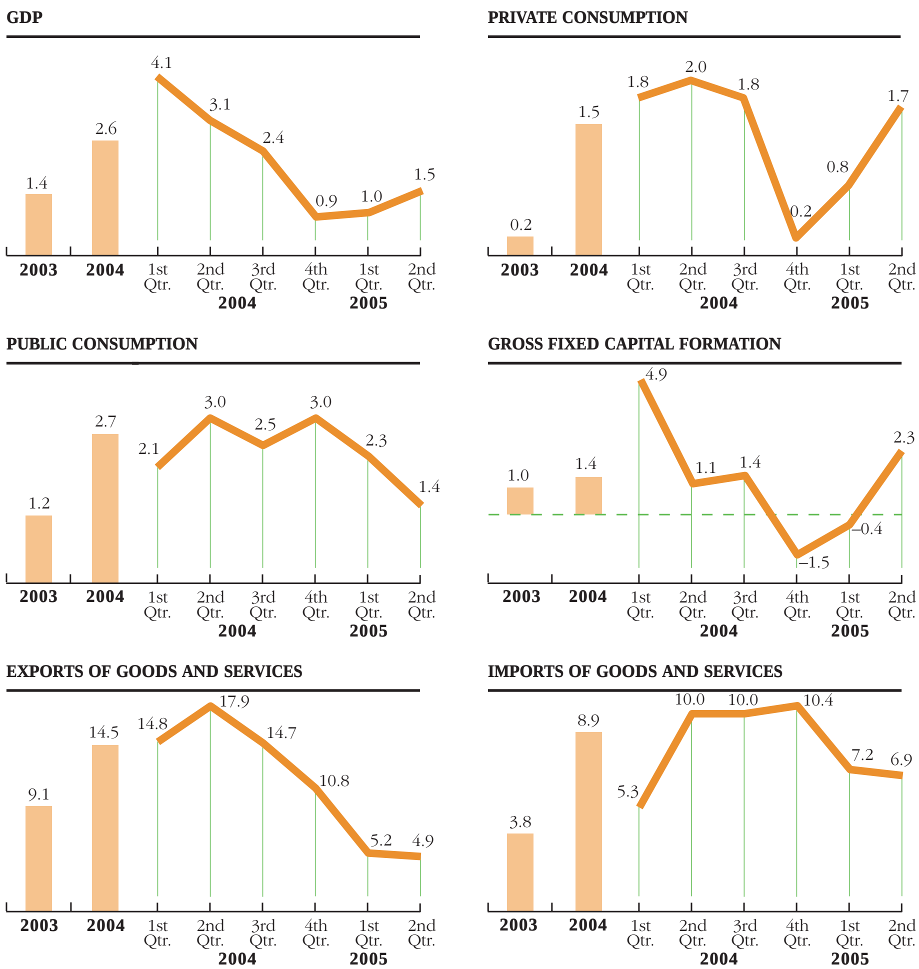
Demand indicators were consistent with the recovery in private consumption. Retail sales were up by 3.0% year-to-year in June maintaining that growth for the third consecutive month, something which had not happened since 1997. Car sales in July, however, were down by 4.5% year-to-year following three months of sharp increases.

...but industrial production stagnant and housing fails to consolidate recovery.

On the supply side, the upward bias was not as clear. Industrial production in June rose by a poor 0.2% year-to-year with machinery orders holding at 3.3%. July showed bankruptcies in 1,024 companies with an easing of the downward trend in recent months. While reporting a slight upward trend, housing failed to consolidate any definite recovery.

TREND IN JAPAN'S GDP BY COMPONENT

Percentage year-to-year change in real terms



SOURCE: Economic and Social Research Institute and internal figures.

JAPAN: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

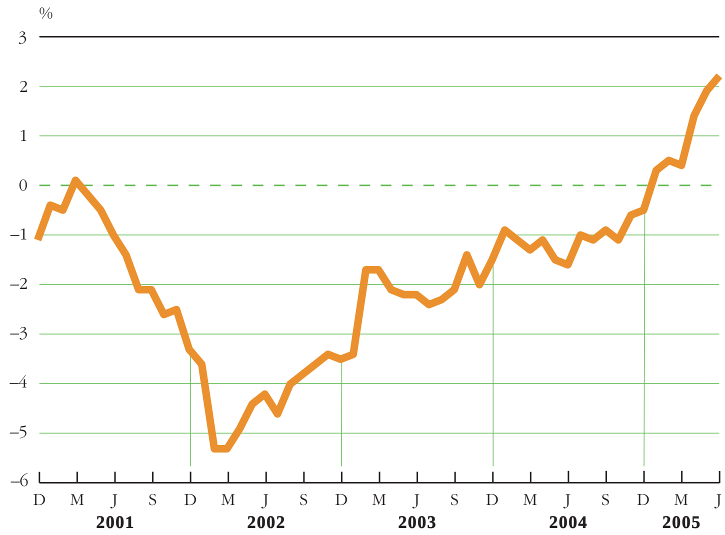
	2003	2004	2004			2005			
			2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June
Real GDP	1.4	2.6	3.1	2.4	0.9	1.0	–	1.5	–
Retail sales	–1.7	–0.9	–1.7	–0.5	–0.4	1.1	3.6	3.1	3.0
Industrial production	3.3	5.3	7.8	6.6	1.6	2.7	1.5	–0.9	0.2
Tankan company index (*)	–21.0	–0.5	0.0	2.0	1.0	–2.0	–	1.0	–
Housing construction	0.6	2.6	–3.5	9.4	–0.1	1.5	0.7	2.9	2.6
Unemployment rate (**)	5.2	4.7	4.7	4.8	4.5	4.6	4.4	4.4	4.2
Consumer prices	–0.3	0.0	–0.3	–0.1	0.5	–0.2	0.0	0.2	–0.5
Trade balance (***)	12.0	13.7	13.7	14.1	13.7	13.3	13.0	12.5	12.3

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

Housing starts in June were up by 2.6% while in July the average sale price of housing in Tokyo rose by 3.7% year-to-year, although sales were down by 3.8%.

RETAIL SALES MOVE UP STRONGLY

Year-to-year change in retail sales (*)



NOTES: (*) Cycle-trend series.
SOURCE: Japan's Ministry of Economy, Commerce and Industry and internal figures.

Unemployment down to 4.2% but deflation continues along with drop in productivity.

The unemployment rate in June dropped to 4.2% of the labour force, the lowest since 1998, although manufacturing productivity in the same month was down by 0.4% year-to-year. Consumer prices in June dropped by 0.5% year-to-year which continues to leave Japan's economy in a state of deflation with prices of non-durable products dropping by 0.8% year-to-year. The trade balance for the 12 months ending in June recorded a surplus of 12,300 billion yen. While this figure indicates a drop, as a result of base effects it does not reflect the recovery in June.

China continues growth while showing no inflationary pressures

China grows by 9.5% in second quarter through drive in industrial and foreign sectors.

The Chinese economy continued to grow at a strong rate with an increase of 9.5% year-to-year in real terms in the second quarter of 2005. In this period all three sectors of the economy showed a slight rise in growth rate. Industry grew by 11.2% year-to-year, agriculture was up by 5.0% and services rose by 7.8%.

From the point of view of spending, investment in urban areas in the second quarter was up by 28% year-to-year. The foreign sector continued to increase its contribution to growth which was 38% higher than in the previous quarter. This all took place in spite of a slowdown in exports which, nevertheless, still grew by a strong 30.9% year-to-year. Imports increased growth rate to 15.5%, somewhat higher than the 12.1% in the previous period but well below rates seen in 2004. The combination of continuing strong investment with imports growing more slowly would indicate increasing Chinese participation in the production of capital goods as against the foreign predominance which has existed up to this time.

CHINA: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2003	2004	2004			2005				
			2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
Real GDP	9.4	9.5	9.6	9.1	9.5	9.4	–	9.5	–	–
Industrial production	16.7	16.3	17.6	15.8	15.0	14.5	16.0	16.6	16.8	16.1
Electrical power production	14.2	15.0	16.5	12.9	14.6	14.7	12.7	13.7	14.8	14.8
Consumer prices	1.2	3.9	4.4	5.3	3.2	2.8	1.8	1.8	1.6	1.8
Trade balance (*)	25.5	31.9	13.5	20.3	31.9	57.0	63.9	71.0	79.1	87.5

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

Chinese industrial production holding to strong growth rate above 16%.

The most recent supply indicators provide a picture of continued growth in keeping with the national accounts. As a result, industrial production in July grew by 16.1% year-to-year, a rate slightly higher than the 2004 average. The pattern in industry followed the trend in previous periods with the heavy industry component growing more than others. Heavy industry production increased by 17.2% year-to-year while light industry was up by 13.9%. The high growth rates continued to reduce the proportion of industrial production represented by the state conglomerates, which are growing at a lower rate putting the relative weight of the state sector at 39.8% in July.

Production of electrical energy and computers showing sharper growth while motor vehicle output remains weak.

Production of electrical energy in July followed a very similar trend with an increase of 14.8% year-to-year, thus indicating a slight rise. Production of personal computers in the twelve months up to July continued to rise with year-to-year growth of 65.3%. The opposite showed up in motor vehicle production which continued to be the weakest sector in Chinese industry with a drop of 0.4% in the same period. It should be pointed out that production of motorcycles fell by 7.2%. Nevertheless, cement production showed a slight increase in growth rate going to 8.1%.

Retail sales moderating but still growing by 13%.

On the demand side, retail sales in July showed a slight downward profile with an increase of 12.7% year-to-year (12.9% in June). Retail sales in the urban areas rose by 13.8% in July, thus showing the same trend as against the high of 17.3% seen in February. In the rural areas, retail sales were up by 10.5% in June. The food product component in July continued to maintain strong growth at 17.5%, a high rate but somewhat lower than in the preceding three months.

Consumer prices being contained with increase of 1.8%.

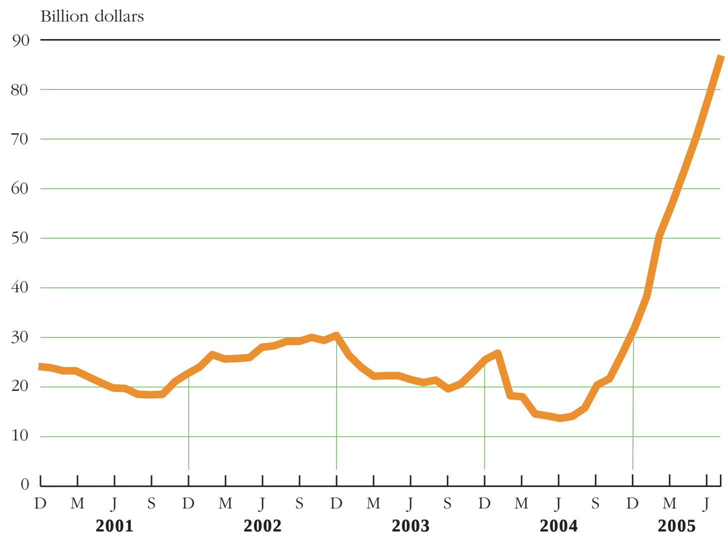
Consumer prices grew by 1.8% year-to-year in July, a rate which is still moderate thus improving the inflation prospects indicated at the beginning of the year. The most notable reduction in inflationary trends continued to show up in the food component with prices going up by 2.3% year-to-year in July, well below the 14.6% in the same period last year. By main region, the city of Shanghai special region showed inflation of 0.2% while in Guangdong it was 2.8% (3.2% in March). Producer prices grew by 5.2% year-to-year in July, a rate also lower than those in recent months.

Trade surplus reaches 88 billion dollars...

The cumulative trade surplus for 12 months ending in July came to 87.5 billion dollars whereas a year ago it was 13.5 billion dollars. Exports in this period rose by 33.4% year-to-year while imports were up by 19.7%. By country and region, it is the increasing surplus with Europe that contributed most to this increase in the trade balance (amounting to 51 billion dollars), 26.9 billion more than in the same period last year. The surplus with the United States continues to be the highest. In July, this reached 90.6 billion dollars, 21.9 billion more than in the previous year. Taiwan, South Korea and Japan continue to maintain positive trade balances with China but Germany's surplus practically disappeared in July.

CHINA'S TRADE SURPLUS SHOOTING UP

Cumulative figure for trade balance over last 12 months



SOURCE: Chinese National Statistics Office.

...thanks to notable reduction in raw material imports.

By product, there was a continuation of heavy export of manufactures combined with a lower rate of imports of raw materials. In the cumulative figure for 12 months ending June, aluminium imports decreased by 24.3% year-to-year by volume, copper dropped by 15.2% while steel imports rose by only 5.8%, whereas in the same period of last year they showed growth of 28.4%. Oil imports were up by 15.7%, a rate also significantly lower than that for previous months.

Mexico: foreign sector showing slower growth

Slowdown in Mexico but domestic demand holding up.

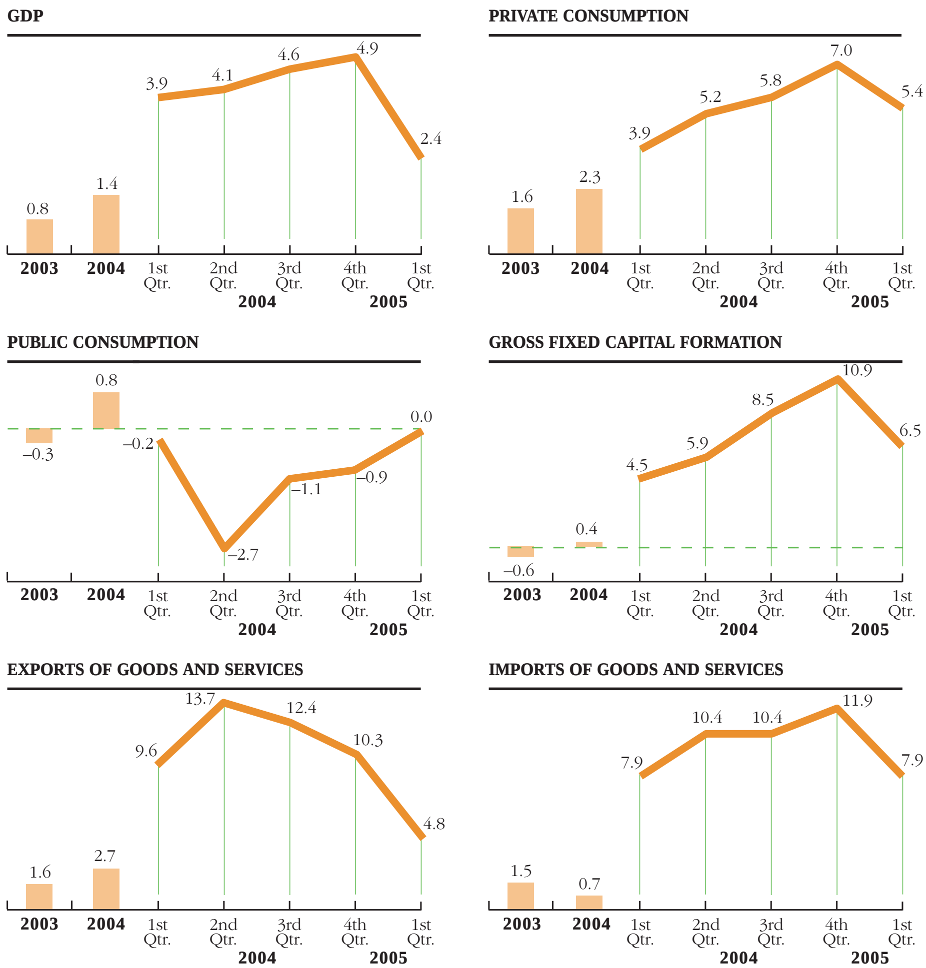
Mexico's economy grew by 2.4% year-to-year in the first quarter of 2005 thus showing something of a slowdown. Domestic demand in that period, however, reported less of a slowdown with the foreign sector the main cause of the drop in growth.

Consumption and investment grow by more than 5% with rise in public investment.

Private consumption rose by 5.4% year-to-year thus making a strong contribution to growth. Public consumption showed nil growth in line with recent quarters. Investment moved up by 6.5% compared with the same period last year, a considerably good rate in spite of being lower than that at the end of 2004 but involving notable substitution of private investment by public investment.

TREND IN MEXICO'S GDP BY COMPONENT

Percentage year-to-year change in real terms



SOURCE: Central Bank of Mexico.

Foreign sector weakness in exports drains off one-third of growth in domestic demand.

The foreign sector was marked by a notable drop in exports which reduced the growth rate to 4.8% year-to-year, whereas at the end of 2004 it was growing at 10.9%. The slowdown in imports, with growth of 7.9%, was more moderate. This weak performance meant that the foreign sector drew off one-third of year-to-year growth from Mexico's domestic demand.

Retail sales holding up but industrial production of manufactures remains weak.

Under demand indicators, retail sales grew by 3.7% year-to-year in May maintaining the situation following robust growth of 8.8% in April. On the supply side, industrial production grew by 0.6% year-to-year in June cutting down the recovery seen in April and May and making apparent the slack in the manufacturing sector. Industrial production of manufactures dropped by 0.1% year-to-year while construction grew by 3.6%. Industrial production by «maquiladoras» (companies located close to the border which import materials and components exempt from customs duty to make products exported to the United States) rose by 6.3% in line with recent trends.

MEXICO: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2003	2004	2004			2005				
			2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
Real GDP	1.4	4.4	4.1	4.6	4.9	2.4	–	...	–	–
Industrial production	–0.2	3.8	3.7	4.8	3.6	–0.2	5.2	2.9	0.6	...
General unemployment rate (*)	3.2	3.7	3.6	4.0	3.5	3.9	4.2	4.3	3.5	3.5
Consumer prices	4.5	4.7	4.3	4.8	5.3	4.4	4.6	4.6	4.3	4.5
Trade balance (**)	–5.8	–8.8	–5.6	–6.2	–8.8	–10.2	–10.2	–10.3	–9.8	...

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

Unemployment drops to 3.5% while manufacturing productivity stagnant.

The general unemployment rate in June dropped to 3.5% of the labour force but the negative note came with the worsening of manufacturing productivity in May with a drop of 0.2% year-to-year. A direct consequence of this dip came in unit labour costs which grew by 7.0% year-to-year with a subsequent loss of competitiveness.

Inflation remains moderate with increase of 4.5%.

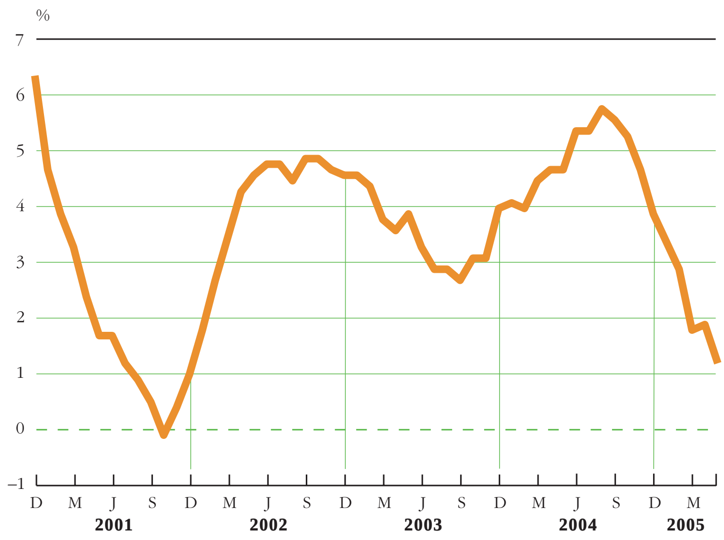
Consumer prices in July rose by 4.5% year-to-year, continuing the moderation which has prevailed during the first half of 2005. The component excluding food and energy for the same month pointed in the same direction, maintaining a rate of 3.4%.

Trade deficit excluding oil exports close to 37 billion dollars.

The trade deficit for the 12 months ending June 2005 stood at 9.8 billion dollars. Oil exports for the same period were up by 33.1% year-to-year aided by high prices although the deficit, not counting oil exports, rose to 36.9 billion dollars, 13.7% higher than at the end of 2004. This deficit, together with the worsening of manufacturing productivity, is the big question for an economy which, on the other hand, combines strong domestic demand with moderate prices.

PRODUCTIVITY STAGNANT

Year-to-year change in manufacturing productivity (*)



NOTES: (*) Cycle-trend series.
SOURCE: Central Bank of Mexico and internal figures.

Oil prices reach new all time highs

Oil breaks through barrier of 66 dollars in August...

The month of August brought a continuing rise above all-time highs in oil prices in nominal terms. One-month forward prices of Brent quality oil that month started out at levels of the order of 60 dollars a barrel going above 65 dollars in various market sessions with an all-time high of 66.56 dollars recorded on August 26. At the end of August, prices stood clearly above 65 dollars a barrel. Compared with prices one year ago, the average monthly price for August (63.9 dollars) was 54% higher.

...a rise due to difficulties for crude oil supply to satisfy expanding demand.

Apart from specific factors such as the growing political tension between Western countries and Iran, behind this notable rise in oil lie the difficulties for crude oil supply to adapt to demand which continues to be very strong. In this respect, both the International Energy Agency (IEA) and the Organization of Petroleum Exporting Countries (OPEC) in recent reports moderately revised upward their growth forecasts for world demand in 2005 and 2006. The most significant factor, however, is that supply from those producing countries outside OPEC will not be able to adapt to the growth in that demand, thus increasing demand for pumping in the OPEC area. If we take into account that the additional oil producing capacity of OPEC is relatively limited, we can understand the current pressure on prices.

Rise in other raw materials in August with outstanding role of metals which go up 17% in one year.

Other raw materials have followed an upward trend but less sharply. «The Economist» index for primary materials in dollars rose to 8% year-to-year in August compared with 3% in July. Expressed in euros, the rise was moderately softened by the appreciation of the single currency so that the year-to-year increase was 7% (5% in July). By category, metals continued to head the increases with rises of the order of 17% year-to-year in August, whereas food raw materials (year-to-year increase of 5% in August) rose to a lesser extent. Finally, we should point out that gold continues to capitalize on the uncertainties perceived by investors going to nearly 440 dollars an ounce in the middle of August (approximately 9% above its value one year earlier).

NEW ALL-TIME LEVELS IN OIL PRICES

One-month forward price of Brent quality oil per barrel as weekly average

SOURCE: Thomson Financial Datastream.

RAW MATERIALS PRICES

	2003	2004	2004 3rd Qtr.	2004 4th Qtr.	2005 1st Qtr.	2005 2nd Qtr.	2005 July	2005 August
«The Economist» index in dollars (*)								
General	**11.7**	**17.4**	**16.0**	**1.5**	**–2.3**	**–1.8**	**2.8**	**7.7**
Food	9.1	11.2	9.4	–7.3	–8.5	–7.7	–0.2	5.1
Industrials	15.9	26.1	25.1	13.8	5.9	6.3	6.8	10.8
Non-food agricultural	*21.8*	*9.2*	*6.8*	*–11.2*	*–10.7*	*–8.6*	*0.9*	*–0.9*
Metals	*11.8*	*38.2*	*38.3*	*31.5*	*16.1*	*15.5*	*10.2*	*17.4*
«The Economist» index in euros (*)	**–6.7**	**6.7**	**6.9**	**–6.5**	**–6.4**	**–6.0**	**4.8**	**6.9**
Oil (**)								
Dollars/barrel	28.4	38.0	40.7	44.7	47.8	53.1	58.1	63.9
Change rate	13.1	34.4	44.4	53.8	52.7	50.9	54.1	53.9
Gold								
Dollars/ounce	364.0	409.6	401.9	434.0	427.3	427.8	424.7	438.3
Change rate	17.3	12.7	10.6	10.6	4.6	8.6	6.7	9.2

NOTES: (*) Year-to-year change rate.
(**) Brent quality: one-month forward price.
SOURCE: «The Economist». Thomson Financial Datastream and internal figures.

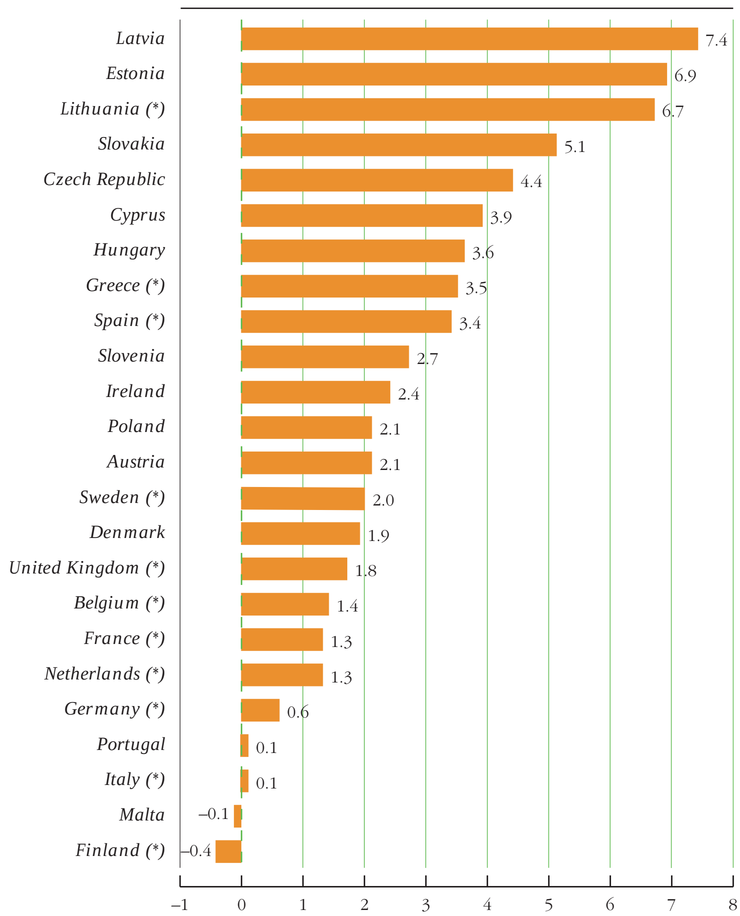
Euro area: economy hits bottom in second quarter

Euro area grows by modest 1.2% in second quarter...

The euro area economy grew by 1.2% year-to-year in the second quarter, a slight drop from the 1.4% year-to-year in the previous quarter. At quarter-to-quarter rate annualized, the gross domestic product (GDP) went from an increase of 1.9% in the first quarter to 1.0% in the April-June period. In the absence of a breakdown of demand components, the most relevant information is to be seen in gross details by country which

UNEVEN GROWTH WITHIN EUROPEAN UNION

Year-to-year change in real gross domestic product as percentage (latest available quarter)



NOTES: Figures for first quarter of 2005 except those countries marked with (*) which are for second quarter of 2005.
SOURCE: Eurostat, national statistical bodies and internal figures.

confirms the poor relative performance by Germany, Italy and, to a lesser extent, by France. In contrast to other occasions, the trend to a slowdown also hit the United Kingdom, whereas it was left to the incipient recovery in the Netherlands to show a positive note.

...but economic activity seems to be recovering at beginning of third quarter.

Latest indicators suggest that in the April-June period the euro area economy may have hit bottom while beginning a slight upward move in the third quarter. As a result, after standing at the 96.1 points in May, the lowest since September 2003, the economic sentiment index rose in June and July adding up to an increase of 1.2 points. This recovery was due to the better state of services and, to a lesser extent, to construction and industry. The most negative note was seen in the persistent stagnation in consumer confidence which held at the level of –15 points between May and July. In keeping with this trend, retail trade confidence also failed to recover in July.

IMPROVED ECONOMIC PROSPECTS IN EURO AREA

Value of economic sentiment index

SOURCE: European Commission.

Consumption remains unresolved issue in euro area.

In fact, the main demand indicators for private consumption, the trend in retail sales which grew at a moderate 0.9% year-to-year in June, confirms that the poor state of household consumption is not improving. Other private consumption indicators confirm this lack of strength. On the other hand, investment seems to be beginning to recover. After weakening in May, production of capital goods rose significantly in June with growth of 1.8% year-to-year. Nevertheless, maintenance of the degree of utilization of production capacity at 81.2% in the third quarter, with no increase over the second quarter, would suggest that recovery of investment has still a long way to go before it can be considered as consolidated.

EURO AREA: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2003	2004	2004			2005				
			2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
GDP	0.7	1.7	2.1	1.8	1.5	1.4	–	1.2	–	–
Retail sales	0.4	0.8	0.5	0.7	1.0	1.0	–0.8	1.9	0.9	...
Consumer confidence (*)	–18	–13.8	–14	–14	–13.0	–13.1	–13	–15	–15	–15
Industrial production	0.3	2.0	3.0	2.8	1.1	0.8	1.2	0.0	0.3	...
Economic sentiment indicator (*)	93.4	100.0	99.9	100.6	100.9	99.0	96.5	96.1	96.3	97.3
Unemployment rate (**)	8.7	8.9	8.9	8.9	8.8	8.8	8.8	8.7	8.7	...
Consumer prices	2.1	2.1	2.3	2.2	2.3	2.0	2.1	2.0	2.1	2.2
Trade balance (***)	80.3	81.0	88.4	85.2	74.1	65.2	55.1	50.7	48.8	...

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

Exports recover in second quarter.

It will be difficult for foreign demand alone to compensate for the domestic slack. In spite of the fact that exports rose in the second quarter (with growth of 6.2% year-to-year), the increase in imports (rise of 10.9%) has been eroding the trade surplus. Specifically, as a cumulative balance for the past twelve months, the positive trade balance stood at 51.6 billion euros in the second quarter, far from the figure of 72.6 billion euros with which it had begun 2005.

Improvement in industrial production still at very early stage with sectors quite uneven.

The main supply indicator, the industrial production index (IPI), has shown an uneven performance, something characteristic of a time of change in trend. As a result, the IPI moved up to 0.3% year-to-year in June compared to nil growth in May. Nevertheless, this recovery was mainly due to the positive trend in the energy industries which very much benefited from the current situation in the market for oil and derivative products.

Energy pushes up inflation to 2.2%.

In the absence of strong domestic demand, consumer prices continued to show few pressures. The harmonized consumer price index (HCPI) grew by 2.2% year-to-year in July, one decimal more than in June. Apart from the energy component which rose by 12% year-to-year, the other components of the index held stable. As a result, the inflation rate obtained after discounting energy showed an increase of 1.3% year-to-year with no change over June.

Unemployment holds at 8.7% in June.

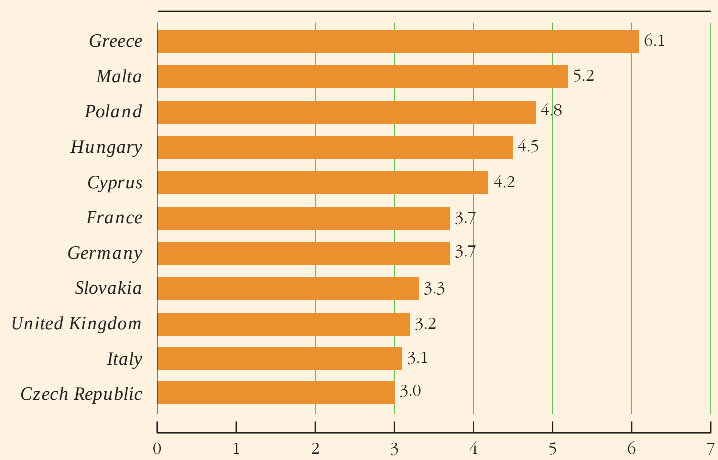
With regard to the labour market, the recent trend seems to be marginally better. Employment is slowly improving in growth rate (increase of 0.9% year-to-year in the first quarter, the latest figure available), whereas the unemployment rate in June for the second consecutive month was again 8.7% of the labour force, a figure two decimals less than that for one year earlier.

BUDGET SITUATION IN EUROPEAN UNION: NO IMPROVEMENT IN VIEW

The current stage of cyclical weakness, together with the insufficient budgetary adjustment during the previous phase of economic boom, has meant that the government deficits of the European Union countries have shown notable increases in recent years. As a result, in 2000, the last year of robust growth in the EU, only four of the current 25 member states went over the government deficit limit of 3% of the gross domestic product (GDP) established under the EU budgetary control mechanism known as the Stability and Growth Pact. On the other hand, in 2004, there were 11 countries showing an imbalance in their public finances which was equal to or above that threshold, including the four big EU economies (Germany, France, Italy and the United Kingdom). At the same time, it should be pointed out that considering the current growth prospects the European Commission itself does not expect that the budgetary situation will improve significantly in 2004 and 2006, a possibility which is confirmed by the budgetary estimates of member states made public up to this date.

MANY EU COUNTRIES FAIL TO MEET GOVERNMENT DEFICIT LIMIT

Government deficit as percentage of gross domestic product (2004)



NOTES: Official figures for Portugal maintain government deficit estimate for 2004 at 2.9% of GDP. Nevertheless, it should be pointed out that the official forecast for 2005 is for 6.2% of the GDP which likely will involve upward modification of the figure for 2004.
SOURCE: Eurostat, European Commission and internal figures.

The worsening of government finances in the EU is not reflected in any toughening of the institutional decisions based on the Stability Pact applicable to those countries participating in the euro. Following reform to the Pact approved in March 2005, the broadening of the factors to be taken into account in evaluating the budgetary situation of a country has led to a notable reduction in the recommendations of the European Commission with regard to situations of excessive deficit in the European Union. Whereas in 2004, the EU executive on six occasions recommended to the Council of Ministers that political measures be adopted with regard to the situation in the different member states of the euro area, in 2005, the first year of application of the new Stability Pact, it has formulated only three recommendations on excessive deficits (Greece, Italy and Portugal in chronological terms) and one request for exclusion from the procedure (the Netherlands).

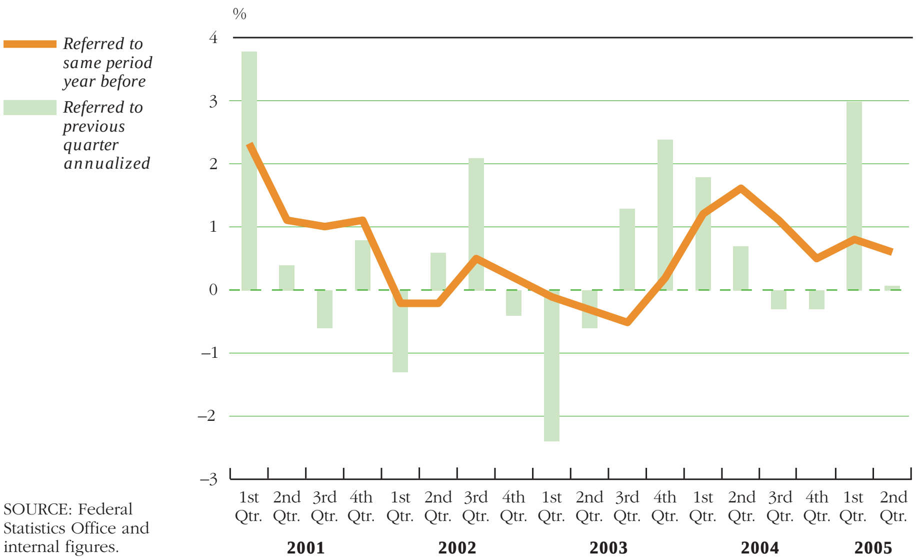
Germany: stagnation in second quarter with prospects of improvement

Poor growth in Germany in second quarter.

After moving up by 0.8% quarter-to-quarter in the first three months of the year, the German economy reported nil growth in the second quarter. At year-to-year rate, the increase in the GDP was 0.6% in the second quarter, two decimals below the 0.8% in the previous quarter. The latest factor shown by the German macroeconomic picture is the better trend in terms of domestic demand, the result a recovery in investment (year-to-year drop of 0.3% as against the dip of 0.7% previously) and in public consumption. On the other hand, private consumption, with nil year-to-year growth, still failed to recover strength. The foreign sector, in turn, drew off one decimal from the change in GDP, its first negative contribution since the third quarter of 2004. This result arose from the greater strength shown in imports and something of a weakness in exports.

SLOWDOWN IN ECONOMIC ACTIVITY IN GERMANY IN SECOND QUARTER

Change in gross domestic product in real terms



SOURCE: Federal Statistics Office and internal figures.

Domestic demand may be beginning stage of reduced slack.

Latest indicators confirm a picture of domestic demand gradually improving although still far from strong. Retail sales in the second quarter as a whole rose by 1.2%, one percentage point above the first quarter. Recovery in investment was stronger if we are to go by the notable drive in the capital goods component of industrial production (year-to-year increase of 4.5% in June).

Industry appears to revive between end of second quarter and beginning of third quarter.

The improved economic situation at the end of the second quarter and the start of the third quarter was reflected in trends by sector. Industrial production in June showed an increase of 2.8% year-to-year, the highest since last January, while the incipient recovery of confidence in the services sector in June led to clearer growth in July. Construction, the sector reporting the worst relative performance, has shown the first signs of moving away from the poor situation in recent years, as may be deduced from the lower drop in building permits which, after marking up year-to-year decreases of more than 30% between December 2004 and March 2005, moved into a drop of only 6% year-to-year in June. The better state of the business sector is reflected in the increase in the IFO index which went up to 95 points in July, a level which it consolidated in August in spite of a marginal decrease.

GERMANY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2003	2004	2004			2005				
			2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
GDP	–0.2	1.1	1.6	1.1	0.5	0.8	–	0.6	–	–
Retail sales	–0.5	0.9	0.1	0.7	1.0	0.2	–0.8	2.7	1.9	...
Industrial production	0.1	2.4	3.3	3.8	1.4	2.4	2.0	0.6	2.8	...
Industrial activity index (IFO) (*)	91.7	95.7	95.7	95.3	95.2	95.3	93.3	92.9	93.3	95.0
Unemployment rate (**)	10.5	10.6	10.5	10.6	10.7	11.7	11.8	11.8	11.7	11.6
Consumer prices	1.0	1.7	1.8	1.9	2.0	1.7	1.6	1.7	1.8	1.9
Trade balance (***)	130	149	150	153	154	156	155	152.8	154.6	...

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

Trade surplus recovers through better export performance.

The foreign sector, after a slack in the months of April and May, showed improvement in June. That month, thanks to the combined effect of strong exports and some slackening in imports, the cumulative balance for the trade surplus for 12 months stood at 154.6 billion euros, as against 152.8 billion euros in May.

Producer prices and consumer prices reflect increase in oil.

With regard to the trend in prices, the rise in oil costs are gradually causing increases. To be specific, consumer prices stood at 1.9% year-to-year in August showing no change over July. While the level in itself is not troubling, it should be pointed out that four consecutive months have now passed without any decrease from the annual low noted in April. Producer prices are showing greater pressure and moved up by a half percentage point in June to 4.6% year-to-year. Finally, it should be noted that the unemployment rate dropped to 11.6% in July compared with 11.7% the month before.

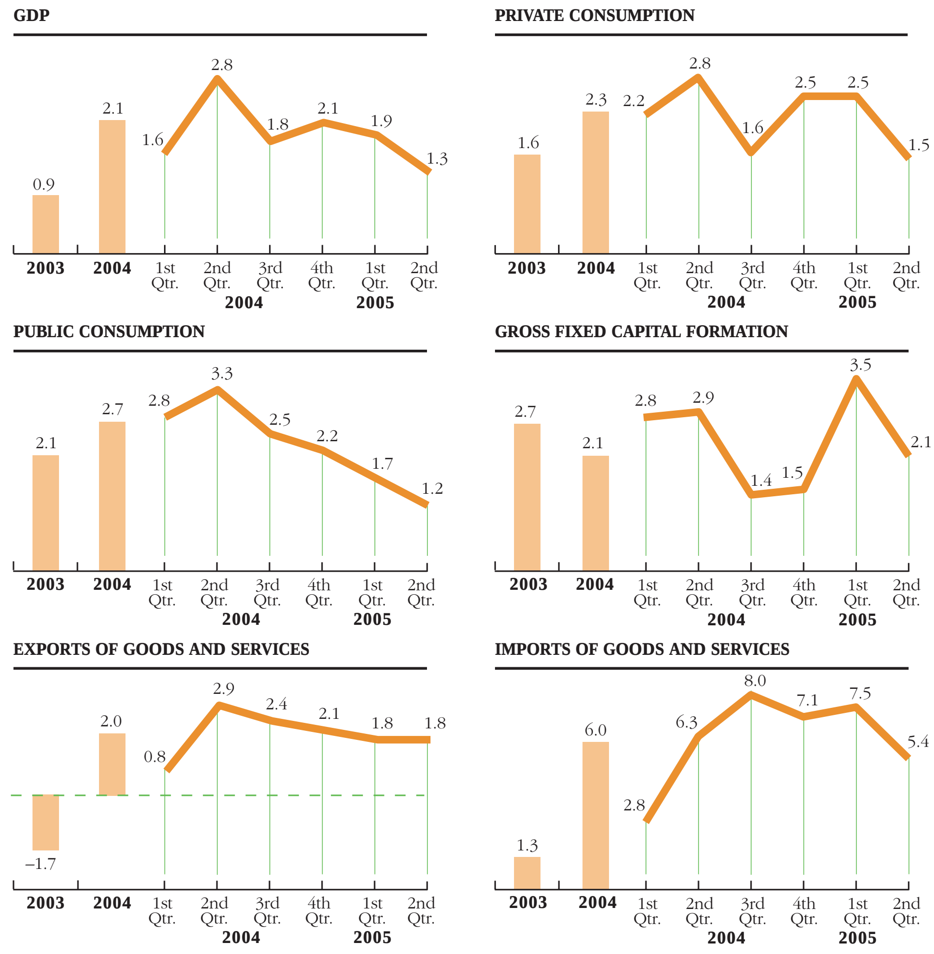
France: low growth reported

French economy slows down in second quarter because of lower household spending...

The French economy slowed down in the second quarter to 1.3% year-to-year as against 1.9% in the first three months of 2005. At quarter-to-quarter rate annualized, it went from 1.6% in the January-March period to 0.5% in the second quarter. The lower growth of private consumption, which was down by one percentage point to 1.5% year-to-year, was the main element responsible for this performance. Nevertheless, public consumption which grew by 1.2% year-to-year (1.7% year-to-year in the first quarter) and gross fixed capital formation (year-to-year increase of 2.1% as against previous 3.5%) and the lower contribution from change in inventories also added to the containment of domestic demand. On the other hand, the foreign sector went from taking off 1.6% from the increase in GDP in the first quarter to reducing it by only 1.1% in the second quarter thanks to lower growth of imports (exports held to the same rate as seen in the first quarter).

TREND IN FRANCE'S GDP BY COMPONENT

Percentage year-to-year change



SOURCE: INSEE and internal figures.

...although drop may be lower in the third quarter.

With regard to the beginning of the third quarter, the few available indicators suggest something of an upturn as in the case of the other large economies of the euro area. French economic sentiment in July stood at a level of 104.3 points compared with 102.5 points on average in the second quarter due to the combined increase in services and industry. Nevertheless, the main non-qualitative indicators published still do not show any such recovery. In June, private consumption grew by a moderate 0.4% year-to-year while industrial production was down by 0.4% year-to-year.

Trade deficit persists as result of notable import strength.

Nor does the trend in the foreign sector end up being positive. While imports rose by 4.8% in June, compared with the same month in 2004, the same strong performance in imports (with growth of 6.0% year-to-year in the same month) prevented any reduction in the trade deficit. The cumulative negative balance for twelve months in June stood at 1.7 billion euros, a notable worsening compared with the trade surplus of 200 million euros recorded one year earlier.

Inflation holds at 1.7% in July.

With regard to prices and the labour market, recent trends continue unaltered. Consumer prices for the moment are showing only limited inflationary pressures (the CPI grew by 1.7% year-to-year in July with no change over June) thanks to the stability of the underlying core which does not include the more erratic components of the index. In a similar way, the improvement in the unemployment rate in June, a month when a decrease of one decimal was recorded putting it at 10.1%, this rate is scarcely any different from the annual highs of 10.2% recorded from March to May.

French government to take advantage of additional tax on oil to compensate affected sectors while also bringing forward new measures to ease labour regulations.

With regard to other matters, we should point out various economic policy measures recently announced. In the first place, the French government has decided that part of tax collections arising from fuel tax, specifically due to the fact that the price of oil has gone above that forecast in the government budget, will be returned to those sectors of the economy most affected by the increase in fuel costs (transport companies, taxis, farmers, fishers, etc.) in the form of tax deductions. A second notable decision was to bring forward a series of measures to liberalize the labour market, initially planned for September but finally brought into effect since August 4. The most relevant of these measures is a new temporary work contract which simplifies and reduces the cost of firing for companies with less than 20 workers.

FRANCE: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2003	2004	2004			2005				
			2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
GDP	0.9	2.0	2.8	1.8	2.1	1.9	–	1.3	–	–
Domestic consumption	1.9	3.3	4.4	2.5	4.0	3.2	2.9	1.3	0.4	...
Industrial production	–0.4	1.8	3.0	1.8	1.6	1.0	0.2	–0.3	–0.4	...
Unemployment rate (*)	9.8	10.0	10.0	10.0	10.0	10.1	10.2	10.2	10.1	...
Consumer prices	2.1	2.1	2.4	2.2	2.1	1.6	1.8	1.5	1.7	1.7
Trade balance (**)	0.3	–0.1	0.2	0.0	–0.6	–1.2	–1.6	–1.7	–1.7	...

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

Italian economy on way to recovery

Surprising increase in Italy's growth in second quarter...

While Italy's economy remains stuck in a stage of low growth, the unexpected improvement in the second quarter may indicate a transition toward a stage of increased economic activity. After a drop in quarter-to-quarter rate in two consecutive quarters, the economy grew by 0.7% in the second quarter (a rise of 0.1% year-to-year as against a decrease of 0.2% year-to-year in the first quarter). In any case, it should be pointed out that the government itself has made a downward revision of its growth forecasts for 2005 as a whole putting the rate at 0% and that the Organization for Economic Cooperation and Development (OECD) considers that the Italian economy will be the only one among the 30 world leaders whose growth will be negative in 2005.

ITALY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2003	2004	2004			2005				
			2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
GDP	0.4	1.0	1.2	1.2	0.8	–0.2	–	0.1	–	–
Retail sales	2.0	–0.4	–0.2	–1.3	–1.1	0.1	–3.9	0.9	...	...
Industrial production	–0.6	–0.6	0.8	–0.7	–2.0	–2.4	–0.6	–1.9	–2.4	...
Unemployment rate (*)	8.4	8.0	8.0	7.9	8.0	7.9	–	...	–	–
Consumer prices	2.7	2.2	2.4	2.2	2.0	1.9	1.9	1.9	1.8	2.1
Trade balance (**)	4.1	1.6	2.9	2.3	–0.9	–2.2	–4.6	–5.1	...	...

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

...which does not definitively clear away doubts about future prospects.

In fact, available monthly indicators confirm the cyclical weakness of the economy. On the demand side, it should be pointed out that consumer confidence dropped by four points in June and July. With regard to supply, the difficulties in the secondary sector grow worse as the year advances. Industrial production in June stood at levels 2.4% less than one year earlier. In this context, the improvement in exports shown in May comes as good news with foreign sales growing by around 9% year-to-year. Nevertheless, the increased strength of imports in May brought about a worsening of the trade deficit putting it at 5.1 billion euros as the cumulative balance for twelve months. Finally, inflation reflects the pressure from the energy component with an increase of three decimals in July putting inflation at 2.1% year-to-year.

United Kingdom: further slowdown in second quarter

United Kingdom GDP grows by 1.8% in second quarter because of slowdown in consumption.

The estimated GDP for the second quarter shows the slowing down in the British economy which grew by 1.8% year-to-year as against 2.1% earlier. The main factor responsible for this slowdown was private consumption which slowed by about one percentage point compared with the first quarter. On the other hand, gross fixed capital formation and public consumption held at approximately the same growth rates as in the previous quarter. Foreign demand in turn added two decimals to the increase in GDP, thanks to a better performance in exports.

UNITED KINGDOM: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2003	2004	2004			2005				
			2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
GDP	2.5	3.2	3.7	3.1	2.7	2.1	–	1.8	–	–
Retail sales	3.0	6.2	6.9	6.7	4.8	3.0	2.0	0.9	1.3	1.9
Industrial production	–0.5	0.8	1.9	0.4	0.0	–1.0	–1.9	–1.5	–1.9	...
Unemployment rate (*)	3.0	2.7	2.8	2.7	2.7	2.6	2.7	2.7	2.8	2.8
Consumer prices	2.8	2.2	2.2	2.1	2.3	2.2	2.3	2.1	2.2	2.4
Trade balance (**)	–46.8	–54.7	–53.7	–56.6	–58.2	–59.3	–60.2	–60.2	–59.9	...

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

Positive performance in services and better prospects for construction.

From a sector point of view, the most notable factor is the improvement in prospects for construction (construction orders grew by 17.2% year-to-year in June) and the recovery in confidence in the services sector in July, which could mean an end to the stage of relatively poor performance seen in the second quarter. With regard to industry, the difficulties in the manufacturing sector seem to be beginning to ease off given that the survey of order books rose by 10 points in July.

Exports recover in second quarter.

One element which could help turn around the negative situation in secondary industry is the recovery in exports for which year-to-year growth went above 10% in the second quarter as a whole (year-to-year increase of 6% in the first quarter). This rise in exports, together with some containment of imports as a result of the slowdown in domestic demand mentioned earlier, has made it possible for the trade deficit to begin a moderate reduction.

Oil pushes up inflation to 2.4% in July.

Consumer prices in turn stood at 2.4% in July, two decimals above the figure for June, due to the increased price of energy. This figure is the highest since March 2004. The labour market is showing fewer changes. The unemployment rate in July held at 2.8% of the labour force, representing no change over June. This level represented a moderate worsening with regard to the all-time lows of 2.6% recorded at the beginning of the year.

MONETARY AND CAPITAL MARKETS

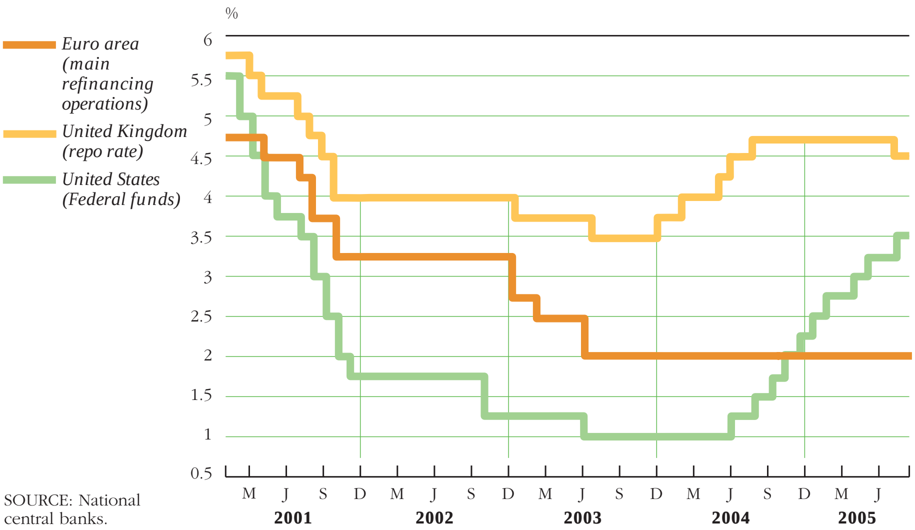
Federal Reserve raises interest rates

Main central banks make different moves on interest rates.

The month of August underlined the notable differences in the monetary policies applying in the leading geographical areas. Whereas the Bank of England turned around the rise in official interest rates made one year earlier, the US Federal Reserve continued a sustained path of increases in reference rates. On the other hand, the European Central Bank and the Bank of Japan have made no moves, thus maintaining their reference rates at all-time low levels. This situation with different moves in interest rates is in contrast to that predominating in recent years, in which decisions on interest rates by the main central banks followed the same course.

FEDERAL RESERVE RAISES OFFICIAL INTEREST RATE TO 3.50%

Monetary policy reference rates



SOURCE: National central banks.

Federal Reserve makes tenth consecutive increase in reference rate...

In the United States, in his appearance before a committee of Congress, Alan Greenspan, chairman of the Federal Reserve Board, confirmed that it would continue gradually raising interest rates. In fact, as expected, at its meeting on August 9 the Federal Open Market Committee decided to raise the Federal Reserve reference rate (the objective level of the daily interbank rate) by 25 basis points putting it at 3.50%. This was the tenth consecutive increase in fourteen months. As a result, this official rate had increased by 250 basis points since June 2004, the moment at which the restrictive turn in monetary policy began. At the same time, the discount rate was also increased by 25 basis points to 4.50%.

...and this will not be the last...

In its press release, the Federal Reserve pointed out that its monetary policy would continue to be an easy one following the new increase. Given that aggregate spending had increased since the winter and that inflationary pressures had been high, the US monetary authorities suggested that the upward move in interest rates would continue although in a gradual manner.

...given that it is expected to reach 4%.

In this context the yield on US 1-year interbank deposits continued to rise in July and August following a pause brought about by speculation that the official interest rate was already close to the top of its cycle. As a result, the yield on US 12-month interbank deposits stood at 4.20% in the middle of the fourth week in August, an increase of 36 basis points over the end of the first half-year and 192 basis points compared with one year earlier. Because of this, the market is discounting new increases. According to the interest rate curve, the Federal Reserve official rate will go above 4% in coming months.

European Central Bank resists pressure in favour of cut...

In the euro area, the European Central Bank (ECB) has steadfastly maintained its position that interest rates in the Eurosystem stand at the correct level and it did not change those rates at its meetings at the beginning of July and August. It has thus resisted considerable pressure in favour of a cut. At the beginning of July, even the European Parliament rejected a non-binding report which supported the action of the ECB. The official interest rate thus continued at 2%, unchanged since June 2003.

...on the basis of improvement in economic prospects in euro area.

The ECB argued that latest figures pointed toward a recovery in domestic demand. On the other hand, although it pointed out that inflationary trends were not significant, it considered that there were risks for price stability because of the jump in oil prices. Inflation rose to 2.2% in July going above the mid-term objective of 2%. Furthermore, there are signs of excessive liquidity in the euro area. In June, loans to the private sector rose to 7.9%. In fact, we note a change in position on the part of international institutions which had recently recommended a cut in ECB interest rates.

SHORT-TERM INTEREST RATES IN NATIONAL MARKETS

Monthly averages as annual percentage

	Euro area			United States		Japan	United Kingdom		Switzerland
	ECB auctions (2)	Euribor 3-month	Euribor 1-year	Federal Reserve Board target level (3)	3-month	3-month	Bank of England intervention rate (4)	3-month	3-month
2004									
July	2.01	2.12	2.36	1.25	1.59	0.00	4.50	4.77	0.50
August	2.01	2.11	2.30	1.43	1.70	0.00	4.72	4.88	0.54
September	2.02	2.12	2.38	1.59	1.88	0.00	4.75	4.85	0.67
October	2.03	2.15	2.32	1.75	2.06	0.00	4.75	4.81	0.71
November	2.05	2.17	2.33	1.92	2.28	0.00	4.75	4.79	0.75
December	2.07	2.17	2.30	2.25	2.47	0.00	4.75	4.78	0.75
2005									
January	2.06	2.15	2.31	2.25	2.64	0.00	4.75	4.79	0.74
February	2.06	2.14	2.31	2.50	2.80	0.00	4.75	4.80	0.75
March	2.05	2.14	2.34	2.59	2.99	0.00	4.75	4.90	0.75
April	2.05	2.14	2.27	2.75	3.12	0.00	4.75	4.86	0.76
May	2.05	2.13	2.19	2.99	3.24	0.00	4.75	4.81	0.76
June	2.05	2.11	2.10	3.01	3.40	0.00	4.75	4.76	0.75
July (*)	2.05	2.12	2.17	3.25	3.59	0.00	4.75	4.60	0.75
August (1)	2.05	2.13	2.21	3.50	3.80	0.00	4.50	4.56	0.76

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: 10-11-04 (2.00%), 14-12-04 (2.25%), 2-2-05 (2.50%), 22-3-05 (2.75%), 3-5-05 (3.00%), 30-6-05 (3.25%), 9-8-05 (3.50%).
(4) Latest dates showing change: 10-7-03 (3.50%), 6-11-03 (3.75%), 5-2-04 (4.00%), 6-5-04 (4.25%), 10-6-04 (4.50%), 5-8-04 (4.75%), 4-8-05 (4.50%).
SOURCE: European Central Bank, Bank of Spain, Thomson Financial Datastream and internal figures.

1-year Euribor stands slightly below twelve months earlier.

In a framework of speculation about reduction in ECB interest rates, the 12-month Euribor went down 9 basis points on monthly average in June going to 2.10%, the lowest rate since March 2004. In July, the 1-year Euribor rose by 7 basis points going to 2.17% on monthly average. In the early weeks of August, the 12-month Euribor tended to stand at around 2.20%, slightly below the level seen one year earlier. At the present time, the market is no longer expecting a drop in the ECB reference rate but, on the other hand, it is not anticipating a rise until well into the second half of 2006.

Bank of England suggests further cuts unlikely in near future.

After publication of the minutes of the meeting of the Bank of England Monetary Committee in July, the result of which was a very narrow vote in favour of maintaining the intervention rate, an early cut was widely expected. This came about on August 4. As a result, the British monetary authorities reduced the reference rate by 25 basis points to 4.50%. It thus turned back the measure taken in the opposite direction one year earlier. The British central bank justified its decision by the sharp slowdown in the British economy and that the real estate market had cooled off. The Bank of England suggested, however, that a new cut in the official interest rate was very unlikely in the near future, given that the rise on the markets and the depreciation of the pound sterling were helping economic activity.

Dollar loses positions in summer

Dollar marks up highest level since October 2004 at beginning of July...

The dollar rose by 3.8% in overall terms in the first half of 2005 after having suffered a substantial drop in the latter part of 2004. This reaction came about in spite of the growing foreign imbalance of the US economy. The greenback was boosted by relatively strong economic expansion and a widening of the interest rate differential following successive increases by the Federal Reserve. As a result, at the beginning of July, the US currency marked up its highest level since October 2004 in relation to a broad group of currencies.

EXCHANGE RATES OF MAIN CURRENCIES

July 2005

	Final session of month		Monthly figures				*Exchange rate August 24, 2005*
	Exchange rate	% monthly change (2)	Average exchange rate	% change (2)			
				Monthly	Over December 2004	Annual	
Against US dollar							
Japanese yen	112.5	1.5	111.9	3.0	7.9	2.3	*110.2*
Pound sterling (1)	1.757	–1.8	1.752	–3.7	–9.2	–5.0	*1.800*
Swiss franc	1.288	0.4	1.294	2.2	12.9	3.9	*1.264*
Canadian dollar	1.224	–0.1	1.224	–1.3	0.5	–7.5	*1.191*
Mexican peso	10.60	–1.6	10.68	–1.3	–4.7	–6.9	*10.88*
Nominal effective index (4)	*111.7*	*–0.3*	*112.2*	*0.5*	*3.0*	*–2.5*	*111.1*
Against euro							
US dollar	1.209	0.0	1.204	–1.0	–10.2	–1.9	*1.221*
Japanese yen	135.9	1.5	134.7	1.9	–3.2	0.5	*134.8*
Swiss franc	1.561	0.7	1.558	1.2	1.4	2.0	*1.555*
Pound sterling	0.689	2.2	0.688	2.8	–1.1	3.3	*0.680*
Swedish krona	9.405	–0.2	9.428	1.8	5.0	2.5	*9.333*
Danish krone (3)	7.459	0.1	7.458	0.2	0.3	0.3	*7.459*
Polish zloty	4.072	0.8	4.099	0.9	–0.9	–8.2	*4.019*
Czech crown	30.15	0.4	30.18	0.5	–1.5	–4.3	*29.66*
Hungarian forint	245.0	–0.9	246.5	–1.0	0.3	–1.4	*245.8*
Nominal effective index (5)	*101.9*	*0.5*	*101.7*	*0.5*	*–5.0*	*–1.2*	*101.8*

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

...but foreign deficit weighs against it.

Nevertheless, the dollar has since lost strength. Concern about the foreign deficit again weighed against it. This tendency was accentuated by the announcement of a revaluation of the yuan of 2.1% by the Chinese authorities on July 21 (see box below), a move which was followed by appreciation by a number of Asian currencies. As a result, by August 12 the dollar had lost 2.7% in terms of a wide group of currencies since the high seen at the beginning of July. Nevertheless, since mid-August the US currency regained strength with the stimulus of publication of positive macroeconomic figures.

In global terms, euro drops by 6% in first half-year…

The euro, in turn, fell by 6.2% in the first half of the year in terms of the currencies of its main trading partners following sharp appreciation in the final quarter of 2004. Modest economic growth in the euro area, the unfavourable widening of the interest rate differential in terms of other currencies and rejection of the European constitution in referendums in France and the Netherlands and the subsequent political crisis weakened the single currency.

…although it partly recovers in summer.

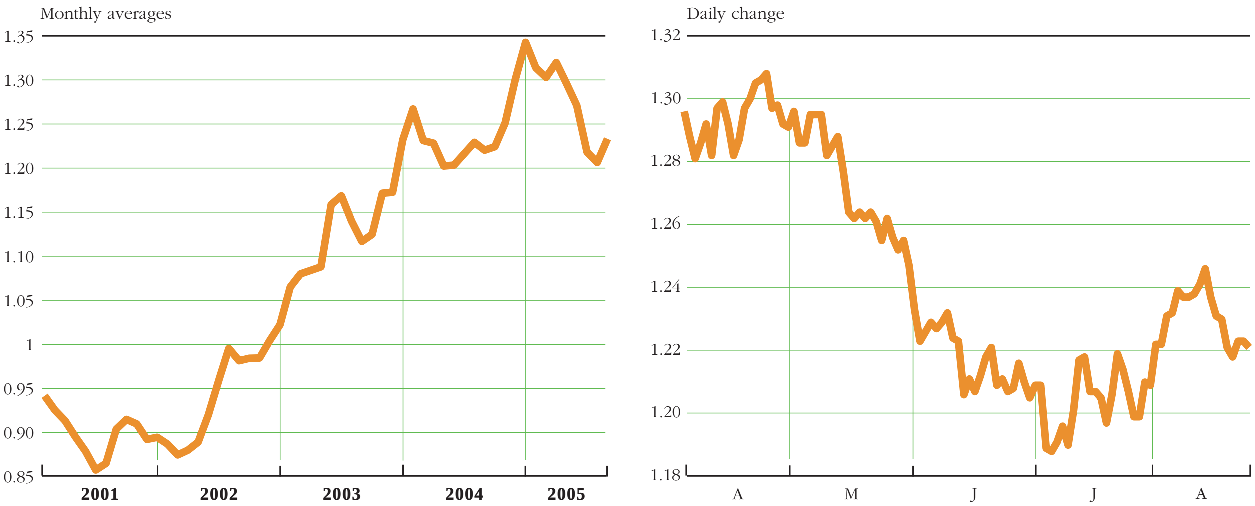
Nevertheless, when prospects of a cut in the European Central Bank interest rate vanished and the outlook for economic recovery became consolidated, the euro gained strength. As a result, at the beginning of August it showed an increase of 1.7% in terms of the main currencies. Later on, however, the single currency again weakened in a situation of uncertainty about increases in oil prices.

Single currency loses 13% against dollar since December.

In terms of the dollar, the euro fell to 1.188 dollars on July 5, the lowest level since May 2004, to show a decrease of 12.8% since the beginning of the year. The European currency later recovered to show an exchange rate of 1.246 dollars on August 12 but encountered resistance stopping this move and it again dropped.

EURO SHOWS SWINGS AGAINST DOLLAR

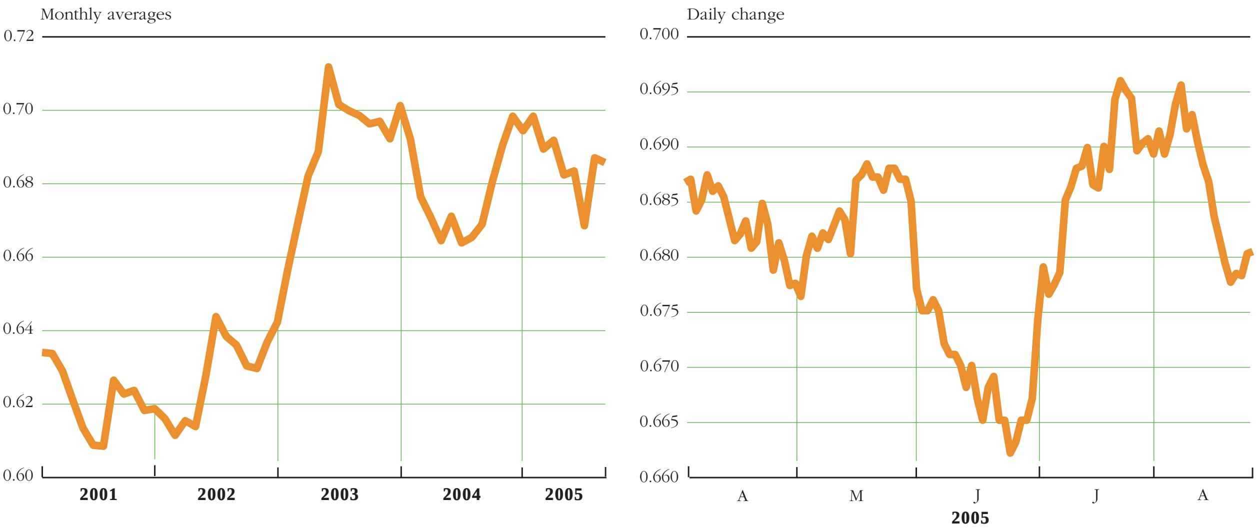
US dollars to euro



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

POUND STERLING RECOVERS IN AUGUST

Pound sterling to euro



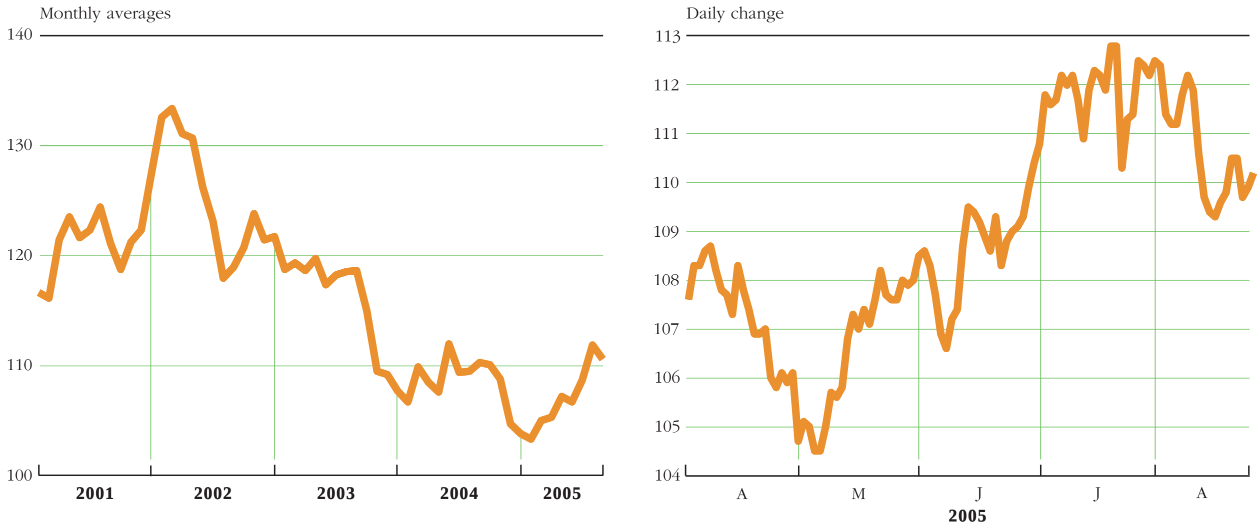
NOTES: Figures go up to August 24. SOURCE: Thomson Financial Datastream.

Pound sterling drops against dollar so far this year but appreciates against euro.

The pound sterling rose by 2.5% in terms of a broad group of currencies in the January-June period aided by the favourable differential in interest rates. Nevertheless, since the end of June, the pound made a downturn in anticipation of an early drop in the Bank of England intervention rate. However, the British currency recovered in August with an easing of prospects of further cuts in the interest rate in coming months following that made at the beginning of the month. In any case, the pound stood notably lower than the level shown at the beginning of the year in terms of the dollar but noticeably above the level in terms of the euro.

YEN APPRECIATES SLIGHTLY

Yen to dollar



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

Yen bounces back on revaluation of Chinese yuan.

On July 20, the yen marked up its lowest level since May 2004 against a broad group of currencies under the effect of an unfavourable differential in interest rates against other currencies with a continuation of Japan's official interest rate at 0%. Nevertheless, the announcement of a revaluation of the yuan against the dollar on July 21 brought about a sharp rise in the Japanese currency. Although this rise was short-lived in view of the limited increase in the yuan, the Japanese currency was helped by an improvement in the country's economic situation. In any case, the yen went through ups and downs as a result of the political crisis set off in Japan which involves early elections. In the fourth week of August the yen stood significantly below the level at the beginning of the year in terms of the dollar, although it was showing a considerable rise in terms of the euro.

Slight appreciation of yuan against dollar following announcement of end to peg with that currency.

Following an announcement of a revaluation of the yuan in terms of the dollar on July 21, the Chinese currency has followed a course of very gradual appreciation against the dollar. At the middle of the fourth week in August the exchange rate was 8.105 units to the dollar as against 8.11 on the day of revaluation. The Chinese measure had an important impact on currencies in the region given the economic and commercial importance of the Asian giant. The decision to break the yuan's link with the dollar was immediately followed by the authorities in Malaysia who also removed the ringgit's link to the US currency placing it under a controlled flotation system based on a basket of currencies. Other Asian currencies such as the South Korean won, the Singapore dollar and the Thailand baht tended to rise against the dollar. On the other hand, the Hong Kong dollar remained linked to the US dollar.

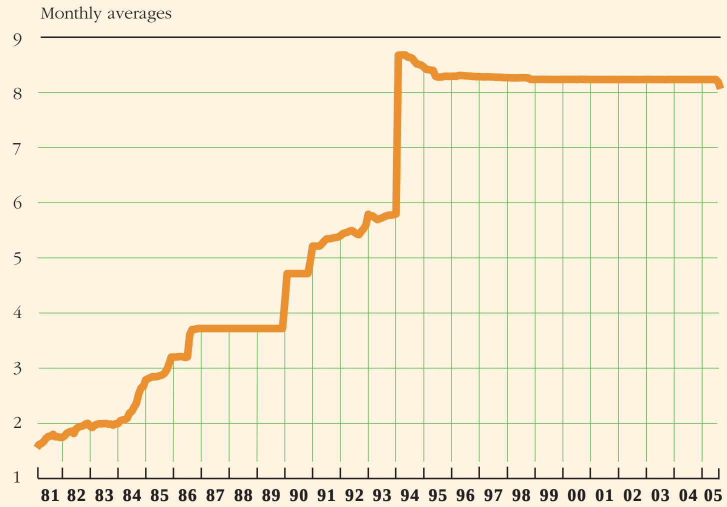
YUAN BREAKS LINK WITH DOLLAR

On July 21, the Chinese authorities announced that the link of the yuan with the dollar was to be removed. The Chinese currency had had a fixed exchange rate with the dollar since 1995. This was modified in 1998 when it was established at 8.28 units to the US dollar. On the first day of the new exchange rate system, the yuan's level was set at 8.11 units to the dollar, a revaluation of 2.1%.

The Bank of China announced that as of that moment the exchange rate for the yuan would be established in terms of a basket of currencies so that it would be maintained at a level of reasonable balance. A few days later, it was announced that this basket would include the dollar, the euro, the Japanese yen, the South Korean won, the Singapore dollar, the pound sterling, the Malaysian ringgit, the rouble, the Australian dollar, the Thailand baht and the Canadian dollar although no explanation was made of the relative weight of these currencies in the total. In principal, the choice of these currencies comes as a result of the main trade and financial flows with the Asian giant although no mention was made of the Taiwan dollar or the Hong Kong dollar. Under the new flotation system the Chinese authorities will limit the daily change in the yuan against the dollar at ± 0.3%.

Flotation of the yuan has been subject to speculation for some months but it was expected that it would be revalued to a greater extent. In fact, this is a first step in its liberalization. In August the Chinese authorities announced complementary measures in this direction, such as authorizing a number of Chinese and foreign financial institutions to operate with yuan futures contracts as cover. Speculation regarding an increased appreciation of the yuan against the *dollar is likely to continue although the Chinese authorities took steps to dampen such hopes and as a result of their intervention and controls on capital the yuan was running close to the new initial level of 8.11 units in August. In any case, appreciation of the yuan against the dollar would appear logical over the long term.*

EXCHANGE RATE OF CHINESE CURRENCY
Yuan to dollar



SOURCE: Thomson Financial Datastream.

With regard to the reasons lying behind the Chinese decision, these include the reduction of trade imbalances and the stimulation of domestic demand. Undoubtedly, heavy US pressure played an important role. On the other hand, China's situation with a great accumulation of foreign reserves was unsustainable. With regard to monetary repercussions of the measure, a number of Asian currencies appreciated and US bond interest rates tended to rise. At the same time, the euro showed lower pressure.

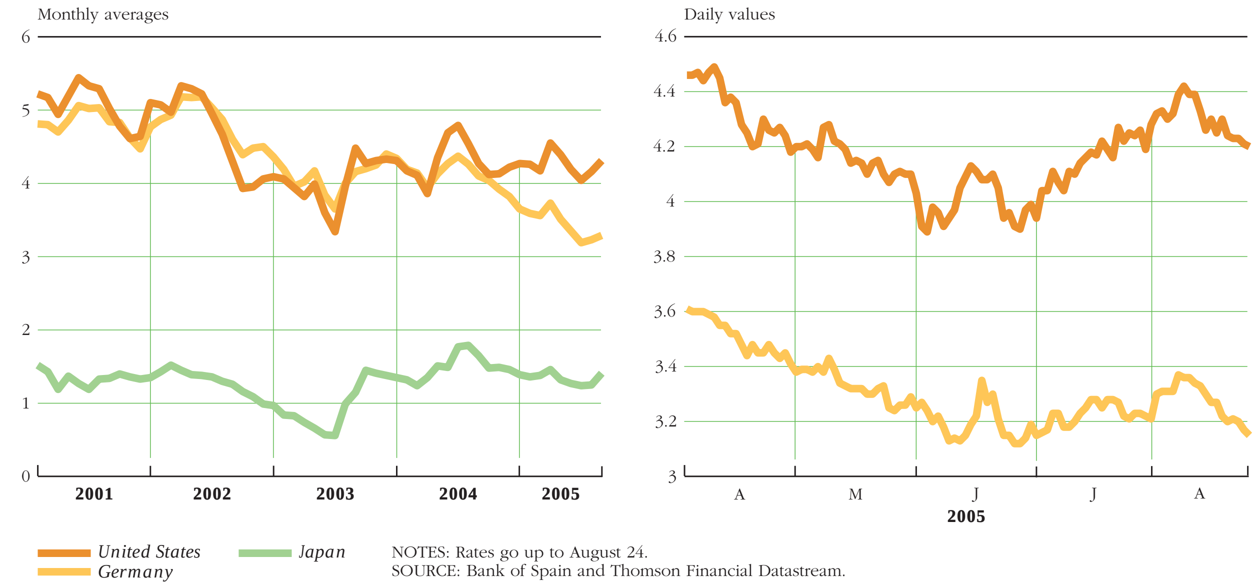
Slight recovery of yields on long-term government bonds

Excess global liquidity keeps bond yield depressed.

The yield on US 10-year Treasury bonds recorded its lowest level since March 2004 at the beginning of June when it went to 3.89%. This figure was unusually low given the stage of economic recovery. This situation may be explained by the coming together of a series of factors, such as the existence of major global liquidity because of still generally easy monetary policies (short-term interest rates remain at 0% in Japan); excessive savings in a situation of unused production capacity; the reduction of risk premium associated with increased credibility of central banks and increased global competition working to contain inflationary pressures. Specifically, US bond acquisitions by Asian central banks in order to avoid appreciation of their currencies are contributing to maintaining of long-term bond yields at abnormally low levels.

WIDENING OF LONG-TERM INTEREST RATE DIFFERENTIAL BETWEEN DOLLAR AND EURO

Yield on 10-year government bonds as annual percentage



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

Yield on US Treasury bonds drops following rise in July.

The yield on US Treasury bonds took on an upward path in July with growing prospects of an increase in interest rates by the Federal Reserve, the announcement of a revaluation of the Chinese yuan on July 21 and the rise in oil prices. As a result, it reached 4.42% on August 8. Nevertheless, it later dropped in a context of recovery of the dollar. The yield on long-term government bonds thus continued to stand at around 4% within a relatively low range.

Further issues of US 30-year Treasury bonds announced.

In addition, at the beginning of August it was officially confirmed that issues of US 30-year Treasury bonds, considered a long-term reference, would be resumed in 2006. It was decided to suspend their issue in 2001 within a framework of budgetary surpluses in contrast to the current situation. With this measure, the US Treasury is diversifying its borrowing instruments and widening the investor base for its products. On the other hand, in keeping with this move to issue very long-term bonds, Poland recently issued bonds with a 50-year maturity.

Long-term interest rate differential between dollar and euro goes above 100 basis points.

The yield on German 10-year government bonds marked up its lowest level in recent decades on June 24 when it went to 3.12%. It later rose slightly due to the improved economic situation in the euro area and disappearance of prospects of an interest-rate cut by the European Central Bank. As a result, it marked up 3.37% on August 5. It later again went down to hold at very low levels. The differential in long-term interest rates between the United States and Germany increased in the summer to stand above 100 basis points.

LONG-TERM INTEREST RATES IN NATIONAL MARKETS

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

	2003	2004	2005					
			I	April	May	June	July	August 24
United States	4.04	4.31	4.34	4.39	4.19	4.04	4.16	4.20
Japan	0.99	1.50	1.41	1.32	1.27	1.24	1.25	1.41
Germany	4.10	4.07	3.63	3.51	3.35	3.19	3.23	3.15
France	4.13	4.10	3.64	3.55	3.38	3.20	3.24	3.17
Italy	4.24	4.24	3.75	3.66	3.52	3.41	3.38	3.38
Spain	4.12	4.10	3.63	3.53	3.36	3.19	3.22	3.15
United Kingdom	4.53	4.93	4.72	4.69	4.47	4.33	4.29	4.23
Switzerland	2.47	2.57	2.15	2.15	2.02	1.96	1.95	1.92

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

Interest rate on Japanese government bonds moves up in summer.

In Japan, the yield on 10-year government bonds at the end of the first half-year marked up its lowest level since August 2003 going down to 1.14%. Nevertheless, it later bounced back because of the better state of the economy and signs of an early exit from deflation. As a result, at the middle of the fourth week in August the yield on 10-year government bonds was running above 1.4%.

Italy's credit rating reduced and risk premium increased slightly to 20 basis points.

Standard & Poor's credit rating agency reduced Italy's rating by one step putting it at AA– for its long-term credit in July. In August, the same rating agency reduced Italy's credit standing from «stable» to «negative» because of the worsening of the public finances. In this way, the risk premium on Italian 10-year government bonds, measured as the differential in yield with similar German bonds, was slightly increased to stand at 20 basis points in the fourth week of August as against 7 at the end of 2004. By contrast, toward the end of August the differential between Spanish government bonds and German bonds was negative at –2 basis points.

Reduction in risk premium on low credit rating bonds.

The rate of global default on low credit rating bonds stood at the lowest figure in the last eight years going to 1.8% in July, according to Moody's rating agency. The default rate has dropped substantially from the 2.4% seen in January and 3.1% twelve months earlier. This, together with the attention coming from investors given the low levels of public bond yields, meant that the risk premium on low credit rating bonds, measured as the difference between the yield on these bonds and that on long-term government bonds, dropped in recent months leaving behind the upturn in May.

Many stock markets mark up highest levels in last three or four years

Favourable corporate profits and ample existing liquidity give upward boost to stock markets.

Favourable corporate profits and abundant existing liquidity, along with interest rates at very low levels, pushed the stock markets up in the early months of the summer. As a result, many stock market indices marked up their highest levels in the last three or four years and some have even recorded all-time highs. As a result, the stock markets have overcome the nervous moments brought about by the terrorist attacks in London and Egypt. They have also risen in spite of the step-up in oil prices, given the moderate effect of this on the economy up to this moment. Nevertheless, the continuing increase in oil prices has limited the rise on the stock markets and brought a number of drops in August.

Dow Jones and Nasdaq again lose par for year.

In the United States, the Standard & Poor's 500 index reached its highest level since June 2001 at the beginning of August. Later on, however, it lost ground and in the middle of the fourth week of August it stood slightly below par for the year. On the other hand, the traditional Dow Jones Industrials index was unable to go above the annual high in March and went below the level at the beginning of the year. The general Nasdaq index, which is representative of hi-tech shares, marked up a high for the last four years at the beginning of August although later on it lost par for the year. The worse trend in US stock markets compared with those in Europe and emerging countries so far this year may be explained by the

INDICES OF MAIN WORLD STOCK EXCHANGES

July 31, 2005

	Index (*)	% monthly change	% cumulative change	% annual change	Figures on August 24, 2005	
					% cumulative change	*% change over same date in 2002*
New York						
Dow Jones	*10,640.9*	*3.6*	*–1.3*	*4.9*	*–3.2*	*17.6*
Standard & Poor's	*1,234.2*	*3.6*	*1.8*	*12.0*	*–0.2*	*28.6*
Nasdaq	*2,184.8*	*6.2*	*0.4*	*15.8*	*–2.1*	*54.2*
Tokyo	11,899.6	2.7	3.6	5.1	8.8	*26.7*
London	5,282.3	3.3	9.7	19.7	9.6	*20.2*
Euro area	3,326.5	4.6	12.7	22.3	11.6	*16.8*
Frankfurt	*4,886.5*	*6.5*	*14.8*	*25.4*	*15.5*	*28.4*
Paris	*4,451.7*	*5.3*	*16.5*	*22.1*	*15.8*	*25.5*
Amsterdam	*395.8*	*3.1*	*13.7*	*20.0*	*12.0*	*–0.1*
Milan	*25,772.0*	*4.2*	*9.5*	*24.2*	*9.5*	*32.8*
Madrid	*10,115.6*	*3.4*	*11.4*	*27.7*	*11.0*	*52.9*
Zurich	6,600.9	5.6	15.9	19.0	14.8	*19.0*
Hong Kong	14,881.0	4.8	4.6	21.6	4.5	*45.2*
Buenos Aires	1,507.6	10.3	9.6	56.0	11.7	*296.8*
São Paulo	26,042.0	4.0	–0.6	16.6	2.0	*176.1*

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.

relative over– valuation on US markets and the successive increases in interest rates by the Federal Reserve.

Spectacular rise in energy sector.

By sector, the trends were quite uneven. The energy sector stood out by the cumulative gains shown. Public utility companies and the health and pharmaceutical sector also recorded considerable capital gains over December. On the contrary, the biggest capital losses as of August showed up in those companies in materials and telecommunications.

Eurostoxx 50 marks up high for past three years.

The DJ Eurostoxx 50 index, made up of the biggest companies in the euro area, at the middle of the fourth week in August showed an increase of 11% over December having reached its highest level in the past three years on August 10. The big increases in profits by European companies helped along by a certain weakness in the euro and maintenance of European Central Bank interest rates at very low levels pushed up the European stock markets. The biggest cumulative gains were concentrated in Paris, Frankfurt and Amsterdam.

Many shares in IBEX 35 mark up all-time highs.

With regard to the Spanish stock market, the IBEX 35 index went above the 10,200 level on August 10 to show the highest level since November 2000, although it later slipped down to some extent. It should be pointed out that in summer many shares included in the IBEX 35 stood at all-time highs and that toward the end of the month only 5 of the 35 shares were in the red compared with December.

Japanese stock market shows high for last four years...

Outside the euro area, the Financial Times 100 index for the London stock exchange also showed a considerable increase in the first eight months of the year with the aid of the drop in the Bank of England intervention rate in August. The SMI index for the Swiss stock exchange showed an even better performance in the January-August period. In addition, the Japanese stock market showed a remarkable rise during the summer. As a result, the Nikkei 225 index marked up its highest level for the last four years in August following the improvement in Japan's economic prospects. Specifically, the official declaration that the bank crisis had ended meant that share quotations for financial institutions were more favourable.

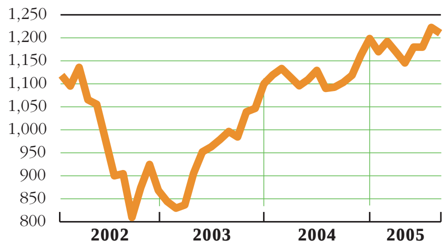
...along with various indices in emerging markets.

With regard to emerging markets, these generally have shown a good performance so far this year reflecting economic recovery aided by the rise in raw materials prices and low international interest rates. A number of stock exchanges in emerging countries, such as Indonesia, India, Russia, Poland, Hungary, Mexico and Chile marked up all-time highs in August. In the middle of the month, stock markets in South Korea and Hong Kong recorded the highest levels in recent years. The stock markets in Buenos Aires and São Paulo showed positive results over December although they did not go above the highs seen in the first quarter.

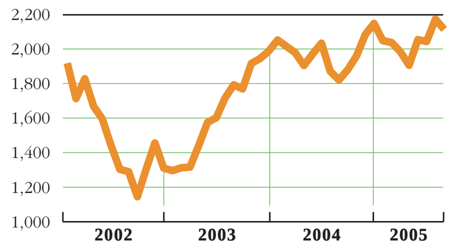
INTERNATIONAL STOCK EXCHANGES

Indices at month-end

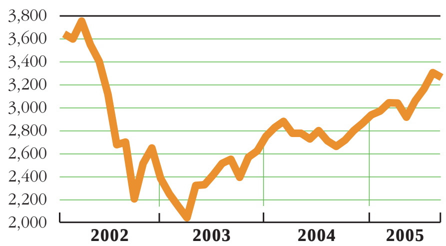
NEW YORK (Standard & Poor's 500)



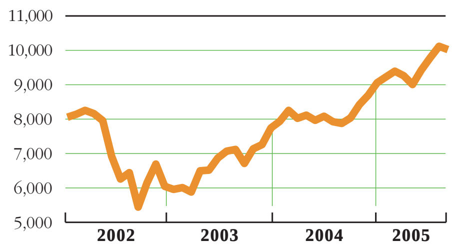
NASDAQ INDEX (UNITED STATES)



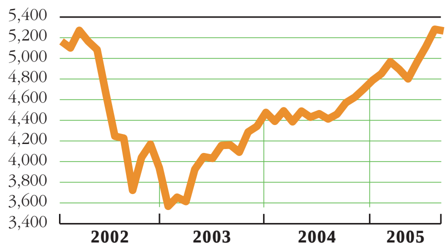
EURO AREA (DJ Eurostoxx 50)



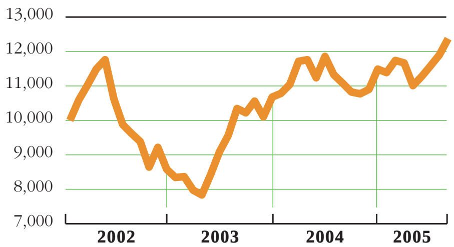
MADRID (IBEX 35)



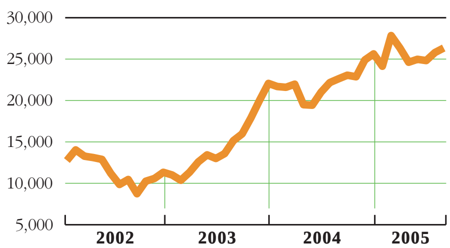
LONDON (Financial Times 100)



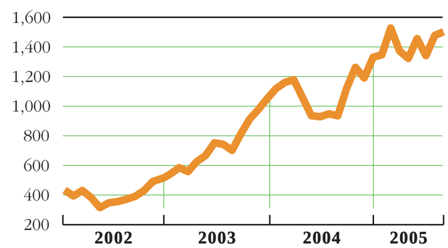
TOKYO (Nikkei 225)



SÃO PAULO (Bovespa)



BUENOS AIRES (Merval)



NOTES: August 24, 2005. SOURCE: Thomson Financial Datastream.

ECONOMIC ACTIVITY

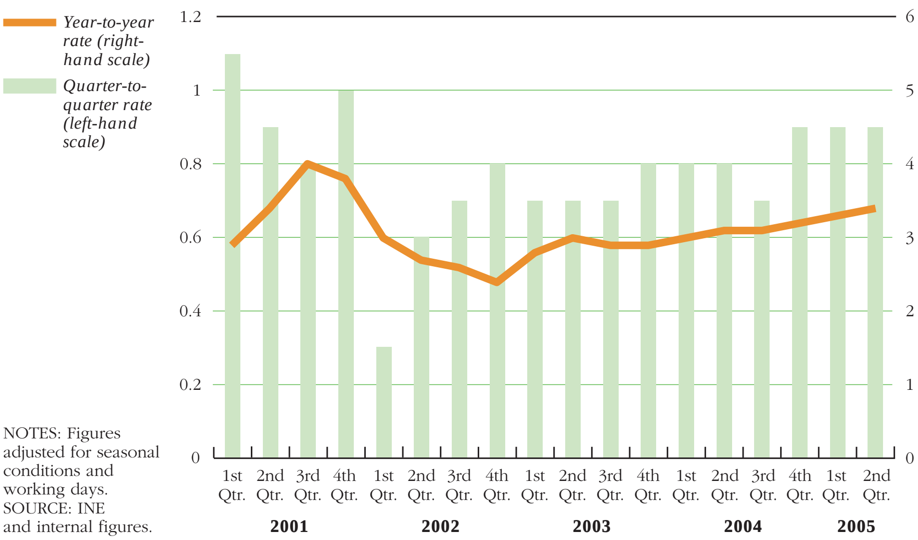
Spain's economy grows by 3.4% in second quarter

GDP growth rate up slightly in second quarter of 2005...

In the second quarter of 2005, the gross domestic product (GDP) generated by Spain's economy grew by 3.4% real compared with the same period last year, one decimal more than in the preceding quarter, according to early estimates by the National Institute of Statistics (INE). The strength of domestic demand with a fairly stable rate of expansion and the slightly less negative contribution from the foreign sector are the main reasons for the gradual increase noted, a situation which, taking into account the trend in the main economic activity indicators, would have scarcely shown any change in the course of the third quarter.

GDP MAINTAINS STRONG GROWTH RATE

Percentage real change



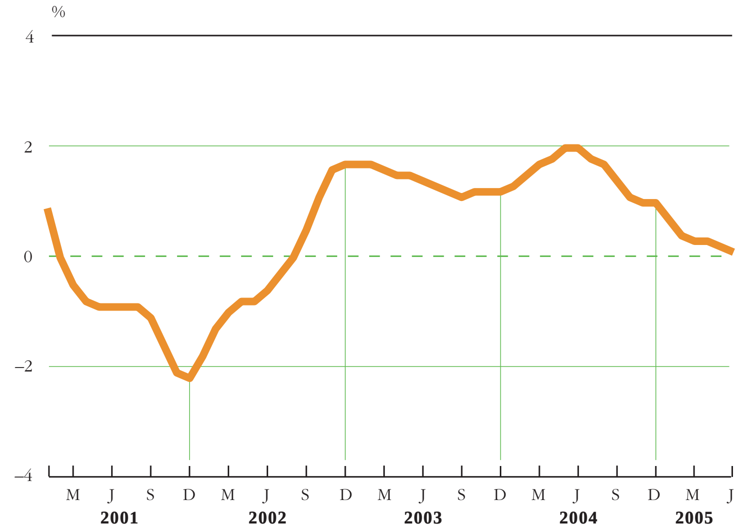
NOTES: Figures adjusted for seasonal conditions and working days.
SOURCE: INE and internal figures.

...and indices likely to continue trend with notable exception of industry...

In general terms, electricity consumption adjusted for calendar and temperature effects (which is highly representative of overall economic activity) shows a profile of slightly increased growth in terms of cycle-trend, a situation more or less repeated in most other indicators. The biggest exception comes in the industrial production index with a growth trend gradually approaching zero. Specifically, a very negative performance is to be seen in the textile industry, clothing, furs, leather and footwear with cumulative decreases in the first six months of between 10% and 15% compared with the same period last year, undoubtedly under the effect of the growth of imports mainly from China.

WEAK GROWTH IN INDUSTRY

Year-to-year change in industrial production index



NOTES: Cycle-trend statistical series corrected for calendar differences.
SOURCE: INE and internal figures.

...which continues to reflect signs of weakness in spite of better state of order books.

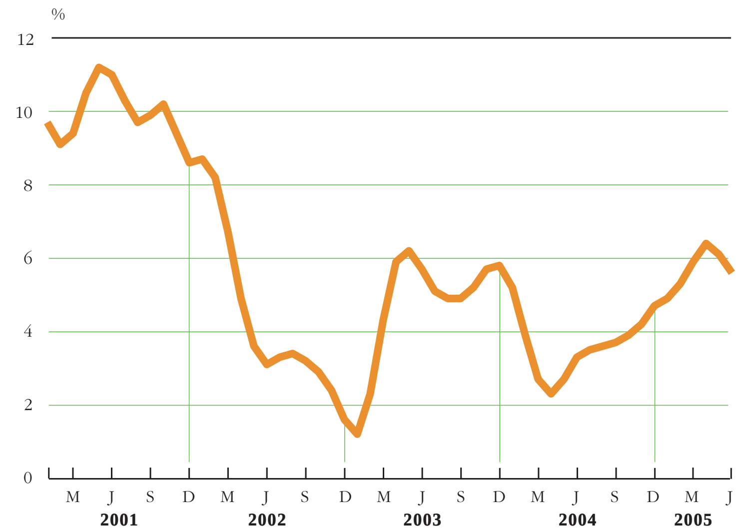
At the other end of the scale, branches such as publishing and graphic arts and electricity and gas production stood outside the general situation to show a more expansionist performance in that six month period reporting average growth in respective indices of more than 5%. At the same time, it should be pointed out on a more positive note that the index for new orders in industry has tended to improve in recent months. From January to June, the average increase in the index representing new orders rose by 5.6% with notably sharp growth in the energy branches along with more moderate growth in the capital goods industry and in intermediate goods.

In construction, short-term prospects remain very positive.

With regard to construction, prospects continue to be optimistic. Both apparent cement consumption and production of construction materials in recent months reflect a growing trend, confirmed from another point of view by registrations with Social Security and registered unemployment related to the sector, which are also showing a favourable trend. To be specific, the indicators point to a gradual increase in housing construction aided by the strong growth of housing loans. With regard to public works, the strong levels seen in government tendering in recent months would point to an increase in that activity in the immediate future.

CEMENT CONSUMPTION MAINTAINS HIGH GROWTH RATE

Year-to-year change in cement consumption



NOTES: Cycle-trend series.
SOURCE: OFICEMEN and internal figures.

Tourism from January to July shows better balance than at first forecast...

With regard to tourism, the balance for the first seven months of the year has turned out more favourable than at first forecast. In the period under consideration, some 31.5 million tourists visited Spain, 6.1% more than in 2004. As of July, Catalonia led the ranking in number of tourists with 8.1 million visitors (12.7% year-to-year increase). Next came the Balearic Islands (5.5 million tourists) and the Canary Islands (5.4 million), but with only a moderate increase (1.8%) in the first case and a year-to-year decrease of 2.1% in the second case. By source markets, the United Kingdom continued in the lead with 9.1 million tourists (1.6% more than in the first seven months of 2004), followed by Germany (5.6 million) and France (4.9 million).

...while increase in revenue inflows definitely reflects more moderate levels.

In strictly economic terms, the foreign tourist balance is more moderate. Overnight stays in hotels by foreign visitors rose by only 2.0% from January to July and cumulative spending, under all headings, grew by around a similar proportion in real terms, according to the survey of tourist spending drawn up by the Institute of Tourist Studies. On the other hand, domestic tourism continued to be very strong amounting to nearly 58 million overnight stays from January to July, 8.1% more than in the same period last year.

Information and communications technology and services to companies stand out as leaders in services.

In other services, the general tone is positive with very significant growth in such sectors as information and communications technology and services to companies. The volume of business in those sectors rose by 9.0% and 7.1% year-to-year respectively in the first half of 2005 to show clearly upward background moves. The trend in retail trade and transportation was equally favourable although with somewhat more moderate growth rates (6.8% and 5.1%).

SUPPLY INDICATORS

Percentage change over same period year before

	2003	2004	2004		2005				
			3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
Industry									
Electricity consumption (1)	5.4	3.3	3.0	2.4	5.2	2.6	4.8	4.6	4.7
Industrial production index (2)	1.4	1.6	2.2	0.4	0.3	0.2	0.2	–0.2	...
Confidence indicator for industry (3)	–0.9	–2.5	–2.7	–2.3	–3.3	–6.0	–7.0	–8.0	–5.0
Utilization of production capacity (4)	79.1	79.8	80.5	80.5	79.4	–	79.5	–	81.1
Imports of non-energy intermediate goods (5)	6.2	6.6	6.0	4.7	0.7	6.4	8.7	–3.5	...
Construction									
Cement consumption	4.8	3.8	3.8	3.9	–0.2	16.0	11.3	3.5	...
Confidence indicator for construction (3)	10.3	13.6	16.0	24.0	23.7	20.0	15.0	10.0	17.0
Housing (new construction approvals)	21.4	8.0	14.9	0.5	3.7	16.5	4.5	...	...
Government tendering	–10.9	17.8	65.5	37.1	5.8	59.5	144.2	...	...
Services									
Retail sales	5.7	5.5	4.4	5.5	4.0	7.2	4.8	4.2	...
Foreign tourists	–1.0	2.6	1.2	10.0	7.4	0.0	5.4	7.8	7.7
Tourist revenue inflows	4.4	3.8	5.2	8.5	–0.8	–7.2	0.9	...	...
Goods carried by rail (km-tonnes)	1.7	–3.5	–8.5	–16.7	–14.3	–3.2	...	...	...
Air passenger traffic	7.5	7.9	6.5	8.3	8.4	5.4	11.1	8.7	11.8
Motor vehicle diesel fuel consumption	7.5	7.2	9.0	5.7	2.5	10.2	7.6	...	...

NOTES: (1) Adjusted for number of working days and temperature.
(2) Adjusted for difference in number of working days.
(3) European Commission survey: difference between percentage of positive and negative replies.
(4) Business survey: percentage of utilization inferred from replies.
(5) By volume.

SOURCE: Red Eléctrica Española, OFICEMEN, AENA, National Institute of Statistics, Bank of Spain, European Commission, Ministry of Public Works, Ministry of Industry, Tourism and Commerce, Ministry of Economy and internal figures.

Consumption strong although apparently tending to more moderate growth rate.

On the demand side, private consumption continues to show great strength although tending to moderate in growth rate. In the first half of 2005, the retail sales index (corrected for calendar effects) grew by 2.2% year-to-year, in real terms, a figure lower than that for one year earlier. In department stores, the increase was higher (3.9%) but also below the figure for 2004.

Paradoxically, consumer confidence remains at low levels.

Another very significant indicator, such as car sales, recorded a notable growth rate (1.6% year-to-year from January to July), keeping in mind that the comparison is being made with the exceptionally high figures for 2004. At a more general level, we should mention the sharp growth in imports of consumer goods (11.0% real from April to May compared with the same months in 2004) and maintenance of a paradoxically low level of consumer confidence which could possibly indicate a greater drop in demand in coming months.

DEMAND INDICATORS

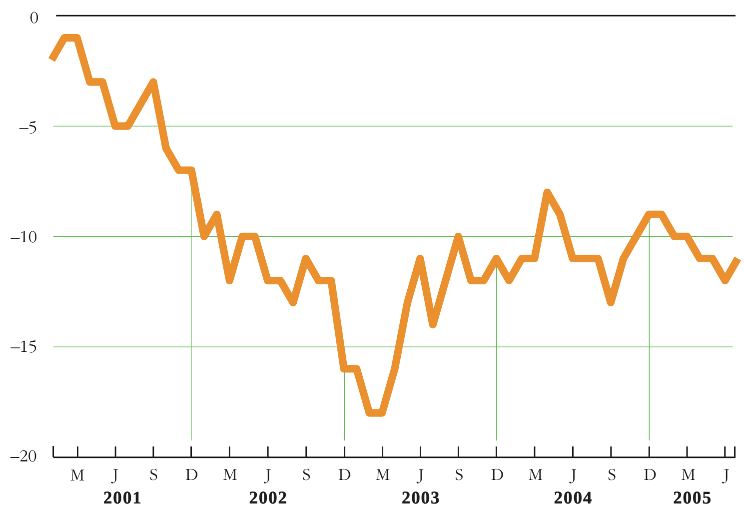
Percentage change over same period year before

	2003	2004	2004		2005				
			3rd Qtr.	4th Qtr.	1st Qtr.	April	May	June	July
Consumption									
Production of consumer goods (*)	0.2	–0.2	0.1	0.1	0.1	2.3	–0.1	0.4	...
Imports of consumer goods (**)	10.9	13.4	9.7	8.3	6.5	6.8	15.5	3.5	...
Car registrations	3.8	9.8	5.3	4.7	–0.0	6.5	7.1	1.8	–2.8
Credit for consumer durables	1.6	5.5	4.4	9.2	8.8	–	–	–	–
Consumer confidence index (***)	–13.7	–10.8	–11.7	–10.3	–9.7	–11.0	–11.0	–12.0	–11.0
Investment									
Capital goods production (*)	0.6	1.8	4.7	–1.7	–0.8	1.8	1.7	–0.9	...
Imports of capital goods (**)	14.8	14.9	19.2	29.0	28.6	50.5	28.4	29.8	...
Commercial vehicle registrations	13.5	11.7	9.4	9.4	9.2	23.6	17.3	13.6	10.3
Foreign trade (**)									
Non-energy imports	8.8	9.8	8.9	9.0	5.7	11.6	13.4	2.7	...
Exports	6.9	5.2	6.7	4.3	–3.1	5.6	1.4	0.4	...

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

CONSUMER CONFIDENCE CONTINUES AT LOW LEVELS

Difference between percentage of positive and negative responses



SOURCE: European Commission.

Capital goods investment continues to rise.

Finally, with regard to capital goods investment, indicators maintain a very expansionist trend. In fact, imports of such goods grew by 33.2% real during the first five months of the year, while registrations of commercial vehicles rose by 13.2% from January to July.

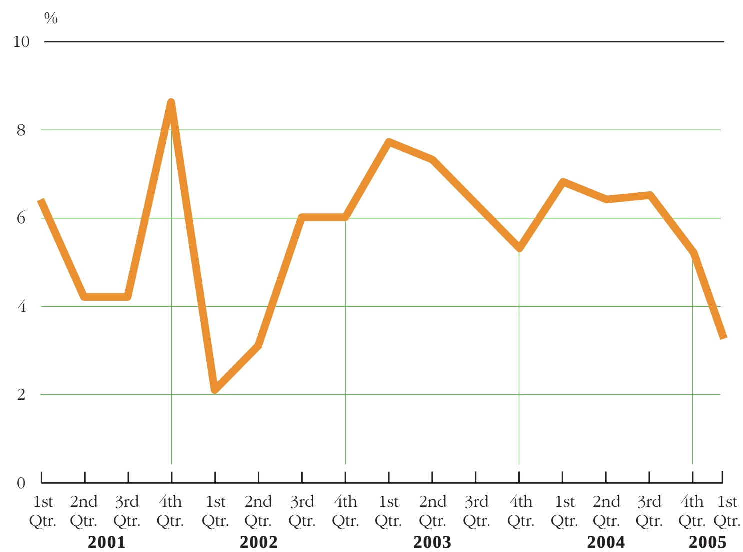
Transportation: slight easing off in economic activity

Transportation maintained high levels in 2004 while showing some weakness extending into 2005.

The transportation sector held at a high level of economic activity in 2004 although this was somewhat lower than in the previous year, according to the general index prepared by the National Institute of Statistics. In fact, this indicator showed growth of 6.3%, four decimals less than in 2003. The slight slowdown in economic activity showed up in the fourth quarter and, if we are to go by available figures, continued even somewhat more strongly at the beginning of 2005. This slowdown does not seem to be in keeping with a weaker economy but with a broad range of factors depending on each mode of transport.

TRANSPORTATION EASES GROWTH RATE

Percentage year-to-year change in IGAT (*)



NOTES: (*) General Transport Activity Index (IGAT).
SOURCE: INE and internal figures.

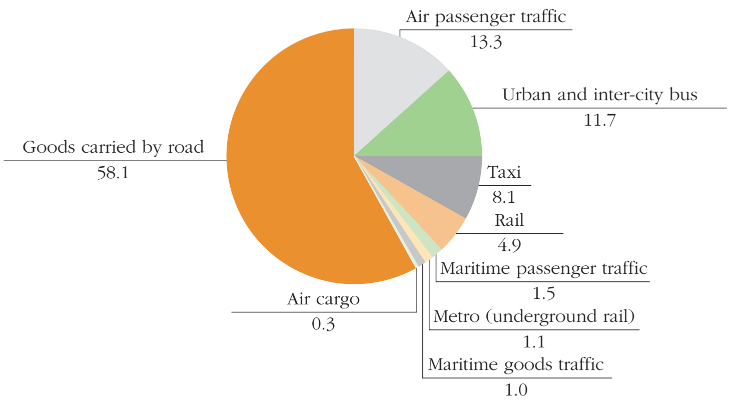
Moderation in economic activity not evenly spread by mode or type of traffic.

The drop in the rate of economic activity was not comparable or general by mode of transport or type of traffic. Road transport had a good year in 2004 as was the case in maritime transport although at the start of 2005 road transport showed some weakness in contrast to sea transport which continued firm. On the other hand, there was some weakness in public urban mass transit along with a notable drop in rail transport. Air transport, on the other hand, continued the same strong level as last year.

Goods transport by road has brilliant year but loses steam at beginning of 2005.

Transport of goods by road, which makes up nearly 60% of value added in the transport sector, according to figures from the most recent services survey (2002), was brilliant in terms of economic activity. Kilometre-tonnes carried rose by 14.8% because of strong international demand. This figure was in contrast to the drop of 3.4% in daily average traffic rate for heavy vehicles on toll roads in the same period. On the other hand, the figures for 2005 are less reliable as they indicate a drop of 1.7% in volume of activity in the first quarter. The harsh weather conditions last winter may be behind this reduction in activity.

TRANSPORTATION: VALUE ADDED BY SUB-SECTORS
2002
Percentage of total transportation



SOURCE: INE and internal figures.

Growing weakness in rail transport in passengers and especially in goods.

The railways, on the other hand, showed up much worse. Their economic activity index was down by 1.3% in 2004 and moreover indicated a markedly downward profile which has been maintained in the early months of 2005. The weakness was spread widely over passenger and goods traffic although the situation grew especially worse in the latter sphere and, in the second half of 2004, this showed a notable drop in activity, largely because of the sharp decline in transport of construction materials.

All rail lines lose passengers except for high-speed trains.

The drop in the number of passengers carried by rail was spread over main lines, local and regional lines but not including high-speed lines, a segment which, in spite of everything, was of relatively less importance. In fact, this mode made up 1.3% of total passenger traffic as against 90.8% in the case of local traffic lines.

Urban mass transit also down.

Urban mass transit (both in bus and metro) showed a similar picture to local rail traffic. In the first case, the number of passengers carried scarcely grew by 1% in 2004 and the profile of activity was clearly downward to show negative values in the fourth quarter which continued at the beginning of 2005. In the case of metro underground services, the increase in traffic stood at 3.5% in 2004 but there was a progressive slackening of activity which likely meant moving into negative figures at the beginning of 2005. The sharp cold snaps last winter no doubt had an effect on use by those who mainly depend on public mass transit.

TRANSPORTATION INDICATORS

Percentage annual change

	2002	2003	2004	2004				2005
				1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.
Transport activity indices								
General (*)	4.5	6.7	6.3	6.9	6.5	6.6	5.3	3.3
Goods (*)	5.9	7.7	6.7	7.5	6.9	7.0	5.6	3.2
Passengers	0.3	3.8	4.8	4.6	5.3	5.2	4.2	4.8
Employment								
Land	7.3	5.7	–1.1	1.4	0.0	–4.6	–1.3	...
Sea	–4.5	6.4	7.7	–3.2	9.9	11.4	12.5	...
Air	–6.1	–3.2	–4.3	–22.5	0.0	0.9	6.5	...
Total	5.9	5.1	–1.1	–0.4	0.3	–3.8	–0.5	...
Urban mass transit								
General index	0.5	4.0	1.2	2.2	1.4	2.5	–0.9	–0.7
Urban buses (passengers)	–2.7	0.7	0.8	1.5	1.2	1.9	–1.1	–1.4
Metro/Underground (passengers)	5.0	6.2	3.5	5.4	3.4	5.4	0.3	–0.6
Road transport								
Inter-city bus passengers	5.7	7.1	6.4	6.9	6.6	6.6	5.4	2.5
Goods (Km-tonnes)	11.5	4.2	14.8	14.7	17.0	13.9	13.4	–1.7
Heavy vehicle traffic (**)	1.2	–5.2	–3.4	–2.8	–3.7	–4.1	–3.1	...
Rail transport								
General index	3.5	1.6	–1.3	0.5	2.2	–1.4	–6.4	–2.8
Total passenger-kilometres	1.4	–0.8	–1.6	–0.7	–3.9	–0.7	–1.0	3.3
Goods (Km-tonnes)	–0.7	1.7	–3.5	6.4	6.2	–8.5	–16.7	–14.3
Air transport								
General index	–1.0	7.0	8.3	10.7	7.0	7.5	8.6	7.9
Landings and take-offs of aircraft (***)	–2.2	6.5	7.8	9.6	7.2	6.9	8.0	8.2
Number of passengers	–1.0	7.4	8.0	11.0	6.8	6.7	8.7	9.9
Cargo (tonnes)	–0.5	0.5	9.1	7.2	11.7	11.5	6.5	4.2
Maritime traffic								
General index	4.9	3.5	7.4	1.9	9.2	10.7	6.8	16.2
Ships tying up (units) (*)	2.3	3.8	–9.2	–0.1	–1.4	–3.1	–32.9	–0.2
Ships tying up (GRT) (*)	9.0	6.4	2.6	2.0	2.7	2.5	3.1	5.9
Number of passengers (***)	2.8	5.1	10.8	8.5	16.7	8.8	10.2	3.4
Goods (tonnes) (*)	3.6	5.0	8.1	8.3	6.2	11.7	6.4	10.2

NOTES: (*) In 2005, figures are for January-February. GRT = gross register tonnage.
(**) Average daily rate of traffic on central government toll highways.
(***) In 2005, figures are for January.
SOURCE: INE, Ministry of Public Works and internal figures.

Air traffic continues strong growth.

Air traffic showed great strength as reflected in the sharp increase in the general activity index (8.3% in 2004) which furthermore was higher than the previous year by more than one percentage point. This very favourable trend continued into the early months of 2005 not only according to the general index (which covers only the first quarter) but also judging by traffic figures from National Airports (AENA). In any case, the continuation of this positive state of affairs showed up only in air passenger traffic, given that cargo traffic was down slightly.

Domestic market grows more than international despite strong activity by low-cost airlines.

The number of passengers entering or leaving Spanish airports rose to 163.9 million in 2004, some 8.0% more than the year before. Some 41% of this traffic was for internal flights while the rest involved international flights. The domestic market was more dynamic with growth of 9.9%, some 3.1 points higher than the international market. Growth of international passenger traffic had a very solid base in low-cost airlines which capitalized on the increase in demand. This situation continued in the early months of 2005. According to AENA, passenger traffic rose by 8.2% in the January-May period with national traffic somewhat higher than international traffic.

Air cargo transport up 9% in traffic in 2004 but rate in early months of 2005 not holding up.

In the cargo field, complete figures for 2004 show growth of 9.2% in tonnage with levels substantially higher in international transport than in domestic. The international segment accounted for 62.3% of tonnage carried. In the January-May period in 2005, on the other hand, cargo was down slightly by volume both in terms of the domestic market and the foreign market.

Favourable balance in maritime transport.

Finally, maritime transport also showed a more favourable balance than the year before both in passengers and cargo. In fact, the number of passengers carried in 2004 was up by 10.8%, five points above the year before. Transport of cargo, in turn, was up by 8.1% in tonnage, three points more than in 2003. In both cases, the profile of activity showed notable strength throughout the year.

Central government presents Strategic Plan for Infrastructures and Transport (2005-2020).

Finally, mention should be made of the recent presentation by the Spanish Prime Minister of the Strategic Plan for Infrastructures and Transport (2005-2020) drawn up by the Ministry of Public Works, which foresees investment of 248.9 billion euros in the period under consideration. The biggest investments are to go into railways which take up close to 50% of the total, including urban works. The second largest package of investments will go into roads involving 63 billion euros, half of which will go into motorways and toll roads. Urban and metropolitan underground rail comes third in volume of investment while maritime transportation and ports will receive 23 billion euros.

LABOUR MARKET

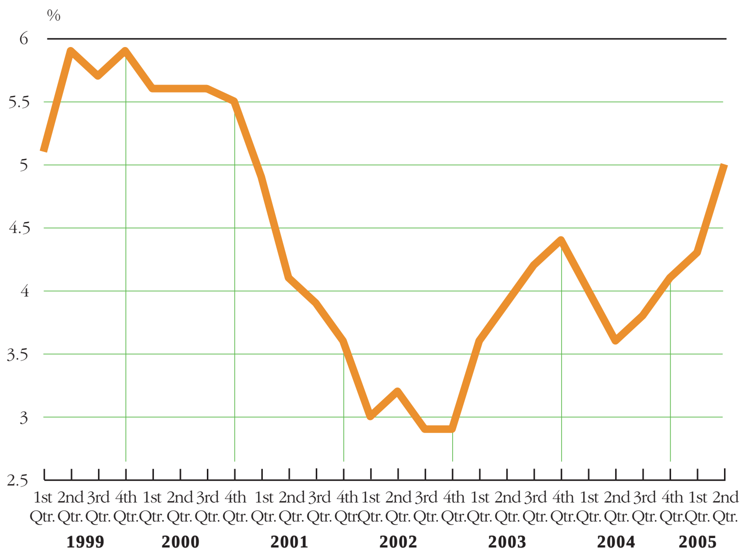
Unemployment stands at lowest level in 25 years

Sharp increase in employment in second quarter raising jobs created in past 12 months to 897,100.

The number of persons employed reached 18.89 million in the second quarter of 2005, according to the Labour Force Survey carried out by the National Institute of Statistics. Some 402,300 new jobs were created during that period which put the cumulative total for the past 12 months at 897,100 persons newly employed which represents a year-to-year increase of 5.0%. These latest figures have been adjusted for the effect of methodological changes made in carrying out the survey introduced in 2005 which tend to overestimate job growth.

EMPLOYMENT STRONG IN SECOND QUARTER

Year-to-year change in estimated employment



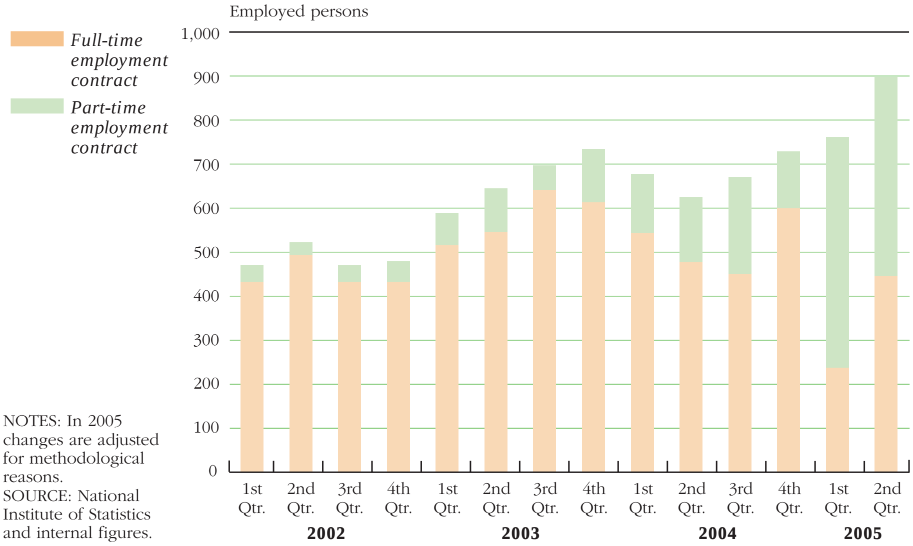
NOTES: In 2005, changes are adjusted for effect of new survey questionnaire and method of gathering information introduced in current year.
SOURCE: National Institute of Statistics and internal figures.

Level of part-time work contributing to this sharp increase...

The high figure for the increase in employment is largely due to the rise in part-time work, a hiring formula which the new Labour Force Survey is better able to measure as it detects more precisely borderline situations in work activity, such as work days involving only a few hours, sporadic work days or work coming under formulas with no set wages. Over the past 12 months the 452,500 part-time jobs created accounted for more than half new jobs. This proportion is much higher than that held by this type of work-day in employment as a whole, namely 12.8% in the second quarter of 2005. Part-time work is especially important in the case of females and 25% of women with jobs choose this option.

PART-TIME WORK KEY TO NEW EMPLOYMENT CREATED

Year-to-year change in estimated employment by time employed



NOTES: In 2005 changes are adjusted for methodological reasons.
SOURCE: National Institute of Statistics and internal figures.

TEMPORARY HIRING INCREASES RELATIVE WEIGHT

Year-to-year change in wage employment according to type of hiring contract

NOTES: In 2005 changes are calculated on the basis of interview surveys.
SOURCE: National Institute of Statistics and internal figures.

...as well as greater recourse to temporary work contracts.

The second basis for the strength of the labour market is temporary hiring. In fact, this moved up by 12.9% in year-to-year rate, ten points higher than permanent hiring to the point where it accounted for 33.3% of wage employment (31.2% in the second quarter of 2004). Under wage employment, the private sector showed greater strength than the public sector which, in total, gave work to 2.85 million persons, that is to say, 18.4% of wage employment or, what is the same thing, 15% of total employment.

ESTIMATED EMPLOYEMENT

Second quarter 2005

	No. of employees (thousands)	Quarterly change		Annual change (*)		Annual change (**)		Share
		Thousands	%	Thousands	%	Thousands	%	%
By sector								
Agriculture	986.6	–30.7	–3.0	5.1	0.5	7.3	0.7	5.2
Non-farm	17,908.4	433.1	2.5	892.0	5.2	1,021.9	6.1	94.8
Industry	*3,262.8*	*5.2*	*0.2*	*8.6*	*0.3*	*62.4*	*2.0*	*17.3*
Construction	*2,339.3*	*68.8*	*3.0*	*168.0*	*7.5*	*101.6*	*4.5*	*12.4*
Services	*12,306.3*	*358.9*	*3.0*	*715.4*	*6.3*	*857.8*	*7.5*	*65.1*
By type of employer								
Private sector	16,045.4	384.2	2.5	...	...	940.1	6.2	84.9
Public sector	2,849.5	18.0	0.6	...	...	89.0	3.2	15.1
By work situation								
Wage-earners	15,440.1	463.2	3.1	907.5	6.2	830.6	5.7	81.7
Permanent contract	*10,305.3*	*102.5*	*1.0*	*300.9*	*3.0*	*381.2*	*3.8*	*54.5*
Temporary contract	*5,134.8*	*360.6*	*7.6*	*606.6*	*12.9*	*449.4*	*9.6*	*27.2*
Non-wage-earners	3,428.3	–57.4	–1.6	–60.8	–1.9	186.9	5.8	18.1
Entrepreneurs with employees	*971.3*	*28.9*	*3.1*	...	...	*–0.2*	*–0.0*	*5.1*
Entrepreneurs without employees	*2,144.1*	*–38.1*	*–1.7*	...	...	*132.1*	*6.6*	*11.3*
Family help	*312.9*	*–48.2*	*–13.3*	...	...	*55.0*	*21.3*	*1.7*
Other	26.6	–3.3	–11.2	50.4	336.7	11.6	77.5	0.1
By time worked								
Full-time	16,476.8	410.3	2.6	444.6	2.7	196.2	1.2	87.2
Part-time	2,418.1	–8.0	–0.3	452.5	28.5	832.9	52.5	12.8
By sex								
Males	11,317.8	154.9	1.4	396.3	3.6	435.4	4.0	59.9
Females	7,577.1	247.3	3.4	500.6	7.2	593.7	8.5	40.1
TOTAL	**18,894.9**	**402.3**	**2.2**	**897.1**	**5.0**	**1,029.1**	**5.8**	**100.0**

NOTES: (*) Adjusted for effect of methodological changes introduced in first quarter of 2005.
(**) Not adjusted for effect of these changes.

SOURCE: National Institute of Statistics and internal figures.

Employment in services strong with weaker situation, although still very firm, in construction.

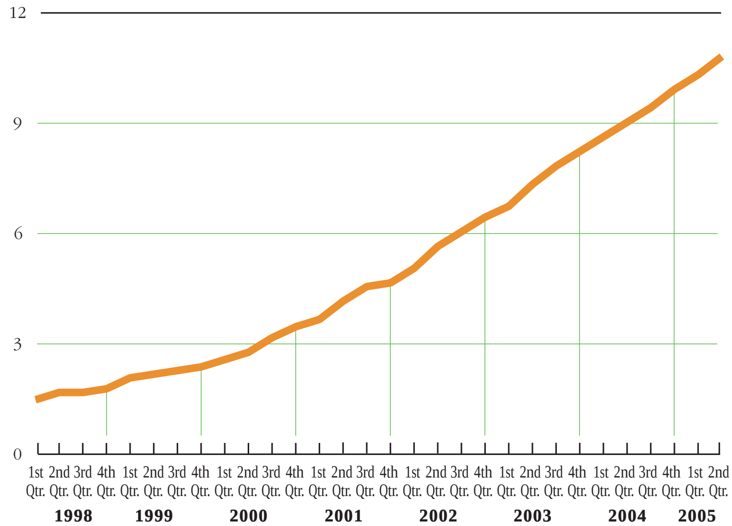
By sector, trends show a stronger situation in employment in services, some stagnation in industry and a slight slow-down in construction although still within very high levels. The development of employment in services, where some 715,400 jobs were created in 12 months, was due to the rise in part-time work. Hotels and personal services, along with the real estate sector, accounted for the greater part of this increase. In agriculture we note the substitution of full-time jobs with part-time work and in industry new employment is also part-time. In construction, on the other hand, new jobs are divided practically in two halves between the two types of work-day.

Foreign workers take up 45% of new jobs created in past year.

A good part of new employment (45.4% of the total in the past year, that is to say 407,100 jobs according to homogenized figures) have been taken up by foreign workers. The strength of Spain's economy and the insufficient supply or lack of adaptation of domestic labour, among other factors, favoured this rise in immigrant labour. In the second quarter of 2005 foreign workers came to represent 10.8% of total employment, a proportion very much higher than the 2% recorded at the end of the previous decade.

FOREIGN WORKERS REPRESENT 11% OF EMPLOYMENT

Foreign workers over total estimated employment



SOURCE: National Institute of Statistics (INE) and internal figures.

Female employment showing increased strength.

On the other hand, the increased strength of employment continues to be especially notable among females. In fact, employment of females is growing sharply (at 7.2% year-to-year), practically double the rate of increase in the case of male employment. As a result, more than half of new jobs (56% of the total) continue to be taken up by females. In any case, the rate of female employment (40.8% of the population 16 years of age or older) is a long way behind male employment at 63.7% in the second quarter of 2005.

Registration with Social Security growing at rate of 5% but two points attributable to special process of giving regular status to foreign workers.

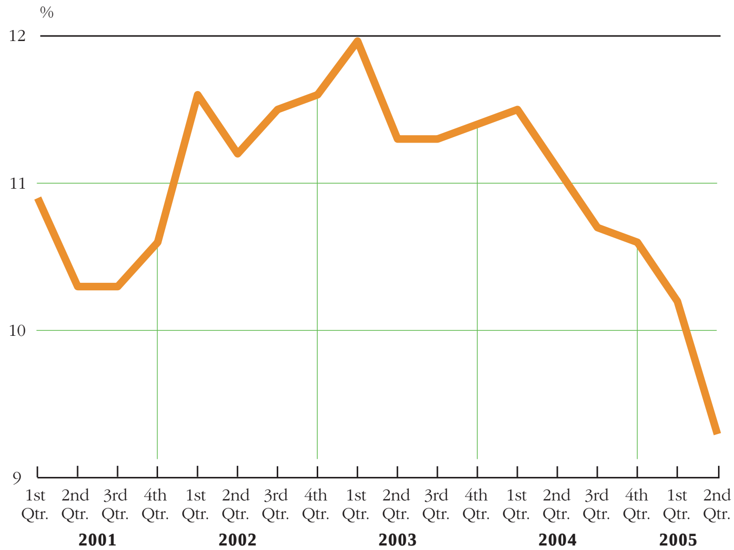
The sharp increase in employment reflected by the Labour Force Survey is also confirmed by registrations with Social Security which in July showed an increase in growth rate to 5.1% with a total of 18.15 million persons registered as working. This very sharp increase may be largely explained by the special process of giving foreign workers regular status carried out in the January-May period which is estimated to have added another 600,000 new participants. If this phenomenon is excluded, it is estimated that the increase in registrations would have been 3.0%.

Estimated unemployment down sharply in spite of increase in labour force.

Estimated unemployment, at 1,944,700 persons in the second quarter, was down by 9.2% compared with the same period in 2004 in spite of the fact that the labour force continued to grow at a higher rate than the population 16 years of age and older. The increase in the labour force in the past 12 months, measured in homogeneous terms, was 693,000 persons as against 599,500 for the population over 16 years. This propensity to actively seek work is higher in the case of females given that new persons entering the labour force (358,000) went well above the increase in the female population, at 279,700. In the male segment, on the other hand, the differential was lower with 335,100 males in the labour force as against a population increase of 319,800.

UNEMPLOYMENT RATE SHOWS SHARPER DROP

Estimated unemployment over labour force



SOURCE: National Institute of Statistics and internal figures.

ESTIMATED UNEMPLOYMENT

Second quarter 2005

	No. of unemployed (thousands)	Quarterly change		Annual change (*)		Annual change (**)		Share	Unemployment rate
		Thousands	%	Thousands	%	Thousands	%	%	% of labour force
By sex									
Males	890.1	–50.8	–5.4	–61.3	–6.3	–82.3	–8.5	45.8	7.3
Females	1,054.6	–103.5	–8.9	–142.8	–11.4	–200.2	–16.0	54.2	12.2
By age									
Under 25 years	508.1	–23.5	–4.4	...	...	–27.9	–5.2	26.1	20.4
Other	1,436.6	–130.8	–8.3	...	...	–254.6	–15.1	73.9	7.8
By personal situation									
Long-term unemployment	593.7	–19.0	–3.1	...	...	20.2	3.5	30.5	–
Seeking first job	258.1	1.0	0.4	...	...	–79.1	–23.5	13.3	–
Other	1,092.9	–136.3	–11.1	...	...	–223.6	–17.0	56.2	–
TOTAL	**1,944.7**	**–154.3**	**–7.4**	**–204.0**	**–9.2**	**–282.4**	**–12.7**	**100.0**	**9.3**

NOTES: (*) Adjusted for effect of methodological changes introduced in first quarter of 2005.
(**) Not adjusted for effect of those changes.
SOURCE: National Institute of Statistics and internal figures.

Unemployment rate down to 9.3%.

The unemployment rate stood at 9.3% (the lowest in the last 25 years), 1.3 points below the same quarter last year, while maintaining sharp differences between the indices for males and females (7.3% and 12.2% respectively). The unemployment level among those under 25 years, in turn, stood at 20.4%.

In 3% of households all members unemployed.

The proportion of households with all members without jobs was much lower given that it stood at 3.0% of the total. The situation was also better in the case of heads of family for whom the unemployment rate dropped to 5.6% and it was also better in the case of spouses and children of the reference person although unemployment rates at 9.2% and 15.5% were higher. Long-term unemployment, that is, lasting more than one year, affected 593,700 persons, some 30.2% of those without work.

LABOUR FORCE, EMPLOYMENT AND ESTIMATED UNEMPLOYMENT BY AUTONOMOUS COMMUNITY (*)

Second quarter 2005

	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	3,415.6	139.9	4.2	2,944.8	214.9	7.9	470.8	–75.0	–13.0	13.8
Aragon	605.8	22.0	3.9	567.8	19.9	3.7	38.0	2.0	6.6	6.3
Asturias	448.4	–3.3	–0.8	399.9	–8.4	–2.2	48.5	5.2	11.4	10.8
Balearic Islands	516.8	25.9	5.2	485.6	40.2	8.9	31.2	–14.4	–31.4	6.0
Canary Islands	935.9	5.7	0.6	820.1	29.7	3.7	115.8	–24.0	–20.5	12.4
Cantabria	259.2	5.4	2.2	235.6	4.4	2.0	23.6	1.0	4.0	9.1
Castile-Leon	1,115.2	37.0	3.5	1,018.9	49.0	5.2	96.3	–12.0	–10.3	8.6
Castile-La Mancha	836.6	69.2	8.9	758.4	47.2	6.7	78.2	22.0	32.0	9.3
Catalonia	3,528.0	77.5	2.3	3,276.6	116.2	3.7	251.3	–38.7	–11.5	7.1
Valencian Community	2,237.3	87.2	4.0	2,030.5	96.8	5.0	206.8	–9.7	–4.4	9.2
Extremadura	456.4	10.1	2.3	387.3	18.3	5.0	69.1	–8.2	–10.3	15.1
Galicia	1,252.6	12.6	1.0	1,113.4	24.6	2.3	139.2	–11.9	–6.7	11.1
Madrid Community	3,085.2	133.6	4.6	2,873.3	158.0	5.8	211.9	–24.3	–12.3	6.9
Murcia	618.4	34.8	5.8	568.6	38.8	7.2	49.8	–4.0	–6.1	8.1
Navarre	286.4	8.9	3.3	271.7	10.7	4.2	14.7	–1.8	–12.2	5.1
Basque Country	1,032.9	15.5	1.5	954.7	22.5	2.4	78.2	–7.0	–7.3	7.6
La Rioja	151.1	13.6	10.2	141.3	14.2	11.2	9.7	–0.7	–10.2	6.4
Ceuta and Melilla	57.9	...	...	46.4	...	...	11.5	...	...	19.9
TOTAL	**20,839.6**	**693.0**	**3.5**	**18,894.9**	**897.1**	**5.0**	**1,944.7**	**–204.0**	**–9.2**	**9.3**

NOTES: (*) Annual changes adjusted for effect of methodological changes introduced in first quarter of 2005.
SOURCE: National Institute of Statistics and internal figures.

La Rioja, Balearic Islands, Madrid Community, Murcia, Castile-La Mancha and Castile-Leon show highest increases in employment.

From a geographical perspective, the situation showed notable differences between autonomous communities. Those regions with greatest growth were La Rioja, Balearic Islands, Murcia, Madrid Community, Castile-La Mancha and Castile-Leon with rates higher than the Spanish average. At the other end of the scale were those autonomous communities in the Cantabrian Rim with increases of less than 2.5% in three cases and a clear drop in Asturias.

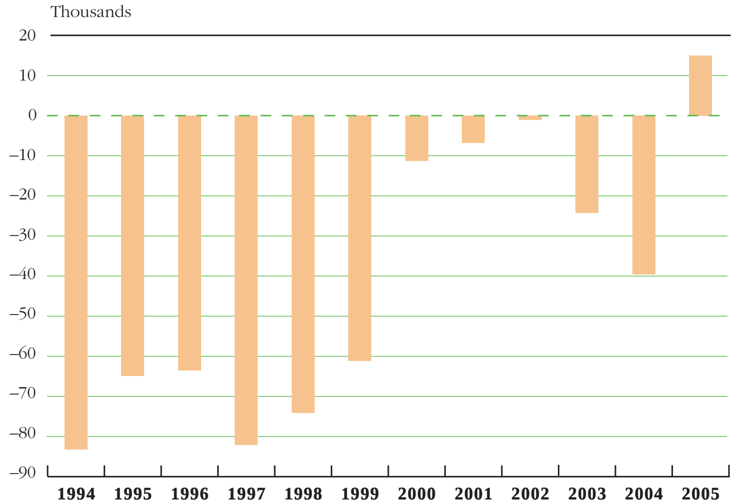
Registered unemployment: unpleasant surprise in July

Registered unemployment moves up in July.

The number of persons registered at offices of the Public Employment Services rose sharply in July following an appreciable decrease the month before. As a result, unemployment at the end of July came to 1,989,417 persons, according to figures provided by the Information System for Public Employment Services, putting the figure 1.2% below the same month in 2004. The July figure meant a turnaround from the positive trend being recorded by registered unemployment in previous months.

UNEXPECTED INCREASE IN REGISTERED UNEMPLOYMENT

Change in registered unemployment in July



SOURCE: Employment Institute.

REGISTERED UNEMPLOYMENT BY SECTOR, SEX AND AGE

July 2005

	No. of unemployed	Change over December 2004		Change over same period year before		% share
		Absolute	%	Absolute	%	
By sector						
Agriculture	58,780	8,488	16.9	7,699	15.1	3.0
Industry	287,705	–15,877	–5.2	–2,224	–0.8	14.5
Construction	218,166	–34,533	–13.7	–6,549	–2.9	11.0
Services	1,198,440	–66,345	–5.2	154	0.0	60.2
First job	226,326	–15,031	–6.2	–23,881	–9.5	11.4
By sex						
Males	763,528	–114,492	–13.0	–34,239	–4.3	38.4
Females	1,225,889	–8,806	–0.7	9,439	0.8	61.6
By age						
Under 25 years	244,257	–24,556	–9.1	–11,694	–4.6	12.3
All other ages	1,745,160	–98,742	–5.4	–13,106	–0.7	87.7
TOTAL	**1,989,417**	**–123,298**	**–5.8**	**–24,801**	**–1.2**	**100.0**

SOURCE: National Employment Institute and internal figures.

PRICES

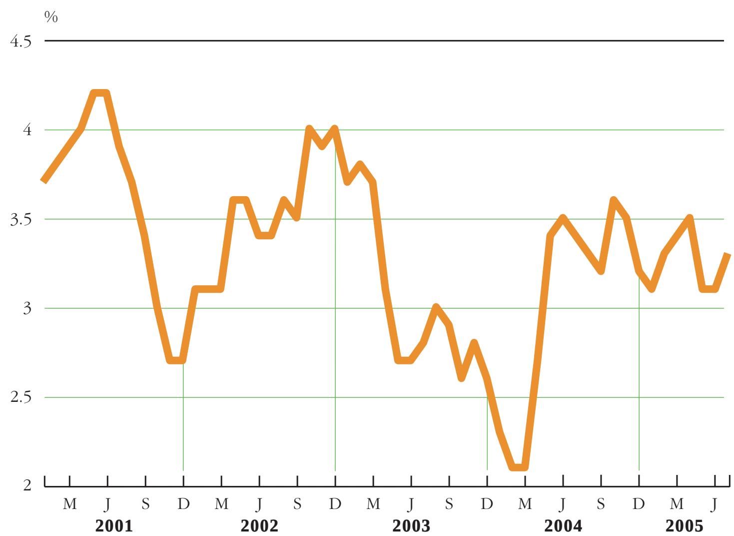
Oil prevents improvement in CPI

Inflation rate up 3.3% in July after holding stable in May and June.

The annual change rate in the consumer price index (CPI) held stable in June only to then rise slightly in July to reach 3.3% year-to-year. The increase in the inflation rate was basically due to the rise in energy prices and was not greater thanks to the compensating effect of most other prices.

MODEST RISE IN INFLATION RATE

Year-to-year change in CPI



SOURCE: National Institute of Statistics.

Services move up following some easing in June.

The decrease in underlying inflation (which excludes fresh food and energy), by one decimal putting the figure at 2.5% year-to-year, was not greater because services prices rose slightly in July after showing some moderation in June. Prices of hotels and organized travel, along with medical services, household costs and housing repairs, as well as public costs for cleaning and health, raised prices in this group to 3.8% year-to-year, one decimal above the month before and putting them at the same level as at the end of 2004.

CONSUMER PRICE INDEX

	2004			2005		
	% monthly change	% change over Dec. 2003	% annual change	% monthly change	% change over Dec. 2004	% annual change
January	–0.7	–0.7	2.3	–0.8	–0.8	3.1
February	0.0	–0.7	2.1	0.3	–0.6	3.3
March	0.7	0.0	2.1	0.8	0.2	3.4
April	1.4	1.4	2.7	1.4	1.6	3.5
May	0.6	2.0	3.4	0.2	1.8	3.1
June	0.2	2.2	3.5	0.2	2.1	3.1
July	–0.8	1.4	3.4	–0.6	1.5	3.3
August	0.4	1.8	3.3			
September	0.2	2.0	3.2			
October	1.0	3.1	3.6			
November	0.2	3.3	3.5			
December	–0.1	3.2	3.2			

SOURCE: National Institute of Statistics.

UNDERLYING INFLATION MODERATING

Year-to-year change in CPI (excluding energy and unprocessed foods)

SOURCE: National Institute of Statistics.

Non-energy industrial goods continue to show decrease.

The performance in non-energy industrial goods was more favourable as they continued a path of gradual containment putting their growth rate 0.7% year-to-year, the lowest figure so far this year. The inflow of low-cost imports and growing competition in consumer goods markets had a greater effect on this trend than the summer retail sales, which were at a similar level to last year, in view of the July performance of those prices which are more susceptible to major decreases, such as clothing, footwear and household goods.

Food prices turn down in June and July.

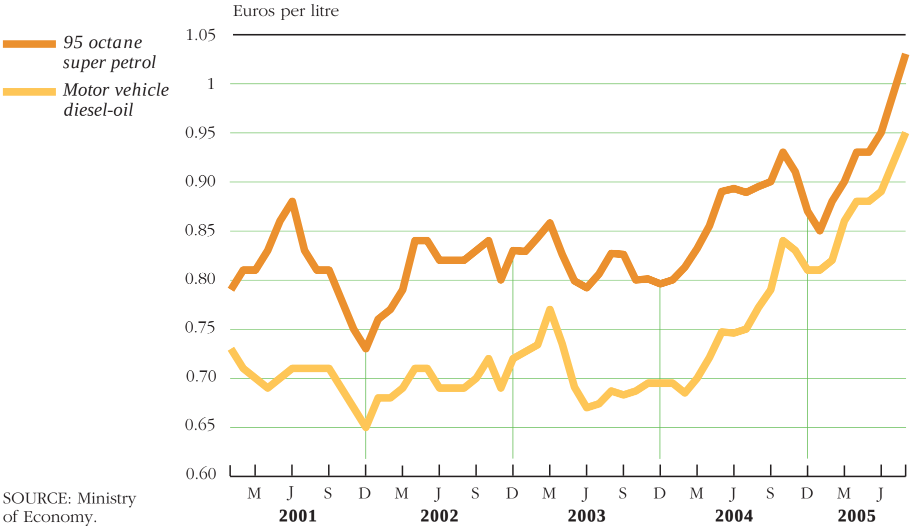
In June and July the CPI was also aided by the appreciable downturn in both fresh and processed foods. Both components stood at the most moderate year-to-year rates so far this year, specifically at 2.1% and 3.0% respectively, leaving behind the figures above 4% recorded at the beginning of the second quarter. Poultry and fruit, in fresh foods, as well as cooking oil among processed foods lay behind the greater part of this rise.

Energy cause of rise in inflation.

The negative note came from energy prices, particularly for fuel-oils and fuels, which in nominal terms stood at all-time highs and made a decisive contribution to the increase in inflation. In fact, the energy component with growth of 11.4% year-to-year (15.0% if we refer only to fuel-oils) has added three decimals to the general inflation rate since the end of 2004, thus in July becoming the only cause for increase (all other components as a whole had taken off two decimals from the inflation rate).

PETROL AND DIESEL-OIL AT ALL-TIME HIGHS

Prices of petrol and diesel-oil



SOURCE: Ministry of Economy.

Inflation prospects subject to trend in energy prices.

From this perspective, the future of the CPI over the short term mainly depends on energy prices, something difficult to vouch for, and the uncertainty seen in food prices. The possibility of any moderation in services prices appears to be limited, if we are to go by the competitive situation in certain markets and the trend in wages. Non-energy industrial goods, on the other hand, are showing a favourable profile which should gradually improve under the impact of low-cost imports and a situation of sharper competition.

CONSUMER PRICE INDEX BY COMPONENT

July

	Indices (*)	% monthly change		% change over previous December		% annual change	
		2004	2005	2004	2005	2004	2005
By type of spending							
Food and non-alcoholic beverages	116.3	0.4	–0.2	2.0	1.5	4.5	2.5
Alcoholic beverages and tobacco	120.5	0.1	0.0	5.5	3.9	5.6	3.9
Clothing and footwear	105.5	–10.7	–10.7	–10.2	–11.2	1.5	1.0
Housing	115.3	0.3	0.8	2.7	4.4	3.7	5.8
Household equipment	107.7	–0.6	–0.8	0.5	0.7	1.7	2.0
Health	106.2	0.2	0.1	–0.1	0.6	0.2	0.9
Transport	116.9	0.1	1.7	5.5	6.4	5.3	6.9
Communications	91.9	–0.2	–0.2	0.1	–1.2	–0.8	–2.0
Recreation and culture	103.6	0.7	1.2	0.4	0.3	0.2	–0.1
Education	117.1	0.0	0.0	0.5	0.6	3.9	4.2
Hotels, cafés and restaurants	120.4	0.9	0.9	3.7	3.8	4.0	4.3
Other	114.3	–0.1	–0.1	2.4	2.7	3.0	3.1
By group							
Processed foods	115.2	0.2	–0.0	3.3	2.1	4.2	3.0
Unprocessed foods	120.1	0.8	–0.5	0.8	1.1	5.5	2.1
Non-food products	112.1	–1.2	–0.8	1.0	1.3	2.9	3.5
Industrial goods	107.7	–2.7	–2.0	–0.9	–0.3	2.2	3.3
Energy products	*118.7*	*0.3*	*3.3*	*6.7*	*10.5*	*6.6*	*11.4*
Fuels and oils	*124.2*	*0.4*	*4.4*	*8.6*	*13.8*	*8.4*	*15.0*
Industrial goods excluding energy products	*104.3*	*–3.7*	*–3.7*	*–3.2*	*–3.5*	*0.8*	*0.7*
Services	117.4	0.6	0.6	3.1	3.1	3.7	3.8
Underlying inflation (**)	112.0	–1.0	–1.1	0.9	0.5	2.8	2.5
GENERAL INDEX	**113.3**	**–0.8**	**–0.6**	**1.4**	**1.5**	**3.4**	**3.3**

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

Inflation differential with euro area holds at 1.1 percentage points.

The inflation differential with the countries of the euro area held stable at 1.1 points, according to the harmonized consumer price index (HCPI), that is to say, two decimals above the figure at the end of 2004. By component, the biggest negative differential for Spain showed up in food, transportation, hotels, restaurants and cafés, as well as in clothing and footwear. The latter group showed decreases in the euro area which were in contrast to increases in Spain.

Improved outlook in prices at origin except in energy

Energy puts pressure on producer price index.

Producer prices showed a clear upward trend in June and July because of the effect of energy prices. In fact, the growth rate for these stood at 4.6% year-to-year, four decimals higher than the annual lows reached in May. In any case, the year-to-year increase was still below the levels at the end of last year.

Other wholesale prices of industrial products show substantial moderation.

The progressive rise in energy prices going as high as 15.7% year-to-year is in sharp contrast to the relative moderation in other index components. Consumer goods showed growth at lows for the year (2.0% year-to-year) helped by food prices which reported very low growth (less than 1%), much lower than those in previous months. In the same way, wholesale prices of capital goods and intermediate goods also moderated slightly, thus helping to relieve the upward impact of energy.

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	
2004											
April	3.3	2.6	2.9	1.3	3.7	1.2	0.2	–4.5	5.1	1.7	–
May	7.1	3.8	3.1	1.2	4.4	7.2	5.6	2.9	5.1	7.0	4.0
June	12.0	4.0	3.2	1.3	4.8	7.1	1.4	–2.9	3.2	3.3	–
July	11.2	4.1	2.8	1.6	5.3	7.2	3.8	5.0	–9.8	6.4	–
August	–5.4	4.4	2.2	1.7	5.7	9.0	6.8	4.4	–1.8	9.9	4.1
September	–10.4	4.6	2.1	1.6	5.9	11.0	5.4	0.8	–3.1	9.6	–
October	–5.1	5.4	2.3	1.8	6.2	14.2	5.2	1.7	–7.3	9.7	–
November	–0.4	5.2	2.2	1.5	6.3	12.6	4.6	1.8	–3.0	7.5	4.2
December	2.5	5.0	2.8	1.6	6.2	10.6	5.8	4.2	–3.7	9.4	–
2005											
January	8.4	4.8	3.2	1.8	6.2	8.7	5.0	3.4	–1.6	7.2	–
February	12.2	4.9	3.2	1.9	5.5	11.0	5.4	1.0	–1.9	9.3	4.2
March	13.2	5.1	2.8	2.0	4.9	13.1	5.3	2.6	–7.6	9.7	–
April	4.7	5.0	2.8	2.0	3.7	14.5	4.6	0.9	–7.5	9.1	–
May	...	4.2	2.5	2.1	3.3	11.0	0.9	–3.2	–6.5	4.7	...
June	...	4.4	2.2	2.1	3.1	13.5	...	...	...	...	–
July	...	4.6	2.0	1.9	3.0	15.7	...	...	...	...	–

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

Import prices contained with exception of oil.

Import prices also continued to be affected by oil costs and showed cumulative year-to-year growth at the still very high level of 4.2% in May. The growth in prices of non-energy products, on the other hand, held at low levels (1.9%). Consumer goods prices showed great moderation, especially food consumer goods.

Farm prices moderate in May but still showing very high growth.

Farm prices moderated in May because of the drop in agricultural prices. In spite of this decrease, the cumulative increase for the first five months of 2005 still stood at a high 7.5%, nearly five points above last year, which undoubtedly represents a pressure point for final prices of food products.

FOREIGN SECTOR

Pressure from imports boosts trade deficit

Trade deficit up by 36% in first half-year.

The trade deficit rose by 19.7% in June, a rate somewhat below that for previous months thanks to some moderation in the rate of increase in imports given that exports continued to show a very modest growth rate. In any case, the balance for the first half-year continued to be negative and clearly more unfavourable than that for the same period last year. In fact, the trade imbalance reached 36.27 billion euros thus going 36.0% above the same period in 2004.

FOREIGN TRADE
January-June 2005

	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	14,252	35.4	12.7	2,738	16.1	3.6	–11,514	19.2
Consumer goods	31,782	8.9	28.3	29,430	–2.3	38.6	–2,353	92.6
Food	*6,512*	*4.8*	*5.8*	*9,678*	*1.2*	*12.7*	*3,166*	*148.6*
Non-foods	*25,270*	*9.7*	*22.5*	*19,752*	*–5.8*	*25.9*	*–5,518*	*78.2*
Capital goods	13,099	26.4	11.6	6,868	4.5	9.0	–6,231	52.4
Non-energy intermediate goods	53,364	6.6	47.4	37,188	8.1	48.8	–16,176	69.7
By geographical area								
European Union (EU-15)	67,423	7.1	59.9	54,129	2.5	71.0	–13,294	80.3
Euro area	*58,905*	*7.3*	*52.4*	*45,575*	*3.2*	*59.8*	*–13,331*	*77.4*
Other countries	45,075	21.2	40.1	22,095	7.1	29.0	–22,980	49.0
Russia	*2,403*	*58.3*	*2.1*	*485*	*14.6*	*0.6*	*–1,919*	*20.2*
United States	*4,245*	*12.4*	*3.8*	*2,835*	*1.2*	*3.7*	*–1,409*	*66.8*
Japan	*2,996*	*5.3*	*2.7*	*574*	*–11.6*	*0.8*	*–2,422*	*19.2*
Latin America	*4,873*	*24.4*	*4.3*	*3,468*	*2.9*	*4.5*	*–1,405*	*71.2*
OPEC	*7,595*	*30.1*	*6.8*	*1,986*	*25.4*	*2.6*	*–5,609*	*26.2*
Rest	*22,962*	*19.0*	*20.4*	*12,747*	*8.1*	*16.7*	*–10,216*	*55.5*
TOTAL	**112,498**	**12.4**	**100.0**	**76,224**	**3.8**	**100.0**	**–36,274**	**67.8**

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

Imports maintain rise reflecting impact of oil bill.

Imports amounted to 112.50 billion euros in the January-June period with growth of 12.4% over 2004. The increase by volume was lower (7.6%) because of the rise in prices (4.4%) largely due to oil purchases. In fact, imported crude oil showed an average cost of 249.5 euros a ton in the first half-year, some 29.5% more than in 2004. Non-energy imports, on the other hand, were up by 2.0%, pushed up mainly by non-energy intermediate goods.

Capital goods imports, along with energy and non-food consumer goods, showing biggest drive.

The biggest component in foreign purchases was capital goods which showed cumulative growth of 32.6% by volume, thanks to the increase in purchases of transportation equipment, mainly ships and aircraft, and engines. Much further down came imports of non-energy intermediate goods which rose by 9.0% real and non-food consumer goods showing 8.3%. In this case, cars, toys, furniture, footwear and clothing were the products to show the biggest increases. Foods showed a real increase of 4.4%, somewhat more than reported by non-energy intermediate goods.

Increase in purchases from third countries, especially China, and oil-producing countries, but drop in those from EU.

By geographical area, purchases from the European Union (EU-25) rose by 3.8% by volume whereas those from the rest of the world showed an increase in growth rate going to 14.0%. These purchases were boosted by the size of those from China as well as those from the ex-Soviet Union, Middle East and Mexico, in all these cases largely in oil.

Exports down by volume.

Exports for the first half-year amounted to 76.22 billion euros, some 3.8% more than in the same period in 2004. This increase was entirely due to prices which, with an increase of 4.1%, compensated the real decrease of 0.3%. The decrease by volume was somewhat higher in sales to the EU-25 at 1.4%, given that goods going to third countries rose by 2.5%. Within the EU, the moderately favourable situation in the French market (and to a lesser extent that of Germany) was in contrast to the drop in the Italian, British and Benelux markets. Outside the EU, sales to Japan were appreciably down whereas those to the United States held at a level similar to last year.

General drop in exports by product, except in intermediate goods.

By product, the drop in foreign sales was across the board with the exception of intermediate goods which held to a minimum increase that may be accounted for by the strength shown in iron, steel and plastics. The biggest weakness came in food sales abroad, except in meat products. Sales of capital goods were also down in real terms, although not so in value, as a result of the poor balance in ships and office equipment. In consumer goods there were notable drops in foreign sales of cars and footwear which was in contrast to the relatively favourable situation in automobile components.

Current account deficit continues to grow

Current account deficit up sharply in May…

The current account balance showed a deficit of 5.26 billion euros in May, some 58.7% higher than in the same month in 2004, according to figures for the new balance of payments statistics issued by the Bank of Spain. The increase in the trade deficit was decisive in this respect as was the increased imbalance in the incomes account, along with the reduced surplus in services and the turnaround in the current transfers balance.

BALANCE OF PAYMENTS

Cumulative figure for last 12 months in million euros

	May 2004	May 2005	% change
Current account balance			
Trade balance	–43,188	–61,058	41.4
Services			
Tourism	*26,549*	*25,511*	*–3.9*
Other services	*–4,012*	*–3,939*	*–1.8*
Total	22,536	21,571	–4.3
Income	–11,213	–16,228	44.7
Transfers	657	–1,058	–
Total	**–31,207**	**–56,772**	**81.9**
Capital account	**9,281**	**7,451**	**–19.7**
Financial balance			
Direct investment	–8,159	–27,736	239.9
Portfolio investment	4,507	108,292	–
Other investment	26,972	–30,903	–
Total	**23,320**	**49,653**	**112.9**
Errors and omissions	1,472	–2,205	–
Change in assets of Bank of Spain	–2,866	1,873	–

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.

…and cumulative balance for 12 months goes above 50 billion euros.

The current account deficit in May put the cumulative imbalance for the last 12 months at 56.77 billion euros. The sharp worsening of the situation was mainly due to the increased trade imbalance which contributed 70% of the increase in the current account deficit. The rest was due to the incomes heading and, to a lesser extent, to the lower surplus in services and the turnaround in the transfers balance.

Worsening of figures under various headings of balance.

In the case of the trade balance, the increase in the imbalance arose from an increase in imports well above that in exports. The progressive reduction in the services surplus, in turn, is being brought about by a tourist balance showing a sharp increase in payments (of around 25%) in a context of weakness in revenues inflows. The transfers balance, which is traditionally positive, has shown a turnaround to negative because of lower net transfers from the European Union and increased remittances abroad by foreign workers.

Capital account surplus fails to compensate current account deficit.

Capital account, in turn, showed s substantially lower surplus than in the same month in 2004 which put the cumulative balance for the first five months of the year some 30.5% below the same period last year. For the past 12 months the balance stood at 7.45 billion euros, a figure insufficient to compensate for the heavy current deficit. As a result, net world borrowing by Spain's economy (obtained by adding the current account balance and capital balance) stood at 49.32 billion euros, that is to say, 5.9% of the GDP.

Direct non-real-estate foreign investment in Spain and Spanish investment abroad showing growth (except in portfolio investment).

In the financial sphere, there was a continuation of the rise in direct foreign investment in Spain (although this did not apply to real property) and in portfolio investment. On the outgoing side, Spanish direct investment abroad showed a sharp recovery, including in the real estate area, while portfolio investment continued to drop severely. These movements, along with other financial system transactions (mainly in loans and deposits) brought about a positive balance in financial account (Bank of Spain transactions excluded) for an amount of 18.50 billion euros as of May, some 6.0% less than in the first five months of 2004.

SAVINGS AND FINANCING

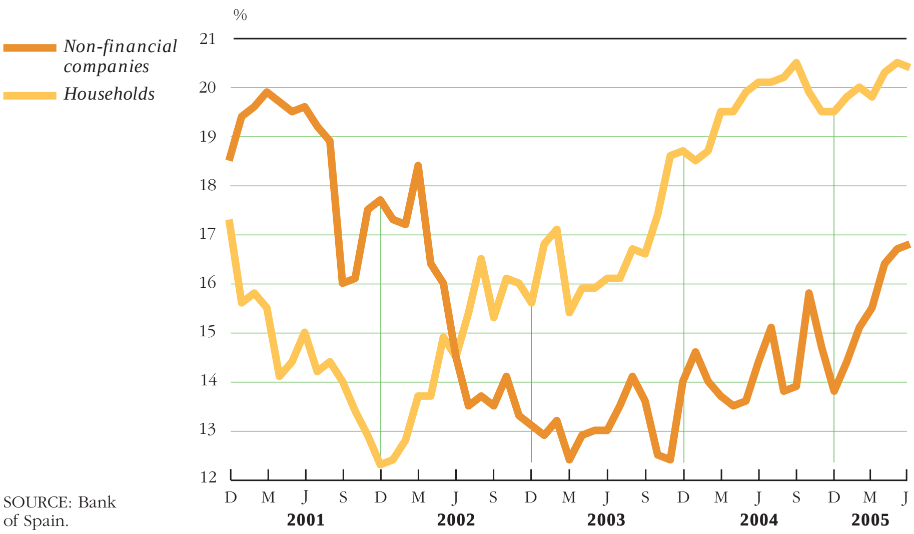
Financing to private sector shows high rate of increase

Mortgage loans continue to boost bank credit.

Financing provided to the private sector in June rose at a year-to-year change rate of 18.4%, according to Bank of Spain figures. It thus rose at the highest rate since September 2000 and well above the rate for the euro area as a whole. The biggest year-to-year increase was recorded by households (20.4%), little below the figure for May. Funding to households, made up mainly of bank credit, continues to be driven by mortgage loans.

SHARP INCREASE IN FUNDING TO COMPANIES AND HOUSEHOLDS

Year-to-year change in total funding, by institutional sector



SOURCE: Bank of Spain.

Funding of companies up 17% in past 12 months.

With regard to funding obtained by non-financial companies, this rose by 16.8% compared with June 2004, a rate one decimal higher than in the previous month. Of total funding, credit provided to non-financial companies by resident credit institutions and securitization funds rose by 21.5% in the past 12 months, the highest rate in recent years.

Bank loan interest rates at very low level.

Bank loan interest rates were generally down slightly in June. As a result, the composite interest rate on loans and credits granted to the private sector was down 10 basis points to stand at 3.79%, marking up a new all-time low. The composite interest rate applicable to households also recorded a low of 4.14% to stand 4 basis points below 12 months earlier. At the same time, the composite rate for non-financial companies showed a low of 3.40%, a decrease of 10 basis points compared with June 2004.

Interest rate on housing loans marks up all-time low in July.

In addition, the composite interest rate on mortgage loans for more than a three-year term for purchase of non-subsidized housing in July fell slightly (down 7 basis points) going to 3.20%. As a result, it stood 13 basis points below the same month in 2004.

Sharp growth of bank deposits

Deposits up at rate considerably higher than in euro area.

Total deposits of resident companies and households in euros and foreign currency grew at a sharp rate in June compared with the same month last year and considerably higher than the rate recorded in the euro area. Nevertheless, the increase in the past 12 months was notably lower than the rise in loans. In order to compensate this imbalance the credit institutions carried out bond issues and securitizations as well as having recourse to the foreign market.

On-demand and savings accounts make up 45% of all private sector deposits.

On the other hand, new accounting regulations applying to credit institutions came into force in June due to adoption of International Financial Information Regulations by the European Union which incorporated changes which make it difficult to make comparisons with previous periods. Nevertheless, it may be stated that time deposits for a term of more than 2 years, which enjoy tax benefits of 40% on interest, showed a major increase. However, the biggest share fell to on-demand and savings accounts which made up 45.3% of the total.

DEPOSITS OF COMPANIES AND HOUSEHOLDS AT CREDIT INSTITUTIONS (*)

June 2005

	Total	Change this year		Change over 12 months		% share
	Million euros	Million euros	%	Million euros	%	
On-demand and savings (**)	377,312	32,238	9.3	39,071	11.6	45.3
2-year term	177,026	16,559	10.3	22,802	14.8	21.2
More than 2-year term	197,297	69,829	54.8	96,928	96.6	23.7
Repos	73,983	–6,499	–8.1	–6,644	–8.2	8.9
Total	**825,617**	**112,127**	**15.7**	**152,155**	**22.6**	**99.1**
Deposits in currencies other than euro	**7,689**	**1,842**	**31.5**	**2,421**	**46.0**	**0.9**
TOTAL	**833,306**	**113,969**	**15.8**	**154,576**	**22.8**	**100.0**

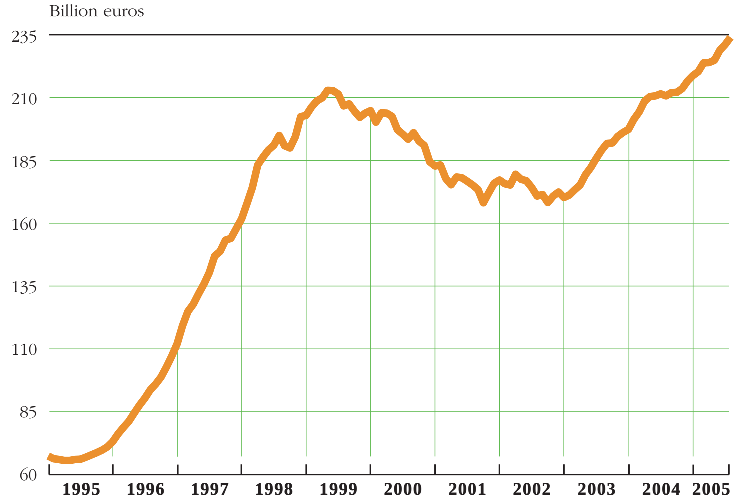
NOTES: (*) As a result of the coming into force of new regulations in application of the International Financial Information Regulations, as of June 2005, changes in the statistics make comparison difficult.
(**) Includes deposits requiring previous advice, according to ECB definition.
SOURCE: Bank of Spain and internal figures.

Very slight swings in bank deposit interest rates.

With regard to bank deposit interest rates applying to companies and households, there were very slight swings in the first half-year putting the rate at a level slightly above the low in October 2003. The composite interest rate for non-financial companies dropped to 1.17% in June but this was 3 basis points above one year earlier. The composite interest rate for households rose slightly in June going to 1.14%, some 3 basis points above 12 months earlier.

SUSTAINED GROWTH OF ASSETS OF SECURITIES MUTUAL FUNDS

Total assets of securities mutual funds



SOURCE: Inverco.

Assets of securities mutual funds up 7% in first seven months of year.

The assets of securities mutual funds rose by 1.9 billion euros in July going to 234.8 billion euros, an increase of 6.9% compared with the end of December. This increase in assets was due to net unit subscriptions (deducting sales) of 1.03 billion euros and capital gains because of the positive trend in financial markets. Net inflows of new money in July were concentrated in bond-based funds, both short-term and long-term, and in global funds. On the other hand, the number of participants rose to 8,195,357 at the end of July, a cumulative increase of 156,266.

Total pension fund assets up by 15% year-to-year in June.

In another sphere, total pension fund assets amounted to 66.4 billion euros at the end of the first half of 2005. This amount represented an increase of 15.4% year-to-year, according to figures from Inverco, the sector organization. By type of plan, the assets of individual pension funds rose by 18.8% in the past 12 months, employee funds were up by 10.9% while associate funds rose by 8.0%. In the past 12 months the number of participant accounts rose by 15.9% going to a total of 8,795,983. It is estimated that this actually involves 7 million participants given that some people have several accounts.

Unemployment benefits and labour market efficiency

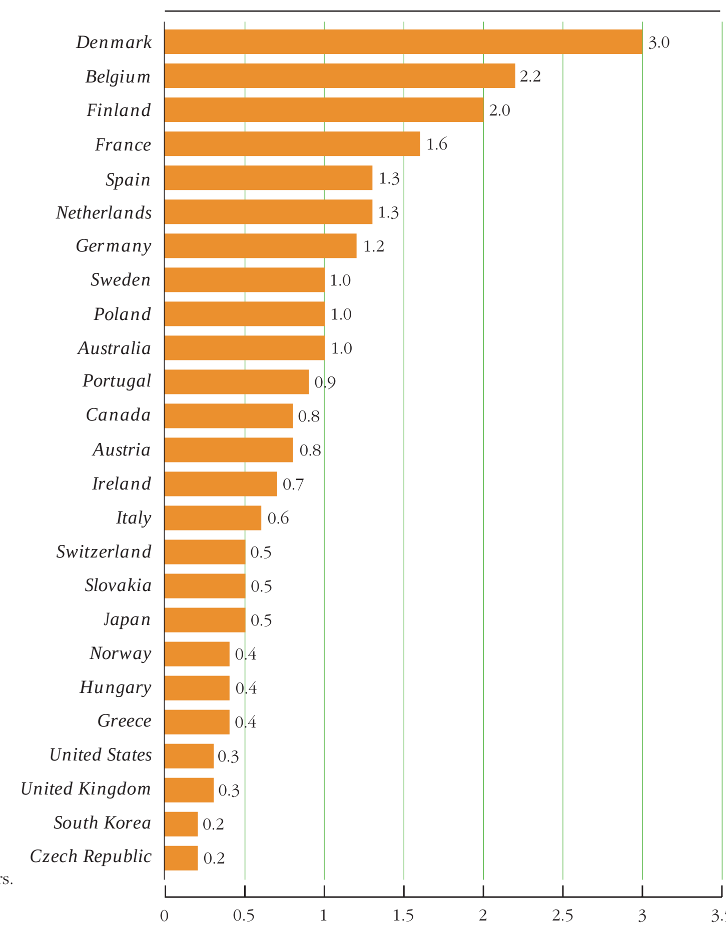
Unemployment benefits can impede labour market efficiency.

Most developed countries have some system of unemployment benefits which temporarily compensate for loss of wages as a result of being unemployed. Occasionally, this system is regarded as having a negative influence when it comes to fostering the search for a job thus possibly contributing to make the labour market less flexible, inflating the unemployment rate and limiting the improvement of productivity. It is for

MAJOR DISPARITIES IN UNEMPLOYMENT BENEFITS

2001

Gross benefits as percentage of gross domestic product (*)



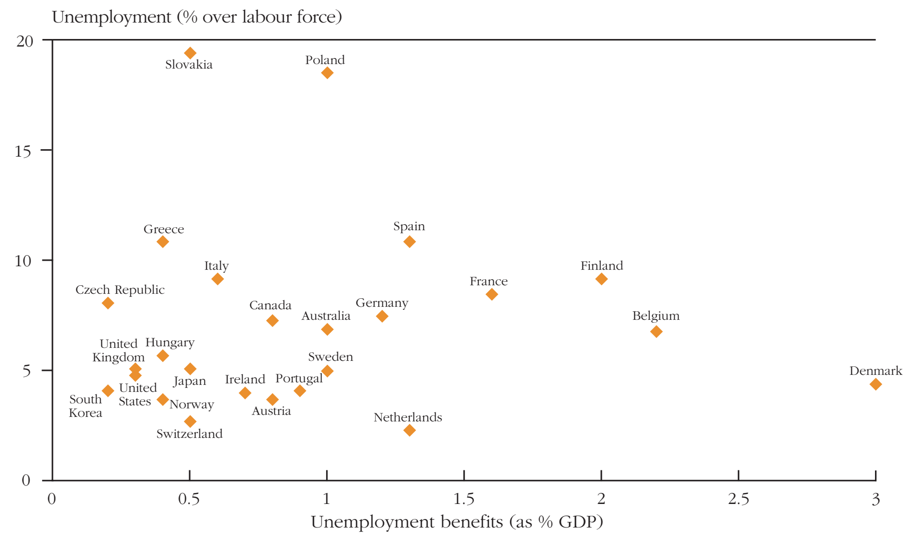
NOTES: (*) Cash transfers.
SOURCE: Benefits and Wages, OECD.

this reason that, within the range of economic and political reforms commonly promoted to improve the growth and competitive capacity of economies, unemployment benefits hold a significant place.

Large countries on European Continent dedicate most resources while United States, United Kingdom and Japan stand at other extreme.

Unemployment benefits differ considerably from country to country. In budgetary terms, we find that within the Organization for Economic Cooperation and Development (OECD), Denmark is the country applying most resources with 3.0% of the gross domestic product (GDP). At the other extreme, we find the Czech Republic which applies a mere 0.2% of its GDP to this end. Generally, those countries where unemployment benefits take up most resources are the large economies of Continental Europe whereas, on the contrary, the United States, the United Kingdom and Japan apply proportionally less funds. It may be thought that this is due to higher rates of unemployment which naturally raise spending on benefits. As may be seen in the accompanying graph, however, there is practically no correlation between the level of unemployment and spending on unemployment benefits.

HIGHER UNEMPLOYMENT DOES NOT IMPLY GREATER UNEMPLOYMENT BENEFITS
2001



SOURCE: Benefits and Wages, OECD.

Unemployment insurance varies notably in developed countries...

As a result, the differences arise basically from the design of benefits in each country. Unemployment insurance is the most important instrument for assisting those who lose their job. In order to obtain benefits, those applying must have contributed to the unemployment fund for a certain period of time, quite variable according to country, as may be seen in the group shown in the accompanying table. Furthermore, in principle, applicants must be actively looking for work and generally the cause of unemployment must be involuntary. Unemployment insurance benefits also vary notably according to country.

UNEMPLOYMENT INSURANCE BENEFITS

2002 (1)

Country	Employment [E] and contributions [C] conditions	Waiting period (days)	Maximum duration (months)	Initial rate of payment (percentage earnings base)	Earnings base (2)	Minimum benefit (3)	Maximum benefit (3)
						% average production worker	% average production worker
Germany	E: 12 months C: 12 months in 3 years	0	12	60	Net	–	103
Spain	C: 360 days in 6 years	0	24	70 (60 after 6 months)	Gross	28	64
United States	E: 20 weeks (minimum earnings requirement)	0	6	53	Gross	13	48
France	C: 4 months in 18	8	30	57-75	Gross	40	295
Italy (4)	C: 52 weeks in 2 years	7	6	40	Average gross earnings in previous 3 months	–	52
Poland	E+C 365 days in 18 months	7	18	Fixed amount (26% of average production worker) (5)	–	–	–
United Kingdom	C: 2 years	3	6	Fixed amount (14% of average production worker)	–	–	–

NOTES: (1) 40-year old single worker without children after working 22 years. All amounts of benefits are annualized.
(2) Gross: gross employment income. Net: gross less taxes on personal income and less Social Security contributions.
(3) Amounts of benefits given for a person with previous full-time employment.
(4) For employees with temporary reduction of hours of work there also exists CIG plan (Cassa Integrazione Generale) which pays out benefits of 80% of average gross average wages for hours not worked.
(5) Amount of basic benefit is adjusted for years worked: 80% for less than 5 years, 100% for 5-20 years and 120% for more than 20 years.
SOURCE: Benefit and Wages, OECD.

...as happens with unemployment assistance benefits...

For those persons who have used up all unemployment insurance benefits and have not found a new job or do not meet requirements to obtain further benefits, there exists unemployment assistance benefits. Nevertheless, these may be subject to conditions and, as in the case of unemployment insurance, are often of limited duration. These are reserved to persons who are actively looking for work. As opposed to unemployment insurance benefits, the main aim of unemployment assistance is to provide a minimum level of resources during a period of unemployment rather than ensure lost wages. As a result, unemployment assistance tends to be of lower amount and is less directly related to previous wages.

...which depend on various factors.

Unemployment assistance also has varied characteristics depending on country. In fact, in some countries, such as the United States, Italy and Poland, it does not exist, although in these cases persons without resources can generally obtain social welfare assistance. In other countries, such as Finland, Ireland and United Kingdom, those unemployed unable to receive unemployment insurance benefits but who are actively looking for work may receive unemployment assistance without other conditions regarding previous employment. With the exception of the Netherlands and Sweden, unemployment assistance also depends on the income of other family members. This may considerably reduce the incentive for spouses of the long-term unemployed to hold or seek a job, given that if they do so they could lose the benefits for the head of the family or have these reduced.

UNEMPLOYMENT ASSISTANCE BENEFITS (*)
2002

Country	Employment record in months (**)	Duration (months)	Rate of payment	Maximum benefit: National currency	Maximum benefit: % average production worker	Tests on income	Limits and dissegards
Germany	UI	No limit	53% of net earnings	28,620	87	Family	Dissegard of spouse's income equal to assistance that would be received if unemployed.
Spain	UI or 3-6	18	Fixed amount	3,980	24	Family	Income below 3,980 € per person. No dissegards.
United States	–	–	Such benefits do not exist	–	–	–	–
France	UI and 60 in last 120	6 months (renewable)	–	4,810	22	Family	Dissegard for earnings below 6,413 €, then reduction 1/1 up to 11,222 €. Limits for couples are 12,826 € and 17,635 €.
Italy	–	–	Such benefits do not exist	–	–	–	–
Poland	–	–	Such benefits do not exist	–	–	–	–
United Kingdom	–	No limit	Fixed amount	2,805	14	Family	Earnings dissegards are 260 £ and 520 £ for individuals and couples respectively.

NOTES: (*) Single 40 year-old worker after working 22 years. All amounts of assistance are shown annualized.
(**) End of unemployment insurance (UI) is requirement for receiving unemployment assistance.
SOURCE: Benefits and Wages, OECD.

Some of those getting unemployment assistance in Spain may lose income if they take more work.

In fact, the net effects of unemployment benefits on household income depend on the possible interaction with other factors in the benefits-tax system. This is due to the fact that benefits are often subject to tax or Social Security contributions; benefits of a certain type may limit the right to receive other benefits; or some benefits may provide more rights to receive other assistance or tax reductions. As a result of these interacting factors, distortions may occur in the incentive to take a job. For example, the OECD points out that some of those receiving assistance in Spain could come to lose income if they take more work.

Net rate of income replacement within 60 months of unemployment in Spain stands below average for developed countries...

Apart from the duration of benefits, rates of income replacement are key indicators of the sufficiency of those benefits. The rate of income replacement shows the proportion of income received by an unemployed person compared with the wages received in his/her previous job. As indicators of net income, they incorporate the direct effects of all relevant types of taxes and benefits included in household incomes. As may be seen in the accompanying table, in the case of Spain, net average income replacement rates stand below the average for the developed countries under consideration, although they stand clearly above some countries such as Italy and the United States. It should be pointed out that the rate of income replacement, calculated for households, is affected by the incomes of other family members.

...whereas effective tax rate for a short-term unemployed person who goes back to work stands above average.

Another key indicator underlining this effect is the so-called average effective tax rate for those unemployed who go back to work. This rate shows to what extent the increase in income is taxed when a person goes back to work, due to the subsequent increase in taxes and the decrease in benefits. This ratio more correctly measures the influence of the tax-benefits system of financial incentives to work. When this indicator goes to high values it shows strong disincentive factors for taking a part-time job at lower wage levels or fewer hours of work than in the previous job. According to the accompanying table, the average effective tax rates for a short-term unemployed person stand above the average in the case of Spain.

A well-designed tax and benefits system can avoid «poverty trap» situations discouraging work.

When a person goes from unemployment to hold a job, taxes are applied to wages and, on the other hand, unemployment benefits are reduced. As a result, remuneration for working drops. This is a particular problem in the case of persons on low-income levels who may become trapped in a state of poverty and dependence on benefits, which is known as the «poverty trap». The availability of low-wage jobs or part-time jobs constitutes a potentially effective means of getting out of a state of poverty in those countries which allow beneficiaries to complement benefits with wages. At the same time, this may make it possible to acquire valuable experience and to move into the labour force. Furthermore, low income tax levels and especially Social Security contributions for this type of work increase the monetary attractiveness of low-wage jobs by increasing the wage part added to family resources.

AVERAGE OF NET REPLACEMENT RATES OVER 60 MONTHS OF UNEMPLOYMENT

2002

Proportion of net income during unemployment compared with net income of an employed person as percentage (*)

	Without social assistance					With social assistance				
	No children		2 children		Total average	No children		2 children		Total average
	Single person	Couple with only one wage	Lone parent	Couple with only one wage		Single person	Couple with only one wage	Lone parent	Couple with only one wage	
Germany	57	54	81	76	67	72	75	85	77	77
Australia	39	34	57	72	51	39	34	57	72	51
Austria	52	55	70	73	62	58	73	75	89	74
Belgium	66	67	74	69	69	66	67	74	69	69
Canada	11	12	27	28	20	32	47	62	67	52
South Korea	6	6	7	6	6	25	37	49	61	43
Denmark	58	64	75	73	67	69	78	84	81	78
Slovakia	28	33	42	45	37	54	86	79	96	79
Spain	29	28	32	31	30	46	48	54	57	51
United States	6	6	5	5	6	13	19	42	47	30
Finland	60	64	77	73	69	64	78	77	89	77
France	62	64	74	74	68	62	69	78	78	72
Greece	22	23	29	29	26	22	23	29	29	26
Hungary	32	32	40	39	36	32	32	40	39	36
Ireland	35	53	47	61	49	61	78	63	82	71
Italy	5	5	6	6	5	5	5	6	6	5
Japan	7	7	27	10	13	45	60	83	79	67
Norway	39	40	80	57	54	60	67	80	78	71
Netherlands	60	67	64	70	65	71	80	76	81	77
Poland	21	21	31	29	26	41	56	65	79	60
Portugal	44	46	51	51	48	56	63	66	66	63
United Kingdom	34	34	32	32	33	54	67	65	75	65
Czech Republic	4	4	13	13	9	39	62	68	81	63
Sweden	17	17	50	42	32	67	83	67	89	77
Switzerland	30	30	33	33	31	68	78	81	87	79
Average	**34**	**37**	**47**	**47**	**41**	**49**	**60**	**65**	**71**	**61**

NOTES: (*) Takes a non-weighted average for earnings levels of 67% and 100% of average salary of a production worker. Taxes on unemployment benefits determined in relation to annualized values of benefits (that is, monthly values multiplied by 12) even where maximum duration of benefit is under 12 months. It is supposed that children are between 4 and 6 years of age and benefits for their care and associated costs are not taken into consideration.

SOURCE: Benefits and Wages, OECD.

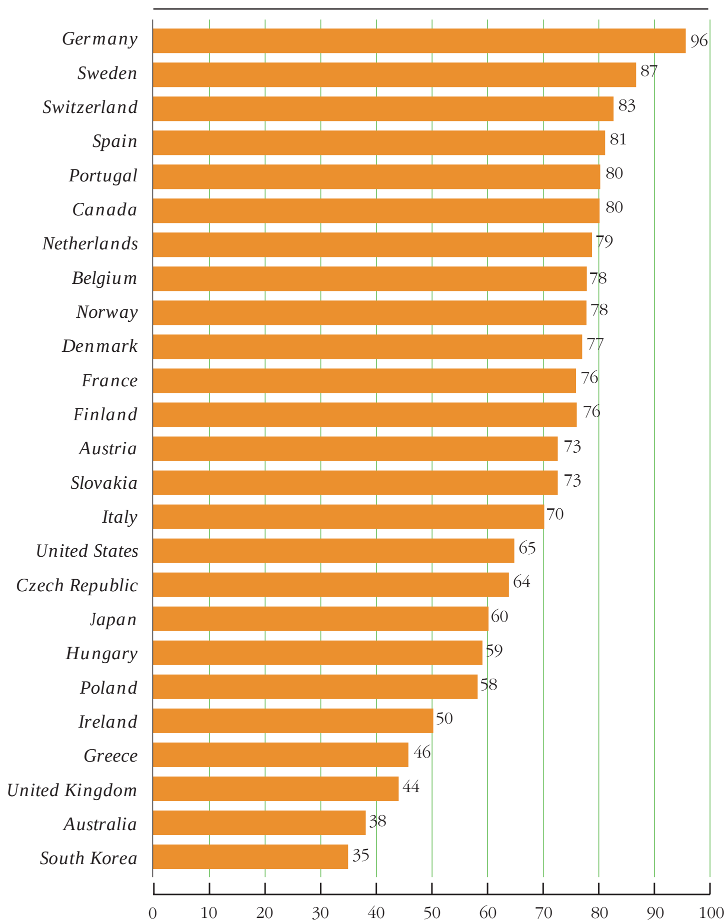
Important that job search be given incentive of prospect of significant increase in income.

In this context, in order to avoid that short periods of unemployment turn into situations of long-term unemployment and in order to promote future work stability, it is essential that payment of benefits be accompanied by active help in finding a suitable job. At the same time, in order to ensure that the unemployed person actively participates in job search, it is necessary that this be fostered by the prospect of a substantial increase in income.

WELL-DESIGNED POLICIES MAY FACILITATE RAPID RETURN TO WORK

2002

Percentage gross earnings «taxed away» when moving back into employment (*)



NOTES: (*) Couple with 2 children. Transition to full-time job. Wages equal to previous levels. It is supposed that unemployed person was obtaining average wage in previous job and was receiving initial unemployment benefits. Spouse employed full-time with two-thirds average wage as income. Children are between 4 and 6 years of age.

SOURCE: Benefits and Wages, OECD.

Some aspects of tax and benefits system need to be redefined.

A number of countries have adopted or announced various measures to encourage work. This is especially so in the case of Germany which, from the beginning of 2005, has cut unemployment benefits and encouraged the long-term unemployed to seek work (restrictions on access to benefits, especially if available jobs not accepted). On the other hand, a number of countries have introduced benefits for certain types of workers in order to reduce poverty, whereas others have restructured their tax systems in order to reduce tax costs associated with accepting a job. In general, the objective is to redefine those aspects of the tax and benefits system which are considered necessary to contribute to a more efficient functioning of the labour market, without impairing necessary social protection.

AVERAGE EFFECTIVE TAX RATES FOR SHORT-TERM UNEMPLOYED PERSONS RE-ENTERING EMPLOYMENT

2002

Percentage of gross earnings «taxed away» when moving back into employment (*)

	No children			2 children		
	Single person	Couple with only one wage	Couple with two wages	Lone parent	Couple with only one wage	Couple with two wages
Germany	77	68	85	87	82	96
Australia	49	44	27	60	70	38
Austria	68	69	70	74	76	73
Belgium	80	72	78	73	69	78
Canada	72	73	72	78	79	80
South Korea	35	35	35	36	35	35
Denmark	77	77	77	82	82	77
Slovakia	69	72	70	70	72	73
Spain	76	75	76	79	77	81
United States	67	65	66	61	58	65
Finland	75	79	72	84	86	76
France	78	74	78	79	79	76
Greece	56	56	47	57	57	46
Hungary	60	60	59	59	59	59
Ireland	41	51	42	31	55	50
Italy	65	67	65	66	65	70
Japan	56	54	58	63	52	60
Norway	76	76	76	84	78	78
Netherlands	73	74	80	75	76	79
Poland	62	62	54	65	65	58
Portugal	82	80	83	78	78	80
United Kingdom	58	58	38	50	51	44
Czech Republic	62	61	63	61	60	64
Sweden	87	87	87	91	87	87
Switzerland	77	76	76	84	83	83

NOTES: (*) Figures refer to situation of a person who, being unemployed, received unemployment benefits based on previous earnings equal to average salary of a production worker. He/she later returns to full-time work. Taxes on unemployment benefits determined in relation to annualized values of benefits (that is, monthly values multiplied by 12) even where the maximum duration of benefits is under 12 months. It is supposed that children are between 4 and 6 years of age and benefits for their care and associated costs are not considered.

SOURCE: Benefits and Wages, OECD.

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