JANUARY 2006

THE SPANISH ECONOMY

Monthly Report

NUMBER 287

RESEARCH DEPARTMENT

"la Caixa"

Forecast

% change over same period year before unless otherwise noted

	2004	2005	2006	2005 1Q	2005 2Q	2005 3Q	2005 4Q	2006 1Q	2006 2Q
INTERNATIONAL ECONOMY		Forecast						Forecast	
Gross domestic product									
United States	4.4	3.6	3.4	3.6	3.6	3.6	3.7	3.7	3.5
Japan	2.3	2.3	1.5	1.1	2.7	2.8	2.8	1.7	1.5
United Kingdom	3.2	1.8	2.1	2.0	1.6	1.7	1.7	2.1	2.2
Euro area	1.8	1.4	1.8	1.2	1.2	1.6	1.7	1.8	1.9
Germany	*1.1*	*1.0*	*1.6*	*0.6*	*0.7*	*1.4*	*1.5*	*1.5*	*1.7*
France	*2.1*	*1.5*	*1.8*	*1.8*	*1.1*	*1.8*	*1.4*	*1.6*	*1.8*
Consumer prices									
United States	2.7	3.5	2.8	3.0	2.9	3.8	4.1	3.6	3.1
Japan	0.0	–0.3	0.0	–0.2	–0.1	–0.3	–0.4	–0.1	0.0
United Kingdom	2.2	2.3	2.3	2.2	2.2	2.4	2.2	2.4	2.1
Euro area	2.1	2.2	2.2	2.0	2.0	2.3	2.4	2.5	2.1
Germany	*1.7*	*2.0*	*1.8*	*1.7*	*1.7*	*2.1*	*2.4*	*2.1*	*1.9*
France	*2.1*	*1.8*	*1.7*	*1.7*	*1.7*	*1.9*	*1.8*	*2.1*	*1.6*
SPANISH ECONOMY		Forecast						Forecast	
Macroeconomic figures									
Household consumption	4.4	4.4	3.7	4.6	4.6	4.4	4.2	4.0	3.8
Government consumption	6.0	4.7	4.4	5.4	4.3	4.6	4.5	4.5	4.4
Gross fixed capital formation	4.9	7.3	6.3	7.2	7.6	7.4	7.1	6.8	6.5
Capital goods	*3.7*	*9.3*	*6.5*	*10.1*	*10.4*	*8.8*	*8.0*	*7.3*	*6.7*
Construction	*5.5*	*6.3*	*5.8*	*6.0*	*6.2*	*6.3*	*6.4*	*6.3*	*6.1*
Domestic demand (contribution to GDP growth)	4.7	5.2	4.6	5.2	5.3	5.2	5.0	4.8	4.6
Exports of goods and services	3.3	0.5	2.8	–2.1	1.1	1.3	1.6	2.0	2.5
Imports of goods and services	9.3	7.6	7.3	5.7	8.5	7.7	8.7	7.7	6.8
Gross domestic product	**3.1**	**3.4**	**3.2**	**3.3**	**3.4**	**3.5**	**3.4**	**3.3**	**3.2**
Other variables									
Employment	2.6	3.1	2.9	3.0	3.2	3.2	3.1	3.0	2.9
Unemployment (% labour force)	11.0	9.1	8.4	10.2	9.3	8.4	8.4	8.5	8.4
Consumer price index	3.0	3.3	3.0	3.3	3.2	3.4	3.5	3.5	3.0
Unit labour costs	2.8	2.4	2.4	2.5	2.4	2.4			
Current account balance (% GDP)	–5.8	–7.4	–7.3	–7.1	–7.9	–6.9			
Not lending or net borrowing rest of the world (% GDP)	–4.8	–6.4	–6.4	–6.6	–6.7	–6.0			
Government balance (% GDP)	–0.1	0.6	0.2						
FINANCIAL MARKETS		Forecast						Forecast	
Interest rates									
Federal Funds	1.3	3.2	4.7	2.4	2.9	3.4	4.0	4.4	4.8
ECB repo	2.0	2.0	2.4	2.0	2.0	2.0	2.1	2.3	2.3
10-year US bonds	4.3	4.3	4.9	4.3	4.2	4.2	4.5	4.6	4.8
10-year German bonds	4.1	3.4	3.7	3.6	3.3	3.2	3.4	3.5	3.6
10-year Spanish bonds	4.1	3.4	3.7	3.6	3.3	3.2	3.4	3.5	3.6
Exchange rate									
$/Euro	1.24	1.25	1.21	1.31	1.26	1.22	1.19	1.20	1.20

THE SPANISH ECONOMY
MONTHLY REPORT
January 2006

CAJA DE AHORROS
Y PENSIONES
DE BARCELONA

Research Department

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

"la Caixa" GROUP: KEY FIGURES

As of December 31, 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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Contents

The year of the dog

Legend has it that many years ago Buddha called all the animals to gather around him to celebrate the New Year. Only twelve actually came and Buddha decided to give each successive year the name of an animal depending on the order they had come to the celebration. As a result, all those persons born each year would take on the personality of the corresponding animal. Furthermore, the characteristics of the animal would have an influence on the events taking place during the year. 2005 was the year or the cock, a brave bird, devoted and a good worker, although somewhat coarse and presumptuous. The end of January marks the start of another Chinese year, the year of the dog. The dog is a strong, faithful animal with a great ability to recover, clever and knowing many tricks, as well as being trustworthy. These are qualities which the economy will need during 2006 in order to consolidate the rather eventful year now ending, a year of record oil prices and hurricane scares but, above all, a good year in terms of growth.

We economic analysts do not usually consult the zodiac but the forecasts for the year now beginning seem to be in keeping with what the Chinese horoscope is forecasting. World growth should hold up thanks to the continuation of growth in the United States, China, Japan and other Asian economies. International trade will maintain its strength. Europe will consolidate its recovery following a long period of weakness. No further surprises are now expected in the area of energy prices which should stay as they are or drop slightly. In the developed countries, inflation was not a problem in 2005 nor will it be in 2006. The major imbalances in the balance of payments (with deficit in the United States and surplus in Asia) cannot be sustained over the long term although over the short term it is still possible they can be continued without major upsets.

Continuity is also the key-note of analyses of Spain's economy. All forecasts coincide in the view that growth of the gross domestic product in 2006 will be somewhat lower than the 3.4% expected for 2005. Domestic demand will slow down because consumption has risen considerably in recent years, along with capital goods investment. In turn, foreign demand will be slightly better because the European economies, Spain's main purchasers of goods and services, are finally beginning to move ahead. We shall continue to create jobs, interest rates will remain low, companies will earn profits and the public sector will show a surplus.

But beware! The dog has its defects. It can be anxious, pessimistic, irritable and aggressive. The imbalance in the balance of payments in the international sphere mentioned above is an outcome of erroneous macroeconomic policies in the United States (excessive government deficit and insufficient stimulus for saving) and in Asia (interventionist foreign exchange rates and financial system). In Spain, growing household indebtedness demonstrates the difficulty in establishing a suitable macroeconomic policy because we are borrowing from the euro area. Nor does it seem that there are any restrictions on the deficit in the balance of payments although we should ask ourselves up to what point is this spending spree sustainable. With regard to inflation, the differential with the euro area average would appear unable to be corrected. These risks are very well-known but this does not mean they are negligible. In any case, nearly all forecasts lean toward optimism. Such unanimity is cause for some concern given that calm often comes before a storm. But, in any case, let us not be superstitious.

December 23, 2005

OVERALL SUMMARY

Oil shock in 2005 becoming thing of the past

Negotiations to liberalize trade in goods and services makes difficult progress but world growth consolidates in 2005 despite rise in oil.

In mid-December, Hong Kong was the location of the ministerial summit of the World Trade Organization, another stage in the development of the so-called *Doha Round*, negotiations aimed at liberalizing world trade in goods and services which is running into almost unsolvable difficulties. The minimal agreement reached between the developing and industrialized countries at this meeting does not inspire much confidence that the outcome of the *Round* (which must become concrete in coming months) will mean a real step forward.

United States regains drive following shock caused by hurricanes while showing absence of inflationary pressures...

In spite of the complexity of international relations, world trade remains buoyant. The volume of trade grew by 10% in 2004, dropped in growth rate to 7% in 2005, but in 2006 and 2007 will again grow by more than 9%, according to the Organization for Economic Cooperation and Development. This reflects the renewed strength of the international cycle which seems to be overcoming the period of high oil prices seen in 2005 without great problems. The containment of the per barrel price, which has not again reached 60 dollars since October, has provided major relief and cleared prospects in the final part of the year.

...but foreign deficit still hanging over US growth.

The United States has recovered its drive following the shock caused by the hurricanes *Katrina* and *Rita* last September. Growth of the gross domestic product (GDP) in the third quarter was 3.6% compared with the same period the year before, the same rate as in the first two quarters. Continuation of US consumer demand, corporate investment and growth of the housing sector would indicate a fourth quarter with little change. Job creation has recovered from the dip at the end of summer and wages appear to again be gaining purchasing power. The best news comes in prices because of the absence of *second round* effects, that is to say, the increase in oil costs has not shifted to other prices. The year-to-year rate in the consumer price index dropped from 4.3% in September to 3.5% in October.

In the foreign sector of the US economy there is more of the same – a growing deficit as a result of spending which goes far above diminishing national savings. The bilateral relationship between United States and Asia is consolidating, under which US consumers buy manufactures cheaply from China and other emerging Asian economies while those economies buy US Treasury bonds. The result is that the trade deficit continues to reach high levels and already stands above 6% of the GDP. As a balancing entry, US bond issues continue to be taken up without any problem while offering a stable yield at still very low levels at around 4.5% for 10-year Treasury bonds.

On the other hand, US short-term rates have continued their upward course following increases by the Federal Reserve. In December, the US central bank applied a further increase in its reference rate for Federal Funds putting it at 4.25%, the 13th consecutive increase in the cycle which began in mid-2004. This cycle may be reaching its end, if we are to go by the press release issued by the Fed following the meeting of its Monetary Committee. Quite an opposite course is being followed by the European Central Bank which, on December 1, decided on what could be the beginning of a stage of increases in interest rates when it raised its reference rate to 2.25% after having maintained it unchanged at 2% since June 2003.

In fact, no one believes that the future increases in reference rate in the euro area will follow a similar course to that taken by the Fed. First of all, because the starting level is not as low as the 1% applied in the United States between the second half of 2003 and the beginning of 2004. Secondly, because the strength of the euro area economy is far from coming close to that of the US economy in recent years. The most recent indicators suggest that recovery of the Twelve continues its course, with a GDP which has changed from growth of 1.2% in the second quarter of 2005 to 1.6% in the third quarter and which in the last three months of the year is holding at this level. These are figures which in any case are a long way from those being recorded in the more dynamic parts of the world and which therefore make it necessary to carefully weigh the decisions of the central bank in Frankfurt.

The key to consolidation of improvement in the euro area undoubtedly lies in the performance of Germany, the economic giant of the area. That country is ending 2005 in its best situation for many years although the German consumer continues to think seriously when it comes to spending, perhaps because prospects in the labour market are not particularly clear. On the other hand, foreign competitiveness of Germany's industrial exports is not dropping and foreign sales remain the driving engine of the economy which is being reflected in a sharp rise in investment. Furthermore, the agreement of the political parties to form a coalition government seems to have pumped optimism into German business circles if we are to judge by results of industrial activity indicators in December based on opinions expressed by executives.

Where the year 2005 may be considered quite positive is in the stock market. The Eurostoxx 50 index, which includes the biggest companies in the euro area, gained 20% in December compared with the beginning of the year. Other stock markets on the Continent and in the UK followed a similar course but without matching the spectacular rise in the Japanese market at nearly 40%. On the other hand, the US stock markets showed a more discreet course adversely affected by the increases in interest rates. As compensation, during the course of 2005 the dollar gained in value about 3.5% in effective terms and around 15% in terms of the euro.

Spain's economy: growth without foreign investment

While waiting for a definitive consolidation of the European economy, Spain's economy continues to be based on the strength of domestic demand. The most recent indicators confirm the strong drive in household consumption which shows up in heavy imports of goods and growth of services, such as transportation, domestic tourism and telecommunications. Other indicators suggest some wearing out of the very strong growth which has lasted for many years, as in the case of car sales, and the index for consumer confidence sentiment.

Federal Reserve again raises reference rate while indicating end of increases close and ECB begins upward cycle.

German business circles look favourably on formation of new coalition government which comes as good news for rest of continent.

Stock markets end excellent year while dollar improves positions thanks to rise in interest rates.

Private consumption driving demand thanks to job creation, wage increases, interest rates and immigration.

The fuel firing consumer spending continues to be the strength of the labour market, wages growing more or less in line with inflation, still low interest rates and a population boosted by a rise in immigration. As an example of the strength of Spain's economy we may point out that the unemployment rate, one of the big problems in recent decades, is now lower than that being recorded by the major European economies such as Germany and France.

Industry suffers most under globalization while tourism benefits and construction marks up nine years of growth.

On the supply side, trends remain expansionist with the exception of industry. Both the industrial production index and the confidence indicator, along with the utilization of production capacity, underline the difficulties being experienced by a sector which is totally exposed to international competition, both when it comes to exports and to domestic sales. The branch of economic activity in worst shape is textiles and clothing, which is not surprising because 2005 was the year involving the definitive and complete opening up of imports from China. Another branch very much affected is electronic equipment, an activity which has recently seen major plant relocations. Finally, car production is also going through some difficult moments due to the drop in export demand in those segments in which Spain's motor vehicle industry specializes.

On the other hand, construction is scarcely showing any signs of fatigue following a long growth cycle which has now been going on for nine years. Nor did housing show any cooling off in 2005 but rather the opposite. Records will be beaten both in the number of housing starts as in housing completions or those under construction. Nevertheless, the profile of growth in some indicators would seem to suggest that within coming months construction will move into a stage of greater moderation. Another area of Spain's economy which did not meet the pessimistic forecasts was foreign tourism. Spain received more tourists than ever, largely due to growth of the low-cost airlines phenomenon. On the other hand, average spending per tourist was down due to the different behaviour pattern of those tourists choosing that option.

With regard to the more important imbalances, we should point out the uneven course followed by the consumer price index. On the one hand, the year-to-year growth rate dropped from 3.7% in September to 3.4% in November thanks to the easing off of fuel prices. On the other hand, however, we are witnessing a gradual increase in core inflation and Spain is failing to cut the differential with the euro area average, so that this problem continues.

Direct foreign investment in companies and real estate gradually slowing down.

With regard to the foreign deficit, the worsening in recent months has eased off although the figures continue to show all-time highs in the current account deficit. As in the case of the United States, foreign capital (that is, savings) is covering the difference in purchases of goods and services and transfers abroad, but in the case of Spain what stands out is the drop in direct foreign investment both in companies and real estate. This represents a loss of attractiveness which is good reason for reflection about an economy which, in any case, is still enjoying the expansionist drive seen in recent years.

CHRONOLOGY

2005

February	2	**Federal Reserve** raises reference rate by quarter point to 2.5%.
	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.
	22	**Federal Reserve** raises reference rate by quarter point to 2.75%.
	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.
	3	**Federal Reserve** raises reference rate by quarter point to 3%.
June	30	**Federal Reserve** raises reference rate by quarter point to 3.25%.
August	9	**Federal Reserve** raises reference rate by quarter point to 3.5%.
September	1	One-month forward price of Brent quality **oil** goes up to all-time high level of 67.48 dollars a barrel.
	17	Increase in **special taxes** on alcohol and tobacco to finance health (BOE 17-9-05).
	20	**Federal Reserve** raises reference rate a quarter-point to 3.75%.
October	4	IBEX 35 index for **Spanish stock exchange** marks up annual high (10,919.2) with cumulative gains of 20.2%.
	13	Government approves **National Reform Programme for Spain**.
November	1	**Federal Reserve** raises reference rate to 4%.
	28	**Slovak crown** joins Exchange Rate Mechanism.
December	1	**European Central Bank** raises official interest rate to 2.25%.
	13	**Federal Reserve** raises reference rate to 4.25%.
	17	European Council approves **2007-2013 Budget**.
	18	Hong Kong Summit of **World Trade Organization** agrees to removal of all aids to agricultural exports of developed countries in 2013.

AGENDA

January

10 Industrial production index (November).
12 Meeting of Governing Council of European Central Bank.
13 Consumer price index (December).
19 Harmonized consumer price index for European Union (December).
25 Producer price index (December).
27 Labour Force Survey (4th Quarter). US GDP (4th Quarter).
31 Meeting of Federal Open Market Committee of Federal Reserve.

February

2 Meeting of Governing Council of European Central Bank. Early HCPI indicator (January).
3 Industrial production index (December).
14 Preliminary Quarterly National Accounts (4th Quarter).
16 Consumer price index (January).
22 Quarterly National Accounts (4th Quarter).
27 Producer price index (January).
28 Harmonized consumer price index for European Union (January). Early HCPI indicator (February).

INTERNATIONAL REVIEW

OECD forecasts: not as strong as they seem

OECD raises 2006 growth forecast.

The Organization for Economic Cooperation and Development (OECD) has raised growth forecasts for its members as a whole. For 2006 the figure has been changed from 2.8% to 2.9% and for 2007 it sees maintenance of the economic activity set for 2006. The United States will continue to lead world economic growth. In 2005 its increases in productivity, the real-estate market and monetary and fiscal stimuli have been the basis of economic activity and it is expected that many of these factors will continue in 2006, which means that growth prospects will go up from 3.3% to 3.5%.

In turn, the euro area will finally leave behind the weak start to 2005 and faces a recovery that, while moderate, seems more and more settled for 2006 when it is expected that growth will reach 2.1%. By country, it is expected that Spain will grow by 3.2% while France and Germany will slightly recover drive with increases of approximately 2%, the same as in the case of Japan. In the second half of 2005, Japan's recovery, based on domestic demand and good corporate profits, lost strength compared with the drive seen at the beginning of the year. Nevertheless, recovery is a fact and has spread to all sectors, as underlined by figures for industrial production, a sector which initially had been left behind.

Significant stability of prices despite rise in oil.

One significant factor helping a continuation of world growth is the limited impact of the rise in energy markets on inflation indices. Forecasts for next year suggest a drop in inflation rates. In the United States this is expected to go from 3.4% in 2005 to 2.8% in 2006 while in the euro area it will drop from 2.2% to 2.1%. For Japan, the prospects are somewhat different given that during 2006 it is expected that it will leave behind its long period of inflation. Recovery, however, will be moderate and it should be borne in mind that, in order to increase potential growth in the present context of aging of the population, a reform process is still awaiting attention, with privatization of the postal service as a first step.

Biggest risk comes in huge deficits and current account surplus.

In spite of such boom conditions, this idyllic scenario of sustained growth with no inflation is less stable than it would seem. Some rich countries are showing excessively low levels of saving while this is being compensated by the surplus savings of emerging economies. This is creating huge current account deficits which in 2006 are expected to reach 6.7% of gross domestic product (GDP) in the United States, 2.0% in the euro area and 8.9% in Spain. In this respect, Germany and Japan are exceptions with surpluses expected to stand at 5.2% and 4.7% respectively. The OECD warns that these current account imbalances could unleash a disorderly flight of securities expressed in dollars which could bring about deflation outside the United States and have a negative effect on growth involving increased interest rates and a drop the price of assets, including housing. Fiscal imbalances are also major risks for 2006. Stimulating savings in the United States and managing an aging population in Japan are difficult tasks ahead.

OECD: ECONOMIC OUTLOOK (1)

	2003	2004	2005	2006	2007
GDP (2)					
United States	2.7	4.2	3.6	3.5	3.3
Japan	1.4	2.7	2.4	2.0	2.0
Germany	–0.2	1.1	1.1	1.8	1.7
France	0.9	2.1	1.6	2.1	2.2
Italy	0.4	1.0	0.2	1.1	1.5
United Kingdom	2.5	3.2	1.7	2.4	2.7
Spain	3.0	3.1	3.4	3.2	3.3
Euro area	**0.8**	**1.8**	**1.4**	**2.1**	**2.2**
OECD	**2.0**	**3.3**	**2.7**	**2.9**	**2.9**
Inflation (3)					
United States	2.3	2.7	3.4	2.8	2.5
Japan	–0.3	0.0	–0.4	0.1	0.8
Germany	1.0	1.8	2.0	1.7	1.3
France	2.2	2.3	1.9	1.7	1.1
Italy	2.8	2.3	2.1	2.7	2.2
United Kingdom	1.4	1.3	2.1	2.1	1.6
Spain	3.1	3.1	3.4	3.0	2.8
Euro area	**2.1**	**2.1**	**2.2**	**2.1**	**1.6**
OECD	**2.0**	**2.0**	**2.1**	**1.9**	**1.9**
Unemployment (4)					
United States	6.0	5.5	5.1	4.8	4.7
Japan	5.3	4.7	4.4	3.9	3.5
Germany	8.7	9.2	9.3	9.1	8.7
France	9.7	10.0	10.0	9.6	9.0
Italy	8.8	8.1	7.7	7.5	7.4
United Kingdom	5.0	4.7	4.8	5.1	5.6
Spain	11.0	10.5	9.1	8.7	8.7
Euro area	**8.9**	**8.9**	**8.7**	**8.4**	**8.1**
OECD	**6.9**	**6.7**	**6.5**	**6.3**	**6.0**
Current account balance (5)					
United States	–4.7	–5.7	–6.5	–6.7	–7.0
Japan	3.2	3.7	3.4	3.9	4.7
Germany	2.2	3.8	4.1	4.6	5.2
France	0.4	–0.4	–1.6	–1.4	–1.1
Italy	–1.3	–0.9	–1.5	–1.9	–2.3
United Kingdom	–1.5	–2.0	–1.8	–2.3	–2.7
Spain	–3.6	–5.3	–7.7	–8.9	–9.8
Euro area	**0.3**	**0.5**	**–0.2**	**–0.2**	**–0.1**
OECD	**–1.1**	**–1.3**	**–1.8**	**–2.0**	**–2.0**
World trade (6)	**5.1**	**10.3**	**7.3**	**9.1**	**9.2**

NOTES: (1) Starting hypothesis: a) Fiscal policies in force or announced will not change; b) Exchange rates will not change from level on November 11, 2005 (1 dollar = 118.0 yen = 0.850 euros); c) Closing date of publication and for including figures was November 22, 2005.
(2) All percentage change rates in real tems.
(3) Percentage change rates in GDP deflator.
(4) As percentage of labour force.
(5) As percentage of GDP.
(6) Arithmetical average of percentage annual growth rates of world imports and exports by volume.
SOURCE: Organization for Economic Cooperation and Development.

OECD: FINANCIAL OUTLOOK (1)

	2002	2003	2004	2005	2006
Government deficit (–) or surplus (+) (2)					
United States	–3.8	–4.6	–4.3	–4.1	–3.9
Japan	–7.9	–7.7	–6.1	–6.1	–5.3
Germany	–3.6	–3.8	–3.6	–3.5	–3.2
France	–3.3	–4.1	–3.7	–3.0	–3.0
Italy	–2.7	–3.0	–3.1	–4.4	–5.0
United Kingdom	–1.8	–3.4	–3.4	–2.9	–3.0
Spain	–0.1	0.4	–0.3	0.5	0.6
Euro area	**–2.5**	**–2.8**	**–2.7**	**–2.8**	**–2.7**
OECD	**–3.2**	**–3.7**	**–3.3**	**–3.2**	**–3.0**
Short-term interest rates (3)					
United States	1.8	1.2	1.6	3.4	4.7
Japan	0.1	0.0	0.0	0.0	0.0
United Kingdom	4.0	3.7	4.6	4.8	4.8
Euro area	**3.3**	**2.3**	**2.1**	**1.8**	**1.9**
Long-term interest rates (4)					
United States	4.6	4.0	4.3	4.5	5.3
Japan	1.3	1.0	1.5	1.4	1.8
Germany	4.8	4.1	4.0	3.4	3.5
France	4.9	4.1	4.1	3.5	3.6
Italy	5.0	4.3	4.3	3.6	3.7
United Kingdom	4.9	4.5	4.9	4.6	4.8
Spain	5.0	4.1	4.1	3.5	3.6
Euro area	**4.9**	**4.1**	**4.1**	**3.5**	**3.6**

NOTES: (1) Starting hypothesis: a) Fiscal policies in force or announced will not change; b) Exchange rates will not change from level on November 5, 2004 (1 dollar = 105.7 yen = 0.780 euros); c) Closing date of publication and for including figures was May 20, 2005.
(2) As percentage of GDP.
(3) 3-month interest rates on national money markets.
(4) Government bond interest rates on most representative issues in each country.
SOURCE: Organization for Economic Cooperation and Development.

United States: more of the same

United States growing with no inflation but trade deficit continues to rise.

The US engine is driving everything. Oil made everyone nervous and housing units more expensive but finally there is always more of the same – growth more and more established and prices moderate. The biggest cloud is the trade deficit which continues to break all records. The tightrope is thus getting tighter and tighter in a process where the exact limit is quite unknown.

Consumption and housing form basis of growth.

In its third estimate, the Bureau of Economic Analysis revised upward growth of the gross domestic product (GDP) to 4.1% quarter-to-quarter annualized putting it above the already healthy 3.8% previously announced. As has now become normal, the revision was based on domestic demand. Under the heading of consumption, non-durables continued firm. In recent months, the strength seen in food has been well compensated by the reduction in petrol consumption. Fixed capital formation also continues to strengthen with a housing sector that, following the revision, raised its contribution to growth by 50%, thus breaking away from a gradual slowdown. Compared with the strength of domestic demand, the foreign sector was again disappointing, something that indicates that satisfying

UNITED STATES: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2003	2004	2004		2005				
			3 Q	4 Q	1 Q	2 Q	3 Q	October	November
Real GDP	2.7	4.2	3.8	3.8	3.6	3.6	3.6	–	...
Retail sales	4.3	7.3	6.4	8.4	7.3	8.4	8.4	6.0	6.3
Consumer confidence (*)	79.8	96.1	100.4	96.1	104.2	102.3	98.9	85.2	98.9
Industrial production	0.6	4.1	4.6	4.3	4.0	3.1	2.6	2.3	2.8
Industrial activity index (ISM) (*)	53.3	60.5	60.1	57.5	55.6	52.8	56.5	59.1	58.1
Sales of single-family homes	11.7	10.0	–0.4	10.8	5.1	6.9	11.1	9.0	...
Unemployment rate (**)	6.0	5.5	5.4	5.4	5.3	5.1	5.0	5.0	5.0
Consumer prices	2.3	2.7	2.7	3.4	3.0	2.9	3.8	4.3	3.5
Trade balance (***)	–495	–618	–573	–618	–652	–673	–699	–712	...

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

desire takes precedence over buying things locally produced. In this third estimate of the GDP, the already lower positive contribution to growth showed a turnaround from being positive to becoming a drain on the GDP, thus making the good figures for the second quarter an exception. The cause of this worsening was mainly due to the increase in imports, in keeping with the strength of consumption. In this respect, it is to be expected that the future replacing of inventories will continue to drive up imports.

On the demand side, retail sales in November kept to the strength shown in recent months. The non-volatile components, excluding cars and petrol, moved up 7.5% year-to-year, certainly strong growth which furthermore comes within a trend to a slight rise. As a result of energy prices, fuel consumption has now become very volatile and distorts the overall figure, as has been happening in the case of motor vehicle sales. In November, the drastic drop in the former was not compensated by the recovery in the latter. Home goods and supermarket sales continued their strong advance and food confirmed increased growth thus compensating for the relative loss of strength in clothing. Backing this strong demand, consumer confidence awoke from its hurricane-induced fears and from the aftermath of serious problems at General Motors, although with a month's delay compared with other indicators. Following the rise in November, the confidence levels seen last summer now are getting nearer.

Retail sales moving up and consumers regaining confidence.

On the supply side, industrial production showed a better performance than in recent months, with growth rates of close to 3% year-to-year. In spite of this hesitant recovery, the sector stands a long way from being a support for current growth, which is a rate of increase half that recorded in previous recoveries. In turn, corporate confidence is holding up with those looking on the immediate future with optimism in the majority. The very slight drop in the November manufacturing index put out by the Institute for Supply Management should be seen as simply maintaining high confidence levels rather than as a sign of the start of a downward trend.

UNITED STATES: CONSUMERS CONTINUE TO SPEND

Retail sales excluding cars and petrol as year-to-year change

SOURCE: Department of Commerce and internal figures.

Housing continues strong growth.

Housing continues to move ahead strongly. Figures for prices and sales in October remained strong while housing starts, which in the summer months showed some slight indication of a slowdown, rose in November with growth of 17.5% compared with the same period the year before. While the price of new housing is slowing down, prices for existing housing moved up to reach rates of more than 16% putting sales of existing housing five times higher than in the case of new housing units. The «soft landing» some people were

UNITED STATES: INDUSTRIAL PRODUCTION

Year-to-year change in industrial production

SOURCE: Federal Reserve and internal figures.

predicting at the beginning of autumn has thus changed into a rise. In this respect, the work of reconstruction following the hurricanes may have introduced upward distortions but the background strength of the sector seems well established at this time, which continues to give support to economic activity in general.

Employment confirmed its strength with the creation of 215,000 new jobs in November. Adding to this impression of boom, following a second revision, the loss of 35,000 jobs in the eventful month of September changed to an increase of 17,000. In keeping with this upward situation, the unemployment rate in November held static at 5.0%. Following earlier decreases. the purchasing power of wages also is recovering with an increase of 1.0% in November, a gain which, in view of the figures for productivity, should be understood more as supporting the level of economic activity than as a sign of inflation. Labour productivity was revised upward from 4.1% to 4.7% year-to-year, which meant a drop of 1.0% in unit labour costs. The labour market, thanks to improved technology and the effects of globalization, continues to show no inflationary trends in spite of its strong levels.

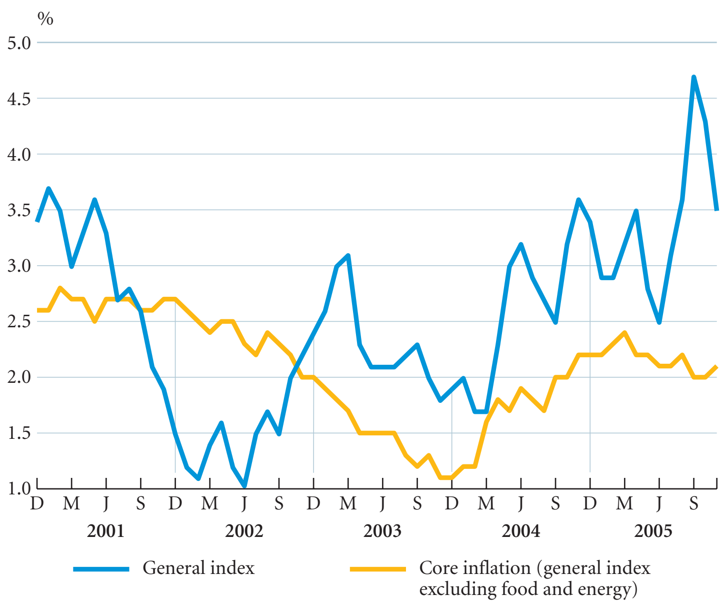
Employment growing and wages recovering thanks to productivity gains.

Inflation dropped from 4.3% to 3.5% year-to-year in October because of the easing off in energy prices which went above expectations. The core component, which excludes energy and food and is the most reliable indication of the general trend, held practically unchanged at 2.1%. Producer prices, which exclude retail margins, showed a similar trend dropping from 6.9% to 4.5% in only two months, with the core component going up by a mere 1.7%. In view of the ups and downs caused by the swings in oil prices, what is notable is the few changes seen in non-energy components, an indication of the firmness of the fundamentals of the current recovery.

Inflation makes fast return to more moderate rates.

UNITED STATES: INFLATION RAPIDLY EASING OFF

Year-to-year change in consumer price index



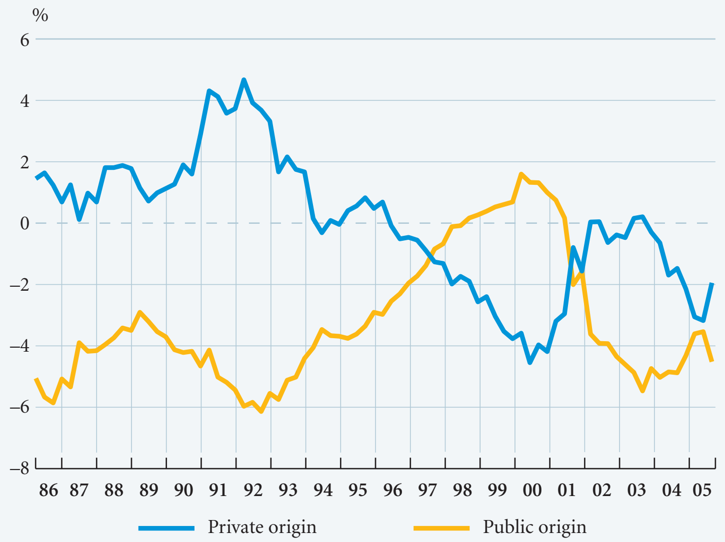
SOURCE: Department of Labour and internal figures.

A generational matter: good times and bad times

The pharaoh had a dream and asked Joseph what it meant and the clever young man replied that in the seven good years he should save and provide for the lean years. In a situation of robust growth with no inflation, the United States is indeed living through the good years but it is not following Joseph's advice seeing that neither household nor government is saving for what lays ahead. The outcome of this is the growing foreign deficit, its biggest imbalance, and at the same time its biggest risk. During the Reagan years, the government deficit was the cause of the foreign deficit then, with Clinton, the responsibility shifted to the private sector. Today, thanks to war costs and aid to economic activity, the government deficit has again become the main cause of the foreign imbalance, while households continue without saving.

PUBLIC SECTOR MAIN CAUSE OF CURRENT ACCOUNT DEFICIT

Deficit in relation to GDP by institutional sector



SOURCE: Bureau of Economic Analysis and internal figures.

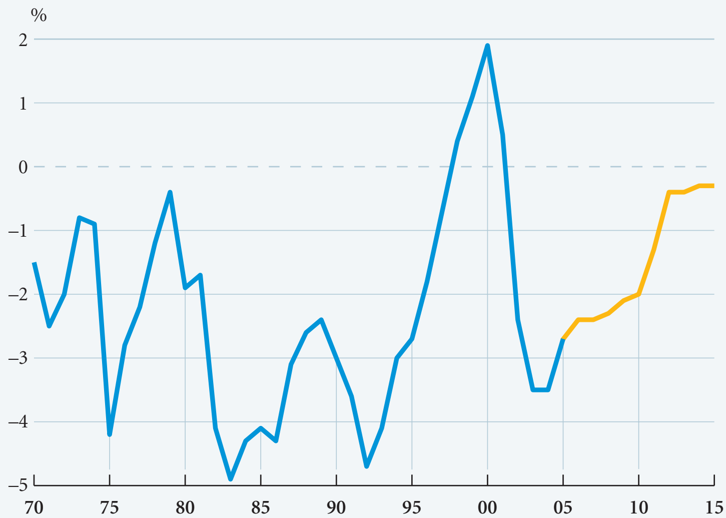
The short-term prospects are for an improvement both in revenue and spending. In the third quarter of 2005, the total current account deficit of general government, not including spending and net capital transfers, stood at 4.5% of the GDP. Of this deficit, the biggest part arose from the federal government, which was 412 billion dollars in 2004 representing 3.5% of the GDP. The Congressional Budget Office (CBO) forecasts a federal deficit of 331 billion dollars, substantially less than expected at the beginning of the year (390 billion dollars) and far from the figure in 2004. In 2006, the CBO expects a federal deficit of 314 billion euros, 2.4% of the GDP. This improvement, larger and better than expected, falls within the process of reduction of the deficit which is expected to take it to 0.4% of the GDP in 2015. Things seems to be straightening out but it is not without reason that economics is known as a sombre science. There is always a negative side.

The improvement is to come through higher revenue and lower spending but the problem is that the good side is temporary while the bad side stays and grows relentlessly. Collections from personal income tax are to increase by 15% year-to-year well above the nominal GDP because, with growth, incomes tend to evolve toward levels with higher tax rates and go above the minimums that are tax-exempt. On top of this comes the end of temporary tax exemptions the current administration put in place in 2001, something that will not be repeated. With regard to corporate profits tax, the increase exceeds 30% year-to-year, well above the actual increase in corporate profits. Possible explanations for this discrepancy suggest that this source of revenue may drop drastically in the future. If at this moment profits have been underestimated in the national accounts, these stand at an unsustainable maximum. If the reason lies in legislative changes or changes in accounting practice, the conclusion is the same, given that the improvements cannot keep continuing. The rate of increase in collections from this source must also drop.

In terms of spending, we can distinguish between discretional spending, which changes very much according to the decisions of the administration, and essential spending, which is less volatile. In recent years, there has been a sharp increase in discretional spending, brought about by the war on Iraq and meeting of national defence needs, with the coda of relieving the effects of hurricane *Katrina*. This reached a high in mid-2003 right at the end of the invasion of Iraq although since then it has been dropping, thus bringing about the current budgetary improvement. Up to here we can talk of the good times.

WE HAVE VERY HIGH HOPES

Federal deficit in relation to GDP (*)



NOTES: (*) Starting out from 2005 CBO forecasts.
SOURCE: Bureau of Economic Analysis, Congressional Budget Office and internal figures.

It is when we look at essential spending that the bad times appear. Starting in 1946, the first year of peace following World War II, there was a sharp increase in births in the United States which gave rise to a large increase in population which has been termed the «baby boom». In the Sixties they went to Vietnam, the newly-designed Ford Mustang came out for their single years, they dreamed with Martin Luther King and they raved over Elvis and Bob Dylan. From *hippies* they turned into *yuppies* and bought houses and company shares and now they are retiring. In 2008 the first baby-boomers will be 62 years old, the earliest age for becoming eligible for federal government retirement benefits. In 30 years, those over 65 will have doubled and there will be a shift from 3.25 persons to 2 persons working for each person taking retirement. As a result, Social Security costs, now growing at 5.5% year-to-year, will go on increasing.

Things, however, do not stop here. Social Security is only one of the three main headings of government spending. These also involve health, with Medicare and Medicaid programmes, and here the expected increase in spending is even greater. A degenerative illness at 80 years of age is more costly to care for than lung cancer at 60. Furthermore, advances in medicine will have a net effect on increasing the cost of treatment. As a result, spending on health care will grow well above the nominal GDP.

The situation is not desperate. There does exist a cure for everything and that is growth and productivity. Improved productivity could make it possible that just two workers per person on retirement could balance the accounts. What is troubling is that at this moment, with the economy booming and a government deficit easing down, this component is still contributing to more than half the current account imbalance. The crossroads facing the United States is that any drastic change in government spending or the level of household savings could have major effects on growth. If during the days of wine and roses we run a deficit, what will happen when the picture changes? The CBO foresees an improvement in coming years but what fails to be convincing in this forecast is that it means that there will have to be a lot more than seven good years.

Growing foreign deficit keeps getting worse.

The trade deficit was again disappointing as it went to new all-time highs going close to 69 billion dollars in November, according to figures for the balance of payments. This figure is 19.4% higher than that recorded in July when the deficit went down for the last time in terms of the month before and the fact is that in the past three months the deficit now exceeds 6% of the GDP. The slight improvement in the second quarter was thus an isolated event brought about by the cycle of inventories and temporary rigidities in imports from Asia. With present levels of consumption and investment, exports failing to make advances and the savings surplus held by its main trading partners, it is difficult to pinpoint where the limit of this situation could lie, a situation which grows worse and worse month by month.

Japan recovering but only just

Japan revises growth downward.

Japan's growth is moving ahead although there is more optimism among manufacturers than among consumers. Doubts about the strength of recovery and the matter of deflation are different faces of the same enigma which for now still remains.

In its first revision, the Ministry of Communications revised downward the figure for GDP growth in the third quarter, which changed from growth of 1.7% quarter-to-quarter annualized to 1.0%. By contrast, the figures for the first half of the year were revised upward which reduced the previous upward trend. The bulk of the revision came about through a reduction in inventory levels, which took some importance away from the announcement although this does not remove doubts about the strength of the current recovery. The main engines of this recovery, private consumption and investment, were slightly revised upward, especially investment, but with few changes. The foreign sector also improved and, thanks to lower imports, stopped draining away from growth. The main doubts about growth lie in the nominal figures. With a deflator that increased its downward trend dropping by as much as 1.4% year-to-year, the GDP in current terms showed a decrease of 0.7% compared with the previous quarter in year-to-year

JAPAN: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2003	2004	2004			2005				
			2 Q	3 Q	4 Q	1 Q	2 Q	3 Q	October	November
Real GDP	1.8	2.3	2.6	2.3	0.6	1.1	2.7	2.8	–	...
Retail sales	–1.7	–0.9	–1.7	–0.5	–0.4	1.1	3.2	0.8	–0.4	...
Industrial production	3.3	5.3	7.8	6.6	1.6	2.7	0.3	0.2	3.0	...
Tankan company index (*)	–1.8	20.5	22.0	26.0	22.0	14.0	18.0	19.0	–	21.0
Housing construction	0.6	2.6	–3.5	9.4	–0.1	1.5	2.1	5.0	8.9	...
Unemployment rate (**)	5.2	4.7	4.6	4.8	4.6	4.6	4.3	4.3	4.5	...
Consumer prices	–0.3	0.0	–0.3	–0.1	0.5	–0.2	–0.1	–0.3	–0.7	...
Trade balance (***)	12.0	13.7	13.7	14.1	13.7	13.3	12.2	10.9	10.7	...

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

Retail sales and car sales dropping...

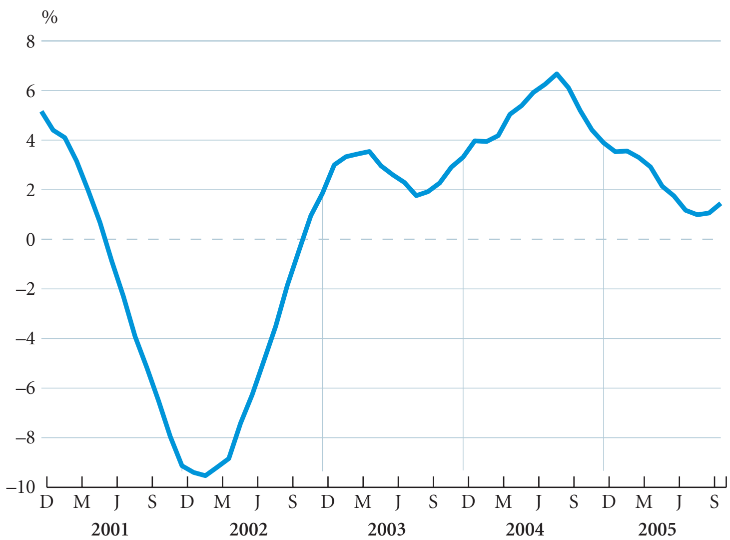
rate, whereas earlier an increase of 0.7% had been announced.

Along the lines of the month before, the latest demand indicators continued to show signs of weakness. Retail sales were down 0.4% year-to-year in October, something which has not happened since the end of 2004. In spite of this, the background upward trend is still not halted. Car sales continued the same weak trend with a decrease for the fifth consecutive month getting even sharper in November at 9.7%.

Also in keeping with previous months, supply indicators showed more positive signs than those for demand. Industrial

JAPAN: INDUSTRIAL PRODUCTION STABILIZING

Year-to-year change in industrial production (*)



NOTES: (*) Cycle-trend series.
SOURCE: Japanese Ministry of Communications, National Statistics Office and internal figures.

...while industrial production ends slowdown and business circles see somewhat better situation.

production in October was revised upward to 3.0% year-to-year, a good figure not seen since February, which stabilizes the slowdown seen in recent months. Machinery orders in October lost some of the strength seen the month before but the domestic component continued to show measured positive signs. In a somewhat worse context, business bankruptcies in October and November rose slightly to levels at the start of 2004. Somewhat indicating the moderate state of the current recovery, the Tankan index for large manufacturing corporations went from 19 to 21 in the fourth quarter, an increase rather lower than was expected but one which again puts business optimism among the highest levels since the beginning of the Nineties, although far from the figures shown before Japan slipped into its «lost decade».

The housing market in November continued its slow but gradual recovery. Housing sales in Tokyo naturally lost the levels of previous months but the general trend in prices and sales continued an upward trend.

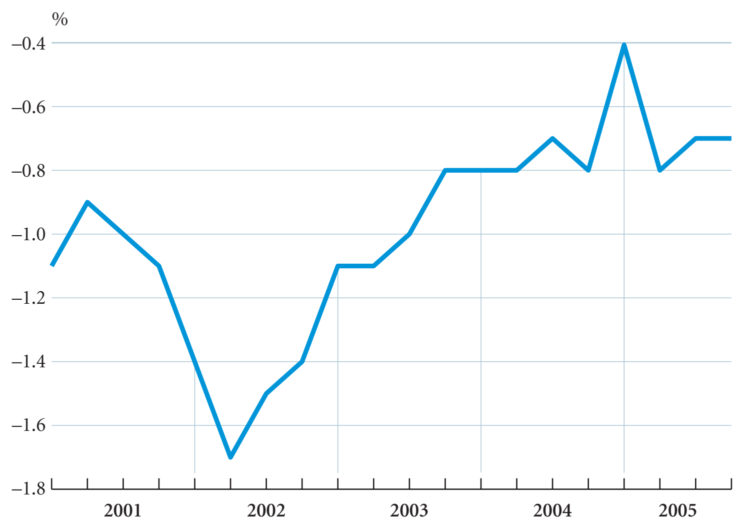
Deflation still continues.

On the inflation front, October prices were down by 0.7% year-to-year and Tokyo prices dropped by 0.9% in November. On the more positive side, excluding volatile fresh foods, prices showed a repetition of the figures in the same period the year before, although this was helped by a rise in energy prices. With these figures, and not forgetting the GDP deflators, which were also negative, it is unlikely that Japan will halt deflation in any consistent way until the end of 2005, as stated by the central bank, or even until early in 2006. As a continuation of what has happened in recent months, the unemployment rate rose to 4.5% of the labour force in September with loss of jobs in construction and gains in services.

Japan's trade surplus continued to drop in November because of increasing imports. On the positive side, exports recovered.

JAPAN: PRICES RESISTING ANY CHANGE FROM DOWNWARD MOVE

Year-to-year change in GDP consumer deflator



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

China continues to grow with no inflationary pressures

China continues unabated its strong advance with sharp growth rates and little inflation. The statistics are to be revised and, in principle, the changes should be upward with a better accounting of services. What is surprising is that we see a strong rate of economic activity along with extremely moderate prices, which can only be understood in the light of higher investment in relation to consumption. What is even more surprising is the stability of growth which during recent quarters has scarcely shown any change in rate of increase.

The Chinese economy grew by 9.4% in the third quarter of 2005. By sector, industry was again the main player with an increase of 11.1% year-to-year, followed by services which were up 8.1% and agriculture with a rise of 5.0%. Investment and exports continue to be the basis of growth standing well above private consumption.

On the supply side, the industrial sector continued to show the biggest growth in the third quarter while services increased their growth rate slightly. It is likely that, with the next revision of the statistics, which may include a better estimate for services, the relative weight of industry could show a lower share of the overall economy.

China making big steps forward with no inflation and surprising stability.

On the demand side, we find the few indicators which give some signs of slowing down. Retail sales rose by 12.4% in November, a rate that, while certainly remaining high, is still the second lowest in the past three years. The reason for this relative slowdown may be found in the rural sphere whereas in the cities we see more of an increase in growth. This divergence is significant in a country where one of the main problems is the income gap between country and city.

Producers, especially industrial concerns, ahead of consumers.

On the supply side, industrial production rose by 16.6% year-to-year in November. Heavy industry continued to gain ground and state-run companies again showed decreases thus reducing their share of total value added to 37.7% from the figure of 41.4% one year ago. This means some reduction of risks, seeing that the state conglomerates and their debt is one of the biggest problems in the Chinese economy. By product, motor vehicle production, including motorcycles, seems to be stagnant whereas production of computers is going full steam ahead with robust growth of 80.2% year-to-year in the 12 months ending in November. Energy production is also going up sharply.

CHINA: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

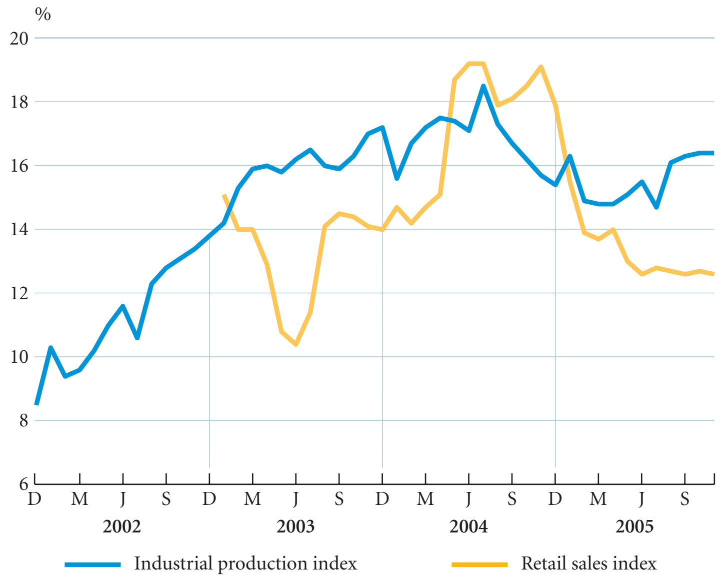
	2003	2004	2004			2005				
			2 Q	3 Q	4 Q	1 Q	2 Q	3 Q	October	November
Real GDP	9.4	9.5	9.6	9.1	9.5	9.4	9.5	9.4	–	...
Industrial production	16.7	16.3	17.6	15.8	15.0	14.5	16.5	16.2	16.1	16.6
Electrical power production	14.2	15.0	16.5	12.9	14.6	14.7	13.7	13.6	9.0	9.9
Consumer prices	1.2	3.9	4.4	5.3	3.2	2.8	1.7	1.3	1.2	1.3
Trade balance (*)	25.5	32.1	13.6	20.4	32.1	57.2	79.4	96.7	101.6	102.1

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

SOURCE: National Statistics Office of China, Thomson Financial Datastream and internal figures.

CHINESE INDUSTRIAL PRODUCERS AHEAD OF CONSUMERS

Year-to-year change (*)



NOTES: (*) Cycle-trend series.
SOURCE: Chinese National Statistics Office and internal figures.

Surplus moderating, except for bilateral balance with United States.

Production of electrical power is continuing to rise as in the same period the year before.

In spite of the high level of economic activity, prices remain at figures surprisingly contained with a general consumer price index advancing by a mere 1.3% year-to-year in November. Apart from the absolute figure, prices in rural areas rose more than in the urban areas in spite of lower retail consumption in the former case. This may be explained by the recognized existence of bottlenecks outside the cities.

In the foreign sector, exports continue to show strong growth with an increase of 29.9% year-to-year in the 12 months ending in November, which nevertheless meant a slight slowdown. Imports also continued to slow recording an increase of 17.7% in the same period. As a result of these dips, the trade surplus for 12 months ending November reached 102.13 billion dollars, a new record, but it is no longer growing at an explosive rate. Always taking into consideration the highly volatile nature shown by this heading, the November figure was lower than in October. Trade deficits were still being maintained with South Korea and Japan but China came to have a surplus with Germany. The surplus with the United States was a special case going 110 billion dollars well above the total surplus. It may be said that China is a net importer at the world level if we exclude its bilateral balance with the United States.

By product, there were no big changes from recent months with exports of manufactured goods growing by 33.0% in the 12 months ending in October and imports of raw materials in the same period up by 32.1%.

Mexico maintaining growth

The Mexican economy grew by 3.3% year-to-year in the third quarter of 2005.

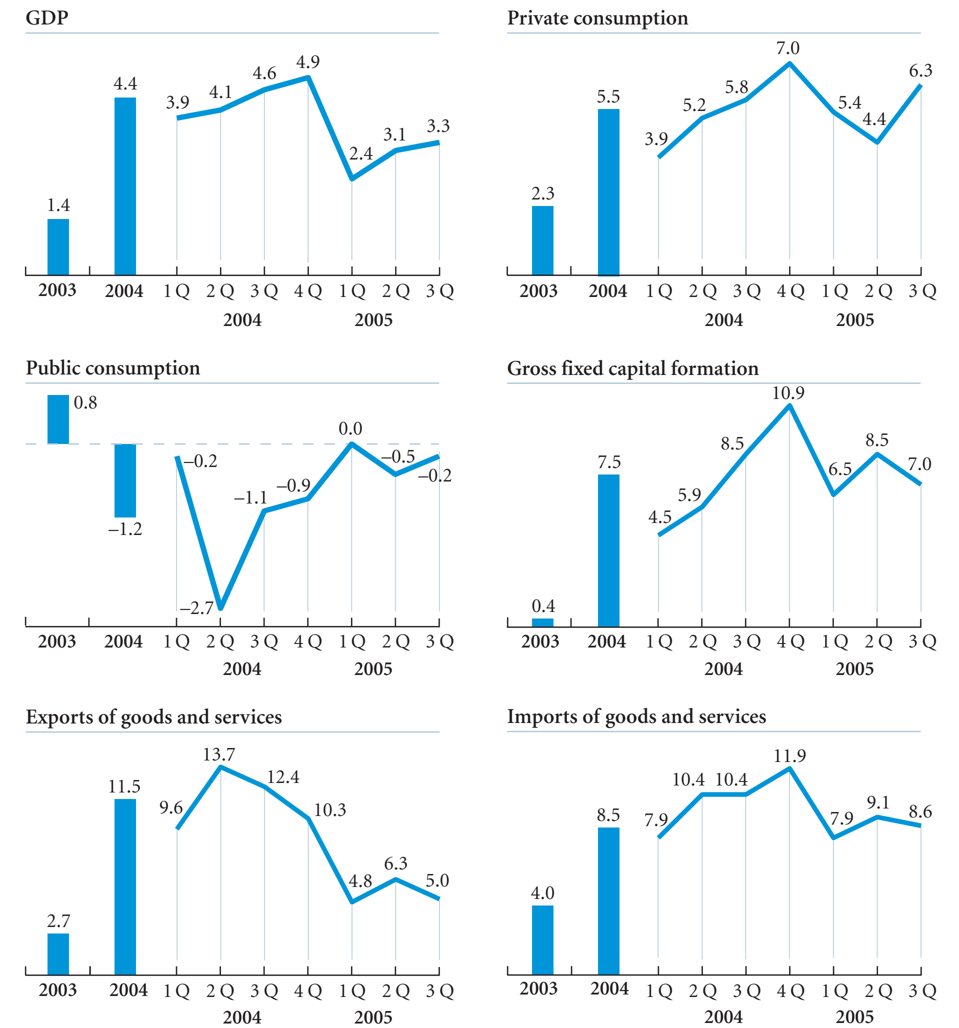
Mexico's growth thus was maintained for the third consecutive year. This growth was based on domestic demand, especially by a notable recovery of private consumption. Investment held firm but investment of public origin grew even more than private. The foreign sector continues to take strength away from growth to show a macroeconomic profile more like that of the United States than other Latin American communities which at this moment are showing trade surpluses. By sector, banking and financial services and transportation continued to be strong points which have been joined by the sharp rise in the food sector. On the other hand, construction has lost a good part of the strength shown in recent months.

Mexico growing with no inflation.

On the demand side, retail sales in October maintained levels with 3.8% year-to-year, somewhat lower than the strong figures for August and September. On the supply side, industrial production in October moved

TREND IN MEXICO'S GDP BY COMPONENT

Percentage year-to-year change in real terms



SOURCE: Central Bank of Mexic and internal figures.

MEXICO'S INDUSTRIAL PRODUCTION NOT SHOWING GREAT STRENGTH

Year-to-year change in industrial production (*)

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

***Maquiladoras* showing slowdown.**

up by 2.6% year-to-year, again with a profile similar to the US and Japanese cases, namely recovery although at more moderate rates than in previous growth periods. Construction is presenting some improvement while the *maquiladoras* showed 3.3% growth, a significant slowdown which could be a result of the effects cheap Chinese labour costs through replacement of exports, is having in low cost countries like Mexico.

Unemployment down but unit labour costs rising.

The general unemployment rate dropped to 3.7% of the labour force in September as a result of the drive in demand. In the same period, manufacturing productivity halted its downturn but is still weak. In this respect, unit labour costs, which rose by nearly 10%, continue to be a problem seriously affecting Mexican competitiveness.

Following a path already familiar, consumer prices sharpened their

MEXICO: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2003	2004	2004			2005				
			2 Q	3 Q	4 Q	1 Q	2 Q	3 Q	October	November
Real GDP	1.4	4.4	4.1	4.6	4.9	2.4	3.1	3.3	–	...
Industrial production	–0.2	3.8	3.7	4.8	3.6	–0.2	2.8	0.7	2.6	...
General unemployment rate (*)	3.2	3.7	3.6	4.0	3.5	3.9	4.0	3.8	...	...
Consumer prices	4.5	4.7	4.3	4.8	5.3	4.4	4.5	4.0	3.1	2.9
Trade balance (**)	–5.8	–8.8	–5.6	–6.2	–8.8	–10.2	–9.7	–9.4	–9.5	...

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

downward trend with an increase of a mere 2.9% compared with the same period the year before. The component excluding food and energy for the same month continued to move downward with a rate at 3.1%.

Mexico's foreign sector is the most negative part of an economy which, on the other hand, is growing without showing any inflationary pressures. The trade deficit for the past 12 months ended October 2005 held close to 9.5 billion dollars. If oil exports are excluded, the deficit came close to 40 billion dollars. A downturn in oil prices could put more pressure on a foreign sector not enjoying its brightest moments.

Dependence on oil exports now becoming risk for Mexican economy.

Oil prices: after rising, prices ease again

Following two months of relative containment of oil prices (between the end of September and the end of November the price per barrel of Brent quality oil dropped by 13% going to 54 dollars a barrel), there was a further upward move in December. In the first two weeks of the month prices again came close to 60 dollars a barrel although at the end of December they eased to 56 dollars a barrel.

Upturn in oil price in first half of December due to harsh weather in Western Hemisphere and OPEC decision not to raise official production quota.

The move was due mainly to the fact that the first two weeks of December were very cold in the United States and Europe, which affected the level of inventories of crude oil and refined products. Also contributing to this upward move was the announcement by the Organization of Petroleum Exporting Countries (OPEC) on December 12 that it would maintain its official production quota unchanged at 28 million barrels a day. This short-term trend should not make us forget that background tendencies continue to move in the direction of creating high oil prices. While the final stages of 2005 have been relatively calm, the International Energy Agency has revised upward demand prospects for 2006.

OIL PRICES MOVE AWAY FROM ALL-TIME HIGHS

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

SOURCE: Thomson Financial Datastream.

RAW MATERIALS PRICES

	2003	2004	2004	2005					
			4 Q	1 Q	2 Q	3 Q	October	November	December
«The Economist» index in dollars (*)									
General	**11.7**	**17.4**	**1.5**	**–2.3**	**–1.8**	**6.2**	**11.1**	**10.9**	**13.9**
Food	9.1	11.2	–7.3	–8.5	–7.7	3.2	9.7	6.7	6.0
Industrials	15.9	26.1	13.8	5.9	6.3	10.0	12.7	15.6	22.8
Non-food agricultural	*21.8*	*9.2*	*–11.2*	*–10.7*	*–8.6*	*0.8*	*10.5*	*9.2*	*13.1*
Metals	*11.8*	*38.2*	*31.5*	*16.1*	*15.5*	*15.0*	*13.8*	*18.7*	*27.2*
«The Economist» index in euros (*)	**–6.7**	**6.7**	**–6.5**	**–6.4**	**–6.0**	**6.6**	**15.4**	**21.6**	**28.2**
Oil (**)									
Dollars/barrel	28.4	38.0	44.7	47.8	53.1	62.0	59.3	56.4	57.3
Change rate	13.1	34.4	53.8	52.7	50.9	52.5	20.6	26.0	42.7
Gold									
Dollars/ounce	364.0	409.6	434.0	427.3	427.8	439.6	470.0	476.9	508.8
Change rate	17.3	12.7	10.6	4.6	8.6	9.4	11.7	8.5	15.2

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

Among other raw materials, metals continue to show surprising rise, with notable increase in copper.

With regard to other raw materials, we have seen a further increase in prices «The Economist» index for December in dollars was up by 14% year-to-year, three points more than in November). Especially troubling is the trend shown in industrial raw materials with metals in the lead. Whereas the general group of industrial raw materials has risen by 23% over the past year, metals have gone close to 30%. Although key metals such as platinum and aluminium are showing appreciable growth rates, in the case of copper (with a year-to-year rise of 45% in December) the increase was especially sharp. Gold, in turn, in the December average went above psychological barrier of 500 dollars an ounce) a year-to-year, an increase of 15%.

EUROPEAN UNION

Euro area: growth continuing its course

The recovery of the euro area is going well ahead. With details of the trend in growth by component in the third quarter we find that the increase in the gross domestic product (GDP), from 1.2% year-to-year to 1.6% in the third quarter, was basically due to the good trend in investment and the foreign sector. Specifically, gross fixed capital formation went from growth of 1.9% year-to-year in the second quarter to 3.2% while other domestic demand components either increased at a substantially better rate (in the case of public consumption) or directly stagnated, as took place with private consumption.

The foreign sector, in turn, which had been taking away drive from the economy for a period of four months, went over to making a positive contribution in the third quarter with a one decimal change in the GDP. Following this performance we see a notable recovery in exports (year-to-year growth of 5.2% compared with 2.9% earlier), which improved on the more moderate increase in exports (increase of 5.3% year-to-year starting out from 4.5% in the second quarter).

Euro area grows by 1.6% in third quarter thanks to recovery of investment and rise in exports but still lacking recovery of consumption...

Attention is now centred on two unknowns. First, following the boost in the third quarter, indicators for the fourth quarter, which give a more global picture of the economic drive, showed a surprising slowdown. As a result, economic sentiment in November dropped to the level of 99.9 points as against 100.2 in October. The trend in industrial production (this grew by 0.1% year-to-year in October, 1.1 percentage

...something needed for euro area to consolidate recovery still not happening according to available figures.

EURO AREA: MAIN ECONOMIC INDICATORS

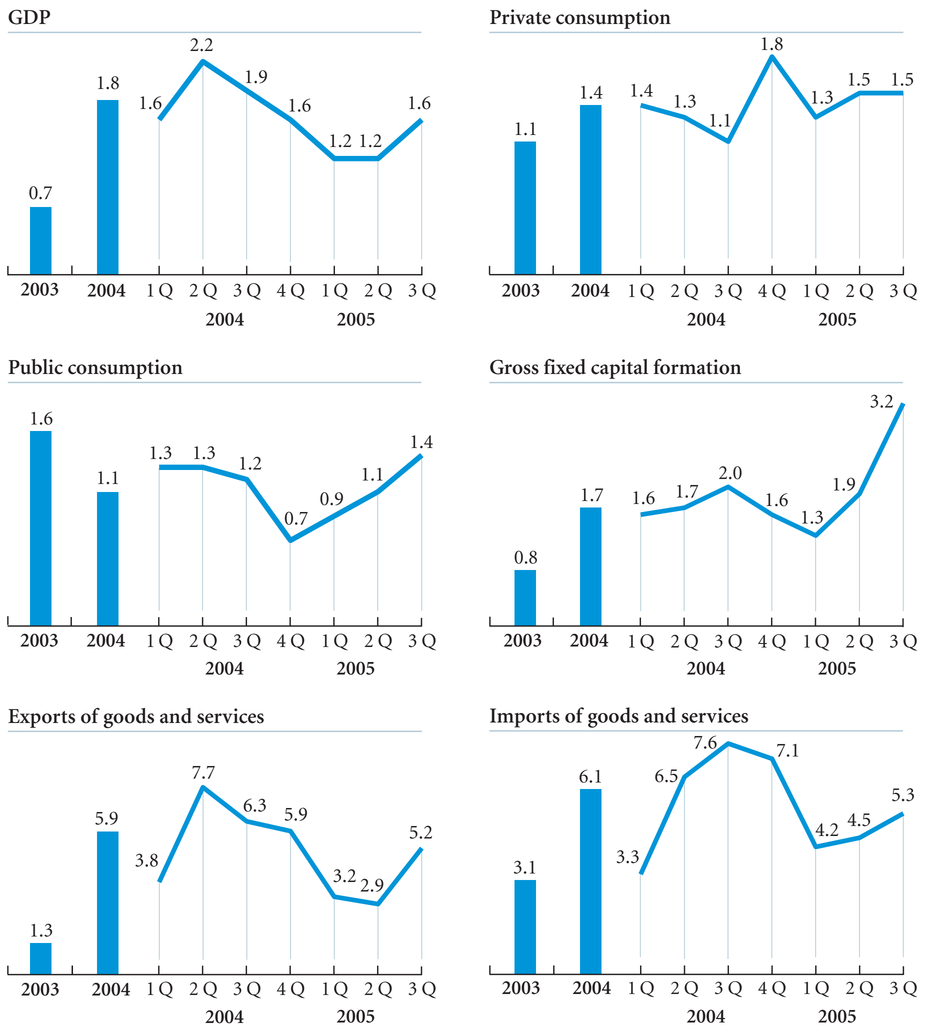
Percentage change over same period year before unless otherwise indicated

	2003	2004	2004	2005				
			4 Q	1 Q	2 Q	3 Q	October	November
GDP	0.7	1.8	1.6	1.2	1.2	1.6	–	...
Retail sales	0.4	0.8	1.0	1.2	0.7	0.8	0.4	...
Consumer confidence (*)	–18	–14	–13	–13	–14	–15	–13	–13
Industrial production	0.3	2.0	1.1	0.6	0.6	1.4	0.1	...
Economic sentiment indicator (*)	93.5	99.5	100.5	98.7	96.1	97.8	100.2	99.9
Unemployment rate (**)	8.7	8.9	8.8	8.8	8.6	8.4	8.3	...
Consumer prices	2.1	2.1	2.3	2.0	2.0	2.3	2.5	2.3
Trade balance (***)	80.3	80.5	73.2	64.7	50.6	39.8	33.0	...

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

TREND IN GDP IN EURO AREA BY COMPONENT

Percentage year-to-year change



SOURCE: Eurostat and internal figures.

Prices move into downward trend in November slowing to 2.3% while labour market seems to be moving into less depressed stage.

points less than in September) also seemed to confirm this. In our opinion, this was a temporary correction which does not change the situation of recovery before us.

The second question, of greater importance, continues to be whether private consumption will change from its state of weakness to a stronger growth rate. Available indicators do not make it possible to dispel existing doubts. The most favourable trend shows up in consumer confidence which stood at –13 points in October and November, an improvement over the –15 points in the third quarter. On the other hand, car sales, a major indicator of the present state of consumption, broke away from a growth path lasting four consecutive months to drop by 0.2% year-to-year in November.

Other available indicators have recently pointed in a moderately positive direction. Recovery will benefit from the containment of inflation. The harmonized consumer price index

(HCPI) dropped to 2.3% year-to-year in November (2.5% year-to-year in October) thanks to lower increases in the energy component. The trend in prices, discounting energy, was even better as it held at a moderate 1.5% year-to-year in October and November. Even the feeble labour market seems to have stopped getting worse. The unemployment rate in October stood at 8.3% of the labour force showing no drop over September and a half-point less than the figure for one year earlier.

Germany: a good fourth quarter

Germany's economy is ending 2005 in the best state for many years. In spite of the long-lasting weakness in consumption (retail sales were down by 1.1% year-to-year in October, failing to reflect the improvement in consumer confidence in October and November) investment and exports, Germany's two strong points, are operating at a good rate. We should mention growth of industrial production of capital goods which recorded a year-to-year increase of 4%, some eight decimals above the good figure for the third quarter and the increase in the trade surplus as of October.

Even more notable is the cyclical increase viewed from the perspective of supply. Industrial production grew by 4.0% year-to-year in October, the highest rate since September 2004. The IFO and ZEW indicators of industrial activity rose sharply in December putting an end to the apparent halt in the middle of the fourth quarter. Industrial orders stood at levels close to 10% higher than in October 2004. Finally, business activity is strong and immediate prospects are tending to improve even more.

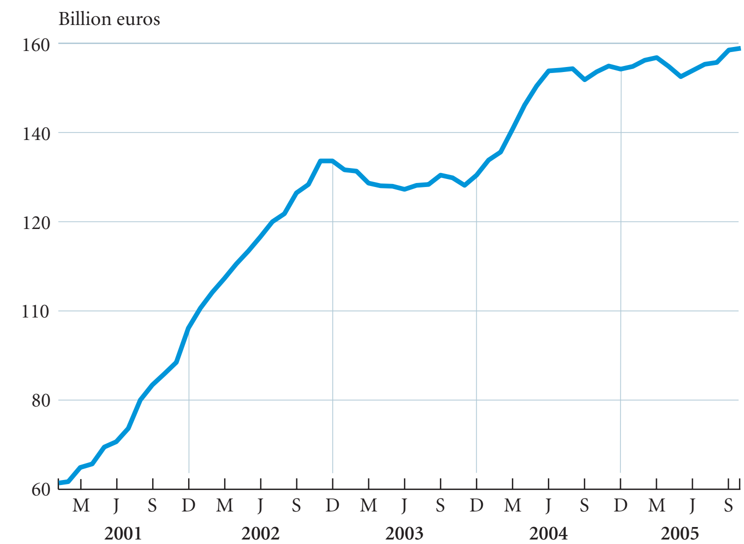
The trend in prices is holding in line with that shown in recent months. Producer prices jumped to 5.0% year-to-year as of November as a result of the upward contribution of energy.

Germany ending 2005 in best form for many years although slack in consumption not easing up and investment and exports take on main role in recovery.

Business activity remains very positive with industrial activity on increase and prospects of going above current figures in coming months.

GERMANY'S FOREIGN SECTOR ENGINE OF RECOVERY

Trade surplus: cumulative balance for 12 months



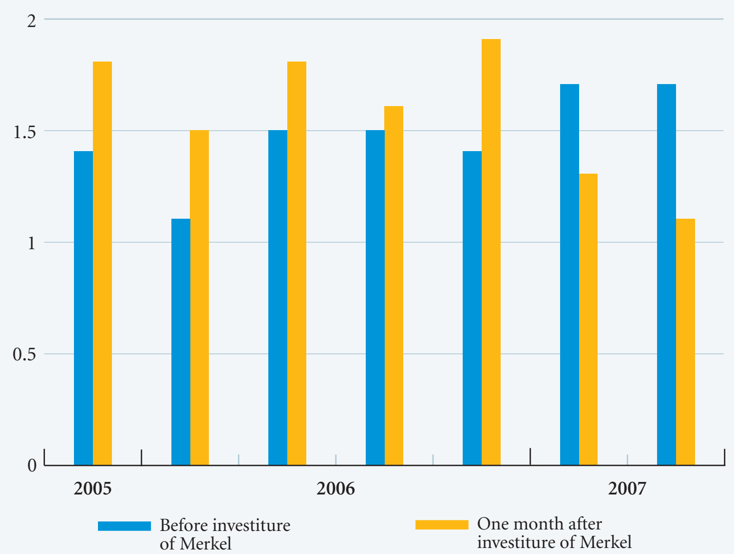
SOURCE: Deutsche Bundesbank and internal figures.

Will 2006 be Germany's year?

The increased growth of Germany's GDP in the third quarter of 2005, which was higher than expected, along with finalization of negotiations to form the «Great Coalition» between Christian Democrats and Social Democrats, gave rise to something akin to euphoria about the prospects for Europe's leading economy in 2006. With just a few days between them, three of the major German think-tanks (the IFO, ZEW and RWI institutes) revised upward their 2006 growth forecasts from levels of the order of 1.2% to figures between 1.5% and 1.7%, a substantial correction of the forecast published at the end of October, less than two months earlier. Private analysts have not hesitated in responding to this change. One week before the investiture of Angela Merkel on November 14, they were expecting growth of 1.2% for 2006. One month later, they were forecasting 1.5%, an unusually sharp rise in such a short period of time.

POLITICAL CHANGE IN GERMANY CHANGES GROWTH FORECASTS

Growth forecasts for gross domestic product in real terms (*)



NOTES: (*) Forecasts given in Consensus Forecast for November 2005 and December 2005.
SOURCE: Consensus Forecast.

What happened during that month? While it is true that available indicators overall were positive, the main new factor was that the programme of Merkel's government had been defined. With the theme «United for Germany with Courage and Humanity» designed to measure up to the first «Great Coalition» in nearly 40 years, the new programme started out with a message that was fully shared by the economists. It stated: «Germany faces major challenges. Unemployment, government debt, demographic change and the pressure of globalization demand great political effort in order to ensure a life of well-being for present and future generations». The government thus clearly established the area in which the success or failure of its economic policy will be shown. It seeks to take measures to deal with restrictions of a structural kind which have strangled Germany's economy in recent years. Indeed, the measures announced set out steps for structural reform.

The key measure is fiscal reform capable of bringing the government deficit in 2007 down below the 3% of the GDP, a limit established under the European Union Stability and Growth Pact. If, as expected, the 2005 deficit ends up coming close to 4% of the GDP, it is a matter of nothing less than being able to increase tax revenues and/or reduce spending by an amount equivalent to 1% of the GDP. In order to do this, the VAT rate is to be raised by three points from 16% to 19% in 2007 and there is to be an increase of 3% in the tax rate applied to personal income tax on the highest income group.

Given that the increase in indirect taxes will provide some 20 billion euros, one-third of which will go toward reducing the cost of unemployment insurance, with only two-thirds remaining to put the public finances in order, the government has in mind rounding out revenues obtained through recourse to privatizations. Specifically, a figure of 54 billion euros up to 2009 has been designated. This solution has not met with the favour of the Bundesbank whose chairman Axel Weber has stated his preference for making use of control of spending as against the emphasis on privatization.

The other policies announced are less ambitious. The government has committed itself to a programme of public investment amounting to 35 billion euros over the next four years. The trial period for persons newly hired has been extended to 24 months in place of the current 9 months. Unemployment insurance has been reduced moderately (although unemployed benefits in the eastern *länder* are improved). Finally, the retirement age is to be increased as of 2012 in order to reach 67 years by 2037.

When one tries to examine the consequences of this group of measures on the incipient recovery in which the Merkel government finds itself, a key question arises about its effects on domestic demand so long as the foreign sector of the world's leading export country can continue, as it likely, to capitalize on a generally favourable international environment.

Up to this date, recovery has been based on a classical transmission-belt process. When growth of foreign demand reaches a sufficient rate, German companies again begin to invest. Nothing in the government programme points to relevant changes on this front. According to most analysts, both investment in capital goods and exports will increase over the satisfactory levels reached in 2005.

On the other hand, there is much greater uncertainty about the trend in private consumption. In most scenarios put out by the analysts, the expected impact is that the consumer will bring forward part of spending decisions to 2006 in order to anticipate the upcoming increase in VAT. As a result, during 2006 the growth rate of consumption will increase slightly. In any case, given that little improvement is expected in consumption fundamentals, the growth reached will be limited. To sum up, 2006 will likely present a Germany in better shape with growth above 1.5% thanks to the twin export-investment factor. Nevertheless, this economy still remains a long way from its historic role as the economic engine of Europe.

Inflation remains contained although pressures showing up in producer prices represent latent threat.

Nevertheless, the poor strength shown by domestic demand has acted as a brake on a complete shift of these increases to consumer prices which again showed 2.3% year-to-year in November.

Finally, we should point out that the unemployment rate is still failing to leave behind the relatively high levels seen in recent months. The unemployment rate stood at 11.5% of the labour force in November, a figure which, while representing a reduction of one decimal over October, is seven decimals worse than that recorded one year earlier.

GERMANY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2003	2004	2004	2005				
			4 Q	1 Q	2 Q	3 Q	October	November
GDP	–0.2	1.1	0.5	0.6	0.7	1.4	–	...
Retail sales	–0.5	1.1	1.4	0.6	2.1	0.1	–1.1	...
Industrial production	0.1	2.4	1.4	1.9	1.9	2.9	4.0	...
Industrial activity index (IFO) (*)	91.7	95.7	95.0	95.2	93.3	95.3	98.8	97.8
Unemployment rate (**)	10.5	10.5	10.8	11.7	11.7	11.6	11.6	11.5
Consumer prices	1.0	1.7	2.0	1.7	1.7	2.1	2.3	2.3
Trade balance (***)	130	149	155	157	154.4	157.2	159.6	...

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

Positively surprising growth in third quarter fails to remove impression that French economy needs more solid bases to benefit from strong recovery.

France: improvement without solid base

The French economy improved on forecasts to show growth of 1.8% year-to-year in the third quarter, seven decimals higher than in the second quarter, and everything would indicate that recovery is on track. Nevertheless, the bases of French growth are not yet sufficiently solid.

Main concern lies in unsatisfactory trend in consumption although low inflation may represent boost to household spending.

In spite of the specific increase in domestic consumption in November (increase of 3.2% year-to-year), the main problem is that the consumer has not yet shed all doubts. In the months of October and November consumer confidence dropped by three points, largely because of the worsening of the component related to the future situation. This was a logical outcome of a rather unfavourable labour market (the unemployment rate is still very close to 10% as of October) and the uncertain impact on future incomes of a moderate tax cut which will not be fully noticeable until 2007.

In this context, the trend in inflation can only be seen as positive as it avoids any excessive reduction in real incomes.

The CPI stood at 1.6% year-to-year in November, a drop of two decimals over

FRANCE: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2003	2004	2004	2005				
			4 Q	1 Q	2 Q	3 Q	October	November
GDP	0.9	2.1	2.0	1.8	1.1	1.8	–	...
Domestic consumption	1.9	3.3	4.0	3.2	1.2	4.4	2.0	3.2
Industrial production	–0.4	1.8	1.5	0.7	–0.5	0.3	–1.4	...
Unemployment rate (*)	9.8	10.0	10.0	10.1	10.2	9.9	9.7	...
Consumer prices	2.1	2.1	2.1	1.6	1.6	1.9	1.8	1.6
Trade balance (**)	0.2	–0.1	–0.5	–1.0	–1.5	–1.8	–1.9	...

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

October. The lack of any increase in inflation shows up especially when we remove the more volatile elements from the index, including the increase in cost of energy. The resulting rate held at around 1% year-to-year between September and November.

Doubts about the strength of France's economic recovery include the trend in the various sectors. Following two months of weak recovery, industrial production, has returned to the range of year-to-year decreases (drop of 1.4% in October). Services have lost something of their drive, as may be seen from the reduction in confidence in the tertiary sector in November. Nor have doubts disappeared about the real strength of construction, a sector in which signs of current recovery go side-by-side with stagnation in the future.

No large sector of French economy showing levels without some doubt.

Italy: very low growth

Italy grew by a modest 0.1% year-to-year in the third quarter (0.2% in the previous quarter). This was a minimal increase in the GDP which underlines the difficulties facing the Italian economy in order to recover strength. To start with, domestic demand continues without showing any clear recovery. While private consumption has begun to improve (increase of 1.4% year-to-year as against the previous 1.0%), the stagnation in public consumption and the insufficient recovery in investment (growth of 0.2% year-to-year) are limiting recovery.

In addition, Italy's previously strong export situation is proving unable to take advantage of the positive international environment. Exports in the third quarter fell by 1.1% year-to-year which, combined with an increase of 2.6% in imports, meant that foreign demand drained off no less than 1.1% from the change in GDP. This was an excessive burden for an economy in bad shape.

Italian economy grows by 0.1% in third quarter as result of weak state of activity and lack of export results...

The few available indicators for the fourth quarter do not point to any significant improvement. In spite of a slight increase in November, consumer confidence remains at a very low level. Industrial production, which is clearly oriented toward exports, is suffering from the weakness of foreign demand and showed a drop of 1.6% in October.

The prospects are not any better. The composite index of early indicators supplied by the Organization for Economic Cooperation and

...having very negative effect on industry which still fails to advance in fourth quarter.

ITALY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2003	2004	2004	2005				
			4 Q	1 Q	2 Q	3 Q	October	November
GDP	0.4	1.0	0.8	–0.3	0.2	0.1	–	...
Retail sales	2.0	–0.4	–1.1	0.1	–1.2	0.3	...	...
Industrial production	–0.5	–0.6	–2.0	–2.6	–1.2	–0.2	–1.6	...
Unemployment rate (*)	8.4	8.0	7.9	7.8	7.7	7.7	–	...
Consumer prices	2.7	2.2	2.0	1.9	1.8	2.0	2.2	2.2
Trade balance (**)	4.1	2.0	–0.8	–1.9	–5.1	–7.0	–8.6	...

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

British government revises downward growth forecasts for 2006 and 2007 thus confirming uncertainty already shown by indicators for immediate future of UK economy...

...which continues to show worst state of consumption for many years with little relief from relative recovery of exports.

Prices not showing any let-up while still low unemployment gradually increasing.

Development was down by 0.7% year-to-year in October to show worse than the year-to-year decrease in September. All of this means that the only positive news is the absence of an increase in consumer prices which, in October and November, held at 2.2% year-to-year.

United Kingdom: prospects worse

On December 5, Gordon Brown, UK Minister of Economy and likely future prime minister, made official what the figures had been indicating for some months. The British economy has left behind the more dynamic stages of the economic cycle and is moving into a range of uncertainty. On the occasion of presentation of the 2006 Budget to the House of Commons, Brown announced that forecast growth for the current year would be 1.75% as against the 3.25% officially announced previously, with 2.25% in 2006, a half-point below former government forecasts. It should be pointed out that, in spite of the reduction in both cases, the consensus of forecasts by analysts, including our own forecast, stands lower than official figures.

This reflects an economy in which consumption, which was previously the driving force of domestic demand, is scarcely moving ahead in the final stages of 2005 whereas investment, by far the main contribution to growth through domestic demand, is beginning to show signs of wearing out. As a result, in only three months, industrial production of capital goods went from an increase of 3.1% year-to-year in August to nil growth in October. In this situation, the improvement in exports, which made it possible for the trade imbalance to be reduced slightly as of October, has been received as a blessing.

Nevertheless, more attention has been given to the poor indicators in supply with industrial production not growing in year-to-year terms since December 2004 and with the real-estate sector undergoing a slack period which meant that housing prices in November grew at the lowest rate since 1996.

To round out this review of the British economic scene, it should be remembered that inflation, while not at alarming levels, still grew by 2.3% year-to-year in November and that the unemployment rate has been progressively departing from all-time lows to come close to 3% of the labour force (2.9% year-to-year in November).

UNITED KINGDOM: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2003	2004	2004	2005				
			4 Q	1 Q	2 Q	3 Q	October	November
GDP	2.5	3.2	2.7	2.0	1.6	1.7	–	...
Retail sales	3.0	6.2	4.7	2.8	1.3	0.9	1.6	2.2
Industrial production	–0.5	0.8	0.1	–1.1	–1.6	–1.2	–1.7	...
Unemployment rate (*)	3.0	2.7	2.7	2.6	2.7	2.8	2.9	2.9
Consumer prices	2.8	2.2	2.3	2.2	2.2	2.4	2.4	2.3
Trade balance (**)	–46.8	–55.5	–59.8	–61.6	–62.5	–63.0	–62.6	...

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

Monetary and capital markets

ECB raises interest rates

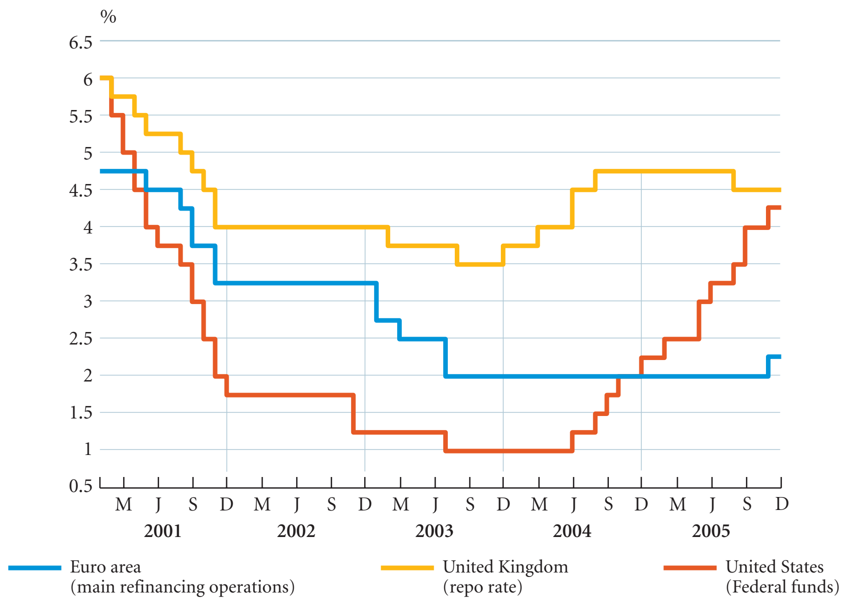
December brought about various changes in official interest rates in the developed countries, all of them increases. The most significant was that carried out by the European Central Bank which, as expected, raised its reference rates at the beginning of December for the first time in five years. The Federal Reserve also continued to raise official interest rates in mid-December while indicating that the upward cycle was near its end. For the moment, only Japan has failed to move, maintaining its interbank rate at close to 0%, although this will probably change in 2006. The central banks have reacted to a change in scenario in recent years which has put out front inflationary risks arising from world economic recovery and increasing prices for raw materials.

On December 1, the Governing Council of the European Central Bank (ECB) decided to increase its reference rates by 25 basis points. As a result, the reference rate moved up to 2.25% from the 2% where it had been held since June 2003, an all-time low. With this move the ECB showed its independence, given that up until the last moment it had been under strong pressure from many governments in the euro area and international bodies to maintain or lower its interest rate.

European Central Bank raises reference rates by 25 basis points to 2.25% after holding it two and a half years at 2%...

EUROPEAN CENTRAL BANK AND FEDERAL RESERVE RAISE INTEREST RATES IN DECEMBER

Monetary policy reference rates



SOURCE: National central banks.

...with other increases likely in 2006.

The ECB justified this measure as a way of containing inflationary prospects over the medium and long-term. At the press conference following the Governing Council meeting on December 1, the ECB chairman, Jean-Claude Trichet pointed out that there was no plan for further interest rate increases along the lines followed by the Federal Reserve but that the ECB would remain vigilant. Nevertheless, during the following week some members of the Governing Council, such as Mersch, and of the Executive Committee, such as Bini Smaghi, gave out indications of an upward trend suggesting that the ECB could again raise interest rates at any moment if circumstances so required. At the same time, it was noted that money supply continued to be very high in the euro area. In fact, loans to the private sector grew by 8.8% in the twelve months ending in October, thus showing an upward trend.

The ECB also released new growth and inflation projections being published on a quarterly basis. These estimated growth of the gross domestic product of the euro area in 2006 within a range of 1.4%-2.4%, a slight increase over previous projections, while putting new figures for 2007 within the same range. With regard to inflation, the projections for 2006 stand at 1.6%-2.6% and at 1.4%-2.6% for 2007 with the centre point at 2%, the objective limit for inflation. Nevertheless, the ECB underlined the inflationary risks. Within this framework, the 12-month Euribor, which had held at 2.68% on monthly average in November in anticipation of the rate increase by the ECB, stood at around 2.8% in the fourth week of December. In this way, the market was discounting further reference rate increases by the ECB to at least 2.75% in 2006, which seems reasonable.

Federal Reserve indicates that end of upward cycle near.

In the United States the Federal Reserve raised its official rate by 25 basis points for the thirteenth consecutive time, putting it at 4.25%, as expected. The real news came in the press release which normally goes along with monetary policy decisions. On this occasion there was no mention of the possibility that easing of monetary policy might be gradually ended. This was interpreted as an announcement that the upward cycle in interest rates was coming to an end. Nevertheless, the press release added that some restrictive action would probably still be necessary in the face of latest economic figures.

As a result, market operators are expecting that the Fed will again raise its reference rate at the beginning of February, at the last meeting during the Greenspan era, and also probably at the following meeting in March seeing that Ben Bernanke, the new Fed chairman, will want to confirm his anti-inflationary reputation. In this way, the ceiling would stand at 4.75%, as we predicted several months ago.

Other central banks raise official interest rates in December.

In addition, as mentioned above, other central banks moved their interest rates upward in December. The Bank of Denmark raised its reference rates by 25 basis points on December 1, putting the discount rate at 2.25% and the 14-day lending rate at 2.40%. On December 6, the Bank of Canada also raised its official interest rates by a quarter point setting the daily rate at 3.25%. On December 8, the Bank of New Zealand also increased its official rate by 25 basis points to 7.25%, the highest current level in the developed countries while, on the same day, South Korea raised its reference rate to 3.75%. Finally, the Bank of Switzerland raised its objective band by a quarter point on December 15 putting it at 0.50%-1.50%.

SHORT-TERM INTEREST RATES IN NATIONAL MARKETS

Monthly averages as annual percentage

	Euro area			United States		Japan	United Kingdom		Switzerland
	ECB auctions (2)	Euribor (5) 3-month	Euribor (5) 1-year	Federal Reserve Board target level (3)	3-month (5)	3-month (5)	Bank of England repo rate (4)	3-month (5)	3-month (5)
2004									
November	2.05	2.17	2.33	1.92	2.31	0.09	4.75	4.88	0.75
December	2.07	2.17	2.30	2.25	2.50	0.09	4.75	4.87	0.75
2005									
January	2.06	2.15	2.31	2.25	2.66	0.10	4.75	4.87	0.74
February	2.06	2.14	2.31	2.50	2.82	0.10	4.75	4.89	0.75
March	2.05	2.14	2.34	2.59	3.03	0.09	4.75	4.99	0.75
April	2.05	2.14	2.27	2.75	3.15	0.08	4.75	4.94	0.76
May	2.05	2.13	2.19	2.99	3.27	0.08	4.75	4.89	0.76
June	2.05	2.11	2.10	3.01	3.43	0.08	4.75	4.84	0.75
July	2.05	2.12	2.17	3.25	3.61	0.09	4.75	4.66	0.75
August	2.05	2.13	2.22	3.43	3.80	0.09	4.53	4.59	0.76
September	2.06	2.14	2.22	3.60	3.91	0.09	4.50	4.60	0.76
October	2.06	2.20	2.41	3.75	4.17	0.09	4.50	4.59	0.81
November (*)	2.06	2.36	2.68	4.00	4.35	0.09	4.50	4.62	0.95
December (1)	2.30	2.50	2.84	4.25	4.52	0.09	4.50	4.64	1.01

NOTES: (*) Provisional figures.
(1) December 26.
(2) Marginal interest rate. Latest dates showing change in minimum rate: 6-3-03 (2.50%), 5-6-03 (2.00%), 1-12-05 (2.25%).
(3) Latest dates showing change: 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%), 20-9-05 (3.75%), 1-11-05 (4.00%), 13-12-05 (4.25%).
(4) Latest dates showing change: 10-7-03 (3.50%), 6-11-03 (3.75%), 5-2-04 (4.00%), 6-5-04 (4.25%), 10-6-04 (4.50%), 5-8-04 (4.75%), 4-8-05 (4.50%).
(5) Interbank offer rate.
SOURCE: European Central Bank, Thomson Financial Datastream and internal figures.

Euro recovers with start of upward move by European Central Bank

In the period January-November 2005, the dollar appreciated by 4.2% against a broad basket of currencies aided by a differential in interest rates in its favour. As a result, it was able to overcome the downward pressures arising from the growing foreign deficit. In the early weeks of December, however, as the end of the upward cycle for interest rates seemed close and with publication of a record trade deficit at mid-month, it moved into a downward course. This trend could shift into 2006.

The euro fell by 6.9% in the first eleven months of 2005 measured against the currencies of its main trading partners, under the effect of the moderate economic growth in the euro area and because the Eurosystem interest rate stood at all-time lows. Nevertheless, following the start of the restrictive turn in monetary policy at the beginning of December it regained some strength. Against the greenback it again recovered an exchange rate of 1.20 dollars in the middle of the month.

Dollar appreciation in 2005 aided by interest rate differential in its favour.

In addition, the Slovak crown joined the Exchange Rate Mechanism (ERM-II)

Slovak crown joins ERM-II.

EXCHANGE RATES OF MAIN CURRENCIES

November 2005

	Final session of month		Monthly figures				*Exchange rate December 26, 2005*
	Exchange rate	% monthly change (2)	Average exchange rate	% change (2) Monthly	Over December 2004	Annual	
Against US dollar							
Japanese yen	119.8	2.8	118.5	3.1	14.2	13.2	*116.4*
Pound sterling (1)	1.729	–2.2	1.735	–1.7	–10.1	–6.8	*1.733*
Swiss franc	1.315	1.9	1.310	1.8	14.4	12.0	*1.314*
Canadian dollar	1.167	–1.3	1.181	0.3	–3.0	–1.2	*1.167*
Mexican peso	10.58	–2.0	10.67	–1.5	–4.7	–6.2	*10.68*
Nominal effective index (4)	*112.4*	*0.3*	*112.7*	*0.8*	*3.4*	*2.3*	*111.7*
Against euro							
US dollar	1.177	–2.1	1.179	–1.9	–12.1	–9.3	*1.186*
Japanese yen	140.8	0.8	139.6	1.1	0.3	2.6	*138.3*
Swiss franc	1.549	0.2	1.545	–0.3	0.6	1.5	*1.557*
Pound sterling	0.682	0.8	0.679	–0.3	–2.3	–2.8	*0.683*
Swedish krona	9.527	–0.1	9.561	1.5	6.5	6.3	*9.460*
Danish krone (3)	7.454	–0.1	7.460	0.0	0.3	0.4	*7.459*
Polish zloty	3.909	–1.8	3.970	1.2	–4.0	–6.7	*3.842*
Czech crown	28.93	–2.2	29.27	–1.4	–4.5	–6.5	*28.93*
Hungarian forint	252.7	0.9	251.0	–0.3	2.1	2.3	*251.5*
Nominal effective index (5)	*100.7*	*–0.8*	*100.7*	*–0.7*	*–6.0*	*–4.7*	*100.7*

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

Yen marks up lowest level since beginning of 1986 in real terms against broad group of currencies.

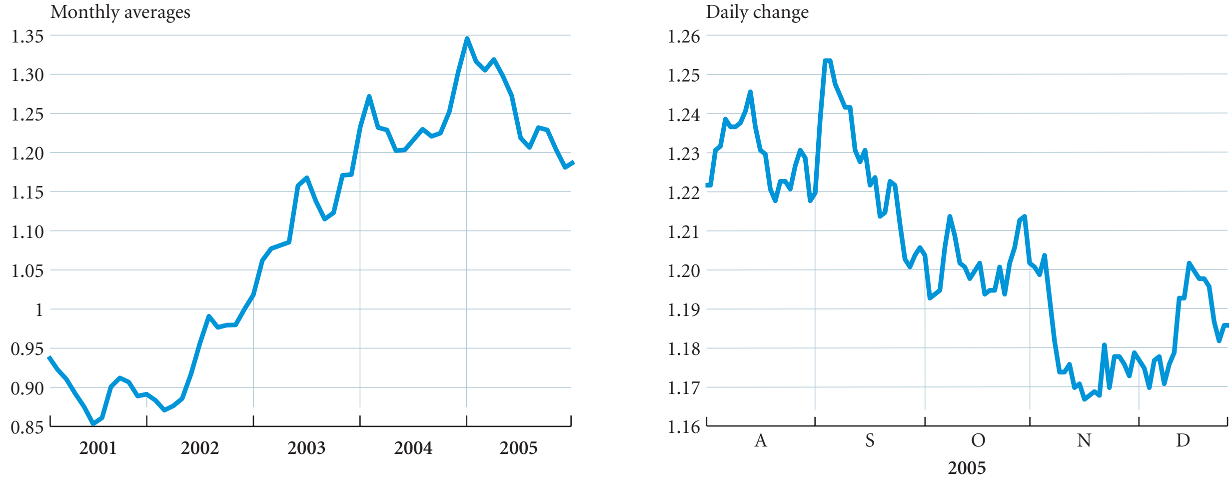
toward the end of November 2005. It thus joins the Danish crown, which runs within a band of ± 2.25% against central parity in terms of the euro, and the Estonian crown, the Cypriot pound, the Latvian lat, the Lithuanian litas, the Maltese lira and the Slovenian tolar which, like the Slovak currency, run within a range of ±15%.

The pound sterling showed cumulative appreciation of 1.4% at the end of November in terms of a broad group of currencies, having lost strength following the official interest rate cut to 4.50% by the Bank of England in August. In the early weeks of December, the British currency tended to rise against the dollar while holding steady in terms of the euro.

The yen has stayed at low levels since the beginning of 1986 when considered in effective real terms, that is to say, taking into account inflation differentials. The weakness of Japan's currency may be attributable to the absolute minimum interest rates operating in that country, close to 0% for the short term. In terms of the dollar, the yen recorded its lowest level in the last 32 months in the second week of December, and in terms of the euro marked up an all-time low in the

EURO BOUNCES BACK AGAINST DOLLAR

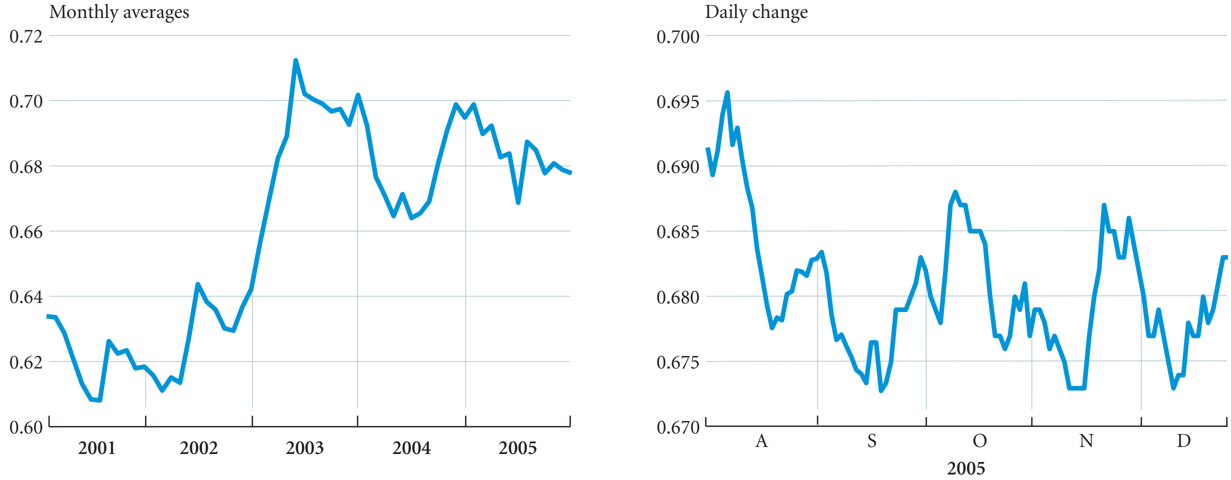
US dollars to euro



NOTES: Figures go up to December 26.
SOURCE: OECD, Thomson Financial Datastream and internal figures.

POUND STERLING STABLE AGAINST EURO

Pounds sterling to euro



NOTES: Figures go up to December 26.
SOURCE: Thomson Financial Datastream.

third week of that month. Nevertheless, it later recovered positions benefiting from the drop in the dollar.

Slight drop in long-term interest rates

The yield on US 10-year Treasury bonds has gone through slight fluctuations in recent weeks with publication of various macroeconomic indicators and the change in expectations regarding Federal Reserve interest rates. This has brought about stabilization of yields on long-term government bonds as a result of the perception that the end of the Fed's interest rate increases was near. As a result, in the fourth week in December,

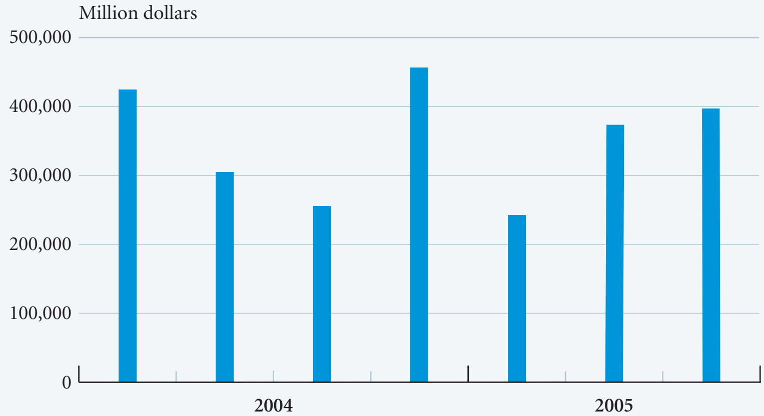
USA: an insatiable appetite for international savings

The growth of the world economy in 2006 will continue to be based on two major engines - the economies of the United States and Asia headed by China and, as has been the case in recent years, each showing a very different pattern of growth. In the United States, strong consumer spending is generating a growing foreign deficit which is turning into a powerful source of world demand. On the other hand, the Asian economies base their growth on exports so that their current balance of payment figures are heavily in surplus. This trade imbalance has its counterpart in heavy financial flows. The savings deficit in the United States is being covered by huge capital inflows which come in large measure from the Asian economies mentioned. For some time various international bodies, analysts and private institutions have been wondering up to what point this growth model is sustainable and what would happen if the flow of savings should undergo a major change. What do the figures reveal?

The US balance of payments for the third quarter of 2005 shows that in this period net capital inflows into the United States amounted to 396.92 billion dollars, a 56% increase compared with the same months in 2004 and an increase of 6% over the previous quarter. This volume of funds was well above the current account deficit for the same period which amounted to 195.82 billion dollars. As a result, following the sharp drop in inflows in the first quarter it seems that a recovery had taken place. For the moment, this presents no problem. But it is necessary to make a more detailed analysis of the components of these capital movements in order to have a clearer idea of the situation given that, for example, short-term capital is usually more volatile.

CAPITAL INFLOWS INTO UNITED STATES RECOVER IN RECENT QUARTERS

Net buying of US securities by non-residents



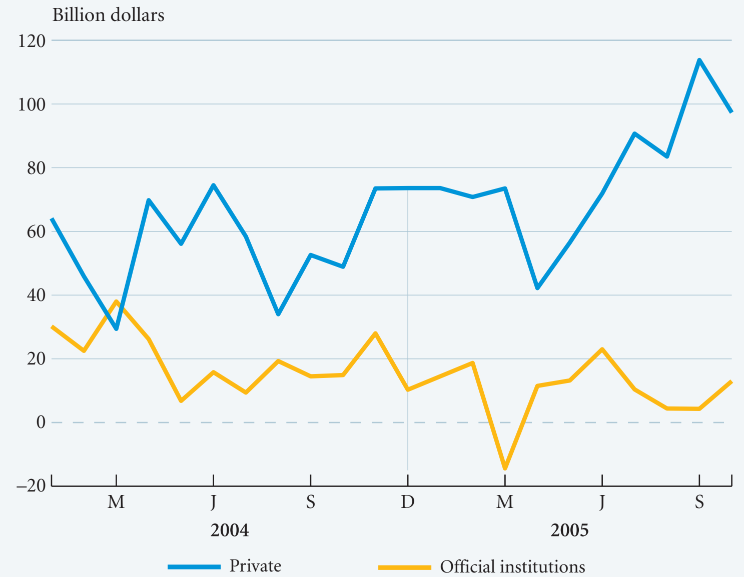
SOURCE: Bureau of Economic Analysis.

The figures show that long-term financing is continuing to flow into the US economy. It is true that buying of US securities by foreign central banks in the January-September period was down to half its size compared with the same months in 2004. As a result, in the third quarter this amounted to 38.39 billion dollars as against 75.79 billion dollars in the same period the year before. It is worth noting that net purchases of Treasury bonds by foreign central banks amounted to only 9.65 billion dollars in the third quarter of 2005 as against 55.36 billion dollars in the same period of 2004. Nevertheless, the trend to lower purchases of Treasury bonds by the central banks has eased only slightly in recent months to judge by figures from the Federal Reserve which go up to mid-December. This has been partly compensated by the increase in 2005 of official bond purchases by agencies guaranteed by the United States government.

At the same time, capital inflows into the United States from the private sector remain buoyant. Direct investment, aimed at control of companies in which investment is being made, was up by 17% in the first 9 months of 2005 compared with the same period the year before so that, in the third quarter, it went above the drop shown in the second quarter. Net purchases of Treasury bonds were of greater amount with an increase of 39% while other securities rose by 68%. In fact, in October, to go by the most recent figures supplied by the US Treasury, purchases of US long-term financial assets by the foreign private sector were nearly double those for the same month in 2004.

BUYING OF SECURITIES BY CENTRAL BANKS DECREASES IN 2005

Net foreign portfolio investment in United States by type of buyer



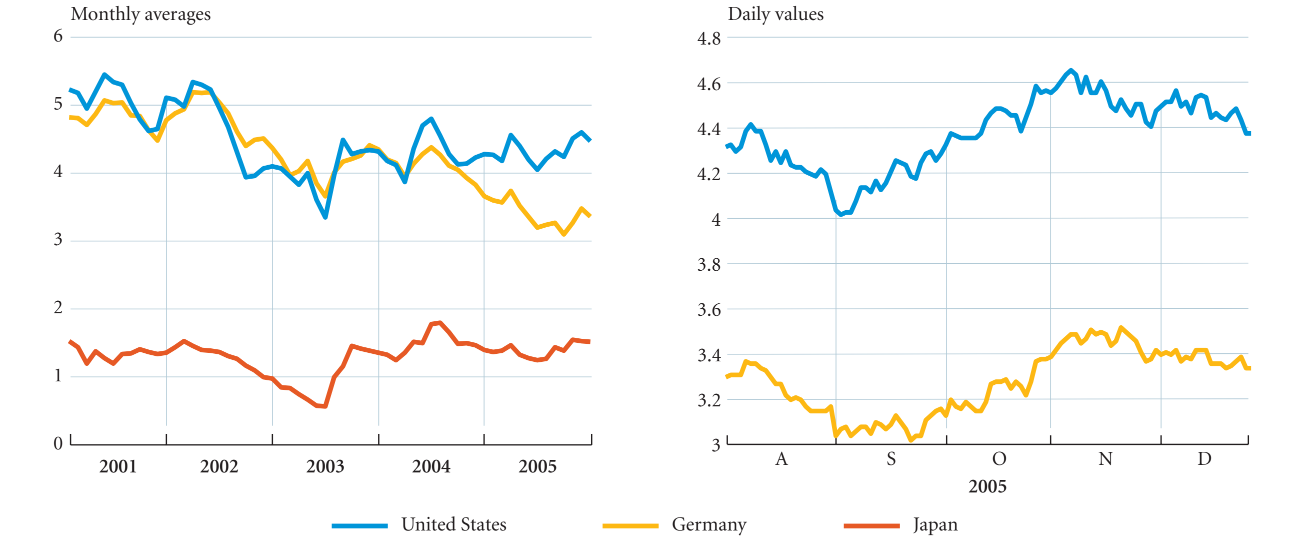
SOURCE: Department of the Treasury.

Another aspect to watch in 2006 will be the role to be played by petro-dollars. These are for foreign investment in petroleum exporting countries which, in recent years, have seen an extraordinary increase in inflows with the spectacular rise in oil prices. According to figures from the Bank for International Settlements which go up to mid-2005, the present upward cycle in crude oil prices is different from that at the end of the Seventies in that there is more diversification in terms of instruments and countries in the foreign investment going to oil exporting countries. As a result, deposits, while being important, have dropped in relative weight. In this manner, regional investment has taken on greater importance and stock markets in the Middle East area are showing a real boom. On the other hand, Russia is showing an inclination toward the euro.

As a result, the year 2006 raises a number of questions. Firstly, it is expected that the oil exporting countries will gain relative weight in world financial investment because of high prices for crude oil and it is not clear that they will bet on the dollar. In any case, the differential in interest rates with the United States, an important factor for capital movements, is expected to remain substantially in favour of the dollar compared with the euro and the yen. As a result, US financial assets will probably continue to enjoy the favour of investors although possibly to a lower extent because of the prospect of a narrowing of the interest rate differential and as a result of the fact that, in 2005, there was repatriation of profits due to requirements of US legislation. In any case, over the medium-term there will be an adjustment to correct the excessive spending of the US economy which will involve greater savings by US households and the public sector as well as a significant depreciation of the dollar, especially in terms of the main Asian currencies.

LONG-TERM INTEREST RATE DIFFERENTIAL BETWEEN DOLLAR AND EURO DOWN IN DECEMBER

Yield on 10-year government bonds as annual percentage



NOTES: Rates go up to December 26.
SOURCE: Bank of Spain and Thomson Financial Datastream.

Flattening out of interest rate curve in United States continues.

the yield on US 10-year Treasury bonds stood at around 4.4%, slightly below the level in June 2004 when the restrictive monetary policy began.

In 2006, long-term interest rates will probably move up moderately. On the other hand, we note a progressive flattening out of the US interest rate curve which stands close to becoming inverted (the point at which short-term interest rates exceed long-term rates).

The yield on German 10-year government bonds dropped slightly in the early weeks of December. Nevertheless, the long-term differential between the dollar and the euro has again narrowed. Over the medium term we should see yields on US and European bonds come closer together with a reduction in the gap between rates of economic growth.

Most stock markets showing big capital gains close to year end

Near the end of the year most stock markets are showing brilliant capital gains, in many cases higher than those forecast at the beginning of the year. This excellent performance was especially based on good corporate profits which showed higher-than-expected growth. Companies have been able to deal with increases in prices of oil and other raw materials, thanks to moderation in wage costs and the increase in productivity. Another important factor contributing favourably to the rise in prices was the substantial liquidity existing as a result of prevailing easy monetary policies. This also favoured activity in corporate acquisitions with its subsequent positive impact on the stock markets. As a result, many indices in 2005 reached all-time highs or highs for recent years.

With regard to stock market prospects for 2006, while the corporate picture remains positive we should not expect the extraordinary increases in indices seen in 2005, given that the increase in profits will probably drop as energy prices will continue at high levels. Furthermore, the high level of liquidity now existing will likely progressively drop and interest rates will rise to some extent. In any case, 2006 could be the fourth consecutive year of stock market rises.

Higher than expected growth in profits and ample liquidity drive stock markets in 2005.

In the United States, the main indices at year-end showed modest advances over December 2004. Factors differentiating it from other stock markets were the relative overvaluation they showed at the beginning of 2005 and the successive increases in interest rates by the Federal Reserve during the year. By sector, the results were uneven. The biggest gains came in the energy sector which benefited from high crude oil prices. On the other hand, companies devoted to telecommunications and cyclical consumption recorded the biggest losses.

Stock market scene in 2006 not looking as positive.

The DJ Eurostoxx 50 index, which includes the largest companies in the euro area, in the fourth week of December stood at its highest level since May 2002. As a result, the DJ Eurostoxx 50 index showed an increase of more than 20% over December. The leading positions in the classification of gains in 2005 were held by stock markets in

Brilliant gains in European stock markets in 2005.

LONG-TERM INTEREST RATES IN NATIONAL MARKETS

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

	2003	2004	2005					
			1 Q	2 Q	3 Q	October	November	December 26
United States	4.04	4.31	4.34	4.21	4.25	4.50	4.59	4.38
Japan	0.99	1.50	1.41	1.28	1.36	1.54	1.52	1.52
Germany	4.10	4.07	3.63	3.35	3.19	3.26	3.47	3.34
France	4.13	4.10	3.64	3.38	3.23	3.29	3.49	3.36
Italy	4.24	4.24	3.75	3.53	3.40	3.45	3.66	3.55
Spain	4.12	4.10	3.63	3.36	3.18	3.27	3.48	3.32
United Kingdom	4.53	4.93	4.72	4.50	4.32	4.40	4.36	4.18
Switzerland	2.47	2.57	2.15	2.04	1.90	1.93	2.18	1.99

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

Germany, the Netherlands and France, among the main markets.

IBEX 35 marks up annual rise of more than 15%.

The Spanish stock market in December reflected the negative valuation put by the market on the acquisition of the O2 company by Telefónica and the uncertainty created in Bolivia following the victory of president-elect Evo Morales. Nevertheless, thanks to spectacular growth in corporate profits, the Spanish market reached cumulative revaluation of 18% in the fourth week in December.

Spectacular recovery in Japanese stock market with return to levels in October 2000.

Outside the euro area, the Financial Times 100 index for the London stock exchange recorded its highest level since August 2001 in the fourth week of December. In the second week of December, the SMI index for the Swiss stock exchange marked up its highest level since May 2001, thus leading the increases among the main stock markets on the Continent with a rise of more than 31% over December 2004. In addition, among the most important stock market surprises in 2005 was that of Japan boosted by lower interest rates and economic recovery along with the contribution of a weak yen. As a result, in December the Nikkei 225 index for the Japanese stock market marked up its highest level since November 2000 with a rise of 40% compared with the end of 2004.

With regard to stock markets in emerging countries, some markets such as those of Mexico, Brazil, Argentina, South Korea and India marked up all-time highs in the final months of 2005, reflecting the good economic climate and

INDICES OF MAIN WORLD STOCK EXCHANGES

November 30, 2005

	Index (*)	% monthly change	% cumulative change	% annual change	*Figures on December 26, 2005* % cumulative change	*Figures on December 26, 2005* *% change over same date in 2002*
New York						
Dow Jones	*10,805.9*	*3.5*	*0.2*	*3.6*	*0.9*	*29.1*
Standard & Poor's	*1,249.5*	*3.5*	*3.1*	*6.4*	*4.7*	*42.6*
Nasdaq	*2,232.8*	*5.3*	*2.6*	*6.5*	*3.4*	*64.4*
Tokyo	14,872.2	9.3	29.4	36.5	40.2	*85.1*
London	5,423.2	2.0	12.6	15.3	16.2	*41.9*
Euro area	3,447.1	3.8	16.8	19.8	22.0	*46.6*
Frankfurt	*5,193.4*	*5.4*	*22.0*	*25.9*	*27.3*	*80.6*
Paris	*4,567.4*	*3.0*	*19.5*	*21.7*	*24.5*	*54.4*
Amsterdam	*418.8*	*6.2*	*20.3*	*24.2*	*26.2*	*34.2*
Milan	*25,909.0*	*3.4*	*10.1*	*15.8*	*14.1*	*51.2*
Madrid	*10,557.8*	*0.6*	*16.3*	*21.5*	*18.1*	*71.9*
Zurich	7,407.5	5.3	30.1	36.1	31.7	*58.5*
Hong Kong	14,937.1	3.8	5.0	6.2	6.7	*58.8*
Buenos Aires	1,554.7	–3.4	13.0	28.2	12.8	*198.8*
São Paulo	31,916.0	5.7	21.8	27.0	27.1	*194.2*

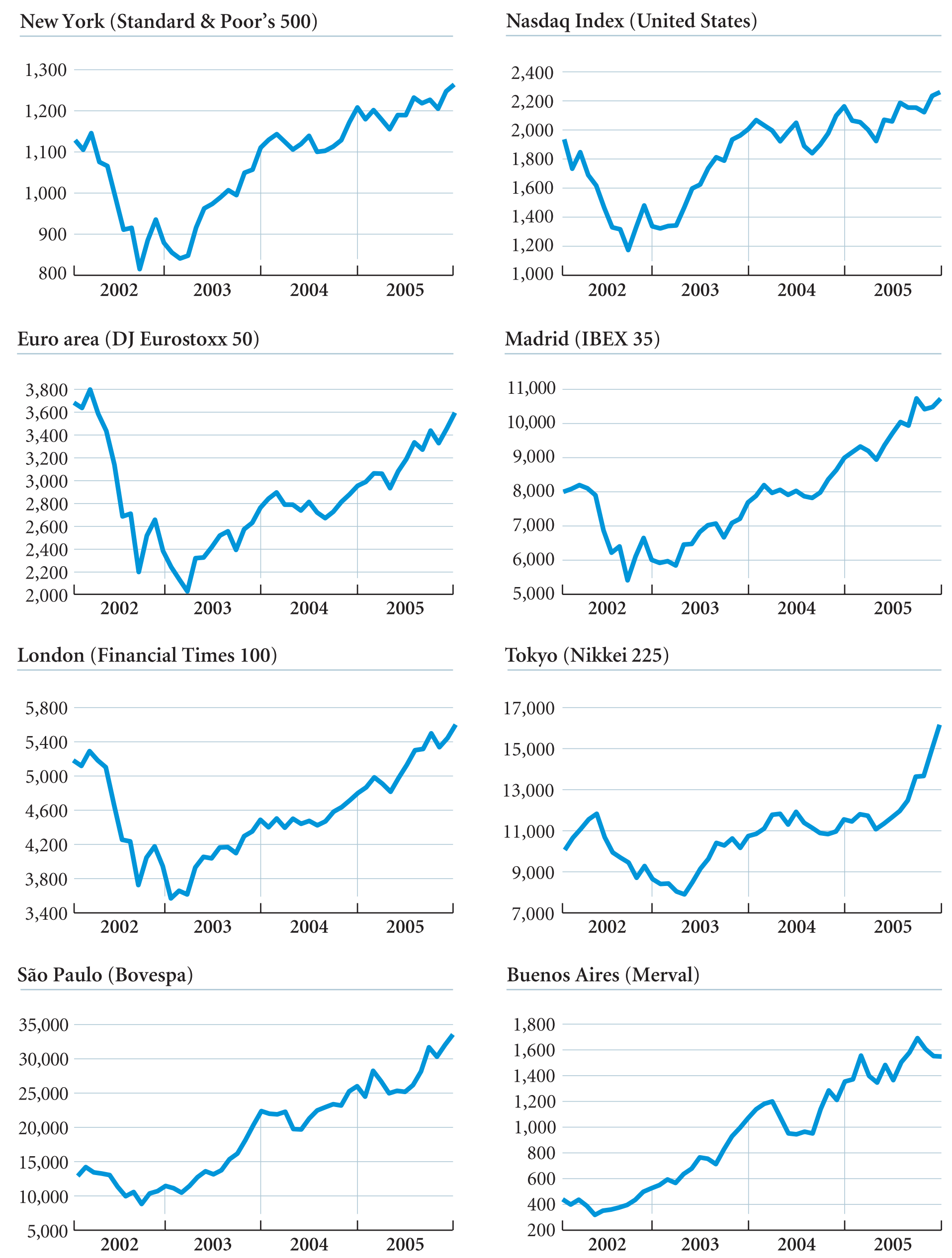
NOTES: (*) New York: Dow Jones Industrials, Standard & Poor's Composite, Nasdaq Composite; Tokyo: Nikkei 225; Euro area: DJ Eurostoxx 50; London: Financial Times 100; Frankfurt: DAX; Paris: CAC 40; Amsterdam: AEX; Milan: MIBTEL; Madrid: IBEX 35 for Spanish stock exchanges; Zurich: Swiss Market Index;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

flows of international investment toward those countries in search of investment opportunities. As a result, a number of stock markets in emerging countries showed major gains in 2005 and in some cases these were spectacular.

Many emerging markets record all-time highs.

INTERNATIONAL STOCK EXCHANGES

Indices at month-end



NOTES: December 26, 2005.

SOURCE: Thomson Financial Datastream.

SPAIN: OVERALL ANALYSIS

Economic activity

Private consumption and construction remain real basis for growth in final stages of 2005.

Economic drive holding up at end of 2005

In the final stages of 2005, Spain's economy is maintaining a very high rate of economic activity, according to most recent figures, although these are still rather incomplete. In any case, we note that private consumption and construction remain the real engines of growth with a tendency to some slight moderation in the former and still very great strength in the latter. If we extrapolate current trends, we should expect a gradual drop in national demand and a somewhat less negative contribution from the foreign sector which could mean a growth rate in the gross domestic product (GDP) equal to or slightly lower than in the third quarter.

SUPPLY INDICATORS

Percentage change over same period year before

	2003	2004	2004		2005				
			3 Q	4 Q	1 Q	2 Q	3 Q	October	November
Industry									
Electricity consumption (1)	5.5	4.0	3.6	3.8	5.3	3.4	2.5	1.1	4.1
Industrial production index (2)	1.4	1.6	2.2	0.4	0.3	0.1	0.6	–0.4	...
Confidence indicator for industry (3)	–0.9	–2.5	–2.7	–2.3	–3.3	–7.0	–4.7	–5.0	–5.0
Utilization of production capacity (4)	79.1	79.8	80.5	80.5	79.4	79.5	81.1	–	80.7
Imports of non-energy intermediate goods (5)	6.2	6.6	6.0	4.7	0.7	3.6	0.6	–0.7	...
Construction									
Cement consumption	4.8	3.8	3.7	3.8	–0.2	11.2	5.9	2.6	1.6
Confidence indicator for construction (3)	10.3	13.6	16.0	24.0	23.7	15.0	22.7	23.0	39.0
Housing (new construction approvals)	21.4	8.0	14.9	0.5	3.7	7.6	2.8	...	...
Government tendering	–10.9	17.9	65.5	37.7	5.8	36.6	2.2	...	...
Services									
Retail sales	5.7	5.5	4.4	5.5	4.1	5.4	4.4	3.3	...
Foreign tourists	–1.0	1.3	–1.5	8.6	7.4	4.6	7.0	4.6	7.7
Tourist revenue inflows	4.4	3.8	5.2	8.5	–0.8	–0.3	6.6	...	...
Goods carried by rail (km-tonnes)	1.7	–3.5	–8.5	–16.7	–14.3	–4.7	–2.3	27.9	...
Air passenger traffic	7.5	7.9	6.7	8.4	8.4	8.5	10.2	8.2	10.5
Motor vehicle diesel fuel consumption	7.5	7.2	9.0	5.7	2.5	7.5	4.9	...	...

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

HOPED FOR RECOVERY OF INDUSTRY NOT CONSOLIDATING

Year-to-year change in industrial production index

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

The most notable exception comes in industry which has not been able to consolidate the slight recovery begun around mid-year. The drop in the October production index (around 0.4%) meant a further disappointment thus cooling off prospects of recovery already noted. The fact is that the sector confidence index has remained stuck at around –5 points in recent months and opinions on the situation in order books have also run in a very negative range.

The textile and clothing industry, leather and furs, along with electronic equipment (all being subject to strong international competition) continue to be the most contractile branches of production with cumulative decreases of between 10% and 15% as of November. Of smaller degree but of great significance was the drop of around 6% in motor vehicle production in the period under consideration. On the other hand, the publishing industry and metal products manufacturing were among the few branches of production to show a positive trend.

Industry fails to recover increased strength with some sectors, such as textiles, electronics and the motor vehicle industry clearly in decline.

The slack in the industrial sector is in contrast to the strong levels seen in construction which continues on the rise. Nevertheless, the growth profile of some indicators seems to suggest that it will move into a stage of greater moderation within coming months. The drop in growth of cement consumption, the lower increase in the number of home units planned and some easing of the increase in government tendering all go in this direction despite high current starting levels.

Construction continues to rise but trend in some indicators suggests more moderate performance ahead.

Among production sectors, services are providing the biggest boost to economic activity, with strong growth trends especially notable in information and communications technology, retail trade and company services. The situation in tourism has also improved considerably in the second half-year. Following a highly satisfactory balance in the summer season (total number of visitors

EXPANSIONIST TREND IN CEMENT CONSUMPTION EASING OFF

Year-to-year change in cement consumption

NOTES: Cycle-trend series.
SOURCE: Oficemen, Ministry of Economy and Finance and internal figures.

and inflows of funds accounted for in the balance of payments grew by 7% year-to-year in the third quarter), it appears that this level will hold up in the final stages of the year.

Appreciable improvement in tourist scene in second half of 2005.

From January to November, nearly 52.4 million tourists came to Spain, again beating the all-time record. Catalonia held top place in Spain with close to 11.8 million visitors (nearly a quarter of all tourists arriving in Spain), 12.7% more than one year earlier. This was followed by the Balearic Islands, Canary Islands and Andalusia which marked up slightly lower figures (between 7.5 and 9.5 million tourists) with slight percentage increases in the Balearic Islands and Andalusia (around 1%) and a decrease in the Canary Islands (1.6%). In those eleven months, the main source market continued to be the United Kingdom with nearly 15 million tourists, almost one third of all those visiting Spain. Next came Germany and France (with 9.1 and 7.2 million visitors respectively).

Consumption and investment holding very firm course but growth rate tending to ease in some segments.

On the demand side, we note that private consumption still held a very firm course. Some indicators, such as imports of goods, are clearly on the rise as in the case of those related to consumption of certain services (transport, domestic tourism and telecommunications, among others). Other indicators, however, show a much more moderate trend as seen in retail sales and particularly passenger car sales which reported a significant drop in recent months (6.8% year-to-year in October and November).

From another point of view, some qualitative indicators show a contradictory picture. Consumer confidence seems to have been stuck at a very negative level over the past two years without this being especially related to the sharp drive seen in consumption during that period. On the other hand, retail trade confidence showed a more coherent improvement in the course of 2005. Finally, with regard to capital goods investment, most indicators are recording very high growth rates although with a tendency to ease off.

DEMAND INDICATORS

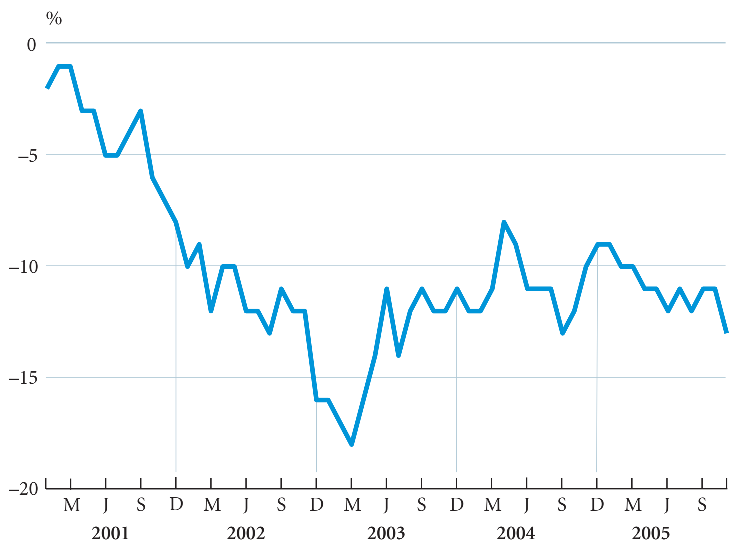
Percentage change over same period year before

	2003	2004	2004		2005				
			3 Q	4 Q	1 Q	2 Q	3 Q	October	November
Consumption									
Production of consumer goods (*)	0.2	–0.2	0.1	0.1	0.1	1.1	1.5	0.2	...
Imports of consumer goods (**)	10.9	13.4	9.7	8.3	6.5	8.4	7.8	6.8	...
Car registrations	3.8	9.8	5.3	4.7	–0.0	4.9	2.3	–9.6	–4.0
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	–11.3	–11.3	–11.0	–13.0
Investment									
Capital goods production (*)	0.6	1.8	4.7	–1.7	–0.8	0.6	–1.5	–2.4	...
Imports of capital goods (**)	14.8	14.9	19.2	29.0	28.6	36.0	13.5	–4.0	...
Commercial vehicle registrations	13.5	11.7	9.4	9.4	9.2	17.9	13.9	1.6	10.9
Foreign trade (**)									
Non-energy imports	8.8	9.8	8.9	9.0	5.7	9.0	4.7	1.4	...
Exports	6.9	5.2	6.7	4.3	–3.1	2.5	1.2	–2.4	...

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 and Finance, European Commission and internal figures.

DROP IN CONSUMER CONFIDENCE NOT MATCHED BY RISE IN CONSUMPTION

Difference between percentages of positive and negative responses



SOURCE: European Commission.

Prospects for Spain's economy in 2006: clear skies ahead

The balance for Spain's economy in 2005 is quite favourable in terms of economic activity and employment but the major imbalances created at the same time (excessive inflation and a growing foreign deficit as key matters) put a cloud over the results obtained and raise some serious questions about the adequacy of the current pattern of growth. Is there then the possibility of a sharp downturn over the short term? Certainly not, given that the reasons behind growth of Spain's economy in recent years (low interest rates, the sharp increase in the labour force added to by immigration and the wealth effect arising mainly from revaluation of real-estate assets, among others) will continue to act over the short term. Backing this, the trends in the main economic activity indicators suggest that the current boom will continue for at least during the course of 2006. This point of view is shared by most economic analysts (as may be seen, for example, in the FUNCAS forecast table) and supported by the main international bodies.

Both the Organization for Economic Cooperation and Development (OECD) and the European Commission itself coincide in forecasting that Spain's GDP will grow by 3.2% in 2006, one decimal less than the Spanish government's own forecast although they differ slightly on estimated growth in 2007. The European Commission foresees growth that year dropping by two decimals while, on the other hand, the OECD estimates that it will again take an upward path (one decimal more than in 2006) based on renewed drive in domestic demand. On the other hand, the European Commission foresees that the growth rate of employment will ease off, which will not prevent the unemployment rate from standing very close to 8% in 2007. Paradoxically, the OECD is more pessimistic on this matter. According to that body, the unemployment rate will tend to stabilize at around 8.7%, considering that real wage pressures will not be compensated by an improvement in productivity.

The widening of the foreign sector gap is a concern shared by both bodies. The OECD estimates that the current account deficit will come close to 10% of the GDP in 2007 while the European Commission calculates that it will go above 9%, the worst figure, along with Portugal and Latvia, within the enlarged European Union. In the matter of prices, there is full agreement on that, once the impact of higher-cost oil has been absorbed, the inflation rate will gradually tend to moderate and will drop below 3% in 2007. This reduction is quite insufficient, given that the existing differential with the European average (above one percentage point) will continue unchanged, something which will undermine the competitiveness of Spanish exports.

Everything would indicate that, in spite of the reserves expressed, 2006 will be a relatively calm year. Over the short term, the main risks will come from abroad. If recovery of the European economy does not manage to consolidate, Spain's exports will not recover the drive being forecast and this will have a negative effect on economic growth and on the already massive foreign deficit. On the domestic scene, heavy household indebtedness (at this time close to 70% of the GDP, twice what it was 8 years ago) and the overvaluation of housing prices (from 24% to 31%, according to the Bank of Spain) hang like a sword of Damocles above Spain's economy, although nothing would suggest that the cord is going to snap in the near future. Nor is it likely that the increase in Eurosystem interest rates will upset the current equilibrium, if we take into account the moderate course adopted by the European Central Bank.

In fact, the prospects for Spain's economy continue to be very favourable over the short term although the picture becomes more complicated over a longer period when the factors which have driven Spain's sharp

MACROECONOMIC TABLE

Percentage year-to-year change unless otherwise indicated

	2004	2005 ("la Caixa" estimate)	Forecast: Ministry of Economy and Finance	Forecast: European Commission		Forecast: FUNCAS (consensus of forecast panel)	Forecast: "la Caixa"	
			2006	2006	2007	2006	2006	2007
GDP by component								
Spending on national private consumption	4.4	4.4	3.6	3.9	3.3	3.9	3.7	3.2
Spending on national consumption of general government	6.0	4.7	4.6	5.3	5.3	4.7	4.4	4.3
Gross fixed capital formation	4.9	7.3	5.1	5.3	4.5	6.0	6.3	5.9
Capital goods and other goods	*4.0*	*8.5*	*7.0*	...	...	*7.2*	*6.6*	*4.6*
Construction	*5.5*	*6.3*	*3.8*	...	...	*5.1*	*5.8*	*4.5*
National demand (*)	4.7	5.2	4.2	4.7	4.2	4.5	4.6	4.1
Exports of goods and services	3.3	0.5	3.2	1.7	2.0	2.7	2.8	4.0
Imports of goods and services	9.3	7.6	6.2	6.4	5.6	6.9	7.3	6.5
Gross domestic product	3.1	3.4	3.3	3.2	3.0	3.2	3.2	3.0
Labour market								
Employment (employment equivalent to full-time work)	2.6	3.1	2.6	2.4	2.2	2.8	2.9	2.6
Unemployment (% of labour force)	11.0	9.1	9.5	8.5	8.1	8.4	8.4	8.2
Prices and costs								
Consumer price index	3.0	3.3	...	3.3	2.6	3.1	3.0	2.7
Unit labour cost	2.8	2.4	2.3	...	...	...	2.4	2.2
Foreign sector (% of GDP)								
Contribution to GDP growth	–1.6	–1.8	–1.1	–1.1	–1.1	–1.3	–1.4	–1.1
Current account balance	–5.8	–7.4	...	–8.3	–9.1	–7.7	–7.3	–7.2
Surplus (+) or deficit (–)	–4.8	–6.4	–7.1	–7.3	–8.2	...	–6.4	–6.3
Public sector (% of GDP)								
Surplus (+) or deficit (–)	–0.1	0.6	0.2	0.1	–0.4	0.3	0.2	0.0
Government debt	46.6	44.3	43.0	41.9	40.7	...	...	...

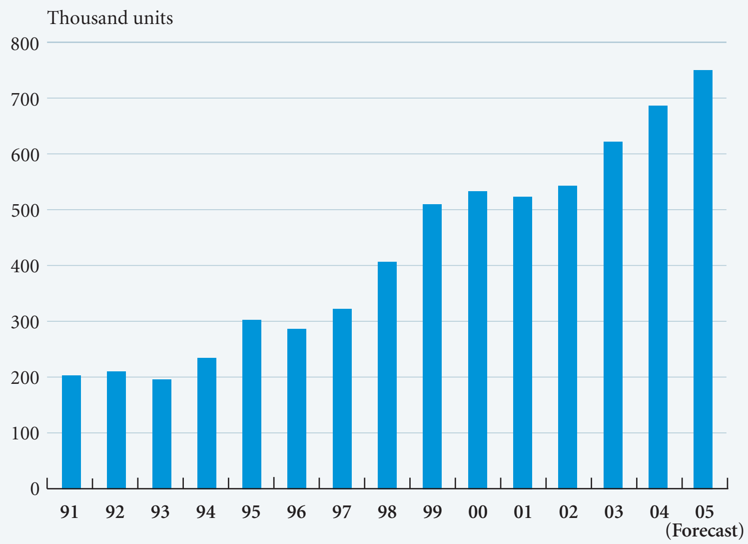
NOTES: (*) Contribution to GDP growth.
SOURCE: INE, Ministry of Economy and Finance, European Commission, Fundación de las Cajas de Ahorros (FUNCAS) and "la Caixa".

growth in recent years begin to lose strength. It does not seem likely, for example, that the extraordinary rise in construction (Spain at this time is the main producer and consumer of cement in the EU) can go on for much longer. In 2005, the number of housing starts may go above 750,000 (again beating the all-time record), as many as France, Germany and the United Kingdom combined, but the upward trend in interest rates, the arrival of fewer immigrants and the drop in foreign investment could contribute to put a future brake on the euphoria that has existed in recent years. The most desirable course would be a gradual slowdown or orderly adjustment to adapt to demand anticipated in coming years, which could stand between 400,000 and 500,000 housing units per annum, going by such basic determining factors as the trend in incomes, the population pyramid and the formation of new households. In principle, the, moderation in housing prices (the price per square metre rose by 13.2% in the third quarter of 2005, nearly 2.5 percentage points less than in the first three months of the year) seems to be heading in that direction.

The slowdown in housing prices will also contribute to some extent to a moderation in private consumption, taking into account the relationship that exists between real-estate wealth and the consumption propensity of households. The Bank of Spain estimates that a change of 10% in the price of housing implies a change of private consumption in the same direction equivalent to 0.8% of the GDP. In addition, we may expect that the trend in other factors which determine household spending decisions (mainly the real interest rate and wages) will also reinforce this effect. In any case, the impact will be quite limited in 2006 but could become greater as of 2007. The ideal situation would be that, as of that moment, investment in production capital goods and exports would take over as the engines of economic growth. It follows that everything that can be done to aid the globalization of companies, to improve competitiveness and the flexibility of the economy would contribute to soften the future impact of the wearing out of the current growth cycle.

SPECTACULAR GROWTH IN TOTAL HOUSING STARTS IN PAST THREE YEARS

Number of housing starts each year



SOURCE: INE and internal figures.

Labour market

Employment strong as year comes to end

The labour market is still holding the strong state it has been showing all through 2005. Registrations with Social Security continue at the spectacular growth rate seen in previous months as a result of the boost from the process of giving normal job status to foreign workers which began in February 2005. If registrations that do not involve new job creation but simply mean normal status for already existing work are ignored, growth of Social Security registrations stands between 3.2% and 3.8%, also a very high rate which does not properly represent the trend in full-time employment which would be somewhat lower.

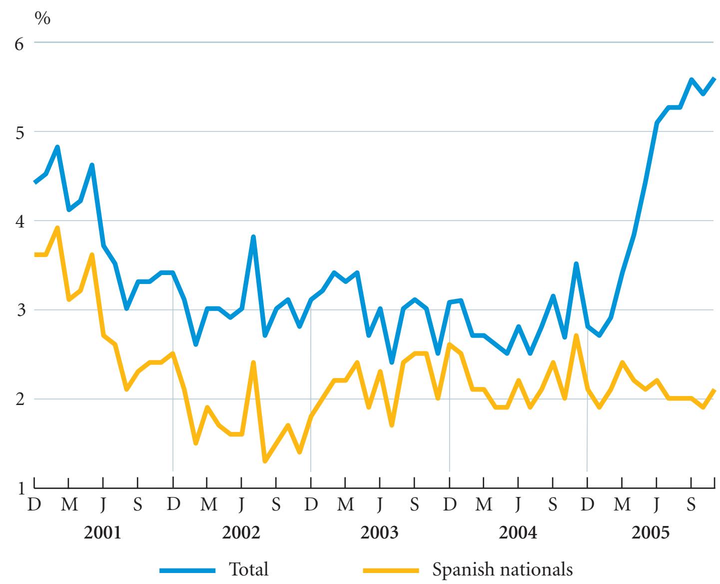
In spite of these distortions, the increase in employment still presents highly stable figures, if we are to go by the increase in registrations of Spanish national workers which make up the more stable core of employment. In fact, growth of registrations in this group stood at 2.1%, a rate practically the same as the reference figure all through the year.

The positive state of employment was also confirmed by figures for the third quarter of 2005 supplied by National Accounting. In fact, employment showed

Employment holding strong growth with construction as main base.

GIVING WORK PAPERS TO FOREIGN WORKERS DISTORTS SOCIAL SECURITY REGISTRATION FIGURES

Year-to-year change in number of persons registered with Social Security by nationality



SOURCE: Ministry of Labour and Social Affairs and internal figures.

EMPLOYMENT INDICATORS

Percentage change over same period year before

	2003	2004	2004		2005				
			3 Q	4 Q	1 Q	2 Q	3 Q	October	November
Persons registered with Social Security									
Wage-earners	3.2	2.7	2.6	3.1	2.8	4.2	5.9	6.1	6.3
Industry	*–0.5*	*–0.5*	*–0.6*	*–0.5*	*–0.9*	*–0.7*	*–0.2*	*–0.4*	*–0.4*
Construction	*4.3*	*5.0*	*4.6*	*6.8*	*5.0*	*7.9*	*10.7*	*11.5*	*11.7*
Services	*4.1*	*4.1*	*4.0*	*4.4*	*4.5*	*5.1*	*5.6*	*5.6*	*5.9*
Non-wage-earners	2.3	3.2	3.2	3.2	2.9	2.7	2.5	2.4	2.4
Total	**3.0**	**2.8**	**2.7**	**3.1**	**2.8**	**3.9**	**5.3**	**5.4**	**5.6**
Persons employed (*)	**4.0**	**3.9**	**3.8**	**4.1**	**5.1**	**5.8**	**5.9**	–	–
Jobs (**)	**2.5**	**2.6**	**2.6**	**2.8**	**3.0**	**3.2**	**3.2**	–	–
Hiring contracts registered (***)									
Permanent	–1.0	11.8	18.2	4.4	0.6	9.2	10.0	16.0	14.5
Temporary	3.9	11.4	14.7	4.0	–9.8	10.1	9.7	10.8	7.9
Total	**3.4**	**11.5**	**15.0**	**4.0**	**–8.8**	**10.0**	**9.8**	**11.2**	**8.5**

NOTES: (*) Estimate from Labour Force Survey.
(**) Equivalent to full-time work. National Accounting estimate; figures adjusted for seasonal effects and number of working days.
(***) At INEM.
SOURCE: National Institute of Statistics, Ministry of Labour and Social Services, National Employment Institute and internal figures.

Part-time work accounts for 23% of new hiring contracts.

an increase of 3.2% over the previous quarter and was thus at the highest levels in recent years. The strength of employment continued to be based on the progress in the construction sector and, to a lesser degree, on the relative firmness in tertiary employment, specifically in non-market services. Industry continued to show a notably weak state although far from the situation of readjustment seen in 2004.

The same positive situation is shown in figures for hiring contracts registered at offices of the Public Employment Service. In the first 11 months of the year as a whole, hiring contracts registered rose by 4.3%, with permanent hiring contracts showing stronger than temporary contracts in spite of the fact that the latter were in the majority. Part-time work, in turn, continued to be the hiring formula enjoying most growth (8.1% year-to-year) and came to represent 23.4% of job placements.

Registered unemployment goes over 2 million but holds below November 2004.

Registered unemployment continues slight downward trend

The good state of the labour market may also be seen in the figures for registered unemployment. The number of persons registered at offices of the Public Employment Service rose although not as sharply as is normal for this month. Total unemployment (2,095,580 persons) was 1.2% below the same month in 2004.

The cumulative change in unemployment as of November was still positive although the overall reduction was well below that recorded in the first 11 months of 2004. Higher unemployment in agriculture and services and a lower reduction in industry and construction was behind this difference. Only the figure for those seeking a first job was down more sharply.

REGISTERED UNEMPLOYMENT: MODEST BUT STABLE DECREASE

Year-to-year change as percentage

SOURCE: Public Employment Services and internal figures.

REGISTERED UNEMPLOYMENT BY SECTOR, SEX AND AGE

November 2005

	No. of unemployed	Change over December 2004		Change over same period year before		% share
		Absolute	%	Absolute	%	
By sector						
Agriculture	66,737	16,445	32.7	15,004	29.0	3.2
Industry	293,531	–10,051	–3.3	–1,480	–0.5	14.0
Construction	223,833	–28,866	–11.4	–7,320	–3.2	10.7
Services	1,282,800	18,015	1.4	–5,997	–0.5	61.2
First job	228,679	–12,678	–5.3	–25,717	–10.1	10.9
By sex						
Males	821,035	–56,985	–6.5	–34,804	–4.1	39.2
Females	1,274,545	39,850	3.2	9,294	0.7	60.8
By age						
Under 25 years	286,670	17,857	6.6	2,140	0.8	13.7
All other ages	1,808,910	–34,992	–1.9	–27,650	–1.5	86.3
TOTAL	**2,095,580**	**–17,135**	**–0.8**	**–25,510**	**–1.2**	**100.0**

SOURCE: INEM and internal figures.

The improvement in unemployment was spread over most autonomous communities, particularly Madrid Community and the Basque Country where unemployment was 7.9% and 6.7% less than in November 2004.

On the other hand, Andalusia, Aragon, Canary Islands, Valencian Community and La Rioja showed a higher level of unemployment than in the same month the year before.

Wages: significant moderation in third quarter

Wage increases tending to containment especially in industry.

According to the quarterly survey of wage costs, the average increase in total wage costs per worker per month moved clearly down in the third quarter of 2005 to stand at 1.9% year-to-year, one and a half points below the previous quarter. This sharp downward trend can also be seen in total wage costs which also include contributions to Social Security and other non-wage benefits, mainly indemnities and compensation payments.

The sharp and somewhat surprising drop in wages was spread over the various sectors of production, particularly in industry where the average increase stood at 1.3%. Apart from distortions which may arise from the increase in part-time work, which is more common in the summer season, the basic trend in labour costs seems, on the one hand, to reflect the restraints imposed by growing competition in the industrial market and, on the other hand, the higher level of immigrant workers in the labour market.

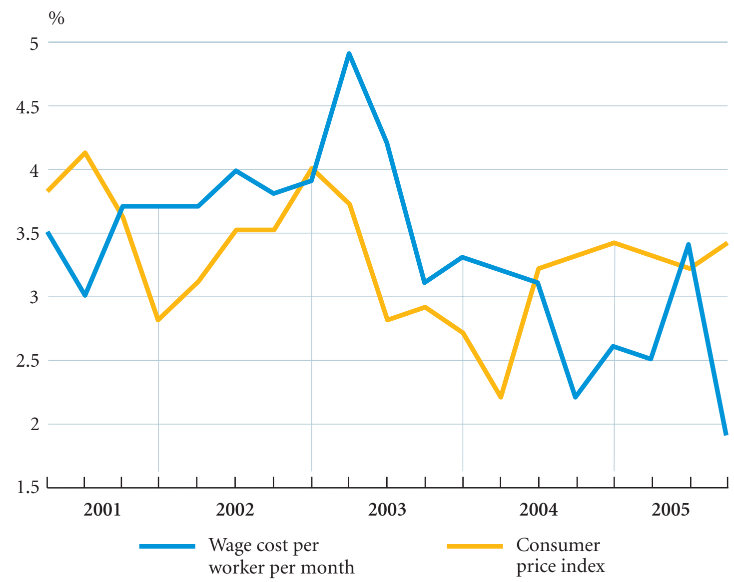
Wage increases under collective bargaining agreements stand at 3%.

Figures according to National Accounting for the third quarter, however, do not reflect this sharp drop but rather a continuation of moderate increases below inflation. In fact, the increase in wages per worker stabilized at 2.6% in the third quarter, according to this source, after having dropped by one percentage point since the second quarter of 2004. This moderation was spread over the various sectors of the economy, particularly construction. The lower increases, however, were recorded in market services, a sector which has absorbed a large part of the inflow of immigrant works.

The greater stability in wages shown by National Accounting is also reflected in figures related to collective bargaining although the average increase in wage

WAGE-EARNERS LOSING PURCHASING POWER

Percentage annual change



SOURCE: INE and internal figures.

WAGE INDICATORS

Percentage change over same period year before

	2003	2004	2004		2005		
			3 Q	4 Q	1 Q	2 Q	3 Q
Increase under general wage agreements	**3.5**	**3.0**	**2.9**	**3.0**	**2.9**	**2.9**	**2.9**
Wage per job equivalent to full-time work (*)	**3.4**	**3.3**	**3.3**	**3.0**	**2.8**	**2.6**	**2.6**
Quarterly labour cost survey							
Wage costs							
Total	3.8	2.8	2.2	2.6	2.5	3.4	1.9
Industry	*4.4*	*3.3*	*3.3*	*3.3*	*3.2*	*3.1*	*1.5*
Construction	*5.0*	*4.2*	*4.6*	*3.1*	*2.4*	*3.3*	*1.3*
Services	*3.5*	*2.5*	*1.6*	*2.5*	*2.5*	*3.8*	*2.6*
Average wages per hour worked	4.3	3.6	2.0	5.7	5.8	1.5	2.8
Other labour costs	5.4	3.6	3.4	3.0	4.2	3.5	3.7
Work day (**)	–0.5	–0.8	0.2	–3.0	–3.1	1.9	–0.9
Farm wages	**2.6**	**2.8**	**2.7**	**2.9**	**3.6**	**3.0**	**2.7**
Labour cost in construction	**5.0**	**4.8**	**3.5**	**3.5**	**1.4**	**1.4**	**1.4**

NOTES: (*) Quarterly National Accounts, corrected gross figures.
(**) Effective hours worked per worker per month.
SOURCE: National Institute of Statistics, Ministry of Labour and Social Affairs, Ministry of Agriculture, Fishing and Food, Ministry of Public Works and internal figures.

levels agreed upon stood at a somewhat higher level, specifically 3.0% as a cumulative average as of November, according to figures supplied by the Ministry of Labour and Social Affairs, but again lower than inflation.

Prices

Fuels cool off CPI in November

Underlying inflation consolidates moderate upward course...

The consumer price index (CPI) rose by 0.2% in November, as it did in the same month in 2004. In spite of this, thanks to rounding out, the year-to-year inflation rate dropped by one decimal to stand at 3.4%. The decrease in fuel prices, which was sharper than in November 2004, and stability in fresh foods went in favour of this situation thus compensating the continued increase in underlying inflation for the third consecutive month.

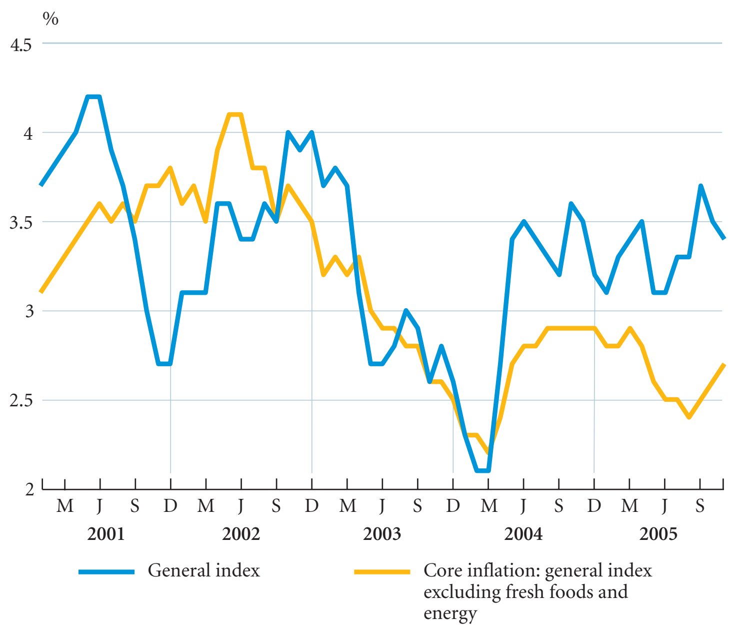
...but increase compensated by drop in oil products.

The upward trend in core inflation, which rose by another decimal to stand at 2.7%, was not isolated from the trends shown in prices of non-energy industrial goods partly attributable to production cost increases. These increases were not greater thanks to the compensatory effect of certain products imported at lower prices. As a result, the year-to-year growth of this component, in spite of a slight increase, held at very moderate levels of 1.2% year-to-year.

Processed foods ran along the same lines and for the second consecutive month moved up because of increased prices for cooking oil and alcoholic beverages. This rise, however, was very moderate and the year-to-year rate (3.2%)

CPI AND CORE INFLATION BEGINNING TO CONVERGE

Year-to-year change in general CPI and core inflation



SOURCE: National Institute of Statistics.

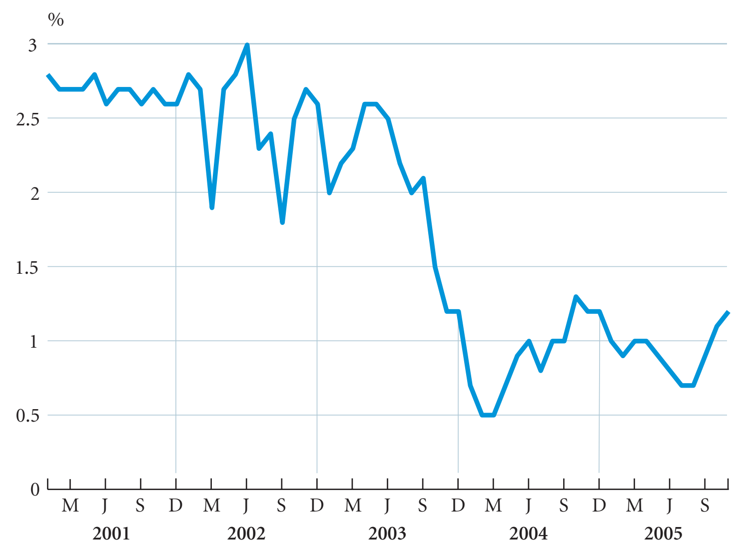
CONSUMER PRICE INDEX

	2004			2005		
	% monthly change	% change over December 2003	% annual change	% monthly change	% change over December 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	0.4	1.9	3.3
September	0.2	2.0	3.2	0.6	2.5	3.7
October	1.0	3.1	3.6	0.8	3.4	3.5
November	0.2	3.3	3.5	0.2	3.5	3.4
December	–0.1	3.2	3.2			

SOURCE: National Institute of Statistics.

COST PRESSURES AFFECTING PRICES OF INDUSTRIAL GOODS

Year-to-year change in industrial goods component (*)



NOTES: (*) Excluding energy components.
SOURCE: National Institute of Statistics and internal figures.

stayed well below the level at the end of 2004.

In terms of the CPI, prices of services were entirely neutral in November and maintained the growth of 3.8% seen in the previous month. This neutral performance, however, does not mask the persistent resistance of these prices to go down. The rigidity of certain public utility markets, their segmentation and the lack of

INFLATION IN SERVICES SHOWS NO SIGN OF IMPROVEMENT

Year-to-year change in services component

SOURCE: National Institute of Statistics and internal figures.

competition in other cases, along with wage cost pressures in some sub-sectors (health, education, transport, and personal services) are sufficient factors to explain the difficulty in controlling growth of prices in these fields.

CPI still at mercy of oil market but could begin to moderate at beginning of New Year.

Similarly, fresh foods also stabilized in growth rate at the annual highs (3.6%) reached the month before. The situation was not worse thanks to the drop in poultry prices which, under the effect of fears generated by the avian flu syndrome, among other things, compensated for increases in certain meat products mainly mutton and prices of fresh vegetables and produce. The rise in food prices may, at least partially, be the result of the effect on final prices of the sharp increase taking place in farm prices in the second half of the year which likely will not end until the beginning of 2006.

This rather unclear picture was suddenly brightened by the drop in fuel prices in November which was sharper than that in the same month in 2004. Something of a drop in international crude oil and fuel prices, in spite of depreciation of the euro, was behind this adjustment in the price of fuel which ended up making a decisive contribution to the containment of the general index.

In keeping with this trend, inflation prospects remain marked by a progressive but moderate increase in core inflation in the wake of prices of industrial goods, processed foods and, to a lesser extent, prices of services still growing at very high levels. Fresh foods could also move up because of farm prices and, finally, energy prices, in a situation of stability of crude oil costs in euros, will not likely begin to generate beneficial effects on the CPI until February 2006, when the general inflation rate may begin a path of moderate decrease.

Containment of prices in November was somewhat greater in the euro area than in Spain, according to the harmonized consumer price index (HCPI) and

CONSUMER PRICE INDEX BY COMPONENT GROUP

November

	Indices (*)	% monthly change		% change over previous December		% annual change	
		2004	2005	2004	2005	2004	2005
By type of spending							
Food and non-alcoholic beverages	117.9	0.4	0.6	2.8	2.9	3.2	3.1
Alcoholic beverages and tobacco	121.7	–0.0	0.1	5.5	5.0	5.6	5.0
Clothing and footwear	121.6	2.9	2.9	2.8	2.4	2.3	1.6
Housing	117.3	0.0	0.2	4.3	6.1	4.3	6.0
Household equipment	109.0	0.4	0.4	1.5	1.9	1.6	2.2
Health	106.4	0.1	0.0	0.2	0.7	0.2	0.8
Transport	117.8	–0.6	–1.8	7.4	7.2	7.4	5.8
Communications	91.6	–0.4	–0.0	–0.6	–1.5	–0.7	–1.6
Recreation and culture	102.5	–0.8	–0.5	–0.9	–0.7	0.1	0.1
Education	121.1	0.6	0.3	4.1	4.0	4.1	4.1
Hotels, cafés and restaurants	120.5	0.1	–0.0	3.9	3.9	4.1	4.2
Other	114.8	0.1	0.1	2.8	3.1	2.9	3.2
By group							
Processed foods	116.3	0.2	0.5	3.9	3.0	4.1	3.2
Unprocessed foods	122.7	0.6	0.6	1.4	3.3	2.3	3.6
Non-food products	114.7	0.2	0.0	3.4	3.6	3.5	3.4
Industrial goods	112.1	0.4	0.0	3.4	3.8	3.3	3.1
Energy products	*120.3*	*–1.2*	*–2.9*	*10.3*	*12.0*	*9.9*	*9.3*
Fuels and oils	*126.4*	*–1.5*	*–3.8*	*13.5*	*15.8*	*13.0*	*12.0*
Industrial goods excluding energy products	*109.5*	*1.0*	*1.1*	*1.3*	*1.3*	*1.2*	*1.2*
Services	117.7	–0.0	0.0	3.4	3.5	3.8	3.8
Underlying inflation (**)	114.4	0.4	0.5	2.8	2.6	2.9	2.7
GENERAL INDEX	**115.6**	**0.3**	**0.2**	**3.3**	**3.5**	**3.5**	**3.4**

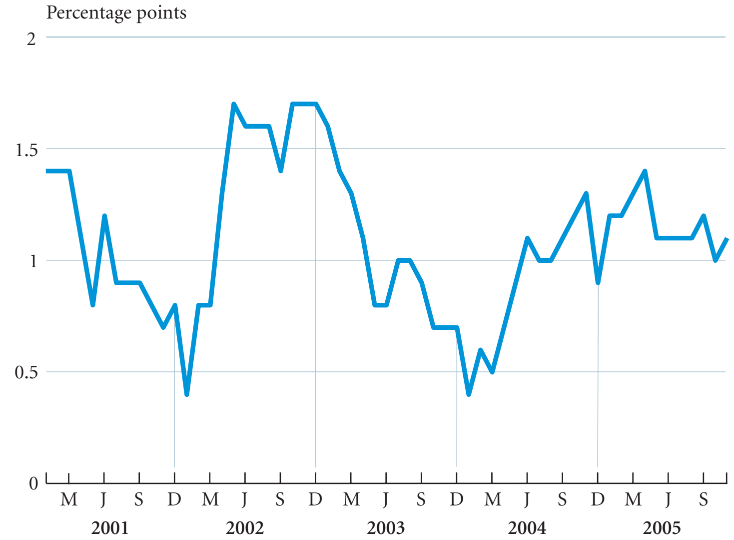
NOTES: (*) Base 2001 = 100.
(**) General index excluding energy products and unprocessed foods.
SOURCE: National Institute of Statistics.

therefore the inflation differential rose slightly to stand at 1.1 percentage points. The most appreciable differentials showed up in food, hotel and restaurant trade, education and transport. On the other hand, there was a lower increase in prices in Spain in alcoholic beverages and medical services.

Food, hotel and restaurant trade, education and transportation components showing biggest inflation differential with euro area.

INFLATION DIFFERENTIAL WITH EURO AREA GOES ABOVE ONE POINT

Difference in year-to-year change in harmonized consumer price index



SOURCE: National Institute of Statistics and internal figures.

Foreign sector

Current account deficit continues to rise

The current account deficit continued its trend to increase in September with growth of the trade imbalance and the imbalances in transfers and incomes in a context of a continuing surplus in the services balance. As a result, the cumulative deficit for 12 months amounted to 63.49 billion euros, that is to say, 7.2% of the gross domestic product, two and a half points more than in September 2004.

The sharp worsening of the current account balance was mainly due to the increase in the trade deficit but also to the poor performance in the other headings of the balance of payments. The trade balance rose by 35.2% in the first nine months of the year with the growth of imports being three times that of exports.

Trade deficit main culprit in current imbalance.

The lower surplus for services reflects the consumer potential of residents travelling outside Spain in contrast to the lower spending of visiting foreign

BALANCE OF PAYMENTS

Cumulative figure for last 12 months in million euros

	September 2004	September 2005	% change
Current account balance			
Trade balance	–48,716	–66,198	35.9
Services			
Tourism	*26,511*	*25,523*	*–3.7*
Other services	*–4,602*	*–4,089*	*–11.1*
Total	21,910	21,434	–2.2
Income	–12,647	–17,543	38.7
Transfers	467	–1,187	–
Total	**–38,986**	**–63,494**	**62.9**
Capital account	**8,721**	**8,161**	**–6.4**
Financial balance			
Direct investment	–11,886	–25,830	117.3
Portfolio investment	53,421	89,484	67.5
Other investment	–14,322	10,178	–
Total	**27,213**	**73,832**	**171.3**
Errors and omissions	1,347	–2,190	–
Change in assets of Bank of Spain	1,705	–16,309	–

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.

Tourist balance reflects low spending by foreign tourists along with potential of Spanish consumer abroad.

tourists. Funds flowing into Spain for tourism rose by a mere 2.7% nominal, well below the prices of tourist services and the number of incoming foreign tourists (6.3% as of September). Payments, on the other hand, were up by 25.9%.

The transfers balance, in turn, showed a turnaround marking up a cumulative deficit because of the impact of the volume of funds coming from the European Union and remittances sent abroad by immigrants. Finally, in the incomes balance, the larger deficit may be attributed to the sharp rise in payments which fully compensated the notable increase in inflows.

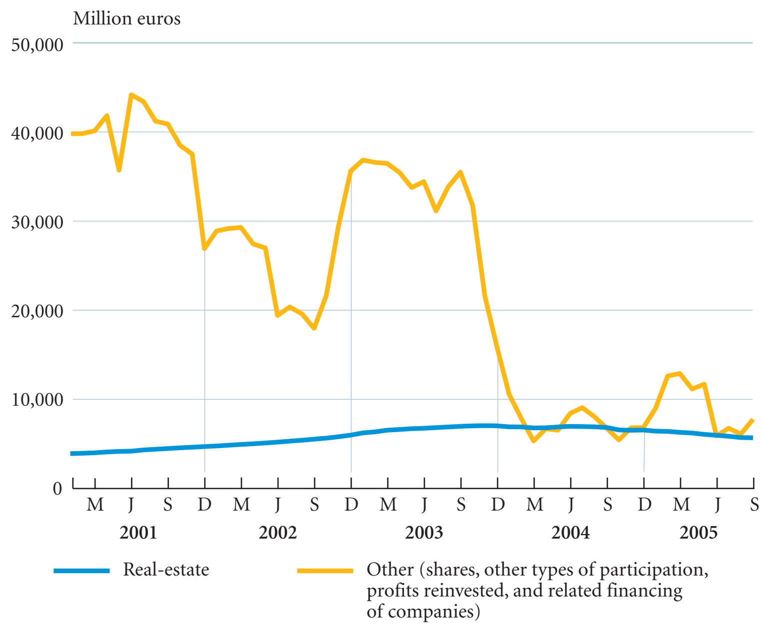
Direct foreign investment in Spain drops by 22% as of September.

Capital account, in turn, showed a higher surplus in September than in the same period the year before with the result that the cumulative figure for the first nine months of the year was lower than in the same period in 2004. Net world borrowing of Spain's economy, the result of adding the current account balance and the capital balance, amounted to 43.08 billion euros in the January-September period, some 82.1% more than in the year before.

In the financial sphere, direct foreign investment in Spain improved notably in September but in the first nine months of the year as a whole it was substantially lower than in 2004 (down 22.7%). This drop was also noted in the real-estate field (down 16.1%). Only foreign portfolio investment moved up strongly. Direct Spanish investment abroad was also down but this was not so in real-estate or portfolio investment.

FOREIGN INVESTMENT IN COMPANIES MATCHES REAL-ESTATE INVESTMENT

Cumulative balance for 12 months in direct foreign investment in Spain



SOURCE: Bank of Spain and internal figures.

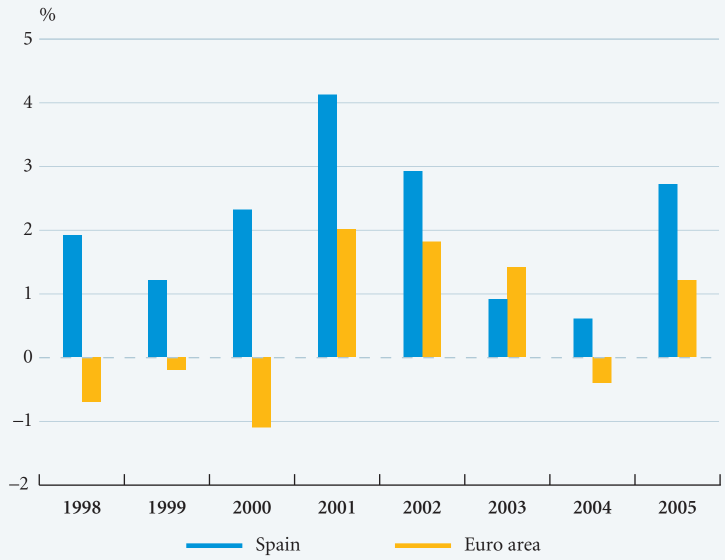
Foreign sector: key to growth in 2006

The foreign sector of Spain's economy has been systematically draining off growth from the gross domestic product (GDP) in recent years. Part of the drive in domestic demand has not been covered through domestic production, thus sending it abroad. In 2005, the foreign sector took close to 2 points away from growth of the economy, well above previous years. For 2006, however, we foresee a turnaround from this negative trend although the foreign sector will still take approximately 1.5 points away from the GDP.

This forecast is based on a very slight decrease in imports and a gradual recovery in exports. In the former case, the reason lies in a slowdown in domestic demand due mainly to containment of the rise in household consumption, while investment will also stand at somewhat lower levels. Furthermore, while the competitiveness of imported products in the domestic market could sharpen slightly (the euro will tend to appreciate), we do not feel that this effect will compensate the former. With regard to exports, the expected recovery in the euro area should shift to Spanish exports, both in goods and services. Here we also come up against the factor of competitiveness, this time in terms of abroad, as a key element. Competitiveness is therefore going to be one of the determining factors in Spain's economic progress not only in 2006 but also in coming years.

UNIT LABOUR COSTS SHOWING HIGHER GROWTH IN SPAIN

Annual change in unit labour costs



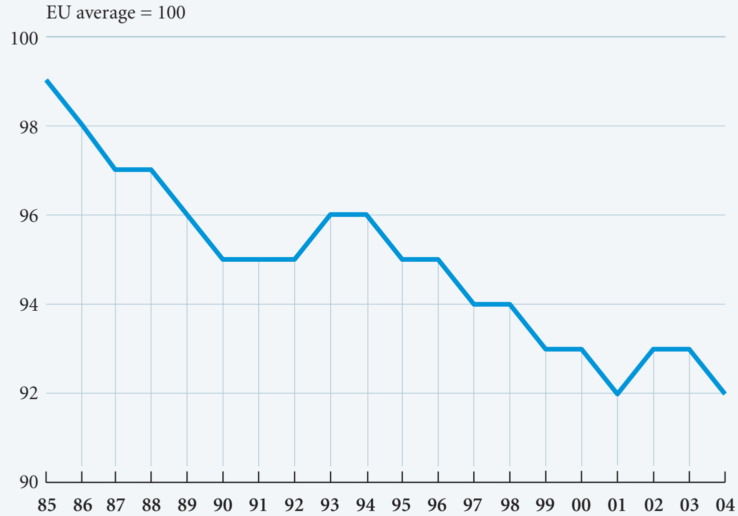
SOURCE: International Monetary Fund and internal figures.

Traditionally, Spain's exports have improved more as a result of the loyalty of customer economies than a question of price, except, of course, following a period of devaluation. For this reason, a stage of economic recovery of Spain's main trading partners should come as the promise of an optimistic future from the point of view of exports, either in goods or services.

This analysis, however, is rather controversial in a context of growing globalization and progressive liberalization of world trade in which any economy possessing the products and resources in quantity and quality is able to take advantage of the rather more buoyant state of the European economy. Because of this, the market share of Spanish exports in world trade depends on competitiveness in price, range and quality, a competitiveness which must be demonstrated in an area where not only traditional rivals are active but also strong emerging economies. Secondly, the future of exports is more and more linked to the location and production strategies of global companies which, in turn, are strongly affected by factors of attraction which Spain's economy may possess as compared with those of its competitors.

LABOUR PRODUCTIVITY IN SPAIN RUNS IN OPPOSITE DIRECTION COMPARED WITH EUROPE

Apparent labour productivity in Spain



SOURCE: Bank of Spain.

There is, however, no way of hiding the risk that this time Spain's economy may not be able to take advantage of the improvement in the world economy and the European economy to the same extent as in upward stages of previous cycles. On the one hand, the indicators continue to point to decreases in competitiveness. In addition, Spain's economy is losing its attraction as a location for plants of exporting companies and both relocations to other geographical regions of the world and readjustments of production in companies mainly interested in outside markets are daily becoming more common.

For all these reasons, correcting the foreign balance will not be an easy task. It is not enough to simply go after demand in a stage of recovery but also a matter of changing the conditions of competitiveness in Spain's economy. This is a complex challenge that depends on improving productivity which today is the matter needing most urgent attention in an economy such as that of Spain now creating considerable employment but with little value added involved.

Public sector

Government revenues continue strong rise

Central government non-financial revenues were down notably in November, which did not prevent cumulative collections in the first eleven months of the year (119.77 billion euros) from holding well above the same period in 2004. This figure does not include the 41.36 billion euros making up the segments of personal income tax collections and the greater part of indirect taxes ceded to Spain's autonomous communities and local government so that this turns out to be of little significance as an indicator of the revenue capacity of the central government through general taxes. If the tax collections thus ceded are included, collections would rise to 161.13 billion euros, which would mean an increase of 12.5% over last year.

Government revenues holding up well...

The sharpest increase (20.7%) showed up in direct taxes which furthermore continued to be the main source of funding thanks to the good state of collections for corporate profits tax and personal income tax. The increase in collections for indirect taxes (7.4%) was considerably lower as a result of the drop in VAT collections for import transactions. On the other hand, collections for domestic transactions were up by 28.6%. Under special taxes, tax on tobacco was helped by an increase in rates

...thanks to increased collections for direct taxes and VAT.

CENTRAL GOVERNMENT BUDGET IMPLEMENTATION

November 2005

	Month		Cumulative for year	
	Million euros	% change over same month year before	Million euros	% change over same month year before
Non-financial revenue	**6,127**	**–21.3**	**119,770**	**13.0**
Non-financial revenue adjusted (*)				
Personal income tax	4,763	12.1	51,488	16.3
Corporate tax	–149	–	28,808	23.4
VAT	2,437	–10.5	48,002	11.3
Special taxes	1,340	–8.8	16,572	3.4
Other	1,798	–20.2	16,261	–1.3
Total	**10,189**	**–7.0**	**161,131**	**12.5**
Non-financial spending	**9,140**	**19.1**	**108,561**	**5.6**
Treasury balance	**–3,013**	**–**	**11,209**	**247.8**
Surplus (+) or deficit (–) (**)	***–5,144***	***–14.8***	***14,871***	***738.3***

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

Treasury surplus wiped out by net increase in financial assets.

applied. Collections for fuel tax, on the other hand, were up by only 0.9% as a result of the increasing switch to diesel oil consumption, a fuel carrying a lower tax rate. Funds from foreign trade were also up strongly because of increased imports and, naturally, as a result of the rise in oil prices.

Central government non-financial spending was up by 5.6% going to a figure of 108.56 billion euros. This figure does not include the balancing entry for those tax segments ceded to the autonomous communities. The biggest increase in spending showed up in capital transactions, given that current spending rose by only 4.2% under the favourable effect of the decrease in purchases of goods and services.

The central government Treasury balance in November, that is to say, the difference between revenues and non-financial spending, was positive showing a figure of 11.21 billion euros, well above the amount seen in the same period last year. This amount was not sufficient to cover the sharp net increase in financial assets thus creating a deficit of 575 million euros, well below the same period last year. In terms of National Accounting, on the other hand, the budgetary balance was positive for an amount well above the figure for the same period in 2004, going to an amount of 14.87 billion euros.

Savings and financing

Sustained rise in private sector funding

Interest rates on bank loans and credits held practically stable at low levels in October with just a slight upward trend. The exception showed up in consumer credit and credit for purposes other than mortgage loans with interest rates dropping slightly by three basis points to 6.29% in a situation of sharp competition. As a result, the rate stood 5 basis points below one year earlier. The average interest rate applicable to households held t 4.14%, some 20 basis points less than 12 months earlier. The average interest rate applied to companies rose slightly by 2 basis points going to 3.43%, some 10 basis points less than in the same month in 2004.

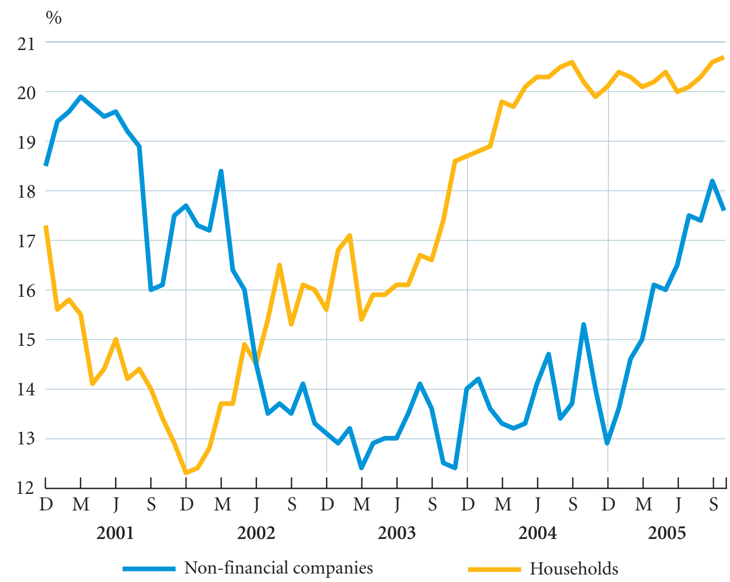
Housing mortgage loan rates up slightly in November but still below inflation.

In addition, the interest rate applied by credit institutions in November to mortgage loans for more than a three-year term for acquisition of non-subsidized housing rose by 4 hundredths to 3.26%. Nevertheless, it stood 12 basis points below one year earlier. It should be pointed out that this interest rate is lower than current inflation, which indicates its abnormally low level. In fact, it is likely to rise moderately in coming months once the upward move is begun by the European Central Bank.

Within this framework of low interest rates and a good economic climate,

FUNDING TO HOUSEHOLDS GROWING AT HIGHEST RATE IN PAST SIX AND HALF YEARS

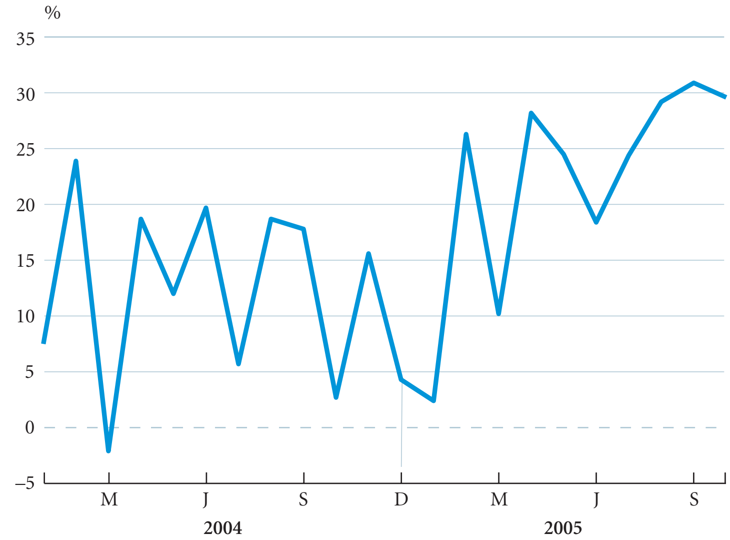
Year-to-year change in total funding by institutional sector



SOURCE: Bank of Spain.

SLIGHT INCREASE IN CONSUMER CREDIT

Year-to-year change in new household consumer loan transactions



SOURCE: Bank of Spain and internal figures.

Funding to private sector grows at more than twice rate in euro area as a whole.

funding to the private sector in October rose at an annual rate of 19%, practically the same level as in the month before and more than twice the rate in the euro area as a whole. Funding to companies, including bank credit, both domestic and foreign, and bond issues (but excluding share issues) was up by 17.6% compared with the same month last year. This rate was 6 decimals lower than that recorded in September but still represented a sharp growth rate.

On-demand accounts and savings accounts up 12% in past 12 months...

Financial resources going to households grew by 20.7% in the 12 months ending in October, the highest level since April 1999. The greater part of funding channelled to households continued to be made up of mortgage loans which kept rising at a sharp rate. The amount of new mortgage loan transactions for home purchase rose by 30% in October compared with the same month in 2004. Consumer credit (to buy cars, motorcycles, appliances, furniture, travel, etc.) was also up notably. As a result, the amount of new consumer credit transactions for households recorded a year-to-year change rate of 29% in October. As for other purposes, the figure for new loan transactions granted in the same month rose by 13% compared with October the year before.

Bank deposits show high growth

Total deposits of resident companies and households rose at a sharp rate in October compared with the same month in 2004, well above the rate in the euro area. Accounts with terms of more than two years, which enjoy a tax benefit of 40% on interest, showed a major increase. In addition, on-demand and savings accounts have risen by 11.9% in the past 12 months.

With regard to bank deposit interest, this held at very low levels in October. Interest rate for companies was down by one basis point to 1.20%, some 8 basis points below 12 months earlier. The interest rate applied to households was up one hundredth to 1.14%, but down 2 basis points from the same month in 2004.

DEPOSITS OF COMPANIES AND HOUSEHOLDS AT CREDIT INSTITUTIONS

October 2005

	Total	Change this year		Change over 12 monts		% share
	Million euros	Million euros	%	Million euros	%	
On-demand savings (**)	374,789	29,715	8.6	39,858	11.9	44.1
Up to 2 years (*)	183,602	23,135	14.4	26,980	17.2	21.6
More than 2-year term (*)	210,021	82,553	64.8	97,259	86.3	24.7
Repos	66,918	–13,731	–17.0	–8,458	–11.2	7.9
Total (*)	**835,329**	**121,671**	**17.0**	**155,638**	**22.9**	**98.2**
Deposits in currencies other than euro	**15,448**	**9,601**	**164.2**	**10,067**	**187.1**	**1.8**
TOTAL (*)	**850,777**	**131,272**	**18.2**	**165,704**	**24.2**	**100.0**

NOTES: (*) As a result of the coming into force of new regulations in application of the International Accounting Standards, as of June 2005, increases in time-deposits as a cross-entry to entries on the assets side of securitizations that had been taken out of the balance sheet make comparison difficult.
(**) Includes deposits redeemable at notice, according to ECB definition.
SOURCE: Bank of Spain and internal figures.

...with similar rise in assets of securities mutual funds.

The assets of securities mutual funds rose by 2.95 billion euros in November to reach 244.26 billion euros, according to figures supplied by Inverco, the sector organization. As a result, they were up 12.4% in the past 12 months. Net subscriptions in investment mutual fund participations in November amounted to 1.25 billion euros. Share-based funds, both national and foreign, recorded net subscriptions of 1.5 billion euros, of which global funds made up 766 million euros. On the other hand, funds based on long-term bonds recorded net disinvestments of 665 million euros. This meant that in recent months investor preference has shifted to share-based funds, given that over the past eleven months funds of this type have attracted some 5.56 billion euros net.

The total number of participants in securities mutual funds rose to 8,507,747, some 109,971 more than in October. As a result, the number of participants rose by 6.1% compared with the same month in 2004. During this period, the biggest increase in participants showed up in guaranteed bond-based funds with a change of 13.5%, followed by short-term bond-based funds with an annual increase of 11.5%.

Average annual yield on securities mutual funds holds at 4.7%.

The average weighted annual yield on securities mutual funds was 4.7%. All types of funds obtained positive annual yields although there was a wide range in results. Share-based funds of emerging countries thus marked up capital gains of 53.7% whereas money-market-based funds brought a yield of 1.2%.

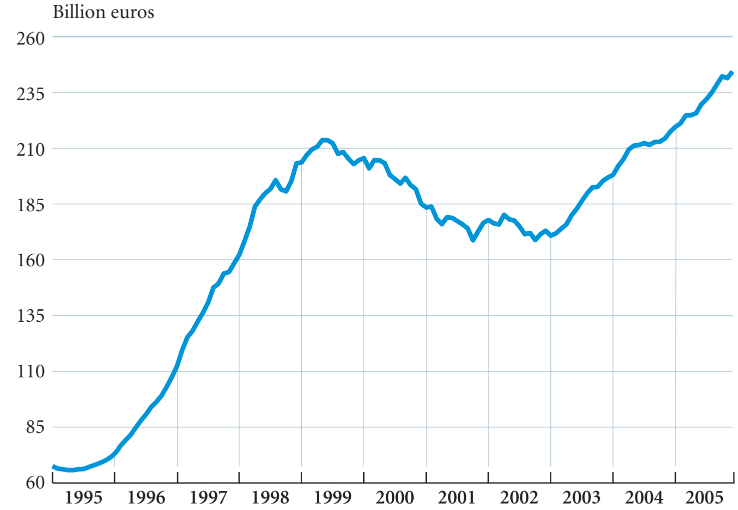
With regard to securities mutual fund companies, which are the usual vehicles for large investors, assets amounted to 26.93 billion euros at the end of July. On that date, the number of shareholders was 395,412. In addition, the volume of assets of securities mutual funds at the end of November 2005 came to 6.35 billion euros, an increase of 45.1%. The number of participants in these funds was 134,256, an increase of 26.4% during the year to that date. Average weighted yield in this type of fund over the past year was 5.4%. Average weighted annual yield in the past three and five years was 6.5% and 7.1% respectively.

Insurance premiums record 9% annual increase in January-September period.

In another sphere, premiums in the insurance field went above 36 billion

ASSETS OF SECURITIES MUTUAL FUNDS REACH NEW ALL-TIME HIGH

Total assets of securities mutual funds



SOURCE: Inverco.

euros in the first nine months of 2005, according to figures supplied the ICEA insurance research organization. As a result, premiums showed an annual increase of 8.6%. By type of insurance, life insurance showed a rise of 11.1% while non-life was up by 7.0%. Within this field, the biggest increases came in multi-risk insurance (up 10.7%) and health insurance (increase of 9.6%). On the other hand, the motor vehicle sub-sector, which was subject to heavy competition, showed an increase of only 3.8%. In addition, savings managed by the life insurance sector, seen in technical reserves, stood at 122.21 billion euros, an increase of 7.5% compared with September 2004.

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