

Monthly Report



NUMBER 304

Poor in the lands of the wealthy: United States awakens while Europe begins to dream [Page 9](#)

Economic growth a major factor in reducing poverty and aiding social integration on both continents

Social exclusion and poverty [Page 29](#)

More than 70 million Europeans close to poverty line

Being poor in Spain [Page 45](#)

Women, elderly persons and children are groups most affected

Information and social exclusion: the digital divide [Page 57](#)

Access to information and communications technology generates growth

Forecast

% change over same period year before unless otherwise noted

	2006	2007	2008	2006			2007		
				2Q	3Q	4Q	1Q	2Q	3Q
INTERNATIONAL ECONOMY									
	Forecast			Forecast			Forecast		
Gross domestic product									
United States	3.3	2.3	2.5	3.5	3.0	3.1	2.1	2.2	2.4
Japan	2.2	2.0	1.9	2.1	1.5	2.4	2.2	2.2	2.0
United Kingdom	2.8	2.5	2.3	2.7	2.9	3.0	2.9	2.6	2.5
Euro area	2.8	2.6	2.4	2.9	2.8	3.3	3.0	2.7	2.5
<i>Germany</i>	3.0	2.5	2.3	2.9	3.2	3.9	3.6	2.8	2.4
<i>France</i>	2.2	2.1	2.1	2.7	2.1	2.2	2.0	1.9	2.1
Consumer prices									
United States	3.2	2.2	2.3	4.0	3.4	2.0	2.4	2.3	2.0
Japan	0.2	0.2	0.4	0.2	0.6	0.3	-0.1	0.3	0.4
United Kingdom	2.3	2.4	2.1	2.2	2.4	2.7	2.8	2.5	2.2
Euro area	2.2	2.1	2.0	2.5	2.1	1.8	1.9	1.9	2.0
<i>Germany</i>	1.7	1.9	1.7	1.9	1.6	1.3	1.8	1.9	2.0
<i>France</i>	1.7	1.4	1.6	1.9	1.7	1.3	1.2	1.2	1.6
SPANISH ECONOMY									
	Forecast			Forecast			Forecast		
Macroeconomic figures									
Household consumption	3.7	3.4	2.9	3.6	3.6	3.7	3.5	3.4	3.3
Government consumption	4.4	4.5	4.3	4.4	4.2	4.9	5.2	4.6	4.1
Gross fixed capital formation	6.3	5.8	4.1	6.2	6.4	6.4	6.6	6.3	5.7
<i>Capital goods</i>	9.7	9.6	5.0	9.1	9.6	11.4	12.1	11.2	9.1
<i>Construction</i>	5.9	5.1	3.8	5.8	6.2	5.7	5.6	5.3	4.9
Domestic demand (contribution to GDP growth)	4.9	4.5	3.8	4.8	4.8	4.9	4.8	4.7	4.4
Exports of goods and services	6.2	4.3	3.6	4.9	3.4	7.3	4.2	4.4	4.5
Imports of goods and services	8.4	5.5	4.8	7.3	6.0	8.8	5.6	5.7	5.6
Gross domestic product	3.9	3.8	3.1	3.8	3.8	4.0	4.1	4.0	3.8
Other variables									
Employment	3.1	2.9	2.3	3.1	2.9	3.1	3.0	2.9	2.8
Unemployment (% labour force)	8.5	8.0	7.8	8.5	8.1	8.3	8.5	8.0	7.9
Consumer price index	3.5	2.6	2.7	3.9	3.5	2.6	2.4	2.4	2.5
Unit labour costs	2.7	2.2	2.3	2.7	2.7	2.8	2.4		
Current account balance (% GDP)	-8.5	-9.4	-9.8	-7.8	-8.4	-7.9	-10.3		
Not lending or net borrowing rest of the world (% GDP)	-7.8	-8.9	-9.4	-7.4	-7.8	-6.7	-9.8		
Government balance (% GDP)	1.8	1.2	0.9						
FINANCIAL MARKETS									
	Forecast			Forecast			Forecast		
Interest rates									
Federal Funds	5.0	5.3	5.3	4.9	5.3	5.3	5.3	5.3	5.3
ECB repo	2.8	3.9	4.5	2.6	2.9	3.3	3.6	3.8	4.1
10-year US bonds	4.8	5.0	5.3	5.1	4.9	4.6	4.7	4.8	5.1
10-year German bonds	3.8	4.4	4.9	4.0	3.9	3.8	4.0	4.3	4.6
10-year Spanish bonds	3.8	4.5	5.0	4.0	3.9	3.8	4.1	4.4	4.7
Exchange rate									
\$/Euro	1.26	1.35	1.31	1.26	1.27	1.29	1.31	1.35	1.35

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Poverty and human development

Born in 2000, Nthabiseng is black, the daughter of a poor family from a rural area of East Cape province, some 700 kilometres from Cape Town. Her mother never went to school. The likelihood of her dying in the first year of her life was 7.2% and her life expectancy fails to go much beyond 50. It is unlikely she will have access to safe drinking water nor to sanitation services while she is growing up.

Amy was born the same day in a remote town in south-east Kentucky, in the United States. She lives with her parents in a broken-down caravan and runs barefoot around the dirty unkempt grounds. They do not have a telephone. To get drinking water they must go to faucets some distance away, but they can watch television on an old set and Amy can go to school. Amy's father lost his job when the factory closed down. He now does odd-jobs but the pay is very low and social welfare programmes are so niggardly that the family has dropped below the poverty line.

Poverty takes on many faces. It is not only a curse in the Third World. In the developed countries, situations may not be as dramatic as those we find in developing economies, thanks to the higher general level of wealth and existing social welfare systems. But what is shocking is that the problem remains in our consumer societies of abundance. This is a moral question but also one of economics. Poverty and social exclusion represent a waste of human potential and a drag on the economy, growth and prosperity of a country.

The term «social exclusion» is often used to describe those situations where an individual has serious difficulties or is unable to have access to normal systems of personal development and full involvement in the community. In any case, social exclusion and poverty are closely related and affect large groups of people. More than 70 million Europeans, including more than 8 million Spaniards, are at risk of poverty. Those most commonly vulnerable are women, the elderly, males who have lost a job, and so on.

What is to be done? World Bank studies show that the spread of economic development since the Eighties has brought about a decrease in the proportion of the world population in a state of extreme poverty. Large countries such as India and China have fully moved into the group of world countries managing to reduce the segment of the population caught into extreme poverty. The opening up of world trade in itself guarantees nothing but it often goes hand in hand with improvements in production capacity and the development of peoples. Direct development aid relieves difficult situations but only in a few cases does it manage to resolve the basic problem.

Apart from having more or less generous social welfare systems, the developed economies apply a broad range of policies aimed at easing the most extreme situations. The development of initiatives, such as micro-credits and increased activity of non-governmental organizations and foundations aimed at improving the Welfare State, the outcome of a growing ethical awareness among companies and ordinary citizens, should serve as an incentive to carry on the fight against one of the main curses of humanity.

OVERALL SUMMARY

Inverted US interest rate curve is a conundrum...

...but curve has normalized in recent weeks thanks to improved growth prospects, limited impact of real estate crisis and strength of private consumption.

Confidence in US economy returning but hardly enough not to warrant some degree of caution.

World economy: mysteries revealed?

At the beginning of 2005, during an appearance before the monetary committee of the US Congress, Alan Greenspan made the word *conundrum* quite famous when he referred to the situation in the bond markets. Interest rates on US bonds are remaining flat at very low levels. The then- chairman of the Federal Reserve (the US central bank) was at a loss to explain why bond yields were not reacting with an upward move, as they had always done, in a stage of economic recovery, an increase in corporate profits, a rise on the stock market and an increase in employment. A later increase in the Fed's reference rate inverted the curve, a situation that often is a prelude to recession. But there was no recession in sight. The key to the *conundrum* could lie in low inflation, the effects of globalization, excessive world savings, decreased risk aversion, excessive production capacity, etc. None of these factors, however, could provide a fully satisfactory explanation. Then suddenly, between the middle of May and mid-June 2007, the inversion of the interest rate curve was no more. What happened?

First of all, following a very poor first quarter, US growth prospects for the second quarter are considerably better. A month before having the first official estimates at hand, forecasts by most analysts indicate a quarter-on-quarter rate raised to annual of 2.5% as against a increase of 0.6% in the first three months. The worst therefore is over. Secondly, the housing recession is not passing through to the consumer. Figures from the real estate sector show a notable

impact but they are not getting worse. Prices have dropped but not very much so that the much-feared turnaround of the «wealth effect» (the price of my house has dropped, I have lost property value, therefore I must cut my consumption spending) does not have to happen. Thirdly, and the most important, the consumer is not losing spirit. In spite of everything, the indicators show a confident consumer whom not even the high price of petrol is going to dissuade from driving to the shopping centre to spend his/her last cent.

These are figures very much related to the current situation but the markets reacted with a sharp rise in long-term rates. Some large investors who were counting on a cut in interest rates by the Fed threw in the towel and went over to those who believe that the next move will be a rise in official interest rates. Interest rates on 10-year bonds rose to 5.25% on June 12, the highest level since May 2002. The return to growth, some increases in the labour market, a lower gain in productivity and the rise in raw materials prices are factors suggesting some return to the classical cycle.

But the *conundrum* has not been solved by a long shot. Long-term interest rates have not kept rising following the high mentioned but rather they have dropped somewhat. And it is not too much to recall the swings the markets often hand out when it comes to trying to guess the future. The latest figures on the housing and mortgage markets show that the end of the recession is still far off and, until then, the risk of a pass-through to the consumer still remains. The US economy

is still flexible and dynamic and should be capable of digesting the real estate upset. But in coming quarters the growth figures will continue to be dragged down by the weight of the real estate situation while other sectors will move ahead in the new scenario with some prudence.

But there is no problem. At this time, the big support of the developed economies comes from the emerging country economies. China is not faltering. Its industrial production and its exports are moving ahead at an overwhelming rate and make it possible to keep accumulating reserves, one of the major sources of global liquidity. In India, the gross domestic product grew by more than 9% in the first quarter and other emerging economies are following similar paths. So far this year, while industrial production in the developed countries has slowed down, that in the emerging countries continues full-steam-ahead.

In fact, Japan and the Euro Area have recently shown signs of lower growth rates. It is nothing to be alarmed at. In Japan, the economy continues to grow above potential, thanks to investment and exports. The fact is consumers are active and the much-feared deflation has not gone away. For this reason the central bank does not dare to raise interest rates that are encouraging the carry trade (borrowing yen at the interbank rate of 0.6% to invest in US bonds at more than 5% or to finance speculative funds at even higher rates). Another producer of global liquidity thus continues to operate at full speed.

In the Euro Area, the economy continues full-ahead. Economists at the European Central Bank (ECB) are lined up with private analysts in suggesting growth of around 2.6% in 2007 and a few decimals less in 2008. According to Eurostat, in the first three months of the year the

economy grew by 3.0% compared with the same period the year before. The most notable figure in the quarterly accounts was the rise in investment which went up to 7.2% year-on-year, the highest figure recorded since this European body began to publish this statistic, not equalled since the beginning of 1998. The figure for unemployment also reached lowest yet published levels, going to 7.1% of the labour force in April.

The latest figures for the situation in the 13-member Euro Area grouping show some slowing down of industrial production in April. This was a correction that may even be positive if we keep in mind the high level of utilization of production capacity (at the highest level in the past 16 years) and the risks this poses for price stability. It is not that inflationary pressures can be noted but the ECB forecasts indicate year-on-year rates in the consumer price index close to 2%, that is to say, at the limit the Frankfurt-based body considers allowable. As a precaution, at the beginning of June the Governing Council of the ECB decided to raise the reference rate by 25 basis points putting it at 4%. Jean-Claude Trichet continues to be concerned about the risks on inflation (prices for oil and other raw materials, increase in credit, wage demands) so that the increase in rates is not going to stay where it is now.

Spain's economy: still very strong

One person who has expressed satisfaction about the increase in Eurosystem rates is the governor of the Bank of Spain. Monetary policy for the euro has been excessively easy for an economy such as that of Spain which has undergone one of its sharpest and longest growth cycles in recent times. The rapid increase in corporate and

While developed economies somewhat ease off growth, emerging economies do not stop.

Japan's recovery not being confirmed and interest rates still kept very low...

...while in Euro Area prospects remain bright and ECB maintains policy of interest rate increases.

Increase in financial costs is welcomed in Spain's economy which is maintaining very high growth rate although inflation remains moderate.

Corporate investment showing very strong spurred on by improvement in traditional export markets.

High growth in 2006 failed to maintain advances in terms of per capita income.

household borrowing, spurred on by low interest rates among other factors, poses a risk that the central bank has kept repeating.

In any case, the main indicator of overheating, inflation, is notable for being practically non-existent. The economy is growing at 4% although in May the year-on-year CPI rate dropped to 2.3%, the lowest level since March 2004. Compared with the Euro Area average, it is still high but the growth differential has been cut by a half-point, a very low level if we take recent history into account. We should also point out that the improvement in inflation in recent months is more apparent than real due to the base effect (one year ago the price of oil was higher than it is now). To the extent this effect keeps reducing over coming months the CPI rate will come close to 3% or more, a level that is above official objectives and one that has proven difficult to reduce permanently.

In any case, the increase in interest rates is beginning to cool off demand for credit from companies and individuals. Funding granted to non-financial companies was up 22.8% in the past 12 months ending in April, some 5.1 points less than in December. Loans to individuals continued ease growth to the point where the annual change rate went to 17.6% in April. This slowdown was mainly due to the performance in housing loans. With the Euribor at 4.5% annual (the highest since 2001), these loans rose at an annual rate of 18.1% at the end of the first four months of the year, 6 points less than the figure recorded at the beginning of 2006.

As a result, at this time demand for housing and consumer spending are the moderating factors in an economy that is still presenting strong growth momentum. This is not the case with

corporate investment given that, in spite of the rise in financial costs, indicators show the great strength of this demand component. Part of the growth in gross capital formation may be explained by the recovery of demand in Spain's traditional export markets. In the first four months of 2007, nearly all export sectors showed a positive performance. In nominal terms, sales of capital goods were up by 5.3% year-on-year while car sales rose by 7.6%. Both sectors reached a share of total exports around 20% each. Other groups recording notable growth were those in food and chemical products, with increases of more than 9%.

We also note some moderation in the rate of job creation although the labour market continues to show very strong. In fact, the number of registrations with Social Security in the first five months of the year was up 3.2% compared with the same period last year, which meant nearly 600,000 new registrations in one year.

The fact that the sectors to grow most up to now are partly characterized by showing a lower than average wage per worker, that has slowed the rise in the wage mass as a whole, has raised something of a polemic. The most troubling was recognition in the Bank of Spain's 2006 annual report just published that the per capita GDP had made no progress that year compared with the Euro Area and had stayed at 92.4% of the average of the 13-member group, despite the higher growth of the Spanish economy and the increase in the employment rate. With regard to the average for the EU-25, the per capita GDP even dropped from 97.9% to 97.5% of the average. This is a warning sign that should not be ignored in the context of the present stage of high growth with low inflation.

June 26, 2007

CHRONOLOGY

2006

June	8 European Central Bank raises official interest rate to 2.75%.
	29 Federal Reserve Board increases reference rate to 5.25%.
July	11 European Council authorizes Slovenia to adopt euro as currency as of January 1, 2007.
	24 Multilateral negotiations in Doha Round of World Trade Organization, aimed at greater liberalization of international trade, indefinitely suspended.
August	3 European Central Bank raises official interest rate to 3.00%.
	8 One-month forward price of Brent quality oil goes up to all-time high of 78.49 dollars a barrel.
	12 UN Security Council approves resolution for cease-fire in Lebanon in conflict between Israel and Hezbollah.
September	26 European Commission gives go-ahead to entry of Romania and Bulgaria into European Union on January 1, 2007.
October	5 European Central Bank raises official interest rate to 3.25%.
November	29 Publication in BOE Official Bulletin of Law 35/2006 on reforms to Personal Income Tax and partial modification of laws on Corporate Tax, Non-resident tax and Property Tax.
December	7 European Central Bank raises official interest rate to 3.50%.

2007

January	1 European Union enlarged to 27 member states following inclusion of Romania and Bulgaria; and euro area numbers 13 members following adoption of European single currency by Slovenia. Reforms to Personal Income Tax and Corporate Tax go into force.
March	8 European Central Bank raises official interest rate to 3.75%.
April	13 Publication of Law 6/2007 in Official Government Bulletin (BOE) modifying the regulations applying to takeover bids which come into force in mid-August.
June	1 IBEX 35 index for Spanish stock market marks up all-time high (15,501.5) with cumulative gains of 9.6% compared with December 2006.
	4 Dow Jones index for New York stock exchange registers all-time record (13,676.3) with rise of 9.7% compared with end of 2006.
	14 Parliament approves new Law on Safeguarding Competition with creation of National Competition Commission.
	21 EU Council of Ministers approves adoption of euro as national currency for Malta and Cyprus as of January 1, 2008.
	23 European Council agrees on basic lines to be adopted in new treaty that takes place of European Constitution .

AGENDA

July

- 3** Registrations with Social Security and registered unemployment (June).
- 5** Industrial production index (May).
Governing Council, European Central Bank.
- 13** CPI (June).
- 16** Balance of payments (April).
Harmonized CPI (HCPI) for EU (June).
- 24** Central government revenues and spending (June).
- 25** Producer prices (June). Foreign trade (May).
- 27** Labour Force Survey (2nd Quarter).
US GDP (2nd Quarter).
- 30** Preliminary HCPI (July).

August

- 2** Registrations with Social Security and registered unemployment (July).
- 3** Industrial production index (June).
- 7** Fed Open Market Committee.
- 10** CPI (July).
- 14** Early GDP (2nd Quarter).
Balance of payments (May).
- 16** Harmonized CPI for EU (July).
- 24** Foreign trade (June).
- 27** Producer prices (July).
- 29** Quarterly national accounts (2nd Quarter).
- 30** Early HCPI (August).
- 31** Central government revenues and spending (July).

INTERNATIONAL REVIEW

United States hoping to recover good economic state after weak half-year.

Consumers keep on doing well...

United States: more growth, but real estate market remains at thread

The United States economy now is not only riding the storm successfully but, following publication of latest indicators, seems to have the prow aimed at a growth horizon with inflation relatively under control. And, while growth of gross domestic product (GDP) in the first quarter ended up a poor 0.7% quarter-on-quarter in annual terms, for the second quarter it is expected to go well above 3%. The biggest growth factor, however, is still coming from consumers helped by a labour market that functions at a good pace. Inventories

are at low levels so that it may be expected they will go up while the expected drive in exports and investment is still to be seen. In spite of this reassuring scenario, risks still remain and the bad genie of the real estate market has not yet been brought to bay.

In this context, retail sales in May, excluding the highly variable figures for cars and petrol, grew by 4.5% year-on-year. This may stay below the growth rates seen in the boom months at the end of 2004 but it shows a level of resistance with increases of around the 5% it has shown in recent months which has been more solid than expected. This strength

UNITED STATES: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006			2007		
			2Q	3Q	4Q	1Q	April	May
Real GDP	3.2	3.3	3.5	3.0	3.1	1.9	–	...
Retail sales	6.6	6.1	6.4	5.4	5.0	3.4	3.1	5.0
Consumer confidence (1)	100.3	105.9	106.6	104.4	106.8	109.9	106.3	108.0
Industrial production	3.2	4.0	4.2	5.1	3.5	2.4	1.6	1.6
Industrial activity index (ISM) (1)	55.5	53.9	55.2	53.8	50.9	50.8	54.7	55.0
Sales of single-family homes	6.5	–18.0	–14.7	–23.3	–21.9	–23.7	–10.6	...
Unemployment rate (2)	5.1	4.6	4.6	4.7	4.5	4.5	4.5	4.5
Consumer prices	3.4	3.2	4.0	3.4	1.9	2.4	2.6	2.7
Trade balance (3)	–714.4	–758.5	–759.4	–777.7	–758.5	–745.6	–741.8	...
3-month interbank interest rate (4)	3.6	5.2	5.3	5.4	5.4	5.4	5.4	5.4
Nominal effective exchange rate	83.7	82.5	82.0	81.6	81.6	81.9	79.9	79.0

NOTES: (1) Index value.

(2) Percentage of labour force.

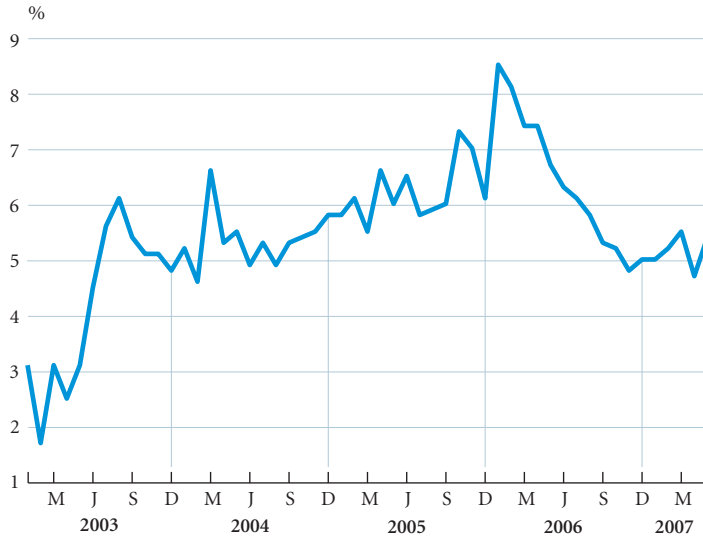
(3) Cumulative figure for 12 months in goods and services balance. Billion dollars.

(4) Percentage.

SOURCE: OECD, national statistical bodies and own calculations.

UNITED STATES: CONSUMPTION HOLDING UP BETTER THAN EXPECTED

Month-on-month change annualized for retail sales excluding cars and petrol (*)



NOTES: (*) Trend series.

SOURCE: Department of Commerce and own calculations.

has been obtained in spite of the fact that these variable components (cars and petrol) have also been gaining strength in recent months, which means an adverse effect on budgets for other purchases. In keeping with this trend, the consumer confidence index published by the Conference Board is maintaining an upward trend which, nevertheless, has been easing off after failing to come close to the high in the previous growth cycle. The help from the labour market remains considerable with some 157,000 new jobs created in May and an unemployment rate at only 4.5% of the labour force.

Largely as a result of the strong consumer drive, business executives are now seeing things more clearly. The business sentiment and economic activity index put out by the Institute for Supply Management (ISM) for May showed significant increases that were rather unexpected. In manufactures, in spite of the low level of industrial production, the index went to the 55.0

points level and in services, the increase was even sharper at 59.7 points. These figures were well above the 50 which indicates there were more optimists than pessimists. New orders, especially for exports, and prices were the factors showing most strength while inventories showed up as the weakest. Utilization of industrial production in May stood at 81.3 points, a high level but lower than the peaks reached last summer and also below average growth in the Nineties so that price pressures should be moderate.

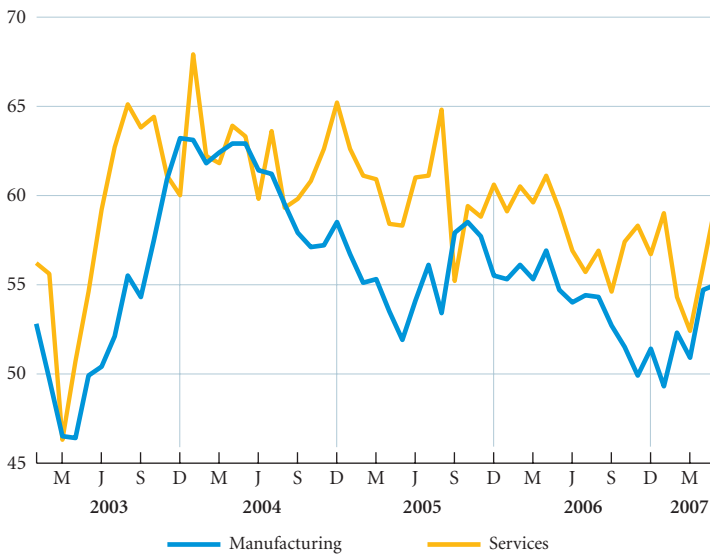
The Fed and the government bond market seem less concerned about the slowdown in economic activity than by inflation, in contrast to just a few months ago. In view of the trend in prices, the former should be more certain than the latter. The consumer price index (CPI) for May rose by 2.7% year-on-year thus showing a slight rise over April. Core inflation, the general index excluding the volatile headings of food and energy, slowed to 2.3% and marked up a downward trend. Clearly in this

...as well as businesses, up to now.

Core inflation moderates to 2.3%.

UNITED STATES: BUSINESS EXECUTIVE GO OVER TO OPTIMISM

Level of ISM indices



SOURCE: Institute for Supply Management and own calculations.

Real estate market still not recovering although for now prices holding up.

direction, the underlying CPI excluding housing rentals (which are more closely linked to possible overheating of the production fabric), increased by 1.2%.

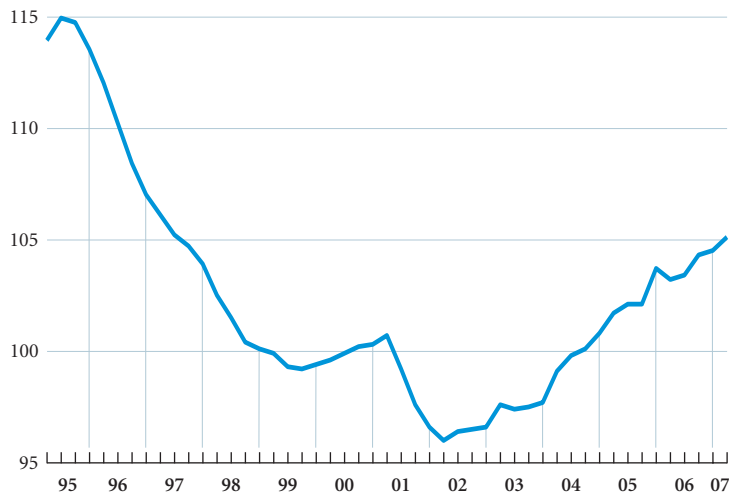
In view of this picture, it seems that the US economy is not presenting major problems. Nevertheless, existing risks are considerable. Firstly, the real estate market is still far from getting onto a recovery course. In April, existing house sales dropped by 10.7% year-on-year putting end to the weak recovery noted in February. Neither did tendering for public works or housing starts respond. The main indicator was housing prices, given that a mortgage based on these prices and the wealth effect, could seriously affect private household consumption that makes up more than 70% of economic activity. For this reason, the fact that up to now price decreases have been minimal is the most positive factor so far. But it is necessary to be cautious given the sharp increase in

the number of properties for sale which in one year has grown from 1.3% to 2% of occupied housing stock.

Secondly, there is the foreign sector in deficit. The trade balance is negative. In the past 12 months up to April it went to 742 billion dollars. This amount is equivalent to 5.5% of nominal GDP although it has been moderating from the 6.0% seen in the summer of 2006. For now, the trade deficit is not in any difficulty in terms of financing. There are two positive factors associated with the deficit that could be turning around. The desire of the Asian countries to keep on piling up dollars and buying US government bonds could dry up with a possible rise in long-term interest rates. Should any thing come of pressures for revaluation of the Chinese currency, the renmimbi, this could more likely bring about a rise in interest rates than a correction in the trade deficit which has improved little since the dollar began its

CHEAP IMPORTS NOW NOT SO EASY

Imports deflator, excluding oil



SOURCE: Bureau of Economic Analysis and own calculations.

downturn. Secondly, up until now the non-energy trade deficit has served to import deflation, that is to say, buying products at a very good price (especially from East Asia) and in the process put a hard brake on possible inflationary pressures. This may also be coming to an

end. Between 1995 and the end of 2001 the deflator for imports excluding oil dropped by nearly 17% but since then it has gone up by close to 10%. With things as they are, the urgency for correction of the trade deficit could begin to be greater than it has been up to now.

Price of imports, excluding oil, up 10% since end of 2001.

Poor in the lands of the wealthy: United States awakens while Europe begins to dream

More than 70% of US citizens believe that, with enough effort, it is possible to jump out of poverty and become rich. Only 40% of Europeans think alike. While the «great American dream» holds optimism up in the United States, most people in Europe see poverty as a trap hard to escape from. Is this perception a reflection of reality? Is the American dream real? Is poverty in Europe a life sentence?

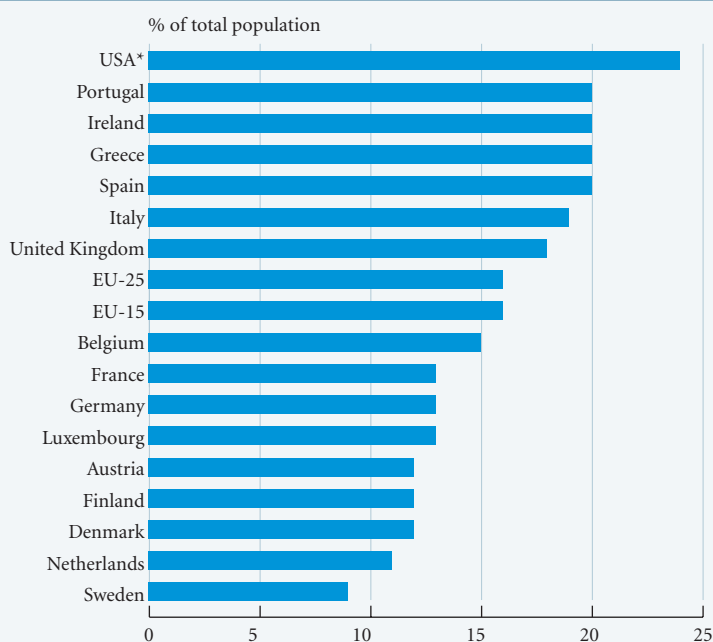
Ernest Hemingway once said that what distinguished the rich was that they had more money. But what does it mean to be poor? Most people associate poverty with malnutrition, illiteracy, limited access to health care and education, early death and deprivation in general. In order to estimate the number of persons living in such conditions, the United Nations (UN) uses a measure of extreme poverty established by the World Bank in 1990 that qualifies as poor those individuals who have to live with less than one dollar a day. Using a definition of this sort to measure poverty in rich countries would lead us to conclude that it had been practically eradicated. For this reason, the poverty line used in those countries is more demanding and

represents the level of income necessary to be able to participate normally in the society; hence it is also an indicator of social inclusion.

To determine the poverty line, the United States uses the cost of a basket of basic goods and services. According to this indicator, 12.6% of people in the United States stood below the poverty line in 2005. The European Union, on the other hand, sets the poverty line at 60% of the median national income. In other words, if we sorted the citizens of a country from the poorest to the richest, the «median individual» would have ahead and behind the same number of fellow citizens. An individual whose income was less than 60% of the income of the «median individual» would be considered poor. Based on this definition, the poverty rate in the United States is higher than in Europe (24% and 16% of the total population, respectively), being in the Northern European countries where this rate is the lowest (see following Graph).

RELATIVE POVERTY IN THE UNITED STATES GREATER THAN IN EUROPE

People with income below 60% of equivalent national median (2005)



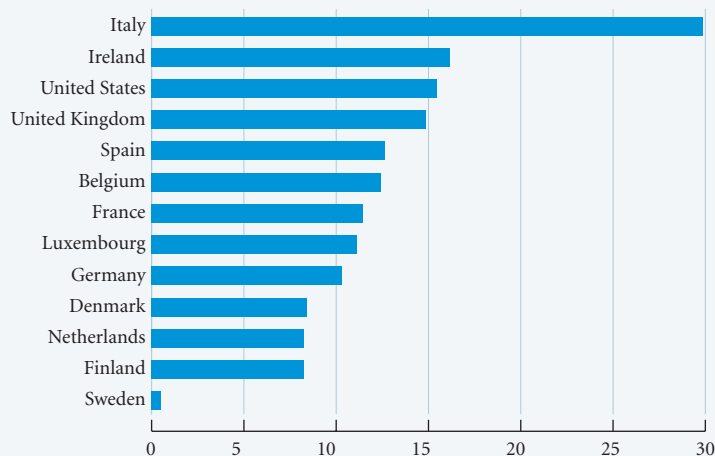
NOTES: (*) Year 2000.

SOURCE: Own calculations based on Eurostat and OECD (Förster and Mira d'Ercole, 2005) data.

Defining the poverty line in terms of the median income presents two problems. First, it is a purely monetary definition and therefore ignores the lack of other resources the poor may face, such as education or health care deprivation. In order to alleviate this problem, the UN designed an index that tries to synthesize various dimensions of poverty by including, besides relative income scarcity, the likelihood of early death, the rate of long-term unemployment, and the literacy level of the population. According to this index, Italy and Ireland fall behind the United States, while the Nordic countries remain in the lead (see following Graph).

WHEN INCLUDING OTHER ASPECTS OF POVERTY, SOME EUROPEAN COUNTRIES ARE IN WORSE SITUATION THAN THE UNITED STATES

Poverty index (0 = less poverty)



NOTES: Human Poverty Index data for late Nineties or beginning of 2000s.

SOURCE: *Human Development Report* (UNO 2006).

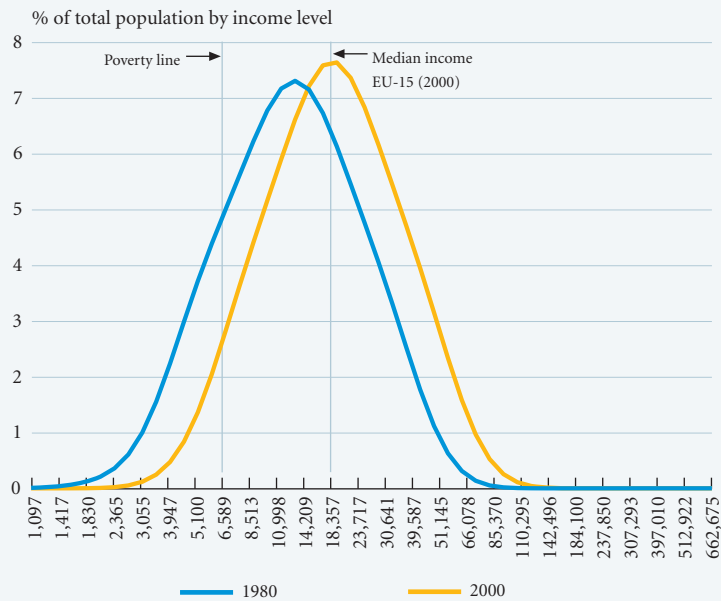
Second, this is an arbitrary and relative definition of poverty. It is arbitrary in the sense that there is no particular reason to use the 60% of the median and not another percentage like, for example, the 50% of the median used by the Organization for Economic Cooperation and Development (OECD). It is relative because it does not define the poverty line as the cost of subsistence but in relation to the median national income, which varies from country to country and from year to year. Furthermore, some claim that 60% of the median income in any rich country is quite a substantial amount; hence, we would not really be measuring poverty but income inequality. In view of these arguments, and still not free of controversy, the definition of «absolute poverty» used in the United States would seem the most appropriate. Nevertheless, not having an equivalent measurement for Europe makes it difficult to compare the two regions.

In this respect, a study by Xavier Sala-i-Martin, professor at Columbia University, turns out to be very useful. Using its estimates of income distribution in various countries (in a common monetary unit) and a poverty line similar to that established in the USA, we can compare the evolution of poverty in the USA and Europe. The following graph shows the percentage of the population per income bracket in each of the two regions in 1980 and 2000.

During this period, and reflecting the economic growth in the two regions, both distributions of income move rightwards. With a fixed poverty line, such displacement implies a reduction in the poverty rate. As the graph illustrates, this reduction is especially pronounced in Europe where the poverty rate dropped from 22.5% to 8%, whereas in the USA it went from 18% to 11.5%. This translates into 50 million people escaping from poverty in Europe (from 80 million in 1980 to 30 million in 2000) whereas only 9 million people moved beyond the poverty line in the United States (from 41 million to 32 million). In contrast, the picture in the upper part of the income distribution is quite different, with a remarkable increase of the percentage of people with high incomes in the United States. According to a study published in the *American Economic*

INCOME DISTRIBUTION IN EUROPE (EU-15)

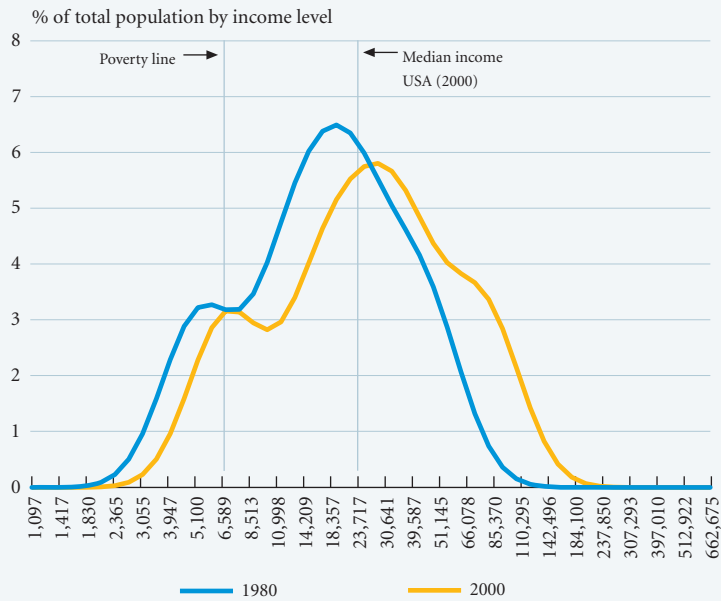
Income: constant 1996 dollars in purchasing power parity



SOURCE: Sala-i-Martin (2006) and own calculations.

INCOME DISTRIBUTION IN THE UNITED STATES

Income: constant 1996 dollars in purchasing power parity



SOURCE: Sala-i-Martin (2006) and own calculations.

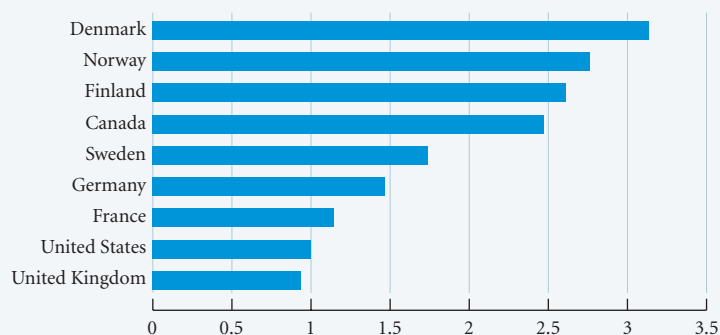
Review in May 2006, the income share of the richest 0.1% in the USA increased from 2% of total income in 1980 to 7% in 2000, whereas in France, for example, this figure remained stable at 2%.⁽¹⁾

Hence, while both, Europe and the United States, have managed to reduce absolute poverty, the more unequal distribution of US growth has meant that the gap between rich and poor has increased more in the United States.

The increase in inequality in the United States would be less troubling if all US citizens had similar chances for economic progress. That is, if one believes in equality of opportunity and in remuneration to effort, the finding that the number of very rich increased while the number of poor was reduced could be interpreted as evidence of the American dream and the possibility for social advancement. Nevertheless, recent studies on economic mobility in the United States do not support this idea. They estimate that the likelihood of a child born in one of the most disadvantaged households reaching the top 5% richest households is only 1%. In contrast, the estimated likelihood that a child born in one of the richest households maintains his/her status is 22%. Recent studies, by the economist Miles Corak for example, even suggest that moving from poor to rich is more difficult in the United States than in other advanced countries. These studies are based on cross-country comparisons of the persistence of income through generations, that is, they estimate what percentage of the economic advantage (or disadvantage) that parents enjoy relative to their cohort is transmitted to their children. The results must be viewed with caution given that they deal with a concept difficult to measure and that figures available for various countries are not fully comparable. Keeping this in mind, Corak's estimates suggest that it is in Northern European countries and in Canada where that mobility is greater, with a transmission rate of 20%; they are followed by France and Germany with 32% and 41% respectively; United States with 51% and United Kingdom with 47% are the least mobile. Furthermore, we shall note that the degree of income persistence across generations of US citizens is estimated to be especially high for the poorest classes, moving them farther away from the American dream. For higher income brackets, on the other hand, estimated mobility varies less across countries.

LESS ECONOMIC MOBILITY IN UNITED STATES THAN IN OTHER ADVANCED COUNTRIES

Mobility ratio relative to the United States



SOURCE: Own calculations based on estimations of intergenerational incomes elasticity in «Do poor children become poor adults? Lessons from a Cross-Country Comparison of Generational Earnings Mobility» (Miles Corak, 2006).

(1) «The evolution of top incomes: A historical and international perspective» by Thomas Piketty and Emmanuel Saenz (2006).

In a nutshell, economic growth is the key force to reduce poverty and improve social integration in both continents. Nevertheless, while keeping an eye on growth, Europe should continue fighting poverty, especially with relatively poorer Eastern European countries joining the EU. At the other side of the Atlantic, the United States cannot ignore the dynamics that affect the most disadvantaged groups in its society, especially regarding mobility. Otherwise, its citizens' dream may come to an end.

Japan grows by 2.7% thanks to private consumption and exports.

Japan: long gradual growth

At the end of May, the Japanese prime minister, Shinzo Abe, listened carefully to an Egyptian journalist asking questions in Arabic. Immediately, without need of simultaneous translation, Abe replied in exquisite detail because the question had been agreed on beforehand. This story illustrates the false «normalcy» and the many factors of inertia affecting the Japanese economy. The governing party is submerged in a deep political crisis without any alternatives being offered by the opposition. Toshikatsu Matsuoka,

Minister of Agriculture, committed suicide over allegations of corruption and Abe is having great difficulty in putting an end to the practice of *amukudari* (something coming down from the skies) through which high political figures end up with lucrative jobs in regulated companies. Following the last revision (upward in this case), the first-quarter GDP grew by 2.7% year-on-year, a continuation of the longest growth period since 1945 but prices continue to drop, dependence on exports remains key and the yield on investment (with the help of the *amukudari*) remains very low.

JAPAN: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006			2007		
			2Q	3Q	4Q	1Q	April	May
Real GDP	1.9	2.2	2.2	1.5	2.4	2.7	–	...
Retail sales	1.4	0.2	–0.2	0.5	–0.2	–0.6	–0.7	0.1
Industrial production	1.5	4.5	4.0	6.0	5.3	3.6	2.4	...
Tankan company Index (1)	18.0	22.5	21.0	24.0	25.0	23.0	–	...
Housing construction	3.9	4.5	8.9	–0.8	5.4	–1.9	–3.4	...
Unemployment rate (2)	4.4	4.1	4.1	4.1	4.0	4.0	3.8	...
Consumer prices	–0.3	0.2	0.2	0.6	0.3	–0.1	0.0	...
Trade balance (3)	10.2	9.4	9.1	8.9	9.4	10.3	10.8	...
3-month interbank interest rate (4)	0.1	0.3	0.3	0.4	0.5	0.6	0.7	0.7
Nominal effective exchange rate (1)	98.1	91.3	92.9	91.0	89.1	87.1	86.9	86.9

NOTES: (1) Index value.

(2) Percentage of labour force.

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

(4) Percentage.

SOURCE: OECD, national statistical bodies and own calculations.

Investment in capital goods, which in the first quarter dropped sharply after having shown very strong in 2006, was revised slightly upward. Also moving in the same direction was an early indicator of investment spending (machinery orders) with an increase of 2.8% year-on-year in April, following a drop of 14.4% in the previous month. As has become customary, the sharpest reaction came in the export sector while domestic demand continued to lose weighting in the total.

Among the more recent demand indicators, retail sales gained 0.1% year-on-year in May thus coming out of the red seen in recent months. Car sales continued along their downward course dropping by 7.0% year-on-year in May, this being nearly a second consecutive year with losses. On the supply side, industrial production slowed in April with an increase of 2.4% compared with a combined increase of 4.5% for all of 2006. At the same time, there was an increase in corporate bankruptcies in

May, something that, while having a undoubted negative aspect, in this case indicated a positive ability to change, especially in a country dominated by the abovementioned aspects of inertia.

In turn, the real estate market in May continued to show the weakness seen in April. The number of homes sold in the capital dropped by 17.6% year-on-year although prices, which were highly volatile, moved up sharply. In line with the general state of things, housing starts in April were down 3.4% and the proportion of units on sale compared with the number of transactions completed held at relatively high levels.

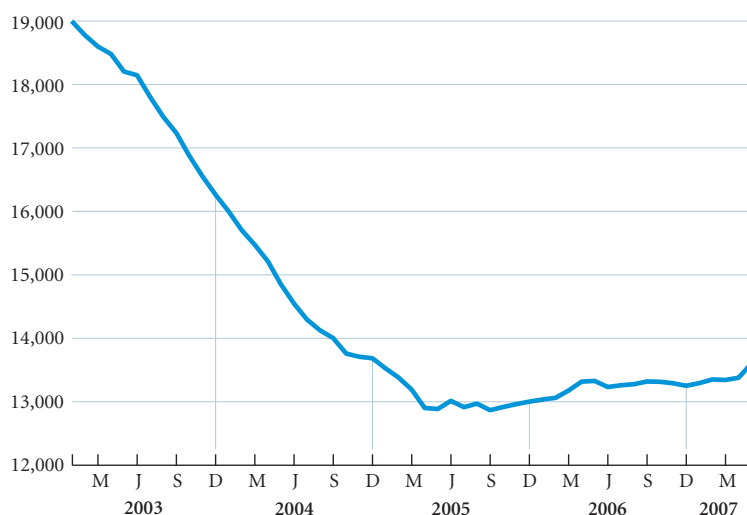
On the prices front, the end of deflation (expected by everyone) continues to be illusive. While the general CPI for April was a repetition of the levels in the same period last year, core inflation, by excluding the very volatile fresh foods from the general index, gives a more accurate picture of the trend in prices,

Investment showing slight signs of recovery following breather in first quarter...

...but demand indicators and real estate market remain slack...

JAPAN: RISE IN BANKRUPTCIES BUT ONLY SLIGHT

Companies in bankruptcy in past 12 months



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

...while prices move down.

again dropped by 0.1% year-on-year. At the same time, the private consumption GDP deflator for the first quarter was down 0.7% year-on-year, thus leaving the move onto positive ground until later. In any case, the unemployment rate for April went down to 3.8% of the labour force, the lowest figure since the beginning of 1998, which confirms the fact that Japan's economy has for some time been running close to or above its production potential.

Foreign sector continues to rise.

Japan's foreign sector continues to be strengthened by the high level of activity in global terms. The trade surplus for 12 months ending in April amounted to 10,800 billion yen, 18.3% above the same period last year, always helped by the weakness of the yen in recent months and by gains in the efficiency of export companies.

China: waiting for consumers to respond

China growing at 11.1% helped by industry and foreign sector.

China continues its sharp growth (11.1% in the first quarter) but with an atypical profile that could bring about problems a social kind and geo-political tensions.

The solution to all this could lie in a revaluation of the renminbi, the Chinese currency, although this does not mean that all the US pressure in this direction are underway because, in real terms, if we take into account the differences in inflation, the Chinese currency has depreciated less than 3% since 1997 against its trading partners, whereas South Korea and Japan have seen depreciation of close to 30%. Chinese growth is heavily based on investment and in the contributions of the foreign sector surplus. The main weakness in this leading engine of the world economy lies in that domestic consumption is still far behind, a fact that has been exacerbating the inequality between country and city.

In addition, the trade surplus, which is excessively biased toward the United States, continues to be a source of diplomatic tension and keeps on piling up complaints from the US government. This time, because of government aid for exports, pirating of computer programmes and restrictions on the marketing of foreign films and music. An appreciated currency would slow down the excessive accumulation of dollar reserves and foster imports which are the

CHINA: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006			2007		
			2Q	3Q	4Q	1Q	April	May
Real GDP	10.1	10.7	11.5	10.6	10.4	11.1	–	...
Industrial production	15.9	16.4	18.0	16.2	14.8	15.1	17.4	18.1
Electrical power production	13.4	14.7	13.2	16.5	15.3	12.4	16.9	18.1
Consumer prices	1.8	1.5	1.4	1.3	2.0	2.7	3.0	3.4
Trade balance (*)	102.0	177.7	123.5	143.4	177.7	200.8	207.2	216.7
3-month interbank interest rate (**)	2.4	2.8	2.9	3.0	3.1	2.8	3.5	3.5
Yuan/dollar exchange rate	8.2	8.0	8.0	7.9	7.8	7.7	7.7	7.6

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

(**) Percentage.

SOURCE: National Statistics Office of China, Thomson Financial Datastream and own calculations.

cause of the surplus to a greater extent than exports.

In any case, things seem to be moving in the right direction. On May 18, the fluctuation bands for the renminbi against the dollar were widened from 0.3% to 0.5% daily. The measure may not have any real effect on exchange rates given that the previous limits had not been reached but this is a concession for purposes of diplomacy. At the same time, the rise in the 1-year deposit rate from 6.30% to 6.57% is an attempt to restrict credit, which was up 15.7% in April, and to soften the latest increases on the stock market.

Industry continues its strong growth with industrial production up 18.1% year-on-year in May while the heavy industry component still dominating. Hydroelectric power generation is

stagnant but iron production moves ahead at a dizzy pace. Nevertheless, the most notable factor was retail sales of consumer goods which continued to rise in May with growth going to 15.9% year-on-year, a rate that in the rural areas hit a notable 13.9% and indicates that Chinese consumers could be coming out of their lethargy.

This awakening could already be causing inflationary pressures. In May the CPI moved up by an apparently moderate 3.4% year-on-year. But these prices are largely regulated. In keeping with the structure of China's economy, growth of the food CPI (8.3%) could be giving a more faithful picture of the real performance of prices. In addition, apart from the figures, we should bear in mind the sharpness of the growth process given that in September 2005 the growth rate for both indices was below 1%.

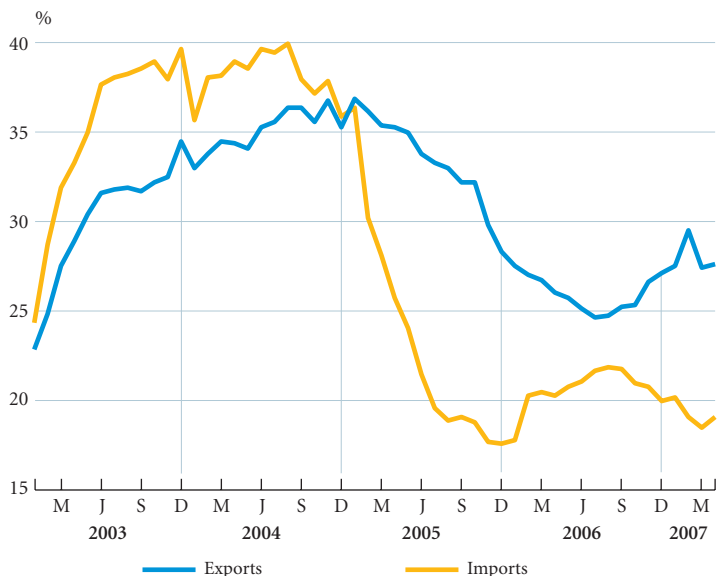
Consumption steps up but still running behind industrial growth.

Inflation holding at moderate rates but increasing.

Explosive increase in trade surplus due mainly to slowdown in imports.

CHINA: SLOWDOWN IN IMPORTS INCREASING TRADE SURPLUS

Year-on-year increase in exports and imports in past 12 months



SOURCE: Chinese National Statistics Office, Economist Intelligence Unit and own calculations.

Exports continue to be based on manufacturing but weighting of technological content running slightly down.

The trade surplus for the past 12 months ending in May rose to 216.7 billion dollars whereas in the same period last year it was 100 billion dollars less. The balance is asymmetric given that in the 12 months up to April the bilateral surplus with the United States was 152 billion dollars, three-quarters of the total. Nevertheless, political pressure seems to be having some effect as in one year the increase has been only 27 billion dollars, equal to a quarter of the increase in the Chinese surplus. In comparison, the positive balance with the European continent grew by 38 billion dollars and the trade deficit with Asia was down by 18 billion dollars. As a result, the increase in the surplus has more to do with a slowing down in imports of raw materials than with a rise in exports.

Mexico grows by 2.6% while slowdown gets sharper.

What continues the same is China's bilateral trade deficit with three countries with a strong manufacturing bias, such as Taiwan, South Korea and Japan, which in the 12 months up to May amounted to 67.56, 42.30 and 27.26 billion dollars respectively. Nevertheless, the predominance of raw materials in imports and of manufactures in exports still continues. In these, the weighting of products of high technology content is beginning to drop following a long period of increases.

Mexico: economic activity slowing down

The Mexican economy grew by 2.6% year-on-year in the first quarter, thus sharpening its slowdown. Private consumption showed a slight rise moving up to 3.5% but this was not enough to compensate for the sharp slowdown in private investment which

Industrial sector remains weak.

grew by 4.0% whereas it had begun 2006 with a rise of 13.0%. The public sector also put a sharp break on increases and, in turn, the foreign sector seems to have come to a sharp halt. Exports and imports were practically stagnant compared with last year whereas only six months ago they were showing two-digit growth rates.

Among the most recent economic activity indicators the general image is far from bright. Industrial production showed a slight rise in April with growth of 1.5% year-on-year following the stagnation seen in recent months. Manufactures ran a similar course with an increase of 0.8% while construction was up 1.5%.

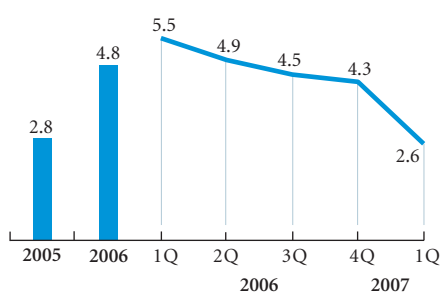
Inflation remains stable although with a very slight downward trend which could continue. In May, prices rose by 3.9% year-on-year while the core index (the general index less energy and foods) was up 3.7%. The official unemployment rate was down to 3.6% of the labour force in April thus eliminating the slight rise seen in 2006.

The trade balance seems to have stabilized its worsening situation without any real correction. While the cumulative balance for the past 12 months ending in April worsened to 10.5 billion dollars, the trend over the short term and the state of oil prices point to a reduction of this figure. Nevertheless, the basic problem is still there. The Mexican economy has a currency that in recent years has appreciated in terms of the other currencies of the region. As a result, the effective exchange rate, calculated in relation to a basket of currencies of its trading partners and keeping in mind inflation differences, has appreciated

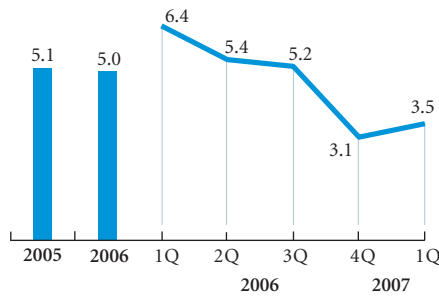
TREND IN MEXICAN GDP BY COMPONENT

Percentage year-on-year change in real terms

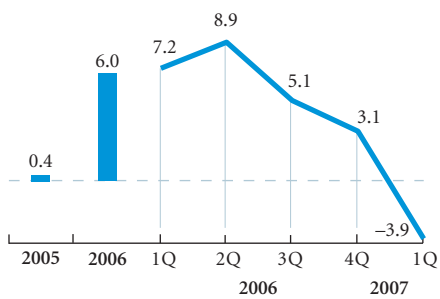
GDP



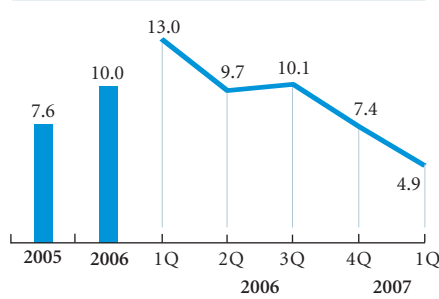
Private consumption



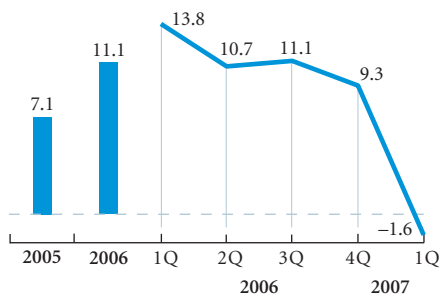
Public consumption



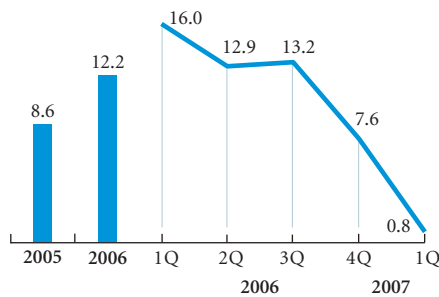
Gross fixed capital formation



Exports of goods and services



Imports of goods and services



SOURCE: Central Bank of Mexico and own calculations.

12% since 1997. By comparison, the other major countries on the Latin American continent have undergone

depreciations that have made them more competitive, as in the case of Brazil, the other major Latin American economy.

Foreign sector stabilizes deficit.

MEXICO: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006			2007		
			2Q	3Q	4Q	1Q	April	May
Real GDP	2.8	4.8	4.9	4.5	4.3	2.6	–	...
Industrial production	1.8	5.0	3.9	5.4	3.6	0.5	1.5	...
General unemployment rate (*)	3.6	3.6	3.2	4.0	3.7	4.0	3.6	...
Consumer prices	4.0	3.6	3.1	3.5	4.1	4.1	4.0	3.9
Trade balance (**)	–7.6	–6.1	–4.5	–5.4	–6.1	–9.5	–10.5	...
3-month interbank interest rate (***)	9.5	7.3	7.2	7.2	7.2	7.2	7.2	7.2
Peso/dollar exchange rate	10.9	10.9	11.2	10.9	10.9	11.1	10.9	10.7

NOTES: (*) Percentage of labour force.

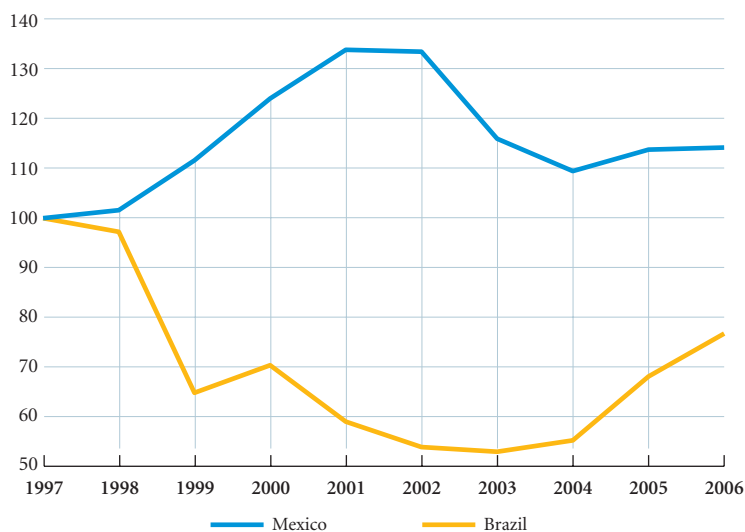
(**) Cumulative balance for 12 months. Billion dollars.

(***) Percentage.

SOURCE: Central Bank of Mexico.

MEXICO A RELATIVELY HIGH-COST COUNTRY

Effective exchange rate in real terms (*)



NOTES: (*) In terms of basket of currencies of main trading partners and keeping in mind inflation differences.

SOURCE: Economist Intelligence Unit and own calculations.

Good news on Nigeria and petrol inventories fail to halt price of crude which marks up annual high.

Raw materials: upward trend in prices continues

A number of factors suggest some moderation in crude oil prices in June. First, the resolving of the strike in Nigeria. Second, the good news on the levels of petrol in the United States.

Nevertheless, Brent quality oil marked up an annual high of 72.71 dollars a barrel on June 22. The market for oil futures moved up even more and prices are being discounted at close to 73.0 dollars a barrel for deliveries set for year-end. While the futures market is very volatile and the appearance of positive news

could correct these prospects, it cannot fail to be a factor underlining the fact that, if world growth continues, the price of oil could consolidate at the level reached in June. Furthermore, operators in the oil market have stopped talking about the geo-political risk premium. That is to say, news about violence in the Middle East does not seem to have had any influence on the latest increase in oil prices.

With regard to petrol prices in the United States, three factors are pushing up the price. Naturally, the first is the rise in the price of the raw material from which it is extracted. The second is changes in technical specifications of petrol which has made it necessary to reduce production capacity in order to carry out industrial modifications at the refineries. The third factor is the obsolescence of refinery installations. Since 1976 no new refinery has been built in the United States. Furthermore,

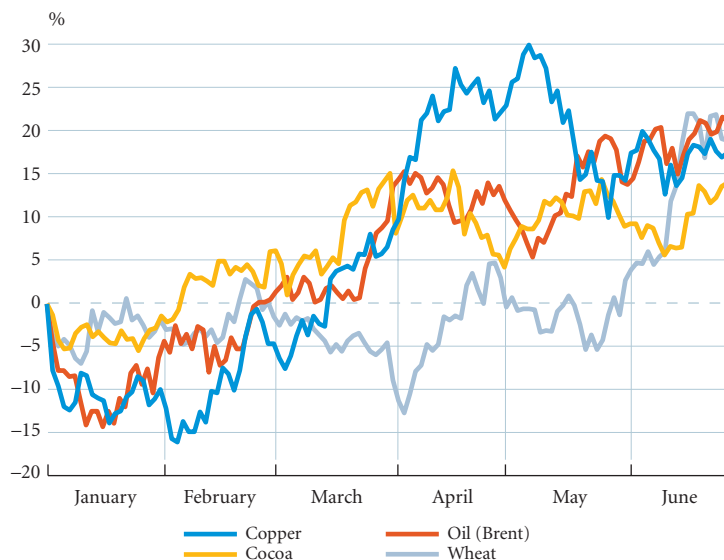
the range of products is now much more sophisticated than when existing refineries were built.

Farm raw materials are not in any way lagging behind oil. The US National Meteorological Institute has confirmed that in the past month there have been even heavier rains in Oklahoma and Texas damaging the wheat harvest of the world's biggest exporter and the third largest producer after China and India. This factor pushed up the price of wheat by 14.5% in June. The US Department of Agriculture forecasts that the supply of wheat this year will be only 112 million metric tonnes, the lowest in the past 26 years. Another trend pushing up the price of wheat is the high percentage of cultivable land in the United States giving up wheat and putting in maize. This is the basic component of bio-ethanol, alcohol produced by the fermentation of the sugar obtained from maize which has become a source of

Farm raw materials maintain upward course, with notable rise in wheat prices.

BUY TODAY, TOMORROW IT WILL COST MORE

Trend in certain raw materials prices since January 2007



SOURCE: Bloomberg.

Gold and silver drop pushed down by feeling that dollar will strengthen against euro.

alternative energy as a substitute for petrol and diesel-fuel.

With regard to metals, gold prices fell by 0.7% in June going to a level of 651.8 dollars an ounce while silver dropped by 5.9%. In both cases, the movements reflect expectations that the dollar will strengthen against the euro thus

reducing the attractiveness of precious metals as investment alternatives. Gold is maintaining a close relationship with the dollar exchange rate. A basket of currencies made up of the Australian dollar, the Canadian dollar, the South African rand, the euro, the yen and the India rupee explains 91% of the movement in gold.

EUROPEAN UNION

Euro Area: ECB joins the optimists

On June 6, the European Central Bank (ECB) announced changes in its forecasts for growth and inflation for the Euro Area in 2007. It raised gross domestic product by one decimal putting it at 2.6% while its added two decimals to inflation with a figure of 2.0%. As technical hypotheses, the ECB used a euro-dollar exchange rate of 1.36 and a per-barrel oil price of 65 dollars on average for 2007. Modification of the central bank's forecasts confirm the good state of growth in the Euro Area.

For the moment, economic activity indicators confirm the good prospects painted by the ECB. Industrial production in the Euro Area in April

grew by 2.9% year-on-year, nearly one point below the first quarter. While this correction is normal following several quarterly figures showing strong growth, it also indicates the possible stabilization of industrial growth. This is news that may even be given a positive reading, in view of the high utilization of production capacity (84.8%), the highest in the past 16 years. If growth levels are kept at around the 5% seen in the last three quarters there will be increased risk of bottlenecks that could result in increased prices in the Euro Area.

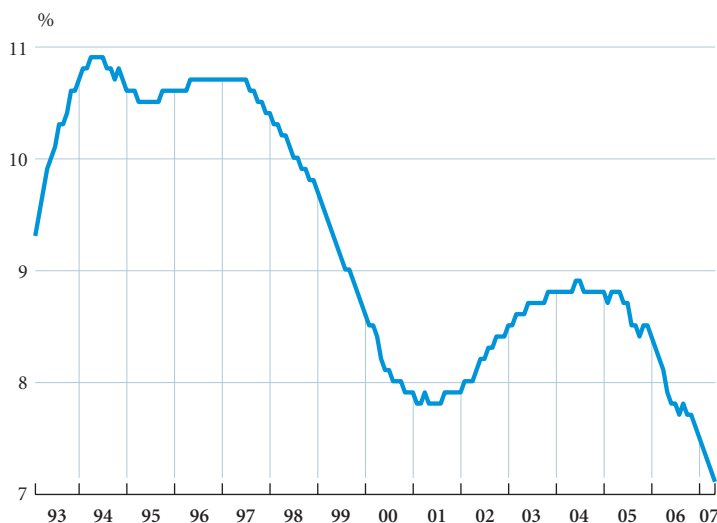
The more economic activity, the less unemployment. The sharp increase in job creation reduced the unemployment rate to 7.1% in April, according to Eurostat. This is the lowest level since the

ECB raises growth prospects in Euro Area for 2007.

Industrial activity shows slower growth in April.

LABOUR MARKET GOING FULL-AHEAD

Unemployed over labour force



SOURCE: Eurostat.

EURO AREA: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006			2007		
			2Q	3Q	4Q	1Q	April	May
GDP	1.6	2.8	2.9	2.8	3.3	3.0	–	–
Retail sales	1.2	2.0	2.3	2.3	2.3	1.5	1.7	...
Consumer confidence (1)	–14	–9.0	–10	–8	–7	–5	–4	–1
Industrial production	1.3	4.0	4.3	4.1	3.9	3.8	2.9	...
Economic sentiment indicator (1)	97.9	106.9	106.8	108.2	109.9	110.0	111.0	111.9
Unemployment rate (2)	8.6	7.9	7.9	7.8	7.6	7.3	7.1	...
Consumer prices	2.2	2.2	2.5	2.1	1.8	1.9	1.9	1.9
Trade balance (3)	42.1	–10.4	–10.0	–21.6	–13.1	–1.2	8.6	...
3-month Euribor interest rate (4)	2.2	3.4	2.8	3.1	3.4	3.7	3.9	4.0
Nominal effective exchange rate (1)	101.2	104.5	102.6	105.1	104.5	105.5	106.4	107.6

NOTES: (1) Index value.

(2) Percentage of labour force.

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

(4) Percentage.

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

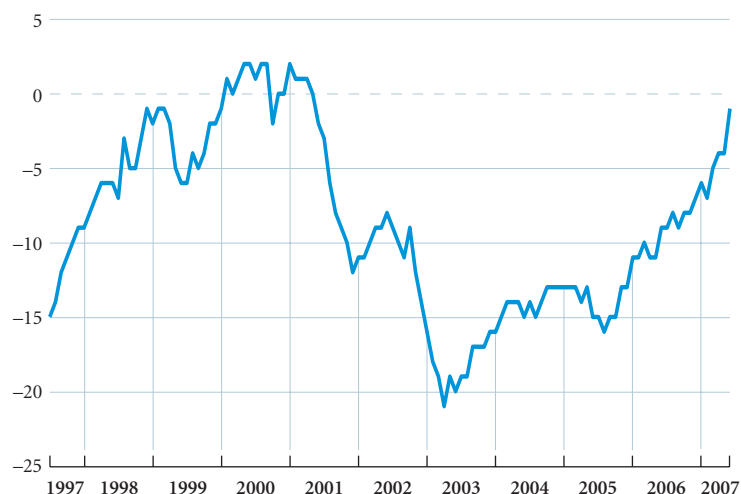
Unemployment rate drops to 7.1%, lowest level since 1993...

statistical series was begun in January 1993. The reduction of 8 decimals in the unemployment rate in one year continues to give support to the optimism of economic players.

With fewer unemployed, the ordinary citizen is less concerned about the future. The consumer confidence index prepared by the European Commission in May reached its highest level since March 2001.

CONSUMER CONFIDENCE: OPTIMISTIC ABOUT FUTURE

Consumer confidence index



NOTES: The indicator represents the arithmetical average of responses to four questions about the financial situation of households, the general economic situation (past and future) and intention to make large purchases.

SOURCE: European Commission and own calculations.

This factor suggests solid growth of consumption in coming quarters. Is there a risk of inflation? For the moment, only a very moderate risk. The estimate put out by Eurostat on inflation in the Euro Area in May was 1.9%, still below the level of 2% the ECB considers a risk.

Furthermore, the rest of the world is helping European growth. The trade balance for April showed a surplus of 1.8 billion euros, which put the cumulative figure for 12 months at 8.6 billion euros. Sharp growth in the rest of the world, which is boosting exports, and the strength of the euro are behind the food figures for foreign trade in the Euro Area. This strength has not had a negative impact on foreign sales but on the other hand has exercised a healthy control over the price of imports of energy products.

Germany: a reference in international politics

Germany has occupied the rotating presidency of European Union during the first half of this year. In addition, this

year it presides over the group of leading world countries known as the G-8. At the latest meeting of the G-8 held in Heiligendamm at the beginning of June, Chancellor Merkel united the leaders of the world economic powers in the need to create a climate protection plan. In addition, notable among other matters raised was pushing forward on the challenge of the Doha Round of the World Trade Organization and support for development in Africa.

Also under German presidency, the European Council met on June 21 and 22. Chancellor Merkel took the opportunity at both meetings to reinforce Germany's weight on the international political scene. Due to the preparation these meetings require, domestic policy has taken second place and discussion about economic reform has been put off.

For the moment, the economic figures are generally positive. Industrial production grew by 3.7% year-on-year in April as against 7.4% in the first quarter. This lower growth is a correction following several months of strong growth. The figure shows that in the

...which translates into increased confidence among economic players.

Inflation consolidates at 1.9% annual in May.

German industrial production slips, a logical correction following many months of high growth.

GERMANY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006			2007		
			2Q	3Q	4Q	1Q	April	May
GDP	1.1	3.0	2.9	3.2	3.9	3.6	–	...
Retail sales	1.4	7.1	6.8	6.6	7.4	–3.9	–2.8	...
Industrial production	2.9	5.9	6.0	6.6	6.1	7.4	3.7	...
Industrial activity index (IFO) (*)	95.5	105.5	106.1	105.2	107.0	107.5	108.6	108.6
Unemployment rate (**)	11.7	10.8	11.0	10.6	10.1	9.4	9.2	9.2
Consumer prices	2.0	1.7	1.9	1.6	1.3	1.8	1.9	1.9
Trade balance (***)	156.3	153.1	151.2	148.3	158.1	168.4	175.4	163.0

NOTES: (*) Index value.

(**) Percentage of labour force.

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

SOURCE: OCDE, national statistical bodies and own calculations.

Business confidence and consumer confidence still holding at high levels.

second quarter economic activity has failed to gain drive and that German industry is moving into a stage of stabilization. In fact, industrial orders are growing at an annual rate of 9.7% annual which, together with the high utilization of production capacity would indicate that German industry must continue to invest if it wants to deal with the challenge of satisfying its customers both international and domestic. Finally, not only orders books but also corporate surveys and job creation suggest high growth of German industrial production in coming months.

unemployed has dropped by 228,000 persons. Furthermore, plans for future hirings measured in the corporate surveys continue a high levels.

In addition, inflation in May confirmed that for the month before (1.9%) thus showing strong resistance to the increase of 30% in oil prices since January. The price of fuel rose by 1.9% year-on-year, the price of electrical power was up 6.1% and gas prices were 3.1% higher. The maintenance of current oil prices would push Germany's consumer price index (CPI) up slightly over coming months.

Inflation keeps below 2%.

In turn, corporate confidence remains high with the IFO index for May at 108.6 as a result of the increase in the corporate expectations component. Germany's strong growth pushed up consumer optimism to a level of 9.2 points, an all-time high since this statistical series was begun in January 1985. Although unemployment was up by 3,000 persons in May, this was due to seasonal effects given that the good weather this winter brought forward hiring that previously came about in April and May. For this reason, it is more informative to look at the general trend. The unemployment rate for May held at 9.2% and since January 1 the number of

France: start of structural reforms

Two substantial changes have taken place in French politics. First, the parliamentary elections in which 577 members of the National Assembly were voted in. The party of president Nicolas Sarkozy won a majority with 345 seats. Second, the president named Christine Lagarde as new minister of Economy, Finance and Employment, the first woman to hold that cabinet post in France and the person entrusted to introduce the so-called bill «to promote work, employment and purchasing power».

Sarkozy wins majority in French parliamentary elections and names Christine Lagarde minister of economy, first woman to hold post.

FRANCE: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006			2007		
			2Q	3Q	4Q	1Q	April	May
GDP	1.7	2.2	2.7	2.1	2.2	2.0	-	-
Domestic consumption	3.2	2.7	3.1	2.9	2.8	3.4	2.5	...
Industrial production	0.2	1.0	1.8	0.7	0.8	1.1	1.7	...
Unemployment rate (*)	9.8	9.0	9.1	8.8	8.6	8.4	8.2	...
Consumer prices	1.7	1.7	1.9	1.7	1.3	1.2	1.3	1.1
Trade balance (**)	-1.3	-2.1	-2.0	-2.2	-2.2	-2.2	-2.2	...

NOTES: (*) Percentage of labour force.

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

SOURCE: OCDE, national statistical bodies and own calculations.

The measure removes taxes and social security payments on workers' overtime which will be 25% higher than for normal time. Companies will benefit from reductions in social security payments in order to encourage them to increase the amount of overtime. The bill also establishes a fiscal shield so that direct taxes and social security payments do not go over 50% of income instead of the present 60%.

Economic indicators point to contained growth. Household consumption in April grew by 2.5% year-on-year, a simple correction following a strong first quarter. Nevertheless, strong job creation will give support to consumption in coming months. The unemployment rate has continued to drop going to 8.2% in April, the lowest level since 1983. Furthermore, the trend to recovery in industrial production in France is being

maintained and in April showed growth of 1.7% year-on-year. Following the last two quarters of last year when French industrial production showed a drop, this has received considerable support from world growth.

The French CPI is maintaining a good performance. The index for May was up 1.1% year-on-year. The price of oil and fresh foods produced the biggest rises. The drop in prices of transport, communications and rents kept down the increase in the price index.

Italy: allegro ma non troppo

Retail sales in Italy in April dropped by 0.4% at annual rate. Those establishments to note this drop most were department stores and especially food sales showed a year-on-year dip of

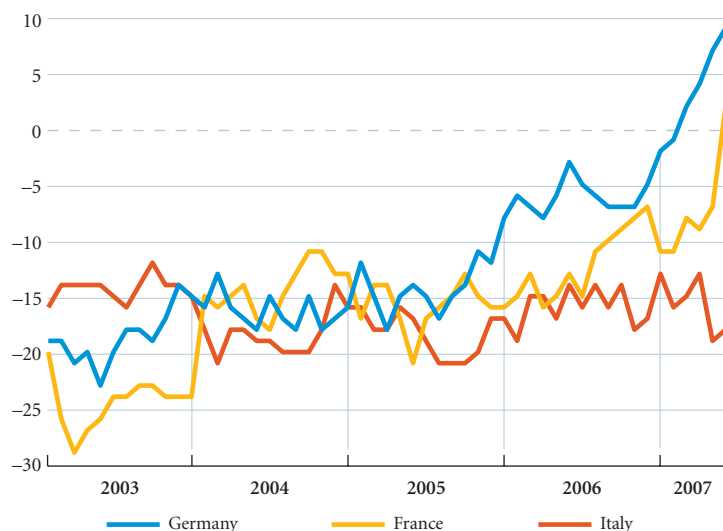
Consumption growing at lower rate but industrial production recovering thanks to foreign orders.

French economy maintaining good price performance.

Italy's retail sales drop in April.

ITALIAN CONSUMERS NOT SETTING OFF FIREWORKS

Consumer confidence index



NOTES: The indicator represents the arithmetical average of responses to four questions about the financial situation of households, the general economic situation (past and future) and intention to make large purchases.
SOURCE: European Commission and own calculations.

ITALY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006			2007		
			2Q	3Q	4Q	1Q	April	May
GDP	0.2	1.9	1.6	1.6	2.8	2.3	–	...
Retail Sales	0.4	1.2	1.8	1.6	1.0	1.0	–0.4	...
Industrial production	–0.8	2.6	2.0	1.8	3.7	1.1	0.6	...
Unemployment rate (*)	7.7	6.8	6.9	6.6	6.4	6.2	...	–
Consumer prices	1.9	2.1	2.2	2.2	1.8	1.7	1.5	1.5

NOTES: (*) Percentage of labour force.

SOURCE: OCDE, national statistical bodies and own calculations.

Jobs still being created and inflation under control.

1.3%. This reflects the stability of consumer confidence in Italy which has been dragging behind that of Germany and France.

This is not a problem of any lack in job creation. Unemployment continues to drop as shown by the drop in the unemployment rate to 6.2%. It is true, however, that this is happening at a lower pace than in the rest of the large European Union countries.

Nevertheless, Italy's unemployment rate has continued to go down since 2000. This has been helped by two factors. First, by a new law favouring temporary hiring and, second, by the legalization of large groups of immigrant labour. A month after taking office, Romano Prodi's government approved a law that cut in half the number of years immigrants must live in Italy in order to obtain citizenship. In addition, the Italian company FIAT, whereas until recently it was unthinkable it would hire new workers because it was going through a process of restructuring, announced its intention to add 950 new employees in coming months to its Cassino plant to produce a new version of the Bravo.

In addition, inflation in May rose by 1.5% year-on-year, a repeat of the rate for the month before. Since September of last year this has run in the range between 1.5% and 1.9%. In a context in which consumers are still watching their shopping lists, Italian companies have little margin for raising prices if they want to avoid losing market share.

United Kingdom: economy taking off

Since July of last year, the Bank of England has raised the official interest rate from 4.5% to 5.5%. In spite of this more restrictive monetary policy, growth of the UK economy has taken a boost along with an increase in prices. For example, retail sales in May held at growth of 3.9% year-on-year without British consumers showing any signs of restraint. The drop in unemployment, the increase in housing prices and consumer optimism about future prospects for the economy are all supporting retail sales.

The unemployment rate in May fell to 2.7%, the lowest figure since September 2005. This is a clear sign that the pressure in the labour market may continue to

Latest interest rate increases fail to slow down UK economy.

Labour market very strong and industrial production now recovered from dip in first quarter.

UNITED KINGDOM: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2005	2006	2006			2007		
			2Q	3Q	4Q	1Q	April	May
GDP	1.9	2.8	2.7	2.9	3.0	2.9	...	...
Retail sales	1.9	3.2	3.4	3.8	3.8	4.6	4.2	3.9
Industrial production	-2.0	0.0	-0.5	0.5	0.9	-0.1	0.4	-
Unemployment rate (*)	2.7	2.9	2.9	3.0	2.9	2.8	2.8	2.7
Consumer prices	2.0	2.3	2.2	2.4	2.7	2.9	2.8	2.5
Trade balance (**)	-64.9	-78.5	-77.5	-81.6	-83.1	-83.5	-82.9	...
3-month Libor interest rate	4.6	5.1	4.6	4.8	5.1	5.3	5.6	5.7
Nominal effective exchange rate	99.5	102.7	97.4	100.0	102.7	103.9	104.0	103.9

NOTES: (*) Percentage of labour force.

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

SOURCE: OCDE, national statistical bodies and own calculations.

make control of inflation difficult although the increase in wages still represents no problem in terms of UK inflation. Wages, including the April bonus, were up 4% year-on-year. Furthermore, April brought confirmation of recovery in the industrial sector. Although the strength of the pound sterling is reducing the competitiveness of British industry, industrial production rose by 0.4% year-on-year, leaving far behind the drop in the first quarter of this year.

In spite of the better performance on inflation, which rose by 2.5% in May, statements by executives of the Bank of England show concern about the potential rise in prices and the need to keep down the inflationary expectations of economic players. In the minutes of the bank's last meeting held on June 5-6, four of the nine members of the monetary policy committee voted in favour of a rise in official interest rates. The bank governor was of the four members most in favour of a rise.

In spite of better performance on inflation, Bank of England still concerned about price increases.

Social exclusion and poverty

We understand by «social exclusion» those situations where an individual has serious difficulties in obtaining access to mechanisms of personal development and insertion in the community. There is a close relationship between the concepts of social exclusion and poverty. A person suffering from a situation of exclusion from the social, political, cultural and economic system is at the same time likely to lack the means for living decently (which is what we understand as poverty) and furthermore will feel marginalized from the group or area in which he/she happens to be. One situation does not necessarily include the other. A poor person may be not be socially excluded (for example, in a rural community) while an individual may be socially excluded without being poor (for political reasons or because of race, ethnic origin, religion or other).

The earliest allusions to the concept of social exclusion appeared in the preamble to the European Social Charter in 1989 and that same year the European Community adopted a resolution on the fight against social

exclusion. Later on, its use spread to the social policy adopted by the European Commission and the use of the term «social exclusion» moved into both academic and political circles.

The roads leading to social exclusion are often economic and closely linked to situations of poverty which are not adequately dealt with by the social welfare system. Starting out from this economic origin, it is logical that situations of poverty-social exclusion are very much linked to the work situation of individuals involved. Lack of work is still the key factor in social exclusion risk. Furthermore, situations of unemployment, under-employment, lack of work qualifications and work handicaps may turn into serious economic problems for the family or the individual. Having a job does not necessarily mean being immune from poverty. Work insecurity may also bring it about.

Other factors raise the likelihood of falling into situations of social exclusion, such as those related to training received, including lack of schooling, illiteracy, low level of education, learning failure or early school-leaving reduce the possibilities for social progress and lower the ceiling for potential income of an individual. Socio-health factors are also behind many cases of social exclusion, as happens with those persons who are subject to addiction, infectious diseases, mental disturbances, physical handicaps or certain chronic illnesses.

In situations of social exclusion we also find factors that cause them to continue. This happens in the residential environment, with housing in poor condition, bad state of repair (overcrowding), degraded urban space, with deficiencies or lacking basic needs. In terms of personal relations, there may be a worsening of family networks (inter-family conflicts or violence), lack of or weakness in family networks (single parenthood, loneliness), scarcity or weakness in social networks, rejection or social stigma. Conditioning factors such as age (the elderly and young people looking for work), ethnic origin or the fact of being a woman increase the risks of social exclusion and make these persons more vulnerable. In general, those persons most vulnerable are women, the elderly and especially households with elderly persons over 65 with no children.

Poverty, the main factor leading to social exclusion, is a concept difficult to measure. In the developing countries the line below which one is considered poor is set at one two US dollars a day. In the developed countries, poverty is often defined in terms of a person's or a household's income. It is not obvious that the concept of poverty must be relative given that this creates paradoxical situations. For example, a poor person or family in one country (in Europe, for example) could be considered comfortable in another (in Africa, for example). But generally one recurs to relative definitions because of the difficulty involved in establishing objective poverty lines in developed societies, especially for purposes of international comparisons. Generally, the following definitions are accepted:

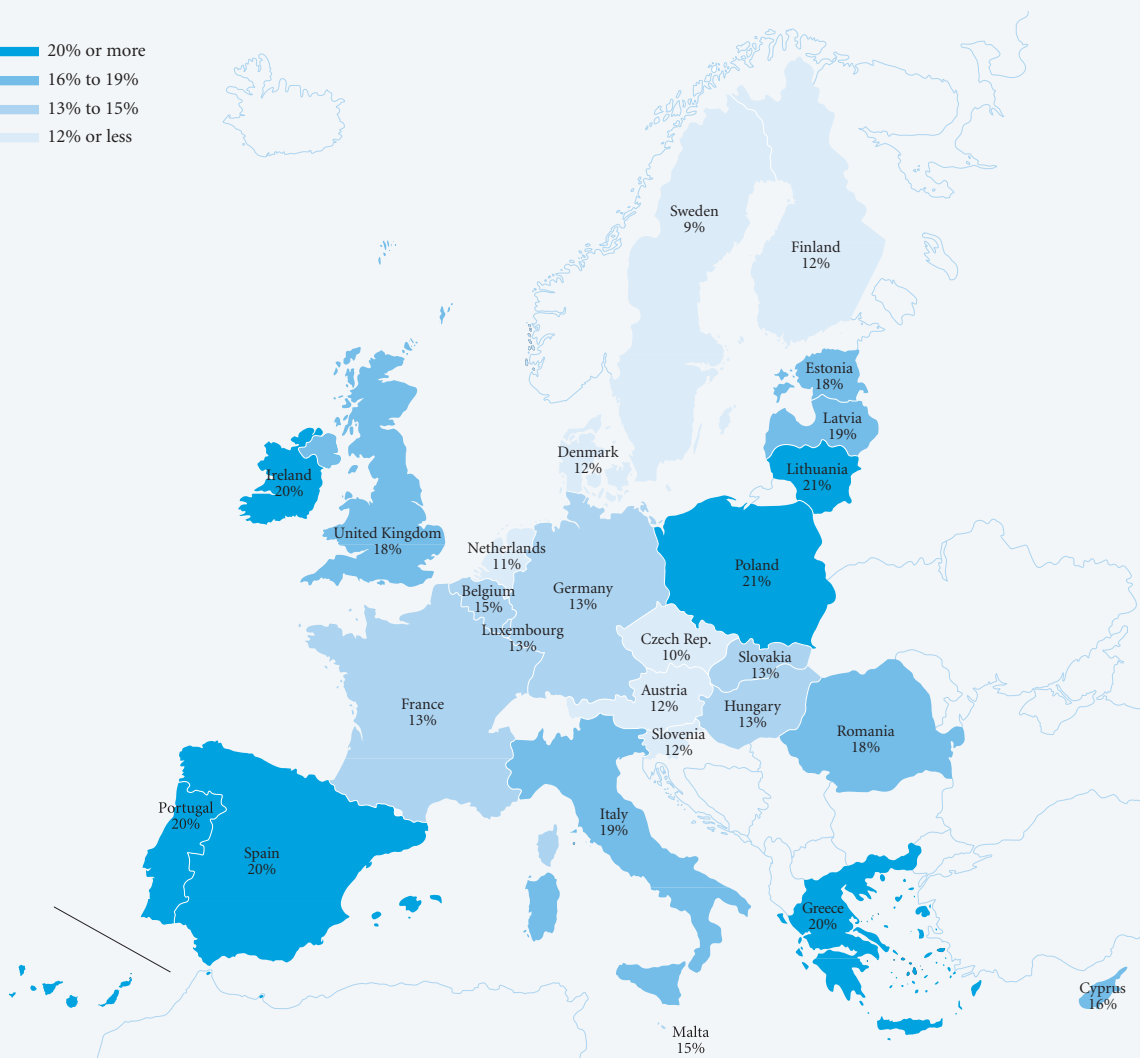
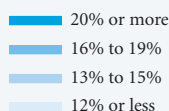
- **Economic precariousness:** population with between 35% and 50% of median income.
- **Moderate poverty:** population with between 25% and 35% of median income.
- **Serious poverty:** population between 15% and 25% of median income.
- **Extreme poverty:** population below 15% of median income.

Within the European Union (EU), the relative poverty line usually stands at 60% of median income.⁽¹⁾ Given the relative nature of this line and the fact that being below it does not necessarily mean living in a state of poverty, the indicator is understood as the *at-risk-of-poverty threshold*. According to this criteria, some 74 million EU citizens (16% of the population) are in this situation (figures for 2005). The social welfare systems

(1) Guio, Anne-Catherine, *Income poverty and social exclusion in the EU25*, Statistics in focus – Population and Social conditions, 13/2005.

MORE THAN 70 MILLION EUROPEANS AT POVERTY RISK

Percentage of individuals with income below 60% of national median, in terms of total population



play an important role when it comes to reducing *poverty risk*. Without welfare transfers, poverty in the EU would go up from 16% to 40%. In the case of Spain, we find that somewhat more than 8.5 million persons are exposed to poverty risk, representing 20% of the population (see box «Being poor in Spain» on page 45).

The relativity of the concept of poverty shows up when we compare the thresholds of poverty risk, in purchasing power standards, for a family of 2 adults and 2 children in each country. The poverty risk line in the EU-25 would stand close to 21,000 euros. But the disparities are evident when we find that with the same criteria the line stands at 6,000 or 7,000 euros in the Baltic countries but shoots up to more than 37,000 euros in the case of Luxembourg. So far as Spain is concerned, the household income threshold stood close to 15,000

euros in 2005, in purchasing power standard, according to Eurostat (see box «Poor in the lands of the wealthy» for poverty thresholds in USA on page 9).

The Lisbon summit meeting in 2000 decided to promote a series of National Plans on Social Inclusion with the aim of maintaining a European growth model based on economic development, equity and social inclusion. These plans are quite different one from the other. The open method of coordination used by the EU starts out from this diversity and sets out long-term agreed-upon convergence processes. In general, special interest has lately been given to matters related to helping people move into the labour force.

In Spain, plans so far developed follow the same line as indicated for the European countries as a whole. The financial effort has been notable and it has been possible to see samples of good practice with incentives for collaboration between various levels of government, public authorities and non-governmental organizations and foundations. Plans include specific measures and others arising in various fields, such as employment policy, regulation of the minimum wage, pensions, housing plans, dealing with domestic violence, etc.

An important milestone in the struggle against social exclusion was the recently approved Law on Dependency, a law that is to be implemented gradually up to 2013 which should provide a social services network to deal with «the needs of those persons who, being in an especially vulnerable situation, require help to develop those activities essential to daily life, acquire greater personal autonomy and be able to fully exercise their rights as citizens», according to the statement of aims. According to the survey on handicaps, deficiencies and state of health carried out in 1999, 9% of the Spanish population fell into that situation.

Moves by the government authorities are more and more relevant but situations of poverty and social exclusion would be very difficult to deal with if there did not exist the so-called *third sector*, namely, non-government organizations (NGOs). In Spain, it is estimated that there are more than 15,000 NGOs involved in social work, of which the majority are associations while the rest hold the legal status of foundations. This is a very new sector given that more than 90% of these associations were set up after 1977, around half are not more than 10 years old and only a small number have been going for more than 40 years. Some 60% of foundations were established after 1977 and less than one third have existed for more than 40 years. The total number of persons on wages in the third sector involved in social work in Spain is around 200,000, while it is estimated that some 700,000 volunteers (as an approximate figure) are involved in this sector.

Finally, social welfare policies introduced in Europe in the past 50 years, which in Spain have received a very significant boost in the past two decades, still have a long way to go in order to satisfactorily respond to the problems which come under the concept of social exclusion.

FINANCIAL MARKETS

Monetary and capital markets

ECB indicates further interest rate rises ahead

In recent weeks many central banks have shown signs that the current upward stage in interest rates is still hale and hearty. Prospects of notable world economic growth, along with the rise in raw materials prices particularly oil, have increased fears of inflation. This has been reflected in moves by many central banks that have shown a desire to help reduce the still abundant money supply.

On June 6, the Governing Council of the European Central Bank (ECB) raised its

reference rates by 25 basis points. As a result, the Eurosystem rate stood at 4.00%. This was the eighth increase since the upturn began in December 2005. This move came as no surprise and was fully discounted by the market. Chairman Jean-Claude Trichet justified the rate increase by the need to keep inflation under control over the medium term, insisting that inflation risks were increasing.

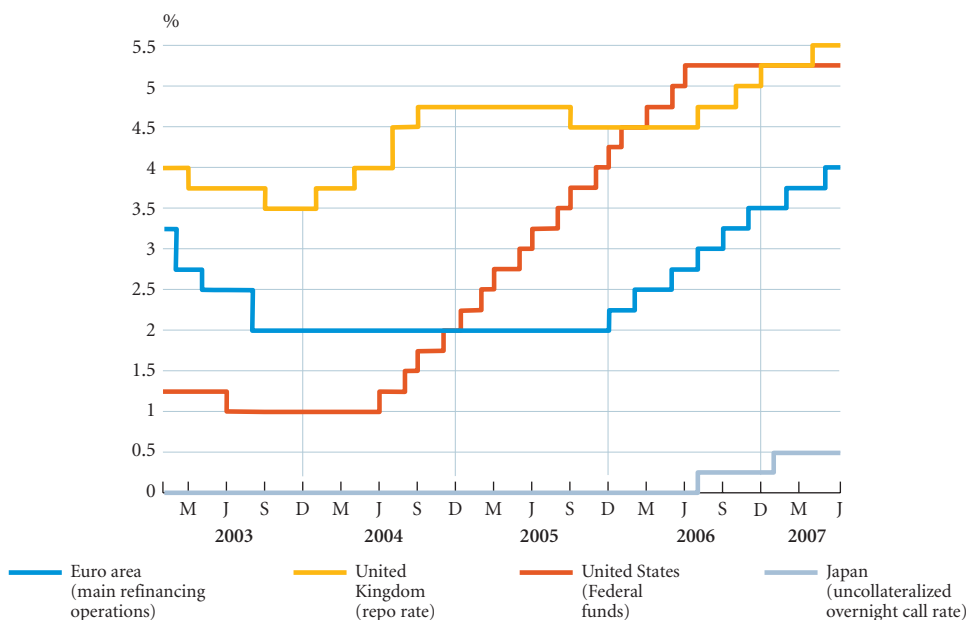
The latest forecasts by the European Central Bank for economic growth in 2007 stand at around 2.6% and 2.3% for 2008. With regard to average inflation, forecasts put this at 2% in 2007 and

Many central banks continue to join restrictive trend in monetary policy in view of inflation risks.

ECB could again raise the official rate in September and December putting it at 4.50%.

EUROPEAN CENTRAL BANK RAISES OFFICIAL RATE TO 4.0%

Monetary policy reference interest rates



SOURCE: National central banks.

SHORT-TERM INTEREST RATES IN NATIONAL MARKETS

Monthly averages as annual percentage

	Euro area			United States		Japan	United Kingdom		Switzerland
	ECB auctions (2)	Euribor (5)		Federal Reserve Board target level (3)	3-month (5)	3-month (5)	Bank of England repo rate (4)	3-month (5)	3-month (5)
	3-month	1-year							
2006									
April	2.58	2.79	3.22	4.75	5.07	0.13	4.50	4.63	1.28
May	2.58	2.89	3.31	5.00	5.18	0.19	4.50	4.70	1.40
June	2.76	2.99	3.40	5.03	5.38	0.31	4.50	4.73	1.48
July	2.80	3.10	3.54	5.25	5.50	0.40	4.50	4.73	1.53
August	2.98	3.23	3.62	5.25	5.42	0.44	4.73	4.94	1.61
September	3.03	3.34	3.72	5.25	5.38	0.44	4.75	5.03	1.74
October	3.23	3.50	3.80	5.25	5.37	0.44	4.75	5.13	1.85
November	3.31	3.60	3.86	5.25	5.37	0.48	4.93	5.23	1.90
December	3.50	3.68	3.92	5.25	5.36	0.53	5.00	5.29	2.02
2007									
January	3.56	3.75	4.06	5.25	5.36	0.55	5.16	5.49	2.15
February	3.55	3.82	4.09	5.25	5.36	0.57	5.25	5.57	2.21
March	3.75	3.89	4.11	5.25	5.35	0.67	5.25	5.55	2.26
April	3.81	3.98	4.25	5.25	5.35	0.65	5.25	5.65	2.32
May (*)	3.82	4.07	4.37	5.25	5.36	0.66	5.42	5.77	2.41
June (1)	4.06	4.16	4.50	5.25	5.36	0.71	5.50	5.95	2.67

NOTES: (*) Provisional figures.

(1) June 25.

(2) Marginal interest rate. Latest dates showing change in minimum rate: 8-6-06 (2.75%), 3-8-06 (3.00%), 5-10-06 (3.25%), 7-12-06 (3.50%), 8-3-07 (3.75%), 6-6-07 (4.00%).

(3) Latest dates showing change: 9-8-05 (3.50%), 20-9-05 (3.75%), 1-11-05 (4.00%), 13-12-05 (4.25%), 31-1-06 (4.50%), 28-3-06 (4.75%), 10-5-06 (5.00%), 29-6-06 (5.25%).

(4) Latest dates showing change: 6-5-04 (4.25%), 10-6-04 (4.50%), 5-8-04 (4.75%), 4-8-05 (4.50%), 3-8-06 (4.75%), 9-11-06 (5.00%), 11-1-07 (5.25%), 10-5-07 (5.50%).

(5) Interbank offer rate.

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

Governor of Bank of England fails to raise again the official interest rate, for now.

2008, a slight increase in the figure for 2007, also because of the rise in oil. If on top of this we add the fact that the movable quarterly average for the broad M3 money supply figure reached an all-time high change rate in April and that the monetary policy position of the ECB is still easy, it is not surprising that chairman Trichet is pointing to further increases. It would not be out of the question to suppose that the ECB could again increase interest rates by 25 basis points in September and it is possible that the year could end with official rates at the 4.50% level.

Fed likely to maintain stand on monetary policy in coming months.

The Bank of England took a break after the increase in May and left its reference rate at 5.50%. In fact, governor Mervyn King would like to raise the rate but, for the second time during his mandate, he did not manage to get the support of a council majority. Nevertheless, the governor made it plain that the trend was upward. The market is thus expecting further increases (up to 6%) in coming months.

With regard to the United States, macroeconomic figures appearing in recent weeks, and job creation and retail

sales (better than expected) raised the prospect that the economic slowdown had hit bottom in the first quarter and that recovery was underway. As a result, the prospect of a cut in the Federal Reserve interest rate in the third week of June vanished and the market even began to take the possibility of further increases as a serious possibility, just as chairman Ben Bernanke has been saying since June 2006. Nevertheless, the fair inflation figure in May reduced those expectations and what seems most likely in coming months is maintenance of the official interest rate as it is.

The Bank of Japan also made no change in the objective level for overnight interbank deposits which has stood at 0.50% since February. Given early macroeconomic figures, however, and the desire of the central bank to continue gradually normalizing its monetary policy, there will surely be a further rise toward the end of summer.

Other central banks did raise their interest rates again. On June 6, in line with the European Central Bank, the Bank of Denmark raised its reference rates by 25 basis points putting 14-day loans at 4.25%. The next day, the Bank of New Zealand also increased its official rate by a quarter-point to 8.0%. One week later, the Bank of Switzerland also raised its reference band by 25 basis points to 2%-3%. The Swiss central bank based its decision on the slight worsening of inflation prospects. On June 19, the Bank of Sweden again raised its official interest rate by a quarter-point to 3.50% and indicated that it would stand at around 4% at year-end. On the other hand, the Bank of Brazil reduced its reference rate by 25 basis points to 12.0% on June 6, thus continuing the downturn begun in September 2005.

Carry trade makes new attack

Calm has been the predominant note in foreign exchange markets in recent times in spite of the volatility in stock markets. In recent weeks, the carry trade (transactions involving borrowing in foreign currencies with low interest rates and simultaneous investment in currencies with high interest rates) has done as it liked. The yen thus has continued to slide downwards. In the fourth week of June, the effective exchange rate for the Japanese currency marked up its lowest level since October 1998. That same week, the Japanese currency showed an all-time low against the euro with a quotation of 166.8 units and its lowest against the dollar in the last four and a half years. In the same period, the Swiss franc, another currency with low interest rates, reported a further all-time low against the European single currency.

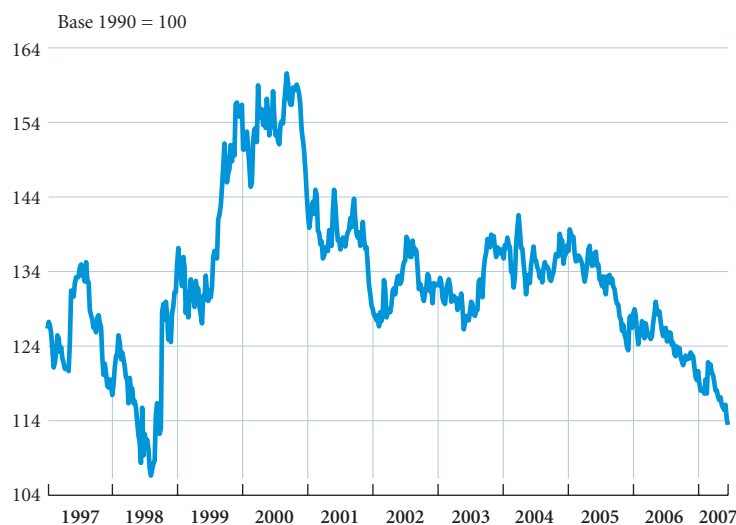
On the other side of the carry trade, the New Zealand dollar, with an official interest rate at 8% (at the top range among the developed countries), has recorded notable appreciation in recent times. In the second week of June the New Zealand currency set a record high against the US dollar for the last 22 years. This rise was considered unacceptable by the Bank of New Zealand and not in keeping with macroeconomic fundamentals to the point where at the beginning of the third week in June it openly intervened in the market for the first time since letting the NZ currency float freely in 1985. Its selling of NZ dollars halted the rise of that currency but this was not enough and it probably had to take further action. In fact, this situation shows some inconsistency given that the rise in the NZ dollar was aided by the rise in New Zealand's official interest rate on June 7, as mentioned above.

Yen and Swiss franc, currencies with low interest rates, record all-time lows against euro.

Bank of New Zealand intervenes to halt sharp appreciation on NZ dollar.

YEN DROPS TO LOWEST LEVEL SINCE OCTOBER 1998

Effective nominal exchange rate for yen



NOTES: Figures go up to June 22.
SOURCE: Bank of England.

EXCHANGE RATES OF MAIN CURRENCES

May 2007

	Average exchange rate	Monthly figures			Exchange rate June 25, 2007
		% change (**)			
		Monthly	Over December 2006	Annual	
Against US dollar					
Japanese yen	120.8	1.6	2.9	8.0	123.7
Pound sterling (*)	1.983	-0.3	1.0	6.1	1.998
Swiss franc	1.222	0.7	0.9	0.2	1.229
Canadian dollar	1.095	-3.5	-5.1	-1.3	1.070
Mexican peso	10.82	-1.5	-0.3	-2.5	10.82
Against euro					
US dollar	1.352	0.1	2.3	5.9	1.346
Japanese yen	163.2	1.7	5.3	14.3	166.2
Swiss franc	1.650	0.8	3.3	6.0	1.654
Pound sterling	0.681	0.3	1.3	-0.3	0.674
Swedish krona	9.204	-0.4	1.9	-1.3	9.245
Danish krone	7.452	0.0	0.0	-0.1	7.443
Polish zloty	3.782	-0.9	-0.8	-2.9	3.789
Czech crown	28.23	0.8	1.7	-0.2	28.72
Hungarian forint	248.4	1.0	-2.1	-5.4	246.8

NOTES: (*) Units to pound sterling.

(**) Plus sign indicates appreciation of dollar (first group) or euro (second group), except in case of exchange rate for pound sterling against dollar.

SOURCE: Thomson Financial Datastream and own calculations.

Another currency that has undergone upward pressure in recent weeks is the Brazilian real, which is showing high interest rates, although in this case we are dealing with an emerging country. The rise in the real to 1.90 units to the dollar led the Bank of Brazil to take a series of measures regarding the exposure of banks in foreign currencies in the second week of June aimed at moderating the appreciation of the Brazilian currency.

The dollar has continued along the downward course it began in 2002, as may be noted from the following graph,

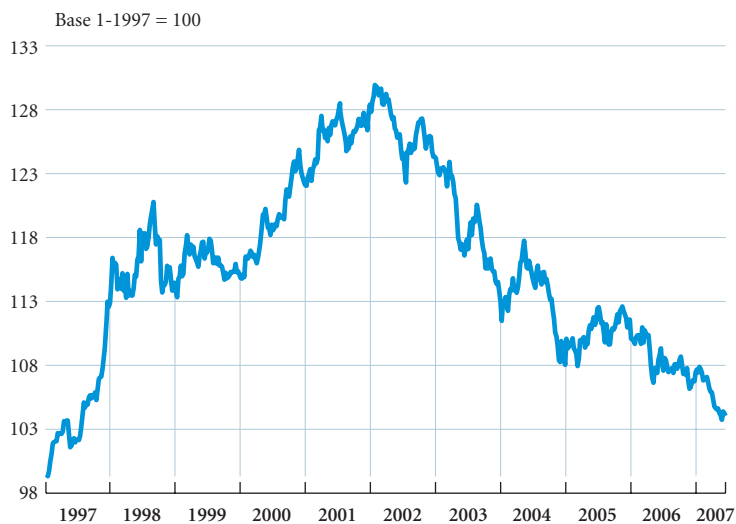
under pressure from the still massive foreign deficit. In the second week of June the effective foreign exchange rate in terms of a broad group of currencies fell to the lowest level since July 1997. Nevertheless, it later recovered to some extent with disappearance of expectations of an interest rate cut by the Federal Reserve.

The euro, however, appreciated in the first half of the year in terms of a wide group of currencies. The raising of the official interest rate by a half-point to 4.0% by the European Central Bank contributed to this trend.

Rise of Brazilian real troubles authorities and Bank of Brazil takes steps to moderate increase.

DOLLAR MARKS UP LOWEST LEVEL IN LAST 10 YEARS

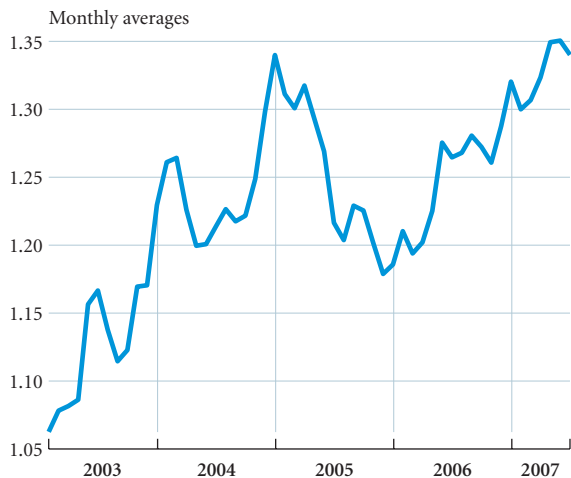
Effective broad nominal dollar exchange rate



NOTES: Figures go up to June 22.
SOURCE: US Federal Reserve.

EURO DROPS AGAINST DOLLAR

US dollars to euro



NOTES: Figures go up to June 25.

SOURCE: Thomson Financial Datastream and own calculations.

Prospects of improvement in US economy, slight rise in expectations on inflation and weaker demand for bonds by foreign investors push up yield on Treasury bonds.

Sharp rise in government bond yields

The yield on US Treasury bonds showed a sharp rise from mid-May to mid-June. The implicit interest rate on 10-year Treasury bonds reached 5.25% on June 12, the highest level since May 2002. This yield rose by 61 basis points in little more than one month starting out from a level slightly below that showing just before the beginning of the upward course taken by the Federal Reserve in June 2004 that raised the official interest rate from 1.0% to the current 5.25%.

What are the reasons for this sharp rise? Various causes seem to have been involved. The most important is the improved prospects for the US economy, as shown by the rise in real interest rates measured by the good signs in inflation. The slight rise in expected inflation has also contributed to this, spurred on by the recent rise in oil prices and prices of other raw materials. Furthermore, there are signs

that foreign investors as well as Asian central banks have reduced their demand for US Treasury bonds. On the other hand, bond yields also reflect the prospect of short-term interest rates going to higher levels than was expected.

Following the sharp rise in the yield on US long-term government bonds, this dropped on subsequent days, again under the effect of moderate figures for inflation in May. In any case, the US interest rate curve has normalized in recent weeks, that is to say, yields are higher depending on how long terms may be, as can be seen in the following graph.

With the recent rise, we can say that bond yields are tending to normalize following a long period when they had been greatly depressed. In spite of this, the risk premium on emerging country sovereign bonds have scarcely risen since the all-time low recorded at the beginning of June. At the same time, risk

LONG-TERM INTEREST RATES IN NATIONAL MARKETS

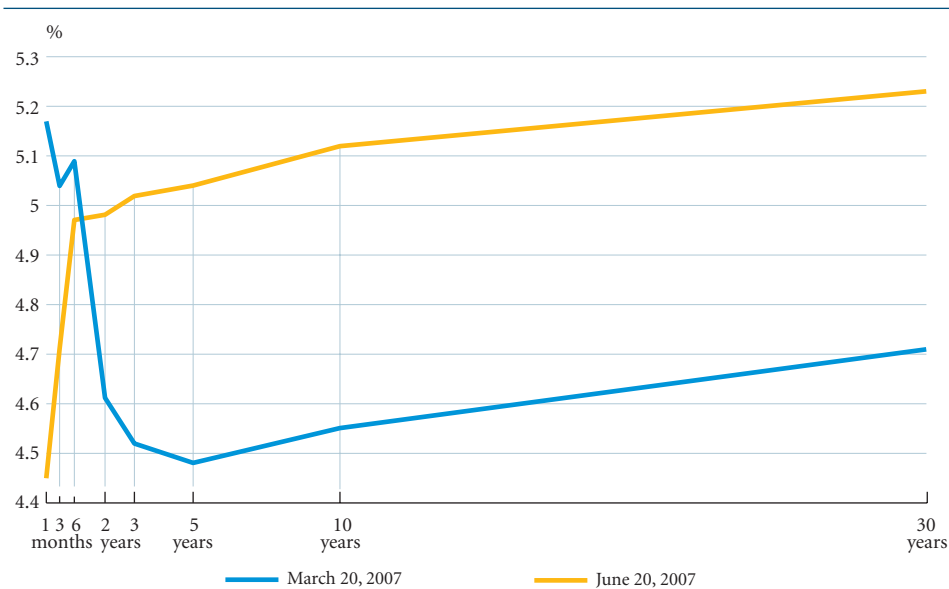
10-year government bonds: average for period as annual percentage

	2005	2006	2006			2007			
			2Q	3Q	4Q	1Q	April	May	June 25
United States	4.33	4.85	5.13	4.96	4.68	4.74	4.75	4.79	5.08
Japan	1.39	1.75	1.90	1.80	1.70	1.68	1.68	1.68	1.88
Germany	3.38	3.78	3.96	3.89	3.77	4.01	4.16	4.29	4.62
France	3.41	3.80	3.99	3.90	3.78	4.05	4.21	4.33	4.66
Italy	3.56	4.05	4.27	4.18	4.03	4.23	4.38	4.49	4.80
Spain	3.39	3.79	3.97	3.89	3.79	4.06	4.21	4.34	4.66
United Kingdom	4.47	4.55	4.65	4.67	4.65	4.92	5.10	5.21	5.48
Switzerland	2.04	2.46	2.67	2.61	2.38	2.57	2.74	2.89	3.11

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

US INTEREST RATE CURVE NORMALIZES

Yield curve for government bonds



SOURCE: Reuters.

premiums on corporate bonds generally stand at low levels.

Bonds cannot beat stock markets

The almost unstoppable boom on the stock markets took many of them to all-

time highs in the early days of June. Notable world economic growth, along with the increase in corporate profits, abundant liquidity in international financial markets and the rash of corporate mergers and other activities continued to aid the stock markets. The upward move on international stock

Bond yields tending to normalize after period of low levels.

International stock exchanges drop after marking up all-time highs at beginning of June, in view of rise in bond yields, but later recover.

exchanges this time sidestepped the sharp drop in the Chinese market at the end of May. Nevertheless, the sharp rise in government bond yields since mi/74-May ended up deflating the spirit of investors.

As a result, international stock markets underwent a notable correction in the second week of June. Nevertheless, once bond yields began to drop in the third week of June, optimism was again the predominant note. As a result, stock market indices regained ground and many emerging country stock markets even went back to marking up new records in the fourth week of the month.

Standard & Poor's index goes above high for 2000.

In the United States the improving economic picture and the buying back

of shares by listed companies contributed to the stock market boom. Near the end of May, the Standard & Poor's 500 index for the US stock market went above the all-time high in 2000 for the first time. In the wake of the good performance of high-tech shares, the Nasdaq index marked up its highest level in the past six and a half years in the fourth week of June, although it was still more than 45% below the all-time high before the bursting of the high-tech bubble. Nevertheless, those sectors showing a better cumulative result were in raw materials and energy. On the other hand, affected by the crisis in high-risk mortgage loans, the financial sector failed to go above par for the year.

INDICES OF MAIN WORLD STOCK EXCHANGES

May 31, 2007

	Index (*)	% monthly change	% cumulative change	% annual change	Quotation on June 25, 2007	
					% cumulative change	% change over same date in 2004
New York						
<i>Dow Jones</i>	13,627.6	4.3	9.3	22.0	7.1	28.7
<i>Standard & Poor's</i>	1,530.6	3.3	7.9	20.5	5.6	32.0
<i>Nasdaq</i>	2,604.5	3.1	7.8	19.5	6.7	27.2
Tokyo	17,875.8	2.7	3.8	15.6	5.0	53.5
London	6,621.5	2.7	6.4	15.7	5.9	46.6
Euro area	4,512.7	2.7	9.5	24.1	8.5	58.6
<i>Frankfurt</i>	7,883.0	6.4	19.5	38.5	20.2	97.6
<i>Paris</i>	6,104.0	2.4	10.1	23.8	8.3	60.4
<i>Amsterdam</i>	540.4	1.8	9.1	22.7	10.7	59.6
<i>Milan</i>	33,724.0	-0.8	5.7	20.8	3.3	55.8
<i>Madrid</i>	15,329.4	6.6	8.4	35.2	5.0	82.8
Zurich	9,450.9	0.2	7.6	24.3	4.0	60.9
Hong Kong	20,634.5	1.6	3.4	30.1	9.3	79.1
Buenos Aires	2,243.0	4.1	7.3	35.6	5.4	136.4
São Paulo	52,268.0	6.8	17.5	43.1	21.5	160.4

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

SOURCE: Thomson Financial Datastream and own calculations.

CHINESE STOCK MARKET SWAYS AFTER MARKING UP RECORD

Index for Shanghai A stock exchange



NOTES: Figures go up to June 25.

SOURCE: Thomson Financial Datastream.

On this side of the Atlantic, the German stock market especially stood out, capitalizing on the turnaround in the economic prospects for that European giant. The Dax index for the Frankfurt stock exchange went above the all-time high in 2000 for the first time and near the end of the first half-year showed an advance of more than 20% over December.

The IBEX 35 index for the Spanish stock exchange recorded a new high on June 1 when it went to 15,501.5 points. Following this notable rise it underwent a correction and dropped below the 15,000 points level. Nevertheless, with the help of further corporate transactions and the growth of corporate profits, it was averse to moving down and showed considerable gains over December.

The index for the Shanghai A stock exchange dropped 6.5% on May 30 as a result of the fact that the Chinese authorities tripled the tax on stock market transactions in an attempt to halt the uncontrolled rise of the market. Just days later this index again dropped by 8.3% in view of investor fears of further restrictive measures. Nevertheless, it later recovered a positive tone and the Chinese index again rose sharply going close to the record set on May 29 although volatility still held sway.

Other emerging country stock markets generally rode the storm quite well and in many cases marked up all-time highs in the final weeks of June. Among those stock exchanges to chalk up new records we may mention those of Poland, South Korea, Hong Kong, Singapore, Philippines, Indonesia and Brazil.

German stock exchange Dax index marks up new record in fourth week in June.

Spanish stock market undergoes correction after recording new high at beginning of June.

Many emerging country stock markets record all-time highs in final weeks of June.

SPAIN: OVERALL ANALYSIS

Economic activity

Investment and exports now engines of growth for Spain's economy.

Spain's economy still in good form

Spain's economy continues buoyant with indications this will continue or show a slight easing off in the growth rate of economic activity. Investment and exports are now acting as the real engines of growth.

In this context, industry continues to show strong growth. The industrial production index for April (adjusted for calendar differences) grew by 4.0% year-on-year although three decimals less than in the first quarter. It therefore seems that the growth rate is tending to ease slightly, which is logical following the strong drive seen in the past two years.

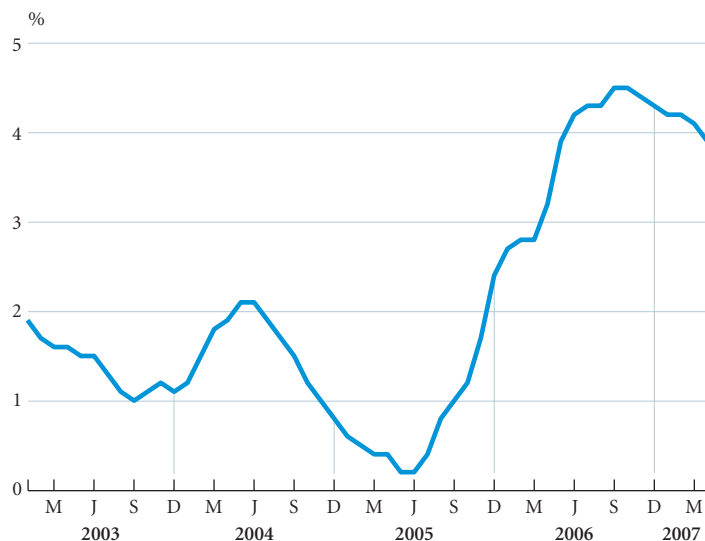
Industry maintaining strong growth rate...

Among the branches of economic activity heading the growth classification are machine building, electrical material and the furniture industry, with increases between 15% and 22% year-on-year. We should also mention the increases marked up in some key sectors, such as motor vehicles, metallurgy and the chemical industry, all close to 5%.

On the other side of the coin we find the textile sector and the electronics industry which continue in recession. Other figures referring to the good state of Spanish industry are to be seen in the trend in indices for orders and business volume which in April rose by 8.9% and 7.7% respectively compared with one year earlier.

INDUSTRIAL PRODUCTION CONTINUES TO GROW AT AROUND 4%

Year-on-year change in industrial production index



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

SUPPLY INDICATORS

Percentage change over same period year before

	2005	2006	2006			2007		
			2Q	3Q	4Q	1Q	April	May
Industry								
Electricity consumption (1)	3.5	3.6	3.1	5.9	3.5	5.1	8.1	2.6
Industrial production index (2)	0.7	3.9	4.0	4.2	4.6	4.3	4.0	...
Confidence indicator for industry (3)	-4.8	-2.7	-2.7	-2.3	-0.3	2.3	2.0	...
Utilization of production capacity (4)	80.2	80.5	80.5	80.3	81.6	80.6	-	81.3
Imports of non-energy intermediate goods (5)	1.6	10.5	6.4	13.8	12.1	8.1	16.4	...
Construction								
Cement consumption	7.3	8.6	4.0	5.7	8.9	3.8	0.0	-2.6
Confidence indicator for construction (3)	22.4	14.2	11.7	14.7	15.0	10.7	16.0	15.0
Housing (new construction approvals)	6.2	18.6	6.9	50.5	0.2	8.0	...	...
Government tendering	18.5	31.4	34.8	19.1	55.1	14.1	...	...
Services								
Retail sales	4.4	5.0	3.8	5.9	5.2	6.2	3.2	...
Foreign tourists	6.6	4.6	9.8	3.7	2.5	5.3	-3.5	-1.4
Tourist revenue inflows	6.0	5.6	11.0	4.9	3.1	5.3	...	...
Goods carried by rail (ton-km)	-3.2	-1.2	-2.7	-3.3	-6.4	-4.1	4.7	...
Air passenger traffic	9.2	6.7	10.1	4.5	7.1	9.5	6.0	...
Motor vehicle diesel fuel consumption	5.1	5.4	4.5	3.9	4.9	5.8	...	...

NOTES: (1) Adjusted for number of working days and temperature.

(2) Adjusted for difference in number of working days.

(3) European Commission survey: difference between percentage of positive and negative replies.

(4) Business survey: percentage of utilization inferred from replies.

(5) By volume.

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

With regard to construction, no significant change can be seen in the rate of business activity in spite of the signs of a cooling off in the real estate market. Nevertheless, there was a noteworthy drop in cement consumption in recent months of the order of 5% in seasonally adjusted terms in the April-May period. In any case, it is likely that this is a transitory adjustment that could be at least partly compensated in coming months.

In services, the general tone is expansionist with information technology and company services

standing out as the most dynamic sectors. Retail trade is also maintaining sustained growth whereas, on the other hand, transport and tourism are tending to ease growth. In fact, for the moment the balance of the tourism sector is fairly modest. In the first five months of the year increases in the number of foreign tourists and overnight stays in national hotels dropped by 1.3% and 2.8% respectively, below the high rates recorded in the last two years.

On the demand side, we note that consumption is still maintaining considerable strength, especially in

...except in some branches such as textiles and electronics, both still in recession.

Construction holding to notable rate of activity despite cooling down in real estate market.

DEMAND INDICATORS

Percentage change over same period year before

	2005	2006	2006			2007		
			2Q	3Q	4Q	1Q	April	May
Consumption								
Production of consumer goods (*)	0.9	2.3	2.2	1.9	4.3	5.0	3.5	...
Imports of consumer goods (**)	7.9	8.9	5.9	2.4	7.6	-1.1	10.6	...
Car registrations	2.1	-0.9	-3.6	-4.1	1.8	-0.7	-6.0	-0.2
Credit for consumer durables	15.0	14.5	15.6	13.2	12.0	...	-	...
Consumer confidence index (***)	-10.8	-12.3	-12.7	-13.7	-10.3	-10.7	-12.0	-13.0
Investment								
Capital goods production (*)	-0.1	8.4	7.6	7.9	11.2	8.9	6.3	...
Imports of capital goods (**)	20.4	3.2	-5.0	6.5	3.4	20.1	9.3	...
Commercial vehicle registrations	13.2	1.5	-0.2	0.5	-1.0	1.7	1.7	-3.4
Foreign trade (**)								
Non-energy imports	6.0	9.0	4.7	8.9	9.3	6.4	13.3	...
Exports	0.2	5.6	3.7	1.7	4.7	3.0	6.7	...

NOTES: (*) Adjusted for difference in number of working days.

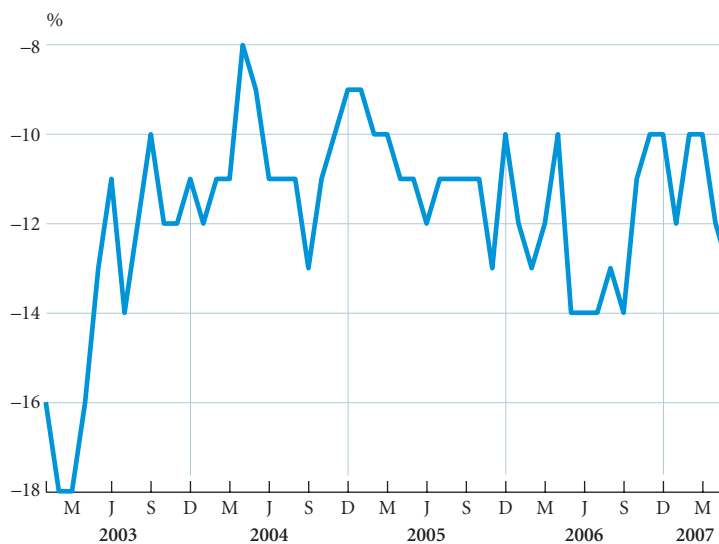
(**) By volume.

(***) European Commission survey: difference between percentage of positive and negative replies.

SOURCE: ANFAC, National Institute of Statistics, Bank of Spain, Ministry of Economy and Finance, European Commission and own calculations.

CONSUMER CONFIDENCE NOT RECOVERING

Difference between positive and negative responses



SOURCE: European Commission.

certain segments, such as non-durable goods. In other segments, however, such as food and durable goods we note increased moderation.

Registrations of passenger cars and four-wheel-drive vehicles, for example, for example, are maintaining a downward trend (drop of 0.9% in 2006 and 1.6% in the first five months of the year).

Nevertheless, thanks to the rise in exports, production of the motor vehicle industry located in Spain grew by more than 8.5% up to May, with an increase of sales abroad of more than 10%.

The consumer confidence index remains at low levels, as in 2006, which turns out

to be contradictory if we take into account the high growth rate of consumption. The reticence of consumers, according to the European Commission survey, shows up especially in trends in the general situation (more than in those in the home itself), employment prospects and the difficulty in saving.

Finally, investment in capital goods continues to show great strength, if we are to go by the performance both in domestic production and in imports of goods of this type. Registrations of commercial vehicles stand outside this trend, showing stagnant growth so far this year.

Modest tourist balance up to May.

With some exceptions, consumption maintaining good level...

...although consumer confidence remains stagnant.

Being poor in Spain

Being poor clearly has different connotations in a developed country and an emerging one. Like other countries of the European Union, Spain considers that a person is poor if his/her resources are so limited that they do not come up to the minimum acceptable in terms of the living standards of the country. This is therefore a relative concept. Among the less developed countries, on the other hand, poverty is usually understood as the inability to meet certain basic necessities (see box entitled «Social exclusion and poverty» on page 29). In any case, policies for reducing poverty demand an understanding of who is most vulnerable to becoming poor. On the following pages we give a detailed picture of the situation in Spain.

According to the latest survey on living conditions carried out by the National Institute of Statistics (INE) in 2005, some 19.8% of Spain's population stood below the poverty risk threshold. This poverty line varied depending on the composition of the household. In the case of a household where one adult lived alone, INE placed the poverty line at 6,347 euros, a figure equivalent to 60% of the median net income (after taxes and social transfers) of households by «consumption unit». Two clarifications may be necessary at this point. First, the median is the point that divides 50% of the population with highest incomes from 50% of the population with lowest incomes. Second, the number of consumption units of a household is calculated according to the standard methodology utilized in the European Union, giving a weighting of 1 for the first adult, 0.5 for other adults and 0.3 for those under 14 years of age. For example, the number of «consumption units» for a household with two adults and two children under 14 is 2.1. The poverty line for this type of household in the 2005 survey was 13,328 euros.

Statistics also show that the risk of poverty does not affect all groups equally. As shown in the accompanying table, the incidence is greater among women, especially those over 65 years of age, and among children. One in three women over 65 and one out of four children live in a household below the poverty line. At-risk-of-

poverty rates also tend to be higher among these groups in other countries of the European Union but the differences are not usually as large as in Spain. The highest rate (nearly 50%) is found among those persons over 65 who live alone although this segment of the population represents only 3% of the total. The figures show the importance of having employment (or living in a household where the adults are employed) in order to avoid economic penury. This reduces the rate of poverty risk to close to 10%. As is to be expected, the incidence of poverty is also reduced with a higher level of education. In this respect, it is troublesome that in Spain a high proportion of young people (among the highest in the EU-25) leave school at the end of compulsory attendance. As an also high proportion go on to university this is certainly due to the well-recognized phenomenon of the lack of attraction of trade (or vocational) schools.

AT-RISK-OF-POVERTY RATES VARY SIGNIFICANTLY ACROSS GROUPS

% of total in 2005

	At-risk-of-poverty rates	Weighting of group in population
Sex		
Males	18.6	49.2
Females	20.9	50.8
Age		
Under 16	24.2	15.3
From 16 to 64	16.4	68.1
Over 65	29.4	16.6
<i>Males</i>	26.4	7.0
<i>Females</i>	31.6	9.6
Work situation		
Employed	10.4	50.8
Unemployed	34.8	7.2
Retired	24.7	14.9
Others not in labour force	27.8	27.1
Type of household		
Single person	34.0	5.8
<i>Under 65</i>	19.0	2.7
<i>Over 65</i>	47.3	3.1
1 adult with 1 child	36.9	1.6
2 adults with 1 or more children	14.2	12.4
2 adults with 2 children	22.8	17.2
2 adults with 3 or more children	34.1	4.6
Educational level (adults)		
Primary or lower	28.3	37.4
First level secondary	20.2	19.8
Second level secondary	13.3	20.7
Higher education	7.4	21.8
TOTAL	19.8	100.0

SOURCE: INE.

The at-risk-of-poverty rate in Spain is among the highest in the EU-15 where the average stands at 16%, according to Eurostat figures. This figure, however, hides significant differences between countries. The lowest rate is found in the Nordic countries closely followed by the Netherlands, France and Germany. None of these countries has a rate above 13%. On the other hand, the situation in Spain is similar to that of Italy, Ireland, Greece and Portugal. The last three countries not only show the relatively highest poverty rates in the EU-15 but they also are the countries with the lowest poverty lines measured in euros. That is to say, these are the countries with the most poverty in the EU-15 not only in relative terms but also in absolute terms.

The phenomenon of poverty is especially troubling if it is difficult to escape from it. This is a situation in which most of those who are poor today will be poor tomorrow. The same poverty rate, however, may reflect a situation of high mobility when falling into a situation of poverty is just a temporary matter (for example, related to losing a job for a few months). To capture these differences, Eurostat calculates what it calls the at-persistent-risk-of-poverty rate. This is the proportion of the population below the poverty line in the year of the survey that was also below it for at least two of the three previous years. According to this index, Spain is at almost the same level as the EU-15 (10% and 9% respectively in 2001, the last year figures are available). No doubt, this is a figure that significantly qualifies (in a positive direction) the position of Spain in relation to its neighbours. Ireland, Greece and Portugal, with at-persistent-risk-of-poverty rates between 13% and 15%, continue to be the countries with the highest rates in the EU-15.

Looking at various studies, for example those of Olga Cantó, Coral del Río and Carlos Gradín, we note that, following a substantial reduction in the Seventies, the relative poverty rate in Spain has fluctuated around levels close to present figures. Poverty rates rose during the recessions at the beginning of the Eighties and Nineties, periods when the unemployment rate in Spain went above 20%, but dropped again in following years. In any case, comparisons between various years are not simple due, among other reasons, to methodological changes in the surveys. While some may be surprised that the poverty rate has not decreased along with the strong economic growth in recent years, it should be remembered that we are talking about relative poverty and a poverty risk threshold that also has risen substantially. Unfortunately, figures available do not make it possible to clarify what may have been the contribution of the immigrant population to the poverty rates.

In conclusion, the situation of poverty in Spain, especially regarding the poverty that is most damaging, permanent poverty, is comparable with that of its European neighbours. In any case, there is obviously room for improvement. The statistics underline the relevance of three areas for reducing poverty – a labour market that fosters job creation and keeps the unemployment rate low; the possibility of access to a good education; and a policy of support to families with children and to the most elderly, two groups that are especially vulnerable.

Labour market

Employment continues to grow at more contained rate.

Total foreign workers registered with Social Security goes up to 10.5%.

Growth of employment eases off

The labour market continues to show great strength but the rate of job creation is tending to ease off. The number of those registering with Social Security grew by 3.2% year-on-year in the April-May period, close to a half-point less than in the first quarter. In absolute figures, the total number of those registered rose by close to 594,000 in the past 12 months. Of these, nearly 72% were registered in economic activities related to services, 17% in construction and 11% in industry.

In May 2007, the total number of foreign workers registered was nearly 10.5% of the total. By sector, the highest percentage of foreign workers was registered among domestic servants (52%), hotels and restaurants (26%), construction (21%) and agriculture (16%). In industry this proportion stood at around 6.5%, while retail trade took up 8%.

Permanent contracts continue to rise at high rates although somewhat less than in the early months of the year. In the period April-May they grew by around 15% year-on-year as against the 2.5%

EMPLOYMENT INDICATORS

Percentage change over same period year before

	2005	2006	2006			2007		
			2Q	3Q	4Q	1Q	April	May
Persons registered with Social Security								
Wage-earners	4.8	4.7	5.3	3.9	3.5	3.9	3.0	3.3
<i>Industry</i>	-0.5	0.0	0.0	0.0	0.2	2.2	2.4	2.6
<i>Construction</i>	8.6	8.7	9.5	7.5	6.8	6.1	4.5	4.3
<i>Services</i>	5.7	5.2	5.8	4.6	4.0	4.1	3.2	3.5
Non-wage-earners	2.6	2.2	2.2	2.1	2.2	2.5	2.6	2.7
Total	4.4	4.3	4.8	3.6	3.3	3.6	3.0	3.2
Persons employed (*)	5.6	4.1	4.2	3.7	3.6	3.4	-	-
Jobs (**)	3.1	3.1	3.1	2.9	3.1	3.0	-	-
Hiring contracts registered (***)								
Permanent	8.7	41.1	16.1	46.6	76.8	25.8	16.0	14.1
Temporary	4.6	4.7	5.5	0.5	0.5	2.6	5.0	-2.4
Total	5.0	7.9	6.4	4.1	7.3	5.3	6.3	-0.7

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

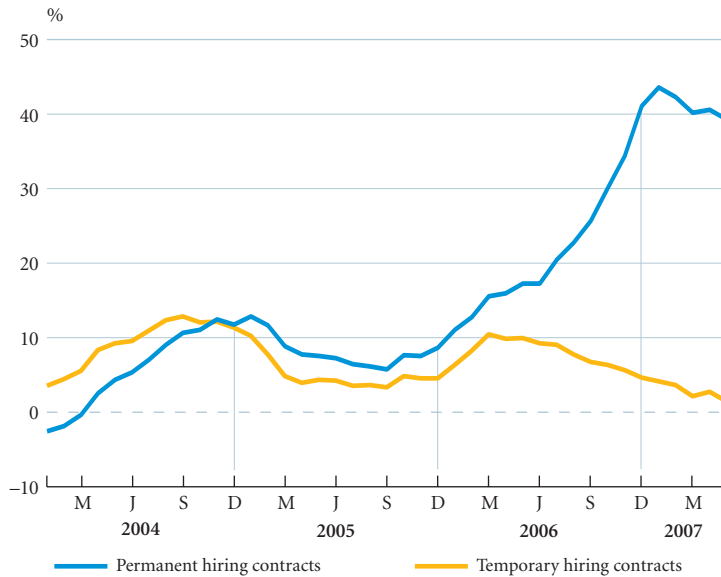
(**) Equivalent to full-time work. National Accounting estimate; figures adjusted for seasonal effects and number of working days.

(***) At INEM.

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

PERMANENT HIRING CONTRACTS STAY HIGH

Contracts registered with INEM: percentage change in cumulative figure for last 12 months compared with same period year before



SOURCE: Employment Institute and own calculations.

marked up by temporary contracts. The latter, however, continue to be well in the majority (representing around 88% of all hiring contracts signed in May).

Drop in unemployment slowing down

Unemployment was down by 49,893 persons in May, again putting the figure below two million. In year-on-year terms, registered unemployment continued to show decreases (1.6% in May) although these decreases were more and more moderate.

In the past 12 months, unemployment has dropped sharply in industry (5.4%) and to a lesser extent in services (1.7%). On the other hand, unemployment was up significantly in construction (1.8%) making it clear that the high point of the growth cycle in that sector is now a thing of the past. In the period under consideration, unemployment rose only in Andalusia, Canary Islands, Valencian Community, Madrid Community and Murcia with various decreases in the other autonomous communities.

Permanent hiring contracts grow in greater proportion to temporary contracts.

Unemployment down sharply in industry while rising in construction.

REGISTERED UNEMPLOYMENT BY SECTOR, SEX AND AGE

May 2007

	No. of unemployed	Change over December 2006		Change over same period year before		% share
		Absolute	%	Absolute	%	
By sector						
Agriculture	62,654	1,160	1.9	1,083	1.8	3.2
Industry	270,156	-11,992	-4.3	-15,558	-5.4	13.7
Construction	214,243	-22,528	-9.5	3,702	1.8	10.9
Services	1,201,624	-23,245	-1.9	-21,303	-1.7	60.9
First job	224,554	6,963	3.2	779	0.3	11.4
By sex						
Males	743,837	-60,437	-7.5	-19,161	-2.5	37.7
Females	1,229,394	10,795	0.9	-12,136	-1.0	62.3
By age						
Under 25 years	228,223	-13,789	-5.7	-22,689	-9.0	11.6
All other ages	1,745,008	-35,853	-2.0	-8,608	-0.5	88.4
TOTAL	1,973,231	-49,642	-2.5	-31,297	-1.6	100.0

SOURCE: Employment Institute and own calculations.

Wages grow by 4.3%...

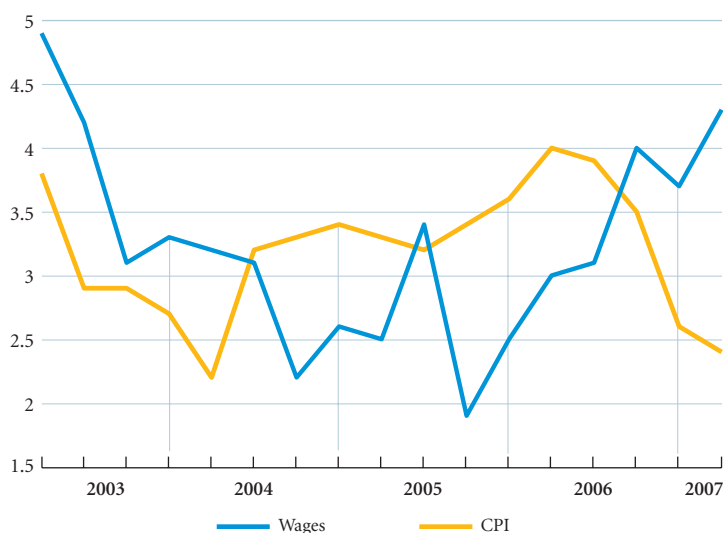
Labour costs rise

In the first quarter of 2007, average wage costs per worker per month rose by 4.3%

compared with the same period last year, according to figures from the quarterly labour cost survey carried out by the National Institute of Statistics (INE).

WAGES RECOVER PURCHASING POWER IN RECENT MONTHS

Percentage year-on-year change rate in wages and consumer price index



SOURCE: INE and own calculations.

WAGE INDICATORS

Percentage change over same period year before

	2005	2006	2006			2007
			2 Q	3 Q	4 Q	1 Q
Increase under general wage agreements (*)	3.2	3.3	3.2	3.2	3.3	2.9
Wage per job equivalent to full-time work (**)	2.6	3.4	3.4	3.6	3.8	3.5
Quarterly labour cost survey						
Wage costs						
Total	2.6	3.4	3.1	4.0	3.7	4.3
<i>Industry</i>	2.7	3.6	3.1	4.1	3.6	3.7
<i>Construction</i>	2.3	3.7	3.1	4.2	3.9	5.5
<i>Services</i>	2.9	3.7	3.4	4.3	4.0	4.5
Average wages per hour worked	3.2	4.2	7.1	4.4	5.0	4.6
Other labour costs	3.6	3.6	4.9	2.6	2.6	3.2
Work day (***)	-0.6	-0.6	-3.8	-0.3	-1.3	-0.2
Farm wages	3.1	2.8	2.6	3.2	2.4	3.1
Labour cost in construction	4.3	4.4	4.5	4.5	4.5	0.2

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

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

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

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

Nevertheless, we should mention that the results of that survey do not coincide with those from other sources that rather point to a slight slowdown.

According to the information supplied by INE, the higher growth in relatives terms arose from construction (5.5% year-on-year). In services, the rise in wage costs was 4.5% while in industry

the increase came to 3.7%. According to the INE figures, there would have been a loss of purchasing power between 2004 and 2006, a situation that would have been completely turned around toward the end of last year and the beginning of 2007. This development may be noted in the above graph which compares the trend in wages with inflation.

...and recover purchasing power.

Prices

Lower rise in fresh foods and bigger drop in energy products bring annual inflation rate down to 2.3% in May...

...but background inflationary pressures persist.

CPI marks up lowest level since March 2004

A smaller increase in fresh foods and a bigger drop in energy products meant that the annual inflation rate for the consumer price index (CPI) dropped by one decimal in May going to 2.3%. As a result, the CPI showed the lowest level since March 2004 with a drop of 3 decimals compared with the end of 2006.

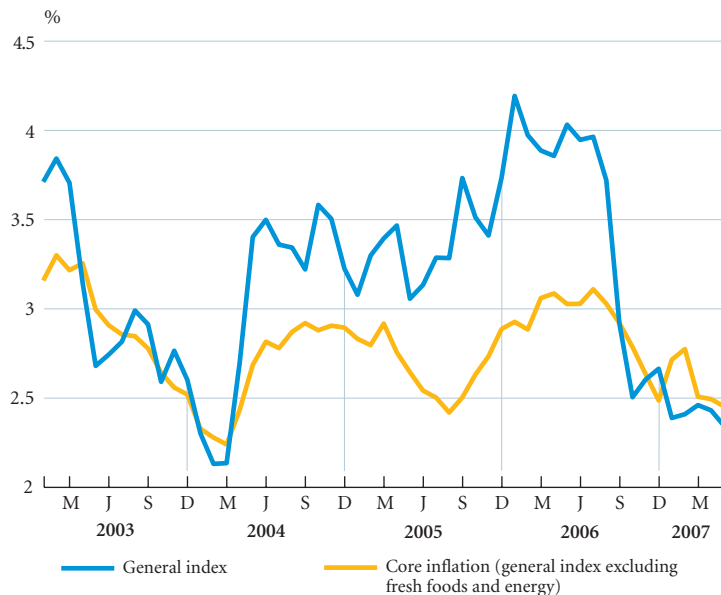
In fact, unprocessed foods reported a more moderate rise following the sharp increase seen in previous months. The annual growth rate went from 6.4% in April to 6.0% in May. It is worth noting that the annual change in potatoes and potato products dropped from 23.8% in

April to 11.5% in May. Poultry also eased although to a lesser extent going from 19.0% in April to 16.4% in May. In any case, poultry is still showing a big increase in the past 12 months as a result limited supply related to a recovery in demand following the avian flu scare.

The improvement in inflation in recent months, however, is more apparent than real. The more stable core of inflation, so-called underlying inflation that excludes the more volatile elements such as fresh foods and energy products, held at 2.5% in May. This came about because the slowdown in prices of durable industrial goods was counteracted by higher inflation in services and processed foods.

CPI HOLDS BELOW CORE INFLATION

Year-on-year change in CPI



SOURCE: National Institute of Statistics.

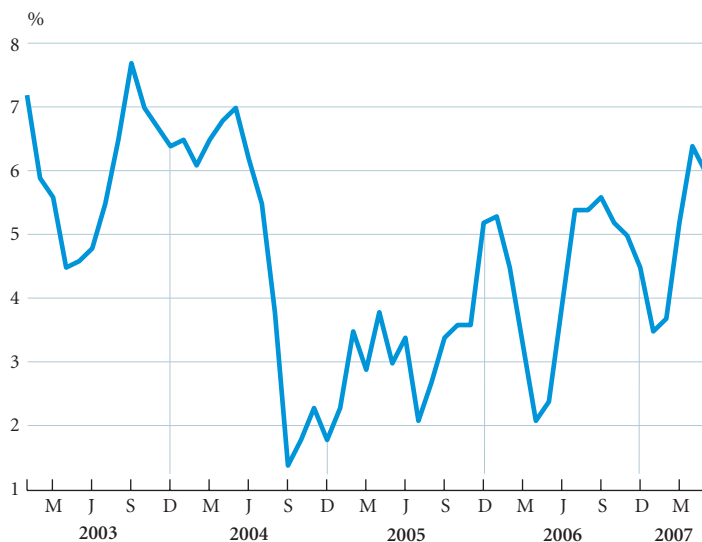
CONSUMER PRICE INDEX

	2006			2007		
	% monthly change	% change over December 2005	% annual change	% monthly change	% change over December 2006	% annual change
January	-0.4	-0.4	4.2	-0.7	-0.7	2.4
February	0.0	-0.4	4.0	0.1	-0.6	2.4
March	0.7	0.3	3.9	0.8	0.1	2.5
April	1.4	1.8	3.9	1.4	1.5	2.4
May	0.4	2.1	4.0	0.3	1.8	2.3
June	0.2	2.3	3.9			
July	-0.6	1.7	4.0			
August	0.2	1.9	3.7			
September	-0.2	1.7	2.9			
October	0.4	2.1	2.5			
November	0.2	2.4	2.6			
December	0.3	2.7	2.7			

SOURCE: National Institute of Statistics.

FRESH FOODS MOVE UPWARD

Year-on-year change in unprocessed foods component of CPI



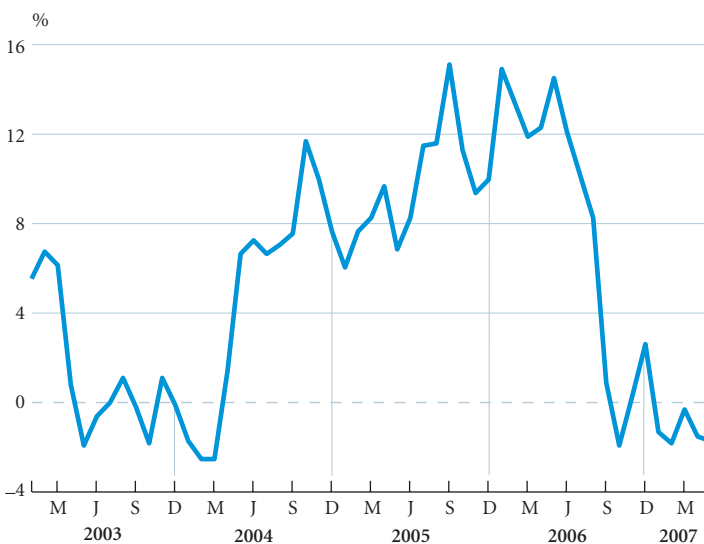
SOURCE: National Institute of Statistics.

Prices of durable industrial foods, subject to sharp competition in international markets, have risen by only 0.5% since May 2006. For example, appliances prices dropped by 0.8% on average last year while male clothing was down 0.7%. On

the other hand, processed foods have risen by one decimal to 2.3% in the past 12 months. Bread rose by 6.3% last year, one decimal more than the year before, showing the sharp increases in cereals in international markets.

ENERGY PRODUCTS PROVIDE A SPELL

Year-on-year change in energy products component of CPI



SOURCE: National Institute of Statistics.

Rise in oil prices makes continuation of downward trend in CPI difficult.

It was especially in services, however, where the persistence of inflation was most to be seen these are more sheltered from international competition. The annual change rate for services thus stood at 4.0% in May, one decimal more than in the previous month. In any case, some services, such as hotel, cafés, restaurants and communications made a slightly negative contribution to CPI growth in May. On the other hand, the drop in recreation and culture slowed to 0.2% in May given that the cut in prices for organized tours following the Easter Week season was less marked than in the same month last year.

Inflation differential with European Monetary Union drops to low levels.

With regard to prospects for the trend in inflation in coming months, the recent rise in oil prices could be a blow to the downward trend in the CPI. What is

more, in the second half-year the base effect brought about by the sharp drop in oil prices in the second half of 2006 will work against it. At the same time, it is expected that world farm price pressures will continue which could have an effect on the prices of fresh foods and processed foods. If to this we add the persistence of core inflation, the picture indicates a rise in the CPI as of the summer so that the year could end at around 3% or even higher.

On the other hand, the annual inflation rate for consumer goods in terms homogeneous with the Euro Area dropped by one decimal in May to stand at 2.4%. In this way, the inflation differential with Spain's Euro Area associates dropped slightly to 0.5 points, the lowest level since March 2004.

CONSUMER PRICE INDEX BY COMPONENT GROUP

May

	Indices (*)	% monthly change		% change over previous December		% annual change	
		2006	2007	2006	2007	2006	2007
By type of spending							
Food and non-alcoholic beverages	102.5	0.2	0.1	1.1	1.1	3.6	3.2
Alcoholic beverages and tobacco	107.0	0.2	0.1	0.8	5.5	2.4	6.2
Clothing and footwear	107.0	1.2	1.3	0.1	0.0	1.4	1.1
Housing	103.3	0.4	0.2	4.6	2.7	7.5	3.0
Furnishings and household equipment	102.9	0.5	0.4	1.6	1.6	2.6	2.6
Health	97.7	0.1	0.2	0.9	-2.8	1.3	-2.1
Transport	102.4	1.1	1.0	5.5	4.1	7.8	0.5
Communications	100.2	-0.1	-0.3	-0.5	1.0	-1.2	0.1
Recreation and culture	99.1	-0.9	-0.8	-1.5	-1.1	0.6	-0.2
Education	103.5	0.0	0.0	0.3	0.5	3.9	4.5
Restaurants and hotels	104.5	0.0	0.0	2.7	3.2	4.5	4.9
Other goods and services	103.3	0.1	0.1	2.8	2.4	3.5	3.4
By group							
Processed food, beverages and tobacco	102.6	0.1	0.2	2.1	2.1	3.9	2.3
Unprocessed food	103.8	0.4	0.0	-1.0	0.5	2.4	6.0
Non-food products	102.9	0.4	0.3	2.5	1.9	4.2	2.0
Industrial goods	102.4	0.9	0.7	2.9	1.5	4.5	0.1
<i>Energy products</i>	101.7	1.7	1.5	9.9	5.3	14.4	-1.7
<i>Fuels and oils</i>	101.1	2.2	2.0	11.7	6.2	17.9	-3.4
<i>Industrial goods excluding energy products</i>	102.6	0.6	0.4	0.7	0.2	1.5	0.7
Services	103.5	-0.1	-0.1	2.1	2.3	3.9	4.0
Underlying inflation (**)	103.0	0.2	0.2	1.6	1.5	3.0	2.5
GENERAL INDEX	103.0	0.4	0.3	2.1	1.8	4.0	2.3

NOTES: (*) Base 2006 = 100.

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

SOURCE: National Institute of Statistics.

Favourable performance in wholesale prices

The drop in prices of intermediate goods brought about a slight drop in inflationary pressures in wholesale markets. While over the very short term this trend could continue the trend in international prices for raw materials would indicate a darker picture on inflation in the second half of the year.

The general index of producer prices rose by 2.4% in the past 12 months ending in May. This year-on-year change rate meant a drop of 3 decimals compared with the month before and puts it at the lowest level since March 2004.

Most producer price components contributed to the slowdown in the year-on-year change rate in May. Prices of

Annual change rate in producer prices marks up lowest level since March 2004...

INFLATION INDICATORS

Percentage change over same period year before

	Farm prices	Producer price index					Total	Import prices			GDP deflator (*)
		General index	Consumer goods	Capital goods	Intermediate goods	Energy goods		Consumer goods	Capital goods	Intermediate goods	
2006											
March	-10.2	5.8	3.3	2.0	4.6	16.4	7.2	3.5	-0.1	5.2	-
April	-8.1	5.7	2.9	2.2	5.1	15.4	7.4	2.6	-0.1	6.3	-
May	-3.6	6.6	3.2	2.3	6.1	17.8	7.7	1.6	-0.6	7.8	4.0
June	6.0	6.3	3.5	2.3	6.8	14.6	6.1	0.9	-0.6	7.3	-
July	0.7	6.4	3.6	2.4	7.0	13.9	5.9	0.6	-0.4	9.3	-
August	0.4	5.7	3.2	2.5	7.2	10.2	5.1	0.7	-0.5	8.9	3.8
September	1.1	4.2	2.7	2.5	6.7	4.1	3.2	0.9	-0.3	9.1	-
October	2.3	3.4	2.3	2.4	6.9	0.5	3.0	0.8	-0.2	9.2	-
November	0.8	3.6	2.4	2.5	6.8	1.0	2.4	0.0	-0.4	8.5	3.6
December	-5.8	3.6	2.0	2.6	6.8	2.3	2.3	0.3	-0.3	7.9	-
2007											
January	-6.7	2.7	1.4	2.9	6.3	-1.2	0.6	0.4	-0.3	7.2	-
February	-6.3	2.5	1.4	2.9	6.6	-2.5	0.0	0.3	-0.3	7.1	3.3
March	1.4	2.8	1.8	3.3	6.2	-1.6	0.1	0.2	-0.3	6.7	-
April	...	2.7	2.2	3.2	6.4	-2.6	0.0	0.6	-0.3	5.7	...
May	...	2.4	2.0	3.4	6.0	-2.8	...	...	...	...	...

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

SOURCE: Ministry of Agriculture, Fishing and Food, National Institute of Statistics and own calculations.

...but capital goods prices show highest inflation in past 11 years.

consumer products thus eased their annual advance to 2.0%, 2 decimals less than in April. Intermediate goods also slowed to 6.0% while energy products showed a stronger drop going to -2.8%. On the other hand, prices of capital goods rose to 3.4% in the past 12 months, the highest rate since February 1996, thus reflecting the increased cost of intermediate goods and strong investment demand in recent times.

In addition, thanks to the strength of the euro in April, prices of imported products stood at the same level as in the same month last year, according to figures supplied by the National Institute of Statistics survey of importers. This stabilization of prices was opposed to year-on-year inflation of

7.4% in April 2006, when oil prices were fully on the rise.

Nevertheless, the various components performed in quite different ways. Whereas intermediate goods rose by 5.7% in the past year, energy has dropped by 9.5%. While consumer products have risen by 0.6%, capital goods dropped by 0.3%. Under consumer goods, durable goods were down 2.2% but non-durables rose by 1.5%. On the other hand, the trend in these in the past month has been uneven. Prices of intermediate goods continued to ease but the drop in energy has tended to halt. Capital goods continued to show an annual drop of 0.3% while consumer goods reported something of an increase.

Imported products record zero annual inflation thanks to appreciation of euro.

Information and social exclusion: the digital divide

Just a few years ago, fishermen in Kerala, a region in the south west of India, on coming to land had to make a quick decision about which market where they would sell their day's catch. Fish is a perishable good and once they decided to go to one market they could not change their choice or their catch would go to waste. It could therefore happen that most fishermen would go to the same market making it impossible to sell the whole catch while at the other market nearby there was not enough fish to meet demand. This meant that the price of fish could vary as much as 50% between two points on the coast of the region that were quite close together and that part of the day's catch would have to be thrown out because there was no buyer. Nevertheless, everything changed with the arrival of the cell-phone in 1997. From then on the fishermen who decided to buy cell-phones could obtain information about demand and supply of fish at the various markets along the coast when they were still at sea and they went to the market offering the best results. Many of them even sold their fish before tying up at quayside. Access at this new technology resulted in big income differences between those fishermen who had cell-phones and those that lacked them. This case, presented by Robert Jensen in a result study, shows the importance of the use of information technology in matters of productivity as well as being a good example of what has become known as the «digital divide».⁽¹⁾

The digital divide is a term to describe the disparity that exists in access to information and communication technology (ICT). Within a country we may find this disparity between different socio-economic groups, ethnic or geographical groupings. In developing countries these differences frequently occur between urban areas, with better digital communications infrastructures, and more isolated rural areas. The *e-choupals* in India, centres with a computer and Internet connection located in rural areas that provide information on agricultural prices in real time, are an example of investment aimed at narrowing the divide with the cities. Thanks to these establishments, small farmers can learn the prices of the crop they are producing and avoid being tricked by farm intermediaries, something that constantly used to happen before the arrival of the digital kiosks.

Differences in digital technology between regions also occur in the industrialized countries, as is the case of Spain, although in these countries this concept at first appeared to be linked to socio-economic groups. At the beginning of the Nineties, the then US president Bill Clinton was one of the first to draw attention to the problem of the widening digital divide between socio-economic groups in the United States. Specifically, he noted that private schools were more likely to provide their students with computer and Internet access than public schools and stressed the negative consequences that this had on the Afro-American population. The economic gap already existing between the two types of young people going to the different categories of school was widening even more as it was the «rich kids» (also largely white) who had greater access to and knowledge of the new ICT.

On the other hand, the concept of the digital divide is also used in a context where different countries are being compared, in which case we talk of the global digital divide. Specifically, the richer and more industrialized countries have greater and better access to ICT and this advantage may mean that existing economic differences between advanced countries and developing countries are more difficult to reduce and may even increase. In a similar way, in the group of advanced countries we also find different levels of access, making it more difficult for those countries left behind in this new information «race» to reach the economic levels of those countries in the lead. This situation is exactly what we find in Spain.

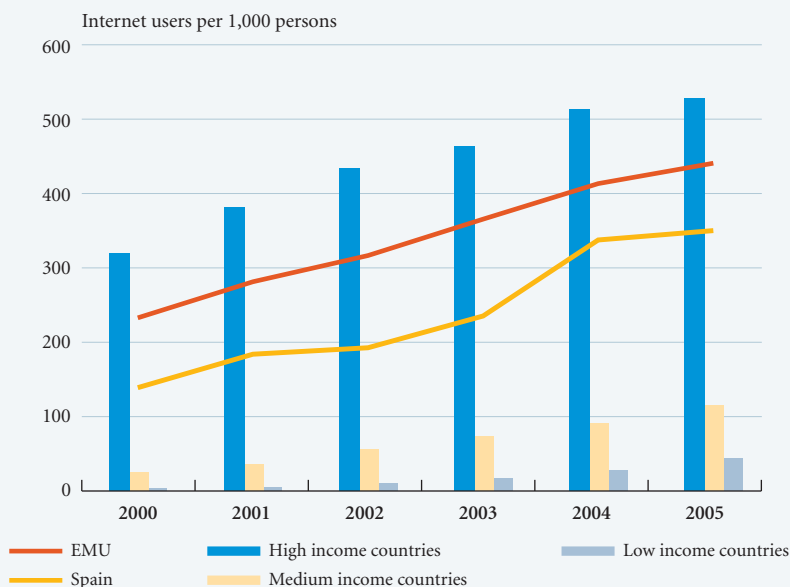
(1) Jensen, Robert, August 2007, «The Digital Provide: Information (technology), market performance and welfare in the South Indian fisheries sector» (Forthcoming publication in *Quarterly Journal of Economics*).

Nevertheless, before looking at the case of Spain, it would be of interest to further examine ICT and its importance as a growth generator. For this purpose, we go back to the study of the fishermen who, as well as helping us to understand the concept of digital divide, shows the importance of information and communications as basic instruments for the good functioning of the market. In other words, if we understand the market as a place where two groups of individuals meet (the buyers who represent demand and sellers who make up supply) and where prices are not anything more than a signal that coordinates the desires of both groups, if information does not flow properly this may create an excess of supply or demand. Jensen shows empirically how cell-phones improved coordination problems that had been causing market failures in the fish market in Kerala by reducing the high volatility of prices and avoiding the cost involved in throwing out part of the catch. The use of this new technology raised the efficiency of this market and the investment of the parties involved. In fact, cell-phones fostered economic growth. In the case of developed countries such as the United States, the adoption of ICT has contributed to the sharp growth in productivity in the past decade.

Having clarified the broad results of access to ICT, we shall proceed to look first at the situation of Spain in the information technology «race» compared with the countries of the Economic and Monetary Union (EMU). Secondly, we shall see whether there exist major differences in accessibility within its population.

There are a number of indices that attempt to measure the degree of ICT development by country. One most frequently quoted is the number of Internet users per thousand population, a measurement in which Spain stands fairly well below the EMU average (see accompanying graph). Specifically, in 2004, some 336 persons per 1,000 population in Spain had access to Internet; 412 in the EMU; and 630 in the United States. Nevertheless, to draw conclusions about the use and development of ICT using only statistics on Internet users would be to oversimplify. *The Economist* and IBM have set up an *e-readiness* index that is more sophisticated and exhaustive and establishes a ranking of 65 countries related to ICT use. This index is based on 100

NUMBER OF INTERNET USERS GROWING BUT NOT CONVERGING WITH EMU



SOURCE: World Development Indicators. World Bank.

quantitative and qualitative criteria classified into 6 different categories – connectivity and technology infrastructure, business environment, consumer and business adoption, legal and policy environment, social and cultural environment and supporting e-services. Spain stood 23rd in this ranking in 2005, just below countries such as France and Japan and ahead of Italy, Portugal and Greece. Compared with 2004 Spain lost a couple of places in the classification. Other indices, such as that appearing in the «Global Information Technology Report» confirm Spain's somewhat backward position in the area of information technology as well as the widening of the digital divide in relation to leading countries in the use of ICT.⁽²⁾ It will be difficult for Spain to catch up to the richer countries of Europe if it does not move ahead in accessibility and adoption of the new information and communication technologies.

INTERNET USERS

Percentage of all persons 16-74 years of age

	2004	2006 (1st wave)	Increase (percentage points)
Madrid Community	49.5	58.6	9.1
Catalonia	47.6	53.2	5.6
Basque Country	45.9	47.9	2.0
Navarre	45.8	50.2	4.4
Balearic Islands	44.1	54.4	10.3
Aragon	42.8	46.9	4.1
La Rioja	42.2	46.4	4.2
Canary Islands	41.5	46.6	5.1
Asturias	39.7	49.7	10.0
Valencian Community	38.3	45.7	7.4
Cantabria	37.7	48.6	10.9
Murcia	37.5	45.4	7.9
Castile-Leon	37.2	45.8	8.6
Extremadura	33.3	34.5	1.2
Galicia	32.5	41.9	9.4
Andalusia	32.5	42.0	9.5
Castile-La Mancha	32.0	40.0	8.0

By level of studies completed

	2004	2006 (1st wave)	Increase (percentage points)
Primary school education	6.7	11.9	5.2
First level secondary school	26.4	37.1	10.7
Second level secondary school	61.2	66.7	5.5
Higher level trade vocational school	64.7	71.5	6.8
Higher education	83.1	87.9	4.8

SOURCE: INE.

(2) *World Economic Forum*, «The Global Information Technology Report 2006-2007», Basingstoke: Palgrave Macmillan.

With regard to the different degree of accessibility to ICT in Spain, we shall concentrate on regional disparities and the differences in the level of studies completed. We note that the autonomous communities with the highest per capita income are those with the highest percentage of Internet users. According to figures from the National Institute of Statistics (INE) for 2006, Madrid Community, the Balearic Islands and Catalonia were the autonomous communities with the largest percentage of persons accessing Internet. Compared with 2004 and using only this indicator of Internet users, the divide between the autonomous communities does not appear to have increased. With regard to access to Internet by level of studies completed, we should not be surprised to find that the percentage of users among those persons with higher education is much greater than all others. In any case, the large increase in accessibility of the large group of persons with first level secondary school education is not to be dismissed. This went from 26.4% in 2004 to 37.1% in 2006. Therefore, the digital divide arising from the level of studies completed does not seem to have widened either.

In conclusion, every day it becomes more important, both for individuals and countries, not to miss the boat on new information technology. To do so would mean giving up major gains in productivity and risking the exclusion of a segment of society.

Foreign sector

Trade deficit continues to ease

In the first four months of 2007, exports of goods and services reported nominal growth of 7.5%, one decimal more than imports. Export prices were up 3.5% putting the real increase at 3.9%. On the other hand, the slight increase in import prices (0.3%) meant that the real rise was 7.0%, twice that for exports.

In the period under consideration, the trade deficit came to 29.98 billion euros, 7.1% higher than the figure for one year earlier. Growth of the trade deficit continued to ease although this was thanks entirely to the easing of the negative figure in the energy balance.

Growth of the deficit generated by non-energy goods stabilized, as may be seen in the following graph.

From January to April, nearly all export sectors showed a positive performance. In nominal terms, sales of capital goods were up 5.3% year-on-year and those for cars rose by 7.6%. Both sectors reached a share of total exports close to 20% each. Other groups to record notable growth were those in food and chemical products, showing increases above 9%.

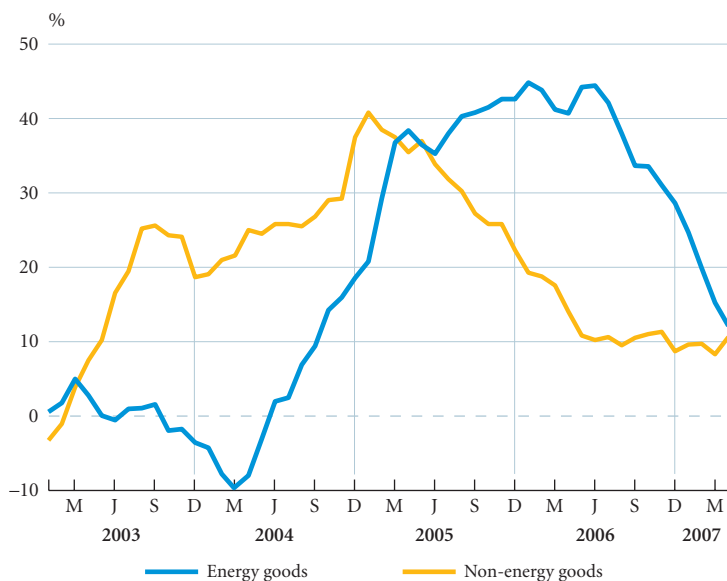
With regard to imports, we should mention the increase in value of capital goods purchases (12.7% year-on-year)

Growth of trade deficit slowed down by lower negative contribution from energy balance.

Capital goods sectors and motor vehicles take up 40% of sales abroad.

GROWTH OF NON-ENERGY TRADE DEFICIT STABILIZING

Year-on-year change in cumulative trade deficit for 12 months



SOURCE: Ministry of Industry, Tourism and Trade and own calculations.

FOREIGN TRADE

January-April 2007

	Imports			Exports			Balance	Export/ Import ratio (%)
	Million euros	% annual change in value	% share	Million euros	% annual change in value	% share	Million euros	
By product group								
Energy products	12,382	-8.1	13.8	2,110	-17.9	3.5	-10,272	17.0
Consumer goods	24,573	4.7	27.5	22,108	7.3	37.1	-2,466	90.0
<i>Food</i>	4,726	11.7	5.3	7,383	8.0	12.4	2,657	156.2
<i>Non-foods</i>	19,847	3.0	22.2	14,725	2.6	24.7	-5,122	74.2
Capital goods	9,741	13.3	10.9	5,406	-0.6	9.1	-4,335	55.5
Non-energy intermediate goods	42,809	13.2	47.8	29,905	11.8	50.2	-12,904	69.9
By geographical area								
European Union EU-25	53,463	7.6	59.7	42,790	7.9	71.9	-10,673	80.0
<i>Euro area</i>	44,534	7.7	49.8	34,412	9.0	57.8	-10,121	77.3
Other countries	36,043	7.0	40.3	16,739	6.6	28.1	-19,304	46.4
<i>Russia</i>	2,669	17.3	3.0	589	40.6	1.0	-2,080	22.1
<i>United States</i>	3,122	7.3	3.5	2,431	2.1	4.1	-691	77.9
<i>Japan</i>	2,082	11.4	2.3	440	-2.9	0.7	-1,641	21.2
<i>Latin America</i>	4,557	3.2	5.1	3,402	8.9	5.7	-1,155	74.6
<i>OPEC</i>	6,544	-9.3	7.3	1,598	15.1	2.7	-4,946	24.4
<i>Rest</i>	17,069	13.9	19.1	8,278	4.4	13.9	-8,791	48.5
TOTAL	89,506	7.4	100.0	59,529	7.5	100.0	-29,977	66.5

SOURCE: Department of Customs and Special Taxes and own calculations.

Increased volume of trade with European Union.

boosted by the drive seen in investment in Spain and in consumer durables (14.7%) in keeping with the growth rate of consumption. The value of energy products bought was down by 8.3% because of the drop in cost of oil and oil-derivatives.

From a geographical point of view, the increase in exports to the European Union (7.9%) went above that for all other countries (6.6%) although in the latter group the increases in sales to Russia (40.6%) and the OPEC countries (15.1%) were of note. In this way, the increase in Spain's purchases from the European Union (7.6%) was higher than those going to all other countries (7.0%).

Current account balance deficit holds at 88 billion euros.

Balance of payments: trade deficit stabilizing

In the first three months of the year, the deficit in the current account balance was 25.49 billion euros, some 3.37 billion euros higher than the result for the same period last year. The trade deficit is tending to ease and has been showing a downward trend since the end of last summer. While it still represents nearly two-thirds of the current account deficit, it contributed only 565 million euros to the worsening of the current account balance. On the other hand, the worsening of 2.34 billion euros in the incomes balance explains two-thirds of the increase. Also taking on new significance is the deficit

in the current transfers balance which, in the period under consideration, underwent a worsening of 368 million euros.

In financial account, we note an improvement in the negative balance of direct investment but this is less drastic than what we see in the year-on-year comparison due to the substantial base effect. This was due more to a slowdown in foreign investment abroad than the entry of funds from outside.

Seen more from a trend point of view, in the past 12 months ending March 2007, the cumulative deficit in the current account balance was 88.11 billion euros, thus repeating the figures for February and adding 17.32 billion euros to the

negative balance for the same period the year before. This drop accounts for 49% of the increase in the trade deficit whereas one year ago it was 73%. The rest may be attributed to the sum of the incomes balance and the current transfers balance whose negative contribution should go up in view of more recent trends.

With regard to financial account, in the 12 months ending in March, net direct investment outflows amounted to 31.53 billion euros, very much in line with the month before and now leaving out the distorting figure for February 2006. Both outflows and inflows for direct investment, however, continued to show a definite downward trend.

Lower downside in trade deficit compensated by increase in net outflows for current transfers and incomes.

Drop in flows for direct investment, both in and out.

BALANCE OF PAYMENTS

March 2007

	Cumulative for year		Last 12 months		
	Million euros	% annual change	Million euros	Annual change	
				Absolute	%
Current account balance					
Trade balance	-19,247	3.0	-80,708	-8,495	11.8
Services					
<i>Tourism</i>	4,677	3.8	27,614	1,159	4.4
<i>Other services</i>	-1,775	17.4	-5,564	-912	19.6
Total	2,902	-3.1	22,050	247	1.1
Income	-6,115	62.1	-23,327	-6,322	37.2
Transfers	-3,026	13.8	-6,121	-2,755	81.9
Total	-25,486	15.2	-88,106	-17,325	24.5
Capital account	1,534	77.7	6,845	-1,054	-13.3
Financial balance					
Direct investment	-5,364	-81.7	-31,528	4,992	-13.7
Portfolio investment	52,834	11.3	203,665	124,761	158.1
Other investment	-17,326	-	-69,533	-109,573	-
Total	30,145	-13.4	102,605	20,181	24.5
Errors and omissions	-385	-87.5	-217	5,471	-96.2
Change in assets of Bank of Spain	-5,808	-44.6	-21,127	-7,273	52.5

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

SOURCE: Bank of Spain and own calculations.

Public sector

Central government revenue grows four points more than nominal gross domestic product.

Little initial impact of personal income and company tax reforms on collections.

Tax reductions fail to depress central government revenue

The central government continues to swell its coffers at a good pace thanks to revenue which has scarcely been affected by the changes in personal income tax and company tax. Over the period January-May central government non-financial revenue rose to 65.52 billion euros, an increase of 12.8% over the same period in 2006. If we include the share of personal income tax, value added tax (VAT) and special taxes of the regional and local governments, the rate would be 12.0%, four points higher than the growth of nominal gross domestic product (GDP).

In the first five months of the financial year, personal income tax provided 29.54 billion euros, 12.3% more than in the same period the previous year. Hold-backs on wages rose considerably owing to higher pay. We should point out that part of the revenue received was not yet affected by the reduction of tax rates under the reform. If we discount that, the change rate is still high, which shows the limited initial impact of the reforms. Moreover, owing to the rise in the withholding rate from 15% to 18% on income from capital, together with the increase in returns on bank deposits and larger dividends paid by companies, withholding tax on capital and investment funds grew spectacularly.

CENTRAL GOVERNMENT BUDGETARY IMPLEMENTATION

May 2007

	Month		Cumulative for year	
	Million euros	% change over same month year before	Million euros	% change over same month year before
Non-financial revenue	3,424	29.5	65,523	12.8
Non-financial revenue adjusted (*)				
Personal income tax	1,745	11.4	29,541	12.3
Corporate tax	477	82.8	8,412	22.2
VAT	1,847	23.3	31,993	9.6
Special taxes	1,536	6.2	7,786	7.9
Other	1,885	19.4	8,120	15.0
Total	7,490	18.0	85,852	12.0
Non-financial spending	8,709	2.1	54,303	7.5
Treasury balance	-5,285	-10.3	11,220	47.6
Surplus (+) or deficit (-) (**)	-6,483	-14.5	14,359	38.7

NOTES: (*) Includes tax segments ceded to regional and local governments under current financing system.

(**) In terms of National Accounting.

SOURCE: Ministry of Economy and Finance and internal figures.

Furthermore, withholding tax on rents also rose sharply.

Meanwhile the Tax Office announced that during the present personal income tax campaign for the financial year 2006 it expected that 17.6 million tax returns would be submitted. That figure is an increase of 5% over the previous year and above all is the result of a larger number of people employed.

The other major heading for direct taxes, company tax, brought in 22.2% more than in the first five months of 2006. This was due to the increase in profits and in withholding tax on capital. The impact of company tax reform through the reduction of tax rates could also be less than initially estimated, to judge by the first figures of the year.

Indirect taxes rose at a considerable pace, 9.1%, though notably lower than direct taxes. The star in this chapter, VAT, brought in revenue of 31.99 billion euros, an increase of 9.6%, in line with the growth of consumption. Special taxes, in turn, rose by 7.9%. The increase of 18.2% in the tax on tobacco is notable. The rise in the tax on fuel was far smaller, 2.6%, affected by the first repayments to farmers and stockbreeders in compensation for the boost in the price of diesel fuel in 2006.

Other non-financial revenues reached 15.0% in year-on-year terms. The profits paid in by the Bank of Spain and capital transfers from European Union funds had a positive influence on this chapter.

Central government cumulative non-financial spending up to May amounted to 54.30 billion euros. That sum

represents an increase of 7.5% over the same period last year. Payments for current transfers rose by 5.6%. Staff costs were up by 6.0% owing to the improvement in salaries in some government departments. Spending on goods and services increased by 17.8%, affected by election expenses, unlike the previous year. Financial spending fell by 11.0% due to a different calendar for payment of interest on the public debt. Meanwhile, real investments rose by 15.0% and capital transfers by 32.8%, continuing the strong trend in investment.

The central government thus recorded a Treasury surplus of 11.22 billion euros in the first five months of the year, 47.6% higher than the same period of the previous year. In national accounting terms, that is recording amounts at the moment rights and obligations, respectively, actually take place, the central government obtained a surplus of 14.36 billion euros in the period January-May, a year-on-year increase of 38.7%. In relation to GDP, the central government surplus was 1.38%, some 0.32 points more than 2006, which shows the excellent trend in the public accounts, thanks largely to the economic boom.

The good accounting results of the public sector do not end here. The budget for 2008, to be submitted shortly after the summer and now in preparation, forecasts a further surplus in the coming financial year, for the fourth consecutive year, which continues the line of budgetary stability. Revenues would increase by 7%, incorporating a 2% reduction in the personal income tax rate. The limit for central government non-financial spending will rise by 6.7% compared with 2007.

Higher wages and income on capital boost personal income tax collections.

Sharp increase in investment spending.

Central government obtains GDP surplus of 1.4% over January-May period.

Savings and financing

Notable increase in loan interest rates in real terms.

Mergers and restructuring of companies and investments continue to raise demand for corporate funding.

Financial institutions toughen loan conditions

The upward move in loan interest rates continues, driven by progressive removal of easy money policies by the European Central Bank. The average interest rate on loans and credits granted to companies and households stood at 5.43% in April, an increase of 109 basis points in the past 12 months. The 1-year Euribor rose to 4.37% in May, an increase of 236 basis points compared with the low in June 2003. No doubt this reference index will continue to rise in June, discounting further increases in the Eurosystem interest rate. In addition, given that the annual inflation rate has dropped in recent months, the 1-year Euribor has risen even more in real terms.

In this environment of rising real interest rates, funding granted to the private

sector continued to ease in April. In any case, the good state of the economy continues to stimulate demand for credit from the private sector, so that the growth rate is nearly twice that for the euro area as a whole. In fact, funding granted to companies and households rose by 20.5% in April compared with the same month last year, a rate 3.7% lower than that recorded in December 2006.

Funding going to non-financial companies slowed more than that granted to households although it still shows a high growth rate. Funding granted to non-financial companies rose by 22.8% over the past 12 months ended April, 5.1 points more than in December. In any case, demand for credit from companies remains high. A number of factors have contributed to the strength of this demand, on the one hand, the reason is investment. Leasing showed

CREDIT GRANTED TO COMPANIES AND HOUSEHOLDS

April 2007

	Total	Change this year		Change over 12 months		% share
	Million euros	Million euros	%	Million euros	%	
Commercial credit	82,064	-3,312	-3.9	5,277	6.9	5.2
Secured loans (*)	978,922	55,946	6.1	188,567	23.9	61.5
Other term loans	442,917	28,328	6.8	92,093	26.3	27.8
Demand loans	34,173	50	0.1	5,727	20.1	2.1
Leasing	42,260	1,547	3.8	5,764	15.8	2.7
Doubtful loans	12,045	1,198	11.0	1,911	18.9	0.8
TOTAL	1,592,381	83,757	5.6	299,339	23.1	100.0

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

SOURCE: Bank of Spain and own calculations.

DEFAULT CLOSE TO ALL-TIME LOW LEVEL

Default rate on credit to private sector



NOTES: In June 2005 there was a break in the statistical series as a result of a change in accounting methodology.
SOURCE: Bank of Spain and own calculations.

an increase of 15.8% in past 12 months. In addition, commercial credit (used to finance working capital) rose by 6.9% in the same period. Also playing part was demand for funding for mergers and company restructuring.

Financial resources granted to individuals continue to ease growth to the point where it marked up an annual change rate of 17.6% in April. This drop was mainly due to the trend in housing loans. These loans rose at an annual rate of 18.1% at the end of the first four months, down 6 points from the figure recorded at the beginning of 2006. The increase in real estate prices also contributed to ease demand for mortgage loans. Loans for other purposes showed a much smaller drop in recent months, although the growth rate of 16.3% is lower than the figure for mortgage loans.

The default rate for loans to the private sector as a whole stood at 0.76% in April,

practically the same level as in the previous three months and only 4 decimals above the all-time low recorded in December 2006. Nevertheless, the financial institutions are not letting down their guard. At least, the «Survey of Bank Loans in Spain» for April 2007 issued by the Bank of Spain shows that the financial institutions toughened their loan conditions slightly. In the first quarter, margins of financial institutions rose and expenses increased, along with securities and commitments. At the same time, the maximum amount lent was down, as well as maturity term. Criteria for approval of home-purchase loans were also substantially toughened, as well as conditions applied to new borrowers, although the maturity term continued to lengthen slightly. Financial institutions also tightened conditions applying to consumer loans and those for other purposes.

In the second quarter, Spanish financial institutions foresee a tightening in

Housing loans slow down more than other funding granted to households.

Financial institutions toughen access to loans and borrowing conditions in spite of low default rate.

Higher wages boost growth of time deposits.

criteria for access to long-term corporate credit. Similarly, the toughening of criteria for household financing is expected to continue both for housing and other purposes. As a result, it can be seen that supply factors are also contributing to the current slowdown in credit to the private sector.

Sharp growth in bank deposits

Bank deposits of households and companies continue to grow at a fast rate. The change rate in the last 12 months ended April was higher than for credits. In absolute terms, however, the increase in deposits continues to be insufficient to finance the high level of loans granted. As a result, financial institutions have largely been obliged to issue bonds to cover this gap in their balance sheets.

The heading to show the biggest increase in the past year was deposits in foreign currency, which benefited from the differences in interest rates in their favour, although the total balance is relatively low. Time deposits also rose notably, by 39.2% in the case of a 2-year

term. This big increase may be explained by the higher interest rates now being paid on such deposits. Average return on time deposits stood at 3.60% in April as against 0.60% for on-demand accounts and savings accounts.

As a result, bank deposits are providing tough competition to other financial products such as participations in mutual funds. Assets of mutual funds rose by 3.3% in the past 12 months ending in May going to 261.03 billion euros, in spite of an average yield of 7.4% in the past 12 months. In fact, in the first five months of the year there were net withdrawals from mutual funds of 339 million euros. The biggest net sales in mutual fund participations in the January-May period took place in guaranteed share-based funds and short-term bond-based funds. On the other hand, there were notable net flows toward guaranteed bond-based funds and European share-based funds.

The yield obtained on mutual funds in the past year ended May showed a high yield in real terms as a result of the decrease in inflation. The medium-term yield on mutual funds was also above

Net sales of mutual fund participations in January-May period...

...in spite of annual yield of 7.4% and positive real return over very long term.

DEPOSITS OF COMPANIES AND HOUSEHOLDS AT CREDIT INSTITUTIONS

April 2007

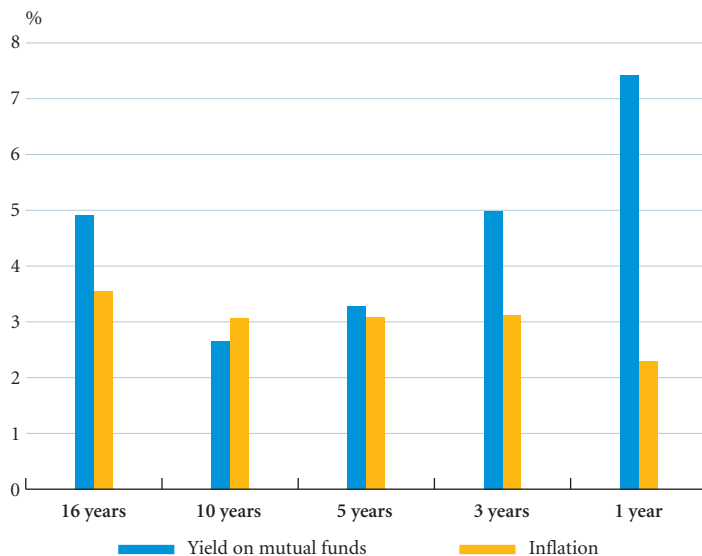
	Total	Change this year		Change over 12 months		% share
	Million euros	Million euros	%	Million euros	%	
On-demand savings (*)	426,551	-21,786	-4.9	29,886	7.5	35.6
Up to 2 years	283,327	36,921	15.0	79,731	39.2	23.7
More than 2-year term	363,518	30,669	9.2	90,777	33.3	30.4
Repos	82,903	-921	-1.1	13,167	18.9	6.9
Total	1,156,298	44,882	4.0	213,560	22.7	96.6
Deposits in currencies other than euro	40,549	7,832	23.9	16,772	70.5	3.4
TOTAL	1,196,848	52,715	4.6	230,333	23.8	100.0

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

SOURCE: Bank of Spain and own calculations.

YIELD ON MUTUAL FUNDS ABOVE INFLATION FOR MOST TERMS

Average annual rates up to May 2007



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

inflation. While over 10 years it is true that average inflation has been slightly higher than the average yield on mutual funds, over the longer term (say, 16 years) the yield on mutual funds works out clearly above inflation. As a result, it is maintained that, while the yield on mutual funds fluctuates according to underlying assets (both bonds and shares), with the trend being affected by some volatility, over the long term the real yield is positive.

On the other hand, hedge funds, which are characterized by greater freedom in investment strategies and the possibility of higher returns (while involving greater risk), for some time now have begun to show their face in the Spanish market. According to figures supplied by Inverco, the association of fund managers, the money attracted by hedge funds had risen to 196 million euros at the end of May 2007. At that date, total participants numbered 300.

Hedge funds attract 196 million euros and 300 participants in early stages of showing face in Spanish market.

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"la Caixa" GROUP: KEY FIGURES

As of December 31, 2006

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

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

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

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