APRIL 2009

THE SPANISH ECONOMY

Monthly Report

NUMBER 323

RESEARCH DEPARTMENT

"la Caixa"

Forecast

% change over same period year before unless otherwise noted

	2007	2008	2009	2008				2009	
				1Q	2Q	3Q	4Q	1Q	2Q
INTERNATIONAL ECONOMY			Forecast						Forecast
Gross domestic product									
United States	2.0	1.1	–2.4	2.5	2.1	0.7	–0.8	–1.9	–3.0
Japan	2.4	–0.7	–4.1	1.4	0.5	–0.2	–4.3	–6.0	–5.1
United Kingdom	3.0	0.7	–2.9	2.6	1.7	0.3	–1.8	–2.9	–3.2
Euro area	2.6	0.9	–2.8	2.1	1.4	0.6	–0.5	–3.2	–3.3
Germany	*2.6*	*1.0*	*–3.1*	*2.8*	*2.0*	*0.8*	*–1.6*	*–4.0*	*–3.8*
France	*2.1*	*0.7*	*–2.1*	*2.0*	*1.2*	*0.6*	*–1.0*	*–2.2*	*–2.5*
Consumer prices									
United States	2.9	3.8	–1.0	4.1	4.4	5.3	1.6	–0.1	–2.0
Japan	0.1	1.4	–1.0	1.0	1.4	2.2	1.0	–0.3	–0.9
United Kingdom	2.1	3.6	1.4	2.4	3.3	4.9	3.9	2.2	1.4
Euro area	2.1	3.3	0.6	3.4	3.6	3.8	2.3	1.0	0.4
Germany	*2.3*	*2.6*	*0.8*	*2.9*	*2.9*	*3.1*	*1.6*	*0.9*	*0.6*
France	*1.5*	*2.8*	*0.6*	*2.9*	*3.3*	*3.3*	*1.8*	*0.7*	*0.2*
SPANISH ECONOMY			Forecast						Forecast
Macroeconomic figures									
Household consumption	3.4	0.1	–2.6	2.0	0.8	–0.2	–2.3	–4.3	–2.8
Government consumption	4.9	5.3	4.3	3.7	5.0	6.1	6.3	5.2	4.8
Gross fixed capital formation	5.3	–3.0	–12.3	2.4	–0.8	–4.1	–9.3	–12.4	–15.5
Capital goods	*10.0*	*–1.1*	*–13.0*	*5.2*	*1.8*	*–1.3*	*–9.7*	*–13.0*	*–13.0*
Construction	*3.8*	*–5.3*	*–14.5*	*0.2*	*–3.1*	*–7.3*	*–10.9*	*–14.1*	*–19.6*
Domestic demand (contribution to GDP growth)	4.4	0.1	–4.2	2.6	1.2	–0.2	–3.0	–5.2	–5.2
Exports of goods and services	4.9	0.7	–6.2	4.8	4.4	1.5	–7.9	–11.6	–6.9
Imports of goods and services	6.2	–2.5	–11.2	3.6	1.8	–2.0	–13.2	–18.4	–13.2
Gross domestic product	**3.7**	**1.2**	**–2.3**	**2.7**	**1.8**	**0.9**	**–0.7**	**–2.2**	**–2.8**
Other variables									
Employment	2.9	–0.6	–5.0	1.6	0.1	–0.9	–3.1	–5.1	–5.6
Unemployment (% labour force)	8.3	11.3	17.6	9.6	10.4	11.3	13.9	16.6	17.4
Consumer price index	2.8	4.1	0.1	4.4	4.6	4.9	2.5	0.5	–0.3
Unit labour costs	2.9	3.4	–0.3	4.2	3.6	3.4	2.6		
Current account balance (% GDP)	–10.1	–9.5	–7.1	–12.1	–9.5	–8.7	–7.9		
Net lending or net borrowing rest of the world (% GDP)	–9.7	–9.1	–6.5	–11.2	–9.0	–8.4	–7.6		
Government balance (% GDP)	2.2	–3.8	–7.8						
FINANCIAL MARKETS			Forecast						Forecast
Interest rates									
Federal Funds	5.0	2.0	0.3	3.2	2.1	2.0	0.9	0.3	0.3
ECB repo	3.8	3.9	1.3	4.0	4.0	4.2	3.4	1.8	1.3
10-year US bonds	4.6	3.6	3.0	3.6	3.9	3.8	3.2	2.8	3.1
10-year German bonds	4.2	4.0	2.7	3.9	4.3	4.3	3.5	3.1	2.7
Exchange rate									
$/Euro	1.37	1.48	1.28	1.50	1.56	1.51	1.34	1.30	1.28

Contents

Manufacturing without borders

Manufacturing activity is often associated with annoyances such as noise, pollution and waste, masses of workers being exploited and huge factories blighting the landscape. In the developed economies it is also often considered an activity in decline in view of the increase in «clean» services based on knowledge. Furthermore, it is believed it will inexorably shift to emerging economies in order to take advantage of abundant cheap labour while leaving behind a trail of unemployment in the developed economies. These are common ideas that need to be measured against a different and complex reality. This Monthly Report includes various boxes that underline certain relevant facts which help to explain the importance of manufacturing in Spain's economy, its core role in general economic activity and, of course, the profound changes it is now undergoing.

While it is true that the statistics show a relative drop in employment in manufacturing and manufacturing value added in Spain, it is also a fact that this may be explained by a growing recourse to outsourcing or sub-contracting to other companies of operations that were previously carried out in the manufacturing plant itself, such as logistics, machinery maintenance, training, data-processing, research and development, etc. The vast development of corporate services in recent years is largely the result of the outsourcing of operations that were formerly carried out in the manufacturing plant. In this way, industry achieves increased specialization with improvements in efficiency and productivity, key factors in dealing with the heavy competition the manufacturing sector has had to face. At the same time, this process blurs the distinction between manufacturing and services, increasing the knowledge and technology component in industry while reducing the purely physical component in the production of goods.

Another hugely important change is the international relocation of companies or part of the production process through offshoring. The range of operations given over to offshoring has increased over time, as a result of cheaper transport and communications and advances in technology and logistics. When a company decides to move some stage of its production or all of it abroad this creates a flow of foreign direct investment followed by a flow of international trade in goods and services. The vast growth of trade and foreign direct investment in recent decades is the result of the international relocation of companies, a phenomenon closely related to the globalization of the world market in goods and services and the incorporation of major economies in that market.

What is Spain's position in this scenario of international competition? Compared with other European countries, Spain's quota of world exports has been relatively favourable while relocation of operations has been modest apart from some specific sectors. But, as noted in a recent study by the Ministry of Industry, Tourism and Trade, Spain's position is critical, standing as it does «between a developed world specializing in manufactures that are technology-intensive and another emerging world rapidly gaining ground in such products, while at the same time maintaining its strength in traditional operations». These are operations that on average are low technology-intensive and therefore exposed to an increasingly competitive world. The productivity gap in Spain's economy is a reason for concern and demands the development of a competitive strategy that will overcome structural weaknesses and facilitate the success of companies in this more and more global market.

EXECUTIVE SUMMARY

Under the sign of recession

Is there light at the end of the tunnel? Some indicators would say so, such as stock market rally and bank rescue plan...

Available indicators for the fourth quarter of 2008 and the first quarter of this year show very negative results in terms of international trade, industrial production, increase in inventories and decrease in utilization of production capacity. But these show some sparks of hope that we may now be in the worst part and that the prospect of recovery (the light at the end of the tunnel) is beginning to emerge. This may be deduced from the stabilization of some indicators for the US economy, a rally on the stock market that has now lasted for three weeks and finalization of plans for rescuing US banks. It is to be hoped that the G-20 summit slated for the beginning of April will confirm these expectations.

...but inevitably world economic activity will drop in 2009 for first time in sixty years.

Nevertheless, the current picture remains dark. World economic activity will drop in 2009 for the first time in 60 years. The International Monetary Fund (IMF) has again revised downward its growth forecasts. While in January it expected that world growth would be 0.5%, it now is estimating a drop of between 0.5% and 1%. In order to show the speed of the drop in expectations it should be remembered that barely four months ago the forecast was for growth of more than 2%.

Many central banks cannot lower interest rates any more because they are now practically at zero.

The IMF's analysis underlines the need to restore confidence in order to resolve the crisis and this means more urgently resolving the problems of the financial sector. It also recognizes the effort made to put expansionist government budgetary measures in place although it regrets that the discretional stimulus of the G-20 does not reach 2% of gross domestic product (GDP) it considers needed. It also underlines the need for an expansionist monetary policy that would also directly boost credit to the non-financial sector.

For the moment, the reply of the central banks has been firm. Reference rates stand at all-time lows and in many cases (practically at zero in a number of countries) recourse to less orthodox measures now comes scarcely as a surprise. The European Central Bank (ECB) has also cut its rates and expanded liquidity provided to financial entities but its moves have been more cautious than those of central banks in the United States and United Kingdom. At the beginning of March, the ECB reduced its reference rate by 50 basis points putting it at 1.50%, the same day the Bank of England cut it to 0.50%, while one week later the Bank of Switzerland put its rate at 0.25%.

The efforts of the central banks appear to be producing some results. The sharp liquidity pressures and extreme risk aversion seen last Autumn seem to have been a thing of the past in interbank and monetary markets. On the other hand, foreign exchange markets have seen movements that at times were violent as a reaction to the exceptional monetary and fiscal policies followed in some countries.

We should especially note the recovery in shares throughout March. While in the early days of the month quotations showed sharp drops to new lows in the

cycle, they later moved into a rapid general recovery. As a result, the S&P 500 index and the Eurostoxx 50 hit levels 60% below the highs reached in 2007 only later to recover by 12% and 15% respectively since that low. The US financial system remains the main protagonist with losses of 60% since the beginning of the year while later on it showed a notable rise.

Stock market enjoys rapid general recovery in March...

The recovery on the stock market is in contrast with the figures coming from the real economy. For the United States we foresee a drop of approximately 2.5% in GDP in 2009 which implies an improvement in the second half-year following a very negative start to the year. As mentioned above, some indicators allow us to note some signs of stabilization, as in retail sales, indices for buying and housing starts. But these are weak signs in a context of deep recession. Consumer pessimism and the rise of unemployment make it necessary to keep risks low. Since January 2008 more than 4 million persons have lost their jobs, a record drop in absolute terms. The unemployment rate rose to 8.1% of the labour force, the highest since 1983 and this will continue to grow in coming months.

In the Euro Area too we have revised downward the forecast for the drop in GDP in 2009 which could come close to 3%. This is a worse forecast than that for the United States due to the impact of the slowdown in world trade on some economies and the lower fiscal boost applied, factors to which must now be added the effect of the economic drop in some countries that recently came into the European Union. On the demand side, retail sales continued to drop in January for the eighth month in a row, although somewhat less than in recent months, but the consumer confidence index is far from showing signs of recovery. On the supply side, after sharp drops in November and December, the industrial production index was down by 4.7% in January so that in year-on-year terms the drop now reached 17% while the economic sentiment index for February also showed no signs of improvement.

In Spain, economic activity is also immersed in a context of world recession. Available indices for the first quarter point to a worsening of the recession that Spain moved into in the second half of 2008. While in the fourth quarter the GDP dropped by 0.7% compared with the same period the year before, in the first three months of 2009 the drop looks like at a rate well above 2%.

Household consumption, the biggest component of demand, is showing a weakness not seen for many years. Of special note is the collapse in car sales of nearly 50%. But, while not reaching such extremes, all indicators of household consumption show largely negative levels. This matches the results of the consumer confidence index which in February recorded an all-time low level since the indicator was first prepared in 1986, putting the figure somewhat below the level in the last recession in 1992-1993.

...but growth forecast for United States and Euro Area revised downward.

The main reason for the weakness in consumption was the rise in unemployment which at the end of February affected nearly 3.5 million people, an increase of 50% compared with one year earlier. In any case, we should point out that more than 70% of the registered unemployed enjoy some kind of benefit because of their situation. We expect that the poor trend in consumer spending will continue over coming months but we are confident that in the second half-year there will be an improvement based on the decrease in interest rates linked to mortgage loans and the practical absence of inflation

In Spain, recession worsens in first quarter of 2009.

Consumption and investment show very negative course.

expected on average in 2009, in a context of a general correction of economic prospects.

Investment has also been showing a deeply negative course in the first quarter. Domestic sales of equipment and software in large companies were down 24.8% in January compared with the same month the year before, thus sharpening its decline, and sales of commercial vehicles showed an annual drop of 58.8% in February. The drop in demand, the decrease in utilization of production capacity, the dip in corporate profits and more restrictive financial terms lay behind the fact that companies have reduced their investment projects until they can see a clearer panorama.

On supply side, real estate crisis has now been joined by sharp recession in industry and troubling prospects in tourist sector.

On the supply side, the industrial sector continues to adjust to the contraction of demand mentioned above, both domestic and foreign. Industrial production was down 20.2% in January compared with the same month in 2008, a drop that in the case of capital goods reached 30% while in the manufacture of motor vehicles, tractor-trailers and semis there was a decrease of 54.4%. The immediate prospects are negative in view of the drop in new orders in industry, down 29.7% in January compared with the same month in 2008. In construction, the severe adjustment in the real estate sector is continuing. In January, housing sales were for 37,931 units, a year-on-year decrease of 38.6% while the permits for new building was down by 47.3% in December compared with the same month in 2007. The poor state of tendering for public works suggests that for the moment this is not relieving the crisis in housing construction. In services, there has been a notable drop in the tourist situation given that arrivals of foreign tourists in February were down by 15.9% compared with the same month in 2008 while overnight hotel stays were down 15.5% thus showing a growing drop.

On the other hand, foreign trade deficit and inflation improve.

In this context, it is not surprising that the drop in employment is increasing. Whereas in the fourth quarter of 2008 those registered with Social Security as being employed was down 3.4% at annual rate, in the first quarter the drop stepped up to levels of 6%. The economic authorities have continued to adopt measures to deal with this delicate situation. In March, the central government approved a new line of funding of up to 6 billion euros to finance working capital of medium-sized companies (provided 50% by the Instituto de Crédito Oficial) and it also announced a series of measures to revive employment and ease the effects of unemployment.

Positive aspects in the current economic situation are an improvement in the foreign imbalance and the containment of prices. The worsening of domestic demand made it possible for Spain's trade deficit in 2008 to show a contraction following five years of growth in a row putting it at 8.6% of GDP, a trend that will strongly continue in 2009. With regard to the inflation rate, the consumer price index stood at 0.7% in February, the lowest level since June 1969 while the differential with the Euro Area was negative in terms of underlying inflation for the first time since 2001.

In any case, the prospects, both for Spain's economy and for the world economy, remain pessimistic while risks point downward. However, for the first time since last Autumn, not everything has been negative and some indicators may be pointing to the possibility that the worst could soon be over. Will this be Spring?

March 25, 2009

CHRONOLOGY

2008

March	**9**	Spanish Socialist Workers Party wins **general elections**.
	18	**Federal Reserve** cuts reference rate to 2.25%.
April	**18**	Government approves a **Plan for measures to stimulate the economy**.
	30	**Federal Reserve** reduces reference rate to 2.00%.
July	**3**	**European Central Bank** raises official rate to 4.25%.
	11	One-month forward price of *Brent* quality **oil** goes up to all-time high of 146.6 dollars a barrel.
	15	**Euro** exchange rate hits 1.599 dollars, highest value since launching of European Single Currency at beginning of 1999.
August	**14**	Government puts into effect its **programme of 24 economic measures** for 2008 and 2009.
September	**19**	US government presents **bailout plan for country's banking system** amounting to 700 billion dollars.
October	**7**	Spanish government announces creation of **fund for purchase of financial assets** of financial institutions up to maximum of 50 billion euros and raises guarantee on deposits and investments to 100,000 euros.
	8	**European Central Bank**, **Federal Reserve** and **Bank of England** cut official interest rates by 50 basis points in joint move with other central banks.
	12	Euro Area countries agree on **joint action** to strengthen financial system up to end of 2009.
	13	Government authorizes granting of **government guarantees** up to 100 billion euros in 2008 on new financial transactions of financial institutions with possible extension to 2009.
	28	IBEX 35 index for **Spanish stock exchange** marks up lowest level (7,905.4) since 2004.
	29	**Federal Reserve** cuts reference rate to 1.00%.
November	**6**	**European Central Bank** lowers official interest rate to 3.25%.
	15	Meeting of G-20 in Washington to **reform international financial system**.
	20	Dow Jones index for **New York stock exchange** records lowest level since 2003 (7,552.3).
	28	Government announces 8 billion-euro **public works plan** for municipalities and 3 billion-euro plan for investment in various sectors and economic spheres.
December	**4**	**European Central Bank** lowers official interest rate to 2.50%.
	16	**Federal Reserve** reduces reference rate to band between 0%-0.25%.
	24	Brent quality **oil** price drops to lowest level since July 2004 (37.23 dollars a barrel).

2009

January	**1**	Further enlargement of **Euro Area** with entry of Slovakia making total of 16 member states.
	15	**European Central Bank** lowers official interest rate to 2.00%.
	20	Barack Obama sworn in as **President of the United States**.
March	**5**	**European Central Bank** lowers official interest rate to 1.50%.
	6	Central government announces measures to **facilitate financing of working capital for medium-sized companies** and to **revive employment** and ease effects of **unemployment**.

AGENDA

April

2 Registrations with Social Security and registered unemployment (March).
Governing Council of European Central Bank.
3 Industrial production index (February).
15 CPI (March).
16 Harmonized CPI for EU (March).
22 Foreign trade (February).
23 Producer prices (March).
24 Labour Force Survey (1st Quarter).
28 Central government revenue and spending (March).
Fed Open Market Committee.
29 Retail sales (March).
30 HCPI flash estimate (April).

May

5 Registrations with Social Security and registered unemployment (April).
6 Industrial production index (March).
7 Governing Council of European Central Bank.
8 Trade balance (March).
13 CPI (April). Harmonized CPI for EU (April).
14 Flash GDP (1st Quarter).
20 Quarterly National Accounts (1st Quarter).
25 Producer prices (April).
26 Central government revenue and spending (April).
27 Retail sales (April).
28 Flash HCPI (May).

INTERNATIONAL REVIEW

United States: difficult task of re-establishing confidence

US economy drops by 0.8% and prospects for 2009 grow worse.

The first review of the gross domestic product (GDP) for the fourth quarter of 2008 confirmed that the economy dropped by 0.8% year-on-year, 6.2% quarter-on-quarter annualized. In its report of the summit meeting of ministers and governors of central banks of the G-20, the International Monetary Fund (IMF) modified downward its growth forecasts with an expected 2.6% for 2009 as a whole. According to the IMF, positive growth will not take place until the second half of 2010. But for this to happen two things will be needed. First, that the improvement in financial conditions take place in the second half of 2009 through implementation of a detailed and credible plan for recovery of the financial sector. Also needed is a continuation of policies to support domestic demand, both monetary and fiscal policies. The risks have a downward bias. First, because there is still uncertainty about the valuation of the «toxic» assets of financial entities. Furthermore, because the bill for the fiscal measures will be high. If we exclude the cost of supporting the financial system under the Geithner plan, the IMF

UNITED STATES: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2007	2008	2008				2009	
			1Q	2Q	3Q	4Q	January	February
Real GDP	2.0	1.1	2.5	2.1	0.7	–0.8	–	...
Retail sales	4.2	–0.4	3.2	2.6	0.6	–8.0	–9.0	–8.6
Consumer confidence (1)	103.4	58.0	76.5	57.3	57.3	40.7	37.4	25.0
Industrial production	1.7	–1.8	1.9	0.2	–3.0	–6.1	–10.1	–11.2
Manufacturing (ISM) (1)	51.1	45.5	49.5	49.1	47.4	36.1	35.6	35.8
Sales of single-family homes	–26.8	–37.6	–33.1	–39.1	–36.7	–42.2	–48.2	...
Unemployment rate (2)	4.6	5.8	4.9	5.4	6.1	6.9	7.6	8.1
Consumer prices	2.9	3.8	4.1	4.4	5.3	1.6	0.0	0.2
Trade balance (3)	–700.3	–681.1	–699.2	–701.8	–714.5	–681.1	–658.0	...
3-month interbank interest rate (1)	5.3	2.8	3.0	2.8	3.2	2.2	1.2	1.3
Nominal effective exchange rate (4)	77.9	74.4	72.0	70.9	73.5	81.3	81.0	83.1

NOTES: (1) Value.
(2) Percentage of labour force.
(3) Cumulative figure for 12 months in goods and services balance. Billion dollars.
(4) Exchange rate weighted for foreign trade movements. Higher values imply currency appreciation.
SOURCE: OECD, national statistical bodies and own calculations.

foresees a fiscal deficit of 9.5% GDP in 2009 and 11% in 2010, which could put government debt above 90% of GDP.

On the demand side, the consumer confidence index put out by the Conference Board in February showed new all-time low for the 40 years the indicator has been published, dropping from 37.3 points to 25.0 points, with record drops both in the view of the present situation and future prospects. Latest indicators point to a possible end to the drastic drops seen in the second half of 2008. But tbe downward background remains and is reinforced by the incipient process of reduction of household borrowing which will keep dragging down growth. Retail sales in February showed a better than expected performance with the second month in a row reporting month-on-month rises following five months of decreases, although the gain was much more modest than in January. Excluding cars and petrol (which fluctuate greatly), retail consumption was compared with the same period the year before by 2.9% in real terms. Along the same lines, car sales were down 11.2% in the final five months of 2008 whereas, in the first two months of 2009, they showed a gain of 2.5%.

Consumer confidence at all-time lows but drastic collapses easing off.

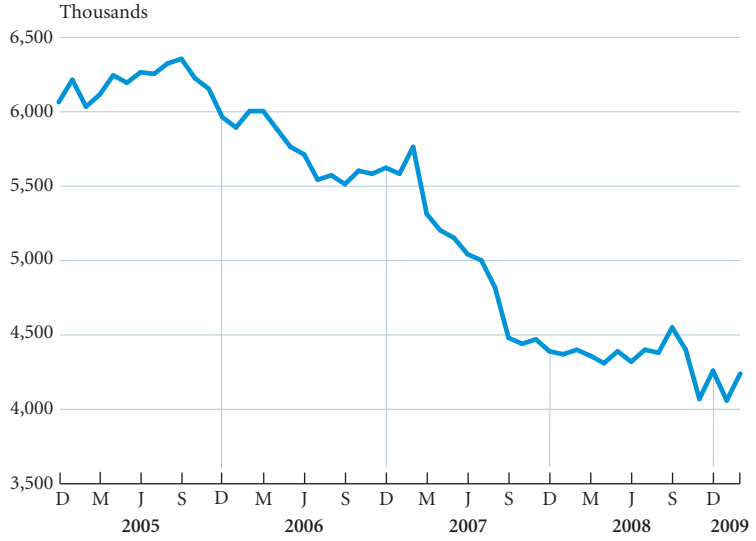
Among supply indicators, the business activity index from the Institute for Supply Management in February held above all-time lows. The manufactured goods index was practically unchanged at the 35.8 points level, still very much below the balance state of 50.0 points that is considered the threshold of risk of recession. In turn, the services index dropped from 44.2 points to the level of 40.2 points. In both cases the weakness in prices and jobs persists. Industrial production, in turn, was down by 11.2% year-on-year in February while utilization of production capacity stood at 70.9%, the lowest figure since the start-up of the indicator in 1967.

Business executives pessimistic especially about employment.

Housing is still showing no signs of recovery. On the demand side, real estate

UNITED STATES: HAVE HOUSING SALES HIT BOTTOM?

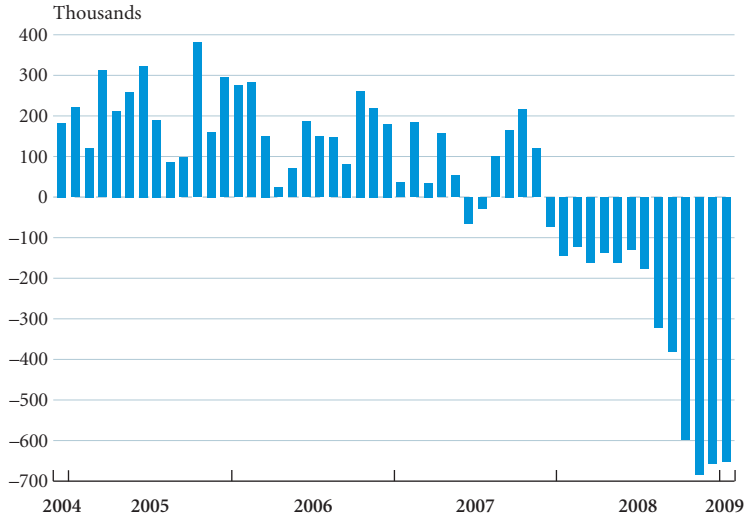
Sales of existing housing in annual terms



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

UNITED STATES: MORE THAN FOUR MILLION JOBS LOST

Net monthly creation (+) or loss (–) of non-farm jobs



SOURCE: Department of Labour and own calculations.

Construction still failing to hit bottom while prices show total drop of 28%.

prices continue to lower the property situation of households. The Case-Shiller index for January showed a drop of 28.3% compared with the high in June 2006 while uncertainty and tightness of credit continued to push down the apparent fund of existing housing sales which dropped by 4.6% year-on-year in February. In the matter of supply, housing starts in February rose to 583,000 in annual terms, 106,000 above the all-time low the month before but far from the 2,200,000 that was the typical level in 2006.

Drop in labour market getting worse with 4.4 million jobs lost since January 2008.

If housing determines the wealth of households, the labour market sets their income and, in this case, the drop continued to grow worse. In February, some 651,000 non-farm jobs were lost. Since January 2008, the month when losses began, some 4,384,000 jobs have been lost, a record decrease in absolute terms that represents 3.3% of total jobs. The unemployment rate also reflected this situation going up to 8.1% of the labour force, the highest since 1983.

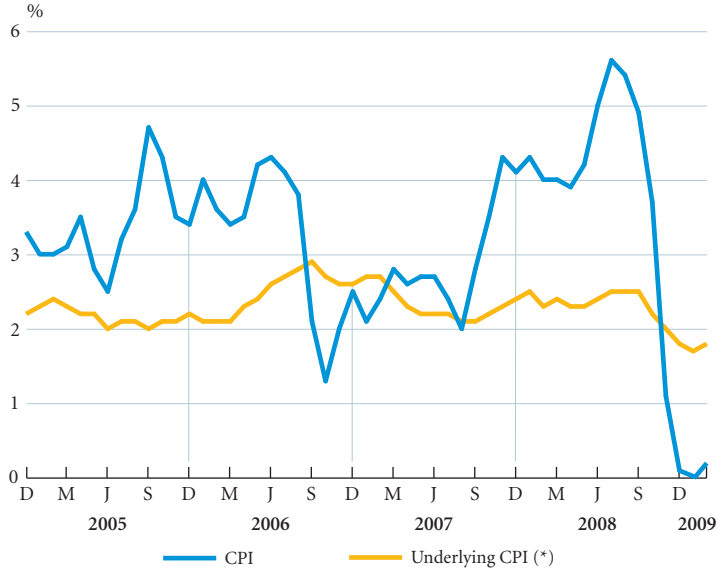
Inflation up but risk of deflation persists.

On the prices front, there are still considerable risks of deflation although latest figures offer some relief. The general consumer price index (CPI) for February rose by 0.2% year-on-year whereas the increase in January was nil. In 2009 it is expected that there will be a drop in CPI largely because of the weakness in demand. To be able to speak of real deflation there would have to be continuous decreases in the underlying index (the general index not including food or energy) and thus not affected by swings in oil prices. In this respect, with two months of month-on-month increases in a row, the underlying index rose slightly to 1.8% year-on-year, thereby moving away for the moment from deflationary trends.

The foreign sector remains troubling, not for the persistent deficit but rather because of the drop in trade. The trade deficit in goods and services continued to drop in January going to 36.03 billion dollars, well below the 56.69 billion in October, a situation that could turn

UNITED STATES: DEFLATIONARY PRESSURE TAKES A BREATHER

Year-on-year change in consumer price indices



NOTES: (*) Underlying index excludes foods and energy.
SOURCE: Department of Labour and own calculations.

around when world trade recovers. The problem is that exports show a drop of 28.5% over five months only to be bettered by the 34.3% decrease in imports, thanks to cheaper petrol.

Trade deficit corrected by drop in volume of trade.

Japan: 2009 looks very difficult

The first revised figures for the GDP confirm that in the fourth quarter of 2008 the GDP dropped by 4.3% year-on-year, 12.1% in quarter-to-quarter terms annualized, of which three-quarters was due to the decrease in exports. This shows Japan's heavy dependence on foreign demand and also underlines the sharp reduction in the volume of world trade. Prospects for 2009 are for an extremely weak economy with a drop of more than 4% in GDP.

Japan's GDP down 4.3% because of foreign sector and investment.

Japan is an export economy whose dependence on demand from the rest of Asia is greater than its dependence on purchases from the United States, which is also heavy. It is precisely its exports to the rest of the Asian continent that have sharpened the downturn in the last four months with decreases of the order of 45%, including sales to China.

The crisis in world trade is sharply shown in latest supply indicators. Industrial production in January continued its downward spiral, the biggest since 1945, with a drop of 30.0% year-on-year over the past three months. The drop in machinery orders, an early indicator of investment, was even sharper with a decrease of 53.3% year-on-year in January. The sharpest decreases again hit the export sector, practically half of the total, which was down 71.2% year-on-year. The number of companies going bankrupt, which in 2008 reached its highest level since 2003 continued to rise in the first two months of 2009 and indicates some of the difficulties being experienced by

Industrial production down 30% reflecting recession in durable goods.

JAPAN: MAIN ECONOMIC INDICATORS

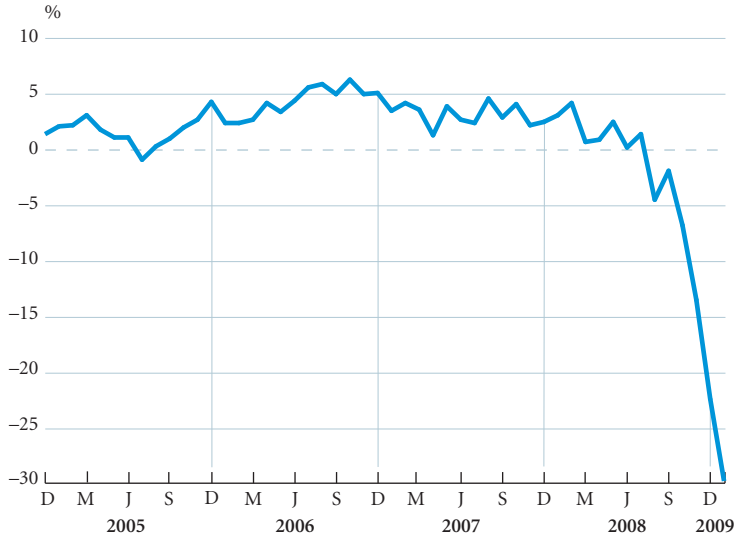
Percentage change over same period year before unless otherwise indicated

	2007	2008	2008				2009	
			1Q	2Q	3Q	4Q	January	February
Real GDP	2.4	–0.7	1.4	0.5	–0.2	–4.3	–	...
Industrial production	2.9	–3.3	2.5	1.0	–1.9	–14.4	–30.0	...
Tankan company Index (1)	22.0	–2.8	11.0	5.0	–3.0	–24.0	–	...
Housing construction	–17.2	2.4	–8.8	–11.1	40.3	3.9	–18.7	...
Unemployment rate (2)	3.9	4.0	3.8	4.0	4.0	4.0	4.1	...
Consumer prices	0.1	1.4	1.0	1.4	2.2	1.0	0.0	...
Trade balance (3)	12.6	4.0	11.7	10.3	7.4	4.0	2.7	...
3-month interbank interest rate (4)	0.7	0.8	0.8	0.8	0.9	0.8	0.7	0.7
Nominal effective exchange rate (5)	77.1	86.6	83.4	82.6	81.9	98.5	105.1	...

NOTES: (1) Index value.
(2) Percentage of labour force.
(3) Cumulative balance for 12 months. Trillion yen.
(4) Percentage.
(5) Change weighted for foreign trade movements. Higher values imply currency appreciation. Average in 2000 = 100.
SOURCE: OECD, national statistical bodies and own calculations.

JAPAN: INDUSTRIAL PRODUCTION PLUMMETS

Year-on-year change in industrial production



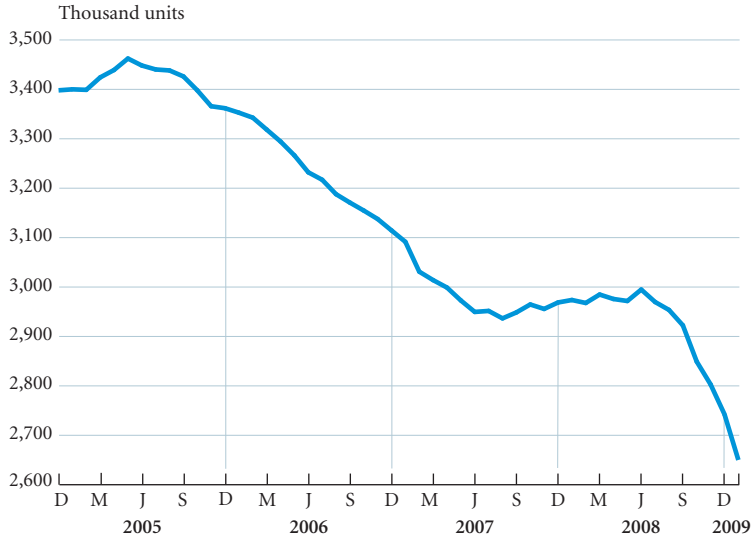
SOURCE: Japanese Ministry of Communications, National Statitistics Office and own calculations.

Japanese manufacturers, which could grow worse if the practical freeze-up of exports should persist.

On the demand side, the decreases have not been as sharp but the slack seen in 2008 is continuing, which makes it difficult to believe that, over the short

JAPAN: DOMESTIC CONSUMPTION FAILS TO HELP

Car sales in past 12 months



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

term, domestic consumption will take over from the foreign sector to revive the economy. In this context, retail sales in January were down 2.4% year-on-year, while car sales in February dropped by 32.2% compared with the same period the year before, which continues on a tendency that has been happening since mid-2005.

With regard to prices, Japan's economy seems condemned to repeat the deflationary process from which it was so difficult to emerge. The January CPI recorded a nil increase compared with the same period last year whereas just four months earlier it was close to 2.1%. It was the underlying index (the general index less energy and food) with a decrease of 0.2% year-on-year that sounded the alert. In marked contrast to the other indicators, the labour market showed how the unemployment rate, that dropped by two decimals to 4.1% of the labour force because many unemployed persons were so dispirited they did not register on the unemployed lists.

Lower demand and, especially, the credit crisis, which means increased difficulty in getting payment, continued to cause distress in the foreign sector, which, in January, showed a deficit for the sixth month in a row. Exports showed sharper decreases to the point where they dropped by 46.9% year-on-year while imports in December were down 32.9% in December. On top of the trade deficit in January came the drop in revenues because of the appreciation of the yen and lower profits from foreign investments, which brought about the first current account deficit in the last 13 years, something that could get worse in coming months.

Investment shows worsening prospects while real estate market remains weak.

Inflation moves onto negative ground and exports down by 47%.

Drop in exports cooling down China

The Chinese economy grew by 6.8% year-on-year in the fourth quarter of 2008, growth which, according to the World Bank, should continue in 2009 with an increase of 6.5% expected. Nevertheless, the government is

China slowing down to 6.8% growth because of drop in exports.

CHINA: MAIN ECONOMIC INDICATORS

Percentage change over same period year before, unless otherwise indicated

	2007	2008	2008				2009	
			1Q	2Q	3Q	4Q	January	February
Real GDP	13.0	9.1	10.6	10.1	9.0	6.8	–	...
Industrial production	17.1	13.0	16.5	15.9	13.0	6.4	3.8	11.0
Electrical power generation	15.7	6.7	16.0	11.9	6.7	–6.0	–14.1	4.8
Consumer prices	4.8	5.9	8.0	7.8	5.3	2.5	1.0	–1.6
Trade balance (*)	262.4	295.1	256.5	247.3	257.0	295.1	314.8	311.5
3-month interbank interest rate (**)	3.6	4.2	4.6	4.6	4.4	3.2	2.5	1.3
Renminbi to dollar	7.6	6.9	7.1	6.9	6.8	6.8	6.8	6.8

NOTES: (*) Cumulative balance for 12 months. Billion dollars.
(**) Percentage.
SOURCE: National Statistics Office, Thomson Reuters Datastream and own calculations.

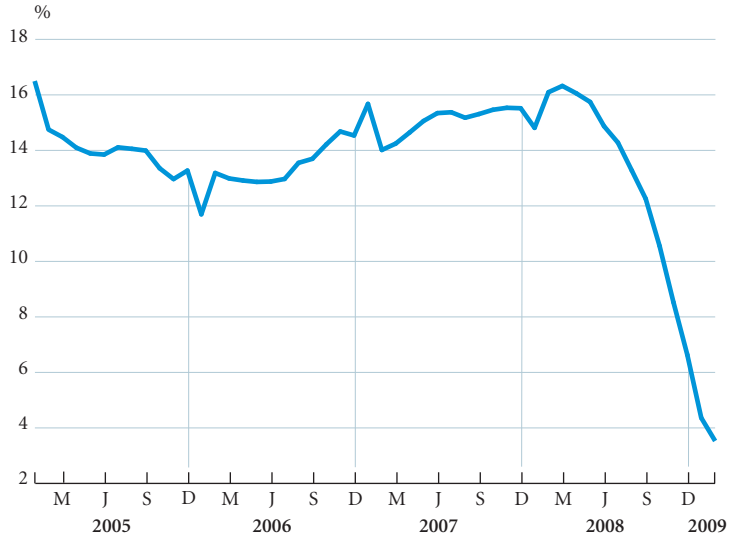
Exports down 25.7% and imports drop 24.6%.

expecting growth of 8.0% which is the minimum increase needed to avoid problems of unemployment in a labour market such as that of China which has large reserves of unskilled labour and must give employment to six million new university graduates each year.

The weakness of the foreign sector, however, will make it difficult to meet this objective. The trade surplus in February was 4.84 billion dollars, a fifth of the norm in 2008. More important than the balance is the drop in exports. Exports, which at the end of 2008 made up 32.8% of the economy, were down

CHINA: INDUSTRY SLOWING DOWN

Year-on-year change in electrical power generation (*)



NOTES: (*) Total for last 12 months.
SOURCE: Chinese National Statistics Office, London Market and own calculations.

25.7% year-on-year in February. Imports in turn were down no less than a whopping 24.6%. By destination, those going to the rest of Asia, which represent 43.1% of all Chinese exports, have been hit most with a decrease of 22.4% year-on-year in January. Those going to Europe, a quarter of the total, were down 18.9% while those for the United States, a fifth of the total, were down a more moderate 9.8% seeing that the slowdown in these had begun earlier.

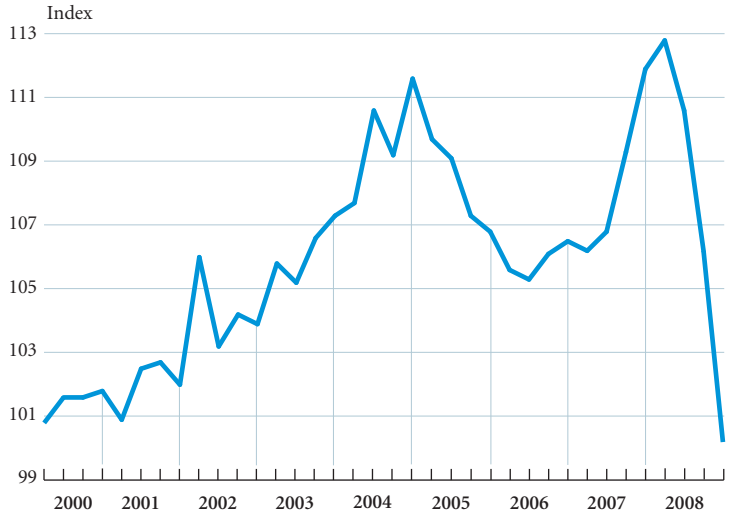
By product, because of the drop in oil prices, the biggest decreases in January showed up in commodities. Exports of manufactured goods and commodities dropped by 19.2% and 49.7% year-on-year respectively, while in the case of imports the decreases were 49.0% and 50.0% respectively. The rapid worsening of economic conditions is also showing up in other economies of the region which have also seen major decreases because of their dependence on the export of manufactured goods. The GDP of South Korea and Taiwan were down by 3.6% and 8.4% year-on-year respectively in the fourth quarter whereas Malaysia grew by 0.1%. In quarter-on-quarter terms annualized, the decreases were of the order of 20%. These figures were similar to the trend in industrial production in January which in these three countries was down by 21.2%, 34.6% and 20.2% respectively in year-on-year terms.

The slowdown may be noted in the most recent indicators of industrial activity. On the supply side, industrial production was up by 3.8% year-on-year in January and 11.0% in February. This disparity showed up because in February there were five more working days than in January, in contrast to the year before, because of the Chinese lunar New Year. No counting this distortion, what remains is a clear slowdown in industry which, up until the summer of 2008, was consistently growing by more than 15%. This slowdown was also notable in national generation of electrical power which in the last 12 months ending in February grew by a slim 3.5% year-on-year whereas, up to October 2008, the

Slowdown in Far East rapid and severe as result of dependence on manufactured goods exports.

CHINA: HOUSING PRICES IN FAR EAST ALSO DROPPING

Existing housing price index



SOURCE: Chinese National Statistics Office and own calculations.

With prices down 1.6% and real estate market in decline, economic policy is clearly expansionist.

growth rate had been above 10%. The real estate sector is also suffering from signs of slowdown. The price of existing housing in the fourth quarter of 2008 was down 8.4% year-on-year while residential housing dropped by 10.5%. With a similar behaviour, the price of land was down 6.4% while sales of commercial properties dropped by 13.7% year-on-year.

Brazil and Mexico confirm state of economic recession...

In prices, the inflationary pressures in mid-2008 have rapidly changed into risks of deflation. The general CPI for February was down 1.6% year-on-year while food prices dropped 1.9%. With the moderation of prices and the downturn in economic activity the central bank has increased the money supply with an M2 showing growth of 20.4% year-on-year in February while the volume of bank loans in January and February was similar to the total for the last nine months of 2008. Fiscal expansion in China is one of the largest in the world economy. According to the IMF, with relatively small automatic stabilizers, the discretional increase in spending for the 2008-2010 period is expected to be 2.1% on average of the annual GDP. If there is a drop in exports, in order to reach the growth objective of 8.0%, China will have to revive private consumption. To do this it will have to transfer resources from export companies to health and social services in the rural areas, although the lack of flexibility makes it difficult too see such changes to taking place rapidly.

...and early economic activity indicators show that GDP continues to contract.

Brazil and Mexico: currencies give up to pressures

The global nature of the financial crisis and its transfer through world trade has meant that the economic contraction is running as if it were exceptionally well synchronized. The growth of Latin America, along with other emerging and developed economies, in the final quarter of 2008 brought a negative surprise. Brazil and Mexico were no exception. Brazil's GDP contracted by 3.6% in quarter-on-quarter terms while that of Mexico showed a contraction of 2.7%.

Unfortunately, early demand indicators for January show a dark picture. Consumer confidence in Brazil, while it recovered in February, is showing negative background trend. The confidence of Mexican households in February showed the lowest level since April 2001, indicating that, in view of the problems in the economy, households

MAIN ECONOMIC INDICATORS

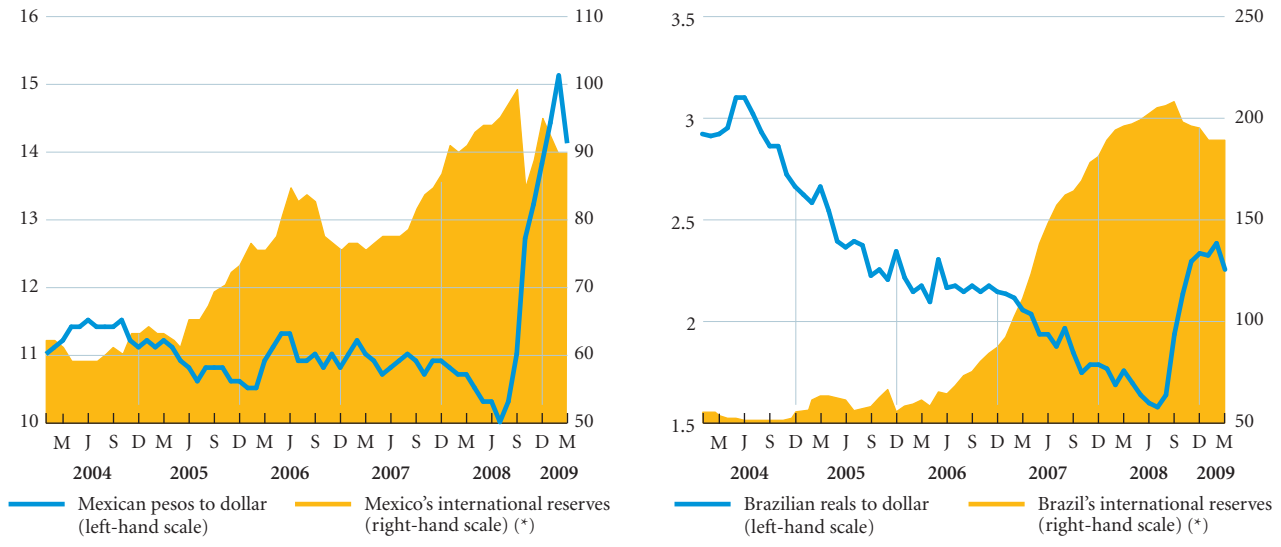
Percentage change over same period year before unless otherwise indicated

	2007	2008	2008				2009	
			1Q	2Q	3Q	4Q	January	February
Brazil								
Industrial production	5.9	4.8	6.7	5.2	6.4	–6.2	–15.2	...
Consumer confidence	132.3	141.5	146.0	146.5	136.3	132.9	124.4	132.9
Consumer prices	3.6	5.6	4.6	5.6	6.3	6.2	5.8	5.9
Mexico								
Industrial production	2.4	3.7	2.0	0.0	–1.5	–4.4	–10.4	...
Consumer confidence	102.4	98.3	99.6	91.8	84.8	79.2	81.9	78.9
Consumer prices	4.0	4.9	3.9	4.9	5.5	6.2	6.3	6.3

SOURCE: Bank of Mexico and own calculations, Instituto Brasileiro de Geografia e Estatistica and Banco Central do Brasil.

BRAZIL AND MEXICO: LEVEL OF INTERNATIONAL RESERVES PROVIDES STABILITY IN BALANCE OF PAYMENTS

Foreign exchange rates and international reserves



NOTES: (*) Billion dollars.
SOURCE: Datastream and own calculations.

will continue to restrict their spending. Industrial confidence also collapsed going to an all-time low.

On the supply side, the industrial production indices have collapsed and give no signs of having hit bottom. Industrial production in Brazil was down by 15.2% year-on-year in January to show three months in a row with decreases. Industrial production in Mexico dropped by 10.4% year-on-year in January. Mexico's industrial sector recorded four consecutive months with increasing drops.

In prices, the short-term and medium-term risks are for a drop due to the weakness of demand. In February, year-on-year inflation in Brazil was down 0.5% from the high in July 2008 to stand at 5.9%. In Mexico, the growth of prices eased in the three months since December, a date when it hit a ceiling of 6.5% year-on-year. In both economies, weak growth (well below potential) along with the sharp correction in the price of commodities has created downward pressure on prices that has more than compensated for the impact of the depreciation of their currencies on inflation.

The sharp depreciation of the Brazilian real and the Mexican peso is being closely watched by the authorities for two reasons. First, a major depreciation can turn into a factor of pressure on domestic prices, which could limit the possibility of continuing with the intrest rates cuts. Secondly, the monetary authorities believe that the loss of value of these currencies does not seem to be entirely supported by economic fundamentals.

The depreciation in terms of the dollar taking place in Brazil and Mexico is not an isolated case but rather is common in the majority of emerging countries. What is exceptional in Brazil and Mexico is that the depreciations reached 48%

Easing of inflation allows central banks margin for manoeuvre.

Brazilian real and Mexican peso depreciate 48% and 41% respectively against dollar since august 2008...

and 41% respectively between August 2008 and March 2009. Part of this depreciation is natural due to the worsening terms of trade, lower growth and the reduction of interest rates, but the fundamentals of these economies continue to be strong.

The world financial situation, characterized by high risk aversion, will mean that both Brazil and Mexico will see their net capital inflows greatly diminished in 2009. In this context, everything would suggest that the balance of payments for both economies could show a deficit of some 10 billion dollars for Mexico and 12 billion dollars in the case of Brazil. In any case, both figures are well below the reserves held by their central banks which, in the case of Mexico amount to 90 billion dollars and 185 billion for Brazil.

...although vulnerability of their foreign positions is low.

The most usual ways of evaluating international reserves suggest that the position of both countries is relatively comfortable, especially for Brazil. First of all, the ratio between reserves and imports shows that Brazil could cover some 14 months of imports with its international reserves while Mexico could cover 4 months. While the figure for Mexico stands in the lower segment considered as a safe cushion for this indicator, according to IMF figures for that country, its reserves cover 145% of its short-term foreign debt or more than 100% of its financing needs for 2009. For Brazil, it is estimated that its reserves cover more than 150% of its short-term foreign debt. All of this suggests that both countries will be able to ride out the present situation without having to face a balance of payments crisis. No doubt, the process of fiscal consolidation taking place in both countries in recent years has been a key in this matter.

If the international recession should get worse than expected making access to world financial markets more difficult, Brazil and Mexico could also take advantage of access to lines of funding from international financial institutions (such as the IMF and the World Bank). The strength of its macroeconomic policies in recent years ensures them practically unconditional access to these sources of funding. Nevertheless, it could be expected that, in an extreme situation that increased pressures on their currencies, their margin for easing monetary policy could disappear and even that their central banks could be obliged to increase interest rates, something that would worsen the recession.

Fragmentation, outsourcing, offshoring... what do we mean?

The constant improvements in transport and communications have radically changed the organization and structure of companies, dividing them up and globalizing them. As a result, a series of phenomena has arisen about which there is some confusion. Terms like outsourcing (subcontracting) and offshoring are often used interchangeably although there are significant differences between them. It is worthwhile to clarify the picture.[1]

(1) Canals, C., «*Offshoring and relocation: new trends in the international economy*», Documentos de Economía "la Caixa", No. 3, December 2006 (available in Spanish), contains a more detailed explanation of all these phenomena.

When organizing its operations, every company must make decisions over two basic dimensions – property and location. First, related to property, the company decides what intermediate goods and services needed to produce the final product will be made by the company itself and which should buy from other companies or outsource. Taking such decisions, linked to the possibility of fragmenting the production process in physically different stages or tasks, is not something new but goes back to the beginning of the Industrial Revolution. Nevertheless, the range of activities outsourced has been increasing over time as a result of advances in technology and logistics. Other factors, such as rigidities in labour relations and increased competition have also changed the balance between what should be produced inside a company plant and what is worth buying outside. Today, outsourcing services in accounting, data-processing or cleaning, replacing services that formerly were carried out within the company, are examples of common organizational changes.

Secondly, in matters of location the company must decide what intermediate goods and services to produce in its own country and which to produce abroad. The possibility of carrying out some production operations in places far from the country where the final good or service is produced is relatively recent in company operations. This has largely been facilitated by the reduction in conventional transport costs (by sea and air), the removal of custom barriers and other similar measures, and because of advances in information technology.

The possible combinations along these two factors (property and location) create the various phenomena associated with globalization (as shown in the following table. For example, we call offshoring or international outsourcing the process by which a national company decides to locate abroad a part of the chain of production that it was carrying out in the base country. This may be carried out by a subsidiary, in which case we talk of offshoring in an integrated firm. If it involves an outside supplier, it is called offshoring in an arm's length relationship. When the company continues to carry out all tasks in its base country but decides to outsource some tasks, we talk about local outsourcing.

PROPERTY AND LOCATION DECISIONS: WHO PRODUCES WHAT AND WHERE?

		Where production takes place	
		Own country	**Abroad**
Who carries out production	**Own company**	–	Offshoring in an integrated firm
	Outside supplier	Local Outsourcing	Offshoring at arm's length

SOURCE: Own calculations.

The case where a company decides to shift some part of its production process abroad may give rise to foreign direct investment (FDI), which may be understood as an extension of its corporate control beyond national borders. Formally, FDI consists of the acquisition of assets by a foreign resident when this involves both a long-term interest and some influence on management of the company acquired. When a company decides to carry out offshoring in an integrated firm, it is carrying out FDI. Nevertheless, not all FDI implies offshoring. For example, if a company wishes to take advantage of the potential of a foreign country and decides to open a plant there to begin producing and selling in the local market for the first time, we are dealing with a case of FDI but not offshoring, as the latter requires the replacement of a task carried out locally with foreign production.

Over the short term, offshoring is often accompanied by a loss of jobs in the country of origin. Nevertheless, a company that relocates part of its production abroad enjoys lower costs or benefits from an increase in productivity and this may result in an increase in sales over the medium term that could contribute to increase overall employment, including in the country of origin. Often, the alternative to offshoring, that is, maintaining all production processes entirely in one country, is not viable in a context of strong international competition and major differences in comparative advantages in various countries and could lead to more job losses in the long term.

To sum up, globalization has opened the door to the creation of true global production chains and an increase in flows of direct investment between countries. This, no doubt, has contributed to improvements in productivity in the world economy through specialization. Unfortunately, we cannot discount the risk of a protectionist wave that undoes some of the progress already made, especially in tough times, like the ones we are now living.

This box was prepared by Claudia Canals
Department of International Economics, "la Caixa" Research Department

Oil price rise despite weak demand

Oil price rises 30% running against economic fundamentals.

The price of oil has recovered, partly because of the depreciation of the dollar. Between February 20 and March 23 oil rose by 30.6% to 53.25 dollars a barrel (one-month delivery, Brent quality) which meant a cumulative increase for the current year of 36.2%.

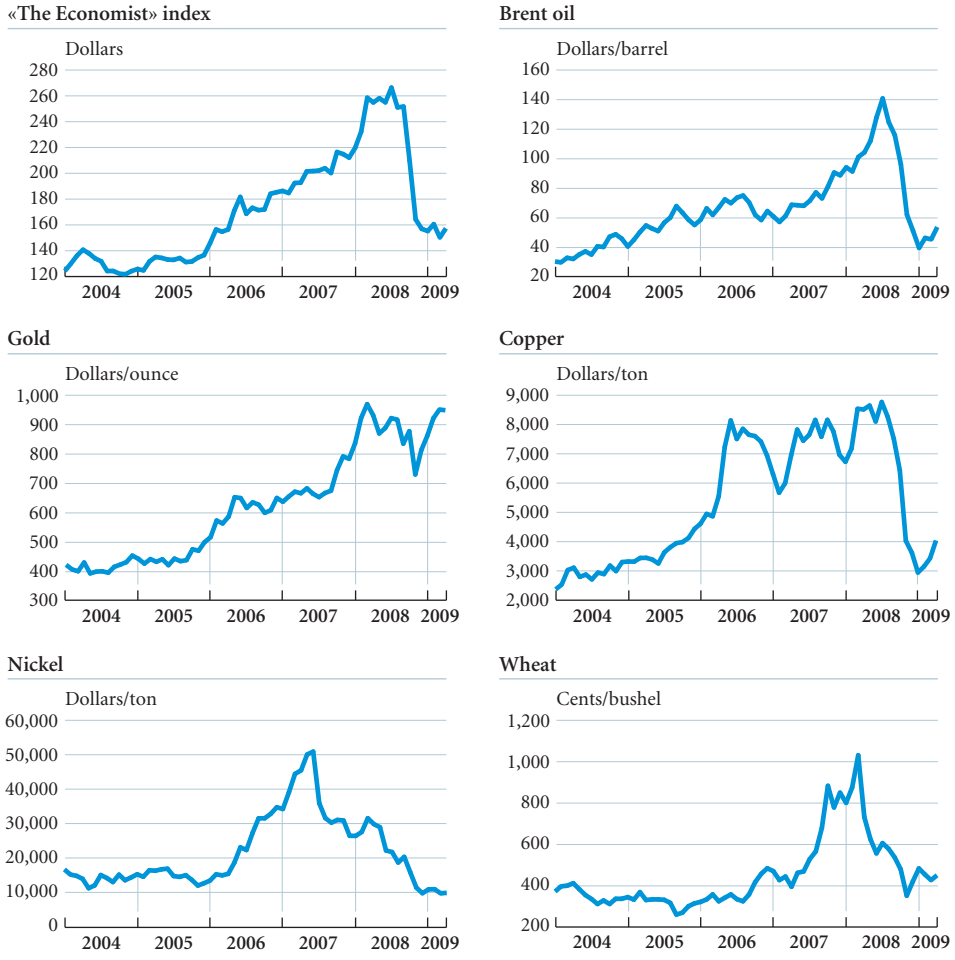
With the drop in world demand and negative growth prospects for 2009, short-term economic fundamentals would not seem to justify the rise in oil in recent weeks, in spite of quantitative easing by the Fed. The decreased production by OPEC has served to stabilize the drop in prices because of lower demand but has not changed the trends. In addition, OPEC decided to put off larger reductions and leave reaching a price objective of 75 dollars a barrel for later. If prices were to go higher there would also be the temptation to increase production which would mean a ceiling for prices.

In addition, the speculative demand that dominated in 2008 will be much lower in 2009 because of the financial crisis.

Chinese demand raises price of copper while gold runs close to 950 dollars an ounce.

In the first 20 days of March, among other commodities the most notable was the upward move in copper. While *The Economist* commodities index rose by 1.6% between February 20 and March 23, copper gained 27.3% in the same period because of demand from China, which amounts to one third of the total. To be specific, the latest price increases were due to the accumulation of reserves by the State Reserves Bureau in Beijing which has reserved 300,000 tons although it is speculated that it will buy 1.2 million tons more out of a world production amounting to 18 million tons a year. After profit-taking in the early days of March, gold has again moved close to the level of 950 dollar an ounce due to risks of competitive devaluations of various currencies as perceived by the market.

TREND IN VARIOUS COMMODITIES (*)



NOTES: (*) Figures for last day of month (latest figure March 23).
SOURCE: «The Economist», Thomson Reuters Datastream and own calculations.

EUROPEAN UNION

Domestic and foreign demand show major decreases in fourth quarter of 2008...

Euro Area: recession spreads into all components of GDP and all sectors

In the March *Monthly Report* we noted that in the fourth quarter of 2008 the Euro Area economy had contracted by 1.5% compared with the previous quarter. We also pointed out that all high frequency indicators showed that the slowdown had been widespread in all components and sectors of the economy. Figures published by Eurostat have confirmed this. Both domestic and foreign demand have shown very severe drops. The slowdown is also affecting all sectors of the economy.

Among all components, there was a notably sharp contraction in exports that showed a drop of 6.4% compared with the previous quarter. Imports were also down 4.7% although net foreign demand ended up contributing to the decrease in economic activity in the Euro Area. Nor was the performance in domestic demand very promising. Private consumption continued to show signs of weakness. It contracted by 0.3% compared with the previous quarter and ended 2008 with growth of 0.5%. Investment, which had recorded moderate drops in the two previous quarters, showed a contraction of 3.7% but still ended the year with growth of

EURO AREA: MAIN ECONOMIC INDICATORS

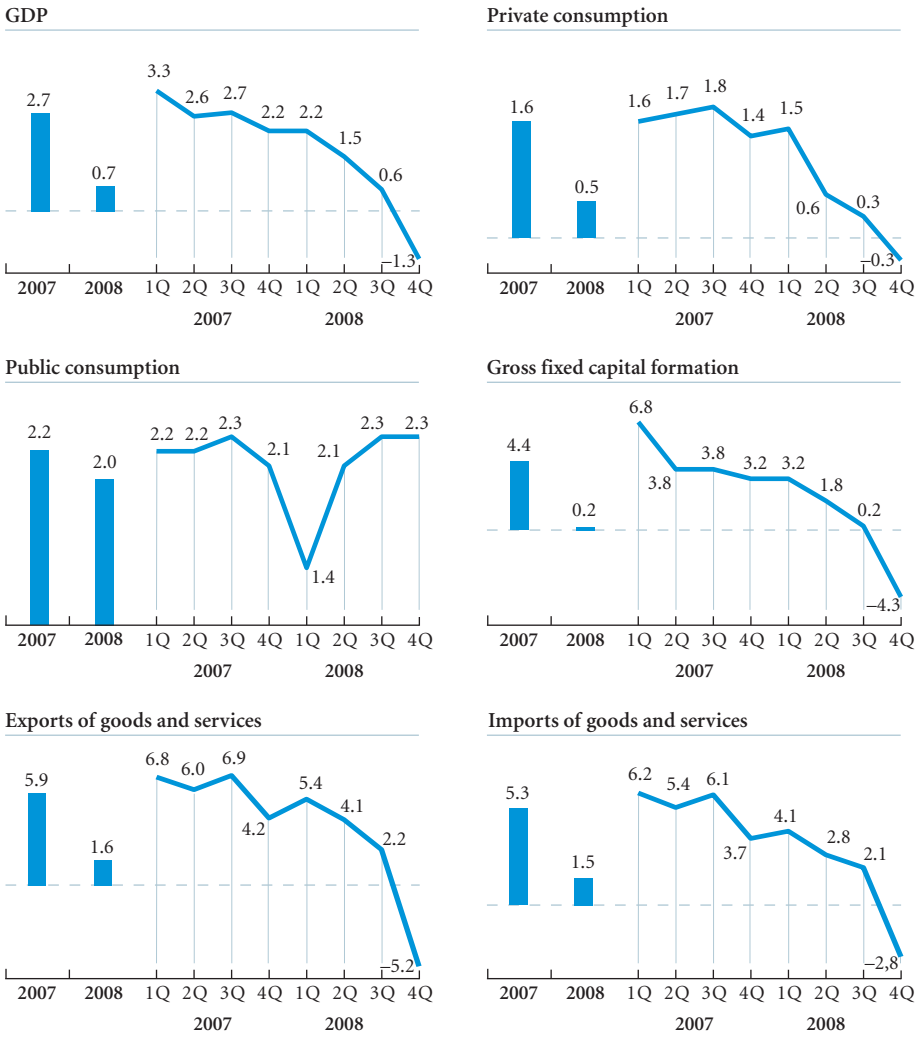
Percentage change over same period year before unless otherwise indicated

	2007	2008	2008				2009	
			1Q	2Q	3Q	4Q	January	February
GDP	2.7	0.7	2.2	1.5	0.6	–1.3	–	...
Retail sales	1.0	–0.9	0.8	–1.0	–1.1	–2.2	–1.6	...
Consumer confidence (1)	–4.9	–17.9	–11.9	–14.6	–19.2	–26.1	–30.5	–32.5
Industrial production	3.5	–1.7	2.5	1.1	–1.4	–8.8	–17.3	...
Economic sentiment indicator (1)	108.9	91.1	101.4	97.5	89.9	75.8	67.2	65.4
Unemployment rate (2)	7.4	7.5	7.2	7.4	7.5	7.9	8.2	...
Consumer prices	2.1	3.3	3.4	3.6	3.8	2.3	1.1	1.2
Trade balance (3)	20.1	–1.3	24.4	13.8	–11.4	–31.8	–33.1	...
3-month Euribor interest rate	4.3	4.6	4.5	4.9	5.0	4.2	2.9	2.1
Nominal effective euro exchange rate (4)	107.9	113.0	113.0	116.0	114.0	109.1	111.9	110.4

NOTES: (1) Value.
(2) Percentage of labour force.
(3) Cumulative balance for 12 months. Billion euros.
(4) Change weighted for foreign trade flows. Higher values imply currency appreciation.
SOURCE: Eurostat, European Central Bank, European Commission and own calculations.

TREND IN EURO AREA GDP BY COMPONENT

Percentage year-on-year change



SOURCE: Eurostat and own calculations.

0.2%. Public consumption is the only component that withstood with a positive growth rate in all quarters of the year and in 2008 as a whole it grew by 2.0%.

The downward stage is also affecting all sectors of the economy. Not all sectors showed negative growth rates in the final quarter of 2008 but the change of trend was general. For the moment, industry is the one suffering most. It marked up an all-time drop of 5.4% compared with the third quarter and ended 2008 with a negative growth rate at –1.1%. The construction sector and retail trade also suffered greatly last year. Both marked up negative rates of quarter-on-quarter growth over the final three quarters and ended the year with modest growth of 0.6% and 0.5% respectively.

Short-term and medium-term prospects are not very bright. This is to be seen

...while short-term and medium-term prospects not bright.

In view of this scenario, IMF and ECB have revised growth forecasts downward...

from early monthly supply and demand indicators for 2009. On the demand side, retail sales continued to drop in January for the eighth month in a row. While it is true that the drop was somewhat lower than in recent months (1.6% compared with the same month in 2008) it is too early to conclude that this figure may have hit bottom. For example, the consumer confidence indicator, for which the February figure is now available, is far from showing any signs of recovery and is still dropping fast.

Nor have supply indicators yet found their bottom but rather the opposite. Figures for industrial production make one dizzy when looked at from an historical perspective. Following the sharp drops in November and December, in the month of January they fell by 4.7% so that in year-on-year terms the decrease came to 17%. As in the case of demand indicators, neither does the economic sentiment index (for which we also have figures for February) show any sign of recovery and is still reporting all-time lows.

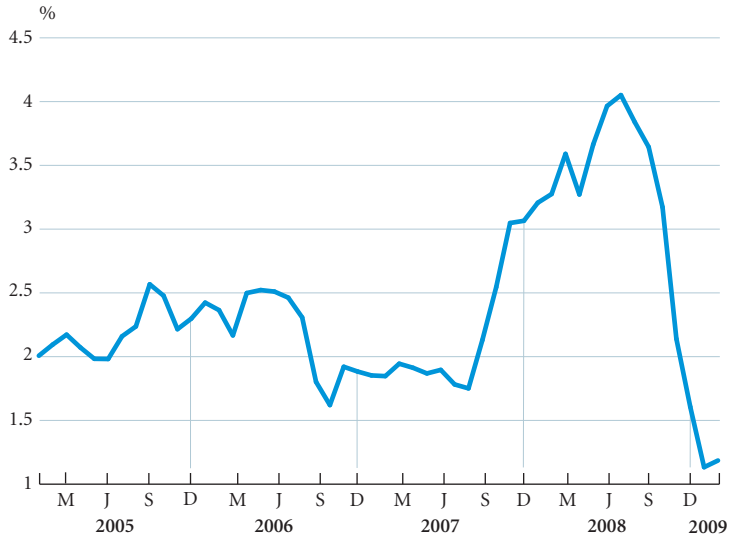
...along with those for inflation.

In view of this very negative scenario, the main international bodies have again revised downward their growth forecasts for 2009. The International Monetary Fund (IMF), for example, is forecasting that the world economy will contract between 0.5% and 1% in 2009, which will weaken domestic demand in the Euro Area even more. This, along with the real estate adjustment in several Old Continent countries, will mean a drop in the gross domestic product (GDP) could reach 3.2%. The European Central Bank (ECB) also underlines the increased weakness of domestic and foreign demand to justify the downward revision of its forecasts. According to the top monetary authority, the economy will contract between 2.2% and 3.2% in 2009. It expects that the economy will begin to recover in 2010 but it does not rule out that the figure could be negative. In this respect, it puts the range of its forecast between a drop of 0.7% and an increase of 0.7%.

In revising the macroeconomic scenario for the Euro Area, the ECB also significantly modified its inflation

INFLATION STANDS WELL BELOW 2%

Annual change in harmonized consumer price index of Euro Area



SOURCE: Eurostat and own calculations.

forecasts. The inflation figure, that had not dropped below 2% since August 2006, was only 1.2% in February and it has been below the limit set by the ECB for three months in a row. According to the new scenario of forecasts it is very likely that it will stay below 1% for 2009 as a whole and that in 2010 it will not go above 1.5%. Because of this, the ECB lowered its reference rate by 50 basis points putting it at 1.5%, the lowest level in the 10-year existence of the ECB.

The sharp drop in interest rates (225 basis points in 6 months) should provide some fresh air to the economy in the second half-year. As this measure is passed through to interest rates on private loans, the financial load of companies and households should become lower. Their access to credit should also improve but for this to take place it is fundamental that liquidity in financial markets increase. In this respect, the ECB is continuing to offer unlimited liquidity to all banks. It is also certain, however, that the instruments it is using are reaching their limit. Pressure for it to begin to take measures to directly stimulate the economy, such as the granting of credit directly to companies carried out by the Fed, may become untenable if signs of improvement do not soon show up. For the moment, credit to the private sector shows no sign of recovery and keeps slowing down. In January, year-on-year growth was 5%, less than half that seen one year earlier.

In earlier editions of *Monthly Report* we have pointed out that both the recovery of the financial system and plans to stimulate the economy will be key in determining the depth and duration of the recession. In this respect, pressure for the various countries of the European Union (EU) to increase spending aimed at reviving their economies has grown, especially from the other side of the Atlantic. An IMF study estimates that this year fiscal stimulus plans will reach 1.9% of GDP in the United States whereas in the Euro Area they will stand at 0.9%. This is a difference that could be reduced given that the public deficit forecast for the Euro Area for 2009 is 4%, much less than the 9% forecast for the United States. Nevertheless, the various European heads of government have reiterated their refusal to increase this spending. On the other hand, they have show no hesitation in affirming that, if it should be necessary, they would aid the countries of Eastern Europe. This is partly because they are aware that a recession in that region would make their own recovery more difficult.

Pressure increases for ECB to take further measures to aid credit...

...and for European governments to increase public spending.

Germany: figures raise fears of worse than expected recession

The German economy remains without showing a single figure that allows for optimism in the face of the recession. After leaving 2008 behind with a reduction of 2.1% in the quarterly GDP, the biggest decrease since reunification, the trend in the most recent indicators does not rule out the possibility that the contraction in the first quarter of 2009 could be even greater. In view of this situation, the Minister of Finance stated that in 2009 the German economy could show a drop of more than 4% in GDP, thus agreeing with the recent revisions made by the main economic institutes of the country and stepping a long way away from the 2.25% forecast by the government at the beginning of the year.

January 2009 saw an unprecedented drop in exports compared with the same month the year before (18.4%). This decrease was accentuated by the worsening of the economic situation in the countries of Eastern Europe and the emerging

New revisions consider German economy downturn above 4% in 2009.

GERMANY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2007	2008	2008				2009	
			1Q	2Q	3Q	4Q	January	February
GDP	2.6	1.0	2.8	2.0	0.8	–1.7	–	...
Retail sales	–3.0	–0.5	–1.0	–0.5	0.3	–0.9	–1.3	...
Industrial production	5.8	0.0	4.8	2.8	0.0	–7.5	–19.2	...
Industrial activity index (IFO) (*)	106.2	96.8	104.0	102.1	94.8	86.2	83.0	82.6
Unemployment rate (**)	9.0	7.8	8.0	7.9	7.7	7.6	7.8	7.9
Consumer prices	2.3	2.6	2.9	2.9	3.1	1.6	0.9	1.0
Trade balance (***)	181.5	195.3	199.5	202.3	196.3	183.0	168.8	...

NOTES: (*) Value.
(**) Percentage of labour force.
(***) Cumulative balance for 12 months. Billion euros.
SOURCE: Eurostat, European Central Bank, European Commission, national statistical bodies and own calculations.

Overall capacity utilization collapses in first quarter of 2009.

countries which up to now seemed less exposed to the world financial upsets. In view of this situation, companies adjusted their production to the new demand levels as shown by the trend in orders and in industrial production in January, with decreases of 35% and 19% respectively, which mark up new all-time lows. The motor vehicle sector was one of the worst hit with a 36.4% drop in production compared with January 2008.

The reduction in industrial activity meant that overall capacity utilization dropped sharply in the first quarter of 2009, according to IFO Institute figures. This put it below the historical average for the statistical series and very close to the lowest figures seen in previous recessions. As may be seen in the accompanying graph, utilization of production capacity in the motor vehicle sector shows an even bigger contraction. The increase in under utilization of production capacity and uncertainty about the duration of the length of the recession brought about a drop in investment in companies of 2.7% in the final quarter of 2008 compared with the previous quarter, which made a negative contribution to the trend in GDP.

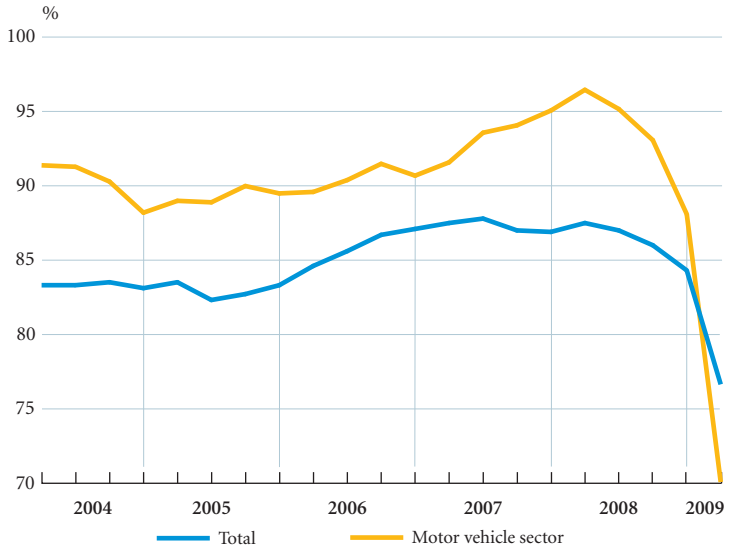
Unemployment rate to show major increase in coming months.

In spite of the major contraction in Germany's economy in the fourth quarter of 2008, the unemployment rate in February stood at 7.9%, only 0.3 percentage points above the low recorded in November. The moderate growth in unemployment was due to the role played by short-time working arrangement plans which are estimated to have affected close to 626,000 workers in the fourth quarter of 2008. Nevertheless, prospects for 2009 are not very bright. It is estimated that the figure for unemployed will go above four million, a large number of whom will come from the manufacturing sector. In view of the worsening of the economy and the labour market, private household consumption has continued to drop, as shown by the 1.3% drop in retail sales in January. Only car registrations showed an increase in February (up 22.1% compared with the same month in 2008), a result of incentives obtained under the second economic stimulus plan.

The current economic situation will force the German government to revise its growth forecasts for 2009, mentioned above. In spite of the worse economic

CAPACITY UTILIZATION COLLAPSES IN GERMANY

Utilization of production capacity in terms of total installed capacity



SOURCE: IFO Institute.

prospects and urging by the United States and the International Monetary Fund for increased government spending by the European countries to revive the economy, the Germany chancellor has announced that there will be no third economic stimulus plan. The fact that it is still too previous to be able to see the effect of the two previous plans and the need to maintain the sustainability of the government budget have been the main reasons put forward to support this refusal.

German government resists increasing fiscal aid.

France: recession grows worse

The series of economic indicators shows that the beginning of 2009 in France was very weak from an economic standpoint. Industrial production was down 13.8% year-on-year in January. Other indicators of industrial activity, such as the index of industrial orders and car registrations also suggest a notable worsening of the economic situation in France in the first quarter of 2009.

The same depressed situation is reflected in the most recent surveys of industry. The economic sentiment index for February continued to show a drop. The confidence index in industry was also down going to levels of the order of 38 negative points.

On the demand side, available indicators suggest that investment will drop sharply. Companies are facing very weak demand prospects as well as under-utilization of production capacity and this will force a reduction in investment plans. In fact, the level of utilization of production capacity dropped by more than six points between October 2008 and January 2009 to stand 8 points below the long-term average. Furthermore, companies are facing very difficult financing terms.

On the other hand, private consumption is holding up slightly better and probably will grow in coming months although only slightly. As a result, consumption of French households rose

France starts off 2009 in weaker than expected state.

FRANCE: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2007	2008	2008				2009	
			1Q	2Q	3Q	4Q	January	February
GDP	2.1	0.7	2.1	1.2	0.6	–1.0	–	...
Domestic consumption	4.4	1.1	2.4	1.5	0.9	–0.2	1.8	...
Industrial production	1.5	–2.5	1.5	–0.4	–2.2	–8.8	–13.8	...
Unemployment rate (*)	8.3	7.8	7.6	7.7	7.7	8.1	8.3	...
Consumer prices	1.5	2.8	2.9	3.3	3.3	1.8	0.7	0.9
Trade balance (**)	–33.4	–48.2	–42.1	–45.8	–50.2	–54.5	–54.0	...

NOTES: (*) Percentage of labour force.
(**) Cumulative balance for 12 months. Billion euros.
SOURCE: OECD, Eurostat, INSEE, European Commission and own calculations.

Investment and exports at negative levels.

by 1.8% year-on-year in January. Moderate price increases, important increases in social benefits and the economic stimulus plan made possible a slight increase in purchasing power, in spite of the increase in the number of unemployed and the decrease in income from economic activity.

In a context of a general contraction of the economy, it is expected that export markets of French products will weaken. According to INSEE, the French statistics body, exports will drop sharply and, following a decrease of 3.7% in the final quarter of 2008, they will drop by 5.8% and 2.5% in the first and second quarters of 2009, respectively.

INSEE forecasts decreases in economic activity in the first half of 2009 of the order of 1.5% and 0.6% in the first and second quarters, respectively. If we suppose that growth in the rest of the year would be nil, the drop in GDP for 2009 as a whole would stand at 2.9%. This figure is more pessimistic than the drop of 1.5% estimated by the French government. Nevertheless, the contraction of the economy in 2009 will likely be higher than that noted in the 1975 and 1993 recessions, with drops of 1.0% and 0.9% respectively, up to this point the worst rates recorded since the end of World War II.

Labour market shows clear downturn.

In view of this very adverse economic situation, it is to be expected that unemployment will increase considerably in 2009. The INSEE Institute estimates that some 330,000 jobs will be lost in the first half of 2009 following the loss of 110,000 jobs in the second half of 2008. The institute also predicts that the unemployment rate will stand at 8.8% at the end of the second quarter of 2009, one and a half points above that in the same quarter of 2008. It was precisely the fear of a sharp increase in unemployment that brought about a general strike of French workers on March 19 with the main aim of defending jobs. At the same time, concern about the worsening of the labour market led the French government to provide substantial resources to the motor vehicle sector. The fact that these supports are linked to domestic production has brought criticism from other economies which have branded this measure as protectionist.

Italy keeps adding negative figures

Economic activity in Italy recorded a drop of 2.9% in the fourth quarter of 2008 compared with the same quarter the year before. Publication in March of the breakdown of GDP by component shows the drastic drop in exports and investment as the main reasons for this downturn. During this period investment was down by 9.3% compared with the same quarter in 2007 showing the biggest drop since 1993. Exports were down 10.7% in the same period with a figure 1.9% higher than the drop in imports. Private consumption also reported a major contraction (1.6%) in this quarter.

More frequently issued indicators show that the first quarter of 2009 continued to report a major worsening of the economy. The decreases in industrial production and exports in January 2009 (15.4% and 25.4% respectively) reached highs for the last 20 years and indicate a big contraction in investment and foreign demand in the first quarter. The motor vehicle sector has been one of the most hurt in this recession with cuts in operations and exports twice as heavy as in the economy as a whole.

Sharp contraction of investment and exports in Italy.

In spite of Italy's going into recession in the third quarter of 2008 and the following collapse in the fourth quarter, the unemployment rate shows a very slight increase as of last December. This differentiated behaviour was due to the temporary work plans selected by companies, which put employees in a situation of technical unemployment while not incorporating them in unemployment statistics. Nevertheless, some forecasts put unemployment above 9% in 2010. In view of this situation, confidence in industry and among consumers dropped in February 2009 with contractions in both present and future components. The Berlusconi government has promised new measures to help companies having problems because of the economic situation. Nevertheless, the high government debt is dissuading the government from adopting measures involving any major increase in that debt, with the result that the volume of the promised help does not seem as if it will be enough to soften the recession.

High government debt puts conditions on adoption of further fiscal measures.

ITALY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2007	2008	2008				2009	
			1Q	2Q	3Q	4Q	January	February
GDP	1.5	–1.0	0.4	–0.4	–1.3	–2.9	–	...
Retail sales	0.5	–0.7	0.9	–1.7	0.5	–1.9	...	...
Industrial production	14.4	–3.4	1.0	–0.1	–4.0	–10.4	–15.4	...
Unemployment rate (*)	6.2	6.7	6.6	6.8	6.7	6.9	–	...
Consumer prices	1.8	3.3	3.1	3.6	4.0	2.8	1.6	1.6
Trade balance (**)	–12.8	–10.0	–8.5	–8.6	–10.8	–12.3	–11.0	...

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

United Kingdom facing severe recession

Industrial production in UK down 11.4% in January 2009.

The British economy is suffering from the effects of the world economic recession. Following the sharp contraction of product in the fourth quarter of 2008, available indicators suggest that recovery will take time. In fact, industrial production continued its sharp decline in January and marked up a negative year-on-year rate of –11.4%. Other variables, such as the volume of industrial orders, industry confidence and economic sentiment, also show the depressed state of the industrial sector.

On the demand side, the figures suggest that private consumption remains weak. The number of car registrations dropped by 21.9% year-on-year in February. On the other hand, retail sales rose by only 0.4% in February, the smallest growth in the past decade. Nevertheless, we should point out that, in earlier contractions of GDP, retail sales showed negative growth rates below the figure reported for February.

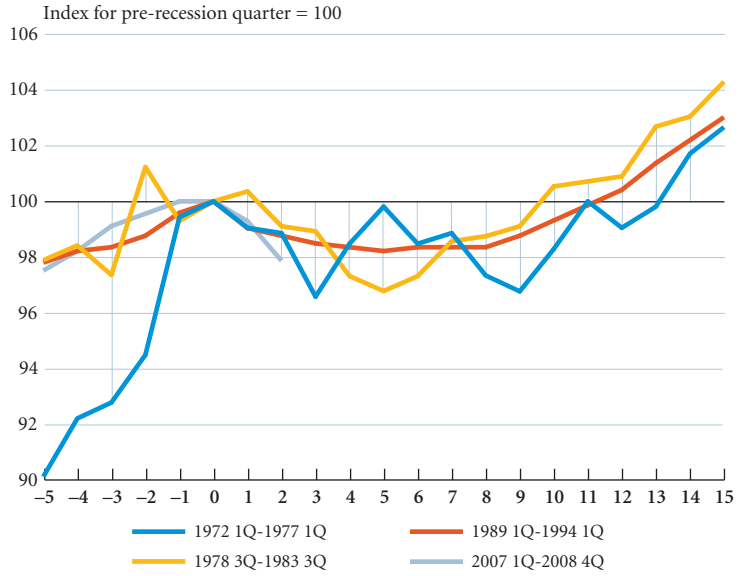
Investment prospects not bright.

What is more troubling is the very poor situation in investment and exports. National accounting figures for the fourth quarter of 2008 show a sharp drop in gross capital formation. Furthermore, the indicators fail to suggest any improvement in investment. According to the latest industry survey by the Confederation of British Industry for February, the percentage of companies that stated they were producing below capacity rose considerably compared with previous surveys. It is therefore very likely that companies will reduce their investment plans over coming months.

On the other hand, the contraction of the world economy has considerably reduced foreign demand for British products. Industrial surveys of orders received by British industry from abroad indicate that the weakness in exports will continue.

CONTRACTION IN BRITISH GDP SIMILAR TO EARLIER RECESSIONS, FOR THE MOMENT

GDP growth



SOURCE: ONS and own calculations.

UNITED KINGDOM: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2007	2008	2008				2009		
			1Q	2Q	3Q	4Q	January	February	March
GDP	3.0	0.7	2.6	1.7	0.2	–1.9	–	...	–
Retail sales	4.4	3.5	5.3	4.4	2.3	2.5	3.6	0.4	...
Industrial production	0.1	–2.8	0.5	–1.3	–2.5	–7.5	–11.4	...	...
Unemployment rate (*)	2.7	2.8	2.5	2.6	2.8	3.3	3.9	4.3	...
Consumer prices	2.3	3.6	2.4	3.3	4.9	3.9	3.0	3.1	...
Trade balance (**)	–83.5	–93.2	–91.3	–93.4	–94.5	–93.4	–92.6	...	...
3-month Libor interest rate	5.3	6.0	6.0	6.0	5.9	6.3	2.8	2.2	2.0
Nominal effective pound exchange rate (***)	103.9	97.6	97.6	92.6	92.8	89.4	73.7	77.0	77.8

NOTES: (*) Percentage of labour force.
(**) Cumulative balance for 12 months. Billion pounds.
(***) Change weighted for foreign trade flows. Higher values imply currency appreciation.
SOURCE: OECD, Bank of England, ONS, European Commission and own calculations.

Experience in previous recessions shows that industry surveys give clues regarding when recovery might come. For now, the bulk of indicators suggest that the recession that began in the third quarter of 2008 will continue at least until mid-2009. For this to happen and not something worse we shall have to see an improvement in indicators as the year progresses.

In this context, it is useful to compare the relative sharpness of the present economic contraction with previous recessions. To some extent, it is comforting to know that, for the moment, the drop in GDP has not been as sharp as in previous recessions from which the United Kingdom emerged well. At the same time, the figure of more than two million unemployed reported in the first quarter of 2009 was also higher in the first quarter of 1991.

Nevertheless, what clearly differentiates the present period of contraction from earlier periods is that interest rates are now at very low levels. What is more, the reduction of interest rates took place beforehand and was sharper than in other periods so that the risk of creating inflation through this was lower. The Bank of England lowered the interest rate a half-point on March 5 last putting it at 0.5%, a new all-time low.

Another distinctive aspect of the present economic contraction is that it resulted from a very sharp financial crisis. This has created the design of new instruments that are trying to give the economy some drive – «quantitative easing» by the Bank of England along with fiscal measures. The former measure consists of printing money to buy government bonds and private sector bonds with the aim of increasing liquidity and credit in the markets. The second measure, the fiscal stimulus plan, provides additional growth although it also puts the public accounts in a position well out of balance. So much so, that the European Union has granted the United Kingdom the longest margin of all member states (up to 2013-2014) to reduce its deficit below 3% of GDP.

Up to now, contraction in British GDP no worse than in previous recessions.

Emerging Europe: a region with problems

Emerging Europe, a region affected by dependence on Euro Area and international financing.

The economic situation of Central and Eastern Europe continues to cause concern. The main problem is that Emerging Europe depends greatly on exports to the rest of the European Union (now in recession) and on financing from abroad, a flow that has dropped in the context of the world financial crisis. If to this we add that an appreciable part of their cumulative debt is denominated in foreign currency, which makes payment difficult in the present situation of currency depreciation, we end up with a potentially explosive combination.

Poland argues that its solid macroeconomic fundamentals should be reflected in less of a penalty from markets...

This was recently noted by the chief economist of the Organization for Economic Cooperation and Development, Klaus Schmidt-Hebbel: «Looking at capital flows, at massive accumulation of foreign debt, there are signals that may point to the repeat of a crisis of the proportions of those that hit South America and Asia (in 1994 and 1997)». While finally history may not repeat itself, the fact is that with the trend in financial markets since last August, the moment when it was felt that the region could not escape from the worsening of the world economic decline, there does exist the perception that there is a major risk in this region. In any case, as various policy players have underlined, the view of the region as a whole entity is mistaken, given that the area is made up of countries with different macroeconomic situations.

...but the truth is it shares problems of cyclical weakness.

Among these, the country that has perhaps been most belligerent in maintaining the thesis of receiving excessive punishment from the markets is Poland. According to those managing its economic policy, its macroeconomic fundamentals are solid and a large part of what is happening is the result of over-reaction on the part of financial players. In spite of having an acceptable situation in terms of fundamental imbalances (inflation, government deficit and balance of payments), Poland has seen its stock markets penalized and its country-risk indicators have shot up since last August. But what has been especially weakening is the fact that its currency, the zloty, has suffered the biggest depreciation in terms of the euro that has taken place in the region (more than 40%), again since last August.

POLAND: MAIN ECONOMIC INDICATORS

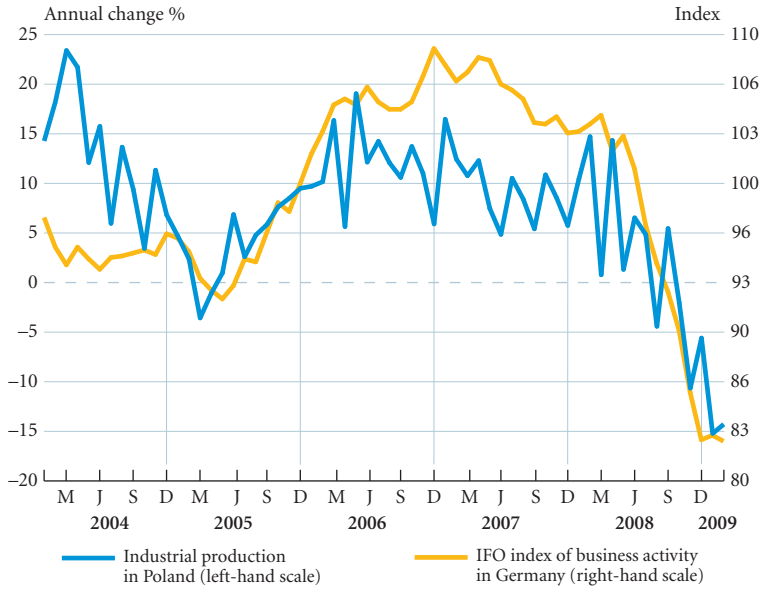
Percentage change over same period year before, unless otherwise indicated

	2007	2008	2008				2009	
			1Q	2Q	3Q	4Q	January	February
GDP	6.8	4.9	6.1	5.5	4.9	3.1	–	...
Retail sales	4.1	–2.5	2.5	0.4	–3.8	–9.1	–16.3	...
Industrial production	9.4	2.7	8.3	7.4	2.1	–6.1	–15.3	–14.3
Economic sentiment (*)	114.8	109.2	116.7	113.7	108.9	97.5	83.6	75.4
Unemployment rate (**)	9.6	7.1	7.7	7.3	6.8	6.6	6.7	...
Consumer prices	2.4	4.3	4.3	4.4	4.8	3.9	3.2	3.7
Trade balance (***)	–61.3	–79.2	–72.8	–77.0	–81.3	–85.9	–84.8	...

NOTES: (*) By value.
(**) Percentage of labour force.
(***) Cumulative balance for 12 months. Billion zlotys.
SOURCE: National statistics bodies, European Commission, Eurostat and own calculations.

WHEN GERMANY SNEEZES, POLAND SHIVERS

Industrial activity indicators



SOURCE: IFO Institute, Polish Central Statistics Office and own calculations.

Nevertheless, we must agree that Poland has a delicate situation with its neighbouring countries. With 25% of its exports of goods going to Germany, a country in recession with poor prospects of growth in 2009, and with production oriented heavily toward industries such as motor vehicles, the only thing to be expected is a notable worsening of the cycle. For the moment, in the fourth quarter of 2008 year-on-year GDP growth was 3.1%, a clear drop from the 4.9% in the third quarter. This trend to weakness worsened in the early months of 2009. As a result, consumption was down, as shown by the drop in retail sales in January (drop of 16% year-on-year) as also happened in industrial production which made two months in a row (January and February) with year-on-year decreases of more than 14%. It is very likely that in 2009 the GDP will contract of the order of 1% going back in 2010 to positive, although moderate, growth figures.

In this situation, what margin is there for manoeuvre in economic policy to support a country on the edge of recession? The options put out by Poland in this matter are also representative of the region as a whole. In the first place, economic policy, both fiscal and monetary, can play only a modest role. With regard to interest rates, if these go down too much they could make depreciation pressures on the zloty worse (this explains why the latest cut in February was only 25 basis points putting the reference rate at 4.25%). Nor can fiscal policy generate an excessive public deficit (a figure of the order of 3% of GDP is forecast for 2009) because there exists the real risk of penalization by the markets (the levels of country risk, measured by the quotation for Credit Default Swaps are now clearly above those for the Czech Republic or Slovakia, to mention two comparable countries) and because having public finances in order is an essential condition for obtaining international financial aid.

Little margin in economic policy compensated by growing commitment of international aid.

No sign of Poland soon adopting euro.

In this respect, while Poland has not officially asked for aid, there is no doubt that the country is benefiting from the announcement of financial aid to other countries in the region because of its effect of lowering regional risk. It is worth remembering recent initiatives, such as the EU proposal to double the amount of the aid package to countries in the EU with balance of payment problems to 50 billion euros or the decision of the World Bank, the European Investment Bank and the European Bank for Reconstruction and Development to provide 25 billion euros for infrastructure projects in Central Europe.

At the same time, another course of action being considered is the possible faster adoption of the euro. While the government is favourable to the single currency, this is far from any strong national consensus. Furthermore, the European Union has repeated that the criteria for adopting the euro will not be relaxed, criteria that none of the countries of emerging Europe can strictly meet. For the moment, therefore, support for the zloty will have to be limited to intervention in the markets and to verbal defence such as that made in February in a joint statement by the central banks of Poland, Romania, Czech Republic and Hungary.

Moving operations around the world

In the context of recession such as now exists, one of the doubts which keeps gnawing away at people's minds is the dark future of Europe in a world where the production of goods will be concentrated in China with services set in India, thus leaving the Old Continent outside the economic game. One element of this concern is to be found in the debate over the relocation of industry and services. Without dismissing the validity of those doubts, a rational view of that process may help toward a better understanding of its causes and the relative position of Europe in these matters.

We should begin with precisely defining what is meant by relocation seeing that the usual difficulties are to be found in methodology. People understand relocation in different ways. Following the criteria defined in the box «Relocation, outsourcing, offshoring… what do we mean?», here we shall concentrate our attention on what is termed international offshoring or outsourcing, that is to say, the location abroad of part of the production of a company that previously was carried out in it own country, either by the company itself or by an outside supplier. Defined in this way, the question now is to find a quantitative measurement that will allow us estimate the trend in this phenomenon over time and between countries.

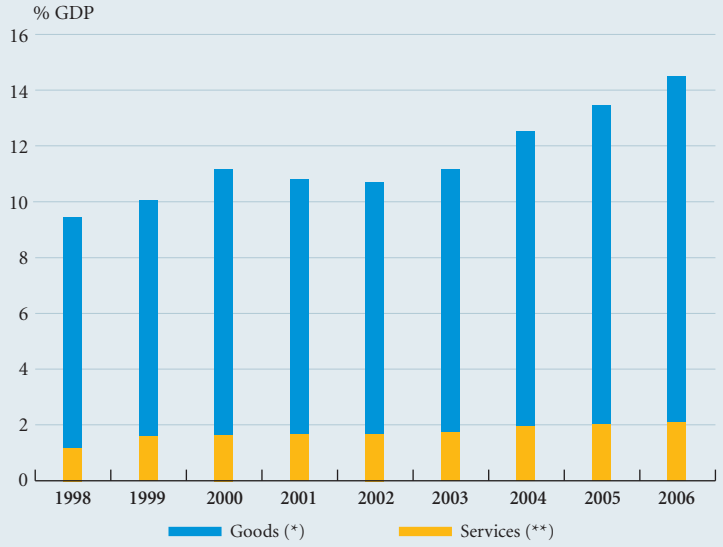
Some economists who have studied this question have opted to combine two measures of offshoring, one for goods and another for services.[1] The measure for goods is made up of the sum of imports of intermediate goods, a group that specifically includes, for example, foreign purchases of accessories for transport equipment or capital goods accessories. The offshoring of services, in turn, is examined through the figure for international payments, made up in the balance of payments by so-called «other services», that is, insurance, finance, communications and information technology, among others.

(1) For a review of this approach and an application to the case of the European Union, see Havik, K. and K. McMorrow (2006): «Global Trade Integration and Outsourcing: How well is the EU Coping with the New Challenges?» Economic Paper 259, European Commission.

The results of these calculations for a group of countries representing approximately 70% of world gross domestic product are given in the accompanying graph and show some interesting conclusions. First, we note that offshoring of goods continues to be by far the most important, representing nearly 85% of the world offshoring market. Even taking into account that some intermediate goods such as energy and food products have shown notable price increases in recent years, it still constitutes a very important figure. In any case, offshoring of services is clearly tending to grow and keep growing. In the period 1998-2006 it grew at an annual average rate of 8%, that is, approximately two and a half percentage points more than goods.

What are the factors lying behind this performance? We should consider three main factors that have appeared in recent decades. First, there has been the emergence of developing economies which are large, open internationally, and have abundant labour supply (at comparatively low wages). These economies are mainly Asian, with China and India in the lead, but we must also put into this category countries such as Brazil and Mexico in Latin America and South Africa on the African continent. Another new development is the notable decrease in trade costs, including transport costs (physical but also in terms of information), the reduction of custom barriers, non-custom barriers, etc. Finally, the third factor behind the surge in offshoring is the growing tendency of many companies to design strategies to split their value chain among different countries, an option facilitated by the development of information and communications technology.

GLOBAL OFFSHORING MARKET TAKING OFF



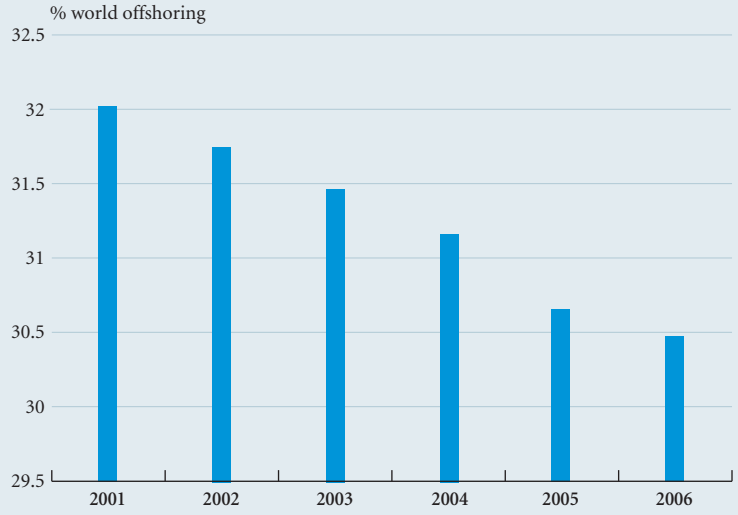
NOTES: Figures for Germany, Brazil, Canada, China, South Korea, United States, France, Spain, India, Ireland, Italy, Japan, Mexico, United Kingdom and Russia.
(*) Imports of intermediate goods: unprocessed and processed foods for industry, industrial supplies, fuels and lubricants, parts and accessories for capital goods and transport.
(**) Current account payments for communications, construction, insurance, finance, data-processing, royalties, personnel, culture and other services.
SOURCE: UN COMTRADE, IMF and own calculations.

In this context, returning to the initial question, does Europe feel that its production future is being menaced by the process of offshoring? To start with, we have to accept that relocation is not a phenomenon to be considered positive or negative in itself in all circumstances. For example, by relocating, a company that cannot be competitive when producing in Europe may «salvage» income that, in the form of profits will return to the country of origin whereas staying in Europe would probably force it to close down. A specific example of this could be that of a manufacturing company that chooses to keep critical operations in Europe (management, research and development and marketing) while at the same time relocating its actual production of goods. For this reason, we should here reformulate the question in terms of asking whether Europe, in the context of the global offshoring market defined above, has seen its position substantially changed in the 1998-2006 period.

One way of answering this question is by analyzing the share of the sum of the six EU countries most active in offshoring in terms of the world total. From this calculation, shown in the above graph, we may deduce that the perception that Europe is suffering from a process of relocation of unusual growth over time should be qualified, given that the EU countries concerned lost approximately one and a half percentage points of their participation in the world offshoring market in 2001-2006. To sum up, offshoring in Europe is growing but it is doing so at a lower rate than in other countries.

This reminds us that, while the world has changed a lot in recent decades, the rules applying to world trade remain valid. In 1924, two Swedish economists, Eli Hecksher and Bertil Ohlin, attempted to understand how to explain the patterns of specialization and international trade of countries through a comparative study of Europe and Australia. Their work established a fundamental conclusion in the analysis of the world economy. Countries, they found, specialize in those activities for which they have abundant and relatively cheap production factors. In their own words, «Australia has a small population and abundant land… As a result, land is cheap and wages are high compared with most other countries…We may therefore say that Australian land is being exchanged for European labour».

EUROPE LOSING WEIGHT IN WORLD OFFSHORING MARKET



NOTES: Figures for Germany, Spain, France, Ireland, Italy and United Kingdom.
SOURCE: UN COMTRADE, IMF and own calculations.

Today, eighty years later, with the appearance of a number of large economies that are rapidly moving toward full development and that have abundant relatively cheap labour (to paraphrase Hecksher and Ohlin), it is now European capital and high technology that are being exchanged for Chinese or Indian labour. We therefore should take care of what we do well, providing ourselves with an environment that makes it possible to take advantage of our comparative advantages and we should do this well. This offers a prescription for serenely facing up to a time of rapid change and a world that has shrunk in size but become large in terms of opportunities.

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FINANCIAL MARKETS

Monetary and capital markets

Interest rates reduced in interbank market and on government bonds

Signs of improvement in liquidity problems and risk aversion.

The financial markets remain unstable although some signs of improvement can be seen. The severe liquidity problems and extreme risk aversion seen last Autumn seem to have been left behind. This is more noticeable in interbank and monetary markets, thanks to the intervention of central banks and governments. On the other hand, foreign exchange markets at times have shown extremely sharp moves as a reaction to the exceptional monetary and fiscal policies in some countries. In share and corporate bond markets, attention seems to be centred on the fundamental state of companies while investments are no longer dominated by forced sales but rather there has been renewed activity in mergers and acquisitions.

Trend to reduced interest rates in interbank market continuing.

In the current context, one of the main objectives, possibly the priority objective, of economic policy managers has been to stabilize the world financial system. During the height of the crisis the seriousness of the situation was reflected in interbank markets that were under severe strain. But thanks to the massive efforts of central banks and governments we began to see a trend to a reduction of differentials back in October last year. This process of normalization continued in March largely due to three factors.

Central banks in Switzerland, United Kingdom and Euro Area cut reference rates.

First, the cuts in reference rates by various central banks have continued to support the decrease in interest rates in the interbank market. This was so in the case of the European Central Bank which cut 50 basis points off the official interest rate putting it at 1.50% on March 5. This fostered a drop in the 3-month Euribor rate which went to 1.60%. This movement also took place in the 12-month Euribor rate with a reduction of 13 basis points from the 2.03% figure at the end of February putting the quote at 1.90% on March 19.

The central banks of the United Kingdom and Switzerland repeated the strategy of easing monetary policy. Whereas the Bank of England cut its official rate to 0.5% on the same day as the Euro Area central bank, the Swiss central bank made its move one week later putting the official interest rate at 0.25%. In both countries the interbank market rate continued to drop for all terms. It is noteworthy that the 3-month Libor in Switzerland was quoted at 0.58% on March 19.

Secondly, another key factor was the good news about some large US banks which have announced that in the first two months of this year they had obtained profits. Following the massive losses published by these institutions for 2008, it is a big relief for the market to feel that, following recapitalization, their ordinary operations were able to generate profits.

Finally, as the weeks passed in March, the macroeconomic figures, while still maintaining a negative slant, were

SHORT-TERM INTEREST RATES IN NATIONAL MARKETS

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						
2008									
March	4.00	4.73	4.73	2.25	2.69	0.91	5.25	6.00	2.78
April	4.00	4.86	4.96	2.00	2.85	0.92	5.00	5.84	2.86
May	4.00	4.86	5.10	2.00	2.68	0.92	5.00	5.87	2.78
June	4.00	4.95	5.39	2.00	2.78	0.93	5.00	5.95	2.73
July	4.25	4.97	5.37	2.00	2.79	0.90	5.00	5.78	2.78
August	4.25	4.96	5.34	2.00	2.81	0.88	5.00	5.75	2.70
September	4.25	5.27	5.50	2.00	4.05	1.02	5.00	6.30	3.00
October	3.75	4.76	4.87	1.00	3.03	0.94	4.50	5.84	2.43
November	3.25	3.85	3.95	1.00	2.22	0.93	3.00	3.91	1.23
December	2.50	2.89	3.05	0.25	1.43	0.10	2.00	2.77	0.75
2009									
January	2.00	2.09	2.27	0.25	1.18	0.10	1.50	2.17	0.70
February	2.00	1.83	2.03	0.25	1.26	0.10	1.00	2.05	0.75
March (1)	1.50	1.60	1.90	0.25	1.29	0.10	0.50	1.79	0.58

NOTES: (1) March 19.

(2) Marginal interest rate. Latest dates showing change in minimum rate: 3-07-08 (4.25%), 8-10-08 (3.75%), 6-11-08 (3.25%), 4-12-08 (2.50%), 5-03-09 (1.50%).

(3) Latest dates showing change: 11-12-07 (4.25%), 22-01-08 (3.50%), 30-01-08 (3.00%), 18-03-08 (2.25%), 30-04-08 (2.00%), 8-10-08 (1.5%), 29-10-08 (1%), 16-12-08 (0%-0.25%).

(4) Latest dates showing change: 10-04-08 (5.00%), 8-10-08 (4.5%), 6-11-08 (3.0%), 04-12-08 (2.0%), 7-01-09 (1.5%), 5-02-09 (1.0%), 5-03-09 (0.50%).

(5) Interbank rate.

SOURCE: National central banks, Bloomberg and own calculations.

somewhat better than the market had discounted.

Bond markets were not left untouched by the factors mentioned above regarding the interbank market so that there were significant reductions in yield rates offered by bonds issued by treasuries in the developed countries. The most notable move showed up in US government bonds following the meeting of the Federal Reserve on March 18. In the press release issued by the Open Market Committee, the Federal Reserve announced a measure to use 300 billion dollars to buy US government bonds over the next six months.

The final aim of this measure, according to the central bank, is to improve the conditions in private credit markets. Perhaps the success of the policy of buying government bonds by the Bank of England has convinced the Fed to adopt this kind of strategy. The surprise for investors was quite notable if we take into account that US 10-year government bonds immediately reduced their profitability by 45 basis points putting the quote at 2.50%. While this may be a small movement, a brief calculation reveals its importance. Bond interest rates and their prices go in opposite directions and a bond-holder who may have invested in 10-year

Lower returns on government bonds.

Federal Reserve to buy up US T-bonds to 300 billion dollars.

LONG-TERM INTEREST RATES IN NATIONAL MARKETS

10-year government bonds at end of period as annual percentage

	Germany	France	Spain	Italy	United States	Japan	United Kingdom	Switzerland
2008								
March	3.90	4.11	4.22	4.42	3.41	1.28	4.35	2.92
April	4.12	4.33	4.39	4.58	3.73	1.59	4.67	3.12
May	4.41	4.59	4.62	4.86	4.06	1.76	4.99	3.19
June	4.62	4.81	4.90	5.17	3.97	1.60	5.13	3.29
July	4.36	4.53	4.67	4.90	3.95	1.54	4.81	3.05
August	4.18	4.38	4.55	4.82	3.81	1.42	4.48	2.89
September	4.02	4.35	4.60	4.90	3.82	1.47	4.45	2.61
October	3.90	4.30	4.61	5.15	3.95	1.48	4.52	2.84
November	3.26	3.68	3.89	4.46	2.92	1.40	3.77	2.28
December	2.95	3.41	3.81	4.38	2.21	1.17	3.02	2.10
2009								
January	3.30	3.81	4.39	4.71	2.84	1.30	3.70	2.18
February	3.11	3.66	4.28	4.68	3.01	1.28	3.62	2.24
March (*)	3.05	3.58	4.09	4.38	2.52	1.27	3.04	1.98

NOTES: (*) March 19
SOURCE: Bloomberg.

Swiss central bank intervenes in foreign exchange market to weaken Swiss franc.

Treasuries would have benefited from a price increase of approximately 4.35%. Taking into account the present low interest rates and the fact that the yield from holding that bond for 10 years provides a meagre 2.50% annual, the sudden increase in bond price represented a gain not to be sneezed at.

Prospects both in the interbank market and on government bonds are for maintenance or even a slight reduction in current interest rate levels due to two key factors. The first is the synchronized world recession and, second, the clear desire of the central banks to maintain interest rates low at any cost in order to aid recovery.

Much activity in foreign exchange markets

In March, foreign exchange markets showed major swings in quotations for the main currencies. Among all these significant changes, however, what stand out are the movements in the Swiss franc and the US dollar. In both cases, the drastic monetary policy decisions made by the respective central banks influenced the quotations for these currencies.

First, the Swiss central bank intervened in the foreign exchange market to weaken the Swiss franc which had appreciated in recent months because it was acting as a refuge currency in the current crisis. This was the first intervention in foreign exchange markets by an important country since Japan had done so in 2004, which has raised expectations that other countries could adopt similar measures. In spite of continuous cuts in official interest rate by the central bank since October, the appreciation of the Swiss franc (equivalent to a restriction in monetary policy) was counteracting the efforts by

EXCHANGE RATES OF MAIN CURRENCIES

March 19, 2009

	Exchange rate	% change (*)		
		Monthly	Over December 2008	Annual
Against US dollar				
Japanese yen	95.0	0.8	4.6	–4.3
Pound sterling	0.690	–1.4	0.7	27.0
Swiss franc	1.128	–4.0	5.3	11.5
Canadian dollar	1.226	–2.6	0.6	17.3
Mexican peso	13.784	–7.1	0.8	22.2
Against euro				
US dollar	1.363	7.0	–2.5	–14.6
Japanese yen	129.5	7.8	2.1	–19.6
Swiss franc	1.538	3.3	2.9	–1.4
Pound sterling	0.941	5.7	–1.5	16.3
Swedish krona	10.886	–1.5	–0.5	13.7
Danish krone	7.451	0.0	0.1	–0.1
Polish zloty	4.541	–5.7	8.6	22.1
Czech crown	26.78	–8.0	–0.3	5.0
Hungarian forint	297.8	–1.9	10.8	13.6

NOTES: (*) Plus sign indicates appreciation of dollar (first group) or euro (second group).
SOURCE: Bloomberg.

the central bank to ease the slowdown in the country's economy. The response was this unusual direct intervention in foreign exchange markets which, for the moment, has served to weaken the Swiss franc against the euro and the currencies of Eastern Europe.

In the case of the dollar, the abovementioned measures taken by the Federal Reserve have been interpreted as a strong sign that the central bank is willing to inject all the liquidity needed to boost the US economy. The depreciation of the dollar against the euro of 7% in one month reflects this potential increase in the stock of dollars. In any case, an aggressive policy of quantitative easing such as that being employed by the Fed implies a depreciation of the dollar.

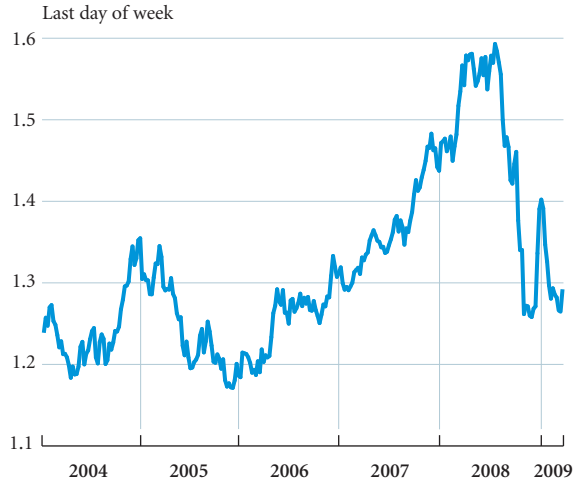
There are two factors that partly explain this movement. The first is the method used by the Fed to inject dollars into the system. The central bank has chosen the buying of long-term government bonds. This involves a reduction in bond yields. And this change means that the differentials with government bonds of other countries will increase. That is to say, the drop in yield on bonds expressed in dollars makes them less interesting to international investors who in turn want fewer dollars for their acquisition.

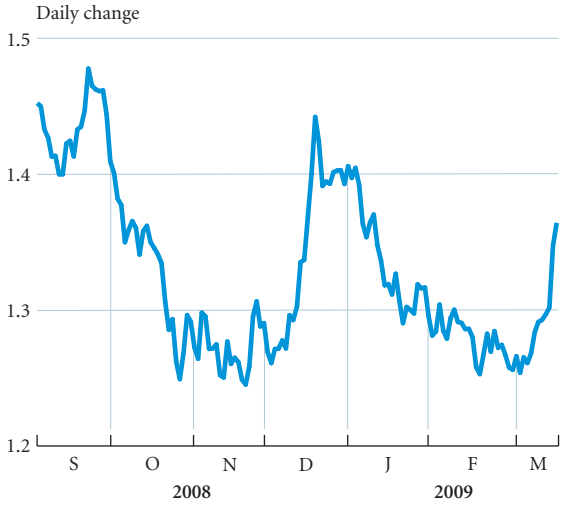
Secondly, there is a simple but implacable law of economics that says that an increase in the supply of any good means that the price will drop. For this reason, the increase in the stock of dollars involves the risk of a relative loss of value compared with other currencies.

Federal Reserve's decisions affecting dollar.

DOLLAR WEAKENING

Euro-dollar exchange rate





SOURCE: Bloomberg.

Stock market begins month with drop that changes into recovery.

Change of trend in shares

In March, activity in the share markets was highly notable. While in the early days of the month quotations showed sharp drops to new lows in the cycle, later on they changed direction and showed a rapid general recovery. For example, the S&P 500 and the Eurostoxx 50 went to levels 60% below the highs reached in 2007 only to later recover 12% and 15% respectively after that low. The US financial sector remains the key player presenting spectacular losses of 60% since the beginning of the year only to later show a notable rise.

What provoked the sharp initial drop? From a macroeconomic point of view, many variables recorded low levels not seen since the end of World War II. Economic figures as a whole showed a devastating situation especially in those countries that are heavily dependent on their foreign sector, such as Japan and Germany.

In this weak economic context, stock market investors concentrated their attention on the negative trend in corporate profits. In such a difficult situation, profit per share of US companies in the final quarter of 2008 fell to the lowest level since the Spring of 1991. As a result, the drop in profits in the second half of 2008 went to a spectacular 67.6% for companies included in the S&P 500 and to 37.1% for non-financial companies. In this process of decreases a convergence movement could be noted between the results in the financial sector and other sectors of the economy. In view of this, financial analysts had no other course than to drastically revise downward their estimates of profits to the point where they converged with profits reported by companies. This process was so intense that it may even be considered that there was a real collapse in the estimating of profits.

As well as the stock markets, corporate debt also succumbed to the decreases in

corporate profits and the worsening of general economic conditions. Because of this, credit differentials showed a further drop of a general nature. In the case of bond issuers with a high risk of default (junk bonds), spreads went to new all-time highs, also partly reflecting increased risk aversion among investors. For bonds of issuers with high credit rating, the increase in spreads was not so sharp but it did not fail to also affect leading international companies. In the United States, for example, corporate bonds of General Electric suffered an increase in their differential indicating a probability of bankruptcy of more than 40% in three years due to rumours about major losses in its financial subsidiary.

Two notable factors added an increased degree of uncertainty in those days when there was a growing flood of negative news. First of all, as a result of events around Citigroup, there was the fear that holders of bonds of financial entities could suffer from failures (in the form of debt releases or forced conversions) as a result of the government rescue programmes. This provoked a notable worsening of subordinated debt and preferential participations in financial entities, dragging with them corporate bonds and shares as whole.

In addition, the granting of bonuses to executives of financial institutions showing losses and that had received government support was another matter that had a negative effect on market sentiment. This matter raised an unfortunate discussion about the management capacity of the US Secretary of the Treasury. Resistance to the granting of further aid, both from

Economic figures and downward revision of corporate profits cause stock market drop in early days of March...

INDICES OF MAIN WORLD STOCK EXCHANGES

March 23, 2009

	Index (*)	% monthly change	% cumulative change	% annual change
New York				
Dow Jones	*7,543.1*	*6.0*	*–14.1*	*–39.0*
Standard & Poor's	*797.4*	*7.3*	*–11.7*	*–40.0*
Nasdaq	*1,506.4*	*8.6*	*–4.5*	*–33.3*
Tokyo	8,215.5	10.8	–7.3	–33.0
London	3,925.7	1.9	–11.5	–28.6
Euro Area	2,104.4	5.7	–14.0	–40.0
Frankfurt	*4,146.1*	*5.3*	*–13.8*	*–34.4*
Paris	*2,841.4*	*4.2*	*–11.7*	*–37.3*
Amsterdam	*218.6*	*–2.4*	*–11.1*	*–48.7*
Milan	*15,631.0*	*1.6*	*–19.7*	*–48.5*
Madrid	*7,902.7*	*4.8*	*–14.1*	*–39.0*
Zurich	4,877.7	1.7	–11.9	–30.4
Hong Kong	13,447.4	2.1	–6.5	–36.3
Buenos Aires	1,099.8	8.9	1.9	–45.4
São Paulo	41,675.7	7.6	11.0	–29.3

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: Bloomberg.

...but initial negative tone eases with less bad news and strong moves by central banks.

the White House and the two Legislative Houses, served to put in doubt the efficacy of the rescue measures.

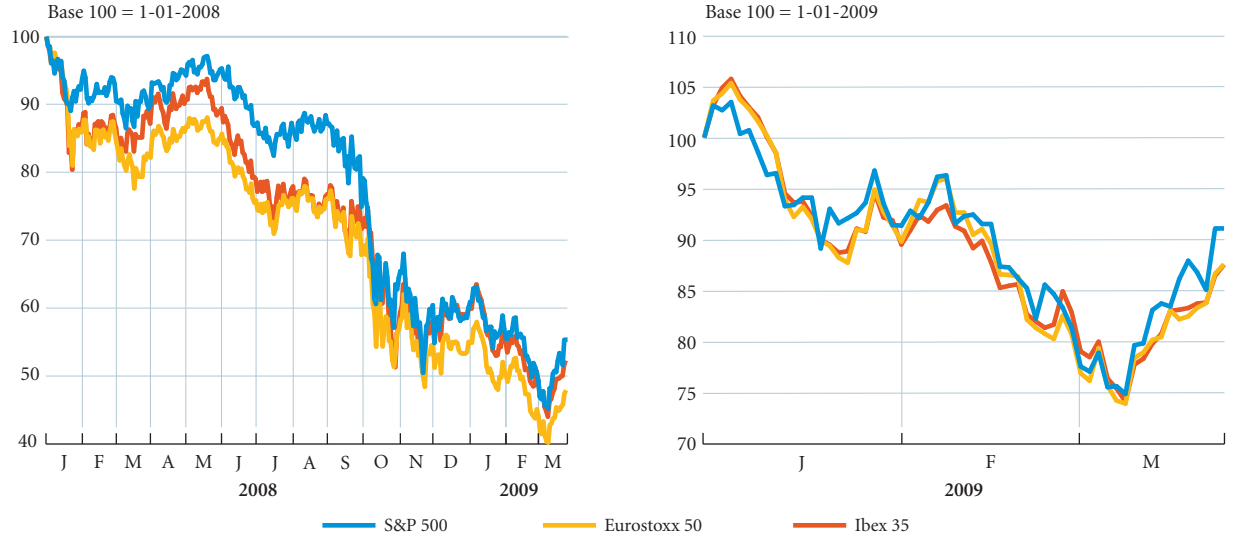
Nevertheless, the negative state gripping the markets began to dissipate and the reaction was a rapid recovery of the quotations mentioned above. As the month advanced the flood of bad news gradually dried up and the market began to centre its attention on the broad series of economic and financial policy measures being announced, thus giving rise to some feeling of hope. Expectations about the G-20 summit increased in view of possible positive results and the favourable impact of its success could have on the recovery from the world economic crisis.

Another decisive factor was the possible modification of evaluation criteria for financial assets in the balance sheets of the banks. This matter represents a key point in order to stabilize the financial system, especially the banking institutions in the United States. During a stage of economic growth, the rules for evaluating financial assets at market prices favour the granting of credit whereas in a period of recession such as this they set in motion a process of economic contraction thus creating a vicious circle. The US Senate is working hard to modify the norms for evaluating financial assets and make them more flexible for some «toxic» assets and thus put their balance sheets in order.

The moves by the central banks, especially the Federal Reserve, are also key for containing economic and financial risks. For example, the simultaneous introduction of various moves in the United States in mid-March has been significant. Among these measures was introduction of the TALF programme and the broadening of quantitative easing for acquisition of assets with mortgage security by the Fed and a new programme announced by the US Treasury. This consists of a public-

TURNAROUND IN DOWNWARD TREND ON STOCK MARKETS

Stock market quotations



SOURCE: Bloomberg and own calculations.

private investment plan to buy «toxic» assets from banks.

Apart from the moves by the Federal Reserve and the ECB, other authorities in various countries have adopted exceptional measures to deal with the crisis. The Bank of England and the Swiss National Bank have begun to acquire government and private bonds. At its meeting on March 17, the Bank of Japan approved an unprecedented measure involving the granting of subordinated loans in order to strengthen the capital ratios of Japanese banks in a weak state. All of this has contributed to improving the state of corporate bond and share markets which were heavily punished at the beginning of the month.

Furthermore, the risk of nationalization of the odd banking institution in the United States faded. During the weeks before this, the share market had given a negative response to the possibility that the US government might nationalize some bank or other. The entry of the government in the shareholder body of a bank would mean, on the one hand, the loss of control of that bank by the private sector and, on the other hand, the weakening of the minority shareholders. Time and again the US authorities have stated that their anti-crisis strategy does not contemplate the nationalization of banks but rather the opposite, the involvement of private initiative and capital in resolving such problems.

There are three key factors for a continuation of the trend toward the recovery of corporate bond and share markets. First, the success of financial stabilization measures put into action by governments and central banks around the world. Secondly, the gradual increase in corporate operations involving mergers and acquisitions. There have been recent examples in the pharmaceutical business, such as the acquisition by Merck & Co of its rival Schering-Plough and, in the high technology field, IBM is having conversations with Sun Microsystems. Finally, current values will attract individuals to invest in the stock market as against the current low levels of investment by households. In the United States at the end of 2008 individuals held investments in the stock market amounting to 20.5% of their total financial assets, below the historical average level of 23.7%. In the early months of 2008 these investments continued to drop. It is foreseeable that from these low levels an improvement in confidence will bring an increase in the flow of funds into shares.

Low quotes on stock markets, success of financial stabilization measures and increase in mergers and acquisitions are key factors for a continuation of recovery trend.

SPAIN: OVERALL ANALYSIS

Economic activity

Car registrations show year-on-year drop of 49% in February and go back to 1993 levels.

Recession grows worse in early months of 2009

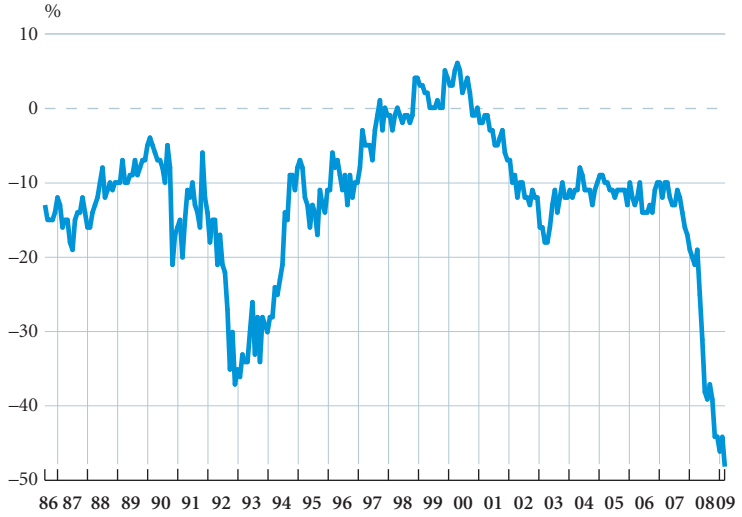
In a situation of sharp world slowdown, in the early months of 2009 available indicators point to a deepening of the recession that Spain's economy moved into in the second half of 2008. The crisis, which began in construction and then spread to industry, is now also striking at private services.

The increase in unemployment meant that the consumer confidence indicator for February showed an all-time low level since this index was first prepared in 1986 putting it substantially below the level during the previous recession in 1992-1993. Car sales thus dropped in the second month of the year with a decrease of 48.8% in spite of the start-up of the VIVE-2 programme to aid the sector. Registrations in February (62,107 units) meant a return to 1993 levels. In turn, retail sales were down 4.1% in the past 12 months ending in January, although this drop was lower than that noted in previous months. According to figures supplied by Anfel, the sector organization, appliances in the white goods line sold in the first two months of the year were down 30.6% compared with the same period the year before. Domestic sales of services by large companies were also down 9.5% in January compared with the same month last year although this drop was lower than that in December.

The weakness of demand, the decrease in utilization of production capacity, the drop in corporate profits and less

CONSUMER CONFIDENCE RECORDS ALL-TIME LOW

Net figure as percentage of consumer confidence indicator



NOTES: Statistics adjusted for seasonal effects.
SOURCE: European Commission.

desirable financing terms are also causing a drop in investment. Domestic sales of equipment and software by large companies dropped 24.8% in January compared with the same month the year before thus sharpening their decrease. Sales of commercial vehicles continued to drop with an annual decrease of 58.8% in February.

With regard to construction investment, apparent cement consumption in February was down 46.0% compared with the same month in 2008. Another early indicator, the go-ahead for new housing construction, fell by 47.3% in December compared with the same month in 2007 but supposes a lower year-on-year drop than in the past two months.

On the supply side, the industrial sector continues to adjust to the contraction in demand, both domestic and foreign. Industrial production was down 20.2% in January (adjusted for calendar differences) compared with the same month in 2008. Nevertheless, this sharp collapse is similar to that taking place in other developed economies and the rate of decrease is the same as that noted in December 2008, so that it would appear that the contraction in production has abated. The 9.2% year-on-year drop in electrical power consumption in February (the highest in recent decades) confirms the lowering of the rate of industrial activity. This applies to most branches of industry with the most affected being the manufacture of motor vehicles, trailers and semis which showed a year-on-year drop of 54.4%.

In any case, the prospects for the secondary sector continue to show weak if we are to go by the reduction of new industrial orders which were down 29.7% in January compared with the same month in 2008. In turn, the industrial confidence indicator for

Domestic sales of equipment and software by large companies sharpen drop.

Electrical power consumption in February records biggest year-on-year decrease in recent decades.

DEMAND INDICATORS

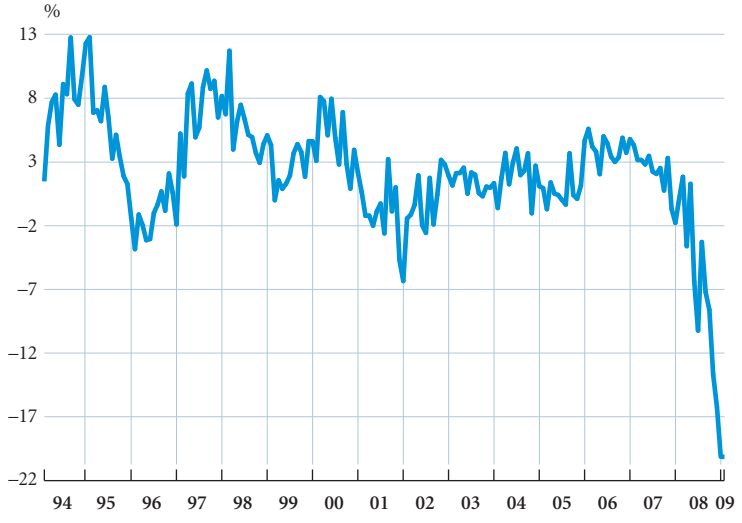
Percentage change over same period year before

	2007	2008	2008				2009	
			1Q	2Q	3Q	4Q	January	February
Consumption								
Production of consumer goods (*)	1.7	–4.7	0.3	–4.4	–4.5	–10.3	–12.6	...
Imports of consumer goods (**)	5.1	–7.7	–1.2	–6.9	–4.1	–17.2	–16.4	...
Car registrations	–1.2	–28.1	–15.3	–19.6	–32.5	–46.6	–41.6	–48.8
Credit for consumer durables	10.0	3.6	8.8	7.1	3.4	–4.2	–	...
Consumer confidence index (***)	–13.3	–33.6	–20.0	–31.3	–38.3	–44.7	–44.0	–48.0
Investment								
Capital goods production (*)	4.6	–8.8	–0.3	–6.1	–8.0	–20.8	–29.9	...
Imports of capital goods (**)	9.8	–19.6	–16.0	–16.4	–15.9	–28.8	–32.3	...
Commercial vehicle registrations	0.3	–43.6	–29.5	–34.1	–50.1	–61.3	–53.5	–58.8
Foreign trade (**)								
Non-energy imports	7.3	–4.9	4.3	0.2	–4.1	–19.0	–29.5	...
Exports	4.2	1.9	2.2	6.6	7.8	–8.4	–23.6	...

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.

COLLAPSE IN INDUSTRIAL PRODUCTION SLOWING DOWN

Year-on-year change in industrial production index



NOTES: Statistics adjusted for calendar effects.
SOURCE: National Institute of Statistics.

Situation in tourist industry grows worse with sharp drops in number of foreign visitors and hotel overnight stays.

February stood at a low level although very slightly above the end of 2008.

Construction also continued to adjust to the recession in the real estate sector. Housing sales in January totalled 37,931 units, a year-on-year drop of 38.6%. On the other hand, according to figures from the Housing Ministry, the price of urban land went down 10.5% in the fourth quarter of 2008 compared with the same period the year before, although in municipalities of more than 50,000 population the year-on-year drop was 1.2%. As a result, in 2008 as a whole the number of housing starts was 264,795, some 59.4% less than in 2007.

With regard to services, the situation is getting worse in the tourism sector. In February, arrivals of foreign tourists was down 15.9% compared with the same month in 2008 while hotel overnight stays fell by 15.5%, thus sharpening the decrease rate. This was largely due to the economic recession affecting the main tourist source markets.

The recessive situation, that shows up in decreased sales by companies and tighter financing terms, is bringing about an increase in default. As a result, the number of commercial effects unpaid in January was up 28.8% over the same month in 2008. As a result, the percentage of unpaid commercial effects out of those falling due rose to 6.4%. In addition, the number of companies created in January was down 44.7% compare with the same month last year.

Central government approves new package of measures to deal with economic recession.

In this situation, in the first week of March the central government adopted a new package of economic policy measures to deal with the unfavourable economic situation. It approved a new line of funding of up to 6 billion euros to finance working capital of medium-sized companies, 50% funded by the Instituto de Crédito Oficial (ICO), as well as measures to revive employment and ease the effects of unemployment. At the same time, the Secretary of State for Housing and the Minister of Science and Innovation announced that they were

SUPPLY INDICATORS

Percentage change over same period year before

	2007	2008	2008				2009	
			1Q	2Q	3Q	4Q	January	February
Industry								
Electricity consumption (1)	4.5	0.7	2.9	2.1	1.6	–3.5	–7.2	–9.2
Industrial production index (2)	2.0	–7.3	–0.8	–5.4	–6.3	–16.6	–20.2	...
Confidence indicator for industry (3)	–0.3	–18.0	–7.0	–13.7	–18.7	–32.7	–33.0	–37.0
Utilization of production capacity (4)	81.3	79.5	81.3	80.3	79.3	76.9	–	72.8
Imports of non-energy intermediate goods (5)	8.0	–0.7	11.4	6.9	–2.1	–18.2	–35.3	...
Construction								
Cement consumption	0.2	–23.6	–13.3	–19.6	–25.3	–37.5	–51.9	–46.0
Confidence indicator for construction (3)	9.3	–22.6	–14.7	–17.3	–23.7	–34.7	–38.0	–35.0
Housing (new construction approvals)	–24.7	–59.4	–59.8	–56.0	–62.4	–60.2	...	...
Government tendering	–15.0	4.1	27.7	–29.9	6.4	16.9	...	...
Services								
Retail sales (6)	2.3	–6.3	–4.0	–6.3	–7.1	–7.8	–4.1	...
Foreign tourists	1.1	–2.3	5.4	1.4	–5.1	–9.0	–9.8	–15.9
Tourist revenue inflows	3.6	–0.7	5.2	1.0	–0.3	–8.2	...	...
Goods carried by rail (ton-km)	–3.7	–7.7	–2.7	0.2	–5.2	–23.0	–39.7	...
Air passenger traffic	9.0	–3.1	7.9	–0.7	–4.9	–12.7	–17.1	...
Motor vehicle diesel fuel consumption	4.9	–3.8	–0.9	–2.8	–3.7	–9.6	...	...

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

expecting approval of the maintenance of tax deductions for R&D&I beyond 2011. This is important in order to strengthen private investment under this heading which, in spite of efforts made, still stands below the more developed countries. R&D&I is needed to increase the strength of growth and make a change in the economic model possible.

Thanks to the fiscal stimulus measures adopted, the economic sentiment index in February stood slightly above the level at the end of 2008, although it was a drop compared with January and stood at a level substantially below the average for recent years. In this framework, we are maintaining our forecast of a contraction of gross domestic product (GDP) of more than 2% in 2009. While it is likely that the recession will get worse in coming months, we expect that there will later be an improvement once the world financial crisis is contained under the effect of monetary and fiscal policy measures adopted.

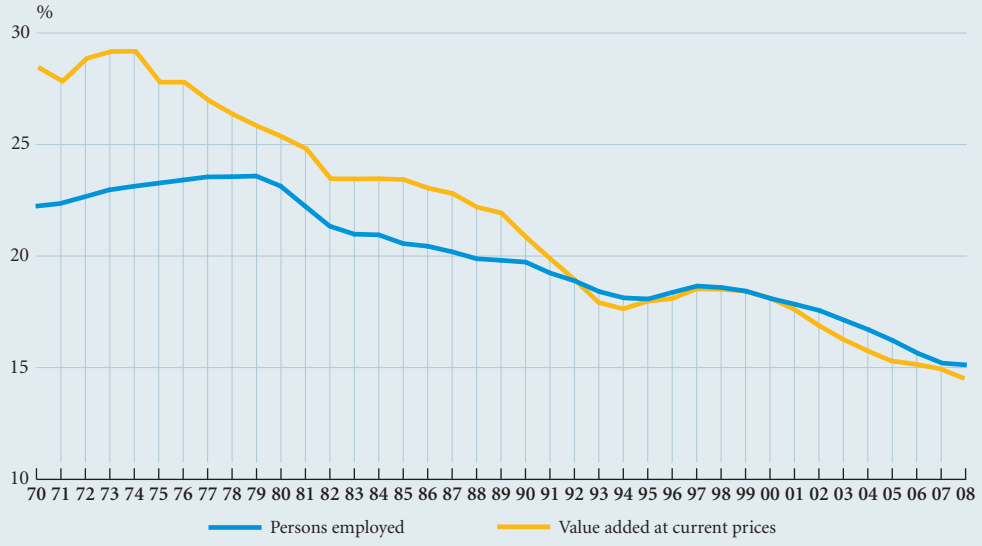
For 2009 as a whole, we forecast contraction of more than 2% in GDP with improvement coming in second half-year.

Deindustrialization, move to tertiary activities and other tricky matters

Industry is losing weight. According to the statistics, only 15% of jobs and value added generated in Spain may be attributed directly to manufacturing industry. This figure is lower than Germany's 19% but very close to that of France and still well above the 10% in the United Kingdom and the United States. The decline of the industrial sector is considered normal in the process of economic development. In backward societies the agricultural sector predominates. The first sign of progress is the introduction of industrial processes which little by little relegate the countryside to a marginal role. In turn, at a later stage, industry finds itself being relegated by the tertiary sector, a basket where we put such activities as transport, retail distribution, finance, government, etc. The advanced economies, it is said, are economies predominantly involved in services where manufacturing ends up having a rather small role.

WEIGHT OF INDUSTRY IN ECONOMY APPARENTLY DROPPING

Added value and persons employed in industry over total for economy



SOURCE: INE and own calculations.

Up to this point, we have dealt with clichés. In fact, the reality is rather different and, as we shall see, industry still holds a key role in the advanced economies and, specifically, in Spain. Some of the misunderstanding comes from the methodology used in the classification of economic activities. The rigid statistical division of the economy into watertight sectors (primary, secondary or industrial, and tertiary or services, plus construction) is not of great use when it comes to analyzing the trend in economic activities and diminishes our view of the real interaction between the various branches of production.

Another distortion arises from the different trend in prices. From the Seventies, manufacturing activities (from textiles to cars) have suffered brutal competition from the emerging countries in a context of reducing prices and increasing international trade. This has forced improvements in productivity and a radical reduction in

manufacturing costs. As a result, industrial producer prices have scarcely increased as against constantly rising prices for services (more sheltered from international trade). The result is that the bigger relative growth of services as against industry largely comes from the higher increase in prices. In Spain, for example, of the 15 points of GDP lost by manufacturing industry between the mid-Seventies and 2008, two-thirds came entirely from the effect of prices. Only one-third represents real loss.

But not even this apparent loss in real terms corresponds with reality. In order to understand why, we must refer to the changes taking place in recent decades in the organization of industrial production in the value chain of products. Let us suppose, for example, a company making household cleaning articles. In the Seventies and Eighties we would likely find a fully-integrated company with one or more plants, various warehousing and distribution points, a fleet of vehicles for transportation and logistics plus central services made up of marketing, advertising, personnel, research and development, etc. What is this company probably like today? Given the changes in industrial activities, it is reasonable to expect that it would have externalized or subcontracted logistics and distribution to outside companies as well as a good part of those activities related to marketing, legal and accounting services, data-processing, cleaning, etc. It surely would have kept its manufacturing plants but is also likely it has contracted out machinery maintenance, personnel training, internal logistics and the development of engineering projects. It is also likely that it is using personnel from temporary work agencies for specific projects. Production activity is the same and all that has changed is the method of organizing the company. The original company has «slimmed down» handing out part of its activities to outside suppliers in the services sector. Why has it done this? In order to gain efficiency, reduce costs and become more competitive and profitable. The overall economy has gained in specialization and this is equal to increased productivity. In terms of national accounting, industrial activity would have been reduced while at the same time there would have been an increase in services. Part of the employment that was previously industrial now would be counted under services. The value chain, however, is the same, and the company continues to hold control of the business as well as the core of operations it generates.

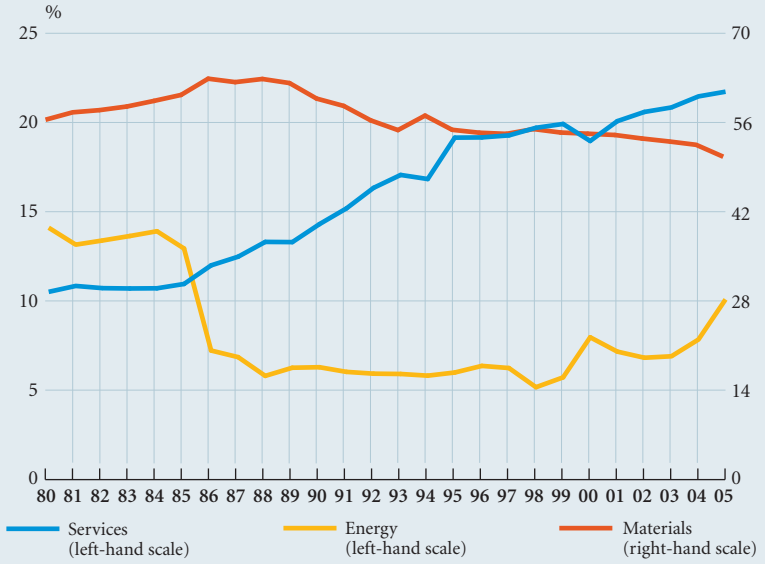
Up to what point is this apparent move of industry to tertiary activity important? Official statistics do not make such an analysis easy but we may construct an index of the move to tertiary activity by relating the payments of manufacturing companies for outside services with operating costs (the sum of personnel costs, total spending on goods and services). The result, shown in the accompanying graph, is that, in the case of Spain, while in 1980 manufacturing companies spent somewhat more than 10% of their operating costs on the purchase of services, in 2005 this figure rose to nearly 22%. In this period, the relative weight of other large groups of inputs scarcely changed, not even in the case of energy, in spite of price increases in that area. The sectors that were the biggest «consumers» of services were pharmaceutal companies, publishing, basic chemicals, plastics and food and tobacco. The lowest «consumers» were recycling, rail transportation equipment and cars.

This process of fusing manufacturing and services may also be seen in the rise in business services sector in which we may group companies involved in data-processing services, legal, accounting and management advice, architecture and engineering consultancies, advertising agencies, temporary work agencies and personnel search. The European Commission considers this sector to be one of the vectors of the knowledge economy and its weight is increasing as it is now growing well above the rate in manufacturing industry,[1] especially in terms of employment.

(1) Eurostat (2008), «Main features of the EU-27 Business Services», Statistics in focus 101.

INCREASING INDUSTRY-SERVICES INTEGRATION

Payments by manufacturing companies to suppliers in terms of total operating costs (personnel costs plus total purchases of goods and services)



SOURCE: EU KLEMS Database, March 2008 and own calculations.

An understanding of the process of externalizing industry to services is important both in order to be fully aware of the technological and organizational changes taking place in companies and to develop public policy, which must be aimed at facilitating structural change aimed at improving productivity, management, competitiveness, quality and profitability. From this point of view, industrial policy does not end with industry but rather spreads over to the services sector to the extent that deregulation and liberalization of that sector has proven to have a direct positive effect on the results of manufacturing sectors.[2]

This box was prepared by Joan Elias
Department of European Economy, "la Caixa" Research Department

(2) Arnold, Jens, Beata S. Javorcik and Aaditya Mattoo (2006), «Does Services Liberalization Benefit Manufacturing Firms?», Discussion Paper Series No. 5902, Centre for Economic Policy Research.

Labour market

Labour market continues to rapidly reflect decline in economy

The loss of jobs continued in February, according to figures for those registered with Social Security, showing a drop of 5.9% compared with the same month in 2008. As a result, on the monthly average, the number of persons registered in February stood at 18,112,611 which meant a drop to employment levels at the beginning of 2006.

On monthly average, some 69,132 jobs were lost in February with a loss of 1,139,514 in the past 12 months. Of these, 964,523 were Spanish nationals while 174,991 were foreign workers, which represents year-on-year decreases of 5.6% and 8.5% respectively.

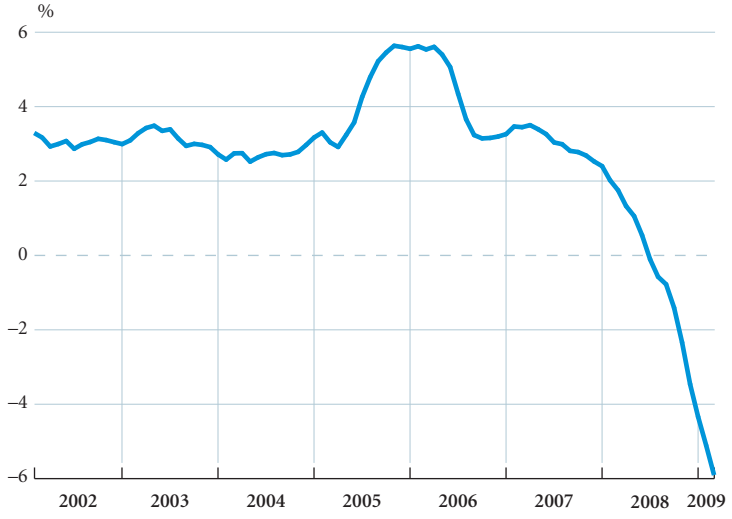
All production sectors showed decreases in February. In the last 12 months the sector to show the biggest drop in those registered was construction with a year-on-year decrease of 25.7%. In industry, the contraction was 9.3% while in services the figure was minus 2.3%. Nevertheless, since January construction has stopped leading the drop in those registered and services has shown the biggest decrease in jobs.

By sex, the drop in employment in the past 12 months has been concentrated among males with a year-on-year decrease of 8.6%. Nevertheless, the figures show that the loss of jobs among females is increasing at a fast rate with a year-on-year drop of 2.3%.

Number of those registered with Social Security down 6% in February 2009 compared with 12 months earlier.

LOSS OF JOBS CONTINUES

Year-on-year change in monthly average of number of workers registered with Social Security



SOURCE: Ministry of Labour and Social Services and own calculations.

EMPLOYMENT INDICATORS

Percentage change over same period year before

	2007	2008	2008				2009	
			1Q	2Q	3Q	4Q	January	February
Persons registered with Social Security (1)								
Sectors of activity								
Industry	*2.4*	*–2.1*	*0.8*	*–1.1*	*–2.6*	*–5.6*	*–8.2*	*–9.3*
Construction	*3.6*	*–10.3*	*–2.2*	*–7.0*	*–12.4*	*–19.6*	*–24.3*	*–25.7*
Services	*3.4*	*1.5*	*2.9*	*2.2*	*1.4*	*–0.4*	*–1.7*	*–2.3*
Job situation								
Wage-earners	*3.1*	*–0.7*	*1.6*	*0.3*	*–1.1*	*–3.7*	*–5.5*	*–6.3*
Non-wage-earners	*2.8*	*0.4*	*2.5*	*1.3*	*–0.1*	*–1.9*	*–3.2*	*–4.0*
Total	**3.0**	**–0.5**	**1.7**	**0.5**	**–0.9**	**–3.4**	**–5.1**	**–5.9**
Persons employed (2)	**3.1**	**–0.5**	**1.7**	**0.3**	**–0.8**	**–3.0**	–	–
Jobs (3)	**2.9**	**–0.6**	**1.7**	**0.1**	**–0.9**	**–3.1**	–	–
Hiring contracts registered (4)								
Permanent	2.0	–14.3	–11.8	–5.6	–13.8	–26.0	–39.4	–37.8
Temporary	0.3	–10.4	–6.5	–7.4	–9.4	–17.9	–27.3	–27.4
Total	**0.5**	**–10.9**	**–7.2**	**–7.2**	**–9.9**	**–18.9**	**–28.8**	**–28.8**

NOTES: (1) Average monthly figures.
(2) Estimate by Labour Force Survey.
(3) Equivalent to full-time work. National Accounting estimate; figures adjusted for seasonal effects and number of working days.
(4) At INEM.
SOURCE: National Institute of Statistics, Ministry of Labour and Social Services, Employment Institute and own calculations.

Drop in hiring contracts.

Naturally, the dismal situation in the labour market is also noted in the rhythm of hiring contracts. In February, the number of contracts signed through the public employment service was 1,016,678, a drop of 28.8% compared with the same month one year earlier. The contracts to show the biggest drop were those for permanent jobs which were down 37.8% while temporary job contracts dropped by 27.4%.

On the other hand, figures from the quarterly labour market survey carried out by the Ministry of Labour and Social Affairs show the same situation of decreasing employment. According to this survey, which, as opposed to the Labour Force Survey, is aimed at companies instead of households and covers the non-farm segment excluding the public service, the number of those employed showed a drop of 6.8% in the final quarter of 2008. Those workers on temporary hiring contract dropped by 19.7% year-on-year while those on permanent contract showed a decrease of 1.0%.

Registered unemployment up 50% in one year.

Registered unemployed figure close to three and a half million

The number of unemployed registered at public employment offices at the end of February was 3,481,859 which meant a year-on-year increase of 50.4%. In keeping with the trend in employment mentioned above, unemployment was noted more in the construction sector than in industry or services, with year-on-year changes of 107.2%, 55.8% and 42.3% respectively.

By sex, over the past 12 months the number of unemployed rose more among males (with an increase of 82.2%) than among females, with a rise of 27.7% in the year-on-year rate. Nevertheless, the increase in unemployed females has sharpened rapidly since January 2009. By age group, registered unemployment showed a bigger rise among those under 25 years than among others with year-on-year rates of 63.1% and 48.7% respectively.

We should point out that the loss of jobs in Spain is considerably higher than in other countries of the Euro Area that are going through a similar or even worse period of recession. Because of this, the central government has adopted measures to help maintain employment, provide for the unemployed and improve liquidity of companies.

In March, the measures announced were aimed at helping those who lose their jobs or who are at risk of losing it. For this purpose, conditions have been improved for workers and companies affected by workforce readjustment procedures. At the same time, the waiting period for receiving unemployment benefits has been eliminated.

A second group of measures has as its objective the maintenance and creation of employment. This measure sets up bonuses for corporate Social Security payments when companies hire unemployed persons and sets special conditions for postponing corporate Social Security payments. It also encourages part-time work through bigger bonuses for this group, especially for workers on very short workdays. Finally, the facilities of public

Government passes measures to ease decline in labour market.

REGISTERED UNEMPLOYMENT BY SECTOR, SEX AND AGE

February 2009

	No. of unemployed	Change over December 2008		Change over same period year before		% share
		Absolute	%	Absolute	%	
By sector						
Agriculture	114,215	12,877	12.7	29,996	35.6	3.3
Industry	453,491	53,619	13.4	162,506	55.8	13.0
Construction	632,505	41,775	7.1	327,242	107.2	18.2
Services	2,001,314	225,264	12.7	595,200	42.3	57.5
First job	280,334	19,361	7.4	51,584	22.6	8.1
By sex						
Males	1,755,969	179,502	11.4	791,736	82.1	50.4
Females	1,725,890	173,394	11.2	374,792	27.7	49.6
By age						
Under 25 years	442,503	57,373	14.9	171,180	63.1	12.7
All other ages	3,039,356	295,523	10.8	995,348	48.7	87.3
TOTAL	**3,481,859**	**352,896**	**11.3**	**1,166,528**	**50.4**	**100.0**

SOURCE: INEM and own calculations.

Wages up 5% in fourth quarter.

employment offices have been improved in order to meet the new situation.

Company labour costs rise more than inflation

According to the quarterly survey of labour costs carried out by the National Institute of Statistics, labour cost per worker per month for companies in the fourth quarter of 2008 rose by 5.4% compared with the same period the year before, marking up the biggest increase in recent years. The increase in labour cost is especially due to the rise in non-wage costs. Wage costs rose by 4.9% at year-on-year rate going from 1,808 euros to 1,897 euros per worker per month. On the contrary, other costs grew by 6.7% mainly due to the increase in indemnities for firing a worker or the end of a contract. In fact, compulsory payments to Social Security, the main component of these costs, showed a more moderate rise of 3.4%.

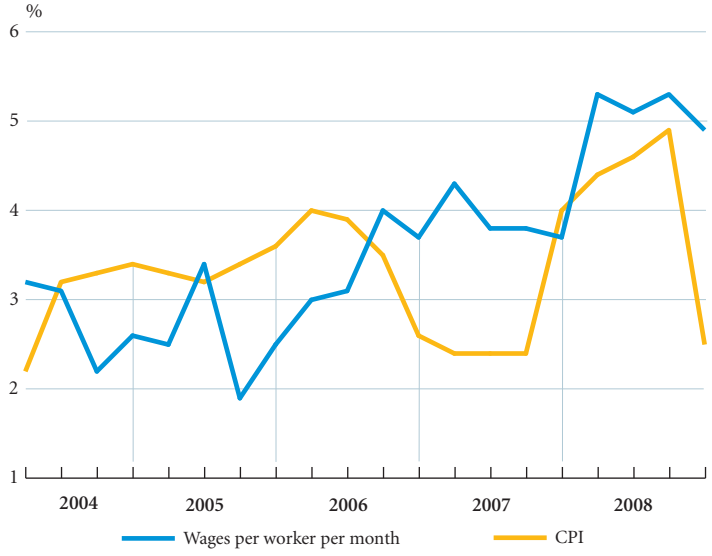
On the other hand, per-effective-hour labour cost was up 3.3% year-on-year. This increase, lower than the cost per worker, was due to an increase in the number of effective hours of work arising from fewer holidays and sick-leave days compared with the year before.

By sector, construction was the sector to show a higher increase in labour cost per worker per month in the fourth quarter of 2008, with a year-on-year rate of 7.8%. Industry and services reported a year-on-year rise of 5.4% and 5.0% respectively.

It should be noted that average earnings per worker per month, which rose by 4.9% at year-on-year rate in the final quarter of 2008, was higher than inflation reported in that period (2.5%). As a result, the purchasing power of workers increased substantially in this period and this clearly contributed the fact that in 2008 as a whole workers gained more in real terms.

WAGE INCREASES GO ABOVE INFLATION IN 2008

Year-on-year change



SOURCE: National Institute of Statistics and own calculations.

In 2009, a substantial moderation of inflation is expected and for this reason the CEOE (representing Spanish business) is proposing a maximum wage increase of 1% for new collective bargaining agreements. Furthermore, the association is proposing that wage revision clauses not apply only upwards but should also be adjustable downwards. At the same time, the proposal asks for the inclusion of option clauses under which companies expecting losses in 2009 could freeze worker wages. The business association proposal seeks the containment of wages in a situation of economic decline with moderation of inflation.

Wage increases agreed upon under collective bargaining agreements show that raises arrived at in the final quarter of 2008 were 3.6%. Nevertheless, increased negotiated in January and February were lower at 2.9% and 2.7% respectively. This would suggest that a halt to wage increases has begun in keeping with the economic situation and it is likely that wage moderation will continue in coming months.

Wages gain in purchasing power in 2008.

WAGE INDICATORS

Percentage change over same period year before

	2007	2008	2007		2008			
			3Q	4Q	1Q	2Q	3Q	4Q
Increase under general wage agreements (*)	**3.1**	**3.6**	**2.9**	**3.1**	**3.4**	**3.5**	**3.5**	**3.6**
Wage per job equivalent to full-time work (**)	**3.7**	**5.3**	**3.8**	**4.1**	**5.2**	**5.4**	**5.3**	**5.2**
Quarterly labour cost survey								
Wage costs								
Total	3.9	5.1	3.8	3.7	5.3	5.1	5.3	4.9
Industry	*3.0*	*5.1*	*2.3*	*2.8*	*5.8*	*5.1*	*4.8*	*4.9*
Construction	*4.8*	*5.8*	*4.8*	*5.1*	*4.8*	*6.5*	*5.8*	*6.2*
Services	*4.2*	*5.0*	*4.2*	*3.8*	*5.1*	*4.8*	*5.3*	*4.7*
Average wages per hour worked	4.4	4.9	4.6	4.1	9.0	1.9	6.5	2.8
Other labour costs	4.4	5.5	5.2	5.3	4.5	5.7	4.9	6.7
Work day (***)	–0.4	0.1	–0.9	–0.3	–3.5	3.1	–1.2	2.0
Farm wages	**3.1**	**5.1**	**3.3**	**3.5**	**4.6**	**5.2**	**6.1**	**4.5**
Labour cost in construction	**2.4**	**5.7**	**2.3**	**2.3**	**0.8**	**6.4**	**7.6**	**7.9**

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

Prices

CPI records lowest annual rate since 1969

Year-on-year change rate in CPI drops to 0.7%, lowest level since June 1969.

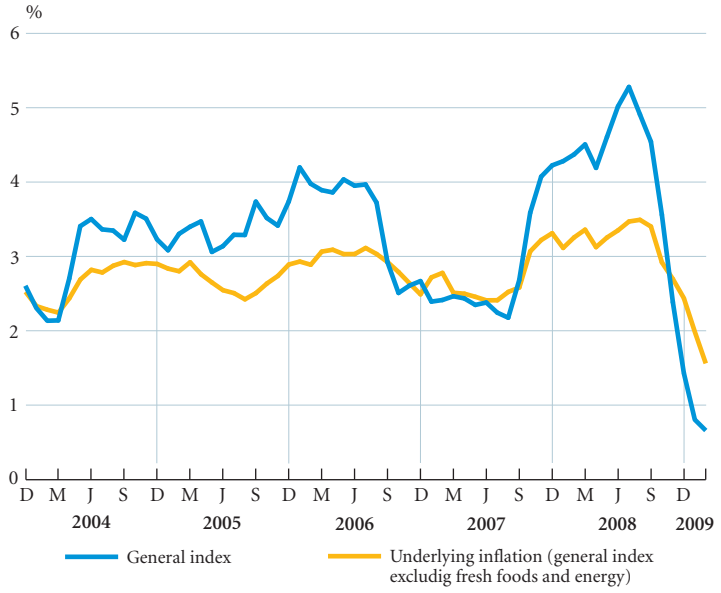
The downward trend in inflation begun in the summer of 2008 continued in February. The consumer price index (CPI) remained unchanged as opposed to the same month last year when it rose by 2 decimals. As a result, the year-on-year CPI change rate dropped by one decimal to stand at 0.7%, the lowest level since June 1969. The inflation rate thus stood 3.7 points below one year earlier due to the collapse in prices of oil and food commodities in recent months. Furthermore, in recent months we have noted deflationary pressures due to the contraction of demand for consumer goods and services. There has also been some pass-through of the decrease in fuel prices.

Sharp 4-decimal drop puts underlying inflation at lowest figure in recent decades.

Nevertheless, as opposed to what has happened in recent months, energy products did not contribute to the drop in inflation in February but rather added a decimal. In turn, fresh foods also made a positive contribution through poultry, fresh fish, produce and fresh vegetables. The downward pressure came from underlying inflation (the most stable core of the CPI which excludes unprocessed foods and energy products. In February, underlying inflation dropped by 4 decimals to 1.6%, the lowest level in recent decades.

UNDERLYING INFLATION ALSO MOVING DOWN

Year-on-year change in CPI



SOURCE: National Institute of Statistics.

CONSUMER PRICE INDEX

	2008			2009		
	% monthly change	% change over December 2007	% annual change	% monthly change	% change over December 2008	% annual change
January	–0.6	–0.6	4.3	–1.2	–1.2	0.8
February	0.2	–0.5	4.4	0.0	–1.2	0.7
March	0.9	0.4	4.5			
April	1.1	1.5	4.2			
May	0.7	2.2	4.6			
June	0.6	2.8	5.0			
July	–0.5	2.3	5.3			
August	–0.2	2.1	4.9			
September	0.0	2.0	4.5			
October	0.3	2.4	3.6			
November	–0.4	2.0	2.4			
December	–0.5	1.4	1.4			

SOURCE: National Institute of Statistics.

Processed foods contributed one decimal to the drop in inflation in February. The contribution of cooking oils, pastries and baked goods, meat specialties and bread stood out.

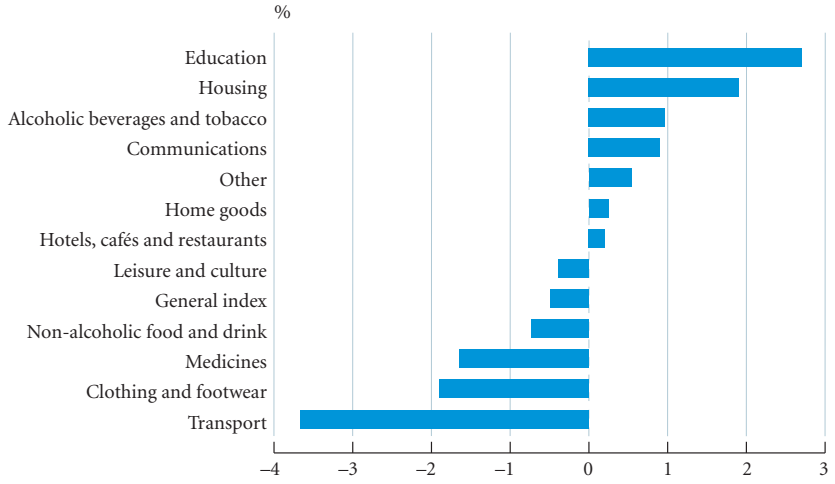
Industrial goods excluding energy products also contributed one decimal to the drop in inflation in February.

This contribution may largely be attributed to clothing and footwear

Manufactured products help cool down inflation.

INFLATION IN SPAIN BELOW EURO AREA

Inflation differential with Euro Area by component



NOTES: February, 2009.
SOURCE: Eurostat and own calculations.

CONSUMER PRICE INDEX BY COMPONENT GROUP

February

	Indices (*)	% monthly change		% change over previous December		% monthly change	
		2008	2009	2008	2009	2008	2009
By type of spending							
Food and non-alcoholic beverages	110.2	–0.1	–0.5	0.4	–0.4	7.0	1.5
Alcoholic beverages and tobacco	115.5	1.0	1.2	3.1	3.3	3.9	4.2
Clothing and footwear	92.5	–1.3	–1.4	–13.0	–15.0	0.8	–1.8
Housing	112.6	0.3	0.4	2.0	0.9	5.3	4.7
Furnishings and household equipment	106.0	0.1	0.1	–0.1	–0.5	2.6	2.2
Health	99.2	0.4	0.2	0.8	0.4	–1.8	–0.1
Transport	99.2	0.3	0.3	0.4	–0.2	7.3	–6.2
Communications	99.7	–0.1	0.0	0.3	0.1	0.9	–0.5
Recreation and culture	98.5	0.3	0.2	–1.1	–1.2	–0.5	0.2
Education	111.6	0.0	0.0	0.2	0.1	3.8	3.9
Restaurants and hotels	110.9	0.6	0.2	1.3	0.4	4.8	3.1
Other goods and services	108.9	0.8	0.3	1.7	1.2	3.1	3.0
By group							
Processed food, beverages and tobacco	111.3	0.7	0.0	1.5	0.2	7.4	1.7
Unprocessed food	109.7	–1.6	–0.7	–1.0	–0.4	5.2	2.2
Non-food products	104.0	0.2	0.1	–0.8	–1.5	3.6	0.3
Industrial goods	98.8	–0.1	–0.1	–2.6	–3.6	3.4	–2.5
Energy products	*100.3*	*0.0*	*1.3*	*1.5*	*0.5*	*13.3*	*–8.1*
Fuels and oils	*94.3*	*0.1*	*1.8*	*0.9*	*–0.5*	*16.7*	*–14.1*
Industrial goods excluding energy products	*98.0*	*–0.2*	*–0.6*	*–3.9*	*–5.0*	*0.2*	*–0.7*
Services	109.6	0.5	0.2	1.1	0.6	3.8	3.3
Underlying inflation (**)	105.8	0.3	–0.1	–0.6	–1.5	3.3	1.6
GENERAL INDEX	**105.6**	**0.2**	**0.0**	**–0.5**	**–1.2**	**4.4**	**0.7**

NOTES: (*) Base 2006 = 100.
(**) General index excluding energy products and unprocessed food.
SOURCE: National Institute of Statistics.

Differential with Euro Area marks up record going to minus 0.5 points.

which showed a negative year-on-year change rate of –1.8 points.

The year-on-year change in services prices was down 3 decimals (more than expected) going to 3.3%, showing that the weakness in demand is tending to ease prices. Hotels, cafés and restaurants were down 4 decimals to 3.1% year-on-year, the lowest rate since August 1998. Insurance, especially car insurance, also helped push inflation down.

The consumer price index harmonized with the European Union also recorded an annual rise of 0.7%. The differential with the Euro Area was thus negative at –0.5 percentage points, marking up a record. This was partly due to the higher weighting of fuels and lubricants as well as foods in the Spanish index but, in fact, the differential in terms of underlying inflation in February was negative for the first time since 2001.

The inflation prospects for coming months are downward. In Spring, we shall probably see negative year-on-year change rates due to the high level of commodity prices in the first half of 2008 but rates will later rise.

Negative year-on-year inflation rates likely to be seen in Spring but these will be temporary.

Further drop in wholesale prices

In the first month of 2009, wholesale prices stood below the same level last year thus reflecting the drop in commodity prices and the sharp decrease in demand in recent months. The year-on-year change rate in producer prices was –0.6 points. This drop was mainly due to intermediate goods for which the annul change rate stood at –1.6 points.

Import prices also stood on negative ground. Prices of goods acquired abroad were down 4.9% compared with January 2008, thus showing a sharper drop.

Collapse of commodity prices brings about 0.6% year-on-year drop in producer prices.

INFLATION INDICATORS

Percentage change over same period year before

	Farm prices	Producer price index					Import prices				GDP deflator (*)
		General index	Consumer goods	Capital goods	Intermediate goods	Energy goods	Total	Consumer goods	Capital goods	Intermediate goods (**)	
2007											
December	17.6	5.7	4.8	3.2	5.0	10.2	5.2	1.0	0.1	0.8	–
2008											
January	11.1	6.3	5.4	2.9	5.5	11.1	7.0	1.1	0.4	1.9	–
February	7.3	6.3	5.6	2.6	5.9	11.0	7.0	1.4	0.2	1.9	3.2
March	10.5	6.6	5.4	2.5	5.9	12.4	6.9	0.7	–0.3	2.3	–
April	8.5	6.6	5.1	2.5	5.8	13.3	6.9	0.6	–0.4	2.3	–
May	15.2	7.4	5.1	2.3	5.9	17.4	9.2	0.7	–0.1	2.5	3.1
June	8.6	8.4	5.2	2.3	6.2	21.1	10.4	1.1	–0.2	2.6	–
July	14.1	10.2	5.1	2.5	7.3	27.4	10.4	0.5	–0.2	3.7	–
August	6.9	9.2	4.8	2.5	7.6	23.2	9.6	1.3	0.3	5.0	3.4
September	–2.3	8.3	4.1	2.4	7.1	19.9	8.5	1.9	0.6	5.9	–
October	–8.2	6.1	2.8	2.4	5.3	14.9	5.2	3.2	1.3	5.1	–
November	–11.4	2.9	2.1	2.3	2.9	4.3	0.9	4.3	1.9	5.0	2.5
December	–9.7	0.4	1.6	2.3	0.9	–3.7	–3.9	2.5	1.6	2.0	–
2009											
January	...	–0.6	0.9	1.9	–1.6	–2.6	–4.9	2.7	1.8	0.6	–

NOTES: (*) Figures adjusted for seasonal and working days effects.
(**) Except energy.
SOURCE: National Institute of Statistics, Ministry of Economy and own calculations.

Foreign sector

Spain's trade deficit in 2008 stood at 8.6% of GDP, a level similar to that in 2005.

Why is the trade deficit decreasing?

As mentioned in our March Monthly Report, Spain's trade deficit recorded a drop in 2008 following five consecutive years of increases and stood at 94.1 billion euros, 4.9% below that in 2007. As a result, the deficit for 2008 as a whole was 8.6% of GDP, a proportion similar to that recorded in 2005 and significantly lower than the high reached in the second quarter of 2008 (9.7%).

An analysis of the trade balance broken down by economic sectors shows that only two sectors showed a positive trade balance in 2008, namely, the food sector (with meat, fruit and vegetables dominating) and non-chemical semi-manufactured goods (with ceramics as the main element). Nevertheless, these positive contributions to the trade balance were well below the deficit in other economic sectors such as chemicals, capital goods and energy products. The latter showed a trade deficit of 44.5 billion euros, 34% more than in 2007.

In spite of the fact that most sectors showed trade deficits, only two (chemical products and energy products) failed to show an improvement in trade surplus in 2008. All other sectors, especially

FOREIGN TRADE

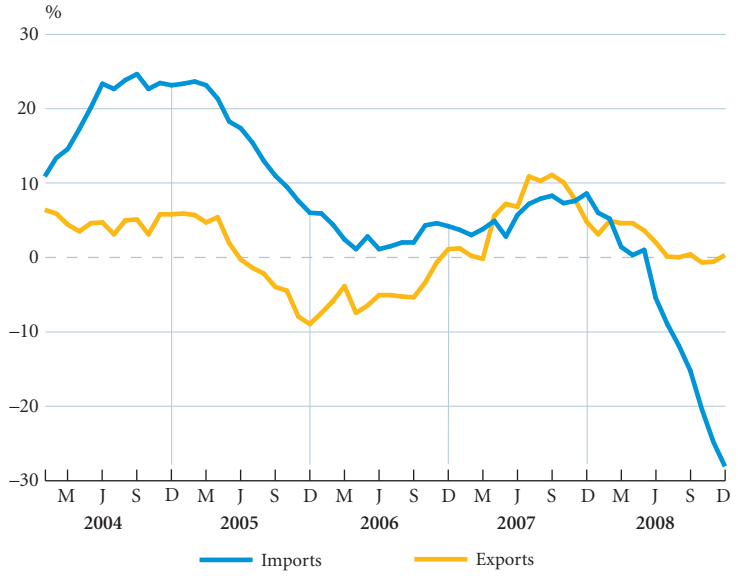
Year 2008

	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								
Food	25,977	6.9	9.2	26,787	7.8	14.2	811	103.1
Energy products	56,563	36.0	20.0	12,076	43.6	6.4	–44,487	21.3
Oil	*42,622*	*32.5*	*15.1*	*10,700*	*39.4*	*5.7*	*–31,923*	*25.1*
Non-energy commodities	9,972	–1.8	3.5	3,606	–1.7	1.9	–6,366	36.2
Non-chemical semi-manufactured goods	23,512	–12.3	8.3	24,535	2.8	13.0	1,022	104.3
Chemical products	35,225	7.6	12.5	25,240	6.4	13.4	–9,985	71.7
Capital goods	62,900	–5.2	22.3	38,733	–1.0	20.6	–24,167	61.6
Motor vehicle sector	33,017	–19.8	11.7	32,310	–2.3	17.2	–707	97.9
Cars and motorcycles	*16,353*	*–27.4*	*5.8*	*21,394*	*0.6*	*11.4*	*5,041*	*130.8*
Consumer durables	7,768	–12.7	2.8	5,128	–9.6	2.7	–2,640	66.0
Consumer manufactures	26,153	–2.4	9.3	15,632	0.7	8.3	–10,521	59.8
Other merchandise	1,166	–26.3	0.4	4,137	15.3	2.2	2,972	355.0
TOTAL	**282,251**	**0.6**	**100.0**	**188,184**	**3.7**	**100.0**	**–94,067**	**66.7**

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

CARS: BIGGER CORRECTION IN IMPORTS THAN IN EXPORTS

Nominal year-on-year change in cumulative figures for 12 months



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

in the second half-year, reported a substantial contraction in imports, largely counteracting the performance in energy imports and putting the overall change at 0.6%. While exports also underwent a drop in this period, this decrease was lower than that for imports with growth of 3.7% compared with the year before. As a result, Spain's volume of trade (calculated as the sum of imports and exports) grew by only 1.8% in 2008, far from the 7.6% in 2007.

The worsening of imports was the result of the collapse in domestic demand which was much greater than the drop in foreign demand for Spanish products. This difference showed up especially in the motor vehicle sector, durable goods and non-chemical semi-manufactured goods. On the other hand, only food and chemical products (especially medicines) showed growth in both imports and exports given that these are sectors less sensitive to economic cycles.

Most non-energy economic sectors show improvement in trade balance.

One of the sectors to show a bigger reduction in deficit in 2008 was motor vehicles and car parts which recorded an improvement of 7.3 billion euros in trade balance. The main factor in this reduction was trade in cars which, in spite of the stagnation in annual exports (with growth of 0.3% compared with 2007) showed a trade surplus of 5.5 billion euros due to the collapse of 28.2% in imports in 2008. Monthly figures underline the drop in domestic demand with a reduction in car imports of 50% and 37% in November and December 2008 respectively. This was well above the reduction in exports which stood at around 15% during these two months.

Drop in car imports brings about surplus of 5.5 billion euros.

Forecasts indicate a reduction in Spain's trade deficit in 2009. The reasons for this

Energy component will reduce its deficit in 2009.

are, first of all, a bigger drop in domestic demand than in foreign demand which will mean that the differential between the performance of imports and exports will be maintained in coming months. The second factor to keep in mind is the performance of energy products.

In 2008, the value of oil and natural gas imports rose by 37.5% contributing 38.7 billion euros to the annual deficit, three-quarters of this coming from trade in oil. The main factor responsible for the increase in oil imports was the rise in price up to July 2008 when it reached its highest level.

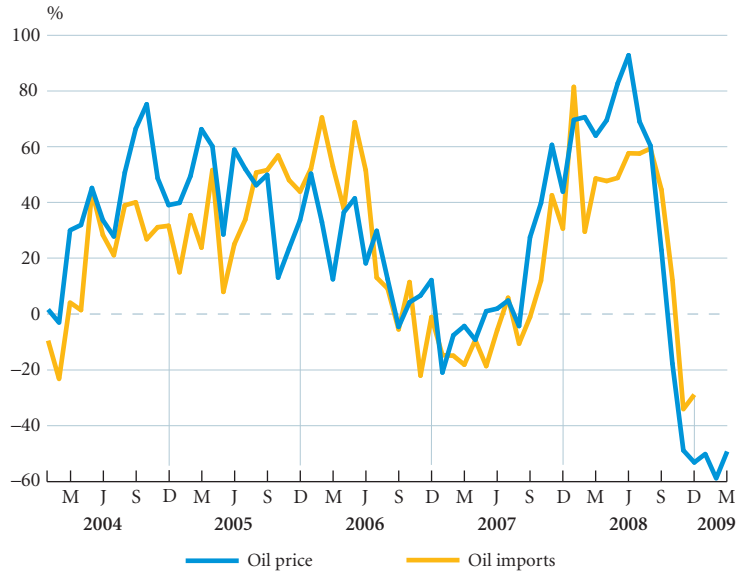
The drop in oil prices in the final months of 2008 and their later stabilization, combined with a contraction in domestic demand, would indicate that the value of oil imports will continue to show negative year-on-year rates, thus easing the deficit in energy products.

Deficit could stand close to 6% of GDP in 2009.

As a result of these factors, it is expected that the trade deficit in 2009 will reach around 6% of GDP, a level similar to that reported in 2006.

OIL IMPORTS TO KEEP DROPPING IN COMING MONTHS

Year-on-year change in value of oil imports



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

How does Spanish industry stand in terms of foreign competitiveness?

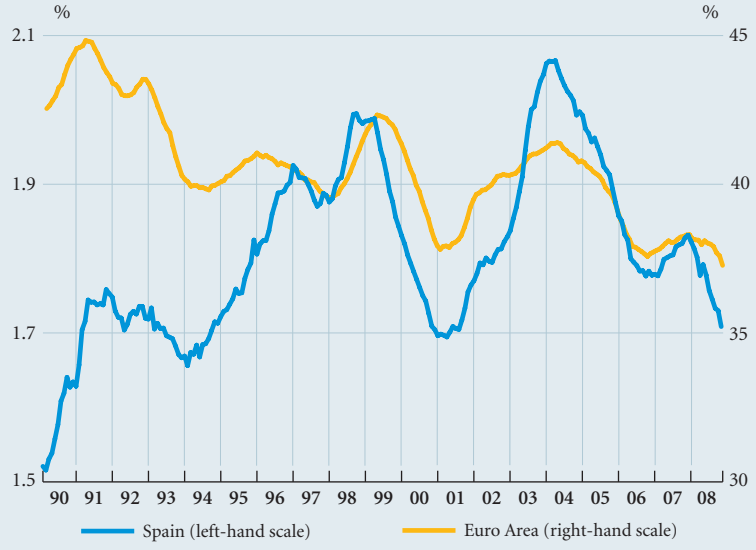
When a country loses competitiveness in the world market its capacity to maintain high economic growth becomes limited, especially in an open market situation in which new producing countries are emerging at a rapid rate. For this reason, it is essential to fully know the state of foreign competitiveness of those products manufactured in an economy, in the case of interest to us, the position of Spain.

We should point out, however, that an examination of foreign competitiveness is not an easy task as there is no single indicator that summarizes all relevant information. This demands the examination of various variables such as, for example, the quota of goods exports in the world market, the technology content of those exports and their competitiveness/price. As may be seen, an analysis of the behaviour of these indicators suggests that Spain has lost competitiveness in recent years.

Let us first look at the course taken by the quota of goods exports which measures the weight of exports of a country in the sum total of world exports. A drop in this variable may partly reveal a loss of competitiveness seeing that, to some extent, it expresses a decrease in the relative results of an economy. As shown in the following graph, Spain's export quota in world trade in goods has dropped in the past five years. Nevertheless, we should point out that this downward trend is common to other advanced economies due to the expansion of trade of the emerging countries. In fact, the graph also shows that the loss of quota of world exports in the case of the Euro Area countries has been greater than that of Spain over the past two decades.

SPAIN AND EURO AREA LOSING WEIGHT IN WORLD EXPORTS

Goods exports quota out of world total

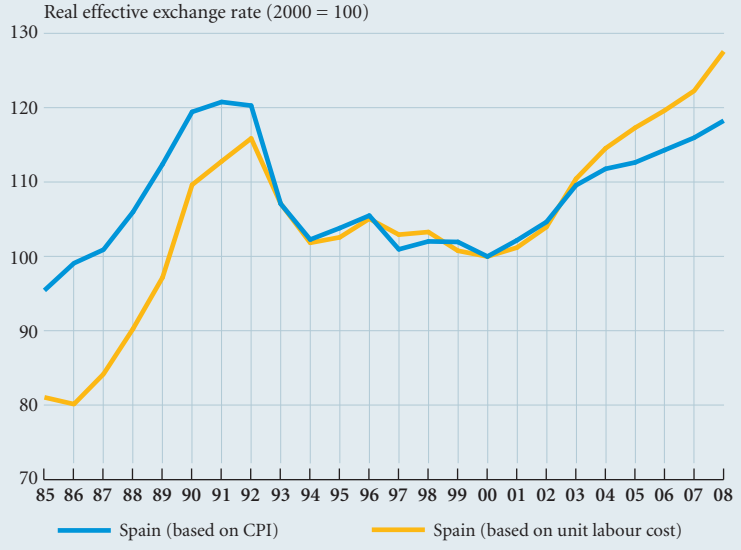


SOURCE: International Monetary Fund and own calculations.

Having reached this point it is important to note that a slight drop in a country's export quota may represent a major loss of competitiveness if the value added or technology content of those exports has dropped at the same time. In this case, companies would base their exports on products that were little different or price-taking and they would be obliged to compete mainly by tightening their margins. According to OECD figures, Spain's industry is specialized in goods of medium/low technology content and this situation has not improved in the past 15 years. As a result, Spanish goods exports have continued to be in products lacking any special differentiation. No doubt, this makes it necessary to qualify the relatively positive course followed by the export quota of Spanish goods.

Another indicator of foreign competitiveness is the price differential of products or competitiveness/price, which is estimated from effective real foreign exchange indices. This index takes two factors into account –differences in production costs in each country (which may come close to the consumer price index, unit labour costs and export prices) and the trend in foreign exchange rates. Competitiveness/price is an especially relevant variable in products of medium/low technology content which represent 95% of goods exported by Spain, given that the buyer is often in better position to negotiate the final outcome of the transaction. The following graph shows that Spain has undergone a drop in competitiveness/price the present decade, thus turning back the gains achieved in the Nineties. This tendency is due to both higher inflation than that of trading partners and the appreciation of the euro against other currencies, especially since 2002.

DROP IN COMPETITIVENESS/PRICE IN SPAIN SINCE 2000



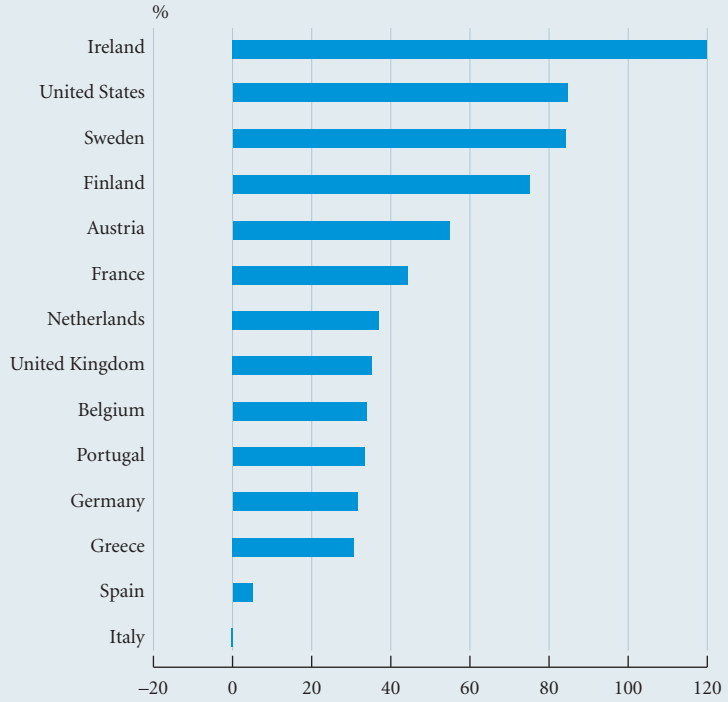
NOTES: A rise in the index indicates a loss of competitiveness.
SOURCE: OECD.

Naturally, Spain is unable to change the foreign exchange rate so that the margin for manoeuvre is restricted to the inflation differential or to costs. In recent years Spanish products have become more expensive than those of its trading partners. To some extent, certain observers have blamed this phenomenon on the existence of a regulatory framework that makes competition difficult in some sectors. Nevertheless, the most important factor in the price differential probably has been the poor trend in Spanish productivity. In fact, as may be seen

in the following graph, Spain stands at the tail-end of average productivity growth in the manufacturing sector. The poor performance in productivity to some extent means that unit labour cost is growing faster in Spain than in other countries, which, in turn, is passed through as bigger increases in final prices.

SPAIN AT TAIL-END OF PRODUCTIVITY IN MANUFACTURING SECTOR

Growth of value added per hour worked in manufacturing sector (1995-2005)



SOURCE: EU KLEMS Database, March 2007 and own calculations.

To sum up, the group of indicators analyzed suggest that there has been a loss of foreign competitiveness in Spain in recent years. What are the factors that could contribute to reverse this situation? No doubt, an improvement in productivity growth given that in this way unit labour cost would be reduced as well as final product prices. Another fundamental factor would be to increase technological innovation. This would make it possible to create products that were more differentiated and would help mean that Spain's foreign competitiveness was less exclusively dependent on price differentials or the tightening of margins.

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Public sector

Public deficit goes above forecasts in 2008 and European Commission opens an excess deficit procedure.

Government finances made sharply worse by economic crisis

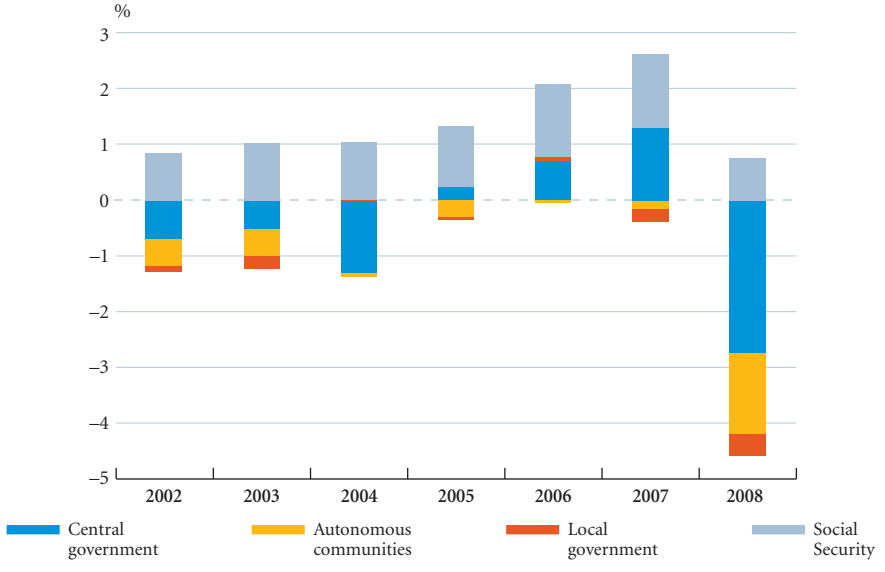
After having recorded the biggest surplus in recent decades in 2007, the year 2008 ended with a huge public deficit of 3.8% of gross domestic product (GDP). This figure was well above forecasts and, for the first time since Spain joined the euro, brought about the opening of an excess deficit procedure by the European Commission, along with five other European Union countries also affected by the economic crisis, because of their going above the limit of 3% of GDP set under the Stability and Growth Pact. Nevertheless, Spain's ratio of government debt to GDP stood at 39.4%, a relatively low level, nearly 30 points below the Euro Area average.

The total deficit was distributed unequally among the various levels of government. The central government showed a deficit of 2.74% of GDP after recording a surplus of 1.30% of GDP in 2007. The accounts of the autonomous communities were also sharply worse and ended up showing a deficit of 1.45% of GDP. The performance by local government was less unfavourable with a deficit of 0.39% of GDP in 2008. Only Social Security showed a positive balance with a surplus of 0.76% of GDP, although this was substantially lower than the 1.31% of GDP reported the year before because of the drop in the number of those employed.

The sharp turnaround in the public accounts in 2008 may be attributed to

PUBLIC DEFICIT RISES TO 3.8% OF GDP IN 2008

Budgetary balance by level of government as percentage of GDP



SOURCE: Ministry of Economy and Finance.

the decided slowdown in the economy which turned into recession in the second half of the year. The direct effects on the public accounts were a drop in taxable incomes, and in consumer spending, investment, wages and corporate profits. On the other hand, payments for unemployment benefits shot up. The cyclical component of the public deficit is thus considered to be close to half. But the component arising from the discretional fiscal measures taken by the government to deal with the economic recession (estimated at 1.8% of GDP) was also significant.

The central government accounts, which allow for a more detailed analysis, sharply reflect the impact of the economic recession. In 2008, tax revenues were down 18.9%, as against an increase of 4.2% in nominal GDP. As a result, the tax load was lower after having increased in recent years.

With regard to central government spending, public servant salaries rose by 6.9% in 2008 while purchases of goods and services were up 8.3%. Interest payments increased by 1.1%. Capital spending was up 16.0%.

Both cyclical component and discretional measures make substantial contribution to raising government deficit.

In addition, the performance in central government revenues and spending in January resulted in a surplus of 0.07% of GDP, measured in National Accounting terms, that is to say, according to recognized rights and obligations. Nevertheless, this surplus was 49.9% lower than the figure in the first month of 2007 and is not indicative of the trend during the year.

Central government tax revenues down 19% in 2008.

In fact, because of the economic recession, which will continue to have a substantial impact on revenues and spending of the various levels of government, and as a result of fiscal stimulus measures expected to come close to two and a half points of GDP, the government deficit will keep rising. It could go as high as twice the figure for 2008 in terms of GDP.

Government deficit in 2009 could be twice 2008 figure.

CENTRAL GOVERNMENT BUDGETARY IMPLEMENTATION

January 2009

	Month	
	Million euros	% change over same month year before
Non-financial revenue	**10,377**	**–19.1**
Non-financial revenue adjusted (*)		
Personal income tax	10,424	–9.6
Corporate tax	552	–55.7
VAT	773	–33.1
Special taxes	1,757	13.7
Other	1,631	–12.4
Total	**15,137**	**–12.7**
Non-financial spending	**12,735**	**–29.7**
Treasury balance	**–2,358**	**–55.4**
Surplus (+) or deficit (–) (**)	***719***	***–49.9***

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 own calculations.

Savings and financing

Financing granted to private sector continues to drop

In just a few months, 1-year Euribor goes from a record high to all-time low.

In recent weeks, the 1-year Euribor, widely used as an interest reference rate, continued the downturn begun toward mid-October with the change in expectations regarding official interest rates in the Euro Area. The reduction of the risk premium, thanks to the measures adopted by governments and central banks to normalize the interbank market, also contributed to the drop in the Euribor. As a result, on monthly average the 12-month Euribor stood at 2.135% in February 2009, a drop of 221 basis points compared with one year earlier and 326 basis points compared with the all-time high in July 2008.

In the early weeks of March, the 1-year Euribor continued its downturn going to 1.86% at the beginning of the fourth week of that month thus marking up an all-time low.

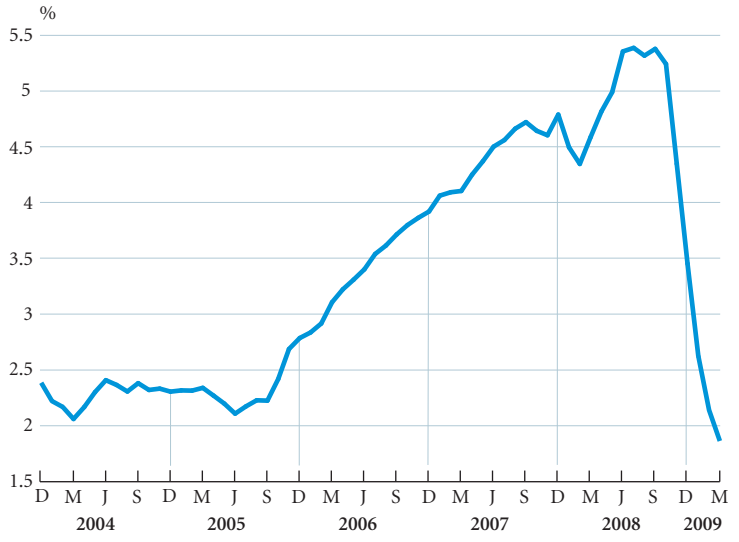
In turn, interest rates on loans and credits granted to companies and households continued to decrease substantially in January with an average of 5.02%, some 98 basis points lower than one year earlier. Nevertheless, in real terms, that is, discounting inflation, they stood above January 2008 seeing that the inflation rate had dropped more sharply.

Weakness in demand for funding and some tightening of loan terms.

Within this framework and given the weakness of demand because of the

ONE-YEAR EURIBOR HITS ALL-TIME LOW LEVEL

12-month Euribor



NOTES: March 23.
SOURCE: Bank of Spain.

CREDIT GRANTED TO COMPANIES AND HOUSEHOLDS

January 2009

	Total	Change over 12 months		% share
	Million euros	Million euros	%	
Commercial credit	68,411	–21,108	–23.6	3.7
Secured loans (*)	1,104,068	32,668	3.0	59.2
Other term loans	522,641	21,482	4.3	28.0
Demand loans	51,973	11,010	26.9	2.8
Leasing	44,321	–1,729	–3.8	2.4
Doubtful loans	72,048	53,663	291.9	3.9
TOTAL	**1,863,463**	**95,987**	**5.4**	**100.0**

NOTES : (*) Greater part made up of secured mortgage loans.
SOURCE: Bank of Spain and own calculations.

recessive situation and some tightening of loan terms, funding granted to the private sector continued to drop to the point where it showed year-on-year growth of 5.4% in January. In fact, the survey of bank loans in Spain for January 2009 carried out by the Bank of Spain showed forecasts of further decreases in the first quarter both in supply and demand for loan funding.

Funding obtained by companies continued to moderate with the year-on-year change dropping by 4 decimals to 6.4%, some 10.7 percentage points less than one year earlier. The greater part of funding granted to non-financial companies was for credit granted to resident companies which rose by 6.1%. In the past 12 months there was a notable drop of 23.6% in commercial credit used to finance working capital. Funding for investment was also down, as shown by the drop of 3.8% annual in leasing. With regard to new operations, overdrafts were up by 2.2% in January compared with the first month in 2008. Other credits up to one million euros amounted to 22.78 billion euros, a year-on-year drop of 27.8%. On the other hand, other credits of more than one million euros going to medium and large companies amounted to 48.82 billion euros with a rise of 6.6% in the past 12 months.

Recovery of bond issues in January.

Bond issues recovered in January with a total up by 17.3% compared with 12 months earlier. Loans from abroad continued to drop to the point where they showed annual growth of 6.1%.

All production sectors showed a drop in credit. Credit going to construction ended up showing a year-on-year change rate of –1.0% at the end of the fourth quarter of 2008. Credit going into services was down by 2.7 points to 9.6%. Real estate activities showed a sharp drop going to annual growth of 4.8% in December 2008, some 19.6 points less than one year earlier. Nevertheless, total credit going to this sub-sector was 0.8% higher than in the third quarter of 2008. Credit granted to services excluding building developers was up 14.2% in the past 12 months, more than that to industry and the primary sector, although this rate was 8.3 points lower than the figure for December 2007.

Year-on-year contraction in credit granted to construction and for acquisition of consumer durables.

Demand for loans to households also continued to decline in view of the rise

CREDIT TO PRIVATE SECTOR BY PURPOSE

Fourth quarter of 2008

	Balance (*)	Change over 12 months	
	Million euros	Million euros	%
Financing of production activities			
Agriculture, livestock raising and fishing	26,244	999	4.0
Industry	156,141	14,570	10.3
Construction	151,911	–1,542	–1.0
Services	682,652	59,835	9.6
Total	**1,016,948**	**73,861**	**7.8**
Financing to individuals			
Acquisition and renovation of own home	649,850	31,639	5.1
Acquisition of consumer durables	54,176	–2,400	–4.2
Other financing	115,386	924	0.8
Total	**819,412**	**30,162**	**3.8**
Financing to private non-profit institutions	**6,091**	**3**	**0.0**
Other unclassified	**27,431**	**5,643**	**25.9**
TOTAL	**1,869,882**	**109,669**	**6.2**

NOTES: (*) By credit institutions as a whole: banking system, loan finance establishments and official credit.
SOURCE: Bank of Spain and own calculations.

Average term for mortgage loans in 2008 down by two years.

in unemployment which caused many households to reduce borrowing and increase savings. As a result, financing granted to households rose by only 3.9% in January compared with the same month the year before, a half-point less than the month before. This drop showed up in all main purposes. Housing loans rose by 4.2% in the past 12 months ending in January. There was a bigger drop in loans for the acquisition of consumer durables such as cars, motorcycles, appliances and furniture for which the total was down 4.2% in December 2008 compared with one year earlier.

On the other hand, according to the National Institute of Statistics, 1,284,318 mortgages against rural and urban properties were signed in 2008, a drop of 27.4% from 2007. By type of institution, savings banks granted 55.8% of total mortgage loans, banks supplied 34.3% while other financial institutions provided 9.9%. Average term was 24 years, two years less than the year before. Some 97.4% of mortgages registered were at variable interest rate, mainly linked to the Euribor. In addition, the average figure for housing mortgages was down by 6.2% annual to 139,780 euros.

The worsening economic situation showed up in an increase in default. The doubtful loan rate stood at 3.9% at the end of January 2009. At a more broken down level, the default rate on housing loans with mortgage security was lower (2.4%) although the doubtful rate for real estate loans was 6.1%.

Outflow of mutual funds moderates in February

The average interest rate on deposits at banks and savings banks stood at 2.3% in January, some 47 basis points less than the month before but this was a lower drop than that for loans. On the other hand, in real terms (discounting inflation) the interest rate on deposits showed a rise.

In this environment, deposits by the private sector in credit institutions rose by 12.9% in January compared with the same month in 2008. This rate meant a slight drop in growth. The highest annual increase showed up in term accounts (24.3%) thanks to returns of around 3% in January, although with a downward trend.

Sharp competition for bank deposits and the unfavourable trend in shares continued to bring about a drop in assets of mutual funds in February which stood at 162.84 billion euros, a year-on-year drop of 27.3%. Withdrawals for the month were 1.40 billion euros higher than subscriptions although net withdrawals were lower than those recorded in earlier months.

Average annual yield on mutual funds was minus 4.4% although there was a wide range of yields. International bond-based funds showed an annual return of 3.4% whereas share-based funds of emerging countries recorded capital losses of 50.3%. Nevertheless, in the past 18 years the average return on mutual funds was 4.2%, higher than inflation during this period.

With regard to insurance, the volume of direct insurance premiums rose to 59.01 billion euros in 2008, an annual rise of 7.6%, according to figures from ICEA (Investigación Cooperativa entre Entidades Aseguradoras y Pension Funds). By branch, life insurance premiums were up by 15.2% while other premiums rose by 2.0%.

Interest on deposits goes up in real terms in January.

Sharp rise in life insurance premiums in 2008.

BANK LIABILITIES DUE TO COMPANIES AND HOUSEHOLDS

January 2009

	Total	Change over 12 months		% share
	Million euros	Million euros	%	
On demand deposits	239,226	–7,794	–3.2	16.9
Savings deposits	179,297	3,644	2.1	12.7
Term deposits	727,740	142,488	24.3	51.5
Deposits in foreign currency	31,222	–4,225	–11.9	2.2
Total deposits	**1,177,486**	**134,113**	**12.9**	**83.3**
Other liabilities (*)	**235,895**	**–39,958**	**–14.5**	**16.7**
TOTAL	**1,413,381**	**94,156**	**7.1**	**100.0**

NOTES: (*) Aggregate balance according to supervision statements. Includes asset transfers, hybrid financial liabilities, repos and subordinated deposits.
SOURCE: Bank of Spain and own calculations.

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"la Caixa" GROUP: KEY FIGURES

As of December 31, 2008

FINANCIAL ACTIVITY	Million euros
Total customer funds	238,407
Receivable from customers	176,100
Profit attributable to Group	1,802

STAFF, BRANCHES AND MEANS OF PAYMENT	
Staff	27,818
Branches	5,530
Self-service terminals	8,113
Cards (thousands)	10,344

COMMUNITY PROJECTS: BUDGET FOR ACTIVITIES IN 2009	Million euros
Social	310
Science and environmental	81
Cultural	79
Educational	30
TOTAL BUDGET	**500**

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