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THE SPANISH ECONOMY

Monthly Report

THE EUROPEAN UNION: ANOTHER STEP

RESEARCH DEPARTMENT

"la Caixa"

Forecast

% change over same period year before unless otherwise noted

	2008	2009	2010	2009 1Q	2009 2Q	2009 3Q	2009 4Q
INTERNATIONAL ECONOMY		Forecast					Forecast
Gross domestic product							
United States	0.4	–2.5	2.1	–3.3	–3.8	–2.5	–0.4
Japan	–0.7	–5.2	1.6	–8.4	–7.1	–4.4	–0.8
United Kingdom	0.6	–4.6	0.8	–5.0	–5.5	–5.1	–3.0
Euro area	0.7	–3.9	1.2	–4.9	–4.8	–4.1	–1.9
Germany	*1.0*	*–4.8*	*1.5*	*–6.7*	*–5.8*	*–4.8*	*–2.0*
France	*0.7*	*–2.3*	*1.3*	*–3.5*	*–2.9*	*–2.4*	*–0.4*
Consumer prices							
United States	3.8	–0.3	2.1	–0.2	–0.9	–1.6	1.4
Japan	1.4	–1.3	–0.2	–0.1	–1.0	–2.2	–1.8
United Kingdom	3.6	2.0	2.1	3.0	2.1	1.5	1.6
Euro area	3.3	0.3	1.2	1.0	0.2	–0.4	0.3
Germany	*2.6*	*0.3*	*1.0*	*0.8*	*0.3*	*–0.2*	*0.3*
France	*2.8*	*0.1*	*1.2*	*0.7*	*–0.2*	*–0.3*	*0.3*
SPANISH ECONOMY		Forecast					Forecast
Macroeconomic figures							
Household consumption	–0.6	–5.1	–0.5	–5.4	–6.0	–5.1	–4.0
Government consumption	5.5	5.0	1.5	6.4	5.2	4.9	3.3
Gross fixed capital formation	–4.4	–15.4	–5.8	–15.1	–17.2	–16.2	–13.1
Capital goods	*–1.8*	*–23.9*	*–7.5*	*–24.4*	*–28.9*	*–24.3*	*–18.0*
Construction	*–5.5*	*–11.6*	*–7.0*	*–11.3*	*–11.8*	*–11.5*	*–11.7*
Domestic demand (contribution to GDP growth)	–0.5	–6.3	–1.4	–6.2	–7.4	–6.5	–5.0
Exports of goods and services	–1.0	–12.3	2.1	–16.9	–15.1	–11.1	–6.2
Imports of goods and services	–4.9	–18.0	–1.9	–22.6	–22.0	–17.0	–10.5
Gross domestic product	**0.9**	**–3.7**	**–0.4**	**–3.2**	**–4.2**	**–4.0**	**–3.4**
Other variables							
Employment	–0.6	–6.7	–2.3	–6.3	–7.2	–7.2	–6.3
Unemployment (% labour force)	11.3	18.1	20.2	17.4	17.9	17.9	19.2
Consumer price index	4.1	–0.3	1.4	0.5	–0.7	–1.1	0.2
Unit labour costs	4.6	0.2	–0.9	1.2	1.4	0.4	
Current account balance (% GDP)	–9.5	–5.9	–3.7	–7.9	–4.5	–3.9	
Net lending or net borrowing rest of the world (% GDP)	–9.1	–5.5	–3.3	–7.6	–4.0	–3.6	
Government balance (% GDP)	–4.1	–10.9	–9.9				
FINANCIAL MARKETS		Forecast					Forecast
Interest rates							
Federal Funds	2.1	0.3	0.6	0.3	0.3	0.3	0.3
ECB repo	3.9	1.2	1.0	1.8	1.1	1.0	1.0
10-year US bonds	3.6	3.2	3.7	2.7	3.3	3.5	3.3
10-year German bonds	4.0	3.3	3.3	3.1	3.4	3.3	3.3
Exchange rate							
$/Euro	1.48	1.40	1.41	1.30	1.36	1.43	1.49

Contents

The European Union: another step

At the beginning of this decade, European leaders launched an initiative to adopt a Constitution that would be the culmination of the project to integrate Europe. Valery Giscard d'Estaing headed this project and, in a long drawn-out process that attempted to be participatory and democratic, produced a text that was solemnly signed by all heads of state and government of the countries of the European Union (EU), including the candidate members at that time, Bulgaria and Romania, in October 2004.

The Constitutional Treaty aimed to simplify the community's regulations and mechanisms, bring the EU closer to its citizens and provide them with strong leadership that was visible at an international level. But it also had certain federalist airs and established European symbols (the euro, anthem and flag), as well as a Charter of Fundamental Rights, issues that aroused severe mistrust on the part of countries or sectors of the population that were more distrustful of Brussels and even more jealous of their national sovereignty.

In spite of the active support of all governments, the constitutional text ran aground during the national ratification process. Nationalist misgivings multiplied and when France and the Netherlands voted «no» in their respective referendums, the march of the great reform was sidelined. The ambition to construct a powerful Europe on the world stage came up against the increasingly diverse and complex reality of present-day Europe.

Now we are about to witness the coming into force of the Lisbon Treaty, welcomed as a weakened and decaffeinated replacement for the rejected Constitution. Moreover, the appointment of two politicians of little international renown, to head the permanent presidency of the European Council and the equivalent of a European Minister for Foreign Affairs, has disheartened many.

However, this pessimistic appraisal does not do justice to the step the European Union is going to take on the first of December. A new EU has emerged from the Treaty, with its own legal personality, with a more rational legal structure, with a more precise demarcation of powers and with institutions that are set up and function better. And, of course, the Treaty underpins the two big economic achievements of the construction of Europe: a large Single Market without obstructions that might disrupt free competition, and a single currency that has consolidated its role both within and outside its area of circulation.

The Lisbon Treaty may be frustrating insofar as it isn't enough to project a Europe with true political weight in the world. It's not the end station that was the aim of the Constitution but a treaty that will be added to the history of reforms of the last few decades. However, perhaps it didn't make much sense to pull out all the stops in order to achieve an ambition that is still not sufficiently shared by all concerned, and attempting to take such an important step is probably not very realistic when such an act would raise so many hesitant voices. It was also difficult, in the recent informal meeting between the heads of state and government, to appoint top officials whose strong political personality would have been very tricky to fit into the community machinery. Machinery that is, in essence, inter-governmental but with a supranational component that makes it unique in history. This is not the great reform planned by Giscard d'Estaing but we are moving in the right direction. Another step. No more, no less.

EXECUTIVE SUMMARY

Encouraging signs for the world economy

Practically all countries have boarded the train to recovery.

The publication of growth data for the leading world powers has capitalized the macro-economic data for November. Practically all countries have boarded the train to recovery. There haven't been any huge surprises but it's very welcome after several tough quarters. We don't expect the train to stop from now on, but it might take a while to build up a head of steam. The collateral damage of the recession has been huge, with repercussions that will last longer than we would like.

The United States and the euro area are starting to come out of the worst recession since the Second World War.

The United States was one of the first developed countries to announce positive quarter-on-quarter growth. With a rise of 0.7% compared with the previous quarter (a 2.5% drop year-on-year), it has reaffirmed its leading role in the world economy in spite of having gone through the worst recession since the Second World War. Nevertheless, the US economy has been hurt and progress towards higher growth will be slow. Evidence of this is that a large part of the upswing in gross domestic product (GDP) is due to state incentives for vehicle purchase. Take away the effect of economic stimulus measures and there are no real signs of solid growth in private consumption.

The crisis is leaving a large trail of unemployment in all countries.

The GDP of the euro area increased 0.4% quarter-on-quarter in the third quarter (the year-on-year rate still fell by 4.1%) and everything suggests this rate of growth will have kept up over the last three months. Although the breakdown by component is not yet available, the foreign sector and economic stimulus measures are very likely to have been the mainstays to coming out of this crisis. A process that is benefitting from the push of Germany, France and Italy, which grew between three to seven percentage points with respect to the previous quarter. However, we don't expect the recovery in the euro area as a whole to be very vigorous in the next year either. As from the second half of 2010, consumption and investment will take over from the foreign and public sectors, but they are very unlikely to do so with sufficient determination to take the growth rate much above 1%.

One of the main elements hindering the recovery capacity both of the United States and the old continent is the significant deterioration in the labour market. This is at its lowest point for several decades in the United States, with more than 7 million jobs having been lost in the crisis and an unemployment rate above 10%. The rise in unemployment has been more moderate in the euro area and the rate does not reach 10%, but the situation would be much worse without the plans for temporary reductions in the workforce and working hours implemented by different countries.

One peculiarity of the global recovery is the push coming from emerging economies, led by China and Brazil. The main indicators for the Asian giant continue to offer spectacular growth rates but, to ensure long-lasting growth, consumption will have to take over as the source of stimulus in the medium

term. China is currently taking its first steps in the right direction. Brazil is also filling the headlines: it's creating jobs, its GDP is growing at an annualized rate of close to 5% and the forecasts for 2010 are giving growth rates of over 4%.

The start of the recovery begs the question of how and when the central banks should withdraw the exceptional expansionary measures applied to avoid disaster. At the end of their respective meetings in November, the European Central Bank (ECB) and the Federal Reserve of the United States (Fed) stressed that the conditions of financial markets and of the real economy are continuing to improve, albeit noting that recovery was expected to be slow. Jean-Claude Trichet hinted that, although it's too soon to implement the exit strategy, its time is nigh, interpreted by the markets as a sign that one-year liquidity injections would not be sustained after December 2009. The risk is that, if liquidity is not withdrawn smoothly, short-term interest rates might rise, in turn forcing up all the other monetary rates.

As far as traditional monetary policy is concerned, both the ECB and the Fed continue to send out the message that official interest rates will remain at their current levels for some time yet. The markets deduce that the ECB might raise the reference rate in the fourth quarter of 2010, and that the Fed might do so throughout the second half of the coming year. Given that the economy's recovery will be very slow, it's difficult to see a rise in interest rates in the first half of next year. On the other hand, if interest rates remain at their current levels for longer, this might encourage excessive risk-taking.

The other focus of attention in the financial markets is exchange rates. The revaluation of the euro against emerging currencies is not in the normal course of events, given the trends in the corresponding economies. But the exchange rate that's causing most controversy is the Chinese currency. The Chinese government's resistance to allowing the exchange rate to fluctuate freely between the renminbi and the dollar seems to be crumbling, as in the last quarterly report on the Chinese central bank's monetary policy, the possibility was mentioned of allowing the renminbi to appreciate further.

Emerging economies are the driving force.

Debate regarding what the future action might be of the main monetary authorities and government in China could lead to uncertainty. However, the tone of the financial markets continues to be favourable in general. Evidence of this is that firms are continuing to take advantage of good market conditions to sell bonds at breakneck speed. The volume of new issues has hit record levels, even in high yield sectors, in spite of default ratios in this segment having also risen to record highs since the Great Depression of the last century.

The central banks are starting to discuss when and how to withdraw the exceptional expansionary measures.

Trends in the main stock market indices, resistant to downgrades of any importance, also reflect the positive tone predominating in the markets. One of the factors that bolstered the stock markets was corporate results. In the case of the S&P 500, 80% of the companies offered pleasant surprises, while in the euro area only 36% of the companies in the Euro Stoxx 50 published higher than expected results. This difference underlines that the upswing in business margins is much faster in the United States.

Meanwhile, the Spanish economy is still seeing negative growth, although a change in trend can be noted and the

The tone of financial markets continues to be favourable in general.

The GDP of the Spanish economy slows up its decline in the third quarter.

slowdown in economic decline in the third quarter was remarkable. GDP fell three percentage points compared with the previous quarter, an improvement of eight percentage points compared with figures for the second quarter. This change can be explained by the improved international situation and the lower deterioration in domestic demand, thanks partly to the monetary and fiscal stimuli put in place.

In year-on-year terms, in the third quarter GDP fell by 4.0%, two percentage points less than in the preceding quarter. The downswing in business was due to the fall in domestic demand, dropping 6.5 percentage points, while the foreign sector contributed 2.5 percentage points to growth. Both exports and imports slowed their fall but the improvement in goods transactions was particularly outstanding, resulting from the improved trends in demand, basically from the European Union.

Domestic demand is still very weak but is very likely to improve.

The Spanish economy's capacity to recover over the coming quarters, as the rest of the developed economies, will be hindered by the sharp deterioration in the labour market. According to data from the National Institute of Statistics, in the third quarter the unemployment rate stabilized at 17.9% of the labour force. However, this was due to a reduction in the labour force as jobs continued to be lost, although at a slower pace. The weak demand this generates is reflected in the trends in prices. The year-on-year percentage change for the consumer price index for October was negative for the eighth consecutive month, at a rate of 0.7%.

The Sustainable Economy Act should help to consolidate recovery.

This fall in prices is also reflected in the GDP deflator which, in the third quarter, was down 0.4% compared with the same quarter the previous year. This was the first drop in the GDP deflator for several decades. However, we expect prices to grow again as from November and, in 2010, they will be affected by the rise in value added tax, announced for July.

Within this context, the confidence indices are still improving and forecasts suggest this will continue in the coming quarters. The Organization for Economic Cooperation and Development predicts a slight drop in GDP in 2010, much lower than forecasted just a few months ago. However, coming out of the recession, which will happen in the first half of next year, will hardly relieve the current deterioration in the job market. The need to provide business with another vigorous push to encourage a new expansionary cycle is behind the presentation, at the end of November, of the Sustainable Economy Act. The aim is to consolidate and appropriately guide trends in the economy over the coming years and, to this end, the government has drawn up an extensive, complex legal text that covers a wide range of regulatory changes. Its objective is to improve the regulatory framework, boost the competitiveness of the economy and push forward with environmental sustainability. Although its results will only be visible in the medium term, a large part of this plan's success depends on the capacity to climb aboard the train to recovery and on this train keeping up a good cruising speed.

27 November, 2009

CHRONOLOGY

2008

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**.
	27	Government approves series of **measures to boost economic activity**: reform of law on meetings of creditors, revival of credit insurance and introduction of EU directive on services.
April	**2**	**European Central Bank** lowers official interest rate to 1.25%. G-20 meeting in London aimed at **reform of international financial system**.
May	**7**	**European Central Bank** lowers official interest rate to 1.00% and announces measures to facilitate liquidity in banking system.
	12	Government announces **new economic policy measures**: partial removal of tax deduction for buying normal residence as of 2011, aids for buying cars, reduced taxes for some small and medium-size businesses and self-employed persons, etc.
June	**12**	Government **increases taxes** on tobacco, petrol and diesel fuel for motor vehicles.
	26	Government establishes **Fund for Orderly Restructuring of Banks**.
September	**26**	The Spanish government passes the **2010 State General Budget**, which eliminates the deduction of 400 euros from income tax, raises the duty on capital income and also the general and low VAT rates as from July 2010.
November	**27**	The government presents the bill for the **Sustainable Economy Act**.

AGENDA

December

- **2** Registrations with Social Security and registered unemployment (November).
- **3** Governing Council Central European Bank.
- **4** Industrial production index (October).
- **15** CPI (November). Fed Open Market Committee.
- **16** EU HCPI (November). Labor cost survey (third quarter).
- **22** International trade (October). Central government revenue and spending (November).
- **23** Producer prices (November).
- **30** Balance of payments (October).

January

- **5** HCPI flash estimate (December).
- **8** Industrial production index (November).
- **14** CPI (December). Governing Council Central European Bank.
- **25** Producer prices (December).
- **26** Fed Open Market Committee.
- **28** HCPI flash estimate (January).
- **29** Labour Force Survey (fourth quarter).
- **30** Balance of payments (November).

INTERNATIONAL REVIEW

The United States is leaving the recession but not in good shape

United States grows 2.8% thanks to fiscal stimuli for consumption and the end to declining investment.

The leading economy on the planet is embarking upon a tough recovery hindered by family debt, a weak labour market and the hangover from the real estate bubble. According to the latest official estimates, in the third quarter of 2009 gross domestic product (GDP) grew by 2.8% annualized quarter-on-quarter, down 0.7 percentage points from initial estimates. The year-on-year decline reached 2.5% due to the burden of the last quarter of 2008 and the first of 2009. More than two thirds of the recovery in GDP was supported by gains in private consumption, up 2.9% quarter-on-quarter thanks to state incentives for buying automobiles, also affecting stock cycles, another factor that strongly contributed to the gains. Upward trends continued with public consumption and construction, the latter from very low levels, whereas the weak points were capital goods investment, hitting bottom, and the foreign sector, going into the negative.

Consumer confidence still low but retail sales perk up after stimuli.

The latest demand indicators confirm that the economy has bottomed out and is stable, but without any convincing signs of progress. On the one hand, retail sales without

UNITED STATES: MAIN ECONOMIC INDICATORS

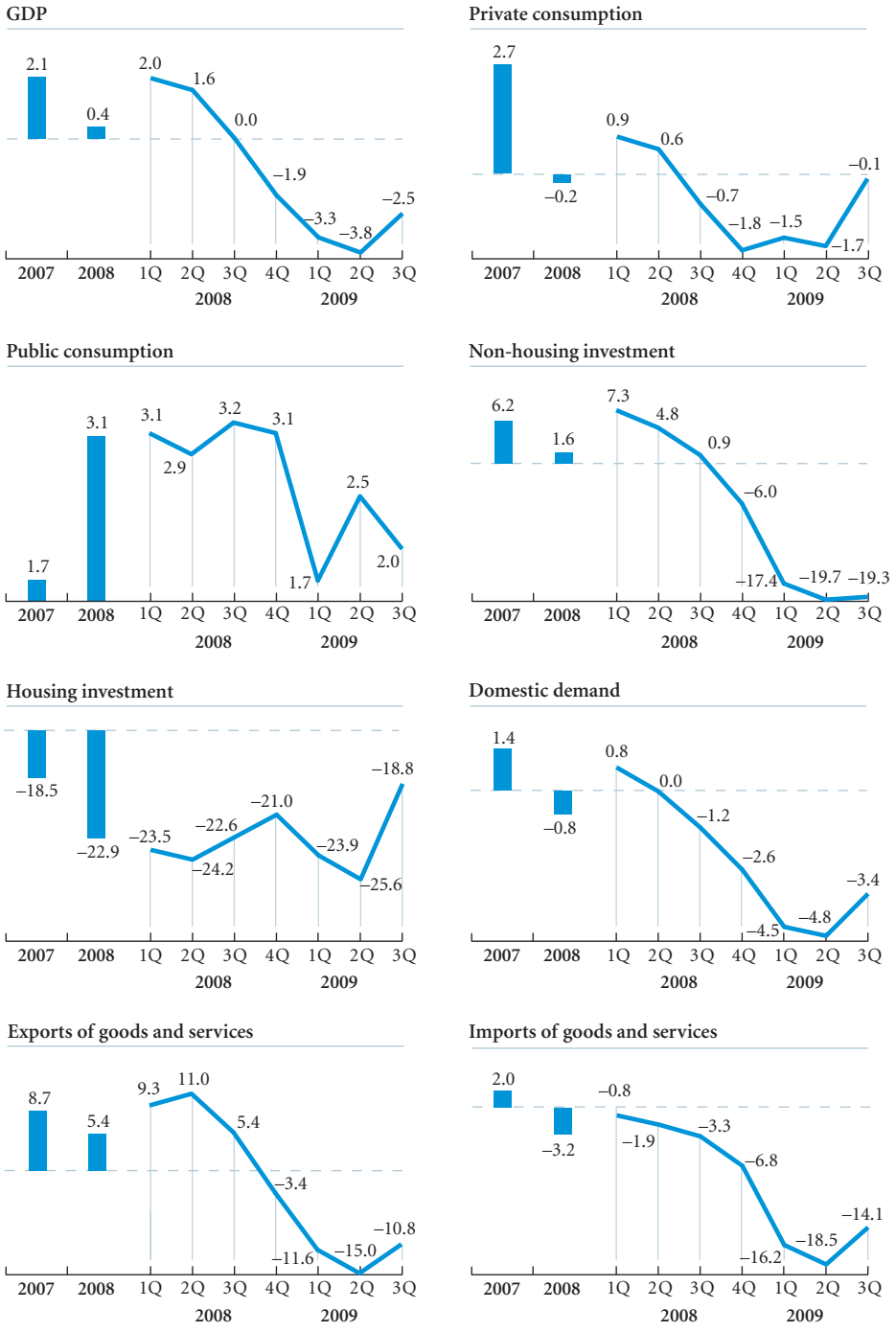
Percentage change over same period year before unless otherwise indicated

	2007	2008	2008	2009				
			4Q	1Q	2Q	3Q	October	November
Real GDP	2.1	0.4	–1.9	–3.3	–3.8	–2.5	–	...
Retail sales	3.3	–0.8	–8.2	–8.9	–9.5	–6.8	–1.7	...
Consumer confidence (1)	103.4	58.0	40.7	29.9	48.3	51.8	47.7	...
Industrial production	1.5	–2.2	–6.7	–11.6	–12.9	–9.6	–7.1	...
Manufacturing (ISM) (1)	51.1	45.5	36.1	35.9	42.6	51.5	55.7	...
Sales of single-family homes	–26.7	–37.4	–41.0	–40.0	–27.1	–10.7	...	...
Unemployment rate (2)	4.6	5.8	6.9	8.1	9.3	9.6	10.2	...
Consumer prices	2.9	3.8	1.6	0.0	–1.2	–1.6	–0.2	...
Trade balance (3)	–701.4	–695.9	–695.9	–605.7	–505.9	–419.1	...	...
3-month interbank interest rate (1)	5.3	2.8	2.2	1.2	0.8	0.4	0.3	...
Nominal effective exchange rate (4)	77.9	74.4	81.3	82.7	79.4	75.4	73.6	73.8

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

TREND IN UNITED STATES GDP BY COMPONENT

Percentage year-on-year change in real terms



SOURCES: Bureau of Economic Analysis and own calculations.

Business optimism is firming up but industrial recovery is slow.

automobiles or petrol once again improved on the previous month, up 0.1%, indicating that consumption is on a relatively solid footing. On the downside, the Conference Board Consumer Confidence Index for October fell further in September, going from 53.4 to 47.7 points. The biggest weaknesses continued to focus on perception of the current situation, reaching its lowest point since 1983.

On the supply side, business sentiment is optimistic and, in October, the manufacturing index of the Institute for Supply Management was up again for the third consecutive month. Services also kept on the upward track, in both cases well above the bar of 50, the threshold for recovery. However, this improved business sentiment still fails to bring substantial improvements in industrial production or increased production capacity utilization, both indicators remaining almost unaltered and very far from pre-crisis levels.

Housing hits bottom. Prices are starting a hesitant recovery but the supply of property still exceeds demand.

The housing market continues to prove that it has bottomed out but it would be premature to talk of any real kind of recovery. In August, the Case-Shiller price index advanced for the third month running, growing 1.0% compared with July, seasonally adjusted. Areas such as San Francisco and Cleveland have now accumulated gains of 9.4% and 6.7% since their minimum levels, respectively. But as the general index has fallen 33.1% since April 2006, the starting levels are very low. This sector's recovery continues to be hampered by mortgage foreclosures, still at record highs according to the National Association of Realtors, making it difficult to reduce the excess supply that still dominates the market, with 2.2 million homes pending sale.

UNITED STATES: HOUSING HITS BOTTOM BUT RECOVERY WILL HAVE TO WAIT

Homes started in annual terms

SOURCES: Department of Commerce and own calculations.

The job market is at its lowest ebb since the end of the Second World War and will continue to be one of the US economy's weak points over the coming months. Although its rate of deterioration has slowed up, with 190,000 jobs lost in October, there is no indication it has bottomed out. Net job losses since the end of 2007 rose to 7.3 million, the unemployment rate climbed to 10.2% and the share of discouraged and involuntary part-time workers is still very high.

The labour market continues to decline with unemployment above 10%.

Weak demand and the high share of leisure resources mean that prices have tended to remain stable although, in October, the fear of deflation retreated a little more into the background. The general consumer price index (CPI) fell in October by 0.3% year-on-year but should pick up again over the coming months due to oil prices, in December 2008 at their lowest for the last five years.

For its part, core inflation (the overall index without food or energy) rebounded slightly and rose 1.7% year-on-year, although it would have risen 2.5% without the drop in home rental prices.

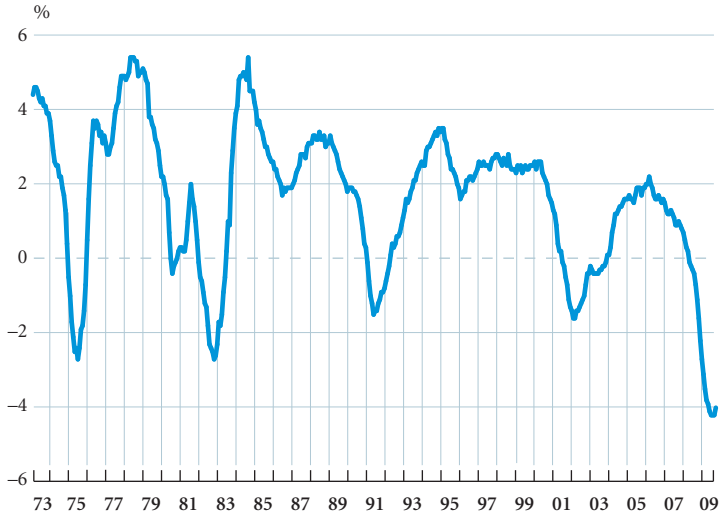
Prices remain stable. CPI down 0.3% while core inflation is up 1.7%.

While domestic demand is improving and trade volumes are recovering slowly, the foreign sector renewed its decline. In spite of the relatively weak dollar, this sector is not expected to contribute to growth over the coming months. The trade deficit in goods and services for September stood at 36,472 million dollars, around 6,000 million higher than August. Exports grew moderately by 2.8% year-on-year but imports rose 5.8%. Excluding oil and its derivates, more indicative of underlying trends, October's deficit climbed to 15,927 million dollars, 11.5% more than in August and the highest since January.

Trade deficit takes a turn for the worse due to higher imports.

UNITED STATES: THE WORST FALL IN EMPLOYMENT

Year-on-year change in employment



SOURCES: Department of Labor and own calculations.

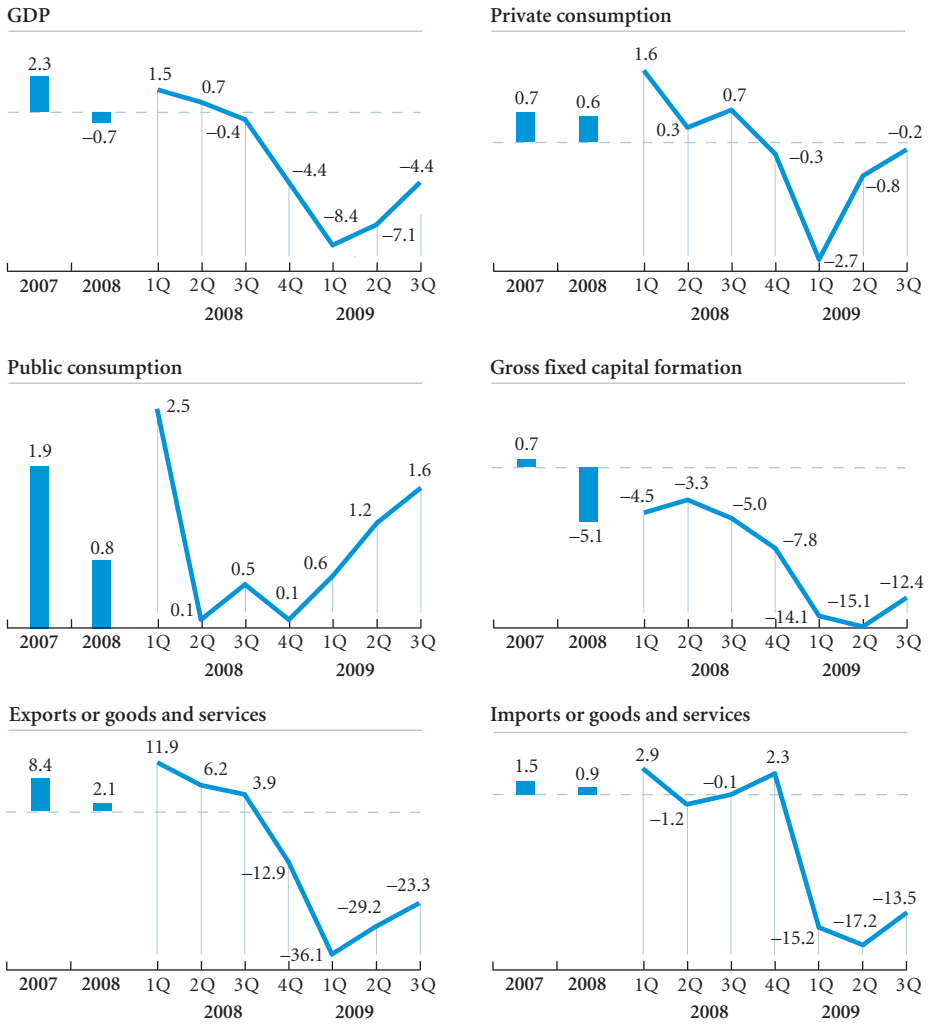
Japan grows 4.8% thanks to exports and government aid.

Japan: not as strong as it looks

In the third quarter, the Japanese economy grew by 4.8% annualized quarter-on-quarter, intensifying the recovery started the previous quarter after a year of recession that took GDP to an accumulated loss of 8.4%. In spite of the growth in national accounts, the land of the rising sun's economy is still immersed in deflation and is unlikely to sustain such growth in GDP. This upswing can be explained, almost equally, by the recovery in private consumption, the replacement of stocks and also the contribution of the foreign sector. Capital goods investment was also back into positive figures but could hardly offset the persistent weakness in construction.

TREND IN JAPAN'S GDP BY COMPONENT

Percentage year-on-year change in real terms



SOURCES: Institute of Economic and Social Investigation and own calculations.

The main downward trends in the Japanese economy are in domestic demand. The recovery in private consumption was mostly due to fiscal stimuli for automobile purchase, but with public debt close to 200% of GDP the continuity and effectiveness of such aid are in doubt. The foreign sector's contribution is due to the Asian recovery, stronger than expected.

Growth in Asia is pushing the Japanese economy but public debt doubles GDP.

The latest supply indicators have improved but are still way below pre-recession levels. Industry continues to recover but at a slower pace than in the first few months. Consequently, from the minimum in February up to September, industrial production has regained 14.8 percentage points out of the 36.4 lost since May 2008. There's also a hint of improvement in machinery orders, an early indicator of investment, which picked up in September thanks to exports.

Industrial recovery continues to be modest while investment hits bottom.

Within demand, consumer confidence in the third quarter reached 40.2 points, its highest in the last two years but still wallowing in the depths. Less daring, retail sales in August fell back 1.3% year-on-year, while government aid underpinned the recovery in automobile sales. For its part, the housing market has yet to get off the ground. Sales in October in the area of Tokyo sustained the gains made in the previous month but the accumulated figure for the last twelve months was less than half the sales for 2007. Prices tended to fall and the homes started in September dropped by 37.0% year-on-year.

The labour market also remained weak although unemployment for September, at 5.3%, fell unexpectedly after having reached a record high in July. The best news came from manufacturing, gaining 120,000 net jobs in September after months of drought. Weak demand

Deflation will continue until 2010, with the CPI falling by 2.2% and unemployment at 5.3%.

JAPAN: MAIN ECONOMIC INDICATORS

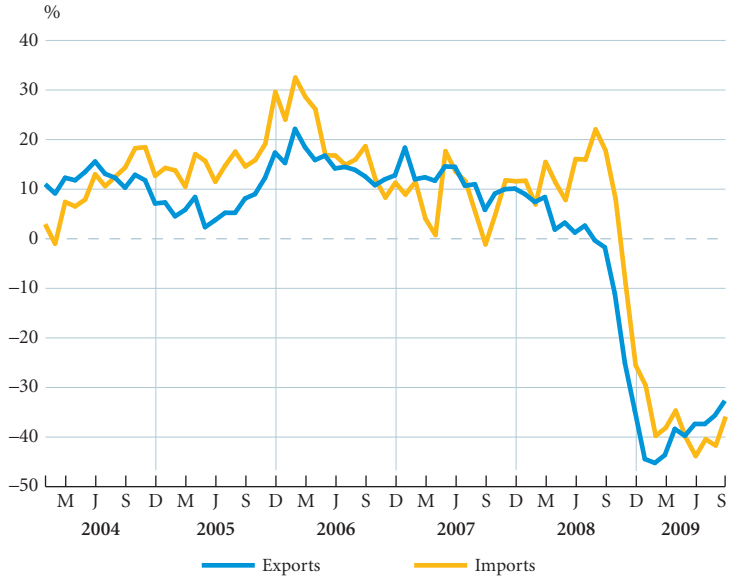
Percentage change over same period year before unless otherwise indicated

	2007	2008	2008	2009			
			4Q	1Q	2Q	3Q	October
Real GDP	2.3	–0.7	–4.4	–8.4	–7.1	–4.4	–
Retail sales	–0.1	0.3	–1.5	–3.9	–2.8	–1.9	...
Industrial production	2.9	–3.4	–15.0	–34.0	–27.6	–19.7	...
Tankan company Index (1)	22.0	–2.8	–24.0	–58.0	–48.0	–33.0	–
Housing construction	–17.2	2.4	3.9	–21.4	–32.0	–35.8	...
Unemployment rate (2)	3.9	4.0	4.0	4.4	5.2	5.5	...
Consumer prices	0.1	1.4	1.0	–0.1	–1.0	–2.2	...
Trade balance (3)	12.6	4.0	4.0	1.4	1.0	1.7	...
3-month interbank interest rate (4)	0.7	0.8	0.8	0.7	0.6	0.5	0.5
Nominal effective exchange rate (5)	77.1	86.6	98.5	102.1	95.7	97.0	99.0

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

JAPAN: A RECOVERY THAT STILL HAS A LONG WAY TO GO

Year-on-year change in foreign trade



SOURCES: Japanese Ministry of Communications and own calculations.

Recovery in the foreign sector is due to the East Asian rebound.

means that deflationist trends will continue throughout 2010 and September's CPI dropped by 2.2% year-on-year, while core inflation, the overall index without energy or food, lost 1.0% year-on-year, its ninth consecutive month of falls.

In terms of foreign trade, Japan is benefitting from the Asian recovery although less than would be expected. Its trade surplus in September was the lowest since February and recovery in exports is weaker than in imports.

Old Europe... What does it want to be when it grows up?

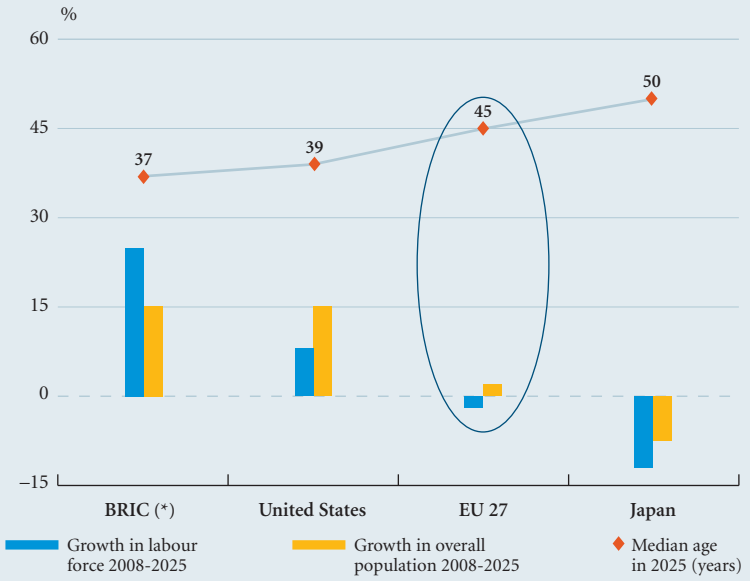
As children, we were all asked at some point what we wanted to be when we grew up. It was a fun question as, when answering, we could venture into an infinite array of futures, like a dressing-up game. However, as we got older, the same question became both more relevant and more unnerving: the day came when we had to grow up once and for all and choose just one costume. Europe is at that stage today, facing a possible decline in its relative importance not only in demographic but also economic terms, being forced to rethink its future in the world of the 21st century.

Over the last few decades, the European population has gradually been declining in its proportion to the world population. Although it accounted for 21% of the total halfway through the 20th century, its current share is less than 11%. Most projections not only claim that this trend will continue but also that Europe will get gradually older, i.e. the share of its young population compared with older segments will fall. Although ageing

is a global phenomenon, it is more or less intense depending on the region and Europe stands out for being the most severely affected, together with Japan. The United Nations Organization (UN) predicts that the median age[1] in the European Union (EU) will rise by 8 years during the first quarter of the century, reaching 45 by 2025, much higher than the age of 34 predicted for Brazil or 39 for China or the United States.

AN OLDER EUROPE WITH A SMALLER LABOUR FORCE

Demographic forecasts by region



NOTE: (*) Average for Brazil, Russia, India and China.
SOURCES: Economic Intelligence Unit, UN and own calculations.

The population's current age structure in Europe reflects its recent demographic history and particularly the substantial changes in its natural and migratory growth patterns. Socio-economic progress has led to improvements in the quality of life and health, which in turn have resulted in greater longevity and life expectancy, eight years in the last half century. Furthermore, and due partly to advances in birth control, the fertility rate fell notably after the baby boom of the sixties, to the point where, today, it does not exceed the threshold that ensures generational replacement (2.1 children per woman) in any EU country (the average is 1.5). On the other hand, net immigration flows soared in the last decade, increasing from 500,000 people in 1998 to more than 2 million in 2003. Nonetheless, and in spite of the fact that, in some years, migratory flows have contributed more than 80% to demographic growth, they only partly offset the decline in natural growth and have recently tended to stabilize, with the number of new immigrants falling to 1.9 million in 2007.

Unless there is a drastic change in these demographic growth patterns, it is predicted that ageing will advance, bringing new economic challenges for European member states. Perhaps the most important will be the greater pressure on the welfare state as the dependency ratio increases (population aged over 65 in relation to

(1) Age that divides the population into two halves and serves as an indicator of demographic ageing.

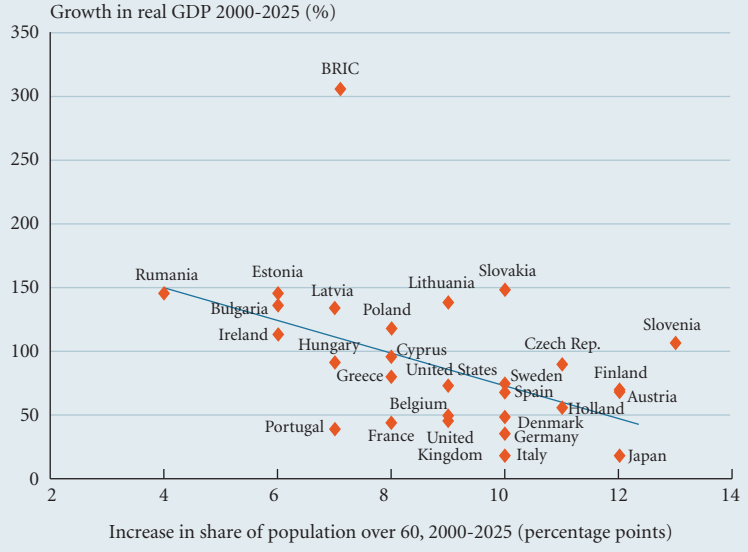
the 15 to 64 age group). In the case of the EU, some forecasts place this ratio at around 50% by the middle of the century. Moreover, and in spite of the fact that dependency is likely to monopolize the discussion, the continuation of Europe's demographic trend, if not offset by notable increases in productivity, is likely to lead to the EU's economic weight declining in the world.

In recent decades, the share of EU gross domestic product in the world total has already suffered a setback in terms of purchasing power parity, going from 27% of world GDP in 1990 to 22% in 2008. Forecasts anticipate a greater decline in coming years, partly due to ageing. As illustrated by the graph below, the economies further ahead in the ageing process will tend to grow less. In fact, according to some estimates the EU's demographic trends might entail a loss of up to 0.5 percentage points in its growth potential as from 2030.

Although the ageing trend seems difficult to reverse, there has been ample debate on the possibility of mitigating its economic impact by using suitable policies, including stimulating the birth rate, encouraging women to join the job market and delaying the retirement age; or migratory policies that encourage entry of working-age immigrants to rebalance the population pyramid. While a higher birth rate would directly widen the base of the pyramid, a higher participation rate of women or delaying the age of retirement would relieve the drop in the labour force, whereas a more balanced population pyramid would encourage growth and favour the solvency of the welfare state.

In any case, empirical evidence has not been able to completely corroborate the effectiveness of this kind of policy and everything suggests that, without a change in the natural growth patterns, any impact from such policies would eventually succumb to the increasing effects of ageing. However, these policies might still temporarily encourage economic growth and therefore provide a window of opportunity to implement

THE ECONOMIES FURTHER AHEAD IN TERMS OF DEMOGRAPHIC AGEING WILL GROW LESS



SOURCES: UN, Economic Intelligence Unit and own calculations.

reforms of a more structural nature leading to a higher fertility rate or advances in productivity, thereby improving long-term growth prospects. The alternative would be to adapt current institutions and policies to the new situation (as many of these emerged when the demographic structure was very different) and possibly get used to the idea of the EU having less relative weight in the future world economy.

In the short term, the EU's future will be affected by the imminent coming into force of the Lisbon Treaty. Among its objectives, the treaty paves the way for Europe to position itself on the future world stage as «an effective and relevant actor». Effectiveness, as well as prioritizing unity, will certainly be decisive in achieving this relevance, but how the demographic challenge is handled will also be key. Seneca said that, if one does not know to which port one is sailing, no wind is favourable. Let's hope that Europe decides sooner rather than later which direction it should be headed in, that it chooses well and acts accordingly. When all's said and done, isn't that what we would wish for anyone dear to us who is about to grow up? That, and a favourable wind.

This box was prepared by Marta Noguer
International Unit, "la Caixa" Research Department

China: moving strongly from the ox to the tiger

China's growth strategy needs a change in course.

In a couple of months we'll be leaving the year of the ox, or perseverance, and marching into the year of the tiger, symbol of vigour and power. «Persevere and you will lead» seems to be the slogan of the Chinese authorities, who refuse to give up the era of growth based on investment and the foreign sector in favour of greater emphasis on domestic consumption. The immovable exchange rate with the dollar and unrelenting injection of liquidity undoubtedly continue to yield good results, but if China wishes to go on advancing at levels of 8%-10%, a medium term change in direction is inevitable.

Early indicators for October consolidate the Asian giant's lively recovery. On the supply side, industrial production surprised once again with an October gain of 16.1% year-on-year, much higher than the 12.3% average of the second quarter. However, October 2008 saw the start of the decline, so we cannot ignore the base effect that will affect this and other indices for several months. Along the same lines, the purchasing managers' index (PMI) for October stood at 55.2, above 50 points for the eighth consecutive month, the threshold separating recession and expansion.

Domestic demand also continued to progress, buoyed by exuberant credit. In October, retail sales grew by 16.2% year-on-year, still far from the 22% of the year before but above the average for the second quarter of 15.4%. Vehicle sales remain solid, as indicated by year-on-year gains of 71.3%, although slightly lower than September's figure – 1.2 compared with 1.3 million units . The vitality in domestic consumption comes along with the upswing in the labour market. In particular, according to a survey by the Ministry of Labour, demand for labour has risen in the third quarter after four quarters of decreases. Furthermore, fixed capital investment was up 32.8% year-on-year in October, with an annual average of 32%.

Industrial production consolidates within the 15%-16% range.

CHINA: MAIN ECONOMIC INDICATORS

Percentage change over same period year before, unless otherwise indicated

	2007	2008	2008	2009			
			4Q	1Q	2Q	3Q	October
Real GDP	13.0	9.0	6.8	6.1	7.9	8.9	–
Industrial production	17.5	12.6	6.4	9.7	9.0	12.3	16.1
Electrical power generation	15.7	6.7	–6.0	–4.3	–0.4	8.0	18.0
Consumer prices (*)	4.8	5.9	2.5	–0.6	–1.5	–1.3	–0.5
Trade balance (**)	262	297	297	319	296	251	239
Reference rate (***)	7.47	5.31	5.31	5.31	5.31	5.31	5.31
Renminbi to dollar (*)	7.6	6.9	6.8	6.8	6.8	6.8	6.8

NOTES: (*) Average.
(**) Cumulative balance for 12 months. Billion dollars.
(***) Percentage at end of period.
SOURCES: National Statistics Office, Thomson Reuters Datastream and own calculations.

Vehicle sales up 71.3%.

Although lively demand is an indication of the country's driving forces coming to the fore again, it's still early days to draw any conclusions. Even more so when growth in investment doubles that of consumption and the trade balance surplus for October is up again to 24,000 million dollars compared with a monthly average of 13,000 million dollars in the third quarter. Our initial estimates for 2009, based on the pattern of Chinese growth from a demand perspective, show contribution from investment above the 2000 average. Specifically, 60% of the drive could come from investment, compared with 50% in previous years.

The CPI falls 0.5% in October and is heading for positive figures.

The deflationist fears from early in the year have also faded thanks to the reactivating economy. The CPI fell in October by 0.5% year-on-year compared with 0.8% in September and much less than the fall of 1.8% in July. A large part of the slowdown in falling prices can be explained by the rise in commodity prices. The rise in housing prices being passed on to the CPI should push inflation into positive figures by the end of the year.

So all indicators place China on the road to strong growth. Whether this lasts will largely depend on the capacity of domestic demand to take over as the driving force. To date, investment is still key, but it seems that initial steps are being taken in the right direction.

Brazil: Cinderella always was a princess

All eyes are on Brazil.

For some years now, Brazil has been getting non-stop headlines, front page coverage and praise from all over the world. Investors, politicians and the international community at large see this country as a new wonderland, a paradise to be explored in search of new opportunities for the future. For many, Brazil has suddenly become the Cinderella of emerging countries. However, its rise has been much more gradual than might first appear.

The Brazilian economy's impressive capacity to recover, revealed during the last crisis, is largely the result of the skill of its institutions for almost two decades now. In the nineties, some of the

BRAZIL: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2007	2008	2008	2009			
			4Q	1Q	2Q	3Q	October
Real GDP	5.6	5.1	1.2	–1.6	–1.2	...	–
Industrial production	5.9	2.9	–6.8	–13.6	–11.3	–8.9	...
Consumer confidence (*)	132.3	140.4	132.9	128.5	128.4	141.9	154.3
Unemployment rate São Paulo (**)	15.0	13.0	11.6	12.6	13.9	13.1	...
Consumer prices	3.6	5.7	6.2	5.8	5.2	4.4	4.2
Trade balance (***)	40.0	24.8	24.8	25.0	27.4	26.4	26.5
Interest rate SELIC (%)	12.75	11.25	13.75	11.25	9.25	8.75	8.75
Reales to dollar (*)	2.1	1.8	2.3	2.3	2.0	1.8	1.8

NOTES: (*) Value.
(**) Percentage of labour force.
(***) Cumulative balance for 12 months. Billion dollars.
SOURCES: Instituto Brasileiro de Geografia e Estatística, Banco Central do Brasil and own calculations.

macro-economic policies were already introduced that form the basis of its resistance today, particularly those whose priorities were to establish fiscal discipline and pin down public debt and inflation, as well as privatizing numerous firms and encouraging foreign trade.

Foreign trade has certainly helped the recession to be fleeting, as other countries' appetites for Brazil's commodities have significantly boosted recovery. So discipline and macro-economic stability meant that domestic expenditure remained firm when the lean years came. In this way, and when many of its neighbours are still fighting to grab hold of growth, Brazil is creating employment, its gross domestic product is growing at an annualized rate of close to 5% and forecasts for 2010 anticipate growth rates of more than 4%.

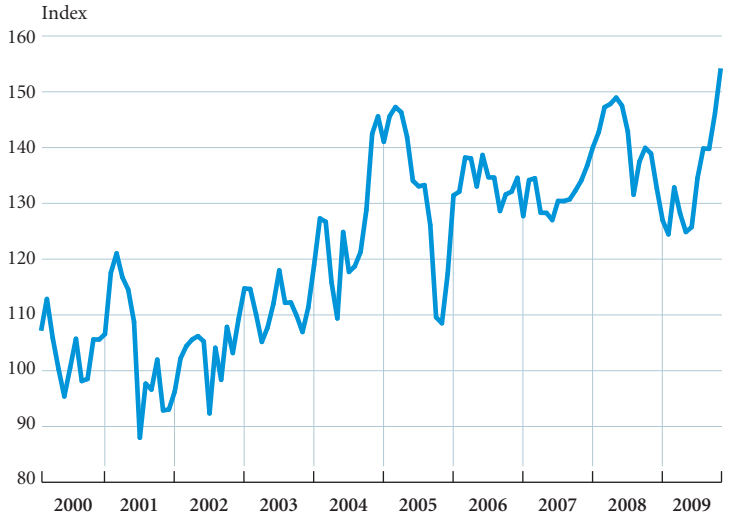
Leading indicators for the fourth quarter merely back up these expectations. Regarding demand, consumer confidence continues its determined upswing, reaching record levels in October (see graph below) with retail sales rising 4.1% year-on-year in September. In supply, the business sentiment index also advanced strongly up to 66 points, a level not reached since January 2005, while the index for industry is already at pre-crisis levels. This improved sentiment coincides with the eighth consecutive rise in industrial production, 0.8% in September compared with August, continuing to reduce its year-on-year decline. Automobile sales, although posting a reduction of 4.6% compared with the high in September, continue to advance in year-on-year terms, gaining 23.1% compared with October 2008.

So the aura of optimism surrounding Brazil and everything Brazilian for the last few months doesn't seem to be at all unfounded. Moreover, the Brazilian authorities have displayed composure regarding any setback that might prevent their economy from advancing. To date, the biggest setback is the dramatic appreciation of the real, to which the government responded in October with a new duty on foreign capital inflows. In November, this rate was extended to

Harvesting the fruits of good work.

BRAZILIAN CONSUMER CONFIDENCE, AT A RECORD HIGH

Consumer confidence index



SOURCES: Thomson Reuters Datastream and own calculations.

Brazilian authorities impose further restrictions on capital inflows.

flows picked up by Brazilian firms on foreign stock markets (American depositary receipts). Although the effectiveness of these measures is no stranger to controversy, they do demonstrate the Brazilian authorities' commitment to stability and economic growth. And, in the short term, the real's appreciation has actually taken a breather.

Mexico: six of one... and half a dozen of the other

After three consecutive quarters of decline, and leaving behind the worst recession in seven decades, Mexico has finally got back to long-awaited growth. In the third quarter, gross domestic product posted its first quarter-on-quarter rise in a year, 2.9% in seasonally adjusted figures, although this couldn't prevent a decrease of 6.3% compared with the same period the previous year. Neither could it stop its sovereign debt from being downgraded by Fitch Ratings which, although still keeping the rating within investment-grade status, attributes its decision to the worldwide economic and financial crisis and Mexico's huge dependence on oil for its public revenue.

Mexico's growing again but can't stop its sovereign debt from being downgraded.

The upswing in the Mexican economy in the third quarter can essentially be explained by renewed energy in foreign demand fed by the incipient recovery in the United States, as well as the base effect of the 'flu season in the previous quarter. Consequently, the rise in Mexico's GDP between July and September reflects, on the one hand, improvements in the tertiary sector, recovering from the initial impact of the pandemic and, on the other hand, the recent push from industry, especially manufacturing, up 2.1% compared with the second quarter of 2009. Early indicators suggest that this rebound in industry will continue into the next quarter. The IMEF manufacturing index also continued to improve in October, reaching 52.9 points and, for the fourth consecutive month, surpassing the threshold of 50 that indicates recovery. This probably reflects the recent

MEXICO: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2007	2008	2008	2009			
			4Q	1Q	2Q	3Q	October
Real GDP	3.3	1.4	–1.7	–9.0	–8.9	–6.3	–
Industrial production	2.4	–0.9	–4.5	–9.9	–10.0	–7.0	...
Consumer confidence (*)	104.9	92.2	83.3	80.1	80.5	83.0	77.0
General unemployment rate (**)	3.7	4.0	4.3	5.0	5.2	6.3	5.9
Consumer prices	–22.7	–11.8	6.2	6.2	6.0	5.1	4.5
Trade balance (***)	–10.1	–17.3	–17.3	–17.6	–15.9	–12.6	–9.3
Official Banxico rate (%)	7.00	7.50	8.25	6.75	4.75	4.50	4.50
Mexican pesos to dollar (*)	11.0	10.6	13.9	14.2	13.2	13.5	13.1

NOTES: (*) Value.
(**) Percentage of labour force.
(***) Cumulative balance for 12 months. Billion dollars.
SOURCES: Banco de México and own calculations.

improvement in automobile production, a direct beneficiary of the «cash for clunkers» programme on the other side of the Río Bravo.

The positive performance of foreign demand will be key over the coming months, not only to establishing a fundamental pillar in Mexico's recovery but also rebuilding the foundations of another pillar, domestic demand, which currently seems to be severely affected by the crisis. In clear contrast to manufacturer sentiment, whose indicator rose 1.39 points in October compared with September, consumer confidence continued its ups and downs of recent months, once again dropping back under 80. For their part, retail sales continue to post falls in year-on-year terms, 4.4% in September, in spite of reducing their rate of decline. Domestic consumption is partly hindered by a labour market whose unemployment rate remains at around 6%, in spite of improving slightly in October.

Within this context of weak domestic consumption, and taking into account the fact that, in the coming year, this consumption will be affected by the fiscal reform approved by the senate, the friendliness of the monetary policy is more than welcome. In any case, the absence of significant inflationary pressure and the relative appreciation of the peso make the work of Mexico's central bank much easier for the time being. Overall, and regarding 2010, we expect growth of around 4%, driven by the gradual recovery both in exports and domestic expenditure, and inflation is also expected to awaken from its lethargy as growth starts to liven up.

Foreign demand is in the driving seat but domestic demand is still suffering.

Consumer confidence is ebbing again.

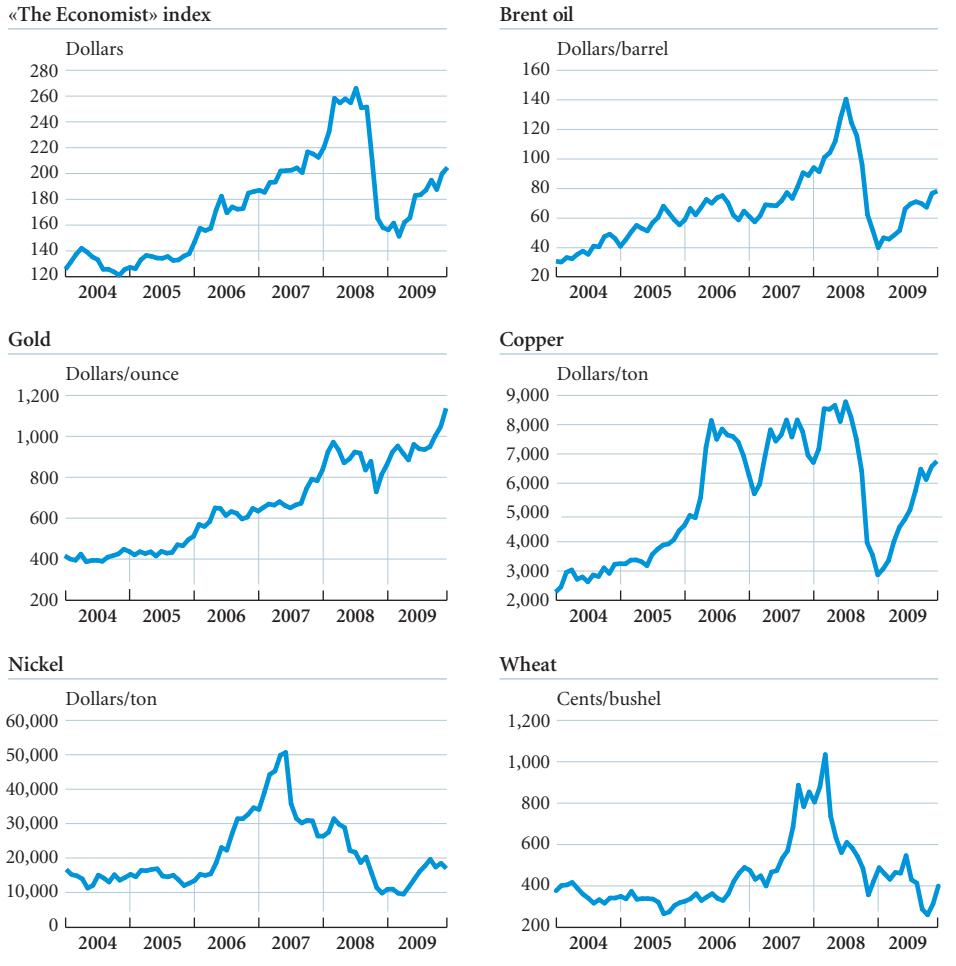
Oil holds on to its gains

Oil prices remained stable for a time after months of continual rises. Between 20 October and 19 November, crude was up 1.0%, reaching 77.65 dollars per barrel (Brent quality, one-month deliveries). Crude has therefore accumulated an increase of 98.6% in the current year and a year-on-year rise of 51.1%.

Higher oil prices and commodity prices in general are in response to the recovery

The price of crude remains at 78 dollars, twice its price at the start of the year.

TREND IN VARIOUS COMMODITIES (*)



NOTE: (*) Figures for last day of month (last date November 19).
SOURCES: «The Economist», Thomson Reuters Datastream and own calculations.

The upswing in industrial production is pushing up commodity prices.

in world demand, particularly in industrial production. The relative lack of inflationary tension in the short term and the signs given out by central banks, suggesting that lax policies will be maintained, have also pushed prices up, while gold benefitted from the weak dollar.

Commodity prices continued to rise in general. *The Economist* commodity price index rose 2.4% between 20 October and 19 November, taking the increase for the current year to 31.3%. Gains in gold were particularly significant, reaching new record highs, as well as wheat, whose prices rose 22.7% in the last month, while base metals were also up, with the exception of nickel.

EUROPEAN UNION

Euro area: end of the recession

The euro area grew 0.4% quarter-on-quarter in the third quarter, the first gain after more than a year of decline. If, as we predict, the fourth quarter also sees growth, the recession will have come to an end, based on the traditional definition. However, the year-on-year change is still negative, 4.1% in fact, and we don't expect it to reach positive figures until the first quarter of 2010. Uncertainty is also still very high, as the president of the European Central Bank (ECB), J.-C. Trichet, never tires of reminding everyone in each of his speeches, so a relapse can't be entirely ruled out as yet.

Although the breakdown of the figures is still not available, the foreign sector and economic stimulus measures are very likely to have been the mainstay of this recovery. Exports, after unexpectedly falling in August, saw solid gains again in September and closed the third quarter up 3.7%. Imports also rose, although to a lesser extent. Hence the foreign sector is once again being put forward as one of the bastions of the recovery, in spite of the significant increase in the euro over the last few months.

The euro area is coming out of the recession with quarter-on-quarter growth of 0.4%.

Economic stimulus measures are the second foundation for coming out of the crisis, seen in the sustained rise in public consumption but particularly in the

The foreign sector is seen as the bastion of this recovery.

EURO AREA: MAIN ECONOMIC INDICATORS

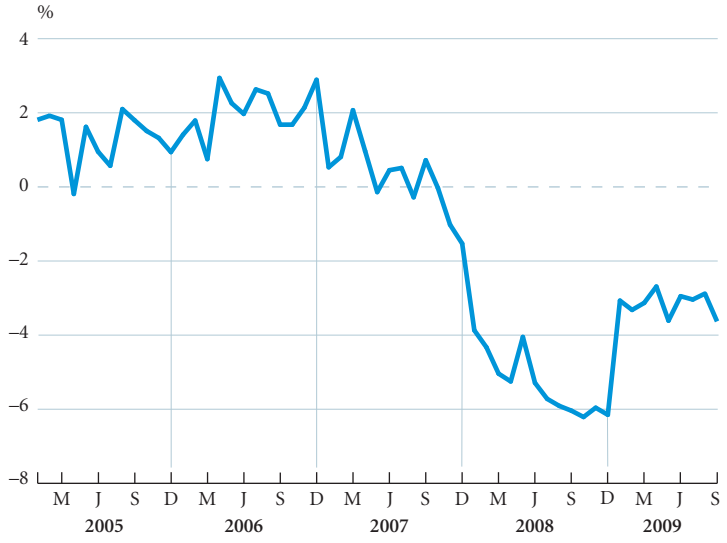
Percentage change over same period year before unless otherwise indicated

	2007	2008	2008	2009			
			4Q	1Q	2Q	3Q	October
GDP	2.7	0.6	–1.8	–4.9	–4.8	–4.1	–
Retail sales	1.8	–0.6	–1.7	–3.1	–2.3	–2.4	...
Consumer confidence (1)	–4.9	–18.0	–27.1	–32.5	–27.9	–21.3	–17.7
Industrial production	3.5	–1.7	–8.9	–18.5	–18.6	–14.6	...
Economic sentiment indicator (1)	108.9	91.1	75.6	65.7	70.2	79.9	86.2
Unemployment rate (2)	7.4	7.5	8.0	8.8	9.3	9.6	...
Consumer prices	2.1	3.3	2.3	1.0	0.2	–0.4	–0.1
Trade balance (3)	20.1	–1.2	–31.7	–36.4	–31.8	–4.4	...
3-month Euribor interest rate	4.3	4.6	4.2	2.0	1.3	0.9	0.8
Nominal effective euro exchange rate (4)	107.9	113.0	109.1	111.9	113.2	114.3	116.6

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

RETAIL SALES STILL STUCK

Retail sale index, year-on-year percent change



SOURCES: Eurostat and own calculations.

Private consumption remains very weak.

upswing in consumer durables and public investment. We do not expect private consumption to have made a positive contribution to economic growth, however, as the consumption of non-durables is still very weak. Evidence of this is the trend in retail sales, falling further in September and reaching 3.6% year-on-year. Moreover, although all confidence indicators continue to recover strongly, they are still at very low levels.

Investment is undergoing a similar situation, while the main business indicators continue to pick up relatively quickly. Industrial production, which had dropped more than 20% year-on-year in the month of April, managed to cut this fall back to 12.9% in the month of September. Industrial confidence indicators and the Purchasing Managers' Index (PMI) suggest that this trend will continue over the coming months. In fact, both the PMI for the manufacturing sector and for services are already above 50 points, the level above which the sector is expected to expand. However, in the short term investment will only manage to slow up its rate of contraction and it won't be until 2010 when positive growth rates will be noticed. Two factors are essentially delaying the recovery in investment: production capacity utilization and financial conditions.

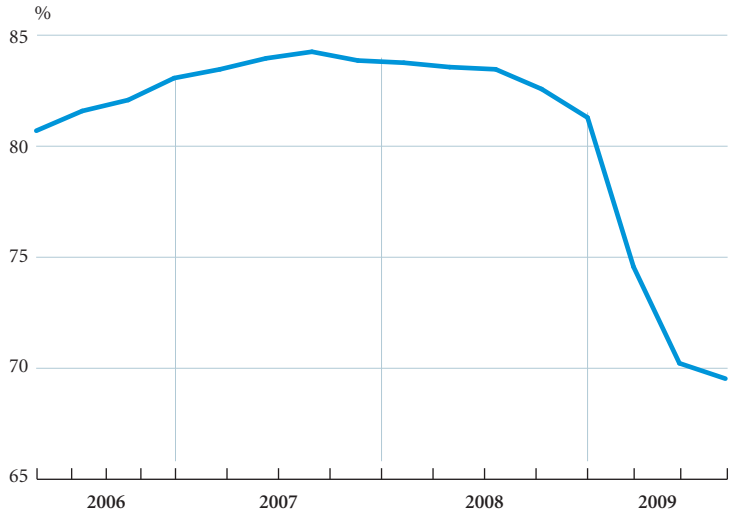
Production capacity utilization is still at record lows, falling to 69.6% in the third quarter, although it's important to note that its rate of decline has slowed up slightly and everything points to it recovering in the fourth quarter. Private sector credit posted negative year-on-year growth for the first time in its short history, showing that the demand for credit is very weak, and that the effects of the recession are still being felt by the financial sector.

The improvement in business has not been passed on to investment.

The solid upswing in early business indicators, as well as the growth expected

PRODUCTION CAPACITY UTILIZATION HITS BOTTOM

Production capacity utilization



SOURCES: Eurostat and own calculations.

for key trading partners for the euro area, have led us to slightly upgrade our growth forecasts for next year to 1.2%. Of course, this does not mean that the risk of downturn has disappeared. One of the biggest risks continues to be the labour market. If recovery in consumption and investment takes a few quarters longer than expected, there might be a significant surge in the unemployment rate. Since the start of the recession, the number of unemployed people has risen non-stop and, in the month of September, was already way past 15 million. However, if we compare the rise in unemployment with the historic fall in business activity, it has been much less than in previous recessions. This is due to plans for temporary workforce adjustments and cuts in working hours implemented by several countries in the euro area. Measures that might be reaching their limit and may not be capable of withstanding another decline in business.

A surge in the unemployment rate is still the greatest risk in the medium term.

In addition, delay in the recovery of consumption and investment would once again place inflation at unusually low levels next year. In the short term, we expect the effect of the fall in oil prices to gradually disappear. The harmonized consumer price index (CPI) for October moderated its fall to 0.1% and will more than likely show a positive year-on-year change in November. But core inflation continues to fall slowly each month, falling one percentage point more in October and standing at 1%. Moreover, price forecasts don't predict any change in trends in the short term, although the pressure on prices will continue to fall over the coming months both in trade and industry and services.

A context of weaker consumption and investment than expected would also present the ECB with a new challenge. For the present, it has warned that it will soon start to withdraw the extraordinary measures taken to boost liquidity in financial markets. We do not expect the

Absence of inflationary tension.

The ECB will postpone any hike in interest rates until the end of next year.

ECB to raise the reference interest rate before autumn next year, once there are convincing signs that consumption and investment have started to recover.

There are risks but these are clearly identified. That's why both the governments of the different countries in the euro area, as well as the key community institutions have valuable time to make sure these risks do not come about. Advantage must therefore be taken of the Lisbon Treaty coming into force this December to tackle recovery with a higher chance of success.

Germany decides to lower taxes

The German economy grows 0.7% quarter-on-quarter in the third quarter.

Germany celebrated the twentieth anniversary of its reunification by announcing that gross domestic product (GDP) was on the up again, by 0.7% in the third quarter compared with the previous quarter. This confirmed the recovery of the German economy after posting, in the first half of 2009, its biggest recession since the Second World War. This has led us to revise our forecasts, now showing a fall of 4.8% in 2009 and growth of 1.5% in 2010. This recovery is in line with the new forecasts by leading economic institutes. However, paraphrasing the German government's Council of Economic Experts (known as the «five wise men») in their annual report: «There is recovery but no boom».

This statement is due to the absence of a clear reference underpinning the economy's growth in the medium term. Unlike the previous quarter when all the GDP components contributed to economic growth, in the third quarter only investment increased significantly, with 1.3% growth quarter-on-quarter. On the other hand, private consumption varied by 0.9%, while public consumption, main stabilizer of the economy during the recession, remained stable. Moreover, increased imports, higher than the rise in exports (5.0% and 3.4% respectively), meant that the foreign sector didn't improve further. Only the slowdown in stock reduction also helped growth in GDP.

GERMANY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2007	2008	2008	2009			
			4Q	1Q	2Q	3Q	October
GDP	2.6	1.0	–1.8	–6.7	–5.9	–4.8	–
Retail sales	–3.0	–0.5	–0.4	–2.8	–1.6	–1.9	...
Industrial production	5.9	–0.1	–7.5	–20.0	–19.3	–15.6	...
Industrial activity index (IFO) (*)	106.2	96.8	86.2	82.6	84.7	89.7	91.9
Unemployment rate (**)	9.0	7.8	7.6	8.0	8.2	8.2	8.1
Consumer prices	2.3	2.6	1.7	0.9	0.3	–0.3	0.0
Trade balance (***)	181.5	195.3	183.0	159.6	138.9	131.1	...

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

Rising investment might surprise us, taking into account the low industrial capacity utilization, in November at ten percentage points below the average of the last few years. However, the upswing in production and industrial orders in the last few months, with month-on-month rises of 2.7% and 1.5% respectively in September, explain this improved investment, as can be seen in the graph below. Moreover, public investment rose, as from the second quarter of 2009, due to the economic stimulus measures implemented by the government. The new rise in the IFO business confidence index in the month of November suggests that this investment trend will continue for the coming quarters.

Greater industrial activity encourages investment.

Looking at demand, the recovery in Europe's economy and rising demand for capital goods will continue to boost German exports, placing the foreign sector as one of the engines of the economy. Private consumption, however, will continue to weaken in the short term, following the path marked out by retail sales which, in the third quarter, fell by 0.9% quarter-on-quarter. In November, the end of the aid plan for automobile purchases and growing uncertainty concerning the labour market are expected to sustain this trend. Regarding the latter, the unemployment rate for October fell again to 8.1%, but everything suggests that it will rise again over the coming months.

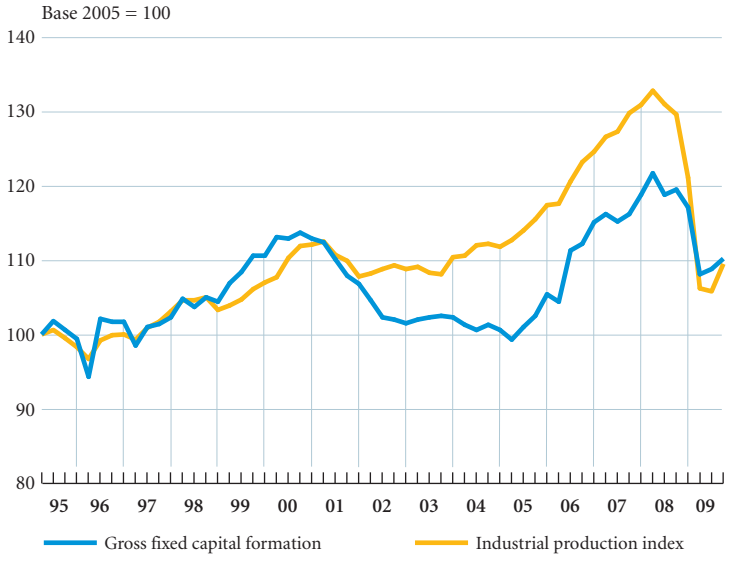
To tackle falling consumption, the new German government decided to cut taxes as from 2010, this cut being estimated at 24,000 million euros (more than 1.0% of German GDP). The measure aims to motivate household consumption, particularly families with children or low incomes, the main beneficiaries.

Consumption will continue to weaken over the coming quarters.

However, there are doubts regarding the effectiveness and consequences of this measure, even in Angela Merkel's own party. Firstly, there is the great tendency

THE UPSWING IN INDUSTRIAL PRODUCTION ELEVATES INVESTMENT

Indices



SOURCES: Deutsche Bundesbank and own calculations.

The rise in German deficit calls into question the appropriateness of tax cuts.

of German society to save and the more than probable deterioration in unemployment in 2010 mean that there is no guarantee that raising household income will lead to greater consumption. Moreover, the fall in revenue will lead to further deterioration in public accounts. The European Commission estimates that the German deficit will reach 5.0% of GDP in 2010, raising public debt close to 80.0% of GDP. Given this situation, many voices can be heard, among them those of the Bundesbank and the «five wise men», criticizing the lack of a strategy to reduce the deficit in the medium term in order to return to sustainable levels.

France grows again in the third quarter

The French economy confirmed its recovery in the third quarter with 0.3% growth quarter-on-quarter, the second in succession. Consequently, the year-on-year drop in the French economy was again reduced over this period, reaching, according to the consensus, a reduction of the economy close to 2% in 2009 compared with the previous year. According to our forecasts, as from the first quarter in 2010 the economy will once again post year-on-year growth.

The French economy confirms its recovery in the third quarter.

An analysis of the different GDP components shows that this upswing has mainly been supported by improved consumption (public and private) and by the foreign sector, thereby offsetting a further reduction in investment. Public consumption and net exports are expected to continue this trend in the coming quarters, becoming the main engines of the economy, while private consumption, which reduced its growth during the third quarter, will continue to lose share.

The most frequent indicators highlight this weak consumption. Consequently, in spite of falling prices in the last few quarters, retail sales still show no clear signs of recovery. It is expected that the labour market, which in September had already reached 10%, its highest level since 1999, will continue to worsen over the coming year. This, together with the expected upswing in prices in the last few months of 2009, will keep private consumption at a secondary level, especially as the fiscal stimuli aimed at encouraging consumption will come to an end.

FRANCE: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2007	2008	2008	2009			
			4Q	1Q	2Q	3Q	October
GDP	2.3	0.3	–1.7	–3.5	–2.9	–2.4	–
Domestic consumption	4.8	–0.6	–2.5	–1.0	0.2	–0.2	...
Industrial production	1.2	–2.4	–8.8	–15.6	–14.7	–11.0	...
Unemployment rate (*)	8.3	7.9	8.3	8.9	9.4	9.8	...
Consumer prices	1.5	2.8	1.8	0.6	–0.2	–0.4	–0.2
Trade balance (**)	–33.8	–48.7	–54.9	–54.3	–52.0	–44.1	...

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

On the other hand, industrial production fell in September after four consecutive months of increases. Given this outlook and the low utilization of production capacity, at 70.8% in the third quarter, investment will remain at low levels. This, however, did not prevent another rise in industrial confidence in the month of October.

The greater relative importance of the French public sector, which helped to contain the declining economy in 2009, will mean that the upswing in 2010 will be less than that of other European economies, with an expected growth in GDP of 1.3%. However, there are some risks that might slow up this recovery: further deterioration in the labour market or less growth than that demanded by the European Union. That's why the French Finance Minister, Christine Lagarde, is cautious when analyzing trends in the French economy and has chosen to maintain government aid to stimulate the economy in 2010.

This is the direction of the new stimulus plan by the government for the coming year, totalling 35,000 million euros and aimed largely at university education and technology. It is expected that a third of this sum will come from the French financial system returning part of the aid it received in 2009. The remaining amount (1.3% of GDP) will be financed by issuing public debt, which is why this plan is called «Le grand emprunt» (the big loan). This will further weaken the French public accounts, which according to the government's estimates will attain deficits of 8.2% and 8.5% of GDP in 2009 and 2010, respectively. Given this situation, the Finance Minister believes it will be very difficult to bring the deficit down to 3.0% in 2013, as required by the European Union.

We expect 1.3% growth in 2010 although there are certain risks.

The French government is launching a new stimulus plan totalling 35,000 million euros.

The Italian economy confirms that the worst is over

The Italian economy came out of its recession in the third quarter with 0.6% growth in GDP quarter-on-quarter, leaving behind fifteen months of consecutive falls. This solid rise, the highest since the fourth quarter in 2006, has led to a generally agreed revision of forecasts for how the Italian economy will perform in 2009, placing the year-on-year fall at 4.5%-5.0%.

In spite of the breakdown by component not being available, everything suggests that the recovery in stocks will be the main driving force behind this upswing. Slightly stronger private consumption, encouraged by public aid, as well as some improvement in the foreign sector have also played their part. Investment, on the other hand, continues to fall in spite of increasing its public component. It is therefore predicted that recovery will be weaker in the coming quarters, as there is no obvious support for the economy in the short term.

A drop in consumer confidence in the months of September and October confirms this perception. Consequently, the rise in unemployment and inflation, which in July reached its lowest level for the last four decades, will weaken gains in household consumption for the coming quarters. Retail sales will therefore continue to lack any clear trend, after the 5.8% fall month-on-month posted in August. On the other hand, subsidies for automobile purchases will sustain the sales of durables. The European Union's economic recovery points to the trade balance improving over the coming months, although the rise in imports will mean that the pace of recovery will not be as fast as it has been.

The Italian economy comes out of recession in the third quarter although it's still fragile.

ITALY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2007	2008	2008	2009			
			4Q	1Q	2Q	3Q	October
GDP	1.5	–1.0	–2.9	–6.0	–5.9	–4.6	–
Retail sales	1.3	–0.3	–1.7	–2.9	–1.2	...	...
Industrial production	2.2	–3.4	–10.7	–21.1	–22.9	–16.0	...
Unemployment rate (*)	6.2	6.7	7.0	7.3	7.4	...	–
Consumer prices	1.8	3.3	2.8	1.5	0.8	0.1	0.3
Trade balance (**)	–12.8	–10.0	–12.3	–11.1	–9.1	–5.3	...

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

Consumption and exports will grow slightly.

Given such perspectives for demand and the fall in industrial production in September, 5.3% compared with the previous month, private investment is not expected to recover until the second half of 2010 in spite of further improved business confidence in the month of October. Moreover, high public debt will reach 115% this year according to the European Commission's estimates. This will not allow public consumption to become one of the mainstays of the Italian economy, unlike what has happened in other European countries.

Investment and public expenditure will not help Italian growth until the second half of 2010.

United Kingdom: the end of a longer than expected recession

As noted in the first estimate, the British economy did not manage to grow in the third quarter of 2009 and its recovery continues to lag behind that of the main world economies. The final figure, slightly upgraded, indicates a quarter-on-quarter drop in GDP of 0.3% in the third quarter (5.1% year-on-year).

British GDP fell 5.1% year-on-year in the third quarter.

The fall in private consumption slowed up during this period, something partially anticipated by the clear improvement in key early indicators for demand over the last few months, such as retail sales and consumer confidence. However, the still restrictive conditions for credit and the rise in VAT in January threaten to prevent this positive tone from becoming consolidated. Trends in the labour market, marked by a fall in payments rather than high job losses, are also damaging household consumption.

Investment has corrected its downward slide, in the third quarter falling 0.3% quarter-on-quarter in contrast to its drop of 5.2% in the previous quarter. The greater optimism shown by the main economic and business sentiment surveys also reinforce the idea that a change in trend is coming about. However, other indicators such as the continued reduction in industrial production make us a little more cautious about these promising conclusions.

The positive impact of public expenditure on economic growth, a reflection of expansionary fiscal policies, will gradually fall away in the medium term due to measures to contain fiscal deficit. In fact, the year-on-year growth in public expenditure in the third quarter of 2009, at 1.9%, has been the lowest

UNITED KINGDOM: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2007	2008	2008	2009			
			4Q	1Q	2Q	3Q	October
GDP	2.6	0.6	–2.0	–5.0	–5.5	–5.1	–
Retail sales	4.2	2.6	1.8	0.4	0.9	2.6	3.5
Industrial production	0.3	–3.1	–8.1	–12.5	–11.7	–10.4	...
Unemployment rate (*)	2.7	2.8	3.4	4.2	4.7	4.9	5.1
Consumer prices	2.3	3.6	3.9	3.0	2.1	1.5	1.5
Trade balance (**)	–83.4	–93.7	–94.1	–91.8	–88.4	–83.7	...
3-month Libor interest rate	5.3	6.0	6.3	2.8	1.6	1.2	0.5
Nominal effective pound exchange rate (***)	103.9	97.6	89.4	73.9	77.0	83.7	79.0

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

since the recession started. On the other hand, the foreign sector, which contributed 0.7 percentage points to GDP growth, will be a greater factor in the British economy's recovery thanks to the depreciation of pound sterling and the upswing in the world economy.

Undoubtedly, the prospects of recovery are improving but the upswing will take place more slowly than predicted. For this reason, the Bank of England decided to up its bond acquisition plan by 25,000 million pounds in November. However, greater monetary stimulus had been expected, suggesting that inflationary risks are of increasing importance. Nonetheless, an end to monetary stimuli in the near future is neither very likely nor advisable. British GDP has fallen over six consecutive quarters, accumulating a total drop of 6%, and the effects of the recession on the financial system and labour market will continue even with positive growth in the coming quarters.

Emerging Europe: 2010, the year of recovery

As 2009 comes to its end, the outlook for 2010 is starting to take shape. Applying a big timeframe, if 2009 was the year of the acute phase of the global credit crisis and when emerging Europe started to come out this crisis, 2010 should be the year of consolidated recovery and, if circumstances allow, the antechamber to a 2011 that sees the region approaching potential growth. What might go wrong? One way of handling this question is by looking at current developments, subsequently identifying some factors that might damage them.

In very general terms, the two large and most notable recent trends are the upswing in business and the financial area getting back to normal. Although economic reactivation is still not very strong, as we are reminded by the trends in GDP in the third quarter of 2009, and is very dependent on the foreign sector, it is expected to consolidate in the

The foreign sector will be one of the key factors in recovery.

The Bank of England boosts monetary stimuli.

In 2010, emerging Europe should consolidate its recovery.

coming quarters. For the moment, business indicators for the fourth quarter, such as economic sentiment, suggest that growth will speed up in the final stages of 2009.

With regard to the financial area, the fateful first quarter is now a long way behind us. Between the end of February and the middle of March, currencies started to appreciate gradually but persistently, and there was a notable rise in stock markets in the region, a trend that is continuing up to the end of 2009. To round off the financial stage, country-risk indicators have fallen significantly since the first quarter and financial capital flows have tended to improve.

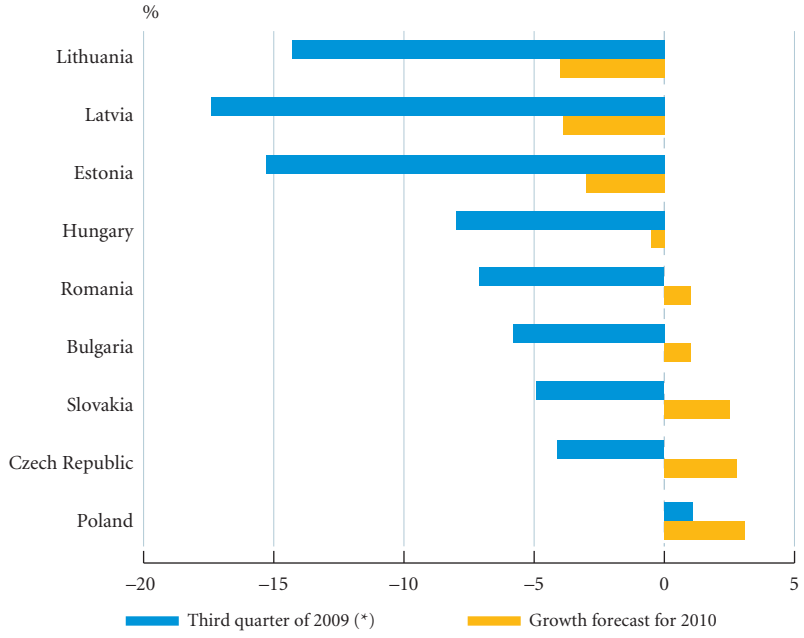
Although the acute phase of the crisis is behind us, business is still expanding weakly.

These positive trends in real and financial business sustain a scenario of average growth in 2010 in Poland, the Czech Republic and Slovakia, countries that have suffered less than the rest of the region in 2009 due to their lower accumulated macro-economic imbalances. A second group would be made up of countries such as Hungary, Romania and Bulgaria, which would come close to zero growth. This is due to the fact that the improvement in business that is more closely related to the foreign sector will be hindered by the notable adjustment carried out internally, precisely in response to macro-economic excesses from boom times. Finally, the Baltic countries will remain in the area of recession.

We wondered previously which factors might upset this recovery. There are probably three main risks: demand weakening unexpectedly, an increase

EMERGING EUROPE SAYS GOODBYE TO RECESSION

Year-on-year real change in gross domestic product



NOTE: (*) The data refer to the second quarter for Poland and Latvia.
SOURCES: Eurostat and own calculations.

in country-risk and the delayed effects of the crisis being more intense than expected. The first of these risks might occur if the euro area performs slightly below the 1.2% expected for 2010. Along the same lines, if there's an apparent fall in car demand due to the end of aid packages for automobile purchases, this would harm those economies more dependent on this sector.

The second threat to this forecast coming about is an appreciable increase in country-risk. This might complicate the international financing of the recovery. Although there are many different factors that might underlie a hypothetical change in perceived country-risk by international investors, lately the issue of the fiscal consolidation that will have to be tackled in the future has aroused concern. This process could be problematic because, in a situation peppered with elections in 2010 and 2011 and not always solid governmental coalitions, the political capital to tackle cuts in public expenditure may be lacking.

Finally, the third source of risk for 2010 concerns the impact of delayed effects of the crisis that may be more severe than expected. Higher unemployment and bank bad debt are of particular concern. According to forecasts, the unemployment rate will be around 8%-15% in Slovakia, Romania, the Czech Republic, Hungary and Poland, and in the range of 15% to 20% in Bulgaria, Estonia, Latvia and Lithuania. Any deviation from these figures, already the worst for many years, would harm the expected recovery in domestic demand and, in turn, bank bad debt. This last variable should rise throughout the first half of 2010 and then gradually tail off. If bad debt levels were significantly worse or if they lasted longer than expected, new injections of capital would be required to sustain bank solvency, which is currently firm.

The financial situation has also been notably redirected.

Recovery will critically depend on European expansion being maintained and political risks not getting out of hand.

Watch out for rising unemployment and bad debt in 2010.

Ten years after Lisbon

Just under ten years ago, at the European Council held in Lisbon in 2000, the European Union (EU) launched an ambitious agenda of economic reforms. The aim was to become the most dynamic and competitive economy in the world by 2010, shortening the gap between Europe and the United States. The results of the Lisbon Strategy, however, are likely to fall short of their targets. Just a few months away from the European Council, under the Spanish EU presidency, approving a new economic strategy for the coming decade, it's worth evaluating what has gone well and what could have gone better with Lisbon.

Although it has undergone some amendments over the years, the Lisbon Strategy is based on three pillars: a knowledge-based economy, encouraging research and development (R&D); employment, with the core target of improving employment rates; and the environment, with the aim of reducing greenhouse gas emissions. A wide range of structural measures and proposals for action have been raised on these pillars, going from fiscal policy to the single market and including active policies for the job market and investment in cross-border infrastructures. Given its ambition, the Lisbon Strategy covers areas that still come under the powers of member states and the EU's actual power for implementing the strategy has therefore been limited. In fact, the lack of progress under the Lisbon Strategy has been blamed on the overloaded agenda, on the conflicts

appearing between so many different priorities and particularly on the lack of a sufficiently strict mechanism for coordination.

LIST OF QUANTITATIVE TARGETS FOR THE EU-15 ON THE LISBON AGENDA

	1999	2008	2010 target
Overall employment rate (%) (1)	62.5	67.3	70
Female employment rate (%) (2)	53.0	60.4	60
Employment rate 55-64 age group (%) (3)	37.1	47.4	50
R&D expenditure (% of GDP) (4)	1.9	1.9	3
Greenhouse gas emissions (1990 index = 100) (4)	96.1	95.0	92

NOTES: (1) Percentage employed out of population of working age.
(2) Percentage of women employed out of population of women of working age.
(3) Percentage employed aged 55-64 out of population of same age group.
(4) The most recent data refer to 2007.
SOURCE: Eurostat.

Although progress has been made, none of the main quantitative targets set by the Lisbon Agenda for the EU-15 as a whole is likely to be met (see the above table). The latest figures available indicate that the employment rate is only over 70% in Denmark, Germany, the Netherlands, Finland and Sweden. France and particularly Italy stand out for their poor improvement since 1999. In Spain, great progress was made up to 2008 but job losses in the last year have moved us further away from the Lisbon target, even sending us back to the end of the line within the EU-15. The employment target for the 55 to 64 age group (50%) doesn't seem achievable either, in view of the terrible results in Italy, Belgium and France (all around 35%). With regard to the female employment rate, although it looked like the Lisbon target was close to being met, it is very likely that the 2009 recession has put a stop to this. In terms of R&D expenditure, only Finland and Sweden have exceeded the target of 3% of GDP, something that, in fact, was already the case ten years ago, but the increase for the EU-15 between 1999 and 2007 has not even reached half a tenth of a percentage point of GDP (0.04%). The only possibility of achieving a Lisbon quantitative target seems limited to the reduction in emissions but, if this is achieved, it will be largely thanks to the economic situation in 2009.

However, it would be unfair to be excessively critical of the EU's economic situation after ten years of Lisbon, when several member states lead the different rankings for competitiveness. For example, the World Economic Forum ranks Sweden, Denmark, Finland, Germany and the Netherlands among the ten most competitive economies in the world. This proves that there are good practices and examples of dynamism within the EU. The challenge is to spread these, as far as possible, to other countries in the Union, particularly to the large economies that are lagging behind: France, Italy and Spain. However, the role of European institutions as catalysts in this process cannot be overstated. The European Commission or Parliament can coordinate or recommend the reforms required to improve competitiveness and can even play a useful role as scapegoat to ensure that countries decide to implement them, but in most cases they cannot force such changes. The political commitment of member states is an absolutely vital ingredient and can almost never be replaced by a community directive. This is particularly evident in the case, for example, of labour market reforms.

Realistically speaking, the strategy that succeeds Lisbon may include some changes that broaden the EU's influence. Firstly, key reforms should be better reflected in the community budget so that funds from Brussels

would become an incentive to carry out reforms (for example, in research). On the other hand, a more selective agenda of reforms, concentrating on those measures believed to be most relevant and that benefit most from coordination between countries, would help to focus the attention of governments, the EU and civil society and would make it more difficult for inaction in crucial areas to be disguised by implementing less significant measures. In this respect, one area where the EU could play a decisive role in the coming years is in coordinating reforms, for example in health and pension systems, which will be under pressure from the ageing of the population, in order to bolster the medium and long-term sustainability of public accounts.

Revising the Lisbon Strategy has not come at an easy time. On the one hand, furthering the single market has been clearly associated with the principles of liberalization, principles that might have been affected by the crisis. On the other hand, public resources are particularly in short supply at the moment. However, difficult times also usually highlight the need to carry out structural reforms. There should be no excuse for not being ambitious. Realistic, but ambitious. This is, without doubt, one of the first challenges for the Europe arising out of the Lisbon Treaty and particularly for its first president.

This box was prepared by Enric Fernández
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FINANCIAL MARKETS

Monetary and capital markets

Central banks are heading for an orderly exit

ECB and Fed still say financial markets are improving...

After their respective meetings in November, the two main central banks in the world, the European Central Bank (ECB) and the US Federal Reserve (Fed), stressed that conditions in financial markets and the real economy are still improving, although recovery is likely to be slow.

ECB President, Jean-Claude Trichet, maintained that not all current liquidity measures would be necessary over the coming months. Trichet therefore hinted that, although it's still too soon to start up the exit strategy, its time is drawing near. An important part of the ECB strategy consists of restoring the liquidity-providing system from before the crisis, where one-week loans (MRO) were the main instrument to affect money market interest rates. In order to achieve its proposal, the ECB must restore those aspects that were altered due to monetary policies over the last two years, such as loan maturities, the value of operations, interest rates charged and the list of assets eligible for collateral.

...and are starting to suggest what steps will be taken in their exit strategies.

In the case of maturities for special loans (LTRO), the markets have interpreted Trichet's comments as a sign that one-year operations will not be sustained beyond December. But the ECB, which stresses that implementation will be gradual, will probably keep three and six-month LTROs for some time yet.

Another alternative, which does not preclude the above measure, is for the ECB to gradually move away from its policy of totally covering the demand received. Some members of the Governing Council have stated that, for the time being, one of the central bank's aims is not to affect the relationship between the EONIA and the deposit facility interest rate. If maturities were shortened and values reduced abruptly, the EONIA could rise, in turn leading to gains in the other monetary rates.

So as not to abandon the policy of totally covering demand, one option is to alter the interest rate charged for long-term operations. In this case, the ECB can apply a premium of 1.0% of weekly loans, or simply use a variable rate. Finally, the ECB has the option of reducing the list of eligible assets, effectively limiting commercial banks' capacity to demand liquidity.

On the other side of the Atlantic, the Fed is also continuing to work on its exit strategy. The Fed's Board of Governors recently issued a memo announcing that the maturity for loans through the discount window system will be reduced from the current 90 days to 28 days as from January 2010. This decision is in addition to the cut already made to the value of funds that can be auctioned via TAF (Term Auction Facility). The Fed also publicised that it will only buy 175,000 million dollars of mortgage bonds and not the 200,000 initially announced.

This is simply for supply-related reasons and is not a case of the Fed rethinking its objectives.

With regard to conventional monetary policy, both the ECB and the Fed continue to state that official interest rates will remain at their current level for some time yet. The markets reckon the ECB might raise the reference interest rate during the fourth quarter of 2010 and the Fed could raise its official rate during the second half of 2010.

In this environment, interbank markets in the euro area have remained extremely stable and, in the United States, the short part of the interbank curve (up to six months) hasn't seen any significant change either. However, rates from the longer part of the curve in dollars have fallen 16 basis points on average throughout November.

Over the last few months, interbank markets have gradually been getting back to normal, one reason why the central banks are pushing the withdrawal of the aforementioned emergency facilities. However, there are still signs that interbank markets are not quite back to what they were. For example, for 12-month operations the differential

US one-year interbank differentials continue to reflect uncertainty.

SHORT-TERM INTEREST RATES IN NATIONAL MARKETS

As annual percentage

	Euro area			United States		Japan	United Kingdom		Switzerland
	ECB auctions (2)	Euribor (5) 3-month	Euribor (5) 1-year	Federal Reserve Board target level (3)	3-month (5)	3-month (5)	Bank of England repo rate (4)	3-month (5)	3-month (5)
2008									
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	0.67	1.50	2.17	0.70
February	2.00	1.83	2.03	0.25	1.26	0.64	1.00	2.05	0.75
March	1.50	1.51	1.81	0.25	1.19	0.60	0.50	1.65	0.63
April	1.25	1.37	1.73	0.25	1.02	0.55	0.50	1.45	0.66
May	1.00	1.27	1.63	0.25	0.66	0.52	0.50	1.28	0.60
June	1.00	1.10	1.50	0.25	0.60	0.46	0.50	1.19	0.33
July	1.00	0.89	1.36	0.25	0.48	0.41	0.50	0.89	0.41
August	1.00	0.82	1.30	0.25	0.35	0.39	0.50	0.69	0.30
September	1.00	0.75	1.24	0.25	0.29	0.35	0.50	0.54	0.31
October	1.00	0.72	1.24	0.25	0.28	0.33	0.50	0.59	0.34
November (1)	1.00	0.72	1.23	0.25	0.26	0.30	0.50	0.61	0.32

NOTES: (1) November 24.
(2) Marginal interest rate. Latest dates showing change in minimum rate: 8-10-08 (3.75%), 6-11-08 (3.25%), 4-12-08 (2.50%), 5-03-09 (1.50%), 2-04-09 (1.25%), 7-05-09 (1.00%).
(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%), 4-12-08 (2.0%), 7-01-09 (1.5%), 5-02-09 (1.0%), 5-03-09 (0.50%).
(5) Interbank rate.
SOURCES: National central banks, Bloomberg and own calculations.

Treasury purchases by the Fed and commercial banks stabilize the US government bond market.

between the LIBOR interbank rate in dollars and the OIS interest rate (Overnight Index Swap), for liquidity and interbank credit premia are still significantly higher in twelve-month operations than before August 2007, while three-month operations have already returned to their previous levels.

The low 3-month differential can be explained by the greater liquidity in this market segment and we mustn't forget the high surplus reserves held by US banks with the Fed as a result of the bond purchase programme it's been running. Moreover, the credit risk premium demanded in longer term operations, although falling, is still quite high, indicating that the markets still believe there's more than appreciable uncertainty in the world economy.

Government bond markets still stable

There have been powerful macroeconomic and financial movements throughout the year. Nonetheless, the government bond markets of the United States and the countries that make up the core of the euro area, namely Germany and France, have behaved relatively calmly. Just think back to how, in the first quarter, numerous observers thought worldwide depression was very likely. But within a short period of time, in fact as from March, the economic policy measures set in motion throughout the world have managed to reactivate the cycle and several countries are now enjoying positive growth. On the other hand, bond issues have increased significantly throughout the year, to tackle the huge public deficit in developed countries.

Differentials have widened slightly for countries on the edge of the euro area.

Contrary to what might have been feared, these great changes have not led to violent movements in US public debt (except for moderate turbulence in June). For example, the table below shows how the yield on bonds issued by the Treasury with a 10-year maturity has fluctuated since the start of this year within a narrow range from 2.84% to 3.53%, and their current yield is 3.34%. Why has public debt not been more volatile?

There are two reasons for such persistent price stability. Firstly, because of the Fed buying bonds. For example, in open market operations since the end of March, the central bank has carried out net purchases of Treasury bonds totalling 300,000 million dollars. These purchases have concentrated on the medium tranche, with maturities of four to seven years. However, it has also bought bonds with much longer maturities, more than 10 years.

The second considerably influential factor is the purchase of bonds by commercial banks. Since early 2009, they have acquired over 139,000 million dollars in public debt, one of the ways they are repairing their battered balance sheets. The banks secure financing in monetary markets where interest rates are around 0.25% and invest in public debt, which gives them a better yield and minimum risk.

The German long-term government bond market has also been remarkably stable, thanks to similar factors to the United States. Specifically, the 10-year bund has a yield of 3.28%, only two basis points (100 basis points is 1%) lower than its yield in January this year.

However, there are still some areas of tension, which to some extent serve as a reminder of what might happen

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								
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	3.00	3.55	4.05	4.39	2.66	1.35	3.17	2.10
April	3.18	3.59	3.92	4.28	3.12	1.43	3.50	2.14
May	3.59	3.95	4.29	4.48	3.46	1.49	3.75	2.41
June	3.39	3.73	4.13	4.43	3.53	1.36	3.69	2.32
July	3.30	3.57	3.85	4.16	3.48	1.42	3.80	1.97
August	3.26	3.54	3.78	4.08	3.40	1.31	3.56	2.03
September	3.22	3.54	3.81	4.02	3.31	1.30	3.59	1.99
October	3.23	3.53	3.79	4.07	3.38	1.42	3.62	2.02
November (*)	3.28	3.56	3.83	4.06	3.34	1.31	3.68	1.97

NOTE: (*) November 19.
SOURCE: Bloomberg.

to global debt markets if actors start to doubt the sustainability of public accounts and/or the control of inflation. In particular, differentials have widened for interest rates demanded by investors from countries on the edge of Europe, such as Greece or Ireland. However, this widening has been moderate and is very far from the maximums seen when the financial crisis was at its peak.

Exchange rates: pressurizing the Chinese renminbi

The dollar has continued to depreciate against the pound sterling and Japanese yen over the last month. For example, one dollar on 26 October bought 92.2 yen, while approximately one month later it was exchanged for just 88.90 yen. However, the dollar has remained stable against the euro at around 1.50.

In any case, in November exchange markets were focusing their attention on the Chinese currency. The Chinese government is taking great pains to keep the exchange rate stable between the renminbi and the dollar, as most Chinese exports are in dollars and stability therefore helps them to be competitive traders.

The dollar continues to depreciate against the Japanese yen and pound sterling.

But China's trade partners and supranational bodies such as the International Monetary Fund believe the renminbi is significantly undervalued. For this reason, during the Chinese-American summit held in November, the US president increased his pressure and publicly asked the Chinese authorities to be more flexible in their exchange rate policy. In fact, Obama expressed his satisfaction with China's commitment to gradually directing its currency's value towards market forces. But it's true that president Hu did not specify any

The United States has asked China to appreciate the renminbi.

EXCHANGE RATES OF MAIN CURRENCIES

November 19, 2009

	Exchange rate	% change (*)		
		Monthly	Over December 2008	Annual
Against US dollar				
Japanese yen	88.8	–2.0	–2.1	–7.9
Pound sterling	0.602	–1.2	–13.8	–11.1
Swiss franc	1.017	0.6	–5.1	–19.3
Canadian dollar	1.068	3.7	–14.1	–17.5
Mexican peso	13.050	0.8	–4.8	–3.6
Against euro				
US dollar	1.488	–0.6	6.1	16.1
Japanese yen	132.0	–2.6	4.0	9.5
Swiss franc	1.513	0.0	1.3	–0.2
Pound sterling	0.895	–1.8	–6.7	6.7
Swedish krona	10.286	–0.7	–6.4	0.4
Danish krone	7.441	0.0	0.0	–0.2
Polish zloty	4.131	–0.8	–0.4	7.8
Czech crown	25.60	–0.6	–4.9	–0.5
Hungarian forint	267.3	1.1	0.6	–1.7

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

Credit indices stabilize but issue premia fall.

particular date or route map for the possible appreciation of the renminbi. However, a change in approach could be seen in the quarterly report on the Chinese central bank's monetary policy, which commented on the possibility and even the appropriateness of allowing the renminbi to appreciate further.

Advances made in corporate bond markets stabilize

In November, after seven consecutive months of improvement, the secondary private bond market has stabilized at the levels reached the month before.

The improvement in the private bond market is about to activate secondary markets.

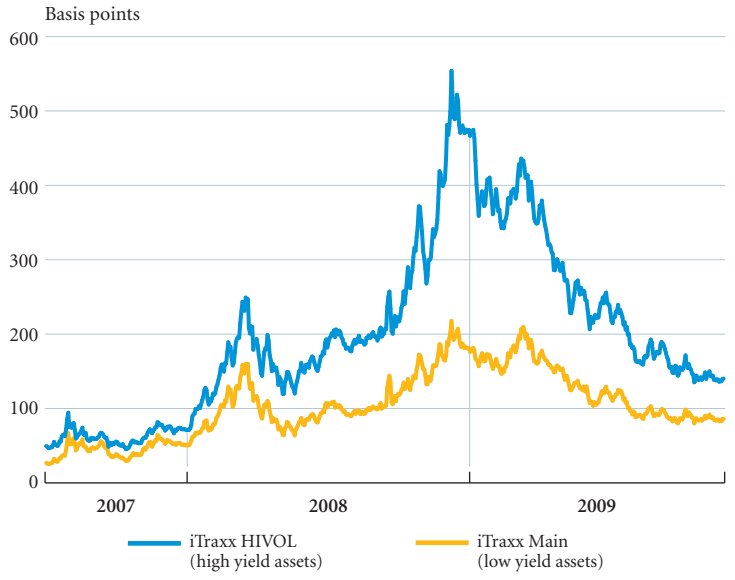
Firms continue to take advantage of good market conditions to sell bonds at a pace that is fast compared to previous months. The volume of new issues has broken records, even in high risk or high yield sectors and, in spite of default ratios reaching record highs in this segment, investors seem to assume the worst has passed.

High yield bond issues are now particularly active in the euro area. This is largely due to the lethargy shown by the bank loan market, including syndicated loans, as a result of the capital restrictions faced by numerous institutions.

However, not only volumes have increased. There has also been a drop in risk premia in the primary markets. This remarkable fact demonstrates that, in November, credit markets prolonged the positive tone of the previous months,

CREDIT SPREADS STABILIZE

Credit spreads in the euro area



SOURCE: Bloomberg.

beyond stabilizing rates in secondary markets.

Throughout the month there was actually a modest rise in secondary market trading, albeit still at low levels. But strong issues in primary markets make secondary trading less attractive. Moreover, institutional investors are covering their investment needs by buying bonds in primary auctions. Over the coming months, as issues slacken off, trade in secondary markets is very likely to pick up much more.

In this benign setting for corporate bond markets, rating agencies are supporting the positive trend with announcements of higher debt ratings for firms. There are some differences in this trend, however, between countries and agencies. Within countries, of note are the improved ratings for American firms compared with the incipient recovery in the euro area and South East Asia. With regard to rating agencies, Standard and Poor's seems to be the most optimistic.

The outlook in credit markets continues to be positive, although in the short term there's a certain fear of investors' initial reactions to the partial withdrawal of liquidity by the central banks. But positive aspects appear to be more significant in the medium term; the key factor is the consolidation of improved expectations for economic recovery, as well as the continued relatively low levels of monetary interest rates and public debt, even when the central banks start to withdraw stimuli and support.

Positive factors continue for private bonds.

Caution reigns supreme in the stock markets

Equity markets were up and down in November. The first sessions of the period were dominated by sales, which

The rate of stock market revaluation slows up.

then gave way to contained but irregular improvement among countries and sectors. Some important stock markets managed to get back to their annual maximums, although investor caution meant that these maximums were not breached. Specifically, the S&P 500 reached 1,100 points, and the Ibex 35 12,000 points, the European market with the highest revaluation since January. On the other hand, the Japanese Nikkei was at its lowest level for four months.

The main feature for risk and volatility indicators was the predominance of calm, even when downgraded, quite different from the tensions of the previous year and the beginning of this one.

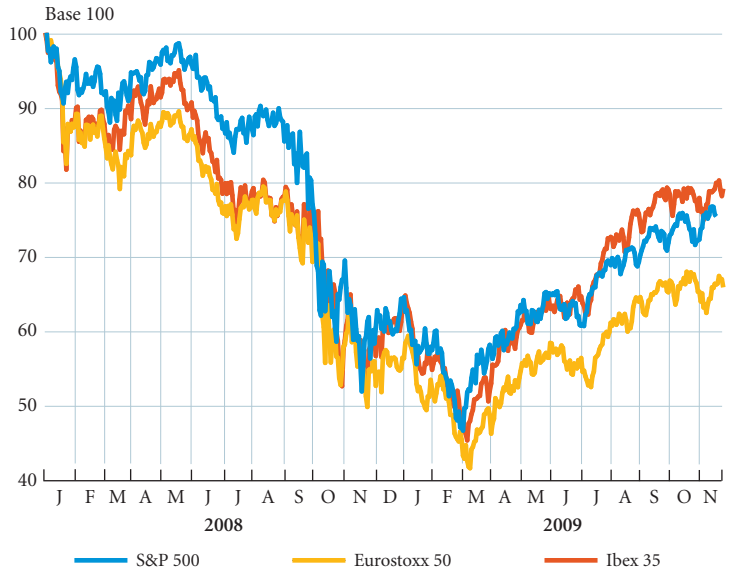
Improvements in corporate results are stronger in the United States.

This resistance shown by stock markets, reluctant to incur any more downgrades, is explained by factors such as the gradual improvement in macro-economic data, a successful end to the corporate quarterly results in the United States and, finally, greater activity in mergers and acquisitions worldwide.

The string of pleasant surprises provided by most countries has once again helped to boost stock markets, also buoyed by corporate results. The publication of corporate results for the third quarter ended in November in the United States and Europe. In the case of the S&P 500, 80% of companies announced favourable surprises, i.e. their results were better than analysts had expected, compared with 73% between April and June. This improvement in results also led to an increase in profit per share of the S&P 500 up to 16.87 dollars, from 16 dollars per share in the previous quarter.

STOCK MARKETS RISE, ALTHOUGH THE PACE SLACKENS

Stock market indices



SOURCE: Bloomberg.

INDICES OF MAIN WORLD STOCK EXCHANGES

November 23, 2009

	Index (*)	% monthly change	% cumulative change	% annual change
New York				
Dow Jones	*10,318.2*	*3.5*	*17.6*	*28.2*
Standard & Poor's	*1,091.4*	*1.1*	*20.8*	*36.4*
Nasdaq	*2,146.0*	*–0.4*	*36.1*	*55.0*
Tokyo	9,497.7	–7.6	7.2	20.1
London	5,341.3	1.9	20.5	41.3
Euro area	2,879.8	–0.2	17.7	33.0
Frankfurt	*5,756.9*	*0.3*	*19.7*	*39.5*
Paris	*3,796.5*	*–0.3*	*18.0*	*31.8*
Amsterdam	*315.8*	*–1.4*	*28.4*	*41.6*
Milan	*22,721.2*	*–3.0*	*16.8*	*22.6*
Madrid	*11,902.1*	*1.4*	*29.4*	*49.3*
Zurich	6,382.7	0.1	15.3	24.1
Hong Kong	22,771.4	0.8	58.3	79.9
Buenos Aires	2,231.5	–2.8	106.7	169.2
São Paulo	66,327.3	1.6	76.6	98.6

NOTE: (*) 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.

For its part, in the euro area 36% of the EuroStoxx 50 firms published results that were higher than generally anticipated, underlining the fact that business margins are recovering notably faster in the United States.

Lastly, mergers and acquisitions are one of the elements gaining in importance in financial markets in the second half of the year. In November, the volume of operations carried out worldwide exceeded 170,000 million dollars, the highest figure since October 2008. This resurge is a reflection of improved liquidity conditions worldwide, as well as a reasonably healthy financial-equity position in the US and European corporate sector (unlike the excessive debt in the family sector and/or financial institutions).

These and other variables related to the basic situation suggest that equity will continue to rise in the medium term. However, in the short term, factors such as the expected brake on liquidity expansion and adjustments in portfolios at the end of the year may lead to fairly strong corrections.

Mergers and acquisitions are up, in a climate of improved business margin estimates.

The new European financial architecture

For some years now, enhancing the integration of financial markets has been basic to the European Union's agenda. Two broad levers have been used to achieve this aim: the creation of a single common currency and the implementation of a great battery of regulatory reforms. In this respect, 1999 was a decisive time, with the legal birth of the euro and the European Commission's start up of its *Financial Services Action Plan* (FSAP).

With its sights set on 2005, the FSAP proposed a long list of rules and actions with three broad strategic objectives. First, completing a single wholesale financial market. Second, developing open and secure markets for retail financial services (note that the aim in this case was not the rapid achievement of a single market). And third, improve the regulatory framework and prudential supervision to ensure continued stability. Post-2005, the FSAP has continued by means of another Commission document: the *White Paper on Financial Services Policy (2005-2010)*, still in force. This re-edition has kept the three strategic objectives, while focusing efforts on the implementation and transposition into national legislation of the rules already contained in the FSAP, as well as a few additional ones.

In the years before the crisis, the emphasis of actions carried out under these plans was aimed towards the first two objectives above, leaving the issue of stability somewhat sidelined. Such interest in financial integration tended to be explained by its favourable effect on economic growth, in a chain of arguments where concepts such as competition between financial organizations, their efficiency, development and innovation were key. Less frequently mentioned were the links between integration and stability. By way of an anecdote, the report annually prepared by the Commission to monitor the integration process, in the edition published in December 2007, dedicated 19 pages to sections on competition-efficiency-innovation and just 5 pages to stability.

The outbreak of one of the most intense financial and economic crises in living memory seems to be altering the priorities on the agenda for European financial integration, now redirecting the focus of attention towards issues directly related to stability.[1] Consequently, standing out among last year's main initiatives were the Directive on alternative investment funds (hedge funds, private equity and similar), the Regulation on rating agencies, new legislation on derivative markets (in particular CDS) and, particularly relevant, the proposal to set up a new pan-European framework of regulation and prudential supervision.

In effect, one of the biggest weaknesses highlighted by the crisis is the obsolescence of the current international architecture of regulation and prudential supervision. Firstly, because financial legislation on this area has not kept up with the intense innovation undergone by the financial markets. Secondly, because the crisis has revealed that not all institutions with systemic risk were regulated or, if they were, such regulation was insufficient (hedge funds and investment banks). Thirdly, because the high degree of heterogeneity in standards and supervisory practices among countries has been reflected, during the crisis, in unilateral action, usually in response to national circumstances and goals. Perhaps individual solutions are optimal insofar as they are aimed at specific, differentiated problems. The down side is that these measures were not the result of a fully agreed action coordinated between the member states of the European Union, and between the latter and other, non-EU states. In spite of the efforts made by the European Council and the Commission for

(1) Continuing with the anecdote, the progress report published in February 2009, after the dramatic months following the Lehman Brothers' collapse, dedicated 21 pages to competition-efficiency-innovation and 12 to stability.

coordination, improvisation has often been ruled the day in order to protect national interests, something which, in turn, tends to lead to unwanted cross externalities. The reality is that, based on some very general directives by the European Central Bank (ECB) and the Commission, each country's authorities have opted for a wide range of actions of local scope to support their financial organizations.

In view of these insufficiencies in the institutional framework, those responsible for the economy and financial system in the euro area, namely the Council, the European Commission and the ECB, have acted with admirable firmness and determination, taking the lead in the most important reform initiatives.

The proposal presented on 23 September by the Commission, based on a report commissioned from a group of experts led by Jacques de Larosière, must be understood within the **internal coordination** of the European Union. In the first phase, the European Systemic Risk Council (ESRC) will be set up, one of whose tasks will be macro-prudential supervision (identifying systemic risk), and which may make recommendations for economic policy.

In a later phase, possibly 2011-2012, the European System of Financial Supervision (ESFS) will be set up, focusing on the micro-prudential area, such as harmonizing standards, monitoring and forcing the implementation of European legislation and, if necessary, sorting out any controversies that might arise between national supervisory bodies. The ESFS is also intended to transform the current coordination committees[(2)] into new authorities with greater hierarchy: for securities (European Securities Authority, ESA), banking (European Banking Authority, EBA) and insurance (European Insurance Authority, EIA).

European authorities have also shown themselves to be capable of initiative in the area of **external coordination.** The foundations for reforming the international financial architecture started to be laid in November 2008, during the G-20 meeting in Washington, with the noteworthy presence of the Council and Commission of the European Union, as well as 6 member countries. At this meeting, the Financial Stability Board (FSB) was set up, as a stronger replacement for the already existing Financial Stability Forum (FSF).

In coordination terms, the creation of the FSB has been the most important international response to the crisis. Among its functions, the FSB will be responsible for developing and implementing the general regulatory and supervisory framework. The focus will be on strengthening financial systems at a national level, at the same time as ensuring global financial stability. The roles of the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) remain unaltered, but with the addition that the FSB has the power to strategically guide the work of both institutions. Moreover, the FSB will also be responsible for international coordination in the area of supervision (creating guidelines to develop supervisory colleges), monitoring (in collaboration with the International Monetary Fund) and information sharing.

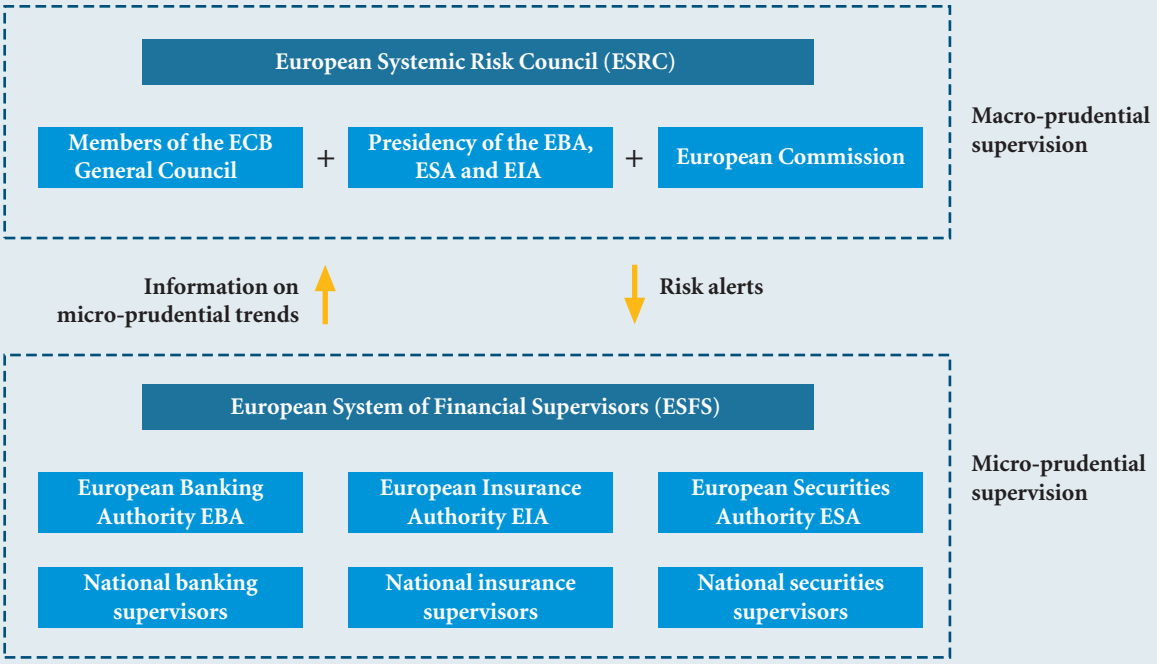
There's no doubt that starting up this new international financial architecture will have a far-reaching impact on the markets and the actors operating in them. But equally huge is the work still pending and the challenges arising. At the level of the European Union, one of the most important challenges is to ensure effective cooperation between the ESRC and the ESFS. Without this, there would be a rupture between

(2) The three committees are: the Committee of European Banking Supervisors (CEBS), the Committee of European Securities Regulators (CESR) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).

supervision at the macro level and micro level, something which, in another crisis, might have terrible consequences. Another crucial challenge is to clearly identify those who are actually responsible, their reach and the hierarchy they occupy in case, in spite of prudential measures, another crisis occurs (i.e. specify the mechanisms to resolve the crisis[3]).

So far, it's only fair to acknowledge that the route taken is going in the right direction. *A priori*, it seems that easy opportunities for arbitration in the area of regulation will not be made room for and that, consequently, the taking of excessive risks will not be encouraged. However, advances must go further and attempt to balance the relationship between stability and loss of efficiency so as to avoid falling into the trap of overregulation, ending up harming the system's competitiveness, inhibiting the creation of new instruments or simply encouraging inappropriate conduct. With a view to the future, it's vitally important that the push at a political level should be suitably large and determined to tackle such challenges successfully. If not, the scope of any initiative will be limited.

SUPERVISION AND MONITORING DIAGRAM



SOURCE: European Commission.

(3) In this respect, in October the Commission initiated a consultancy procedure to establish a crisis management framework for the banking sector.

This box was prepared by the Financial Market Department, "la Caixa" Research Department

SPAIN: OVERALL ANALYSIS

Economic activity

Economic slowdown eases

Gross domestic product (GDP) posted a quarter-on-quarter drop for the fifth consecutive time in July-September 2009, of 3 percentage points. However, this figure is 8 percentage points better than the previous quarter and confirms the turnaround started in the second quarter. This trend can be explained by the improved international situation, by the financial markets gradually getting back to normal and particularly by the monetary and fiscal stimuli implemented.

These lower quarter-on-quarter falls also started to be felt in the year-on-year percentage change in GDP, down 4.0%, two percentage points less than the previous quarter. The fall in activity was due to the drop in domestic demand, down 6.5 points but 0.9 points less than the previous quarter. The foreign sector's contribution to growth was 2.5 points, 7 percentage points lower than three months earlier.

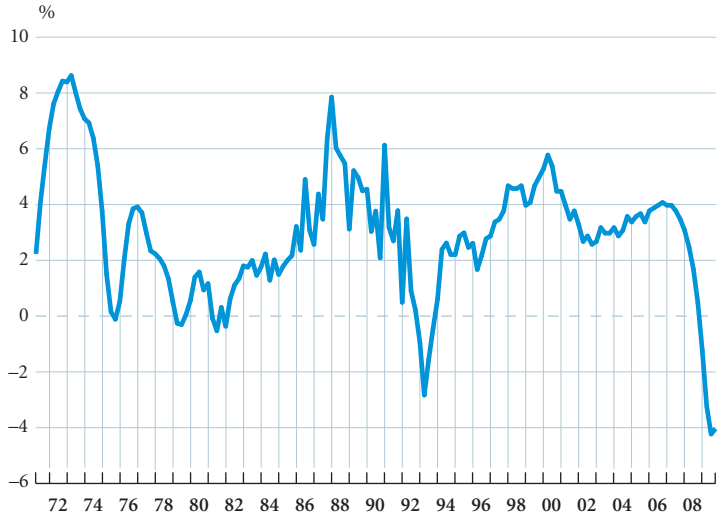
Looking at expenditure, family consumption notably moderated its decline and posted a year-on-year fall of 5.1%, 9 percentage points less than in the second quarter. This fall is attributable to a decline in salary income given severe job losses, falling property prices, less favourable financing terms and a greater propensity to save due to precaution given the rise in unemployment.

GDP falls for the fifth consecutive quarter but its turnaround is confirmed.

Domestic demand improves but takes 6.5 points from year-on-year growth in GDP.

UPSWING IN GROSS DOMESTIC PRODUCT

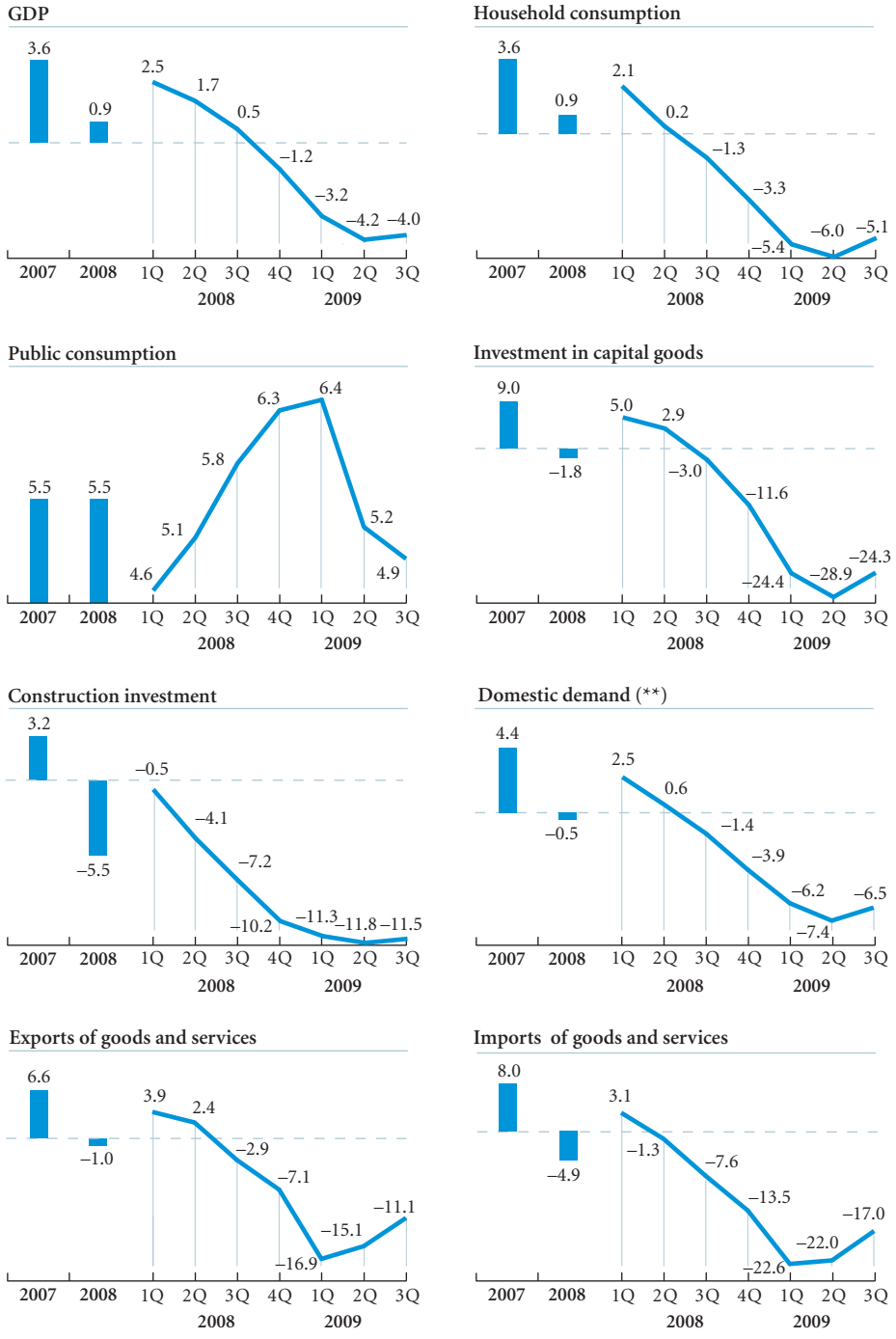
Year-on-year percentage change in gross domestic product in real terms. Quarters



NOTE: Data adjusted for seasons and public holidays.
SOURCES: INE and own calculations.

TREND IN SPAIN'S GDP BY COMPONENT

Percentage year-on-year change (*)



NOTES: (*) Data adjusted for seasons and public holidays.
(**) Contribution to GDP growth.
SOURCE: National Institute of Statistics.

However, lower interest rates, official stimuli and stock market recovery helped consumer confidence to improve in the second quarter. Automobile sales picked up significantly thanks to direct subsidies from the Plan 2000E and, in October, posted a year-on-year rise of 26.4%.

Automobile sales rose 26% in October compared with the same month last year thanks to official subsidies.

For its part, public consumption rose by 4.9% compared with the third quarter of 2008, 3 percentage points less than in the second quarter. Both the rise in purchases of goods and services and also staff costs slowed up.

Investment moderated its fall in the third quarter to a year-on-year decrease of 16.2%, one percentage point less than the previous quarter. This improvement came both from capital equipment and construction, offsetting the decline in other products, including computer software and mining and petrol prospection. The sharp drop in gross capital formation in the last year is attributable to weak demand, the fall in corporate profits and uncertainty concerning the economic outlook.

Of particular note is the rise in capital goods investment, up 1.9% in the third quarter and with a year-on-year fall of 4.6 points to 24.3%. Both investment in transport material and in machinery posted positive quarter-on-quarter growth, reducing their year-on-year drops, standing at 15.0% and 28.3%, respectively.

Investment in construction posted a year-on-year fall of 11.5%, up 3 percentage points compared with the previous quarter. This was thanks to the non-residential segment posting an annual increase of 1.5%, slightly higher than in the second quarter due to infrastructure building work related to the State Local Investment Fund and the

Increased investment in transport material and machinery.

DEMAND INDICATORS

Percentage change over same period year before

	2007	2008	2008	2009			
			4Q	1Q	2Q	3Q	October
Consumption							
Production of consumer goods (*)	1.7	–4.7	–10.3	–12.6	–9.4	–8.7	...
Imports of consumer goods (**)	5.1	–7.7	–17.2	–9.4	–14.9	–3.4	...
Car registrations	–1.2	–28.1	–46.6	–43.1	–33.7	–0.6	26.4
Credit for consumer durables	10.0	3.6	–4.2	–11.9	–14.1	...	–
Consumer confidence index (***)	–13.3	–33.8	–45.3	–44.7	–28.0	–20.7	–21.0
Investment							
Capital goods production (*)	4.6	–8.8	–20.8	–30.5	–24.7	–19.5	...
Imports of capital goods (**)	9.8	–19.6	–28.8	–31.3	–35.1	–23.4	...
Commercial vehicle registrations	0.3	–43.6	–61.3	–52.4	–51.9	–30.8	–19.2
Foreign trade (**)							
Non-energy imports	7.3	–4.9	–19.0	–26.0	–26.8	–13.4	...
Exports	4.2	1.9	–8.4	–17.9	–14.7	–9.6	...

NOTES: (*) Adjusted for public holidays.
(**) By volume.
(***) European Commission survey: difference between percentage of positive and negative replies.
SOURCES: ANFAC, National Institute of Statistics, Bank of Spain, Ministry of Economy and Finance, European Commission and own calculations.

Residential construction down 26%.

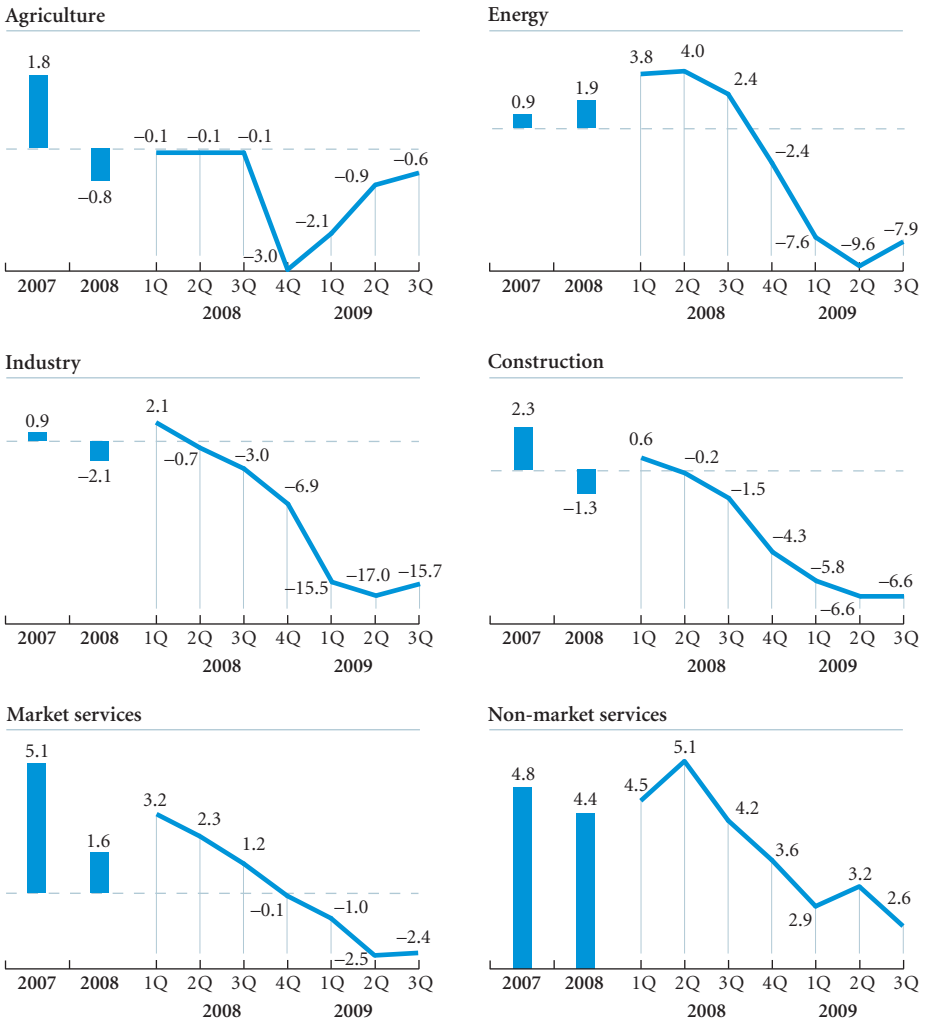
high-speed train network. Residential construction continued depressed, however, and posted a year-on-year drop of 25.5%, 2 percentage points more than the previous quarter. Nevertheless, a slowdown was noted in the fall in prices for homes and property transactions, buoyed by low interest rates.

In the foreign sector, both exports and imports cut back their decline. Exports were down 11.1% compared with the third quarter in 2008, 4 points less than in the second quarter, thanks to the improvement in goods transactions due to the upswing in demand, basically from the European Union. On the other hand, tourist expenditure by non-residents maintained its 9.5% drop year-on-year. For their part, imports reduced their annual fall by 5 points to 17.0%.

On the supply side, construction and services posted the same year-on-year

TREND IN SPAIN'S GDP BY SUPPLY SECTOR

Percentage year-to-year change (*)



NOTE: (*) Data adjusted for seasons and public holidays.
SOURCE: National Institute of Statistics.

SUPPLY INDICATORS

Percentage change over same period year before

	2007	2008	2008	2009			
			4Q	1Q	2Q	3Q	October
Industry							
Electricity consumption (1)	4.4	0.6	–4.1	–7.0	–6.6	–2.1	–1.2
Industrial production index (2)	2.0	–7.3	–16.6	–22.6	–18.6	–14.6	...
Confidence indicator for industry (3)	–0.3	–18.0	–32.7	–36.7	–35.5	–29.0	–24.0
Utilization of production capacity (4)	81.3	79.5	76.9	68.8	69.5	68.5	69.9
Imports of non-energy intermediate goods (5)	8.0	–0.7	–18.2	–32.9	–31.1	–17.1	...
Construction							
Cement consumption	0.2	–23.8	–38.1	–46.1	–36.0	–26.4	–21.1
Confidence indicator for construction (3)	9.3	–22.6	–34.7	–36.7	–35.0	–26.3	–29.0
Housing (new construction approvals)	–24.7	–59.4	–60.2	–64.1	–62.8	–52.4	...
Government tendering	–15.0	3.0	12.4	–5.3	–8.3	4.9	...
Services							
Retail sales (6)	2.3	–6.3	–7.7	–6.3	–4.2	–2.8	–1.8
Foreign tourists	1.1	–2.5	–9.0	–16.2	–8.2	–7.8	–3.6
Tourist revenue inflows	3.3	–0.4	–8.0	–14.3	–8.0	–8.6	...
Goods carried by rail (ton-km)	–3.7	–7.7	–23.0	–34.1	–34.9	–32.4	...
Air passenger traffic	9.0	–3.0	–12.7	–18.2	–8.7	–5.2	–2.7
Motor vehicle diesel fuel consumption	–5.1	–3.8	–7.7	–10.3	–5.1	–3.2	...

NOTES: (1) Adjusted for public holidays.
(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.
SOURCES: 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.

change as the previous quarter. However, both farming and fishing as well as energy and industrials improved.

The gross value added of the manufacturing industry slowed up its year-on-year drop by 1.3 points to 15.7%, while energy reduced its annual drop by 1.7 points to 7.9%. An improvement can therefore be seen in the secondary sector, whose confidence has increased, although it continues to be affected by problems of competitiveness and weak demand.

With regard to services, the gross value added of private services cut back their decline by one percentage point to 2.4% and trade performed better, while corporate services and property business recorded the most negative trends.

From the point of view of income, the payment of salaried workers fell by 6 percentage points to 3.4%. This was mostly due to a fall in the growth of average payment by 8 percentage points to 3.9%, although this was much higher

Industry slows up its decline.

Adjustment in the job market occurring more in jobs than wages.

than inflation over the last twelve months, highlighting that, unlike other countries, the adjustment in the Spanish labour market has occurred in jobs rather than in salaries. For their part, gross operating surplus and mixed income increased their fall to 3.3% year-on-year.

The apparent productivity of labour rose 3.4% in the last year, 2 percentage points more than in the second quarter. Unit labour costs therefore slowed down by one point to 0.4%, 8 percentage points more than the economy's implicit deflator.

We predict positive year-on-year growth for business as from 2010.

Within this context, an upward trend can be observed in confidence indices, although these are still slightly below their historic averages. In its last report on the Spanish economy, the Organization for Economic Cooperation and Development recommended delaying the planned tax hike for 2010 to the following year in order to reinforce the recovery. For its part, the European Commission advised increasing competitiveness by moderating wages and increasing productivity, among other measures. As such, and if there are no changes in economic policy, we predict a slow exit from the recession, with positive year-on-year growth in the second half of 2010 coming from the push provided by the foreign sector and a gradual improvement both in consumption and investment.

Labour market

Rising unemployment takes a breather in the third quarter

According to data from the Labour Force Survey (LFS), labour market trends in the third quarter are most notable for unemployment stabilizing at 17.9% of the labour force, although this drop is due to a reduction in the labour force since job losses continue, albeit at a slower rate.

The labour force, i.e. those people who are working or available for work, fell for the second consecutive quarter after sustained rises over many years. This can be mostly attributed to the so-called «demotivation» effect, i.e. unemployed people who, disheartened because it is so difficult to find a job, stop actively looking for one. Although both the Spanish and foreign labour force decreased in the first six months, in the last twelve months there has been a drop in the Spanish workforce of 0.2%, while the foreign labour force is up 2.5%.

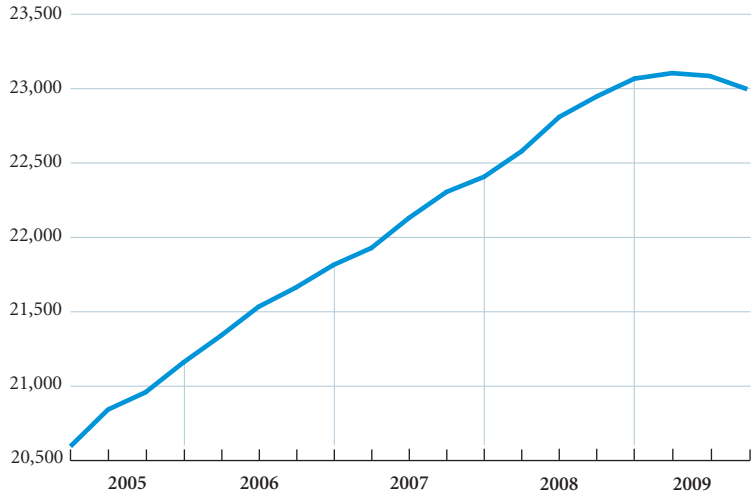
Job losses ease off.

Job losses also seem to be slowing up. According to the LFS, the average number of employed in the third quarter of 2009 was 18,870,200, 74,800 less than in the second quarter. However, in the last twelve months the estimated number of employed fell by 1,476,200, a rate of 7.3%, similar to the second quarter. In the last two years, since the highest level reached in the current cycle, job losses

Number of employed fallen by 1.6 million in the last two years, mostly in construction.

THE LABOUR FORCE IS DECLINING DUE TO DEMOTIVATION

Labour force in thousands of people



SOURCE: National Institute of Statistics.

Public sector employment up 3.7% on last year, while the private sector falls 9.1%.

total 1,640,400, most in construction: 922,800.

By sector, the biggest drop in the last twelve months was in construction, 562,800 workers, 23.3%, particularly because of the marked changes in the residential segment. But industry has also been hit hard, with a loss of 475,600 jobs, 14.9%. The hardest hit in absolute terms was the metallurgy sector, with 130,400 jobs lost, whereas employment trends in services were less drastic, down 2.8%, although 387,600 actual jobs were lost, most of these in retail (222,600). However, in the public sector the number of employed rose by 111,800, a rate of 3.7%, compared with a year-on-year decrease of 9.1% in the private sector.

By gender, trends were disparate in the third quarter. While the rate of employed women rose by 0.2% compared with the previous quarter, for men this fell by 0.8%. Employment has decreased for

ESTIMATED EMPLOYMENT

Third quarter 2009

	No. of employees (thousands)	Quarterly change		Cumulative change		Annual change		% share
		Absolute	%	Absolute	%	Absolute	%	
By sector								
Agriculture	737.2	–49.5	–6.3	–66.6	–8.3	–50.2	–6.4	3.9
Non-farm	18,133.0	–25.4	–0.1	–920.0	–4.8	–1,426.0	–7.3	96.1
Industry	*2,719.6*	*–79.8*	*–2.9*	*–323.1*	*–10.6*	*–475.6*	*–14.9*	*14.4*
Construction	*1,850.3*	*–71.7*	*–3.7*	*–330.4*	*–15.2*	*–562.8*	*–23.3*	*9.8*
Services	*13,563.1*	*126.2*	*0.9*	*–266.5*	*–1.9*	*–387.6*	*–2.8*	*71.9*
By type of employer								
Private sector	15,768.3	–125.6	–0.8	–1,059.0	–6.3	–1,587.9	–9.1	83.6
Public sector	3,101.9	50.8	1.7	72.4	2.4	111.8	3.7	16.4
By work situation								
Wage-earners	15,650.1	–86.7	–0.6	–658.1	–4.0	–1,096.0	–6.5	82.9
Permanent contract	*11,604.1*	*–161.2*	*–1.4*	*–149.8*	*–1.3*	*–197.3*	*–1.7*	*61.5*
Temporary contract	*4,046.0*	*74.5*	*1.9*	*–508.3*	*–11.2*	*–898.8*	*–18.2*	*21.4*
Non-wage-earners	3,209.5	13.6	0.4	–325.4	–9.2	–375.3	–10.5	17.0
Entrepreneurs with employees	*1,061.7*	*–18.4*	*–1.7*	*–103.6*	*–8.9*	*–119.8*	*–10.1*	*5.6*
Entrepreneurs without employees	*1,967.9*	*19.1*	*1.0*	*–204.8*	*–9.4*	*–215.3*	*–9.9*	*10.4*
Family help	*180.0*	*12.9*	*7.7*	*–17.0*	*–8.6*	*–40.2*	*–18.2*	*1.0*
Other	10.5	–1.7	–13.9	–3.1	–22.8	–4.9	–31.6	0.1
By time worked								
Full-time	16,554.0	59.6	0.4	–823.8	–4.7	–1,468.4	–8.1	87.7
Part-time	2,316.1	–134.4	–5.5	–162.9	–6.6	–7.8	–0.3	12.3
By sex								
Males	10,613.3	–87.6	–0.8	–727.3	–6.4	–1,145.7	–9.7	56.2
Females	8,256.9	12.8	0.2	–259.3	–3.0	–330.5	–3.8	43.8
TOTAL	**18,870.2**	**–74.8**	**–0.4**	**–986.6**	**–5.0**	**–1,476.2**	**–7.3**	**100.0**

SOURCES: National Institute of Statistics and own calculations.

ESTIMATED UNEMPLOYMENT

Third quarter 2009

	No. of unemployed	Quarterly change		Annual change		Share %	Unemployment rate over labour force %
		Absolute	%	Absolute	%		
By sex							
Males	2,290.9	1.8	0.1	937.3	69.3	55.6	17.8
Females	1,832.5	–15.9	–0.9	587.3	47.2	44.4	18.2
By age							
Under 25 years	885.7	30.5	3.6	272.7	44.5	21.5	38.6
Other	3,237.6	–44.7	–1.4	1,251.8	63.0	78.5	15.6
By personal situation							
Long-term unemployment	1,207.2	112.7	10.3	597.7	98.1	29.3	–
Seeking first job	314.4	27.8	9.7	57.1	22.2	7.6	–
Other	2,601.8	–154.6	–5.6	869.8	50.2	63.1	–
TOTAL	**4,123.3**	**–14.1**	**–0.3**	**1,524.6**	**58.7**	**100.0**	**17.9**

SOURCES: National Institute of Statistics and own calculations.

both during the last year but the fall has been much harder for men, at 9.7%, than for women, at 3.8%, partly due to fewer women being employed in the heaviest hit sectors, such as construction.

By age, the biggest drops in the quarter were to be seen among those aged between 25 and 29 and those over 55, while employment increased by 11.1% among young people aged 16 to 19, thanks to the tourist season. However, all age groups have suffered falls in employment over the last twelve months, albeit with different intensities. The lowest drop is in the 50 to 54 age group, down 0.1%, and the highest among young people aged 16 to 19, down 38.2%.

By profession, it's clear that the recession is affecting non-salaried workers to a greater extent. Consequently, in the last year the level of employment among salaried workers fell 6.5%, while the rest decreased by 10.5%. On the other hand, in the third quarter the number of workers with temporary contracts was up 1.9%, thanks partly to the tourist season, while those with permanent contracts fell 1.4%. It can therefore be seen that job losses are gradually affecting this last group. Overall, in the last twelve months, temporary jobs were down 18.2%, compared with a fall of 1.7% in permanent contracts.

Job losses are increasingly affecting employees with permanent contracts...

Employment fell more sharply among the foreign than the local population. In the last twelve months, the number of employed foreign nationals dropped by 10.0% compared with 6.8% for Spaniards. Consequently, the share of foreign workers in employment was down by 14.1%.

This fall in employment has eased off in the third quarter, according to the National Accounts figures for the number of full-time equivalent jobs, thanks to improved performance on the part of private services, with the year-on-year drop stabilizing at 7.2%. According to this source, construction employment

...and foreigners.

Social Security registrations falter again in October.

fell by 24.3% last year, whereas industry was down 12.7% and services 3.0%.

However, in October, the number of new Social Security employment registrations showed a quickening decline for the second consecutive month. This is partly due to the municipal works plan, funded by the government, running out of steam.

Unemployment stays at 17.9% but is likely to rise.

As a result of trends in the labour force and in employment, the number of unemployed fell slightly by 14,100 people in the third quarter, after two solid years of rises, standing at 4,123,300. Consequently, the unemployment rate took a breather and held steady at 17.9% of the labour force. However, there's still an upward trend in unemployment as jobs are likely to continue shrinking in the coming quarters.

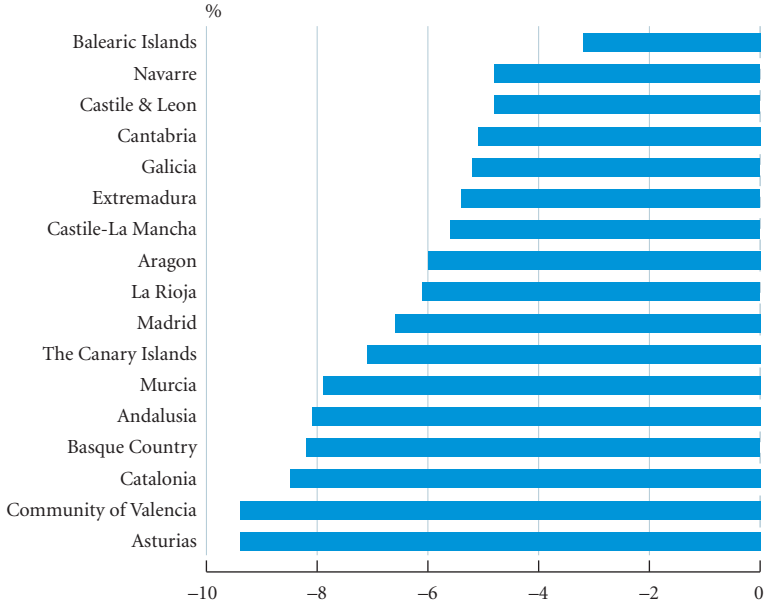
Long-term unemployment almost doubles in the last twelve months.

Of note is the increase in long-term unemployed, i.e. among those who lost their job more than a year ago, which has practically doubled in the last twelve months to 1,207,200. The number of households with all members unemployed has also risen dramatically, up to 6.6% of the total.

Employment fell in all autonomous communities over the last twelve months, although to differing degrees. The lowest drop year-on-year was in the Balearic Islands, at 3.2%, while in Asturias and the Community of Valencia this fell by 9.4%. However, the lowest unemployment rate was in Navarre, namely 10.4%, while the highest rates were to be found in the Canary Islands, 26.0% and in Andalusia, 25.6%.

THE NUMBER OF EMPLOYED DROPS IN ALL AUTONOMOUS COMMUNITIES

Third quarter of 2009
Year-on-year change in employment levels by autonomous community



SOURCES: National Institute of Statistics and own calculations.

Prices

Energy reverses the fall in consumer prices

The consumer price index (CPI) was up 7 percentage points in October compared with September, particularly due to price rises in clothing and footwear for the new winter season. The year-on-year percentage change for the CPI was therefore up 4 percentage points, although prices continued to fall for the eighth consecutive month, by 0.7%. This drop was also seen in the gross domestic product (GDP) deflator, a broader price indicator than the CPI, which fell by 0.4% in the third quarter compared with the same quarter the year before. This was the first time the GDP deflator had fallen in several decades.

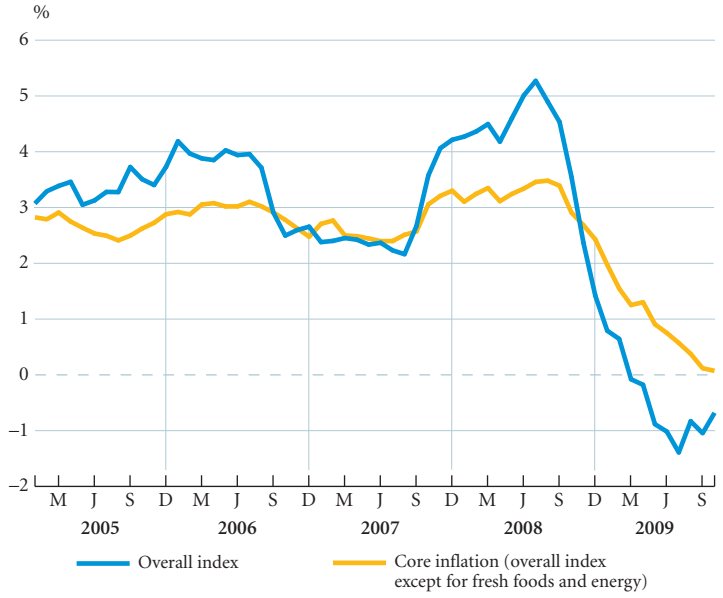
The year-on-year rise in the CPI can be attributed to fuel prices, as their year-on-year drop has reduced by almost five points. The other highly volatile component, unprocessed food, practically had no effect at all on the year-on-year change in the overall index.

The most stable core of inflation, also known as underlying inflation, which excludes unprocessed food and energy products, remained at 0.1%, at its lowest level for several decades and with a sharp drop of 2.8 points in the last twelve

Negative year-on-year CPI for the eighth consecutive month.

CORE INFLATION IS CLOSE TO 0%

Year-on-year change in the CPI



SOURCE: National Institute of Statistics.

months. The fall in core inflation to almost 0% reflects the influence of the recession. Lower consumption means that many firms are slashing their prices to boost sales.

Services, although somewhat protected from foreign competition, are also feeling the pressure of weak demand and continued to slow up. The year-on-year percentage change in their prices fell one

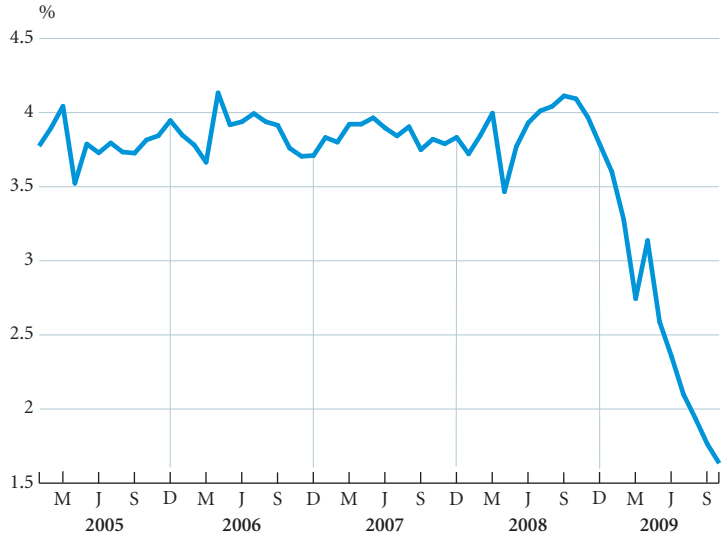
CONSUMER PRICE INDEX

	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	0.2	–1.1	–0.1
April	1.1	1.5	4.2	1.0	–0.1	–0.2
May	0.7	2.2	4.6	0.0	–0.1	–0.9
June	0.6	2.8	5.0	0.4	0.3	–1.0
July	–0.5	2.3	5.3	–0.9	–0.5	–1.4
August	–0.2	2.1	4.9	0.3	–0.2	–0.8
September	0.0	2.0	4.5	–0.2	–0.4	–1.0
October	0.3	2.4	3.6	0.7	0.3	–0.7
November	–0.4	2.0	2.4			
December	–0.5	1.4	1.4			

SOURCE: National Institute of Statistics.

SERVICE PRICES ARE NOTICEABLY SLOWING UP

Year-on-year change in the service price index (including home rental)



SOURCE: National Institute of Statistics.

percentage point to 1.6%, the lowest in several decades. There was a marked slowdown in education to 2.2% year-on-year, 1.1 points less than in September, because higher education prices rose less than in October 2008. Hotels and restaurants also slackened to an annual rate of 1.2%.

The EU harmonized CPI (EU HCPI) posted a year-on-year fall of 0.6% in October, four percentage points more than the previous month. As a result, the difference between inflation in Spain and the euro area continued to narrow, down to 0.5 points in Spain's favour, moving away from the record 0.9 points in May.

Given that oil prices in dollars in mid-November are double what they were twelve months before, the CPI change rate is likely to be positive this month and continue to rise in December, even accounting for the appreciation of the euro. However, inflation is likely to be

The favourable differential for inflation with the euro area continues to narrow, down to half a point.

CONSUMER PRICE INDEX BY COMPONENT GROUP

October

	Indices (*)	% monthly change		% change over previous December		% monthly change	
		2008	2009	2008	2009	2008	2009
By type of spending							
Food and non-alcoholic beverages	107.8	–0.1	–0.2	2.2	–2.6	4.0	–2.4
Alcoholic beverages and tobacco	126.0	0.1	0.0	3.8	12.8	4.0	12.9
Clothing and footwear	104.6	9.2	9.6	–1.5	–3.9	0.7	–1.9
Housing	112.1	0.1	0.2	6.6	0.4	7.4	–0.3
Furnishings and household equipment	107.1	0.5	0.3	2.1	0.5	2.7	1.0
Health	97.5	0.2	0.0	0.3	–1.4	0.5	–1.3
Transport	102.7	–2.5	0.0	1.9	3.2	4.2	–4.4
Communications	99.3	0.0	0.0	0.3	–0.3	0.0	–0.9
Recreation and culture	98.0	–0.6	–0.7	–0.2	–1.8	0.4	–1.3
Education	114.3	2.7	1.6	4.3	2.5	4.6	2.2
Restaurants and hotels	112.1	–0.2	–0.2	4.3	1.5	4.7	1.2
Other goods and services	109.6	0.2	0.1	3.4	1.9	3.7	2.1
By group							
Processed food, beverages and tobacco	111.6	0.1	0.0	3.1	0.5	4.5	0.4
Unprocessed food	106.6	–0.4	–0.5	0.9	–3.3	3.0	–2.6
Non-food products	106.2	0.5	0.9	2.4	0.5	3.4	–0.7
Industrial goods	102.1	0.9	2.0	1.2	–0.4	2.7	–3.0
Energy products	*105.8*	*–3.9*	*0.0*	*5.3*	*6.1*	*9.3*	*–6.6*
Fuels and oils	*100.5*	*–5.1*	*0.0*	*3.7*	*6.0*	*8.9*	*–11.0*
Industrial goods excluding energy products	*100.5*	*2.7*	*2.7*	*–0.2*	*–2.6*	*0.5*	*–2.1*
Services	110.7	0.0	–0.1	3.6	1.5	4.1	1.6
Underlying inflation (**)	107.2	0.9	0.9	2.2	–0.2	2.9	0.1
GENERAL INDEX	**107.2**	**0.3**	**0.7**	**2.4**	**0.3**	**3.6**	**–0.7**

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

Inflation will probably return to positive figures by November but will remain low for 2010.

moderate in 2010, due to the recessive situation and in spite of the expected rise in value added tax in July. Although we estimate the theoretical impact of this tax rise on the CPI to be 1.2 points, if it is immediately and completely passed on, in real terms this will probably be much less, since weak consumption will, for the most part, help it to be absorbed by business margins.

The fall in wholesale prices slows down

Farm prices at source pick up in August but drop sharply year-on-year.

Producer prices posted a year-on-year decrease of 4.2% in October, 2.5 points higher than the highest year-on-year fall of the last few decades, namely 6.7% in July 2009. The upward trend in wholesale prices has therefore been confirmed, due principally to trends in commodity prices and particularly crude oil. All producer price components tended to speed up, although their year-on-year rates were negative, except for capital equipment, which continued to rein in with a year-on-year change rate of 0.2%.

For their part, import prices continued to check their fall in September due to energy, although posting a year-on-year decrease of 9.2%, higher than for domestic prices, while farm prices at source picked up slightly in August after their collapse of the preceding months. Overall, their year-on-year drop was 15.3%.

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 (**)	
2008											
August	6.0	9.2	4.8	2.5	7.6	23.2	9.6	1.3	0.3	5.0	2.6
September	–0.8	8.3	4.1	2.4	7.1	19.9	8.5	1.9	0.6	5.9	–
October	–7.6	6.1	2.8	2.4	5.3	14.9	5.2	3.2	1.3	5.1	–
November	–10.5	2.9	2.2	2.3	2.9	4.3	0.9	4.3	1.9	5.0	1.7
December	–10.3	0.4	1.6	2.3	1.0	–3.4	–3.9	2.6	1.6	2.0	–
2009											
January	–7.2	–0.5	0.9	1.9	–1.6	–2.2	–4.9	2.8	2.0	0.4	–
February	–5.4	–1.1	0.4	1.6	–3.2	–1.9	–5.6	3.0	2.6	–1.2	1.4
March	–7.1	–2.5	–0.4	1.3	–4.3	–5.0	–6.9	2.6	3.1	–2.7	–
April	–7.7	–3.4	–0.8	1.2	–5.5	–6.8	–7.4	2.5	3.1	–3.7	–
May	–15.1	–4.4	–1.1	1.1	–6.3	–9.8	–9.9	1.8	2.5	–5.4	0.2
June	–17.2	–4.9	–1.3	0.9	–6.9	–10.1	–10.8	1.3	2.4	–6.0	–
July	–17.9	–6.7	–1.3	0.5	–7.8	–16.0	–11.4	2.0	2.3	–7.0	–
August	–15.3	–5.5	–0.9	0.3	–7.7	–11.5	–9.8	0.6	2.0	–7.3	–0.4
September	...	–5.4	–0.7	0.4	–7.5	–11.5	–9.2	–0.5	1.6	–7.5	–
October	...	–4.2	–0.6	0.2	–6.3	–8.2	...	...	...	...	

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

Foreign sector

Fall in trade deficit slows up

In September, the Spanish trade deficit stood at 5,432 million euros, 26.9% less than September 2008, the fifteenth consecutive month of falls. The accumulated deficit for the last twelve months was therefore down 44.5% compared with the same period the year before, totalling 56,869 million euros. This figure equals 5.3% of gross domestic product (GDP) accumulated over the last four quarters, significantly lower than the record high of the first quarter of 2008 (9.7%). Nevertheless, this ratio is still very high, only exceeded by countries such as Greece, Portugal and the United Kingdom.

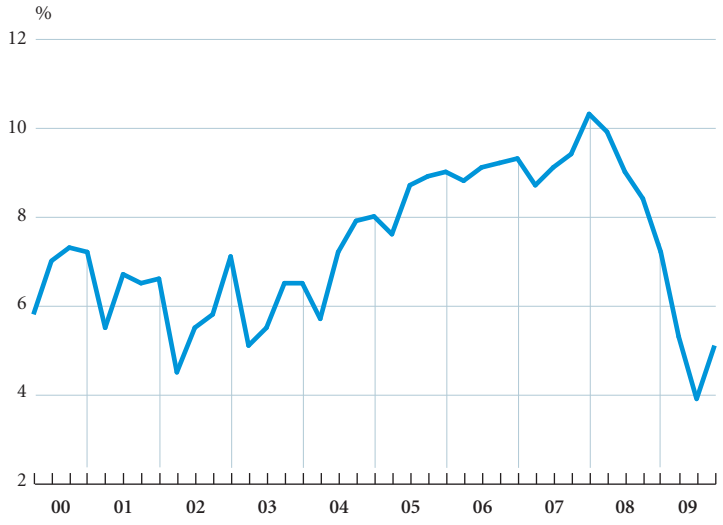
Once again, the shrinkage of the deficit occurred within a context of sliding trade flows, with imports down 21.9% in September compared with the same month last year, dropping 2.2 percentage points more than exports. This differential, however, has fallen sharply since June, when it reached 18.9 percentage points, leading to a gradual slowdown in the deficit's reduction. This convergence is even more evident in an analysis by volume (without taking price trends into account). Consequently, for the first time in fifteen months, real imports posted a lower fall than exports, confirming that the correction in the trade imbalance is coming to an end.

Trade deficit falls again in September by 27%.

Signs are that the correction in the trade imbalance is starting to slow up.

THE TRADE DEFICIT MOVES AWAY FROM THE RECORD HIGHS OF 2008

Accumulated quarterly trade balance related to GDP



SOURCES: Ministry of Economy and own calculations.

FOREIGN TRADE

January-September 2009

	Imports			Exports			Balance	Export/ Import rate (%)
	Million euros	% annual change by value	% share	Million euros	% annual change by value	% share	Million euros	
By product group								
Energy products	25,152	–44.5	16.4	4,975	–45.1	4.3	–20,177	19.8
Consumer goods	48,258	–9.3	31.6	46,341	–9.4	40.1	–1,917	96.0
Food	*10,718*	*–9.8*	*7.0*	*15,629*	*–4.8*	*13.5*	*4,911*	*145.8*
Non-foods	*37,540*	*–9.2*	*24.5*	*30,712*	*–11.5*	*26.6*	*–6,828*	*81.8*
Capital goods	12,021	–33.7	7.9	9,621	–22.3	8.3	–2,400	80.0
Non-energy intermediate goods	67,523	–33.8	44.1	54,670	–23.5	47.3	–12,853	81.0
By geographical area								
European Union	89,235	–25.2	58.3	80,153	–20.0	69.3	–9,082	89.8
Euro area	*73,831*	*–26.1*	*48.3*	*66,030*	*–17.7*	*57.1*	*–7,800*	*89.4*
Other countries	63,719	–35.9	41.7	35,454	–19.1	30.7	–28,265	55.6
Russia	*3,371*	*–47.4*	*2.2*	*1,048*	*–52.0*	*0.9*	*–2,323*	*31.1*
United States	*6,364*	*–25.6*	*4.2*	*4,362*	*–22.8*	*3.8*	*–2,002*	*68.5*
Japan	*2,208*	*–44.5*	*1.4*	*870*	*–19.4*	*0.8*	*–1,339*	*39.4*
Latin America	*8,051*	*–33.7*	*5.3*	*5,616*	*–18.6*	*4.9*	*–2,435*	*69.8*
OPEC	*12,452*	*–41.8*	*8.1*	*4,742*	*–2.7*	*4.1*	*–7,710*	*38.1*
Rest	*31,272*	*–33.3*	*20.4*	*18,815*	*–18.7*	*16.3*	*–12,456*	*60.2*
TOTAL	**152,953**	**–30.0**	**100.0**	**115,607**	**–19.8**	**100.0**	**–37,347**	**75.6**

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

This trend will continue for the remainder of 2009.

This can be seen in the previous graph. After six consecutive quarters of falls in the trade deficit related to GDP, in the third quarter of 2009 it posted a rise of 1.4 percentage points, back to levels similar to those of 2003. One of the main reasons for this rise is the strength of the euro, significantly reducing exports to countries outside the euro area. In the third quarter of the year, exports to euro countries fell by 12.8%, almost ten percentage points less than the fall in exports to the remaining countries (22.3%). Consequently, exports to countries in the euro area have become more important over the last few months.

Current account deficit continues to fall in August.

The fall in the trade deficit is expected to continue to slow up in the short term, reaching levels close to 5.0% of Spanish GDP. The economic recovery of the main trading partners in Europe (France and Germany) will drive exports. The most notable are those of automobiles which, due to plans to encourage consumption, will continue to rise until year-end.

Balance of payments: current deficit continues to fall

Improvements in the trade balance and income balance for the month of August led to the current account deficit falling by 55.2% compared with the same month in 2008, standing at 3,187 million euros. This trend was only marred by the services balance, posting a reduction in their

surplus for the fourth consecutive month, due mainly to less revenue from tourism. This fall, however, is lower than that posted in July, namely 73.6%, and everything suggests that the figures for September will confirm the same slowdown as already seen in international trade.

Looking at a broader timeframe, the accumulated deficit in the last twelve months maintained the trend recorded previously, with a fall of 37.8% compared with the same period the year before. The lower current deficit vastly offset the capital account's falling surplus and placed financing needs accumulated over the last twelve months at 65,277 million euros, similar levels to April 2006. International trade figures suggest a reduction in financing needs over the coming months, although at an increasingly lower rate.

With regard to financial flows, this fall in financing needs resulted in a reduction in foreign capital inflows for the year. The most affected area was short-term investment, posting net outflows in August totalling 12,643 million euros. Portfolio investments became the main net financing inflow this month, with a net inflow of 7,081 million euros.

Short-term financing gives way to portfolio investment.

BALANCE OF PAYMENTS

August 2009

	Cumulative for year		Last 12 months		
	Balance in million euros	% annual change	Balance in million euros	Annual change	
				Absolute	%
Current account balance					
Trade balance	–28,841	–54.0	–53,759	42,745	–44.3
Services					
Tourism	*18,178*	*–7.8*	*26,531*	*–1,918*	*–6.7*
Other services	*–530*	*–50.2*	*–1,266*	*1,304*	*–50.7*
Total	17,647	–5.4	25,265	–614	–2.4
Income	–20,174	–7.3	–32,192	–239	0.7
Transfers	–6,614	–12.8	–8,267	80	–1.0
Total	**–37,981**	**–48.3**	**–68,953**	**41,972**	**–37.8**
Capital account	**2,625**	**–41.1**	**3,676**	**–3,236**	**–46.8**
Financial balance					
Direct investment	–503	–	–10,601	4,636	–30.4
Portfolio investment	16,536	4.3	4,438	–5,840	–56.8
Other investment	4,189	–84.3	45,905	–17,167	–27.2
Total	**20,222**	**–55.9**	**39,742**	**–18,371**	**–31.6**
Errors and omissions	80	–	4,642	3,142	209.4
Change in assets of Bank of Spain	15,053	–38.0	20,893	–23,507	–52.9

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

Testing times for the Single Market

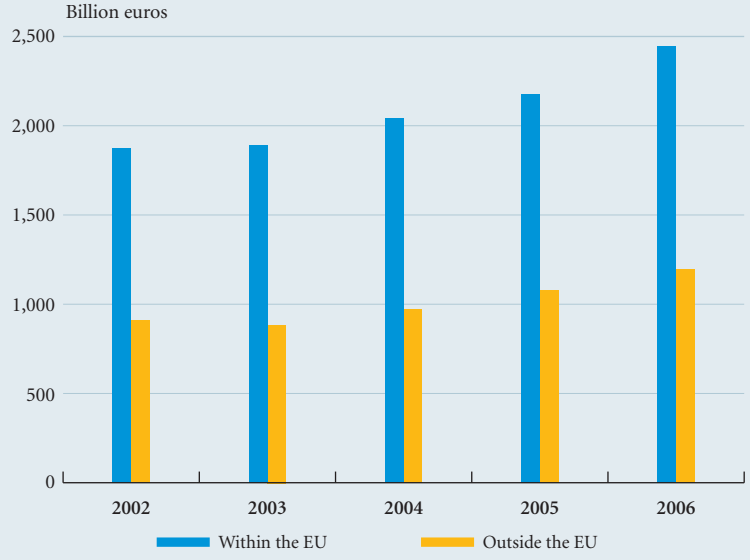
«The intense economic recession resulting from the financial crisis, combined with an abrupt fall in flows of international trade at the end of 2008, have led to most European countries reacting with protectionist measures that have aggravated the decline in business. France has raised its import duties on automobiles in order to protect its automobile industry, while Germany has toughened work permit requirements for immigrants to avoid higher unemployment and the United Kingdom has implemented a plan to subsidize its national industries that has triggered furious protests from the rest of the countries in Europe. The consequent drop in trade between European countries and increasing obstacles to immigration, together with restrictions on the circulation of capital –justified by the need to stabilize the exchange rates of national currencies– have amplified the damage caused by the worldwide economic crisis.»

The above paragraph is pure fiction. Moreover, right now it's impossible, due to requirements resulting from membership of the euro area or European Union (EU). Thanks to these, the worldwide economic crisis, which is indeed real, has had more moderate effects than if the EU had not existed. Can we, for a moment, imagine what would have happened if each central government of a current member state had retained control over its international trade, industry subsidies, capital movements or own currency? Very likely the results would have been a protectionist wave with added competitive devaluations, all to relieve job losses and the destruction of manufacturing, but which very quickly would have aggravated the effects of the crisis, resulting in less growth, higher unemployment and more government deficit.

In spite of EU laws, the protectionist reflex is actually alive and well, but it can no longer flourish in the form of impediments to the free circulation of goods after decades of the Common Market, the first great achievement and main goal of the European Economic Community, way back in the sixties.

MORE TRADE BETWEEN MEMBERS THAN WITH NON-MEMBERS

Exports of goods from the EU-25



SOURCES: Eurostat and own calculations.

Neither would it make much sense to raise trade barriers, due to the industrial interdependence resulting from the segmentation of production processes among several different countries. Nowadays, most of the member states' international trade is made up of trade with other EU countries, as a part of growing industrial integration. However, the protectionist reflex continues to appear in the form of veiled obstacles that usually have a greater effect on small and medium-sized firms, taking the form of technical regulations, standardization requirements, mandatory certification or documentation, rules regarding presentation and content, etc.

These are apparently innocuous obstacles but they manage to distort or directly eliminate competition from other non-national producers. Business Europe, the organization that represents European business associations, estimates that around half those firms attempting to trade with other member states come up against this kind of obstacle, in spite of the efforts of the Commission to apply the principle of «mutual recognition» (any product lawfully marketed in a member state should be allowed to be marketed in any other member state, as is) or to standardize the different national regulations. The latest report drawn up by the Secretary of State for Trade and the Spanish Confederation of Business Organizations on the problems of Spanish firms in the Single Market highlights that technical standards and clients not recognizing the tests and trials for approval and certification provided by Spanish companies often constitute an obstacle to trade. It is a similar case with the lack of uniformity in packs and packaging and the sectors most affected are processed foods and beverages, farming, textiles, capital equipment and wood and furniture.

However, where protectionist resistance emerges in all its glory is in state aid, direct or indirect, manifest or hidden. Even in normal times a large number of proceedings related to state aid are brought by the Commission, but in times of crisis this phenomenon gets worse. Given the risk of firms closing down, rising unemployment or the loss of foreign investors, the immediate reaction of national authorities is to give a helping hand with the budget and grant state funds to find a way out of the problem. State aid is not absolutely forbidden in the EU, but can only be granted in highly specific cases and provided it does not distort free competition or free circulation.

No member state can use national interest as an excuse to violate these principles, but it's true that the Commission has a hard time keeping order in the area of state aid. The current economic and financial crisis has tested the principles established in the treaties and shaped by the decisions of the Court of Justice, which the Commission defends. In the financial area, the exceptional crisis has forced governments to intervene directly with an unprecedented avalanche of state aid in order to avoid even greater problems. Given the absence of a regulatory authority, the Commission has had to «police» these actions and impose some kind of order.[1]

The Commission has also ensured that the financial aid set up by several countries in order to re-establish, as far as possible, the flow of credit to small and medium-sized firms does not violate the principles of the Single Market. To this end, and given the extent of the crisis, the Commission has temporarily suspended, until the end of 2010, the regulations regarding state aid for this purpose, in any case subject to strict notification procedures. In this way, the aim is also to ensure that financial aid reaches the non-financial sector, to partly offset the blockage in credit.

(1) See, for example, Jódar-Rosell, Sandra y Jordi Gual (2009) «Ayudas públicas en el sector bancario: ¿rescate de unos, perjuicio de otros?» *Documentos de Economía "la Caixa"*, n.º 13.

Something similar has happened in the real economy, albeit on a different scale. For example, at the beginning of 2009, France announced a plan to support its automobile industry that set off alarms in other member states with French factories, which looked like they were going to be left out of the aid package. Given the Commission's reaction, the French government had to provide formal guarantees that it would not contravene the provisions of the Single Market and, in particular, that the manufacturer's location would not be a condition for the aid nor would it prioritize suppliers located on French soil. On the other hand, several European countries have adopted plans to grant subsidies for buying automobiles, although none have been able to explicitly reward the purchase of cars made in their own country.

Overall, the most talked about case in industry is probably the frustrated sale of the European division of Opel, subsidiary of General Motors, to Magna. The German government granting a large bridging loan to facilitate the operation, which would implicitly favour production plants on German soil, aroused loud protests on the part of other affected European countries, once again forcing the Commission to intervene in order to minimally preserve the rules of the Single Market.

In short, although government pressure can be unbearable at times, the Commission is managing to uphold the principles of the Single Market. These are fundamental to the EU and, although they may not always be fully understood, are key to keeping the economies stable. We mustn't forget that the Great Depression of the 1930s triggered a protectionist spiral that brought international trade flows close to a state of collapse, considered by some historians to be the root of the Second World War. At that time it became clear that trade flows needed to be preserved internationally as a source of stability and prosperity, an idea that the EU has inherited and that constitutes one of the history lessons we must never forget.

This box was prepared by Joan Elias
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Public sector

Central government deficit up to October seven times higher

The effects of the economic situation, with a sharp drop in tax revenue and a rise in payments, continues to have a negative effect on the central government's accounts. During the period January-October, central government revenue in Treasury terms, i.e. according to the monetary flows recorded, totalled 140,418 million euros (before payments to autonomous communities and local governments). This is down 13.8% compared with the same period in 2008.

Revenue from direct taxes fell 13.4% in the first ten months of the year while revenue from the main item, namely personal income tax, totalled 54,342 million euros, a drop of 10.0%. This figure falls to 7.0% after adjusting the revenue for the impact of the 400-euro discount, the introduction in the last few months of a deduction for renting any habitual residence, longer deferment periods and earlier rebates for 2008 income tax returns. For its part, corporate tax fell by 22.3% due to the slowdown in corporate profits and some regulatory changes.

The squeeze in consumption and investment meant that the drop in indirect taxes was even greater, namely 21.1%, with the star of this group, value added tax (VAT), falling by 29.1%. This

The economic situation and measures to relieve the recession have hurt public accounts.

CENTRAL GOVERNMENT BUDGETARY IMPLEMENTATION

October 2009

	Month		Cumulative for year	
	Million euros	% change over same month year before	Million euros	% change over same month year before
Non-financial revenue	**18,816**	**–1.4**	**89,517**	**–20.5**
Non-financial revenue adjusted (*)				
Personal income tax	7,503	–4.1	54,342	–10.0
Corporate tax	6,103	7.0	20,507	–22.3
VAT	6,815	–5.1	30,631	–29.1
Special taxes	1,806	9.3	16,122	–1.3
Other	1,349	11.3	18,816	13.4
Total	**23,576**	**0.0**	**140,418**	**–13.8**
Non-financial spending	**13,618**	**5.7**	**147,119**	**23.2**
Treasury balance	**5,198**	**–16.0**	**–57,602**	**744.9**
Surplus (+) or deficit (–) (**)	***3,470***	***–30.7***	***–59,310***	***597.7***

NOTES: (*) Includes tax segments ceded to regional and local governments under current financing system.
(**) In terms of National Accounting.
SOURCES: Ministry of Economy and Finance and own calculations.

Tax revenue tumbles while costs shoot up.

decrease has been affected by bringing forward tax rebates, extending the system of monthly rebates and longer deferment periods. Special taxes, however, limited their fall to 1.3%, thanks partly to the rise in rates levied on tobacco and hydrocarbons around the middle of June.

The rest of non-financial income rose 13.4%. This was helped by commissions on guarantees granted for issues by financial institutions, as part of the Joint Action Plan for countries in the euro area.

On the other side of the balance sheet, non-financial payments made by the central government over the first ten months of the year totalled 147,119 million euros, a year-on-year rise of 23.2%.

Approval for the creation of the new State Fund for Employment and Local Sustainability.

Under current spending, personnel costs rose 4.8% and the purchase of goods and services was up 1.7%, while financial costs rose 0.1%. But the highest year-on-year growth was for current transfers, up 28.5% to 86,519 million euros. Particularly of note was the 15,767 million euros for the State Employment Service in order to cover unemployment benefit.

Regarding capital costs, real investment only rose by 0.2%, thanks to investment made by the Ministry of Public Works. Capital transfers grew much more, however, up 131.6%, driven particularly by the 5,500 million euros of the State Local Investment Fund.

The Central Government Economic-Financial Balancing Plan for fiscal consolidation is now underway.

Because of these trends in revenue and spending, the central government accounts showed a non-financial cash deficit of 57,602 million euros, compared with 6,818 million in the same period in 2008. On a national accounts basis, i.e. taking into account the rights and obligations generated, this deficit came to 59,310 million euros, almost seven times the figure for the same period in 2008. This accounts for 5.6% of gross domestic product, compared with 0.8% from the previous year.

The end of October saw approval for the creation of the State Fund for Employment and Local Sustainability. This replaces the State Local Investment Fund, allocated 8,000 million euros, which has financed municipal works in 2009. In addition to boosting economic activity in the short term, this new extraordinary fund is also meant to contribute towards economic, social and environmental stability. Work will be financed as from the beginning of 2010.

Finally, on 30 October the Spanish cabinet approved the Central Government Economic-Financial Balancing Plan to ensure medium-term budgetary sustainability. The central government budget for 2010 represents the first step in the process of fiscal consolidation. This plan sets out the strategic lines to redirect the general government deficit towards a balance in 2012, in line with the Stability and Growth Plan and according to the requirements of the Excessive Deficit Procedure initiated by the European Commission last 27 April. Subsequently, the European authorities recommended extending the period for achieving this balance up to 2013.

Savings and financing

Adjustments continue to be made in household accounts

In October, the one-year Euribor, widely used as a reference rate, set a new record low for its monthly average when it reached 1.24%, 401 basis points below the figure twelve months earlier. In the first few weeks of November, the one-year Euribor continued to slide, by the middle of the month reaching the minimum rate of 1.22%. This downward trend in the Euribor over the last year reflects the successive cuts in the official European Central Bank interest rate due to the worldwide economic and financial crisis, but is also due to the reduction in interbank risk premium as market conditions start to get back to normal.

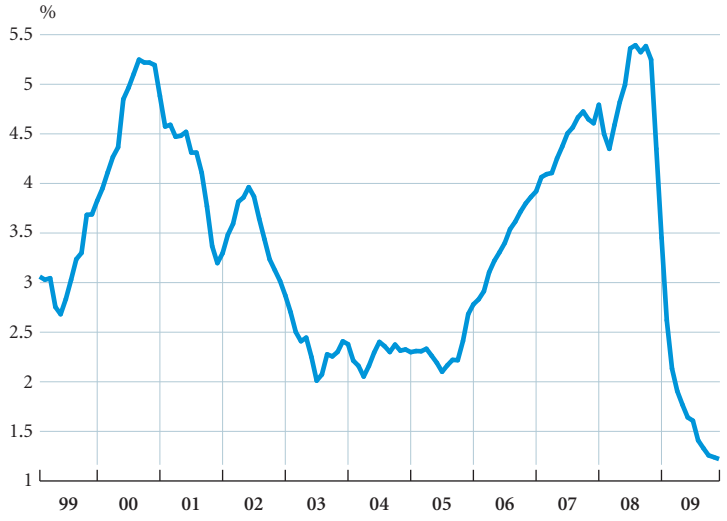
Interest rates on loans by financial institutions have also fallen in the last period, with the average interest rate for bank asset transactions standing at 3.55% in September, 301 basis points below the same month in 2008. This fall could have been greater had it not been for the rise in risk premium, the result of bad debt picking up sharply due to the economic situation.

In spite of nominal cuts in interest rates, demand for funding in the private sector is still weak, within a situation of shrinking consumption and investment. For its part, the supply of credit has adapted its financing conditions to the situation, in line with prudent risk management. Consequently, financing

One-year Euribor hits record low monthly average for the eighth consecutive time in October.

ONE-YEAR EURIBOR HITS A NEW RECORD LOW

12-month Euribor rate



NOTE: 23 November.
SOURCE: Bank of Spain.

Corporate bond issues soar.

for firms and households continued to slow down and only recorded a year-on-year increase of 0.4% in September, a little less than the euro area as a whole.

Funding granted to non-financial companies was higher than that of households but still only rose very slightly, by 0.7% compared with September 2008. The improved conditions in capital markets and lower interest rates over the last period led to a notable increase in the use of bond issues, with a year-on-year rise of 26.6%, although their share in corporate funding overall was modest, less than 4%. For their part, foreign loans were up 5.6% over the last twelve months.

Drop in family financing over the last twelve months.

The trend in commercial credit, used to finance the working capital of firms, with an annual drop of 32.8%, reflects the reduction in economic activity over the last year, while the 16.3% year-on-year decrease in financial leasing reveals the meagre demand for investment. However, these falls are a little less than those seen in the preceding month.

Households recorded a moderate positive effective flow of funding in September, although slightly below that of a year earlier. Most private financing is aimed at housing and this continued to slow up, resulting in a year-on-year increase of just 0.2%, while the remaining loans for consumption and other purposes showed a year-on-year decrease of 0.9%. Consequently, adjustments continue in household debt, which had reached high levels before the crisis and is still slightly above the average for the euro area.

For its part, bad debt took a break in September and held steady at 4.9%. This rate is 2.2 percentage points higher compared with the same month last year and has led to strong growth in financial institutions' provisions.

FINANCING OF NON-FINANCIAL SECTORS (1)

September 2009

	Balance	Change this year	Change over 12 months		% share
	Million euros	Million euros	Million euros	% (2)	
Private sector	2,207,061	–10,107	8,317	0.4	84.5
Non-financial corporations	1,303,821	–2,811	12,535	0.7	49.9
Resident credit institution loans (3)	*924,865*	*–29,269*	*–21,786*	*–2.0*	*35.4*
Securities other than shares	*49,282*	*8,206*	*10,346*	*26.6*	*1.9*
External loans	*329,674*	*18,252*	*23,975*	*5.6*	*12.6*
Households (4)	903,240	–7,296	–4,218	0.0	34.6
Housing loans (3)	*676,335*	*–2,113*	*336*	*0.2*	*25.9*
Other (3)	*224,241*	*–5,472*	*–4,899*	*–0.9*	*8.6*
External loans	*2,664*	*288*	*346*	*14.9*	*0.1*
General government	404,192	74,046	103,382	34.4	15.5
TOTAL	**2,611,253**	**63,938**	**111,699**	**4.5**	**100.0**

NOTES: (1) Resident in Spain.
(2) Year-on-year rates of change calculated as effective flow/stock at beginning of period.
(3) Include bank off-balance-sheet securitized loans.
(4) Include those non-profit institutions serving households.
SOURCES: Bank of Spain and own calculations.

With regard to general government financing, this has seen big growth, with a year-on-year rise of 34.4% at the end of the third quarter. However, it only partially offset private sector deleveraging, so that the financing of non-financial sectors continued to slow up, recording a year-on-year variation of 4.5%, 3.6 points less than in September 2008.

Resurgence of mutual funds

In an environment that is still recessive, and with the improvement in the wholesale financing conditions of financial institutions, the private sector's urgency to obtain deposits has eased off. Within this context, deposits of firms and households continued to calm down in September, also influenced by the drop in yields and competition from rival products. Consequently, in the last twelve months, private sector deposits grew by 4.2%, one percentage point less than in August.

However, savings deposits continued to accelerate, with an annual rise of 13.0%, showing the preference of households for liquidity given the uncertain economic situation and rising unemployment. Meanwhile, foreign currency deposits fell by 37.7% in the last few months, affected by the unfavourable difference in interest rates and the adverse trend in exchange rates.

Less competition in deposits and good performance on the part of financial markets helped to reactivate mutual funds in October, with the number of participants standing at 5,702,235, a monthly increase of 0.3%, the first since May 2007. Net subscriptions for the month totalled 551 million euros, the highest monthly total in two and a half years. There also seemed to be less aversion to risk, with significant net withdrawals from money market and guaranteed funds. Hedge funds also recorded net inflows.

The average yield for mutual funds in the last twelve months stood at 3.95%, greatly exceeding inflation. Particularly of note are the returns from emerging market equity, namely 39.5%, and from domestic equity, 26.5%. Consequently, mutual fund assets rose by 341 million euros in October, up to 162,857, although these assets have fallen by 6.6% over the last twelve months.

Hiatus for bad debt in September.

Slowdown in private sector deposits but savings deposits speed up.

BANK LIABILITIES DUE TO COMPANIES AND HOUSEHOLDS

September 2009

	Total	Change this year		Change over 12 months		% share
	Million euros	Million euros	%	Million euros	%	
On demand deposits	255,778	10,967	4.5	8,009	3.2	18.0
Savings deposits	197,964	18,186	10.1	22,780	13.0	13.9
Term deposits	727,907	–1,366	–0.2	31,469	4.5	51.2
Deposits in foreign currency	22,435	–6,883	–23.5	–13,568	–37.7	1.6
Total deposits	**1,204,083**	**20,905**	**1.8**	**48,691**	**4.2**	**84.7**
Other liabilities (*)	**216,949**	**–31,681**	**–12.7**	**–29,661**	**–12.0**	**15.3**
TOTAL	**1,421,032**	**–10,776**	**–0.8**	**19,029**	**1.4**	**100.0**

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

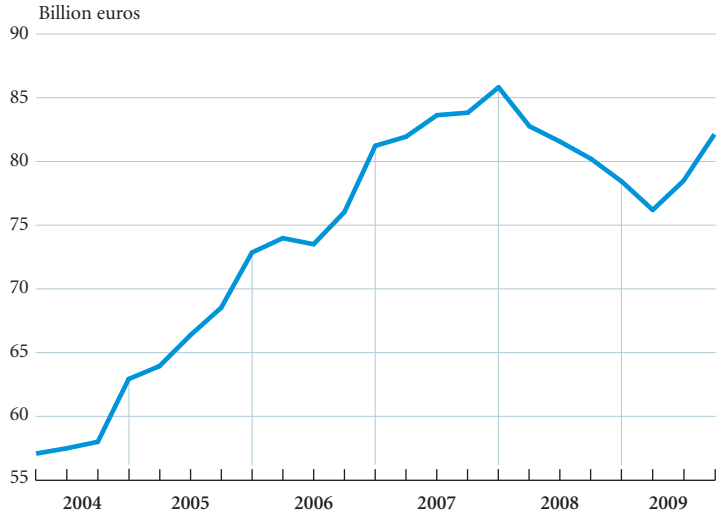
Average annual yield for mutual funds reaches 4%.

On the other hand, pension funds continued to recover in the third quarter. Total assets rose by 4.6% quarter-on-quarter, up to 82,161 million euros. This figure represents 2.4% growth compared with a year before. Net contributions from the third quarter came to 260 million euros, while the number of participant accounts increased by 0.6% in the last twelve months, bringing the estimated number of participants to around eight million.

By category, assets from the individual system were up 2.3% over the last twelve months, totalling 51,038 million euros, whereas assets from the employment system rose by 2.9% in the last year, to 30,125 million euros. For its part, the associated system, used by organizations such as trade unions and professional colleges, reached 997 million euros. The average annual yield for all plans stood at 3.3%. Over the last nineteen years, the average yield has been 5.5%, above the inflation rate for the period.

PENSION FUNDS RECOVER

Total assets in pension funds



SOURCE: Inverco.

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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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