

BULLETIN

EU & US INFLATION AND MACROECONOMIC ANALYSIS

INSTITUTO
FLORES
DE LEMUS



Instituto Flores de Lemus de Estudios Avanzados en Economía N. 92 May 2002

MAIN POINTS

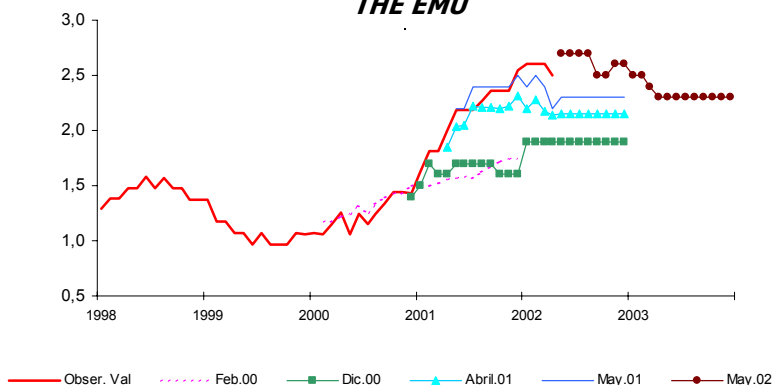
"The European core inflation rate has remained above the inflation objective since September 2001, and is expected to maintain this value in 2002 and 2003"

FORECASTING UPDATES FOR CORE INFLATION RATES IN THE EMU FOR 2002 AND 2003

Base forecast period	Core Inflation	
	Average annual rate for 2002	Average annual rate for 2003
June 2001	2.3	----
August 2001	2.0	----
October 2001	2.3	----
December 2001	2.2	2.2
February 2002	2.5	2.2
April 2002	2.4	2.2
May 2002	2.6	2.3

Source: Institute Flores of Lemus / Date: May 20, 2002

ANNUAL FORECASTS FOR CORE INFLATION IN THE EMU



Source: Eurostat & I. FLORES DE LEMUS / Date: 20/05/02

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N. 92

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I. MAIN POINTS AND NEW RESULTS

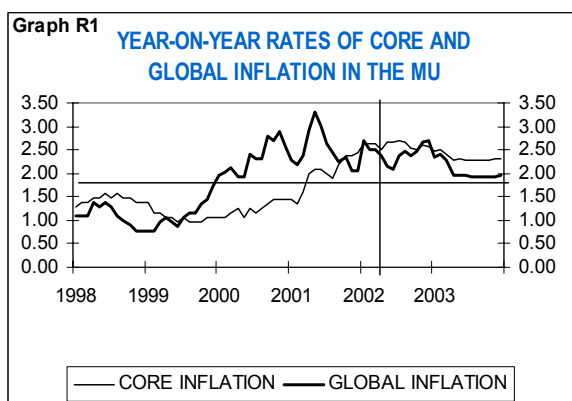
I.1. MONETARY AND EUROPEAN UNIONS

- The May monthly inflation rate in the MU is forecasted at 0.2%; therefore, the corresponding year-on-year rate will decrease to 2.1%, compared to the 2.4% observed in April (graph R1).

- The monthly rate registered in April was 0.54%, above our prediction, 0.41%, due to the upward innovation in core inflation, came in prices of services and commodities. In residual inflation, the downward surprise derives from prices of non-processed food, so energy prices registered a null innovation (tables R1 and A2 in the appendix).

Harmonized Indices of Consumer Prices	Observed growth Apr. 2002	Forecast	Confidence interval at 80%
Consumer Price Index (HICP)	0.54	0.41	± 0.09
Core inflation (83,20%)	0.37	0.21	± 0.08
Residual inflation (16.80%)	1.19	1.37	± 0.39

(*) Al 80% de significación
Source : EUROSTAT & IFL / Date: May 16, 2002.



Source : Eurostat & IFL / Date: May 20, 2002.

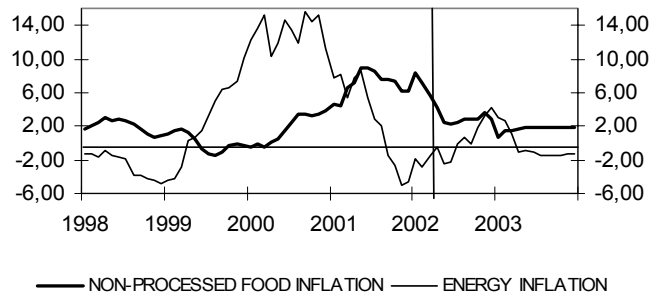
- The expectations for the average annual rate of **core inflation** in the MU are 2.6% in 2002 and 2.3% in 2003. In the US, the mean annual rate for core inflation is predicted to reach 2.6% in 2002 and 2.7% in 2003, overcoming the corresponding to the MU, as a consequence of the evolution in services prices (graph R1).

- The differential between core inflation in goods and services stayed in April at 0.8 percentage points and it is expected to stay at this value in the remaining months of 2002 and in 2003, as a consequence of the analogous decrease of annual inflation in services and in goods. The average annual rates of prices of non-energy processed goods for 2002 and 2003 are forecasted at 2.2% and 1.9%, respectively. In the services market the expectations for the average annual rates are 3.1% in 2002 and 2.8 % in 2003 (table R2).
- The incorporation of sales prices in different countries of the EMU came in an oscillating evolution of **commodity prices**, whose year-on-year rate of inflation will change from 2.2% in July 2002 to 1.7% in October 2002. Consequently, the evolution of **core inflation** also shows important oscillations. It is forecasted that its year-on-year rate will reach 2.7% next May and stay at this value till August to decrease at 2.3% in 2003, as a consequence of a better behaviour in 2003 of prices of processed food and services.
- The forecasted average annual rate in **global inflation** for 2002 increases to 2.5 % in 2002 and to 2.0% in 2003, compared with the predictions in previous bulletin (see table R2).

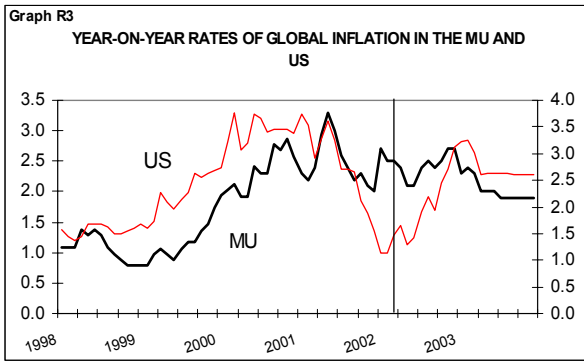


- The uncertainty in evolution in the prices of energy come also in an oscillate evolution of global inflation, which from 2.4% registered in April 2002, it is expected to decrease to 2.1% in May and June to increase again to 2.7% in November and December, and to stay around 2.0% in 2003; overcoming the objective of 2% in 2002 (see graph R2).

Graph R2
YEAR-ON-YEAR RATES OF NON-PROCESSED FOOD AND ENERGY INFLATION



Source : Eurostat & IFL / Date: May 20, 2002.



Source : Eurostat, BLS & IFL / Date: May 20, 2002.

- The inflation differential of the Monetary Union with the United States has systematically been a percentage point in favour of the MU, as can be observed in the accompanying graph. Currently, the annual rate of growth in April in the USA was 1.6%, below the corresponding rate in the MU, 2.4% (graph R3). It is expected that this differential inflation will remain favourable for the US until November 2002 but at the end of 2002 and in 2003, inflation in the MU will again be lower than in the US.

- This differential is favourable for the MU in services, and for the US in goods. The different behaviour of commodity prices are noticeable, for while the expectations for the average annual rate in the US decrease to -0.6 % in 2002 and 0.2% in 2003, in the MU they are 1.8% in 2002 and 2003.

Table R2

FORECASTS FOR THE MEAN ANNUAL RATES IN THE HICP OF THE MU

Harmonised Indices of Consumer Prices (HICP)	2000*	2001*	Forecasts	
			2002	2003
GLOBAL HICP IN THE MU (100%)	2.3	2.5	2.5	2.0
CORE INFLATION (83,20%)	1.3	2.0	2.6	2.3
Non energy processed goods HICP (44,29%)	0.8	1.6	2.2	1.9
Services HICP (38,90%)	1.7	2.5	3.1	2.8
RESIDUAL INFLATION (16.80%)	7.6	4.7	1.7	0.6
Non Processed Food HICP(8.10%)	1.7	7.0	3.9	1.7
Energy HICP (8.70%)	13.3	2.7	-0.2	-0.4

• Observed Values

(1) Monthly and annual rates can be found in tables A5A and A5B in the appendix.

Source: Eurostat & IFL/ Date: May 20, 2002.



I.2 MACROECONOMIC TABLE OF EURO-ZONE

	ANNUAL AVERAGES GROWTHS		
	Forecasts BIAM (*)		
	2001	2002	2003
GDP pm	1.5	1.3	2.1
Demand			
Final Consumption	1.8	1.7	2.0
Gross Investment	-2.3	-0.5	1.1
Domestic Demand	0.9	1.1	1.8
Exports of Goods and Services	3.4	4.3	6.4
Imports of Goods and Services	1.8	4.1	6.0
Net Exports	33.1	2.5	11.9
Supply			
Gross Value Added Total (market prices)	1.5	1.3	2.1
Net Taxes	-4.4	-2.0	0.1
Gross Value Added Total (basic prices)	1.9	1.5	2.1
Gross Value Added Agriculture	-0.8	1.3	1.7
Gross Value Added Industry	1.0	1.0	1.6
Gross Value Added Construction	-0.5	-0.1	0.4
Gross Value Added Services	2.5	1.9	2.5
Prices			
CPI harmonized, annual average	2.5	2.5	2.0
CPI harmonized, dec./dec.	2.0	2.7	1.9
Employment			
Unemployment rate	8.3	8.7	8.4
Others Economic Indicators			
Production Index of Industry (excluding construction)	0.0	0.4	1.5

Source: EUROSTAT & I. FLORES DE LEMUS / Date: May 22, 2002.

(*) Boletín Inflación y Análisis Macroeconómico.

- The most recent data from Euro-zone indicators are slightly more favourable than those of the last quarter of 2001. Some indicators however, are showing rather disparate behaviour and those with a more positive evolution do not yet allow for a solid affirmation on the recovery in the zone. **The economic slowdown in the EMU is being reflected in the labour market, but compared with similar phases in earlier cycles, in this one the relative behaviour of the labour market is more positive.**

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I.3. UNITED STATES

- In **May**, the overall CPI is forecasted to increase 0.11% leaving the year-on-year rate at 1.30%, a little over three tenths less than in April. A slight pick-up in core inflation annual rate is forecasted, due to commodities less food and energy. However, motor-fuel prices will again be the ones which determine or explain the decrease in the CPI general rate, since the expected motor-fuel prices increase is -0.18% , as opposed to last year's 9.88% in May.

Table R3

OBSERVED VALUES AND FORECAST ON CONSUMER PRICE FIGURES IN US April 2002

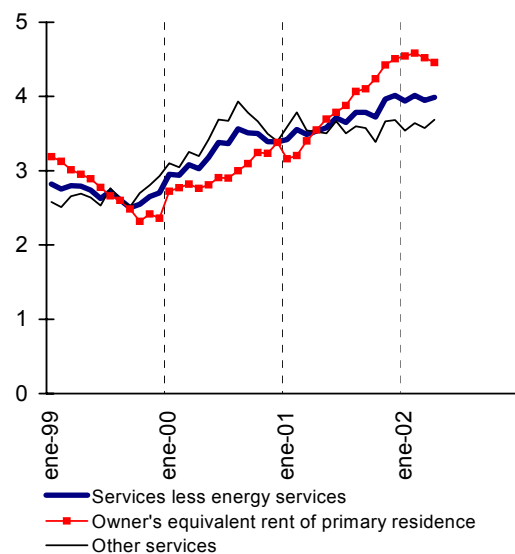
CONSUMER PRICES INDEX (CPI)	Monthly Growth (T ¹ ,)		Confidence Intervals at 80% level (+ -)
	observed (a)	forecasts (b)	
Residual Inflation	1.74	1.77	0.56
Core Inflation	0.25	0.14	0.12
All items	0.56	0.48	0.17

Source: BLS & INSTITUTO FLORES DE LEMUS
Data: May 15, 2002

- US monthly inflation rate in **April** registered an increase slightly over the expected: 0.56% as opposed to 0.48%, with the corresponding year-on-year rate rising from 1.48% up to 1.64%. This pick up is partially explained by non-food and non-energy goods and service prices, but mostly by energy prices, especially by motor-fuel prices, whose monthly rate increases 12.75% (as expected), augmenting its annual rate 4.3 points. In relation to previsions, it is important to underline the positive innovation in non-durable goods as the consequence of the increase in tobacco taxes and a reduction in the discounting of

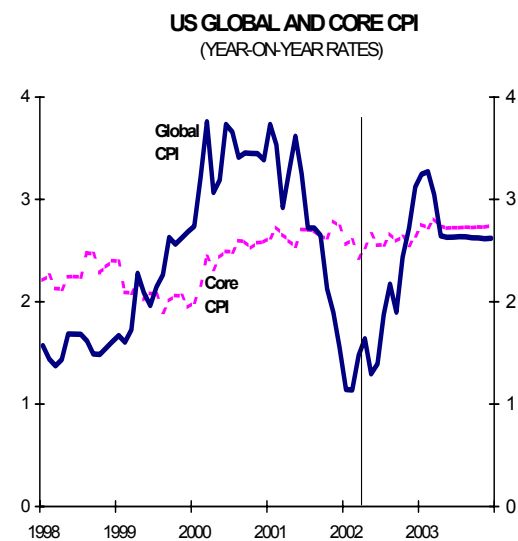
selected major brands (see Table R3).

Graph R4



Source: IFL & BLS / Date: May 15, 2002

Graph R5



Source: IFL & BLS / Date: May 15, 2002

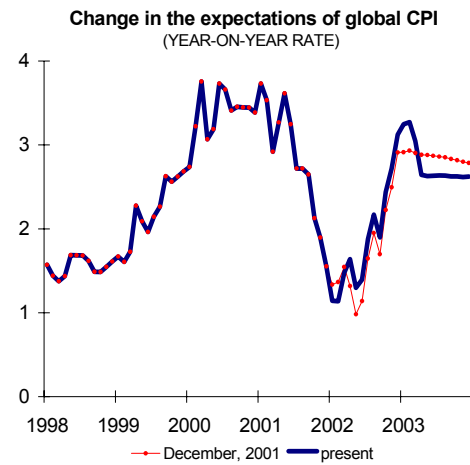
- Core inflation registered an increase of 0.25% instead of the forecasted 0.14%, increasing the annual rate from 2.45% to 2.53%. Within core inflation, service prices rose 0.19%, over the expected (0.12%), a deviation that is explained mostly by lodging away from home and medical service prices, the year-on-year rate rises from 3.95% up to 3.99%. Within service prices, in this Bulletin, the index of the owners' equivalent rent of primary residence should be highlighted. As opposed to the idea of services registering a constant acceleration progress along the last two years; if owner's equivalent rent of primary residence is removed, we can see that this acceleration occurred in 2000, but along 2001 the annual rate of the rest of the services, as a whole, have remained stable. It also shows how the owners' equivalent rent of primary residence prices in April have registered a slight deceleration for the second consecutive month.
- On the other hand, commodities less food and energy prices rose 0.35%, instead of the 0.19% forecasted. The annual rate takes a value of -1.0% as opposed to the -1.1% of the previous month. Durable goods decrease 0.16%, similar to the forecasted -0.14% , and non-durable goods rise 1.01%, above the foreseen



0.54%; a deviation explained by the increase of tobacco taxes and the reduction in the discounting of selected major brands. Indeed, tobacco prices rose 6.8% in April, 2.7 points of which are due to the increase in taxes. The tobacco year-on-year rate rises from 6.4% up to 9.0%.

- Residual inflation registered an increase of 1.74%, as forecasted (1.77%). However, a slight downward deviation in food prices has taken place, due to fresh fruit and vegetables, which has been partly balanced by the very slight upward deviation in energy products. The important registered increase in motor-fuel prices has coincided with the forecasts, 12.75% as opposed to the expected 12.62%, thus, motor-fuel prices annual rate increase from -13.22% up to -9.11%.
- For the rest of **2002** and **2003** previsions have worsened very slightly due to the increase of tobacco taxes. (see **Table R4**). **Graph R6** shows the changes in inflation expectations since December 2001.

Graph R6



Source: IFL & BLS / Date: May 15, 2002

- US April economic data has shown strong numbers in terms of expenditure and production, very much in contrast to the disappointing performance of the labor markets. The combined effect of weak employment and strong production has led to an improvement in the first quarter productivity and unit labor cost numbers which suggests little urgency to raise interest rates.

Table R4

AVERAGE ANNUAL RATE OF GROWTH IN US (*)						
CONSUMER PRICES INDEX (CPI)	1998	1999	2000	2001	2002 (forecasts)	2003 (forecasts)
Food	2.2	2.1	2.3	3.1	2.4	2.6
Energy	-7.7	3.6	16.9	3.8	-5.9	3.4
Residual Inflation	-1.6	2.5	6.8	3.3	-0.5	2.9
Non-food and non-energy goods	0.6	0.7	0.5	0.3	-0.6	0.2
Non-energy services	3.1	2.7	3.3	3.7	3.9	3.8
Core Inflation	2.3	2.1	2.4	2.7	2.6	2.7
All items	1.6	2.2	3.4	2.8	1.9	2.8

(*) Monthly and annual growth rates can be found in tables A6A and A6B in Appendix

Source: BLS & INSTITUTO FLORES DE LEMUS

Data: May 15, 2002



I.4. SPAIN

□ Monthly inflation in May is expected to have a null value. The year-on-year rate of 3.6% observed in April, will decrease to 3.3% in May (graph R6).

□ The monthly rate observed in April, a positive value of 1.36%, registered an upward innovation in trend inflation, came in prices of commodities. Residual inflation registered a downward innovation from prices of tourist packages and tobacco (table R5).

□ The monthly inflation rates in April corresponding to prices of apparel and footwear show a longer duration of winter sales in 2002 than in 2001, so the period of prices recuperation in these sectors has been different to the corresponding of the previous year. This fact was foreseen with March data, when prices of apparel and footwear registered downward innovations, so the effect of ending winter sales was postponed to forecasts for April. As a consequence, it was obtained a good forecast for the monthly inflation in April.

□ **Trend inflation** increased in April to 3.6%, with respect to the 3.2% registered last March. Most components in trend inflation in services showed annual rates near or greater than 5%, for example prices of transport, postal services, restaurants, hotels and culture services. Trend inflation in food decreased in April to 3.1% with respect to the 3.3% observed in March and the 5.1% observed in the last quarter of 2001. Taking into account commodities prices, its year-on-year rate increased in April to 2.8% compared to the 1.9% registered in March, and is expected that the mean annual rate will decrease to 2.3% in 2002 to increase again to 2.6% in 2003.

Consumer Price Index (CPI)	Observed growth April 2002	Forecast	Confidence interval at 80%
Global Inflation(100%)	1.36	1.23	± 0.15
Trend Inflation (77,23%)	1.21	0.99	± 0.13
Residual Inflation (22,77%)	1.89	2.05	± 0.22

Source : INE & IFL / Date: May 14, 2002.

Consumer Prices Index (CPI)	2000*	2001*	Forecasts	
			2002	2003
GLOBAL INFLATION (100%)	3.4	3.6	3.5	3.6
TREND INFLATION (77.23%)	2.5	3.5	3.4	3.6
Non energy processed goods, excluding tobacco, oils and fats CPI (44.28%)	1.9	3.1	2.4	2.6
Services excluding tourism CPI (32,95%)	3.5	4.1	4.6	5.1
RESIDUAL INFLATION (22.77%)	6.5	3.7	3.4	3.5
Non processed food CPI (9.07%)	4.2	8.7	4.2	4.2
Energy CPI (9.41%)	13.3	-1.0	0.7	2.0

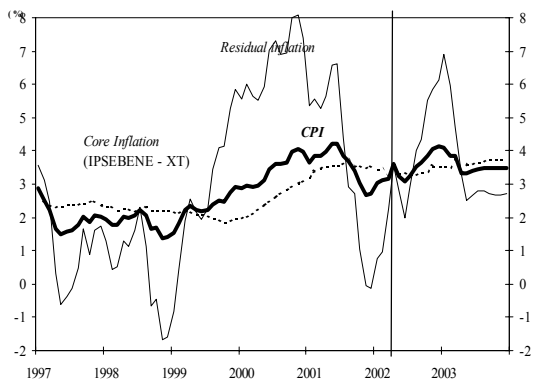
* Observed Values

- Monthly and annual rates can be found in tables A7A and A7B in the appendix
- Source: INE & .IFL / Date: May 28, 2002.



Graph R7

YEAR ON YEAR RATES OF GROWTH OF TREND, RESIDUAL AND GLOBAL INFLATION



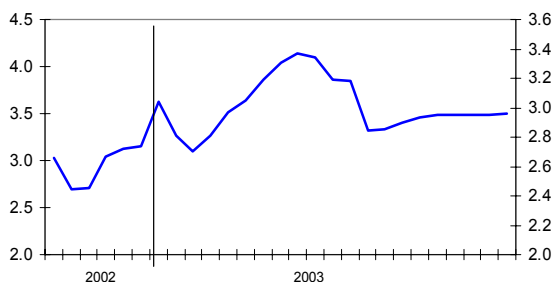
Source: INE and IFL / Date: May 28 , 2002.

- It is expected that trend inflation will decrease in May to 3.3%, below the expected mean annual rate in 2002, 3.4%, and in 2003, 3.6%; as a consequence of the worse behaviour of rates of growth of prices in non-energy processed goods, excluding fats, oils and tobacco and rates of growth of prices of services, excluding tourist packages (table R6).
- Core inflation in the MU stayed at 2.5% in April and the expectations for the average annual rate for core inflation are 2.6% in 2002 and 2.3% in 2003, so there remains a consolidated inflation differential between Spain and the MU of around one percentage point.

- Taking into account **residual inflation** prices of non-processed food show a worse evolution. The expectations of the average annual rates of inflation are 4.2% for 2002 and 2003. On the other hand, it is expected that energy prices will register average annual rates of inflation of 0.7% in 2002 and 2.0% in 2003.

Graph R8

ANNUAL RATES OF GLOBAL INFLATION IN SPAIN



Source: INE and IFL / Date: May 28, 2002.

- Due to the oscillations in energy and non-processed food prices and the increase in expectations of trend inflation, especially worrisome in services, with a weight of 33% and expected annual rates of growth in 2002 near of 5%, the year-on-year rate of growth of **global inflation** will oscillate in a relevant way. Therefore, the annual inflation will decrease to 3.1% in May and June and to increase again at the end of 2002 to reach 4%, so the average annual rates of growth will stay at 3.5% in 2002 and 3.6% in 2003 (table R6 and graph R8).



I.5. MACROECONOMIC TABLE OF SPANISH ECONOMY

MACROECONOMIC TABLE AND INDICATORS			
	Annual Rates		
	2001	Forecasts BIMA (*)	
		2002	2003
Private Final Consumption Expenditure	2.7	2.2	2.8
Public Final Consumption Expenditure	3.1	3.2	3.1
Gross Fixed Capital Formation	2.5	2.7	3.5
Equipment	-2.2	0.7	4.4
Building	5.7	4.2	3.7
Other products	0.8	1.1	1.7
Inventory change (1)	0.1	0.0	0.0
Domestic Demand	2.8	2.1	3.0
Exports of Goods and Services	3.4	2.4	5.5
Imports of Goods and Services	3.7	2.8	5.9
Net Exports (1)	-0.1	-0.2	-0.2
GDP	2.8	1.9	2.8
GDP, current prices	6.5	5.1	5.8
Prices and Costs			
CPI, annual average	3.6	3.5	3.6
CPI, dec./dec.	2.7	4.1	3.5
Average earning per worker	4.3	3.5	3.6
Unit labour cost	3.9	2.6	2.5
Labour Market (Data poll labor force)			
Labor Force (% variation)	2.0	2.1	2.2
Employment:			
Data adjusted from changes in the employment survey			
Annual average variation in %	3.7	2.1	2.6
Annual average variation in thousands	575.9	335.0	423.2
Unemployment rate	10.6	11.2	10.8
Basic balances			
Foreing sector			
Current Account (billions Pts.)	-19.256	-22.286	-21.342
Net lending or borrowing (% GDP) (2)	-1.9	-1.7	-2.0
AA.PP. (Total) / Public Administration			
Net lending or borrowing (% GDP) (2)	0.0	-0.5	-0.3
Other Economic Indicators			
Industrial Production Index	-1.1	0.5	1.7

Source: INE & I. FLORES DE LEMUS
Date: May 22, 2002.

(*) Bulletin EU & US Inflation and Macroeconomic Analysis.



- In the first quarter of 2002, the Labour Force Sample Survey (EPA) employed some methodological changes in order to correct certain biases implicit in the previous Survey. As a result of the changes, the level of both employment and activity have increased, but the level of unemployment and the unemployment rate have dropped. **The new data show that the economic slowdown continues to be reflected in the behaviour of the labour market** and, for this reason, the occupational slowdown is intensifying. During the first quarter, employment grew at an inter-annual rate of 2.2%, almost one point below that of the previous quarter and 2.6 pp less than the year before. Unemployment increased significantly in this quarter, 189.000 and the unemployment rate rose one point to 11.5%. Nevertheless, this data seems to show certain contradictions arising from the application of the new methodology.

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I.6 FORECAST SUMMARY

INFLATION FORECASTS IN THE MU AND USA (1998-2003)						
	1998	1999	2000	2001	Forecasts	
					2002	2003
GLOBAL INFLATION						
Euro-zone (100%).	1.1	1.1	2.3	2.5	2.5	2.0
USA (100%).	1.6	2.2	3.4	2.8	1.9	2.8
CORE INFLATION						
Services and Non-energy industrial goods excluding food.						
Euro-zone (70.97%).	1.4	1.1	1.3	1.9	2.5	2.4
USA (75%).	2.3	2.1	2.4	2.7	2.6	2.7
DIFFERENT COMPONENTS OF CORE INFLATION						
(1) Services.						
Euro-zone (38.90%).	1.9	1.5	1.7	2.5	3.1	2.8
USA (45.90%).	3.1	2.7	3.3	3.7	3.9	3.8
(2) Non-energy industrial goods excluding food.						
Euro-zone (32.07%).	0.9	0.7	0.7	1.1	1.8	1.8
USA (29.10%).	0.6	0.7	0.5	0.3	-0.6	0.2
INFLATION IN EXCLUDED COMPONENTS FROM CORE INFLATION						
(1) Food.						
Euro-zone (20.39%).	1.6	0.6	1.3	4.5	3.4	1.9
USA (14.9%).	2.2	2.1	2.3	3.1	2.4	2.6
(2) Energy.						
Euro-zone (8.64%).	-2.6	2.4	13.3	2.7	-0.2	-0.4
USA (9.90%).	-7.8	3.6	16.9	3.8	-5.9	3.4

Source: EUROSTAT & BLS & IFL
Date: May 20, 2002.



INFLATION FORECASTS IN THE MU AND SPAIN (1998-2003)						
	1998	1999	2000	2001	Forecasts	
					2002	2003
GLOBAL INFLATION						
Spain (100%).	1.8	2.3	3.4	3.6	3.5	3.6
Euro-zone (100%).	1.1	1.1	2.3	2.5	2.5	2.0
CORE INFLATION						
Services and Non-energy industrial goods.						
Spain (81.51%).	2.2	2.3	2.4	3.4	3.7	3.7
Euro-zone (83.25%).	1.5	1.1	1.2	2.0	2.6	2.3
DIFFERENT COMPONENTS OF CORE INFLATION						
(1) Services.						
Spain (34.10%).	3.6	3.4	3.8	4.2	4.8	5.2
Euro-zone (38.90%).	1.9	1.5	1.7	2.5	3.1	2.8
(2) Non-energy industrial goods.						
Spain (47.41%).	1.4	1.7	1.7	2.9	2.9	2.6
Euro-zone (44.35%).	1.1	0.7	0.8	1.6	2.2	1.9
INFLATION IN EXCLUDED COMPONENTS FROM CORE INFLATION						
1) Non-processed food.						
Spain (9.07%).	2.1	1.2	4.2	8.7	4.2	4.2
Euro-zone (8.11%).	2.0	0.0	1.7	7.0	3.9	1.7
(2) Energy.						
Spain (9.41%).	-3.8	3.2	13.3	-1.0	0.7	2.0
Euro-zone (8.64%).	-2.6	2.4	13.3	2.7	-0.2	-0.4

Source: EUROSTAT & INE & IFL. / Date: May 28, 2002.



II. ANALYSIS OF INFLATION, MONETARY POLICY AND INTERNATIONAL ANALYSIS

II.1 Monetary and European Unions

In April 2002, inflation in the Monetary Union registered a monthly rate of 0.5% with a year-on-year rate of 2.4%.

In April 2002, inflation in the Monetary Union registered a monthly rate of 0.5% with a year-on-year rate of 2.4%, respect the 2.5% observed in March.

Table 1 summarises the discrepancies between observed and forecasted values for the different basic aggregations in the Euro- Zone.

Consumer Price Index (HICP)	Current growth April 02	Forecast	Confidence intervals (*)
(1) Processed Food - AE (12.281%)	0.36	0.17	± 0.14
(2) Commodities - MAN (32.072%)	0.57	0.41	± 0.10
Non-Energy Manufactured Goods - BENE [1+2] (44.353%)	0.51	0.34	± 0.09
(3) Services - SERV (38.901%)	0.18	0.06	± 0.14
Core Inflation:			
Non-Energy Manufactured Goods and Services, (excluding fats, oils, tobacco and tourist packages) - IPSEBENE [1+2+3] (83.253%)	0.37	0.21	± 0.08
Non-Processed Food - ANE (8.109%)	0.34	0.60	± 0.46
(5) Energy Goods - ENE (8.638%)	2.04	2.08	± 0.60
Residual Inflation:			
Fats, Oils, Tobacco, Tourist Packages, Non-Processed Food and Energy - R [4+5] (16.747%)	1.19	1.37	± 0.39
General CPI - IPC [1+2+3+4+5] (100%)	0.54	0.41	± 0.09

(*) At 80% confidence level

Source: EUROSTAT & INSTITUTO FLORES DE LEMUS / Date: May 16, 2002.

As shown in table 1, the month on month rate registered in April was 0.54%, above our prediction, 0.41% as a consequence of the upward innovation registered in core inflation, derives from both, prices of goods and services.

It is important to note the existence of rounding errors in the aggregation of different sectors of HICP in the MU. Eurostat publishes data with one decimal point and apparently they use more decimals in obtaining the aggregate indexes. The question is that the aggregate values can not be exactly replicated by the users of Eurostat data. For this reason, in the forecast errors tables in the appendix (table A2) the errors in the aggregation are pointed out.

Core inflation registered an upward innovation.

The breakdown of the harmonised consumer price index into basic market groups shows that the prices of processed food (the AE index) increased more than was predicted (0.36% observed instead of 0.17% forecasted). The prices of the remaining processed goods excluding energy prices (the MAN index) also increased more than was forecasted (0.57% observed instead of 0.41% forecasted). With this, core inflation in goods calculated on the



basis of the aggregation of the previous indexes, (the BENE index) registered a monthly rate of 0.51%, above that was foreseen, 0.34%. The services prices (the SERV index) also increased more than was forecasted (0.18% observed instead of 0.06% forecasted), so that finally core inflation registered an upward innovation.

Residual inflation a downward surprise

In Residual inflation (non-processed food and energy), the downward innovation came in prices of non-processed food, so energy prices registered a null surprise.

Table 2 shows annual observed HICP rates for energy and those corresponding to the remainder of goods and services – denominated HICP excluding energy.

	HICP excluding Energy					HICP energy				
	Observed		Forecasts			Observed		Forecasts		
	Apr. 02	Average 2000	Average 2001	Average 2002	Average 2003	Apr. 02	Average 2000	Average 2001	Average 2002	Average 2003
Germany	1.8	0.7	1.9	1.8	1.3	0.4	14.4	6.4	0.8	0.4
Spain	4.0	2.6	4.0	3.3	3.7	-0.4	13.3	-1.0	0.7	2.0
France	2.3	0.8	2.1	2.2	1.3	-0.8	12.1	-1.5	-0.8	1.0
Italy	3.0	1.9	2.4	3.1	3.0	-3.4	11.6	1.6	-1.8	0.5
Monetary Union	2.7	1.3	2.4	2.8	2.3	-0.4	13.3	2.7	-0.2	-0.4

Source: EUROSTAT & INSTITUTO FLORES DE LEMUS / Date: May 31, 2002.

There is an important inflation differential excluding energy among countries. Italy and Spain show a similar behaviour and on the other hand France and Germany also present a similar evolution.

Annual energy rates are registering negative values in April 2002, excluding Germany, as shown in table 2. This contrasts with the different behaviour of the other non-energy prices (HICP excluding energy). For the mentioned non energy prices, Germany registered in April a year on year rate of 1.8%; forecasts for the annual average rates will be around this value, in 2002 and to decrease to 1.3% in 2003. France registered for the HICP excluding energy an annual rate of 2.3% in April and the forecasts for the annual average rate are 2.2% in 2002 and 1.3% in 2003 (analogous to Germany). On the other hand, observed values in Italy were 3.0% and forecasts are also 3.1% in 2002 and 3.0% in 2003. In the case of Spain, the annual rate was 4.0% in April and a mean annual rate of 3.3% is expected in 2002, and 3.7% in 2003. Therefore, in the HICP excluding energy, Germany and France show a similar evolution, with annual average rates around 2% in one side, and on the other hand, Italy and Spain also present a similar behaviour with annual mean rates overcoming 3%.

	Fuels					Electricity and gas				
	Observed		Forecasts			Observed		Forecasts		
	Apr. 02	Average 2000	Average 2001	Average 2002	Average 2003	Apr. 02	Average 2000	Average 2001	Average 2002	Average 2003
Germany	0.7	24.4	-0.4	1.5	1.2	0.2	5.8	13.2	0.2	-0.2
Spain	1.1	18.1	-2.1	2.0	2.5	-2.7	0.2	2.4	-1.1	1.3
France	-3.6	20.8	-5.7	-2.5	1.6	2.9	1.1	4.7	1.3	0.1
Monetary Union	-1.0	20.9	-2.5	0.4	1.7	0.2	5.3	8.9	-0.8	-2.7

Source: EUROSTAT & INSTITUTO FLORES DE LEMUS / Date: May 31, 2002.



As shown in table 3, the differential in gas and electricity prices is greater than in fuel prices as a consequence of the strong dependency of gas and electricity prices on domestic regulations prices.

The forecast for annual inflation in May 2002 is 2.1%

The inflation forecast for May 2002 in the Monetary Union is 0.2 %. Therefore, the year-on-year rate will decrease to 2.1%, respect to the 2.4% registered in April. The expectations for the average annual rate are 2.5% for 2002, and 2.0% for 2003.

By countries, the expectation for monthly inflation for next May is a positive rate of 0.2% for Germany and France, 0.4% in Italy and a null value in Spain.

Table 4 summarises the forecasts for the different components in the Monetary Union. Monthly and annual rates may be found in tables A5A and A5B in the appendix.

Table 4. AVERAGE ANNUAL RATE OF GROWTH IN MONETARY UNION						
	Observed				Forecasts	
	1998	1999	2000	2001	2002	2003
16.803%						
Residual Inflation	-0.4	1.2	7.6	4.7	1.7	0.6
8.100%						
Non-Processed Food	2.0	0.0	1.7	7.0	3.9	1.7
8.703%						
Energy	-2.6	2.2	13.3	2.7	-0.2	-0.4
83.197%						
Core Inflation	1.4	1.1	1.3	2.0	2.6	2.3
12.269%						
Processed Food	1.4	0.9	1.1	2.8	3.0	2.1
32.024%						
Non-Energy Commodities	0.9	0.6	0.7	1.1	1.8	1.8
38.904%						
Non-Energy Services	2.0	1.6	1.7	2.5	3.1	2.8
100%						
HICP Inflation	1.1	1.1	2.3	2.5	2.5	2.0

Source: EUROSTAT & INSTITUTO FLORES DE LEMUS / Date: May 20, 2002.

The year-on-year rate for next May, 2.1%, will be composed of a rate of 2.7% in core inflation and of -0.2% in residual inflation. The expectations of the average annual rate in 2002, 2.5%, will be achieved through increments in core inflation in 2002 to 2.6% and, decreases in residual inflation, due to the decrease in prices of non-processed food and energy, compared with the values registered in 2001.

It seems difficult that in the short-term the EMU inflation rate could be systematically below 2%. But the probability of being within a range between 1 and 3% is reasonable high. With a redefinition of the inflation target adopting the mentioned range the ECB will not tend to move the interest rates for the time being. But keeping the target as it is, the ECB will tend to increase interest rates before too long.

Eurostat has again reviewed the weights and the figures for the aggregates indexes that make up the global HICP in the MU, due to the revisions registered in the Spain HICP.

Table 5 summarises average annual growth rates for the main countries. Monthly and annual forecasts for all the countries can be found in tables A4A, A4B, A4C and A4D in the appendix

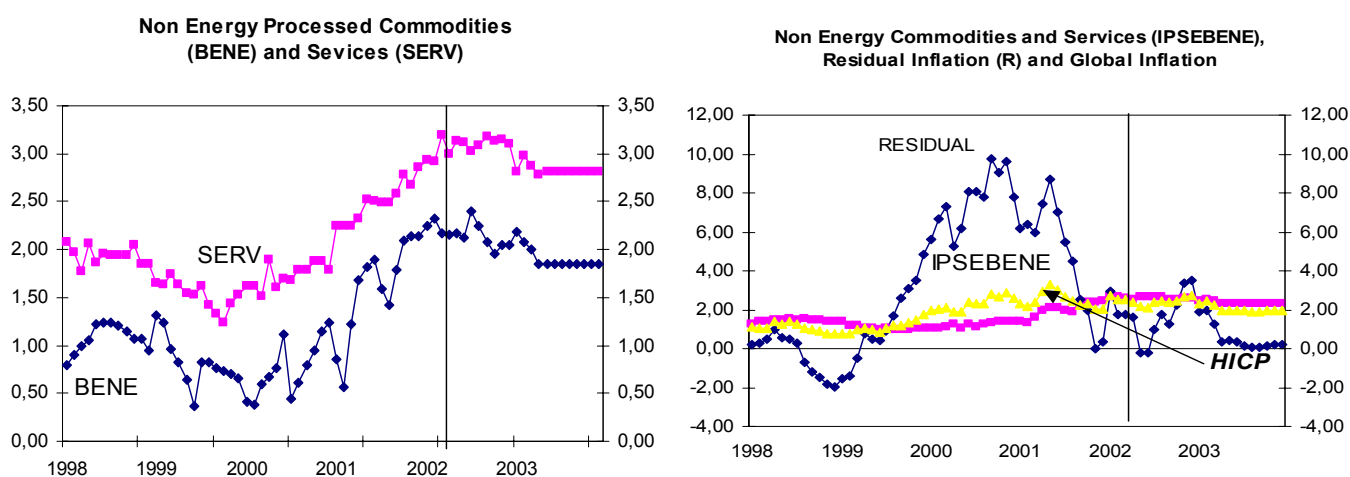


Table 5					
ANNUAL AVERAGE RATES OF GROWTH					
	Observed			Forecasts	
	1999	2000	2001	2002	2003
Spain HICP – 10.34%	2.2	3.5	2.8	3.5	3.7
Germany HICP – 30.56%	0.6	2.1	2.4	1.7	1.2
France HICP – 20.41%	0.6	1.8	1.8	2.0	1.3
Italy HICP – 19.34%	1.6	2.6	2.3	2.7	2.9
MU HICP – 100%	1.1	2.3	2.5	2.5	2.0

Source: Eurostat & I. Flores de Lemus / Date: May 31, 2002.

Graph 1

HICP ANNUAL GROWTH RATES IN MU



Source: EUROSTAT & I. FLORES DE LEMUS / May 20, 2002.

The macroeconomic forecast published in the last few months will not be modified due to the fact that the latest available information on the evolution of economic indicators in the Euro-zone does not warrant a revision. **The most recent economic data exhibit some contradictions and show that the economic activity in the zone is still showing some signs of weakness.** This does not allow for any firm declarations that a recovery is underway, although it is true that by synthesizing the data, one can speak of more favourable, or less negative, results than in previous months. The indices for business prospects in the Euro-zone for the last few months have been showing some improvement but they are not yet reflected clearly in the effective production indicators.

Industrial production improvement in march

In March, **industrial production showed an inter-month advance of 0.5%** reflecting increases in the production of intermediate goods and energy and declines in capital and consumer goods, as seen in the chart 6.



Table 6						
INDUSTRIAL PRODUCTION. MONTHLY VARIATION						
	Oct-01	Nov-01	Dec-01	Jan-02	Feb-02	Mar-02
Total industry	-1.5%	-0.6%	0.3%	0.3%	0.15%	0.5%
Intermediate goods	-1.1%	-1.5%	-1.3%	1.8%	1.6%	0.2%
Energy	-1.3%	1.7%	2.7%	-2.1%	-0.3%	0.9%
Capital goods	-1.1%	-1.0%	-0.6%	-0.3%	-0.6%	-0.5%
Durable consumer goods	-2.4%	-0.3%	1.8%	-1.2%	-0.8%	-1.7%
Non-durable consumer goods	-1.3%	-0.3%	-0.1%	-0.8%	1.3%	-0.1%

Source: EUROSTAT

Nevertheless, the annual advance rate of this indicator still shows a significant slide of 2.9%. This weakness can be explained mainly by the evolution of domestic demand, still the principal factor slowing the industrial activity recovery in Europe. In Germany, industrial production in March dropped 0.8%, and 0.7% in Italy. France, however, showed an increase of 0.5% which adds up to increases over three consecutive months. At the same time, the inter-annual industrial growth rates in these countries is still showing a strong decline of 3.8% in Germany, 4.1% in Italy and 0.9% in France.

From the demand side of the economy, retail sales in February rose by 1,3% owing to a 1,3% increase the sales of "food, drinks and tobacco" and a 0,2% in the non food sectors.

Germany, the principal economy in the Euro-zone, showed a fall of 4.3 points in its industrial climate indicator in May which means two consecutive drops. These can be attributed to recent uncertainty concerning the sustainability of the recovery in the second quarter of this fiscal year. At the same time, private spending in Germany as well as in other Euro-zone countries is still weak, as reflected in retail sales which dropped in the first quarter of this year by 2.5%.

Positive GDP growth in Germany in the first quarter

The preliminary estimates on Germany's economic performance in the first quarter 2002, show a 0,2% GDP growth in the first quarter 2002 as compared to the fourth quarter 2001. On a year on year basis, GDP has declined by 1,2% reflecting a reduction in gross value added in the production industries.

The quarter improvement mainly reflected a positive contribution from net exports which added 1.6 percentage points to GDP partly offset by inventories subtracting 1.2 percentual points.

Table 7					
GERMANY CONTRIBUTION TO 1 ST QUARTER GDP GROWTH.					
	I - 01	II - 01	III - 01	IV - 01	I - 02
Final consumption expenditure of households.	0.6	0.4	- 0.1	- 0.3	- 0.1
Government final consumption expenditure	0.2	0.0	- 0.1	0.2	0.1
Gross fixed capital formation	- 0.5	- 0.3	- 0.3	- 0.2	- 0.2
Changes in inventories	- 1.8	0.2	- 0.4	0.4	- 1.2
Net exports	1.8	- 0.3	0.8	- 0.4	1.6

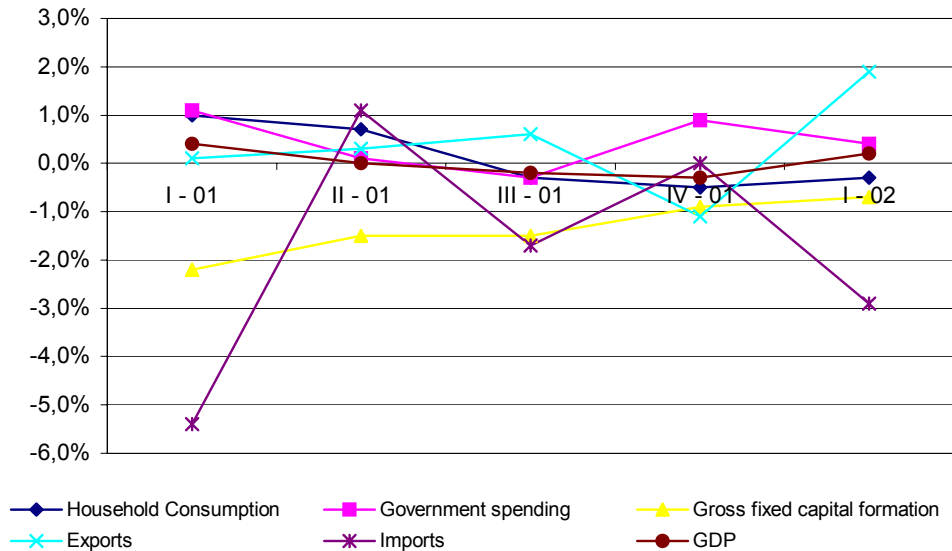
Source: Destatis



The performance of domestic demand was quite disappointing as both private consumption and business investment continued to decline.

Graph 2

**GERMANY.
GDP GROWTH AND COMPONENTS.
QUARTER ON QUARTER PERCENTAGE CHANGE.**



Source: Destatis.

The slowdown in economic activity in the Euro-zone is being reflected in the labour market. The unemployment rate stopped its descent of last year and, after a slight increase at the end of 2001, reaching 8.4% of the active population, remains at around this level until March. This stability is expected to continue through the end of the current year. Nevertheless, **it is worth noting that the labour markets in the Euro-zone are far from being homogeneous** given their disparate behaviour. On one side are the countries with high unemployment rates like Spain, Germany and France with rates of 11.5%, 9.5% and 9.1% respectively. On the other side are the countries with moderate unemployment rates like Austria and Ireland with 4.0% and 4.4% respectively.

In the current economic cycle, it can be seen that the unemployment rate is rising only slightly, and that employment is behaving relatively well in spite of the slowdown in the GDP. In the fourth quarter of 2001, employment marked an inter-quarterly growth rate of 0.3%, which was somewhat greater than in previous quarters, and the rate of inter-annual variation in the same period was 0.9%, 1.2 points lower than the year before. This behaviour highlights, as the European Forecasting Network (EFN) pointed out in its recent report, that the current cycle is seeing more positive behaviour from the labour market than in previous cycles, where loss of jobs was more intense. This is likely due to both a lesser cyclical intensity and to an increase in the degree of labour flexibility which was reached in the nineties.



II.2 United States

CPI datum in April has not been a surprise.

US monthly inflation rate in **April** registered an increase slightly over the expected: 0.56% as opposed to 0.48%, with the corresponding year-on-year rate rising from 1.48% up to 1.64%. This pick up is partly explained by non-food and non-energy goods and service prices, but mostly by energy prices, especially by motor-fuel prices, whose monthly rate increases 12.75% (as expected), augmenting its annual rate by 4.3 points. In relation to previsions, it is important to underline the positive innovation in non-durable goods as the consequence of the increase in tobacco taxes and a reduction in the discounting of selected major brands (see **Table 9**).

In **Table 8** we can see the breakdown scheme in our US CPI analysis.

USA CPI DESAGGREGATION			
CPI (1+2+3+4) (100%)	1) Energy CPI (E – 6,2%)	RESIDUAL INFLATION (1+2) (RI – 20,9 %)	CPI (1+2+3+4) (100%)
	2) Food CPI (F – 14.7%)		
	3) Non-energy Services CPI (S – 55,2%)	CORE INFLATION (3+4) (CI – 79,1 %)	
	4) Commodities less food and energy (C – 23,9%)		

Source: BLS & INSTITUTO FLORES DE LEMUS

Table 9

CONSUMER PRICES INDEX (CPI)	Annual Growth (T ⁻¹²) observed	Monthly Growth (T ⁻¹)			Confidence Intervals at 80% level (+ -)
		observed (a)	forecasts (b)	(a)-(b)	
Food	2.5	0.06	0.16	-0.11	0.38
Energy	-8.2	5.71	5.58	0.13	1.28
- Fuel Oil	-14.4	2.04	3.38	-1.34	
- Gas & Electricity	-7.8	-0.08	-0.21	0.13	
- Motor fuel	-9.1	12.75	12.62	0.13	
Residual Inflation	-1.2	1.74	1.77	-0.03	0.56
Non-food and non-energy goods	-1.0	0.35	0.19	0.15	0.21
-Durable Goods	-2.8	-0.16	-0.14	-0.02	
-Non-durable Goods	1.1	1.01	0.54	0.47	
Non-energy services	4.0	0.19	0.12	0.07	0.15
Core Inflation	2.5	0.25	0.14	0.11	0.12
All items	1.6	0.56	0.48	0.08	0.17

Source: BLS & INSTITUTO FLORES DE LEMUS
Data: May 15, 2002



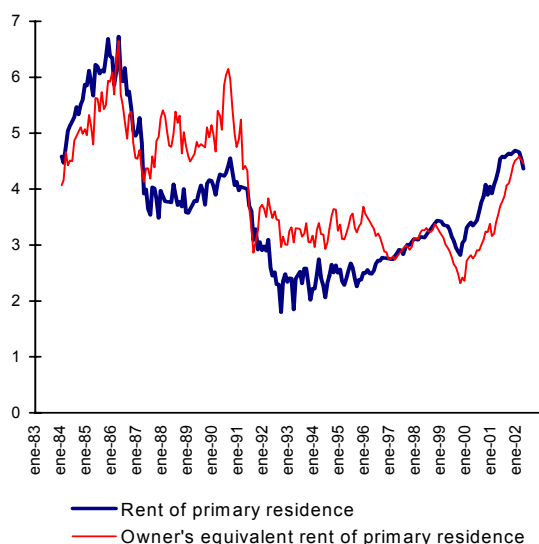
Core inflation increases almost one tenth up to 2.53% due to tobacco prices.

The rent of primary residence and the owners' equivalent rent of primary residence prices are pushing the service prices slightly upward.

Core inflation has registered an increase of 0.25% instead of the forecasted 0.14%, increasing the annual rate from 2.45% to 2.53%. Within core inflation, service prices rose 0.19%, over the expected (0.12%), a deviation that is explained mostly by lodging away from home and medical service prices, the year-on-year rate rises from 3.95% up to 3.99%.

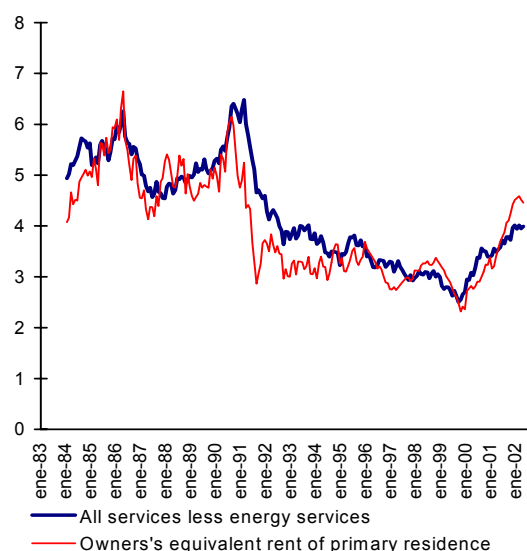
In this Bulletin the index of the owners' equivalent rent of primary residence should be highlighted again. Indeed, for the last two years this index has been showing two characteristics that had not taken place in the last twenty years: a strong acceleration progress, and the constant increase above the general service index (see **Graph 4**). As shown in **Graph 3**, this index price's behaviour is similar to the rent of primary residence, and both show an important acceleration in the last two years. This rare behaviour needs to be included when forecasting prices. As opposed to the idea of services registering a constant acceleration progress along the last two years, if owner's equivalent rent of primary residence is removed, we can see that this acceleration occurred in 2000, but during 2001 the annual rate of the rest of the services, as a whole, have remained stable (see **Graph 5**). It also shows how the owners' equivalent rent of primary residence prices in April have registered a slight deceleration for the second consecutive month.

Graph 3



Source: BLS & IFL / Date: May 15, 2002.

Graph 4



Source: BLS & IFL / Date: May 15, 2002.

On the other hand, commodities less food and energy prices rose 0.35%, instead of the 0.19% forecasted. The annual rate takes a value of at -1.0% as opposed to the -1.1% of the previous month. Durable goods decrease 0.16%, similar to the forecasted -0.14%, and non-durable goods rise 1.01%, over the foreseen 0.54%, a deviation explained by the increase of tobacco taxes and the reduction in the discounting of selected major brands. Indeed, tobacco prices have risen 6.8% in April, 2.7 points of which are due to the tax increases. The tobacco year-on-year rate rises from 6.4% up to 9.0%.

The differential between service and commodities less food and energy prices has situated itself at 5.0 points in April, the same as the previous month, which is, as we can see in **Graph 6** at a historically high level.

Residual inflation registered an augment of 1.74%, as forecasted (1.77%). However, a slight downward deviation in food prices has taken place, due to fruit and fresh vegetables, which has been partly balanced by the very slight energy products' upward deviation. The important

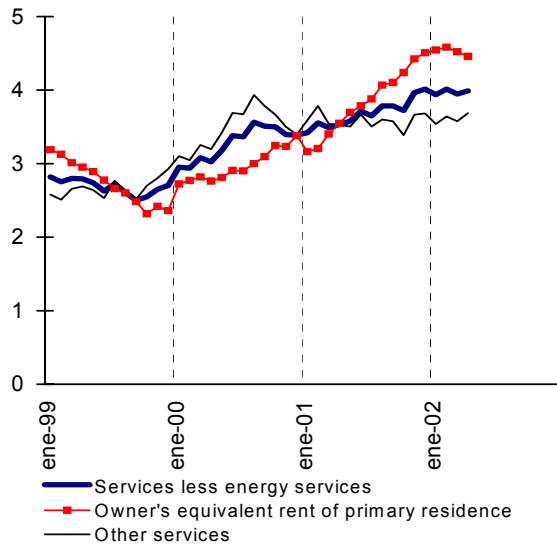


registered increase in motor-fuel prices has coincided with the forecasts, 12.75% as opposed to the expected 12.62%, thus, motor-fuel prices annual rate increase from -13.22% up to -9.11%.

US monthly inflation rate forecasted for May is 0.11%, cutting its annual rate three tenths down to 1.3%. This is due to the increase of motor fuel prices during May last year.

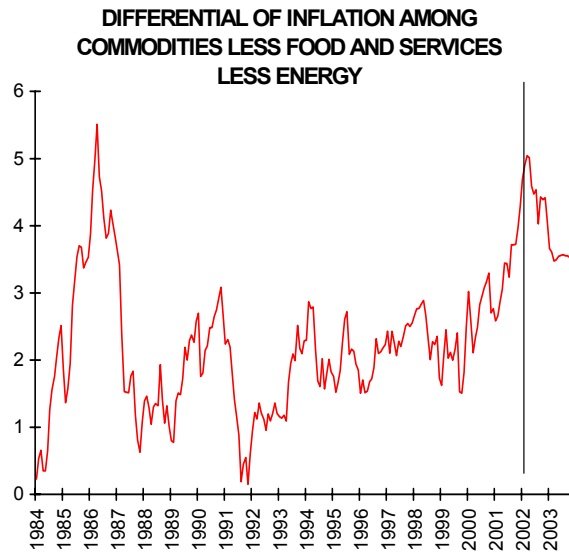
In **May**, the overall CPI is forecasted to increase 0.11% leaving the year-on-year rate at 1.30%, a little over three tenths less than in April. A slight pick-up in core inflation annual rate is forecasted, due to commodities less food and energy. However, motor-fuel prices will again be the ones which determine or explain the decrease in the CPI general rate, since the expected motor-fuel prices increase is -0.18%, as opposed to last year's 9.88% in May.

Graph 5



Source: BLS & IFL / Date: May 15, 2002.

Graph 6



Source: BLS & IFL / Date: May 15, 2002.

Core inflation is expected to rise 0.11%, raising the annual rate one tenth. Service prices are expected to increase 0.18% as they did last year. Commodities less food and energy are forecasted to drop 0.20%, which would make the annual rate rise four tenths up to -0.6%. Within commodities less food and energy, slight increases are expected in both durable and non-durable goods annual rates. Thus, non-durable goods decrease 0.17%, raising the year-on-year rate five tenths, and durable goods are expected to decrease 0.23%, which would cause its annual rate to rise from -2.8% up to -2.6%.

Residual inflation is expected to increase 0.27%, which would cut the year-on-year rate 1.8 points, down to -2.98%. This deceleration is explained by the strong increase registered by motor-fuel prices last year. The gas and electricity index is forecasted to rise 1.0%. Food prices are predicted to increase 0.16%, cutting their annual rate two tenths, down to 2.3%.

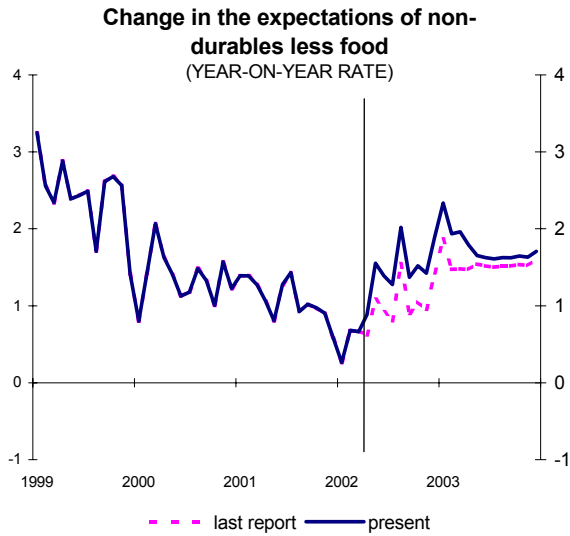
Forecasts for **2002 and 2003** only register a slight worsening due to tobacco prices. Indeed, the increase in tobacco taxes has had a permanent effect, thus, it will influence the next eleven months' annual rates. This slightly changes the non-durable goods forecasts (see **Graph 7**). Crude-oil behaviour is expected to be the same as the last report's. Middle term forecasts are of 28\$ per barrel in the middle of 2003, to stabilize later.

With this hypothesis, mean CPI annual rates forecasted for 2002 and 2003 are 1.9% and 2.8% respectively, which means an increase of one tenth with regard to last month's previsions. This means a forecasting of a core inflation mean annual rate of 2.6% and 2.7% for 2002 and 2003 respectively. Services will reach 3.9% and 3.8%, whereas commodities less food and energy are expected to be at -0.6% and 0.2% respectively (see **Graph 8**).

Forecasts for 2002 and 2003 are modified slightly upward due to the increase in tobacco taxes.

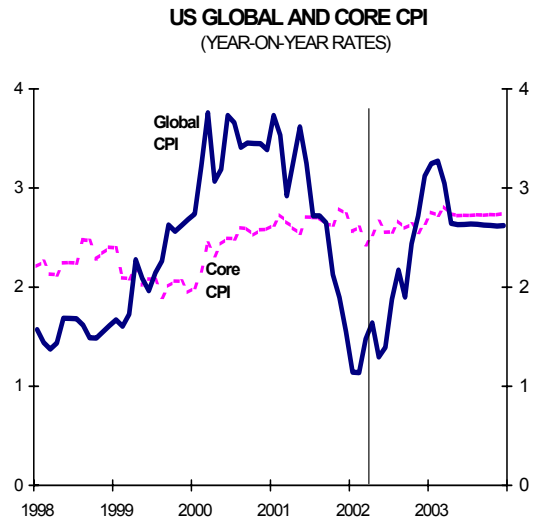


Graph 7



Source: BLS & IFL / Date: May 15, 2002.

Graph 8



Source: BLS & IFL / Date: May 15, 2002.

In conclusion, April US CPI datum has behaved as expected, and has not changed the forecasts, except from the effects caused by the increase of tobacco taxes.

Table 10 shows the average annual growth rates forecasts for 2002 and 2003 for the different components of the US Consumer Price Index (monthly and annual rates can be found in Tables A6A and A6B in the Appendix)

Table 10

AVERAGE ANNUAL RATE OF GROWTH IN US (*)

CONSUMER PRICES INDEX (CPI)	1998	1999	2000	2001	2002 (forecasts)	2003 (forecasts)
Food	2.2	2.1	2.3	3.1	2.4	2.6
Energy	-7.7	3.6	16.9	3.8	-5.9	3.4
- Fuel Oil	-9.9	1.6	41.9	-0.3	-10.1	2.8
- Gas & Electricity	-3.1	-0.3	5.9	11.2	-5.8	0.9
- Motor fuel	-13.2	9.3	28.4	-3.6	-6.4	6.2
Residual Inflation	-1.6	2.5	6.8	3.3	-0.5	2.9
Non-food and non-energy goods	0.6	0.7	0.5	0.3	-0.6	0.2
-Durable Goods	-0.9	-1.2	-0.5	-0.6	-2.4	-1.3
-Non-durable Goods	2.3	2.4	1.4	1.1	1.2	1.8
Non-energy services	3.1	2.7	3.3	3.7	3.9	3.8
Core Inflation	2.3	2.1	2.4	2.7	2.6	2.7
All items	1.6	2.2	3.4	2.8	1.9	2.8

(*) Monthly and annual growth rates can be found in tables A6A and A6B in Appendix

Source: BLS & INSTITUTO FLORES DE LEMUS
Data: May 15, 2002



US April economic data has shown ongoing improvements in both sales and output and persistent weakness in labor markets.

Both retail sales and industrial production were up in March.

Retail sales were up by 1.2% in April from the previous month. The gain was broadly based and reflected strong sales in motor vehicle and parts, building and gardening equipment, health and personal care and clothing. With respect to the industrial performance, output from US factories, mines and utilities rose for the fourth consecutive month by 0.4% in April, following a downwardly revised gain of 0.4% in March from a 0,7% initial estimate. As a result the capacity utilization rate rose to 75.5 from 75.3 in March. The April gain reflected sharp increases in output in the automotive and mining industries as well as in the high-tech productive sector.

Ongoing weakness in the labor market.

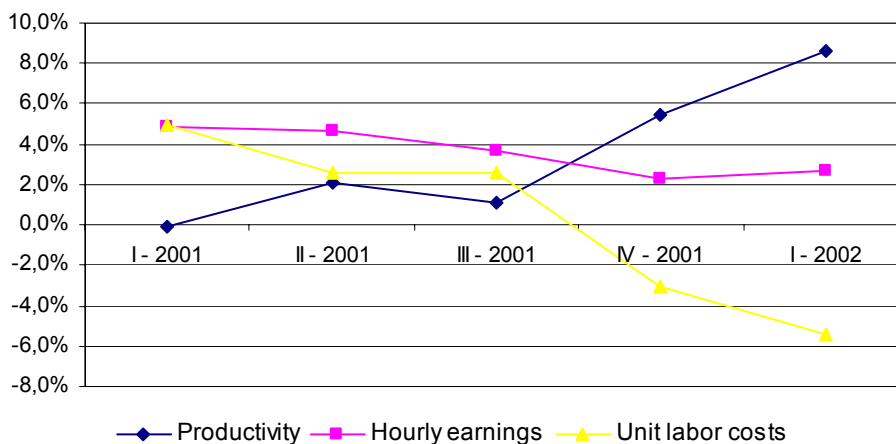
The strong numbers in terms of expenditure and production were in contrast to the disappointing performance of the labor markets. US April payroll employment showed a modest gain of 43,000 that was not enough to prevent the unemployment rate from growing to 6.0% from 5.7% in March.

The improvement in productivity and the decline in unit labor costs suggest little inflation pressure in the economy.

The combined effect of weak employment and strong production has led to an improvement in the first quarter productivity and unit labor cost numbers. According to the Bureau of Labor Statistics, productivity grew by 8.6% in the nonfarm business sector during the first quarter 2002 as compared to the previous one. This was the largest increase in nonfarm business sector output per hour since the second quarter of 1983, when it rose 9.9 percent. The increase resulted from output growth of 6.5 % in combination with a 1,9% decline in hours worked. The 9,7% productivity gain registered in manufacturing as a result of a 3,25 increase in output and a drop of 5.9% in hours worked, stands out among the different industrial sectors.

Graph 9

**PRODUCTIVITY, HOURLY EARNINGS AND UNIT LABOR COSTS
PERCENT CHANGE FROM PREVIOUS QUARTER AT ANNUAL RATE**



Source: BLS / Date: May 7, 2002

The increase in productivity in the first quarter more than offset the 2,7% increase in hourly compensation bringing unit labor costs down by 5,4% following a 3,1% decline in the fourth quarter of 2001. The first-quarter decrease was the largest since the second quarter of 1983, when unit labor costs fell 6.5 percent. Declining unit labor costs suggest little inflation pressure in the system. This implies little urgency for the Fed to raise interest rates.



II.3 Spain

The CPI for April 2002 showed a monthly rate of 1.4% with a year-on-year rate of 3.6%.

The CPI for April 2002 showed a positive monthly rate of 1.36%, above our prediction 1.23%, with a year-on-year rate of 3.6%, compared with the 3.1% observed in March and February.

Trend inflation, calculated on the basis of the IPSEBENE-XT index, registered a year-on-year rate of 3.6% in April, equal to that corresponding to global inflation. Since April 2001, residual inflation has also been 3.6%.

The upward innovation in core inflation arose from commodities prices and in residual inflation the downward surprise came in prices of tourist and tobacco.

The upward innovation in trend inflation came in prices of commodities. Regarding residual inflation, it registered a downward surprise, arising from prices of tourist packages and tobacco.

In order to analyse this in greater detail, it is necessary to refer to tables 11 and 12. Table 11 shows the breakdown used in this Bulletin to study inflation behaviour (there is a more detailed version in table A1 at the end of the document) and table 12 summarises prediction errors made for different components.

Table 11 SPANISH CPI DISAGGREGATION (*)			
1. Processed Foods CPI (excluding Fats and Tobacco)	AE-X (12.87%)	Trend Inflation (1+2+3) IPSEBENE-XT (77.23%)	CPI (100%)
2. Non Energy Commodities CPI	MAN (31.41%)		
3. Non Energy Services CPI (excluding Tourism)	SERV-T (32.95%)		
4. Fats, Tobacco and Tourism	XT (4.28%)	Residual Inflation (4+5+6) R (22.77%)	
5. Non Processed Foods CPI	ANE (9.07%)		
6. Energy CPI	ENE (9.41%)		

(*) More detailed information can be found in table A1 in Appendix.

Table 12 OBSERVED VALUES AND FORECASTS ON CONSUMER PRICE FIGURES IN SPAIN			
Consumer Price Index (CPI)	Current growth April 02	Forecast	Confidence Intervals (*)
(1) AE-X (12.87%)	0.24	0.23	± 0.18%
(2) MAN (31.41%)	2.42	1.88	± 0.16%
BENE-X [1+2] (44.28%)	1.78	1.40	± 0.14%
(3) SERV-T (32.95%)	0.45	0.45	± 0.17%
IPSEBENE-X-T [1+2+3] (77.23%)	1.21	0.99	± 0.13%
(4) X+T (4.28%)	2.47	4.72	
(5) ANE (9.07%)	0.99	0.25	± 1.09%
(6) ENE (9.41%)	2.49	2.52	
R [4+5+6] (22.77%)	1.89	2.05	± 0.22%
IPC [1+2+3+4+5+6] (100%)	1.36	1.23	± 0.15%

(*) At 80% confidence level.

Source: INE & INSTITUTO FLORES DE LEMUS Date: May 14, 2002.



Trend inflation in goods (measured by the BENE-X index) was 1.78%, below our prediction, 1.40%, as a consequence of the upward innovation in prices of non-energy commodities. Prices of **non-energy commodities** registered growth of 2.42% in April, instead of the 1.88% forecasted. The monthly inflation rates in April corresponding to prices of apparel and footwear show a longer duration of winter sales in 2002 than in 2001, so the period of prices recuperation in these sectors has been different to the corresponding of the previous year. This fact was foreseen with March data, when prices of apparel and footwear registered downward innovations, so the effect of ending winter sales was postponed to forecasts for April. As a consequence, it was obtained a good forecast of monthly inflation in April.

The annual inflation differential in commodities market with the MU has increased in April 2002 to 1.1% respect the 0.2% observed in March 2002.

The year-on-year rate registered in April was 2.8%, respect the 1.9% observed in March. This contrasts with these prices in the Euro-zone, with a year-on-year rate of growth of 1.7% in April. Therefore, in April 2002 the inflation differential in this market with the MU has increased to 1.1%, compared with the 0.2% observed in March 2002. The year-on-year rates of growth in apparel and footwear are 5.9% and 5.6%, respectively. If these increases in prices are not reflected in improved quality of corresponding goods, the Spanish economy will suffer a loss of competitiveness in relation to Europe, which will translate to lower economic growth. The predictions for mean rates in commodity prices are 2.3% for 2002 and 2.6% in 2003, with respect to the 2.6% registered in 2001.

The offers picked up by the INE derive in a more erratic evolution of trend inflation in food.

The monthly rate of **trend inflation in food** in April stayed at 0.24%, coinciding with our prediction. Prices of processed food are now affected by offers that the National Statistics Institute (INE) picks up; this fact derives in a more erratic evolution of this kind of prices. The year-on-year rate stayed in April at 3.1%, respect to the 3.3% registered in March and the 5.1% observed in the last quarter of 2001. The mean growth expectations of trend inflation in food for 2002 and 2003 are 2.9% and 2.6%, respectively, with respect to the 4.1% observed in 2001.

The mean growth expectations for trend inflation in goods for 2002 and 2003 will stay at 2.4% and 2.6%, respectively.

The upward innovations in prices of non-energy commodities increase **trend inflation expectations for goods** (measured by the BENE-X index) in 2002 and 2003 to 2.4 and 2.6%, respectively.

Table 13 shows a summary of average annual predictions for the different components that make up core and residual inflation (more detailed information may be found in tables A7A and A7B at the end of the document.)

SPANISH AVERAGE RATES OF GROWTH						
	1998	1999	2000	2001	Forecasts	
					2002	2003
Residual Inflation	0.6	3.0	6.5	3.7	3.4	3.5
Fats	-11.1	14.9	-7.6	-7.3	15.89	5.38
Tobacco	7.9	4.3	2.5	4.9	7.21	2.22
Tourism	15.4	7.2	12.3	7.1	11.52	8.32
Non Processed Foods	2.1	1.2	4.2	8.7	4.15	4.17
Energy	-3.8	3.2	13.3	-1.0	0.7	2.0
Trend Inflation	2.2	2.1	2.5	3.5	3.4	3.6
BENE-X	1.4	1.3	1.9	3.1	2.4	2.6
SERV-T	3.3	3.3	3.5	4.1	4.6	5.1
CPI Inflation	1.8	2.3	3.4	3.6	3.5	3.6

(^c) More detailed information can be found in tables A6A and A6B in Appendix.

Source: INE & Institute Flores of Lemus / Date: May 28, 2002.



The worrisome evolution of prices of services derives an inflation differential between trend inflation in services and trend inflation in goods of 1.7%, double that of the MU, 0.8%.

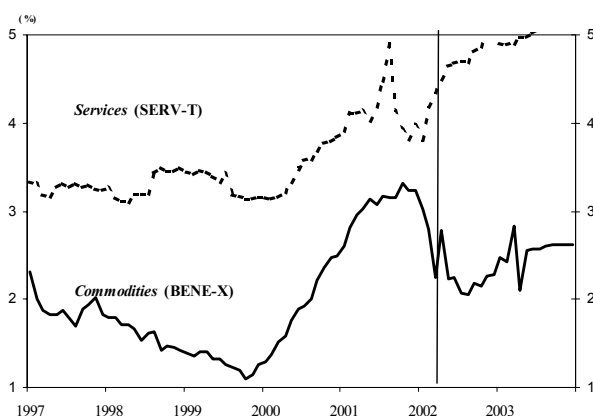
With regards to the **services sector, excluding those components known as tourist packages** (the SERV-T index), monthly inflation, 0.45%, behaved as was foreseen. The evolution of prices of services is especially worrisome in transport, postal services, restaurants, hotels, housing, medicine and culture which show monthly rates of growth near or greater than 5%. So, the inflation differential between the market of non-energy processed goods, excluding fats and tobacco, and the services market, excluding tourism, decreased in April to 1.7 percentage points. This differential is double that of the MU (0.8%); the year-on-year rate of growth in April of services was of 4.4%, while that corresponding to the Euro-zone was 3.0%. The year-on-year trend inflation in services (SERV-T) increased by 4.5% in April, with respect to the 4.3% of last March. Mean growth expectations stayed at 4.6% for 2002 and 5.1% for 2003, with respect to the 4.1% registered in 2001.

The mean annual rate of trend inflation will stay at 3.4% in 2002 and at 3.6% in 2003.

With the aforementioned innovations in the goods and the services market, trend inflation, calculated on the IPSEBENE-XT index, registered an annual rate of 3.6%, higher than registered last March, 3.2%. It is predicted that **trend inflation** will stay at 3.4% in 2002 and to increase to 3.6% in 2003, compared to 3.5% observed in 2001.

Graph 10

AVERAGE RATES OF GROWTH OF CPI INFLATION IN GOODS AND IN SERVICES



Source : INE & INSTITUTO FLORES DE LEMUS / Date: May 28, 2002.

Residual inflation registered a downward innovation in prices of tourist packages and tobacco.

Those prices which serve as a basis for calculating residual inflation have registered a null innovation in prices of energy; an upward innovation in prices of fats and oils and prices of non-processed food; and finally a downward surprise in prices of tourist packages and tobacco. In the non-processed food groups (the ANE index) there were upward innovations in prices of all components, excluding eggs and potatoes. Prices of tourist packages decreased by -3.5% in April with respect to March 2002. Finally, energy prices increased by 2.5% with respect to March 2002.

With all of this, residual inflation registered a year-on-year growth rate of 3.6% in April. It is forecasted an oscillating evolution for residual inflation, from 2.0% in June to 6.1% in December, due to the erratic behaviour of non-processed and energy prices, as with the rest of the MU.

As a consequence of the uncertainty in prices of crude, with an estimation of a mean price of brent around 26\$, the expectations of average growth in consumer energy prices are of 0.7% and 2.0% for 2002 and 2003, respectively, compared to the -1.0% observed in 2001. Average annual variation rates for oils and fats are expected to increase by 15.9% in 2002 and to reduce to 5.4% in 2003. As far as average growth of non-processed foods, expectations are 4.2% for 2002 and for 2003. Lastly, tourist package prices will reach average values of 11.5% in 2002 and 8.3% in 2003. Therefore, **the estimated average growth of residual inflation is 3.4% in 2002 and 3.5% in 2003.**



The monthly inflation prediction for May 2002 is null; the annual rate will decrease to 3.3%.

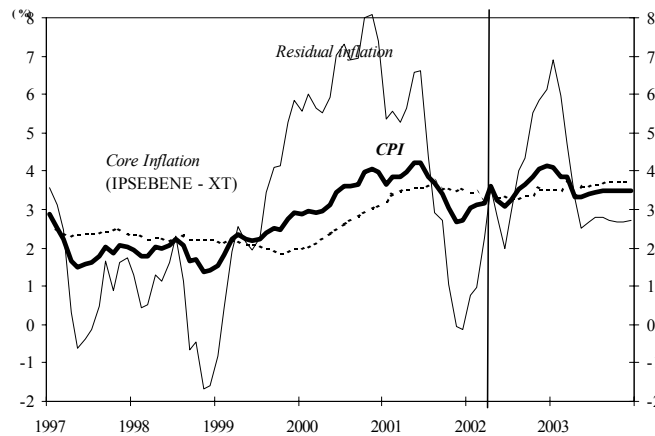
As a result, the monthly inflation prediction for May 2002 is for a null growth; which will decrease annual growth to 3.3% in May, respect to the 3.6% observed in April. Monthly trend inflation and residual inflation will also be null. The average inflation rate within the overall CPI is placed at 3.5% in 2002 and 3.6% in 2003. The average rate of trend inflation will be 3.4% in 2002 and 3.6% in 2003.

The expectations of global inflation at the end of 2002 stay around 4%, as a consequence of a high year-on-year rate of trend inflation that will reach a 3.5% in December 2002, and the worse behaviour of non-processed food and energy prices. The year-on-year rates of global inflation in November and December 2002 are used in order to review wages, contracts, These year-on-year rates show an extremely oscillate evolution, for example, in 2001 they moved from 2.7% in November and December to 4.2% in June, in contrast to the average annual rate of 3.6%. Nevertheless, forecasts in 2002 point out to a year-on-year rate in December of 4.1%, greater than the average annual rate of 3.5%

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Graph 11

AVERAGE RATES OF GROWTH OF TOTAL INFLATION, CORE AND RESIDUAL INFLATION



Source : INE & INSTITUTO FLORES DE LEMUS / Date: May 28, 2002.

Table 14 shows the average annual rates for 2000, 2001, 2002 and 2003 of the different sectors in the MU and Spain, where the relevant differential in non-energy industrial goods and services can be observed.



Table 14

**HARMONIZED ICP ANNUAL GROWTH BY SECTORS
IN THE MU AND SPAIN 2000-2001-2002-2003**

		Forecasts			
		2000	2001	2002	2003
AE	MU	1.1	2.8	3.0	2.1
AE-X	SPAIN	1.4	4.1	2.9	2.6
MAN	MU	0.7	1.1	1.8	1.8
	SPAIN	2.1	2.6	2.3	2.6
BENE	MU	0.8	1.6	2.2	1.9
BENE-X	SPAIN	1.9	3.1	2.4	2.6
SERV	MU	1.7	2.5	3.1	2.8
SERV-T	SPAIN	3.5	4.1	4.6	5.1
IPSEBENE	MU	1.3	2.0	2.6	2.3
IPSEBENE-XT	SPAIN	2.5	3.5	3.4	3.6
ANE	MU	1.7	7.0	3.9	1.7
	SPAIN	4.2	8.7	4.2	4.2
ENE	MU	13.3	2.7	-0.2	-0.4
	SPAIN	13.3	-1.0	0.7	2.0
RESIDUAL	MU	7.6	4.7	1.7	0.6
	SPAIN	6.5	3.7	3.4	3.5
HICP	MU	2.3	2.5	2.5	2.0
CPI	SPAIN	3.4	3.6	3.5	3.6

Source: INE, EUROSTAT & Institute Flores of Lemus / Date: May 28, 2002.

Recently the National Statistics Institute (INE) published the **results of the Labour Force Sample Survey (EPA) for the first quarter of the current accounting year which were obtained with new methodology**. The change was introduced to try and correct certain biases contained in the previous survey at the same time that a new definition for unemployment is adopted in an EU Regulation.

The change has three fundamental aspects. First, new projections of the population are used in the calculation of elevation factors in the Survey. These new projections take the immigrant population into account more realistically, while the previous ones deduced an infra-estimation of the growing importance of this population. Second, the elevation factors of the EPA are reconsidered in order to correct the lack of response produced in the previous Survey among the central age groups, 25 to 40 years of age, which translates to a sub-estimation of these age groups in different variables contemplated by the EPA.

The third aspect of this methodology to be pointed out is the use of a new definition of unemployed which is found in the Regulation (EC) Number 1987/2000. With the application of this Regulation, the criteria has become stricter for those workers seeking employment via public employment offices to be considered unemployed. The new definition of unemployed is the same as before; workers who have no employment and are actively seeking work and who are available to start in the next 15 days. Nevertheless, now those workers who use the Public Employment Offices, in order to be listed as unemployed, must have had some contact with the Office in the last four weeks to look for a position. Previously, the period for renewal of the offer could be as long as three months and included administrative type contacts.

The results of the EPA for the first quarter of 2002 obtained with this new methodology are a more accurate reflection of reality than previous ones since many of the biases which analysts have traditionally highlighted have been corrected, such as obsolescence of the population projections and the under-estimation of central age groups. **As a result of the application of the new methodology there has been an increase in levels of occupation and activity but a decrease in both the unemployment level and rate**. On the other hand, in contrast to earlier methodological changes in the EPA in which the INE did not provide homogenous series, in the latest change the INE has made an effort to homogenize the series for occupations back to 1976, and those of unemployment and activity back to the first quarter of



2001. In any event, the inter-quarterly and inter-annual comparisons of occupation, activity and unemployment for 2002 are homogeneous.

Table 15			
MAIN LABOUR SEGMENTS FOR THE FOURTH QUARTER OF 2001 ESTIMATED BY THE EPA			
(Thousand o %)			
	Old	New	Difference
Labour Force	17080	18013	933
□ year-on-year %	1,0	2,2	1,2 (p.p.)
Employment	14867	16121	1254
□ year-on-year %	1,8	3,1	1,3 (p.p.)
Unemployment	2213	1892	-321
Activity rate	51,8	53,3	1,5 (p.p.)
Unemployment rate	13,0	10,5	-2,5 (p.p.)

Source: INE(EPA)

The INE has evaluated the impact of the EPA's new methodology on the main labour segments measures for the fourth quarter of 2001. Table 15 shows the comparison of that quarter with results using the old and new methodology. From an observation of this, it can be deduced that the change has produced a noticeable increase in the level of employment, 1,254 thousand employed, of those active, 933,000 and of the rate of activity (1.5pp). At the same time, there is a reduction in the volume of unemployment; 322,000 and in the unemployment rate (2.5 pp).

The EPA data from the first quarter of this year highlight the fact that the economic slowdown continues to be reflected in the behaviour of the labour market, and because of that, the deceleration of occupation is intensifying. In that period, employment was growing at an inter-annual rate of 2.2%, almost one point below that of the previous quarter and 2.6 points less than the year before. In the first quarter the estimate is for 16,055.5 thousand employed, 80,000 fewer than the previous quarter. Nevertheless, if this inter-quarterly comparison is carried out with seasonality adjusted series employment has not dropped, but instead has increased slightly (5,000 people). All of the sectors point to the slowdown although construction and services continue to show dynamic activity by registering rates inter-annual variation rates of 6.7% and 3.6% respectively. Contrarily, industry and the primary sector show significant inter-annual drops of 2.5% and 4.5%, respectively.

The results of the employment demand estimate obtained with the new EPA seem to show a certain degree of coherence, but those of the active population and unemployment present noticeable contradictions. Indeed, the unemployment rate with the new methodology is around 11.5%, one point more than the previous quarter and the number of those unemployed increased in the same period by 189.3 thousand, ending up at 2,081.1 thousand unemployed. The INE explains that half of this increase in unemployment is due to the new methodology since by previously announcing that those unemployed who were signed up with the INEM employment offices could be excluded from unemployment benefits if they had not renewed their status in the last four weeks. This itself could have increased the propensity of the unemployed to renew their employment requests and thus, increase unemployment.

As a result of the new predictions, **the average annual growth of employment for 2002 is estimated to be 2.1%, 1.6 points below last year, and for 2003 2.6%**. These rates of growth mean an increase in employment of 335,000 workers in the current year and of 423,000 for next year. The unemployment rate is set at 11.2% of the active population in 2002, six tenths higher than last year, and at 10.8% in 2003.

