



OF E.U. AND US INFLATION AND MACROECONOMIC ANALYSIS

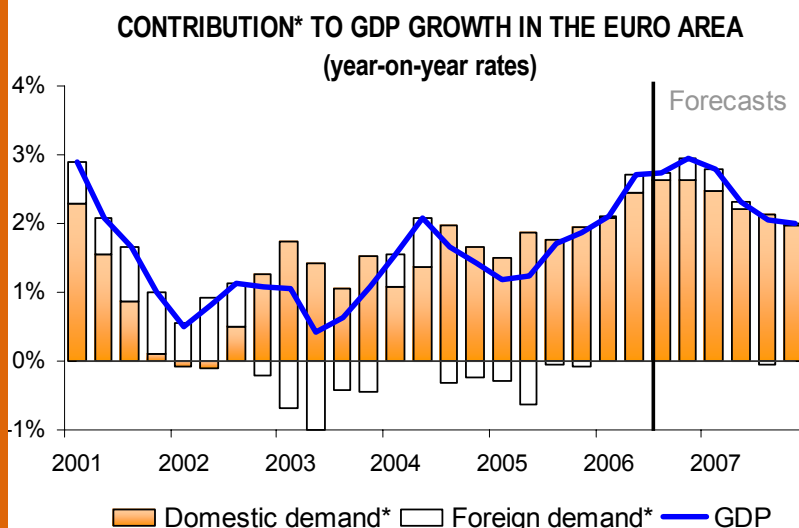


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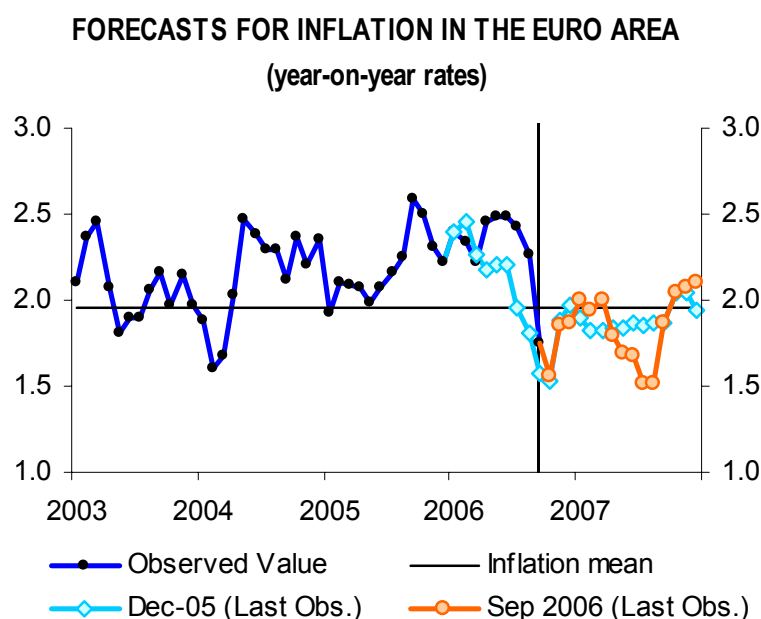
Second Phase

Growth expectations improve in the euro area, but deceleration continues to be forecast for 2007.



Source: EUROSTAT & IFL (UC3M)
Date: October 31, 2006

In 2006, headline inflation in the euro area has experienced the heavy deceleration forecast a year ago.



Source: EUROSTAT & IFL (UC3M)
Date: October 26, 2006

Nº 145, October 2006

ANALYSIS OF THE SPANISH ECONOMY: The performance of the Spanish productivity in the last few years **p.51**

The importance of the recovery of productivity in the Spanish economy is derived from the fact that productivity is a key variable in how an economy works, since real salary increases, payment for other productive factors, competitiveness, per capita income and future welfare all depend on its growth. On the other hand, growth of productivity is an important factor in macroeconomic stability, since it reduces inflationist pressure and stimulates the competitiveness of internal and external markets, leading to a better allocation of productive resources and a better balanced balance of trade.

MONTHLY DEBATE:
China: more than just a factory.
By Emilio Ontiveros **p.73**

"I have just returned from a professional trip to China. (...) What I am actually trying to present is not only some updated notes providing evidence of the most outstanding case of economic transformation in the last three decades, but also some information which could confirm or not some of the most widespread beliefs in this regards".

Nº145



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OF E.U. AND US INFLATION AND MACROECONOMIC ANALYSIS



DIRECTOR: Antoni Espasa.

COORDINATION: Agustín García

MACROECONOMIC ANALYST: Michele Boldrin

INFLATION ANALYSIS AND FORECASTS:

EUROPE AND SPAIN: Agustín García, and César Castro.

UNITED STATES: Ángel Sánchez

MACROECONOMIC ANALYSIS AND FORECASTS: Nicolás Carrasco, Coordination and Román Mínguez

INDUSTRIAL PRODUCTION ANALYSIS: Eva Senra (Universidad de Alcalá)

MADRID STOCK EXCHANGE MARKET: Pablo Gaya.

COLLABORATOR IN INFLATION FORECASTS: Federico Suárez.

COMPOSITION: Elena Arispe.

ADVISORY BOARD: Paulina Beato, Guillermo de la Dehesa, José Luís Feito, Alberto Lafuente, José Luís Larrea, José Luís Madariaga, Teodoro Millán, Emilio Ontiveros, Amadeo Petitbò, Narcís Serra, Tomás de la Cuadra-Salcedo and Juan Urrutia.

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Macroeconomic Forecast and Analysis Laboratory, Instituto Flores de Lemus

Universidad Carlos III de Madrid

C/ Madrid, 126 E-28903 Getafe (Madrid) Tel +34 91 624 98 89 Fax +34 91 624 93 05

www. uc3m.es/boletin E-mail: laborat@est-econ.uc3m.es

TERMINOLOGY USED:

In inflation analysis it is advisable to break down a consumer price index for a country or an economic area in price indexes corresponding to homogenous markets. An initial basic breakdown used in this publication is 1) Non-processed Food price index (ANE) 2) Energy price index (ENE), 3) Processed Food (AE), 4) Other commodities (MAN), 5) Other services (SERV). The first two are more volatile than the others, and in Espasa et al. (1987) a **core inflation** measure exclusively based on the latter ones was proposed; the Spanish Statistical Institute and Eurostat proceed in the same way. Later, in the BULLETIN EU & US INFLATION AND MACROECONOMIC ANALYSIS was proposed to eliminate from components of core inflation those indexes which are excessively volatile.

Thus, the previous basic breakdown has been amplified for Spain in the following manner: a) ANE, b) ENE, c) Tobacco, Oils and Fats, and Tourist Packages, d) Processed Foods excluding Tobacco, Oils and Fats, (AEX).ge) Other Goods (MAN), and f) Other services, excluding Tourist Packages (SERT). The measure of inflation obtained with the AEX, MAN, and SERV indexes we term **trend inflation**, as an alternative indicator similar to core inflation, but termed trend inflation to indicate a slightly different construction. The measure of inflation established with the price indexes excluded from the CPI to calculate trend inflation or core inflation, depending on the case, is termed **residual inflation**.

For the United States the breakdown by markets is principally based on four components: Food, Energy, Services, and Commodities. **Trend inflation** or **core inflation** is based in this case as the aggregation of services and non-energy commodities.

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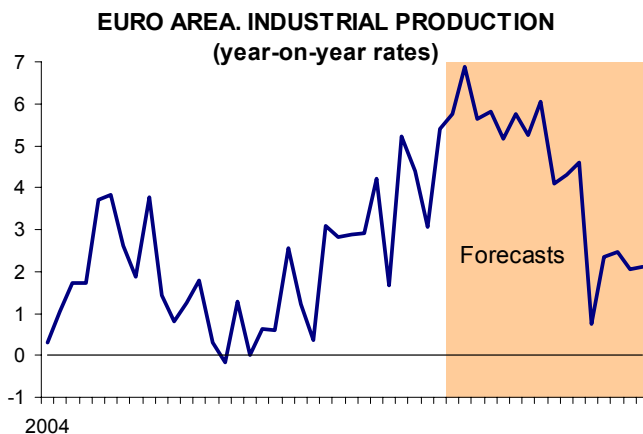
I. ECONOMIC OUTLOOK

EURO AREA

In the last estimation published by Eurostat, year-on-year **economic growth in the euro area** was revised upwards slightly in the second quarter of 2006, to 2.7%, six tenths higher than the previous quarter. The evolution of the GDP increased by two tenths from the previous quarter in terms of the quarter-on-quarter rate, to 0.9%.

According to the Industrial Production Index (IPI), forecast growth for the **industrial sector** is revised upwards for both 2006 and 2007. Expectations show greater growth in the third and fourth quarters of 2006, tending to decline gradually from the first quarter of 2007 to a year-on-year rate of growth of around 2.2% in the fourth quarter, similar to that registered in the last quarter of 2005. We therefore **expect average annual IPI growth of 4.5% and 3.8% for 2006 and 2007**, respectively (see graph I.1). This pattern of growth expected for the IPI in the euro area is consistent with the GVA forecast for the industrial sector, estimating an average annual growth rate of 4.3% in 2006 and 3.2% in 2007.

Graph I.1

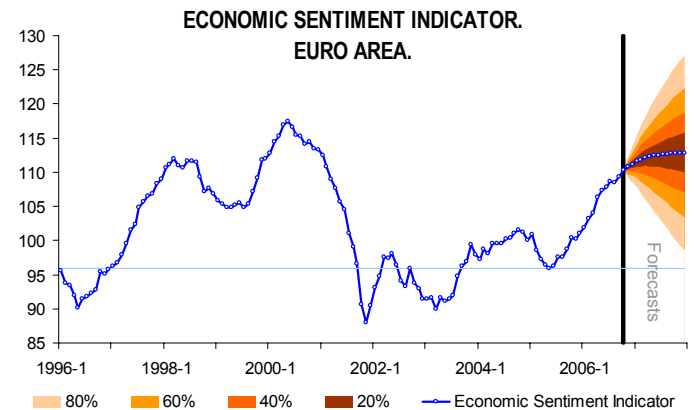


Source: EUROSTAT & IFL(UC3M)
Date: October 17, 2006

With regards to soft data, the fall registered in the **Economic Sentiment Indicator** in August practically disappears with the new country weightings used by Eurostat to obtain the aggregate indicator. In October, this indicator performed slightly better than expected, reaching 110.3 points, due to improved confidence of the industrial sector, services and the retail trade. As a result of this slight upwards innovation and the aforementioned methodological change, **the forecasts for this indicator are revised upwards, expecting a slight improvement in the next few**

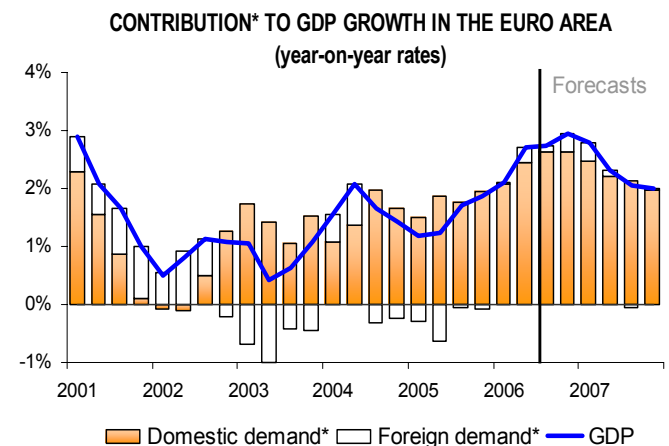
months and then tending to stabilise in the last quarter of 2007 at around 112.8 points (see graph I.2).

Graph I.2



Source: EUROPEAN COMMISSION & IFL(UC3M)
Date: October 31, 2006

Graph I.3



Source: EUROSTAT & IFL(UC3M)
Date: October 31, 2006

With all this new information, we have updated our forecast GDP growth in the euro area for 2006-2007, giving rise to an upwards revision due both to the upwards re-estimation of the growth figure in the second quarter of 2006 and to the improved expectations of more recent indicators. Indeed, **average annual GDP growth in real terms for 2006 is revised upwards slightly by 0.1 pp to 2.6%**, although we continue to expect a slight reduction in economic growth in the first quarter of 2007, which will become more pronounced during the year, so the economy of the euro area in 2007 is expected to grow by around 2.3%, 0.1 pp more than our previous forecast.



In terms of the quarter-on-quarter rate, however, GDP growth may have reached a local peak in the second quarter of 2006, with a rate of 0.9%. We are expecting a slight fall in the next two quarters, with rates of around 0.5% in 2007.

The dynamic euro area economy is consistent with the good evolution of both exports and investment. As a result of this pattern of growth, internal

demand will increase its contribution to economic growth in 2006 by 0.6 pp to 2.4 pp, whereas external demand will provide the remaining 0.2 pp, increasing its contribution by 0.5 pp compared with 2005. For 2007, however, due to the expected slow-down, the contribution of internal demand will fall to 2.2 pp and that of external demand to 0.1 pp (see graph I.3 and table I.1).

Table I.1

ANNUAL RATES OF GROWTH IN GDP AND COMPONENTS												
	Observed		Forecasts									
			Annual		Quarterly*							
	2004	2005	2006	2007	2006 QI	2006 QII	2006 QIII	2006 QIV	2007 QI	2007 QII	2007 QIII	2007 QIV
Private Final Consumption Expenditure	1.3	1.4	1.8	1.7	1.8	1.7	1.9	1.9	1.8	1.7	1.7	1.6
Public Final Consumption Expenditure	1.2	1.4	2.4	2.3	2.4	2.4	2.5	2.5	2.4	2.4	2.3	2.2
Gross Fixed Capital Formation	2.6	3.3	4.4	3.6	2.8	4.8	5.0	5.1	4.7	3.5	3.4	3.0
Exports of Goods and Services	6.3	4.5	8.1	5.6	9.3	8.6	6.9	7.7	5.8	5.7	5.6	5.2
Imports of Goods and Services	6.2	5.5	8.0	5.5	9.7	8.2	6.9	7.2	5.2	5.6	6.0	5.3
Contributions of Domestic Demand	1.5	1.8	2.4	2.2	2.1	2.4	2.6	2.6	2.5	2.2	2.1	2.0
Contributions of Foreign demand	0.2	-0.3	0.2	0.1	0.0	0.3	0.1	0.3	0.3	0.1	-0.1	0.0
Real GDP	1.7	1.5	2.6	2.3	2.1	2.7	2.7	2.9	2.8	2.3	2.0	2.0
Gross Value Added Total	1.8	1.5	2.7	2.3	2.1	2.7	2.9	3.1	2.7	2.3	2.1	2.1
GVA Agricultura	11.1	-5.4	0.0	1.0	-2.7	0.4	1.5	0.8	2.0	1.3	0.8	-0.1
GVA Industry	2.2	1.3	4.3	3.2	3.4	3.9	4.7	5.1	4.3	3.5	2.7	2.5
GVA Construction	1.1	1.0	2.2	0.8	2.0	3.0	2.4	1.5	1.4	0,5	0.7	0.7
GVA Market services	2.3	2.1	3.3	2.8	2.9	3.5	3.5	3.4	3.2	2.8	2.6	2.5
GVA Financial services	1.1	2.2	2.6	2.6	1.9	2.7	2.6	3.2	2.9	2.4	2.4	2.6
GVA Public services	1.0	1.3	1.2	1.2	0.9	1.1	1.2	1.4	1.1	1.3	1.3	1.2
	Levels at the end of the period											
Economic Sentiment Indicator	100.0	101.1	111.2	112.9	104.0	107.8	109.3	111.2	112.1	112.5	112.8	112.9

(*) Appreciation from same quarter one year earlier

Source: EUROSTAT & IFL (UC3M)

Date: October 31, 2006

According to the most recent data about **inflation in the euro area economy**, in September it performed as expected with a monthly rate of growth of zero, so the annual inflation rate has fallen by 0.6 pp from the August figure, to 1.7%.

As for the components of core inflation, an upwards innovation has been seen in non-energy industrial goods. **The forecast average annual core inflation rate for both 2006 and 2007 has been revised upwards by 0.1 pp to 1.5% (± 0.04)¹ and 1.8% (± 0.34), respectively.**

Outside core inflation, we have observed an upwards innovation in unprocessed food which has partly been compensated by the downwards innovation observed in energy products. **Our**

headline inflation forecast for the euro area in 2006 remains unaltered at 2.2% (± 0.04).

Table I.2

ANNUAL RATES OF GROWTH IN THE EURO AREA *						
INFLATION	Observed		Forecasts			
	Aver ⁽²⁾ 2005	2006 Sep ⁽¹⁾	2006 Oct ⁽¹⁾	Aver ⁽²⁾ 2006 ⁽²⁾	Aver ^{**} 2007 ⁽²⁾	Aver ^{***} 2007 ⁽²⁾
CORE (83.83%)	1.5	1.5	1.5 (± 0.14)	1.5 (± 0.04)	1.6 (± 0.34)	1.8 (± 0.34)
TOTAL (100%)	2.2	2.3	1.6 (± 0.12)	2.2 (± 0.04)	1.6 (± 0.39)	1.9 (± 0.39)

* Intervals at 80% of confidence calculated with historical errors.

** Without considering the effect of the change of the VAT on the inflation.

*** Considering the effect of the change of the VAT on the inflation.

Source: EUROSTAT & IFL(UC3M)

Date: October 26, 2006

⁽¹⁾ Year-on-year rate

⁽²⁾ Annual average rate

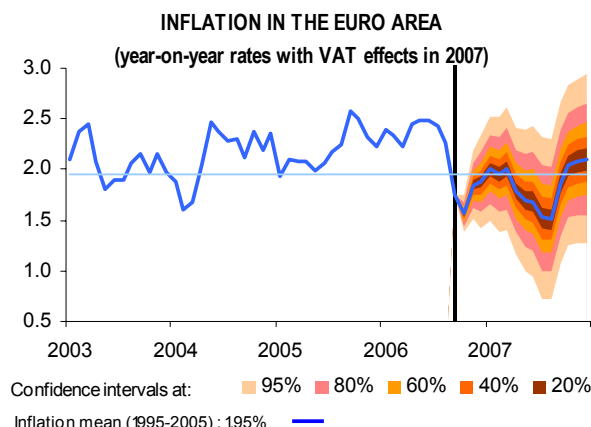
Considering the impact on euro area inflation of the three-point increase in the German VAT rate and assuming that 80-85% of this increase is



¹ The values in brackets correspond to 80% confidence intervals.

transferred to consumer prices, **our headline inflation forecast for 2007 in the euro area remains at around 1.9% (± 0.39)**. In other words, even using this measure of inflation, the likelihood of failing to meet the inflation target established by the ECB for 2007 is just over 50% (see graph I.4).

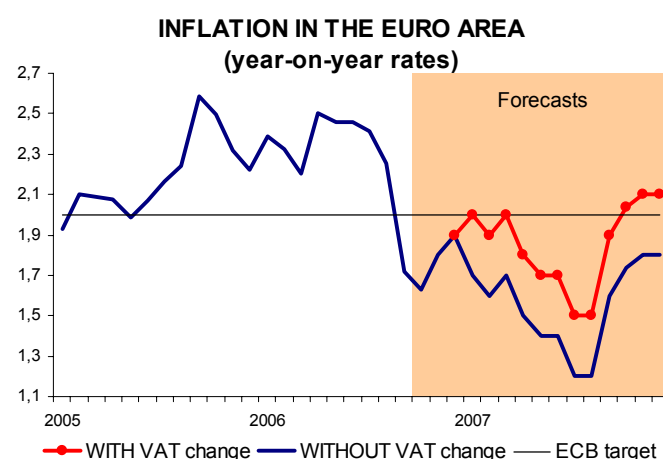
Graph I.4



Source: EUROSTAT & IFL (UC3M)
Date: October 26, 2006

In as much as the price increases due to the VAT increase in Germany in 2007 do not correspond to greater inflationist pressure on the markets, it should not be taken into account when designing monetary policy. Based on this, the forecast average annual core inflation rate is revised upwards by 0.1 pp to 1.6% (± 0.34) in 2007, whereas our headline inflation forecast for next year published last month remains at 1.6% (± 0.39) (see graph I.5).

Graph I.5

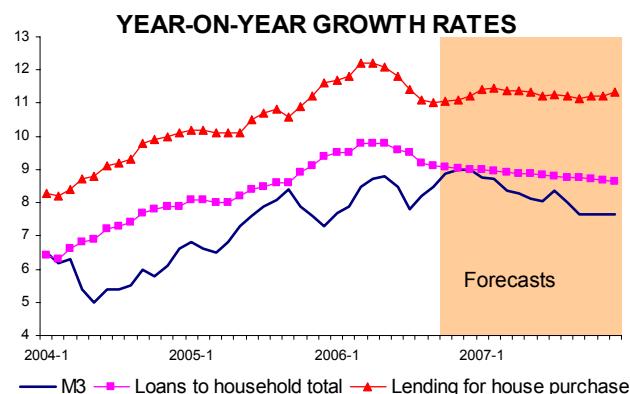


Source: EUROSTAT & IFL(UC3M)
Date: October 26, 2006

As for the evolution of inflation forecasts for 2006 (see graph I.4), we are expecting a slight fall in inflation in October, to 1.6% (± 0.12), largely due to the expected fall in energy prices, returning to the

central values in the 1.6% to 2.1% range in November and 1.6% to 2.2% in December (80% confidence interval).

Graph I.6



Source: ECB & IFL (UC3M)
Date: October 27, 2006

Ultimately, the current situation of the economy in the euro area is characterised by: (a) maintaining its expectations to meet the inflation target for the rest of 2006 and the average of 2007, (b) an evolution of monetary aggregated with high growth, but tending to stabilise in the last quarter of this year and decrease slightly during 2007 (see graph I.6), and (c) the consolidation of the European economy, although tending to stabilise at rates of around 2% in the last quarter of 2007. **In this context, the ECB might decide to increase the interest rate of reference by a quarter of a point in December in order to anchor the inflation expectations of economic agents. If our growth and price forecasts are confirmed in the next few months, these interest rate increases could stop at 3.5%.**

UNITED STATES

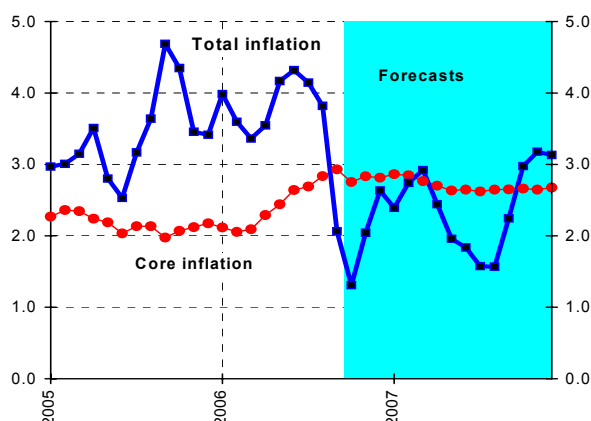
With regards to U.S. inflation, prices performed as expected, both in relation to general inflation and core inflation. Indeed, the monthly general CPI rate fell in September by 0.49%, with the annual rate falling drastically from 3.82% to 2.06%. This heavy fall in the annual rate is due to energy prices, the monthly rate of which fell by 7.27% compared to the 11.47% increase registered last year. All these movements are linked to the evolution of crude oil prices on the international markets.

On the other hand, in September the core index grew by 0.24% per month, and its annual rate rose from 2.84% to 2.93%.

The price per barrel of West Texas crude oil continued to fall in October to 60\$. For the next few months, we have considered the hypothesis of slight increases, in line with the futures markets.



Graph I.7

DIFFERENT ANNUAL INFLATION RATES IN THE US

Source: BLS & IFL (UC3M)
Date: October 18, 2006

For October, we are forecasting a fall in the annual headline inflation rate from today's 2.06% to 1.31% (± 0.13), explained by fuel prices, the monthly rate of which falls by 13%. Likewise, for core inflation we are forecasting a slight cut in its annual rate from 2.93% to 2.75% (± 0.14), tending to stabilise at 2.6% next year (see graph I.7).

On the other hand, in September the unemployment rate fell from 4.7% to 4.6% (seasonality adjusted) and the rate of use of productive capacity, although it fell slightly, remains at the highest levels since 1998. Both these indicators show the high point in the cycle of the North American economy, facilitating the possible transfer of crude oil price increases to consumer prices. No second round effects have been observed to date, however.

For 2006 and 2007, we are forecasting average annual headline inflation rates of 3.2% (± 0.07) and 2.4% (± 0.48), respectively, one tenth less than last month's report. On the other hand, the average annual core inflation rates forecast for these years are 2.5% (± 0.05) and 2.7% (± 0.36), respectively, the same as last month's forecast (see table I.3).

Table I.3

ANNUAL RATES OF GROWTH IN EE.UU*						
Inflation in the CPI	Observed			Forecasts		
	Ave ⁽²⁾ 2004	Ave ⁽²⁾ 2005	2006 Sep ⁽¹⁾	2006 Oct ⁽¹⁾	Ave ⁽²⁾ 2006	Ave ⁽²⁾ 2007
Core (77.4%)	1.8	2.2	2.9	2.8 (± 0.14)	2.5 (± 0.05)	2.7 (± 0.36)
Total (100%)	2.7	3.4	2.1	1.3 (± 0.13)	3.2 (± 0.07)	2.4 (± 0.48)

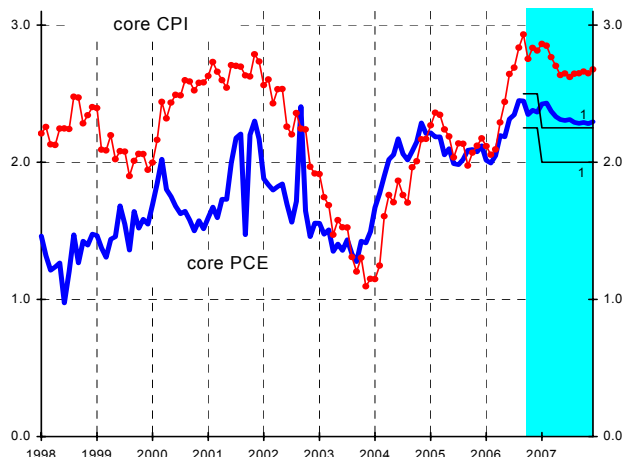
*Intervals at 80% of confidence calculated with historical errors.

Source: BLS & IFL (UC3M)
Date: October 18, 2006

(1) Year-on-year rate
(2) Annual average rate

For the most significant variable for the FED in relation to inflation, the core personal consumption expenditure index – core PCE – the forecast for 2007 places it on the upper limit of the target central trend (2%-2.25%) (see graph I.8).

Graph I.8

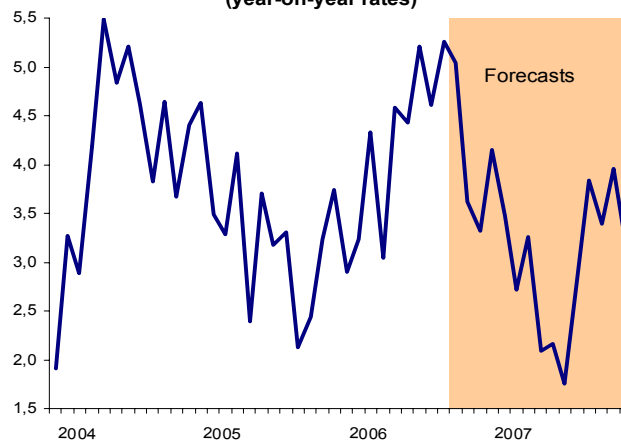
DIFFERENT ANNUAL CORE INFLATION RATES IN THE US

1/ FED forecasting range for core PCE.

Source: BLS & IFL (UC3M)
Date: October 18, 2006

As for **economic activity** in the US, the **Industrial Production Index shows a decline of the industrial sector next year**. Furthermore, for the second consecutive month, the Bulletin's forecast average annual growth rate for the industrial sector have been revised downwards for both 2006 and 2007, to 4.2% and 3.1%, respectively (see graph I.9).

Graph I.9

US. INDUSTRIAL PRODUCTION (year-on-year rates)

Source: FED & IFL (UC3M)
Date: October 19, 2006



SPAIN.

As for **inflation in Spain**, the Spanish CPI in September was slightly lower than expected, with a negative monthly growth rate of 0.2% and with the annual rate decreasing by 0.8 pp from the August figure, to 2.9%, largely due to the fall in energy prices.

For October, we are forecasting a monthly inflation rate of 0.5%, with the annual rate falling to 2.6% from the 2.9% observed in September (see table I.4).

Table I.4

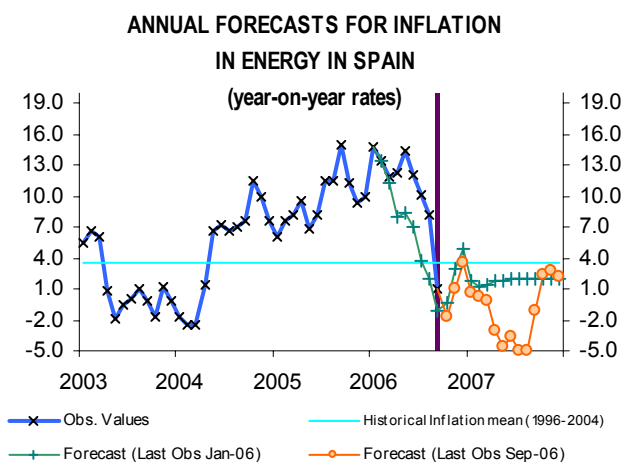
ANNUAL GROWTH RATES IN SPAIN*						
Inflation in the CPI	Observed			Forecasts		
	Ave ⁽²⁾ 2004	Ave ⁽²⁾ 2005	2006 Sep ⁽¹⁾	2006 Oct ⁽¹⁾	Ave ⁽²⁾ 2006	Ave ⁽²⁾ 2007
Core (82.31%)	2.7	2.7	2.9	2.9 (±0.17)	2.9 (±0.06)	2.6 (±0.38)
Total (100%)	3.0	3.4	2.9	2.6 (±0.18)	3.6 (±0.07)	2.4 (±0.62)

* In parenthesis confidence intervals calculated with historical errors.
Source : INE & IFL (UC3M)
Date: October 24, 2006

(1) Year-on-year rates
(2) Average rates of growth

For the second consecutive month, the main reason for reduced inflation lies in the growth of energy prices, which reduced their annual rate in September from the 8.2% observed in August to 0.9%. For October, we are expecting a negative rate of 1.3%. Such low annual energy inflation rates have not been seen since the first quarter of 2004 (see graph I.10).

Graph I.10

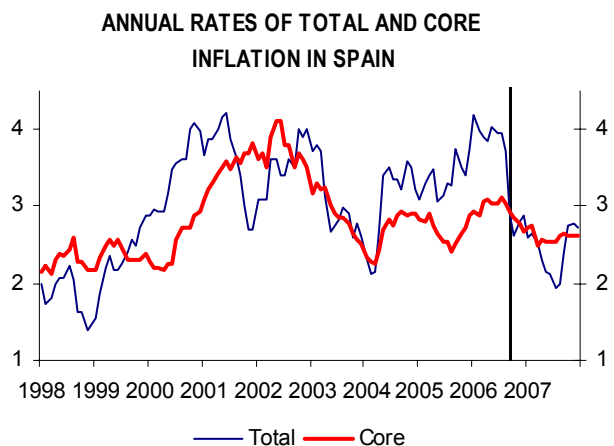


Source: INE & IFL (UC3M)
Date: October 24, 2006

The other CPI components are not expected to vary significantly from September. The annual core inflation rate is expected to continue at 2.9% (±0.17).

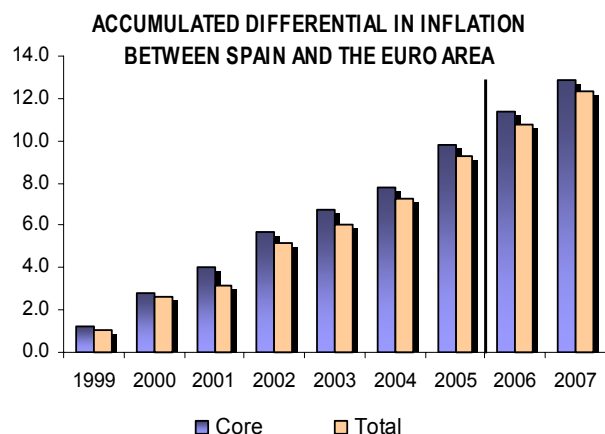
Our forecast is that the average annual rate for 2006 will grow from the 3.4% registered in 2005 to 3.6% (±0.07), due to the high inflation values observed at the beginning of year, falling to 2.4% (±0.62) for the average 2007 figure, with core inflation of 2.6% (±0.38) (see graph I.11), two tenths of a percentage point above the average value for 1998-1999. This means that, like then, core inflation in Spain maintains a differential of no less than one percentage point with European core inflation. Both now and then, this involves a 2 pp differential in service inflation, but also more than half a percentage point in the consumer prices of non-energy industrial goods.

Graph I.11



Source: INE & IFL (UC3M)
Date: October 24, 2006

Graph I.12



Source: EUROSTAT, INE & IFL (UC3M)
Date : October 24, 2006



With regards to the headline inflation differential with the euro area, it is expected to increase by two tenths of a percentage point in 2006, to 1.4% compared with the 1.2% of 2005, although in 2007 it could fall to 0.5%. **The accumulated differential since the introduction of the euro in 1999 would therefore be 12.3% by the end of 2007** (see graph I.12).

With regards to **economic activity** in Spain, **the GDP is expected to register an average growth**

rate, in real terms, of 3.6% for 2006 and 3.4% for 2007. Indeed, the national demand is expected to reduce its contribution to growth slightly to 4.8 pp in 2006 and 4.5 pp in 2007, whereas resulting from the expected evolution of foreign trade flows, external demand is expected to drain 1.2 and 1.1 pp in 2006 and 2007, respectively.

Table I.5

ANNUAL RATES OF GROWTH IN GDP AND COMPONENTS IN SPAIN												
	Observed		Forecasts*									
			Annual		Quarterly**							
	2004	2005	2006	2007	2006 QI ⁽²⁾	2006 QII	2006 QIII	2006 QIV	2007 QI	2007 QII	2007 QIII	2007 QIV
Private Final Consumption Expenditure	4.2	4.2	3.6	3.6	3.8	3.6	3.6	3.5	3.6	3.7	3.4	3.6
Public Final Consumption Expenditure	6.3	4.8	4.4	4.4	4.4	4.4	4.5	4.4	4.4	4.3	4.3	4.4
Gross Fixed Capital Formation	5.0	7.0	5.9	5.5	6.3	6.1	5.7	5.7	5.4	5.6	5.7	5.3
Equipment	4.4	9.0	7.9	7.2	8.6	9.1	7.7	6.2	7.0	8.0	7.1	6.6
Building	5.5	6.0	5.8	5.1	5.8	5.7	5.7	5.9	5.2	4.9	5.2	5.0
Other products	4.5	7.5	3.8	4.5	4.8	3.3	3.1	4.2	3.7	4.9	5.0	4.5
National Demand (1)	4.9	5.2	4.8	4.5	5.0	4.8	4.7	4.6	4.5	4.6	4.5	4.5
Exports of Goods and Services	4.1	1.5	6.1	4.0	9.5	5.3	3.8	5.8	3.0	3.7	5.0	4.5
Imports of Goods and Services	9.6	7.0	8.8	7.0	12.4	7.9	7.1	7.9	5.6	7.3	7.7	7.2
Foreign demand (1)	-1.7	-1.7	-1.2	-1.1	-1.4	-1.1	-1.2	-1.0	-1.0	-1.3	-1.1	-1.1
Real GDP	3.2	3.5	3.6	3.4	3.6	3.7	3.5	3.6	3.5	3.3	3.4	3.4
Gross Value Added Total	3.1	3.3	3.5	3.4	3.4	3.5	3.5	3.8	3.3	3.4	3.5	3.5
GVA Agriculture	1.9	-10.0	-0.7	1.1	-3.7	-0.4	0.4	0.9	0.4	1.4	2.0	0.5
GVA Industry	0.6	0.7	2.6	2.3	1.7	2.9	2.9	3.0	3.0	2.2	2.0	1.9
GVA Construction	5.1	5.4	5.0	4.3	5.3	5.0	4.9	4.8	4.5	4.3	4.3	4.2
GVA Market services	3.6	4.6	3.7	3.6	3.9	3.5	3.3	4.1	3.0	3.7	3.8	4.0
GVA Non market services	3.7	3.5	3.9	3.6	3.7	3.4	4.4	4.0	4.3	3.3	3.5	3.4
Taxes	4.4	5.7	4.4	3.3	5.9	6.4	2.9	2.8	3.4	3.0	3.8	3.6

(1) Contribution to the GDP growth

(*) The shadow figures are forecasts

(**) Appreciation from same quarter one year earlier

Source: INE & IFL (UC3M)

Date: August 30, 2006

As for **industrial activity**, the Industrial Production Index registered an annual growth rate of 5%. According to the forecasts of the Bulletin of Inflation and Macroeconomic Analysis, the recovery of exports and the sustained increase in capital investment are the reasons behind the **recovery of the industrial sector in Spain for 2006, expecting a 4% growth rate for the IPI**, compared with the low (0.1%) variation registered in the sector in 2005. Furthermore, according to the National Accounts figures for the second quarter of 2006, the sector's GVA registered a year-on-year growth rate of 2.9%, the highest in the last four years. This growth is expected to become consolidated at rates of around 3% in the third and fourth quarters of this year. **For 2007, we are forecasting a growth rate of 4.7% for the industrial sector, since both the capital goods and intermediate goods sectors**

are expected to continue to recover, representing three quarters of the total sector's growth.

Finally, according to the estimations of the **Active Population Survey (EPA)** for the third quarter of 2006, the Spanish labour market continues to be dynamic, with employment continuing to increase at a good pace (3.7%), although less than the previous quarters. The labour supply continues to register high growth rates (3.4%) and the unemployment rate has fallen to levels comparable with those of the EU (8.1%).

Employment forecasts for 2006 indicate that this dynamism will continue in the fourth quarter of this year, with rates similar to the third quarter, so an average annual rate of 4.1% is forecast for the end



of the year. For 2007, employment will remain strong, with a slightly lower annual growth rate (3.8%), consistent with the lower GDP growth forecast. The growth of the active population will continue to be strong in 2006-2007, due to immigration, but with rates similar to those registered in the previous years, 3.3% in 2006 and 3.1%, slightly lower, in 2007. The unemployment rate applicable to the active population in this period remains practically unaltered from the previous quarter, becoming consolidated on one-digit levels and similar to those registered in the EU, with 8.5% forecast for 2006 and 7.8% for 2007 (see table I.6).

Table I.6

LABOUR MARKET IN SPAIN			
AVERAGE RATE OF GROWTH			
	ACTIVE	EMPLOYMENT	UNEMPLOYMENT
2004	3.3	3.9	11.0
2005	3.2	4.8	9.6
2006	3.3	4.1	8.5
2007	3.1	3.8	7.8

Bold figures are forecasts. For 2005, the rates are corrected of the impact produced by the changes incorporated in the first quarter of 2005.

Source: INE & IFL (UC3M)

Date: October 27, 2006

AUTONOMOUS REGIONS

In the Madrid region, **the evolution of the economy will continue to be positive in the short term**. The growth of 2005 is revised downwards slightly and the same applies to the forecast for 2006. In spite of these revisions, the situation continues to be a good one, since the new growth figures for 2005 and 2006 are highly satisfactory and the growth forecast for 2007 has even increased.

The good growth perspectives are based on a modest reactivation of the energy plus industry aggregate (more in energy than in industry), a very good evolution of construction and firm evolution of the service sector, in which growth nonetheless appears to have peaked. All this is accompanied, and largely motivated by, an excellent evolution of employment.

The GDP of the Madrid region is expected to grow by 3.5% in 2006 and 3.5% in 2007, representing a slight fall from the 3.7% estimated for 2005.

With regards to **inflation**, for October in the Madrid region we are forecasting a monthly rate of 0.31% for the total CPI, corresponding to a 2.5% annual rate. **For the core index, we maintain our forecast average annual rate for 2006 at 3% (± 0.13), while revising the forecast for 2007 upwards by 0.1 pp to 2.8% (± 0.45), largely due to**

our upwards revision of 0.1 pp in the rate of inflation of non-energy industrial goods.

Once again, we have revised our forecast annual headline price indices due to better expectations for energy prices. Indeed, **the average rates forecast for the headline index are 3.6% (± 0.16) for 2006 and 2.5% (± 0.57) for 2007** (see table I.7).

Table I.7

ANNUAL GROWTH RATES IN MADRID						
Inflation in the CPI	Observed			Forecasts		
	Aver ⁽²⁾ 2004	Aver ⁽²⁾ 2005	2005 Sep ⁽¹⁾	2006 Oct ⁽¹⁾	Aver ⁽²⁾ 2006	Aver ⁽²⁾ 2007
Core (82.70%)	2.7	2.6	2.9	2.8 (± 0.2)	3.0 (± 0.13)	2.8 (± 0.45)
Total (100%)	3.0	3.1	2.9	2.6 (± 0.2)	3.6 (± 0.16)	2.5 (± 0.57)

*Intervals at 80% of confidence calculated with historical errors.

Source : INE & IFL (UC3M)

Date: October 11, 2006

(1) Year-on-year rates

(2) Average rates of growth

The most inflationist indices in the autonomous region in relation to the country as a whole will be in services and unprocessed food in 2006. For 2007, we are expecting more inflation in the region than in Spain, due to the weight of the service index in Madrid, the only to register an unfavourable price differential in 2007.

In the **Valencia region**, for 2006 we are forecasting an average core inflation rate of 2.8% (± 0.10) and 2.7% (± 0.60) for 2007. The unfavourable differential of 0.1 pp relative to the country as a whole is largely due to greater forecast growth in processed food prices, together with the greater weighting given to these products in the region's CPI. As for total inflation, we are expecting the average annual headline inflation rate to 0.1 pp than for Spain in 2006, 3.5% (± 0.15) and the same in 2007, 2.4% (± 0.70) (see table I.8).

Table I.8

ANNUAL GROWTH RATES IN VALENCIA						
Inflation in the CPI	Observed			Forecasts		
	Aver ⁽²⁾ 2004	Aver ⁽²⁾ 2005	2005 Sep ⁽¹⁾	2006 Oct ⁽¹⁾	Aver ⁽²⁾ 2006	Aver ⁽²⁾ 2007
Core (82.70%)	2.7	2.7	2.8	2.8	2.8 (± 0.10)	2.7 (± 0.60)
Total (100%)	3.0	3.4	2.9	2.7	3.5 (± 0.15)	2.4 (± 0.70)

*Intervals at 80% of confidence calculated with historical errors.

Source : INE & IFL (UC3M)

Date: October 11, 2006

(1) Year-on-year rates

(2) Average rates of growth



Table I.9

ANNUAL GROWTH RATES IN ANDALUCÍA						
Inflation in the CPI	Observed			Forecasts		
	Aver ⁽²⁾ 2004	Aver ⁽²⁾ 2005	2005 Sep ⁽¹⁾	2006 Oct ⁽¹⁾	Aver ⁽²⁾ 2006	Aver ⁽²⁾ 2007
Core (82.70%)	2.6	2.6	3.0	3.0 (±0.3)	3.0 (±0.1)	2.4 (±0.8)
Total (100%)	3.0	3.3	3.0	2.8 (±0.3)	3.5 (±0.2)	2.2 (±0.7)

*Intervals at 80% of confidence calculated with historical errors.

Source : INE & IFL (UC3M)

Date: October 11, 2006

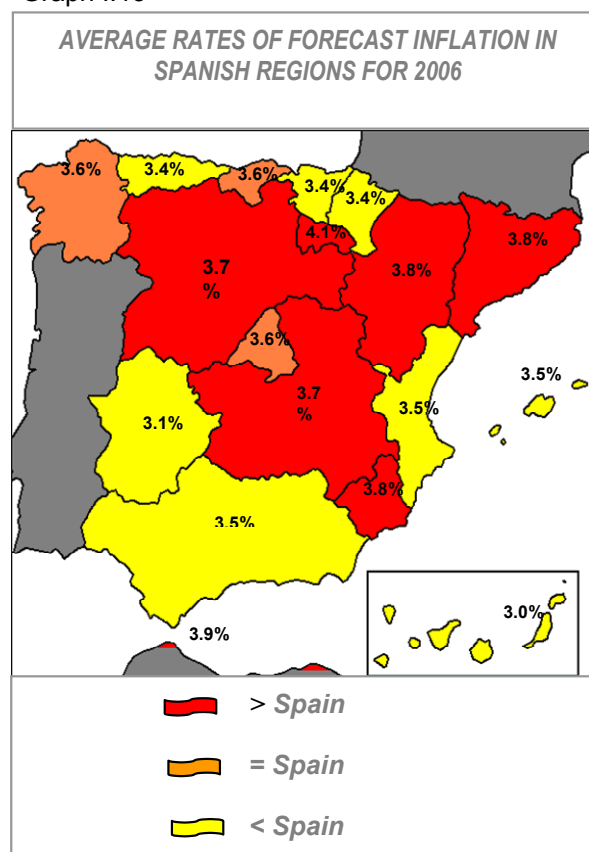
(1) Year-on-year rates

(2) Average rates of growth

In **Andalucía**, for 2006 we are forecasting an average annual core inflation rate of 3% (±0.10) and 2.4% (±0.80) for 2007. The slight differential in 2006 is largely due to the worse performance of processed foods and services in the region. The same components are expected to fall, improving our forecast for core inflation in Andalucía compared with Spain for 2007. As for headline inflation, we are forecasting the same average annual rate as for the country for 2006, 3.5% (±0.16) falling to 2.2% (±0.70) in 2007 (see table I.9).

Graph I.13 shows the mean annual inflation rates forecast in all the autonomous regions, with a dispersion ranging from 2.9% in the Islas Canarias to 4.1% in La Rioja.

Graph I.13



Source: INE & IFL (UC3M)

Date: October 11, 2006

November 1, 2006



II. THE ECONOMY IN THE EURO AREA.

II.1 MACROECONOMIC FORECASTS.

II.1.1 MACROECONOMIC TABLE AND INDICATORS IN THE ECONOMY OF THE EURO-AREA: ANNUAL RATES.

	Annual Averages Growths				
	2003	2004	2005	Forecasts BIMA (*)	
				2006	2007
GDP mp (1)	0.8	1.7	1.5	2.6	2.3
Demand					
Private Final Consumption	1.2	1.3	1.4	1.8	1.7
Public Final Consumption	1.8	1.2	1.4	2.4	2.3
Gross Capital Formation	2.1	2.6	3.3	4.4	3.6
Contribution Domestic Demand	1.4	1.5	1.8	2.4	2.2
Exports of Goods and Services	1.1	6.3	4.5	8.1	5.6
Imports of Goods and Services	3.1	6.2	5.5	8.0	5.5
Contribution Foreign Demand	-0.6	0.2	-0.3	0.2	0.1
Supply					
Gross Value Added Total (market prices)	0.8	1.7	1.5	2.6	2.3
Gross Value Added Total (basic prices)	0.7	1.8	1.5	2.7	2.3
Gross Value Added Agriculture	-5.7	11.1	-5.4	0.0	1.0
Gross Value Added Industry	0.3	2.2	1.3	4.3	3.2
Gross Value Added Construction	0.4	1.1	1.0	2.2	0.8
Gross Value Added Trade Services	0.0	2.3	2.1	3.3	2.8
Gross Value Added Financial Services	1.7	1.1	2.2	2.6	2.6
Gross Value Added Public Services	1.4	1.0	1.3	1.2	1.2
Prices (2)					
CPI harmonized, annual average	2.1	2.1	2.2	2.2	1.6 / 1.9 (*)
CPI harmonized, dec./dec.	2.0	2.4	2.2	1.9	1.8 / 2.1 (*)
Employment (2)					
Unemployment rate	8.7	8.9	8.6	8.0	7.8
Others Economic Indicators (2)					
Production Index of Industry (excluding construction)	0.3	2.0	1.2	4.5	3.8

* Without VAT effects / with VAT effects in 2007

Source: EUROSTAT & IFL (UC3M)

Date: (1) October 31, 2006.

(2) October 26, 2006



II.1.2 QUARTERLY FORECASTS OF GDP AND COMPONENTS OF DOMESTIC AND FOREIGN DEMAND.

Table II.1.2.1

ANNUAL RATES OF GROWTH IN GDP AND COMPONENTS (1)												
	Observed		Forecasts									
			Annual		Quarterly*							
	2004	2005	2006	2007	2006 QI	2006 QII	2006 QIII	2006 QIV	2007 QI	2007 QII	2007 QIII	2007 QIV
Private Final Consumption Expenditure	1.3	1.4	1.8	1.7	1.8	1.7	1.9	1.9	1.8	1.7	1.7	1.6
Public Final Consumption Expenditure	1.2	1.4	2.4	2.3	2.4	2.4	2.5	2.5	2.4	2.4	2.3	2.2
Gross Fixed Capital Formation	2.6	3.3	4.4	3.6	2.8	4.8	5.0	5.1	4.7	3.5	3.4	3.0
Exports of Goods and Services	6.3	4.5	8.1	5.6	9.3	8.6	6.9	7.7	5.8	5.7	5.6	5.2
Imports of Goods and Services	6.2	5.5	8.0	5.5	9.7	8.2	6.9	7.2	5.2	5.6	6.0	5.3
Real GDP	1.7	1.5	2.6	2.3	2.1	2.7	2.7	2.9	2.8	2.3	2.0	2.0
Contributions of Domestic Demand	1.5	1.8	2.4	2.2	2.1	2.4	2.6	2.6	2.5	2.2	2.1	2.0
Contributions of Foreign demand	0.2	-0.3	0.2	0.1	0.0	0.3	0.1	0.3	0.3	0.1	-0.1	0.0
	Levels at the end of the period											
Economic Sentiment Indicator (2)	100.0	101.1	111.2	112.9	104.0	107.8	109.3	111.2	112.1	112.5	112.8	112.9

(*) Appreciation from same quarter one year earlier

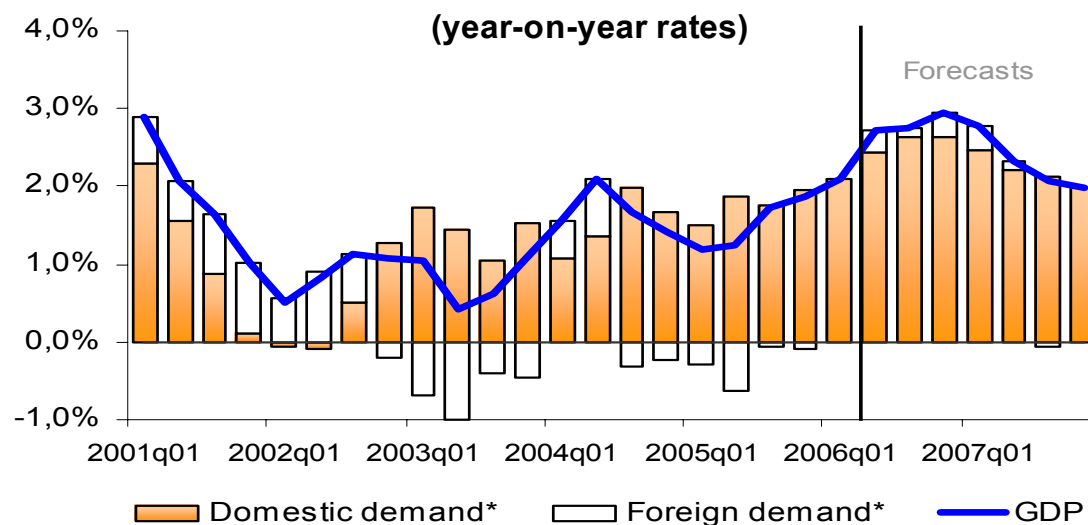
Source: EUROSTAT & IFL (UC3M)

Date: (1) October 31, 2006

(2) October 31, 2006

Graph II.1.2.1

CONTRIBUTION* TO GDP GROWTH IN THE EURO AREA



Source: EUROSTAT & IFL (UC3M)

Date: October 31, 2006



II.1.3 INDUSTRIAL PRODUCTION INDEX: MONTHLY AND QUARTERLY FORECASTS.

Table II.1.3.1

ANNUAL RATES OF GROWTH IN THE IPI AND SECTORS*												
	Observed		Forecasts									
			Annual		Quarterly**							
	2004	2005	2006	2007	2006 QI	2006 QII	2006 QIII	2006 QIV	2007 QI	2007 QII	2007 QIII	2007 QIV
Total	2.0	1.2	4.5	3.8	3.4	3.8	4.7	6.1	5.4	4.8	2.7	2.2
Consumer goods												
Durable consumer goods	0.1	-1.0	4.5	2.5	2.1	3.5	5.6	6.9	6.0	3.1	0.7	0.4
Non-durable consumer goods	0.6	0.9	2.6	2.1	2.0	2.1	2.2	3.9	3.8	2.3	1.2	1.2
Capital equipment	3.3	2.6	5.7	4.8	5.1	4.8	4.9	7.9	6.4	5.7	4.0	3.4
Intermediate goods	2.2	0.7	5.6	4.8	2.9	5.2	6.8	7.5	7.7	6.0	3.1	2.3
Energy	2.0	1.2	2.4	1.6	3.8	0.7	2.8	2.0	0.0	3.8	1.4	1.5

(*) Adjusted by working days

(**) Appreciation from same quarter one year earlier

Source: EUROSTAT & IFL (UC3M)

Date: October 19, 2006

Table II.1.3.2

OBSERVED VALUES AND FORECASTS IN THE ANNUAL RATES OF IP IN THE EURO AREA*

	2001	2002	2003	2004	2005	2006	2007
January	5.30	-2.88	1.40	0.32	1.77	2.88	5.17
February	4.54	-3.30	1.64	1.06	0.29	2.92	5.77
March	3.79	-2.23	0.22	1.71	-0.18	4.20	5.24
April	1.28	0.04	0.58	1.72	1.28	1.68	6.04
May	0.21	-0.89	-1.48	3.72	0.00	5.25	4.09
June	1.77	-0.46	-1.81	3.83	0.63	4.46	4.31
July	-0.60	0.69	0.85	2.61	0.60	2.99	4.59
August	0.63	-0.41	-0.54	1.89	2.57	5.39	0.76
September	-0.79	0.58	-1.23	3.78	1.23	5.75	2.34
October	-2.05	1.15	1.31	1.42	0.36	6.88	2.47
November	-4.06	2.33	0.81	0.79	3.09	5.63	2.04
December	-4.52	0.17	2.15	1.25	2.81	5.82	2.12

* Adjusted by working days

The shaded values are forecasts.

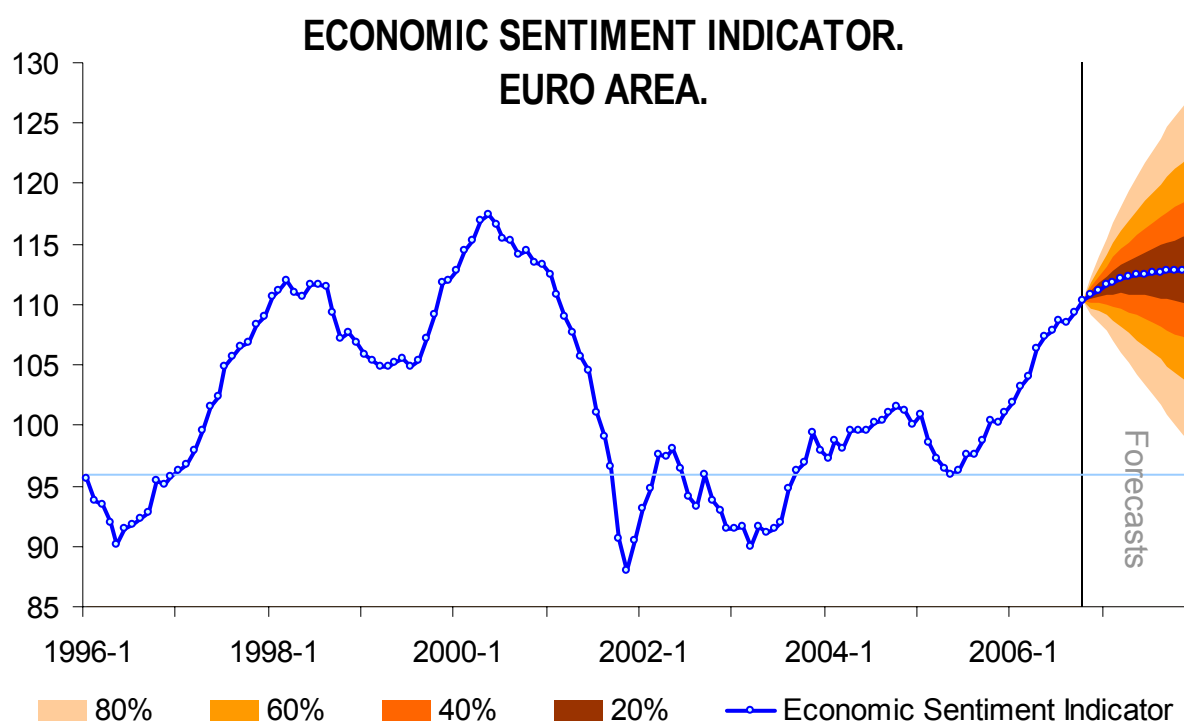
Source: EUROSTAT & IFL(UC3M)

Date: October 19, 2006



II.1.4 ECONOMIC SENTIMENT INDICATOR.

Graph II.1.4.1



Source: EUROPEAN COMMISSION & IFL (UC3M)
Date: October 31, 2006



II.1.5 INFLATION.

Table II.1.5.1

FORECASTS IN THE ANNUAL AVERAGE RATE IN INFLATION IN THE EURO AREA					
Harmonized Index of Consumer Price (HICP)	2003	2004	2005	Forecast	
				2006	2007
TOTAL (100%)	2.1	2.1	2.2	2.2	1.6
CORE (82.3%)	2.0	2.1	1.5	1.5	1.6
Processed food with tobacco (9.3%)	2.1	1.3	0.5	1.7	1.6
Processed food without tobacco (11.8%)	3.3	3.4	2.0	2.0	2.0
Non-energy industrial goods (29.5%)	0.8	0.8	0.3	0.6	0.7
Services (35.8%)	2.5	2.6	2.3	2.0	2.1
RESIDUAL (17.7%)	2.6	2.6	5.7	5.6	1.5
Non-Processed food (8.4%)	2.1	0.6	0.8	2.8	3.3
Energy (9,3%)	3.0	4.5	10.1	7.8	0.0

FORECASTS FOR 2007 WHITOUT VAT EFFECTS IN GERMANY INFLATION

Source: EUROSTAT & IFL (UC3M)

Date: October 26, 2006

Table II.1.5.2

STANDARD DEVIATION FOR THE FORECASTS ERRORS IN THE EURO AREA			
	Horizon	Total inflation	Core inflation
ANNUAL RATES	1	0.094	0.108
	2	0.175	0.145
	3	0.233	0.178
	4	0.263	0.195
	5	0.289	0.210
	6	0.311	0.227
	7	0.322	0.255
	8	0.355	0.283
	9	0.382	0.306
	10	0.405	0.322
	11	0.403	0.338
	12	0.406	0.338
AVERAGE ANNUAL RATES	1	0.035	0.033
	2	0.305	0.264

Source: IFL (UC3M)

Date: October 26, 2006



HICP ANNUAL GROWTH BY SECTORS IN THE EURO AREA															
		Harmonized Consumer Prices Index										TOTAL (Without VAT effects in 2007)	TOTAL (With VAT effects in 2007)	Confidence Intervals at 80% *	
		Core				TOTAL		Confidence Intervals at 80% *		Residual					
		Processed food excluding tobacco	Tobacco	Non energy industrial goods	Services					Non processed food	Energy				TOTAL
Weights 2006		9.3%	2.5%	30.7%	40.8%	83.4%			7.4%	9.2%	16.6%	100%	100%		
ANNUAL AVERAGE RATE	1998	0.9	4.0	0.9	1.9	1.4			2.0	-2.6	-0.3	1.1			
	1999	0.5	3.1	0.7	1.5	1.1			0.0	2.4	1.2	1.1			
	2000	0.7	3.4	0.5	1.5	1.0			1.8	13.0	7.4	2.1			
	2001	2.7	3.8	0.9	2.5	1.9			7.0	2.2	4.4	2.3			
	2002	2.4	5.9	1.5	3.1	2.5			3.1	-0.6	1.2	2.2			
	2003	2.1	8.4	0.8	2.5	2.0			2.1	3.0	2.6	2.1			
	2004	1.3	12.2	0.8	2.6	2.1			0.6	4.5	2.6	2.1			
	2005	0.5	7.8	0.3	2.3	1.5			0.8	10.1	5.7	2.2			
	2006	1.7	3.4	0.6	2.0	1.5	± 0.04		2.8	7.8	5.6	2.2	2.2	± 0.04	
	2007	1.6	3.6	0.7	2.1	1.6	± 0.34		3.3	0.0	1.5	1.6	1.9	± 0.39	
ANNUAL RATES (growth of the month over the same month of the previous year)	2005	January	0.4	12.2	0.5	2.4	1.8			-0.6	6.2	2.9	1.9		
		February	0.3	12.1	0.2	2.4	1.6			0.7	7.7	4.3	2.1		
		March	0.3	6.4	0.4	2.5	1.6			1.3	8.8	5.2	2.1		
		April	0.4	6.5	0.3	2.2	1.4			0.8	10.1	5.6	2.1		
		May	0.3	5.9	0.3	2.5	1.6			1.0	6.8	4.1	2.0		
		June	0.3	6.0	0.2	2.2	1.4			0.5	9.4	5.2	2.1		
		July	0.2	6.6	0.0	2.3	1.3			0.3	11.7	6.3	2.2		
		August	0.3	6.7	0.0	2.2	1.3			1.0	11.5	6.6	2.2		
		September	0.5	9.1	0.2	2.2	1.4			1.0	15.0	8.5	2.6		
		October	0.6	9.1	0.3	2.2	1.5			1.1	12.1	7.1	2.5		
		November	0.9	9.0	0.4	2.1	1.5			1.5	10.0	6.1	2.3		
		December	1.1	4.3	0.4	2.1	1.4			1.5	11.2	6.7	2.2		
	2006	January	1.3	4.0	0.2	2.0	1.3			2.0	13.6	8.2	2.4		
		February	1.5	3.7	0.3	2.0	1.3			1.7	12.5	7.5	2.3		
		March	1.6	4.6	0.6	1.9	1.4			0.6	10.5	5.9	2.2		
		April	1.6	4.1	0.7	2.2	1.6			1.2	11.0	6.5	2.5		
		May	1.7	4.2	0.7	1.8	1.5			1.5	12.9	7.6	2.5		
		June	1.6	4.2	0.7	2.0	1.6			2.1	11.0	6.9	2.5		
		July	1.8	4.1	0.6	2.1	1.6			3.2	9.5	6.7	2.4		
		August	1.7	4.0	0.6	1.9	1.5			3.9	8.1	6.3	2.3		
		September	1.8	2.0	0.8	2.0	1.5			4.6	1.5	2.9	1.7		
		October	1.8	1.9	0.8	2.0	1.5	± 0.14		4.8	-0.3	1.9	1.6	1.6	± 0.12
		November	1.7	1.9	0.8	2.0	1.5	± 0.19		4.3	2.6	3.4	1.8	1.8	± 0.22
		December	1.6	1.9	0.8	2.0	1.5	± 0.23		3.6	3.4	3.5	1.9	1.9	± 0.30
	2007	January	1.5	2.0	0.8	2.1	1.5	± 0.25		4.1	1.1	2.4	1.7	2.0	± 0.34
		February	1.5	2.0	0.8	2.1	1.5	± 0.27		3.8	1.0	2.2	1.6	1.9	± 0.37
		March	1.4	3.6	0.8	2.1	1.6	± 0.29		4.5	0.8	2.5	1.7	2.0	± 0.40
		April	1.5	3.5	0.8	2.1	1.6	± 0.33		4.8	-1.7	1.1	1.5	1.8	± 0.41
		May	1.5	3.3	0.7	2.1	1.6	± 0.36		4.4	-2.4	0.6	1.4	1.7	± 0.45
		June	1.6	3.1	0.7	2.1	1.6	± 0.39		4.0	-2.1	0.6	1.4	1.7	± 0.49
		July	1.6	2.6	0.8	2.0	1.5	± 0.41		3.4	-3.1	-0.3	1.2	1.5	± 0.52
		August	1.7	2.6	0.8	2.1	1.6	± 0.43		2.6	-2.9	-0.5	1.2	1.5	± 0.52
		September	1.7	4.9	0.7	2.1	1.6	± 0.43		2.2	0.6	1.3	1.6	1.9	± 0.52
		October	1.7	4.9	0.7	2.1	1.6	± 0.44		2.1	2.6	2.4	1.7	2.0	± 0.52
		November	1.7	5.0	0.7	2.1	1.6	± 0.44		2.1	3.0	2.6	1.8	2.1	± 0.53
		December	1.7	5.0	0.7	2.1	1.6	± 0.46		2.1	3.2	2.7	1.8	2.1	± 0.55

* Confidence intervals calculated with historical errors.

Bold figures are forecasts

Source: EUROSTAT & IFL (UC3M)

Date: October 26, 2006

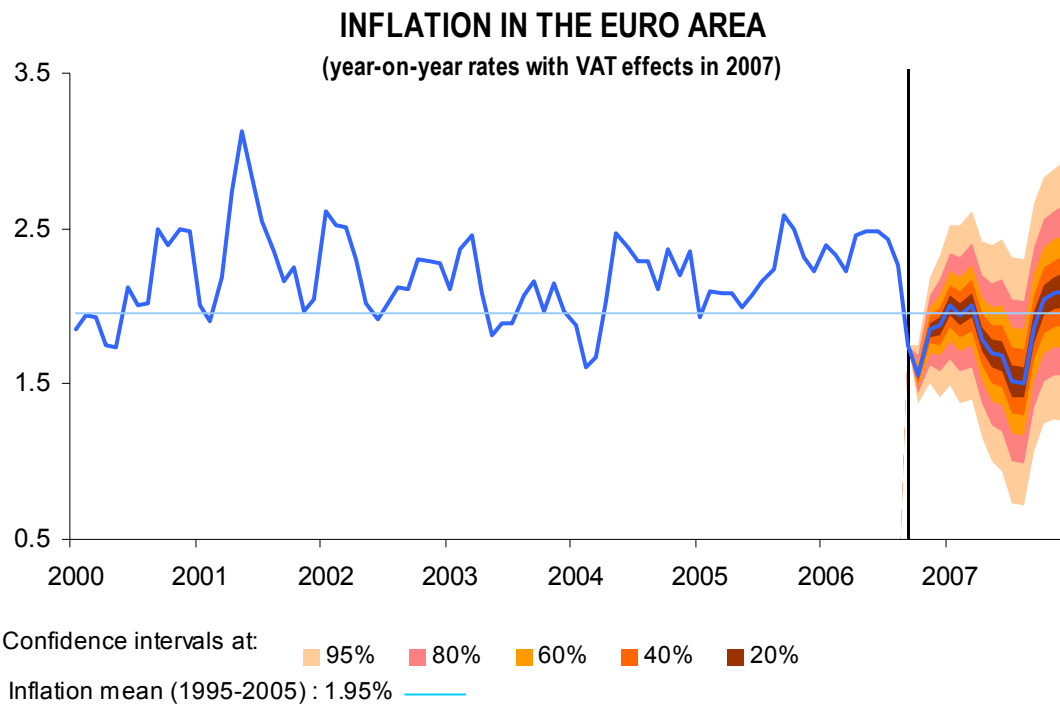


HICP MONTHLY GROWTH BY SECTORS IN THE EURO AREA												
		Harmonized Consumer Prices Index										
		Core					Residual			TOTAL (Without the VAT effects in 2007)	TOTAL (With the VAT effects in 2007)	
		Processed food excluding tobacco	Tobacco	Non energy industrial goods	Services	TOTAL	Non processed food	Energy	TOTAL			
Weights 2006		9.3%	2.5%	30.7%	40.8%	83.4%	7.4%	9.2%	16.6%	100%	100%	
MONTHLY RATES (Growth of the month over the previous month)	January	2004	0.2	1.7	-1.6	0.0	-0.5	1.1	0.9	1.0	-0.2	
		2005	0.1	0.2	-1.8	-0.3	-0.8	0.4	0.3	0.4	-0.6	
		2006	0.3	0.0	-2.0	-0.4	-0.9	0.9	2.4	1.8	-0.4	
		2007	0.2	0.0	-2.0	-0.3	-0.9	1.4	0.2	0.7	-0.6	-0.3
	February	2004	0.3	0.3	0.2	0.5	0.4	-0.6	-0.1	-0.3	0.2	
		2005	0.1	0.2	-0.1	0.4	0.2	0.7	1.4	1.1	0.3	
		2006	0.3	0.0	0.0	0.4	0.2	0.4	0.4	0.4	0.3	
		2007	0.3	0.0	0.0	0.4	0.2	0.1	0.3	0.2	0.2	0.2
	March	2004	0.0	5.3	1.1	0.1	0.6	0.3	1.3	0.8	0.7	
		2005	0.1	0.0	1.3	0.2	0.6	0.9	2.3	1.7	0.7	
		2006	0.2	0.8	1.6	0.1	0.7	-0.2	0.5	0.2	0.6	
		2007	0.1	2.4	1.5	0.1	0.7	0.6	0.3	0.4	0.6	0.6
	April	2004	0.1	0.4	0.8	0.3	0.4	0.3	1.1	0.7	0.4	
		2005	0.1	0.5	0.7	0.0	0.3	-0.2	2.3	1.1	0.4	
		2006	0.1	0.1	0.8	0.2	0.4	0.4	2.8	1.7	0.7	
		2007	0.2	0.0	0.8	0.3	0.4	0.6	0.3	0.4	0.4	0.4
	May	2004	0.1	0.6	0.1	0.1	0.1	0.4	2.4	1.5	0.3	
		2005	0.1	0.1	0.1	0.4	0.3	0.6	-0.6	-0.1	0.3	
		2006	0.1	0.2	0.2	0.1	0.1	0.9	1.0	1.0	0.3	
		2007	0.2	0.0	0.2	0.1	0.1	0.6	0.3	0.4	0.2	0.2
	June	2004	0.0	0.1	-0.1	0.4	0.1	0.1	-0.7	-0.3	0.0	
		2005	0.1	0.2	-0.2	0.1	0.0	-0.4	1.6	0.7	0.1	
		2006	0.0	0.3	-0.2	0.3	0.1	0.2	-0.1	0.1	0.1	
		2007	0.1	0.0	-0.2	0.3	0.1	-0.2	0.3	0.1	0.1	0.1
	July	2004	0.1	0.0	-1.6	0.7	-0.2	-1.1	0.6	-0.2	-0.2	
		2005	0.0	0.6	-1.8	0.7	-0.3	-1.3	2.7	0.9	-0.1	
		2006	0.1	0.5	-2.0	0.8	-0.3	-0.2	1.4	0.7	-0.1	
		2007	0.1	0.0	-1.9	0.8	-0.3	-0.8	0.3	-0.2	-0.3	-0.3
	August	2004	0.0	0.0	0.1	0.3	0.2	-1.3	1.5	0.2	0.2	
		2005	0.1	0.1	0.1	0.3	0.2	-0.6	1.3	0.5	0.2	
		2006	0.0	0.0	0.1	0.1	0.1	0.0	0.1	0.0	0.1	
		2007	0.1	0.0	0.1	0.2	0.1	-0.8	0.3	-0.2	0.1	0.1
	September	2004	-0.2	0.0	1.1	-0.4	0.2	-0.1	-0.2	-0.1	0.2	
		2005	0.0	2.2	1.3	-0.5	0.3	-0.1	3.0	1.6	0.5	
		2006	0.1	0.2	1.5	-0.4	0.3	0.6	-3.2	-1.6	0.0	
		2007	0.1	2.4	1.4	-0.4	0.4	0.2	0.3	0.2	0.4	0.4
	October	2004	-0.1	0.0	0.6	-0.1	0.2	0.0	2.9	1.5	0.3	
		2005	0.1	0.1	0.7	-0.1	0.2	0.1	0.2	0.2	0.3	
		2006	0.1	0.0	0.7	-0.1	0.3	0.2	-1.6	-0.8	0.1	0.1
		2007	0.1	0.0	0.7	-0.1	0.2	0.2	0.3	0.2	0.2	0.2
	November	2004	0.0	0.1	0.2	-0.1	0.0	0.1	-1.2	-0.6	-0.1	
		2005	0.2	0.0	0.3	-0.1	0.1	0.4	-3.0	-1.5	-0.3	
		2006	0.1	0.0	0.3	-0.1	0.1	-0.1	-0.2	-0.1	0.0	0.0
		2007	0.1	0.0	0.3	-0.1	0.1	-0.1	0.3	0.1	0.1	0.1
	December	2004	0.0	4.6	-0.1	0.9	0.5	1.0	-1.8	-0.5	0.4	
		2005	0.2	0.0	-0.1	0.9	0.4	1.1	-0.7	0.1	0.3	
		2006	0.1	0.0	-0.1	0.9	0.4	0.4	0.0	0.2	0.4	0.4
		2007	0.1	0.0	-0.1	0.9	0.4	0.4	0.3	0.3	0.4	0.4

Bold figures are forecasts
Source: EUROSTAT & IFL (UC3M)
Date: October 26, 2006

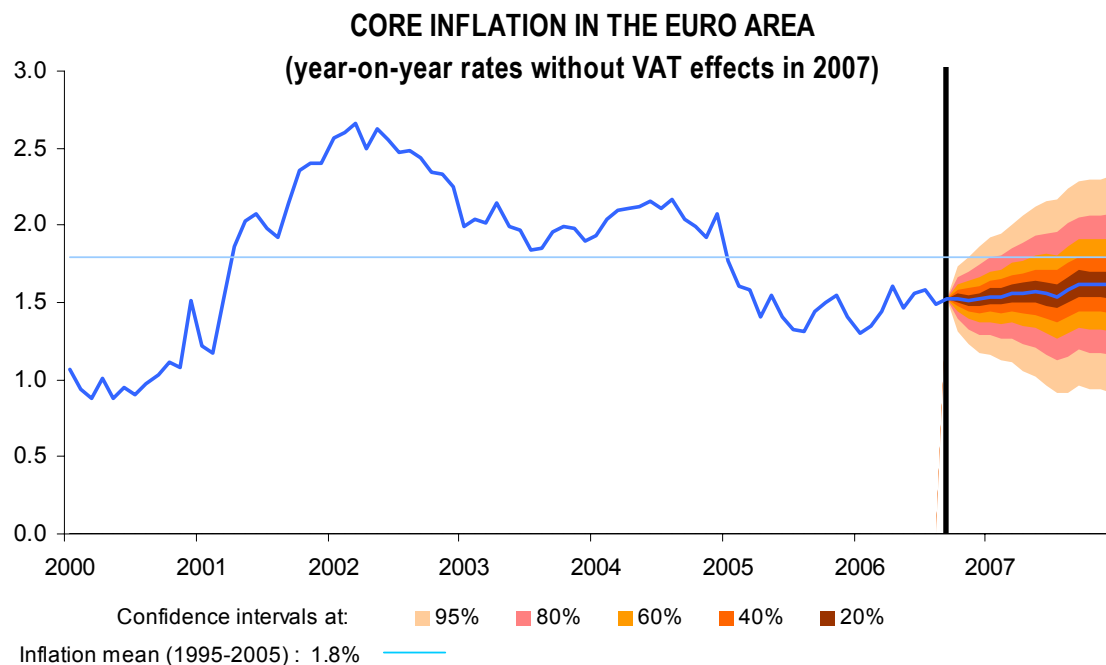


Graph II.1.5.1



Source: EUROSTAT & IFL (UC3M)
Date: October 26, 2006

Graph II.1.5.2

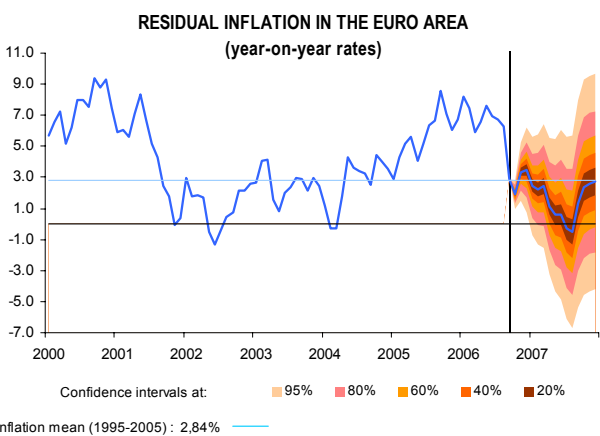
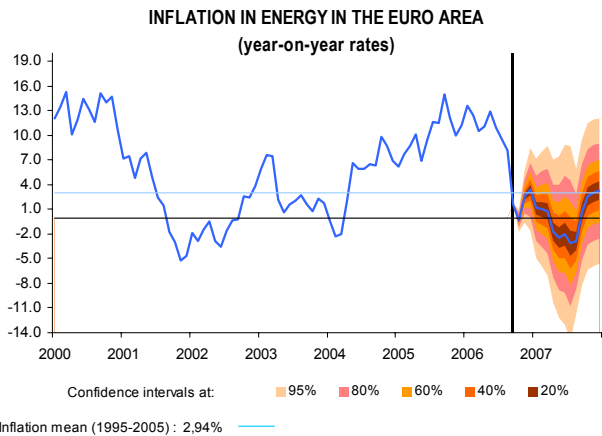
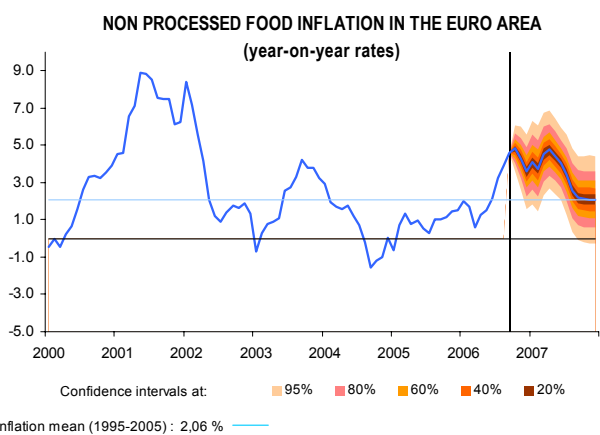
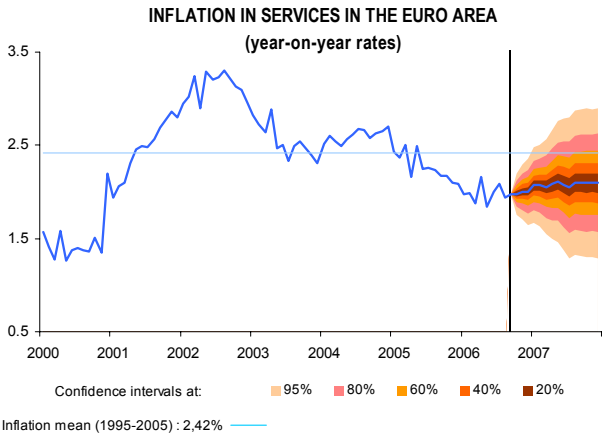
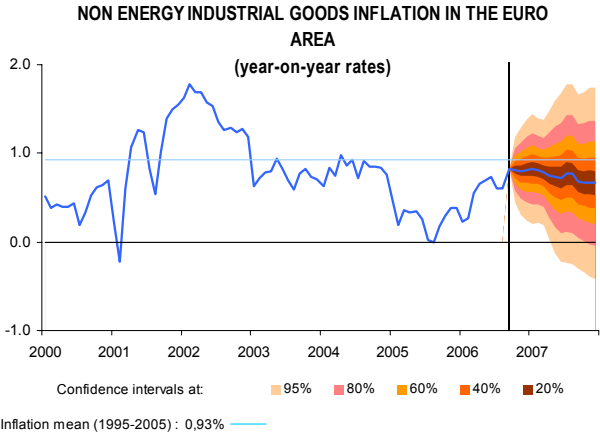
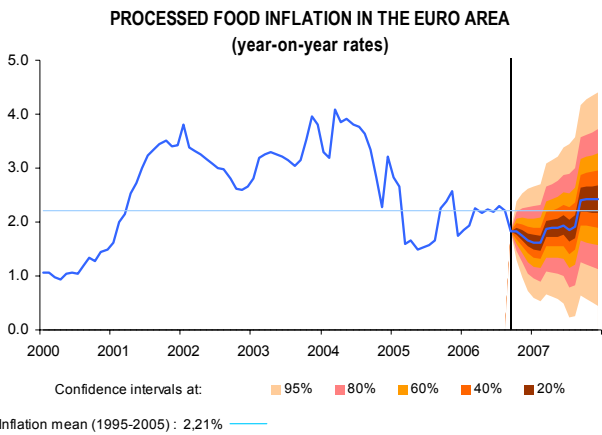


Source: EUROSTAT & IFL (UC3M)
Date: October 26, 2006



Graph II.1.5.3

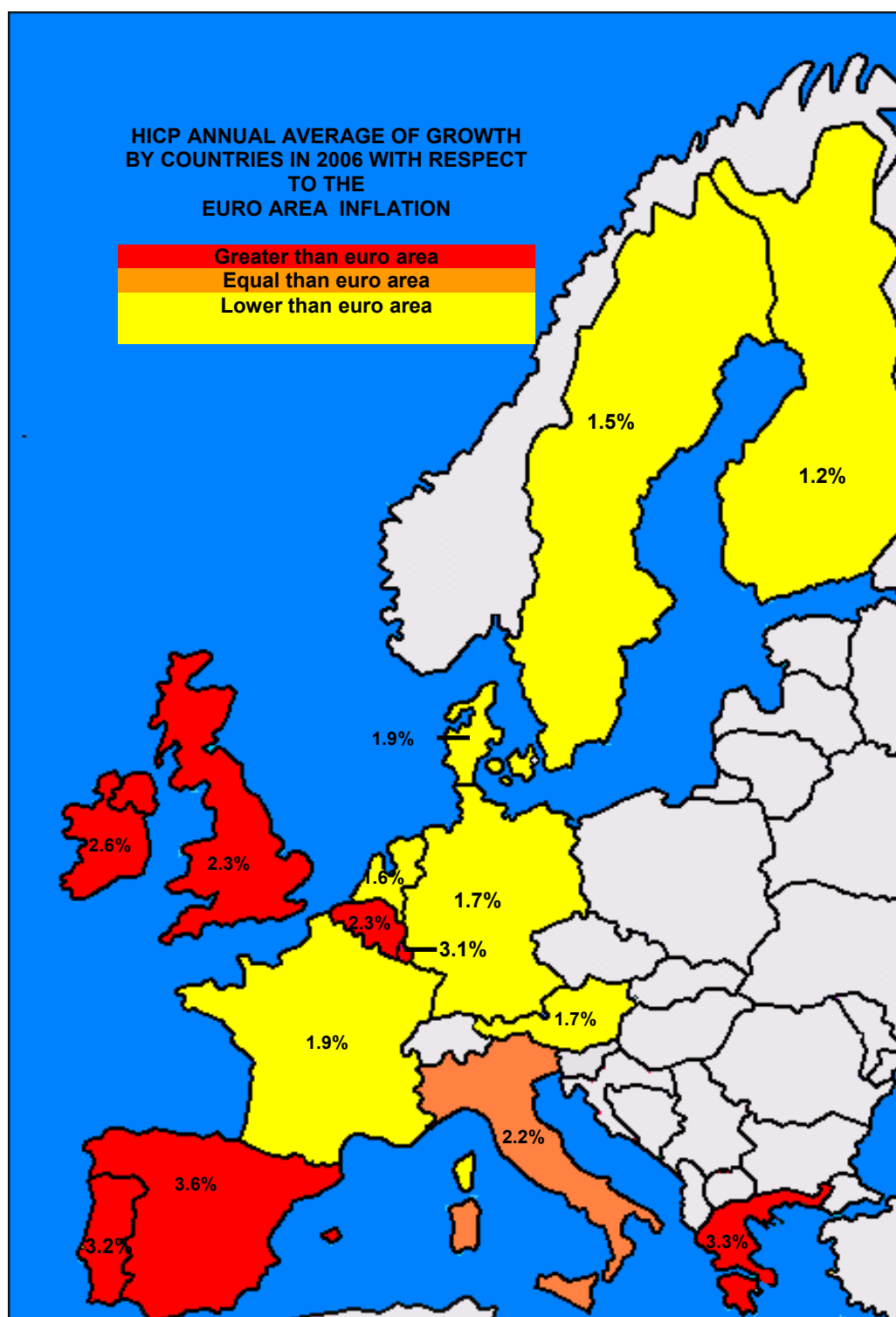
FAN CHARTS FOR ANNUAL RATES OF HICP COMPONENTS IN EURO AREA
(without VAT effects in 2007)



Source: EUROSTAT & IFL (UC3M)
Date: October 26, 2006



Graph II.1.5.4



Source: EUROSTAT & IFL (UC3M)
Date: October 26, 2006



HICP ANNUAL GROWTH BY COUNTRIES IN THE EURO AREA AND EU																	
		European Union															
		Euro Area															
		Germany	France	Italy	Spain	Netherlands	Belgium	Austria	Greece	Portugal	Finland	Ireland	Luxembourg				
Weights 2005		28.7%	20.3%	19.1%	12.0%	5.2%	3.4%	3.1%	2.9%	2.2%	1.6%	1.3%	0.3%	18.7%	1.9%	1.2%	
ANNUAL AVERAGE RATE	1998	0.6	0.7	2.0	1.8	1.8	0.9	0.8	4.5	2.2	1.3	2.1	1.0	1.6	1.0	1.3	
	1999	0.6	0.6	1.7	2.2	2.0	1.1	0.5	2.1	2.2	1.3	2.5	1.0	1.3	0.5	2.1	
	2000	1.4	1.8	2.6	3.5	2.3	2.7	2.0	2.9	2.8	2.9	5.3	3.8	0.8	1.3	2.7	
	2001	1.9	1.8	2.3	2.8	5.1	2.4	2.3	3.7	4.4	2.7	4.0	2.4	1.2	2.7	2.3	
	2002	1.4	1.9	2.6	3.6	3.9	1.6	1.7	3.9	3.7	2.0	4.7	2.1	1.3	1.9	2.4	
	2003	1.0	2.2	2.8	3.1	2.2	1.5	1.3	3.4	3.3	1.3	4.0	2.5	1.4	2.3	2.0	
	2004	1.8	2.3	2.3	3.1	1.4	1.9	2.0	3.0	2.5	0.1	2.3	3.2	1.3	1.0	0.9	
	2005	1.9	1.9	2.2	3.4	1.5	2.5	2.1	3.5	2.1	0.8	2.2	3.8	2.0	0.8	1.7	
	2006	1.7	1.9	2.2	3.6	1.6	2.3	1.7	3.3	3.2	1.2	2.6	3.1	2.3	1.5	1.9	
	2007	1.0	1.5	3.0	2.5	1.7	1.5	1.6	2.9	3.0	0.8	2.2	2.2	2.0	1.3	1.7	
ANNUAL RATES (growth of the month over the same month of the previous year)	2005	January	1.6	1.6	2.0	3.1	1.2	2.0	2.4	4.2	2.0	-0.2	2.1	2.9	1.6	0.5	0.8
		February	1.9	1.9	2.0	3.3	1.5	2.3	2.3	3.2	2.1	0.0	2.1	3.2	1.6	1.2	1.0
		March	1.6	2.1	2.2	3.4	1.5	2.8	2.4	2.9	2.3	0.9	1.9	3.5	2.0	0.5	1.3
		April	1.4	2.0	2.1	3.5	1.3	2.4	2.3	3.3	2.0	1.2	2.2	3.7	1.9	0.4	1.7
		May	1.6	1.7	2.3	3.0	1.0	2.3	2.0	3.2	1.8	0.6	2.1	3.7	1.9	0.2	1.2
		June	1.8	1.8	2.1	3.2	1.5	2.7	2.0	3.2	0.6	1.0	1.9	3.2	1.9	0.8	1.7
		July	1.8	1.8	2.1	3.3	1.5	2.7	2.1	3.9	1.9	0.9	2.2	4.0	2.4	0.7	1.8
		August	1.9	2.0	2.1	3.3	1.6	2.9	1.9	3.6	2.5	1.0	2.1	4.3	2.3	1.1	2.4
		September	2.5	2.4	2.2	3.8	1.7	3.0	2.6	3.8	2.7	1.1	2.7	4.7	2.4	1.1	2.3
		October	2.3	2.0	2.6	3.5	1.5	2.2	2.0	3.7	2.6	0.8	2.6	5.0	2.3	0.9	1.9
		November	2.2	1.8	2.4	3.4	1.6	2.3	1.7	3.4	2.5	1.0	2.2	3.6	2.1	1.2	1.8
		December	2.1	1.8	2.1	3.7	2.0	2.8	1.6	3.5	2.5	1.1	1.9	3.4	1.9	1.3	2.2
	2006	January	2.1	2.3	2.2	4.2	1.8	2.8	1.5	3.0	2.7	1.2	2.5	4.1	1.9	1.1	2.0
		February	2.1	2.0	2.2	4.1	1.4	2.8	1.5	3.1	3.0	1.3	2.7	3.9	2.1	1.1	2.1
		March	1.9	1.7	2.2	3.9	1.4	2.2	1.3	3.3	3.8	1.2	2.8	3.7	1.8	1.5	1.8
		April	2.3	2.0	2.3	3.9	1.8	2.6	2.1	3.5	3.7	1.5	2.7	3.5	2.0	1.8	1.8
		May	2.1	2.4	2.3	4.1	1.8	2.8	2.1	3.3	3.7	1.7	3.0	3.6	2.2	1.9	2.1
		June	2.0	2.2	2.4	4.0	1.8	2.5	1.9	3.4	3.5	1.5	2.9	3.9	2.5	1.9	2.1
		July	2.1	2.2	2.3	4.0	1.7	2.4	2.0	3.9	3.0	1.4	2.9	3.4	2.4	1.8	2.0
		August	1.8	2.1	2.3	3.8	1.9	2.3	2.1	3.4	2.7	1.3	3.2	3.1	2.5	1.6	1.9
		September	1.0	1.5	2.4	2.9	1.5	1.9	1.3	3.1	3.0	0.8	2.2	2.0	2.4	1.2	1.5
		October	0.8	1.4	1.9	2.7	1.5	1.7	1.5	3.1	3.1	0.9	2.1	1.6	2.4	1.2	1.6
		November	1.2	1.7	2.1	2.9	1.5	1.9	1.5	3.1	3.2	1.0	2.2	2.3	2.4	1.3	1.9
		December	1.3	1.7	2.2	2.9	1.4	1.6	1.5	3.1	3.2	1.0	2.4	2.7	2.4	1.3	1.6
	2007	January	1.1	1.6	3.2	2.7	1.6	1.7	1.6	3.1	3.4	1.1	2.3	3.3	2.4	1.6	1.9
		February	1.1	1.7	3.1	2.7	1.7	1.4	1.7	3.2	3.2	0.9	2.2	2.3	2.3	1.6	1.8
		March	1.2	1.6	3.0	2.6	1.8	1.7	1.7	3.0	2.6	0.8	2.2	2.3	2.4	1.4	1.9
		April	0.8	1.4	2.9	2.4	1.7	1.5	1.5	2.9	2.8	0.6	2.2	2.1	2.3	1.1	1.7
		May	0.7	1.2	2.9	2.2	1.7	1.4	1.5	2.8	2.9	0.6	2.1	1.8	2.1	1.1	1.7
		June	0.8	1.3	2.9	2.2	1.6	1.3	1.6	2.8	3.1	0.7	2.1	1.9	1.9	1.1	1.6
		July	0.6	1.2	2.8	2.0	1.7	1.3	1.6	2.9	3.2	0.8	2.1	2.4	1.8	1.3	1.6
		August	0.7	1.1	2.8	2.0	1.6	1.2	1.5	3.0	3.2	0.8	2.0	1.7	1.8	1.3	1.5
		September	1.2	1.5	2.8	2.5	1.8	1.6	1.7	2.8	3.0	0.9	2.3	2.0	1.9	1.3	1.8
		October	1.4	1.6	3.0	2.8	1.8	1.7	1.7	2.8	3.0	1.0	2.3	1.8	1.9	1.3	1.8
		November	1.4	1.7	3.1	2.9	1.8	1.6	1.7	2.8	3.0	1.0	2.4	2.4	1.9	1.4	1.8
		December	1.4	1.7	3.2	2.8	1.8	1.7	1.7	2.7	2.9	1.0	2.4	2.6	1.9	1.4	1.8

* Forecasts for Germany without VAT effects in 2007

Bold figures are forecasts

Source: EUROSTAT & IFL (UC3M)

Date: October 26, 2006



HICP MONTHLY GROWTH BY COUNTRIES IN THE EURO AREA AND EU																	
			European Union														
			Euro Area														
			Germany	France	Italy	Spain	Netherlands	Belgium	Austria	Greece	Portugal	Finland	Ireland	Luxembourg			
Weights 2005			28.7%	20.3%	19.1%	12.0%	5.2%	3.4%	3.1%	2.9%	2.2%	1.6%	1.3%	0.3%	18.7%	1.9%	1.2%
MONTHLY RATES (Growth of the month over the previous month)	January	2004	0.0	0.1	-0.6	-0.8	0.5	-1.3	0.1	-0.8	0.0	-0.3	-0.7	-0.3	-0.5	-0.2	-0.1
		2005	-0.6	-0.6	-1.0	-1.0	0.5	-1.3	0.0	0.2	-0.6	-0.5	-1.0	-1.0	-0.5	-0.5	-0.2
		2006	-0.6	-0.1	-0.9	-0.5	0.2	-1.3	-0.1	-0.2	-0.4	-0.4	-0.5	-0.4	-0.5	-0.7	-0.4
		2007	-0.8	-0.2	0.1	-0.7	0.4	-1.3	0.1	-0.2	-0.3	-0.3	-0.6	0.2	-0.5	-0.4	-0.1
	February	2004	0.2	0.4	-0.1	0.1	0.6	1.9	0.4	-0.7	-0.2	0.4	0.9	1.3	0.2	-0.2	0.4
		2005	0.4	0.7	-0.1	0.2	0.8	2.2	0.4	-1.7	-0.1	0.6	0.9	1.7	0.2	0.4	0.6
		2006	0.4	0.4	-0.1	0.1	0.5	2.3	0.3	-1.6	0.2	0.8	1.2	1.5	0.4	0.4	0.7
		2007	0.4	0.4	-0.2	0.1	0.6	2.1	0.3	-1.4	0.0	0.6	1.1	0.5	0.3	0.3	0.6
	March	2004	0.5	0.4	1.0	0.7	0.8	0.1	0.4	2.9	0.2	-0.4	0.4	0.1	0.2	0.9	0.5
		2005	0.3	0.7	1.2	0.9	0.8	0.6	0.4	2.5	0.4	0.4	0.2	0.3	0.5	0.3	0.8
		2006	0.1	0.4	1.2	0.7	0.8	-0.1	0.3	2.7	1.2	0.3	0.3	0.2	0.2	0.7	0.5
		2007	0.1	0.4	1.2	0.6	0.8	0.2	0.3	2.5	0.7	0.2	0.3	0.2	0.3	0.5	0.6
	April	2004	0.2	0.3	0.8	1.4	0.3	0.5	-0.1	0.4	1.0	0.0	0.3	0.5	0.4	0.3	0.1
		2005	0.0	0.2	0.8	1.4	0.2	0.2	-0.2	0.8	0.7	0.3	0.6	0.7	0.4	0.2	0.5
		2006	0.4	0.4	0.9	1.4	0.5	0.6	0.6	1.0	0.6	0.6	0.5	0.5	0.6	0.5	0.5
		2007	0.0	0.2	0.8	1.2	0.4	0.4	0.4	0.9	0.7	0.3	0.5	0.3	0.5	0.3	0.3
	May	2004	0.2	0.4	0.1	0.6	0.2	0.3	0.4	0.5	0.8	0.2	0.2	0.5	0.3	0.4	0.4
		2005	0.4	0.0	0.3	0.2	-0.1	0.2	0.0	0.4	0.6	-0.3	0.2	0.5	0.3	0.1	-0.1
		2006	0.2	0.4	0.3	0.4	0.0	0.4	0.0	0.1	0.5	-0.1	0.5	0.6	0.5	0.2	0.2
		2007	0.2	0.2	0.3	0.2	0.0	0.3	0.0	0.1	0.6	-0.1	0.4	0.4	0.4	0.2	0.2
	June	2004	0.0	0.1	0.2	0.2	-0.7	-0.1	0.2	-0.2	1.2	-0.1	0.5	0.4	0.0	-0.5	-0.3
		2005	0.2	0.2	0.0	0.3	-0.3	0.3	0.3	-0.2	0.1	0.3	0.3	-0.1	0.0	0.1	0.2
		2006	0.1	0.0	0.1	0.2	-0.3	0.1	0.0	-0.1	0.0	0.0	0.2	0.3	0.3	0.0	0.2
		2007	0.2	0.1	0.1	0.1	-0.4	0.0	0.1	-0.1	0.2	0.1	0.3	0.3	0.1	0.0	0.1
	July	2004	0.4	-0.2	-0.2	-0.7	-0.3	-1.0	-0.3	-1.9	-0.9	-0.3	-0.4	-0.8	-0.3	-0.2	-0.3
		2005	0.4	-0.2	-0.2	-0.6	-0.3	-1.0	-0.3	-1.3	0.4	-0.3	-0.1	-0.1	0.1	-0.3	-0.2
		2006	0.5	-0.2	-0.3	-0.5	-0.4	-1.1	-0.2	-0.8	-0.1	-0.5	-0.1	-0.6	0.0	-0.3	-0.3
		2007	0.3	-0.3	-0.4	-0.7	-0.3	-1.1	-0.2	-0.8	-0.1	-0.3	-0.1	-0.1	-0.1	-0.2	-0.3
	August	2004	0.1	0.2	-0.2	0.5	0.2	1.7	0.4	-0.3	-0.4	0.3	0.6	1.1	0.3	-0.1	-0.4
		2005	0.2	0.4	-0.2	0.5	0.3	1.8	0.2	-0.6	0.2	0.4	0.5	1.4	0.3	0.3	0.1
		2006	-0.1	0.3	-0.2	0.2	0.5	1.7	0.3	-1.0	-0.1	0.3	0.8	1.1	0.4	0.0	0.0
		2007	0.0	0.3	-0.2	0.3	0.3	1.7	0.3	-0.9	0.0	0.3	0.7	0.4	0.3	0.1	0.0
	September	2004	-0.3	0.1	0.5	0.2	0.8	-0.1	-0.1	2.1	-0.1	0.4	0.1	0.2	0.1	0.8	0.8
		2005	0.3	0.4	0.6	0.6	0.9	0.0	0.6	2.4	0.2	0.6	0.7	0.6	0.2	0.8	0.8
		2006	-0.5	-0.2	0.7	-0.2	0.5	-0.5	-0.1	2.0	0.4	0.1	-0.3	-0.6	0.1	0.5	0.4
		2007	0.0	0.1	0.7	0.3	0.7	-0.2	0.0	1.8	0.2	0.3	0.0	-0.2	0.2	0.5	0.6
	October	2004	0.2	0.4	0.3	1.0	0.2	0.5	0.5	0.7	0.5	0.4	0.1	0.5	0.2	0.4	0.4
		2005	0.0	0.0	0.7	0.8	0.0	-0.2	0.0	0.7	0.4	0.0	0.0	0.8	0.1	0.3	0.0
		2006	-0.2	-0.1	0.2	0.5	0.0	-0.3	0.1	0.6	0.5	0.1	0.0	0.4	0.1	0.2	0.1
		2007	0.0	0.1	0.4	0.8	0.0	-0.2	0.1	0.5	0.4	0.1	0.0	0.2	0.1	0.2	0.1
	November	2004	-0.4	0.0	0.2	0.2	-0.4	-0.2	0.2	0.1	0.3	-0.5	0.2	0.3	0.2	-0.7	-0.3
		2005	-0.5	-0.3	0.0	0.2	-0.3	-0.1	-0.2	-0.2	0.2	-0.3	-0.2	-1.0	0.0	-0.3	-0.4
		2006	-0.1	0.0	0.3	0.4	-0.3	0.1	-0.1	-0.2	0.3	-0.3	-0.1	-0.4	0.0	-0.3	-0.1
		2007	-0.1	0.1	0.3	0.4	-0.3	0.0	-0.1	-0.2	0.3	-0.2	-0.1	0.2	0.0	-0.2	-0.1
	December	2004	1.1	0.2	0.3	-0.1	-0.8	-0.3	0.4	0.5	0.1	0.0	0.1	-0.3	0.5	0.0	-0.3
		2005	1.0	0.2	0.0	0.2	-0.4	0.1	0.3	0.6	0.1	0.1	-0.2	-0.4	0.3	0.1	0.1
		2006	1.1	0.2	0.1	0.3	-0.5	-0.1	0.3	0.5	0.1	0.1	0.0	0.1	0.3	0.1	-0.1
		2007	1.2	0.2	0.2	0.3	-0.5	-0.1	0.3	0.5	0.1	0.1	0.0	0.2	0.3	0.1	-0.1

Forecasts for Germany without effects in 2007

Source: EUROSTAT & IFL (UC3M)

Date: October 26, 2006

Bold figures are forecasts



II.2. INFLATION, ECONOMIC GROWTH AND MONETARY POLICY.

II.2.1. Inflation

In September, euro area inflation performed as expected with a zero monthly growth rate and the annual inflation rate falling by 0.6 pp from the August figure, to 1.7%.

Table II.2.1.1

ANNUAL RATES OF GROWTH IN THE EURO AREA *						
INFLATION	Observed		Forecasts			
	Aver (2) 2005	2006 Sep ⁽¹⁾	2006 Oct ⁽¹⁾	Aver 2006 ⁽²⁾	Aver ** 2007 ⁽²⁾	Aver *** 2007 ⁽²⁾
CORE (83,83%)	1,5	1,5	1,5 (±0,14)	1,4 (±0,04)	1,6 (±0,34)	1,8 (±0,34)
TOTAL (100%)	2,2	1,7	1,6 (±0,12)	2,2 (±0,04)	1,6 (±0,39)	1,9 (±0,39)

* Intervals at 80% of confidence calculated with historical errors.

** Without considering the effect of the change of the VAT on the inflation.

*** Considering the effect of the change of the VAT on the inflation.

Source: EUROSTAT & IFL(UC3M)

Date: October 26, 2006

⁽¹⁾ Year-on-year rate

⁽²⁾ Annual average rate

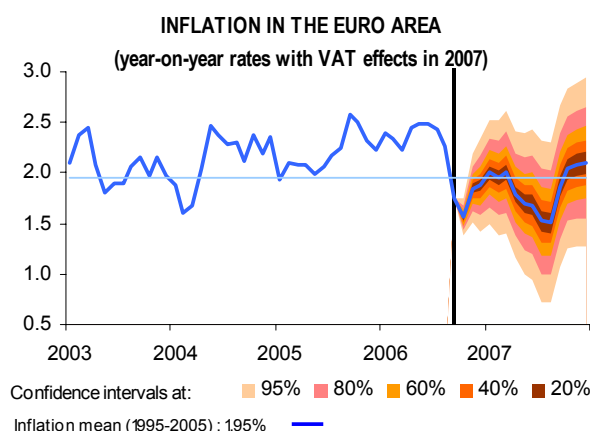
With regards to core inflation components, an upwards innovation was observed in non-energy industrial goods, partly due to the upwards revision of 0.1 pp to 1.6% performed by Eurostat on their monthly inflation rate in March, 2006. For both 2006 and 2007, the forecast mean annual core inflation rate is revised upwards by 0.1 pp to 1.5% (±0.04)² and 1.8% (±0.34), respectively.

Outside core inflation, there was an upwards innovation in unprocessed food, which was partly compensated by the downwards innovation observed in energy productions. The latter, and considering the latest information available about international energy prices, compensates for the expected small increase in core inflation, maintaining our forecast for headline inflation in 2006 in the euro area at 2.2% (±0.04).

Considering the impact on euro area inflation of the three percentage point increase in the German VAT rate, and assuming that 80-85% of the increase is transferred to consumer prices, our forecast for headline inflation in the euro area remains at around 1.9% (±0.39). In other words, even using this measure of inflation, the likelihood of meeting the inflation target established by the ECB for 2007 is just over 50% (see graph II.2.1.1).

² The values in brackets correspond to 80% confidence intervals.

Graph II.2.1.1

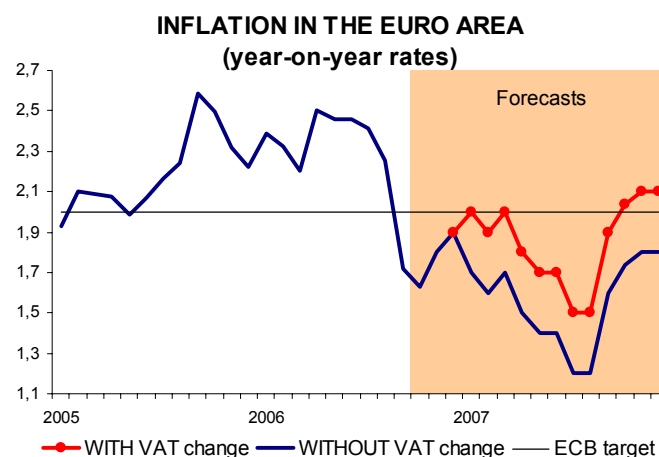


Source: EUROSTAT & IFL(UC3M)

Date: October 26, 2006

In as much as the price increase due to rising VAT rates in Germany does not represent greater inflationist pressure on the markets, it should not be taken into account when designing monetary policy. With this assumption, we are revising our forecast mean annual core inflation rate upwards by 0.1 pp to 1.6% (±0.34) for 2007, whereas our last month's headline inflation forecast for next year remains unaltered at 1.6% (±0.39) (see graph II.2.1.2).

Graph II.2.1.2



Source: EUROSTAT & IFL(UC3M)

Date: October 26, 2006

As for the evolution of inflation expectations for 2006 (see graph II.2.1.1), we are expecting inflation to slow down slightly in October, to 1.6% (±0.12), largely due to the expected fall in energy prices, returning to the central values in the 1.6% to 2% range in November, and from 1.6% to 2.2% in December, at 80% significance.



Table II.2.1.2

	EXPECTED INFLATION		REAL INTEREST RATE	
	Three Months	One Year	Three Months	One Year
Portugal	3.07	3.03	0.42	0.76
Greece	2.96	2.91	0.53	0.88
Italy	2.81	2.97	0.68	0.82
Spain	2.49	2.49	1.00	1.30
Ireland	2.20	2.21	1.29	1.58
Luxembourg	2.20	2.20	1.29	1.59
Netherlands	1.66	1.72	1.83	2.07
Austria	1.59	1.62	1.90	2.17
Belgium	1.51	1.49	1.98	2.30
France	1.46	1.46	2.04	2.33
Germany	1.01	1.03	2.48	2.76
Finland	0.84	0.85	2.65	2.94

Source: EUROSTAT & IFL(UC3M)

Date: October 26, 2006

Within the euro area, the most inflationist countries in 2006 and 2007 will be Portugal, Greece, Italy, Spain and Ireland. The least inflationist will be Finland, Germany, France, Belgium and Austria. The heterogeneity of the different inflation rates in the euro area is the reason for the real wide interest rate differentials (see table II.2.1.2). However, the increases in nominal interest rates in the last few months and the slight improvement in inflation expectations for most euro area countries, means that two thirds of these countries present real interest rates of over 1%, with the exception of Portugal, Greece, Italy and Spain, where lower real interest rates can be found.

II.2.2 Economic growth

In the last estimation published by Eurostat on October 11, year-on-year economic growth in the euro area was revised upwards slightly by 0.1 pp to 2.7% in the second quarter of 2006, six tenths more than the rate observed in the previous quarter. The evolution of the GDP grew by two tenths from the previous quarter in terms of its quarter-on-quarter rate, to 0.9%.

This economic dynamism is consistent with the good evolution of exports, supported by strength in other economic areas in the same period, and investment, the strength of which is explained by the high growth of business profits and the still low interest rates, which compensated for the negative impact of high oil prices during the first part of the year.

Indeed, analysing the composition of this growth, we observe that in the second quarter, private consumption fell slightly by reducing its annual growth rate from 1.8% to 1.7%, whereas investment presented a year-on-year rate of 4.8%, 0.6 pp higher than the first estimate published by Eurostat

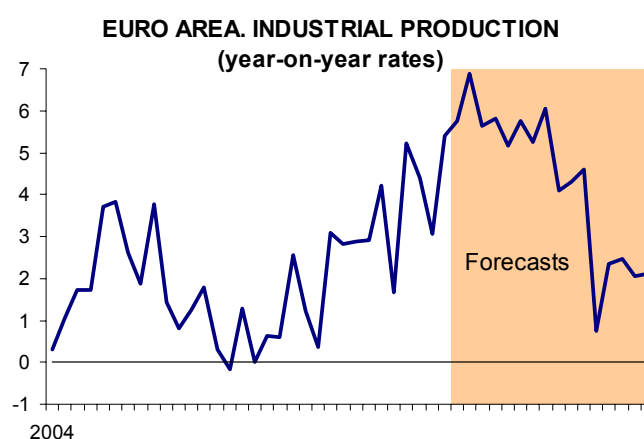
and 2 pp more than in the first quarter of this year. As a result of this, internal demand increased its contribution to GDP growth by 0.3 pp to 2.4 pp, 0.2 pp more than the first estimate.

As for the foreign sector, both exports and imports registered annual rates lower than those observed in the first quarter, although exports grew more (8.6%) than imports (8.2%), so external demand provided the remaining 0.3 pp compared with a zero contribution in the first quarter.

On the other hand, the most recent quantitative and qualitative indicators, unlike the information provided in last month's report, indicate that this economic dynamism will remain in the third and fourth quarters of 2006.

According to the Industrial Production Index (IPI), forecast growth in the industrial sector is revised upwards both for 2006 and 2007, consolidating the recovery which started in the third quarter of 2005. Expectations show an acceleration of growth in the third and fourth quarter of 2006, but tend to gradually decline starting in the first quarter of 2007, to a year-on-year IPI rate of around 2.2% in the fourth quarter, similar to that registered in the last quarter of 2005, when the industrial sector had already started to recover. We therefore expect a mean annual IPI growth rate of 4.5% and 3.8% for 2006 and 2007, respectively (see graph II.2.2.1). This pattern of growth forecast for the IPI in the euro area is consistent with our forecast for the industrial sector's GVA, as we are estimating a mean annual growth rate of 4.3% in 2006 and 3.2% in 2007.

Graph II.2.2.1



Source: EUROSTAT & IFL(UC3M)

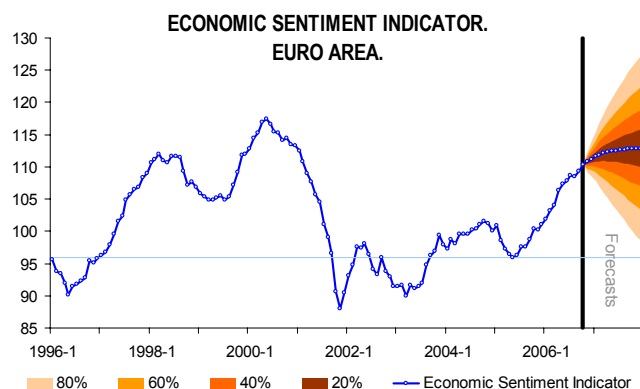
Date: October 26, 2006

With regards to qualitative information, the fall in the Economic Sentiment Indicator in August, which we included in our models in the last report, practically disappears with the new weightings used by



Eurostat to obtain the aggregate indicator. In October, this indicator performed slightly better than expected, reaching 110.3 points compared with the 109.3 observed in September, due to the confidence of the industrial sector, services and retail trade. As a result of this slight upwards innovation and the aforementioned methodological change, the forecast for this indicator is revised upwards, expecting a slight improvement in the next few months, after which it will tend to stabilise in the last quarter of 2007 at around 112.8 points (see graph II.2.2.2)

Graph II.2.2.2



Source: European Commission & IFL (UC3M)
Date: October 31, 2006

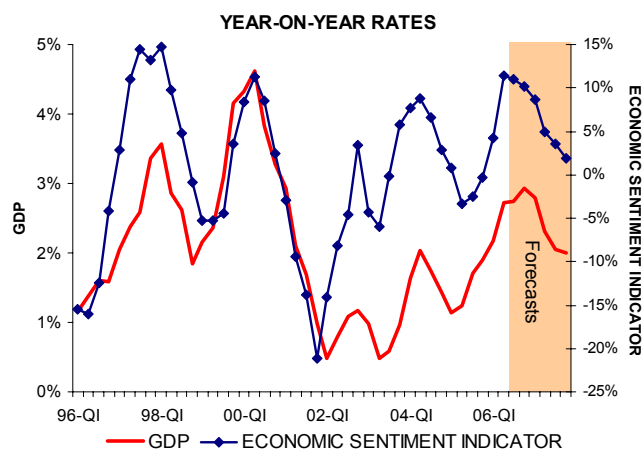
With all this new information, we have updated our GDP growth forecasts for the euro area for 2006-2007, giving rise to an upwards revision resulting both from the slight higher estimation for the second quarter of 2006 and the improved expectations derived from more recent indicators. Indeed, the mean annual GDP growth rate in real terms for 2006 is revised upwards slightly to 2.6%, although we continue to expect a slight fall in economic growth in the first quarter of 2007, which will increase during the year, so in 2007 we expect the euro area economy to grow by around 2.3%, 0.1 pp more than our previous forecast. Graph II.2.2.3 shows both economic growth in the euro area and the growth in the expectations of economic agents about the evolution of the area's economy.

In terms of the quarter-on-quarter rate, GDP growth may have reached a local peak in the second quarter of 2006, with a quarter-on-quarter rate of 0.9%, expecting a slight slow down in the next two quarters, but remaining at around 0.5% in 2007.

As for the two components on which economic dynamism in the euro area is based, we expect investment to remain strong in the third and fourth quarters of this year, although it will fall from the first quarter of 2007 on, reaching a mean annual rate of 3.6%, whereas the growth of exports will fall

in the last two quarters of 2006 and even more so in 2007 (see table II.2.2.1).

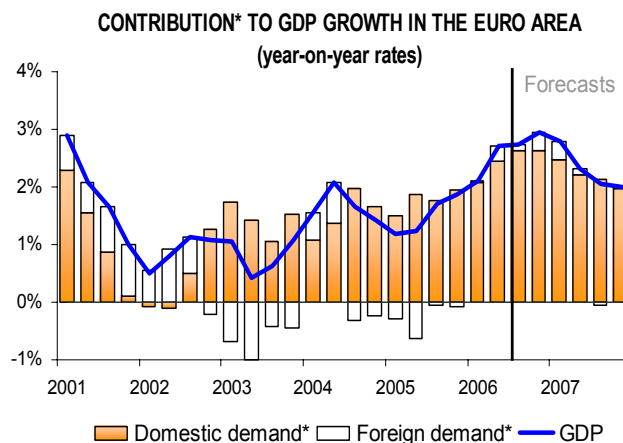
Graph II.2.2.3



Source: EUROSTAT, European Commission & IFL (UC3M)
Date: October 31, 2006

Ultimately, as a result of this pattern of growth, internal demand will increase its contribution to economic growth in 2006 by 0.6 pp to 2.4 pp, whereas external demand will provide the remaining 0.2 pp, increasing its contribution by 0.5 pp relative to 2005. For 2007, however, due to the expected slow down, the contribution of internal demand will fall to 2.2 pp and that of external demand to 0.1 pp (see graph II.2.2.4).

Graph II.2.2.4



Source: EUROSTAT & IFL (UC3M)
Date: October 31, 2006

In this scenario of inflation and economic growth, the ECB might decide to increase the reference interest rate by a quarter of a point in December, in order to anchor the expectations of economic agents. If our growth and price forecasts are confirmed in the next few months, the increases in the ECB reference interest rate could stop at 3.5%.



Table II.2.2.1

ANNUAL RATES OF GROWTH IN GDP AND COMPONENTS												
	Observed		Forecasts									
			Annual		Quarterly*							
	2004	2005	2006	2007	2006 QI	2006 QII	2006 QIII	2006 QIV	2007 QI	2007 QII	2007 QIII	2007 QIV
Private Final Consumption Expenditure	1.3	1.4	1.8	1.7	1.8	1.7	1.9	1.9	1.8	1.7	1.7	1.6
Public Final Consumption Expenditure	1.2	1.4	2.4	2.3	2.4	2.4	2.5	2.5	2.4	2.4	2.3	2.2
Gross Fixed Capital Formation	2.6	3.3	4.4	3.6	2.8	4.8	5.0	5.1	4.7	3.5	3.4	3.0
Exports of Goods and Services	6.3	4.5	8.1	5.6	9.3	8.6	6.9	7.7	5.8	5.7	5.6	5.2
Imports of Goods and Services	6.2	5.5	8.0	5.5	9.7	8.2	6.9	7.2	5.2	5.6	6.0	5.3
Contributions of Domestic Demand	1.5	1.8	2.4	2.2	2.1	2.4	2.6	2.6	2.5	2.2	2.1	2.0
Contributions of Foreign demand	0.2	-0.3	0.2	0.1	0.0	0.3	0.1	0.3	0.3	0.1	-0.1	0.0
Real GDP	1.7	1.5	2.6	2.3	2.1	2.7	2.7	2.9	2.8	2.3	2.0	2.0
Gross Value Added Total	1.8	1.5	2.7	2.3	2.1	2.7	2.9	3.1	2.7	2.3	2.1	2.1
GVA Agricultura	11.1	-5.4	0.0	1.0	-2.7	0.4	1.5	0.8	2.0	1.3	0.8	-0.1
GVA Industry	2.2	1.3	4.3	3.2	3.4	3.9	4.7	5.1	4.3	3.5	2.7	2.5
GVA Construction	1.1	1.0	2.2	0.8	2.0	3.0	2.4	1.5	1.4	0.5	0.7	0.7
GVA Market services	2.3	2.1	3.3	2.8	2.9	3.5	3.5	3.4	3.2	2.8	2.6	2.5
GVA Financial services	1.1	2.2	2.6	2.6	1.9	2.7	2.6	3.2	2.9	2.4	2.4	2.6
GVA Public services	1.0	1.3	1.2	1.2	0.9	1.1	1.2	1.4	1.1	1.3	1.3	1.2
	Levels at the end of the period											
Economic Sentiment Indicator	100.0	101.1	111.2	112.9	104.0	107.8	109.3	111.2	112.1	112.5	112.8	112.9

(*) Appreciation from same quarter one year earlier

Source: EUROSTAT & IFL (UC3M)

Date: October 31, 2006



II.3. TABLES AND PLOTS.

Tables:

- Euro area Harmonized Index of Consumer Price (HICP) disaggregation.
- Europe Forecast errors by sectors for euro area.
- Euro area and European Union countries forecasts errors.

Plots:

- HICP monthly growth rates in the euro area (observed and forecasts).
- Annual forecast for the euro area Inflation.
- Fan chart of annual forecast for the euro area Inflation.
- Year-on-year rate of euro area inflation and contributions of main components.
- Box diagram of the euro area countries annual average rates of growth.
- Euro area , United Kingdom, France and Germany Inflation (year-on-year rate)



METHODOLOGY: ANALYSIS OF EURO AREA INFLATION BY SECTORS

BASIC COMPONENTS AGGREGATES			BASIC COMPONENTS
HICP TOTAL	IPSEBENE 83.365% 1 + 2 + 3 + 4	BENE 42.582% 1 + 2 + 3	(1) AE (a) 9.335% <i>HICP Processed Food</i> (2) TOBACCO 2.505% <i>HICP Tobacco</i> (3) MAN 30.742% <i>HICP Non Energy Industrial Goods</i> (4) SER 40.783% <i>HICP Services</i> (5) ANE 7.436% <i>HICP Non processed Food</i> (6) ENE 9.199% <i>HICP Energy</i>
	CORE INFLATION (IT IS CALCULATED ON THE IPSEBENE INDEX)		
	RESIDUAL INFLACION 16.635% 5 + 6 RESIDUAL INFLATION (IT IS CALCULATED ON THE RESIDUAL INDEX)		
$IPCA = 0.09335 \text{ AE} + 0.02505 \text{ TABACO} + 0.30742 \text{ MAN} + 0.40783 \text{ SER} + 0.07436 \text{ ANE} + 0.09199 \text{ ENE}$			

(a) To date the aggregate AE, following Eurostat methodology, included tobacco prices. From now on, our definition of AE, processed food, is more accurate and does therefore not include tobacco prices.

Source: Eurostat & IFL (UC3M)
2006 weights

FORECAST ERRORS IN THE MONTHLY INFLATION RATE BY SECTORS IN THE EURO AREA IN SEPTEMBER					
	Weights 2006	Annual Growth Observed	Observed Monthly Growth	Forecast	Confidence interval at 80%
HICP Processed Food	118.40	1.83	0.08	0.01	± 0.14
HICP Processed Food excluding tobacco	93.35	1.80	0.06	-0.01	± 0.09
HICP Tobacco	25.05	1.97	0.16	0.10	± 0.13
HICP Non Energy Industrial Goods	307.42	0.82	1.49	1.29	± 0.10
HICP Non Energy Processed Goods	425.82	1.10	1.09	0.92	± 0.09
HICP Services	407.83	1.98	-0.43	-0.43	± 0.14
CORE INFLATION (1)	833.65	1.53	0.33	0.25	± 0.08
HICP Unprocessed Food	74.36	4.62	0.56	0.31	± 0.46
HICP Energy (2)	91.99	1.54	-3.25	-2.51	± 0.60
RESIDUAL INFLATION (3)	166.35	2.88	-1.59	-1.29	± 0.39
GLOBAL INFLATION (4)	1000	1.75	0.00	-0.02	± 0.09
(1) aggregation error 0.02%					
(2) aggregation error -0.03%					
(3) aggregation error 0.04%					
(4) aggregation error -0.09%					

Source: EUROSTAT & IFL(UC3M)
Date: October 17, 2006



**FORECAST ERRORS IN THE MONTHLY INFLATION RATE IN THE EURO AREA AND EUROPEAN UNION
IN SEPTEMBER**

	Weights 2006 euro area	Weights 2006 EU	Observed Monthly Rate	Forecast	Confidence Intervals at 80%	Observed Annual Rate
Spain	119.62		-0.19	-0.09	± 0.15	2.94
Germany	287.48		-0.49	-0.33	± 0.29	0.99
Austria	31.13		-0.14	0.48	± 0.37	1.33
Belgium	33.60		-0.47	0.12	± 0.32	1.86
Finland	15.83		0.10	0.48	± 0.37	0.79
France	202.98		-0.20	-0.18	± 0.20	1.48
Greece	28.70		2.05	1.98	± 0.78	3.14
Netherlands	52.18		0.48	0.88	± 0.33	1.51
Ireland	13.40		-0.29	0.53	± 0.30	2.17
Italy	190.51		0.68	0.12	± 0.23	2.39
Luxembourg	2.68		-0.56	0.37	± 0.32	1.97
Portugal	21.89		0.41	0.01	± 0.66	2.99
Denmark		11.73	0.39	0.69	± 0.27	1.49
United Kingdom		186.86	0.10	0.27	± 0.33	2.39
Sweden		18.74	0.48	0.61	± 0.50	1.24

(1) aggregation error -0.03%

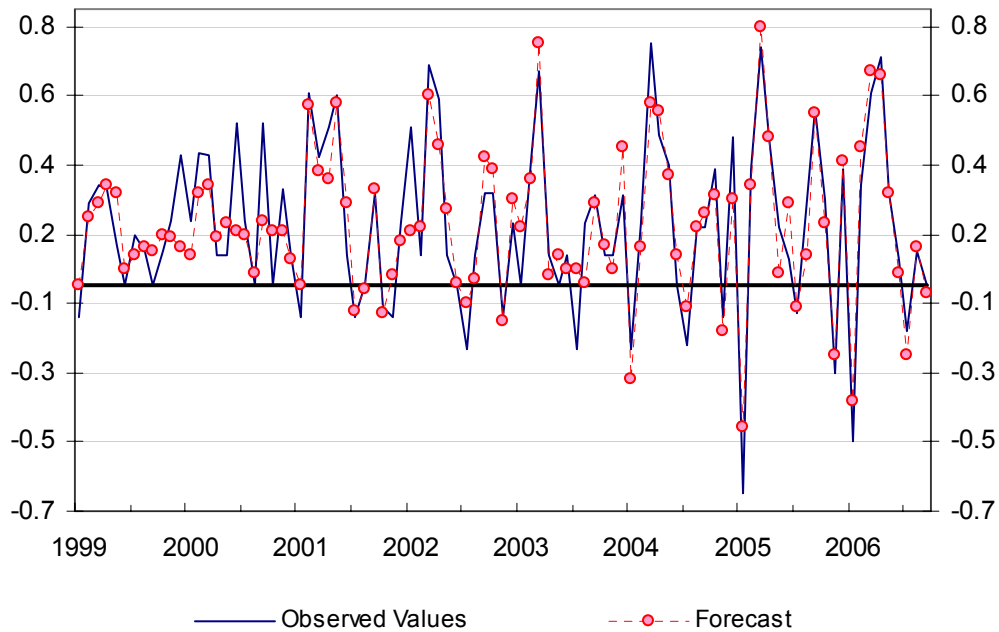
(2) aggregation error -0.08%

Source: EUROSTAT & IFL(UC3M)

Date: October 17, 2006



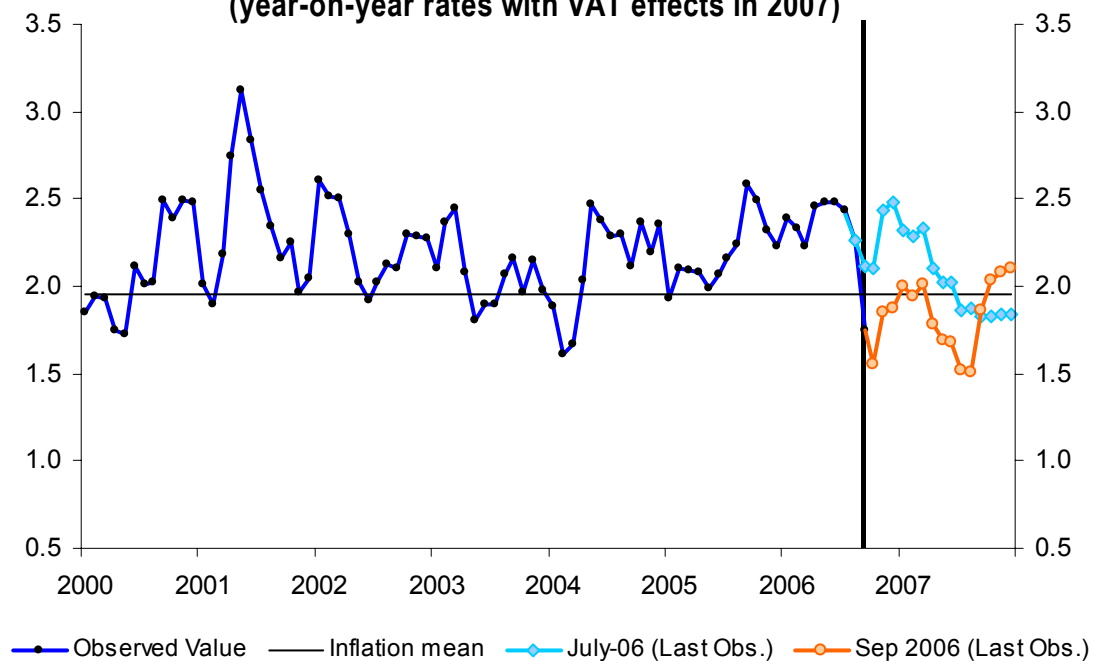
HICP MONTH-ON-MONTH RATES OF GROWTH IN THE EURO AREA



Source : EUROSTAT & IFL(UC3M)
Date: October 17, 2006

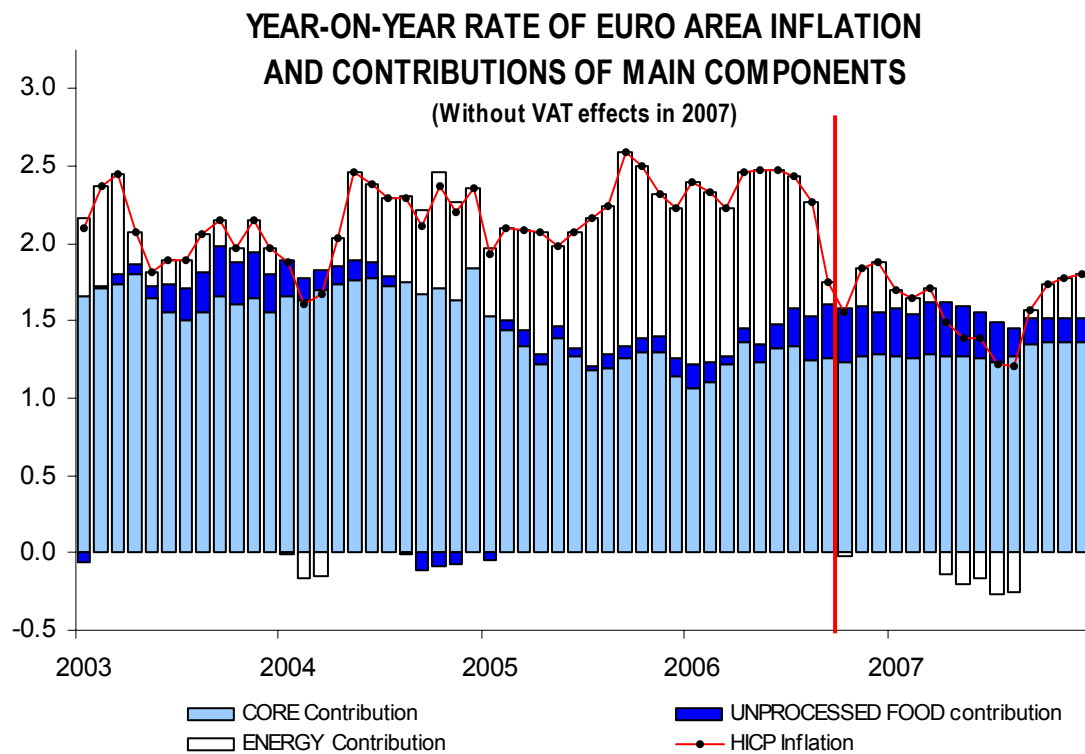
* the roof of mean square error for one month ahead is 0.09

INFLATION IN THE EURO AREA (year-on-year rates with VAT effects in 2007)

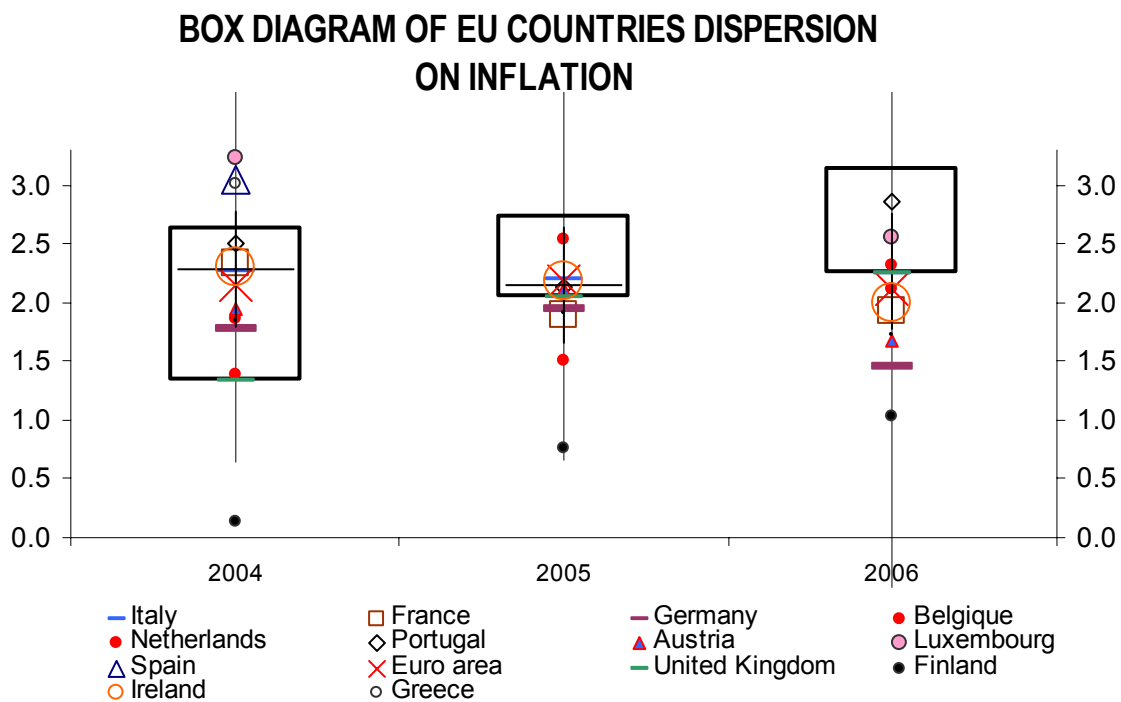


Source: EUROSTAT & IFL(UC3M)
Date: October 26, 2006



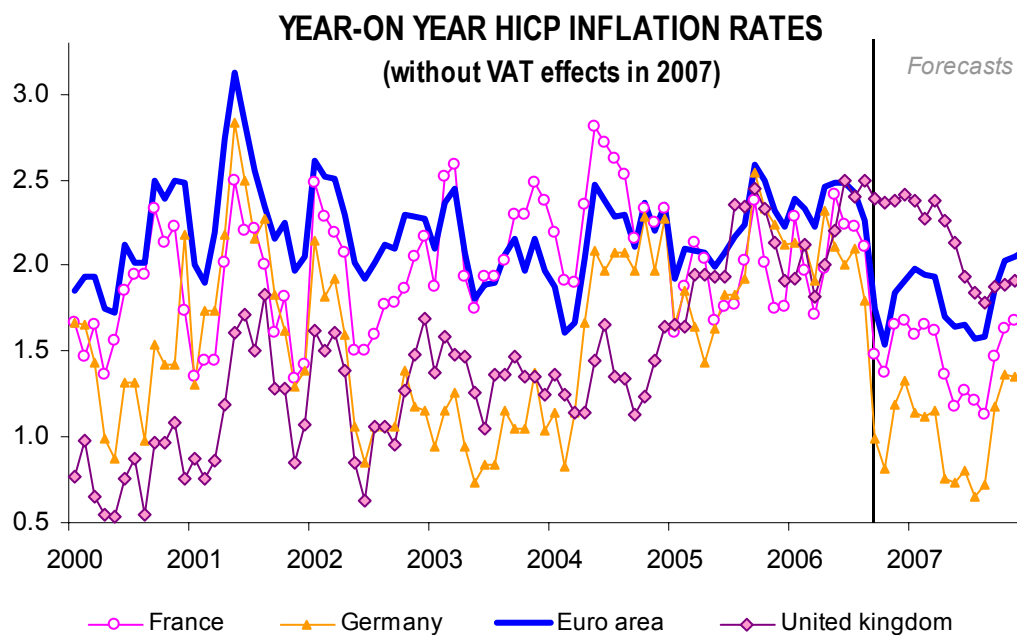


Source: EUROSTAT & IFL(UC3M)
Date: October 26, 2006



Source: EUROSTAT & IFL(UC3M)
Date: October 26, 2006





Forecasts for Germany inflation without effects of VAT in 2007.
 Source: EUROSTAT & IFL(UC3M)
 Date: October 26, 2006





III. UNITED STATES.

III.1. MACROECONOMIC FORECASTS.

III.1.1 INDUSTRIAL PRODUCTION INDEX: MONTHLY AND QUARTERLY FORECASTS.

Table III.1.1.1

ANNUAL RATES OF GROWTH IN THE IPI AND SECTORS												
	Observed		Annual		Forecasts							
	2004	2005	2006	2007	Quarterly*							
					2006 QI	2006 QII	2006 QIII	2006 QIV	2007 QI	2007 QII	2007 QIII	2007 QIV
Total	4.1	3.3	4.1	3.1	3.5	4.0	5.0	4.0	3.4	2.5	2.6	3.5
Consumer goods												
Durable consumer goods	2.8	2.3	1.7	3.0	2.7	1.7	0.5	1.8	1.2	3.1	3.8	3.7
Non-durable consumer goods	1.8	2.4	1.7	1.6	1.2	1.2	2.4	1.8	1.7	1.5	1.3	1.6
Equipment & Supplies	4.6	4.9	4.9	3.7	5.0	4.7	5.6	4.3	3.8	3.8	3.1	3.5
Materials	4.2	2.0	4.7	4.4	2.5	3.8	5.7	6.7	5.1	4.5	4.0	4.0

(*) Appreciation from same quarter one year earlier

Source: FEDERAL RESERVE & IFL (UC3M)

Date: October 19, 2006

Table III.1.1.2

OBSERVED VALUES AND FORECASTS IN THE IPI ANNUAL RATES

	2001	2002	2003	2004	2005	2006*	2007*
January	0.32	-4.01	2.13	1.91	4.63	2.90	4.15
February	-0.64	-3.27	2.61	3.27	3.48	3.24	3.48
March	-1.59	-2.54	1.66	2.88	3.28	4.33	2.71
April	-3.62	0.15	-0.60	4.19	4.12	3.04	3.26
May	-3.25	-0.24	-0.51	5.49	2.39	4.58	2.09
June	-4.08	1.12	-1.49	4.83	3.70	4.43	2.16
July	-3.92	0.79	-0.61	5.21	3.17	5.21	1.75
August	-3.79	1.38	-0.37	4.63	3.31	4.61	2.83
September	-4.99	2.00	0.00	3.82	2.13	5.26	3.84
October	-5.32	2.03	0.69	4.64	2.44	5.05	3.39
November	-5.77	2.31	1.76	3.67	3.24	3.62	3.96
December	-5.77	2.05	2.36	4.41	3.74	3.32	3.22

*The shaded values are forecasts.

Source: FEDERAL RESERVE & IFL (UC3M)

Date: October 19, 2006



III.1.2 INFLATION.

AVERAGE ANNUAL RATE OF GROWTH IN US

CONSUMER PRICES INDEX (CPI)	2002	2003	2004	2005	2006 (forecasts)	2007 (forecasts)
Food (1)	1.8	2.1	3.4	2.4	2.3	2.4
Energy (2)	-5.9	12.2	10.9	16.9	11.0	0.1
Residual Inflation (3=2+1)	-0.8	5.3	6.0	7.6	5.7	1.5
Non-food and non-energy goods (4)	-1.1	-2.0	-0.9	0.5	0.4	0.3
Less tobacco	-1.5	-2.1	-1.0	0.3	0.2	0.2
-Durable goods	-2.6	-3.2	-2.3	0.4	-0.5	-0.2
-Nondurable goods	0.4	-0.7	0.5	0.6	1.3	0.8
Non-energy services (5)	3.8	2.9	2.9	2.8	3.4	3.6
-Services less owner's equivalent rent of primary residence (5-a)	3.6	3.2	3.3	3.1	3.4	3.3
-Owner's equivalent rent of primary residence (a)	4.1	2.4	2.3	2.3	3.5	4.0
Core Inflation (6=4+5)	2.3	1.5	1.8	2.2	2.5	2.7
Core inflation less owner's equivalent rent of primary residence (6-a)	1.7	1.1	1.6	2.1	2.1	2.1
Core inflation less owner's equivalent rent of primary residence and tobacco	1.6	1.1	1.6	2.1	2.1	2.1
Total Inflation (7=6+3)	1.6	2.3	2.7	3.4	3.2	2.4
All items less owner's equivalent rent of primary residence (7-a)	0.9	2.2	2.8	3.7	3.2	1.9

Source: BLS & IFL (UC3M)

Date: October 18, 2006



USA ANNUAL RATES OF GROWTH ON CPI AND ITS COMPONENTS															
		CONSUMER PRICE INDEX													
		CORE INFLATION								Confidence Intervals at 80% level	RESIDUAL INFLATION			ALL	Confidence Intervals at 80% level
		Non energy commodities less food			Non energy services			ALL			ALL				
		durables	non durables less energy	ALL	Owner's equivalent rent of primary residences	Other services	ALL		Food			Energy			
IR December 2005		11.6%	10.7%	22.3%	23.4%	31.6%	55.1%	77.4%		13.9%	8.7%	22.6%	100.0%		
AVERAGE ANNUAL	2001	-0.6	1.1	0.3	3.8	3.6	3.7	2.7		3.1	3.8	3.3	2.8		
	2002	-2.6	0.4	-1.1	4.1	3.6	3.8	2.3		1.8	-5.9	-0.8	1.6		
	2003	-3.2	-0.7	-2.0	2.4	3.2	2.9	1.5		2.1	12.2	5.3	2.3		
	2004	-2.3	0.5	-0.9	2.3	3.3	2.9	1.8		3.4	10.9	6.0	2.7		
	2005	0.4	0.6	0.5	2.3	3.1	2.8	2.2		2.4	16.9	7.6	3.4		
	2006	-0.5	1.3	0.4	3.5	3.4	3.4	2.5	± 0.05	2.3	11.0	5.7	3.2	± 0.07	
	2007	-0.2	0.8	0.3	4.0	3.3	3.6	2.7	± 0.36	2.4	0.1	1.5	2.4	± 0.48	
2005	January	0.8	0.9	0.9	2.3	3.1	2.8	2.3		2.9	10.6	5.5	3.0		
	February	0.6	0.9	0.7	2.5	3.4	3.0	2.4		2.6	10.4	5.2	3.0		
	March	0.5	0.6	0.6	2.4	3.4	3.0	2.3		2.5	12.4	6.0	3.1		
	April	0.5	0.4	0.5	2.3	3.3	2.9	2.2		3.1	17.1	8.0	3.5		
	May	0.8	0.5	0.6	2.3	3.1	2.7	2.2		2.4	9.9	5.1	2.8		
	June	0.8	0.2	0.4	2.2	3.0	2.7	2.0		2.2	7.3	4.1	2.5		
	July	0.7	0.3	0.5	2.3	3.1	2.8	2.1		2.1	14.2	6.5	3.2		
	August	0.6	0.8	0.7	2.2	3.1	2.7	2.1		2.2	20.2	8.7	3.6		
	September	0.4	0.7	0.6	2.3	2.7	2.5	2.0		2.5	34.8	14.2	4.7		
	October	0.2	0.5	0.4	2.3	3.0	2.7	2.1		2.2	29.5	12.2	4.3		
	November	-0.3	0.6	0.1	2.4	3.2	2.9	2.1		2.2	18.3	8.1	3.5		
	December	-0.5	0.9	0.2	2.5	3.3	2.9	2.2		2.3	17.1	7.6	3.4		
2006	January	-0.6	1.0	0.1	2.5	3.3	2.9	2.1		2.6	24.8	10.5	4.0		
	February	-0.6	0.7	0.0	2.5	3.2	2.9	2.1		2.8	20.1	9.0	3.6		
	March	-0.5	1.0	0.3	2.7	3.0	2.8	2.1		2.6	17.3	8.0	3.4		
	April	-0.4	1.3	0.4	3.0	3.1	3.1	2.3		1.8	17.8	7.9	3.5		
	May	-0.7	1.3	0.3	3.3	3.3	3.3	2.4		1.9	23.6	10.0	4.2		
	June	-0.7	1.7	0.5	3.6	3.5	3.5	2.6		2.2	23.3	10.1	4.3		
	July	-0.3	1.4	0.5	3.7	3.4	3.5	2.7		2.2	20.5	9.2	4.1		
	August	-0.1	1.5	0.6	3.9	3.6	3.7	2.8		2.4	15.1	7.4	3.8		
	September	-0.7	1.8	0.5	4.0	3.8	3.9	2.9		2.5	-4.3	-0.4	2.1		
	October	-0.7	1.6	0.3	4.1	3.5	3.7	2.8	± 0.14	2.4	-11.2	-3.3	1.3	± 0.13	
	November	-0.5	1.5	0.4	4.2	3.4	3.8	2.8	± 0.21	2.2	-4.8	-0.6	2.0	± 0.36	
	December	-0.3	1.2	0.4	4.3	3.4	3.8	2.8	± 0.28	2.2	1.9	2.1	2.6	± 0.58	
2007	January	-0.5	1.1	0.3	4.3	3.5	3.9	2.9	± 0.35	2.1	-0.7	1.0	2.4	± 0.67	
	February	-0.5	1.1	0.3	4.4	3.4	3.8	2.8	± 0.39	2.2	2.9	2.4	2.7	± 0.69	
	March	-0.3	0.9	0.3	4.3	3.3	3.8	2.8	± 0.43	2.3	4.9	3.3	2.9	± 0.71	
	April	-0.4	0.7	0.2	4.2	3.3	3.7	2.7	± 0.47	2.5	0.3	1.6	2.4	± 0.72	
	May	-0.3	0.7	0.2	4.0	3.3	3.6	2.6	± 0.50	2.6	-4.0	-0.2	2.0	± 0.74	
	June	-0.2	0.7	0.3	3.9	3.3	3.5	2.6	± 0.54	2.6	-5.1	-0.7	1.8	± 0.76	
	July	-0.3	0.9	0.3	3.9	3.3	3.5	2.6	± 0.57	2.6	-7.7	-1.8	1.6	± 0.77	
	August	-0.3	0.8	0.3	3.8	3.3	3.5	2.6	± 0.58	2.5	-8.0	-1.9	1.6	± 0.79	
	September	-0.1	0.6	0.3	3.9	3.4	3.6	2.6	± 0.59	2.4	-1.3	0.9	2.2	± 0.80	
	October	0.0	0.7	0.4	3.9	3.3	3.6	2.7	± 0.59	2.4	6.8	4.1	3.0	± 0.81	
	November	0.0	0.7	0.4	3.9	3.3	3.5	2.6	± 0.60	2.5	9.2	5.0	3.2	± 0.82	
	December	0.0	0.8	0.4	3.9	3.3	3.6	2.7	± 0.60	2.5	8.2	4.7	3.1	± 0.83	

Confidence intervals are calculated with historical errors.

The shaded values are forecasts

Source: BLS & IFL (UC3M)

Date: October 18, 2006



USA MONTHLY RATES OF GROWTH ON CPI AND ITS COMPONENTS												
CONSUMER PRICE INDEX												
CORE INFLATION												
RESIDUAL INFLATION												
ALL												
Non energy commodities less food												
Non energy services												
durables non durables less energy ALL Owner's equivalent rent of primary Other services ALL ALL Food Energy ALL ALL												
IR December 2005 11.6% 10.7% 22.3% 23.4% 31.6% 55.1% 77.4% 13.9% 8.7% 22.6% 100.0%												
January	2004	0.1	-0.8	-0.4	0.2	0.7	0.5	0.2	0.1	4.2	1.5	0.5
	2005	0.4	-0.6	-0.1	0.3	0.5	0.4	0.3	0.3	-1.2	-0.2	0.2
	2006	0.3	-0.5	-0.1	0.3	0.5	0.4	0.2	0.6	5.3	2.4	0.8
	2007	0.1	-0.6	-0.2	0.3	0.6	0.5	0.3	0.5	2.6	1.3	0.5
February	2004	0.2	1.0	0.6	0.1	0.6	0.4	0.5	0.2	2.3	0.9	0.5
	2005	0.0	1.0	0.4	0.3	0.8	0.6	0.6	-0.2	2.2	0.7	0.6
	2006	0.0	0.6	0.3	0.3	0.8	0.6	0.5	-0.1	-1.6	-0.7	0.2
	2007	0.0	0.6	0.3	0.3	0.7	0.6	0.5	0.0	1.9	0.8	0.5
March	2004	-0.2	1.7	0.7	0.2	0.9	0.6	0.6	0.2	1.8	0.7	0.6
	2005	-0.3	1.4	0.6	0.1	0.9	0.6	0.6	0.2	3.6	1.4	0.8
	2006	-0.2	1.8	0.9	0.3	0.7	0.5	0.6	0.0	1.2	0.5	0.6
	2007	0.0	1.6	0.8	0.3	0.6	0.5	0.6	0.1	3.2	1.3	0.7
April	2004	-0.1	0.4	0.1	0.3	0.2	0.2	0.2	0.1	2.0	0.7	0.3
	2005	-0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.6	6.3	2.7	0.7
	2006	0.0	0.4	0.1	0.4	0.3	0.3	0.3	-0.2	6.8	2.6	0.9
	2007	0.0	0.2	0.1	0.3	0.3	0.3	0.2	0.1	2.1	0.9	0.4
May	2004	-0.2	-0.3	-0.2	0.2	0.0	0.1	0.0	0.9	5.6	2.5	0.6
	2005	0.1	-0.2	-0.1	0.2	-0.2	0.0	0.0	0.2	-0.9	-0.2	-0.1
	2006	-0.2	-0.2	-0.1	0.5	0.0	0.2	0.1	0.3	3.9	1.8	0.5
	2007	-0.2	-0.2	-0.2	0.3	0.0	0.1	0.0	0.3	-0.5	0.0	0.0
June	2004	-0.3	-1.0	-0.6	0.2	0.3	0.3	0.1	0.1	3.6	1.4	0.3
	2005	-0.3	-1.2	-0.8	0.1	0.3	0.2	-0.1	-0.1	1.2	0.4	0.1
	2006	-0.3	-0.8	-0.6	0.4	0.4	0.4	0.1	0.2	1.0	0.5	0.2
	2007	-0.1	-0.9	-0.5	0.3	0.4	0.3	0.1	0.1	-0.2	0.0	0.1
July	2004	-0.3	-1.3	-0.9	0.2	0.5	0.3	0.0	0.3	-2.1	-0.6	-0.2
	2005	-0.4	-1.2	-0.8	0.2	0.6	0.4	0.1	0.2	4.1	1.7	0.5
	2006	0.0	-1.5	-0.8	0.4	0.5	0.4	0.1	0.3	1.8	0.9	0.3
	2007	-0.1	-1.3	-0.7	0.3	0.5	0.4	0.1	0.3	-1.0	-0.2	0.0
August	2004	-0.4	0.1	-0.1	0.3	0.1	0.2	0.1	0.0	-0.6	-0.2	0.1
	2005	-0.4	0.6	0.1	0.2	0.1	0.1	0.1	0.1	4.5	1.8	0.5
	2006	-0.3	0.7	0.2	0.4	0.2	0.3	0.2	0.3	-0.2	0.1	0.2
	2007	-0.2	0.7	0.2	0.4	0.2	0.3	0.3	0.2	-0.5	-0.1	0.2
September	2004	0.4	1.6	0.9	0.2	0.0	0.1	0.3	-0.1	-0.6	-0.3	0.2
	2005	0.2	1.6	0.9	0.2	-0.4	-0.1	0.1	0.3	11.5	4.8	1.2
	2006	-0.4	1.8	0.7	0.3	-0.1	0.0	0.2	0.4	-7.3	-2.9	-0.5
	2007	-0.2	1.6	0.7	0.3	-0.1	0.1	0.2	0.2	-0.5	-0.1	0.2
October	2004	0.5	1.0	0.8	0.2	0.2	0.2	0.4	0.6	2.2	1.2	0.5
	2005	0.3	0.8	0.6	0.2	0.6	0.4	0.5	0.4	-1.8	-0.5	0.2
	2006	0.2	0.6	0.4	0.3	0.3	0.3	0.3	0.3	-8.9	-3.4	-0.5
	2007	0.3	0.7	0.5	0.3	0.2	0.3	0.3	0.3	-1.4	-0.4	0.2
November	2004	0.5	-0.4	0.1	0.1	-0.2	-0.1	-0.1	0.2	0.6	0.3	0.1
	2005	0.0	-0.3	-0.1	0.2	0.0	0.1	0.0	0.2	-8.2	-3.4	-0.8
	2006	0.2	-0.3	0.0	0.4	-0.1	0.1	0.1	-0.1	-1.6	-0.6	-0.1
	2007	0.3	-0.3	0.0	0.4	-0.1	0.1	0.1	0.1	0.6	0.3	0.1
December	2004	0.2	-1.4	-0.6	0.2	-0.1	0.0	-0.2	0.2	-3.1	-1.0	-0.4
	2005	0.0	-1.1	-0.5	0.3	-0.1	0.0	-0.1	0.3	-4.1	-1.5	-0.4
	2006	0.2	-1.3	-0.5	0.3	-0.1	0.0	-0.1	0.3	2.7	1.2	0.2
	2007	0.2	-1.2	-0.5	0.3	-0.1	0.1	-0.1	0.3	1.8	0.9	0.1

The shaded values are forecasts

Source: BLS & IFL (UC3M)

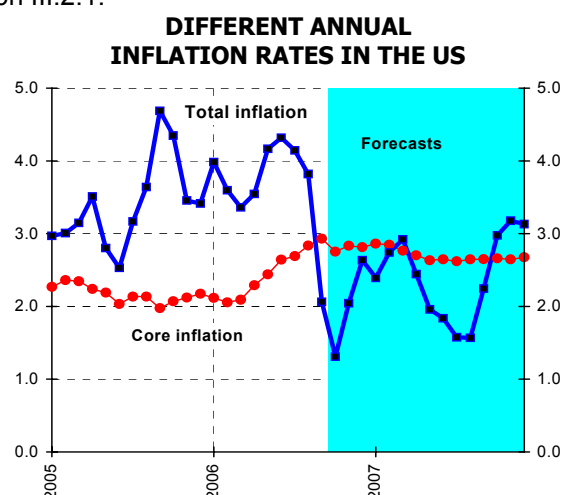
Date: October 18, 2006



III.2. INFLATION. MAIN POINTS AND CONCLUSIONS.

With regards to U.S. inflation, prices performed as forecast both for headline and core inflation. Indeed, the monthly rate of the headline CPI fell by 0.49% in September, a little more than the expected 0.45%³. The annual rate fell drastically, as forecast, from 3.82% to 2.06%. This heavy decrease in the annual rate is due to energy prices, with a monthly fall of 7.27% versus a 11.47% increase last year, all linked to crude oil prices on the international markets. Their effects will continue to be felt in October, with the annual headline CPI rate falling from 2.06% to 1.31% (see Graph III.2.1).

Graph III.2.1.



Source: BLS & IFL (UC3M)
Date: October 18, 2006

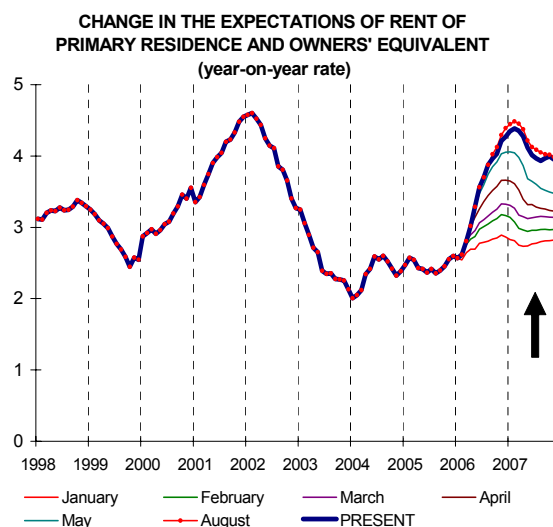
On the other hand, in September, the core index grew by a monthly 0.24%, slightly less than the forecast 0.28%. The annual rate rose from 2.84% to 2.93%. This one point increase was expected and is temporary, as it is due to the heavy fall in hotel prices in September last year.

There have been slight upwards deviations in some non-durable non-energy industrial goods (clothing and footwear), which have been compensated by downwards innovations in some services such as education, transport and communications.

Another point of interest this month is the slightly better than expected performance of owner's equivalent rent of primary residence, whereas real rental prices registered exactly the forecast variation, after quite a few months of increasing our expectations (graph III.2.2). Although the forecast was accurate, the annual real rental rate rises from 3.76% to 3.89% and owner's rent of primary residence from 3.90% to 3.98%.

³ In our reports related to the US CPI, rates are adjusted for seasonality unless otherwise specified

Graph III.2.2.



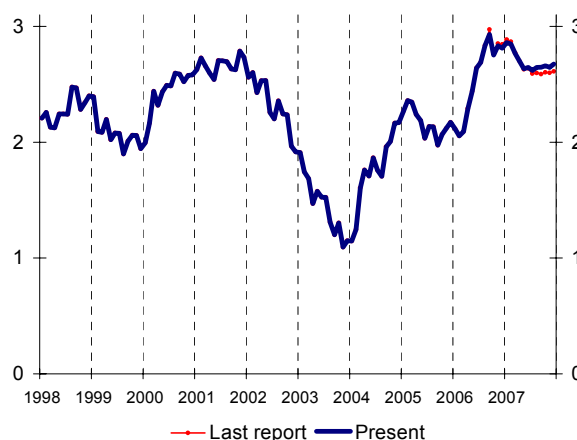
Source: BLS & IFL (UC3M)
Date: October 18, 2006

Another negative figure this month can be found in durable good production prices, with the September figure compensating for the excellent August number. Car prices, for example, registered annual rates of -3.75%, -5.43% and -3.63% in July, August and September, respectively.

The price per barrel of West Texas oil continued to fall in October to under 60\$. For the next few months, we have considered the hypothesis of slight increases, in line with the futures markets. The crude oil price situation is therefore slightly better than the previous month. This is the variable behind the better headline inflation forecasts, with core inflation expectations remaining unaltered (graph III.2.3).

Graph III.2.3.

CHANGE IN THE EXPECTATIONS OF CORE INFLATION (year-on-year rate)



Source: BLS & IFL (UC3M)
Date: October 18, 2006



Indeed, for October we expect the annual total inflation rate to fall from today's 2.06% to 1.31% (± 0.13)⁴, explained by fuel prices, the monthly rate of which falls by 13%. Likewise, for core inflation we are forecasting a slight fall in its annual rate from 2.93% to 2.75% (± 0.14), tending to stabilise at around 2.6% next year.

On the other hand, the unemployment rate fell from 4.7% to 4.6% (rate adjusted for seasonality) in September and although the rate of use of productive capacity fell a little, it remains at its highest levels since 1998. These two indicators reveal a high point in the cycle of the American economy, so crude oil price changes can be transferred to end prices. No second round effects, however, have been registered to date.

Table III.2.1.

DIFFERENT ANNUAL INFLATION RATE MEASURES IN THE US

	CPI		PCE ¹	MB-PCE ²
	Total	Core	Core	Core
	% annual	% annual	% annual	% annual
2006 January	4.0	2.1	2.0	1.6
February	3.6	2.1	2.0	1.6
March	3.4	2.1	2.0	1.6
April	3.5	2.3	2.2	1.8
May	4.2	2.4	2.2	1.8
June	4.3	2.6	2.3	2.0
July	4.1	2.7	2.3	2.0
August	3.8	2.8	2.5	2.1
September	2.1	2.9	2.4	2.2
October	1.3	2.8	2.3	2.1
November	2.0	2.8	2.4	2.1
December	2.6	2.8	2.4	2.1
average annual				
2003	2.3	1.5	1.4	1.1
2004	2.7	1.8	2.0	1.5
2005	3.4	2.2	2.1	1.7
2006	3.2	2.5	2.3	1.9
2007	2.4	2.7	2.3	2.0

(1) PCE: chain-type price index for personal consumption expenditures

(2) MB-PCE: Market-based components of PCE prices

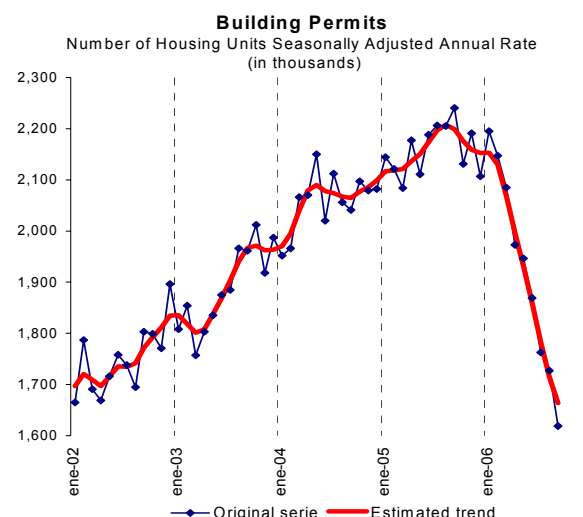
Source: BLS & IFL (UC3M)

Date: October 18, 2006

Based on all this information, for 2006 and 2007 we are forecasting average annual total inflation rates of 3.2% (± 0.07) and 2.4% (± 0.48), respectively, one tenth less than in last month's report. On the other hand, the average annual core inflation rates forecast are 2.5% (± 0.05) and 2.7% (± 0.36), respectively, the same as in the last report.

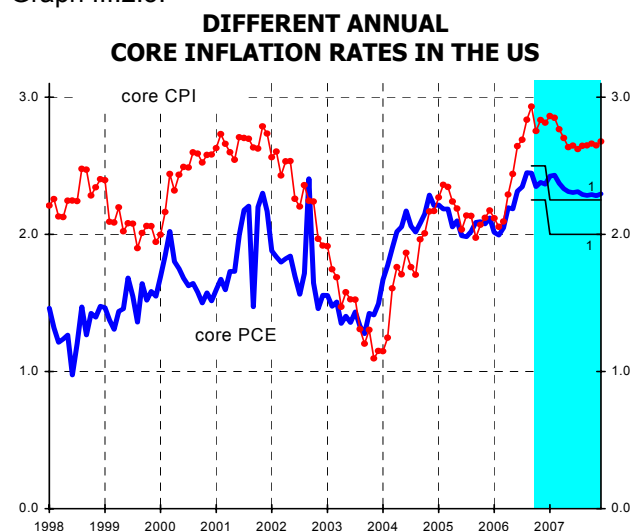
⁴ Considering an 80% confidence interval for all indices

Graph III.2.4.



Source: The U.S. Census Bureau and the Department of Housing and Urban Development & IFL (UC3M)
Date: October 18, 2006

Graph III.2.5.



Source: BLS & IFL (UC3M)

Date: October 18, 2006

The Federal Reserve, besides following the CPI, also considers the evolution of the property market. According to all the indicators, the housing market continues to slow down. This can be seen from the number of building permits, which fell strongly again in September (see graph III.2.4).

The price information published this month was in line with our forecasts. Only the favourable evolution of crude oil prices on the international markets leads us to reduce our annual headline CPI rate forecast by one tenth. At the same time, all property market indicators continue to show a significant slow down, which has not yet affected other sector. In all, for the most significant variable for the FED in relation to inflation, the core personal consumption expenditure index – core PCE – the forecasts for 2007 are at the upper limit of its target central trend (2.00-2.25%) (see graph III.2.5).



III.3. OTHER TABLES AND PLOTS.

Tables:

- Forecast errors by sectors.

Plots:

- CPI monthly growth rates.
- Annual rates of different components for the USA inflation.

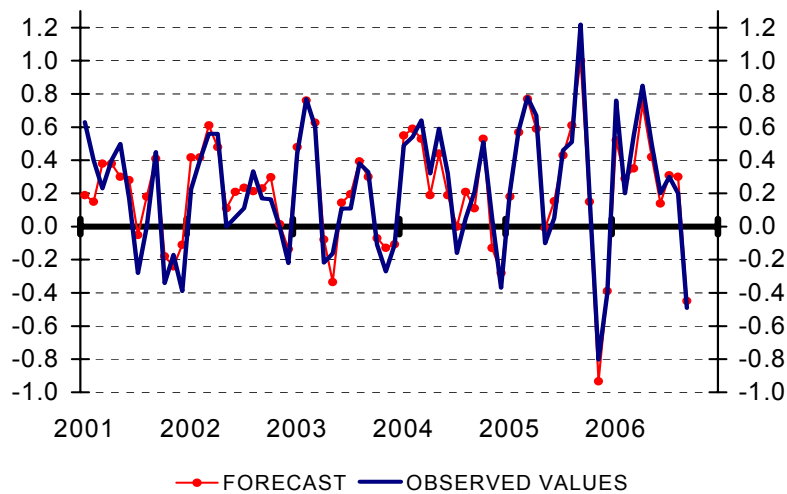


OBSERVED VALUES AND FORECAST ON CPI IN US
(September 2006)

CONSUMER PRICES INDEX (CPI)	Relative Importance Dec. 2005	Annual Growth (T ¹ ₁₂) observed	Monthly Growth (T ¹ ₁)		Confidence Intervals at 80% level (+ -)
			observed (a)	forecasts (b)	
Food (1)	13.9	2.51	0.36	0.19	0.33
Energy (2)	8.7	-4.28	-7.27	-6.91	1.30
Residual Inflation (3=2+1)	22.6	-0.44	-2.87	-2.81	0.51
Non-food and non-energy goods (4)	22.3	0.50	0.71	0.59	0.25
Less tobacco	21.6	0.44	0.74	0.57	0.23
-Durable goods	11.6	-0.70	-0.44	-0.41	0.30
-Nondurable goods	10.7	1.77	1.81	1.66	0.35
Non-energy services (5)	55.1	3.88	0.04	0.16	0.16
-Services less owner's equivalent rent of primary residence (5-a)	31.6	3.80	-0.14	0.01	0.23
-Owner's equivalent rent of primary residence (a)	23.4	3.98	0.29	0.37	0.12
Core Inflation (6=4+5)	77.4	2.93	0.24	0.28	0.14
Core inflation less owner's equivalent rent of primary residence (6-a)	53.9	2.48	0.22	0.25	0.17
Core inflation less owner's equivalent rent of primary residence and tobacco	53.2	2.48	0.22	0.23	0.17
Total Inflation (7=6+3)	100.0	2.06	-0.49	-0.45	0.13
All items less owner's equivalent rent of primary residence (7-a)	76.6	1.50	-0.73	-0.70	0.18

Source: BLS & IFL (UC3M)
Date: October 18, 2006

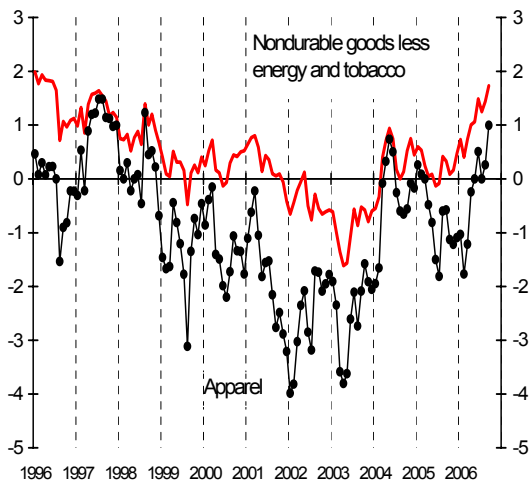
CPI MONTHLY GROWTH RATES IN USA



Source :BLS & IFL (UC3M)
Date: October 18, 2006

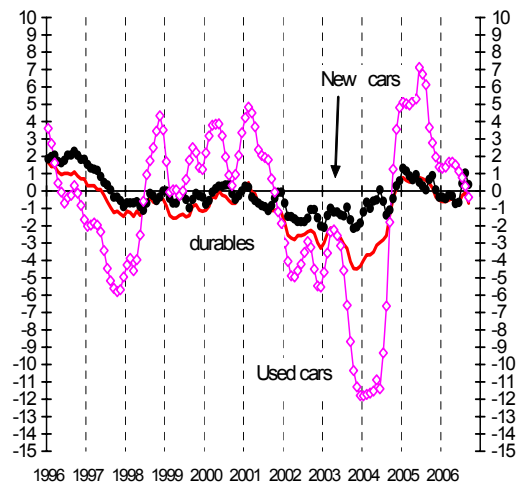


COMMODITIES LESS FOOD AND ENERGY
(YEAR ON YEAR RATES)



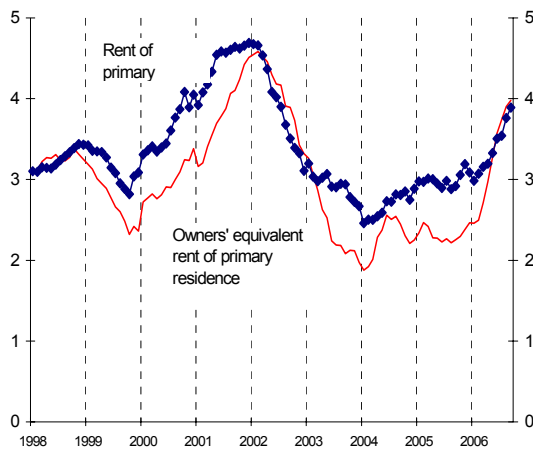
Source: BLS & IFL (UC3M)
Date: October 18, 2006

DURABLES COMMODITIES
(year-on-year rates)



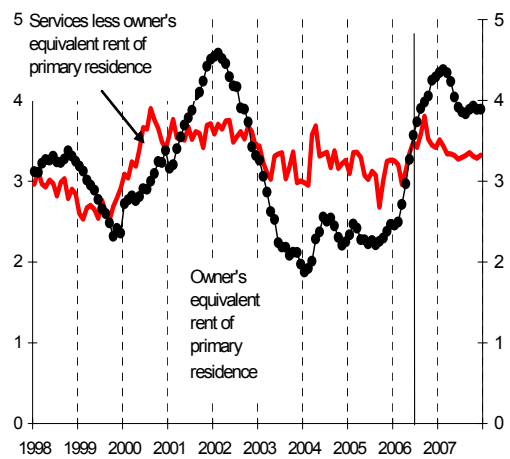
Source: BLS & IFL (UC3M)
Date: October 18, 2006

RENT OF PRIMARY RESIDENCE
(year-on-year rate)



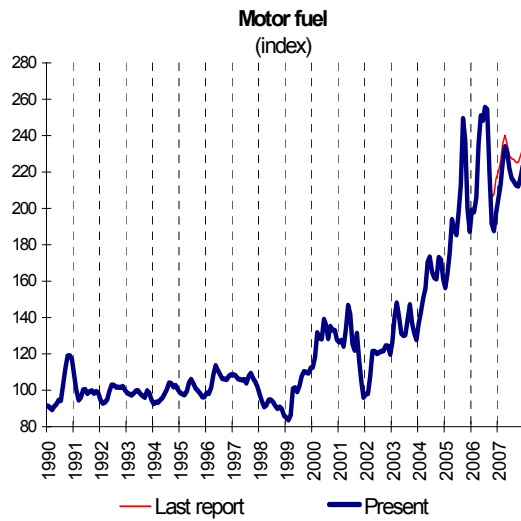
Source: BLS & IFL (UC3M)
Date: October 18, 2006

SERVICES
(year-on-year rates)

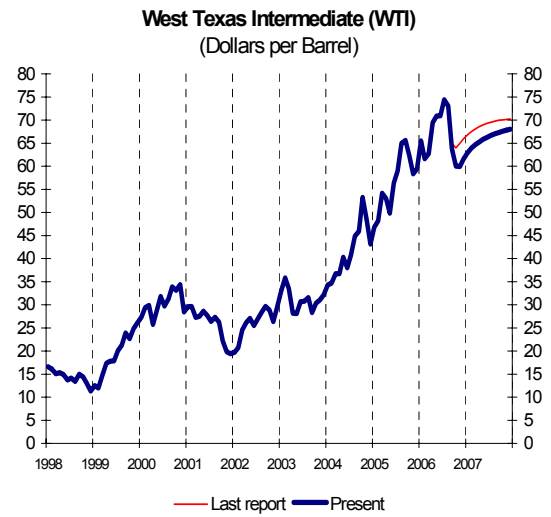


Source: BLS & IFL (UC3M)
Date: October 18, 2006

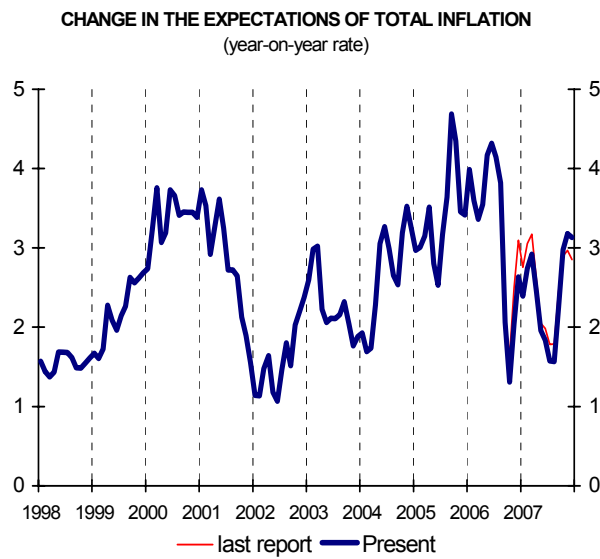




Source: BLS & IFL (UC3M)
Date: October 18, 2006



Source: BLS & IFL (UC3M)
Date: October 18, 2006



Source: BLS & IFL (UC3M)
Date: October 18, 2006



IV. THE SPANISH ECONOMY.

IV.1 MACROECONOMIC FORECASTS.

IV.1.1 MACROECONOMIC TABLE AND INDICATORS OF SPANISH ECONOMY: ANNUAL RATES.

MACROECONOMIC TABLE AND INDICATORS				
	Annual Rates			
	2004	2005	Forecasts BIMA(*)	
			2006	2007
Private Final Consumption Expenditure	4.2	4.2	3.6	3.6
Public Final Consumption Expenditure	6.3	4.8	4.4	4.4
Gross Fixed Capital Formation	5.0	7.0	5.9	5.5
Equipment	4.4	9.0	7.9	7.2
Building	5.5	6.0	5.8	5.1
Other products	4.5	7.5	3.8	4.5
National Demand (1)	4.9	5.2	4.8	4.5
Exports of Goods and Services	4.1	1.5	6.1	4.0
Imports of Goods and Services	9.6	7.0	8.8	7.0
Foreign demand	-1.7	-1.7	-1.2	-1.1
GDP (a)	3.2	3.5	3.6	3.4
GDP, current prices	7.4	7.8	7.9	7.8
Prices and Costs (b)				
CPI, annual average	3.0	3.4	3.6	2.4
CPI, dec./dec.	3.2	3.7	2.9	2.7
Average earning per worker	3.3	2.5	3.0	3.2
Unit labour cost	2.7	2.1	2.8	2.9
Labour Market (Data poll labour force) (2) (c)				
Labour Force (% variation)	3.3	3.2 / 3.5	3.3	3.1
Employment (EPA)				
Annual average variation in %	3.9	4.8 / 5.6	4.1	3.8
Annual average variation in thousands	674.9	870.3/1002.4	781.9	747.5
Unemployment rate	11.0	9.6 / 9.2	8.5	7.8
Basic balances (a)				
Foreign sector				
Current Account (m.€.)	-44.164	-66.627	-78.744	-88.169
Net lending or borrowing (% GDP) (2)	-5.3	-7.4	-8.1	-8.5
AA.PP. (Total) / Public Administration				
Net lending or borrowing (% GDP) (2)	-0.3	1.1	0.5	0.0
Other Economic Indicators (d)				
Industrial Production Index	1.8	0.1	4.0	4.7

(1) Contribution to the GDP growth
(2) Annual Rate EPA Testigo / Annual Rate EPA 2005
(3) In term of national accounts

Source: INE & IFL

Date: (a) August 30, 2006

(b) October 24, 2006

(c) October 27, 2006

(d) October 5, 2006



IV.1.2 QUARTERLY FORECASTS OF GDP AND COMPONENTS OF DOMESTIC AND FOREIGN DEMAND.

Table IV.1.2.1

ANNUAL RATES OF GROWTH IN GDP AND COMPONENTS												
	Observed		Forecasts									
			Annual		Quarterly*							
	2004	2005	2006	2007	2006 QI	2006 QII	2006 QIII	2006 QIV	2007 QI	2007 QII	2007 QIII	2007 QIV
Private Final Consumption Expenditure	4.2	4.2	3.6	3.6	3.8	3.6	3.6	3.5	3.6	3.7	3.4	3.6
Public Final Consumption Expenditure	6.3	4.8	4.4	4.4	4.4	4.4	4.5	4.4	4.4	4.3	4.3	4.4
Gross Fixed Capital Formation	5.0	7.0	5.9	5.5	6.3	6.1	5.7	5.7	5.4	5.6	5.7	5.3
Equipment	4.4	9.0	7.9	7.2	8.6	9.1	7.7	6.2	7.0	8.0	7.1	6.6
Building	5.5	6.0	5.8	5.1	5.8	5.7	5.7	5.9	5.2	4.9	5.2	5.0
Other products	4.5	7.5	3.8	4.5	4.8	3.3	3.1	4.2	3.7	4.9	5.0	4.5
Nacional Demand (1)	4.9	5.2	4.8	4.5	5.0	4.8	4.7	4.6	4.5	4.6	4.5	4.5
Exports of Goods and Services	4.1	1.5	6.1	4.0	9.5	5.3	3.8	5.8	3.0	3.7	5.0	4.5
Imports of Goods and Services	9.6	7.0	8.8	7.0	12.4	7.9	7.1	7.9	5.6	7.3	7.7	7.2
Foreign demand (1)	-1.7	-1.7	-1.2	-1.1	-1.4	-1.1	-1.2	-1.0	-1.0	-1.3	-1.1	-1.1
Real GDP	3.2	3.5	3.6	3.4	3.6	3.7	3.5	3.6	3.5	3.3	3.4	3.4

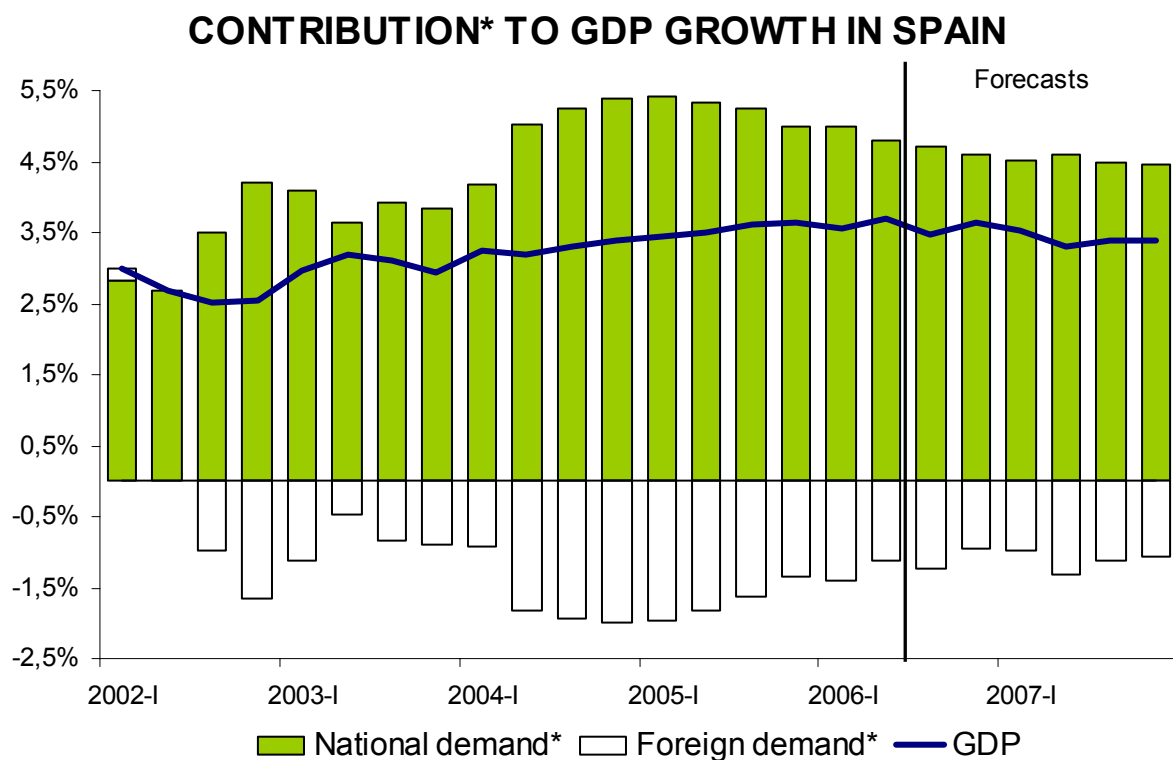
(2) Contribution to the GDP growth

(*) Appreciation from same quarter one year earlier

Source: INE & IFL (UC3M)

Date: August 30, 2006

Graph IV.1.2.1



Source INE & IFL (UC3M)

Date: August 30, 2006.



IV.1.3 INDUSTRIAL PRODUCTION INDEX AND PRODUCTION SECTORS: MONTHLY AND QUARTERLY FORECASTS.

Table IV.1.3.1

ANNUAL RATES OF GROWTH IN THE IPI AND SECTORS												
	Observed		Forecasts									
	2004	2005	Annual		Quarterly*							
			2006	2007	2006 QI	2006 QII	2006 QIII	2006 QIV	2007 QI	2007 QII	2007 QIII	2007 QIV
Total	1.8	0.1	4.0	4.7	6.4	1.2	4.1	4.6	5.5	4.5	3.4	5.3
Consumer goods	0.0	0.2	1.8	1.9	4.7	-0.8	1.4	2.0	3.9	1.3	0.1	2.4
Durable consumer goods	0.1	-1.0	10.3	5.6	7.8	6.7	14.4	13.0	15.9	4.2	-0.5	3.2
Non-durable consumer goods	0.0	0.3	0.5	1.3	4.3	-1.9	-0.4	0.3	2.0	0.8	0.2	2.3
Capital equipment	1.9	-0.7	8.9	10.6	11.6	4.1	9.1	11.2	11.1	10.1	9.7	11.4
Intermediate goods	1.9	-0.6	4.4	4.5	6.5	1.3	4.7	5.3	5.3	4.3	3.4	4.9
Energy	4.9	2.9	1.7	2.8	3.5	0.9	2.4	-0.1	1.7	3.9	2.5	3.3

(*) Appreciation from same quarter one year earlier

Source: INE & IFL (UC3M)

Date: October 5, 2006

Table IV.1.3.2

OBSERVED AND FORECASTS VALUES OF THE IP ANNUAL GROWTH IN SPAIN							
	2001	2002	2003	2004	2005	2006	2007
January	4.8	-2.1	-0.1	-2.9	0.8	5.4	8.0
February	-3.4	-0.9	1.7	1.8	-1.0	2.7	5.3
March	-3.6	-10.6	9.7	7.2	-6.7	11.0	3.4
April	-0.3	11.4	-4.5	0.7	7.4	-9.8	8.2
May	-0.9	-2.0	-1.2	2.7	0.1	8.1	4.5
June	-2.5	-5.2	4.5	5.7	-0.2	5.2	1.6
July	-0.4	3.6	1.9	0.0	-3.5	4.2	6.0
August	3.2	-3.4	-1.4	5.3	3.7	5.0	3.4
September	-2.9	2.4	2.5	3.8	0.2	3.5	0.9
October	3.0	5.1	0.8	-7.0	-0.1	7.3	8.1
November	-4.8	0.3	1.4	4.3	0.9	5.9	3.0
December	-4.4	3.5	4.2	1.2	1.4	0.3	4.7

The shaded values are forecasts

Source: INE & IFL (UC3M)

Date: October 5, 2006



IV.1.4 INFLATION.

Table IV.1.4.1

FORECASTS IN THE ANNUAL AVERAGE RATE IN INFLATION IN SPAIN					
Consumer Price Index (CPI)	2003	2004	2005	Forecast	
				2006	2007
TOTAL (100%)	3.0	3.0	3.4	3.6	2.4
CORE (82.3%)	2.9	2.7	2.7	2.9	2.6
Processed food (17.0%)	3.0	3.6	3.4	3.6	2.1
Non-energy industrial goods (29.5%)	2.0	0.9	0.9	1.4	1.2
Services (35.8%)	3.7	3.7	3.8	3.9	4.0
RESIDUAL (17.7%)	3.6	4.7	6.5	6.4	1.5
Non-Processed food (8.4%)	6.0	4.6	3.3	4.4	4.8
Energy (9.3%)	1.4	4.8	9.6	8.2	-1.3

Source: INE & IFL (UC3M)
Date: October 24, 2006

Table IV.1.4.2

STANDARD DEVIATION FOR THE FORECASTS ERRORS IN SPAIN			
	Period	Total inflation	Core inflation
ANNUAL RATES	1	0.139	0.136
	2	0.250	0.198
	3	0.332	0.257
	4	0.391	0.272
	5	0.450	0.291
	6	0.472	0.283
	7	0.527	0.322
	8	0.569	0.341
	9	0.596	0.373
	10	0.607	0.381
	11	0.621	0.401
	12	0.649	0.406
AVERAGE ANNUAL RATES	1	0.054	0.048
	2	0.482	0.299

Source: IFL (UC3M)
Date: October 11, 2006



CPI ANNUAL GROWTH BY SECTORS IN SPAIN

		Consumer Prices Index									TOTAL 100% Confidence intervals at 80% *	
		Core					Residual					
		Processed food	Non energy industrial goods	Services	TOTAL	Confidence intervals at 80% *	Non processed food	Energy	TOTAL			
Weights 2006		17.0%	29.5%	35.8%	82.3%		8.4%	9.3%	17.7%			
ANNUAL AVERAGE RATE	1998	1.3	1.5	3.6	2.3		2.1	-3.7	-0.2	1.8		
	1999	2.1	1.5	3.4	2.4		1.2	3.5	2.2	2.3		
	2000	0.9	2.1	3.7	2.5		4.2	13.5	8.8	3.4		
	2001	3.4	2.4	4.2	3.5		8.7	-0.7	3.6	3.6		
	2002	4.3	2.5	4.6	3.7		5.8	-0.2	2.6	3.5		
	2003	3.0	2.0	3.7	2.9		6.0	1.4	3.6	3.0		
	2004	3.6	0.9	3.7	2.7		4.6	4.8	4.7	3.0		
	2005	3.4	0.9	3.8	2.7		3.3	9.6	6.5	3.4		
	2006	3.6	1.4	3.9	2.9	± 0.06	4.4	8.2	6.4	3.6	± 0.07	
	2007	2.1	1.2	4.0	2.6	± 0.38	4.8	-1.3	1.5	2.4	± 0.62	
ANNUAL RATES (growth of the month over the same month of the previous year)	2005	January	4.2	1.0	3.8	2.8		2.3	6.0	4.2	3.1	
		February	3.8	0.9	3.9	2.8		3.5	7.6	5.6	3.3	
		March	4.0	1.0	4.0	2.9		2.9	8.2	5.6	3.4	
		April	4.3	1.0	3.5	2.8		3.8	9.6	6.8	3.5	
		May	3.4	0.9	3.8	2.6		3.0	6.8	5.0	3.1	
		June	3.2	0.8	3.7	2.5		3.4	8.2	5.9	3.1	
		July	3.0	0.7	3.8	2.5		2.1	11.4	6.9	3.3	
		August	2.8	0.7	3.7	2.4		2.7	11.5	7.2	3.3	
		September	2.8	0.9	3.7	2.5		3.4	15.0	9.4	3.7	
		October	2.9	1.1	3.8	2.6		3.6	11.2	7.6	3.5	
		November	3.2	1.2	3.8	2.7		3.6	9.3	6.5	3.4	
		December	3.8	1.1	3.9	2.9		5.2	9.9	7.7	3.7	
	2006	January	3.7	1.4	3.8	2.9		5.3	14.8	10.1	4.2	
		February	3.4	1.5	3.8	2.9		4.5	13.3	9.1	4.0	
		March	4.5	1.5	3.7	3.1		3.3	11.8	7.7	3.9	
		April	3.9	1.4	4.1	3.1		2.1	12.2	7.4	3.9	
		May	3.9	1.5	3.9	3.0		2.4	14.4	8.7	4.0	
		June	3.9	1.5	3.9	3.0		3.9	12.0	8.2	3.9	
		July	4.0	1.5	4.0	3.1		5.4	10.1	7.9	4.0	
		August	3.6	1.5	3.9	3.0		5.4	8.2	7.0	3.7	
		September	3.5	1.3	3.9	2.9		5.6	0.9	3.0	2.9	
		October	3.4	1.3	3.9	2.9	± 0.17	5.3	-1.6	1.5	2.6	± 0.18
		November	3.1	1.2	3.9	2.8	± 0.25	5.3	1.0	3.0	2.8	± 0.32
		December	2.7	1.2	3.8	2.7	± 0.33	4.3	3.6	3.9	2.9	± 0.43
	2007	January	2.8	1.2	3.9	2.7	± 0.35	3.6	0.7	2.0	2.6	± 0.50
		February	2.9	1.2	4.0	2.8	± 0.37	4.5	0.2	2.2	2.6	± 0.58
		March	1.5	1.2	4.0	2.5	± 0.36	5.9	-0.2	2.6	2.5	± 0.60
		April	1.9	1.2	4.0	2.6	± 0.41	6.4	-3.1	1.2	2.3	± 0.67
		May	1.9	1.2	4.0	2.5	± 0.44	6.4	-4.6	0.3	2.1	± 0.73
		June	1.8	1.2	4.0	2.5	± 0.48	5.0	-3.7	0.2	2.1	± 0.76
		July	1.8	1.3	3.9	2.5	± 0.49	4.5	-5.0	-0.7	1.9	± 0.78
		August	2.3	1.2	4.0	2.6	± 0.51	4.2	-5.1	-0.9	2.0	± 0.79
		September	2.2	1.3	4.0	2.6	± 0.52	4.3	-1.1	1.4	2.4	± 0.83
		October	2.2	1.3	3.9	2.6	± 0.54	4.4	2.3	3.3	2.7	± 0.89
		November	2.2	1.3	3.9	2.6	± 0.56	4.3	2.7	3.5	2.8	± 0.92
		December	2.1	1.3	4.0	2.6	± 0.58	4.4	2.2	3.3	2.7	± 0.94

* Confidence intervals calculated with historical errors.

Bold figures are forecasts

Source: INE & IFL (UC3M)

Date: October 24, 2006



CPI MONTHLY GROWTH BY SECTORS IN SPAIN										
		Consumer Prices Index							TOTAL 100%	
		Core				Residual				
		Processed food	Non energy industrial goods	Services	TOTAL	Non processed food	Energy	TOTAL		
Weights 2006		17.0%	29.5%	35.8%	82.3%	8.4%	9.3%	17.7%		
MONTHLY RATES (Growth of the month over the previous month)	January	2004	0.4	-3.6	0.6	-1.0	0.6	0.6	0.6	-0.7
		2005	0.4	-3.8	0.6	-1.0	1.0	-0.8	0.1	-0.8
		2006	0.3	-3.6	0.5	-1.0	1.0	3.5	2.4	-0.4
		2007	0.4	-3.6	0.6	-0.9	0.4	0.7	0.5	-0.7
	February	2004	0.5	-0.2	0.4	0.2	-1.9	0.4	-0.7	0.0
		2005	0.1	-0.2	0.5	0.2	-0.7	2.0	0.7	0.3
		2006	-0.1	-0.1	0.5	0.1	-1.5	0.7	-0.3	0.0
		2007	0.0	-0.2	0.5	0.2	-0.6	0.2	-0.2	0.1
	March	2004	0.3	0.9	0.5	0.6	0.8	1.5	1.2	0.7
		2005	0.4	1.0	0.6	0.7	0.3	1.9	1.1	0.8
		2006	1.4	1.0	0.5	0.9	-0.9	0.6	-0.1	0.7
		2007	0.1	1.1	0.5	0.6	0.5	0.1	0.3	0.6
	April	2004	0.5	3.0	0.7	1.5	0.3	1.3	0.8	1.4
		2005	0.9	3.0	0.2	1.3	1.1	2.6	1.9	1.4
		2006	0.3	2.8	0.7	1.4	-0.1	3.1	1.6	1.4
		2007	0.7	2.9	0.6	1.4	0.4	0.1	0.2	1.2
	May	2004	1.0	0.6	-0.1	0.4	0.8	2.5	1.7	0.6
		2005	0.1	0.5	0.1	0.3	0.0	-0.2	-0.1	0.2
		2006	0.1	0.6	-0.1	0.2	0.4	1.7	1.1	0.4
		2007	0.1	0.5	-0.1	0.2	0.5	0.2	0.3	0.2
	June	2004	0.4	-0.1	0.4	0.2	-0.5	0.0	-0.2	0.2
		2005	0.1	-0.1	0.4	0.1	-0.1	1.3	0.6	0.2
		2006	0.1	-0.1	0.4	0.1	1.3	-0.7	0.2	0.2
		2007	0.1	-0.1	0.4	0.1	-0.1	0.2	0.1	0.1
	July	2004	0.2	-3.7	0.6	-1.1	0.8	0.3	0.5	-0.8
		2005	0.0	-3.7	0.6	-1.1	-0.5	3.3	1.5	-0.6
		2006	0.1	-3.7	0.7	-1.0	0.9	1.5	1.2	-0.6
		2007	0.1	-3.6	0.6	-1.0	0.5	0.1	0.3	-0.8
	August	2004	0.2	-0.1	0.6	0.3	0.3	1.8	1.1	0.4
		2005	0.1	-0.1	0.6	0.2	0.9	1.9	1.4	0.4
		2006	-0.3	-0.1	0.5	0.1	0.9	0.2	0.5	0.2
		2007	0.1	-0.2	0.6	0.2	0.7	0.1	0.4	0.3
	September	2004	0.2	1.1	-0.4	0.2	-0.2	0.1	-0.1	0.2
		2005	0.2	1.3	-0.4	0.3	0.5	3.1	1.9	0.6
		2006	0.1	1.1	-0.4	0.2	0.6	-3.8	-1.8	-0.2
		2007	0.1	1.2	-0.4	0.2	0.7	0.1	0.4	0.3
	October	2004	0.1	2.6	0.0	0.9	0.0	2.6	1.4	1.0
		2005	0.2	2.8	0.1	1.1	0.2	-0.7	-0.3	0.8
		2006	0.1	2.7	0.1	1.0	0.0	-3.2	-1.7	0.5
		2007	0.0	2.7	0.1	1.0	0.0	0.1	0.1	0.8
	November	2004	0.2	1.0	0.0	0.4	0.6	-1.2	-0.4	0.2
		2005	0.5	1.1	0.0	0.5	0.6	-2.9	-1.3	0.2
		2006	0.2	1.0	0.0	0.4	0.5	-0.3	0.1	0.3
		2007	0.2	1.0	0.0	0.4	0.5	0.2	0.3	0.4
	December	2004	0.2	-0.2	0.4	0.1	0.4	-2.5	-1.2	-0.1
		2005	0.7	-0.2	0.5	0.3	1.9	-1.9	-0.1	0.2
		2006	0.3	-0.2	0.4	0.2	0.9	0.6	0.7	0.3
		2007	0.3	0.4	0.4	0.2	1.0	0.1	0.6	0.3

Bold figures are forecasts
Source: INE & IFL (UC3M)
Date: October 24, 2006



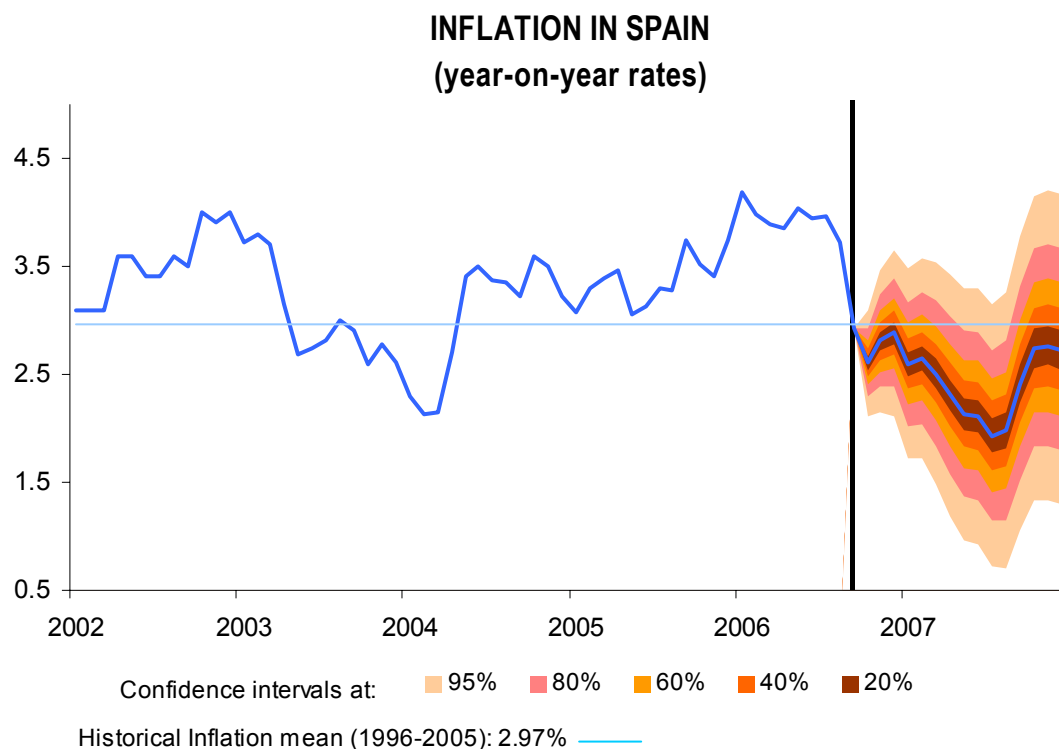
CPI ANNUAL AVERAGE GROWTH OF RATES BY COMPONENTS IN SPAIN WITH FORECASTS FOR 2006 AND 2007

					Weights 2006	2002	2003	2004	2005	2006	2007
HICP Total Inflation	Core Inflation	Processed food	AE less tobacco & fats	13.2	3.1	2.8	2.7	2.5	2.8	3.1	
			Oils & Fats	3.1	15.2	3.5	14.7	10.5	24.2	-15.9	
			Tobacco	2.2	7.4	3.8	5.6	6.6	1.4	3.9	
			Processed food	17.0	4.3	3.0	3.6	3.4	3.6	2.1	
		Non energy industrial goods	Vehicles	7.3	1.7	1.7	1.6	1.8	2.3	1.7	
			Footwear	1.9	5.6	3.6	1.9	2.2	1.5	2.3	
			Clothing	6.6	5.2	3.8	1.8	1.1	1.2	1.7	
			Rest	13.8	2.4	0.9	0.3	0.5	1.2	0.7	
			Non energy industrial goods	29.5	2.5	2.0	0.9	0.9	1.4	1.2	
		Services	Postal services	4.0	13.3	3.3	3.1	2.7	5.7	3.0	
			Cultural services	1.4	4.5	3.0	3.0	2.7	2.6	3.7	
			Education	1.0	3.3	4.6	3.6	4.1	3.4	3.6	
			Hotels	0.6	5.8	3.4	3.0	2.3	3.6	3.9	
			Health	1.7	4.8	4.0	3.2	4.0	4.2	3.6	
			Household equipment	1.3	4.8	5.1	4.4	4.5	4.4	4.7	
			Restaurants	9.6	5.8	4.4	4.1	4.3	4.5	4.4	
			Telephone	2.9	-3.1	-2.7	-1.1	-1.6	-1.3	-0.3	
			Transports	4.5	5.3	3.6	4.4	4.4	4.2	4.0	
			Package holidays	1.1	8.7	3.1	1.4	2.2	4.0	6.7	
			University	0.5	5.0	5.4	4.9	4.6	4.5	3.5	
			Housing	4.9	4.6	4.0	4.5	4.8	4.7	4.4	
			Rest	2.2	4.2	3.9	4.2	3.8	4.3	4.5	
			Services	35.8	4.6	3.7	3.7	3.8	3.9	4.0	
			Core Inflation			82.3	3.7	2.9	2.7	2.7	2.9
		Residual Inflation	Non processed foods	Meat	3.2	1.7	4.7	3.6	3.8	6.1	3.7
				Fruits	1.4	9.8	11.6	6.3	2.7	0.2	4.8
	Eggs			0.2	1.7	8.4	11.6	-3.2	2.7	2.0	
	Vegetables			0.9	18.0	5.1	3.6	5.4	-1.1	6.9	
	Mollusc			0.7	7.3	2.4	3.1	5.4	2.8	4.6	
	Potatoes			0.3	0.4	2.5	16.2	-8.2	17.6	14.2	
	Fish			1.6	5.0	4.4	2.0	3.8	5.6	3.4	
	Non processed foods			8.4	5.8	6.0	4.6	3.3	4.4	4.8	
	Energy		Heat energy	5.3	0.5	1.4	7.1	12.3	6.9	-2.9	
			Fuels	0.4	-3.1	6.1	12.0	26.8	12.7	2.3	
			Electricity and gas	3.6	-1.4	0.8	0.8	4.0	9.5	0.6	
			Energy	9.3	-0.2	1.4	4.8	9.6	8.2	-1.3	
	Residual Inflation			17.7	2.6	3.6	4.7	6.5	6.4	1.5	
	HICP Total Inflation			100.0	3.5	3.0	3.0	3.4	3.6	2.4	

Bold figures are forecasts
Source: INE & IFL (UC3M)
Date: October 24, 2006

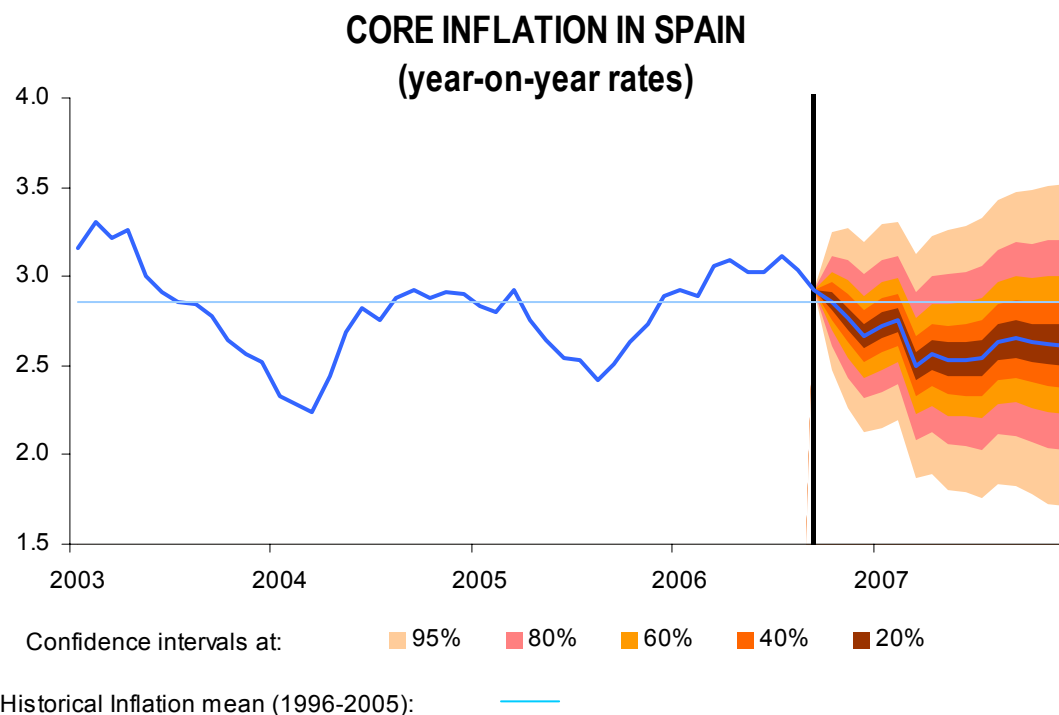


Graph IV.1.4.1



Source INE & IFL (UC3M)
Date: October 24, 2006

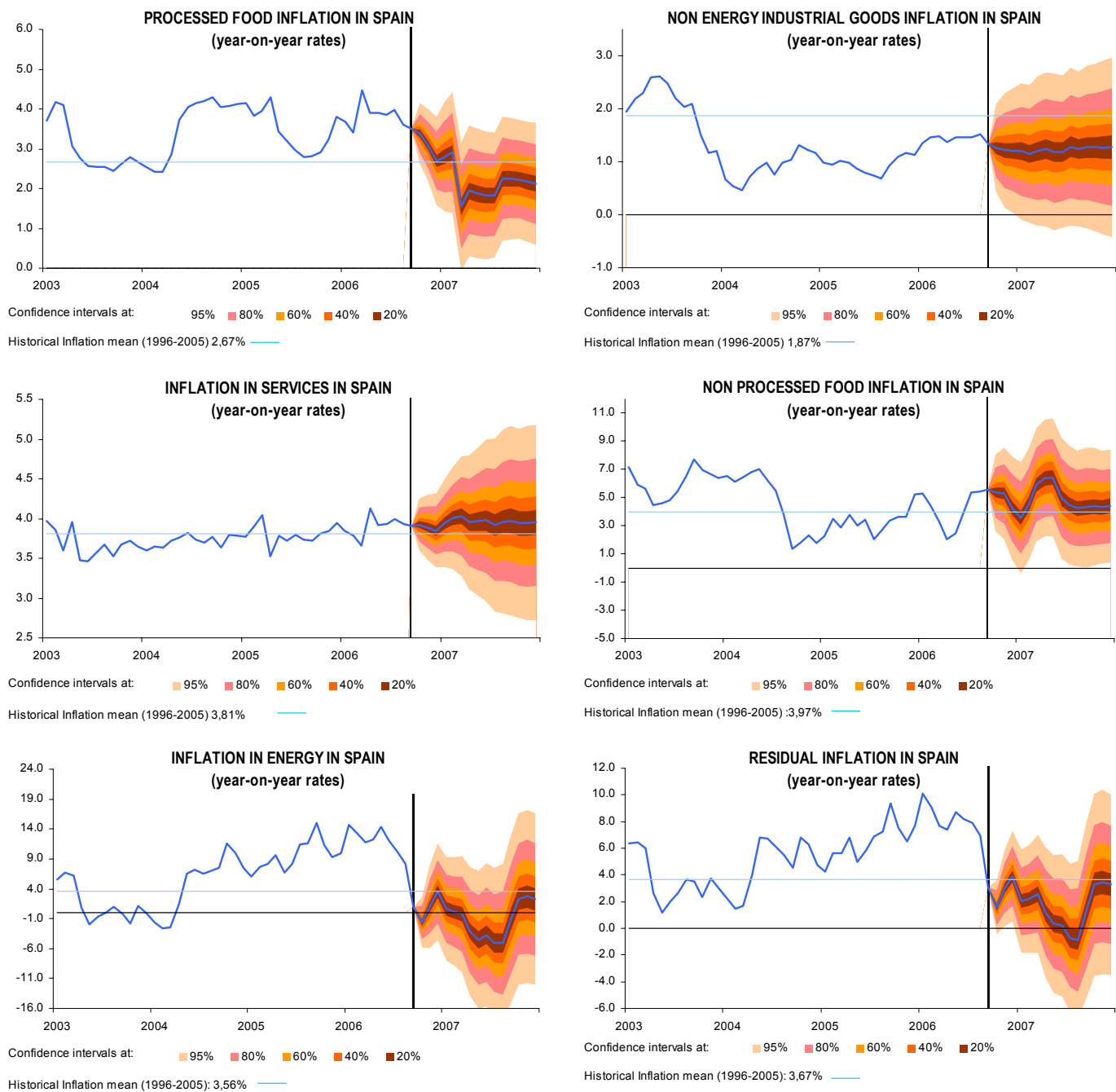
Graph IV.1.4.2



Source INE & IFL (UC3M)
Date: October 24, 2006



FAN CHARTS FOR ANNUAL RATES OF CPI COMPONENTS IN SPAIN



Source INE & IFL (UC3M)
Date: October 24, 2006



IV.2 ANALYSIS OF THE SPANISH ECONOMY.

IV.2.1 ECONOMIC OUTLOOK.

IV.2.1.1. The performance of productivity in the Spanish economy in the last few years.

Since the mid-nineties, the Spanish economy has been registering a real GDP growth rate greater than that of the euro area. In some years, the difference was so significant that it was practically double. The reasons why it has been more dynamic are well known and include the following: (1) significantly looser monetary conditions for the Spanish economy than for the rest of the euro area, (b) the effect of the reforms made to the labour and goods and services markets, (c) the stability of the public accounts and, particularly, (d) the heavy increase of the immigrant population, which has given the Spanish economy a large and flexible labour supply, leading to more moderate labour costs.

The greater dynamism of the Spanish economy relative to the euro area is largely derived from its greater ability to generate employment, with a clear structural change having affected the demand for employment in the second half of the nineties, significantly increasing employment/GDP elasticity. The pattern of growth followed by the Spanish economy in the last few years has been based on national demand, largely household consumption, and construction, is labour-intensive, shows a limited growth of productivity and has helped to leave the current account deficit at an all time high.

As we mentioned in previous issues of the Bulletin of EU and US Inflation and Macroeconomic Analysis, the slow growth of productivity in the Spanish economy in recent years, significantly lower than the euro area, is starting to be a cause for concern and is one of its weakest points. At the same time, it questions the viability of the pattern of growth observed for years. The recovery of productivity is absolutely essential to guarantee the long-term growth of the Spanish economy, so it is currently one of the most important issues in the economic debate.

The importance of this recovery is derived from the fact that productivity is a key variable in how an economy works, since real salary increases, payment for other productive factors, competitiveness, per capita income and future welfare all depend on its growth. On the other hand, growth of productivity is an important factor in macroeconomic stability, since it reduces inflationist pressure and stimulates the competitiveness of internal and external markets, leading to a better allocation of productive resources and a better balanced balance of trade.

The pattern of growth maintained by the Spanish economy since the mid-nineties, given the initial situation, has had positive effects in reducing the high unemployment rate. This rate has fallen to one-digit levels (8.5%) in the first half of 2006, from over 20% of the active population in 1995. At the same time, the rate of occupation and activity has increased greatly, although there is still a way to go before we reach the average values of these ratios in the euro area. An analysis of the pattern of growth followed by the Spanish economy since the mid-nineties, its advantages, disadvantages and future viability, can be seen in the article by Professor Michele Boldrin, published in the September issue of the Bulletin.

Labour productivity is usually analysed with reference to the ratio between the real GDP and either employed individuals or hours worked. The estimation of hours work provided by the different sources of statistics continues to be deficient in Spain, so we used the number of employed to estimate the labour factor. However, of the different statistical sources estimating employment, the best for calculating productivity is equivalent full-time employment (Efte) estimated by the National Accounts. The employment figure estimated in the Active Population Survey (*Encuesta de Población Activa- EPA*), due to the many methodological changes affecting the survey, is highly unstable and its use to estimate productivity leads to very imprecise results. On the other hand, labour productivity, or apparent productivity, measured in this way, does not reflect all productivity and total factor productivity (TFP) should be considered, as it is the part of production which is not directly attributable to the production factors, labour and capital, which depend on many factors, particularly the effect of technical progress on production. Within the neoclassic context of growth theory, the so-called Solow residual is identified with TFP.

Table IV.2.1.1.1 and graphs IV.2.1.1.1 and IV.2.1.1.2 show the evolution of growth of productivity by employed person and total factor productivity since the mid-nineties for the Spanish economy and the euro area. At first sight, we can observe the following:

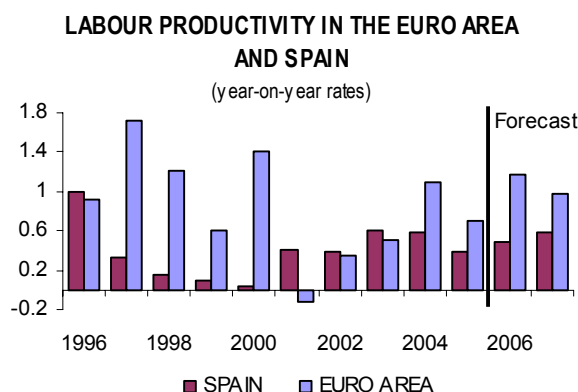
1/. Labour productivity in the Spanish economy shows very low growth since 1995, and is nearly zero in some years. The short and medium-term perspectives do not indicate a significant improvement.



2/. The evolution of core labour productivity is decreasing slightly, as is the TFP, although more so.

3/. The Spanish TFP shows low growth rates, lower than those of apparent productivity, clearly declining since 2001.

Graph IV.2.1.1.1



Source: INE & IFL (UC3M)
Date: October 26, 2006

Table IV.2.1.1.1

GDP, EMPLOYMENT AND PRODUCTIVITY IN SPAIN AND THE EURO AREA (year-on-year rates)												
	1995-2000		2000-2005		2004		2005		2006		2007	
	Spain	EMU	Spain	EMU	Spain	EMU	Spain	EMU	Spain	EMU	Spain	EMU
GDP	4.1	2.7	3.2	1.7	3.2	1.9	3.5	1.4	3.6	2.4	3.4	2.1
Employment (1)	3.8	1.5	2.7	1.2	2.6	0.8	3.1	0.7	3.1	1.2	2.8	1.1
Labour productivity	0.3	1.2	0.5	0.5	0.6	1.1	0.4	0.7	0.5	1.2	0.6	1.0
Total productivity	0.3	1.1	-0.5	0.2	-0.1	1.1	-0.2	0.2	-0.3	0.7	-0.3	0.5

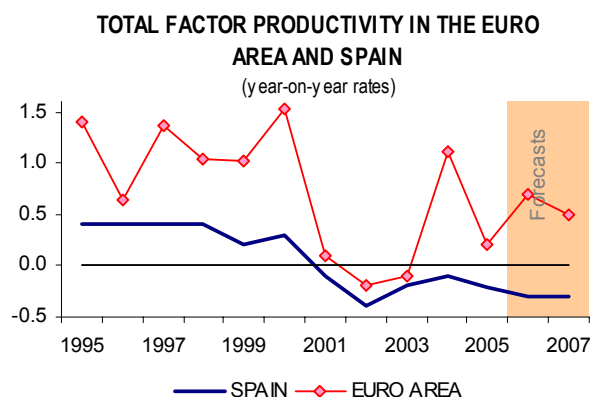
(1) Full time Employment
Source: INE, EUROSTAT & IFL (UC3M)
Date: October 26, 2006

In the 1995-2000 period, labour productivity registered a tiny average annual growth rate of 0.2%, recovering slightly in 2000-2005, when it grew by 0.5%. The forecasts for 2006-2007 show no signs of recovery, estimating rates of 0.5% and 0.6%, respectively. On the other hand, the data on table IV.2.1.1.1 shows that the contribution of productivity to GDP growth has been very low since the mid-nineties, with said growth depending on employment.

Spanish labour productivity has been growing less than in the euro area for the last decade. In 1995-2000, the average annual growth rate in the euro area was 1.2%, although unlike productivity in Spain, in 2000-2005 it fell by registering an average annual growth rate of 0.5%. However, unlike Spain, the contribution of apparent productivity to GDP

4/. Both labour productivity and TFP in Spain grow less than in the euro area, except for apparent productivity in 2001, 2002 and 2003. In turn, these productivity rates in the euro area also show a falling trend.

Graph IV.2.1.1.2



Source: INE & IFL (UC3M)
Date: October 26, 2006

growth was very significant, representing around 40% in 1995-2000 and 30% in the next five years.

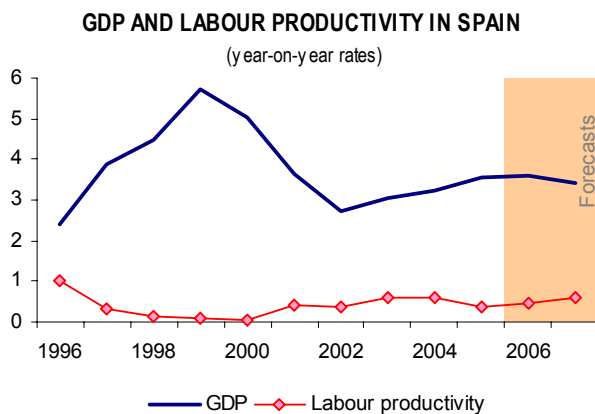
One characteristic of the performance of labour productivity in Spain since 1985, distinguishing it from other western economies, is that it is counter-cyclical. Graphs IV.2.1.1.3 and IV.2.1.1.4 show the evolution of productivity growth and its comparison with the economic cycle, calculated from the rates of variation of the GDP, both for the Spanish economy and the euro area.

In most western economies, productivity is usually procyclical and this is shown on graph IV.2.1.1.4 for the euro area as a whole. This is largely due to the adjustment costs involved in the variation in employment derived from so called labour hoarding in recessive phases. This procyclical behaviour of apparent productivity is because, in the low phases



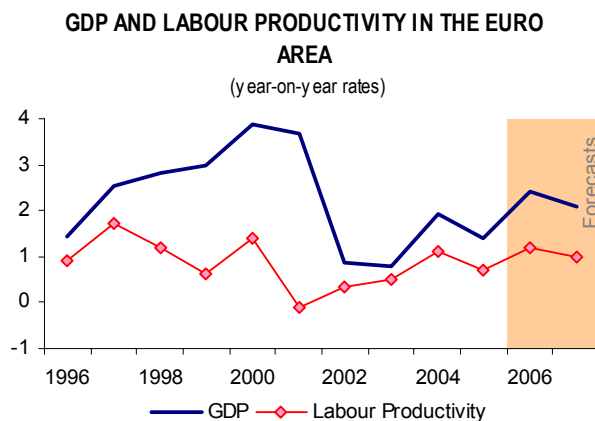
of the cycle, employment does not decrease at the same pace as product and is never fully adjusted due to the costs involved in varying employment. Growth of productivity therefore slows down, as does GDP growth. At high times in the cycle, both the product and employment rise, but at a lower rate because labour was hoarded in the immediately prior phase, so there is an increase in the rate of growth of apparent productivity. The Spanish economy, however, shows a countercyclical pattern (see graph IV.2.1.1.3) in the period analysed, although it was procyclical prior to 1985.

Graph IV.2.1.1.3



Source: INE & IFL (UC3M)
Date: October 26, 2006

Graph IV.2.1.1.4



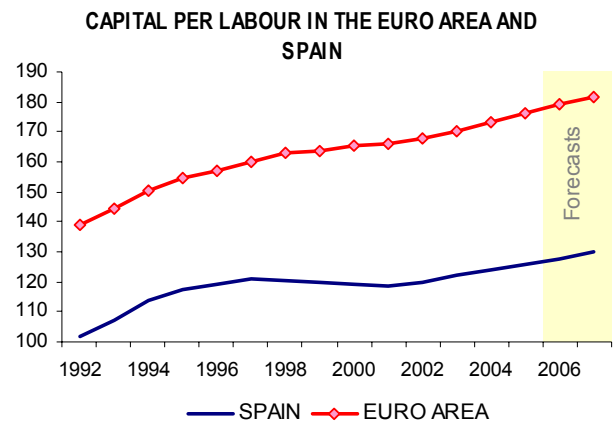
Source: EUROSTAT & IFL (UC3M)
Date: October 26, 2006

It is difficult to explain this cyclical reversion of productivity in the Spanish economy, but some analysts claim that, as a result of the introduction of different measures for temporary hiring in 1984, firms resort to this method, significantly increasing both temporary employment and the ease with which such employees can be dismissed at a low cost, so the rate of temporary employment in Spain is currently 34.6%, triple that of the euro area. This

phenomenon has recurred in the following phases of the cycle, enabling firms to hire largely temporary employees at high points in the cycle at a rate above that of GDP growth and easily dismiss such employees at the low points, decreasing labour productivity in the former and increasing it in the latter.

The possible causes of the low growth of productivity in Spain in the last few years are varied. Firstly, we have the low allocation of capital per worker (see graph IV.2.1.1.5), significantly lower than in the euro area, which is in a way a result of the pattern of growth of the Spanish economy, since it is excessively based on the construction and service sectors, where productivity is usually lower than in industry.

Graph IV.2.1.1.5



Source: AMECO & IFL (UC3M)
Date: October 26, 2006

Secondly, the large number of workers with temporary contracts on the Spanish labour market, more than a third of total employment and nearly triple the rate in the euro area, is another factor which limits the growth of productivity, largely due to the few incentives for firms to invest in training for these workers (for an analysis of why the heavy volume of temporary workers could be one of the reasons behind the low productivity rate, see last September's Bulletin of EU and US Inflation and Macroeconomic Analysis).

Another factor responsible for the low rate of growth of productivity could be the relatively low cost of labour, due to immigration, which has increased the labour supply and moderated salary increases, thus providing no incentive for capital investment and decreasing the assignment of capital per worker. In the last few years, the growth of the Spanish economy has been based on construction and some service branches, both of which are not capital-intensive.



Table IV.2.1.1.2

LABOUR PRODUCTIVITY BY SECTORS IN SPAIN (year-on-year rates)							
	2000 - 2005	2001	2002	2003	2004	2005	2006 (1)
Agriculture	-1,3	-1,1	-0,5	-0,6	4,1	-8,5	-1,4
Industry without energy	1,0	1,7	0,2	1,9	1,3	-0,1	2,1
Energy	2,7	6,4	4,6	2,8	-3,5	3,0	2,3
Construction	-0,4	-0,8	1,4	-0,2	-0,5	-1,5	-1,9
Services	0,3	0,5	0,2	-0,1	0,2	0,8	0,2
Market services	0,0	0,2	-0,2	-0,4	-0,2	0,8	-0,6
Non-market services	1,0	1,0	1,0	1,0	1,2	0,7	2,2
Total	0,5	0,4	0,4	0,6	0,6	0,4	0,5

(1) First semester

Source: INE

Date: October 26, 2006

One aspect resulting from the evolution of apparent productivity is the differences between the growth rates registered in different branches of activity (see table IV.2.1.1.2). In industry it systematically grows more than the economy as a whole and in services less. In any event, productivity in both industry and services also show the falling trend identified for the economy in general.

In 2000-2005, the greatest gains in productivity were found in the energy sector, with an average annual growth rate of 2.7% and in non-energy industry (1.0%), followed by services (0.3%). However, when services are broken down into market and non-market (public sector), the productivity in the former remained the same throughout the period, whereas the latter registered an average annual growth rate of 1%. In agriculture and construction, productivity fell in the period with negative average annual growth rates of 1.3% and 0.4%, respectively.

There are general reasons explaining the greater growth of apparent productivity in industry, the main one being that most industrial branches are more prone to technological innovation and more easily benefit from technological process than tertiary branches. However, we should underline the heterogeneity of service branches, which include some groups with very low productivity rates, such as bars and restaurants, and others with high rates, such as banking services.

IV.2.1.2. The Active Population Survey in the third quarter of 2006 and perspectives for employment, activity and unemployment.

According to the estimations of the Active Population Survey (EPA) for the third quarter of 2006, the performance of the labour market continues to be dynamic, as employment continues to grow at a

good pace, although less than the previous quarters, the labour supply also continues to grow and the unemployment rate has fallen to levels comparable with that of the EU. Nonetheless, in spite of these positive results, some of the problems which have been affecting the Spanish labour market for years are yet to be corrected.

In the third quarter of this year, employment grew by 202.5 thousand people, although in terms corrected for seasonality the increase was smaller (165.5 thousand people). Relative to a year earlier, creation of employment represented 704.6 thousand people, representing a year-on-year rate of variation of 3.7%, half a point less than the previous quarter, so the pace continues to slow down. The high rate of growth of employment is due to different factors identified in previous issues of the Bulletin, including (a) more moderate salary increases, (b) low interest rates, and (c) plenty of labour supply due to immigration.

From a sectorial perspective, the growth of employment reflects the pattern of growth of the Spanish economy and therefore continues to rest of construction and services. Construction continues to lead the growth process and improve forecasts, with a year-on-year growth rate of 8.1%, three tenths higher than the previous quarter and doubling the rate of growth registered at the end of last year. It is followed at some distance by services (4.9%), whereas employment had fallen in the last year in agriculture (8%) and industry (0.7%).

With regards to professional status, both salaried and non-salaried employment decreased, although the latter more intensely. Indeed, salaried employment grew at a year-on-year rate of 3.9%, four tenths less than the previous quarter, whereas non-salaried employment grew by 2.6%, 1.1 pp less than the previous period. In turn, by gender, female



employment continued to register much higher year-on-year growth rates than male employment. In the third quarter, female employment registered a year-on-year rate of 4.8% versus 2.9% for men. These figures show a fall in the growth rate for both groups.

By type of contract, workers with temporary agreements continue to show significantly higher growth rates than those with indefinite contracts. The year-on-year growth rate of salaried employees with indefinite contracts in the third quarter of 2006 was 3.6%, and 4.5% for temporary contracts. This shows an increase in this quarter in the growth of indefinite contracts, and a heavy decrease in temporary contracts. Workers with fixed contracts increased their annual growth rate by 1 point, whereas temporary contracts decreased theirs by 3.4 pp. After this evolution, the temporary employment rate increased by two tenths to 34.6%. The labour reform which came into effect at the beginning of July, which introduced measures to combat the excessive number of temporary employees, has not been capable of reducing the temporary employment rate yet, although its growth rate has fallen. It was significantly higher, 1 pp, in the second quarter of the year

By duration of employment, it increased in both in full-time and part-time categories. The former registered a year-on-year growth rate of 4% in the third quarter and the latter by a lower rate (1.1%). In comparison with the previous quarter, the former reduced their rate of growth and the former increased it. The participation of full-time employees in the total fell in the third quarter to 11.3%, nine tenths beneath the ratio registered in the previous period.

The active population totalled 21660.7 thousand people in the third quarter of 2006, with a year-on-year rate of variation of 3.4%, one tenth more than in the previous period. After these results, the activity rate was 58.4%, one tenth higher than the previous period. This dynamic labour supply is largely based on the immigration phenomenon and also the growing trend for women to become part of the work force, a process which has become more intense in recent years. By gender, there is still greater growth in the female than in the male active population, clearly due to certain structural factors. During the last twelve months, active males have grown by 2.9%, and women by 4.6%, figures representing lower growth in both cases, half a point in the former and six tenths in the latter.

As a result of the evolution of the supply and demand of labour, the number of unemployed fell by 21 thousand in the third quarter, to 1765 thousand. Relative to a year earlier, unemployment has not varied, contrasting with the fall of 5.5% registered in the previous quarter. This performance of

unemployment led to a cut in the unemployment rate/active population ratio in relation to the previous quarter of four tenths, to 8.1%.

In spite of the good results of the EPA in the third quarter, there continue to be some problems in the Spanish labour market. Firstly, the evolution of employment reflects the pattern of growth of the Spanish economy, depending too much on construction and services, sectors with low productivity rates. In turn, over a third of all employees have temporary contracts. On the other hand, in the last few years the employment figures estimated by the EPA show certain instability, leading us to question its reliability, largely due to the many methodological changes made to the survey in the last decade. The first doubt arises when we observe the slow down in employment growth in this year. From 4.9% in the last quarter of 2005 it has gone to 3.7% in the third quarter of 2006, contrasting with the growth profile of the GDP. Another inconsistency found in EPA employment is that its rate of growth continues to be higher than that of the GDP practically systematically, so apparent labour productivity has been declining for years.

After these EPA results for the third quarter, we have updated our forecasts for employment, active population and unemployment (see table IV.2.1.2.1). The revisions are slightly upwards in the active population but employment and unemployment remain practically unaltered.

Table IV.2.1.2.1

LABOUR MARKET IN SPAIN			
AVERAGE RATE OF GROWTH			
	ACTIVE	EMPLOYMENT	UNEMPLOYMENT
2004	3.3	3.9	11.0
2005	3.2	4.8	9.6
2006	3.3	4.1	8.5
2007	3.1	3.8	7.8

Bold figures are forecasts. For 2005, the rates are corrected of the impact produced by the changes incorporated in the first quarter of 2005.

Source: INE & IFL (UC3M)

Date: October 27, 2006

The employment forecasts for 2006 show that it will continue to be dynamic in the fourth quarter of this year, with rates similar to those of the third, so we expect the year to end with an average annual rate of 4.1%. For 2007, employment will remain strong, but with a slightly lower growth rate (3.8%), consistent with the lower growth rate forecast for the GDP. The active population will continue to be strong in 2006-2007, fostered by immigration, but with rates similar to those of previous years, 3.3% in 2006 and 3.1% in 2007. The unemployment/active population ratio for this period remains practically unaltered from the previous quarter, becoming consolidated at one-digit levels similar to those of the EU, with 8.5% expected for 2006 and 7.8% for 2007.



IV.2.2 INFLATION.

For October, we are forecasting a monthly inflation rate of 0.5% in Spain, with the annual rate falling to 2.5% from the 2.9% observed in September. The 80% confidence interval for the annual rate ranges from 2.4% to 2.8% (see table IV.2.2.1).

In September, the Spanish CPI was slightly lower than expected, with a negative monthly growth rate of 0.2% and with the annual rate falling by 0.8 pp from the August figure, to 2.9%, largely due to falls in energy prices.

Table IV.2.2.1

ANNUAL GROWTH RATES IN SPAIN*						
Inflation in the CPI	Observed			Forecasts		
	Ave ⁽²⁾ 2004	Ave ⁽²⁾ 2005	2006 Sep ⁽¹⁾	2006 Oct ⁽¹⁾	Ave ⁽²⁾ 2006	Ave ⁽²⁾ 2007
Core (82.31%)	2.7	2.7	2.9	2.9 (±0.17)	2.9 (±0.06)	2.6 (±0.38)
Total (100%)	3.0	3.4	2.9	2.6 (±0.18)	3.6 (±0.07)	2.4 (±0.62)

* In parenthesis confidence intervals calculated with historical errors.
Source : INE & IFL (UC3M)
Date: October 24, 2006

(1) Year-on-year rates
(2) Average rates of growth

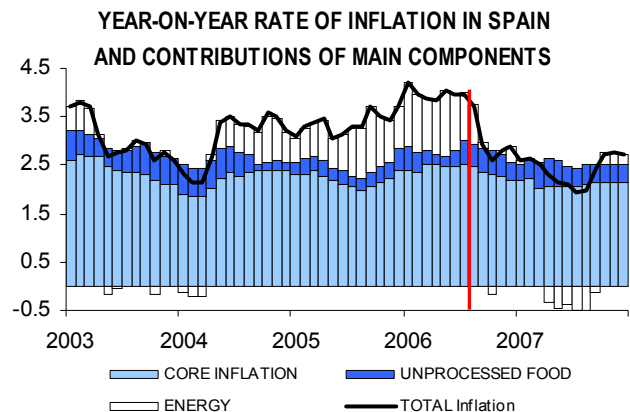
With regards to core inflation, there has been a downwards innovation in both non-energy industrial goods and in services, basically in transport and hotels. In September, core inflation fell to 2.9%, 0.1 pp less than the rate registered in August. With the most recent information, there is a slight improvement in the expectations for core inflation, so we have reduced its forecast average annual rate by 0.1 pp for both 2006 and 2007, to 2.9% (±0.06)⁵ and 2.6% (±0.38), respectively.

Outside core inflation, there has been an upwards innovation in the growth of energy prices which has partly compensated the downwards innovation registered in the inflation of unprocessed food. However, the latest information about international energy prices sterilises the effects of this slight upwards innovation, and expectations related to the growth of energy process have fallen, and for the first time since 2004 are expected to provide a negative contribution to total GDP growth in October (see graph IV.2.2.1).

As a result of the above, although it is revised downwards slightly, rounded to one decimal point the forecast average annual headline inflation rate in Spain is still 3.6% (±0.07) for 2006, although it has fallen by 0.3 pp for 2007 to 2.4% (±0.62).

⁵ The values in brackets correspond to 80% confidence intervals calculated with historical errors.

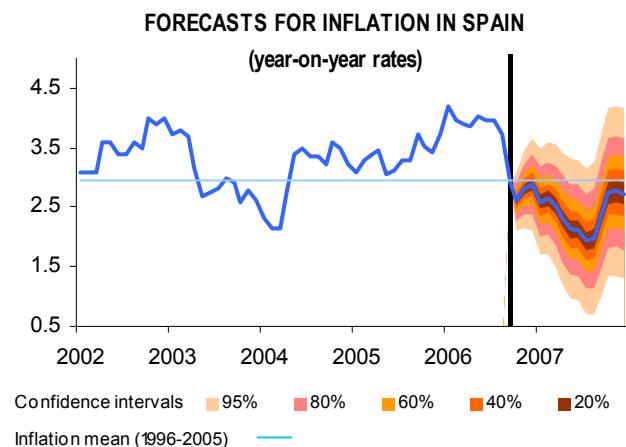
Graph IV.2.2.1



Source: INE & IFL (UC3M)
Date: October 24, 2006

As for the evolution of inflation forecasts for 2006 (see graph IV.2.2.2), we are expecting a heavy reduction in inflation growth in the next few months, to 2.6% (±0.18) in October, increasing to the middle values of the 2.5% to 3.1% range for November, and 2.5% to 3.3% for December (80% confidence intervals).

Graph IV.2.2.2



Source: INE & IFL (UC3M)
Date: October 24, 2006

For 2007, we are expecting quite a stable evolution of core inflation, with annual growth rates of around 2.6% whereas, due to the greater volatility of energy prices, we are expecting annual headline inflation rates of around 2.7% in the first quarter of 2007, although it will subsequently tend to fall to values of around 2% in July and August, rising again to 2.8% in the last quarter of 2007.

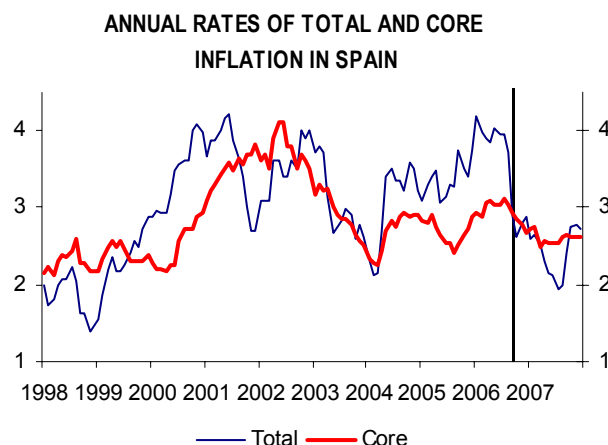


Furthermore, the advanced annual inflation rate for the harmonised Spanish CPI for October 2006 was 2.6%, consistent with the CPI forecast published by the Bulletin of EU and US Inflation and Macroeconomic Analysis on October 11. This confirms the moderate annual rates of inflation that the Bulletin has been forecasting for the last quarter of 2006 since 2005.

The last time there was a rate similar to 2.6% in annual inflation was April, 2004, when it was 2.7%. As graph IV.2.2.3 shows, the April 2004 figure was temporary and we have to go back as far as 1998-1999 to find average annual rates of less than 2.5%. We forecast that the average annual rate for 2006 will go from the 3.4% of 2005 to 2.6%, due to the high inflation values registered at the beginning of the year, with the average value falling to 2.4% in 2007, with 2.6% core inflation, two tenths of a percentage point higher than the average value for 1998-1999. This means that, like then, Spanish core inflation has a differential of no less than one percentage point with core inflation in Europe. Both now and then, this is configured with a 2 pp differential in service inflation, but with a differential of over half a percentage point in the consumer prices of non-energy industrial goods.

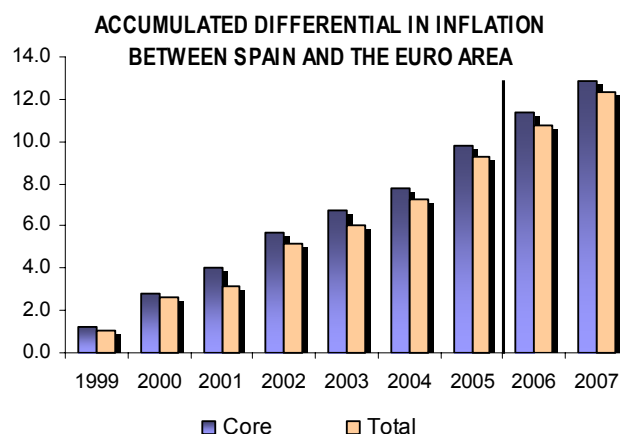
As for the headline inflation differential with the euro area, it is expected to increase by two tenths of a percentage point in 2006, to 1.4% compared with the 1.2% of 2005, although it could fall in 2007 to 0.5%. The accumulated differential since the introduction of the euro in 1999 would therefore be 12.3% by the end of 2007 (see graph IV.2.2.4).

Graph IV.2.2.3



Source: EUROSTAT, INE & IFL (UC3M)
Date : October 24, 2006

Graph IV.2.2.4



Source: EUROSTAT, INE & IFL (UC3M)
Date : October 24, 2006



IV.3. TABLES AND PLOTS.

Tables:

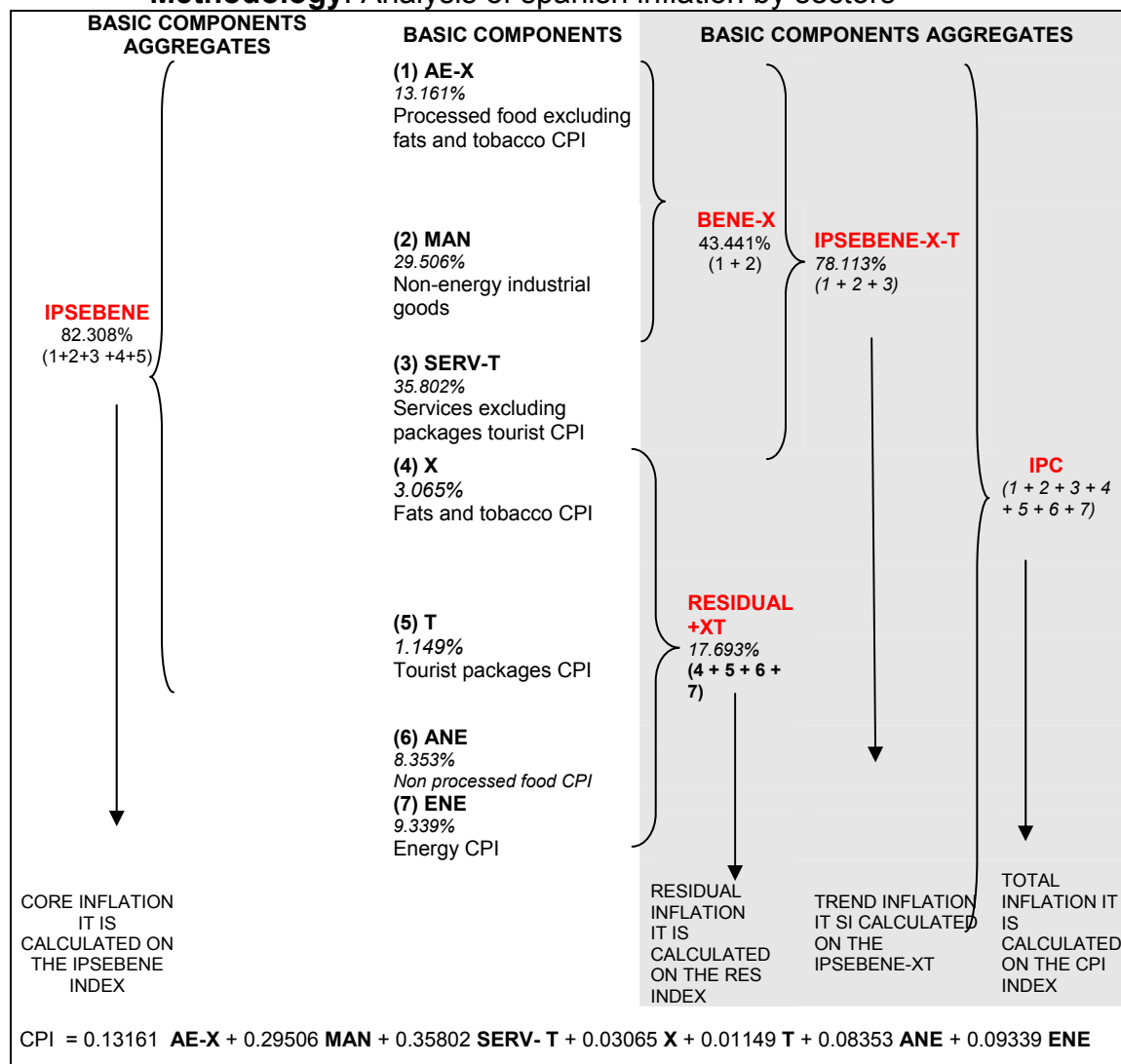
- Spain Consumer Price Index (CPI) desegregation.
- Forecast errors by sectors for Spain.

Plots:

- CPI monthly growth rates in Spain.
- Annual Forecasts for the Spain Inflation.
- Year-on-year rate of Spain inflation and contributions of main components



Methodology: Analysis of spanish inflation by sectors



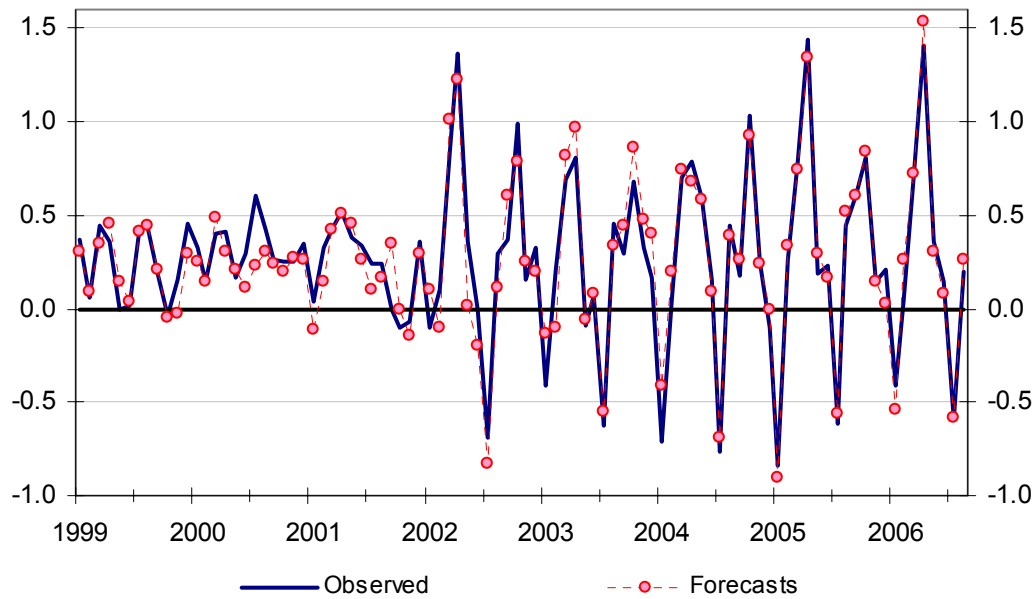
Source: INE & IFL (UC3M) Weights 2006

FORECAST ERRORS IN THE MONTHLY INFLATION RATE BY SECTORS IN SEPTEMBER IN SPAIN				
	Weights 2006	Observed Monthly Growth	Forecast	Confidence interval at 80%
Processed food	17.00	0.07	0.05	0.28
Non energy industrial goods	29.51	1.12	1.20	0.27
Services	35.80	-0.42	-0.29	0.12
CORE	82.31	0.21	0.29	0.14
Non-processed food	8.35	0.63	0.72	0.90
Energy	9.34	-3.82	-4.03	0.72
RESIDUAL	17.69	-1.81	-1.88	0.48
TOTAL INFLATION	100.00	-0.16	-0.11	0.14

Source INE & IFL (UC3M)
Date: October 11, 2006



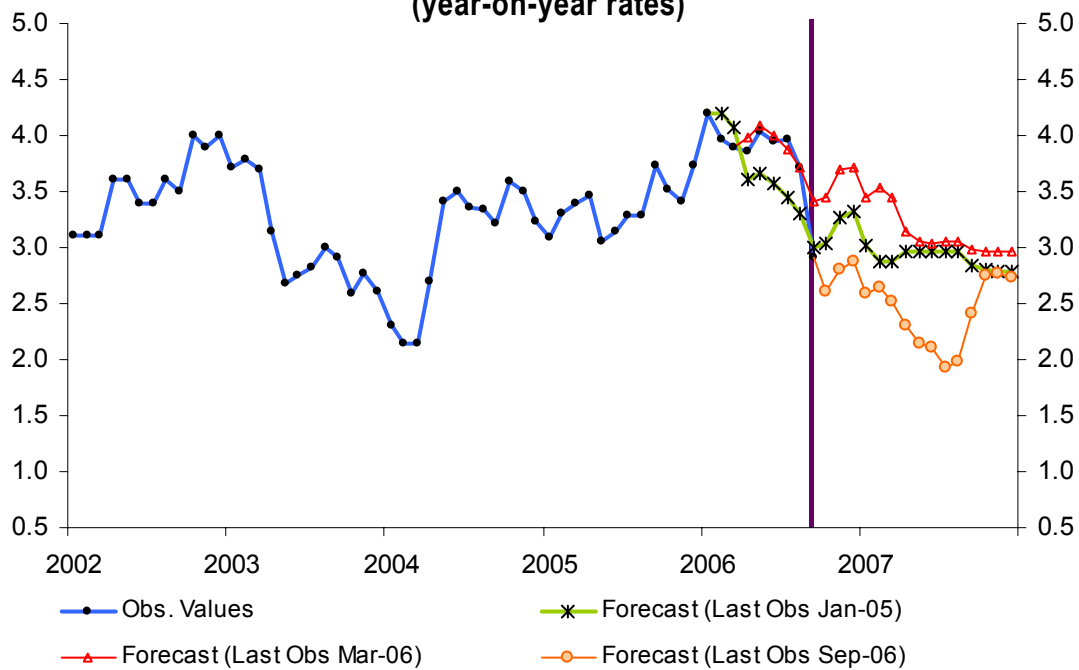
CPI MONTH-ON-MONTH RATES OF GROWTH IN SPAIN



Source: INE & IFL (UC3M)
Date: October 11, 2006

*The roof of mean square error for one period a head is 0.09

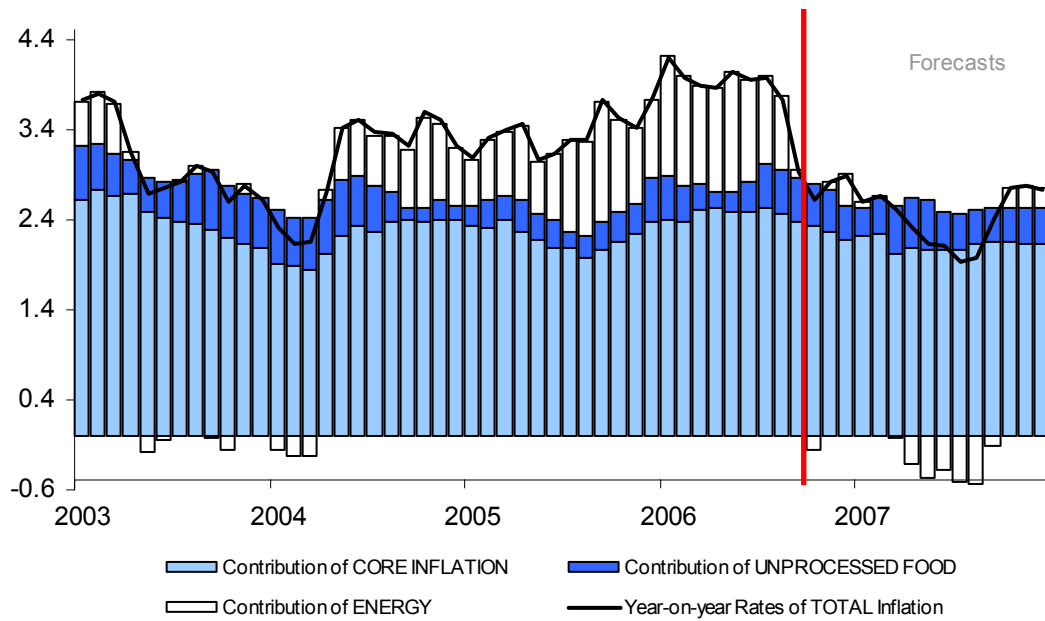
ANNUAL FORECASTS FOR INFLATION IN SPAIN (year-on-year rates)



Source INE & IFL (UC3M)
Date: October 24, 2006



YEAR-ON-YEAR RATE OF INFLATION IN SPAIN AND CONTRIBUTIONS OF MAIN COMPONENTS



Source INE & IFL (UC3M)
Date: October 24, 2006





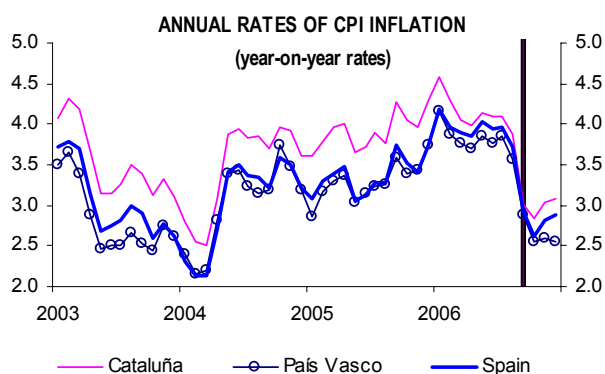
V. SPANISH REGIONS.

V.1. INFLATION.

V.1.1. MAIN POINTS AND CONCLUSIONS.

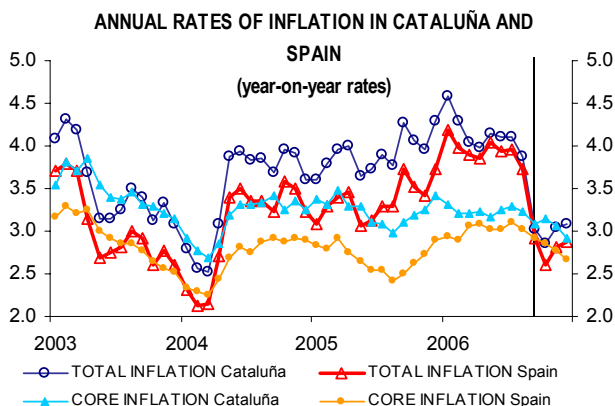
In September, the most significant downwards innovations in inflation were observed in the autonomous regions of Extremadura and La Rioja. The rest of the regions performed as expected, except Ceuta y Melilla, where there was a significant upwards innovation.

Graph V.1.1.1



Source: INE & IFL (UC3M)
Date: October 11, 2006

Graph V.1.1.2



Source: INE & IFL (UC3M)
Date: October 11, 2006

With the September figures, the inflation forecasts for 2006 improve in most of the autonomous regions, as they do for Spain, for which we maintain our forecast average annual headline inflation rate at 3.6% (see graph V.1.1.1), rounded to one decimal point, even though it has been revised downwards slightly.

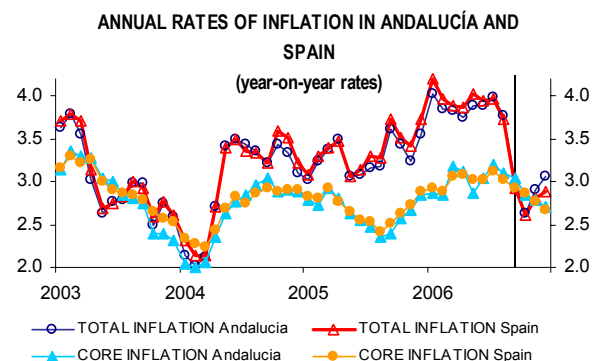
Following is a detailed analysis of Cataluña, Andalucía, Valencia and the País Vasco. In this section we use functional disaggregation (core inflation, unprocessed food and energy products) to

identify the price components accumulating the greatest variations.

In Cataluña, with the September figure, last month's headline inflation forecast for 2006 is revised downwards by 0.1 pp to 3.8%, so the unfavourable differential relative to Spain falls to 0.2 pp. In September, the annual CPI growth rate was 3.0%, significantly lower than the August rate, which reached 3.9%. Although the core inflation forecast for 2006 remains at 3.2%, Cataluña increased its unfavourable differential relative to Spain to 0.3 pp (see graph V.1.1.2).

In view of the September figure, for Andalucía the headline inflation forecast is revised downwards by 0.1 pp, to 3.6%. The annual core inflation rate in September was 3.0%, the value forecast for the average annual rate in 2006 for both Spain and this region, confirming the similarity in the evolution of the two rates (see graph V.1.1.3).

Graph V.1.1.3

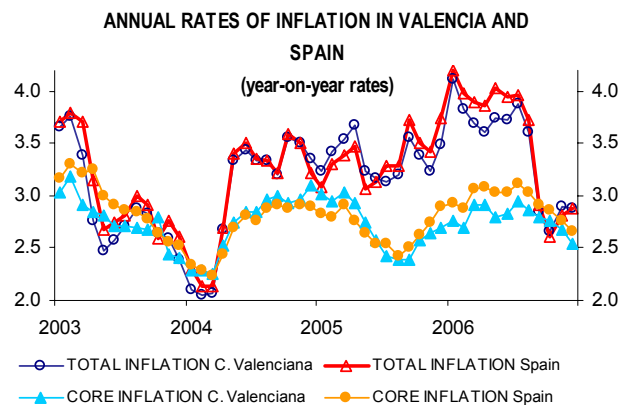


Source: INE & IFL (UC3M)
Date: October 11, 2006

In the autonomous region of Valencia, with the figure observed in September, the annual inflation rate is taken to 2.9%. The headline inflation forecast for 2006 remains unaltered at 3.5%, representing a favourable differential relative for Spain of 0.1 pp in 2006. With the latest information available, the core inflation rate forecast for 2006 remains at 2.8%, representing a small favourable differential relative to the Spanish core rate forecast for 2006 of 0.1 pp. For 2007, the average core inflation rate is expected to fall to 2.7% (see graph V.1.1.4).



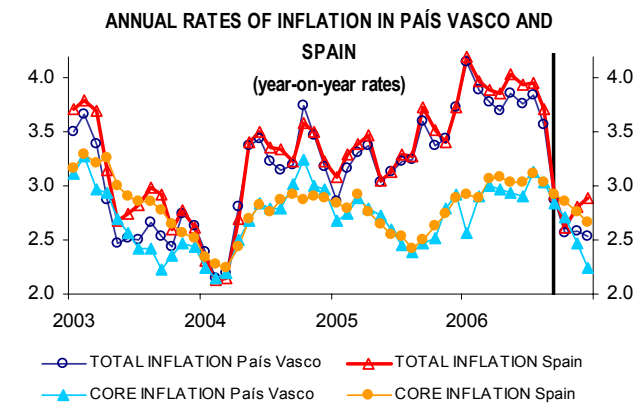
Graph V.1.1.4



Source: INE & IFL (UC3M)
Date: October 11, 2006

In the País Vasco, the headline inflation forecast for 2006 is revised downwards by 0.2 pp to 3.4%, 0.2 pp less than the national rate. The annual inflation rate in September was 2.9%, 0.7 pp less than in August. With the latest information available, the core inflation rate expected for 2006 has been revised downwards by 0.2 pp to 2.8% 0.1pp less than the national rate (see graph V.1.1.5).

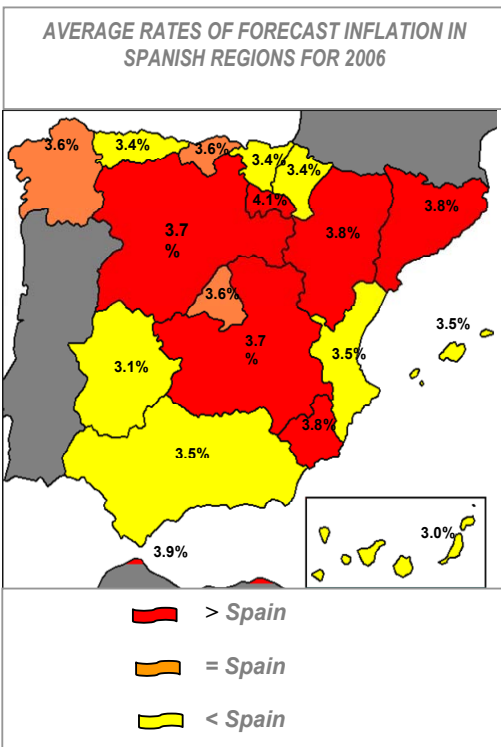
Graph V.1.1.5



Source: INE & IFL (UC3M)
Date: October 11, 2006

Graph V.1.1.6 shows the average annual rates of inflation forecast for all the autonomous regions of Spain in 2006.

Graph V.1.1.6



Source: INE & IFL (UC3M)
Date: October 11, 2006



V.1.2. TABLES AND PLOTS

Tables:

- Forecast Errors by regions
- Consumer Price Index (CPI) Annual Growth Rates by Regions in Spain.
- Consumer Price Index (CPI) Monthly Growth Rates by Regions in Spain.

FORECAST ERRORS IN THE MONTHLY INFLATION RATE BY SPANISH REGIONS IN SEPTEMBER				
	Observed Monthly Growth	Forecast	Error	Annual rate observed
Andalucia	-0.13	-0.11	-0.02	3.89
Aragón	-0.11	-0.12	0.01	4.23
Asturias (Principado de)	-0.24	-0.33	0.09	3.69
Islas Baleares	-0.30	-0.35	0.05	3.92
Canarias	-0.14	-0.08	-0.06	3.56
Cantabria	-0.32	-0.29	-0.03	4.01
Castilla y León	-0.05	-0.08	0.03	4.03
Castilla - La Mancha	-0.22	-0.25	0.02	4.16
Cataluña	-0.25	-0.20	-0.05	4.10
C.Valenciana	-0.27	-0.23	-0.04	3.73
Extremadura	-0.04	0.01	-0.05	3.38
Galicia	-0.05	-0.12	0.07	4.08
C. de Madrid	0.05	0.05	0.05	0.05
Región de Murcia	-0.23	-0.18	-0.05	4.16
Navarra	-0.11	-0.16	0.05	3.79
País Vasco	0.06	0.09	-0.03	3.76
La Rioja	-0.35	-0.29	-0.06	4.46
Ceuta y Melilla	0.55	0.35	0.20	4.38

Source: INE & IFL (UC3M)

Date:: October 11, 2006



CPI ANNUAL GROWTH BY REGIONS IN SPAIN																				
		Spain																		
		Regions																		
		Andalucia	Aragón	Asturias	Baleares	Canarias	Cantabria	Castilla y León	Castilla La Mancha	Cataluña	Valencia	Extremadura	Galicia	Madrid	Murcia	Navarra	País Vasco	Rioja	Ceuta y Melilla	
ANNUAL AVERAGE RATE	1998	1.4	1.4	1.9	2.0	2.4	1.9	1.5	1.4	2.1	2.0	1.4	1.9	1.7	2.2	2.0	2.3	2.0	2.5	
	1999	1.9	2.4	2.5	2.3	2.3	2.4	2.2	1.8	2.8	2.0	1.7	2.5	2.1	2.7	2.6	2.8	3.2	1.5	
	2000	3.1	3.3	3.2	3.6	3.1	3.2	3.4	3.5	3.8	3.4	2.5	3.3	3.4	3.9	3.5	3.5	4.0	3.3	
	2001	3.6	3.5	3.6	4.1	3.1	3.3	3.7	3.5	3.5	3.6	3.7	3.4	3.6	4.1	3.7	3.9	4.1	3.8	
	2002	3.4	3.6	3.7	3.8	2.6	3.4	3.4	3.5	3.7	3.5	3.1	3.8	3.6	3.5	3.8	3.7	3.7	3.3	
	2003	3.0	2.9	3.0	3.0	2.2	2.7	2.7	2.9	3.5	2.9	2.5	3.1	3.0	3.7	3.1	2.8	3.3	3.5	
	2004	3.0	2.7	2.9	2.7	2.3	2.7	2.8	3.1	3.5	3.0	2.5	3.0	3.0	3.4	3.0	3.0	2.8	3.7	
	2005	3.3	3.5	3.1	3.1	2.5	3.2	3.3	3.5	3.9	3.4	2.8	3.4	3.1	3.4	3.4	3.3	3.7	2.8	
	2006	3.5	3.8	3.4	3.5	3.0	3.6	3.7	3.7	3.8	3.5	3.1	3.6	3.6	3.8	3.4	3.4	4.1	3.9	
	2007	2.2	2.6	2.7	2.4	1.9	2.5	2.5	2.4	2.7	2.4	2.5	2.4	2.5	2.7	2.4	1.8	3.0	2.7	
ANNUAL RATES (growth of the month over the same month of the previous year)	2005	January	3.0	3.0	2.7	3.2	2.3	2.6	3.0	3.2	3.6	3.2	2.6	3.1	2.9	2.9	3.1	2.9	3.2	3.0
		February	3.2	3.4	2.9	3.1	2.6	3.2	3.1	3.3	3.8	3.4	2.8	3.4	3.1	3.1	3.3	3.2	3.4	2.9
		March	3.4	3.6	3.0	3.0	2.5	3.1	3.3	3.3	4.0	3.5	2.8	3.4	3.1	3.2	3.5	3.3	3.6	2.9
		April	3.5	3.7	3.1	3.2	2.4	3.2	3.4	3.7	4.0	3.7	3.1	3.4	3.0	3.7	3.5	3.4	3.7	2.7
		May	3.1	3.2	2.7	2.6	2.2	2.8	2.9	3.2	3.6	3.2	2.5	2.9	2.6	3.1	3.1	3.0	3.5	1.9
		June	3.1	3.2	2.9	2.8	2.1	2.9	3.0	3.3	3.7	3.2	2.6	3.0	2.9	3.1	3.2	3.1	3.6	1.9
		July	3.2	3.5	3.2	3.0	2.3	3.4	3.2	3.4	3.9	3.1	2.6	3.2	3.1	3.1	3.3	3.2	3.7	2.3
		August	3.2	3.3	3.2	2.9	2.4	3.4	3.3	3.4	3.8	3.2	2.8	3.3	3.1	3.3	3.3	3.2	3.6	2.1
		September	3.6	3.8	3.6	3.3	2.8	3.6	3.7	4.1	4.3	3.6	3.1	3.8	3.6	3.9	3.6	3.6	4.0	2.8
		October	3.4	3.7	3.3	3.3	2.8	3.1	3.4	3.5	4.1	3.4	2.9	3.5	3.3	3.8	3.5	3.4	3.8	3.2
		November	3.2	3.5	3.1	3.1	2.6	3.2	3.3	3.4	4.0	3.2	2.8	3.4	3.3	3.9	3.4	3.4	4.0	3.7
		December	3.6	3.8	3.5	3.5	2.8	3.6	3.7	3.8	4.3	3.5	3.1	3.7	3.7	4.1	3.7	3.7	4.4	3.7
	2006	January	4.0	4.2	4.0	3.8	3.2	4.1	4.3	4.6	4.6	4.1	3.5	4.1	4.1	4.6	4.2	4.2	4.5	4.1
		February	3.8	3.9	4.0	3.8	3.1	4.0	4.1	4.4	4.3	3.8	3.4	3.9	3.9	4.5	4.0	3.9	4.4	4.1
		March	3.8	3.9	3.8	3.6	3.3	4.0	3.9	4.3	4.0	3.7	3.3	4.0	3.9	4.2	4.0	3.8	4.3	4.0
		April	3.7	4.0	3.8	3.7	3.3	3.9	3.9	4.0	4.0	3.6	3.2	4.0	4.1	4.0	3.9	3.7	4.2	4.0
		May	3.9	4.3	3.9	4.0	3.7	4.1	4.1	4.2	4.1	3.7	3.4	4.2	4.2	4.2	4.0	3.9	4.5	4.3
		June	3.9	4.2	3.7	3.9	3.6	4.0	4.0	4.2	4.1	3.7	3.4	4.1	4.0	4.2	3.8	3.8	4.5	4.4
		July	4.0	4.3	3.5	3.9	3.3	4.0	4.0	4.1	4.1	3.9	3.5	4.0	4.0	4.4	3.6	3.8	4.5	4.3
		August	3.8	4.1	3.4	3.7	3.2	3.6	3.8	3.9	3.9	3.6	3.3	3.7	3.7	4.1	3.3	3.6	4.4	4.3
		September	3.0	3.3	2.7	3.0	2.3	3.4	3.0	2.8	3.0	2.9	2.5	2.9	2.9	3.1	2.6	2.9	3.6	3.8
		October	2.6	3.0	2.4	2.8	2.0	2.8	2.9	2.6	2.8	2.7	2.4	2.5	2.6	2.8	2.2	2.6	3.6	3.3
		November	2.9	3.3	2.8	3.0	2.3	2.9	3.1	2.9	3.0	2.9	2.6	2.7	2.7	2.9	2.4	2.6	3.5	3.1
		December	3.1	3.3	2.9	3.1	2.3	3.1	3.2	3.0	3.1	2.9	2.8	2.9	2.7	3.1	2.6	2.5	3.5	3.4
	2007	January	2.7	3.0	2.8	2.8	2.2	2.8	2.8	2.4	2.8	2.7	2.4	2.6	2.6	2.8	2.5	2.1	3.2	3.3
		February	2.7	3.0	2.8	2.7	2.1	2.7	2.7	2.5	2.9	2.7	2.6	2.6	2.7	2.9	2.5	2.3	3.2	3.1
		March	2.4	2.9	2.8	2.7	2.0	2.6	2.6	2.4	2.8	2.6	2.6	2.4	2.6	3.0	2.4	2.1	3.2	3.2
		April	2.0	2.5	2.6	2.3	1.9	2.4	2.4	2.1	2.6	2.2	2.3	2.1	2.3	2.6	2.2	1.9	2.9	3.0
		May	1.8	2.5	2.5	2.2	1.5	2.3	2.3	2.0	2.5	2.0	2.4	2.1	2.2	2.5	2.0	1.7	2.6	2.6
		June	1.8	2.3	2.5	2.2	1.6	2.4	2.2	2.0	2.4	1.9	2.3	2.1	2.2	2.4	2.1	1.6	2.6	2.4
		July	1.6	2.0	2.3	1.8	1.6	2.0	2.0	1.8	2.2	1.8	2.2	2.0	2.1	2.2	2.1	1.3	2.4	2.4
		August	1.7	2.0	2.3	1.9	1.5	2.0	1.9	1.9	2.2	2.0	2.1	2.0	2.2	2.2	2.2	1.3	2.5	2.5
		September	2.2	2.5	2.7	2.3	1.9	2.4	2.4	2.5	2.7	2.5	2.7	2.5	2.6	2.8	2.6	1.6	3.0	2.3
		October	2.6	2.8	3.1	2.7	2.2	2.8	2.8	3.0	3.0	2.9	3.0	2.8	2.9	3.2	2.8	1.9	3.4	2.5
		November	2.7	2.8	3.0	2.6	2.2	2.8	2.8	3.0	3.0	2.9	3.0	2.8	2.9	3.1	2.8	1.9	3.3	2.4
		December	2.6	2.7	2.9	2.6	2.1	2.7	2.7	2.9	2.9	2.8	2.9	2.8	2.9	3.0	2.8	1.9	3.2	2.4

Source: INE & IFL (UC3M)
Date: October 11, 2006

* The shaded areas represent forecasted values



CPI MONTHLY GROWTH BY REGIONS IN SPAIN																				
		Spain																		
		Regions																		
		Andalucía	Aragón	Asturias	Balears	Canarias	Cantabria	Castilla y León	Castilla La Mancha	Cataluña	Valencia	Extremadura	Galicia	Madrid	Murcia	Navarra	País Vasco	Rioja	Ceuta y Melilla	
MONTHLY RATES (Growth of the month over the previous month)	January	2004	-0.9	-0.8	-0.9	-0.6	-0.4	-0.9	-0.9	-0.9	-0.6	-0.7	-0.9	-0.9	-0.4	-0.8	-1.1	-0.4	-1.0	-1.2
		2005	-1.0	-1.0	-1.3	-0.4	-0.6	-1.0	-1.0	-1.1	-0.6	-0.8	-1.1	-1.1	-0.6	-1.2	-1.4	-0.7	-1.1	-1.5
		2006	-0.6	-0.6	-0.8	0.0	-0.2	-0.5	-0.5	-0.3	-0.3	-0.2	-0.6	-0.7	-0.2	-0.7	-0.8	-0.3	-1.0	-1.1
		2007	-0.9	-0.9	-1.0	-0.3	-0.4	-0.8	-0.9	-0.9	-0.6	-0.4	-0.9	-1.0	-0.2	-0.9	-0.9	-0.8	-1.2	-1.3
	February	2004	0.2	0.0	0.0	0.2	0.0	-0.4	0.1	0.1	0.0	0.2	0.0	0.1	0.0	0.1	0.0	-0.1	0.0	0.3
		2005	0.4	0.4	0.2	0.0	0.3	0.1	0.2	0.2	0.2	0.4	0.2	0.4	0.2	0.4	0.2	0.2	0.1	0.2
		2006	0.2	0.0	0.1	0.0	0.2	0.0	0.1	0.1	-0.1	0.1	0.0	0.1	0.0	0.2	0.0	-0.1	0.1	0.2
		2007	0.2	0.0	0.2	-0.1	0.1	-0.2	0.0	0.1	0.0	0.2	0.1	0.1	0.1	0.3	0.0	0.1	0.0	0.1
	March	2004	0.8	0.7	0.6	0.6	0.5	0.7	0.7	0.8	0.7	0.7	0.6	0.7	0.7	0.8	0.7	0.7	0.4	1.0
		2005	0.9	0.9	0.7	0.6	0.5	0.7	0.9	0.8	0.8	0.8	0.7	0.8	0.7	0.8	0.9	0.9	0.6	1.0
		2006	0.9	0.9	0.6	0.4	0.7	0.7	0.7	0.7	0.6	0.6	0.6	0.8	0.7	0.6	0.9	0.8	0.5	0.9
		2007	0.7	0.8	0.5	0.4	0.6	0.6	0.6	0.6	0.5	0.5	0.6	0.6	0.6	0.6	0.9	0.6	0.5	1.0
	April	2004	1.5	1.4	1.6	1.0	1.0	1.4	1.3	1.3	1.4	1.5	1.5	1.4	1.2	1.5	1.3	1.2	2.2	1.9
		2005	1.7	1.5	1.7	1.1	0.9	1.5	1.4	1.7	1.4	1.6	1.7	1.4	1.1	2.1	1.3	1.3	2.2	1.7
		2006	1.6	1.6	1.6	1.2	1.0	1.5	1.4	1.5	1.4	1.5	1.6	1.5	1.2	1.8	1.2	1.2	2.1	1.7
		2007	1.1	1.3	1.4	0.8	0.9	1.2	1.1	1.2	1.2	1.2	1.4	1.2	0.9	1.5	0.9	1.0	1.9	1.4
	May	2004	0.7	0.5	0.6	0.8	0.4	0.6	0.6	0.7	0.6	0.7	0.6	0.7	0.4	0.7	0.8	0.4	0.4	0.9
		2005	0.2	0.0	0.2	0.3	0.2	0.2	0.1	0.2	0.2	0.3	0.1	0.2	0.1	0.1	0.5	0.1	0.3	0.1
		2006	0.4	0.2	0.3	0.5	0.6	0.4	0.4	0.4	0.4	0.4	0.2	0.4	0.2	0.3	0.6	0.2	0.6	0.4
		2007	0.2	0.2	0.2	0.4	0.2	0.3	0.3	0.3	0.3	0.2	0.3	0.3	0.1	0.2	0.4	0.1	0.3	0.1
	June	2004	0.1	0.2	0.1	0.2	0.2	0.1	0.2	0.2	0.2	0.1	0.0	0.2	0.1	0.1	0.3	0.1	0.2	0.1
		2005	0.2	0.2	0.3	0.3	0.1	0.1	0.3	0.3	0.3	0.1	0.1	0.3	0.3	0.2	0.3	0.2	0.3	0.2
		2006	0.2	0.2	0.1	0.3	0.0	0.0	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.2	0.2
		2007	0.2	0.0	0.1	0.2	0.0	0.1	0.2	0.2	0.2	0.0	0.1	0.2	0.2	0.1	0.2	0.0	0.2	0.0
	July	2004	-1.0	-1.0	-1.0	-0.1	-0.7	-0.6	-0.7	-0.8	-0.7	-0.8	-1.0	-1.0	-0.4	-1.1	-0.6	-0.7	-1.3	-1.6
		2005	-0.9	-0.7	-0.7	0.1	-0.5	-0.1	-0.5	-0.7	-0.5	-0.9	-0.9	-0.8	-0.3	-1.1	-0.4	-0.6	-1.2	-1.3
		2006	-0.8	-0.6	-0.8	0.1	-0.7	-0.1	-0.5	-0.7	-0.5	-0.7	-0.8	-0.8	-0.3	-0.8	-0.6	-0.5	-1.1	-1.3
		2007	-1.0	-0.9	-1.0	-0.2	-0.7	-0.5	-0.8	-0.9	-0.7	-0.8	-1.0	-1.0	-0.4	-1.1	-0.6	-0.8	-1.3	-1.3
	August	2004	0.4	0.6	0.5	0.3	0.2	0.3	0.5	0.4	0.6	0.4	0.2	0.4	0.4	0.4	0.4	0.4	0.5	0.5
		2005	0.4	0.4	0.5	0.1	0.3	0.3	0.5	0.4	0.4	0.5	0.4	0.5	0.5	0.5	0.4	0.5	0.4	0.3
		2006	0.2	0.3	0.3	-0.1	0.2	0.0	0.3	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.2	0.3	0.3
		2007	0.3	0.2	0.3	-0.1	0.1	0.0	0.2	0.2	0.2	0.4	0.2	0.3	0.3	0.2	0.1	0.2	0.4	0.3
	September	2004	0.2	0.2	0.0	0.0	0.3	0.2	0.4	0.2	0.1	0.1	0.4	0.3	0.1	0.2	0.2	0.4	0.0	0.4
		2005	0.6	0.6	0.4	0.4	0.7	0.4	0.8	0.8	0.6	0.5	0.7	0.8	0.5	0.7	0.6	0.7	0.4	1.0
		2006	-0.1	-0.1	-0.2	-0.3	-0.1	-0.3	0.0	-0.2	-0.2	-0.3	0.0	0.0	-0.2	-0.2	-0.1	0.1	-0.4	0.5
		2007	0.4	0.4	0.2	0.2	0.3	0.1	0.4	0.4	0.2	0.2	0.5	0.4	0.2	0.3	0.3	0.4	0.2	0.4
	October	2004	0.9	1.3	1.2	0.3	0.5	1.4	1.0	1.4	1.0	0.9	1.3	1.4	0.8	1.3	0.8	1.2	1.6	1.1
		2005	0.8	1.1	0.9	0.3	0.5	0.9	0.8	0.9	0.8	0.8	1.0	1.1	0.6	1.3	0.7	1.0	1.4	1.5
		2006	0.4	0.8	0.6	0.1	0.2	0.8	0.7	0.7	0.6	0.6	0.9	0.8	0.3	1.0	0.2	0.7	1.3	1.0
		2007	0.8	1.2	0.9	0.4	0.5	1.1	1.1	1.2	1.0	0.9	1.2	1.1	0.6	1.3	0.5	1.0	1.7	1.2
	November	2004	0.3	0.3	0.5	0.5	0.3	0.2	0.3	0.2	0.3	0.3	0.1	0.2	0.1	0.2	0.6	0.1	0.4	0.1
		2005	0.1	0.2	0.4	0.4	0.1	0.4	0.1	0.0	0.2	0.2	0.0	0.1	0.1	0.3	0.5	0.1	0.6	0.5
		2006	0.4	0.5	0.7	0.6	0.3	0.5	0.4	0.4	0.4	0.4	0.2	0.3	0.2	0.5	0.7	0.1	0.5	0.3
		2007	0.5	0.4	0.7	0.5	0.3	0.5	0.4	0.4	0.4	0.4	0.3	0.3	0.2	0.4	0.7	0.1	0.4	0.3
	December	2004	-0.1	-0.2	-0.1	-0.1	0.0	-0.2	-0.3	-0.2	0.0	-0.1	-0.2	-0.2	-0.1	-0.1	-0.1	-0.2	-0.1	0.0
		2005	0.2	0.1	0.3	0.2	0.2	0.1	0.1	0.2	0.3	0.2	0.1	0.1	0.3	0.0	0.1	0.1	0.3	0.0
		2006	0.3	0.1	0.4	0.3	0.2	0.2	0.2	0.3	0.4	0.2	0.2	0.2	0.3	0.2	0.3	0.1	0.3	0.2
		2007	0.2	0.0	0.3	0.2	0.2	0.2	0.1	0.1	0.3	0.1	0.2	0.2	0.2	0.1	0.3	0.0	0.2	0.2

Source: INE & IFL (UC3M)

Date: October 11, 2006

* The shaded areas represent forecasted values



VI. FORECAST SUMMARY.

VI.1 EURO AREA AND USA

INFLATION FORECASTS AND EVOLUTION IN THE EURO AREA AND USA								
	2000	2001	2002	2003	2004	2005	Forecast	
							2006	2007
TOTAL INFLATION								
Euro-area (100%).	2.1	2.3	2.2	2.1	2.1	2.2	2.2	1.6
USA (81.5%). ⁽¹⁾	3.5	2.6	0.9	2.2	2.8	3.7	3.2	1.9
A HOMOGENEOUS MEASURE OF CORE INFLATION ⁽²⁾								
Services and Non-energy industrial goods excluding food and tobacco.								
Euro- area (71.52%).	1.0	1.8	2.4	1.8	1.8	1.4	1.4	1.5
USA (55.6%). ⁽¹⁾	2.1	2.1	1.6	1.1	1.6	2.1	2.1	2.1
DIFFERENT COMPONENTS OF THE HOMOGENEOUS MEASURE OF CORE INFLATION								
(1) Services.								
Euro- area (40.78%).	1.5	2.5	3.1	2.5	2.6	2.3	2.0	2.1
USA (27.4%). ⁽¹⁾	3.5	3.6	3.6	3.2	3.3	3.1	3.4	3.3
(2) Non-energy industrial goods excluding food and tobacco.								
Euro- area (30.74%).	0.5	0.9	1.5	0.8	0.8	0.3	0.6	0.7
USA (29.0%).	0.5	0.3	-1.1	-2.0	-0.9	0.5	0.4	0.3
INFLATION IN EXCLUDED COMPONENTS FROM THE HOMOGENEOUS MEASURE OF CORE INFLATION								
(1) Food.								
Euro- area (19.28%).	1.4	4.5	3.1	2.8	2.3	1.5	2.3	2.5
USA (14.9%).	2.3	3.1	1.8	2.1	3.4	2.4	2.3	2.4
(2) Energy.								
Euro- area (9.20%).	13.0	2.2	-0.6	3.0	4.5	10.1	7.8	0.0
USA (9.90%).	16.9	3.8	-5.9	12.2	10.9	16.9	11.0	0.1

⁽¹⁾ less owner's equivalent rent of primary residence.

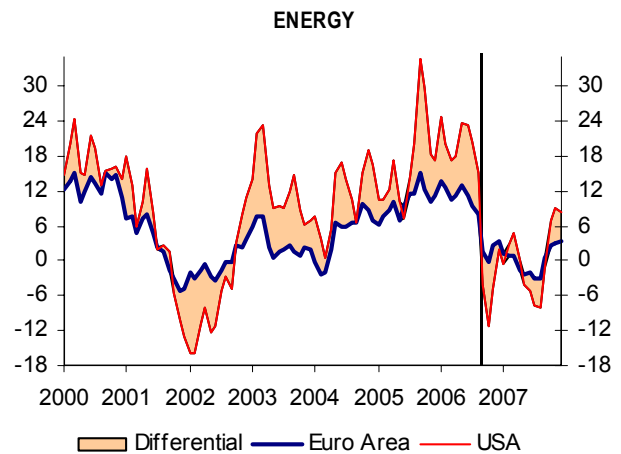
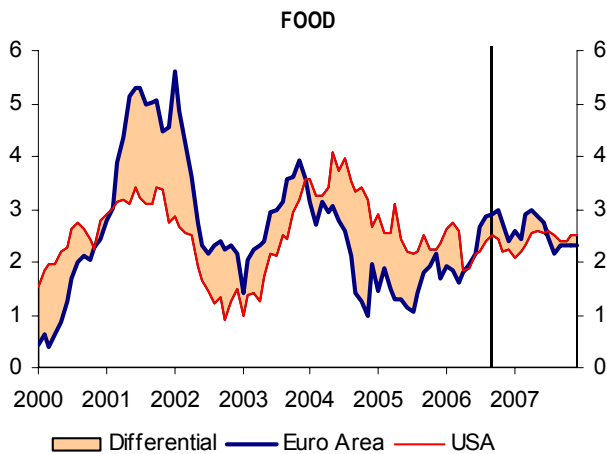
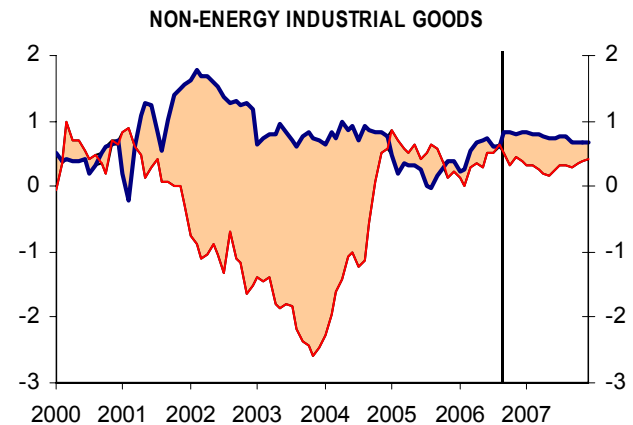
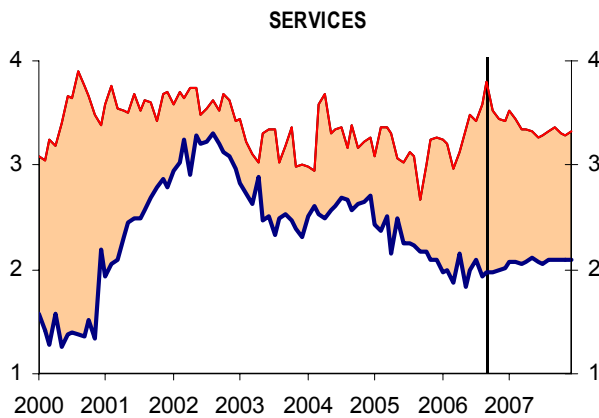
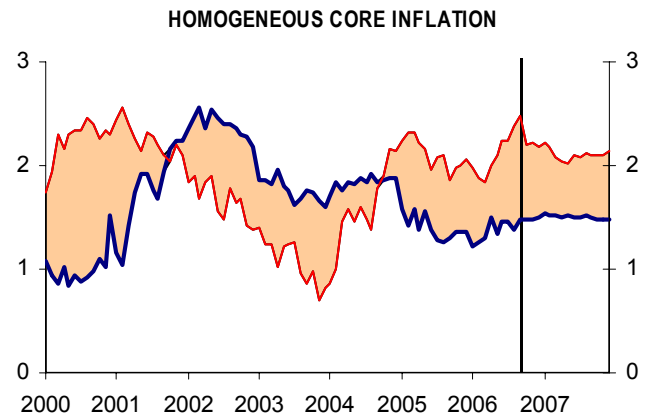
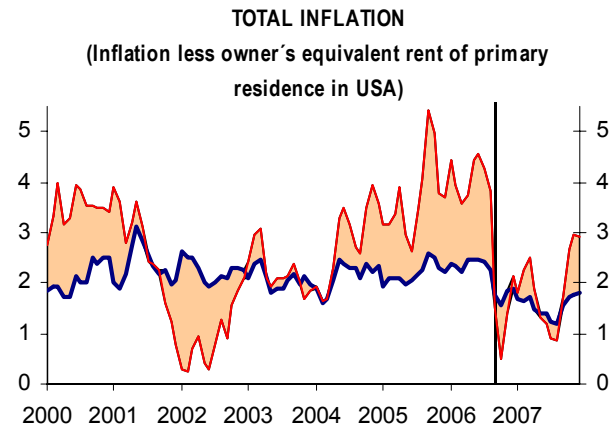
⁽²⁾ This homogeneous measure of underlying inflation does not coincide with the usual measure of core inflation for the EMU nor for the USA. It has been constructed in order to compare the data in the Euro area and in the USA.

Source: EUROSTAT, BLS & IFL (UC3M)

Date: October 27, 2006



YEAR-ON-YEAR RATES OF INFLATION IN THE EURO AREA AND USA



Source: EUROSTAT, BLS & IFL (UC3M)

Date: October 27, 2006

Total inflation is less owner's equivalent rent of primary residence. The core inflation has been constructed in order to compare the data in the Euro area and in the USA.



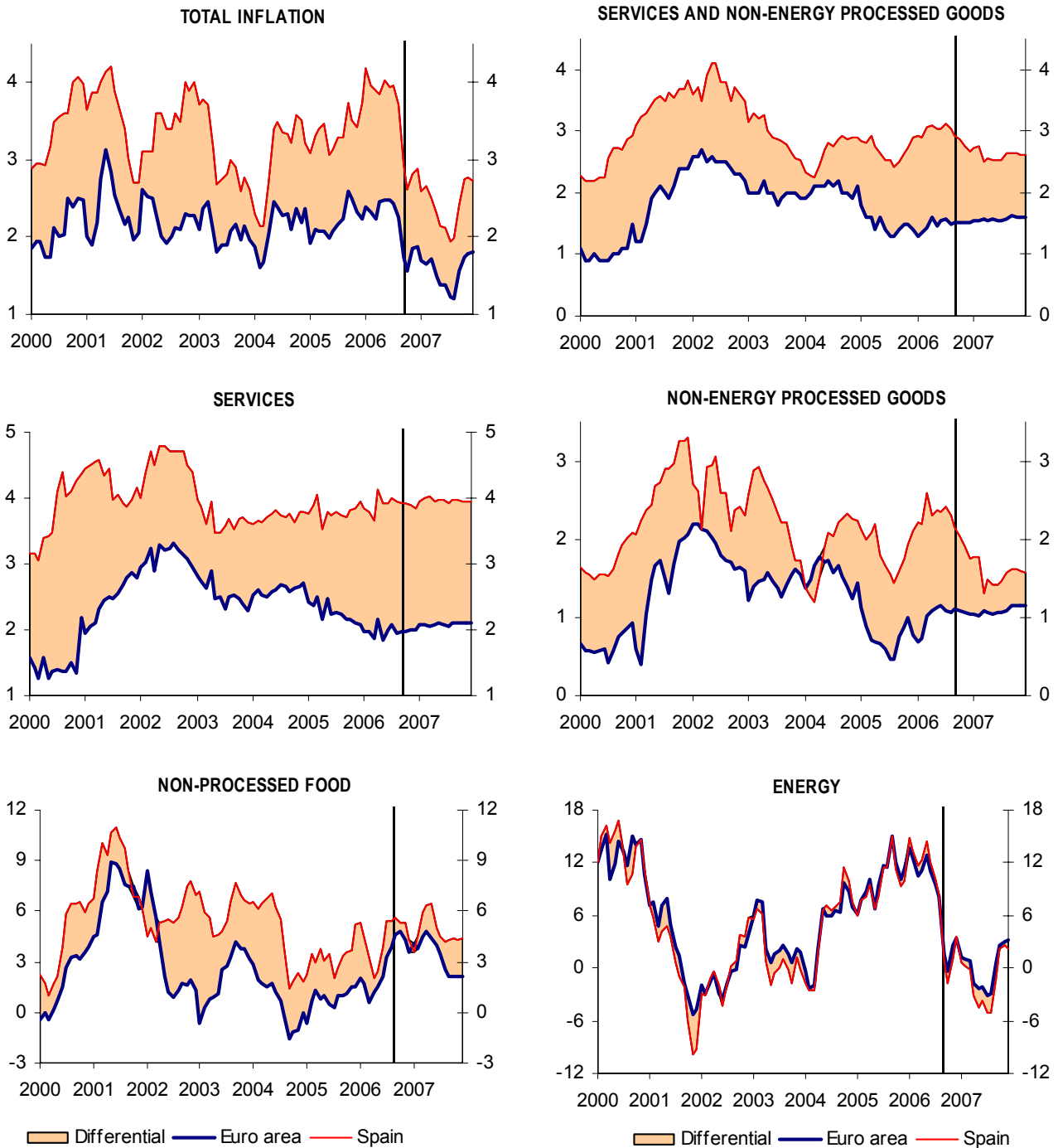
VI.2 EURO AREA AND SPAIN

INFLATION FORECASTS AND EVOLUTION IN THE EURO AREA AND SPAIN								
	2000	2001	2002	2003	2004	2005	Forecasts	
							2006	2007
TOTAL INFLATION								
Spain (100%).	3.4	3.6	3.5	3.0	3.0	3.4	3.6	2.4
Euro-area (100%).	2.1	2.3	2.2	2.1	2.1	2.2	2.2	1.6
CORE INFLATION								
Services and Non-energy processed goods.								
Spain (82.31%).	2.5	3.5	3.7	2.9	2.7	2.7	2.9	2.6
Euro-area (83.37%).	1.0	1.9	2.5	2.0	2.1	1.5	1.5	1.6
DIFFERENT COMPONENTS OF CORE INFLATION								
(1) Services.								
Spain (35.80%).	3.7	4.2	4.6	3.7	3.7	3.8	3.9	4.0
Euro- area (40.78%).	1.5	2.5	3.1	2.5	2.6	2.3	2.0	2.1
(2) Non-energy processed goods.								
Spain (46.51%).	1.7	2.8	2.6	2.4	1.9	1.9	2.2	1.6
Euro- area (42.84%).	0.7	1.5	1.9	1.4	1.5	0.7	1.0	1.1
INFLATION IN EXCLUDED COMPONENTS FROM CORE INFLATION								
1) Non-processed food.								
Spain (8.35%).	4.2	8.7	5.8	6.0	4.6	3.3	4.4	4.8
Euro- area (7.69%).	1.8	7.0	3.1	2.1	0.6	0.8	2.8	3.3
(2) Energy.								
Spain (9.34%).	13.3	-1.0	-0.2	1.4	4.8	9.6	8.2	-1.3
Euro- area (8.13%).	13.0	2.2	-0.6	3.0	4.5	10.1	7.8	0.0

Source: EUROSTAT, INE & IFL
Date: October 27, 2006



YEAR-ON-YEAR RATES OF INFLATION IN THE EURO AREA AND SPAIN



Source: EUROSTAT, BEA & IFL (UC3M)
Date: October 27, 2006



VII. FORECASTS OF DIFFERENT INSTITUTIONS.

FORECASTS OF DIFFERENT INSTITUTIONS ¹										
INFLATION										
	BIAM ²		CONSENSUS FORECASTS ³		FMI ⁴		BCE ⁵		OCDE ⁶	
	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007
EURO AREA	2,2	1,6	2,3	2,2	2,3	2,4	2,3	2,1	2,1	2,0
USA	3,2	2,4	3,5	2,5	3,6	2,9	-	-	3,3	2,4
SPAIN	3,6	2,4	3,7	2,9	3,8	3,4	-	-	3,6	2,7

REAL GDP (Percentage change from previous year)										
	BIAM		CONSENSUS FORECASTS		FMI		BCE		OCDE	
	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007
EURO AREA	2,6	2,3	2,6	1,9	2,4	2,0	2,2	1,8	2,2	2,1
USA	-	-	3,4	2,6	3,4	2,9	-	-	3,6	3,1
SPAIN	3,6	3,4	3,7	2,9	3,4	3,0	-	-	3,3	3,0

1 The forecasts are based on CPI in USA and Spain and on HICP in the Euro area.

2 Bulletin EU & US Inflation and Macroeconomic Analysis, October 2006.

3 October, 2006

4 IMF. World Economic Outlook. September, 2006.

5 Results of the ECB Survey of Professional Forecasters for the third quarter of 2006: ECB. Monthly Bulletin August 2006.

6 OECD Economic Outlook 79. May, 2006. For the Euro area and Spain the forecast are for the HICP.

Our forecasts for total inflation in the euro area and Spain are slightly greater than the previsions derived from other institutions because with the methodology applied in our Bulletin, total inflation is breaking down in core and residual inflation. Last one is composed by inflation in non-processed food and energy prices.

The innovations come in different components are transferred in future thorough different multipliers. The innovations derived from residual inflation are less persistent.



VIII. MONTHLY DEBATE

CHINA: MORE THAN JUST A FACTORY

Emilio Ontiveros

I have just returned from a professional trip to China. Several weeks before I left, the Bulletin's president, Juan Urrutia, had warned me that I would have to comply with one of my obligations as a member of the advisory council in October. I departed, therefore, thinking that I could write a chronicle. Even when most of the issues approached here are related to the Spanish economy, I finally made use of the freedom allowed by the editor to order some of my notes about the trip, in the hope that the final result will be use for some of our readers. What I am actually trying to present is not only some updated notes providing evidence of the most outstanding case of economic transformation in the last three decades, but also some information which could confirm or not some of the most widespread beliefs in this regards. I hope you are not disappointed.

More than just an emerging market

Never before has what is classified as a developing economy had such a specific weight on the global scene than in China today. Although the footnotes to the reports issued by multilateral organisations have recently contained detailed information about the criteria by which economies are classified, China is still classified as an "emerging market". This euphemistic description, however, is less precise, more eclectic and more provisional than the group of "developing economies" in which some institutions continue to include economies whose only common denominator is a lower per capita GDP than OECD members.

Unlike what happened just ten years ago, the correspondence between this indicator and the specific weight of some emerging economies on the global scenario, in the preservation of their stability, is, to say the least, deceiving. This applies to India and, of course, China, together with the other two BRIC members, Brazil and Russia, which are responsible for over 30% of the world's GDP. This proportion alone questions the virtuality of the G7 and the other instances on which we assume global capacity for economic and financial coordination depends.

It is worth remembering that this is the most highly populated country in the world, with the fourth economy in relation to the size of the GDP and the third in relation to its volume of international trade. Its trade surplus, indeed the largest in the world,

could exceed 170,000 million dollars this year, compared with last year's 102,000 million; a significant part of this is defined versus the US although, truth be told, all OECD countries except Japan and Germany, have a trade deficit with China. It is the magnitude of the bilateral balance of trade between China and the U.S. which leads to the use of another euphemism, the "global disequilibria" which has been one of the greatest threats to stability in recent years. The reason most usually accepted in the U.S. is the maintenance of an artificially depreciated exchange rate to support competitiveness by permanent intervention on the currency markets.

The Chinese foreign reserves, now around 1,000 million dollars, 40% of its GDP, are certainly somewhat intimidating. As most of them are dollars, in the form of bonds issued by the American treasury, there is no need to explain what would happen, in the US and in the rest of the world, if the Chinese authorities changed the apparently wise way in which they are managing those funds. Such wisdom, however, does not mean that there is total consensus regarding their use and degree of diversification. The debate in the Chinese government also emerged publicly in the last few weeks. Attitudes less in agreement with the rate of growth of these reserves and the interventions in defence of the exchange rate which help them to grow are certainly present, with their principal supporter being Zeng Qinghong, a vice-president.

The authorities are evidently aware that the reserve level cannot be chosen with a fixed exchange rate system, but a looser system would not be as harmless or politically feasible as some American senators would have us believe. The development of a local currency market, still in the bud, and the additional rehabilitation of the banking system are seen by all as necessary conditions for the exchange system to become completely flexible. As we have seen, higher interest rates are not the best solution in an economy with hardly any inflation, hungry for significant growth in consumption and, in any event, with the greatest ability to attract capital in the world.

Unlike another trip seven years ago, this time there was sufficient evidence of the importance of China for the stability of the world's economy. On the outward flight, I was able to read with satisfaction how the new US Treasury Secretary, Hank Paulson, wrote about this new climate of understanding based on his valuable experience. He was announcing the recent agreement with the Chinese authorities to create a high-level bilateral committee to monitor all economic issues, not only



particularly sensitive topics, and also to support the continuity of the reforms that the Chinese economy needs. His first official visit, at the end of September, was certainly profitable.

If I had to emphasise one of the virtues of the American government's new treasury secretary it would be his knowledge of Chinese reality; over 70 visits, most of them as a partner of the Goldman Sachs investment bank. A very different capacity for relating to the country's authorities than his predecessor, which has already has visible results in the slight appreciation in the yuan/dollar exchange rate, the most visible since the 2.1% change decided in July, 2005, when I was able to confirm the satisfaction of both analysts and the business community at first hand in different meetings in Shanghai. And this satisfaction was not so much for the economic effects of an increase in this trend on the results of some companies, but for the reduced political tension with the US revealed by the decision, in view of the emerging signs of sinophobia in Washington. The most explicit of the favourable consequences of this new understanding was the withdrawal of the bill presented by senators Charles Schumer and Lindsey Graham which attempted to establish additional duties, up to 27.5% (equivalent, according to these senators' estimated, to the under-evaluation of the yuan/dollar exchange rate) for imports from China, precisely as punishment for the continued under-evaluation of the exchange rate.

I suppose that Paulson would also have liked the historic authorisation granted in early October to Morgan Stanley to fully operate on the domestic market to be offered to his old bank. The significance of this decision cannot be ignored, although the Chinese authorities' commitment with the World Trade Organisation (WTO) to open their financial system to foreign banks is far from being fulfilled. Before the above decision, foreign banks had spent close to 25,000 million dollars on shares in Chinese banks in the hope that, some day, they could extend their business to Chinese savers and consumers. Although their commitments with the WTO are close to being fulfilled in theory, there are still important procedural barriers hindering normal banking activities.

In the same press package I prepared for my trip for Peking, there were opinions on the IMF's decision to increase the relative importance of China and other "emerging economies" in the institution's fees, and therefore its governing bodies, in order to be consistent with their rising importance in the global economy. China now has the fourth largest GDP in the world, but all the G7

members have greater presence and more decision-making power from a global perspective.

The intensification of the problem with North Korea after their recent nuclear tests has reinforced China's role in global geopolitics. It is actually a way of underlining the need for a geopolitical projection more in line with its economic significance. This episode certainly requires the country to reduce such calculated asymmetry, for its own good and for the good of us all. May there be no doubt, China is more than just an emerging market.

More than just a factory

China's main advantage on the global economic scene certainly continues to be its ability to produce with significantly lower labour factor costs than most internationally integrated economies. This is what most of the companies which have made China one of the three main targets for direct foreign investment in the last fifteen years were looking for. But it would be a mistake to ignore that these advantages are going hand in hand with a growing quality, enabling goods to be manufactured with more added value. This is certainly true of the motor vehicle industry, in which the country is already the third largest producer in the world, with over 7 million units a year, more than Germany, when it was seventh in the ranking just five years ago; also, micro-electronics, a field in which the country was the largest exporter in the world in 2004 instead of the U.S. The value of its ITC exports that year was over 180,000 million dollars, according to the OECD, compared with 149,000 million for the U.S. Total Chinese trade in this type of good represented over 329,000 million dollars, compared with the 35,000 million of 1996.

At my stopover in Frankfurt, I came across an old IFA collaborator, now the managing director of a medium-sized firm in Aragon which manufactures transformers. Their main client is Phillips. They have had an establishment in the vicinity of Shanghai for over ten years, and in spite of the many problems associated to their relations with their Chinese partner, they are firmly decided to continue. The reason does not only lie in the lower salaries, but also in the fact that the work force is increasingly qualified and more and more corporate purchasing centres are moving to the country. I was reminded of our conversation when I heard a few days ago that the Dutch multinational sold its mobile phone division, trademark included, on October 13 to a Chinese corporation, CEC (China Electronics Corporation), one of the leading manufacturers of these terminals in the world. The CEC trademark will be replacing Phillips within five years.



Nearly simultaneously, IBM announced its intention to move its world purchasing centre from New York to Shenzhen, where its servers have been manufactured for some time. This is not just another decision; it is the first time that an American multinational corporation moves one of its central business units out of the U.S. A little more than a year ago, IBM, remember, sold its personal computer division to Lenovo, established in Peking in 1984 by a group of investigators, and now one of the world leaders in the manufacture of this equipment.

This gradual shift to more knowledge-intensive industries has also been seen in the country's progress in the space race. There have been two successful space flights, the second last year. They are now trying to put a satellite into the moon's orbit next year. The investment made in this industry is, with reason, a relevant indicator of potential to generate and absorb scientific and technological innovation. Indeed, China spends more on R&D relative to the size of its economy (nearly 2% last year) than some developed economies, including Spain. No less significant is the investment in technological training for its students, in the country itself and elsewhere.

All the above are signs of China's growing hegemony as a provider in the global economy, but it would be a mistake to restrict our attention to this dimension; the country is also a great buyer, as its neighbours have found in recent years, particularly after the financial crisis triggered in the region in the summer of 1997. There is no shortage of examples. Total imports continue to grow at rates of over 20%, albeit ten points less than exports. Actually, over a third of the increase in global imports in the last six years are down to China. The specific weight of raw material purchases is part of this import trend; as is the growing interest in guaranteeing their supplied by direct foreign investment. These trade flows grew by 123% last year, according to the UNCTAD, to 12,300 million dollars. The same organisation estimated that over 60,000 million dollars will be invested in 2010, with Latin America being one of the preferred destinations.

The same doubts

I must admit that my return to China has taught me no more about the future of its economy. My prior readings, observations and on site conversations confirmed my easy assumption concerning what is behind such a major transformation; the willingness to reform (what Prasad and Rajan describe as an incremental and experimental approach to reform in a certainly singular world) and the virtually unconditional welcome given to globalisation; the

continued and spectacular saving and investment rate and a determination to strengthen primary education to support another transformation, associated to the mobility of the labour factor between sectors. But our readers will doubtless already be aware of all these explanations.

There are still some surprises, however. The main one is found in the co-existence of a will to plan with encouragement to develop the market in different areas of the economy; a political reality which attempts to maintain its essence in the presence of a national economic reality which is all the more distant the greater the demands established by the globalisation process. There is also uncertainty concerning the country's ability to preserve some of the attributes of this paradigm, its flexibility, adaptability and pragmatism.

The people, professionals and businessmen, with whom I talked agree on emphasising the pace with which the country is changing from an economic perspective, with its growth helping to relieve the social and political tension involved in such dynamics. The evident possibilities of better welfare appear to draw our attention away from the model's most adverse implications. The effects of the growing inequality in the distribution of income and wealth, one of the greatest in the world, is one of those unknowns with which travellers return. What will happen when the nearly 10% per a year GDO growth rate registered in the last 27 years falls to rates less able to absorb the enormous mass of people emigrating from the countryside to the cities? So far, million of people are escaping from poverty: since the reform started in 1978, over 400 million have escaped from poverty according to the statistical conventions established by the World Bank; but there are still more than 135 million trying to survive on less than a dollar a day. The per capita GDP, remember, is less than 1,800 dollars. A recent supplement of *The Economist* (September 16, 2006) providing a review of the world's economy, mentioned that China has doubled its per capita GDP in just nine years, whereas the US and Great Britain needed 50 years after their industrialisation in the 19th century.

Another major threat to continued stability is increasingly explicit corruption. I also saw some signs of it during my stay. On September 24, when I landed in Shanghai, the city's leading communist party leader, and one of the main supporters of the country's economic modernisation, Chen Liangyu, was arrested and accused of corruption based on the fraudulent use of pension funds and illegal support to business colleagues. I heard local opinions that he is meant to be an example and give the impression that no one will escape the persecution of widespread corruption. The same



had happened months earlier to another collaborator (who also happens to be one of the best known translators of the work of Jean Paul Sartre), also accused of the embezzlement of social security funds.

The emergence of nationalist feelings is another cause for concern. There is increasing sensitivity to foreign firms taking over State companies. It is worrying how often sectors until recently closed to foreign capital are classified as strategic. Another example is the blocking of the attempt by Carlyle, the American private equity firm, to buy Xugong, a State construction equipment company. In compensation, who knows whether as a sign of growing pragmatism, is the recent acquisition by Wal-Mart of the major Chinese distributor, Trust-Mart, for over 800 million euros.

And so I end, not sure that I have avoided transmitting the image of China which, according to Stephen Roach, suffers from "macro generalisations linked to the 1,300 millions

syndrome". And I do so suggesting three more sources of information (the presentation of the third in Shanghai, I humbly confess, was one of the reasons for my trip), sure that they will satisfy most of the curiosity I may have awakened. President Urrutia, let's hope I did.

Suggested reading:

Prasad, Eswar S. y Raghuram G. Rajan, 2006, "Modernizing China's Growth Paradigm", International Monetary Fund, Policy Discussion Paper, PDP/06/3, March

Center for Strategic and International Studies and Institute for International Economics, 2006, "China. The Balance Sheet", Public Affairs, N. York

Analistas Financieros Internacionales (AFI), 2006, "China, nuevos retos para el siglo XXI" Ediciones Empresa Global, Madrid



IX. INDICATORS CALENDAR.

OCTOBER

						1
2	3	4	5	6	7	8
9	10	11 Spanish HICP (september)	12	13	14	15
16	17 Euro area HICP (september)	18 USA CPI (september)	19	20	21	22
23	24	25	26	27	28	29
30 Spanish HICP (A.D. october)	31 Euro area HICP (A.D. october)					

NOVEMBER

		1	2	3	4	5
6	7	8	9	10	11	12
13	14	15 Spanish HICP (october)	16 Euro area HICP USA CPI (october)	17	18	19
20	21	22	23	24	25	26
27	28	29	30 Euro area HICP Spanish HICP (A.D. november) USA PCE			

* ESI: Economic Sentiment Indicator
 F.E.: Flash estimate
 CPI: Consumer Prices Index
 HICP: Harmonised Consumer Price Index
 N.A: National Accounts
 PCE: Note on the Personal Consumption Expenditure Price Index





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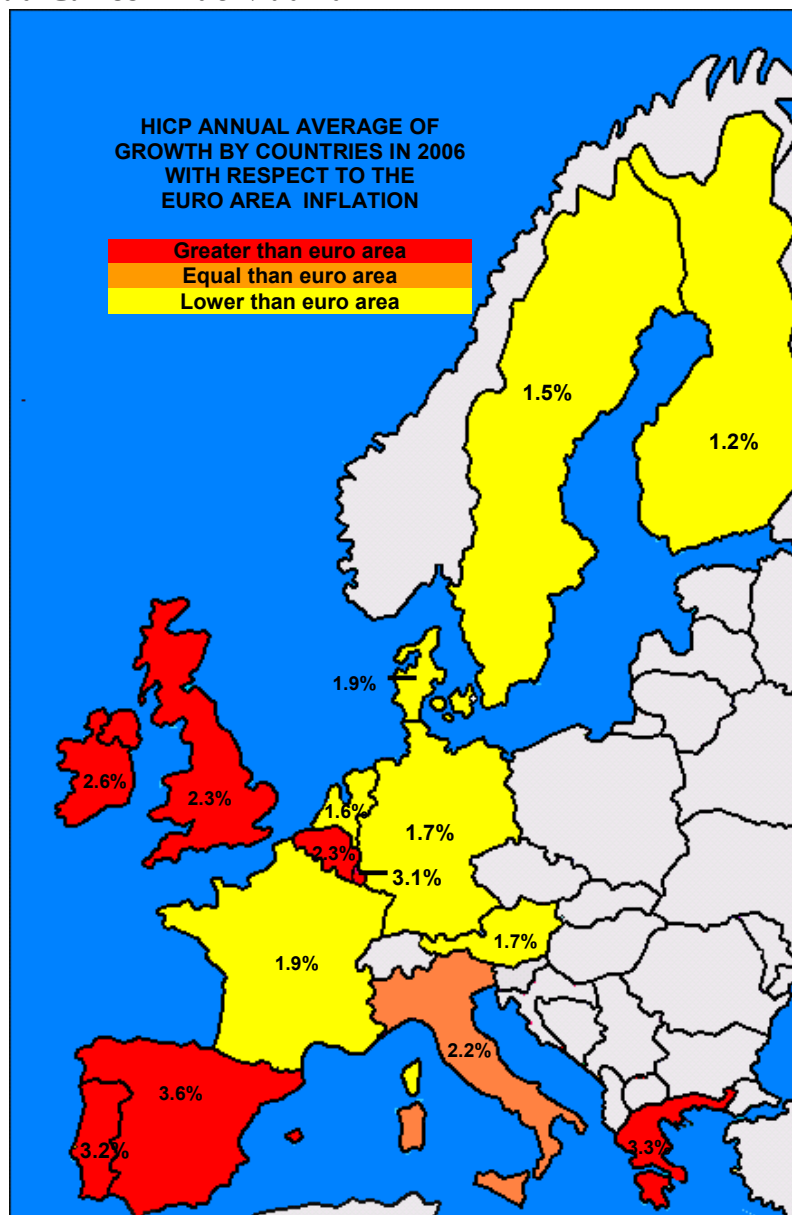
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HICP ANNUAL RATES OF GROWTH IN THE EURO AREA (Without VAT effects in 2007)			
WITH CONFIDENCE INTERVAL AT 80%			
	Core		Total
Average rates	2005	1.5	2.2
	2006	1.5 ± 0.04	2.2 ± 0.04
	2007	1.6 ± 0.34	1.6 ± 0.39
2006	Jan	1.3	2.4
	Feb	1.3	2.3
	Mar	1.4	2.2
	Apr	1.6	2.5
	May	1.5	2.5
	June	1.6	2.5
	July	1.6	2.4
	Aug	1.5	2.3
	Sept	1.5	1.7
	Oct	1.5 ± 0.14	1.6 ± 0.12
	Nov	1.5 ± 0.19	1.8 ± 0.22
	Dec	1.5 ± 0.23	1.9 ± 0.30
2007	Jan	1.5 ± 0.25	1.7 ± 0.34
	Feb	1.5 ± 0.27	1.6 ± 0.37
	Mar	1.6 ± 0.29	1.7 ± 0.40
	April	1.6 ± 0.33	1.5 ± 0.41
	May	1.6 ± 0.36	1.4 ± 0.45
	June	1.6 ± 0.39	1.4 ± 0.49
	July	1.5 ± 0.41	1.2 ± 0.52
	Aug	1.6 ± 0.43	1.2 ± 0.52
	Sep	1.6 ± 0.43	1.6 ± 0.52
	Oct	1.6 ± 0.44	1.7 ± 0.52
	Nov	1.6 ± 0.44	1.8 ± 0.53
	Dec	1.6 ± 0.46	1.8 ± 0.55

* Intervals calculated with historical errors

Source: EUROSTAT & IFL (UC3M)

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